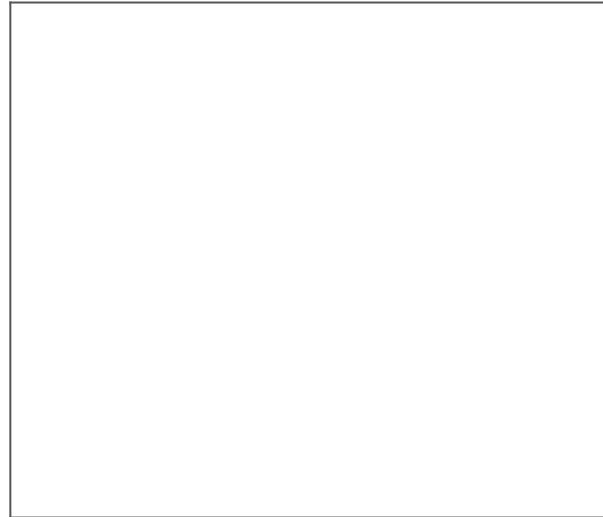


Obtaining Maximum Benefit for the Assets of an Insolvent Business

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The Office of the Superintendent of Bankruptcy Canada reports that there were 4,281 insolvencies filed by businesses in Canada for the 12 month period ending December 31, 2013. Acquiring assets from an insolvent business involves important business and legal considerations. With rare exceptions, buyers of insolvent vendors must understand that the assets are being purchased on an "as is, where is" basis without benefit of the standard representations and warranties that accompany the sale of the assets of a business. In addition, all statutory warranties and conditions will be expressly excluded.



Statutory Framework

The sale of assets of an insolvent business is usually conducted in the context of either the *Companies' Creditors Arrangement Act* ("CCAA") or the *Bankruptcy and Insolvency Act* ("BIA"). Access to the CCAA is limited in that it only applies if a debtor company is insolvent, wishes to restructure, and has claims against it of more than \$5,000,000.

Section 36(3) of the CCAA establishes the factors which a court must consider in determining whether to authorize the sale of assets under this legislation. It provides a non-exhaustive list of factors for the court to consider that includes whether the process that led to the proposed sale was reasonable in the circumstances and whether the consideration for the assets is reasonable and fair, taking into account their market value.

While the stated objective of the CCAA is to allow a debtor company to restructure and continue to carry on business, there has been a growing practice in recent years to use the CCAA for the purpose of liquidating the debtor company and distributing the realized cash to creditors in accordance with their rights. If a debtor company meets the \$5,000,000 threshold, the CCAA (which is typically invoked by the debtor) is generally considered to be preferable to proceedings under the BIA, which is somewhat more restrictive and more likely to lead to the bankruptcy of the company.

If a debtor company does not satisfy the threshold requirement of claims of more than

\$5,000,000, the debtor (through the filing of a proposal) or its creditors (through use of a receivership) may pursue restructuring or selling of assets under the BIA. Section 247 of the BIA establishes the duty of a court appointed receiver to act honestly and in good faith and to deal with the property of the insolvent person or the bankrupt in a commercially reasonable manner. It is in the context of these statutory provisions of either the CCAA or the BIA that the assets of an insolvent business may be sold. Alternatively, it is possible that either the debtor or the creditors may seek the benefit of the general provisions of the BIA by putting the debtor into bankruptcy, in which case, the assets will be assigned to the trustee subject to the claims of secured creditors.

The Basics: Obtaining the Maximum Benefit for the Parties

A receiver has a duty, when selling the assets of an insolvent business, to do everything reasonably possible to obtain the maximum benefit for the parties who have an interest in the sale proceeds. This duty will take into account not only the price which a prospective purchaser is offering to pay but also the ability of the purchaser to complete the transaction. The receiver may use a number of approaches to fulfill its duty, which includes sale by auction, sale by tender, use of the stalking horse bid process, and sale by way of a credit bid.

Auction Sale

A receiver may use the auction sale process to sell assets of an insolvent business, particularly if a decision has been made to liquidate on a piecemeal basis. The distinguishing feature of this process is its openness. Each bidder who wishes to participate in the auction must exceed a previous bid. Depending on the nature of the asset, the receiver may establish criteria which restrict bidding that include specifying a reserve bid or establishing minimum bidding increments with a view to selling the asset to the highest bidder.

Tender Sale

Unlike the open auction process, the tender sale process is closed. The receiver defines the terms of the bidding process, in particular the manner in which bids are to be submitted and the date and time when they are to be received. In a tender sale, secrecy of the bids is essential. Bids are submitted without the knowledge of the other bids.

The receiver is not obligated to sell an asset to the highest bidder in a tender sale process. In *Re Shape Foods Inc. (Receiver of)* (2009), 54 C.B.R. (5th) 224 (Man. Q.B.), the receiver-manager advertised the sale of the assets of the debtor by way of tender. Tenders closed with the highest bid being \$750,000. The receiver-manager did not sell the assets to the highest bidder. Instead, it distributed a sales and information package to potential purchasers, received proposals from the potential purchasers and ultimately sold the assets

for \$4.5 million.

Stalking Horse Bid Process

When the stalking horse bid process is used, the debtor company or its principal creditor(s) identifies a potential buyer who is willing to make a binding bid which, if no better offer comes forward, will be recommended for approval. This bid is known as the “stalking horse”. Terms of this bid are disclosed publicly and establish the floor for any subsequent bids. One of the terms of this bid is that the initial bidder will be compensated for its willingness to participate in the process, including its costs for preparing the bid, if it is subsequently outbid. The compensation received by the initial bidder is known as a “break fee”.

The Ontario Superior Court of Justice approved an asset sale agreement involving a “stalking horse” bidding process in *Re Nortel Networks Corp.* (2009), 55 C.B.R. (5th) 229 (Ont. S.C.J.). More recently, the Ontario Superior Court of Justice approved a stalking horse agreement in *CCM Master Qualified Fund Ltd. v. blutip Power Technologies Ltd.* (2012), 90 C.B.R. (5th) 74 (Ont. S.C.J.).

Credit Bid

Courts have approved the purchase of assets from an insolvent business by way of a credit bid under the CCAA. Credit bidding is the means by which secured creditor(s) use the debt that it is owed to purchase the collateral of the debtor. In *Re White Birch Paper Holding Co.*, 2010 QCCS 4915, the Quebec Superior Court reviewed the use of credit bidding where a stalking horse bid process had been put in place. In *Montrose Mortgage Corp. v. Kingsway Arms Ottawa Inc.*, 2013 ONSC 6905 (Ont. S.C.J.), the Ontario Superior Court of Justice noted that a proposed sale by way of a credit bid will be scrutinized carefully as a sale involving a credit bid by one of the debtor’s secured creditors, will normally disadvantage all subordinate creditors.

Due Diligence Searches and Vesting Orders

The purchase of assets “as is, where is” and the absence of enforceable representations or warranties from the vendor emphasize the importance of conducting comprehensive due diligence searches in regard to the assets to be purchased. A purchaser should insist on receipt of a vesting order to obtain clear title to assets purchased from the receiver.

Will the Court approve the sale?

Before selling an asset of an insolvent business, a court appointed receiver will generally be

required to obtain court approval. In *Skyepharma PLC v. Hyal Pharmaceutical Corp.* (2000), 47 O.R. (3d) 234 (C.A.), the Ontario Court of Appeal stated that, "...the fundamental purpose of the sale approval motion is to consider the best interests of the parties with a direct interest in the proceeds of the sale, primarily the creditors." Dissatisfied creditors, unsuccessful bidders, and/or owners of the insolvent business may oppose approval of the sale.

In an often cited judgment, *Royal Bank v. Soundair Corp.* (1991), 7 C.B.R. (3d) 1 (Ont. C.A.), the Ontario Court of Appeal accepted that a court should consider the following issues in examining a proposed sale of assets by a receiver:

1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.
2. It should consider the interests of all parties.
3. It should consider the efficacy and integrity of the process by which offers are obtained.
4. It should consider whether there has been unfairness in the working out of the process.

In *Re Winnipeg Motor Express Inc.*, 2008 MBQB 297, the Court of Queen's Bench of Manitoba considered an application for approval of the sale of certain assets under the CCAA. Justice Suche examined the issues described in *Royal Bank of Canada v. Soundair Corp.* and concluded that it was "...in the interests of all stakeholders that the transaction proceed."

The Court of Queen's Bench of Manitoba also considered an application by a receiver-manager for approval of sale of certain corporate assets in *Re Shape Foods Inc. (Receiver of)*. The application was opposed by parties who had attempted unsuccessfully to purchase these assets. Relying on *Royal Bank of Canada v. Soundair Corp.*, Justice Menzies stated that, "...a court should place a great deal of confidence in the actions taken and the opinions formed by the receiver-manager" and that "...a court should be reluctant to second-guess, with the benefit of hindsight, the considered business decisions of the receiver-manager."

A purchaser may obtain financial benefits in purchasing assets under the BIA or CCAA. However, there are risks to the purchaser which should be minimized by proper due diligence and use, in appropriate circumstances, of a vesting order. In selling the assets of an insolvent business in the context of the CCAA or the BIA, approaches that include sale by auction or tender, and use of a stalking horse bid or credit bid may be used to obtain the maximum benefit for interested parties. Court approval will normally be required with respect to any proposed sale of the assets of an insolvent business. Taking into account reported cases, it is apparent that a court will give considerable weight to the recommendation of the monitor, receiver or trustee, as the case may be.

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