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Interpreting the Generalized Duty of Good Faith in Insolvency Proceedings

By: Jassmine Girgis

Case Commented On: *CWB Maxium Financial Inc v 2026998 Alberta Ltd*, 2021 ABQB 137 (CanLII)

In *CWB Maxium Financial Inc v 2026998 Alberta Ltd*, 2021 ABQB 137 (CanLII), the court considered the duty of good faith in the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, s 4.2 [*BIA*], and the *Personal Property Security Act*, RSA 2000, c P-7, s 66(1) [*PPSA*], in relation to the plaintiff lenders seeking a final order of receivership against the defendant debtors. This post will focus on the duty in the context of insolvency. It will also comment on and contrast the equitable duty of fairness under the corporate oppression remedy.

Section 4.2 of the *BIA* (and the identical provision in the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, s 18.6 [*CCAA*]), came into force on November 1, 2019 (pursuant to Bill C-97), and provides that, "[a]ny interested person in any proceedings under this Act shall act in good faith with respect to those proceedings" (*BIA* at s 4.2(1)). The amendments also give courts the power, upon the application of any interested person, to make any order they consider appropriate in the circumstances if an interested person fails to act in good faith (*BIA* at s 4.2(2); *CCAA* at s 18.6(1)). I have been following case law on how this good faith duty is being interpreted. See my earlier post, "A Generalized Duty of Good Faith Applied to Disclaimer Under the CCAA", about *Laurentian University v Sudbury University*, 2021 ONSC 3392 (CanLII) [*Laurentian University*] here.

Facts

The plaintiff lenders sought a final order of receivership against the defendant debtors, arguing they had defaulted on their loans. An interim receivership order had already been in place and extended several times, pending a final determination. The defendant debtors opposed the final order on the basis of three arguments: the plaintiffs were estopped from relying on their strict legal rights under their security, the plaintiffs' conduct disentitled them from the remedy of a final order of receivership because of lack of good faith under the *BIA* and *PPSA*, and that it would not be just and convenient to grant an order of receivership, as it is an equitable remedy (para 37).

The facts in this case are factually dense and involve various entities, loans, and events. For the purpose of the good faith discussion in this post, however, it suffices to say that the allegations revolved around whether the plaintiff lenders engaged in dishonesty or misrepresentation, either deliberate or reckless, in their dealings with the defendant debtors, at the time of the initial loans in 2017 or during the restructuring talks in 2019 and 2020 (para 204).

The court found no dishonesty or deception by the plaintiffs, though it also did not provide a "ringing endorsement" of their conduct and found that they had not "achieved high levels of customer service in its handling of [the] account" (para 215).

Analysis

Equitable doctrines

Equitable doctrines, such as the duty of good faith, are incapable of precise or formulaic definitions, but they do require a clear test or standard against which inequitable conduct can be assessed or for courts to apply the test in a manner that makes its meaning evident. The duty in s 4.2 of the *BIA* (and s 18.1 of the *CCAA*) is freestanding and abstract, as in, it is not anchored to parties or to their obligations, nor is there a test or standard in the legislation. For those reasons, I have questioned its efficacy. See J Girgis, "A Generalized Duty of Good Faith in Insolvency Proceedings: Effective or Meaningless?" (2020) 64 Can Bus LJ 98 [Girgis, Generalized Duty].

However, these open-ended, freestanding duties can eventually take shape. If judges articulate factors and standards, and consistently apply them in the case law, a structured body of jurisprudence will develop, allowing us to identify the principles through which good faith can be identified. This might prove to be how the freestanding duty of good faith develops over time in insolvency legislation, particularly because a specific duty of good faith already appears in several provisions. Unlike the freestanding duty, these provisions impose a good faith duty on specific parties in specific circumstances, but since courts are well versed in applying these specific duties, similar principles might prove to be applicable. "Good faith" is largely undefinable, but we have seen that courts can determine when parties have discharged a duty of good faith.

Additionally, the goals of insolvency legislation, which play a significant part in shaping the duty of good faith in relation to what a party should be doing in a particular context, are well-defined and focused. In *9354-9186 Québec Inc v Callidus Capital Corp*, 2020 SCC 10 (CanLII), the SCC said that the supervising judge's discretionary authority must be "exercised in furtherance of the remedial objectives of the *CCAA*" while the court keeps in mind the "baseline considerations [of appropriateness, due diligence and good faith]" (para 41). The goals of the *BIA* are two-fold; to provide an equitable distribution to creditors and a fresh start for the debtor. The goal of the *CCAA* is to facilitate compromises and arrangements between companies and their creditors, which entails maximizing creditor returns, protecting wider stakeholder interests and rehabilitating the debtor. For these reasons, while some aspects of this broad, freestanding duty might remain problematic (for example, the potentially broad range of parties who might feasibly constitute an "interested person"), overall, courts can draw upon the principles already established, meaning its boundaries could crystallize relatively quickly.

For example, upon an application to extend the initial stay of proceedings under the *CCAA*, an applicant must show that the circumstances exist to make the order appropriate and that it has acted and is acting in good faith and with due diligence (*CCAA*, s 11.02(2), (3)). Although the provision does not include guidance as to what "good faith" means in that context, the case law indicates that an applicant must "demonstrate to the court and stakeholders that extending the proceedings will advance the purpose of the *CCAA*", which is to restructure the company (*North American*

Tungsten Corp (Re), [2015 BCSC 1376 (CanLII)] at para 26, citing *Azure Dynamics Corporation (Re)*, [2012 BCSC 781 (CanLII [In Chambers])]. This would include being forthcoming and transparent with the monitor, following court orders, disclosing financial information, and actively working to decrease costs.

Contrast, for example, the corporate oppression remedy, which imposes the equitable duty of fairness. Fairness is a broader duty than good faith, and it is contained within legislation with a broader ambit, the *Canada Business Corporations Act*, [RSC 1985 c C-44], the Alberta *Business Corporations Act*, [RSA 2000, c B-9], and other provincial business corporations' legislation. Unlike insolvency legislation, which governs specific periods in an individual's life or corporation's existence, corporate legislation governs many aspects of corporations, from their incorporation to their management, governance, dissolution, and much more, making it difficult to articulate distinct goals that would sufficiently encompass all aspects of the legislation. Absent a definition, guidelines and or distinct legislative goals to help ground it, courts have struggled to interpret and refine the remedy. Although there is now a test for the oppression remedy (see *BCE Inc v 1976 Debentureholders*, [2008 SCC 69 (CanLII)]), it continues to be the most litigated aspect of corporate-commercial law in Canada, despite being enacted over four decades ago (Kevin P McGuinness, *Canadian Business Corporations Law*, 3rd ed, vol 3 (Toronto: LexisNexis Canada, 2017) at §21.693).

Good Faith

To date, how have courts been interpreting s 4.2 (and its identical *CCAA* provision)? As mentioned above, in one decision since the amendments, *Laurentian University*, *supra,* the debtor sought to disclaim an agreement under s 32 of the *CCAA*. The contractual parties argued that the debtor was violating its duty of good faith by using the *CCAA* restructuring process for a collateral or illegitimate purpose, namely, to destroy a competitor. Section 32 does not impose an express duty of good faith on the parties, but the court applied the generalized duty in s 18.6 to determine that the debtor had not been acting improperly by disclaiming the contract but had simply been pursuing the legislative goals by attempting to cease its unsustainable financial model and save the business.

In this case, which provides a good sum-up of many of the good faith principles, Justice Douglas Mah determined that the plaintiffs had not breached the duty of good faith under either s 4.2 of the *BIA* or s 66(1) of the *PPSA* (which he concluded involved the same considerations as pertaining to the conduct of creditors (para 62)) (para 208) because they had not engaged in dishonesty or lying when they initiated the loans or during the restructuring talks (para 204). In particular, as noted above, he said that the plaintiffs had always pursued the goals of the legislation by working toward a restructuring but that the parties were unable to reach a consensus (para 206).

He started his analysis by noting that there is no statutory definition of "good faith" (para 41). And indeed, it is a non-substantive duty, as in, it has no content as a stand-alone concept; it derives meaning from the underlying substantive obligations and governs parties' behaviour as they perform those obligations (see Girgis, Generalized Duty, *supra* at 108). This was acknowledged when Justice Mah, limiting his analysis in this decision to secured creditors' conduct in events

leading up to the application to appoint a receiver, maintained, "[t]he content or degree of the good faith requirement will necessarily vary with different *BIA* actors and different facts" (para 60).

The good faith duty arises after the proceedings are initiated but can stretch back to encompass conduct connected to or "in respect of" the proceedings, though not indefinitely (paras 45 & 49). The judge relied on cases dealing with the duty of good faith in contractual performance to inform the good faith requirement in the *BIA*, maintaining that the relationship between a debtor and lender is contractual and that the remedy of receivership has a contractual component (para 56). He said that a good faith duty requires parties not to lie or mislead the other (para 59), which can sometimes include half-truths, omissions or even silence, but that it should not be equated with a fiduciary duty, in that it does not require one party to subvert its interests in favour of the other party (para 55).

Justice Mah also referred to the good faith duty in the *PPSA*, which is required alongside the conjunctive duty to act in a commercially reasonable manner. Section 66.1(1) provides, "[a]ll rights, duties or obligations arising under a security agreement, under this Act or under any other applicable law shall be exercised or discharged in good faith and in a commercially reasonable manner" (s 66.1(1)). Despite the fact that the duty of good faith in the *PPSA* relates to a secured creditor's procurement and carrying out of the security agreement, and, in the *BIA*, to a secured creditor's conduct in insolvency proceedings, Justice Mah maintained that the duty would not be much different in relation to the conduct of creditors (paras 62 & 203).

He concluded by saying that the plaintiffs' failure to disclose the steps involved in an internal approval process or levels of authority within an organization did not violate the duty of good faith, and that the good faith requirement in private commercial relations is different from the duty of fairness and transparency with regard to decision-making in the public law realm (para 192). To that, I would add that although the duties of good faith and fairness have overlapping qualities, they are indeed different. The duty of fairness in the oppression remedy has two elements: fair process, the process of arriving at a decision, and fair outcome, the substantive decision itself. Determining whether a process is fair requires considering several factors, including transparency, participation in decision-making, impartiality of decision-making processes, and notice to stakeholders. Substantive fairness has two elements and requires consideration of the conduct, its purpose, or what motivated the actor, which would also be considered for good faith, but also of the effect of the conduct or its outcome on a complainant.

The duty of fairness does frequently come into play in the public law realm, as he notes, but I would argue that fairness in the private realm would involve the same considerations, as stakeholders impacted by corporate decisions have similar concerns to individuals dealing with public authorities: that the decision-makers carried out the right procedures in arriving at their decisions, and that the decisions themselves are fair and justified (see J Girgis, "Fairness in the Oppression Remedy: How Does Harm Become Unfair?", forthcoming in 2022 Annual Review of Insolvency Law, available at SSRN: https://ssrn.com/abstract=3952068). Justice Mah seems to allude to that point himself, as, even though he distinguishes between the private and public law realms in relation to the duty of fairness, he refers to facts that speak to the transparency of decision-making by a private lender in that same context.

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