Commercial Bankruptcies and Proposals

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Bankruptcy

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FUNDAMENTALS OF COMMERCIAL INSOLVENCY

The "Business" vs the "Legal Entity"

Commercial insolvency has been quite usefully characterized as a "business problem" which, in addition to potentially affecting the interests (sometimes quite severely) of a seemingly innumerable breadth of stakeholders, may occur as a result of an equally innumerable breadth of external factors.

When intellectually conceptualizing commercial insolvency, it is useful to think of it in this fashion. Specifically, one ought to at all times distinguish between the business and the legal entity that owns it.[1] Businesses do not become insolvent; instead, they are either viable or they are not. A business is viable if its collection of assets, as measured by the perception of its goods and services in the marketplace and the employees that deliver or perform them, hold a value greater than that which they would hold if they were simply liquidated. Rather, companies and their owners become insolvent. If the business fails to be viable, the insolvency of the corporate owner of the business typically leads to its bankruptcy and, as a result, its eventual liquidation. If the business is viable, however, the insolvency of the corporate owner of the business does not necessarily lead to its bankruptcy, which is but one of the various insolvency regimes available to struggling entities in Canada. Instead, the corporate owner might, as a means of economically rehabilitating its viable, though struggling, business, attempt to simply restructure it by means of the invocation of commercial proposal proceedings brought pursuant to Division I of Part III of the *Bankruptcy and Insolvency Act*.[2]

The Basic Similarities between Commercial Bankruptcy and Commercial Proposal Proceedings

In proceeding with our discussion of the often quite vast differences between commercial bankruptcy proceedings and commercial proposal proceedings, it is useful to begin by first emphasizing their similarities.

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[1] This very helpful and basic, though perhaps not immediately obvious, distinction forms the initial basis of Kevin P. McElcheran's discussion in *Commercial Insolvency in Canada* (Toronto: LexisNexis, 2011) at 1.
[2] RSC 1985, c B-3 ["*BIA*"].

First, by the imposition of a stay of proceedings upon their respective commencement, both regimes collectivize the claims of stakeholders in order to prevent the free-for-all that would prevail if stakeholders, frenzied upon sensing the insolvency of the debtor company, were permitted to individually attempt to enforce their claims via ordinary civil processes. By instituting a "single proceeding" model regardless of the regime chosen, the provisions of the *BIA* are crafted with the overarching legislative objective of promoting enforcement in an orderly, efficient, and equitable fashion.

Secondly, insolvency should be thought of, first and foremost, as a legal status or fact.[3] The various insolvency regimes that exist in Canada are merely a method of responding to that status or fact. The status of insolvency is therefore the necessary precondition to the initiation of insolvency proceedings. The importance of this should not be, though it often is, underestimated. As a result, insolvency law is often envisioned as a means of coercing payment from a reluctant borrower. Rather, at its core, insolvency law is concerned with providing a set of legal responses to address a debtor company's legal *inability* to fulfill legal claims owing to others, whether they arise from contractual claims voluntarily incurred by the debtor company in its capacity as, for example, a borrower or involuntarily incurred where, for example, the debtor company has breached a contract. Where the debtor company has the means to pay, but simply refuses to do so, ordinary civil, rather than insolvency proceedings, are more appropriate.

In addition to being the necessary precondition to the initiation of insolvency proceedings, a state of insolvency is also a necessary precondition to the availability of many of the remedial options available to a Trustee as provided for by the *BIA*. For example, in order to have the ability to dispute a pre-bankruptcy transaction under the fraudulent preference provisions of the *BIA*,[4] the Trustee must be able to prove that the debtor company was insolvent at the time of the transaction. The Trustee must similarly be able to prove insolvency where it seeks to recover, for example, dividends paid to the shareholders of the debtor company in the 12 months prior to bankruptcy.[5]

[3] See Roderick J. Wood, *Bankruptcy and Insolvency Law* (Toronto: Irwin Law, 2009) at 16-23, for an illuminating discussion of the concept of insolvency and its (perhaps often unnoticed) legal significance.

[4] The concept of insolvency is also used in the provincial fraudulent preference statutes, which can also be invoked by the Trustee in preference (no pun intended) to those set forth in the *BIA*. However, the test for insolvency used in the *BIA* versus that used in the provincial statutes is, though similar, not identical.

[5] Wood at 17.