Cassels

Bankruptcy and Insolvency in Canada: Rights and Considerations of an Insurer

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Amidst the COVID-19 pandemic and its adverse impact on the economy, insurers may find that their insureds are more frequently subject to bankruptcy or insolvency proceedings. In this new environment, it is important for insurers to be aware of the various types of bankruptcy or insolvency proceedings available in Canada and how those proceedings may impact coverage, claims, and underwriting decisions. Insurers are likely to have many questions about what rights and obligations they and the insured have during insolvency proceedings, including:

- Is the insured required to continue to pay premiums?
- Is the insurer permitted to collect unpaid premiums for the periods before and during the insolvency proceeding?
- Can the insurer cancel or terminate a policy?
- Can the insurer refuse to renew an expiring policy?
- Does the insurer have to accept requests for additional coverage?
- Can premiums be increased to account for additional risk?

The answers to these questions depend on the type of insolvency proceeding in issue and the terms of the policy.

Insolvency Proceedings an Insured may be Subject to in Canada

In Canada, there are two main insolvency statutes which provide for four types of bankruptcy and insolvency proceedings: (i) *Companies' Creditors Arrangement Act* (CCAA) restructurings, (ii) *Bankruptcy and Insolvency Act* (BIA) proposals, (iii) BIA bankruptcy proceedings and (iv) receiverships.

CCAA Proceeding

- A CCAA proceeding involves an insolvent Canadian company that has more than $5 million in debts. The company may apply to a provincial superior court (the Court) for an Initial Order that provides relief against creditor enforcement actions during restructuring proceedings, including a stay of proceedings against the debtor. The Initial Order typically requires suppliers to continue to provide goods and services (including insurance) to the debtor according to existing terms. A CCAA proceeding is a flexible and debtor-driven restructuring where the Court has significant discretion to grant relief based on the individual circumstances of the debtor. This type of proceeding typically requires insurers to continue coverage as long as the insured pays premiums for the period of the restructuring (but not before). Termination of the policy in the middle of its term is usually prohibited. An insurer can generally choose to not renew an insurance policy that expires while the insolvency proceeding is ongoing, subject to any contractual terms, legislation or court order issued in the proceeding that may impact the right to renew.

BIA Proposal

- An insolvent debtor with uncomplicated affairs may choose to restructure pursuant to the proposal provisions contained in the BIA. A BIA Proposal is similar to a CCAA proceeding as they both seek to compromise and settle claims against the debtor. However, a BIA proposal involves rigid rules and deadlines. A BIA proposal proceeding is commenced by filing a proposal or notice of intention to make a proposal which provides the debtor with an automatic stay of proceedings for an initial 30-day period. After this period, the debtor may apply to the Court for an order to extend the stay of proceedings. The insurer cannot cancel coverage because of the debtor's insolvency, and normally the insured will continue to pay premiums during this process in order to maintain coverage.

BIA Bankruptcy

- A BIA bankruptcy is a liquidation proceeding that is commenced by a bankruptcy order, an assignment in bankruptcy, or the failure of a BIA Proposal. Upon bankruptcy, a trustee is appointed and all assets of the debtor vest in, and are disposed of by, the trustee. Coverage is not likely to continue during the bankruptcy period.

Receivership

- Secured creditors may seek the appointment of a receiver by court order or, in more limited cases, privately under the terms of a security agreement. Receivers sell the debtor's assets for the benefit of creditors, especially secured creditors. In some cases, receivers will operate the business for a limited period to permit a going concern sale. In Court-ordered receiverships, service providers like insurers are often ordered to continue to provide goods and services to the debtor according to existing terms and they are prevented from collecting unpaid premiums for the pre-receivership period. This means that the insurer will generally need to continue coverage so long as premiums for the period of the receivership (but not the period before) are paid. In some cases, the receiver will obtain its own insurance.
- Insurers' rights to collect premiums, cancel a policy, or exercise other contractual rights are not affected by a private receivership.

Common Themes

All of these situations generally lead to the insurer recovering less than the full unpaid premium for the period prior to the insolvency proceeding. A claim for such unpaid premium is made by completing and submitting a proof of claim to the insolvency professional administering the proceeding (i.e., a monitor, proposal trustee, bankruptcy trustee, or receiver). Since insurers are generally unsecured creditors, recoveries could be minimal. That is why it is so important to keep actively collecting premiums while the company is still solvent.

Key Lessons

Insolvency proceedings affect the rights of insurers to undertake their usual functions of collecting premiums and terminating policies where permitted. “Self-help” remedies are generally prohibited and could lead to serious consequences such as a finding of contempt.

When faced with a potentially insolvent insured, proper insolvency advice should be obtained to consider permissible actions to mitigate risk, such as the following:

- insisting on timely payment of premiums so there is no material amount of unpaid premium at any time;
- terminating a policy before insolvency proceedings begin (if permitted);
- re-assessing risk during insolvency proceedings and then seeking permission of the Court to terminate the policy or increase premiums if there is a material change in risk;
- obtaining collateral as security for payment of premiums or insisting on up-front payment of premiums to reduce credit risk; or
- non-renewing policies and thereby allowing coverage to terminate during the insolvency proceeding.

With the possible exception of companies going through a BIA Bankruptcy, maintaining insurance coverage during an insolvency proceeding is generally very important to insolvent companies. As such, insureds are often willing to negotiate a continuation of coverage on revised terms or to permit termination of coverage in an orderly manner if replacement coverage can be obtained.

There is no “one-size-fits-all” solution and the best course of action must be determined based on an evaluation of an insured’s financial circumstances, risk profile and the constraints imposed by the insolvency proceeding.
