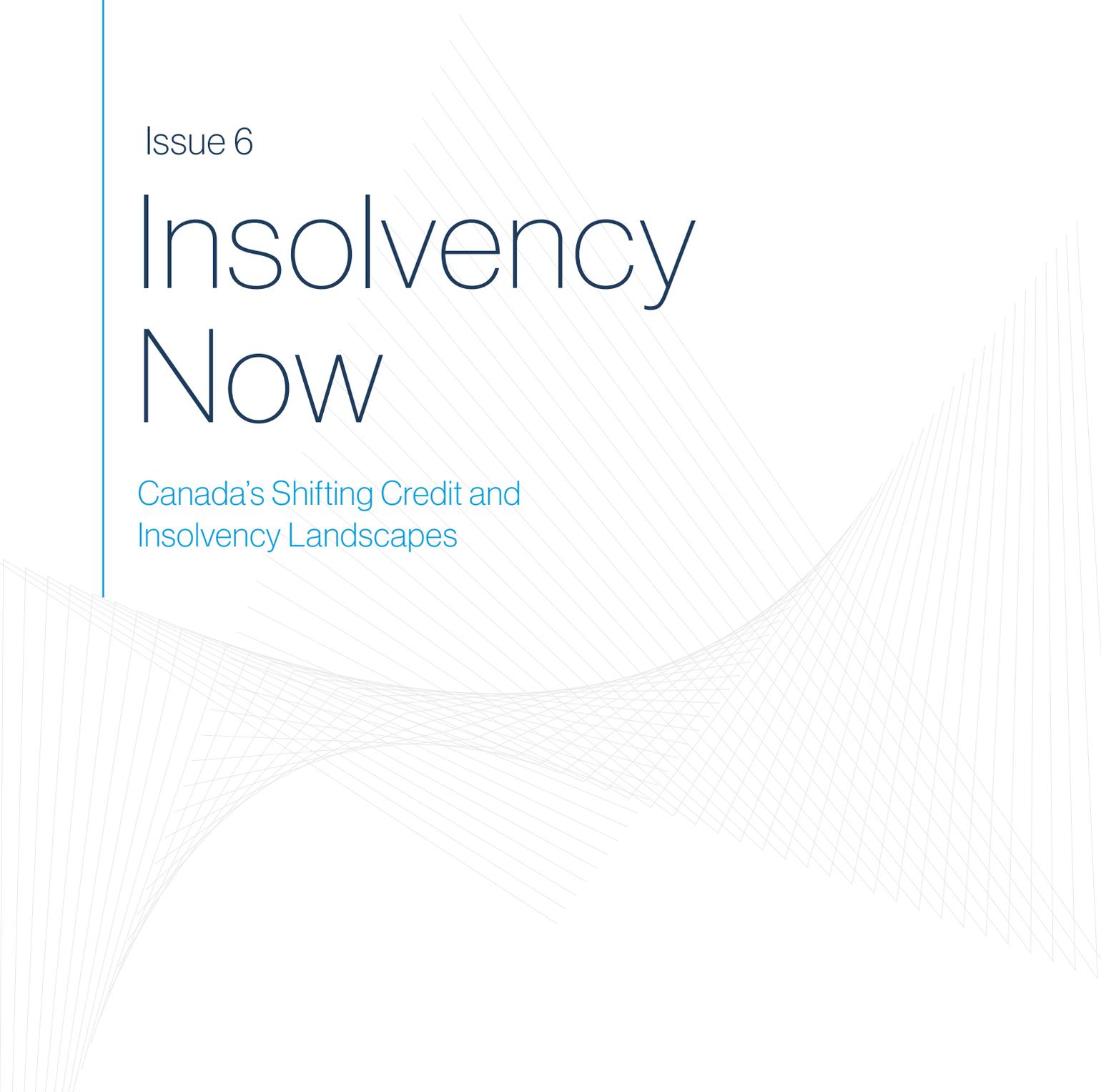


DAVIES

Issue 6

Insolvency Now

Canada's Shifting Credit and
Insolvency Landscapes



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Despite optimistic predictions earlier in 2022, slowed global growth resulting, in part, from the war in Ukraine has elevated inflation and interest rates, reducing the availability of credit, increasing business borrowing costs and threatening the ability of companies to retain the confidence of their stakeholders. With this competitive credit market in mind, in this issue of *Davies Insolvency Now*, we take a deep dive into the legislation that regulates rates of interest in Canada, drawing on recent case studies to provide guidance to lenders. We then highlight the Canadian data for Q1 2022, which reveal that total business insolvencies increased by 33.8% compared with the same period in 2021. We conclude by discussing a potential template for future insolvency-related emergency measures in Canada.

Davies Insolvency Now is a quarterly publication authored by Natasha MacParland, Robin B. Schwill and Stephanie Ben-Ishai that analyzes key trends and developments in the insolvency and restructuring community.

Canada's Criminal Interest Rate Framework

Section 347 of the *Criminal Code* makes it an offence to “enter into an agreement or arrangement to receive interest at a criminal rate, or [receive] a payment or partial payment of interest at a criminal rate.” Recent regulatory and case law developments suggest that careful attention needs to be paid to this area. In the following section, we draw insights from section 347 court decisions in the context of the *Companies' Creditors Arrangement Act* (CCAA) to help parties avoid potential pitfalls in structuring deals.

LESSONS FROM THE COURTS: HOW HIGH IS TOO HIGH?

***Re Port Capital Development (EV) Inc.*, Supreme Court of British Columbia**

Lenders in distressed situations need to proactively manage the risk of exceeding the criminal interest rate threshold. As CCAA supervisory courts may be reluctant to provide comfort to an interim lender, these lenders should consider certain important factors in managing the risk of a future section 347 claim: the terms of a credit agreement, various fees and charges that may constitute “interest” and the conduct of the parties.

***Re 12178711 Canada Inc.*,¹ Alberta Court of Queen's Bench**

Lenders can draw some comfort from the fact that a high threshold must be met to be held liable under section 347 in a commercial restructuring context. However, we caution lenders that the section could apply to arrangements under the *Canada Business Corporations Act* and to other similar agreements. Accordingly, parties should actively document their intentions and agreement terms regarding any obligation that could fall within the meaning of “interest.”

***Re Crystallex International Corporation*, Ontario Superior Court of Justice (Commercial List)**

Explicit language in a credit agreement prohibiting a criminal rate of interest would be a helpful preventive measure against a potential section 347 claim. For there to be an offence, the agreement or arrangement in question must, on its face, require payment at a criminal rate of interest. If a credit arrangement did not require, and in fact expressly prohibited, payment of interest at a criminal rate, section 347 would be found not to apply.

***Re Great Basin Gold Ltd.*, Supreme Court of British Columbia**

Section 347 is not a particularly useful tool in challenging a competing interim financing proposal without specific facts being present on which to base such a challenge. However, the possibility

¹ Case available to Westlaw subscribers.

of such a challenge continues to exist, depending on the way an interim financing agreement is implemented.

Transport North American Express Inc. v New Solutions Financial Corp., Supreme Court of Canada

If parties have any doubts about the application of section 347, they should consider structuring contracts in a manner that allows for potential severance. However, parties should not rely on this possibility alone.

Garland v Consumers' Gas Co., Supreme Court of Canada

Section 347 may be raised in a future claim, many years down the road. Accordingly, due consideration must be given to the finality of transactions in the insolvency context with this risk in mind.

PROPOSED AMENDMENTS TO LOWER THE CRIMINAL RATE OF INTEREST

Bill C-274, a private member's bill that received first reading in 2021, proposed lowering the threshold at which an interest rate becomes a criminal rate to 30%, from 60%, plus the Bank of Canada's overnight rate, and repealing section 347.1, which had allowed certain exceptions for payday loans. More recently, Bill S-239, a Senate public bill that passed first reading on March 1, 2022, and was debated during second reading on March 22, 2022, proposes to

- reduce the criminal rate of interest to 20%, from 60%, plus the Bank of Canada's overnight rate, and
- define the Bank of Canada's overnight rate to mean the "rate on the day on which the agreement or arrangement under which the credit is or is to be advanced is entered into or renewed."

Importantly, Bill S-239 focuses on the interest rate on the day a credit agreement is entered into or renewed. Furthermore, in contrast to Bill C-274, Bill S-239 will not affect payday lenders because it does not modify section 347.1 of the *Criminal Code*.

GOVERNMENT CONSULTATION

The 2021 Budget announced that the federal government planned to launch a consultation on lowering the criminal rate of interest applicable to, among other things, installment loans offered by payday lenders. However, according to a [news release](#) from ACORN Canada in March 2022, the government has not yet launched the consultation. The ACORN [report](#) found that payday loans were the predominant type of high-cost loan that Canadians resorted to during the pandemic, though installment loans continue to increase. The report, like other commentary on this issue, focused on the impact of high-cost loans on individuals rather than on businesses.

Insolvency Data for Q1 2022: Highlights

In Q1 2022, total business insolvencies increased by 33.8% over those in Q1 2021. This growth was driven by a 44.7% rise in business proposals and a 30.8% rise in business bankruptcies by the end of Q1 2022. The Q1 2022 data indicate that business insolvencies overall are higher than in 2021, and the monthly fluctuations closely match the pattern seen in the past year.

The following are our main findings from the Q1 2022 data:

- While the increase in filings looks significant when the point of reference is Q3 2021, the actual volume of filings might not be that remarkable overall and was potentially a correction to longer-term historical levels before the Q3 2021 lows.
- In Q1 2022, there were 807 business insolvencies across Canada, averaging 269 filings per month. The most affected sectors were construction and accommodation and food services, which collectively made up 25.9% of all insolvencies.
- In Q1 2022, there were 31 court-appointed and 14 privately appointed receiverships. Both the volume of receiverships and the value of assets in receivership have been well below previous years' first quarter figures. Specifically, the \$185.5 million assets in receivership this quarter is lower than in Q1 2021 (\$199.3 million), and much lower than in Q1 2020 (\$875.7 million) and Q1 2019 (\$476.6 million). January had a notably low value of assets in receivership at \$7.6 million (9.3% of total assets in receivership in January 2021).
- CCAA proceedings continued the decline that began in Q2 2020, with only four proceedings filed in Q1 2022.

Blueprint for Future Emergency Responses in the Insolvency Context

The best approach to future emergencies, according to international consensus, is one that is flexible, includes long-term legislative reforms to support viable businesses facing significant financial distress, and provides access to simple and cost-effective liquidation processes for unviable businesses. The May 2022 global report [From Hibernation to Revitalization: Analysis of Insolvency COVID-19 Response Measures and their Wind-Down](#) (Report) offers a commentary and summation of data collected from a survey jointly conducted by The World Bank Group, INSOL International and the International Association of Insolvency Regulators.

The authors classify Canada as an outlier in not introducing significant substantive reforms to its insolvency legislation. Canada's insolvency system stayed largely intact throughout the pandemic, with most insolvency legal services remaining available. Canadian commentators hypothesized that Canada's lower business insolvency rates were likely due to its preventive approach, extension of substantial financial and liquidity supports to businesses, and patience on the part of lenders and banks toward non-performing loans and their willingness to enter into informal workouts.

In terms of short-term procedural changes, Canadian courts fluctuated between easing and tightening restrictions. On application by the Superintendent of Bankruptcy, Canadian courts extended certain timelines under the *Bankruptcy and Insolvency Act*. The Superintendent of Bankruptcy issued directives to provide additional flexibility to licensed insolvency trustees in performing their functions to comply with social distancing measures. Furthermore, various government agencies enhanced the monitoring of insolvency trends by (i) establishing an inter-agency group comprising different departments and regulators, as well as Statistics Canada, to take a global monitoring approach; and (ii) seeking feedback from various insolvency stakeholders, such as experts, judges, trustees and lenders.

At this point, the most significant challenge regarding the rollback of government supports is ensuring that procedures are in place to address a likely increase in insolvencies during the phase-out of temporary measures. As discussed in our [previous issue](#), alternative dispute resolution (ADR) is increasingly being used as a tool to address judicial resource shortages and time pressures associated with the expected uptick in insolvency filings.

The Report suggests that Canada's insolvency system could respond to future emergencies by (i) encouraging restructuring over liquidation, (ii) continuing to offer a quick and efficient liquidation process that maximizes creditor recovery and prevents a build-up of zombie companies, and (iii) encouraging new business formation. A full spectrum of tools would include (i) strengthening formal insolvency frameworks, (ii) developing informal workout tools, (iii) developing electronic platforms to facilitate insolvency processes, (iv) facilitating ADR tools, and (v) developing specific midsize enterprise (MSE) responses and procedures. In the Canadian context, growth opportunities exist in the development of electronic platforms and MSE-specific responses and procedures. As we have documented in the past, Canada continues to be well equipped with strong formal insolvency frameworks, informal workout tools and emerging ADR processes.

Key Contacts

With extensive experience in emergency insolvency measures, including developing quick and efficient liquidation processes to support recovery, Davies draws on the strategic skills of our team to help you navigate the intricacies of a restructuring or insolvency. We would be happy to discuss your specific circumstances and answer any questions you may have. Please contact any of the individuals listed below or visit our website at www.dwpv.com.



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The information in this publication should not be relied upon as legal advice. We encourage you to contact us directly with any specific questions.

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