**Bankruptcy, Liquidation, Reorganization**

**Learning Outcomes**

When you have completed this module, you should be able to:

1. Identify the warning signs and causes of financial distress.
2. Describe the legal framework governing the bankruptcy process.
3. Explain the conditions for bankruptcy.
4. Demonstrate how to liquidate the assets and liabilities of a bankrupt business.
5. Develop a basic plan to successfully reorganize a business.

**Introduction**

Most companies experience financial distress at some point. Falling profit margins, shrinking cash flows, and declining asset turnover ratios are all symptoms of a troubled company. When analyzing financial distress, it is important to differentiate between these symptoms and their causes. For example, shrinking cash flows are a concern, but if the company is going to deal with the problem, it needs to know that it was caused by a new competitor, rapid growth, or inefficient factory operations.

If a company can determine the causes of financial distress, it can quickly act either alone or with its creditors to solve the problem. It is best to deal with financial distress informally to keep costs low and give management more flexibility. If it appears that the company cannot be saved or the issues are overly complex, then court assistance may be required.

In Canada, bankruptcy is the jurisdiction of the federal government so there is only one set of rules for the entire country. Under the Bankruptcy and Insolvency Act, companies experiencing financial distress can either be liquidated or reorganized. In a liquidation, a creditor representative takes possession of the bankrupt company’s assets, disposes of them, and distributes the proceeds according to a specified priority of claims. They also try to remedy any fraudulent actions taken by the company to ensure creditors are treated fairly. In a reorganization, a company’s management and its creditors decide that the business is worth saving and develop a plan to revive it. By saving the company, creditors feel they can receive a larger payout than in a liquidation, while management sees potential for future profits. Employees and governments benefit from continued employment and additional tax revenue as well.

Liquidation and reorganization are forms of restructuring like mergers & acquisitions, divestitures, spin-offs, or split-ups studied in the Module: Mergers & Acquisitions and Corporate Restructuring. The tools and skills used to diagnose and address financial distress were examine throughout this course as well as the introductory course in financial management.

* 1. **| Financial Distress**

**Warning Signs of Financial Distress**

Financial distress occurs when a company has difficulty paying its financial obligations as they come due. Managers must be able to identify the warnings signs of financial distress early on so action can be taken before bankruptcy becomes a major concern. Like doctors, managers must focus on addressing the underlying causes of a problem and not just its symptoms. They must also learn to act quickly and decisively and be willing to seek outside professional advice. Warning signs of financial distress vary in severity, but they all indicate a need to investigate further to determine the causes. Some common warning signs include:

* Stagnating or declining sales
* Rising sales discounts and returns
* Falling profit margins
* Rising inventories
* Shrinking cash balances and frequent bank overdrafts
* Increased age of receivables and payables
* Being placed on cash on delivery
* Having to change suppliers due to non-payment
* Conversion of accounts payable to notes payable
* Increasing interest costs and debt levels
* Rising selling and administration costs
* Missed expense payments and government remittances
* Customer complaints
* Senior managers and skilled employees leaving for new jobs

Businesses should also carefully monitor their bankers for signals of potential problems with their accounts. These include:1

* More frequent communications including requests for additional information.
* On-site visits by senior bank personnel or requests to meet at the regional office.
* A change of loan supervisor to one who deals with problem loans.
* The appearance of specialists such as lawyers, accountants, and insolvency experts.
* Request for an independent review by an outside consultant who reports directly to the bank about the viability of the business and the quality of their collateral.
* Delays responding to requests for new loans or loan limit increases.
* Having new loan requests refused, existing loan limits reduced, and a request for the owner to invest more of their own capital in the business.
* Demands for collateral appraisals, additional collateral, lower margin ratios, new personal and third-party guarantees, and higher interest rates and fees.
* Introduction of more demanding loan terms and conditions.
* Warnings about violating lending conditions and having loans labelled as non-performing or under-margined.
* Request to refinance existing loans at another bank.

**Causes of Financial Distress**

The causes of financial distress can be grouped into five main areas:

**General Management.**  Poor or inexperienced management is a major cause of financial distress, especially for small businesses. New entrepreneurs may know their products or services well, but they usually lack the financial, marketing, operations, and human resource skills needed to succeed. Initially, new ventures may not be able to find or afford the professional managers required, but even when they can, an entrepreneur’s inability to delegate responsibilities may lead to internal management conflict and bad decision-making. The sudden illness, death, or departure of key management personal may also cause difficulties.

**Finance.**  Using excessive amounts of long-term debt to finance a business, especially one in a cyclical industry can cause serious financial distress. High fixed interest and principal payments may become unmanageable especially in an economic downturn, so the use of debt should be balanced with equity which has no required payments. Companies generally avoid selling new equity though because of high issuance costs and an unwillingness to give up control. This creates a serious problem for companies undergoing rapid expansion as their retained earnings are usually insufficient and they must issue a higher proportion of debt if they hope to grow. This is made worse if companies spend extravagantly on new assets or acquisitions as part of their growth strategy or the owners withdraw excessive amounts of cash from the business for personal use.

Many companies also experience financial distress because they do not have sufficient financial flexibility in the form of high cash reserves or unused borrowing capacity to deal with unexpected problems. Poor working capital management, internal accounting controls, information systems, and financial planning practices can also result in serious cash shortages.

**Marketing and sales.** Faulty market research, product obsolescence due to a lack of product development, and inferior marketing plans can lead to financial distress especially if these problems are accompanied by major acquisitions or large investments in fixed assets and working capital. If higher sales do not materialize, companies will have to sell assets, usually at a loss, to pay down debt and offer expensive sales discounts to move surplus stock. Ineffective profit analysis can cause problems if a company does not charge the optimum price that maximizes its revenue or devotes too many resources to low-profit products or geographical regions instead of its more lucrative business segments. A lack of diversification also exposes the company to the risk of losing a major customer or contract.

**Operations.**  Poorly maintained and outdated equipment and inferior production and management information systems can be a major source of financial distress. Higher production costs and excessive inventories reduce operating cash flows. A lack of production control makes it difficult to react to market changes and growth opportunities quickly. Product quality issues may result which can be intensified by low educational standards, inferior training, union conflicts, and poor compensation. Many companies also have difficulties implementing new technology leading to production delays.

Companies with high fixed cost structures will likely have cash flow problems during an economic slowdown when their sales fall much faster than their costs. This is especially true for fixed selling and administration costs where businesses tend to spend extravagantly without realizing the effect on cash flow until it is too late.

**External Factors.**  These factors are largely outside of management’s control but they are major contributors to financial distress. They include economic recessions; increased industry or overseas competition and overcapacity; changing consumer tastes and new technologies; natural disasters such as fires, floods, and hurricanes; acts of war or terrorism; business or supply interruptions due to bankruptcies, strikes, lockouts, or global shortages; costly regulatory changes; penalties for environmental or health and safety infractions; legal settlements relating to product liability or workplace harassment; and employee fraud and embezzlement.

**Tools for Analyzing Financial Distress**

**Ratio analysis.** Practitioners use a variety of tools to analyze financial distress. The most popular is ratio analysis where users calculate trends for different liquidity, asset management, long-term debt-paying ability, and profitability ratios and then compare them to recent industry averages to assess a company’s performance. These industry average ratios can be developed internally or gotten from different public or private providers such as Statistics Canada, Standards & Poor’s, RMA, or industry associations. A company’s cash flow statements can also be studied to determine the reasons (i.e. operations, investing, or financing) for increasing or decreasing cash flows.

In addition to analyzing a company’s financial statements, the aging of accounts receivable, aging of payables, inventory lists, tax returns, loan agreements, and current and potential litigations should be reviewed.

**Bankruptcy prediction models.** These models measure the likelihood that a company will be unable to pay its debts and go bankrupt. They are used by financial institutions to assess the credit quality of borrowers and are especially useful in evaluating smaller loans where the cost of a thorough credit investigation is not justified. They are also employed by analysts to identify undervalued shares or potential company turnaround opportunities.

There are many different bankruptcy prediction models developed by both practitioners and academics. Most practitioner models are proprietary and are not shared with the public. Of the academic models, Professor Edward Altman’s Z-Score is the best known. Altman Z-Score uses multi-discriminate analysis to generate a linear function that differentiates between categories of dependent variables based on a combination of independent variables. The two categories in the Altman Model are bankrupt and non-bankrupt companies. Based on the Altman Z-Score, users can determine if a company is likely to go bankrupt or not. There are four variations of the Altman Z-Score formula based on the data sets used.

**Public U.S.-Based Manufacturing Companies**

Z = 3.3 (EBIT/Total assets) + 1.2 (Net working capital/Total assets) + 1.0 (Sales/Total Assets) + 0.6 (Market value of equity/Book value of debt) + 1.4 (Retained earnings/Total assets)

The higher the Z-Score, the lower is the likelihood of bankruptcy. Specially:

Z ≥ 2.99 – Safe

Z ≥ 1.81 ≤ 2.98 – Caution

Z ≤ 1.80 – Financial distress

The independent variables measure different aspects of a company’s financial performance that directly affects its ability to pay its debts on time. These include:

EBIT/Total assets – Profitability

Net working capital/Total assets – Liquidity

Sales/Total assets – Asset turnover or efficiency

Market value of equity/Book value of debt – Financial leverage and business prospects

Retained earnings/Total assets – Financial leverage

**Private U.S.-Based Manufacturing Companies**

Z’ = 3.11 (EBIT/Total Assets) + 0.72 (Net working capital/Total assets) + 1.0 (Sales/Total assets) + 0.42 (Book value of equity/Book value of debt) + 0.85 (Retained earnings/Total assets)

Z’ ≥ 2.90 – Safe

Z’ ≥ 1.23 ≤ 2.90 – Caution

Z’ ≤ 1.23 – Distress

Book value of equity is used instead of market value since the shares of private companies do not trade publicly.

**Public and Private U.S.-Based Non-Manufacturing Companies**

Z” = 6.72 (EBIT/Total Assets) + 6.56 (Net working capital/Total assets) + 1.05 (Market value of equity/Book value of debt) + 3.26 (Retained earnings/Total assets)

Z” ≥ 2.90 – Safe

Z” ≥ 1.23 ≤ 2.90 – Caution

Z” ≤ 1.23 – Distress

Sales/Total assets is left out of the formula since these companies have proportionately far fewer assets.

**Public and Private Non-U.S. Companies**

Z’’’ = 3.25 + 6.72 (EBIT/Total Assets) + 6.56 (Net working capital/Total assets) + 1.05 (Book value of equity/Book value of debt) + 3.26 (Retained earnings/Total assets)

Z’’’ ≥ 2.60 – Safe

Z’’’ ≥ 1.10 ≤ 2.60 – Caution

Z’’’ ≤ 1.10 – Financial distress

Through his business Altman Z-Score+, Dr. Altman provides company Z-Score rankings by industry, default estimates for the next 1-to-10 years, and bond-rating equivalents (BRE). A BRE is an estimate of what a company’s bond rating would be based on their Z-Score.

The Altman Z-Score model is accurate (approximately 80% to 90%) over the next two years, but its reliability falls significantly after that. Some shortcomings of the model are that it uses ratios based on 1) the current year’s results only instead of longer-term averages and 2) book value and not market value. The accuracy of the model also falls as the data set used to compute the formula becomes dated or is not very representative of a company’s industry.

* 1. **| Bankruptcy Basics**

**Legislation**

The purpose of bankruptcy legislation in Canada is to 1) allow debtors to be released from their obligations so they can continue leading productive lives including pursuing new business ventures, 2) ensure all creditors are treated fairly in the distribution of assets, 3) punish debtors who try to defraud their creditors, and 4) support companies in restructuring their operations so they can successfully re-emerge from bankruptcy and again become valued sources of employment and economic growth.

Bankruptcy law is federal jurisdiction under the Canadian constitution, so the laws are applicable across the country. This is important given that many companies operate throughout Canada and have creditors in nearly every province. Also, international creditors are more willing to lend to Canadian companies if they only have to comply with one set of rules. The main sources of bankruptcy law in Canada include:

**Bankruptcy and Insolvency Act (BIA).** The primary federal act dealing with commercial (business) and consumer (individual) bankruptcy and the rights of creditors.

**Companies’ Creditors Arrangement Act (CCAA).** An alternative to the BIA for commercial reorganizations of larger companies with debts exceeding CAD 5,000,000. This act is less rules-based than the BIA providing more flexibility and judicial discretion to deal with complex restructuring issues, but it is being used less often as improvements are made to the BIA.

**Winding Up and Restructuring Act.**  A federal act dealing with the liquidation and restructuring of financial institutions only.

**Provincial Statutes.** Several provincial acts relating primarily to security registration and creditor fraud are also relevant. The contents of these statutes vary by province but typically include a Personal Property Security Act, Landlord and Tenant Act, Fraudulent Conveyances Act, Assignment and Preferences Act, Family Law Act, and Bulk Sales Act.

The remainder of this module deals with commercial bankruptcy under the BIA.

**Key Players**

The key players in the bankruptcy system in Canada include:

**Superintendent of Bankruptcy (SOB).** A federal government appointee who supervises the administration of the bankruptcy process in Canada. Their duties include: overseeing the Official Receivers located across Canada; maintaining a public record of all BIA and CCAA cases; licensing all Trustees and reviewing their performance and financial records; issuing legal interpretations and directives that guide Official Receivers and Trustees in their duties; investigating complaints regarding the bankruptcy process; intervening in the courts to protect the public interest or integrity of the bankruptcy system; and updating and enforcing bankruptcy legislation and regulations including working with law enforcement to prosecute those guilty of creditor fraud.

**Official Receiver.** A federal government appointee who administers the bankruptcy process in each division across Canada on behalf of the SOB. Normally, each province is a division, but they can be divided further depending on case volume.

**Trustee.** Professionals licenced by SOB to either liquidate bankrupt companies or help reorganize them so they can re-emerge from bankruptcy. Trustees are typically Chartered Professional Accountants (CPAs) at accounting firms with large bankruptcy practices who also have the Chartered Insolvency and Restructuring Professional (CIRP) designation.

**Inspectors.** Legal representatives elected by creditors to protect their interests in bankruptcy. Inspectors work closely with Trustees monitoring their activities, providing advice, approving important transactions such as the sale of assets, and applying to remove them if warranted. Inspectors must also be Licenced Insolvency Trustees.

**Secured Creditor.** A creditor who has a security interest against property that allows it to be sold to satisfy their claim ahead of most other creditors. To be enforceable, the security interest must be properly registered by filing a charge through a Provincial Land Titles System for land and building or a lien with a Provincial Property Registry for all other tangible assets.

**Unsecured Creditor.** A creditor whose debt is not secured or whose security is not sufficient to satisfy the entire amount owed.

**Receiver.** A representative appointed by a secured creditor or the courts to take possession of assets held as collateral for non-payment of a debt. The Receiver liquidates the asset and distributes the net proceeds to the secured creditors. A company does not have to be bankrupt for a Receiver to repossess security for non-payment. Receivers must also be Licenced Insolvency Trustees.

**Types of Bankruptcy**

Commercial bankruptcies can be either informal or formal.

**Informal.** Increasingly debtors and creditors are using “workouts” to save on high legal and accounting costs by settling bankruptcy matters outside of the court system themselves or by using a mediator or arbitrator. An informal bankruptcy also allows the company to address the claims of each creditor individually and avoid the stigma of being declared bankrupt under the BIA.

**Formal.** Sometimes court intervention is required due to a lack of flexibility by the parties, attempts to defraud creditors, a large company’s complex capital structure, or difficult legal issues. A debtor can either enter bankruptcy voluntarily or be forced into involuntary bankruptcy by their creditors.

The remainder of this module deals with formal bankruptcy under the BIA.

**Options in Bankruptcy**

In a formal bankruptcy, the company is either liquidated or reorganized under the BIA.

**Liquidation.** A trustee works with the creditors’ Inspectors under the supervision of the Official Receiver and the courts to secure and dispose of all company assets, determine valid creditor claims, and distribute the net proceeds to creditors following the statutory priority of claims and relevant case law.

**Reorganization**. The courts allow a bankrupt company to continue in business while its management prepares a formal plan to restructure its operations to return it to financial health. The process is supervised by a court-appointed Trustee, and the plan must be approved by the company’s creditors and the courts. If it is not approved, the company is liquidated.

Approximately 85% of bankruptcies in Canada result in liquidations and the remainder are reorganizations. Reorganizations are more complex and costlier than liquidations and take much longer, usually years, to complete. They involve many outside professionals such as lawyers, accountants, tax specialists, and insolvency experts and extensive negotiations with creditors, unions, employees, landlords, and governments.

Reorganizations are advantageous in that the company controls the restructuring process and the company’s assets as they attempt a turnaround. They also have more flexibility in dealing with creditors. In a reorganization, creditors may think more strategically and be willing to forgive part of their debt, extend it or convert it into equity in hopes of realizing more in the future if the reorganization is successful. In a liquidation, creditors are simply allocated what the BIA prescribes.

**Acts of Bankruptcy**

In a formal bankruptcy, any of the following acts may be found by the courts to be grounds for declaring a debtor company bankrupt. The debtor:

1. Does not pay its financial obligations as they come due. This is referred to as technical insolvency.
2. Gives verbal or written notice that payments have or will be suspended.
3. Gives verbal or written notice that the fair value of its assets has fallen below its liabilities and thus are insufficient to pay its obligations. This is referred to as accounting insolvency.
4. Leaves the country, remains outside of the country, or does not reside at their normal dwelling within the country with the intent to defraud its creditors.
5. Gives, transfers, or sells property at below-market prices to hinder, delay, or defraud creditors. These acts are referred to as fraudulent conveyances.
6. Gives a creditor an unfair preference over another creditor relating to the payment of obligations to hinder, delay, or defraud creditors. These acts are referred to as fraudulent preferences.
7. Attempts to hide property to hinder, delay, or defraud its creditors.
8. Fails to comply with an Execution Order by a Receiver on behalf of a secured creditor to take possession of their collateral.
9. Defaults on an obligation under a court-approved Proposal as part of a reorganization.
	1. **| Liquidation**

**Steps in a Liquidation**

In a formal bankruptcy, the steps for liquidating a company include:

1. A bankrupt company can declare Voluntary Bankruptcy by filing an Assignment in Bankruptcy with the Official Receiver. The bankrupt company appoints a Trustee who takes possession of the company’s assets to safeguard them until the first meeting of its creditors. This may include selling perishable assets or continuing to operate a business until it can be sold. The Trustee also takes possession of all the bankrupt company’s financial records including deeds to any property.
2. Creditors can file a petition for a Receiving Order in the courts to try to force a company into Involuntary Bankruptcy. Courts will determine whether an act of bankruptcy has taken place and issue a Receiving Order if appropriate. A Trustee will be appointed by the creditor making the petition. Interim Receiving Orders may be granted by the courts if they feel the assets of the company need to be protected from the debtor before the court hearing. In anticipation of being declared bankrupt, debtors can sell assets at below-market prices, conceal or steal assets, pay off loans to shareholders, or give preference to other creditors. Debtors may also be incompetent or reckless and need supervision.

An Interim Receiver is an officer of the courts and does not represent either the company or the creditors. They take physical control of the business’s premises and bank accounts but do not interfere with the normal operation of the business. They authorized payments for regular expenses such as payroll, utilities, or accounts payable and ensure all sales are legitimate and that the proceeds remain in the business until the case goes before the courts.

1. Once a company is declared bankrupt, the courts issue a Stay of Proceedings and all further legal actions by individual creditors against the bankrupt company cease. Working with the bankrupt company, the Trustee prepares a Statement of Affairs which includes a listing of the bankrupt company’s assets and liabilities, a listing of all unsecured and secured creditors with their claims, liens that have been filed against the bankrupt company’s assets, and any personal or third party guarantees provided by outside parties. Creditors must formally establish their claim by providing the Trustee with a Proof of Claim which describes the amount of the claim, whether it is preferred, secured, or unsecured, and whether the creditor’s relationship with the bankrupt company is non-arm’s length. Non-arm’s length creditors are family and friends or directors, officers or employees of the bankrupt company.
2. The Trustee holds a meeting of all creditors. At this meeting, the Trustee previously appointed is re-affirmed or a new Trustee is elected by the creditors. Individual creditors may also challenge the amount of their claims in the Statement of Affairs, and the Trustee will investigate further. Only unsecured creditors whose Proof of Claim has been accepted by the Trustee can vote at creditor meetings. These creditors receive one vote for each dollar of their claim and votes are on a majority basis. Secured creditors can vote if their security is inadequate and they receive votes for the unsecured portion of their claims only. Non-arm’s length creditors cannot vote to elect the Trustee or Inspectors.

One or more Inspectors may be elected by the creditor group to represent them. They initially meet with the Trustee to agree on how to dispose of the debtor’s assets and to select a lawyer and then subsequently to approve all transactions by the Trustee.

1. A trustee liquidates the bankrupt company’s assets at the best possible price to maximize the distribution to the creditors. One option is to sell the business as a going concern to new owners with more capital and a better business plan. Another option is to sell the fixed assets and inventory separately. This can be done as part of a formal liquidation sale where assets are sold in an orderly manner over an extended period. This way Trustees have time to find multiple buyers who will pay the best price possible. Because of significant carrying costs related to asset storage and financing, this method is best for high-value, specialized assets where the costs can be recovered. For more standardized equipment and inventory, auctions can be used. Auctions are fast and affordable and competition between bidders can drive up the prices received especially if web-based technology is used to attract bidders nationally or internationally.

Any leases can be retained by the Trustee if the bankrupt company is sold as a going concern, or the leased assets can be sublet to other acceptable businesses or surrendered to the lessor. Legal action can be initiated to collect any amounts owed to the bankrupt company and these amounts can be reduced or written off at the discretion of the Trustee if the collection costs are not warranted. Trustees can borrow funds and incur reasonable expenses in liquidating the bankrupt company including employing lawyers, accountants, and other professionals. All transactions must be approved by a majority of the Inspectors, but any decisions can be overturned by a majority vote of the creditors or the courts. Proper financial records including tax returns must be maintained and are regularly reviewed by the Inspectors.

1. Trustee reviews transactions before the bankruptcy for possibly illegal actions by the bankrupt company to defraud its creditors. These include fraudulent conveyances, fraudulent preferences, bulk sales, and improper dividends. If individual creditors disagree with the Trustee and the Inspectors decide not to challenge that transaction, they can take separate legal action. Any award will first go to covering these creditors’ legal costs and their full claim. The remainder, if any, will be shared by the other unsecured creditors.

Fraudulent conveyances are the gift, transfer, or sale of the property at nominal or no value to hinder, delay, or defraud creditors. Beneficiaries of these one-sided transactions may be friends or family members who agree to share the proceeds with the debtor once the bankruptcy process is complete. These transactions can be reversed by the Trustee through the courts if they have occurred in the last year or for up to five years if the Trustee can prove the bankrupt company could not pay all its debts without this property at the time the conveyances were made. Buyers can defend themselves in court if they can prove they paid fair value for the property or they acted in good faith and did not collude with the bankrupt company.

Fraudulent preferences give one creditor an unfair preference over another creditor relating to the payment of obligations. This can include a preferential cash payment to the creditor, providing them with additional security, or returning goods to them prematurely. These transactions can be reversed if they took place within three months of bankruptcy or one year if the transaction was with a non-arm’s length person. If a creditor can convince the courts that these transactions were made in the ordinary course of business or that the creditor did not know of any intent to defraud the bankrupt company’s other creditors, then these transactions will not be reversed. For example, if the bankrupt company was placed on C.O.D. by a supplier due to non-payment of its account, C.O.D. payments would be considered to be in the ordinary course of business if their outstanding account balance with that supplier did not go down.

Bulk sales occur when a bankrupt company sells all or nearly all of its inventory to one buyer. Bankrupt companies may use bulk sales to liquidate their inventory quickly at below-market prices before being seized to defraud their creditors. Most provinces have a Bulk Sales Act that requires these types of transactions to be registered with the government. The registration document includes a listing of the debtor’s secured and unsecured creditors and is signed by both the debtor and buyer of the inventory. If the transaction is not registered, the courts may allow the Trustee to take possession of the inventory or require the buyer to pay the Trustee any proceeds from the sale.

Improper dividends are dividends or stock repurchases made by a bankrupt company within one year of bankruptcy when the company has already met the conditions for bankruptcy or the payment of the dividends rendered them bankrupt. Bankrupt companies use improper dividends to defraud their creditors by removing cash needed to pay them from the business. The courts may require that the bankrupt company’s directors repay these amounts if it finds that the directors did not display due diligence in the performance of their duties. Directors may use as a defense that they relied on information from the bankrupt company’s officers and auditors who did not indicate a problem, or the owners accepted dividends instead of salary justifying the amounts paid.

1. A Final Statement of Receipts and Disbursements by the Trustee must be approved by the Inspectors and Courts. The net proceeds are then distributed to creditors according to the priority of claims in liquidation in the BIA. The courts then discharge the Trustee from their duties. Any bankrupt persons (i.e. sole proprietors or partners) are also formally discharged from bankruptcy so they can start again free of any obligations.

**Priority of Claims in Liquidation**

When distributing the net proceeds in a liquidation, claims at each level must be paid in full before proceeding to the next level. If funds are insufficient, creditors at that level are paid prorate based on the amount of their claims.

1. **Special Claims.** Suppliers may reclaim goods delivered in the 30 days preceding the bankruptcy provided they apply within 15 days of the date of the bankruptcy and the goods can be specifically identified, have not been fully paid for, and have not been used in operations or resold. This rule addresses a frequent complaint from suppliers that companies order excessive amounts of inventory just before applying for bankruptcy to increase the collateral available to pay their secured creditors. The 30-day requirement is problematic because creditors are slow to learn of bankruptcies. Also, goods are not easy to identify if they are similar to other inventories. In practice, only blatant cases of abuse are enforced and reputable secured lenders will not participate in such schemes.

2. **Trust Claims.** Employers deduct provincial and federal income tax, Employment Insurance (EI) premiums, and Canada Pension Plan (CPP) contributions on behalf of the federal government and also make matching EI and CPP payments. These are forwarded to the federal government regularly but companies experiencing financial distress often defer payment to preserve cash. The courts have found that the federal government has a higher priority in collecting these remittances as they are the property of the federal government being held in trust by the employer who is acting as a collection agent. Other government claims such as income taxes on business income and Goods and Services Tax (GST) or Harmonized Sales Tax (HST) liabilities are not considered trust claims so the federal government is an unsecured creditor for these amounts.

3. **Secured Claims.** Properly registered charges or liens against receivables, inventory, equipment, or real estate of the bankrupt company can be exercised. If the secured creditor’s Receiver realizes more than the value of their claim which includes interest, principal, and other related costs, they will return the difference to the Trustee. If deficient, the secured creditor becomes an unsecured creditor for the difference.

 As discussed, creditors can enforce charges or liens without forcing a company into bankruptcy. Regardless, the Receiver must give the debtor and its creditors 10-days notice of their actions. They must also provide interim and final reports relating to the disposition of these assets to the Official Receiver, the debtor or their Trustee if they are bankrupt, and any creditors who request them. These reports indicate if the Receiver has realized more than the secured creditors claim in which case the difference must be returned to the debtor or Trustee to satisfy other creditors. These parties can also apply to the courts to have a Receiver removed if they are not carrying out their duties properly.

4. **Preferred Claims.** Under the BIA, certain unsecured claims are given preference in liquidation. For commercial bankruptcies, these include:

* Administrative and legal costs relating to the bankruptcy process.
* Wages and salaries of up to CAD 2,000 payable in the previous six months per employee who is not related to the company.
* Expenses of traveling salespersons of up to CAD 1,000 payable in the previous six months per employee who is not related to the company.
* Municipal taxes that are payable in the last two years.
* Three month’s rent before and three months after bankruptcy payable only from the proceeds of the sale of the property on the leased premises.
* Employee injury claims not covered by the Worker’s Compensation Board (WCB) up to the amount of any insurance proceeds related to the injury.

Each of these preferred claims must be paid in full before moving on to the next claim. Legal and administration costs are ranked first to ensure Trustees and other participants accept bankruptcy work. The remaining claims are included because it is deemed that the financial need of these creditors is greater than other unsecured creditors. Recently, the Canadian Association of Retired People (CARP) lobbied the federal government to classify unfunded pension liabilities as a preferred claim. The government refused and indicated that including these large liabilities would leave too little for the unsecured creditors thus discouraging them from extending needed credit. The federal government’s Wager Earner Protection Program (WPP) supplements what workers receive as preferred creditors up to a maximum of seven times EI maximum weekly insurable earnings.

5. **Unsecured Claims.** All claims of unsecured creditors except any deferred claims have equal standing and the net proceeds remaining are divided pro-rata based on the dollar amount owed. The only exception is with senior and subordinated debentures. Debentures are different from bonds in that they are not secured. Debenture holders receive a pro-rata allocation of the net proceeds, but the subordinated debtholders then allocate their share to senior debtholders until they are paid in full.

6. **Deferred Claims.** There are usually only enough net proceeds remaining to pay unsecured creditors a fraction of what they are owed, but if any net proceeds remain the deferred claims are paid pro-rata. Deferred claims are weaker claims that are only paid after other creditors are fully compensated. They include:

* Amounts owed relating to fraudulent conveyances, fraudulent preferences, bulk sales, and improper dividends.
* Compensation owed to relatives.
* “Silent partners” whose return varies with the profits of the company and who are thus very much like an equity investor.
1. **Preferred Shareholders.**  Preferred shares have preference over common shares in a liquidation. If any net proceeds remain after paying the deferred claims, the preferred shareholders are paid pro-rata based on the liquidation or par value of their share class plus any dividends in arrears. Different classes of preferred shares can also negotiate liquidation preferences to increase their distribution in bankruptcy. These preferences allow them to be paid in full before other classes of preferred shares or include a multiple such as two times that increases the value of their claim leaving less for other shareholders. Liquidation preferences are often used in venture capital to protect those investors if the business fails.
2. **Common Shareholders.** The Canada Business Corporations Act (CBCA) requires that any remaining net proceeds be distributed to common shareholders in accordance with their respective rights. Normally net proceeds are allocated pro-rata based on the number of shares owned.
	1. **| Reorganization**

**Steps in a Reorganization**

In a formal bankruptcy, the steps for reorganizing a company include:

1. The company experiencing financial distress may file a 30-day Notice of Intention to Make a Proposal with the Official Receiver to obtain a Stay of Proceedings from its secured and unsecured creditors while its management prepares a Proposal. If approved, a Stay of Proceedings prevents secured and unsecured creditors from taking further collection action during the Proposal process, but they are not required to extend any further credit. This provides the company immediate financial relief making cash available for payroll and other operating expenses. It also serves as a cooling-off period allowing creditors an opportunity to learn more about the company’s financial situation and to monitor their actions. Extensions of 45 days to a maximum of five months may be granted if the company continues to act in good faith and the courts feel there is a reasonable chance of reaching an agreement.
2. A Trustee is appointed to monitor the company and assist in the development of the Proposal until it is approved by the courts. A Statement of Assets and Liabilities, Creditors List, and Statement of Projected Cash Flows for the workout period must be provided to the Trustee who reports any material problems to the Official Receiver. While preparing the Proposal, companies may apply to the courts to raise Debtor-in-Process (DIP) Financing. This is interim financing used to fund a business while it restructures because other lenders are unwilling to deal with insolvent companies. DIP lenders are given “super-priority” so they are paid first if the company eventually liquidates.
3. Creditors must meet within 21 days of the Proposal being filed with the Official Receiver. Secured and unsecured creditors are each divided into one or more creditor classes based on the commonality of their interests. Factors to be considered include the nature of the claim (i.e. trade creditors, landlords, government), the nature and priority of the collateral available to satisfy the claim, and the extent to which creditors will likely recover their claim with existing remedies without the Proposal. Each unsecured class must approve the plan by a double majority for it to go forward in the approval process. Double majority means a majority of the creditors in the class by number who also own at least 2/3 of the value of the claims. Secured classes are only bound by the Proposal if their class supports it by a double majority vote. A Proposal can still go forward if it has the approval of all unsecured classes but only some of the secured classes. Secured classes who do not support the Proposal are not bound by it and can exercise their security claims. The courts will sometimes approve a plan without the support of all classes of creditors in a “cram-down.” In general, debtors prefer having fewer classes to reduce the probability of one class voting down the proposal. Creditors prefer having a greater number of classes as they are more likely to be outvoted as part of a larger class.
4. Courts must approve the Proposal and will do so if it is in the interest of all creditors and has a reasonable chance of success. If the company fails to file a Proposal, it is voted down, or the court does not approve it, the company is immediately liquidated.
5. If approved, the Proposal is implemented by the company and its creditors under the supervision of the Trustee and any elected Inspectors over usually a one- to five-year period. Revisions can be filed to the Proposal in the future if the debtor is unable to satisfy the terms of the agreement, but these revisions must go through the same approval process. As part of the Proposal, the BIA requires that companies pay any outstanding Trust Claims, what employees are entitled to as preferred creditors, and six-months of rent to landlords of cancelled leases. Special claims relating to goods delivered in the last 30 days do not apply.
6. After the completion of the Proposal, the Trustee files a Final Statement of Receipts and Disbursements and applies to the courts to be discharged from their obligations.

**Actions in a Reorganization**

Developing a reorganization plan that allows a company to emerge from bankruptcy and have long-term success is difficult. Those involved must understand the underlying causes of the financial distress. If these causes are not addressed, the reorganization will have little chance of success and should not be pursued.

Even if a reorganization has the potential to succeed, many times the company’s management and the Trustee do not go far enough in restructuring its operations. They may know what actions are needed, but they have to gain the support of a majority of the creditors who may be more interested in maximizing their payout as creditors than building a strong company. This failure to do what is needed can lead to additional reorganizations or even a liquidation in the future. The courts contribute to this problem by not ensuring that the proper steps are taken early on. Judges with better business knowledge are needed.

When reorganizing a company, management focuses primarily on reducing its financial leverage and generating new cash flows to service the remaining debt and improve operations. Some options in a reorganization include:

1. Restructure liabilities by:
* Negotiating longer debt repayment periods (called extensions) and lower interest rates.
* Capitalizing unpaid interest or settling debts at less than 100% of their value (called compositions).
* Altering loan conditions to provide more financial flexibility.
* Making interest and principal payments contingent on future profitability to eliminate required fixed payments.
* Swapping debt for preferred or common equity.
* Raising new debt or equity from existing owners, venture capitalists, or those with a special interest in reorganizing the business such as suppliers, customers, or employees.
* Eliminating unfunded pension liabilities by issuing common shares.
* Reaching an agreement with provincial governments to reduce environmental clean-up obligations.
* Securing government assistance in the form of grants, direct investments, or loan guarantees.
* Relinquishing some assets to satisfy certain secured creditors who do not want to participate in the reorganization.
* Selling the company to a firm that can utilize the loss carryforwards quickly.
1. Increase cash inflows by:
* Entering new markets and focusing on higher-margin products.
* Following up on delinquent accounts and asking key customers to pay faster or make up-front deposits.
* Factoring receivables.
* Convincing suppliers to provide extended credit terms or sell on consignment.
* Finding new lower costs suppliers, possibly overseas, with longer credit terms.
* Reducing raw materials and finished goods inventories by applying just-in-time, outsourcing, and other inventory management techniques.
* Improving production processes to reduce costs and work-in-progress inventory.
* Downsizing corporate staff and reducing other overhead items.
* Renegotiating expensive union agreements, leases, and other contracts.
* Providing early retirement plans.
* Re-mortgaging assets, entering sale-leaseback arrangements, or selling unneeded divisions, product lines, or assets.
* Removing a poorly performing management group and installing a creditors’ committee or new managers who specialize in reorganizations.

Companies can also negotiate informal proposals or arrangements with their creditors outside of the courts. As discussed, this lowers their legal and accounting costs, provides more flexibility when dealing with individual creditors, and avoids the embarrassment of being declared bankrupt. Disadvantages are the company does not receive a Stay of Proceedings and all creditors must agree to the informal arrangement, which increases the probability that hold-outs will demand special treatment.

**What is in a Proposal?**

A Proposal is a binding legal agreement between a company and its creditors outlining the terms of a reorganization. It helps to keep the company “on track” in its restructuring efforts and provides further legal protection to their creditors. These agreements typically have a duration of one to five years. During this time, the Trustee continues to act as the intermediary between the company and its creditors enforcing the Proposal and remitting any funds to the creditors as prescribed by the agreement. There are no specific legal requirements for what has to be included in a Proposal, but failure to follow any terms can result in the company being liquidated by the courts. A typical Proposal may contain:

* Definitions of the different creditor classes and the amounts owed to each class after any agreed-upon reductions of their claims.
* Schedules to pay creditor claims over time from company sales, profits, or tax refunds relating to loss carryforwards.
* Stipulations that key management personnel remain with the company.
* Schedules of payments to creditors relating to any fraudulent conveyances, fraudulent preferences, bulk sales, or improper dividends discovered.
* Provision to regularly submit financial information to the Trustee.
* Conditions to meet specified financial ratios.
* Limitations on business operations including business expansion, asset acquisitions, new borrowings, and salary or dividend payments.
* Instructions on when certain business units or assets are to be liquidated and how the proceeds are to be distributed to creditors.
* Requirements to make specific payments (i.e. utilities, rent, income taxes, GST/HST, payroll remittances, or insurance) on time.

**Getting a Proposal Approved**

Practitioners have identified several factors that are critical to negotiating a successful Proposal. These include:

* Ensuring creditors realize a much higher proportion of their claim compared to liquidation.
* Paying creditor claims as soon as possible.
* Having creditors who have extensive business dealings with the company, so they see greater value in it continuing.
* Maintaining the strong support of secured creditors and landlords so they do not repossess collateral or terminate leases.
* Developing a conservative business plan that generates considerable cash and does not burden the company with unattainable goals or excessive debt.
* Demonstrate with budgets and forecasts that there will be sufficient funds to pay creditor claims in the future through operations, new equity investments, and personal and third-party guarantees.
* Having a capable management team that is committed to leading the company through the restructuring process.
* Having management and owners demonstrate their commitment by eliminating lucrative salaries, bonuses, and dividends and investing in the business.
* Proving to creditors that the company has rehabilitated itself if poor management or dishonest behaviour contributed to its financial distress.
* Recruiting a strong group of insolvency, legal, and accounting professionals to assist management.
* Developing an open, honest, and cooperative relationship with creditors, employees, and unions and working jointly with them to develop a business plan that is acceptable to all parties.

**Vulture Capitalists**

Some private equity firms, commonly referred to as vulture capitalists, specialize in buying the debt of bankrupt or near-bankrupt companies at low prices to earn a profit on that firm’s liquidation or reorganization. These investors provide valuable market liquidity for creditors who do not want to be involved in the bankruptcy process and are willing to take whatever they can get now.

Vulture capitalists are experienced in liquidations and reorganizations and can make the hard decisions needed to be successful. In liquidations, they diversify their holdings across many distressed companies and concentrate on buying senior debt with the best claims at the lowest price possible.

With reorganizations, vulture capitalists purchase debt because the company’s existing equity is usually wiped out and their debt is turned into new equity giving them much greater influence over the reorganized firm. Once in control, venture capitalists are free to restructure the company and address the operational and financial problems that led to their demise. A leaner and more focused company usually emerges that is taken pubic again at a considerable profit. Some common strategies used by vulture capitalists include:

* Convince distressed companies to reorganize early when the turnaround is the easiest and the least damage has been done to the company resulting in lower risk.
* Invest in very troubled companies where price discounts are the largest and the turnaround is the most complicated, but the returns are the highest.
* Buy low, reorganize the company quickly, and make a substantial profit by selling to long-term investors who will not risk being involved in the initial turnaround.

Vulture capitalists appear to have an important role in saving companies and jobs, but they are not without their critics. To return a company to financial health, costs must be lashed resulting in employee layoffs, shuttered factories, store closures, and the elimination of entire product lines. To execute the takeover of a troubled firm, the vulture capitalist borrows heavily against the company’s assets. Some believe that these high interest and principal payments force the company to be more efficient. Others feel they prevent them from making the capital and R&D expenditures needed to recover. Toys R Us and Sears are recent bankruptcies of iconic retailers that were partially caused by excessive borrowing by vulture capitalists.

**Strategic Bankruptcy**

Companies may abuse bankruptcy laws by attempting to reorganize when they are not yet bankrupt. This is referred to as strategic bankruptcy and it can help them achieve certain goals:

* Break expensive leases and contracts to re-negotiate better prices.
* Re-negotiate union agreements with costly wage and benefit provisions or strict work rules.
* Eliminate product or environmental liabilities arising from large court settlements.
* Enhance a company’s performance before a merger or acquisition to secure a better price.

Creditors, landlords, and unions should be prepared to challenge companies in the courts to maximize their payout. Existing shareholders should also be concerned as they may be eliminated in a reorganization.

* 1. **| Professional Designations**

## All trustees must be licenced by the Office of the Superintendent of Bankruptcy (OSB) which is part of Innovation, Science and Economic Development Canada, a department of the Government of Canada. To become a Licensed Insolvency Trustee, candidates must first complete the Chartered Insolvency and Restructuring Professional Qualification Program (CQP). Through an agreement with the OSB, this program is offered by the Canadian Association of Insolvency and Restructuring Professionals (CAIRP) which is the professional association and advocacy group for bankruptcy professionals in Canada.

## To be accepted into the CQP, candidates must have a degree, hold an accounting designation or LL.B., or have five years of related work experience including at least one accredited course in both accounting and business law. To complete the CQP, candidates must:

1. Complete four courses:

**Introduction to Insolvency.** Provides an overview of the profession and a general understanding of the insolvency and restructuring discipline.

**Core Knowledge.** Develops the technical knowledge and skills required by bankruptcy professionals.

**Applied Knowledge.** Applies the technical knowledge and skills developed to solving insolvency and restructuring problems and operating an insolvency practice.

**Practical Course in Insolvency Counselling (PCIC).** Deals with the money management principles and the interviewing and counselling skills needed to deal with personal bankruptcy.

1. Acquire a minimum of 2,400 hours of insolvency experience
2. Pass the Competency-Based National Exam (CNIE)

The CQP must be completed under the supervision of a sponsor who is a Licensed Insolvency Trustee in good standing and likely the candidate’s employer. The sponsor guides them through their studies, marking their assignments, providing mentorship, and indicating their readiness to write exams. They also plan and verify their work experience which must be spread across the competency areas of insolvency law and practice, taxation, general business law, financing, managing business operations, and financial analysis and reporting.

## Candidates who complete the CQP become Licensed Insolvency Trustees after passing the OSB’s Oral Board examination. Over 95% of Licensed Insolvency Trustees also choose to become Chartered Insolvency and Restructuring Professionals (CIRP) through CAIRP. The CIRP is the professional designation for insolvency and restructuring professionals in Canada. In addition to meeting the requirements for a Licensed Insolvency Trustee, CIRPs must adhere to CAIRP’s code of conduct and remain current by completing professional development activities on an ongoing basis.

BIA also requires that all individuals who counsel debtors or bankrupt persons be Registered Insolvency Counsellors. Counsellors complete CAIRP’s PCIC to meet this requirement.

* 1. **| Bankruptcy at Canadian Companies**

The OSB maintains an online database of court documents and other disclosures relating to bankruptcies and proposals in Canada including the records of companies who have been given protection under the CCAA. As discussed, the CCAA is an alternative to the BIA for commercial reorganizations of larger companies with debts exceeding CAD 5,000,000 which is more flexible and provides more judicial discretion when dealing with complex restructuring issues. This database charges a fee for most searches except for those relating to CCAA records. Two recent cases, Toys R Us Canada and Rothmans and Benson & Hedges provide practical examples of how businesses are restructured under the CCAA versus the BIA. The terminology in the two acts varies somewhat, but their goals are the same.

**Toys R Us Canada**

Toys R Us was founded in the U.S. in 1957 and grew into an 800-store “category killer” in the children’s toys, baby supplies, and children’s clothing segments operating in over 40 countries. With market encroachments by discount chains including Walmart and online retailers like Amazon, Toy R Us began to decline. In 2005, the company was purchased by a consortium of private equity firms including KKR and Bain Capital who planned to revamp its operations and return it to financial health. Despite efforts to improve their in-store and online businesses, the company was forced to declare bankruptcy in 2017 burdened by debt payments from the 2005 leveraged buyout and reduced credit terms from worried suppliers.

Toys R Us’ Canadian subsidiary was formed in 1983 and grew to 82 stores. Even though it was generating positive cash flows, Toys R Us Canada declared bankruptcy alongside its American parent in 2017 as they shared a USD 200 million secured revolving credit facility and a USD 125 million secured term loan facility and the U.S. company defaulted on its payments.

On September 20, 2017, the Ontario Superior Court found Toys R US to be “a strong performing business facing a liquidity crisis that causes it to suffer technical insolvency” and awarded a Stay Order to protect it from claims by its secured and unsecured creditors while it attempted to restructure its operations under the CCAA. In the court’s decision, the judge stressed the value of the Stay Order in:

* Maintaining a “level playing field” for all creditors during the restructuring.
* Creating a situation where new creditors will lend to the business during the restructuring.
* Preventing the elimination or tightening of credit terms just before the Christmas season.
* Stopping some creditors from acting immediately so the company has sufficient time to successfully restructure its operations benefiting all creditors.
* Allowing the business to continue to operate as a going concern as it restructures to protect the value of the business and its brand name.

The court decision authorized the Monitor (i.e. CCAA name for a Trustee) to pay some pre-filing claims (i.e. claims before the Stay Order being issued) including wages and gift certificates. The Monitor was also allowed to pay the pre-filing claims of critical suppliers when there was an “inordinate risk” to the operation of the business if these creditors were not paid immediately. The judge indicated that this should only occur in a few instances. Under the CCAA, the courts may declare a creditor to be a critical supplier and force them to supply the company. Toys R Us Canada did not request this from the courts.

A DIP credit facility was authorized that allowed the company to repay its existing asset-backed lending facilities and borrow new funds to build up its inventories for the Christmas season. The DIP lenders were able to enforce their collateral rights if there was a default, but they had to give 5-days’ notice, so the company had sufficient time to challenge their proposed action in court. During this time, creditors were not required to make any further loan advances. The judge felt that no further protection for the DIP lender was needed given that they had a strong collateral position. Toys R Us was paying the DIP lender over CAD 20 million in fees plus a higher interest rate, and there was only one Canadian case of a DIP lender not being paid in full.

Grant Thornton Ltd. was appointed as the Monitor under the CCAA. Cassels, Brock, and Blackwell LLP were retained as the Monitor’s legal counsel. Toys R Us Canada selected Alvarez & Marsal Canada as their financial advisor and their investment banker was Lazard Freres & Co. LLC. A syndicate of lenders led by JPMorgan Chase Bank provided DIP financing. Between September 2017 and May 2018, Toy R Us Canada’s management continued to operate the business making needed improvements to its in-store and online operations. The company and its financial advisor prepared regular cash projections in consultation with the Monitor and received extensions of the Stay Period from the courts on October 11, 2017, December 11, 2017, January 25, 2018, and April 27, 2018. During this time, the company worked closely with its suppliers, creditors supplying DIP financing, and its Monitor reviewing all cash receipts and disbursements. The Monitor also prepared a summary of Proofs of Claim and Notices of Dispute of Claim Statement with total pre-filing claims of CAD 70 to 80 million by April 2018.

In April 2018, Toy R Us Canada’s American parent signed a share purchase agreement (SPA) with Fairfax Financial Holdings (FFH) Ltd., a Canadian value investor, to purchase 100% of the company’s equity for CAD 300 million before adjustments. The SPA was approved U.S. Bankruptcy Court on April 25, 2018, and on May 9, 2018, the Ontario Superior Court issued a Discharge Order for Toys R Us Canada which removed it from CCAA protection.

The proceeds of the SPA were used to immediately pay off Toy R Us Canada’s DIP credit facility. The remaining funds were then paid to the Monitor and who placed them in an Equity Reserve to pay all pre-filing claims against Toys R Us Canada within 60 days. After 60 days, creditors filed objections if they felt they were not paid fairly. After 75 days, the remaining funds in the Equity Reserve minus a holdback for any credit objections that had not been settled was forwarded to Toys R Us Canada’s U.S. parent who was in the process of winding-up its U.S. operations.

After completing the restructuring, FFH is expected to take Toys R Us Canada public in an initial public offering or sell the company to another Canadian or U.S. retailer at a significant profit. Currently, the company is focusing on making less costly renovations and improving store cleanliness, layout, merchandising and customer service including new uniforms. The company launched an updated website in September 2019 that makes it easier to find items and provides faster shipping. It is also experimenting with smaller stores and services such as birthday parties, car seat installation, and fast food. Toys R Us Canada is emphasizing the total customer experience again to better compete with the discount chains and online retailers.

**Rothmans and Benson & Hedges**

Rothmans and Benson & Hedges (RBH) is a [Canadian](https://en.wikipedia.org/wiki/Canada) manufacturer and distributor of [tobacco](https://en.wikipedia.org/wiki/Tobacco) products and a wholly-owned subsidiary of U.S.-based Phillip Morris International. As with most tobacco companies, RBH is subject to considerable litigation relating to the harmful health effects of its products and the health costs incurred by the provincial governments dealing with tobacco-related illnesses. Currently, Alberta, Ontario, Newfoundland, and Quebec have separate actions to recover health care costs, while British Columbia, Manitoba, New Brunswick, Nova Scotia, Prince Edward Island, and Saskatchewan have formed a consortium and are acting together. Also, RBH is subject to several class action lawsuits.

On March 1, 2019, the Quebec Court of Appeal upheld an earlier court decision that awarded claimants CAD 13.5 billion in a class action lawsuit. In response, RBH received a Stay Order under the CCAA that prevents any new actions from being brought against the company and all existing actions from proceeding further. RBH is currently generating positive cash flows but applied for a Stay Order to allow it to deal with all its litigation claims globally at once. The courts agreed and felt this would ensure that all litigants and the company’s creditors are treated equally in the distribution of its assets regardless of when they initiated their actions. RBH has had to deposit CAD 1 billion in Quebec to pursue an appeal to the Quebec Court of Appeal. Without this Stay Order, claimants from Quebec would have had an unfair advantage.

Ernst & Young has been appointed as the Monitor under the CCAA. On April 5, 2019, the Honorable Warren K. Winkler Q.C was appointed by the court to mediate a global settlement of RBH’s tobacco claims. Alvarez & Marsal was appointed by the courts as the mediator’s financial advisor. The Stay Period was extended on June 26, 2019, and October 4, 2019, and meetings with all parties are still on-going.