Harper Grey LLP

INSOLVENCY & RESTRUCTURING LAW

Can Insolvent Businesses Survive After the COVID-19 Pandemic?

Some Common Questions & Issues

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Businesses are facing unprecedented challenges as a result of the COVID-19 pandemic. For some businesses, the impact has been immediate such as in the travel and events industries where sales have come to a sudden halt. For many other client facing businesses, such as in the hospitality and retail industries, revenues have taken a sharp decline due to social distancing measures. The effects of the COVID-19 pandemic on the economy are expected to continue well after the easing of restrictions and re-opening of various sectors of the economy.

Even with governments and financial institutions extending assistance through deferrals and subsidies, many businesses are unable to pay their liabilities even after taking drastic measures to reduce expenses. Businesses that have deferred obligations are uncertain about how they will pay for them when they become due after the deferral period.

There are some common issues and questions we are assisting businesses with as they face these difficult circumstances.

1. How can businesses access capital?

Even with reduced cash flows, depending on the business and its past re-payment record, loans and operating facilities remain available through private equity firms and financial institutions. Businesses may also qualify for provincial, federal and industry specific government loan programs. These measures may

allow the business to preserve its goodwill and assets until there is an increase in revenues after the easing of restrictions and re-opening of businesses.

2. How can businesses be protected against claims from creditors against the business and its officers and directors?

As businesses are reducing expenses and re-negotiating existing payments and agreements with employees, landlords, banks and other creditors due to their loss of revenues, businesses are faced with the added burden to ensure its actions do not give rise to claims against the business or its officers and directors.

Payments made to one creditor over other creditors when the business is insolvent can, in certain circumstances, potentially expose its officers and directors to personal liability. It is possible to restructure existing security arrangements and negotiate forbearance agreements with creditors to delay the exercising of their rights and remedies under their agreement. Risk management strategies are critical to mitigate potential claims against directors and officers to ensure they are not offside on their fiduciary duties.

> “Decisions made in circumstances when the business is insolvent can lead to significant risks for the business and its officers and directors.”

3. Where continued operation is not feasible, how can a business close its operations and dissolve the company?

A voluntary wind down of the business requires, among other things, that a director of the company swear an affidavit that the company has no assets and that the company has no liabilities or has made adequate provision for payment of each of its liabilities. Many businesses are not able to take advantage of a voluntary wind down due to its on-going liabilities.

4. What is the best way to structure the sale of a business?

While the sale structure will depend on the specific circumstances of the business and the agreement reached between the parties, the practical challenge faced by insolvent businesses is to find a purchaser willing to assume liabilities of the company. The purchaser will often not be willing to acquire shares of the company which will result in the purchaser also assuming the company’s liabilities. Purchasers are often looking to acquire assets of the business and are not willing to assume the company liabilities or will only do so at a severe discount.

5. Can businesses seek protection through insolvency proceedings to restructure or sell their business?

There are two primary federal insolvency legislations in Canada. Under the Bankruptcy and Insolvency Act (“BIA”), a proposal may be filed by an insolvent company. If the debts of the company are over $5 million, a proceeding may be initiated pursuant to the Companies’ Creditors Arrangement Act (the “CCAA”).

A proposal under the BIA or a plan of arrangement under the CCAA provides the company an opportunity to reach an agreement with its creditors to allow the business to continue and restructure the payment of debts. There is a stay of proceedings with respect to claims by creditors against the company and claims against its’ directors. A stay of proceedings suspends ongoing and future legal proceedings. It can also allow the business to obtain additional capital and sell assets through a court approval process.

Upon approval of the proposal or a plan of arrangement by the creditors and the court, the company is legally released from the claims included in the proposal or a plan of arrangement. If the proposal is not

approved, the company is automatically assigned into bankruptcy. If a plan of arrangement is not approved, the stay of proceedings is lifted and creditors may then pursue claims against the company which may force the company to file for bankruptcy.

Decisions made in circumstances when the business is insolvent can lead to significant risks for the business and its officers and directors. It is critical for the business and its officers and directors to understand the legal risks and restructuring alternatives that are available to continue operating or to sell the business.

If you are looking for advice and strategy on options that may be available to your business during the evolving COVID-19 pandemic or would like more information on issues discussed in the article, please contact Salman at **sbhura@harpergrey.com**.

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