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The Economic Impact of COVID-19: Practical strategies for Canadian businesses

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Having ensured, to the extent possible, the safety of their workplace and workforce, many companies are turning their mind to the economic impact of the COVID-19 pandemic. All businesses are impacted, and in many cases, the impact will be adverse, whether caused by travel restrictions, office or workforce disruptions or decreased demand.

It is crucial for companies to identify ways to minimize the negative consequences of the pandemic on their business, particularly if they are experiencing financial distress. It is also important to be prepared for the prospect of severe liquidity issues. A full understanding of the duties, obligations and liabilities for directors and officers and the corresponding insolvency tools available to companies, their directors and management will position companies to weather this storm and best manage the potential personal exposure of directors and officers. Companies experiencing or concerned about financial distress should consider taking the following steps:

1. **Review the company 's cash flows with financial advisors** – identifying weaknesses or potential risks at an early stage is often the difference between a successful restructuring of the company's business and processes that may result in outright liquidation of its property and assets or processes that are controlled by their creditors;
2. **Identify key suppliers and customers** – identify any suppliers or customers which are integral to operations and cash flow, and determine whether any are likely to be adversely impacted or prevented from operating as a result of the pandemic;
3. **Review key commercial agreements** – determine whether there are any key provisions that may be impacted by the pandemic, including representations and warranties, covenants, termination rights and exclusivity clauses which could limit a company's ability to shift to alternative suppliers in case of supply interruptions. Also, consider whether agreements with suppliers or customers contain force majeure clauses, which may excuse parties to that agreement from performing their obligations under the agreement. For more information on force majeure clauses, please see BLG's recent article regarding invoking such clauses and their effect: Contractual Risks amid the COVID-19 Outbreak, published on March 11, 2020.

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4. **Review financing agreements** – consider whether the company may be at risk of breaching financial covenants as a result of income loss or a fall in asset value, and whether it meets all other conditions necessary to access additional funds;
5. **Review the company's business interruption insurance policy** – ensure that the company's policy will cover business losses arising from the COVID-19 pandemic.

These steps will ensure the company is able to identify and address potential issues and risks.

Companies should also consider the obligations directors and officers owe to the corporation and other stakeholders, such as the government (provincial or federal), creditors and employees. Directors and officers can be exposed to significant personal liability pursuant to various statutes. The most significant statutory based liabilities for directors personally are:

1. **environmental liability** – at minimum, directors are required to (i) ensure officers have been instructed to setup and report on sufficient environmental compliance programs; (ii) review environmental reports and follow up with officers; and (iii) react immediately when environmental problems come to their attention;
2. **pension plan liability** – directors should ensure that an adequate governance policy is in place that identifies the board's responsibilities in regards to employee pension plans, review annual actuarial reports, audits and Pension Committee minutes and insist that they receive an indemnity for action taken in respect of employee pension plans;
3. **unremitted source deductions (including HST/GST liability)** – directors should ensure that (i) there are established accounts for withholdings and remittances; (ii) the financial officers of the corporation regularly report on the status of these accounts, and (iii) confirmation is obtained from management that withholdings and remittances have, in fact, been made;
4. **unpaid employee wages** – directors should require that senior management provide updates confirming timely payment of employment wages including the payment of any bonuses, overtime and vacation pay; and,
5. **liability under the *Bankruptcy and Insolvency Act* (the BIA)** – directors should review the company's financial statements before approving payments for dividends, share redemptions, termination and severance pay, and incentive benefits. Directors should protest if the management of the company, or the board decides to make a payment if they believe it is (i) made at a time when the company is insolvent or the payment could render the company insolvent, (ii) conspicuously over fair market value and (iii) made outside the ordinary course of business.

In most cases, directors will not be held personally liable if they can establish that they relied in good faith on financial statements prepared by an officer or a written report of an auditor and that they exercised the degree of care, diligence and skills that a reasonably prudent person would in comparable circumstances.

Once a company has verified that its directors and officers have taken all the necessary steps to ensure that they will not be exposed to unwarranted personal liability, the company should consider its options with regard to dealing with an impending or actual

liquidity crisis. These often include out-of-court restructurings that include one or more of:

1. the sale of redundant, non-core assets;
2. renegotiating with key customers, suppliers and financers (e.g. revised supply and resourcing agreements, renegotiating all or part of the contract price of a commodity due to increased costs, exclusivity provisions and entering into forbearance agreements);
3. the conversion of certain debt to equity; and
4. potential mergers or divestitures of business divisions, or operating lines.

In some cases, an out-of-court restructuring is not feasible or the company requires the assistance of a formal process to implement its restructuring, including:

1. **Filing a proposal under the BIA** – this method of restructuring is typically used for smaller companies whose goal is to undergo a less complicated restructuring. Proposals are a comparatively inexpensive means of restructuring, but involve tighter deadlines. If a company fails to submit a proposal that is approved by the requisite number of its creditors in each class, the company will automatically be assigned into bankruptcy;
2. **Filing a plan of arrangement or compromise under the *Companies' Creditors Arrangement Act* (CCAA)** – restructuring under the CCAA offers companies far more flexibility than restructuring under the BIA and does not involve strict timelines pursuant to which a plan of arrangement or compromise must be prepared. However, use of the CCAA is restricted to companies (or affiliated groups of companies) with over C$5 million of claims in the aggregate. Restructuring under the CCAA is not available to banks, foreign banks, insurance companies, trust companies or partnerships;
3. **Submitting a corporate plan of arrangement under the *Canada Business Corporations Act* (CBCA)** – the arrangement provisions of the CBCA can be used to implement changes in a corporation's capital structure. It has been used to convert debt into equity, convert preferred shares into common shares or extinguish or dilute issued common shares; or
4. **Making an assignment into bankruptcy under the BIA** – if a company is unable to restructure, it may choose to, or be forced on account of actions by one or more of its creditor, to carry out a liquidation under the BIA. Under the bankruptcy provisions of the BIA, a trustee in bankruptcy will be appointed over the property and assets of the company. The company's directors and officers are relieved of any decision-making authority on behalf of the company. A liquidation under the BIA is intended to provide for the fair distribution of a debtor's unencumbered assets among its unsecured creditors.

During this crisis, if a company is facing any of these issues, including the prospect of a liquidity crisis and a consequent insolvency, a proactive approach will best position the company and its directors and officers to better navigate those challenges. The BLG Insolvency and Restructuring Team is here to help companies and their directors and officers in these troubled times.

Should you have any questions or concerns, please do not hesitate to reach out to any of our insolvency and restructuring experts below.

Expertise

[Insolvency & Restructuring]

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