INSOLVENCY

Extraordinary first day relief, EFC guidance, good faith and more: Notable themes in CCAA restructurings

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Due to a number of factors, including the extent of available capital in the markets and the continued backstop provided by government programs designed to blunt the economic effects of the pandemic, 2021 was not the apocalypse many were predicting. Nevertheless, Canadian restructuring professionals and courts continued to confront and overcome issues in a number of important areas, including extraordinary first day relief, good faith and lack thereof, eligible financial contracts and liquidating *Companies' Creditors Arrangements Act* (CCAA) proceedings. We have distilled these notable themes in restructuring law into key takeaways for anyone dealing with a distressed Canadian company – whether as the company, a lender or other stakeholder.

Just Energy: Tailored relief for unusual circumstances

The CCAA filing of the Just Energy Group in early 2021 showed that a CCAA court can grant extraordinary relief that takes effect during the first 10 days of a filing where the specific and unique circumstances faced by the debtor justify it. Osler acts for Just Energy.

Just Energy's urgent need to file under the CCAA was precipitated by financial pressures caused by an extreme weather event in Texas. For a brief period of time in February 2021, unprecedented cold weather caused electricity prices in the Texas market to spike. Just Energy, whose business consists of buying electricity and natural gas in the market for supply to its customers, was suddenly required to purchase electricity in Texas – its largest market in the U.S. – for several days at exponentially higher prices than had ever been seen before. It was then required on very short notice to make settlement payments amounting to hundreds of millions of dollars to the Texas market operator, Electric Reliability Council of Texas (ERCOT).

The resulting liquidity crunch led Just Energy to seek an initial order under the CCAA on March 9, 2021, followed by a recognition order under Chapter 15 of the U.S. *Bankruptcy Code*. In its initial order, Just Energy obtained two forms of relief that are noteworthy.

Substantial DIP financing to be drawn in the first 10 days

Under provisions of the CCAA that took effect in 2019, a debtor is only entitled to obtain an initial order for a period of 10 days. Given that an initial order is generally obtained *ex parte*, the debtor can only obtain relief for this initial 10-day period that can be justified as reasonably necessary to "keep the lights on" during that period.

Just Energy obtained $125 million of DIP financing on the first day. In Just Energy's unique circumstances, it was not possible to wait to obtain court approval of this financing and the related super-priority charge until after the come-back hearing. If Just Energy did not satisfy ERCOT's settlement payment demands within two business days, Just Energy could have lost its right to operate in the Texas market and all its Texas customers, which would effectively have made its restructuring impossible.

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The quantum of the DIP charge and the fact that the DIP facility would be almost fully drawn and utilized by the business in the first 10 days was unusual. However, in light of the specific circumstances faced by Just Energy, this relief was entirely consistent with the requirements of the amended CCAA provisions to ensure that initial orders are limited to what is necessary to keep the debtor's business running.

The Court's reasoning demonstrates that the 2019 amendments to the CCAA do not entirely foreclose the ability of a debtor company to obtain approval for DIP financing in a very material amount on the first day of a filing. However, to obtain such relief, the debtor company must be prepared to demonstrate why the amount and timing of the financing are necessary before the come-back hearing when affected stakeholders can have their say.

Regulatory stay preserves the debtor's licences

The regulatory stay of proceedings obtained in Just Energy's initial order was the first of its kind. The default rule under the CCAA is that a stay of proceedings can prevent regulators from taking steps against a debtor to recover money, but cannot prevent those regulators from taking other non-monetary steps, except with leave of the court. The circumstances in which a CCAA court can agree to extend the stay of proceedings to regulatory actions, such as suspensions or revocations of licences, had never been considered before Just Energy sought this relief.

Just Energy's business is heavily regulated. The company depends on multiple licences and other relationships with regulators in both Canada and the U.S. Without those licences, Just Energy could not operate. At the time of filing, Just Energy was operating in compliance with its regulatory obligations. However, Just Energy's filing under the CCAA could itself have been a basis for regulators to seek to suspend or revoke its licences, to impose otherwise onerous terms or even to transfer its customers to another provider.

To ensure that Just Energy's business could continue as a going concern during the restructuring, the Ontario Superior Court of Justice granted a stay preventing Canadian regulators from taking steps against Just Energy based on its insolvency or its CCAA filing. A similar order was granted in relation to the U.S. regulators by the U.S. Court in the Chapter 15 recognition proceeding.

The availability of the regulatory stay was based, principally, on the premise that Just Energy would continue to comply with all applicable regulatory requirements while under CCAA protection, including the requirement to maintain its licences in good standing. This premise was key to satisfying the Court, as required under the CCAA, that the regulatory stay was not contrary to the public interest.

The Court was also prepared to grant the regulatory stay for the initial 10-day period without prior notice to the affected regulators. Despite the express requirement to provide advance notice under the CCAA, the Court recognized that it would have been impracticable to do so in the circumstances. The potential disruption that could have been caused if the regulators had taken steps against the debtor during the initial 10-day period justified this immediate *ex parte* relief. Just Energy was thereafter able to engage proactively with all affected regulators. Ultimately, no regulator formally objected to the regulatory stay, including at the come-back hearing.

The regulatory stay represents a valuable precedent for other heavily regulated debtor companies seeking to preserve their status during a CCAA proceeding.

Whither good faith?

As recognized by the Supreme Court of Canada in its 2020 decision in *Callidus* and more recently, in *Canada North*, good faith is a baseline standard of conduct that underpins the discretionary relief available to a debtor company under the CCAA. It is measured against the purposes and the remedial objectives of the CCAA.

In 2019, the CCAA was amended to mandate that "any interested person" in a CCAA proceeding shall act in good faith "with respect to the proceeding." If the court determines that such interested person has failed to do so, the court may make any order it thinks fit. An equivalent provision was also added to the *Bankruptcy and Insolvency Act* (BIA). These provisions apply to all parties in a proceeding, not just the debtor company. The provisions were enacted for the stated purpose of making insolvency proceedings more fair, more transparent and more accessible to vulnerable stakeholders such as pensioners or workers.

When first introduced, insolvency practitioners feared that a statutory duty of good faith would become an ill-defined tool to impose judicial morality on a CCAA proceeding. There was also concern that it would encourage tactical motions by stakeholders, creating uncertainty, additional expense and delay. Certain steps taken in an insolvency proceeding may appear harsh to those who will not recover their claims in full, or perhaps at all, or whose contractual relationships with the debtor may be terminated. When will such steps, which are often taken in an adversarial context, be constrained by the concept of good faith? Now that two years have elapsed since the enactment of the statutory duty, it is not yet clear whether those initial fears will prove to be justified.

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There are few cases that analyze the scope and application of the new statutory duty in any detail. In 2021, the Ontario Superior Court of Justice decided two related CCAA cases that may help shed some light on the Court's approach.

In the CCAA proceeding seeking to restructure the affairs of Laurentian University, the debtor was party to three contracts with so-called "federated universities": Thorneloe University (Thorneloe), Huntington University (Huntington) and University of Sudbury (USudbury). The debtor determined that its restructuring required the disclaimer of all three contracts. Thorneloe and USudbury objected to the disclaimer on several grounds, including alleging bad faith. It was argued that the disclaimer was motivated by an improper purpose – namely, to eliminate two competitors of the debtor. Both Thorneloe and USudbury argued that the disclaimer would lead to their own insolvency.

The Court rejected both the Thorneloe and the USudbury objections. The Ontario Court of Appeal subsequently denied leave to appeal to Thorneloe. USudbury did not seek leave to appeal.

In the Thorneloe decision, the Court expressly stated that "restructurings are not easy" and noted that they "often result in treatment that a party can consider to be extremely harsh." However, that did not necessarily mean that the other party has acted in bad faith. The Court noted that the Monitor had supported the disclaimers without indicating any reservation about the good faith conduct of the debtor. Moreover, the Monitor supported the extension of the stay of proceedings, which required a determination that the debtor had been acting in good faith and with due diligence.

The debtor had demonstrated that the disclaimers were reasonably necessary for the restructuring and the debtor had been transparent about its intention to disclaim these agreements if a negotiated solution could not be found. One of the federated universities – Huntington – had reached a resolution with the debtor. In rejecting the objections, the Court noted that the devastating effect of the disclaimers on Thornloe and USudbury was to be balanced against the fact that the debtor company was facing its own potential demise if it could not restructure. If the restructuring failed, the federated universities would be insolvent in any event.

Consistent with *Callidus*, the focus of the bad faith argument in the Laurentian University case was on the propriety of the purpose for which the debtor sought to disclaim the agreements. The decisions provide some comfort to debtors that, as long as their actions can be justified by reference to the objectives of the CCAA, and are supported by the Monitor, the risks of a finding of bad faith should be low. Osler is continuing to monitor developments in this area, as more stakeholders seek to rely on the new statutory duty.

Port Capital: Intending to propose a plan is no longer required for a CCAA stay in B.C.

A recent B.C. decision has brought earlier precedent into step with today's flexible approach to the CCAA. Since its 2008 release, *Cliffs Over Maple Bay* has presented a hurdle to insolvent companies in B.C. According to the decision, to obtain a CCAA stay, the debtor must intend to propose a plan of arrangement or compromise to its creditors. More than 10 years and a five-judge panel later, in *Port Capital Development*, the B.C. Court of Appeal has demoted this principle from a requirement to a factor.

Port Capital loosens the restrictive approach adopted in *Maple Bay*. Like in *Maple Bay*, the debtors were also owners of a real estate project. The debtors commenced proceedings under the CCAA when their construction lender cut off funding. In addition to various liquidation offers made through a sales process, a refinancing offer emerged which, if completed, would be a materially better outcome for stakeholders. The refinancing offer required the company to remain in its CCAA proceedings for six months while financing was raised, with the expectation that the company would be able to emerge thereafter and complete the project. Critically, the refinancing did not contemplate a plan for creditors to vote on at any point.

Citing *Maple Bay*, the chambers judge refused to approve the refinancing offer under the CCAA, finding that there was nothing to suggest that any party intended to put forward a plan of arrangement or compromise for a vote. The Court of Appeal granted leave to appeal, convening a five-justice panel with the power to reconsider *Maple Bay* if appropriate.

The Court of Appeal took advantage of the opportunity to reconsider the law, holding that the expansion of the scope of the CCAA's remedial objectives and approved strategies rendered *Maple Bay's* more restrictive focus outdated. The chambers judge therefore erred in treating the absence of a proposed plan of compromise as a determinative factor.

Maple Bay was not entirely cast aside, however: whether the debtor plans to present a plan of compromise may still be relevant on the facts of the case in determining whether the protections of the CCAA should be available in the circumstances. Debtor companies should not resort to the CCAA "simply to buy time, without having some proposal in hand" that is likely to further the objectives of the CCAA. However, these objectives can be achieved by various means.

Through a clear-eyed reconsideration of its own decision, the B.C. Court of Appeal has lent even more weight to the CCAA's broad scope for innovative approaches to restructuring beyond a traditional plan of compromise or arrangement. This decision will be of particular interest to restructurings in the real estate sector, where the financing opportunities described above are common; that said, we expect to see ripple effects of this decision across all industries.

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Re Bellatrix: Developments regarding eligible financial contracts in insolvency proceedings

The broad restructuring powers afforded debtors under the CCAA include the ability to disclaim contracts, while at the same time, counterparties are prohibited from terminating those same agreements. Such disclaimer is a powerful tool in a debtor's restructuring toolkit, with one critical carve out: eligible financial contracts (EFCs). An EFC cannot be disclaimed by the debtor. Unlike other contractual counterparties, however, an EFC counterparty can invoke its right to terminate based on the debtor's insolvency default, despite the stay of proceedings.

What constitutes an EFC is set out in the CCAA regulations. Broadly speaking, an EFC is a financial agreement meant to manage financial risk, including certain derivatives agreements and agreements to settle securities, futures, options or derivatives transactions. Even with the guidance provided in the CCAA regulation, however, EFCs by their nature are hard to define, in part because derivatives products are a constantly evolving tool in financial markets. It is necessary to consider the purpose of an agreement in evaluating its status as an EFC.

In the CCAA proceedings of Bellatrix Exploration Ltd., Bellatrix had entered into a number of contracts with BP Canada for the long-term supply of natural gas to BP. Bellatrix sought to disclaim the contracts shortly after filing for CCAA protection. The debtor also immediately ceased performing under the contracts, despite the requirement under the CCAA that any contract disclaimer is subject to a 30-day notice period.

In a February 2020 ruling, the Alberta Court of Queen's Bench determined that the gas supply agreements did fall within the definition of an EFC. The Court looked at the agreements as a whole, keeping in mind the overarching theme of management of financial risk inherent in business transactions. Notably, the contract included express language that the contracts constituted EFCs as defined by the CCAA regulations. However, while this was a relevant factor, such language in and of itself does not make a contract an EFC.

The Court considered surrounding evidence, such as Bellatrix's characterization of the contracts in a press release, as well as the purpose of the contracts to manage future price risk, to assess the true nature of the contracts. Based on the structure and purpose of the contracts and the surrounding facts, the Court held that the contracts were EFCs and therefore, could not be disclaimed.

The Alberta Court of Appeal granted leave to appeal, and heard the appeal in the fall of 2020. Before the decision could be released, in December 2020 the Alberta Court of Queen's Bench heard and determined a second motion regarding the ability of the debtor company to cease performing the agreements.

The Court determined that, even though the EFCs could not be disclaimed, the debtor was not compelled to continue to perform those contracts by delivering gas to BP at the uneconomic contract price. Requiring the debtor to keep performing a contract could prevent the debtor from restructuring at all if the contract in question is particularly onerous. Rather, the prohibition on disclaimer simply gives an EFC counterparty control over whether and when it wants to exit the relationship and close out its position.

At the time of the second motion, the Bellatrix business had been sold and BP had not terminated the EFCs. The Court held that, if the EFC counterparty does not close out its position and the debtor ceases performing its obligations, the counterparty will be left with a claim in damages against the debtor. Unless the counterparty has a security interest, it participates in the process as an unsecured creditor and recovers accordingly.

In March 2021, the Alberta Court of Appeal denied leave to appeal in the second motion, noting that there was no reason to doubt the correctness of the reasoning. Then, in April 2021, as a result of the decision in the second motion and of the sale of the business, the Alberta Court of Appeal dismissed the appeal from the first motion on the basis that it had become moot.

The dismissal of the appeal in the first motion addressing the status of the agreements as EFCs leaves uncertainty regarding the scope of the definition of EFCs. It also leaves uncertain the benefit of using express language characterizing their agreements as EFCs in an attempt to fit within the CCAA safe harbour provisions. However, the decision in the second motion confirms that debtor companies possess a further tool – unilateral cessation of performance – that could be of assistance in obtaining relief from onerous EFCs outside the disclaimer process.

Conclusion

We expect courts will continue to grapple with the thorny issues of stakeholder dynamics, good faith, the nature of eligible financial contracts and *ex parte* relief through 2022. As government programs expire and companies face financial distress in uncertain markets, those tensions will continue to be front and centre in insolvency proceedings.

AUTHORS

Marc Wasserman
Partner, National Chair, Insolvency & Restructuring

mwasserman@osler.com
416.862.4908

Jacqueline Code
Partner and Chair, Research

jcode@osler.com
416.862.6462

Kathryn Esaw
Partner, Insolvency and Restructuring

kesaw@osler.com
416.862.4905