Canadian Bond Investors' Association
Association canadienne des investisseurs obligataires

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Director General
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Via e-mail: cbca-consultations-lcsa@ic.gc.ca

Re: Response of Canadian Bond Investors' Association (the "CBIA") to Notice of Consultation on the Canada Business Corporations Act (the "CBCA")

The CBIA was established in 2011 and currently represents over 32 of the largest fixed income institutional investor organizations in Canada, including those from the insurance (buy-side), asset manager (including bank-owned) (buy-side), pension and investment counsel sectors. Those institutions represent more than $550 billion of fixed income assets under management. As such, the CBIA is the independent voice of Canadian bond investors, and hence of the millions of pensioners, policyholders and retail investors who depend on CBIA members and other similar industry participants for the sound management of these investments.

The purpose of this letter is to provide Industry Canada with the CBIA's feedback on the public consultation and review of the CBCA, specifically with respect to the arrangement provisions of the CBCA (the "Arrangement Provisions") to restructure insolvent corporations. Our comments are outlined below:

1. IN LIGHT OF THE COMPANIES' CREDITORS ARRANGEMENT ACT (THE "CCAA") AND THE BANKRUPTCY INSOLVENCY ACT (THE "BIA"), DO CANADIAN COMPANIES TRULY NEED ACCESS TO A THIRD REGIME FOR RESTRUCTURING?

There are already two substantive and well-developed statutes governing and facilitating the restructuring of insolvent business enterprises in Canada – the CCAA and the BIA. Thus far, on a limited basis the courts have allowed recourse to the Arrangement Provisions of the CBCA for otherwise insolvent enterprises, but under the watchful eye of the courts themselves and of the Director. There is also the clear and specific policy statement of the Director which speaks to the use of the Arrangement Provisions.

The CBIA asks why it would be necessary or useful to create an entire third regime for insolvent companies – one lacking much of the direct court oversight and the oversight of the Monitor or Trustee (which is a court officer) that are key to the other two statutes – when two very satisfactory statutes and oversight regimes already exist and have undergone the test of time and ongoing amendment. There are not so many corporate restructurings in Canada each year that Canada needs a third statute to be utilized regularly in that regard. Indeed, the U.S., which is a far bigger market for restructurings, has essentially one such statute.

(a) Historical reasons for recourse to the CBCA Arrangement Provisions – the need for limited and judicious use

It seems that many of the early cases of recourse to the CBCA were the result of specific deficiencies in the other restructuring statutes (e.g. in the case of Dome Petroleum), most of which deficiencies have now been rectified. More recently, it would appear that many of the situations in which companies have sought recourse to the CBCA, rather than the CCAA or the BIA, involved companies where it was either highly desirable or absolutely necessary to avoid the stigma of having availed oneself of a statute involving insolvency. Query whether that perceived (sometimes necessary) "benefit" will be lost if the CBCA Arrangement Provisions become available to blatantly insolvent entities.

The CBIA is not advocating that recourse to the CBCA for restructurings should never be allowed. However, when it comes to the necessary statutory and procedural framework for effecting fairly a corporate restructuring and to the judicial oversight necessary to protect creditor and other stakeholder interests, the CBCA simply falls far short of adequate protection for the rights of creditors and adequate certainty for the functioning of an effective market. The Arrangement Provisions were never designed for that purpose and would need wholesale and extensive amendment (largely to replicate significant portions of the CCAA) if the CBCA Arrangement Provisions were to be able to be used regularly for restructuring by insolvent companies.

Aside from the need to import major procedural structure and oversight provisions from the CCAA, it is important to note that the CBCA is not a statute which focuses to any significant degree upon the rights of creditors. It was not created for that purpose. It is a statute that was crafted to deal with the conduct of the business while the company remains solvent. To suggest that the CBCA can be easily and properly amended to encompass fairly a focus on the rights and protections of creditors is to misunderstand its current shortcomings in that regard. The CBIA submits that this would be a very broad and significant task, and that it is certainly not a task worth undertaking in order to afford restructuring debtor companies access to an unnecessary third restructuring choice.

(b) The case for limited use of the CBCA Arrangement Provisions

In our experience, having the CBCA available for restructurings in certain limited circumstances has sometimes been useful, but certainly never necessary. The CBIA does not support allowing the use of the CBCA restructuring provisions for insolvent corporations in a manner that expands its availability beyond current usage. Aside from being unnecessary, it could even be very confusing and would constitute a huge step backward for creditors' rights. It would open up restructurings to significantly more potential abuse and would deal a major blow to certainty in the debt markets at least.

As well, amending the CBCA in that regard would cause it to lose its one current potential advantage in restructuring, which is the ability of the restructuring debtor to avoid being seen as having resorted to an insolvency remedy.

The uncertainty and potential abuse points above merit elaboration. In that regard, it is important that the Director and Parliament understand that which often goes on behind the scenes in a restructuring. From the creditor perspective, much of the leverage a debtor – which by the relevant time has already defaulted or is about to default on its legal obligations to creditors – is able to create for itself derives from (i) its willingness and ability to threaten credibly that it will scorch its own earth if the creditors do not agree to restructure on Management's terms and (ii) its ability to use legal tactics to disadvantage the creditors practically and from a legal perspective. The CCAA and the BIA help provide some of the latter leverage, but at least the rules therein are generally understood and, while there is also judicial discretion, it is limited by the statute and the case law. The CBCA Arrangement Provisions, on the contrary, have almost no rules or guidelines (beyond the Director's policy), provide for little oversight and leave a relatively wide open field in terms of possible application of individual (both court and board of directors) discretion and the like.

While that might sound good if the only relevant policy were to help an individual company in a specific set of circumstances, Canada has learned the hard way in the evolution of the CCAA and BIA that there are serious implications for the broader lending markets and our economy when we do not proceed wisely in this regard. One example of this was the virtual ostracism of Canadian companies from the ISDA swap contract market for months after a single judge's ruling in the Confederation Treasury

CCAA matter by which he stayed the enforcement of internationally recognized and crucial ISDA swap contracts. That necessitated a rushed amendment of the CCAA and BIA, amendments which produced rules that are not in the CBCA. Another was the havoc wreaked upon users of letters of credit a few years earlier when, in order to protect a retail chain, the same court ruled that they could not be drawn in CCAA. These types of problems are much more likely to arise when there is limited structure.

(c) The current limited availability of the Arrangement Provisions provides a unique opportunity, but also promotes proper usage of them

Our observation is that currently the CBCA is utilized rather sparingly for restructurings. Because of the tenuous nature of its use for insolvent companies in light of the wording of the CBCA, our experience is that most of those uses involve situations that work out to be largely consensual, which consensus often makes for good restructurings. There of course must be a level of consensus that allows a debtor to proceed without all of the oversight that would be available to creditors under the other two statutes.

Although the CBCA Arrangement Provisions contain very few procedural or substantive rules governing restructurings, in most cases it would appear that the courts have adopted in CBCA Arrangement restructurings very similar rules to those set out in the CCAA, almost always upon the debtor's application. One of the reasons those processes often adopt rules very similar to those of the other statutes (when there is no statutory requirement to do so) is because of the need on the part of debtors to achieve a level of consensus with their creditors in order to avoid having their use of the CBCA Arrangement Provisions for the restructuring of an insolvent company challenged.

In other words, there is a very real danger that, if the use of the CBCA Arrangement Provisions for restructuring insolvent companies were expressly permitted, there would be a significant potential for abuse, or at least repeated attempted abuse by debtors, since each case would involve the court approving or not approving rules formulated by the debtor, with the expected concomitant court battle among the parties. In some jurisdictions there are standard CCAA orders expected to be utilized, but those don't provide for the many substantive issues that are clearly set out in the CCAA (which means that such orders are likely to be wholly insufficient for use in a contested CBCA restructuring), they are not in every jurisdiction and, even where they exist, they are routinely amended for use by debtors trying to gain some advantage over their creditors and others.

(d) A CBCA Stay of Proceedings should be allowed only in the case of a consensual CBCA restructuring

Under current statutory regime, the CBCA Arrangement Provisions have been used to implement restructuring transactions which have been pre-negotiated with a "critical mass" of proposed affected creditors. The CBIA believes that the thus-far practical requirement for there to have been pre-negotiation of the fundamental elements of the proposed restructuring has had a positive influence on the efficient and successful use of the CBCA Arrangement Provisions as a restructuring tool which should be enhanced

in any amendments. In that regard, it is important that the CBCA Arrangement Provisions be amended in a manner which codifies the requirement for pre-filing negotiation and consensus. One manner in which this goal could be furthered is by requiring that no stay of proceedings in respect of the debtor company be granted unless the court is satisfied with the level of creditor consensus which has been achieved prior to the commencement of the CBCA Arrangement proceeding. For greater clarity, under no circumstances should the CBCA Arrangement Provisions be allowed to be used for a protection filing that is not at least mostly pre-negotiated with a substantial portion of the affected creditors (that which is sometimes referred to as a freefall). The CCAA (with its more specific rules and closer judicial oversight) or the BIA should be used instead of the CBCA for such instances.

(e) Why would an insolvent debtor use the CCAA or the BIA if the CBCA Arrangement Provisions were unreservedly available to it?

The CBIA asks generally why it would be expected that any debtor would utilize the CCAA, with all its rules and its level of judicial and Monitor supervision, when it can try to create a new and more flexible set of rules and avoid most of that oversight in a CBCA case? Indeed, one even wonders whether the directors of a troubled company would be exposing themselves to lawsuits, including class actions, from their shareholders if they ever resorted to the CCAA without trying first under the CBCA (if it were always available for insolvent companies).

2. COST

There are some who might suggest that cost is a main reason why there should be expanded use of the CBCA Arrangement Provisions. After all, there is less court involvement, no Monitor supervision and perhaps even less formality and process-related work to be done than would be the case under the CCCA, for example. Based on our experience, for a number of reasons, the CBIA rejects that contention. First, all anecdotal evidence would suggest that a complex restructuring under the CBCA is not likely to be significantly less expensive than one under the CCAA. The recent restructuring of Yellow Media would be a good example in that regard. In fact, much of the cost of any such process relates to the degree to which there are disputes among the parties that need to be resolved through lengthy negotiations or court involvement. As stated previously, most CBCA restructurings have been largely consensual in nature. Had they not been, undoubtedly someone would have forced the issue as far as the Supreme Court of Canada as to whether or not the CBCA Arrangement Provisions can be used by corporate groups that have a primary insolvent entity. In any event, if there are disputes, the CBCA provides appeal as of right, whereas the CCAA requires leave, which is often not granted. Therefore, the likelihood of delay and high cost is not necessarily lower under the CBCA.

As was also pointed out previously, if there is a restructuring that is able to be completed expeditiously and very largely on consent, such a restructuring is currently able to be effected under the CBCA in most cases due to that consensual nature. Therefore, where there is a relatively straightforward and consensual restructuring that

can be effected much more cost effectively than might be the case with all of the CCAA procedures, the current structure of the CBCA Arrangement Provisions (with the necessary amendment referred to below) will help to ensure a cost-efficient restructuring.

Having said all of that, however, the CBIA believes that, in situations other than those described immediately above, it is more important to have the necessary protections of procedures, substantive law and judicial and court officer oversight than to attempt to save costs to the detriment of the creditors.

3. IN ANY EVENT, THE CBCA ARRANGEMENT PROVISIONS SHOULD BE AMENDED TO CLARIFY THEIR APPLICATION TO ALL LENDERS – OR TO NONE

The current drafting of the CBCA Arrangement Provisions creates a significant problem due to apparent uncertainty as to whether or not bank debt can be considered to be a "security" (section 2(1)) within the meaning of those provisions. Indeed, in the recent high-profile Yellow Media case, the bank lenders took the position before the court that a restructuring pursuant to the CBCA Arrangement Provisions could not be utilized to affect them as members of a creditor class. In other words, their position was that, while other creditors (bondholders) could have their rights and debt affected by the Arrangement Provisions, bank lenders could only be affected with their unanimous consent; hardly a level playing field for restructuring. The result in this case was a delay in the proceedings and the closing of the restructuring of almost three months at considerable cost to the process and all the stakeholders, but also to the business of the restructuring company. Had the proceedings been commenced under the CCAA, there would have been no issue or doubt whatsoever.

While it is not necessarily surprising that the current drafting of the CBCA Arrangement Provisions is not completely clear on this point – largely because those provisions were never intended to be used in complex corporate restructurings where significant creditor rights would be affected – it is simply unfair and inappropriate for either the courts or the Director to allow a restructuring which proceeds pursuant to the CBCA to afford a particular creditor group (in this case banks) undue and additional leverage by virtue of their view as to the ambiguity of those provisions.

It is therefore important that, to the extent that it is determined appropriate for the CBCA Arrangement Provisions to apply expressly to insolvent corporations (and, in fact, unless the CBCA is amended to specifically prohibit the existing practice of insolvent corporations availing themselves of the CBCA Arrangement Provisions), the CBCA Arrangement Provisions should be amended to specify precisely which creditor interests are capable of compromise thereunder. There is simply no policy or other basis to support the argument made by the banks in Yellow Media that the nature of the interests held by a bank which has lent money to a corporate debtor should be treated differently from funds advanced by any other type of financial player (such as a bond investor). To not make such amendments will only serve to increase the potential for uncertainty for investors and will foster inefficiency and additional cost in the operation of the CBCA Arrangement Provisions.

4. SHAREHOLDER VOTE ISSUE

While the CBCA Arrangement Provisions as they exist provide discretion to the presiding judge to determine (among other things) whether to order a shareholder vote on any specific CBCA Arrangement, the clear practice has evolved whereby the debtor corporation requires a shareholder vote on any proposed CBCA Arrangement. While this is, of course, appropriate in the context of clearly solvent corporations, when the CBCA Arrangement Provisions are used to restructure an insolvent corporation, the threat of a negative shareholder vote (and resultant requirement to utilize the CCAA after having spent the time and money to pursue a CBCA restructuring) has, in our experience, allowed shareholders extra leverage to receive an undue recovery in circumstances where affected creditors are not being repaid in full, which is contrary to well-recognized corporate and insolvency law principles that, absent creditor consent, creditors must be paid in full before shareholders recover anything. If the CBCA Arrangement Provisions are to be amended, certain of those amendments should make it clear that no shareholder vote on the Arrangement is necessary or may be permitted in circumstances in which creditors are not paid in full (similar to those set forth in sections 4 and 6(8) of the CCAA).

5. SUMMARY

In summary, the position of the CBIA is:

(1) the use of the CBCA Arrangement Provisions for restructuring should not be expanded beyond the use for largely consensual balance sheet restructurings; and

(2) in order to promote that result, to ensure that CBCA restructurings will proceed on a level playing field, the following amendments to the CBCA Arrangement Provisions should be made in any event:

- (a) the amendment referred to in No. 3 above should be made;
- (b) as set out in No. 4 above, amendments should be made to make it clear that no shareholder vote shall be permitted in circumstances in which creditors are not paid in full pursuant to the Arrangement; and
- (c) the court in a CBCA Arrangement should not grant a stay of proceedings unless there is good reason to believe that the major creditor constituencies are supportive of the use of the CBCA for that purpose.

We appreciate the opportunity to participate in this consultation and would be pleased to meet with Industry Canada to address any questions you may have.

Sincerely,

Joe Morin
Chair