



DEBTORS AND CREDITORS SHARING THE BURDEN:

A Review of the
Bankruptcy and Insolvency Act
and the
Companies' Creditors Arrangement Act

Report of the Standing Senate
Committee on Banking, Trade and Commerce

Chair
The Honourable Richard H. Kroft

Deputy Chair
The Honourable David Tkachuk

November 2003

Ce rapport est aussi disponible en français.

Des renseignements sur le Comité sont donnés sur le site:

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The Committee

The following Senators have participated in the study:

The Honourable Richard H. Kroft, C.M., Chair of the Committee

The Honourable David Tkachuk, Deputy Chair of the Committee

and

The Honourable Senators:

W. David Angus

Michel Biron, C.M.

D. Ross Fitzpatrick

Céline Hervieux-Payette, P.C.

James F. Kelleher, P.C.

E. Leo Kolber (past Chair of the Committee)

Paul J. Massicotte

Michael A. Meighen

Wilfred P. Moore

Donald H. Oliver

Marcel Prud'homme, P.C.

Raymond C. Setlakwe, C.M. (retired from the Senate on July 3, 2003)

Ex-officio members of the Committee:

The Honourable Senators: Sharon Carstairs, P.C. (or Fernand Robichaud, P.C.) and
John Lynch-Staunton (or Noël A. Kinsella)

Other Senators who have participated from time to time on this study:

The Honourable Senators Maria Chaput, Leonard J. Gustafson, Pana Merchant and Madeleine Plamondon

Staff of the Committee:

Mr. Yoine Goldstein, Special Advisor to the Committee, Partner, Goldstein, Flanz & Fishman

Ms. June M. Dewetering, Acting Principal, Parliamentary Research Branch, Library of Parliament

Mr. Denis Robert, Clerk of the Committee, Committees and Private Legislation Directorate, The Senate

Mrs. Kelly J. Bourassa, Barrister and Solicitor, Policy Advisor to the Chair

Ms. Rhonda Walker, Policy Advisor to the Deputy Chair

Order of Reference

Extract from the *Journals of the Senate* of October 29, 2002:

“The Honourable Senator Kolber moved, seconded by the Honourable Senator Bacon:

That in accordance with the provisions contained in section 216 of the *Bankruptcy and Insolvency Act* and in section 22 of the *Companies' Creditors Arrangement Act*, the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report on the administration and operation of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*; and

That the Committee submit its final report no later than June 19, 2003.

The question being put on the motion, it was adopted.”

Extract from the *Journals of the Senate* of May 15, 2003:

“Resuming debate on the motion of the Honourable Senator Kolber, seconded by the Honourable Senator Rompkey, P.C.:

That the date for the presentation by the Standing Senate Committee on Banking, Trade and Commerce of the final report on its study on the administration and operation of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*, which was authorized by the Senate on October 29, 2002, be extended to Thursday, December 18, 2003.

After debate,

The question being put on the motion, it was adopted.”

Paul Bélisle
Clerk of the Senate

Recommendations

Consumer Insolvency:

Federal Exempt Property:

1. The Bankruptcy and Insolvency Regulations be amended to provide a list of federal exempt property. The debtor should be required to choose, at the time of filing for bankruptcy and in its entirety, either the list of federal exempt property or the list of provincial/territorial exempt property available in his or her locality. The value of the property in the list of federal exempt property should be increased annually in accordance with increases in the cost of living as measured by the Consumer Price Index. (page 23)

Exemptions for RRSPs and RESPs:

2. The *Bankruptcy and Insolvency Act* be amended to exempt funds in all Registered Retirement Savings Plans from seizure in bankruptcy, provided that three conditions are met: the Registered Retirement Savings Plan is locked in; contributions made to the Registered Retirement Savings Plan in the one-year period prior to bankruptcy are paid to the trustee for distribution to creditors; and the exempt amount is no greater than a maximum amount to be set by regulation and increased annually in accordance with increases in the cost of living as measured by the Consumer Price Index. (page 29)

3. The *Bankruptcy and Insolvency Act* be amended to exempt funds in a Registered Education Savings Plan from seizure in bankruptcy, provided that two conditions are met: the Registered Education Savings Plan is locked in; and contributions made to the Registered Education Savings Plan in the one-year period prior to bankruptcy are paid to the trustee for distribution to creditors. (page 32)

Reaffirmation Agreements:

4. The *Bankruptcy and Insolvency Act* be amended to prohibit reaffirmation by conduct or by express agreement. (page 36)

Summary Administration:

5. The *Bankruptcy and Insolvency Act* be reviewed in order to eliminate all unnecessary procedural requirements and to provide parties to a bankruptcy with an opportunity – to the extent possible – to choose their level of involvement in accordance with a “by exception rather than by rule” approach. Moreover, the use of electronic communication should be encouraged in order to simplify and expedite the insolvency process. (page 39)

Non-Purchase Money Security Interests in Personal Exempt Property:

6. The *Bankruptcy and Insolvency Act* be amended to prohibit non-purchase money security interests in property that would otherwise be exempt from seizure in bankruptcy. Property should be defined to include exempted property intended for use or consumption by the debtor or the debtor’s family, and should encompass apparel, household furnishings and motor vehicles owned by the debtor. (page 42)

Mandatory Counselling:

7. The *Bankruptcy and Insolvency Act* be amended to require the completion of mandatory counselling by first-time and second-time bankrupts as a condition of automatic discharge from bankruptcy available after 9 and 21 months respectively. Debtors making a consumer proposal should also undertake mandatory counselling. The nature and timing of mandatory counselling should be examined to ensure its effectiveness. (page 45)

Consumer Liens:

8. The issue of consumer liens continue to be addressed within provincial/territorial consumer protection legislation. (page 47)

Student Loans:

9. The *Bankruptcy and Insolvency Act* be amended to reduce, to five years following the conclusion of full- or part-time studies, the length of time prior to permitting the potential discharge of student loan debt. As well, the Act should allow the Court the discretion to confirm the discharge of all or a portion of student loan debt in a period of time shorter than five years where the debtor can establish that the burden of maintaining the liability for some or all of the student debt creates undue hardship. (page 56)

Discharge from Bankruptcy and the Treatment of Second-Time Bankrupts:

10. The *Bankruptcy and Insolvency Act* be amended to provide automatic discharge from bankruptcy after 21 months for second-time bankrupts who have completed mandatory counselling. The Superintendent of Bankruptcy, the trustee or any interested party should have the opportunity to oppose the automatic discharge, in the same way that the discharge of a first-time bankrupt can be opposed, thereby requiring a Court hearing. (page 59)

Contributions of Surplus Income to the Bankrupt's Estate:

11. The *Bankruptcy and Insolvency Act* be amended to require bankrupts with surplus income to contribute to their estate for a total of 21 months. Trustees should have the discretion to permit a shorter contribution period in cases of undue hardship. Surplus income should continue to be determined in accordance with the directive of the Superintendent of Bankruptcy. The discharge of the debtor should not be delayed merely because of the obligation to continue to contribute for a total of 21 months. In appropriate circumstances, a trustee should be able to seek a summary judgment to require such payments. (page 62)

Voluntary Agreements to Make Post-Discharge Payments:

12. The *Bankruptcy and Insolvency Act* be amended to allow trustees to enter into voluntary payment agreements with bankrupts who do not have surplus income. Fees payable to the

trustee in accordance with such an agreement should not exceed the minimum legal amount established for summary administration bankruptcies. (page 65)

Non-Dischargeable Credit Card Purchases:

13. The matter of purchases by the debtor of luxury or non-essential goods and services shortly prior to filing for bankruptcy continue to be decided either during the course of a discharge hearing or through an accusation of fraud. (page 67)

International Insolvency:

14. The *Bankruptcy and Insolvency Act* be amended to recognize the effect of a foreign discharge or compromise of debt with respect to an individual, provided certain conditions are met. The conditions should be: the bankrupt foreign-resident Canadian has a real and substantial connection with the foreign jurisdiction; the foreign procedure is fair and non-prejudicial to creditors; and the personal exemptions used by the bankrupt foreign-resident Canadian in the foreign proceedings are substantially similar to those in Canada. (page 70)

Debt Forgiveness by the Canada Customs and Revenue Agency:

15. The *Bankruptcy and Insolvency Act* be amended to provide that, for consumer proposals, the year-end date for income tax purposes is the date on which the proposal is filed with the Official Receiver. For commercial proposals, the year-end date should be the earlier of: the date of filing of the notice of intention to file a proposal; and the date of filing of the proposal with the Official Receiver. Moreover, the *Income Tax Act* should be amended to ensure that the debt forgiveness provisions in Section 80 of the Act are not applicable to individuals who file proposals under the *Bankruptcy and Insolvency Act*. (page 73)

Ipsa Facto Clauses:

16. The *Bankruptcy and Insolvency Act* be amended to provide that *ipso facto* clauses in agreements for basic services are not enforceable with respect to consumer proposals and consumer bankruptcies. (page 75)

Credit Reporting:

17. The Office of the Superintendent of Bankruptcy take a leadership role in convening a meeting among credit granting agencies, credit grantors, provincial/territorial representatives and other relevant parties with a view to negotiating a mutually acceptable credit scoring regime. (page 79)

Inadvertent Discharge of Selected Claims in Proposals:

18. The *Bankruptcy and Insolvency Act* be amended to ensure that an insolvent debtor will not be released from the debts and liabilities referred to in Section 178 of the Act unless the holder of those debts provides affirmative and informed consent. (page 81)

Bankruptcy and Family Law:

19. The *Bankruptcy and Insolvency Act* be amended to:
- ensure that bankruptcy does not prevent a claimant from recovering the total amount of support arrears from a bankrupt spouse;
 - clarify that only Court orders made under Section 68 of the Act have priority over enforcement of spousal and child support against the bankrupt's income during the period of bankruptcy;
 - provide that bankruptcy does not stay or release any claim for equalization or division against exempt assets under provincial/territorial legislation regarding equalization and/or the division of marital property;

- **exclude, from assets vesting in the trustee, the right to sue the bankrupt's spouse for equalization or division of property under provincial/territorial matrimonial property law; and**
- **add, to the debts that survive bankruptcy, a debt for equalization or division of property under provincial/territorial matrimonial property law, to the extent that the debt arises from malicious or fraudulent dissipation or concealment of property by the bankrupt. (page 86)**

Commercial Insolvency:

Compensation Protection: Wages and Pensions:

20. The *Bankruptcy and Insolvency Act* be amended to provide that unpaid claims for wages and vacation pay arising as a result of an employer's bankruptcy be payable to an amount not to exceed the lesser of \$2,000 or one pay period per employee claim. The funding of these claims should be assured by creating a super priority over secured claims to inventory and accounts receivable. The secured creditor or creditors should be able to assume the rights of the employees against the directors. (page 96)

21. The *Bankruptcy and Insolvency Act* not be amended to alter the treatment of pension claims. (page 99)

Debtor-in-Possession Financing:

22. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit Debtor-in-Possession financing. The Court should be given the jurisdiction to provide that the lien by the Debtor-in-Possession lender can rank prior to such other existing security interests as it may specify. As well, any secured creditor affected by such priority should be given notice of the Court hearing intended to authorize the creation of security ranking prior to its security. In deciding whether to authorize a Debtor-in-Possession loan, the Court should be required to consider the seven factors outlined by the Joint Task Force on Business Insolvency Law Reform in its March 2002 report. (page 103)

The Rights of Unpaid Suppliers:

23. The *Bankruptcy and Insolvency Act* be amended to repeal, subject to the noted exception, the provisions that provide protection for unpaid suppliers of goods to bankrupt companies.

The provisions that protect the rights of farmers, fishers and aquaculturalists as suppliers should be retained. (page 111)

Cross-Border Insolvencies:

24. The *Bankruptcy and Insolvency Act* be amended to incorporate the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency. Consideration should be given to adding a reciprocity provision and provisions that would assure the creation of a creditors' committee, consisting of Canadian creditors, to protect their interests. The reasonable expenses of the members of this committee should be paid by the foreign debtor, if considered appropriate by the Canadian Court. (page 117)

Director Liability:

25. The *Bankruptcy and Insolvency Act* be amended to include a generally applicable due diligence defence against personal liability for directors. (page 120)

Transfers at Undervalue and Preferences:

26. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to ensure consistent and simplified rules for challenging fraudulent preferences, conveyances at undervalue and other reviewable transactions. A trustee/monitor under a proposal should have the same powers as a trustee in bankruptcy. The Acts should provide a standard for challenging transactions that may affect the value of creditors' realizable claims. (page 123)

Bankruptcies by Securities Firms:

27. The *Bankruptcy and Insolvency Act* be amended to clarify: the definition of "net equity;" the status of cash in the accounts of bankrupt securities firms; and the applicability of Part XII of the Act to electronic transactions. (page 125)

Financial Market Issues:

28. The *Companies' Creditors Arrangement Act* be amended to give the Court the right to exempt securities regulators from Court-ordered stays of proceedings in instances where two conditions are met: the exemption is needed for the protection of third parties; and the exemption does not subject directors or senior management to undue pressure and loss of time. (page 127)

Insolvency Practitioner Liability as a Successor Employer:

29. The *Bankruptcy and Insolvency Act* be amended to separate clearly the personal liability of an insolvency practitioner from the liability of the debtors' estate. (page 130)

Executory Contracts:

30. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit disclaimer of executory contracts in existence on the date of commencement of proceedings under the Acts. This disclaimer should apply to all executory contracts, provided a number of conditions are met. In particular: the debtor should be obliged to establish inability or serious hardship in restructuring the enterprise without the disclaimer; the co-contracting party should be permitted to file a claim in damages in the restructuring; and, where a collective agreement is being disclaimed, the debtor should also have the burden of establishing that post-filing negotiations have been carried on, in good faith, for relief of too onerous aspects of the collective agreement and should establish in Court that the disclaimer is necessary in order to allow for a viable restructuring. (page 137)

31. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit trustees, Court-appointed receivers and monitors, if authorized by judgment, to assign executory contracts when appropriate, in connection with going concern transactions and on a liquidation basis, provided that two conditions are met: the proposed assignee is at least as

credit worthy as the debtor was at the time the contract was entered into; and the proposed assignee agrees to compensate the other party for pecuniary loss resulting from the default by the debtor or give adequate assurance of prompt compensation. (page 138)

Workers' Compensation Board Premiums:

32. The *Bankruptcy and Insolvency Act* be amended to return the treatment of Workers' Compensation Board premiums to that which existed prior to 1997. (page 143)

Interim Receivers:

33. The *Bankruptcy and Insolvency Act* be amended to clarify the role of the interim receiver, and the duration and meaning of the term "interim." As well, the definition of "receiver" should be amended to include interim receivers when they operate in a manner similar to Court-appointed receivers. (page 145)

Going Concern and Asset Sales:

34. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit the debtor, subject to prior approval of the Court, to sell part or all of its assets out of the ordinary course of business, during reorganization and without complying with bulk sales legislation. Similarly, the debtor should be permitted to sell all or substantially all of its assets on a going concern basis. On an application for permission to sell, the Court should take into consideration whether the sales process was conducted in a fair and reasonable manner and whether major creditors were given reasonable notice, in the circumstances, of the proposed sale and had input into the decision to sell. No such sale to controlling shareholders, directors, officers or senior management of the debtor having a significant financial interest in the purchaser or in the sales transaction should be permitted, other than in exceptional circumstances. (page 148)

Governance:

35. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit the Court to replace some or all of the debtor's directors during proposals or reorganizations if the governance structure is impairing the process of developing and implementing a going concern solution. Moreover, prior to appointment, a trustee/monitor should disclose, to the Court, any business and legal relationships it has or has had with the debtor. The auditor or recent former auditor of the debtor should not be permitted to be the monitor. Furthermore, the monitor should not be permitted, in the event of a failed restructuring, to become the trustee or a receiver for a secured creditor. (page 150)

Plan Approvals:

36. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to require a trustee/monitor to provide, in connection with a request for Court approval of a reorganization plan, an opinion that, as a group, each of secured creditors and unsecured creditors are likely to receive no less under the plan than it would receive in a liquidation. Moreover, Section 54(3) of the *Bankruptcy and Insolvency Act* regarding related parties should be incorporated in the *Companies' Creditors Arrangement Act*. Finally, the Acts should be amended to provide the Court approving a reorganization plan with the power to approve a restructuring of the equity of the debtor, with or without shareholder approval. (page 152)

Priorities:

37. The *Companies' Creditors Arrangement Act* be amended to incorporate the priority rules in the *Bankruptcy and Insolvency Act*. (page 153)

Insolvency of Other Vehicles:

38. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to provide for the liquidation or the reorganization of a business trust. (page 155)

Income Tax:

39. The *Income Tax Act* be amended to provide that distress preferred share treatment for tax purposes be afforded to qualifying debt, for a specified period of time, by filing a notice of election with the Canada Customs and Revenue Agency. Moreover, on the consummation of a plan of arrangement, a debtor should be able to elect to use fresh start accounting for tax purposes, with tax obligations relating to the period prior to the date of bankruptcy addressed as pre-filing claims. (page 157)

Subordination of Equity Claims:

40. The *Bankruptcy and Insolvency Act* be amended to provide that the claim of a seller or purchaser of equity securities, seeking damages or rescission in connection with the transaction, be subordinated to the claims of ordinary creditors. Moreover, these claims should not participate in the proceeds of a restructuring or bankruptcy until other creditors of the debtor have been paid in full. (page 159)

Administrative Tribunals and Stays of Proceedings:

41. The *Companies' Creditors Arrangement Act* be amended to exempt, from the application of stays of proceedings and subject to Court discretion, all proceedings brought before non-judicial administrative tribunals. The exemption should be granted where two conditions are met: the exemption is needed for the protection of third parties; and the exemption does not subject directors or senior management to undue pressure and loss of time. (page 162)

Administrative and Procedural Issues:

Volume of Filings, Access to the Process and Funding of the Office of the Superintendent of Bankruptcy:

42. The *Bankruptcy and Insolvency Act* be reviewed in order to identify opportunities that will contribute to greater efficiency within the insolvency system, including efforts regarding the adoption of new technologies. (page 167)

43. The *Bankruptcy and Insolvency Act* be amended to provide the Superintendent of Bankruptcy with the authority to finance research and education programs from the account which contains unclaimed dividends and undistributed funds. Amounts that are unclaimed or undistributed after a two-year period should be used in this way. (page 169)

Consolidation of Insolvency Statutes:

44. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* continue to exist as separate statutes. (page 173)

Statutory Review of Insolvency Legislation:

45. The *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act*, the *Winding-Up and Restructuring Act* and the *Farm Debt Mediation Act* be amended to require a review by a Parliamentary committee at least once every five years. (page 176)

A Specialized Judiciary:

46. The federal government consult with relevant stakeholders with a view to developing education and training programs that

would enable judges in Canada to develop specialized expertise in the area of insolvency law. (page 180)

Issues of Costs:

47. The *Bankruptcy and Insolvency Act* be amended to repeal the Tariff of Costs. Instead, costs should be paid in accordance with civil Court tariffs as they apply from place to place throughout Canada. (page 183)

Conflicts of Interest:

48. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be reviewed in order to identify and eliminate any opportunities for the roles and responsibilities of insolvency practitioners to place them in a real or perceived conflict of interest. Moreover, in order to ensure that all practitioners fulfill their duties with a high level of integrity, the federal government should adopt guidelines for insolvency practitioners regarding professional conduct and conflicts of interest, expanding upon Rules 34 to 53 of the *Bankruptcy and Insolvency Act* where appropriate. (page 185)

The Definition of Income:

49. The *Bankruptcy and Insolvency Act* be amended in order to clarify the meaning of the term “total income.” As well, clarity – in the form of guidelines contained in a directive of the Superintendent of Bankruptcy – should be provided to trustees regarding the manner in which lump-sum settlements received after bankruptcy and before discharge should be divided between debtors and creditors. Finally, a bankrupt’s tax refunds received during a period to be determined by statute should be made available to the trustee for distribution to creditors. (page 189)

The Definition of Consumer Debtor:

50. The *Bankruptcy and Insolvency Act* be amended to raise the indebtedness threshold contained in the definition of “consumer

debtor” to \$100,000, with annual increases thereafter to reflect increases in the cost of living as measured by the Consumer Price Index. Moreover, two years after the new indebtedness threshold comes into force, the federal government should initiate a review of the degree to which insolvent debtors are using the consumer proposal option rather than pursuing a commercial reorganization. (page 190)

Selection of the Bankruptcy Trustee:

51. The *Bankruptcy and Insolvency Act* be amended to provide that the debtor is required to submit to the Official Receiver his or her choice of a trustee to administer his or her bankruptcy. (page 193)

Non-Arm’s Length Creditor Voting Rights:

52. The *Bankruptcy and Insolvency Act* be amended to provide voting rights to non-arm’s length creditors who have been dealing with the debtor at non-arm’s length in the year prior to the bankruptcy, if they represent together more than 40% of the value of the total claims. In the event that the non-arm’s length creditors vote changes the outcome of the vote, any interested party should then seek leave of the Court to have the vote included. (page 196)

Debts Not Released by an Order of Discharge:

53. The *Bankruptcy and Insolvency Act* be amended to require that fraud be proven in order for a debt to survive discharge from bankruptcy. Moreover, the provisions should apply to both debts for property and debts for services acquired through false pretences or fraudulent misrepresentation. (page 198)

Acknowledgements

I would like to express my personal thanks to the members of the committee who were available for many extended meetings in order to hear the evidence of all of the witnesses who appeared before us over the course of our study. Additionally, I would like to thank all of the witnesses who appeared before us, representing the various stakeholder groups. The quality of the evidence presented to us, both orally and in written submissions, and the ability of the witnesses before the committee to respond, on short notice, to often complex questions demonstrated their expertise and dedication to improving Canada's bankruptcy and insolvency laws. They were of great assistance to the committee in completing such a lengthy study in a very short period of time.

Particular mention must be given to the Parliamentary Research Branch of the Library of Parliament and, in particular, the researcher for our committee, Ms. June Dewetering. June's work in assisting the committee to complete this report has been outstanding. I would also like to thank the Clerk of the Committee, Denis Robert, Senate support staff and translators who assisted the committee in completing this study in a very short time frame. The result is a review of Canadian insolvency legislation, and particularly the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act, that the committee hopes will be helpful to the federal government in drafting much needed legislation. Counsel for the committee, Mr. Yoine Goldstein, provided enormous assistance to the committee in addressing all of the many areas that required consideration and in advising the committee with respect to those areas of review that were particularly technical. It is no exaggeration to say that we could not have completed our work in the time and the way that we have without the benefit of his wisdom, experience and commitment.

I know I speak on behalf of our entire committee in saying; it is our sincere hope that the government will lose no time in acting to implement amended legislation in these areas. We look forward to our opportunity to review such legislation when it reaches the Senate for review.



Richard H. Kroft

Chair, Standing Senate Committee on Banking, Trade and Commerce

DEBTORS AND CREDITORS SHARING THE BURDEN: A REVIEW OF THE *BANKRUPTCY AND INSOLVENCY ACT AND THE COMPANIES' CREDITORS ARRANGEMENT ACT*

CHAPTER ONE: INTRODUCTION

Canada has a long history of insolvency legislation, beginning in 1869 with *An Act Respecting Insolvency*, which covered voluntary and compulsory bankruptcies, provided for compositions and applied only to traders. This legislation was followed by the *Insolvent Act of 1875*, which was repealed in 1880. For the next four decades, until the passage of the *Bankruptcy Act* in 1919, Canada lacked bankruptcy legislation of uniform application across the nation. Since then, Canadian bankruptcy legislation has been amended in a substantive manner in 1949, 1992 and 1997.

Furthermore, although not used frequently until the 1980s, the *Companies' Creditors Arrangement Act* (CCAA) became law in 1933, with amendments made in 1997. The third pillar of insolvency legislation, the *Winding-up and Restructuring Act*, was passed in 1882. A fourth statute, the 1997 *Farm Debt Mediation Act*, was passed as the successor to the 1986 *Farm Debt Review Act*, and applies to the farming industry.

Numerous attempts have been made in the last three decades to amend Canada's bankruptcy and insolvency laws, and although six omnibus reform bills were introduced in Parliament between 1975 and 1984, none of the proposals became law. Moreover, during that period, a number of advisory committees examined various aspects of the laws and made recommendations for change. In view of the relative lack of success with omnibus legislation, however, a strategic decision was made to propose amendments in selected areas.

Numerous attempts have been made in the last three decades to amend Canada's bankruptcy and insolvency laws ...

Consequently, in June 1991, Bill C-22 was introduced in the House of Commons. The Bill, which came into force in November 1992, contained a provision requiring review of the *Bankruptcy and Insolvency Act* (BIA) by a Parliamentary committee three years after coming into force. With a statutory Parliamentary review required in 1995, Industry Canada – then the Department of Consumer and Corporate Affairs – established the Bankruptcy and Insolvency Advisory Committee, with several working groups and task forces comprised of public and private sector representatives.

Designed as a forum in which priorities for reform to bankruptcy and insolvency laws could be discussed and in which consensus on policy recommendations might be reached, the Bankruptcy and Insolvency Advisory Committee made a number of recommendations that found legislative expression in Bill C-5, which was originally introduced in the first session of the Thirty-Fifth Parliament as Bill C-109.

Bill C-5 was introduced in the House of Commons in March 1996. The Bill proposed to amend the BIA with respect to: the licensing and regulation of bankruptcy trustees; the liability of trustees for environmental damage and claims; liability of directors and stays of action against directors during reorganizations; compensation for landlords where leases are disclaimed in a proposal under the BIA; procedures in consumer proposals; consumer bankruptcies; the dischargeability of student loan debt; Workers' Compensation Board claims; a requirement for bankrupts to contribute part of their income to the bankruptcy estate; international insolvencies; and securities firm insolvencies. The Bill also proposed amendments to the CCAA in order to align more closely the provisions of the CCAA and the BIA. Beginning in November 1996, the Standing Senate Committee on Banking, Trade and Commerce reviewed Bill C-5, and recommended amendments that were adopted by the Senate and, subsequently, the House of Commons before the Bill received Royal Assent in April 1997.

Anticipating a five-year statutory Parliamentary review of the BIA and the CCAA, as required by Bill C-5, in 2001

and 2002 Industry Canada held consultations with stakeholders on a range of insolvency issues. Consumer insolvency concerns were also examined by the Personal Insolvency Task Force, an independent panel established in 2000 by the Office of the Superintendent of Bankruptcy with membership from the principal stakeholder groups.

The Personal Insolvency Task Force released its report in August 2002, while Industry Canada published its *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* in September 2002. A third insolvency statute – the *Winding-up and Restructuring Act* – is not subject to the current statutory Parliamentary review; nor is the fourth law, the *Farm Debt Mediation Act*.

With the knowledge gained through examination of previous amendments to the BIA and the CCAA, in May 2003 the Standing Senate Committee on Banking, Trade and Commerce began a review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* with a view to determining whether the legislation, as it is currently written, is meeting the needs of the full range of stakeholders: debtors, creditors, judges, lawyers, trustees and other insolvency practitioners, the Office of the Superintendent of Bankruptcy and – importantly – all Canadians through the impact of insolvency laws on our economy.

In the course of the Committee's study, we have heard from a wide range of groups and individuals: academics, a variety of practitioners, credit counsellors, labour unions, business groups and others. They have shared their invaluable insights about this enormously complex area: what is working, what is not, and how they think the BIA and the CCAA should be changed.

This report comments on the Committee's philosophy regarding the fundamental principles that should guide the design of insolvency laws in Canada, with particular reference to the two statutes that are the subject of this review: the BIA and the CCAA. It also discusses the socio-economic importance of insolvency legislation, and describes the magnitude and nature of the insolvency problem in Canada. Most importantly, the testimony presented to the Committee by witnesses, as well as

In the course of the Committee's study, we have heard from a wide range of groups and individuals: They have shared their invaluable insights about this enormously complex area: what is working, what is not, and how they think the BIA and the CCAA should be changed.

[W]e believe that the ideas [contained in Chapters 4 and 5 of the Personal Insolvency Task Force’s Report] have merit – particularly from the perspective of streamlining the process and of reducing costs –
...

our recommendations for changes to the statutes and conclusions reached, are highlighted.

Although no discussion or recommendations occur with respect to the procedural changes regarding consumer bankruptcies and proposals identified by the Personal Insolvency Task Force in Chapters 4 and 5 of its report, we believe that the ideas have merit – particularly from the perspective of streamlining the process and of reducing costs – and urge relevant stakeholders to engage in the discussions needed to achieve consensus about how they should be addressed in future amendments to our insolvency legislation.

Finally, a number of Appendices provide relevant background information. Appendix A summarizes the key elements of the *Winding-up and Restructuring Act* and the *Farm Debt Mediation Act*, which are not part of the Committee’s current review, while Appendix B notes changes over time to Canada’s main insolvency laws – the BIA and the CCAA – and provides a general discussion of how the insolvency process works for consumers and corporations. Appendix C summarizes the report published by Industry Canada following its consultations with stakeholders on administrative policy, commercial insolvency and consumer insolvency issues, and Appendix D concludes with brief details on selected aspects of insolvency legislation in other countries.

CHAPTER TWO: THE COMMITTEE'S PHILOSOPHY WITH RESPECT TO INSOLVENCY LAW

As the Committee began this study, we focussed on what we believe should be the fundamental principles guiding the design of insolvency laws in this country. Certain prerequisites for a well-functioning insolvency system continually struck us as important: fairness, accessibility, predictability, responsibility, cooperation, efficiency and effectiveness. These are all critical hallmarks to remember as legislative changes are proposed.

Canada's insolvency system must be – and must be perceived to be – fair. Fairness is an essential consideration not only for Canadians, but also for residents of other countries. It must be fair for debtors, who should be provided with tools to avoid bankruptcy if that is the best option or with a true “fresh start” when they are discharged from their bankruptcy, and for creditors, who extend credit with the expectation of full repayment on a timely basis or, when this circumstance does not occur, are provided with a predictable, fair and orderly means by which loss is both shared appropriately and minimized to the extent possible.

Moreover, it must be fair for judges, who should have both clear rules to guide their decision making and the flexibility needed to address the unique circumstances of each case, and for trustees, monitors and other insolvency practitioners, who also require comprehensive guidelines about their rights and responsibilities. It must also be fair for foreign entities, who may find themselves involved in a cross-border insolvency, and for Canadians more generally, who need a fair, predictable system that provides stakeholders with incentives to act with integrity and transparency in order that our economic system remains sound and facilitates prosperity for all.

The redistributive effects of bankruptcy must be considered from the perspective of fairness, since bankruptcy-related losses for creditors may lead to higher costs of credit for those who pay their debts fully and in a timely manner. In some sense, fairness would dictate that the burden faced by those who

Certain prerequisites for a well-functioning insolvency system continually struck us as important: fairness, accessibility, predictability, responsibility, cooperation, efficiency and effectiveness. These are all critical hallmarks to remember as legislative changes are proposed.

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pay their debts must not be too great because of the actions and omissions of those who do not.

As well, the Committee believes that the insolvency system must be accessible to debtors – with any level of debt and in all regions of Canada – as a right, not a privilege. In order for the system to be meaningful, it must also be accessible from the perspective of being easily understood by stakeholders. It should be, at least to some extent, flexible. Each situation of insolvency is different, and while uniformity and predictability generally are critically important, some flexibility is also needed so that judges can make the decisions required in the best interest of all stakeholders.

The Committee also believes that Canadian insolvency laws must be drafted in a manner that ensures a high level of predictability for all stakeholders, domestic and international. Everyone should have a clear understanding of how the insolvency process operates and the options that are available; consistency should enable the likely outcomes to be predicted with a relatively high degree of accuracy. Predictability will enable stakeholders to make the best possible choices given their particular circumstances: debtors to decide between bankruptcy and a consumer proposal or commercial reorganization, suppliers and creditors to assess the likely outcome of debtor default as a contributing factor in their decision about whether to supply and extend credit and at what cost, domestic and foreign investors about whether to make an investment, and judges to determine the most appropriate orders to be made and actions to be taken in particular circumstances, among others.

Canada's insolvency system must also be characterized by responsible behaviour and cooperation. Recognizing that insolvency often occurs for reasons unrelated to financial mismanagement, the system must provide incentives for debtors to behave responsibly in managing their finances and for creditors to act likewise in their granting of credit. Trustees and other insolvency practitioners must also fulfill their responsibilities in a conscientious manner. There must be

meaningful consequences for any party that fails to act in accordance with the law.

The parties must also be provided with the incentives needed to ensure that they act cooperatively, since cooperation is also a prerequisite for a well-functioning insolvency system: cooperation among debtors and their creditors as they attempt to negotiate a mutually acceptable restructuring arrangement, among the Court, debtors and creditors as reorganization plans are finalized, and among trustees, debtors and creditors as bankruptcy estates are administered. Canada's insolvency system is highly regarded internationally, in part because of its emphasis on cooperation.

The Committee feels, as well, that our insolvency system must be efficient and effective. It must consider the social and economic costs of bankruptcy and ensure that these costs are minimized and shared appropriately. Moreover, situations of insolvency must be resolved with the least possible cost to stakeholders; every action taken by trustees, monitors and others must have a useful purpose. The system must also facilitate the efficient reallocation of resources in the event of bankruptcy, incorporate incentives for proper behaviour by all stakeholders and meet the needs of all stakeholders in an ever-changing environment.

Throughout our hearings, the Committee was mindful that the emphasis in Canada has been on finding the proper balance between providing debtors with unmanageable debt with a reasonable opportunity to make a financial recovery or to have a "fresh start" following discharge from their bankruptcy and ensuring that creditors, to the extent possible, share the burden of loss appropriately. A fundamental issue underlying insolvency is that there are inadequate resources available to satisfy everyone and the situation is a zero-sum game: a fresh start for a bankrupt means that creditors do not fully recover the moneys owed to them, and the greater the share of assets allocated to any particular creditor or class of creditors, the smaller is the share of assets available for distribution to all other creditors or classes of creditors.

The Committee considers that in a society such as ours, and particularly as globalization continues, risk-taking behaviour

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If we, as a society, support risk-taking behaviour because of the prosperity it brings, then we, as a society, must also be willing to bear the cost of failures – within reason – and to forgive instances where the taking of risks has a negative outcome.

contributes to success in a market-based economy; it is this behaviour that will help to ensure our prosperity as a nation and our place globally. Risk-taking behaviour, however, inevitably carries with it some failures. Data illustrating the extent to which the self-employed and small businesses experience financial difficulties show this fact to be true. If we, as a society, support risk-taking behaviour because of the prosperity it brings, then we, as a society, must also be willing to bear the cost of failures – within reason – and to forgive instances where the taking of risks has a negative outcome.

From this perspective, the manner in which a country addresses insolvency is tied to other decisions: about support for entrepreneurial behaviour as an engine of growth, about the promotion of education as a contributor to the well-educated workforce needed for the future, and about the extent to which safety nets are provided by governments to assist those who are less fortunate, among others. In this sense, a country's insolvency laws are framework legislation. They are a key indicator of how a country governs itself, its businesses and its citizens, and about its priorities for its future. These laws are also among those thought to be important for nations that participate in the global economy, since they regulate certain aspects of international commerce and are considered by those wishing to invest in Canada and make multinational corporate decisions.

The Committee has given consideration to the proper sharing of the burden of loss between debtors and creditors. We want a discharged bankrupt to have the best possible chance for future success and for a meaningful contribution to our economy and to our society. We also want to ensure, however, that due consideration is given to how the treatment of debtors affects others, including creditors, those who pay their debts in full and on time, and the Canadian economy more generally. In developing our recommendations, we continuously reflected on the extent to which our proposals would ensure that the fundamental principles of fairness, accessibility, predictability, responsibility, cooperation, efficiency and effectiveness are respected. We believe that our recommendations strike the appropriate balance.

CHAPTER THREE: INSOLVENCY LEGISLATION AND WHY IT IS NEEDED

A. The Socio-Economic Importance of Insolvency Laws

Bankruptcy and insolvency situations usually have devastating effects for everyone affected: the consumer or corporate debtor, family and friends, communities, unpaid suppliers, uncompensated – and perhaps unemployed – employees, creditors and shareholders, among others. A debtor's financial difficulties generally mean that shareholders lose value, unpaid suppliers and creditors may themselves face insolvency or bankruptcy, uncompensated employees may experience personal insolvency or bankruptcy, communities – particularly if they are small, have a single industry, and involve a number of affected suppliers and employees – probably will not thrive, even if they do survive, and governments at all levels potentially lose tax revenues as a consequence of reduced economic activity yet may face higher costs for employment insurance and social assistance.

In essence, insolvency laws exist in order to provide:

- debtors with an opportunity to obtain a discharge from their debts, subject to conditions, and thereby become productive and useful citizens free from an unsustainable debt burden, in essence to get a fresh start;
- a relatively quick, inexpensive method by which insolvent debtors can be compelled to give their non-exempt property to a trustee with a view to realizing these assets for the benefit of creditors;
- a mechanism for the orderly distribution of the non-exempt property of insolvent debtors among their creditors in order that the burden is shared appropriately;

Bankruptcy and insolvency situations usually have devastating effects for everyone affected: the consumer or corporate debtor, family and friends, communities, unpaid suppliers, uncompensated – and perhaps unemployed – employees, creditors and shareholders, among others.

... with an increased focus on global competitiveness, Canada's insolvency laws must be – and must be seen to be – effective and fair, and amendments to the laws must be made with efficiency and predictability in mind.

- an opportunity to investigate the affairs of bankrupts and to reverse any improper transactions that occurred prior to bankruptcy; and
- a framework within which the financial obligations of debtors can be compromised or restructured in order to avoid bankruptcy.

Canada's insolvency laws fundamentally contribute to the effective and efficient functioning of the marketplace, since their existence gives some security to all stakeholders, domestic and foreign. From a financial perspective alone, the fairness and predictability provided by these laws increase the amount of credit that is available and help to ensure that it is available at reasonable cost. In turn, the availability of credit at reasonable cost has implications for the levels of domestic and foreign investment, entrepreneurship and innovation, and personal investment and consumption.

In the event of financial difficulty, the timeliness, transparency and fairness with which assets can be redeployed to more productive and profitable uses affects economic performance and minimizes losses for creditors. Moreover, with an increased focus on global competitiveness, Canada's insolvency laws must be – and must be seen to be – effective and fair, and amendments to the laws must be made with efficiency and predictability in mind.

Of Canada's insolvency laws – the *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act*, the *Winding-up and Restructuring Act* and the *Farm Debt Mediation Act* – the two most important are the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA). The BIA applies to individuals and companies with unsustainable debt burdens, while companies can reorganize under either statute in the event of financial difficulty provided a \$5 million debt threshold is met with respect to the CCAA. The third statute – the *Winding-up and Restructuring Act* – is primarily used in situations involving financial institutions, while the fourth – the *Farm Debt Mediation Act* – applies to insolvent farmers; these latter two Acts are not part of the Committee's current review.

B. The Magnitude and Nature of the Problem

In developing an insolvency regime that is appropriate to the magnitude and nature of the insolvency problem, some consideration must be given to the circumstances giving rise to insolvency and its recurrence. The preferred option must surely be an identification of the reasons for insolvency, in order that preventive measures can be developed to assist consumers and corporations in avoiding financial difficulties. The public interest is thereby served.

In general, financial difficulties might occur for a number of economic and non-economic reasons, bearing in mind that non-economic reasons frequently have economic consequences. Studies have revealed the following factors as contributors to insolvency: unemployment; underemployment; retirement; compulsive spending; a change in marital, family or health status; substance addiction; gambling; loss of corporate market share; bad weather; international trade sanctions; and business failure which may cause personal insolvency. While also a potential cause of insolvency, financial mismanagement might more often be a contributing factor where one or more other factors also exist.

Individuals and corporations most often cannot control economic circumstances, while non-economic factors may be only partially controllable. Nevertheless, most agree that financial counselling designed to help individuals and businesses assess their attitudes and beliefs regarding credit and its uses, acquire money management and budgeting skills, and identify warning signs associated with financial difficulty are useful. This type of counselling, however, is perhaps most effective before financial difficulties occur. It is for this reason that many advocate money management and budget skills as a skill area that should be taught to high school students.

While some believe that the increased availability of reasonably priced credit is to blame for financial difficulties, it is perhaps more useful to examine the extent to which

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consumer bankruptcies have been rising while the aggregate amount of consumer credit as a proportion of disposable income has been relatively stable.

The magnitude and nature of insolvency problems among Canadians and Canadian businesses have varied over time, largely in response to changing economic conditions, but perhaps also because the stigma of bankruptcy appears to have lessened somewhat. As well, in a society where credit is important and readily available, a certain number of bankruptcies might be seen as a logical and inevitable consequence of credit availability.

Studies reveal that, for some Canadians, their personal debt more than exceeds their annual disposable income. At present, the ratio of personal debt to annual disposable income exceeds 100%, an increase from 61% two decades earlier. The level of consumer indebtedness is thought to have risen by more than 238% over the 1981 to 2001 period, from \$262.4 billion (\$1997) in 1981 to \$625.6 billion in 2001. The changing debt-to-income ratio could reflect changing attitudes by debtors and creditors to risk, a more tolerant attitude toward bankruptcy and/or a reduced stigma associated with bankruptcy.

Over the 1966 to 2002 period, insolvency cases filed with the Office of the Superintendent of Bankruptcy (OSB) increased, on average, by 8.8% annually, although the highest annual average rates of increase occurred in the 1970s; since 1997 the rate has been 1.1%. There are relatively significant differences between the average rate of increase in commercial and in consumer insolvencies filed with the OSB.

Over the 1966 to 2002 period, the average annual rate of increase in consumer insolvencies was 11.4%, and in 2001 there were almost 93,000 consumer insolvencies or 2.98 per 1,000 Canadians. The average annual rate of increase in consumer insolvencies reached 22.6% in the 1970s before falling to about 7.5% in the 1980s and 1990s. Over the 1997

to 2002 period, the average annual rate of increase in consumer insolvencies was markedly lower, at 2.0%.

Since 1999, the number of consumer bankruptcies filed with the OSB has been rising, although consumer proposals are increasingly popular with debtors as a means of avoiding bankruptcy and protecting certain assets, such as their homes. The 1993 to 2002 period has seen a continuous increase in the number of consumer proposals filed with the OSB; the number of such proposals has increased from about 1,900 in 1993 to more than 15,200 in 2002, which represents an average annual increase of 25.9% over the period.

The average annual rate of increase in corporate insolvencies was 3.6% over the 1966 to 2002 period, about one-third the rate of increase in consumer insolvencies. The average annual rate of increase reached 8.0% in the 1970s and 6.0% in the 1980s before falling to -0.6% in the 1990s. The average annual rate of increase declined further to -4.7% over the 1997-2002 period, and reached -7.6% for 2001-2002.

Corporate proposals have also been popular over the 1993 to 2002 period; during this time, the number of these proposals has increased, on average, 14% annually. Since the mid-1970s, the majority of the Office of Superintendent of Bankruptcy's cases have been consumer insolvencies, and in 2002 corporate insolvencies represented 10% of all cases addressed by the OSB.

Ontario and Quebec have the largest number of insolvency cases filed with the OSB each year, both by consumers and by corporations. This fact is not surprising given their population size and the number of businesses operating there.

In 2002, the Atlantic region, Quebec and Alberta exceeded the national average in terms of consumer insolvencies per 1,000 residents aged 18 years and over, while Ontario, Manitoba/Saskatchewan and British Columbia were

below the national average. In that year, the national average was 3.8 per 1,000 residents aged 18 years and over.

In 2002, corporate insolvencies per 1,000 businesses exceeded the national average in the Atlantic region, Quebec and Alberta; the rate in Ontario, Manitoba/Saskatchewan and British Columbia was lower than the national average. In that year, the national average was 5.9 per 1,000 businesses. In 2002, most corporate insolvency cases arose in the services and wholesale/retail trade sectors; the lowest number of cases occurred in the finance, insurance and real estate, manufacturing and primary sectors.

The regional pattern is, therefore, consistent for both consumer and corporate insolvencies when population and business distribution are considered.

As noted above, the level and depth of insolvency and economic prosperity are linked. In 1992, the percentage of declared liabilities in insolvencies reached 1.75% of Gross Domestic Product. Although this percentage declined until 1999, since that time it has risen, reaching 1.5% in 2002. The increase is largely the consequence of corporate liabilities.

... the level and depth of insolvency and economic prosperity are linked.

C. *The Bankruptcy and Insolvency Act*

Canada's *Bankruptcy and Insolvency Act*, which applies to commercial and consumer – or corporate and personal – insolvencies, provides a number of options for debtors who find themselves with an unsustainable debt burden, including bankruptcy in either case, and proposals for consumers and reorganizations for commercial enterprises, depending on the debtor's degree of financial difficulty.

Consumers and corporations who are in financial difficulty may make a proposal to their creditors – a “consumer proposal” or a “reorganization,” as the case may be – to restructure their debt. This restructuring generally involves the acceptance of partial payment in fulfillment of debt and/or payments over a longer period of time. With this option, debtors retain control of their assets and creditors generally recover a greater amount; the consumer or corporation can continue to function and, hopefully, return to financial viability. Creditors generally have an incentive to agree to a proposal or reorganization if they expect that a greater return could be realized than if the consumer or corporation were to become bankrupt.

To be eligible to make a consumer proposal, an individual's debts cannot exceed \$75,000, excluding the mortgage on a principal residence, and he or she must have adequate resources to enable the development of a fair and realistic proposal. Consumer proposals are not binding on secured creditors; these creditors retain their right to realize on their security if timely payments are not made. Commercial proposals can be filed regardless of the amount of indebtedness, and secured creditors are similarly able to realize on their security if timely payments are not made.

The BIA contains incentives that encourage insolvent debtors to make a proposal rather than pursue bankruptcy. For example, some consumer bankrupts are required to make surplus income payments to their estate, which provides less

Creditors generally have an incentive to agree to a proposal or reorganization if they expect that a greater return could be realized than if the consumer or corporation were to become bankrupt.

The BIA, with its structured system for consumer proposals, corporate reorganizations, and bankruptcies, is thought to ensure a relatively predictable and consistent outcome.

flexibility than a consumer proposal that provides the debtor with more flexibility regarding payments. Moreover, the trustee is required to report – prior to discharge from bankruptcy being granted – whether the debtor could have made a feasible consumer proposal; if so, the Court may grant a conditional discharge and the conditions imposed may resemble the payment arrangements in a proposal.

Where there is no reasonable hope of returning to financial viability, insolvent consumers and corporations may declare bankruptcy. Alternatively, creditors may request that insolvent consumers or corporations be placed in bankruptcy. In situations of bankruptcy, the process serves a number of functions:

- it provides a mechanism for liquidating the debtor's assets for the benefit of creditors;
- it enables the debtor to start over without the burden of unsustainable debt; and
- it allows assets to be re-allocated for use in an environment where profitability may exist.

The BIA, with its structured system for consumer proposals, corporate reorganizations and bankruptcies, is thought to ensure a relatively predictable and consistent outcome.

D. *The Companies' Creditors Arrangement Act*

Corporate reorganizations that involve in excess of \$5 million in debt can occur under either the BIA or the *Companies' Creditors Arrangement Act*; consumer proposals are not possible under the CCAA. At one time, the BIA contained reorganization provisions only for companies that were bankrupt; for those that were insolvent but not bankrupt, reorganization under the CCAA was possible. At present, reorganization for insolvent corporations can occur under either statute, although the \$5 million debt threshold must be met with respect to the CCAA.

The CCAA provides a relatively flexible framework that allows for reorganizations – rather than the relatively more specific rules under the BIA – and allows the Court a fairly high degree of discretion in determining how best to resolve the cases before it. The statute itself is short and relatively few guidelines are provided.

With the proclamation of Bill C-5, the CCAA was amended to align procedures under it more closely with those under the BIA.

The CCAA provides a relatively flexible framework that allows for reorganizations – rather than the relatively more specific rules under the BIA – and allows the Court a fairly high degree of discretion in determining how best to resolve the cases before it.

CHAPTER FOUR: THE SENATE COMMITTEE'S EVIDENCE AND RECOMMENDATIONS ON CONSUMER INSOLVENCY ISSUES

A. Federal Exempt Property

When an individual becomes bankrupt and a trustee takes possession of the debtor's property in order to satisfy creditors, certain classes of property – exempt property – continue to belong to the debtor. There is a public policy rationale underlying these exemptions: these types of goods are required as basic necessities of life for the debtor and his or her family, and assist in the debtor's reintegration into society.

The *Bankruptcy and Insolvency Act* (BIA) establishes three categories of exempt property:

- property held by the bankrupt in trust for others;
- Goods and Services Tax credit payments and prescribed payments related to the personal needs of individuals; and
- property of the bankrupt that is exempt from seizure under provincial/territorial law where the property is situated and the bankrupt resides.

This third category – provincial/territorial exemptions – varies across jurisdictions. Nevertheless, there are certain similarities. For example, the following assets are generally considered to be exempt property, often up to some monetary limit: food; furniture; appliances; medical devices; tools required to earn an income; and a vehicle. Some jurisdictions provide an exemption for equity in real estate, while others do

There is a public policy rationale underlying [exempt property]: these types of goods are required as basic necessities of life for the debtor and his or her family, and assist in the debtor's reintegration into society.

... the types and values of exempt assets do vary somewhat, and some have not been updated to reflect increases in the cost of living or societal changes.

not. That being said, the types and values of exempt assets do vary somewhat, and some have not been updated to reflect increases in the cost of living or societal changes. Assets in life insurance Registered Retirement Savings Plans are also exempt from seizure under provincial/territorial law.

Since 1970, when the Study Committee on Bankruptcy and Insolvency Legislation – the Tassé Committee – recognized the benefits of a list of federal exempt property and saw no constitutional barriers to its existence yet supported continuation of provincial/territorial exemptions, there has been debate about whether a list of federal exempt property should exist, either as a substitute for lists of provincial/territorial exempt property or as an alternative to them.

Supporters of lists of provincial/territorial exempt property argue that the current system allows needed consideration of regional variations in the cost of living and property use. Opponents, on the other hand, believe that lists of provincial/territorial exempt property are inconsistent with a fundamental premise of Canada’s insolvency legislation: that bankrupts and their creditors should be treated identically, regardless of residence or place of business. They believe that the current system lacks uniformity and can create inequities in the treatment of debtors; in extreme cases, it may encourage debtors to survey the lists of exempt property in all provinces/territories – in essence, to “forum shop” – and to move to the jurisdiction with the most generous list of exempt property before filing for bankruptcy. Consistent with this view, federally determined exempt property with specified monetary amounts should apply, in the same way that the Superintendent of Bankruptcy’s directive with respect to surplus income is applied consistently across the country.

Witnesses provided the Committee with a range of views on the issue of federal exempt property: for, against, and as an option. The Personal Insolvency Task Force recommended a list of federal exempt property, as an alternative to provincial/territorial exempt property, that could be selected by debtors when filing for bankruptcy:

- apparel and household furnishings, to a maximum value of \$7,500;
- medically prescribed aids and appliances, and medication for use or consumption by the debtor or his or her family;
- one motor vehicle, to a maximum value of \$3,000 in equity;
- tools of the trade and professional books, exclusive of motor vehicles used in trade or business, to a maximum value of \$10,000 in equity;
- equity in a debtor's residence, to a maximum of \$5,000, with each debtor entitled to the full exemption in cases of joint filing; and
- real and personal property used by a debtor whose livelihood is derived from farming, fishing, forestry and other activities related to the natural resource sector to a value of not less than \$10,000 and not more than \$20,000 in equity, as governed by provincial/territorial law.

Furthermore, the Task Force recommended that the value of the exempted assets be periodically adjusted to reflect increases in the cost of living. This could occur by regulation under the BIA or, preferably, by exercise of the Superintendent's directive powers. "Trading" among different categories of exemptions – what is known as a "wild card" exemption and is an American practice – was not recommended.

Professors Ziegel and Telfer, representing a number of professors of law, voiced support for the notion of an optional list of federal exempt property, as did the Canadian Bar Association, although the latter told the Committee that it is concerned about the complexities that could be introduced with two exemption schemes. The Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada generally supported the Task

Force’s proposal since, in their view, “[t]his federally prescribed list of exemptions [would] bridge the disparity that currently exists among provincial exemption levels on specific assets.” They also told us that “the bankrupt must choose either one system or the other and not be allowed to ‘cherry pick’ between the federally and provincially prescribed exemptions.”

Some of the Committee’s other witnesses, however, argued that a federal list would not adequately recognize regional variations and would not ensure uniformity across Canada, but would add complexity. Omega One Ltd. told the Committee that a parallel system of federal exempt property would “add complexity for little apparent benefit. Debtors ... in provinces with lower exemptions [would] likely adopt the proposed federal exemptions as a routine choice. The federal scale [would] become the *de facto* scale for those provinces. Residents of provinces with generous exemptions [would] ignore the proposed federal *schema*. There [would] remain unequal protection across Canada.” In fact, in its view, irregularities regarding property rights would be created within some provinces/territories.

Advocis, formed through the merger of the Canadian Association of Insurance and Financial Advisors and the Canadian Association of Financial Planners, also does not support a list of federal exempt property. The organization told the Committee that the BIA should continue to incorporate provincial/territorial exempt property by reference; the BIA should not override those exemptions.

The Canadian Bankers Association advocated one system of property exempt from seizure, whether the provincial/territorial lists that already exist or the development of a federal list. In its view, the BIA should either maintain the status quo or include a federal list of exempt property, but not both; the bankrupt should not be able to choose between a federal list and a provincial/territorial list. The Association believes that allowing choice “would not eliminate any regional discrepancies and it would add more complexities to the process for little apparent benefit.”

... we believe that a federal list of exempt property should be available as an option for bankrupts.

While the Committee respects the arguments made by witnesses who supported only a list of provincial/territorial exempt property and those who believed that the law should clearly provide for either provincial/territorial exempt property or federal exempt property but not both, we believe that a federal list of exempt property should be available as an option for bankrupts. In our view, the bankrupt should select either the federal list or the provincial/territorial list of exempt property in their locality in its entirety and at the point of filing for bankruptcy. Moreover, recognizing the argument made by some witnesses about the extent to which the value of the assets in the provincial/territorial lists have not been updated over time, we believe that adjustments should be made annually in order to recognize the effects of inflation. We feel that providing bankrupts with this option would help to ensure the fairness that we are seeking in our insolvency system, and for this reason the Committee recommends that:

We feel that providing bankrupts with [the option of a list of federal exempt property] would help to ensure the fairness that we are seeking in our insolvency system ...

The Bankruptcy and Insolvency Regulations be amended to provide a list of federal exempt property. The debtor should be required to choose, at the time of filing for bankruptcy and in its entirety, either the list of federal exempt property or the list of provincial/territorial exempt property available in his or her locality. The value of the property in the list of federal exempt property should be increased annually in accordance with increases in the cost of living as measured by the Consumer Price Index.

B. Exemptions for RRSPs and RESPs

... since federal and provincial/territorial pension and insurance laws make registered pension plans and insurance policy proceeds exempt from execution and seizure, benefits from registered pension plans and Registered Retirement Savings Plans (RRSPs) associated with life insurance policies are generally exempt from seizure in bankruptcy.

Under the BIA, the property of a debtor which is exempt from seizure in bankruptcy under the laws of the province/territory in which the property is situated and the bankrupt resides is not part of the bankrupt's estate and is not available for distribution to creditors. Consequently, since federal and provincial/territorial pension and insurance laws make registered pension plans and insurance policy proceeds exempt from execution and seizure, benefits from registered pension plans and Registered Retirement Savings Plans (RRSPs) associated with life insurance policies are generally exempt from seizure in bankruptcy. That being said, there are a limited number of cases in which a debtor with exempt RRSP savings has been obliged, as a condition of discharge, to collapse a portion of his or her RRSP and to contribute the after-tax proceeds to the trustee for distribution to creditors. In Quebec, RRSPs convertible to annuities held by trust companies are also exempt.

Other types of RRSPs – such as those held by banks, brokerages or in self-directed funds, or what might be termed “non-insurance” – are generally non-exempt, unless for example they are locked in by virtue of the RRSP funds having been transferred from a pension fund on termination of employment. If the holder of a non-insurance RRSP that is not locked in becomes bankrupt, the funds become the property of the trustee and are available for distribution to creditors.

Arguments both for and against extending an exemption from seizure in bankruptcy to all RRSPs exist. Supporters point to the public policy objective of helping Canada's citizens to save for their retirement. From this perspective, if the federal government feels that this undertaking is sufficiently worthwhile that it is willing to provide tax assistance for retirement savings, then it is logical to protect retirement savings from seizure in bankruptcy, and to protect all forms of retirement savings to the same extent. This protection may be particularly important for those

employees who do not have an employer-sponsored registered pension plan and for self-employed individuals.

Opponents, however, note that exempting non-insurance RRSPs from seizure in bankruptcy would reduce the moneys available for distribution to creditors. They also observe that non-locked-in RRSPs can be used for purposes other than retirement, and that RRSP holders have the option to purchase an insurance RRSP and thereby protect those assets from seizure. Finally, opponents believe that RRSPs are a form of investment and should not be treated differently than other investments; if RRSPs are exempt from seizure in bankruptcy, then other investments should be similarly exempted.

Witnesses provided the Committee with recommendations both for and against exempting non-insurance RRSPs from seizure in bankruptcy. The Personal Insolvency Task Force pointed out that the federal government has made a policy choice in deciding to provide individuals with an incentive to save for their retirement. In particular, incentives exist through the exempt status given to registered pension plans and the tax treatment of registered pension plans and Registered Retirement Savings Plans, among others. It argued that “it would be inappropriate if the bankruptcy system treated RRSPs in exactly the same way as pensions ... because there are several key differences that call for different treatment.” For example, pension contributions are usually compulsory, periodic and fixed in amount, while RRSP contributions are voluntary, often irregular and self-determined in amount. As well, registered pension plans generally cannot be accessed until retirement, while RRSPs can be collapsed at any time, unless they are locked in, and may be used for reasons unrelated to retirement.

While the Task Force believed that “the BIA ought not to be available for strategic use by those who intend to shelter their assets from the reach of impending or foreseeable creditors,” it also shared the view that “[i]t would be consistent with both retirement and bankruptcy policies if bankruptcy legislation afforded exempt status to RRSP

Opponents, however, note that exempting non-insurance RRSPs from seizure in bankruptcy would reduce the moneys available for distribution to creditors.

savings that have accumulated through prudent retirement savings practices before the period of insolvency.” Consequently, the Task Force recommended that legislative change occur in order that RRSPs would be eligible for exemption in bankruptcy, subject to a number of requirements, including: locking in to ensure that funds are used, subject to exceptions in cases of financial hardship, for retirement; non-exempt status for contributions made in the three years prior to bankruptcy in order to prevent strategic behaviour and to allow seizure of those moneys that reasonably could have been used for debt repayment; treatment of the proceeds from a locked-in RRSP as income subject to surplus income standards; and a cap on the exemption, tied to the debtor’s age and the maximum RRSP contribution limit in the year of bankruptcy, so that older bankrupts would be able to protect more of their retirement savings.

The Canadian Bar Association expressed general support for the Task Force’s proposal, but advocated a two-year clawback and no cap; if a cap were to be imposed, however, the Association felt that it should be adjusted periodically. It supported locking in until retirement because “[a] policy that helps to discourage withdrawals prior to retirement would be socially beneficial ... [T]here is no policy justification for exempting savings accounts not earmarked for retirement.” Similarly, the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada were generally supportive of the Task Force’s position, but argued for a clawback of the lesser of the contributions in the three-year period and the realizable value in the RRSP at the end of bankruptcy.

An exemption for RRSPs was also supported by the Canadian Federation of Independent Business, which told the Committee that the majority of its members are “clearly in favour.” Advocis also indicated that equitable treatment of retirement savings should occur, and suggested that “[i]ndividuals who save for their retirement in whole or in part through RRSPs or [Deferred Profit Sharing Plans] or who receive retirement income from [Registered Retirement Income Funds] or annuities funded by proceeds from those

registered plans should enjoy similar protection from creditors as individuals who fund their retirement through [registered pension plans].” Protection would be made available to a larger number of individuals, which may be of particular benefit to employees of small employers, who may lack a registered pension plan, or self-employed individuals with a modest income.

The organization also believes that income acquired from an RRSP, Deferred Profit Sharing Plan (DPSP) or Registered Retirement Income Fund (RRIF) should be protected to the same extent as pension income from a registered pension plan. It also commented on the Task Force’s recommendation regarding non-exempt status for contributions made in the three years prior to bankruptcy. In particular, it rejected “the presumption of the [Task Force] that all new contributions to a protected RRSP made within three years preceding bankruptcy will be fraudulent conveyances intended to defraud a creditor.”

In the view of the Alberta Law Reform Institute, “[t]here is an unfairness in [the] exposure of non-insurance RRSPs, compared to the virtually complete protection of insurance RRSPs and annuities, and most pensions.” In essence, the Institute believes that “insurance and non-insurance RRSPs, DPSPs and RRIFs . . . , and obligations to pay money out of such plans, should be totally exempt from all judgment creditors’ remedies. No distinction should be drawn among remedies nor should the exemption be different between insurance and non-insurance products.” Finally, noting that many – and perhaps most – debtors have no RRSP or have already collapsed it, the Institute argued that the “practical impact of a total exemption is likely to be minimal in most situations.”

The Canadian Bankers Association shared with the Committee its view that a level playing field should be created among retirement savings and income products and indicated that the law should “[make] such products either subject to seizure in bankruptcy or exempt from seizure in bankruptcy.”

[The Committee was told that with an exemption for RRSPs, protection] would be made available to a larger number of individuals, which may be of particular benefit to employees of small employers, who may lack a registered pension plan, or self-employed individuals with a modest income.

The Committee found arguments made by those witnesses who urged uniformity of treatment of retirement savings quite compelling.

The Association advocated additional research to determine if an exemption of non-insurance RRSPs from seizure in bankruptcy is an issue that needs to be addressed through legislative amendment.

The Committee found arguments made by those witnesses who urged uniformity of treatment of retirement savings quite compelling. In our view, the public interest is served when Canadians save for their retirement. While some Canadians are able to do so through a registered pension plan available as deferred compensation from their employer – perhaps augmented by private savings and Registered Retirement Savings Plans – those who do not have access to a registered pension plan and those who are self-employed must rely on RRSPs.

As noted above, proceeds from a registered pension plan and some RRSPs – notably those associated with insurance policies and those that are locked in – are generally protected from seizure. The Committee is concerned about the inequity: the inequity between the treatment of registered pension plans and RRSPs, and the inequity between insurance RRSPs and non-insurance RRSPs. In our view, with this differential treatment in the latter case, there is some danger that protection would be given only to those RRSP holders who perhaps were debtors anticipating a future bankruptcy or who had received more expert financial advice. That being said, we are also fully aware of the differences that exist between registered pension plans – which are deferred compensation – and most RRSPs – which are a retirement savings vehicle that generally cannot be viewed as deferred compensation. Moreover, we are also aware that registered pension plans provide primarily retirement benefits and that contributions are locked in until that time, while funds in RRSPs that are not locked in can currently be used for purposes that are not restricted to retirement, since they can also be used for home purchases and education under certain circumstances or collapsed and used for other purposes.

In the past, in particular during our examination of Bill C-5, the Committee expressed support for exempting all

RRSPs from seizure in bankruptcy, subject – of course – to appropriate measures to prevent abuse. In seeking uniform treatment that would make exemption rules more equitable and provide consistent protection to all RRSPs, regardless of their type, we urged the federal government to address the inequities that exist between insurance and other RRSPs.

The Committee’s views have not changed. We continue to believe that amendments are needed to ensure fairness. Fairness to debtors requires equitable treatment among retirement savings vehicles, while fairness to creditors requires that RRSPs be locked in and that contributions in the year prior to bankruptcy – when the funds could reasonably have been used to pay debts – be available to satisfy their claims. From this perspective, the Committee recommends that:

Fairness to debtors requires equitable treatment among retirement savings vehicles, while fairness to creditors requires that RRSPs be locked in and that contributions in the year prior to bankruptcy – when the funds could reasonably have been used to pay debts – be available to satisfy their claims.

The *Bankruptcy and Insolvency Act* be amended to exempt funds in all Registered Retirement Savings Plans from seizure in bankruptcy, provided that three conditions are met: the Registered Retirement Savings Plan is locked in; contributions made to the Registered Retirement Savings Plan in the one-year period prior to bankruptcy are paid to the trustee for distribution to creditors; and the exempt amount is no greater than a maximum amount to be set by regulation and increased annually in accordance with increases in the cost of living as measured by the Consumer Price Index.

Education Savings Plans, previously known as Scholarship Trust Plans, have existed in Canada for more than four decades as a vehicle to save funds to finance the cost of future post-secondary education of children. Capital was returned to the plan holder, while the income on the capital was paid in the form of a scholarship to students pursuing post-secondary studies at a degree-granting institution. Income earned in the Plan was attributed to the plan holder as earned income, and was taxed. During the 1970s, tax sheltering for funds held in these Plans resulted in the development of Registered Education Savings Plans (RESPs).

Except in special circumstances, proceeds from an RESP may only be used to finance post-secondary education.

In 1998, the federal government created the Canada Education Savings Grant (CESG), which has increased participation in RESPs. Under the program, the government matches up to 20% of the first \$2,000 contributed annually by Canadian residents to an RESP. The Grant may only be paid to students attending approved post-secondary institutions. By the end of 2000, there were approximately 1.7 million RESP contracts with more than \$7.1 billion in assets under administration, up from about 700,000 contracts with about \$2.4 billion in assets three years earlier.

In the event that the RESP plan holder becomes bankrupt, the trustee withdraws the contributions made by the plan holder and the Canada Education Savings Grant is returned to the federal government.

Believing that RESPs serve the public interest by encouraging a more highly educated population, some have argued that RESP funds should be exempt from seizure in bankruptcy; in their view, federal assistance to RESPs and support through the CESG indicate the importance that is placed on education. Others, however, suggest that granting such an exemption would disadvantage creditors by reducing the moneys available for distribution to them and eroding the principle of a fair distribution of assets in bankruptcy. As well, in their view, RESPs could be viewed as an investment, which should receive the same treatment in bankruptcy as other investments.

Believing that RESPs serve the public interest by encouraging a more highly educated population, some have argued that RESP funds should be exempt from seizure in bankruptcy ...

The Committee received testimony from the RESP Dealers Association about the treatment of Registered Education Savings Plans when the plan holder becomes bankrupt. The Association suggested that, with the rapidly increasing costs of post-secondary education, “RESPs are often the only secure investment vehicles that children have to fund their post-secondary education needs. Against this background, all funds (principal, interest, CESG) should be

fully protected and shielded from creditor seizure in the event of a bankruptcy filing.” In its view, “the concept of shielding RESPs from creditor seizure is akin to shielding life insurance policies which already receive protection.” According to the Association’s calculations, the maximum that would be shielded from creditors over a span of an average Plan duration of 15 years would be \$19,649 in principal, interest and Canada Education Savings Grant contributions.

The Association also noted the need to strike an “equitable balance ... between the promotion of consumer protection rights and securing the rights of creditors.” From this perspective, it recommended that any new RESP opened, or any non-standard principal contributions made, within one year or less of the date of bankruptcy filing should not be accorded any level of protection. Finally, because of the existence of different client categories, it recommended different levels of protection for the custodial parents of a beneficiary and persons other than the custodial parents of the beneficiary.

The Committee, too, supports the notion of a highly educated workforce and believes that there is a federal role in this regard. In our view, however, it is not appropriate for the funds in an RESP to be entirely protected from seizure in the event of the plan holder’s bankruptcy. In addition to the CESG, the federal government has a variety of grants and loans that assist students in pursuing post-secondary education. In this instance, our focus is on fair treatment for both creditors and the beneficiaries of RESPs. Fairness for creditors suggests that the moneys available for distribution to them should be as great as is reasonably possible, while fairness for the beneficiaries of RESPs suggests that they should be able to access moneys that have been saved for their education. We believe, as we did with RRSPs, that the funds should be locked in as a means of ensuring that they are used for the intended purpose – education – and that contributions in the year prior to bankruptcy should be available to satisfy creditors claims, since those contributions

In our view, however, it is not appropriate for the funds in an RESP to be entirely protected from seizure in the event of the plan holder’s bankruptcy.

could reasonably have been available to pay debts.
Consequently, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to exempt funds in a Registered Education Savings Plan from seizure in bankruptcy, provided that two conditions are met: the Registered Education Savings Plan is locked in; and contributions made to the Registered Education Savings Plan in the one-year period prior to bankruptcy are paid to the trustee for distribution to creditors.

C. Reaffirmation Agreements

A reaffirmation agreement is an agreement between a bankrupt and his or her creditor(s) to reaffirm – or revive – responsibility for pre-bankruptcy debts that have been discharged. Reaffirmation can occur through conduct or through express agreement. The first type of reaffirmation occurs when the bankrupt continues to make payments to creditors following the discharge of the relevant debts; the Court has interpreted this conduct by the bankrupt as re-establishing his or her promise to make payments. The second type of reaffirmation occurs when bankrupts expressly enter into written agreements with creditors to repay discharged debts. The Court is likely to enforce these agreements where sufficient or new consideration is offered, such as the granting of new credit.

A number of considerations exist with respect to such agreements. One issue is the extent to which reaffirmation agreements of either type are occurring within Canada. No data are available, although anecdotal evidence suggests that reaffirmation is occurring as a condition of new credit. As well, there may be reasons why a discharged bankrupt might want to make payments voluntarily; consider, for example, loans that have been made by relatives or creditors with whom the debtor has had a longstanding relationship. There is some concern that reaffirmation of discharged debt undermines the fresh start principle, although it may be the sole means by which a bankrupt can obtain credit and in some cases may be in the best interest of both parties.

At present, the BIA is silent on the issue of reaffirmation agreements, although the Court has permitted such agreements in certain circumstances.

The Committee received arguments from witnesses both for and against reaffirmation agreements. Regarding reaffirmation by conduct, the Personal Insolvency Task Force told the Committee that “bankrupts did not, in general, intend to reaffirm their pre-bankruptcy promises; instead, they

No data are available, although anecdotal evidence suggests that reaffirmation is occurring as a condition of new credit.

[The Committee learned that] there is also the danger that discussions between debtors and creditors may occur at a point of relative vulnerability of debtors, who might be susceptible to pressure.

probably continued to make the payments in order to retain possession of the leased or mortgaged asset and did not appreciate that they were reaffirming their covenant to pay.” It recommended that reaffirmation agreements in respect of unsecured transactions be prohibited in all circumstances and prohibited except subject to certain conditions in respect of secured transactions; the conditions are related to such matters as the possession of the asset when the written reaffirmation agreement is signed, limits on the amount that can be reaffirmed, time limits within which reaffirmation can occur, and an opportunity for a bankrupt to rescind a reaffirmation within a certain period of time.

The Task Force also believed that it should be an offence, under the BIA, for a creditor who knows about a bankrupt’s discharge to accept payment of any indebtedness released upon the bankrupt’s discharge, except in certain circumstances, including voluntary payments made by a discharged bankrupt to a relative. Moreover, it recommended that reaffirmation not occur through the continuation of payments or through any other conduct, since decisions by bankrupts in this regard may be uninformed. In general, the Task Force’s view was that reaffirmations are inconsistent with the fresh start principle. There is also the danger that discussions between debtors and creditors may occur at a point of relative vulnerability of debtors, who might be susceptible to pressure.

Supporting the general thrust of the Task Force – if not its recommendations, which they view as too complex and probably unworkable in practice – Professors Ziegel and Telfer shared their view that “abuses in reaffirmation agreements need to be curbed.” They identified the need for further study of existing reaffirmation practices in Canada.

The Canadian Bar Association supported only the Task Force’s proposal with respect to reaffirmation by conduct, arguing that “[r]eaffirmation should not occur through unconscious or unknowing acts,” and expressed concern about limiting the individual autonomy of Canadians without exploring other, less intrusive, means of controlling the alleged

abuse. In its view, “there is insufficient evidence or justification at this time to warrant regulating voluntary reaffirmations at all.”

The Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada, on the other hand, did not support the Task Force’s position, and advocated greater study into the scope and frequency of reaffirmation agreements and the correct policy response.

Omega One Ltd. told the Committee that, in its opinion, there are “very few attempts by arm’s-length creditors to obtain payment for an unsecured debt that was previously discharged by bankruptcy. ... In our experience, this practice (while very rare) is usually generated by a customer request. ... Canadian credit providers will usually accept gratuitous repayment for previously discharged debts, but the offer must come from the customer and there must be no coercion.” Perceiving that this situation is not problematic, the organization felt that legislative provisions are unnecessary.

The Canadian Bankers Association, too, argued that “[t]here should be no legislation put in place to prohibit such agreements. It should be left to individual consumer choice whether they wish to repay a debt after that debt has been extinguished. ... Some borrowers want to redeem their standing with a particular creditor and this should be allowed.” It suggested that credit counselling can be used to “prevent unscrupulous creditors from taking advantage of bankrupts.”

The fresh start principle is a hallmark of insolvency law in Canada. From this perspective, individuals who declare bankruptcy are able to begin again, with only their non-dischargeable debts. Reaffirmation agreements are inconsistent with this principle. In the Committee’s opinion, banning reaffirmation agreements is simple, consistent with the fresh start principle and supports the objective of fairness in the distribution of assets, which would be undermined if

In the Committee’s opinion, banning reaffirmation agreements is simple, consistent with the fresh start principle and supports the objective of fairness in the distribution of assets ...

some creditors continued to receive payment under such an agreement but others did not. This approach would also contribute to the goal of predictability, since reaffirmation agreements would be disallowed in all cases. For these reasons, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to prohibit reaffirmation by conduct or by express agreement.

D. Summary Administration

Canada has had a simpler and less expensive bankruptcy process for consumer debtors with few assets since 1949. Before the 1992 amendments to the BIA, only debtors with assets valued at less than \$500 could use the summary administration – or simplified – process. Recognizing, however, that many debtors had minimal exempt unsecured assets and that a simpler, less expensive bankruptcy process was needed for them, amendments to the BIA in 1992 raised the asset threshold to \$5,000, thereby enabling more debtors to use the simplified process. Since then, the asset threshold has been increased again, to \$10,000, and the summary administration procedure was used in more than 96% of the bankruptcies administered by the Office of the Superintendent of Bankruptcy (OSB) in 2002, an increase from 83.2% in 1987.

In the summary administration process, some of the requirements of the ordinary process are either streamlined or eliminated; for example, newspaper bankruptcy notices are not required, creditor meetings are held only on request and there is no requirement that inspectors be appointed. The trustee does, however, hold an initial assessment interview with the debtor, send documents to creditors and prepare a report that includes information on the bankrupt's affairs, the causes of the bankruptcy, the debtor's conduct before and after the bankruptcy, and a recommendation regarding whether the debtor should be automatically discharged after nine months in bankruptcy. The OSB and creditors may oppose the trustee's recommendation and/or the debtor's discharge.

The ordinary administration procedure is used where the bankrupt's realizable assets will exceed \$10,000. With this process, creditors meet and may confirm the appointment of the trustee selected by the debtor or may appoint a trustee selected by them. They may provide the trustee with directions about the administration of the bankrupt's estate, and may vote on the appointment of inspectors to assist the trustee.

... the summary administration procedure was used in more than 96% of the bankruptcies administered by the Office of the Superintendent of Bankruptcy (OSB) in 2002, an increase from 83.2% in 1987.

We believe ... that there is a need not only to take action to minimize the number of bankruptcies, but also to ensure that cases that do arise are addressed as effectively and efficiently as possible, while ensuring the ongoing integrity of the insolvency system.

As noted earlier, the Personal Insolvency Task Force made a number of recommendations for change regarding procedural issues in consumer proposals and bankruptcies, many of which would provide a more streamlined and less costly process if adopted, since they would allow the parties involved to choose their level of involvement on the basis of “by exception rather than by rule.” The recommendations are not discussed here, but are presented in Chapters 4 and 5 of its report.

In presenting its view on the summary administration process, the Canadian Bankers Association suggested that the Task Force’s proposal “provides a reasonable balance between keeping costs down and protecting the integrity of the process.” It, too, identified the cost savings that would likely result with streamlining, and noted that these savings should increase disbursements to creditors. Describing the proposed changes as “reasonable and appropriate,” the Canadian Bar Association also advocates the adoption of the recommendations in Chapters 4 and 5 of the Task Force’s report. Finally, the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada argued for an increase in the asset value permitted under summary administration to \$15,000. They believed that the amount should be “updated so as not to exclude people unnecessarily.”

The Committee is aware that bankruptcy cases are rising in Canada, that the Office of the Superintendent of Bankruptcy is facing resource constraints, and that more cases generally means higher costs – both economic and societal – for all. We believe, therefore, that there is a need not only to take action to minimize the number of bankruptcies, but also to ensure that cases that do arise are addressed as effectively and efficiently as possible, while ensuring the ongoing integrity of the insolvency system. In view of our desire to respect the fundamental principles of efficiency and effectiveness, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be reviewed in order to eliminate all unnecessary procedural requirements and to provide parties to a bankruptcy with an opportunity – to the extent possible – to choose their level of involvement in accordance with a “by exception rather than by rule” approach. Moreover, the use of electronic communication should be encouraged in order to simplify and expedite the insolvency process.

E. Non-Purchase Money Security Interests in Exempt Personal Property

In most provinces/territories, creditors can take security on personal property located in a person's home, even though that property would otherwise be exempt under provincial/territorial law from seizure in bankruptcy or in the event of a consumer proposal. For example, consumer loan companies may – as a condition of granting a loan – take a security interest in household goods or vehicles, even if the credit is unrelated to the purchase of those items and the items are exempt from seizure in bankruptcy. This security interest is also known as a lien or a non-purchase money security interest in exempt personal property. It differs from a purchase money security interest, where the goods bought with the credit are the security.

There has been some criticism of this practice, since it is possible that such lenders could threaten to repossess the household property – even if limited in value – in order to perhaps obtain better treatment than other creditors and perhaps more than the property is worth at fair market value. In essence, intimidation may be used by the lien holder to obtain a preference. Trustees may also feel pressured to satisfy lien holders ahead of other creditors in order to ensure that the debtor and his or her family retain their personal property. In general, problems such as these arise in relation to motor vehicles.

The BIA does not contain provisions to protect a bankrupt's personal property that would otherwise be exempt under provincial/territorial law. Provincial/territorial consumer legislation has application to these issues, but some feel that additional controls are also needed.

Witnesses shared a variety of views on this issue. The Personal Insolvency Task Force studied non-purchase money security interests in exempt personal property and

The BIA does not contain provisions to protect a bankrupt's personal property that would otherwise be exempt under provincial/territorial law.

recommended that the BIA be amended to avoid such interests in property that would otherwise be exempt from seizure. In its view, the proposal should apply to consumer proposals as well as bankruptcies, and should “extend to all non-purchase money security interests in exempted property intended for use or consumption of the debtor or the debtor’s family, including apparel, household furnishings and motor vehicles.” Regarding motor vehicles, it believed that the provisions should apply to any motor vehicle owned by a debtor that is exempted from the assets to be divided among creditors. In the event that the value of creditors’ non-purchase money security interests in apparel and household furnishings exceed the value of the exemption provided in the BIA, the debtor should select the items that are to be exempt from seizure; regarding a motor vehicle, the lender should be required to pay the debtor the exempted amount before he or she can enforce the security interest.

Moreover, the Task Force informed the Committee that “the non-uniformity in the provincial treatment of this important aspect of exemption legislation will continue in the foreseeable future [and] justifies the need for a federal provision to ensure that all bankrupts, and those making consumer proposals, will have a uniform level of protection.”

Professors Ziegel and Telfer supported the avoidance of non-purchase money security interests in exempt household goods and vehicles, as did the Canadian Bar Association, the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada.

Expressing a different view, the Canadian Bankers Association opposed any change that would render unenforceable such security interests. In its opinion, if lenders have security over non-household goods, they should be able to realize on the security in accordance with the agreement reached with the debtor; otherwise, credit availability could be reduced and the cost of credit could rise. The Association did, however, support measures that would prevent the use of coercive tactics.

... the Committee believes that the proposal made by the Personal Insolvency Task Force has merit.

Like a number of our witnesses, the Committee believes that the proposal made by the Personal Insolvency Task Force has merit. It would ensure a uniformity of protection across Canada, would safeguard the basic necessities of life for an insolvent debtor and his or her family, and could reduce problems arising from reaffirmation agreements. In essence, the fundamental principles of fairness, predictability and consistency would be assisted. As a consequence, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to prohibit non-purchase money security interests in property that would otherwise be exempt from seizure in bankruptcy. Property should be defined to include exempted property intended for use or consumption by the debtor or the debtor's family, and should encompass apparel, household furnishings and motor vehicles owned by the debtor.

F Mandatory Counselling

At present, first-time bankrupts must undertake two mandatory counselling sessions prior to receiving an automatic discharge from their dischargeable debts; counselling is also required with respect to consumer proposals. Costs are paid out of the bankrupt's estate, which in essence means that creditors are financing the counselling sessions, since the moneys available for distribution are thereby reduced. It is thought that counselling has been effective in: helping insolvent debtors to manage better their financial affairs; changing behaviour; and developing skills and acquiring knowledge. Given the timing of mandatory counselling, however, it is perhaps most useful in helping to avoid future problems; earlier sessions might be considered as a mechanism to help debtors avoid insolvency and thereby reduce the possibility of bankruptcy. As well, it should be noted that a debtor may become insolvent even if he or she has exemplary financial management skills, since insolvency is often related to an unforeseen personal or business event.

In general, the Committee's witnesses supported the concept of counselling. Credit Counselling Canada told us that "individuals who make a consumer proposal or file for bankruptcy [should] be compelled to attend compulsory counselling sessions given by properly trained credit counsellors." In its view, individuals "benefit tremendously" from this counselling, which is "an important component in the financial rehabilitation of individuals."

The organization also shared with the Committee the importance of properly trained counsellors and suggested the establishment of standards in order to ensure some uniformity in the level of counselling; in its view, training must go beyond the BIA Insolvency Counsellor's Qualification Course. Credit Counselling Canada also believed that the timing of the counselling sessions should be re-evaluated, and recommended the addition of a third mandatory session.

A third mandatory counselling session was also suggested by the Union des consommateurs, which

It is thought that counselling has been effective in: helping insolvent debtors to manage better their financial affairs; changing behaviour; and developing skills and acquiring knowledge.

commented more generally on the lack of standardization of the content and duration of these sessions. The group also recommended fines for trustees who fail to give mandatory counselling, with the moneys used “to develop training programs and to support outreach campaigns, or to fund consumers’ associations offering services across Canada.”

Professors Ziegel and Telfer argued that if mandatory counselling provisions are retained, they should be “matched by provisions addressing irresponsible credit granting practices and (i) authorizing courts, *inter alia*, to subordinate creditors’ claims against the estate where the creditor has shown clear carelessness or recklessness in extending credit to the consumer debtor, and (ii) extending the powers of inquiry of the Superintendent of Bankruptcy to include credit granting practices.” In their opinion, there is a “striking disparity between requiring consumer insolvents to receive credit counselling while no restrictions are imposed on the credit granting practices of retailers, lenders, and credit card companies.” They also support federally sponsored studies of the effect of credit counselling on bankruptcy, and credit education for consumers, including earlier in their careers and at the high school level.

Finally, the Canadian Bankers Association supported counselling provided by an independent party in order to ensure that borrowers are educated about their alternatives, and the pros and cons of each. It recommended that consideration be given to amending the BIA to require mandatory independent counselling prior to declaring bankruptcy.

The Committee strongly believes that prevention is better than a cure. While we recognize that insolvency often occurs for reasons completely unrelated to financial management skills, we hold the view that mandatory counselling is important in helping bankrupts to avoid future financial difficulties. The timing and content of counselling is, however, the key to success, and we wonder whether the mandatory counselling required for automatic discharge may be, in some sense, “too little too late.” That being said, we support mandatory counselling as a contributor to the

The Committee strongly believes that prevention is better than a cure. While we recognize that insolvency often occurs for reasons completely unrelated to financial management skills, we hold the view that mandatory counselling is important in helping bankrupts to avoid future financial difficulties.

principles of responsibility and fairness. We, as a nation, have a responsibility to help our citizens avoid financial difficulty, if we can, and citizens have a responsibility to do what they can to avoid the insolvency that has social and economic costs for themselves, their families and our country. In fairness, we must help each other avoid these costs. It is for these reasons that the Committee recommends that:

In fairness, we must help each other avoid [the social and economic] costs [associated with bankruptcy].

The *Bankruptcy and Insolvency Act* be amended to require the completion of mandatory counselling by first-time and second-time bankrupts as a condition of automatic discharge from bankruptcy available after 9 and 21 months respectively. Debtors making a consumer proposal should also undertake mandatory counselling. The nature and timing of mandatory counselling should be examined to ensure its effectiveness.

G. Consumer Liens

Consumer liens exist in order to protect to consumer depositors who may not view themselves as creditors and who do not intend to incur risk.

Consumers often must leave a deposit with a retailer in partial payment for goods or services to be delivered or provided at a later date; in some cases, the consumer will pay for the good or service in full, but will await delivery. If the vendor goes bankrupt before the goods or services are received by the consumer, he or she generally has an unsecured claim and no realistic chance of recovery.

Consumer liens exist in order to protect consumer depositors who may not view themselves as creditors and who do not intend to incur risk. These liens rank ahead of secured claims and protect a particular group of creditors at the expense of other creditors. As well, they may affect the availability and cost of credit. Like non-purchase money security interests, the issue of consumer creditors can be addressed in provincial/territorial legislation.

At present, the BIA contains no provision for consumer liens.

The Consumers Association of Canada made the point that “[i]n commercial transactions (business to business) the assumption is usually made that the parties to a transaction, whether it be a loan or extending credit for the purchase of goods and/or services, are in a position to assess the risk, or to seek appropriate assistance, and make an informed decision. In a consumer to business transaction ... the positions of the participants are not equivalent. Even when following the basic principle of ‘caveat emptor’/buyer beware and avoiding situations which appear to be risky, the consumer is basically at the mercy of the vendor.”

The Association cited examples of consumers who purchase advance tickets to public performances that are subsequently cancelled and air travellers who purchase a ticket to fly on an air carrier that subsequently ceases operations.

Similar situations arise when consumers make deposits on merchandise that is unavailable at the time but will be delivered in the future, and when they purchase goods for future delivery or use. In its view, consumer protection legislation is deficient, and any moneys given to a vendor for future goods or services should be returned; in effect, the moneys have been held in trust and should not be included among the assets seized and subsequently liquidated by the trustee.

The Canadian Bankers Association, however, suggested to the Committee that the BIA should not be amended to enact a consumer lien provision. In its view, such a change would limit credit availability and increase borrowing costs. Moreover, efficiency would be affected, since creditors would be unable to determine accurately the financial position of borrowers.

While the Committee has sympathy for individuals who find themselves disadvantaged when a vendor to whom they have given a deposit or made a purchase for future delivery becomes bankrupt, we believe that it would be inappropriate for the issue to be addressed within federal legislation. As well, it is our view that protecting a particular group of creditors at the expense of other creditors is perhaps unfair, could affect efficiency, and should only occur after very careful consideration of any unintended consequences that might result. For these reasons, the Committee recommends that:

... it is our view that protecting a particular group of creditors at the expense of other creditors is perhaps unfair, could affect efficiency, and should only occur after very careful consideration of any unintended consequences that might result.

The issue of consumer liens continue to be addressed within provincial/territorial consumer protection legislation.

H. Student Loans

Canada has a long history of assisting students who wish to pursue post-secondary education.

Evidence reveals that a minority of student loan borrowers in Canada experience severe difficulty in repaying their student loans, and those that default do so not because they do not want to pay their debt, but rather because their financial situation is such that they cannot pay. Moreover, those that file for bankruptcy and have student loan debt are thought to have a more difficult financial situation than that of the average person who seeks bankruptcy protection.

Canada has a long history of assisting students who wish to pursue post-secondary education. For almost four decades, the federal government has assisted needy students through loans that are interest-free while they are in school, with a six-month grace period after leaving school before interest payments are required. At present, about 350,000 students annually benefit from the federal Canada Student Loans Program, and the majority of these students repay their loans in full and on time. As noted below, those that are unable to do so can access a variety of debt management measures to help avoid bankruptcy. Students may also access provincial/territorial student loan programs.

In the last decade, relatively significant changes have occurred with respect to the treatment of student loans under the BIA, perhaps because of rising levels of default among student loan holders in the early 1990s. In the 1990-1991 period, more than 5,600 borrowers holding \$40.5 million in student loans declared bankruptcy. Five years later, about 11,000 borrowers filed for bankruptcy; they held more than \$100 million in student loans. Over the 1990-1997 period, about 53,000 borrowers declared bankruptcy or participated in a bankruptcy-related event, holding about \$445 million in federal student loans at the time; most did so within seven years after leaving school. This bankruptcy activity meant losses for governments and, through them, for taxpayers.

Prior to 1997, student loan debt was treated in the same manner as other consumer debt; in general, student loans were discharged along with other debt provided the trustee or creditor did not believe that students were abusing the system, in which case they could oppose the discharge or creditors could refuse to accept a consumer proposal.

Amendments to the BIA that took effect in September 1997, however, changed the status of student loan debt and, some believe, moved the insolvency system away from the goal of reducing the extent to which any particular class of creditors receives special treatment under the Act. In particular, student loan debts were made non-dischargeable if a debtor filed for bankruptcy before ceasing full- or part-time studies or within two years after studies were completed. A debtor who went bankrupt during the two-year period could, however, apply to the Court at the end of the period for discharge of his or her student loan debt; the Court could order a discharge if the student demonstrated that he or she had acted in good faith in trying to repay the debt but was unable to do so and repayment would result in significant hardship. Those who filed for bankruptcy after the two-year period could have their student loans discharged in a manner similar to other consumer debt during the bankruptcy process. It is thought that the change was made, in part, in order to safeguard the sustainability of the Canada Student Loan Program.

Also in that year, the federal Budget extended the period for which eligible borrowers meeting certain income requirements could receive interest relief. In particular, the period was increased from 18 to 30 months and made available throughout the loan repayment period. As well, no interest or principal payments are required when receiving interest relief, and interest does not accrue.

Amendments to the BIA in 1998 increased the two-year period during which student debt could not be discharged to ten years. Other changes were also made to the Canada Student Loans Program as a consequence of the 1998 federal Budget, and these were thought to provide students

Amendments to the BIA that took effect in September 1997, however, changed the status of student loan debt and, some believe, moved the insolvency system away from the goal of reducing the extent to which any particular class of creditors receives special treatment under the Act.

with assistance that would help them to avoid bankruptcy induced by their student loan debt. Interest relief periods were again extended, so that students with income below the established income thresholds – which were increased by 9% – could be eligible for up to 54 months of interest relief within the first five years of completing their studies which, when combined with the six-month grace period, allows the deferment of payments on interest and principal for the first five years after leaving school. Moreover, federal income tax credits on interest paid on government student loans were created, and a debt reduction in repayment measure was introduced. Two grant programs were also established, including the Millennium Scholarship Fund providing students with non-repayable grants.

More recently, the 2003 Budget announced enhancements to the debt reduction in repayment program by, among other initiatives, removing the restriction that limited debt reduction to 50% of outstanding debt, so that borrowers are now eligible for an initial loan remission of up to \$10,000, and by creating an additional reduction of up to \$5,000 one year after the initial debt reduction if the borrower is still in financial difficulty, with a further reduction of up to \$5,000 available two years after the first reduction if the financial difficulty continues to exist. Moreover, students who default on their Canada Student Loans or who have declared bankruptcy have access to interest relief.

Views on the treatment of student loan debt in discharge are diverse. Some believe that the ten-year period is too onerous, and that it is inconsistent with the fresh start principle, the public interest aspect of a highly educated workforce and the principle that all types of consumer debt should be treated similarly. Others, however, feel that incentives are needed to prevent abuse and to ensure that governments, and through them taxpayers, do not experience unacceptable loan losses.

The Personal Insolvency Task Force noted arguments both for and against the special treatment of the discharge of student loan debt. Arguments against immediate

Views on the treatment of student loan debt in discharge are diverse.

dischargeability include: former students may be insolvent only temporarily, and do have the ability to repay their loans because they will have higher-than-average income in the future; allowing immediate discharge would increase federal and provincial/territorial government student loan losses; and debt relief – such as the interest and debt relief programs offered by the federal and some provincial/territorial governments – is available to former students that should reduce the extent to which bankruptcy is required.

Regarding these arguments, the Task Force made the point that while the interest and debt relief programs do provide relief that is not available to other debtors, they “are not a replacement for bankruptcy as a method of providing a ‘fresh start.’” Moreover, the Canada Customs and Revenue Agency could also face large losses that “could be relieved by prohibiting debtors from discharging their debts. Why should those making student loans receive special treatment?”

Arguments also exist, however, to support the immediate discharge of student loan debt, including: student loans are no different than other dischargeable consumer debt; the non-dischargeable nature of student debt constitutes discrimination on the basis of age, which is a violation of the *Canadian Charter of Rights and Freedoms*; and some debtors experience particular hardship that makes repayment of their student loans virtually impossible.

After consideration of these arguments, the Task Force recommended that – with respect to both consumer proposals and bankruptcy – the BIA be amended in order to: reduce the length of time prior to discharge of student loans to five years after the conclusion of full- or part-time studies; allow, on the basis of a Court-administered hardship hearing, the discharge of student loans at any time more than one year after the completion of full- or part-time studies; and clarify that partial discharge of student loans is allowed as a consequence of a Court-administered hardship hearing.

Most of the Committee’s witnesses supported the general thrust of the conclusions reached by the Task

Force, and told the Committee that the current treatment of student loan debt is burdensome. From their perspective, the requirement that students must wait ten years before their student loan debt can be discharged is too onerous and should be eliminated or, at a minimum, shortened. Moreover, some believe that student debt should not be treated differently than other debt in bankruptcy, and that the Court should be able to discharge debt more expeditiously in cases of exceptional circumstances.

Credit Counselling Canada argued for a “significant reduction” in the ten-year period, and suggested that “[t]he ten-year period during which discharge ... is not allowed is often a period of social atrophy. With this and often other debts a financially struggling individual faces a form of economic void as he or she wades through the waiting period. The individual is thus neither able to pay the debt, nor is he or she able to move on under the traditional auspices of bankruptcy proceedings. ... [A] person in these circumstances should not face such a needless period of unproductivity.” As well, it believed that student loans should not be treated in a significantly different manner from other dischargeable personal debts.

Professors Ziegel and Telfer also argued for earlier discharge of student loans, and the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada supported the Task Force’s recommendations. The groups also recommended, however, an amendment to the BIA to define clearly what constitutes “studies.” In their view, “[t]here should also be a clear definition of when the bankrupt has left school, perhaps linking the discharge period to the specific study program or period for which the loan was given. This issue requires further study.”

The onerous nature of the ten-year period was echoed by Ms. Viola Doucet, a non-discharged bankrupt with student debt, who told the Committee that “[individuals with student debt] need a way out, and to wait 10 years is not reasonable. Our lives are on hold. That is why we are here today, to

support the change [to] 5 years [and to argue for such individuals] to present themselves [to] a judge to be discharged ... earlier [in exceptional cases], because no matter how long they wait, their situation will not get any better.” The frustration that some individuals with student loans feel was also presented to us by Ms. Lori Gravestock who, with a high level of student debt, said that “[f]iling for bankruptcy seems to be my only option.”

Ms. Doucet’s position was supported by her trustee, Mr. Paul Stehelin, Trustee in Bankruptcy with A.C. Poirier & Associates. He noted that the ten-year threshold was enacted without consultation with stakeholders – a point also made by the Canadian Federation of Students – and argued that the inability of judges to grant a discharge of student loan debt within the ten-year period in cases of exceptional circumstances is “an extraordinary provision.” He, too, supported a reduction from ten years to five years and the ability of judges to discharge student debt in fewer than ten years in cases of hardship.

Mr. Stehelin also addressed the assertion that student debt should be treated differently than other debt because it is made on the “expectation of future earnings.” He argued that “all of the credit card debt that students [are] granted during their student years is on the basis of an expectation of future income. ... [T]here really is no difference between a student loan, a credit card or student line of credit, all of which are made on an unsecured basis and in expectation of future income.”

The Canadian Federation of Students agreed that “there is no doubt that throughout the 1990s students had a more difficult time repaying their loans. ... [S]tudent debt went from an average of \$8,000 in 1990 to \$25,000 in 1998 Tuition fees rose by 126% and grants were eliminated in most provinces. ... The reality is that students were and are taking on huge debt to finance an education. In addition, as a needs based system, those who borrow the most are those that come to the system with the least. ... [T]he social suffering this law has caused continues to mount.”

The frustration that some individuals with student loans feel was also presented to us ...

The Federation also commented on other aspects of the Canada Student Loan Program. The Committee was informed that “[t]hrough students are currently eligible for interest relief for a maximum of 5 years after graduation, eligibility for the program is dependent upon the loan being in good standing. . . . [I]f you don’t miss your payments you are eligible for assistance – such a restriction ignores the reality that for those students with the highest debt, making the payments on the principal is a burden they cannot meet.” It urged the federal government to repeal this “regressive legislation,” and to “enact concrete solutions to address the problem of student debt. Students who borrow under the [Canada Student Loan Program] do so to finance an education and expand their ability to productively participate (sic) in society.”

The Canadian Alliance of Student Associations described the requirement that individuals must wait ten years after leaving school before the discharge of their student debt as “very poor public policy” and noted the lack of public consultation before the two-year period was increased to ten years. Like most witnesses, the group recommended that the BIA be amended to permit the discharge of student loan debt five years after leaving school. It believed that such a change would strike the correct balance between “the protection of the financial sustainability of the Canada Student Loan Program and the need to treat all individuals who have fallen into serious financial misfortune in a fair and compassionate manner.”

A reduction in the ten-year discharge period to five years and the possibility of a hardship hearing were supported by the Canadian Bar Association, which noted its awareness of “the hopelessness of some former students [The ten-year] restriction is not compatible with Canadian values of fairness and equality.”

The Canadian Bankers Association advocated no change in the treatment of student loan debt, and made particular mention of the federal government’s interest relief program.

The Committee believes that investing in a post-secondary education is an increasingly risky undertaking, particularly in the changing environment in which we all live. Students may invest considerable time and financial resources in a chosen course of study, only to find that upon graduation they are unable to find secure, adequately remunerated employment and in their chosen field; some are not able to find employment at all, or find themselves underemployed. As well, some may leave their post-secondary studies prior to graduation. There is, quite simply, no guarantee that the investment made in post-secondary education will yield the expected return on that investment. That being said, our future prosperity as a nation requires a highly educated and highly skilled workforce, which necessitates investments in post-secondary education.

At the same time, the Committee is aware that taxpayers bear a cost for student loans in a number of ways. First, taxpayers – through provincial/territorial and federal governments – pay the interest on student loans from the time when the loan is made until a certain period following graduation, at which point the student borrower begins to pay the interest. Second, taxpayers – again through provincial/territorial and federal governments – bear the costs associated with default on student loans. Moreover, loans are given without consideration of the future ability of the student borrowers to repay their student loan debt, which could be the cause of at least some defaulted loans.

From a public interest perspective, the dual goals of providing incentives for the post-secondary education needed to ensure a properly skilled and educated workforce for our future and of ensuring that taxpayers do not bear an unreasonable cost associated with government-sponsored student loans must be met. While the Committee supports the range of federal initiatives that exist to support post-secondary education, like the majority of our witnesses we believe that the ten-year period is unduly onerous and that judges must have the discretion to act in cases of exceptional circumstances. For a variety of reasons, however, including considerations related to the period of interest relief provided in the Canada Student Loan Program, we do not believe that

The Committee believes that investing in a post-secondary education is an increasingly risky undertaking, particularly in the changing environment in which we all live.

a two-year period is appropriate. Moreover, we are convinced that, in circumstances of undue hardship, earlier discharge is appropriate. The changes we recommend will, in our view, contribute to fairness for both students and taxpayers, and contribute to accessible post-secondary education for more of our residents. From this perspective, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to reduce, to five years following the conclusion of full- or part-time studies, the length of time prior to permitting the potential discharge of student loan debt. As well, the Act should allow the Court the discretion to confirm the discharge of all or a portion of student loan debt in a period of time shorter than five years where the debtor can establish that the burden of maintaining the liability for some or all of the student debt creates undue hardship.

I. Discharge from Bankruptcy and the Treatment of Second-Time Bankrupts

Prior to discharge from bankruptcy, a debtor's trustee in bankruptcy files a report with the Superintendent of Bankruptcy summarizing the material aspects of the bankruptcy, including the debtor's conduct during the bankruptcy and the factors contributing to his or her bankruptcy. The trustee must also report on whether the debtor has made any surplus income payments required and whether he or she could have made a viable consumer proposal.

At present, the BIA allows first-time bankrupts to receive an automatic discharge from bankruptcy nine months after filing for bankruptcy, provided that they undertake mandatory counselling and that there are no objections by creditors, the Superintendent of Bankruptcy or the trustee. When the discharge occurs, bankrupts are relieved from liability for their debts, with exceptions. Most of the non-dischargeable debts listed in the BIA have a public policy perspective that outweighs the importance of providing bankrupts with a completely fresh start following their discharge from bankruptcy. Included among non-dischargeable debts are: fines imposed in respect of an offence; debt for alimony or child support; and student loan debt, unless the bankruptcy is filed more than ten years after the debtor has left school.

Creditors rarely oppose the automatic discharge from bankruptcy, although trustees may do so because of misconduct – such as failure to attend mandatory counselling sessions – or because the bankrupt has not contributed funds adequate to pay administrative costs and/or trustee fees. Where opposition to the discharge does occur, a judge or Bankruptcy Registrar will hold a hearing, and may delay or refuse the discharge; he or she may also make a conditional order requiring that the debtor make future payments.

At present, the BIA allows first-time bankrupts to receive an automatic discharge from bankruptcy nine months after filing for bankruptcy, provided that they undertake mandatory counselling and that there are no objections by creditors, the Superintendent of Bankruptcy or the trustee.

Debtors who are bankrupt for the second time are currently not eligible for an automatic discharge. They must appear before the Court in order to seek a discharge, even when no opposition has been filed. It is estimated that about 10% of debtors filing for bankruptcy have been bankrupt on a previous occasion.

The Personal Insolvency Task Force told the Committee that “the workload of the courts remains high in many areas. ... Any future increase in the number of bankruptcies would make it even more difficult for the courts to deal with discharges of bankrupts who are not eligible for an automatic discharge.” It believes that the BIA should be amended to permit second-time bankrupts to be eligible for an automatic discharge 24 months after filing for bankruptcy, assuming there is no opposition; in situations of hardship, the bankrupt could apply to the Court to vary the duration of the bankruptcy. This change would “ensure that there is still a discernible and transparent consequence to individuals using the bankruptcy process for a second time.” In its view, the Court should deal with discharges for third or subsequent bankruptcies on a case-by-case basis.

While the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada supported automatic discharge for second-time bankrupts, they recommended that the time period be 18 months from the date of filing for bankruptcy if more than five years have passed since the date of discharge of the previous bankruptcy; the 24-month period suggested by the Task Force should apply otherwise.

Omega One Ltd. told the Committee that the period of bankruptcy should be extended to a minimum of 15 months for all bankrupts – “if only to extend the discharge period beyond the twelve-month income tax cycle” – and for a period of 21 months for debtors who are able to make a contribution to their estates. The organization also noted that “all other countries with a bankruptcy discharge mechanism (except for

one US program) have a longer bankruptcy period than Canada.” In Omega One Ltd.’s opinion, attention must be paid by legislators to “the growing misuse of the insolvency system by individuals who set out to take full advantage of a planned bankruptcy by obtaining property and cash soon before their assignment date.”

The Committee believes that most bankruptcies occur as a consequence of events that are largely outside of the control of the bankrupt. While financial mismanagement may be a contributing factor, it alone is unlikely to result in bankruptcy in the absence of some other event. Given the unpredictable and uncontrollable nature of the events that may have bankruptcy as a consequence, we feel that the principle of fairness would suggest that we allow second-time bankrupts the opportunity for an automatic discharge, with the same possibility for opposition that exists for first-time bankrupts, but that their period prior to discharge from bankruptcy be relatively longer and that mandatory counselling be required. From this perspective, the Committee recommends that:

The Committee believes that most bankruptcies occur as a consequence of events that are largely outside of the control of the bankrupt.

The *Bankruptcy and Insolvency Act* be amended to provide automatic discharge from bankruptcy after 21 months for second-time bankrupts who have completed mandatory counselling. The Superintendent of Bankruptcy, the trustee or any interested party should have the opportunity to oppose the automatic discharge, in the same way that the discharge of a first-time bankrupt can be opposed, thereby requiring a Court hearing.

J. Contributions of Surplus Income to the Bankrupt's Estate

... trustees are obliged to collect a prescribed portion of the bankrupt's surplus income for the benefit of the debtor's estate and, thereby, of creditors.

Since amendments to the BIA in 1997, trustees are obliged to collect a prescribed portion of the bankrupt's surplus income for the benefit of the debtor's estate and, thereby, of creditors. In determining the amount of the surplus income, the trustee considers the bankrupt's personal and family situation, and calculates the amount of surplus income with reference to standards published by the Superintendent of Bankruptcy; these standards are based on the Low Income Cut-Offs published annually by Statistics Canada. Estimates suggest that 15-20% of bankrupts have surplus income and, as such, are required to make surplus income payments.

Trustees can recommend terms of discharge from bankruptcy that require the payment of up to 12 additional monthly payments for bankrupts with surplus income. The decision made by the trustee will be based on: whether the bankrupt has met his or her surplus income obligations during the period of bankruptcy; the amount paid to the estate in relation to total liabilities; and whether the bankrupt could have made a viable consumer proposal rather than pursue bankruptcy. This discretion allows a lack of uniformity, and could give debtors an incentive to select a trustee that is unlikely to require additional payments.

In commenting on this issue, the Personal Insolvency Task Force indicated to the Committee that "bankrupts with the financial means to contribute more to their estates should ... do so, and ... additional payments should be made in almost all cases for a standard 12 months." With the current nine-month period prior to discharge from bankruptcy, the result would be a duration of 21 months for bankrupts with surplus income. It believed that trustees should recommend that bankrupts with surplus income make 12 additional months of surplus income payments to their estate, and that this requirement should be included in a directive to be developed by the Superintendent of Bankruptcy, rather than included in the BIA; the directive should specify the criteria to be used in

determining the number and amount of additional payments, but should give trustees limited discretion in cases where the additional payments would create hardship.

The Task Force's proposal was supported by the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada, although they questioned whether 12 months is the appropriate length of time and expressed concern that no studies have been done to support the rationale. In their view, "[f]urther study and data are required in order to consider the number of months that may be appropriate."

In the view of Omega One Ltd., bankrupts who are able to make surplus income payments – estimated to be 15% of bankrupts – could have made a consumer proposal but, instead, selected bankruptcy; those with the financial ability to make a reasonable contribution to their creditors should be required to do so. The organization believed that "[c]onsumers who feel a need to obtain a new car, or some other desirable item, are quite prepared to commit to credit contracts lasting 36 or 48 months. It is not unreasonable to expect bankrupts who want a discharge to make (geared to income) payments for 21 months." Similarly, the Canadian Bankers Association supported allowing bankrupts with sufficient income to make reasonable contributions to their creditors.

Professors Ziegel and Telfer disagreed with those who advocated giving trustees the power to postpone a bankrupt's discharge from nine months to 21 months where he or she has surplus income.

The Union des consommateurs argued for flexibility in the formula used to calculate the surplus income. In addition to the need to make adjustments to recognize changes in the cost of living, the group suggested that there should be "some leeway ... in [cases of] unforeseen events."

The Committee, in the interests of fairness and responsibility, believes that bankrupts with surplus income

... we believe that trustees should have the flexibility to modify the payments to relieve undue hardship ...

should be required to make contributions to their estate that would increase the moneys available for distribution to creditors; an additional 12 months appears to be an appropriate length of time. In our view, there is some truth in the notion that these individuals could, perhaps, have made a consumer proposal that would likely involve greater recovery for creditors than is likely to be the case with bankruptcy. We also feel, however, that circumstances may arise where unforeseen events make continued surplus income payments to his or her estate difficult for a bankrupt; in these situations, we believe that trustees should have the flexibility to modify the payments to relieve undue hardship, since this too seems fair. Consequently, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to require bankrupts with surplus income to contribute to their estate for a total of 21 months. Trustees should have the discretion to permit a shorter contribution period in cases of undue hardship. Surplus income should continue to be determined in accordance with the directive of the Superintendent of Bankruptcy. The discharge of the debtor should not be delayed merely because of the obligation to continue to contribute for a total of 21 months. In appropriate circumstances, a trustee should be able to seek a summary judgment to require such payments.

K. Voluntary Agreements to Make Post-Discharge Payments

Until recently, when a filing for bankruptcy was made, a debtor and his or her trustee typically entered into an agreement providing that the debtor would make payments to his or her estate which would then be distributed to creditors in accordance with the BIA, and the payments could extend into the period after the bankrupt's discharge. Except in specific situations, the payment of trustees' fees and other administrative costs have the first claim. Trustee fees may be determined by creditors or by a tariff based on a percentage of the total value of realized assets.

A 1999 ruling held that such agreements were not enforceable, and limited the flexibility of arrangements between trustees and bankrupts regarding payment arrangements. Consequently, it was less certain that trustees would receive fair and adequate compensation for their services.

The payment of trustee fees may be a barrier to access to the bankruptcy process for some debtors, since trustees who believe that it may be difficult to collect fees may require an advance or security as a condition for accepting the case. Access is, however, facilitated by the OSB's Bankruptcy Assistance Program, through which trustees may voluntarily provide free services to debtors unable to afford the fees of a trustee.

The Personal Insolvency Task Force considered a number of options for increasing the probability of adequate payment for trustees, including an across-the-board lengthening of the period before a bankrupt would be eligible for a discharge and a guarantee of compensation for services. It felt that the bankrupt's application for discharge should not be opposed by the trustee solely because of inadequate funds to pay trustee fees or the costs of administration of the bankruptcy, and that what was needed was not a guarantee of payment for trustees but rather a means by which the probability of payment was greater. In the end, it

Access [to the insolvency system] is ... facilitated by the OSB's Bankruptcy Assistance Program, through which trustees may voluntarily provide free services to debtors unable to afford the fees of a trustee.

recommended that the BIA be amended to “allow trustees to enter into voluntary payment agreements with bankrupts who do not have surplus income.”

Moreover, in the Task Force’s view, there should be a “ceiling on the payments made through these ... agreements ... related to the sum of trustees’ fees and other administrative costs of the bankruptcy.” Any agreement reached between the bankrupt and his or her trustee should not cause undue hardship for the bankrupt, and there should be a maximum 12-month limit on the time during which additional voluntary payments would be made. Failure by the bankrupt to sign such an agreement could result in opposition, by the trustee, to the discharge. The Task Force’s views on the issue of voluntary agreements to make post-discharge payments were supported by the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada.

Omega One Ltd. told the Committee that “any agreement between the trustee and the bankrupt for the payment of scale fees and estate expenses should be deemed a non-dischargeable debt. This is the very first commitment that the bankrupt will have made to follow bankruptcy. ... If the former bankrupt is allowed ... to default on the very first contract he [or she] makes following bankruptcy, the rehabilitation effort is severely compromised.”

Finally, Professors Ziegel and Telfer indicated that they do not support fee arrangements between a trustee and a bankrupt enforceable where the debtor’s income is below Statistics Canada’s Low Income Cut-Offs. They also mentioned to the Committee the Federal Insolvency Trustee Agency (FITA), through which – in the past – the federal government made low-cost bankruptcy services available through regional offices of the OSB. Although the FITA no longer exists, they recommended that it be revived in order to administer bankruptcies for insolvent persons whose income falls below the level of the Low Income Cut-Offs and who cannot afford the fees of private trustees.

The Committee believes that trustee fees may be a barrier to access for some insolvent debtors. Mindful that in Chapter Two we identified accessibility as a fundamental principle that we would like to characterize Canada's insolvency system, we believe it is appropriate that bankrupts be permitted to make an agreement with their trustees that would allow the payment of trustee fees following the discharge of the bankruptcy, with a limit placed on the amount of any such agreement. If accessibility to the insolvency system is to be a right, rather than a privilege, these agreements must be permitted. For this reason, the Committee recommends that:

If accessibility to the insolvency system is to be a right, rather than a privilege, [voluntary agreements to make post-discharge payments] must be permitted.

The *Bankruptcy and Insolvency Act* be amended to allow trustees to enter into voluntary payment agreements with bankrupts who do not have surplus income. Fees payable to the trustee in accordance with such an agreement should not exceed the minimum legal amount established for summary administration bankruptcies.

L. Non-Dischargeable Credit Card Purchases

It has been argued that – according to a practice known as “bulking up” – some debtors purposely make “luxury” or non-essential purchases on their credit cards to the maximum of their credit limit, knowing that they will soon file for bankruptcy.

Omega One Ltd. told the Committee that it routinely sees cases where credit card users appear to have “formed an intention to become bankrupt, and who use their cards to the maximum allowed just before going to see a trustee.” The organization believed that Canadian insolvency legislation should include a provision providing for the non-discharge of debt that is “out of character for that particular individual.” This provision would include extraordinary credit usage within a short period before bankruptcy. Similarly, the Canadian Bankers Association suggested that the BIA be amended to make luxury items purchased shortly before bankruptcy non-dischargeable.

Although the Personal Insolvency Task Force considered the issue of non-dischargeable credit card purchases, it argued that this behaviour could best be addressed by the Court on the discharge hearing of the debtor.

... in our opinion, it is not efficient to examine the credit card purchases of every credit card held by the bankrupt prior to bankruptcy with a view to identifying which purchases are “luxury” or non-essential; in any event, this determination would be subjective.

The Committee supports the view of the Personal Insolvency Task Force for a number of reasons. First, we are not convinced that the problem is so severe – in magnitude or frequency – that legislative action is appropriate. Second, in our opinion, it is not efficient to examine the credit card purchases of every credit card held by the bankrupt prior to bankruptcy with a view to identifying which purchases are “luxury” or non-essential; in any event, this determination would be subjective. Third, we support the existing availability of recourses to address these types of occurrences during the bankrupt’s discharge hearing and/or by an accusation of fraud. Feeling that legislative change would not contribute to the

predictability or efficiency we believe should characterize our insolvency system, the Committee recommends that:

The matter of purchases by the debtor of luxury or non-essential goods and services shortly prior to filing for bankruptcy continue to be decided either during the course of a discharge hearing or through an accusation of fraud.

M. International Insolvency

With globalization and increased mobility of labour, there are cases in which Canadians working and living in other countries experience financial difficulties and pursue relief from creditors under the insolvency legislation in their locality.

With globalization and increased mobility of labour, there are cases in which Canadians working and living in other countries experience financial difficulties and pursue relief from creditors under the insolvency legislation in their locality. These individuals may not be entitled to pursue relief under the BIA because they may not meet Canadian jurisdictional requirements for filing, and a foreign filing may not discharge their Canadian debts without a Canadian bankruptcy filing. A foreign bankruptcy discharge does not extinguish debts governed by Canadian law; a similar situation exists with respect to a foreign reorganization order that varies or modifies debt or contracts.

If and when these insolvent debtors return to Canada, any debts incurred here before leaving the country will have survived, and only a bankruptcy filing in Canada will relieve them of these debts. In essence, they will lose their assets – and undergo rehabilitation – twice. These situations may grow in number as globalization and labour mobility continue.

The international insolvency provisions in the BIA are primarily asset-based and the definition of “debtor” is restricted to those having property in Canada, which may not be the case with a foreign-resident Canadian.

Noting that “[t]he current BIA rules ... do not adequately address [the] problem,” the Personal Insolvency Task Force described the current situation as inadequate and argued that the BIA should recognize the discharge or compromise of an individual’s unsecured debts through a foreign bankruptcy proceeding, although with safeguards against abuse and violations of policy-based exemptions from discharge in Canada law. A second option would be extending jurisdictional requirements in the BIA so as to allow non-residents to have access to the Act’s remedies.

The Task Force recommended that the BIA be amended to add a provision that would recognize the effect of a foreign discharge or compromise of debt provided that certain conditions are met. In particular, it believed that individuals should be provided with the opportunity to bring proceedings to recognize a discharge or compromise of unsecured debt granted under foreign bankruptcy proceedings. Discharge or compromise of unsecured debt effected by a foreign bankruptcy proceeding should be recognized if: there is a real and substantial connection with the foreign jurisdiction; the recognition will not violate Canadian norms of public policy; the foreign procedure was not unfair or prejudicial to creditors; and the personal exemptions used by the debtor in the foreign proceedings are substantially similar to those in Canada. No claim that survives discharge under the BIA should be extinguished by the foreign discharge. This proposal was supported by the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada, and the Canadian Bar Association also advocated the creation of a remedy for cross-border personal insolvency.

Professors Ziegel and Telfer shared a different view with the Committee. They argued that “recommendations involving the recognition of foreign personal insolvencies in Canada are both unnecessary and too complex.”

Globalization and labour mobility are realities for Canada, as they are for many other countries, and are – in part – a logical consequence of some of the trade agreements that Canada negotiates. With enhanced labour mobility comes the increased possibility of international insolvency and bankruptcy by consumers having debts in more than one jurisdiction. The Committee believes in fairness and in the principle of a fresh start for bankrupts. We also support the notions of effectiveness and efficiency. All of these principles would be furthered through the development of a mechanism that would recognize insolvency filings experienced by foreign-resident Canadians, where those filings have occurred in countries that have a similar – but not necessarily identical

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With enhanced labour mobility comes an increased possibility of international insolvency and bankruptcy by consumer having debts in more than one jurisdiction.

insolvency system and approach to that which exists in Canada. We feel that foreign-resident Canadians who become bankrupt should not have to lose their assets twice, and that the Canadian insolvency system should not have to use its limited resources to duplicate a process that has already occurred in a “like-minded” country, if you will. Consequently, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to recognize the effect of a foreign discharge or compromise of debt with respect to an individual, provided certain conditions are met. The conditions should be: the bankrupt foreign-resident Canadian has a real and substantial connection with the foreign jurisdiction; the foreign procedure is fair and non-prejudicial to creditors; and the personal exemptions used by the bankrupt foreign-resident Canadian in the foreign proceedings are substantially similar to those in Canada.

N. Debt Forgiveness by the Canada Customs and Revenue Agency

When filing for bankruptcy, a year-end date for the bankrupt is established, for income tax purposes, as the day of bankruptcy, and debt owed to the Canada Customs and Revenue Agency (CCRA) is determined by what is owed on this date. This debt is typically discharged along with other dischargeable debts.

The situation is different, however, for those who pursue the consumer proposal option. Since there is no year-end date, the CCRA holds the view that debt owed for income tax between the beginning of the calendar year and the date of the proposal is not a pre-proposal debt that can be compromised in the proposal; rather, it is a post-proposal debt that cannot be included in the proposal and consequently must be paid in full.

The Personal Insolvency Task Force shared with the Committee its belief that this differential treatment could create, for some insolvent debtors, an incentive to file for bankruptcy rather than to pursue a consumer proposal. In its view, “[l]ogic would dictate that provisions of the *Income Tax Act* should not encourage bankruptcies over proposals.” It noted that similar incentives to pursue bankruptcy rather than reorganization are provided in the *Income Tax Act* for small business owners because of the Act’s treatment of forgiven debt.

To resolve these perverse incentives, the Task Force recommended that “[f]or consumer proposals, ... the year-end date for income tax purposes for individuals be the date when the proposal is filed with the Official Receiver. For commercial proposals, ... the year-end date should be the earlier of (a) the date of filing of the notice of intention to file a proposal and (b) the date of filing of the proposal with the Official Receiver.” Moreover, “the ‘debt forgiveness’ provisions found in section 80 of the *Income Tax Act* should

Since there is no year-end date, the CCRA holds the view that debt owed for income tax between the beginning of the calendar year and the date of the proposal is not a pre-proposal debt that can be compromised in the proposal; rather, it is a post-proposal debt that cannot be included in the proposal and consequently must be paid in full.

not be applicable to individuals who file proposals under the BIA.”

The Canadian Bar Association told the Committee that, in light of the “considerable frustration with the problems presented by the discrepant tax treatment of proposals as opposed to bankruptcy,” it supported the Task Force’s recommendation. In the Association’s view, the “discrepancy has no apparent foundation in policy” and “prevents many well-intentioned debtors from addressing their obligations through a proposal, and forces them into bankruptcy despite the clear policy goals of the BIA.”

Support for the Task Force’s position was also expressed by the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada, which told the Committee that “[t]he codification of a deemed tax year-end period for personal proposals would enhance ease of administration and allow for greater consistency in how these periods are treated. ... By recognizing a deemed tax year-end at the date of the proposal, the tax liabilities would be clearly and easily identified within the proposal, creating certainty as to the debtor’s liabilities.”

The Committee believes that the insolvency system should not be structured in such a manner that debtors are provided with an incentive to pursue a filing for bankruptcy rather than a consumer proposal.

The Committee believes that the insolvency system should not be structured in such a manner that debtors are provided with an incentive to pursue a filing for bankruptcy rather than a consumer proposal. These incentives do not serve debtors well, given the social and economic costs of bankruptcy, but nor do they serve the interests of creditors, who are likely to experience a lower level of recovery with bankruptcy than they would with a consumer proposal. Believing that the tax change recommended by the Personal Insolvency Task Force would create the proper incentives and thereby contribute to fairness, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to provide that, for consumer proposals, the year-end date for income tax purposes is the date on which the proposal is filed with the Official Receiver. For commercial proposals, the year-end date should be the earlier of: the date of filing of the notice of intention to file a proposal; and the date of filing of the proposal with the Official Receiver. Moreover, the *Income Tax Act* should be amended to ensure that the debt forgiveness provisions in Section 80 of the Act are not applicable to individuals who file proposals under the *Bankruptcy and Insolvency Act*.

O. *Ipso Facto* Clauses

[Ipso facto clauses] can mean that consumers lose access to essential services and facilities, including banking and utilities.

Consumer agreements with some creditors contain a provision that permits the non-consumer party to terminate the agreement immediately in the event of the consumer's bankruptcy, even if he or she has met all obligations under the agreement. Referred to as *ipso facto* clauses, these provisions can mean that consumers lose access to essential services and facilities, including banking and utilities.

While the BIA nullifies these clauses with respect to consumer proposals, the Act's provisions do not affect the right of the non-consumer party to terminate the agreement if it is violated after a consumer proposal is filed. Moreover, the non-consumer party can apply to the Court for relief if the debtor's avoidance of the *ipso facto* clause will cause it undue hardship. The BIA does not nullify these clauses with respect to consumer bankruptcies.

Believing that there is “no good reasons why this distinction between consumer proposals and consumer bankruptcies should be maintained in the BIA,” the Personal Insolvency Task Force shared with the Committee its recommendation that the BIA be amended to provide that *ipso facto* clauses can be nullified with respect to consumer bankruptcies. Avoidance of *ipso facto* clauses in contracts for the supply of utilities and other essential services was also supported by Professors Ziegel and Telfer, the Canadian Bar Association, the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada.

A different view was shared with the Committee by the Canadian Bankers Association, which “does not agree that a lender should be prevented from accelerating repayment under, and otherwise terminating, a loan agreement because the borrower is in bankruptcy.” In the event of bankruptcy, the Association believed that an *ipso facto* provision should be

restricted to the ability to maintain a bank account and other basic banking services. In its opinion, the BIA should not have a provision that would prohibit *ipso facto* clauses for bankruptcy.

The Committee agrees with most of our witnesses, and believes that no distinction should be made between proposals and bankruptcies with respect to *ipso facto* clauses; to maintain otherwise would diminish consistency. Moreover, we feel that these clauses should be unenforceable in order to ensure that debtors continue to have access to the basic services that they and their families need. From this perspective, the Committee recommends that:

The Committee ... believes that no distinction should be made between proposals and bankruptcies with respect to ipso facto clauses; to maintain otherwise would diminish consistency.

The *Bankruptcy and Insolvency Act* be amended to provide that *ipso facto* clauses in agreements for basic services are not enforceable with respect to consumer proposals and consumer bankruptcies.

P. Credit Reporting

Canada's credit reporting agencies assist credit grantors in their assessment of the degree of risk associated with granting credit in any particular case. This assistance takes the form of credit reports on credit applicants, who are rated using letters and numbers to describe a particular applicant's credit worthiness.

Credit reporting agencies assign bankrupts the lowest credit rating – R-9 – which may prevent them from receiving credit, although the decision to grant credit is always at the discretion of the credit grantor. This score may remain on the bankrupt's record for six years following the date of filing for bankruptcy, although it may be upgraded to R-7 two years after the debtor has successfully completed a mandatory counselling program. Since 1992, mandatory credit counselling has been required for first-time bankrupts seeking an automatic discharge from bankruptcy. With an R-7 rating, some credit grantors will once again give credit to a credit applicant.

When consumer proposals were introduced in 1992, debtors using this option were assigned an R-9 rating for three years following the successful completion of their proposal. Since proposals often last three years, however, debtors who make successful proposals are penalized through facing an R-9 credit rating for the same length of time as bankrupts, even though their creditors recover more than would have been the case in bankruptcy. In fact, depending on the length of the proposal, it is possible that debtors with successful proposals will have an R-9 rating for a longer period of time than debtors who choose bankruptcy. This situation seems to be inconsistent with the notion that debtors should be encouraged to pursue consumer proposals rather than bankruptcy.

[The situation with respect to credit rating] seems to be inconsistent with the notion that debtors should be encouraged to pursue consumer proposals rather than bankruptcy.

To rectify what it sees as an anomaly, the Personal Insolvency Task Force recommended the initiation of formal discussions between the Office of the Superintendent of

Bankruptcy, credit scoring agencies and those who use their services in order to develop “a protocol that would ensure that debtors who make successful proposals have adverse credit ratings for a shorter time than debtors who go into bankruptcy.” In the event that these discussions do not bring about the desired result, the Task Force recommended that legislation be enacted to limit the extent to which a credit scoring agency can maintain an adverse credit score for a debtor who has made a successful consumer proposal; this period should be limited to no more than two-thirds of the amount of time that a bankrupt has an R-9 rating. In the event of an unsuccessful proposal, the R-9 rating would remain in force for as long as would have been the case had the debtor selected bankruptcy.

Believing that enhanced incentives to encourage debtors to undertake proposals are needed, the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada expressed their support for the Task Force proposal. They also indicated, however, that in situations where the debtor files a proposal that fails and a bankruptcy is filed shortly thereafter, “[t]he bankrupt should not be penalized for having attempted a proposal that subsequently failed.” Otherwise, the debtor could have an adverse credit rating that is longer than if he or she had made an assignment in bankruptcy immediately, rather than attempting a proposal. The Canadian Bar Association also indicated its support for the Task Force proposal.

The Canadian Bankers Association shared with the Committee its belief that “debtors with successful consumer proposals should be accorded consumer reports that are less derogatory than those that go into bankruptcy ... and ... the rating reflected on a consumer’s credit report should reflect the level of relief that they have undertaken to address their financial difficulties.” In particular, it believed that “[f]ull bankruptcy should receive an R-9 rating for the full seven years, a consumer proposal should receive a less derogatory rating for a lesser time period, and a consumer that has fulfilled an orderly payment of debt program or debt management program from a credit counselling (sic) should

receive an even less derogatory rating for less time than the previous two options.” Similarly, in the view of Omega One Ltd., “[c]onsumer [p]roposal debtors should be accorded consumer (credit) reports that are less derogatory than those for bankrupt consumers.”

The Canadian Bankers Association believed that this treatment of ratings would give consumers an incentive to enter into a credit counselling proposal before filing for bankruptcy. The Association also told the Committee that decisions about the credit rating assigned to debtors with successful consumer proposals should be left to negotiations between credit bureaus and provincial/territorial governments, and not addressed through legislation.

At the very least, we should not permit legislative, administrative and procedural measures to give debtors an incentive to choose bankruptcy rather than a consumer proposal.

In the Committee’s view, debtors should have appropriate incentives to pursue consumer proposals, when that is preferable to bankruptcy for them. At the very least, we should not permit legislative, administrative and procedural measures to give debtors an incentive to choose bankruptcy rather than a consumer proposal. We believe that successful proposals represent a win-win situation: the debtor does not become bankrupt and presumably is better able to attain credit in the future, and creditors are likely to recover greater moneys than would be the case if the debtor became bankrupt.

The Committee does not, however, believe that credit rating agencies should be statutorily compelled to implement a strict regime with designated ratings for bankrupts, debtors who have made a successful consumer proposal and debtors who have made a consumer proposal that has not succeeded. In the interests of fairness for debtors, credit grantors, credit rating agencies and other stakeholders, we are wary of federal legislative intervention in this area and we are concerned that constitutional issues with respect to property and civil rights might well arise. Nevertheless, the Committee feels that the current credit rating system contains perverse elements and does not reward efforts by insolvent debtors to honour a greater portion of their obligations than would be the case if

such debtors were to go into bankruptcy. In some sense, fairness is lacking. As a result, the Committee recommends that:

The Office of the Superintendent of Bankruptcy take a leadership role in convening a meeting among credit granting agencies, credit grantors, provincial/territorial representatives and other relevant parties with a view to negotiating a mutually acceptable credit scoring regime.

Q. Inadvertent Discharge of Selected Claims in Proposals

Section 178 addresses, among others, those holding claims for: support arrears; fraud or misrepresentation; a restitution order; or damages for intentional bodily harm.

The BIA provides that if a consumer proposal or a commercial reorganization is accepted by creditors and approved by the Court, it is binding on creditors in respect of all unsecured claims, but it does not release the insolvent debtor from the debts and liabilities referred to in Section 178 of the Act, unless the creditor agrees. Section 178 addresses, among others, those holding claims for: support arrears; fraud or misrepresentation; a restitution order; or damages for intentional bodily harm. Consequently, with the agreement of the holder of a claim, debts and liabilities in Section 178 may be released, and agreement will end non-dischargeable pre-proposal claims other than those paid through the proposal.

The Personal Insolvency Task Force believed that there is a technical problem with the BIA in connection with the discharge of Section 178 claims in proposals. It raised the question of the meaning of “assent,” and argued that the Court has not historically interpreted the provision to require, for Section 178 claims to be ended, the claimant to specifically agree to waive Section 178 protection.

The Task Force believed that “[i]t was definitely not the intention of the 1997 BIA support amendments to prohibit or deter support claimants from participating in bankruptcy proposals” and that “[b]ecause of the important public policy reasons that underlie the Section 178 exceptions to discharge, and particularly those relating to support, it is essential to protect such creditors from unknowing or inadvertent extinction of their claims through otherwise responsible conduct.” It suggested that the BIA should be amended to revise and clarify these provisions to provide that Section 178 protection is lost in a proposal only if the creditor votes in favour of a proposal which specifically and explicitly provides for the compromise of Section 178 claims. The Task Force’s position was supported by the Canadian Bar Association.

The Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada, however, shared with the Committee their view that the options considered by the Task Force are too limited. They believed that the BIA should be amended so that, in the absence of an affirmative and informed consent by each Section 178 claimant, all Section 178 claims in proposals should survive discharge from bankruptcy. In their opinion, “[t]he public policy objective of Section 178 is that certain debts are not discharged in bankruptcy because of their special nature, including court imposed monetary fines, awards for bodily harm, spousal support, child support, fraud and student loans. The nature of these claims is such that, on balance, the survival of the claim outweighs the possible benefit in the bankrupt being relieved of them. There should not be any differentiation among creditors covered under Section 178.”

The Committee unequivocally supports the general opinion of the witnesses that the BIA must be amended to ensure that the holders of Section 178 claims do not inadvertently or innocently extinguish their rights. Many of these claims, by their very nature, are instrumental to the mental and/or physical health and well-being of groups in society that might be considered relatively vulnerable.

The Committee agrees with the assertion that, in order for Section 178 claims to be ended, those holding the claims must explicitly agree to their termination; termination must not occur because of confusion among stakeholders about what “assent” means and whether the holder of a claim has “assented” to its termination. The law needs absolute clarity in this area, given the particular importance of many of the Section 178 claims. Consequently, believing that fairness must be enhanced, the Committee recommends that:

Many of these [Section 178] claims, by their very nature, are instrumental to the mental and/or physical health and well-being of groups in society that might be considered relatively vulnerable.

The *Bankruptcy and Insolvency Act* be amended to ensure that an insolvent debtor will not be released from the debts and liabilities referred to in Section 178 unless the holder of those debts provides affirmative and informed consent.

R. Bankruptcy and Family Law

In 1997, the BIA was amended to provide for the provability and limited priority for child and spousal support arrears, thereby resulting – in some cases – in the payment of a dividend to the claimant spouse for the arrears where no payment had before existed in the event of the non-claimant spouse’s bankruptcy. Unpaid remaining claims for support arrears, however, survive discharge from bankruptcy. The Office of the Superintendent of Bankruptcy receives a 5% levy on these dividends, as it does in all cases where dividends are paid by trustees to creditors. A Court decision has confirmed that the claimant spouse cannot recover the amount of the levy.

Recognizing the “special vulnerability of support claimants” and “public policy favouring the collection and payment of spousal and especially child support,” Mr. Robert Klotz, of Klotz Associates, recommended that the BIA be amended to ensure that bankruptcy does not prevent support claimants from recovering the total amount of their support arrears from the bankrupt spouse. In his view, the burden of the levy should be borne by the individual paying support, rather than by the recipient of the support payments; otherwise, the support claimant “would suffer from the bankrupt’s choice to declare bankruptcy.” He believed that this provision should apply with respect to all Section 178 creditors, but particularly those with claims for support arrears.

In theory, the bankrupt should make surplus income payments to his or her trustee, for disbursement to creditors, only if there are sufficient moneys available after meeting the reasonable financial needs of his or her family; for a separated family, this should include support obligations.

Under Section 68 of the Act, the trustee and the Court are required to have regard to the personal and family situation of the bankrupt, and the Superintendent of Bankruptcy’s surplus income standards require that the trustee permit the

In theory, the bankrupt should make surplus income payments to his or her trustee, for disbursement to creditors, only if there are sufficient moneys available after meeting the reasonable financial needs of his or her family; for a separated family, this should include support obligations.

bankrupt to deduct both child and spousal support payments in the calculation of surplus income. Section 69.41(2)(b) of the Act, however, provides that the enforcement of support claims is stayed against “amounts that are payable to the estate of the bankrupt under s. 68.” In some cases, this provision has been interpreted as allowing the trustee to enforce this obligation in priority over the support claimant’s wage garnishment once a surplus payment agreement has been made.

Mr. Klotz informed the Committee that, because of the interaction among Section 68 and Section 69.41 of the BIA and the Superintendent’s surplus income standards, difficulty is being created for spouses who attempt to collect support from the wages of a bankrupt spouse when that spouse has entered into a surplus income agreement with his or her trustee. To correct the ambiguity that has been created, he recommended that the BIA be amended to clarify that only Court orders made under Section 68 of the Act have priority over the enforcement of spousal and child support against the bankrupt’s income during bankruptcy. He believed that agreements made between the bankrupt and the trustee should not have priority over support obligations.

A third issue to be considered with respect to family law and insolvency is the extent to which bankruptcy may be used to frustrate division of the bankrupt’s pension and such other exempt assets as life insurance Registered Retirement Savings Plans (RRSPs).

The Committee was told by Mr. Klotz that “[t]here is no policy reason for permitting bankruptcy, which does not distribute [pension and life insurance RRSPs] among creditors, to frustrate the principles of matrimonial property division against these assets. [Allowing this to occur] would amount to rehabilitating the bankrupt at the expense of his or her spouse.”

In Mr. Klotz’s view, an amendment is needed to the BIA in order to provide that bankruptcy does not stay or release any claim for equalization or division against exempt

assets under provincial/territorial legislation in the areas of equalization and/or division of matrimonial property.

In some provinces/territories and in certain circumstances, the trustee acquires the right of the bankrupt to sue the non-bankrupt spouse for matrimonial property division or equalization. This right is treated as an asset that vests with the trustee, although the matrimonial property claim is generally not a valuable right in the hands of the trustee.

Mr. Klotz believed that “one cannot reliably bring this kind of claim to fruition when it has been detached from the spouse for whose benefit the remedy was designed. ... [E]ven if the right to sue for equalization or division accrues to the trustee, the sad fact is that the trustee is rarely in a position to realize upon this asset in any meaningful way. It must usually be settled for a steep discount, or surrendered for nothing.” Confidence in the system is thereby undermined, since: the bankrupt spouse is denied the opportunity to obtain matrimonial justice; the non-bankrupt spouse retains most of the bankrupt spouse’s share of the family assets; the creditors receive very little; and the bankrupt spouse cannot trade his or her equalization claim for reduced spousal or child support. He supported an amendment to the BIA that would exclude, from the assets vesting in the trustee, the right to sue the bankrupt’s spouse for equalization or division of property under provincial/territorial matrimonial property law.

In some cases of marital discord, bankruptcy is used by a spouse as a means to ensure that the other spouse receives nothing when the marital assets are divided.

A final issue to be considered is malicious or fraudulent dissipation or concealment of property. In some cases of marital discord, bankruptcy is used by a spouse as a means to ensure that the other spouse receives nothing when the marital assets are divided. Other means that might be used by the spouse include: deception; dissipation; concealment; destruction of property; phony creditors; fraudulent transfers; and corporate machinations. A problem arises, however, in proving the allegation that the spouse acted in this way. While there are mechanisms for addressing this problem in cases of

bankruptcy, opposition to the bankruptcy discharge hearing is useful only if the other creditors are limited.

The Committee was also told by Mr. Klotz that “[i]f we are to take seriously the injustice created by such conduct, we ought to provide a simple remedy to the victim, if we can, that does not embroil him or her in a fresh round of litigation once bankruptcy ensues. At the same time, we must be concerned that this remedy is appropriately designed so as not to prejudice an honest but unfortunate debtor.”

Mr. Klotz suggested to the Committee that the BIA be amended to exclude, from a discharge from bankruptcy, any provable claim for matrimonial property division that arises from the bankrupt’s malicious or fraudulent dissipation or concealment of property. This exclusion should be limited to the amount of the dividend that the creditor would have received had the conduct not occurred. In particular, he believed that Section 178 of the BIA should be amended to add, to the debts that survive bankruptcy, a debt for equalization or division of property under provincial/territorial matrimonial property law, to the extent that the debt arises from malicious or fraudulent dissipation or concealment of property by the bankrupt.

The Committee endorses the recommendations and reasoning provided by Mr. Klotz. We are concerned about the manner in which a law – and interaction between laws – can have unintended consequences that negatively affect innocent individuals. The issues raised by him require prompt resolution. We must ensure that the devastating effects of marital breakdown and its aftermath are, to the extent possible, minimized – financially and otherwise – for all parties concerned, but particularly for those who are blameless. We are concerned, as well, about the fact that the Crown may receive any moneys owed in priority to child support and alimony payments. Clearly, the changes that Mr. Klotz proposed support our fundamental principles of fairness and responsibility. From this perspective, the Committee recommends that:

We must ensure that the devastating effects of marital breakdown and its aftermath are, to the extent possible, minimized – financially and otherwise – for all parties concerned, but particularly for those who are blameless.

The *Bankruptcy and Insolvency Act* be amended to:

- ensure that bankruptcy does not prevent a claimant from recovering the total amount of support arrears from a bankrupt spouse;
- clarify that only Court orders made under Section 68 of the Act have priority over enforcement of spousal and child support against the bankrupt's income during the period of bankruptcy;
- provide that bankruptcy does not stay or release any claim for equalization or division against exempt assets under provincial/territorial legislation regarding equalization and/or the division of marital property;
- exclude, from assets vesting in the trustee, the right to sue the bankrupt's spouse for equalization or division of property under provincial/territorial matrimonial property law; and
- add, to the debts that survive bankruptcy, a debt for equalization or division of property under provincial/territorial matrimonial property law, to the extent that the debt arises from malicious or fraudulent dissipation or concealment of property by the bankrupt.

CHAPTER FIVE: THE SENATE COMMITTEE'S EVIDENCE AND RECOMMENDATIONS ON COMMERCIAL INSOLVENCY ISSUES

A. Compensation Protection: Wages and Pensions

Under the 1949 *Bankruptcy Act*, unpaid wage claims arising during the course of an employer's bankruptcy were preferred over the claims of general creditors, to a maximum of \$500. With amendments to the *Bankruptcy and Insolvency Act* (BIA) in 1992, up to \$2,000 for unpaid wages, salaries and similar entitlements earned in the six months immediately preceding bankruptcy are a preferred claim; they rank ahead of ordinary creditors' claims in the event of bankruptcy but behind secured creditors' claims and some Crown claims. In particular, the claims of workers for wages and salaries rank fourth in the list of unsecured creditors having a priority of distribution, behind funeral and testamentary expenses, fees and expenses of the trustee, and legal costs. If funds are available – and often they are not – unpaid wages, salaries and similar entitlements are normally paid out some time after the date of bankruptcy.

Protection for wage earners has received a great deal of attention in Canada, having been studied by Parliament, a number of committees and others. A variety of options for protection have been proposed, including: super priority for wage claims that would rank ahead of secured claims; recognition of existing provincial/territorial priorities within the BIA regime; a waiver of the waiting period for employment insurance benefits; and a wage earner protection fund financed out of general tax revenues, or by employer and employee contributions directly or indirectly out of the employment insurance fund.

Protection for wage earners has received a great deal of attention in Canada, having been studied by Parliament, a number of committees and others.

The notion of a wage protection fund administered by the federal government began in 1975, when Bill C-60 proposed to implement a recommendation by the Study Committee on Bankruptcy and Insolvency Legislation – the Tassé Committee – to give super priority status to unpaid wage claims up to \$2,000, binding secured and general creditors.

Each of these options has advantages and disadvantages. Regarding the latter, there are concerns that a fund to which employers and employees contribute, whether through a new tax or the employment insurance system, would mean that employers with a low risk of bankruptcy, such as public service employers, would subsidize those employers with a higher risk. With a fund paid out of general tax revenues, taxpayers would finance wage protection. A super priority for wage claims would mean, in essence, that secured creditors would pay for wage earner protection.

Between the options of super priority and a wage earner protection fund – however financed – some believe that super priority status is less attractive because of: a relative lack of certainty that adequate funds will be available; the possibility of significant delay in receiving payment pending the sale of the insolvent employer's assets; difficulties associated with allocating the burden of paying claims among the secured creditors; and the creation of an unexpected burden on secured creditors and the consequent possibility of credit cost and availability problems, particularly for labour-intensive industries. It is thought that a wage earner protection fund would allow more timely payment of wages owed, thereby enabling employees to meet their most immediate financial needs pending their finding alternative employment or receiving employment insurance benefits.

The notion of a wage protection fund administered by the federal government began in 1975, when Bill C-60 proposed to implement a recommendation by the Study Committee on Bankruptcy and Insolvency Legislation – the Tassé Committee – to give super priority status to unpaid wage claims up to \$2,000, binding secured and general creditors. With objections raised by secured creditors, the Standing Senate Committee on Banking, Trade and Commerce recommended the creation of a federal government wage protection fund, with contributions from employers and employees used to pay outstanding employee wages to a maximum of \$2,000 immediately upon bankruptcy. At the time, the Committee believed that super priority status for

wages would be detrimental to a borrower's ability to obtain financing, particularly in labour-intensive industries.

As originally introduced in 1991, Bill C-22 would have created a wage claim protection program – pursuant to the proposed Wage Claim Payment Act – financed by a payroll tax of 0.024% of an employee's weekly insurable earnings on all employers – including those in the public and quasi-public sectors whose employees would likely never benefit from the fund – to provide direct compensation to terminated employees of companies that became bankrupt, were being liquidated or were in receivership. The program envisioned payments of 90% of an employee's unpaid wages and vacation pay earned within the preceding six months, to a maximum of \$2,000, and 90% of salesperson's expenses unpaid during the preceding six months, to a maximum of \$1,000. The program would not have covered pension contributions, severance payments or termination pay.

In May 1992, however, the Minister of Consumer and Corporate Affairs withdrew the proposed program from the Bill and in June 1992 announced the intention to refer the matter of wage claims to a Special Joint Committee of the Senate and the House of Commons for reconsideration. The Special Joint Committee, which was to have reported by June 1993, was not established. Consequently, the BIA maintains preferred creditor status for unpaid wage claims and salesperson's expenses, and the amount that can be claimed is a maximum of \$2,000 for the former and \$1,000 for the latter. In cases where the insolvent employer makes a proposal, these amounts are paid immediately after Court approval of the proposal. Bill C-5 did not make any changes to the amounts, although it allowed a representative of a federal or provincial/territorial ministry of labour, or a trade union, to file a claim on behalf of all employees.

Many believe that employees need better protection than that now given in the BIA. Employees are seen as vulnerable creditors with inadequate individual bargaining power and a limited ability to assess accurately the risk that their employer will become bankrupt. Whatever protection they receive – whether through super priority, a fund or

Employees are seen as vulnerable creditors with inadequate individual bargaining power and a limited ability to assess accurately the risk that their employer will become bankrupt.

The Committee received a range of testimony from witnesses on the issue of unpaid compensation claims, particularly wages.

preferred claim – may have a maximum dollar amount of protection, protection related to a fixed number of pay periods and/or limitations on the compensation that is protected; some believe that protection should extend to vacation, severance and termination pay, as well as to pensions.

The Committee received a range of testimony from witnesses on the issue of unpaid compensation claims, particularly wages. Some supported enhanced protection, and recommended super priority status and the development of a wage protection fund. Professor Janis Sarra, of the Faculty of Law at the University of British Columbia, commented on protection for unpaid wages and on the testimony that other witnesses had presented to us. She expressed her concern “about the lobbying for a shift away from the protection of the interests of workers in the financially distressed corporation. ... It seems that the discussions regarding enhanced or super-priority for wage claims and the need for a wage adjustment fund are considerably underdeveloped in the legislative review, partly because workers are disadvantaged as a group able to lobby for legislative protection.” In her opinion, “[b]oth enhanced priority for workers’ wages and a national wage adjustment system should be seriously considered as mechanisms to protect against unnecessary defeat of the claims of workers for compensation for services already rendered to the corporation.”

Professors Ziegel and Telfer, representing a number of professors of law, also supported enhanced protection for wage earners, and expressed a preference for “a modestly enlarged Employment Insurance fund,” although they also supported as an alternative solution, “a first lien against the employer’s inventory and accounts receivable,” particularly for a trial period to test its effectiveness. Arguing that unpaid workers are “seriously underprotected” in the existing BIA provisions, they recommended that the expanded employment insurance scheme include protection for unpaid wages, but not vacation or severance pay, up to a prescribed ceiling.

Representatives of organized labour also supported enhanced protection for the unpaid compensation of workers,

including wages but also such other elements of compensation as vacation, severance and termination entitlements, as well as pension contributions and benefits. Although speaking specifically about the *Companies' Creditors Arrangement Act* (CCAA) process, the National Automobile, Aerospace, Transportation and General Workers Union of Canada (CAW-Canada) told the Committee that “this process must recognize that workers employed by an insolvent employer have an increased vulnerability to the failure of their workplace, more so than bankers, corporate landlords, and institutional suppliers, as loss of employment may frequently mean a drastic reversal with respect to a worker’s personal living conditions, and opportunities available for his/her family and community.”

The United Steelworkers of America advocated both a super priority for unpaid worker claims and a wage earner protection fund, with priority for wages, vacation, severance and termination pay, and any wind-up deficiency in the pension fund. It felt that this dual protection would achieve four important objectives: the wage earner protection fund would “guarantee prompt payment of [these amounts], pending the final resolution of the issues in bankruptcy and insolvency;” it would eliminate a bias whereby severance payments for senior executives have received Court protection through the establishment of trust funds or prioritized charges; it would protect the public purse, since the sponsor/guarantor of the protection fund would assume the rights to recover some or all of the payments made by it; and it might encourage the expansion of a pension benefits guarantee fund to more jurisdictions in Canada.

The union also noted that vacation pay, pension contributions, pay in lieu of notice of termination pay and severance pay are important aspects of compensation that are compromised when an employer becomes insolvent. Moreover, among these, “an employee’s severance and termination pay claim generally represents the bulk of the employee’s individual claim. ... The inferior ranking of employee claims must be re-visited and changed. Employees are particularly vulnerable when their employer fails, more so than a bank, landlord, commercial supplier, or other corporate

creditor. ... Banks and other commercial lenders ... carry a diverse range of loans. A default pertaining to one individual lending relationship should not have a material impact on the bank's prospects in the mid- to long-term. Furthermore, in the course of a banking relationship with a corporate employer, a bank has the means to analyze the risks associated with the loan in question, and manage its loan portfolio accordingly."

In the view of the United Steelworkers of America, the definition of "wages" should include termination and severance pay, and the wage priority should be increased to at least \$20,000 and elevated above the claims of secured creditors. It supported an employee wage protection program that would resemble that which existed in Ontario in the early 1990s, and believed that a similar program is needed with respect to bankruptcies. A broadly based national pension benefit insurance program is also needed, in its opinion. The Canadian Labour Congress supported these proposed changes.

Furthermore, like the United Steelworkers of America, the Canadian Labour Congress noted that "[c]reditors may have a diversified portfolio of loans, and investors may be able to diversify their financial exposures, but employees have all their eggs in one basket. These circumstances create economic, legal and psychological vulnerabilities, which can easily be (and are) exploited in insolvency crises." It also told the Committee that "[t]he courts have held that 'wages' includes vacation pay but does not include pension contributions nor does it include severance and termination pay. ... The Supreme Court of Canada has held in wrongful dismissal cases that because termination pay is really pay in lieu of notice it is in fact 'wages' of an employee. Accordingly, it is incongruous that the definition of wages in ... the BIA excludes termination pay." In the labour federation's view, the definition of "wages" in the BIA should be amended to conform to the Supreme Court of Canada's definition of "wages", which would include termination and severance pay.

The Canadian Labour Congress also supported a federally regulated wage protection fund financed by

compulsory employer contributions based on insurable income to pay the difference between the total amount of wages owed and the amount that can be paid from the company's assets. The fund would be able to pay promptly any amounts owed to employees, beginning on the date on which payments were last made and ending on the date that insolvency proceedings were commenced. It, too, mentioned the fund that existed in Ontario in the 1990s.

While the Canadian Bar Association acknowledged the vulnerable position of employees in insolvency situations and noted that they are economically dependent but “unable to protect themselves as adequately as creditors when an employer becomes insolvent,” it told the Committee that “a super priority is neither a fair nor an efficient means of protecting the wage earner.” In its opinion, a super priority would place the entire cost burden on creditors rather than spreading it amongst other interested stakeholders, particularly employers and employees, and reduce the availability of credit, among other problems. The Association expressed support for a wage protection fund under the employment insurance regime that would provide up to 90% of unpaid wages for one pay period to a maximum of \$2,000. On payment to the employees, the fund would assume the rights of the employees.

Since a significant majority of its members are opposed to a comprehensive wage insurance plan that would be financed through the employment insurance fund, and consistent with its past resistance, the notion of a wage earner protection fund was opposed by the Canadian Federation of Independent Business. It told the Committee that it opposes such a fund for a number of reasons: the fund would increase the burden of payroll taxes and thereby negatively affect economic growth and job creation; from an equity perspective, well-run firms should not be required to subsidize the poor business practices of others; the BIA currently gives preferred creditor status for unpaid wage claims that meet certain criteria, and this level of protection is similar to that found in the United States; and consideration should be given to super priority for wage claims in the event that the federal

[The Committee was informed about the fund that existed in Ontario in the 1990s.]

[The Committee was told] that super priority status would not ensure the certainty or promptness of payment needed by employees.

government were to determine that existing wage earner protection is inadequate.

Speaking on behalf of the banking industry, the Canadian Bankers Association expressed, as its major concern, provisions that create super priorities. In its view, the imposition of a super priority for unpaid wages would be inconsistent with the principle of efficiency, since it would impair “the ability of creditors to accurately ascertain (sic) the financial position of a borrower, Creditors are faced with adopting stricter lending practices because of this uncertainty, thereby limiting the availability of credit and increasing borrowing costs.” It also argued that super priority status would not ensure the certainty or promptness of payment needed by employees.

The Association believed that the key issue is: who should bear the cost of providing greater protection to wage earners? In its view, “[i]t is society as a whole, and the employee specifically, that benefits from an employee receiving some compensation for unpaid wages. Therefore, either society or the employee should bear at least part of the cost of this protection. To impose this cost solely on secured creditors would be unfair and simply cause a reduction in credit availability.”

Nevertheless, should the consensus be that employees require additional protection, the Association believed that the most effective method for achieving this goal is the establishment of a wage fund that would: replace a maximum of \$2,000 per employee; exclude compensation for pension contributions, severance pay and termination pay; and be financed either from the Consolidated Revenue Fund, the employment insurance scheme or equal financing by employees and employers.

Finally, the Joint Task Force on Business Insolvency Law Reform provided its view that “the case for giving wage claims higher priority than they presently have has not been made. . . . Our proposal is for the current priorities with

respect to wage claims to be maintained, subject to clarification that pension contributions are included in wages for the purposes of the BIA.”

Unpaid wages were equated with unpaid royalties by the Writers’ Union of Canada, which told the Committee that authors should be treated as preferred creditors and receive their unpaid royalties *pari passu* with the unpaid wages of employees. In its opinion, such a provision should also exist in the *Canada Business Corporations Act* and similar provincial/territorial legislation to make directors jointly and severally liable for the royalties of authors.

The Committee believes that the current protection provided by the BIA to unpaid wage claims is inadequate, and has carefully considered the views of witnesses about super priority status and a wage earner protection fund. One of our fundamental principles identified in Chapter Two – fairness – is critically important here. As we formulated our recommendation, we tried to be fair to employees, employers, creditors and taxpayers. An insolvent employer should have to bear part of the cost of protection, but so too should its employees, since they are – in some sense – creditors, having supplied services yet awaiting payment.

Employees are not, however, like other creditors in every respect, and thus should perhaps be protected differently. For example, they probably have a situation of economic dependence not found with other creditors, and are not well placed to assess accurately the probability that their employer will become insolvent. Fairness to taxpayers suggests that a fund financed out of the Consolidated Revenue Fund is inappropriate, while fairness to creditors means that they should not bear all of the cost of the employer’s indebtedness to employees. Finally, fairness to solvent employers means that they should not have to bear the burden of costs incurred by insolvent employers. In the interest of fairness, the Committee believes that unpaid wages and vacation entitlements arising as a result of an employer’s bankruptcy should be funded by a super priority over secured claims to

As we formulated our recommendation [about unpaid wage claims], we tried to be fair to employees, employers, creditors and taxpayers.

inventory and accounts receivable to a determined maximum amount. The secured creditors would be able to assume the rights of employees against directors. Consequently, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to provide that unpaid claims for wages and vacation pay arising as a result of an employer's bankruptcy be payable to an amount not to exceed the lesser of \$2,000 or one pay period per employee claim. The funding of these claims should be assured by creating a super priority over secured claims to inventory and accounts receivable. The secured creditor or creditors should be able to assume the rights of the employees against the directors.

Many believe that pensioners are similar to employees: they are poorly protected by current legislative provisions; they lack bargaining power; and they are relatively unable to assess accurately the risk of bankruptcy by the employer sponsoring their pension plan.

Another compensation issue that arises in situations of employer insolvency is protection for pension plans. While the BIA contains no provisions regarding unpaid contributions to pension plans, federal and provincial/territorial pension standards legislation provide priorities. There is, however, some question about whether priorities established in provincial/territorial legislation would be protected in bankruptcy.

Many believe that pensioners are similar to employees: they are poorly protected by current legislative provisions; they lack bargaining power; and they are relatively unable to assess accurately the risk of bankruptcy by the employer sponsoring their pension plan. Options for protection of pensions mirror those for wages – super priority and a fund – and have similar advantages and disadvantages.

In funding pensions, there are two issues to consider: unfunded pension liabilities and unremitted periodic contributions to the pension plan. To some extent, unfunded pension liabilities should be reduced through the payments that must be made following the identification of an actuarial deficiency arising as a consequence of mandatory periodic actuarial reviews of registered pension plans.

Regarding pension protection, the Canadian Bankers Association advocated monthly employer contributions to pension plans and annual actuarial reviews of pension plans to identify any unfunded liability. In its view, if additional protection is needed for pension contributions, a fund would be the most efficient and effective method.

Organized labour also spoke to the Committee about pension protection for employees. In speaking about reorganizations under the CCAA, the CAW-Canada told us that “the CCAA should make it abundantly clear that a Court has no jurisdiction (inherent or otherwise) to interfere with the promises enshrined in a collective agreement to adequately fund (sic) for pension credits earned while the corporation carries on business under CCAA coverage, and moreover, that no pension benefit may be reduced by unilateral order of a Court. Simply put, an employer operating under CCAA coverage cannot take the continuing benefit of services rendered to it by employees but be excused by the Court from performing any one of its obligations under a collective agreement, including the funding of pensions.”

The United Steelworkers of America also commented on pensions, and told the Committee that “the Courts have not been consistent in requiring that companies operating under CCAA protection continue to contribute to the pension plans of their employees. CCAA orders require that employees continue to be paid; there is no reason why the CCAA should not explicitly protect pension funds which are, after all, deferred wages.” It advocated a super priority, immediately following federal and provincial/territorial taxes, for unfunded pension liabilities.

Furthermore, the Canadian Labour Congress argued that “current and future pensioners ought to be afforded maximum protection in an insolvency situation [since] of all the parties affected by an insolvency, current and future pensioners are least able to protect themselves. ... [T]hey are not able to take security for future indebtedness ... [and] ... they are not able to impose or even bargain funding terms.”

... insolvency – at its essence – is characterized by insufficient assets to satisfy everyone, and choices must be made.

The labour federation recommended two methods of protecting pension accruals: pension insurance or the creation, under the BIA, of a super priority in cases of pension underfunding, either to overdue contributions and payments on account of the underfunding or to the overall value of the solvency deficiency at the time of windup.

For the same reasons that it did not support a super priority for employees' unpaid wages, the Canadian Bar Association also did not favour a super priority for unpaid pension contributions. Instead, it advocated protection as part of a wage earner protection fund in the event that Parliament intends to provide additional protection for these contributions.

Although the Committee recognizes the vulnerability of current pensioners, we do not believe that changes to the BIA regarding pension claims should be made at this time. Current pensioners can also access retirement benefits from the Canada/Quebec Pension Plan, and the Old Age Security and Guaranteed Income Supplement programs, and may have private savings and Registered Retirement Savings Plans that can provide income for them in retirement. The desire expressed by some of our witnesses for greater protection for pensioners and for employees currently participating in an occupational pension plan must be balanced against the interests of others. As we noted earlier, insolvency – at its essence – is characterized by insufficient assets to satisfy everyone, and choices must be made.

The Committee believes that granting the pension protection sought by some of the witnesses would be sufficiently unfair to other stakeholders that we cannot recommend the changes requested. For example, we feel that super priority status could unnecessarily reduce the moneys available for distribution to creditors. In turn, credit availability and the cost of credit could be negatively affected, and all those seeking credit in Canada would be disadvantaged. Moreover, we cannot support a fund financed out of the Consolidated Revenue Fund or by employers and employees

generally, since this proposal would be unfair for taxpayers, solvent employers and the employees of these employers. In this situation, we believe that fairness is best served by the status quo. Consequently, the Committee recommends that:

[Regarding the treatment of pensions claims] we believe that fairness is best served by the status quo.

The *Bankruptcy and Insolvency Act* not be amended to alter the treatment of pension claims.

B. Debtor-in-Possession Financing

Debtor-in-Possession – or DIP – financing is a financial vehicle used to assist insolvent businesses that are restructuring. Businesses that are attempting to reorganize typically require cash, and their usual sources of credit may be unwilling to lend to them, or to lend to them at an affordable cost, because of their insolvency. Lending to these businesses is relatively risky.

With DIP financing, a new lender provides cash in exchange for a higher priority than other secured creditors; in general, existing secured creditors may not support having their security diminished by the granting of an interest to a new lender that may rank prior to, or “prime,” their own. If the restructuring is not successful, the new lender is protected at the expense of other creditors, who may find their loss to be greater than if the company had instead gone bankrupt. If, however, the company reorganizes successfully, the other creditors are likely to recover more than they would have in the case of bankruptcy and job losses are reduced, with implications for employees, their families and the communities in which they live.

Some believe that new lenders should have a higher priority than other secured creditors as a premium for the risk they bear and because their financing may be instrumental to a successful reorganization.

Some believe that new lenders should have a higher priority than other secured creditors as a premium for the risk they bear and because their financing may be instrumental to a successful reorganization. The extent to which this latter point is true, however, cannot be determined statistically, since data are not systematically collected on CCAA restructurings.

While the BIA and the CCAA do not contain provisions regarding DIP financing, this financing has been authorized in CCAA cases by judges using their inherent jurisdiction. To a limited extent, the Court has allowed the security given to DIP lenders to rank prior to that of other secured creditors. Because there may be a lack of clarity about the circumstances under which DIP financing may be

authorized and the extent to which the reorganization is likely to be successful with such financing, uncertainty may prompt creditors to take action early and seize their security; there might also be implications for the availability and cost of credit.

Views about whether DIP financing should be permitted in cases of BIA proposals are mixed. Some believe that such financing would not be appropriate in smaller cases and would raise concerns about governance, while others feel that it should be available as a tool to enhance the possibility of a successful reorganization.

The Joint Task Force on Business Insolvency Law Reform was among the witnesses that spoke to the Committee about DIP financing. It supported an express statutory power in CCAA cases to allow DIP loans, and told us that “it would be helpful to expressly codify the court’s authority in the CCAA to give the court guidance in its consideration as to whether to grant such financing and on what basis.” The Joint Task Force stressed “the link between the granting of interim financing and the governance of the corporation during the workout period,” and suggested that the Court should exercise its discretion to grant DIP financing according to criteria specified in the statute. Among other considerations, it believed that the following seven factors would be appropriate:

- “(a) what arrangements have been made for the governance of the debtor during the proceedings;
- (b) whether management is trustworthy and competent, and has the confidence of significant creditors;
- (c) how long will it take to determine whether there is a going concern solution, either through a reorganization or a sale, that creates more value than liquidation;
- (d) whether the D.I.P. loan will enhance the prospects for a going concern solution or rehabilitation;
- (e) the nature and value of the assets of the debtor;

Some believe that [DIP] financing would not be appropriate in smaller cases and would raise concerns about governance, while others feel that it should be available as a tool to enhance the possibility of a successful reorganization.

(f) whether any creditors will be materially prejudiced during that period as a result of the continued operations of the debtor; and

(g) whether the debtor has provided a detailed cash flow for at least the next 120 days.”

The Canadian Bankers Association also commented on the issue of DIP financing, indicating that it is inappropriate in the context of the BIA and should be restricted on a case-by-case basis to larger companies being reorganized under the CCAA; in the latter case, the Court’s authority to grant DIP financing should be codified, as should the factors to be considered in determining whether the financing should be granted. It supported some of the recommendations made by the Joint Task Force regarding DIP financing.

The Association’s concern, in part, is about the effect of super priority status. In particular, it told the Committee that “[a]ny change in the negotiated priority position of a secured party will create uncertainty and limit the availability of credit. Providing for a super priority for new credit in a reorganization will have an adverse effect on pre-insolvency lending arrangements. If new and innovative companies are to receive adequate credit at reasonable costs, secured parties must be assured that their priority position will not be diminished.”

In questioning the reason for allowing DIP financing to occur under the CCAA but not under the BIA and finding no policy justification for the difference, Mr. Max Mendelsohn, of Mendelsohn, G.P., told the Committee that “[i]f a reorganizing entity believes that it is too expensive to seek DIP financing in its reorganization, it will not do it or it will not be able to do it. However, it should not be denied the opportunity to try to do it if the concept makes sense.”

This sentiment was supported by the Canadian Bar Association, which argued that “the same factors that lead to the need for DIP financing in a CCAA reorganization also

exist in BIA proposals.” It recommended that DIP financing be available on a consistent basis in both BIA proposals and CCAA reorganizations. Since the granting of DIP financing affects the interests of stakeholders, the Association also told the Committee that the debtor should have the burden of proof on application for DIP financing.

The Committee believes that Debtor-in-Possession financing may be instrumental in ensuring the continued operation of businesses during restructuring, but cautions that reorganization may not be the preferred solution in all cases, since there may be instances where liquidation is the option that, in the long run, will be best for all stakeholders.

That being said, if DIP financing is to be used, the Committee believes that the Court should be provided with some guidance in deciding whether to approve this financing, and that it should – in the interests of fairness – be available in both CCAA reorganizations and BIA proposals; some proposals can be relatively significant in their size and scope. In our view, the entity providing the financing should be compensated for the risk that it is taking, but existing secured creditors should receive notice that the Court is contemplating the approval of DIP financing and a DIP lien that would have priority over their interests. The availability of DIP financing, criteria to guide the Court’s decision making, notice to secured creditors and priority for DIP lenders would help to meet several of the fundamental principles identified by us in Chapter Two, including fairness, predictability and efficiency. For these reasons, the Committee recommends that:

... if DIP financing is to be used, the Committee believes that the Court should be provided with some guidance in deciding whether to approve this financing, and that it should – in the interests of fairness – be available in both CCAA reorganizations and BIA proposals; some proposals can be relatively significant in their size and scope.

The *Bankruptcy and Insolvency Act* and the *Companies’ Creditors Arrangement Act* be amended to permit Debtor-in-Possession financing. The Court should be given the jurisdiction to provide that the lien by the Debtor-in-Possession lender can rank prior to such other existing security interests as it may specify. As well, any secured creditor affected by such priority should be given notice of the Court hearing intended to authorize the creation of security ranking prior to its security. In deciding whether to

authorize a Debtor-in-Possession loan, the Court should be required to consider the seven factors outlined by the Joint Task Force on Business Insolvency Law Reform in its March 2002 report.

C. The Rights of Unpaid Suppliers

The notion of protection for unpaid suppliers when a purchaser goes bankrupt is not new in Canada. A provision in this regard was found in Quebec's *Civil Code* and was proposed in the *Report of the Study Committee on Bankruptcy and Insolvency Legislation* – the Tassé Report – in 1970. Unpaid suppliers were first given protection in the BIA in 1992, when they were provided with the right to repossess merchandise delivered to a purchaser who goes bankrupt or goes into receivership, although a number of conditions apply:

- the supplier must make a written demand for the goods within 30 days after delivery;
- the purchaser must be bankrupt or in receivership when the demand is made;
- the goods must be in the possession of the receiver, trustee or purchaser;
- the goods must be identifiable and not fully paid for; and
- the goods must be in the same state as they were on delivery and not resold at arm's length or subject to an agreement for sale.

When the purchaser has made partial payment for the goods, the supplier may repossess a portion of the goods that is proportional to the amount owing; alternatively, he or she may repossess all of the goods after repaying any partial payment received. While the right to repossess does not extend to situations where the company is reorganizing under the BIA, if the company subsequently becomes bankrupt the supplier may exercise its right to repossess goods delivered just prior to reorganization, provided the 30-day period has not expired.

Special rights exist for farmers, fishers and aquaculturalists who deliver their products to a purchaser who

Unpaid suppliers were first given protection in the BIA in 1992, when they were provided with the right to repossess merchandise delivered to a purchaser who goes bankrupt or goes into receivership, although a number of conditions apply ...

The “30-day goods rule” was introduced to protect suppliers – who often lack a realistic ability to demand security for the transaction – from harm by insolvent debtors who order excessive amounts of inventory prior to bankruptcy as a means of increasing the assets available to satisfy secured creditors, a practice that is sometimes referred to as “juicing the trades.”

subsequently becomes bankrupt or is placed in receivership. Where these products are delivered within 15 days prior to the bankruptcy or receivership and the farmer, fisher or aquaculturalist files a claim for any unpaid amount in respect of them within 30 days thereafter, the claim is secured by a charge on all inventory held by the purchaser and takes priority over all other rights or charges against that inventory except a specific unpaid supplier’s right of possession.

The “30-day goods rule” was introduced to protect suppliers – who often lack a realistic ability to demand security for the transaction – from harm by insolvent debtors who order excessive amounts of inventory prior to bankruptcy as a means of increasing the assets available to satisfy secured creditors, a practice that is sometimes referred to as “juicing the trades.” It also, however, can assist businesses in financial difficulty; because suppliers can recover their goods under certain circumstances, they may be willing to continue supplying to these businesses.

There is some controversy about the effectiveness of the 30-day goods recourse and about whether it should exist at all. While suppliers support the concept of protecting trade creditors, there are some criticisms. For example, the time frame within which unpaid suppliers must act to preserve their right to repossess often bears no relationship to the date of the purchaser’s bankruptcy, which is the event that prompts repossession. When a purchaser goes bankrupt near the end of the 30-day delivery period, it may be difficult – if not impossible – for the unpaid supplier to receive notice of the bankruptcy and to deliver the repossession demand before the period expires. Effective exercise of the right may require advance knowledge about the impending bankruptcy.

A second problem concerns the requirement that the goods be in the same state as they were on delivery; any transformation through a production process means that the repossession right ceases to exist. Problems also arise where the goods are sold prior to the unpaid supplier making a claim for repossession. Moreover, the protection is limited to suppliers of goods, since those who supply services and credit

have no protection, and to situations of bankruptcy, since no protection is given by either the BIA or the CCAA in situations of reorganization. Some debtors have, for example, liquidated assets during the period of the stay of proceedings that occurs with the filing of a notice of intention to make a proposal, and have paid other creditors from the proceeds of the sale of these goods.

Supplier repossession reduces the assets in the bankrupt's estate and, consequently, the moneys available for distribution to creditors. As a result, credit availability and cost could be affected. In some sense, other creditors bear the cost of protection for the suppliers of 30-day goods. Moreover, the ability to repossess gives the supplier a right that was not part of the contract negotiated between it and the company; the argument may be made that if the supplier wanted to obtain security, this protection could have been available through the negotiation of the contract.

Witnesses shared with the Committee a variety of views about the 30-day goods rule, with some suggesting that it be abolished for the reasons cited above, and others recommending that it be changed to correct the deficiencies that have been identified. The Joint Task Force on Business Insolvency Law Reform told the Committee that "there is no justification for preferring suppliers over other unsecured creditors. ... In our view, there is no case for increasing further the protection of unpaid suppliers in bankruptcy. On the contrary, there is a strong case for removing the special preference for suppliers of goods altogether."

Mr. Andrew Kent, of McMillan Binch LLP, expressed support for the position of the Joint Task Force that the claim should be eliminated. In his view, if the law were to be amended to give enhanced status to the claims of suppliers of 30-day goods, then the business would have no bargaining leverage with the supplier. He also believed that suppliers already have a number of tools that they can use to protect themselves, and are making "a conscious business choice" if they fail to do so.

Supplier repossession reduces the assets in the bankrupt's estate and, consequently, the moneys available for distribution to creditors.

[The Committee was told that giving suppliers more rights] ... could undermine restructuring efforts in cases where compromising supplier claims is required.

Mr. Kent also provided the Committee with a third reason for not providing enhanced status to suppliers. Describing the situation as a “pure special interest group grab,” he suggested that there is no policy justification for favouring this group and noted that many of the beneficiaries would be large, foreign companies. According to him, “pandering to special interest groups without good policy justification will make [Canada] less competitive and hurt all of us.” He also opposed suppliers being given more rights in restructuring proceedings, which could undermine restructuring efforts in cases where compromising supplier claims is required.

In support of Mr. Kent’s position, the Canadian Bankers Association advocated repeal of the relevant sections of the BIA. In its view, the rights for unpaid suppliers have a number of consequences; in particular, their existence: limits the availability of operating credit; adds to the monitoring cost of creditors which, in turn, results in higher interest rates; adds to the costs of debtors, who need to provide more detailed inventory accounting; duplicates existing supplier protection mechanisms; and may promote lax credit granting practices on the part of suppliers. At a minimum, the Association opposed any enhancement to unpaid supplier protection in the form of a super priority.

The Canadian Bar Association described the protection for unpaid suppliers as “difficult to apply in practice” and “largely illusory.” Among the problems identified by the Association were the timing of commencement of the 30-day period and its lack of application to suppliers of services or of credit. In its view, if Parliament wishes to retain the provision, the notice should be given to the trustee within 15 days of the effective date of bankruptcy/receivership for goods delivered in the 30 days prior to the bankruptcy/receivership.

Other witnesses supported statutory protection for unpaid suppliers. The Canadian Federation of Independent Business described some of the challenges faced by small businesses that supply goods to firms that become bankrupt. For example, since customers generally have 30 days in order to pay for their goods, the last day on which goods could be

seized is the same day that the invoice is due to be paid. As well, since goods must be in the same state as when they were delivered, slight alteration of the goods or simply opening the box may preclude repossession by the unpaid supplier. Third, some small and medium-sized businesses have encountered debtors that “load up” on goods on credit before initiating bankruptcy proceedings; this action has the effect of increasing the asset base, and thus recovery by secured creditors, at the expense of the unpaid suppliers. Moreover, small and medium-sized businesses are concerned about “quick flips,” whereby a company enters receivership, does not pay unsecured creditors, and begins operations shortly thereafter under a new name but with the same assets and management structure.

The Federation provided the Committee with a number of recommendations for change that would provide unpaid suppliers with relatively more effective protection: the repossession right should be extended beyond 30 days; the rules should be clarified and made fairer for unsecured creditors; ownership of goods purchased on credit should not pass to the debtor until the goods are paid in full; unpaid suppliers should be represented on a creditors’ committee that would help to oversee the bankruptcy process; the debtor should be at arm’s length from the disposal of assets; and rules regarding asset rollovers should be tightened, with more severe penalties to prevent abuse.

Professors Ziegel and Telfer urged improved protection for unpaid suppliers of goods and argued that the “seller’s right of repossession should be converted to a lien right where the debtor has initiated reorganizational proceedings under the BIA or the CCAA.”

Equifax Canada Inc. argued that “[t]he ... 30-days goods rights ... have not provided satisfactory protections [A] reorganizing business can invariably stave off the statutory claims of unpaid suppliers until the goods in question have been consumed in the manufacturing process or have

otherwise become unavailable for recovery under the restrictive terms of the BIA.”

The Writers’ Union of Canada also commented on the issue, and told the Committee that while authors “do not own the physical copies of their works, [they] should be treated in a manner akin to the treatment of unpaid suppliers to repossess their goods proportional (sic) to unpaid amounts. ... A publisher’s ‘goods’ ... include the intellectual property. If that intellectual property has not been fully paid for, the author should have a lien on the physical books to the extent of the accrued royalties or other shortfall in payment.” The Union would like to have rights comparable to those given to farmers, fishers and aquaculturalists in the BIA.

The Committee, on balance, believes that the current provisions [with respect to unpaid supplier rights] in the BIA are not working as they were intended.

The Committee, on balance, believes that the current provisions in the BIA are not working as they were intended. According to a recent Court judgment, when abuses such as “loading up” or “quick flips” take place, creditors who are prejudiced have recourse against the directors and/or management of the offending debtor. Like our witnesses, we believe that there is a myriad of problems with the 30-day goods rule, with the consequence that the protection has no practical value. The question then to be decided is: should we recommend improvements to the existing provisions, or should we recommend that the provisions be repealed? We received much testimony to suggest that the existing provisions are not effective; moreover, they are not accessible to all suppliers – being limited to goods and to situations of bankruptcy – and are not fair from the perspective that they provide protection to recent unpaid suppliers at the expense of other creditors. Clearly, a number of the fundamental principles identified by us in Chapter Two are not being served by the current provisions. We believe that the appropriate action is their repeal, rather than their amendment, with the exception of farmers, fishers and aquaculturalists for whom the provisions remain appropriate. For this reason, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to repeal, subject to the noted exception, the provisions that provide protection for unpaid suppliers of goods to bankrupt companies. The provisions that protect the rights of farmers, fishers and aquaculturalists as suppliers should be retained.

D. Cross-Border Insolvencies

... it is important that the legal approaches to insolvency in the affected countries be adequate and harmonious in order to facilitate the recovery of financially troubled businesses if that is possible and desirable, to ensure the equitable sharing of the loss if it is not and, most generally, to ensure a fair, efficient and predictable administration of cross-border insolvencies in order to safeguard capital flows and international investment.

Canadian insolvency legislation is designed to address domestic corporate failures. With the globalization of international markets and businesses, however, there are increasing numbers of insolvencies that are international – or cross-border – in nature. From this perspective, it is important that the legal approaches to insolvency in the affected countries be adequate and harmonious in order to facilitate the recovery of financially troubled businesses if that is possible and desirable, to ensure the equitable sharing of the loss if it is not and, most generally, to ensure a fair, efficient and predictable administration of cross-border insolvencies in order to safeguard capital flows and international investment.

Through amendments in 1997, the BIA and the CCAA seek to harmonize Canadian bankruptcy and reorganization proceedings with those of other countries and to reduce jurisdictional conflicts that may arise when insolvencies involve assets that are located in more than one country. Despite the existence of these provisions, however, a number of the Committee's witnesses spoke about the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency. The stated purpose of the Model Law is:

“to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:

- Cooperation between the Courts and other competent authorities ... involved in cases of cross-border insolvency;
- Greater legal certainty for trade and investment;
- Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;

- Protection and maximization of the value of the debtor’s assets; and
- Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.”

Initiated by the United Nations Commission on International Trade Law in cooperation with the International Association of Insolvency Practitioners and with the assistance of the International Bar Association, the 1997 Model Law seeks to implement a “modern, harmonized and fair framework” – respecting differences among national laws – to apply in cases where “the insolvent debtor has assets in more than one State, or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place.” More than 70 countries – including Canada – and international organizations participated in the development process, and consensus was reached on each of the Model Law’s provisions.

In the Commission’s view, while the Model Law itself envisages the possibility of modification or incomplete adoption into the system of any particular country, this flexibility should be exercised with caution, since the desired degree of harmonization and certainty across countries is diminished when changes are made, and cooperation and coordination among affected countries in any particular case of insolvency is made more difficult.

Foreign representatives would have more rights and powers regarding possession and distribution of a debtor’s assets with the adoption of the Model Law than they now have under the BIA. Canadian insolvency rules, however, would continue to exist, and Canadian Courts would have the jurisdiction to require adequate protection for Canadian creditors and other interested parties.

Some of the Committee’s witnesses recommended that Canada adopt the Model Law as written, while others preferred that it not be adopted and still others argued that – if adoption

More than 70 countries – including Canada – and international organizations participated in the development process, and consensus was reached on each of the Model Law’s provisions.

is to occur – changes should first be made. In support of the adoption of the Model Law by Canada, the International Insolvency Institute informed the Committee that “[i]n a typical international insolvency, different sets of creditors assert different kinds of claims to different assets under different rules in different countries. . . . When insolvency or financial failure affects a multinational business, it is still most commonly dealt with through a variety of independent, separate and often-unconnected administrations, most often for different, if not conflicting, purposes.” The adoption of the Model Law would help to ensure uniformity of treatment across nations.

A number of witnesses suggested that the Model Law, if adopted, should contain a reciprocity provision according to which foreign representatives could benefit from Canadian Model Law provisions only if their country has also adopted the Model Law; such a provision would, in their view, give assistance to foreign insolvency representatives that have adopted the Model Law but deny cooperation to those that have not.

[The Committee was informed that] among the countries that have considered the Model Law, only a limited number have reciprocity requirements; Canada’s North American Free Trade Agreement partners are not among them.

The International Insolvency Institute indicated that, among the countries that have considered the Model Law, only a limited number have reciprocity requirements; Canada’s North American Free Trade Agreement partners are not among them. In its view, “to date, the weight of international opinion seems to be against the concept of a reciprocity requirement.” Moreover, “[a]dopting a reciprocity requirement would be contrary to Canada’s long-standing position of leadership in international insolvency issues. It would also be inconsistent with the international insolvency provisions that were enacted . . . in 1997 into the BIA and the CCAA.” At that time, reciprocity requirements were not considered.

Witnesses also made other suggestions. The Insolvency Institute of Canada, for example, suggested that the recognition of a foreign representative under the Model Law be conditioned by the contemporaneous appointment of a Canadian creditors’ committee to safeguard the interests of Canadian creditors in a multinational reorganization or

insolvency. The International Insolvency Institute supported this view, as did the Joint Task Force on Business Insolvency Law Reform. Even though it believed that consideration should be given to retaining the current BIA and CCAA provisions, with any needed amendments, the Joint Task Force told the Committee that “if Canada does decide to adopt the Model Law, the legislation should incorporate provisions to protect the interests of Canadian creditors [A] Canadian creditor’s (sic) committee must be appointed. . . . The committee would be funded out of foreign main proceedings and entitled to appoint legal counsel and financial advisers if necessary.”

Mr. David Baird, Q.C., of Torys LLP, told the Committee that the introduction of the Model Law into Canada should be deferred until the resolution of a number of issues raised by him regarding the transfer of assets to a foreign jurisdiction. Should the Model Law be introduced without consideration and resolution of these issues, he believed that “as a condition precedent to any order authorizing the transfer of assets to a foreign jurisdiction, the court should be required to either appoint a creditors’ committee or a licensed trustee as a monitor with such powers as may be stipulated by the court and ensure that provisions are in place to provide the creditors’ committee or monitor with reasonable funding.” He also recommended that select provisions in the BIA and the CCAA regarding coordination in cross-border insolvencies be amended to limit their use to the affairs of an insolvent party.

Further study was recommended by the Canadian Bankers Association, which indicated that it “would be opposed to the adoption of the Model Law if it would have an adverse effect on Canadian sovereignty.” It believed that the Model Law should not be adopted until analysis has assured that it would not infringe on Canadian sovereignty or negatively affect the rights of Canadian creditors, and that it would be consistent with the structure of the Canadian insolvency system.

Professor Keith Yamauchi, with the Faculty of Law at the University of Calgary, opposed the adoption of the Model

We believe – as we do with respect to international trade agreements – that harmonized and predictable rules among countries with respect to insolvency will have desirable consequences for the world’s nations, but more particularly for Canada: higher levels of trade, more investment and increased access to reasonably priced credit.

Law. He suggested that the Model Law is probably not the best law, since “it was primarily created through the work of certain proponents who represented relatively affluent countries.” In his view, “[t]he fact that Eritrea has adopted it, and certain relatively affluent countries have not, raises the concern as to whether this one-size-fits-all model will work in a major industrialized nation such as Canada.” Moreover, he commented on modifications to the Model Law, suggesting that “[m]aking changes to [it] to address Canadian culture and economics goes against the urgings of [the] UNCITRAL. ... I feel Canada must conduct a thorough review of the [M]odel [L]aw from a Canadian perspective to see if it adds anything to the Canadian business culture.”

The Canadian Bar Association indicated that “cross-border insolvencies present unique challenges to stakeholders and to the courts in coordinating and harmonizing the administration of a liquidation or a reorganization for the benefit of stakeholders in multiple jurisdictions.” In its view, “adoption of the Model Law is something to which Canada should aspire,” although modifications may be needed to ensure that the interests of Canadian stakeholders are not negatively affected by foreign insolvency proceedings. Ms. H el ene Beaulieu also shared with the Committee her views about the Model Law.

In the Committee’s view, Canadian insolvency law must be compatible with – although not necessarily identical to – the legislation in other countries, particularly the United States which is our largest and most important trading partner and the country with which the largest proportion of cross-border bankruptcies may occur. We believe – as we do with respect to international trade agreements – that harmonized and predictable rules among countries with respect to insolvency will have desirable consequences for the world’s nations, but more particularly for Canada: higher levels of trade, more investment and increased access to reasonably priced credit.

The Committee is cognizant of the leadership role Canada has had in the creation of an international insolvency law framework and in the development of the Model Law. As

well, the 1997 amendments to the BIA and the CCAA with respect to international insolvency confirm our belief that international insolvencies are occurring and require a regime within which they can be resolved. We view the adoption of the UNCITRAL Model Law as important in safeguarding the economic health of our nation and in retaining our historic leadership role. We believe, however, that reciprocity and the fair and equitable treatment of Canadian creditors in foreign proceedings are also important, particularly as a means of ensuring fairness and transparency. It is from this perspective that the Committee recommends that:

We view the adoption of the UNCITRAL Model Law as important in safeguarding the economic health of our nation and in retaining our historic leadership role.

The *Bankruptcy and Insolvency Act* be amended to incorporate the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency. Consideration should be given to adding a reciprocity provision and provisions that would assure the creation of a creditors' committee, consisting of Canadian creditors, to protect their interests. The reasonable expenses of the members of this committee should be paid by the foreign debtor, if considered appropriate by the Canadian Court.

E. Director Liability

... reduced exposure to personal liability might encourage desirable individuals to accept positions as directors.

Federal and provincial/territorial statutes expose corporate directors to personal liability for a range of corporate debts, including unpaid wages and taxes. While due diligence and/or good faith reliance defences are available in most cases, directors are subject to absolute liability for some debts, and no defence is possible. Even in the former instances, however, there is some risk.

This liability may dissuade highly competent individuals from becoming corporate directors, and from remaining with the organization during periods of financial difficulty. From this perspective, reduced exposure to personal liability might encourage desirable individuals to accept positions as directors. A high level of personal liability, however, might be supported on the basis that it should lead to highly responsible behaviour by directors in order to reduce their risks.

The subject of director liability has been examined by a federal government working group, which concluded that while their liability has increased over the 1970s and 1980s, the marketplace could address the problem and risks are manageable. In the group's view, personal liability provides directors with an incentive to perform their duties properly. The issue of director liability has also received the attention of the Standing Senate Committee on Banking, Trade and Commerce, as noted below.

Regarding sanctions for director conduct detrimental to creditors, some Courts have recently increased the responsibility of directors to consider the interests of creditors when their company becomes insolvent; in particular, they may – in appropriate circumstances – be held personally liable for failure to consider these interests.

In 1970, the *Report of the Study Committee on Bankruptcy and Insolvency Legislation* – the Tassé Report –

recommended the disqualification of directors of bankrupt companies from serving as directors and, in some situations, the imposition of personal liability on them for deficiencies in company assets. Director liability for creditors' losses was included in insolvency legislation proposed in the late 1970s and early 1980s that died on the Order Paper, and in 1986 the *Report of the Advisory Committee on Bankruptcy and Insolvency* – the Colter Report – recommended amendment of the BIA for director disqualification and personal liability for “wrongful conduct.” In the 1990s, discussion has focussed on “asset rollovers,” which occur when the assets of a bankrupt company are sold to its principals, usually its directors, sometimes at relatively low cost. The principals may begin operations using these low-cost assets, while creditors bear the burden of loss.

In the view of Professor Sarra, “[w]hile the good faith and duly diligent efforts of corporate directors and officers ought to be protected, a blanket safe harbour provision is likely to create *ex ante* incentives to fail to pay small trade suppliers, workers and pensioners, absent statutory language that appropriately balances these interests.”

Professors Ziegel and Telfer supported the concept of a uniform provision in the BIA governing the liability of directors of an insolvent corporation for unpaid wages. They noted the liability that directors have for unpaid wages under a number of business corporations acts, and highlighted the lack of uniformity, since in some cases liability is absolute while in others a due diligence defence exists.

Regarding the personal liability of directors, the Joint Task Force on Business Insolvency Law Reform told the Committee that “independent directors [should be relieved of] personal liability for obligations arising immediately prior to a filing. Independent directors typically have little or no control over whether such obligations are satisfied and so it is not appropriate to hold them personally liable for these sums so long as the debtor files for reorganization or bankruptcy on a timely basis before there are significant arrears.”

Director liability for creditors' losses was included in insolvency legislation proposed in the late 1970s and early 1980s that died on the Order Paper ...

... in earlier studies this Committee has recommended measures that would limit the scope of directors' liabilities in insolvencies.

The Joint Task Force also indicated that, “in exercising their duties during the course of a reorganization proceeding, the debtor’s directors and officers and the applicable insolvency administrators [should] take into account the priority of claims of different value and priority in the face of considerable uncertainty about the values of the business and the assets of the debtor.” It believed that doing so “would reinforce the trend in Canadian jurisprudence toward recognizing that, in insolvency, the fiduciary duties of officers and directors include an obligation to consider the best interests of creditors as well as shareholders.”

As noted above, in earlier studies this Committee has recommended measures that would limit the scope of directors’ liabilities in insolvencies. Our 1996 report *Corporate Governance* recommended incorporating provisions covering directors’ liability for wages into the BIA, with a due diligence defence. Furthermore, in our 1997 report on Bill C-5, we recommended legislating, in the BIA, a generally applicable due diligence defence against personal liability for directors. We continue to support this change, and believe that it is, in essence, a question of fairness and of responsibility. We also hope that such a change might have the desirable effect of increasing the number of competent individuals who wish to serve as directors, since in our June 2003 report *Navigating Through “The Perfect Storm”: Safeguards to Restore Investor Confidence* we identified the concern of some about the limited pool of directors in Canada. For this reason, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to include a generally applicable due diligence defence against personal liability for directors.

F Transfers at Undervalue and Preferences

Canada's provisions with respect to preferences – when an insolvent debtor pays one or more creditors at the expense of other creditors – have remained largely unchanged since the 1919 *Bankruptcy Act*. Provincial/territorial assignments, preferences and conveyances legislation has existed, as well, since Confederation. In 1967, a new concept was added to the *Bankruptcy Act*: that of “reviewable transaction.” A reviewable transaction is a transaction between parties not dealing at arm's length where the consideration given or received – as the case may be – by the debtor is significantly greater or less – as the case may be – than fair market value. In this situation, a financial advantage is effectively conferred on the other party to the transaction, to the disadvantage of the debtor and the debtor's other creditors.

These kinds of transactions, which may occur when the debtor is insolvent or may cause the debtor's insolvency, are addressed by the law because they have the effect of reducing the moneys or assets available for distribution to other creditors. Concerns exist with respect to: difficulties that may be encountered in enforcing remedies resulting from reviewable transactions that diminish the debtor's assets; uncertainty about what transactions would, and would not, be considered to be prohibited; and the limited nature of some of the provisions, with legislation at the federal level supplemented by provincial/territorial legislation.

In particular, the provinces/territories have assignments, preferences and conveyances legislation that addresses transactions or conveyances without consideration or at undervalue. The application of this legislation, however, is not limited to situations of insolvency.

The federal legislation currently focuses on fraud and intent, which are difficult to prove. Some have argued that it may be more appropriate to examine the result of the transaction, rather than the intent behind it. The federal

The federal legislation currently focuses on fraud and intent, which are difficult to prove.

legislation is rarely used because of the difficulty, time and expense associated with it; as an alternative, the parties are more likely to access provincial/territorial legislation.

In the opinion of the Canadian Bankers Association, the current framework requires improvement. The Joint Task Force on Business Insolvency Law Reform argued for consistency between the CCAA and the BIA, and advocated “a complete code in federal insolvency law, so that there would be a national standard for challenging transactions that may affect the value of creditors’ realizable claims. ... Current provincial conveyances, preferences and assignments legislation ... would continue to be available to creditors outside of the insolvency context.”

Regarding intent, the Joint Task Force told the Committee that “[t]here is some debate as to whether the BIA should retain the current test ..., which is one of establishing that the transaction was made ‘with a view to’ preferring a creditor, i.e. a subjective intention test. Other jurisdictions have moved away from this approach to a standard of assessing the effect of the transaction on the position of creditors with claims in bankruptcy. The difficulty is that transactions made in good faith are not necessarily protected from an ‘effects-based’ standard”

The Committee believes that there should be a uniform system nationwide for the examination of fraudulent and reviewable transactions in situations of insolvency. At present, there is a lack of fairness, uniformity and predictability by virtue of both federal and provincial/territorial legislation addressing fraudulent and reviewable transactions. We feel that a national standard is needed for reviewable transactions that diminish the value of the insolvent debtor’s estate and thereby reduce the value of creditors’ realizable claims. Provincial/territorial legislation would continue to exist for transactions not occurring in the context of insolvency. A national system for review of such transactions would provide the fairness and predictability that we want in our insolvency system. From this perspective, the Committee recommends that:

The Committee believes that there should be a uniform system nationwide for the examination of fraudulent and reviewable transactions in situations of insolvency.

The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to ensure consistent and simplified rules for challenging fraudulent preferences, conveyances at undervalue and other reviewable transactions. A trustee/monitor under a proposal should have the same powers as a trustee in bankruptcy. The Acts should provide a standard for challenging transactions that may affect the value of creditors' realizable claims.

G. Bankruptcy by Securities Firms

In 1997, provisions were added to the BIA to provide a regime for bankruptcy by securities firms. Although a securities firm holds securities and cash in trust for its clients who have ownership rights in that property, the BIA's provisions provide that only "customer name securities" are to be given to the clients who own them; almost all securities and cash held by the bankrupt are pooled and distributed *pro rata* among its clients.

Since the provisions came into force, a number of bankruptcies by securities firms have highlighted ways in which the BIA's provisions might be improved. In particular, problems have been encountered with respect to mutual funds held in Registered Retirement Savings Plan accounts and whether a trustee should be permitted to liquidate a large quantity of very low-valued securities and distribute cash rather than the securities.

The Canadian Bankers Association expressed support for technical changes that would aid in the efficient distribution of assets resulting from the insolvency of a securities firm.

The Committee is aware that the BIA's provisions with respect to bankruptcies by securities firms are relatively recent, and that certain problems have arisen as the new provisions have been applied since their enactment. In some sense, this outcome is predictable, since it is seldom the case that legislation – particularly in a new area of application – can fully anticipate all circumstances or all unintended consequences. In our view, efficiency and effectiveness require that changes be made to the BIA to resolve any problems regarding bankruptcy by securities firms that have been identified by stakeholders since 1997. Consequently, the Committee recommends that:

... it is seldom the case that legislation – particularly in a new area of application – can fully anticipate all circumstances or all unintended consequences.

The *Bankruptcy and Insolvency Act* be amended to clarify: the definition of “net equity;” the status of cash in the accounts of bankrupt securities firms; and the applicability of Part XII of the Act to electronic transactions.

H. Financial Market Issues

When a business reorganization occurs, the automatic stay of proceedings that occurs as a consequence has been held to apply to such financial regulators as securities commissions and/or stock exchanges.

When a business reorganization occurs, the automatic stay of proceedings that occurs as a consequence has been held to apply to such financial regulators as securities commissions and/or stock exchanges. This circumstance could limit the ability of these regulators to perform their regulatory duties and take action against companies that conduct themselves improperly, which might be particularly important when there is a heightened need to control or supervise an insolvent company and thereby ensure the integrity of the country's capital markets. From this perspective, it may be appropriate to exempt financial regulators from the automatic stay of proceedings that occurs during a reorganization.

The Ontario Securities Commission (OSC) informed the Committee that it is “concerned that a court-ordered stay of proceedings under the CCAA, which extends to the actions or proceedings by a regulator, will restrict and compromise the OSC’s ability to carry out its duties and mandate under the *Securities Act* to provide protection to investors and to foster the integrity of and confidence in the capital markets through enforcing compliance with Ontario securities law.” It noted that other securities regulators in Canada also share this concern.

The OSC believes that the current provision in the CCAA interferes with the ability of securities regulators to exercise their statutory mandate; in particular, the OSC’s mandate is to: protect investors from unfair, improper or fraudulent practices; and foster fair and efficient capital markets, and confidence in those markets. The investing public and capital market participants rely on securities regulators to carry out these types of responsibilities, and where they are restricted from doing so as a consequence of a Court-ordered stay of proceedings, faith in – and the integrity of – the system are compromised.

Consequently, the OSC proposed an amendment to the CCAA in order to exempt securities regulators from the application of a Court-ordered stay of proceedings. Such an exemption would, in its view, mirror that which is currently available for the federal Minister of Finance, the Superintendent of Financial Institutions, the Governor in Council and the Canada Deposit Insurance Corporation.

The Committee, too, is concerned about protecting investors from unfair, improper and fraudulent practices. In our June 2003 report *Navigating Through “The Perfect Storm”*: *Safeguards to Restore Investor Confidence*, we made recommendations designed to ensure the investor confidence in publicly traded companies and capital markets that is needed for our continued economic growth and prosperity. We also believe that the amendment sought by the Ontario Securities Commission would contribute to greater effectiveness and the restored confidence we – and others – are seeking. As a result, the Committee recommends that:

The Committee, too, is concerned about protecting investors from unfair, improper and fraudulent practices.

The *Companies’ Creditors Arrangement Act* be amended to give the Court the right to exempt securities regulators from Court-ordered stays of proceedings in instances where two conditions are met: the exemption is needed for the protection of third parties; and the exemption does not subject directors or senior management to undue pressure and loss of time.

The Committee also received testimony about another financial market issue: electronic money and a “partial security interest.” According to van Leeuwen Engineering Limited, a partial – or shared – security interest would allow a number of creditors to share their interest in a piece of property and essentially become secured creditors; it would enable “smaller debts to be secured, which would reduce bad debt.” While provincial/territorial legislative change would be required to establish the partial security interest, a federal amendment would be needed to allow “electronic money.” The organization suggested that access to the Canadian Payments Association should be given so that “small start-up financial-

Believing that this proposal falls outside the scope of our review, the Committee makes no specific recommendation [about electronic money and a partial security interest].

transaction companies can plug in and try out their methodologies. If they grow, they can either eventually migrate to being a bank or ... some other form of structure.” The notion of a joint payment guarantee instrument was also raised.

The Committee is aware that van Leeuwen Engineering Limited has had discussions with the Bank of Canada about the proposal, and urges the organization to continue to pursue those discussions. Believing that this proposal falls outside the scope of our review, the Committee makes no specific recommendation.

I. Insolvency Practitioner Liability as a Successor Employer

At present, trustees, receivers and other insolvency practitioners may be held personally liable, as successor employers, for certain obligations of a bankrupt or insolvent debtor. While the BIA provides some protection, not all administrators have legislative protection from all claims. In particular, obligations might include wages, vacation, severance and termination pay, as well as pension claims, even where these arise prior to the appointment of the administrator. Moreover, the administrator may be unaware of the nature and scope of these obligations when he or she agrees to provide services.

If competent individuals are to become insolvency practitioners, they must be provided with some measure of protection from personal liability in their role as administrator and not be assimilated to, or treated as, successor employers. In essence, their protection must exceed the risk they assume in providing services, otherwise they are unlikely to do so.

The Canadian Bankers Association believed that there should be greater protection for insolvency practitioners against being treated as successor employers, and supported “a clear separation of the personal liability of a trustee from the liability of the debtor’s estate. ... [T]rustees should only be personally liable for claims occurring after their appointment, and only those that arose through their negligence.”

Earlier, the Committee commented on the protection needed for directors, in part to ensure that competent individuals are willing to become directors. Similarly, we believe that insolvency practitioners need protection from personal liability, otherwise individuals are likely to be unwilling to provide these critical services. From a fairness perspective alone, it would seem reasonable to ensure that any liability they face is not the consequence of actions taken by the debtor before their appointment. For this reason, the Committee recommends that:

... we believe that insolvency practitioners need protection from personal liability, otherwise individuals are likely to be unwilling to provide these critical services.

The *Bankruptcy and Insolvency Act* be amended to separate clearly the personal liability of an insolvency practitioner from the liability of the debtors' estate.

J. Executory Contracts

Executory contracts are contracts under which something remains to be done by one or more of the parties to the contract. In essence, it is a contract where there are obligations yet to be completed. Examples include leases, intellectual property rights and employment contracts, among others. Neither the BIA nor the CCAA uses the expression “executory contract.”

Nevertheless, the existence of these contracts in a situation of insolvency raises the question of the extent to which these private contracts – negotiated in good faith and with due consideration of risk – should be altered or terminated, under what circumstances and by whom. Alteration or termination of contractual rights change expectations, reduce predictability in contracting and increase risks, which will have negative implications. As well, both contracting parties may experience harm, since the continuation of a contract may be in the best interest of both parties.

Canadian legislation in this area has existed for some time. The *Bankruptcy Act* passed in 1949 contained few restraints on completed contracts; as well, it explicitly recognized the applicability of provincial/territorial law to real estate leases. Various omnibus bills in the 1970s and 1980s, all of which died on the Order Paper, proposed that an insolvent person who wished to make a proposal could disclaim any executory contract, and the co-contracting party would have the right to file a claim in the proposal for damages; the insolvent company could continue as a going concern, while the co-contracting party to the disclaimed contract would be no worse off than if a bankruptcy had occurred.

Amendments to the BIA in 1992 provide that, after a reorganization begins, secured creditors cannot exercise their security; the termination of a lease, licensing agreement or public utility because of default was also prevented. Debtors, however, were given the ability to disclaim leases on real property.

... the existence of [executory] these contracts in a situation of insolvency raises the question of the extent to which these private contracts – negotiated in good faith and with due consideration of risk – should be altered or terminated, under what circumstances and by whom.

Witnesses presented the Committee with divergent opinions on whether disclaimer of executory contracts should be allowed, with the Court's permission, by insolvency practitioners or by co-contracting parties. Some witnesses told us that a company involved in a reorganization should be permitted to renounce such contracts. This view was held, for example, by Mr. Mendelsohn, who told the Committee – in reference to the CCAA – that “reorganizing entities [do and should] have the ability to renounce executory contracts, ... with appropriate judicial supervision.” After noting that, under the BIA, only commercial leases of real estate where the reorganizing entity is the lessee can be renounced, he argued that a coherent system of restructuring must permit the entity to renounce other executory contracts as well. He informed us that “[i]f executory contracts have to be renounced, they have to be renounced whether ... [the] company [is big or small].”

Mr. Mendelsohn also shared the view that a bankruptcy trustee should be able to assign and transfer executory contracts to third parties, including licensing arrangements and leases of premises. He believed that “a trustee in bankruptcy should be given the right to realize, for the benefit of creditors, whatever economic value resides in the assets, including executory contract assets.”

The Joint Task Force on Business Insolvency Law Reform also spoke about the ability to disclaim executory contracts and assignment to third parties. In the Joint Task Force's opinion, “[t]here should be a general right to disclaim (reject) executory contracts (including real property leases) in all bankruptcy and reorganization proceedings.” Although it does not believe that insolvent organizations or the trustee in bankruptcy should require Court approval in order to disclaim these contracts existing at the date of commencement of proceedings, the Joint Task Force argued that “the legislation could impose some pre-conditions to the exercise of the disclaimer power either generally, or with respect to certain types of contracts.”

Regarding the ability to assign executory contracts, the Joint Task Force informed the Committee that “trustees in

bankruptcy and court-appointed receivers should have the power to assign executory contracts (not including eligible financial contracts) both in connection with going concern transactions and on a liquidation basis,” subject to a number of limitations. It went on to note, however, that “[t]here should be provision for the court to prohibit an assignment if [the non-bankrupt party to the contract] establishes that the proposed assignee does not meet, in a material way, criteria reasonably applied by [it] before entering into similar agreements ... or the proposed assignee is less creditworthy than [the bankrupt] was when the executory contract was entered into and reasonable assurances of payment have not been provided with respect to any credit required to be extended to the assignee by [the non-bankrupt party] under the executory contract after the assignment.”

The Canadian Bankers Association, however, told the Committee that “[i]nsolvency law constraints on contracts can affect pre-insolvency contracting behaviour and may reduce credit availability. The new economy dictates that companies must be innovative and dynamic. In order to finance such new enterprises, financiers must be able to rely on the negotiated terms of their contracts.”

A particular executory contract – a collective agreement – was discussed by several witnesses, including representatives of organized labour. In general, their view is that the Court should not be able to terminate a collective agreement, in whole or in part. The CAW-Canada told the Committee that “the CCAA offers no authority to a Court to abrogate a collective agreement. Nor should it do so. Still, some counsel and commentators believe that Superior Courts in Canada have an ‘inherent jurisdiction’ to issue an order pursuant to the CCAA which suspends or temporarily cancels one or more terms of a collective agreement. We fundamentally disagree.”

In the union’s opinion, “[t]here can be no dispute that if the preservation of the status quo is a key objective of the CCAA, then the terms and conditions of employment defined in a collective agreement at the time of the issuance of a CCAA order must be maintained subject to the parties’ mutual authority to negotiate changes.” From this perspective, the

A particular executory contract – a collective agreement – was discussed by several witnesses, including representatives of organized labour.

CAW-Canada told the Committee that “[t]he CCAA should ... make clear that it is not open to a Court, in exercising its ‘inherent jurisdiction’ to alter, waive, or override the provisions of a collective agreement without the consent of the employer and the relevant trade union.”

A similar view was presented to the Committee by the United Steelworkers of America, which told us that “the Courts should not be entitled, under the guise of a CCAA proceeding, to interfere with the operation of freely negotiated collective agreements which affect the rights of many workers. ... [U]nions have demonstrated, in times of legitimate economic crisis, that they are capable of acting responsibly and in the best interests of their membership to agree to amendments to a collective agreement which may be necessary to enable the employer to survive. This cooperative approach is to be preferred to an approach which would eliminate workers (sic) rights with the stroke of a pen and subvert the primacy of collective bargaining.”

Moreover, the Canadian Labour Congress differentiated collective agreements from other executory contracts, and indicated to the Committee that “[j]ust as employees are not like other creditors, collective agreements are not like other contracts. ... [T]he bankruptcy and CCAA courts should not be accorded any jurisdiction over collective bargaining agreements. ... Unlike other creditors, workers are not in a position to negotiate the terms upon which they may become creditors of their employer. Unlike other creditors, they are not in a position to assess the risks that they are required to bear. Unlike other creditors, they are not able to guarantee their employer’s obligation by way of a secured charge. And unlike senior executives, they are not in a position to have their termination entitlements, including golden parachutes, set aside in trust accounts and thereby protected from bankruptcy proceedings.”

The labour federation also informed the Committee that it does not support disclaimer of collective agreements. In its view, “[t]he debtor company and the union are in the best

position to evaluate the needs of the company and are also the parties with the greatest interest in preserving the company as a going concern; they are, therefore, the appropriate parties to determine any changes to the collective agreement. The key incentive for the parties to reach an agreement is the threat that a failure to do so will lead to the bankruptcy of the debtor. ... Neither the courts nor the monitor or receiver should have the power to vacate or amend a collective bargaining agreement that was arrived at within the provincial or federal statutory framework.” The Canadian Labour Congress, however, went farther, and argued that “the value of each concession should be assigned unsecured creditor status with no less priority of valuation than any other unsecured creditor.”

In support of the views of organized labour, Professor Sara commented that “treating collective agreements as commercial executory contracts that can be unilaterally set aside ... is highly problematic.”

From the perspective of intellectual property rights, the Intellectual Property Institute of Canada indicated its preference for an approach that would limit the right of disclaimer to “unprofitable,” rather than “executory,” contracts, since there is “too much uncertainty as to what types of agreements would be found to be ‘executory’.” The Institute also made other suggestions for change.

For example, the Institute recommended that: the time limit for the exercise of the right of disclaimer be three months; the Court have the discretion to maintain the contract if the disclaimer would cause undue hardship not compensable in damages; the Court be permitted to make an order discharging the agreement and ordering payment for damages for non-performance by the trustee; aggrieved persons be given the status of a creditor of the bankrupt, to the extent of any loss suffered by reason of the disclaimer; and, where the bankrupt is a licensor of intellectual property rights, the licensee have the right to elect – within one month after receipt of the notice of disclaimer – to retain the licence. Recommendations were also made by it with respect to patents, trademarks and trade secrets.

[The Committee received testimony] with respect to patents, trademarks and trade secrets.

... we urge relevant parties to engage in the discussion needed to ensure a satisfactory resolution to the full range of issues identified to us by the Intellectual Property Institute of Canada.

Similarly, Mr. Baird, Q.C., spoke to the Committee about intellectual property issues and noted the debate that has existed for some years about “whether a trustee in bankruptcy or a bankrupt licensor or a debtor under the protection of the CCAA has the right to repudiate licences issued by the bankrupt or the insolvent debtor.” In supporting a recommendation made by the Insolvency Institute of Canada, he said that “the BIA and the CCAA [should] be amended to provide protection for a licensee of a right to intellectual property similar to that provided in the United States.”

The Writers’ Union of Canada also commented on copyright, noting the absence of copyright issues in the CCAA and the extent to which “the *Bankruptcy and Insolvency Act* less frequently applies – or doesn’t apply initially. ... When [it] does apply, it provides writers with very limited protection and often too late. A receiver or trustee in bankruptcy may already have assigned his or her rights and sold the inventory, short circuiting a possible statutory reversion of rights, depriving the author of possible revenues from sales by the trustee, and interfering with the author’s future opportunities for republication.” It also recommended that a trustee not be permitted to transfer or assign the copyright, or any interest in it, since the relationship between a writer and his or her publisher is personal; the writer should be permitted to make any alternative arrangements in the event of his or her publisher’s insolvency. Finally, the Union commented that there is a lack of clarity about whether a publishing agreement is a partial assignment of copyright or a licensing agreement under which the author retains the copyright.

While we believe that there are a variety of unresolved issues related to the insolvency of a licensor or a licensee in the context of an intellectual property licence, intellectual property law is a highly specialized area and we feel that the limited examination given by the Committee to this particular aspect of insolvency does not enable us to make any meaningful recommendations for change. Nevertheless, we urge relevant parties to engage in the discussion needed to ensure a satisfactory resolution to the full range of issues identified to us by the Intellectual Property Institute of Canada.

More generally, the Committee supports the concept of permitting disclaimer of all executory contracts, since we believe that the flexibility to take this action increases the probability of successful reorganization and thereby – in some sense – a fresher, if not fresh, start for the business. We also feel, however, that the parties to executory contracts should meet in good faith with a view to negotiating mutually acceptable changes to their contract that would enable them to meet their goals and permit the contract to continue, albeit in a changed form. We strongly believe that, in most cases, the parties will be able to come to a successful resolution; however, it is likely that situations will arise in which the parties cannot reach agreement, and in these cases we believe that disclaimer should be permitted by the Court. Nevertheless, disclaimer should only be allowed where certain conditions are met, including good faith attempts to negotiate mutually acceptable changes to the contract and serious hardship in restructuring without the disclaimer. Believing that this approach would enhance fairness, predictability and effectiveness, the Committee recommends that:

... the Committee supports the concept of permitting disclaimer of all executory contracts, since we believe that the flexibility to take this action increases the probability of successful reorganization and thereby – in some sense – a fresh, if not fresher, start for the business.

The Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act be amended to permit disclaimer of executory contracts in existence on the date of commencement of proceedings under the Acts. This disclaimer should apply to all executory contracts, provided a number of conditions are met. In particular: the debtor should be obliged to establish inability or serious hardship in restructuring the enterprise without the disclaimer; the co-contracting party should be permitted to file a claim in damages in the restructuring; and, where a collective agreement is being disclaimed, the debtor should also have the burden of establishing that post-filing negotiations have been carried on, in good faith, for relief of too onerous aspects of the collective agreement and should establish in Court that the disclaimer is necessary in order to allow for a viable restructuring.

Moreover, the Committee is of the view that trustees, Court-appointed receivers and monitors should be able to assign executory contracts where doing so would enhance the value of the assets and, thereby, moneys available for

distribution to creditors. We recognize that while this circumstance would not permit the co-contracting party to choose its commercial partner, we feel that if the co-contracting party is no worse off financially, it would suffer no prejudice. As well, efficiency and effectiveness – two principles that we believe should characterize our insolvency system – would be enhanced. From this perspective, the Committee recommends that:

The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit trustees, Court-appointed receivers and monitors, if authorized by judgment, to assign executory contracts when appropriate, in connection with going concern transactions and on a liquidation basis, provided that two conditions are met: the proposed assignee is at least as credit worthy as the debtor was at the time the contract was entered into; and the proposed assignee agrees to compensate the other party for pecuniary loss resulting from the default by the debtor or give adequate assurance of prompt compensation.

K. Workers' Compensation Board Premiums

Based on a system that originated in Germany in 1884, workers' compensation is a form of insurance designed to help employees who are injured on the job or who are affected by industrial disease to receive compensation and, ideally, return to work. In essence, it represents a compromise between employers and employees; with enactment of legislation across Canada, workers gave up the right to sue their employers for injuries at work and employers agreed to contribute to a fund that finances benefits for work-related injuries and illnesses, regardless of fault.

Across Canada, workers' compensation systems generally ensure that injured workers receive: first-aid treatment on the job or at the nearest local treatment facility; benefits while recuperating from injuries; proper treatment for injuries; and, if needed, rehabilitation to help the employee return to his or her job, or to a modified job if required by the circumstances.

Prior to 1997, the BIA provided that claims of Workers' Compensation Boards were granted a priority over claims of unsecured creditors; this priority ended, however, with respect to bankruptcies occurring after 1997. Since that time, these claims have only been secured if a security interest was registered, or otherwise obtained, in the same manner as is available to persons other than the Crown or a workers' compensation body. As a result Workers' Compensation Board claims have, generally, been treated as unsecured claims since 1997.

The Association of Workers' Compensation Boards of Canada spoke to the Committee about the important role played by workers' compensation as "an essential component of an integrated fabric of social and economic support that is fundamental to our society." As a program of wage replacement and services, in 2001 about 374,000 Canadian workers and their families received a range of benefits from workers' compensation, including wage replacement, health care, rehabilitation services and family fatality benefits; the cost of these benefits totalled \$6 billion.

Prior to 1997, the BIA provided that claims of Workers' Compensation Boards were granted a priority over claims of unsecured creditors; this priority ended, however, with respect to bankruptcies occurring after 1997.

The Committee was told that, prior to recent amendments to the BIA, Workers' Compensation Board premiums were considered to be deemed trusts. We were informed that, since 1996, the removal of this status has resulted in an estimated \$175 million loss for Workers' Compensation Boards as workers' compensation premium claims are now treated as unsecured commercial debts. Moreover, we were told that the loss, in turn, has compromised the benefits and services that would otherwise be available to injured workers and their families. In the view of the Association, this reduced status neglects the role historically played by workers' compensation as a "public insurance program supporting the economic and social needs of injured workers and their families." In its opinion, this role differs fundamentally from that played by commercial creditors.

Consequently, the Association recommended that the *Bankruptcy and Insolvency Act* be amended to recognize Workers' Compensation Board premiums as deemed trusts, which would give them the same secured creditor priority as the Canada/Quebec Pension Plan and employment insurance premiums over lending institutions and other secured creditors. In its opinion, allowing Workers' Compensation Boards to recoup their claims in bankruptcy would affect credit costs in Canada negligibly.

The result of this change would be that, in a bankruptcy, Workers' Compensation Board claims would be superior to those in favour of a bank or other lending institution in all jurisdictions. The Association informed the Committee that this treatment would have several advantages. First, it would "[e]nsure the primacy and sustainability of [the] social-economic safety net." Workers' compensation, along with employment insurance and the Canada/Quebec Pension Plan, is "fundamental to Canadian society ... [and] must be protected from revenue loss as a result of employer bankruptcy." It is a key component of the nation's social safety net and "should be recognized as a secured creditor serving the public interest rather than as another commercial creditor."

Second, while provincial/territorial legislation gives workers' compensation assessments/premiums priority in bankruptcy, the BIA does not do so and thereby "creates two different systems for distributing the debtor's assets, depending on whether or not there is formal bankruptcy;" from this perspective, amending the BIA to provide for this priority would contribute to legislative consistency across jurisdictions and support "certainty in commercial relations."

Third, priority status for workers' compensation assessments/premiums would contribute to "the fair distribution of [a] debtor's assets" since the Canada/Quebec Pension Plan, employment insurance and workers' compensation would be "equal as income security and trusts."

Fourth, returning the treatment of workers' compensation assessments/premiums in bankruptcy to their pre-1997 status would promote the "economic sustainability of workers' compensation." This sustainability is important, in the Association's view, since affordable premiums are important to help businesses constrain their labour costs and thereby enhance their competitiveness; affordability also makes Canada a more attractive country within which to invest. According to the Association, the current inability of Workers' Compensation Boards to recover moneys from insolvent companies indirectly means that premium-paying employers are paying for the bankruptcies. As well, "[u]npaid premiums result in additional costs for paying employers" as premiums rise.

Finally, in the Association's opinion, priority status for workers' compensation assessments/premiums would ensure that the proper parties bear responsibility for bad credit decisions. The Association believes that the "BIA places the burden of failed business loans on workers' compensation, not the lenders where it belongs." As a legislated program, workers' compensation is not able to choose its customer or limit its risk; Workers' Compensation Boards must recognize the claim of an injured worker regardless of his or her employer's payment of assessments/premiums, and they are unable to refuse insurance to workplaces or employers that

[The Committee was informed that] Workers' Compensation Boards must recognize the claim of an injured worker regardless of his or her employer's payment of assessments/premiums, and they are unable to refuse insurance to workplaces or employers that may have significant liabilities or that may default on assessments/premiums.

may have significant liabilities or that may default on assessments/premiums. The Association believed that banks and lending institutions, on the other hand, select their clients to manage their risk.

The Association also told the Committee that one of the goals of the BIA is not being realized with the current system. It said that “[o]ne of the goals of the BIA is the fair distribution of debtor’s assets among the creditors. However, in reality, the current scheme is not fair to workers, employers and workers’ compensation boards and commissions because it allows lenders to use the BIA to obtain the assets of bankruptcy thereby defeating the interests of workers, employers and workers’ compensation.”

In recognition of workers’ compensation as an element of our social safety net, it argued that “[a]s a matter of public policy, workers’ compensation should not be penalized or placed at a disadvantage in a bankruptcy proceeding. The financial stability of workers’ compensation ... should not be put at risk. Nor should the capacity of workers’ compensation boards and commissions to meet commitments be weakened because of difficulties in recovering unpaid premiums.”

The Committee was informed that, in turn, the ability of Workers’ Compensation Boards to deliver benefits would be increased and workers’ compensation would have the same treatment as employment insurance and the Canada/Quebec Pension Plan, which – according to the Association – likewise offer wage protection. Re-establishing this priority would reduce the extent to which Workers’ Compensation Board revenues are lost to chartered banks in the event of bankruptcy.

While the Committee agrees that workers’ compensation is a key component of a system designed to assist workers and their families in the event of job-related illness or injury, we are unable to support the recommendation of the Association of Workers’ Compensation Boards of

Canada. In our view, the situation that existed before 1997 whereby priority over unsecured claims was granted to claims of all Workers' Compensation Boards should be reinstated. Moreover, we note that a recommendation made by us elsewhere in the report would, if adopted, import the priorities contained in the BIA into the CCAA; this change would give Workers' Compensation Board premium claims the same treatment under CCAA proceedings as under BIA proceedings. From this perspective, the Committee recommends that:

... we note that a recommendation made by us elsewhere in the report would, if adopted, import the priorities contained in the BIA into the CCAA ...

The *Bankruptcy and Insolvency Act* be amended to return the treatment of Workers' Compensation Board premiums to that which existed prior to 1997.

L. Interim Receivers

Before 1992, the interim receiver's role was to be a "temporary watchdog" of the debtor's property, and he or she was appointed to protect the estate or the interest of creditors pending the granting of a receiving order.

Under the BIA, receivers are appointed to liquidate a debtor's assets for the benefit of secured creditors. To an increasing extent, interim receivers are being used for that purpose. There are concerns about the extent of an interim receiver's powers, the jurisdictional basis for the scope of the orders made and the impact on the rights of affected third parties in the absence of the Court determining the need for such liquidations prior to judgment.

Before 1992, the interim receiver's role was to be a "temporary watchdog" of the debtor's property, and he or she was appointed to protect the estate or the interest of creditors pending the granting of a receiving order. In some jurisdictions, however, interim receivership is now being used in a manner that permits the interim receiver to take possession of the debtor's assets, operate its business and, in some cases, sell assets and distribute the proceeds to secured creditors before judgment. Consequently, at times, the powers of the interim receiver closely resemble those of a trustee or Court-appointed receiver; the interim receiver has not, however, been bound by the duties and responsibilities of a trustee or receiver.

The Canadian Bar Association argued that the expanded role of some interim receivers fails to protect the debtor, ordinary creditors or affected third parties. In its view, the interim receiver's role must be more clearly defined. Moreover, the Association believed that if interim receivers play a role analogous to that of Court-appointed receivers, they should be subject to the same obligations and requirements; where their roles are the same, the definition of "receiver" should be amended to include, specifically, "interim receivers."

The Committee believes that the role of interim receivers has evolved over time, and that clarity is needed

about what should be their role, duties and responsibilities. In our view, “interim” should mean exactly that, and if a broadened or extended role is needed – or desired – then legislative change should occur in order to reflect this fact. It is, in essence, a matter of fairness and predictability, since interim receivers who act in a capacity similar to trustees or Court-appointed receivers should have not only the same powers, but also the same duties and responsibilities. Consequently, the Committee recommends that:

In our view, “interim” should mean exactly that, and if a broadened or extended role is needed – or desired – then legislative change should occur in order to reflect this fact.

The *Bankruptcy and Insolvency Act* be amended to clarify the role of the interim receiver, and the duration and meaning of the term “interim.” As well, the definition of “receiver” should be amended to include interim receivers when they operate in a manner similar to Court-appointed receivers.

M. Going Concern and Asset Sales

During a reorganization, an insolvent company may benefit from an opportunity to sell part of its business in order to generate capital, avoid further diminution in value and/or focus better on the financially solvent aspects of its operations.

During a reorganization, an insolvent company may benefit from an opportunity to sell part of its business in order to generate capital, avoid further diminution in value and/or focus better on the financially solvent aspects of its operations. In some situations, a win-win situation would be created: insolvent companies would be able to increase their chance of survival as they gain capital and focus on their solvent operations, and creditors would avoid further reductions in the value of their claims. These sales would occur outside the normal course of the organization's business. In some cases, the best situation for stakeholders might involve the sale of the business in its entirety.

At present, the Court exercises its inherent jurisdiction in approving these asset sales. It does so, however, without any legislative guidance about when and how such sales should occur.

The Joint Task Force on Business Insolvency Law Reform told the Committee that “[i]n practice, successful restructurings usually require much more than simply obtaining financial concessions from existing creditors. They usually involve an operational restructuring of the business as well as a financial restructuring. ... The debtor may need to sell or shut down parts of its business, either to generate new capital or to withdraw from the financially unhealthy parts of its business in order to save the financially sound parts. ... In some situations, the economic and social objectives of the insolvency system can be better achieved through a sale of the debtor's business as a going concern to a new owner, rather than through the restructuring of the legal entity that is the current owner.”

The Joint Task Force provided the Committee with a non-exhaustive list of guidelines that it believed would give the Court “substantive direction” regarding factors to consider in deciding whether to approve a sale of assets – in whole or in part – on a going concern basis during a CCAA proceeding.

In particular, it suggested that the Court might assess whether the sales process has been conducted:

- “(a) in a fair and reasonable manner;
- (b) by an insolvency administrator;
- (c) by a credible, independent chief restructuring officer reporting to a credible, independent restructuring committee of the board of directors either with or without supervision of the court; and/or
- (d) in consultation with major creditors.”

When the debtor – instead of being reorganized under the CCAA – has made a proposal under the BIA, the Joint Task Force indicated that there may not be a restructuring officer or a restructuring committee. In that case, input should be sought and obtained from major creditors, as is envisaged with respect to reorganizations under the CCAA, but with greater emphasis on their views.

The Committee was also informed about “quick flips,” which involve shareholders, directors or other senior officers of the company becoming involved in a sale of assets where they have a significant financial interest in the purchaser of the assets or in the sales transaction. The Joint Task Force noted that, in some cases, a sale of this nature may be beneficial since it may maximize realizable value for creditors. It believed, however, that such sales should only be permitted in “exceptional circumstances” unless “there was a proper sales process either subject to court supervision or conducted by persons acting independently of such persons.”

The Committee also believes that there are circumstances where all stakeholders would benefit from an opportunity for an insolvent company involved in reorganization to divest itself of all or part of its assets, whether to raise capital, eliminate further loss for creditors or focus on the solvent operations of the business. We feel, however, that the Court must be involved in approving such sales and that it should be provided with some guidance

regarding minimum requirements to be met during the sale process. Finally, in our view, asset sales to shareholders, directors, officers or senior management – whether in whole or in part – should only occur in exceptional circumstances, which would include situations where it can be shown that such a sale would benefit creditors. Believing that such sales would contribute to greater fairness and efficiency, the Committee recommends that:

The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit the debtor, subject to prior approval of the Court, to sell part or all of its assets out of the ordinary course of business, during reorganization and without complying with bulk sales legislation. Similarly, the debtor should be permitted to sell all or substantially all of its assets on a going concern basis. On an application for permission to sell, the Court should take into consideration whether the sales process was conducted in a fair and reasonable manner, and whether major creditors were given reasonable notice, in the circumstances, of the proposed sale and had input into the decision to sell. No such sale to controlling shareholders, directors, officers or senior management of the debtor having a significant financial interest in the purchaser or in the sales transaction should be permitted, other than in exceptional circumstances.

N. Governance

In insolvency proceedings, especially CCAA reorganizations and BIA proposals, all persons to whom power and authority have been given should act in good faith, competently and without conflict of interest. They should also diligently and conscientiously perform any responsibilities they may have been given. In essence, good governance must prevail. To some extent, good governance is assured through the obligations placed on insolvency practitioners appointed or approved by the Court, including trustees, receivers and monitors. As well, it is enhanced when practitioners are licensed, and when all stakeholders act transparently.

The Joint Task Force on Business Insolvency Law Reform informed the Committee that “there is [a] need to give statutory recognition to the importance of proper governance of financially troubled businesses.” It also noted that “[m]anaging the affairs of an insolvent debtor often involves balancing the conflicting interests of parties with claims of different value and priority in the face of considerable uncertainty about the values of the business and assets of the debtor.” It believed that “there are certain situations ... where the court should have the ability to alter the debtor’s management, including by replacing some or all of the existing directors or by appointing a qualified party with some degree of authority to manage the debtor’s operations.”

Independence of insolvency practitioners was supported by the Canadian Bar Association, which recommended that “a general standard of independence of insolvency representatives be adopted.”

The Committee has long had an interest in good governance, and has issued a number of reports addressing the principles of good governance, including our 1996 report *Corporate Governance* and our June 2003 report *Navigating through “The Perfect Storm”: Safeguards to Restore Investor Confidence*. In the current context, we believe that all officers of the Court involved in proceedings under the BIA and/or the CCAA

In insolvency proceedings, especially CCAA reorganizations and BIA proposals, all persons to whom power and authority have been given should act in good faith, competently and without conflict of interest.

... proper governance of the organization involved in the restructuring is required, and the organization's directors must positively assist in the restructuring efforts; ...

should act in a manner characterized by good faith, competent execution of their duties and freedom from real or perceived conflicts of interest; disclosure of any circumstances that could be construed as a conflict of interest must occur. Behaviour consistent with such a standard will ensure the fairness, predictability and transparency we seek and will instil, in domestic and foreign stakeholders, confidence that our insolvency system has integrity. Moreover, proper governance of the organization involved in the restructuring is required, and the organization's directors must positively assist in the restructuring efforts; if they do not, they should be replaced and a proper governance structure implemented. For these reasons, the Committee recommends that:

The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit the Court to replace some or all of the debtor's directors during proposals or reorganizations if the governance structure is impairing the process of developing and implementing a going concern solution. Moreover, prior to appointment, a trustee/monitor should disclose, to the Court, any business and legal relationships it has or has had with the debtor. The auditor or recent former auditor of the debtor should not be permitted to be the monitor. Furthermore, the monitor should not be permitted, in the event of a failed restructuring, to become the trustee or a receiver for a secured creditor.

O. Plan Approvals

In general, reliance upon “majority rule” as a voting mechanism can be problematic, since this rule can be abused by related parties or by parties who derive collateral benefits from the decisions of the group. In recognition of this potential problem, the BIA and the CCAA give the Court discretion to refuse to approve a restructuring plan or proposal even if it has received approval by a majority of the creditors. The Acts, however, provide very limited guidance about the manner in which the Court is to exercise that discretion.

While the BIA provides guidance on procedures to follow in order to secure approval of a restructuring plan, virtually no guidance in this regard is provided in the CCAA.

The Joint Task Force on Business Insolvency Law Reform informed the Committee that the BIA’s provision regarding the vote of a creditor who is related to the debtor should be extended to the CCAA, and that minority creditors should be protected through a requirement “under both the BIA and the CCAA that ... dissenting minority creditors will not be prejudiced by the reorganization plan as compared to a liquidation.”

As a matter of fairness and predictability, and recognizing the potential for abuse of majority voting mechanisms, the Committee believes that the Court should continue to have discretion, under both the BIA and the CCAA, to not approve a restructuring plan even where the plan has the support of the majority of voting creditors. To assist the Court in determining whether it should exercise this discretion, we feel it would be useful to require the trustee or monitor to provide his or her opinion about whether dissenting creditors are likely to receive less under the plan than they would receive in a liquidation. We also feel that, in some cases, the prospect of successful reorganization is enhanced where the equity of the organization is reorganized.

... the Committee believes that the Court should continue to have discretion, under both the BIA and the CCAA, to not approve a restructuring plan even where the plan has the support of the majority of voting creditors.

At this time ... neither Act gives the Court the authority to reorganize share capital.

At this time, however, neither Act gives the Court the authority to reorganize share capital. In our view, this inability limits effectiveness. We believe that the Court should have this ability, and should be able to exercise its authority to reorganize share capital, with or without consent of shareholders, who could veto an arrangement to the detriment of creditors. For these reasons, and to enhance fairness, predictability and effectiveness, the Committee recommends that:

The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to require a trustee/monitor to provide, in connection with a request for Court approval of a reorganization plan, an opinion that, as a group, each of secured creditors and unsecured creditors are likely to receive no less under the plan than it would receive in a liquidation. Moreover, Section 54(3) of the *Bankruptcy and Insolvency Act* regarding related parties should be incorporated in the *Companies' Creditors Arrangement Act*. Finally, the Acts should be amended to provide the Court approving a reorganization plan with the power to approve a restructuring of the equity of the debtor, with or without shareholder approval.

P. Priorities

The BIA creates a priority scheme for the distribution of the proceeds of realization of the debtor's assets. This scheme, which implicitly recognizes that situations of insolvency – by definition – involve insufficient realizable assets to satisfy all claims, provides that – subject to the claims of secured creditors – certain other groups of creditors, such as employees, municipalities and landlords, have priority over other unsecured creditors in the distribution of the proceeds of realizations of the debtor's assets, subject to certain limitations.

The priority scheme in the BIA does not apply to CCAA proceedings or to receiverships. Moreover, provincial/territorial legislation has created statutory security interests and deemed trusts that give some claims priority over those of even secured creditors and, in any event, priority over the claims of unsecured creditors. The priority accorded Crown claims applies in the case of BIA proceedings but does not apply to CCAA proceedings or receiverships.

On the issue of differences in priorities, the Joint Task Force on Business Insolvency Law Reform commented that “[t]here is no justification for these discrepancies.” It advocated the application of BIA priority rules in BIA and CCAA proceedings and in receiverships, suggesting that “[c]reditors’ relative entitlements should not vary depending on the nature of the proceedings.”

From the perspective of fairness, the Committee too believes that the same priority rules should govern the distribution of the proceeds of realization of the debtor's assets, regardless of the insolvency legislation under which proceedings are occurring. For this reason, the Committee recommends that:

The Companies’ Creditors Arrangement Act be amended to incorporate the priority rules in the Bankruptcy and Insolvency Act.

... situations of insolvency – by definition – involve insufficient realizable assets to satisfy all claims ...

Q. Insolvency of Other Vehicles

As a risk management tool, business – or income – trusts may be used as financing vehicles.

As a risk management tool, business – or income – trusts may be used as financing vehicles. In fact, it has been estimated that 86% of initial public offerings in Canada in 2002 were offerings of units in income trusts. In 2003, more than 100 income trusts, with more than \$45 billion in market capitalization, were listed on the Toronto Stock Exchange.

At a simplistic level, a trust sells units to the public and invests in a business; the unitholders are the beneficiaries of the trust, and the trustees hold all or part of the equity interests in the business; most of the funds are advanced to the business in the form of a loan. The terms of the loan frequently provide that the before-interest-expense income of the business will be distributed to the trustees as interest, thereby reducing the taxable income of the business. In turn, the trustees distribute the moneys received to the unitholders, and the moneys are then taxed as income. From the perspective of the holder, holding a unit in an income trust is conceptually similar to holding a share in a corporation.

In the view of the Joint Task Force on Business Insolvency Law Reform, the BIA should be amended to clarify that trusts used as financing vehicles can be liquidated under the BIA, but they cannot be reorganized.

Mr. Bruce Leonard told the Committee that “[t]he problem with income trusts from a bankruptcy or reorganizational point of view is that their structure is such that it is not clear that they are covered or dealt with under either ... the BIA or the CCAA. My suggestion ... would be to have both [Acts] amended so that these vehicles, which are becoming so important commercially in Canada, ... would be able to reorganize in the same fashion as ordinary corporations [should they fall into financial difficulty] I would use the definition of ‘commercial trust’ meaning a trust in which interests are acquired for consideration so that it is clear that it is a commercial transaction, not a family or a charitable transaction.”

The Committee is aware that business trusts are increasingly popular and are being used to finance a wide range of business undertakings, including real estate, utilities, transportation, ice manufacturing, cheque printing, customs brokerage, seafood processing and natural resources. Clearly, they are becoming a tool in which investors have confidence, which is particularly important in times such as these when North America has witnessed a number of corporate scandals. Since these trusts are not accumulating retained earnings and are not re-investing in capital equipment, they are perhaps relatively more vulnerable to financial downturns. Trusts, however, are neither persons nor corporations, and consequently are not covered by either the BIA or the CCAA. We believe that, given their structure and importance as a financing mechanism for companies, they should be addressed within insolvency legislation.

Although the Joint Task Force limited its recommendations to allowing trusts to be liquidated under the BIA, the Committee believes that circumstances could arise in which reorganization of a trust under either the BIA or the CCAA, rather than its liquidation, would be beneficial. For these reasons, and to recognize the contribution made by business trusts to the efficient operation of Canadian businesses, the Committee recommends that:

The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to provide for the liquidation or the reorganization of a business trust.

We believe that, given their structure and importance as a financing mechanism for companies, [business trusts] should be addressed within insolvency legislation.

R. Income Tax

At present, the conversion of debt into equity can lead to debt forgiveness in certain circumstances, and the financial implications of debt forgiveness rules can effectively hinder reorganization.

In certain situations, insolvent debtors are able to convert debt into “distress preferred shares,” which are accorded special treatment under the *Income Tax Act* but are relatively costly to create. In particular, revenue received by the holder in respect of such shares is given favourable tax treatment, since it is treated as dividend income rather than as interest income. This treatment provides a relatively low cost means of financing a restructuring.

At present, the conversion of debt into equity can lead to debt forgiveness in certain circumstances, and the financial implications of debt forgiveness rules can effectively hinder reorganization. Consequently, an insolvent debtor could sell assets rather than reorganize. Moreover, proposed distress preferred share holders frequently require a favourable tax ruling before accepting this treatment and the delays in obtaining such rules are inconsistent with the speed required in reorganizations.

The Joint Task Force on Business Insolvency Law Reform proposed to the Committee that “a creditor and an insolvent debtor [be allowed] to elect to treat a loan as if distress preferred shares had been issued.” Such a change, it argued, is “aimed at both fairness and efficiency in complying with current tax policy ... and [would] not require any change in tax policy ... [or the *Income Tax Act*] requirements for qualifying for the tax benefit of distress preferred shares. Rather, the election is aimed at making use of distress preferred shares more accessible Instead of requiring an elaborate set of ... transactions in order to convert the debt into distress preferred shares, parties could simply file a notice of election.” Consequently, costs would be reduced, as would the time taken to make decisions and rulings; accessibility to this means of financing a restructuring would be enhanced.

The Joint Task Force also suggested that “tax policy should be neutral as between a choice of the debtor company restructured or a new corporation acquiring the business

assets, and thus the same tax treatment should be available in either situation.” In its view, the debtor should be permitted to elect fresh start accounting for tax purposes as if it were a new taxpayer from the point in time when the restructuring plan is approved and effective.

The Committee feels that the costs of restructuring should be minimized, to the extent reasonably possible, in order to provide insolvent companies with an incentive to reorganize rather than become bankrupt, should that be in the best interest of stakeholders. We feel that allowing an election that would permit a loan to be treated as distress preferred shares would promote efficiency in the insolvency system. Moreover, in our view, fairness and efficiency would be enhanced if the debtor, on consummation of a plan of arrangement, is allowed to use fresh start accounting for tax purposes. Both of these changes would, we believe, lead to reorganization rather than bankruptcy, where preferable for stakeholders. For these reasons, the Committee recommends that:

The Committee feels that the costs of restructuring should be minimized, to the extent reasonably possible, in order to provide insolvent companies with an incentive to reorganize rather than become bankrupt, should that be in the best interest of stakeholders.

The *Income Tax Act* be amended to provide that distress preferred share treatment for tax purposes be afforded to qualifying debt, for a specified period of time, by filing a notice of election with the Canada Customs and Revenue Agency. Moreover, on the consummation of a plan of arrangement, a debtor should be able to elect to use fresh start accounting for tax purposes, with tax obligations relating to the period prior to the date of bankruptcy addressed as pre-filing claims.

S. Subordination of Equity Claims

Canadian insolvency law does not subordinate shareholder or equity damage claims.

Insolvency legislation in the United States has created the concept of “subordination of equity claims.” Equity claims are those claims that are not based on the supply of goods, services or credit to a corporation, but rather are based on some wrongful or allegedly wrongful act committed by the issuer of an instrument reflecting equity in the capital of a corporation. Conceptually, this type of claim relates more to the loss of a claimant who holds shares or other equity instruments issued by a corporation, rather than the claims of traditional suppliers. In American legislation, such claims are subordinated to the claims of traditional suppliers.

Canadian insolvency law does not subordinate shareholder or equity damage claims. It is thought that this treatment has led some Canadian companies to reorganize in the United States rather than in Canada.

Mr. Kent, for example, told the Committee that “[i]f [a shareholder’s rights claims by people who say that they have been lied to through the public markets] is filed in Canada, there is no facility in place to deal with it. They have no choice but to file in the U.S. where there is a vehicle to deal with these claims in a sensible, fair and reasonable way. In Canada, we have no mechanism. Thus, you end up with situations where it becomes difficult to reorganize a Canadian enterprise under Canadian law because our laws do not generally deal with shareholder claims.”

He also indicated, however, that shareholder claims may be addressed within specific corporate statutes. Mr. Kent mentioned, in particular, the *Canada Business Corporations Act* and some provincial/territorial statutes, and shared his view that “[i]t becomes a lottery, depending on where the corporation is organized, whether there is a vehicle for dealing with some of these claims or there may not be. It is a hodgepodge system.”

The Joint Task Force on Business Insolvency Law Reform shared with the Committee a proposal that all claims arising under or relating to an instrument that is in the form of equity are to be treated as equity claims. Consequently, “all [equity] claims against a debtor in an insolvency proceeding ... including claims for payment of dividends, redemption or retraction or repurchase of shares, and damages (including securities fraud claims) are to be treated as equity claims subordinate to all other secured and unsecured claims against the debtor” It also proposed that these claims could be extinguished, at the discretion of the Court, in connection with the approval of a reorganization plan.

In view of recent corporate scandals in North America, the Committee believes that the issue of equity claims must be addressed in insolvency legislation. In our view, the law must recognize the facts in insolvency proceedings: since holders of equity have necessarily accepted – through their acceptance of equity rather than debt – that their claims will have a lower priority than claims for debt, they must step aside in a bankruptcy proceeding. Consequently, their claims should be afforded lower ranking than secured and unsecured creditors, and the law – in the interests of fairness and predictability – should reflect both this lower priority for holders of equity and the notion that they will not participate in a restructuring or recover anything until all other creditors have been paid in full. From this perspective, the Committee recommends that:

In view of recent corporate scandals in North America, the Committee believes that the issue of equity claims must be addressed in insolvency legislation.

The *Bankruptcy and Insolvency Act* be amended to provide that the claim of a seller or purchaser of equity securities, seeking damages or rescission in connection with the transaction, be subordinated to the claims of ordinary creditors. Moreover, these claims should not participate in the proceeds of a restructuring or bankruptcy until other creditors of the debtor have been paid in full.

T. Administrative Tribunals and Stays of Proceedings

At present, the CCAA gives provincial/territorial Superior Courts the power to stay “an action, suit, or proceeding brought against the company” when an insolvent company becomes subject to a CCAA order.

At present, the CCAA gives provincial/territorial Superior Courts the power to stay “an action, suit, or proceeding brought against the company” when an insolvent company becomes subject to a CCAA order. Consequently, some Courts have issued stay of proceedings orders with respect to administrative tribunals. Administrative tribunals are used to resolve disputes in the areas of labour relations, human rights, the environment, energy, transportation, communication, securities and justice, among others.

Although the Ontario Securities Commission presented testimony to the Committee, most of our witnesses focused on administrative tribunals in one area only: labour relations. The CAW-Canada shared with the Committee its view that “the word ‘or’ ... must be interpreted in the context of the words ‘action’ and ‘suit,’ which both refer to judicial proceedings. The common feature of the words ‘action,’ ‘suit’ and ‘proceeding’ is that they are judicial proceedings. The term ‘proceeding’ ... was not intended to include extra judicial (that is non-court) proceedings such as grievance/arbitration matters, health and safety complaints before labour boards, or human rights complaints filed with human rights commissions. Regrettably, several courts ... have issued wide ranging stay orders, covering administrative tribunals ..., which have only an incidental impact on the financial or business affairs of an insolvent company.”

The union argued that “[i]t is important to discern what the purpose of a stay order is: it is to preserve the status quo between creditors in the company by preventing any maneuvers for positioning among creditors during the interim stay period which would give an aggressive creditor an advantage to the prejudice of others, ..., and would further undermine the financial position of the company, making it less likely that the eventual ‘arrangement’ would succeed. ... If a broad stay order suspending the prosecution of employment rights disputes is issued in favour of an insolvent corporation

... then the CCAA has been used to place the insolvent company in a better position than it was before the statute was triggered. ... [T]he statute is designed to preserve the status quo, not put the insolvent corporation in a better position, and fundamentally above the law.”

In the view of the CAW-Canada, the CCAA should be clarified in order to exempt, from the application of a stay of proceedings, all employment-related proceedings brought before non-judicial administrative tribunals. It told the Committee that “a working grievance and arbitration process is critical if day to day issues in the workplace are to be resolved with a minimum of disruption. ... Grievances routinely deal with both monetary and non-monetary matters, including, for example, health and safety issues, sexual harassment complaints, discrimination complaints, and providing remedies for employees who have been wrongfully disciplined, or whose employment [has] been wrongfully terminated. ... [T]he remedies afforded by the grievance and arbitration process are not in the nature of a pre-filing debt or liability which can be compromised under the CCAA.” It believed that there is no justification for eliminating recourse to the grievance arbitration process while employees continue to work for a company undergoing reorganization.

In the Committee’s view, administrative tribunals decide a number of issues that are important to Canadians. While employees themselves are probably the main beneficiaries of decisions in certain labour relations matters, society benefits – in a broad sense – from the existence of human rights tribunals to safeguard the protection from discrimination that our nation desires. Moreover, administrative tribunals decide issues in a number of other areas that have a public interest component, including disputes related to the environment, justice and securities, among others. We generally believe that a stay of proceedings granted under the CCAA should not apply to the activities of administrative tribunals, since many of their decisions are made in areas that clearly fall within the public interest.

The Court and commentators have justified staying proceedings of administrative tribunals by asserting that the

We believe that a stay of proceedings granted under the CCAA should not apply to the activities of administrative tribunals, since many of their decisions are made in areas that clearly fall within the public interest.

... an appropriate balance must be sought between the fundamental importance of a broad range of administrative proceedings in our current environment and the need to focus the attention of directors and senior management on a successful reorganization.

energy and attention of the directors and senior management of companies undergoing reorganization should be devoted – virtually entirely – to the reorganization, and not diverted or distracted by the requirement to deal with administrative proceedings. As is the case in some other areas, however, an appropriate balance must be sought between the fundamental importance of a broad range of administrative proceedings in our current environment and the need to focus the attention of directors and senior management on a successful reorganization.

While allowing administrative tribunal activities to continue would support the fundamental principles of fairness and predictability that we are seeking in our insolvency system, we feel that directors and senior management of corporations in reorganization procedures must remain focused on the goal of a successful reorganization. Consequently, the Committee recommends that:

The *Companies' Creditors Arrangement Act* be amended to exempt, from the application of stays of proceedings and subject to Court discretion, all proceedings brought before non-judicial administrative tribunals. The exemption should be granted where two conditions are met: the exemption is needed for the protection of third parties; and the exemption does not subject directors or senior management to undue pressure and loss of time.

CHAPTER SIX: THE SENATE COMMITTEE'S EVIDENCE AND RECOMMENDATIONS ON ADMINISTRATIVE AND PROCEDURAL ISSUES

A. Volume of Filings, Access to the Process and Funding of the Office of the Superintendent of Bankruptcy

The *Bankruptcy and Insolvency Act* gives the Office of the Superintendent of Bankruptcy (OSB) several responsibilities. The Office: supervises the administration of bankruptcy estates, business reorganizations, consumer proposals and receiverships under the Act; keeps records of insolvency proceedings that occur under the Act; records and investigates complaints by creditors, debtors and the general public; and licenses and oversees the trustees who administer bankruptcy estates under the Act.

Since becoming a Special Operating Agency in 1997, the OSB has depended exclusively on income generated by its operations to fulfill its statutory mandate. Adopting a user-pay principle, a variety of fees exist: filing fees; levies on dividends payable to creditors; licence fees; and fees for searching the public record. Although the OSB does not use the funds, the Superintendent administers an account for unclaimed dividends and undistributed funds. In August 2003, there was about \$9.3 million in the fund.

The OSB's responsibilities and powers were increased by the 1992 and 1997 amendments to the BIA. These responsibilities, together with the increase in commercial and consumer bankruptcies over time and the increased complexity of cases, have generated comments on the need for more resources for the OSB.

Although the OSB does not use the funds, the Superintendent administers an account for unclaimed dividends and undistributed funds.

A focus on prevention raises the question of how programs and initiatives should be funded.

Moreover, there has been speculation about the role that enhanced education and preventive approaches to insolvency might play in reducing financial difficulties, and thereby insolvency, among individuals and businesses. To be effective, education and prevention measures must be offered at the correct time and in the correct manner. A focus on prevention raises the question of how programs and initiatives should be funded. In addition, it is important to encourage studies and research, predominantly but not exclusively, by academics. In the past, the OSB has benefited significantly from such research, but there are insufficient funds to research broader subjects, such as credit granting practices in Canada and other issues that would help Parliament to determine the direction and scope of future amendments to Canadian insolvency legislation.

The OSB plays no supervisory or administrative role with respect to the *Companies' Creditors Arrangement Act*; any records that exist about the growing number of proceedings under the Act are resident with the Court in which the cases were commenced. It is perhaps for this reason that limited data exists about activities under the Act. Consequently, it is virtually impossible to assess meaningfully the effectiveness of proceedings under the CCAA, the frequency with which companies initiate procedures under the Act, the characteristics of these companies, and the consequences of the Act and its operations for Canadian companies and the Canadian economy.

The inability to carry out an assessment of the operations and effectiveness of proceedings under the CCAA might have particularly serious consequences, since many of Canada's large businesses that experience financial difficulties pursue options under the CCAA. Moreover, the absence of supervisory oversight and lack of data may undermine the trust of lenders and investors, with potentially negative implications for the economy.

Witnesses commented on a wide range of issues, including the current role of the OSB and how it should be

expanded, access to the process supervised by the OSB, funding concerns related to the Office, the lack of CCAA-related data and other information because of the absence of supervisory oversight, and the importance of research and preventive measures.

A number of witnesses shared with the Committee their views on how the role of the Office of the Superintendent of Bankruptcy should be expanded. The Union des consommateurs, for example, recommended that the Office establish a procedure that would require trustees to “standardize the information to be given ... to debtors” and that it organize or contribute to “outreach campaigns on credit, debt overload and their consequences.” The group also identified the need for a practical “how to” manual for debtors – containing information on their responsibilities and those of the trustee, as well as on procedural issues – written in a manner that is easily understood by users, without excessive use of specialized terminology.

Others, including a number of professors of law represented by Professors Ziegel and Telfer, identified the need for research to enable policy makers and stakeholders to make informed decisions about how the existing system works and the likely impact of various policy options; they envisioned the Office playing a role regarding research. In particular, they recommended: the establishment of an annual budget for insolvency research purposes; the establishment of an advisory committee to advise Industry Canada and the Office of the Superintendent of Bankruptcy on research projects to be initiated during the year; public announcements about these initiatives to promote visibility and transparency; and greater collection of insolvency data, especially about consumer insolvencies and reorganizations under the CCAA.

Professors Ziegel and Telfer also advocated an expanded role for the OSB when they recommended that it have record keeping and administrative functions with respect to the CCAA. To help finance expenses associated with these functions, they believed that CCAA estates should be required to contribute a “modest” levy. Moreover, they felt that the

... the need for research to enable policy makers and stakeholders to make informed decisions about how the existing system works and the likely impact of various policy options ...

Superintendent of Bankruptcy should have a role in “CCAA hearings where important constituencies are not represented or major issues of public policy or interpretation of the legislation are at issue.” As examples of the latter, Professors Ziegel and Telfer mentioned: whether a CCAA Court has the power to oblige the debtor and its unions to reopen collective agreements, whether the Court can excuse a debtor from remitting collections held in trust for another party, and whether an order can be made binding third parties who are not involved in the CCAA proceedings.

Commenting on access to the bankruptcy process, Professors Ziegel and Telfer informed the Committee about the Federal Insolvency Trustee Agency (FITA), through which the federal government made low-cost bankruptcy services available via regional offices of the OSB. Although this Agency no longer exists, they believed that it was useful in enhancing access for low-income debtors.

A different view on supervision was presented to the Committee by the Canadian Bankers Association, which did not support the implementation of a supervisory regime for the CCAA without additional study. Regarding funding of the OSB, the Association told us that it would object to any increase in user fees as a means of increasing funding for the OSB’s operations. It believed that “[i]ncreased costs reduce the ability of creditors to recover their funds.”

In support of greater use of technology, the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada shared their view that “[f]urther opportunities need to be explored for electronic communications. Transparency and accessibility could be enhanced further by the use of electronic access to information.”

The Committee believes that the Office of the Superintendent of Bankruptcy plays a key supervisory and administrative role with respect to the BIA, and provides high quality services to stakeholders despite budgetary pressures. Its existence, and the actions it takes in such areas as ensuring

The Committee believes that the Office of the Superintendent of Bankruptcy plays a key supervisory and administrative role with respect to the BIA, and provides high quality services to stakeholders despite budgetary pressures.

compliance with the legislation and safeguarding transparency, accountability and integrity, help to ensure that all Canadians, Canadian companies and foreign investors benefit from an insolvency system that is characterized by the highest level of integrity. We applaud the Superintendent and others in the Office of the Superintendent of Bankruptcy and encourage them to continue with their efforts to ensure that Canada continues to be regarded as having an insolvency system that ranks among the best in the world.

The Committee has heard the concerns about inadequate funding for the OSB and the notion that Canadian taxpayers should contribute to the funding of operations because of the benefits that the country enjoys as a consequence of the Office's compliance and supervisory efforts. Nevertheless, we support a strict application of the user-pay principle, and believe that fees must be set at a level sufficient to enable the Office to carry out its statutory duties responsibly.

The Committee believes that the greater use of technology and a streamlining of the bankruptcy process for consumers and companies will help to constrain fee increases, since further fee increases may negatively affect access to the insolvency process. In our view, the adoption of new technology must be a priority in our economy whenever it has the potential to improve efficiency, effectiveness, accessibility and equity. From this perspective, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be reviewed in order to identify opportunities that will contribute to greater efficiency within the insolvency system, including efforts regarding the adoption of new technologies.

Industry Canada's *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* presents the question: should the concept of universal access to bankruptcy services be redefined, with new measures to ensure access, or should

... the Committee believes that access to the bankruptcy system is increasingly compromised for low-asset, low-income debtors, although the OSB's Bankruptcy Assistance Program is useful in providing access to some debtors.

access cease to be seen as a right? Like our witnesses, the Committee believes that access to the bankruptcy system is increasingly compromised for low-asset, low-income debtors, although the OSB's Bankruptcy Assistance Program is useful in providing access to some debtors. We believe that this Program is important to help ensure the access that is a fundamental principle underlying the insolvency system we seek, and applaud those trustees who provide their time and expertise without payment.

The Committee, like a number of our witnesses, is of the opinion that research, education and prevention are critically important. We are particularly concerned about the lack of data related to the CCAA, about the lack of a research program that would help to identify the causes of bankruptcy and thus assist in the development of appropriate solutions, and about the extent to which prevention of insolvency may begin with the proper type of education delivered at the proper time.

Clearly, the current resources of the OSB do not permit it to fund initiatives in these areas, and the Committee firmly believes that fees must not be increased in order to finance this type of research, education and prevention. Instead, we believe that the account administered by the Superintendent which contains unclaimed dividends and undistributed funds should be reallocated to these uses, particularly to a research program to be directed and overseen by the OSB. At the end of August 2003, that account contained more than \$9.3 million, as noted above. In our view, dividends that remain unclaimed and funds that remain undistributed after a two-year period should be allocated to research and education. In stipulating a two-year period, the Committee intends that sufficient funds should always be retained to pay claims, and does not intend that claimants should be barred from claims after two years. Under no circumstances, however, should these funds be used to finance the operations of the OSB. Research and education would hopefully assist in ensuring efficiency, effectiveness and responsibility. It is for these reasons that the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to provide the Superintendent of Bankruptcy with the authority to finance research and education programs from the account which contains unclaimed dividends and undistributed funds. Amounts that are unclaimed or undistributed after a two-year period should be used in this way.

B. Consolidation of Insolvency Statutes

The phrase “historical circumstances” has been used to describe why Canada has two insolvency statutes under which companies can reorganize. In 1923, reorganizations under the BIA were restricted to debtors who were actually bankrupt. The CCAA was introduced in the 1930s to assist companies that were insolvent but not bankrupt, although companies rarely used it for the next five decades.

Although amendments were made to the CCAA in 1997 to align more closely its provisions with those of the BIA, debate continues about whether these reorganization statutes should be combined, whether the status quo should prevail, or whether the CCAA should be repealed. As noted in Chapter Three, the BIA is viewed as providing a relatively predictable and consistent outcome, particularly when compared to the CCAA. The CCAA is thought, however, to give the flexibility needed in certain situations, which might be the case with larger businesses that are attempting to restructure. The financially troubled company selects the statute under which it wants to reorganize, subject to the threshold requirements of the CCAA.

Under the CCAA, the Court appoints a monitor to oversee the reorganization, and he or she files reports with the Court on the state of the insolvent company’s finances. This process is analogous to what occurs with a reorganization under the BIA, where a trustee files reports with the Office of the Superintendent of Bankruptcy. The statutes do differ, however, since the Court makes or approves most decisions under the CCAA while, generally, under the BIA the Court is involved only in sanctioning a proposal that has already been approved by creditors.

Because of the relative flexibility and lack of predictability associated with the CCAA process, some creditors perceive that they are disadvantaged relative to the

outcome that would occur under the BIA. In the absence of data regarding proceedings under the CCAA, this perception can be neither affirmed nor disputed. One means of ensuring data on this issue, as well as others related to the CCAA, might be providing the Office of the Superintendent of Bankruptcy with a supervisory and administrative role with respect to both the CCAA and the BIA, as has been suggested by some. Another option, however, involves the research program recommended earlier in this Chapter. Either option does not, however, exclude the other.

Witnesses presented a range of views to the Committee on the issue of whether the BIA and the CCAA should be merged or retained as separate statutes. The Canadian Bankers Association told us that the current system of separate statutes recognizes the needs of both smaller and larger organizations. Similarly, the Joint Task Force on Business Insolvency Law Reform supported the status quo, with the CCAA for the reorganization of large companies, and the BIA for smaller corporations and other entities. It shared with us the view that “Canada’s experience with two reorganization systems has generally been positive. The principal virtue of the two-system approach is that it responds to the fact that different types of reorganization legislation are appropriate for different types of debtors.” The Joint Task Force, however, also noted that retention of separate statutes “should not preclude harmonization of specific provisions of the CCAA and the BIA” and made particular mention of reviewable transactions and filing requirements.

Professor Keith Yamauchi, of the Faculty of Law at the University of Calgary, supported the status quo as well, and argued that “[t]he flexible, court-driven nature of a proceeding under the *Companies’ Creditors Arrangement Act* lends itself to large multinational entities.” At the same time, “the rigid provisions of the *Bankruptcy and Insolvency Act* fit quite nicely with the reorganization of small to medium-sized businesses.” He believed that the system in Canada “works well from a practitioner’s perspective.” The wide judicial discretion given by the CCAA’s provisions has not been abused, in his view, but has instead been used “wisely to

Witnesses presented a range of views to the Committee on the issue of whether the BIA and the CCAA should be merged or retained as separate statutes.

effect results that could not otherwise be reached in a strict, rule-oriented system.”

Professor Janis Sarra, of the Faculty of Law at the University of British Columbia, also noted the benefits of the flexibility inherent in the CCAA, and informed the Committee that “the courts and parties affected by ... corporate insolvency have been able to utilize the relatively flexible process under the CCAA in order to arrive at successful restructurings that are reflective of the appropriate balance of various interests in such proceedings.” In speaking to us, she underscored the importance of the interests of workers, communities and the broader public interest.

The Committee believes that, fundamentally, the current system is working well, which does not mean that changes are not required for the benefit of all domestic and international stakeholders. For example, changes may be required to ensure the collection of data about proceedings under the CCAA, and some matters that are not addressed in the CCAA – but are covered in the BIA – should be considered. Stakeholders have now gained experience with the process under both statutes and jurisprudence has developed. We believe that the CCAA should continue to exist for companies with a relatively high level of indebtedness, while the BIA should be available for all organizations; the level of indebtedness required to take action under the CCAA should, however, be reviewed on an ongoing basis to ensure its continued relevance. There were historic reasons for two separate statutes, and these reasons continue to have importance today. The CCAA appears to be relatively effective in assisting larger companies in their reorganization efforts, while the BIA seems to be working well for smaller organizations.

The CCAA appears to be relatively effective in assisting larger companies in their reorganization efforts, while the BIA seems to be working well for smaller organizations.

In deciding whether to recommend the status quo or an integration of the statutes, the Committee was mindful of the fundamental principles outlined in Chapter Two. In particular, we know that the flexibility that is inherent in the CCAA is probably inconsistent with consistency and predictability, and may not result in fairness. Nevertheless, tradeoffs must be

made and an appropriate balance must be struck. We believe that the need for flexibility is paramount with the CCAA, but urge relevant parties to respect the principles of predictability, consistency and fairness – to the extent that they can – when involved in proceedings under the Act. For this reason, the Committee recommends that:

The Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act continue to exist as separate statutes.

C. Statutory Review of Insolvency Legislation

The BIA and the CCAA require that a Parliamentary review of their administration and operation occur five years after the coming into force of the relevant sections, which occurred in 1997. Although late by one year, the current examination by the Standing Senate Committee on Banking, Trade and Commerce fulfills this requirement for statutory Parliamentary review.

Witnesses told the Committee that ongoing review of insolvency legislation in Canada is needed. While the current review of the BIA and the CCAA by this Committee was welcome, in their view it must occur regularly in order to ensure that Canada's insolvency legislation: meets the needs of all stakeholders in the best possible manner; continues to accommodate the changing socio-economic conditions of an evolving society and the challenges that this change implies for stakeholders; and remains consistent with – although not identical to – the insolvency regimes that exist worldwide but most particularly those of our major trading partners. Mr. David Baird, Q.C., of Torys LLP, told us that “the reform process never ends and further reforms of our bankruptcy and insolvency legislation are required to keep that legislation effective and efficient.” Furthermore, the Joint Task Force on Business Insolvency Law Reform indicated that “because of the remarkable pace of change in insolvency law and practice, it is advantageous to continue with regular five-year reviews of insolvency statutes for continuous improvements, as well as to reflect changed circumstances and new developments.”

While the Committee's review was limited to the BIA and the CCAA, witnesses also commented on the need for ongoing statutory Parliamentary review of two additional insolvency statutes – the Winding-up and Restructuring Act and the Farm Debt Mediation Act.

While the Committee's review was limited to the BIA and the CCAA, witnesses also commented on the need for ongoing statutory Parliamentary review of two additional insolvency statutes – the *Winding-up and Restructuring Act* (WURA) and the *Farm Debt Mediation Act* (FDMA). Regarding the former Act, Mr. Baird shared his view that revisions are needed that would “make the restructuring of financial institutions much more efficient and cost effective. This would greatly enhance the recovery for consumers and other creditors of insolvent financial institutions.” Describing

the WURA as “an insolvency statute that has been very neglected and has not received a comprehensive review for more than 100 years,” he made particular mention of the recommendations made by the Insolvency Institute of Canada for amendments to the WURA and told us that the Act should contain a comprehensive scheme for the restructuring of a financial institution. In its presentation to us, the Canadian Bankers Association supported a limitation on the WURA’s application to financial institutions in order to “eliminate overlap, increase efficiency and facilitate efforts to tailor the WURA to the needs of financial institutions.”

The *Farm Debt Mediation Act* requires the Minister of Agriculture and Agri-Food to undertake a review of its operations every three years, and to table a report in Parliament. The Act, however, stipulates only that the Minister may, for this purpose, consult with representatives of appropriate organizations. Mr. Brian O’Leary, Q.C., of Burnet, Duckworth & Palmer LLP, told the Committee that it “would be prudent to have the [*Farm Debt Mediation Act*] reviewed every 5 years along with the BIA and the CCAA.”

Regarding the WURA, the Committee feels that while its application is limited to financial institutions, it too is an important pillar in our insolvency system that should receive ongoing review by Parliament, particularly since there has been – and is likely to continue to be – merger and acquisition activity in this sector and our financial institutions are critically important to the health and prosperity of an economy such as ours. The FDMA, too, is an important insolvency statute for a particular part of our economy. Canada’s agricultural industry faces ongoing challenges, and these challenges sometimes result in unsustainable levels of debt for Canadian farmers. The FDMA must also be reviewed by Parliament on a regular basis to ensure that it is continuing to meet the needs of stakeholders in the agricultural industry in the best possible manner.

The Committee strongly believes that statutory Parliamentary review of the operation and administration of

We fear that if our insolvency regime – as part of the set of laws designed to contribute to the health and prosperity of Canadians and the Canadian economy – differs markedly from – or is less effective than – that in other countries, negative economic consequences would be the result.

federal legislation is useful in a range of areas, including insolvency. Given our particular focus at this time, however, and testimony from our witnesses about the need to ensure that Canada’s insolvency regime continues to meet the evolving needs of domestic and international stakeholders and recognizes the changing socio-economic environment, we are firmly convinced that ongoing Parliamentary review of our four insolvency statutes must occur. One way to ensure that needed review occurs is statutory provisions to that effect. We fear that if our insolvency regime – as part of the set of laws designed to contribute to the health and prosperity of Canadians and the Canadian economy – differs markedly from – or is less effective than – that in other countries, negative economic consequences would be the result. Our insolvency system must be at least as efficient, effective and fair as those found in other countries. From this perspective, and to ensure the efficiency and effectiveness that we seek, the Committee recommends that:

The Bankruptcy and Insolvency Act, the Companies’ Creditors Arrangement Act, the Winding-Up and Restructuring Act and the Farm Debt Mediation Act be amended to require a review by a Parliamentary committee at least once every five years.

Although not, strictly speaking, an issue related to statutory Parliamentary review, the Committee would like to comment on the recommendation made by Professors Ziegel and Telfer that “an advisory committee of outside experts [be appointed], similar in purpose to the Colter Committee of 1984, to prepare draft provisions for the federal government’s consideration.” Throughout our study, we have assumed that legislation to amend Canada’s insolvency laws would result from our review, and in a timely manner. There is, however, no guarantee that legislation will be introduced in Parliament expeditiously or that, if it is, it will become law. Certainly, when one considers the number of insolvency-related legislative attempts that have died on the Order Paper, there is perhaps cause for pessimism rather than optimism. It was perhaps from this perspective that Professors Ziegel and Telfer

made their recommendation to allow outside experts to draft the legislation in order to assist in a timely amendment process.

The socio-economic environment has changed since the last substantive amendments to the BIA and the CCAA in 1997. The Committee believes that all laws in Canada, but particularly those of fundamental importance to the health of our economy and our citizens, must be reviewed and amended regularly to ensure that they meet their intended goals in the best possible manner. From this perspective, we urge the federal government to introduce amendments to the BIA and the CCAA – and perhaps to the WURA and the FDMA as well – at the earliest opportunity, and certainly no later than the first session of the next Parliament.

D. A Specialized Judiciary

Certain areas of the law implicitly recognize the benefits of specialized knowledge.

Certain areas of the law implicitly recognize the benefits of specialized knowledge. For example, the privative clauses that exist to protect decisions made by administrative tribunals – including labour relations and human rights, among others – recognize the specialized perspective and background that tribunal members bring to the fulfillment of their duties and to the decisions they make. In these cases, appeals to the Court are limited in part because the Court generally lacks specialized expertise in those particular areas.

Witnesses supported the development of a specialized judiciary to hear and resolve insolvency cases within Canada. The International Insolvency Institute, for example, told the Committee that “a greater degree of specialization in administering bankruptcies and reorganizations would be beneficial both in enhancing the interests of stakeholders in reorganizations and in furthering the Canadian public interest in having an experienced, understandable and predictable system for reorganizations and restructurings.” In the Institute’s view, however, a specialized insolvency judiciary probably could not be achieved under the existing system, where provincial Chief Justices designate the judges to deal with insolvency matters. Consequently, it suggested that responsibility for designating these judges be given to the Governor in Council on the recommendation of the Chief Justice.

The Committee was also informed that, to some extent, this specialization is already beginning to develop and some uniformity in decision making exists across Canada. Professor Yamauchi indicated that “provincial judicial bodies ... are, for lack of a better term, starting to create specialist judges to deal with reorganizations. ... In terms of getting uniformity across the country, it seems ... that most of the judges refer to cases from other jurisdictions and do their balancing to come out with a fair and reasonable approach for all of the stakeholders.” Mr. Mendelsohn, of Mendelsohn, G.P, also

commented on the issue of specialization, arguing for the creation of “more specialized judiciaries in the major centres of Canada.”

This Committee has long been a supporter of specialization, training and education. For example, in our June 2003 report *Navigating Through “the Perfect Storm”: Safeguards to Restore Investor Confidence*, we recommended the development of specifically tailored education and training initiatives to enhance the knowledge of board directors. We, like a number of our witnesses, believe that judges with specialized knowledge of insolvency matters are best equipped to resolve cases in the best interests of all stakeholders. We do not, however, believe that specialization should be limited to insolvency; more generally, we support the development of specialized judges in the full range of areas that are decided by our Courts. We are pleased that some specialization already seems to exist with respect to insolvency and that judges appear to be deciding cases in a relatively uniform manner across the country. Nevertheless, we support formal specialization through education and training programs, and believe that these programs will assist in the uniformity, consistency and predictability that we feel are important.

A question then arises about how this specialized knowledge is acquired. While it might occur simply through hearing repeated insolvency cases – through “on-the-job training,” if you will – the Committee believes that more must be done. In the same manner that courses are being developed and offered to individuals to make them more knowledgeable members of boards of directors, we feel that education and training programs must be developed that would enable judges – who may currently adjudicate the full range of cases before the Court – to develop specialized expertise in the area of insolvency. We wonder whether the National Judicial Institute might play a useful role in this regard. Feeling that a specialized insolvency judiciary would contribute to the fairness, predictability and consistency that we believe are important in our insolvency system, the Committee recommends that:

We ... believe that judges with specialized knowledge of insolvency matters are best equipped to resolve cases in the best interests of all stakeholders.

The federal government consult with relevant stakeholders with a view to developing education and training programs that would enable judges in Canada to develop specialized expertise in the area of insolvency law.

E. Issues of Costs

The insolvency process, insofar as the payment of professional fees is concerned, is internally financed, with fees paid to trustees, monitors and lawyers, among others. Trustees are paid from the funds generated by the estate, in priority to the claims of other creditors, and the level of trustees' fees may either be determined by the creditors or, where this is not the case, paid pursuant to a tariff based on a percentage of the total value of realized unsecured assets – presently 7.5% – subject to variation by the Court through the process known as “taxation,” that is, approval of fees.

Similarly, the monitor appointed during restructuring under the CCAA receives fees for services rendered, as approved by the Court, throughout Canada, with the exception of Quebec where the fees are determined – in the first instance – by agreement between the monitor and the debtor. While the CCAA does not specify the priority given to the payment of monitors' fees, in practice the debtor pays the fees to the monitor as an administrative cost during the restructuring process and ranking ahead of the creditors.

In CCAA proceedings, the debtor will usually – although not always – pay the legal costs of creditor groups, which generally enhances their cooperation during the restructuring process.

When litigation arises, the losing party is generally required to pay legal costs – sometimes referred to as judicial costs – to the lawyer of the winning party. This practice is intended to defray, in some measure, the cost of litigation that the winning party has incurred. These judicial costs are payable according to the Tariff of Costs contained in the Act.

Mr. Baird shared his views with the Committee regarding the Tariff of Costs. After noting that the tariff was introduced five decades ago and has not been revised since

that time, he suggested that it is “completely outdated” and that “[i]n most jurisdictions, the tariff has been ignored.” He believed that the Tariff of Costs should be repealed and the BIA amended to provide that, should the losing party be obliged to pay the legal costs of the winning party, the Tariff of Costs applicable in the province/territory in which the litigation occurs should apply.

Representatives of organized labour suggested to the Committee that trade unions should have their costs paid, and the Canadian Labour Congress told us that “[union] costs related to a restructuring are not always paid in the same way as the costs of other creditor groups.” The labour federation suggested that “[i]f a company or an estate has sufficient funds to pay a trustee in bankruptcy or a monitor and their legal counsel respectively, then a company or estate should also be made to pay the legal costs incurred by a trade union (or by unorganized employees) to advance their claims in the insolvency proceedings. ... Further, the payment of the legal costs of trade unions and employees would facilitate their organization (in a multi-union environment) into one cohesive group which can be dealt with by the estate in a much more streamlined manner”

A tariff that allows a cost of \$1.00 for a letter or \$4.00 to \$6.00 for the drafting of assignments, proposals or statements of claim bears no relationship to the realities of today.

The Committee is aware of the Tariff of Costs which, since it has not been amended since 1949, has no practical relevance today. A tariff that allows a cost of \$1.00 for a letter or \$4.00 to \$6.00 for the drafting of assignments, proposals or statements of claim bears no relationship to the realities of today. We know that various *ad hoc* practices have been developed to overcome this problem, and that while the BIA permits recourse to the regular Tariff of the Court, this civil tariff cannot – in the absence of legislation – displace the Bankruptcy Tariff in its entirety. Moreover, the CCAA makes no provision for a tariff; consequently, costs that are incurred under the CCAA follow the tariff of ordinary civil cases.

In contemplating how to address the problems associated with the Tariff of Costs, the Committee decided that the best course of action is to abolish it and instead use the civil Court tariffs as they apply across the provinces/territories.

We do not support updating the Tariff that currently exists, since there is a danger in leaving a Tariff schedule in legislation that may be updated only infrequently. Nor do we believe that providing the Governor in Council with the regulatory authority to set tariffs is appropriate, since there is an easier and more logical solution available: use civil Court tariffs.

These tariffs are the preferred solution for the Committee because they already exist, and because they presumably reflect regional variations and the judgments of various provincial/territorial legislatures as to the extent that judicial costs should or should not fully or substantially compensate – or indemnify – the winning party at the expense of the losing party. Some provinces/territories provide for substantial or full indemnification, while others provide only for relatively modest tariffs of costs in order to avoid discouraging those with relatively modest means from pursuing their rights before the Court. We believe that using the Tariff of Costs applicable in the province/territory in which the litigation occurs would respect a number of the fundamental principles identified by us as important, including fairness and predictability; it would also provide an element of transparency. Consequently, the Committee recommends that:

... there is an easier and more logical solution available: use civil Court tariffs.

The *Bankruptcy and Insolvency Act* be amended to repeal the Tariff of Costs. Instead, costs should be paid in accordance with civil Court tariffs as they apply from place to place throughout Canada.

F Conflicts of Interest

Debtors who file for bankruptcy under the *Bankruptcy and Insolvency Act* give control of their assets to a trustee, who has a variety of roles: to advise the debtor who is paying his or her fees; to maximize the returns to creditors from the sale of non-exempt assets in the bankrupt's estate and to distribute them in accordance with the provisions of the Act; and, more generally, to carry out his or her duties with respect to administering the bankruptcy while maintaining the integrity of the BIA. These multiple roles may create conflicts of interest for the trustee.

Professors Ziegel and Telfer noted the potential for conflicts of interest, and told the Committee that “once bankruptcy has ensued or the debtor has made a consumer proposal the trustee owes duties to the debtor's creditors and to the court. This gives rise to a conflict of interest between the trustee's duty to the consumer and his [or her] duties to the creditors and the court.” In their view, adoption of some of the recommendations made by the Personal Insolvency Task Force would add to this conflict.

The CCAA requires the appointment of a monitor to oversee the affairs and finances of the insolvent company during the reorganization period, in accordance with the orders of the Court. The Act is silent with respect to qualification requirements and rules of professional conduct and, like trustees, monitors may face conflicts of interest.

In speaking to the Committee about the role played by monitors in CCAA proceedings, Equifax Canada Inc. voiced the view that “most other systems ... provide more transparency and are much freer from conflicts of interest Canada should be able to devise a standard of independence that would ensure that insolvency officeholders are free from other interests and other relationships that might impact on their objectivity and their ability to serve creditors they are appointed to represent.”

The [CCAA] is silent with respect to qualification requirements and rules of professional conduct and, like trustees, monitors may face conflicts of interest.

The organization went on to note that “[m]onitors are expected to act in a variety of inconsistent and conflicting roles. It is commonplace for monitors to act as a financial consultant to the debtor, as a financial consultant to the secured creditors of the debtor, as a trustee in bankruptcy representing the interests of unsecured creditors, or as a receiver or receiver and manager representing the interests of secured creditors. It is not unusual for a monitor to occupy one or more of these roles in sequence as a case develops and there are examples of monitors occupying all of these positions *at the same time*.” As a solution, Equifax Canada Inc. advocated improved guidelines in the BIA and the CCAA regarding conflicts of interest and the duties of officeholders.

The Committee is firmly of the opinion that roles and responsibilities that would create conflicts of interest – whether real or perceived – for trustees, monitors or other insolvency practitioners must be avoided. If other stakeholders perceive these individuals to be in a position of conflict, then their faith in the integrity of our insolvency system and their sense of fairness in the process are reduced. While this occurrence has negative implications for Canadian stakeholders, the effects extend to foreign investors and thereby to the Canadian economy. The insolvency system in Canada must be – and must be seen to be – fair and transparent. Consistent with the desire to uphold these fundamental principles, the Committee recommends that:

The Committee is firmly of the opinion that roles and responsibilities that would create conflicts of interest – whether real or perceived – for trustees, monitors or other insolvency practitioners must be avoided.

The *Bankruptcy and Insolvency Act* and the *Companies’ Creditors Arrangement Act* be reviewed in order to identify and eliminate any opportunities for the roles and responsibilities of insolvency practitioners to place them in a real or perceived conflict of interest. Moreover, in order to ensure that all practitioners fulfill their duties with a high level of integrity, the federal government should adopt guidelines for insolvency practitioners regarding professional conduct and conflicts of interest, expanding upon Rules 34 to 53 of the *Bankruptcy and Insolvency Act* where appropriate.

G. The Definition of Income

Under the BIA, not all of a bankrupt's financial resources are treated equally. The Act specifies that non-exempt assets are available to the trustee for liquidation and hence for administrative costs and distribution among creditors.

“Assets” and “income” are treated differently under the [BLA].

“Assets” and “income” are treated differently under the Act. All assets of the bankrupt, other than exempt assets, are vested in the trustee upon the bankruptcy of the debtor. Income earned by the debtor during his or her bankruptcy and prior to discharge remains with the debtor in order to permit him or her to maintain a reasonable standard of living for himself or herself and his or her family. Where the income of the debtor exceeds certain standards, however, the income – referred to as excess or surplus income – is to be paid to the trustee for distribution to creditors after payment of administrative expenses. This situation is perceived to be a fair treatment of the debtor's income during bankruptcy, since income that exceeds the debtor's needs should properly be used to reimburse the creditors to the extent possible.

Prior to amendments to the BIA in 1997, income was defined as “salary, wages or other remuneration from a person employing the bankrupt.” Changes in 1997 subjected “income” to a needs test involving “all revenues of a bankrupt of whatever nature or source.” While the usual interpretation has been income both earned and received during bankruptcy – with any income earned before the date of filing for bankruptcy and received after the date vesting with the trustee absolutely and not included in the needs analysis – recent Supreme Court of Canada decisions have resulted in the application of the needs analysis to income entitlements arising from pre-bankruptcy events, such as personal injury awards, pay equity settlements and wrongful dismissal damages. The result has been that these types of non-periodic, lump-sum,

pre-bankruptcy entitlements received after bankruptcy have been classified as income.

In the view of the Personal Insolvency Task Force, “income” has three characteristics: it is earned through labour market activity; it is generally intended to finance the costs of current consumption; and it is generally received on a periodic basis. Wages and salaries are income, while lottery winnings and inheritances are not.

The Task Force recommended that the BIA be amended to clarify the definition of “income.” In particular, it believed that the term “total income” should be defined to include revenues earned at any time before the date of discharge, including revenue earned before the date of bankruptcy, that have not been received before the date of bankruptcy. To the extent that pre-bankruptcy income entitlements received after the date of bankruptcy are not required to meet the current financial needs of bankrupts and their families, the entitlements should accrue in full to the trustee for distribution to creditors; if these financial needs are being met out of current income, creditors could realize higher levels of recovery.

Moreover, the Task Force believed that guidance should be given to trustees about the manner in which lump-sum entitlements should be allocated between bankrupts and creditors; guidance in this area should result in consistency and predictability. Finally, trustees should acquire, for distribution among creditors, any tax refund to which the bankrupt is entitled in his or her pre-bankruptcy return and post-bankruptcy return, as well as any tax refund for any prior year.

The Task Force’s recommendations were supported by a number of the Committee’s other witnesses. For example, the need for clarification of the term “total income” was also highlighted by Professors Ziegel and Telfer, and the Task Force’s position was supported by the Canadian Bar Association, which told the Committee that “[r]ecent case law has rendered reform necessary.” The Canadian Association of

Insolvency and Restructuring Professionals and the Insolvency Institute of Canada too expressed support for the Task Force's recommendations.

The view of the Canadian Bankers Association went somewhat farther than the Task Force. In particular, the Association suggested to the Committee that, "in addition to making the pre-bankruptcy and post-bankruptcy tax return available to creditors, a refund arising from any subsequent tax return filed during the bankruptcy should also be made available to creditors." It also believed that the discharge period should be extended to 15 months in order to allow the estate to benefit from the additional moneys from income tax refunds. The additional six months beyond the current nine-month period prior to discharge would also permit the trustee to offer additional counselling.

The Committee feels that clarification of the term "total income" is needed, and that trustees should be provided with guidelines to assist them in properly allocating lump-sum entitlements between debtors and creditors. Key definitions such as "total income" must have a clear and appropriate meaning, and trustees must be provided with guidance in order to ensure transparency, fairness, consistency and predictability in their dealings with debtors and creditors. Moreover, to the extent that is equitable, tax refunds payable to the debtor must be available to the trustee for distribution to creditors. We want the bankrupt to have a fresh start, certainly, but it is also important to us that proper consideration be given to maximizing assets in the estate in order that creditors receive more.

The Committee stresses the importance of ensuring adequate recovery for creditors not because we feel the need to be their advocate, but rather because inadequate recovery for creditors can have negative consequences, including a lower availability of credit and credit available only at a higher cost. These consequences have implications for the prosperity of the Canadian economy and, in fact, any Canadian who is forced to pay a higher cost of credit. Believing that clarity and

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guidance are needed, and that these will result in greater fairness and predictability, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended in order to clarify the meaning of the term “total income.” As well, clarity – in the form of guidelines contained in a directive of the Superintendent of Bankruptcy – should be provided to trustees regarding the manner in which lump-sum settlements received after bankruptcy and before discharge should be divided between debtors and creditors. Finally, a bankrupt’s tax refunds received during a period to be determined by statute should be made available to the trustee for distribution to creditors.

H. The Definition of Consumer Debtor

In order to file a consumer proposal, an insolvent debtor must fall within the definition of “consumer debtor.” A consumer debtor is a “natural person who is bankrupt or insolvent and whose aggregate debts, excluding any debts secured by the person’s principal residence, do not exceed seventy-five thousand dollars or such other maximum as prescribed.” The definition does not restrict the nature of the debts; they may be business- or consumer-related.

The \$75,000 liability threshold, however, may be prompting many self-employed individuals and higher-income debtors to use the more complex and costlier option.

When the consumer proposal provisions were included in the BIA in 1992, it was expected that the administration of consumer proposals would be relatively straightforward and would not warrant the more complex and costlier option provided for commercial reorganizations. The \$75,000 liability threshold, however, may be prompting many self-employed individuals and higher-income debtors to use the more complex and costlier option.

In the view of the Personal Insolvency Task Force, the current definition of “consumer debtor” is too restrictive, and the more complex process is not justified or needed for many of the debtors now using it. Higher costs reduce recovery for creditors, and failure of a commercial proposal results in automatic bankruptcy for the insolvent debtor; there is no “deemed bankruptcy” when a consumer proposal fails. It recommended that the BIA be amended to include a revised definition of “consumer debtor” for those filing a consumer proposal; it should include “an individual whose indebtedness, consequent of commercial or self-employed activity, does not exceed \$100,000 or such other amount as is prescribed” and should include no ceiling on the amount of non-business indebtedness or on the debtor’s assets.

Professors Ziegel and Telfer also supported a higher indebtedness threshold for consumer proposals, as did the Canadian Bar Association, which told the Committee that

“eligibility for consumer proposals should be enhanced, whether by raising the dollar ceiling from \$75,000 to some higher figure, or in some other convenient manner.” The Association, however, noted the absence of a provision in the consumer proposal scheme for payment of legal services rendered to the administrator and argued that “[s]ome provision must be made for the administrator to seek legal advice or representation. It is unfair to force the administrator to do so only at personal cost.”

The general support by the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada for the Task Force’s recommendations was augmented by their view that the proposed indebtedness threshold is too low. They believed that all debt should be classified together, since “it is difficult to distinguish between commercial and consumer debt ... and consumer debts are frequently commingled with commercial debts for sole proprietors and small business owners,” From this perspective, they advocated an indebtedness threshold of \$250,000 for all types of debt except residential mortgage debt.

A different view was shared with the Committee by the Canadian Bankers Association, which did not support the Task Force’s recommendation to increase the indebtedness threshold for debtors filing a consumer proposal. It believed that “[i]ncreasing the threshold would increase the consumer debt to a level that was beyond that which a consumer could reasonably handle for payments under a proposal.” Nevertheless, the Association informed us that, in the event that a decision is made to amend the BIA to increase the indebtedness threshold, it should be raised only in accordance with increases in the cost of living.

Like a number of our witnesses, the Committee believes that consumers should pursue a consumer proposal rather than a commercial reorganization, if possible. We hold this view because failure in the former situation does not result in a “deemed bankruptcy,” while in the latter case it does. Moreover, the consumer proposal option should be

... the Committee believes that consumers should pursue a consumer proposal rather than a commercial reorganization, if possible.

Clearly, accessibility is hampered if the indebtedness threshold needed to access the simpler, less costly process is a barrier.

pursued because it is simpler and less costly. We recognize, however, that the current indebtedness threshold may be limiting the extent to which consumers are eligible to pursue a consumer proposal. One of the fundamental principles articulated by us in Chapter Two is accessibility. Clearly, accessibility is hampered if the indebtedness threshold needed to access the simpler, less costly process is a barrier. It is from this perspective that the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to raise the indebtedness threshold contained in the definition of “consumer debtor” to \$100,000, with annual increases thereafter to reflect increases in the cost of living as measured by the Consumer Price Index. Moreover, two years after the new indebtedness threshold comes into force, the federal government should initiate a review of the degree to which insolvent debtors are using the consumer proposal option rather than pursuing a commercial reorganization. (page 184)

I. Selection of the Bankruptcy Trustee

At present, the BIA requires the Official Receiver to select a trustee to administer a bankruptcy; to the extent possible, this selection is required by law to reflect the wishes of the most interested creditors. In reality, however, in most cases the debtor chooses a trustee to administer his or her bankruptcy; it is rarely the case that the Official Receiver determines that a different trustee should be appointed.

The Personal Insolvency Task Force believed that the BIA should be amended in a manner that reflects the current reality with respect to trustee selection. The Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada supported this position, and told the Committee that the BIA should “be amended to reflect that in most cases, the debtor has initially selected the trustee to administer the bankruptcy.”

The Committee completely agrees with the notion that legislation should reflect reality in those situations where the reality appears to be working well for all stakeholders. The situation regarding the selection of the trustee by the debtor rather than by the Official Receiver is an illustration of this point. In some sense, the fundamental principle of effectiveness appears to be well-served. For this reason, the Committee recommends that:

The Committee completely agrees with the notion that legislation should reflect reality in those situations where the reality appears to be working well for all stakeholders.

The *Bankruptcy and Insolvency Act* be amended to provide that the debtor is required to submit to the Official Receiver his or her choice of a trustee to administer his or her bankruptcy.

J. Non-Arm's Length Creditor Voting Rights

At present, the voting rights of creditors in a bankruptcy, who have been dealing with the debtor at non-arm's length in the year prior to the bankruptcy, are restricted by the BIA. This restriction applies to relatives of the debtor, as well as to other creditors who do not deal at arm's length. The concept of "arm's length" is borrowed from the *Income Tax Act* definition of that term. The BIA establishes a presumption that people who are related, within the meaning of the definition of "related" in the BIA, never deal at arm's length. The Court has the right to restore the voting rights of non-arm's length creditors if they represent more than 80% of the value of the total claims.

Non-arm's length creditors can never vote in favour of a proposal, although they may vote against acceptance of the proposal.

Designed to impede collusion between the bankrupt and a non-arm's length creditor that would undermine the interests of other creditors or that would give an advantage to a relative or other non-arm's length party, the provision is predicated on the notion that collusion with the bankrupt is more likely to occur with non-arm's length than with arm's length creditors. There may be situations, however, where this situation is unlikely; consider, for example, spouses involved in litigation. Until one year after a divorce is finalized, the non-arm's length estranged spouse is not permitted to vote as a creditor if his or her claim is less than 80% of the total claim; in the event that it is, Court approval is required in order to vote.

... the provision is predicated on the notion that collusion with the bankrupt is more likely to occur with non-arm's length than with arm's length creditors.

In the opinion of the Personal Insolvency Task Force, the BIA should be amended to: remove the 80% requirement so that, subject to Court approval, a non-arm's length creditor could vote at a creditor's meeting; and permit non-arm's length parties to appoint inspectors, subject to Court approval. The

Canadian Bar Association informed the Committee that it supported the Task Force's recommendations.

The Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada shared with the Committee their qualified support for the Task Force's recommendation. In particular, they believed that the vote should proceed prior to seeking leave of the Court; if the non-arm's length creditor's vote changes the outcome, the creditor should then seek leave of the Court to have the vote counted. They believed that a similar modification to the Task Force's recommendation is needed with respect to the vote to appoint inspectors. Finally, they told us that "the definition of 'non-arm's length' and 'related' [should] be clarified, to make the BIA more accessible for those wishing to participate."

The Committee feels that a premise on which this provision was designed may be faulty, since it implicitly assumes that collusion is significantly more likely to occur between the debtor and a non-arm's length creditor than between the debtor and an arm's length creditor. We think that this premise explains both the 80% threshold and the requirement to seek leave of the Court prior to participating in a vote. While we believe that there is some chance – and perhaps even a good chance – that collusion between the debtor and a non-arm's length creditor may occur, we believe that the premise is faulty in the sense that it perhaps occurs much less frequently than might commonly be thought. Certainly, although we lack data to support our view, we think that its frequency does not justify the relatively onerous nature of the provision as it is currently drafted.

The Committee, in deciding whether this provision should be amended – and, if so, how – returned to the fundamental principles articulated in Chapter Two. We first put the current provision through the lens – if you will – of fairness, accessibility, predictability, efficiency and effectiveness. The provision failed to meet the standard expected in a number of areas. Change, then, is needed.

While we believe that there is some chance – and perhaps even a good chance – that collusion between the debtor and a non-arm's length creditor may occur, we believe that the premise is faulty in the sense that it perhaps occurs much less frequently than might commonly be thought.

We also feel that the proposal for voting by the non-arm's length creditor, to be followed by a request to the Court if the vote changes the outcome, is wise and we endorse this approach.

Of the options presented to us by witnesses, the Committee believes that a change to the 80% threshold should occur, but do not believe that the elimination proposed by the Task Force is wise; in the absence of data about the extent to which collusion occurs, complete elimination may be too extreme and may have implications for the extent to which the Courts would be required to hear requests for the restoration of voting rights. Instead, we believe that it should be lowered, with a subsequent examination of the consequences of the reduction as a means of assessing whether additional change is required. We also feel that the proposal for voting by the non-arm's length creditor, to be followed by a request to the Court if the vote changes the outcome, is wise and we endorse this approach. Feeling that the changes we suggest will help to ensure fairness and accessibility for non-arm's length creditors, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to provide voting rights to non-arm's length creditors who have been dealing with the debtor at non-arm's length in the year prior to the bankruptcy, if they represent together more than 40% of the value of the total claims. In the event that the non-arm's length creditors vote changes the outcome of the vote, any interested party should then seek leave of the Court to have the vote included.

K. Debts Not Released by an Order of Discharge

Certain debts are not released by an order of discharge from bankruptcy, including “any debt or liability for obtaining property by false pretences or fraudulent misrepresentation.” Sections 178(1)(d) and (e) of the BIA address some debts that are not released through discharge.

Some creditors have tried to invoke section 178 in order to prevent their claims from being discharged by arguing that an allegation of fraud is all that is required; that is, there is no requirement that fraud be proven to have occurred. As well, Section 178(1)(d) covers theft by a fiduciary, but does not cover theft by a stranger. Furthermore, Section 178(1)(e) applies to debts for property obtained through false pretences or fraudulent misrepresentation; debts for services obtained by improper means are not included.

The Personal Insolvency Task Force believed that these Sections of the BIA should be modernized. In particular, it argued that an allegation of fraud is insufficient and that a Court finding of fraud is required in order for the debt to survive discharge, and that debts for services obtained through false pretences or fraudulent misrepresentation should be covered in order to recognize the importance of services in our economy. Finally, it said that all theft should be covered, since there is “no policy reason to include only theft by a fiduciary ...” This recommendation was supported by the Canadian Bar Association, as well as by the Canadian Association of Insolvency and Restructuring Professionals and the Insolvency Institute of Canada.

Professors Ziegel and Telfer recommended that all of the non-dischargeable debts and penalties in Section 178 be reviewed.

In the Committee’s view, the witnesses made a compelling case for amendment of Section 178 of the BIA.

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... the provisions should apply to debts for services obtained through false pretences or fraudulent misrepresentation, as well as debts for property.

We, too, believe that fraud should be proven rather than merely alleged in order for the debt to survive discharge. As well, the provisions should apply to debts for services obtained through false pretences or fraudulent misrepresentation, as well as debts for property. In our opinion, changes of this nature would contribute greatly to fairness in the process. From this perspective, the Committee recommends that:

The *Bankruptcy and Insolvency Act* be amended to require that fraud be proven in order for a debt to survive discharge from bankruptcy. Moreover, the provisions should apply to both debts for property and debts for services acquired through false pretences or fraudulent misrepresentation.

CHAPTER SEVEN: CONCLUSION

Throughout our hearings, the Committee pondered the question of how “fresh” the “fresh start” should be for debtors, whether consumers or corporations. An answer to this question requires careful consideration of the balance that must be struck between providing honest but unfortunate debtors with an opportunity to be discharged from their debts and thereby begin again to contribute to society in a relatively unencumbered manner and the right for creditors of all types to recover as much as possible of the moneys owed to them and to share the burden of any shortfall in an appropriate manner. This philosophy is the fundamental premise on which Canadian insolvency law has evolved.

The answer, then, is: the fresh start should not be so fresh that creditors – whether suppliers of goods and services, grantors of credit or providers of labour – are unduly disadvantaged in the extent to which they can recover moneys owed to them, and thereby continue to provide goods, services, credit and labour with a reasonable expectation that they will be paid; but nor must the fresh start be so stale that debtors are unable, following discharge of their bankruptcy, to participate meaningfully in economic life because their non-dischargeable debt is overly burdensome for them. In the end, the true challenge is finding that elusive balance, recognizing that re-balancing is required from time to time as the domestic and international environments within which we live and do business change.

In this report, the Committee has provided recommendations that we believe will help to ensure opportunities for consumers and corporations to avoid bankruptcy – and thereby maximize opportunities for their personal or corporate recovery – and to share the burden of loss equitably should bankruptcy be unavoidable – and thereby allocate the burden fairly. This task is not easy. There are inherent conflicts and the problem is a “zero sum game.” Most

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A bankruptcy occurs because a debtor has insufficient assets to satisfy the claims of a range of creditors; in its simplest terms, there are inadequate resources available to pay debts as they become due.

generally, improving recovery for one stakeholder occurs only at the expense of one or more other stakeholders.

By definition, insolvency involves opposing and competing interests. A bankruptcy occurs because a debtor has insufficient assets to satisfy the claims of a range of creditors; in its simplest terms, there are inadequate resources available to pay debts as they become due. The Committee was mindful of the changes over time that have diminished the moneys available for recovery by creditors. Consequently, in our recommendations we were cautious in recommending additional exemptions from seizure in bankruptcy and discharge of debts that would further reduce these moneys and affect the balance between stakeholders.

Finally, the Committee believes that review must be ongoing, for insolvency legislation must respond to the changing domestic and global socio-economic environment. Our report – and the legislation that we expect will follow – are movements along the road. It is our hope that we will continually travel this road but never arrive at the end of it, for it is the continuous travel that reflects the change that must always occur in order to ensure that our insolvency regime is the best that it can be and that it continues to meet the often-conflicting needs of stakeholders in the fairest and most accessible, predictable, responsible, cooperative, efficient and effective manner possible.

APPENDIX A: THE *WINDING-UP AND RESTRUCTURING ACT* AND THE *FARM DEBT MEDIATION ACT*

A. The *Winding-up and Restructuring Act*

Enacted in 1882, the *Winding-Up Act* (WUA) provided a process for the liquidation of both solvent and insolvent corporations. With the passage of the *Bankruptcy Act* in 1919, a second regime for liquidating insolvent companies was created, and the *Bankruptcy Act* was made paramount with amendments in 1966 that had the effect of limiting the WUA's application to the winding-up of certain financial institutions. In that year, the Minister of Justice initiated a major reform process with respect to insolvency law; part of this process involved the establishment of the Study Committee on Bankruptcy and Insolvency Legislation, or the Tassé Committee.

When the Tassé Committee reported in 1970, it proposed that the *Bankruptcy Act* and the *Winding-Up Act* – to the extent that the latter applied – be merged in a single bankruptcy statute applicable to the liquidation of all insolvent companies. Although a number of legislative proposals that would have enacted a comprehensive insolvency statute and repealed provisions related to insolvent corporations in the WUA have been considered since that time, no merger of the WUA and the *Bankruptcy and Insolvency Act* has occurred. In recent years, the *Winding-Up Act* has been amended to facilitate the liquidation of financial institutions and to rename the Act.

At the present time, the *Winding-Up and Restructuring Act* (WURA) applies to insolvent financial institutions, such as banks, insurance companies, trust companies and loan companies; these companies cannot be liquidated under the *Bankruptcy and Insolvency Act*, and the WURA's provisions have been tailored to address the unique circumstances associated with administering the liquidation of insolvent financial institutions. The Act also applies to a range of solvent companies that wish to be wound up; however the federal *Canada Business Corporations Act* (CBCA) excludes the WURA's application to CBCA corporations, and other federal and provincial/territorial incorporations legislation may also do so. Consequently, most – although not all – solvent companies can be wound up under other legislation as well, including liquidation and dissolution provisions or federal and provincial/territorial corporations legislation and provincial/territorial winding-up legislation.

Different in both structure and procedure from the BIA, proceedings under the WURA are largely Court-driven. A liquidator is appointed by the Court to carry out the day-to-day administration of the process, and the Court must approve all key decisions made by the

liquidator. The Act requires the liquidator to take possession of the company's property, wind up its business and distribute the assets to creditors.

The Act provides two categories of preferred claims: a portion of the claims of employees for wages, and claims for the costs of administration. Moreover, since the Crown is not bound by the WURA, it is in a relatively stronger position to pursue its claims. Finally, the Act lacks rules governing international insolvencies and provides a relatively limited reorganization regime. In particular, the Act authorizes the Court to call a meeting of creditors in order to vote on a reorganization proposal and allows the Court to make the proposal binding on all creditors provided 75% of the creditors in any class vote in favour of the proposal.

A number of practitioners and analysts have recommended that the *Winding-up and Restructuring Act* be amended. This Act is not subject to the current statutory Parliamentary review.

B. The *Farm Debt Mediation Act*

Under the *Farm Debt Review Act*, proclaimed into force on 5 August 1986, provincial Farm Debt Review Boards were established to ensure that farm operations in financial difficulty or facing foreclosure had access to impartial third-party review and possible financing or refinancing. Each Board identified persons available to serve on three-person Farm Debt Review Panels, which were established for each farm debt review to consider the financial affairs of the farmer and to facilitate an arrangement between him or her and his or her creditor(s).

Two types of applications were possible. In the case of an insolvent farmer, the Act required a secured creditor(s) to give the farmer at least 15 business days' notice of action being taken and of his or her right to make an application under the Act. The farmer was then able to apply to the Farm Debt Review Board, and the Board notified all creditors and issued a 30-day stay of proceedings against foreclosure; the stay could be extended at 30-day intervals for a total of 120 days if the Board felt that an extension of the period was essential to the formulation of an agreement between the farmer and his or her creditor(s). A Farm Debt Review Panel met with field staff, the farmer and his or her creditor(s) to assess the situation and to attempt to achieve a mutually satisfactory agreement. If successful, any agreement reached constituted a legal contract. In the event of failure, the creditor(s) were able to proceed with foreclosure.

A farmer in financial difficulty could apply to the Farm Debt Review Board for a review of his or her financial affairs or for assistance in reaching an agreement with his or her creditor(s). A Farm Debt Review Panel was established, and field staff were assigned to evaluate the situation with the farmer and, if requested by him or her, his or her creditor(s); preliminary suggestions for improving the farmer's prospects were made. After reviewing

the final report, the Panel met with the farmer and, if he or she so requested, his or her creditor(s), to discuss the report and to attempt to enter into an agreement. Any agreement signed became a legal document.

In May 1996, Bill C-38 was introduced in the House of Commons. It repealed the *Farm Debt Review Act* and enacted the *Farm Debt Mediation Act* (FDMA). The FDMA, which came into force in April 1998, implemented a simplified procedure that focuses on mediation and applies to insolvent farmers. In general terms, the Act provides for: a review of an insolvent farmer's financial affairs; mediation between the farmer and his or her creditor(s) with the objective of reaching a mutually acceptable arrangement; and, if requested by the farmer, an order temporarily suspending the right of his or her creditor(s) to take or to continue proceedings against the farmer's assets.

To be eligible to make application under the Act, a farmer must meet one of three criteria: to be unable to meet his or her obligations as they generally become due; to have ceased paying his or her current obligations in the ordinary course of business as they generally become due; or to have property the aggregate of which is not, at a fair market valuation, sufficient to enable payment of all of his or her obligations due. These criteria correspond to the definition of "insolvent person" in the *Bankruptcy and Insolvency Act*.

A farmer meeting one of these three insolvency criteria can make one of two types of applications: for a stay of proceedings against him or her by all creditors, a review of his or her financial affairs, and mediation between him or her and all creditors for the purpose of assistance in reaching a mutually acceptable arrangement; or for a review of his or her financial affairs and mediation between him or her and all secured creditors for the purpose of assistance in reaching a mutually acceptable arrangement, although one or more unsecured creditors can be involved in the mediation in certain circumstances. With the first type of application, the farmer has access to a 30-day stay of proceedings, which can be extended in some circumstances for up to three further periods of 30 days each and can be terminated under a variety of circumstances; during the period of the stay, a guardian of the farmer's assets is appointed. With permission, farmers can change their application from one type to the other at any time during the mediation. There is a duty on the administrator of the process to give notice of the application to each of the farmer's creditors in the first case or to secured creditors in the second case.

Following the financial review of the farmer's affairs, a single, neutral mediator is appointed to assist the farmer and any relevant creditors in reaching a mutually acceptable arrangement; the mediator neither advises farmers nor negotiates on behalf of either them or their creditor(s). In the first type of application, mediation ends when the stay of proceedings is terminated. Different restrictions apply in the second type of application. In particular, if the administrator of the process believes that the farmer or most of the creditors refuse to participate in good faith in the mediation, or that the farmer and most of the creditors will not reach agreement, then he or she can direct that the mediation be terminated. Mediation is also terminated on the signing of an arrangement between the farmer and any creditor.

Every secured creditor intending to enforce a remedy against a farmer's property or to commence any proceeding or action, execution or other proceeding for the recovery of a

debt, the realization of any security, or the taking of any of the farmer's property is required to give the farmer written notice of this and to advise him or her of the right to make an application under the *Farm Debt Mediation Act*. This notice is required at least 15 business days prior to taking any of the acts described.

During Parliamentary examination of Bill C-38, some commentators criticized the proposed process because it would not apply to farmers in financial difficulty, as had been the case under the *Farm Debt Review Act*. A Farm Consultation Service, however, is available as a complementary program to the *Farm Debt Mediation Act*. It provides confidential financial management counselling to farmers.

The Minister of Agriculture and Agri-Food undertakes a review of the operation of the Act every three years, and tables a report on the review before the Senate and the House of Commons. The most recent report was tabled on 13 June 2001 for the period of 1998 to 2000. There is no statutory Parliamentary review of the Act.

APPENDIX B: THE EVOLUTION OF INSOLVENCY LEGISLATION IN CANADA WITH PARTICULAR REFERENCE TO THE *BANKRUPTCY AND INSOLVENCY ACT*

A. The Early Years

Canada's first federal insolvency statute was enacted by Parliament in 1869 with the passage of *An Act Respecting Insolvency*. This legislation covered voluntary and involuntary bankruptcies, provided for compositions and applied only to traders. Although the law was revised and consolidated in a new Act, the *Insolvent Act of 1875*, the legislative provisions did not have the intended effects and the law was repealed in 1880. Thereafter, for almost four decades Canada lacked a general bankruptcy law in force throughout Canada.

The situation changed with the 1919 *Bankruptcy Act*, which was modelled on the English statute of 1914. Major changes were not made, however, until three decades later, when a new *Bankruptcy Act* was passed in 1949. Nevertheless, some amendments were made during the 1919 to 1948 period. For example, in 1932 the Act was amended to establish the position of the Superintendent of Bankruptcy, and provision was made for the licensing of trustees.

B. The 1949 *Bankruptcy Act*

Legislation was introduced in 1949 to amend the *Bankruptcy Act* in order to attain several objectives:

- to provide a system of summary administration for small estates;
- to permit a debtor to offer, and creditors to accept, a proposal without the debtor going into – or being put into – bankruptcy;
- to clarify the priorities given to various classes of claims when distributing the debtor's assets; and
- to increase creditor control over a bankrupt's estate by vesting, in the creditors and inspectors, responsibilities and obligations for which they were previously required to resort to the Court.

Royal Assent was given in December 1949.

C. The 1966 Amendments

When amendments to the *Bankruptcy Act* were introduced in 1966, they were viewed as interim measures designed to address the most pressing issues, pending complete revision of the legislation. In particular, the *Bankruptcy Act* was amended in order to:

- provide more adequate means of addressing fraud connected with bankruptcies;
- enable the dissemination of information about bankruptcies so that creditors could better assess the credit rating of prospective clients;
- enable the Courts to review transactions that might not fall within what might be called “moral business practices;”
- tighten provisions related to proposals to give creditors better protection and to prevent a proposal from being used as a stalling device that would allow a debtor to dissipate his or her assets;
- require bankrupts to deposit, with their trustee for the benefit of creditors, a certain proportion of their salaries, wages or other remuneration;
- expand provisions dealing with offences by trustees; and
- prevent a bankrupt corporation from applying for a discharge.

The legislation received Royal Assent in July 1966.

D. The 1970s, Legislative Inertia and a Focus on Wage Earner Protection

A number of insolvency-related initiatives occurred in the 1970s, beginning with the publication of the report of the Tassé Committee. Formed in 1966 as the Study Committee on Bankruptcy and Insolvency Legislation, the Committee’s task was to undertake an in-depth study of Canadian insolvency law. In its report, the Committee recommended that a completely new bankruptcy and insolvency statute be enacted that would establish an integrated and comprehensive system. The Committee believed that a new statute was needed in light of the economic and social changes that had occurred since the enactment of the *Bankruptcy Act* in 1949. The 113 recommendations made by the Committee focussed on such areas as: measures to facilitate the payment of debt; “the last resort solution;” liquidation outside bankruptcy; crime and the protection of the credit system; administrative issues; and the Courts. As well, an area for change identified in the Tassé Report was super priority status for unpaid wage claims up to \$2,000, binding secured and general creditors.

Bill C-60 – intended to implement the recommendations of the Tassé Report – was introduced in the House of Commons on 5 May 1975 and, after first reading, was referred to

the Standing Senate Committee on Banking, Trade and Commerce. Following its study, the Committee recommended 139 changes to Bill C-60, and the Bill was permitted to lapse. One area in which the Committee recommended change was unpaid wage claims.

On 21 March 1978, Bill S-11 was introduced in the Senate. It contained 128 of the amendments to Bill C-60 that had been recommended by the Senate Committee. Although second reading occurred on 4 April 1978, the Bill was not passed. It was, however, re-introduced as Bill S-14 on 27 February 1979 and progressed to second reading before it died on the Order Paper when Parliament was dissolved on 26 March 1979.

Finally, Bill S-14 was re-introduced in the Senate on 8 November 1979 as Bill S-9. Following first reading, it too died on the Order Paper on 13 December 1979.

E. The 1980s and a Continued Focus on Wage Earner Protection

In 1980, the Committee on Wage Protection in Matters of Bankruptcy and Insolvency, chaired by Raymond Landry, was asked to make recommendations on wage protection. The Committee's report, published in October 1981, concluded that – in the absence of complete and accurate data on the number and value of unpaid wage earner claims – it was unable to determine the severity of the problem of unpaid wages. The limited evidence available did, however, indicate the existence of a problem.

In its report, the Landry Committee noted that the United Kingdom, France, West Germany, Belgium and Denmark had wage earner protection schemes, and recommended the same for Canada. In its view, however, a permanent legislative solution could not be drafted until the size of the problem had been determined and until federal and provincial/territorial policies had been coordinated. Consequently, the Committee recommended an interim three-year solution during which up to \$1,000 in unpaid wages would be paid out of the Consolidated Revenue Fund.

On 16 April 1980, Bill C-12 was introduced in the House of Commons and was referred to the House of Commons Standing Committee on Finance, Trade and Economic Affairs following second reading. The Bill died on the Order Paper when Parliament was dissolved during the Committee's hearings, which did not begin until 1983.

Bill C-17, which was essentially the same as Bill C-12 except for the addition of technical amendments, was introduced in the House of Commons on 31 January 1984. Although additional amendments were tabled on 28 May 1984, the Bill died on the Order Paper after second reading. With respect to unpaid wage claims, the Bill provided that a claim for wages up to \$4,000 would rank in priority over the claims of all secured creditors. The idea of a wage protection fund lacked support because of the absence of statistical data on the cost and the possibility that it would provide a disincentive to employers to pay wages on time.

In March 1985, the Minister of Consumer and Corporate Affairs established an Advisory Committee comprised of trustees and lawyers to examine the bankruptcy system, assess

possible reforms and recommend legislative amendments. The Committee's report – known as the Colter Report – was released in January 1986. The Report made 122 recommendations for change in such areas as: wage earner protection; receivers and secured creditors; commercial reorganizations; suppliers of merchandise; consumer bankruptcies and arrangements; preferred claims; farmers and fishers; securities firms, insurance companies and financial institutions; international insolvencies; estate administrative matters; and directors' and officers' liabilities.

With respect to wage earner protection, the Colter Report advocated the establishment of a fund, financed by employer and employee contributions, which would make certain payments to employees whose employers had been either declared bankrupt or put into receivership; payments would be made, to a maximum of \$2,000, for wages and commissions, vacation pay and pension benefits, although amounts due as severance payments would remain as unsecured claims.

Following the release of the Colter Report, in September 1986 the Department of Consumer and Corporate Affairs released a discussion paper on amendments to the *Bankruptcy Act*, and provided a number of recommendations based on the findings of the Colter Report and on its consultations with stakeholders and the provinces/territories. In 1988, the Department released *Proposed Revisions to the Bankruptcy Act*, in which it proposed reforms in eight areas. This approach involved reform of certain key aspects of the law rather than the presentation of a completely new statute with far-reaching reforms.

The Department's report also addressed the issue of unpaid wage claims, but differed somewhat from the recommendations made in the Colter Report. In particular, the Department proposed that the program be financed by the federal government rather than by employer and employee contributions; it did, however, support the recommendation made in the Colter Report regarding a maximum monetary limit, although the extent to which unpaid wages and vacation pay would be covered differed between the proposals.

Finally, the issue of unpaid wages was also addressed in the March 1989 *Report of the Advisory Council on Adjustment* – also known as the de Grandpré Report – which examined adjustment issues arising as a consequence of the Canada-United States Free Trade Agreement. As part of its examination of employment issues in an age of globalization, the Report recommended amendments to the *Bankruptcy Act* that would create a national wage earner protection fund that would cover up to \$4,000 in unpaid amounts owing to employees for wages, vacation pay, pension and benefit premiums, and severance pay. In the event that the fund was not created, the Report recommended that the federal government enact legislation, on an expeditious basis, to ensure that wage earner claims would have priority over all other claims in the disposition of assets of an insolvent employer.

F. Bill C-22: The 1992 Changes

Bill C-22 was introduced in the House of Commons on 13 June 1991 and its provisions came into force on 30 November 1992. The Bill was designed to:

- achieve a better balance between the rights of various categories of creditors as well as between the rights of creditors and debtors;
- enable individuals and businesses to reorganize their financial affairs in an effort to avoid bankruptcy; and
- make the laws more effective, less costly and easier to apply.

Principal areas of reform contained in the Bill included:

- wage claims, although this proposal was subsequently withdrawn;
- secured creditors and receivers;
- commercial reorganizations;
- consumer proposals, including mandatory counselling in order to receive a nine-month unconditional discharge;
- Crown claims and priorities;
- protection for unpaid suppliers; and
- technical amendments.

The Bill also introduced the concept of insolvency into the title of the legislation, and required Parliamentary review after three years.

G. Bill C-5: The 1997 Changes

Anticipating the three-year statutory review that had been included in the 1992 *Bankruptcy and Insolvency Act* (BIA), the federal government established the Bankruptcy and Insolvency Advisory Committee, comprised of government and private sector representatives, to examine various areas of bankruptcy law and to make recommendations for change. Many of the Committee's recommendations were included in Bill C-5.

Introduced in the House of Commons on 4 March 1996, Bill C-5 was essentially the same as Bill C-109, which had been introduced in the House of Commons on 24 November 1995 but died on the Order Paper following first reading.

As introduced in the House of Commons, Bill C-5 proposed to amend the BIA with respect to:

- the licensing and regulation of bankruptcy trustees;
- the liability of trustees for environmental damage and claims;
- the liability of directors and stays of action against directors during reorganizations;
- compensation for landlords where leases are disclaimed in a reorganization proposal;
- procedures in consumer proposals;
- consumer bankruptcies;
- the dischargeability of student loan debt;
- Workers' Compensation Board claims;
- codification of requirements for bankrupts to contribute part of their income to the bankruptcy estate;
- international insolvencies; and
- securities firm insolvencies.

The Bill also proposed amendments to the *Companies' Creditors Arrangement Act* (CCAA) in order to align more closely the provisions of the CCAA and the BIA. It did not, however, address such issues as the rights of unpaid suppliers and a wage earner protection fund.

After consideration in the House of Commons, the Bill was studied in the Senate by the Standing Senate Committee on Banking, Trade and Commerce. In February 1997, the Committee issued a report on the Bill and recommended a number of amendments; Bill C-5, as amended, received third reading in the Senate in February 1997. On 15 April 1997, the House of Commons concurred in the Senate amendments, and the Bill received Royal Assent on 25 April 1997. Provisions came into force in September 1997 and April 1998.

H. Bill C-36: Student Loan Debt

Bill C-36, An Act to implement certain provisions of the budget, was introduced in the House of Commons on 24 February 1998 and proposed amendments to the *Bankruptcy and Insolvency Act*, among other Acts. As part of a package of changes related to the financing of post-secondary education – which included provisions related to interest relief – the Bill proposed that student loan debt not be dischargeable where bankruptcy occurs within ten years after the completion of studies; prior to this change, the period was two years.

I. The Current Insolvency Process: Consumers

At present, individuals who find themselves with an unmanageable debt burden have several options available to help them return to financial health. For example, these individuals might consider: a debt consolidation loan; an informal proposal with creditors; or, in some provinces/territories, a Consolidation Order setting out the amount and times when payments are due to the Court, which then distributes payments to creditors on behalf of the debtor. In Quebec, the Voluntary Deposit scheme – or Lacombe Law – is similar to a Consolidation Order.

In addition to these options, an insolvent debtor may consider bankruptcy or the making of a proposal. In order to meet the definition of insolvency, the individual must: owe at least \$1,000 and be unable to meet his or her debts as they are due to be paid; have ceased paying his or her current obligations in the ordinary course of business as they generally become due; or have property the aggregate of which is not, at a fair market valuation, sufficient to enable payment of all of his or her obligations due.

Under the *Bankruptcy and Insolvency Act*, a trustee or an administrator may file a consumer proposal, which is a proposed agreement between the debtor and his or her creditors whereby the parties agree that the debtor will pay off a portion of his or her debt, that the time period over which the debt will be paid will be extended, or that some combination of both of these will occur; in essence, it involves restructuring the payment obligations. The trustee is required to provide the creditors with a report on the affairs of the debtor, the causes of the financial difficulties, and an estimate of what the creditors would realize under a bankruptcy as compared with the amount offered under the proposal.

Two types of proposal are possible: a consumer proposal where the debtor's aggregate debt, excluding debt secured by a principal residence, does not exceed \$75,000 and the proposal includes a maximum five-year debt repayment scheme; or a proposal, available as an option for individuals regardless of their level of indebtedness and for corporations. If creditors fail to accept the first type of proposal, the debtor is not automatically bankrupt; with the second type of proposal, however, failure by the creditors to accept the proposal results in the debtor becoming bankrupt.

In order for a proposal to be acceptable to creditors, it must generally be the case that they would be better off – as a result, for example, of quicker distribution, lower administrative costs, a higher level of payment or a more certain outcome of issues – than they would be if the debtor were to become bankrupt. Thus, since 1992 when the option of consumer proposals was added to the BIA, proposals have been seen by many as a win-win situation: creditors gain because they are better off than they would be if the debtor were bankrupt, and the debtor avoids bankruptcy. The growth of proposals as an alternative to bankruptcy has been particularly rapid since 1997, although one might have expected relatively rapid growth following the enactment of the proposal option in 1992.

If creditors vote in favour of a proposal – which requires that the proposal be approved by at least 66.6% in dollars and 50% plus one in number of eligible creditors who vote – then it

is approved by the Courts and is a contract that is binding on all creditors. The debtor retains control of his or her assets, except where the proposal stipulates otherwise.

In the event of a debtor's bankruptcy – whether it occurs voluntarily or, more rarely, as a result of creditors asking the Court to order that a person is bankrupt – certain property is exempt from seizure. The range and value of exempt property varies across provinces/territories, although apparel, household furnishings, one vehicle, professional tools and books, and medical devices are generally exempt to certain limits. Funds in registered pension plans and life insurance Registered Retirement Savings Plans are also exempt. Assets held by the bankrupt or acquired by the bankrupt during the period of bankruptcy that exceed these exemptions vest with the trustee, who will dispose of the non-exempt assets for the benefit of the bankrupt's creditors.

Individuals who are bankrupt for the first time receive an automatic discharge after nine months, provided the creditors, the Superintendent of Bankruptcy or the trustee do not oppose the discharge and the bankrupt has undergone mandatory counselling; with the 1992 amendments to the BIA, Canada became the first country to make financial counselling mandatory prior to an unconditional discharge. The discharge cancels the bankrupt's debts, with certain exceptions, including child support payments, alimony payments, Court-imposed fines and student loan debts if the bankruptcy occurs within ten years after the completion of studies. The bankruptcy remains on the individual's credit record for six years.

J. The Current Insolvency Process: Corporations

Insolvent corporations have a number of options, including reorganization or bankruptcy. Reorganization can occur under either the *Bankruptcy and Insolvency Act* or the *Companies' Creditors Arrangement Act*, although a \$5 million debt threshold must be met if the corporation elects to proceed under the CCAA.

In the case of reorganization, a trustee files a proposal with the organization's creditors, who are more likely to accept a proposal if they are better off with the reorganization of the business than they would be if the company were to become bankrupt. Proposals for reorganization typically involve the organization paying off only a portion of its debts and/or paying its debts over a longer period of time, or both. This circumstance is viewed as a potentially win-win situation: the organization remains in business, workers continue to be employed, and creditors both retain a customer and receive at least a portion of the moneys owed to them.

The trustee must provide creditors with a report on the financial affairs of the company, the causes of the organization's financial difficulties and an estimate of the amount creditors would realize under a bankruptcy as compared with the amount being offered under the reorganization proposal. The proposal must include provision to pay both employee source deductions outstanding within six months after Court approval, and outstanding wages and

vacation pay owed to employees and former employees, up to a maximum of \$2,000 each, immediately after Court approval.

Organizations can be placed into bankruptcy through a number of circumstances: a creditor petitioning the company into bankruptcy (a Court proceeding); the company's directors filing an assignment of the company; defeat of a proposal at the meeting of creditors; refusal of the Court to ratify a proposal which had been approved by the creditors; or annulment of a proposal as a result of non-performance. In these circumstances, a trustee acquires control of the organization's assets that remain following enforcement by secured creditors and liquidates them for the benefit of unsecured creditors.

APPENDIX C: THE REPORT BY INDUSTRY CANADA

In the *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (hereafter, the IC report or the report), Industry Canada presents the issues raised and conclusions reached during its consultations with stakeholders in three areas: administrative policy issues; commercial insolvency issues; and consumer insolvency issues.

A. Administrative Policy Issues

In general, stakeholder comments on administrative policy issues focussed on the needs of the Office of the Superintendent of Bankruptcy (OSB) in order to administer the system effectively, and on impediments that can be removed or minimized.

1. Volume, Access and Funding

The IC report notes the continued growth in the number of insolvency files in recent decades, and questions whether preventive approaches should be adopted to halt this trend and to encourage debtors to adopt credit management practices that would reduce the likelihood of insolvency.

It also suggests that, because of the costs associated with entering into bankruptcy, low-income debtors may be unable to access the system. In particular, if a trustee believes that it may be difficult to collect the fees for services rendered, he or she may require an advance or security as a condition of accepting the assignment; this situation could be a barrier to access for some debtors. Nevertheless, the Bankruptcy Assistance Program established by the Office of the Superintendent of Bankruptcy (OSB) facilitates access, since trustees voluntarily provide services at no charge to debtors unable to afford the services of a trustee. The IC report questions whether universal access to bankruptcy services should be redefined, with new measures to ensure access, or whether access should cease to be seen as a right.

Moreover, the report notes that, since becoming a Special Operating Agency, the OSB depends on income generated by its operations to fulfill statutory obligations. The Office must ensure compliance with the *Bankruptcy and Insolvency Act* (BIA) within its budgetary limits, which is increasingly difficult with a rising number of files received each year. A number of options exist for increasing OSB funds, including the identification of new bases of revenue and higher fees. Also mentioned in the IC report is the contribution that new

technology can make in enhancing the efficiency of the system for all users; almost 80% of the Office's services are currently available electronically and all services are likely to be available electronically by 2004, which means that there are limited opportunities for cost savings in this area. Nevertheless, amendments to the BIA may be required to provide more clarity for electronic transactions.

2. The Debtor Compliance Program

In order to prevent abuse and maintain the public's trust in the integrity of the insolvency system, an effective program is needed to ensure debtor compliance with the BIA; the need may be particularly acute in light of growing caseloads, more complex cases and increasingly scarce resources. The IC report questions whether the BIA should be modernized and reviewed to determine if certain offences would be better addressed through civil and/or administrative remedies, rather than through criminal proceedings.

3. Regulatory Supervision of Reorganizations under the *Companies' Creditors Arrangement Act*

Unlike the BIA, the *Companies' Creditors Arrangement Act* (CCAA) is not subject to any administrative supervision and there is no centralized public record of CCAA reorganizations. Consequently, it is difficult to assess – in any meaningful or verifiable manner – the extent to which reorganization plans are effective and to which the CCAA's provisions are being applied and administered consistently; one consequence of this lack of supervisory process could be reduced trust by lenders and investors. Moreover, the monitors appointed to monitor the affairs and finances of a business during its reorganization are not bound by rules of professional conduct and are not subject to qualification requirements.

In light of the social and economic importance of reorganizations under the CCAA and the increasing frequency with which they occur, the IC report questions whether a supervisory regime would be appropriate in order to provide: a national and public registry; mechanisms to address complaints; the power to intervene in Court proceedings; and licensing requirements for monitors.

4. Regulatory Supervision of Receiverships

According to some stakeholders, the provisions in the BIA that govern receiverships have not been effective and are not being used in the manner intended. The provisions apply when a secured creditor or its agent – a receiver – takes possession of all or substantially all

of the assets of a business to realize them for the secured creditor's benefit. The IC report notes a number of deficiencies with these provisions, including the definition of "receiver," a restrictive interpretation of the provisions by common law Court, and inadequate penalties for those who do not comply with the provisions.

5. Consolidation of Insolvency Statutes

As part of its examination of corporate insolvency issues, the IC report addresses the concept of whether the BIA and the CCAA should be integrated. Here, the concept is presented as an administrative policy issue rather than a corporate insolvency concern because integration of the statutes could involve Superintendent of Bankruptcy oversight over the merged law.

The IC report notes that the existence of these separate insolvency statutes is a consequence of historical circumstances, and indicates that stakeholders hold various opinions about whether the BIA and the CCAA should be merged and, if so, to what extent. It also comments on the lack of data regarding the use and application of the CCAA, which limits meaningful debate on the issue.

B. Commercial Insolvency Issues

Stakeholders identified a range of commercial insolvency issues during the consultation process. While they were able to reach consensus on some issues – including securities firm bankruptcies, the *Winding-up and Restructuring Act*, financial market issues, and trustee liability for successor employer obligations and pension claims – other issues remained unresolved because of significant or extreme differences of opinion among stakeholders. The unresolved issues included: wage earner and pension protection; Debtor-in-Possession (DIP) financing; unpaid supplier rights; adoption of the UNCITRAL Model Law on Cross-Border Insolvency; contractual rights; integration of the BIA and the CCAA; director liability; sanctions for director and officer conduct detrimental to creditors; and transfers at undervalue and preferences.

1. Compensation Protection: Wages and Pensions

The extent to which the wage and pension income of employees is protected in insolvency proceedings is a longstanding concern in Canada, and while some wage protection has existed since 1949, the issue has been examined repeatedly since the 1970s. The IC report describes the various legislative and other proposals that have been discussed over time to protect wages, including: preferred-claim status and the maximum amount that is

appropriate; super priority protection; a wage protection fund financed by some combination of employers, employees and the Consolidated Revenue Fund; and protection through the employment insurance system. It raises questions about the distributional effects of compensation protection, and about the impact of such measures on economic activity and efficiency as well as on credit availability and cost.

Moreover, the IC report identifies concerns about the extent to which existing protection for unpaid contributions to – and unfunded liabilities of – pension plans is adequate and, if inadequate, how the protection might be improved. At the present time, Ontario is the only jurisdiction that provides funded protection for pension claims, although bankruptcy legislation tabled in the 1970s and 1980s, as well as a number of advisory committees, have commented on such issues as priority for pension claims and the establishment of a fund to cover pension claims.

2. Debtor-in-Possession Financing

Debtor-in-Possession (DIP) financing assists insolvent businesses that need financing in order to reorganize; since this type of lending is usually risky, lenders may require that they have priority over other secured creditors. The BIA and the CCAA are silent on the issue of DIP financing, although Canadian judges – using their inherent jurisdiction – have authorized such financing in CCAA cases.

The IC report notes concerns by stakeholders about whether DIP financing should: have a legislative basis; be imposed on creditors without further defining the circumstances under which it is warranted; and rank ahead of existing creditors. Another concern is that insolvent companies – which may have financial and management difficulties – may not succeed even with DIP financing, a situation that would result in even greater loss than would otherwise be the case. The absence of data regarding the success of reorganizations under the CCAA – and the role that DIP financing may play in that success – limits meaningful debate on this issue.

3. The Rights of Unpaid Suppliers

Stakeholders have concerns about the effectiveness of the protection for unpaid suppliers, or the “30-day goods rule,” which has existed in the BIA since 1992. In particular, the IC report identifies concerns about: the fact that the 30-day recovery period begins on the date of delivery rather than the date of the debtor’s initiation of bankruptcy; the limitation requiring that recovery be limited to goods that are in the same state as when they were delivered; and the application of the provisions to the supply of goods but not of services.

4. Cross-Border Insolvencies

UNCITRAL – the United Nations Working Group on Insolvency Law – has recommended that countries adopt, as part of their domestic insolvency law, its Model Law on Cross-Border Insolvency. Adoption of the Model Law in Canada would involve replacing parts of the BIA adopted in 1997 in response to increasing globalization and the rising number of insolvencies that are international in nature. The IC report notes that adoption of the Model Law would assist international harmonization efforts regarding the treatment of international insolvencies, with more uniform interpretation of rules and easier administration of international insolvencies.

The IC report reflects stakeholder questions about whether: Canada should adopt a reciprocity provision if it adopts the Model Law; adopting the Model Law could reduce the number of insolvency cases heard in Canada; the Model Law should be adopted as written, or adopted with modifications; and Canada should adopt select Model Law features and add them to existing provisions in the BIA.

5. Contractual Rights

The IC report questions whether – and, if so, the extent to which and in what circumstances – insolvency law should intervene in private contracts in order to ensure fair distribution or maximization of value in an insolvency, recognizing that contracts contain terms negotiated in good faith and reflective of risks. The report notes stakeholder concerns about whether: secured creditors should be temporarily stayed from enforcing their rights in bankruptcy; the BIA requires rules governing leases; and existing intellectual property rights reflect the competing interests of various parties.

Allowing intervention in contractual rights is likely to affect contractors' expectations, reduce predictability, lower certainty in contracting and increase risk. The report suggests that, in this context, the benefits of intervention should be assessed against the costs of such intrusion. Situations cited in the report to illustrate the desirability of continuing a contract include: allowing a trustee to use leased premises for a period of time while assets are being evaluated and liquidated; and the continued use of software under licence that may be integral to a business. While it may be the case that “valuable” contracts should be allowed to survive, creditors and debtors may not always agree on which contracts are “valuable.”

6. Directors: Liability and Sanctions

On the issue of directors' liability, the IC report questions whether existing rules in this area strike the appropriate balance between attracting competent directors and creating a sufficient obligation to ensure that they act diligently in the performance of their duties.

While federal and provincial/territorial laws provide that directors are exposed to personal liability for a number of corporate debts, in most cases they have access to due diligence or good faith defences; in other cases, however, they are subject to absolute liability and have no defence.

The report notes that reduced exposure by directors to personal liability could encourage competent individuals to accept positions as directors, and to remain as directors when their companies are insolvent. Nevertheless, reduced exposure would lower the incentive for directors to ensure that payments are made to wage earners and others protected by directors' liability provisions. A number of options for reform are presented, including: placing directors' liability for wages directly in the BIA, with a due diligence defence; allowing directors to be exonerated from liability for claims arising in the period immediately prior to or after insolvency proceedings are commenced; and focussing efforts on identifying – and taking action against – wrongdoing by directors, but otherwise allowing them to be blameless in insolvencies.

The IC report also comments on sanctions for director and officer conduct detrimental to creditors. There is some concern about whether the existing sanctions for inappropriate conduct are properly balanced with ensuring diligent performance while encouraging competent persons to act as directors, and about whether sanctions are effectively enforced. At the present time, directors may be held personally liable for failure to consider creditors' interests when their companies become insolvent.

Although the report notes that recent case law has resulted in directors and officers taking fewer risks in their efforts to revive insolvent companies, it questions whether director disqualification provisions might be effective in identifying incompetent directors and reducing abuse; such provisions could, however, be costly to enforce effectively and could have negative implications for the recruitment of competent individuals to serve as directors and decision making by them. The report identifies a prohibition on asset rollovers as a provision that might promote integrity in the bankruptcy system, but also notes such potential disadvantages as reduced returns and interference with the reallocation of resources to their most efficient uses. Finally, the possibility of replacement of directors by the Courts was raised.

7. Transfers at Undervalue and Preferences

The IC report questions whether the BIA's current provisions regarding transfers at undervalue and preferences should be modernized and made more comprehensive, since they have remained almost unchanged since the 1919 *Bankruptcy Act* and are generally thought to be unusable. In some cases, the transfers may be fraudulent; in all cases, they occur at the expense of other creditors. Since provincial/territorial legislation governing commercial transactions has been used to address questionable transactions, the report suggests that the fragmentation that currently exists is both confusing and inefficient; a

solution might be the inclusion of provincial/territorial provisions in federal insolvency legislation to form a single, comprehensive regime.

Moreover, the report notes that fraud and intent are difficult to prove, and may involve both costly and lengthy litigation. To resolve this problem, legislation could focus on the result of the transaction, rather than the intent underlying it. This solution is not, however, without problems, particularly for creditors who are more diligent in collecting payments owed to them and for third parties who negotiate a favourable deal immediately prior to a reorganization or insolvency.

8. Bankruptcy by Securities Firms

In 1997, provisions were added to the BIA to enact a regime governing bankruptcies by securities firms. Part of this regime provides a mechanism to override the trust relationship between a securities firm and its customers, and enables almost all securities and cash held by a bankrupt firm to be pooled and distributed *pro rata* among customers, with only “customer name securities” given to customers who own them. The IC report suggests that technical amendments are needed to clarify certain issues that have arisen during recent bankruptcies of securities firms.

9. Application of the *Winding-up and Restructuring Act*

During Industry Canada’s consultations with stakeholders, the question of whether the *Winding-up and Restructuring Act* (WURA) should be restricted to financial institutions in situations of insolvency was raised. The IC report notes that, with the availability of the BIA, there is perhaps no reason to allow insolvent companies that are not financial institutions to use the WURA. Moreover, limiting the application of the WURA to financial institutions helps to maintain both the integrity of the system and consistent treatment of companies having a similar purpose.

10. Exemptions for Securities Commissions and Exchanges

Financial regulators – such as securities commissions and exchanges – have expressed concerns about their ability to carry out their regulatory duties in light of reorganization-related stays of proceedings, which have been held to apply to them. The IC report notes broad stakeholder support for the notion that regulatory agencies be exempted from stay provisions. This exemption would enable them to take action against a company that is conducting itself inappropriately, particularly at a time when their control and supervision roles may be most critical.

11. Protection for Trustees against Liability as Successor Employers

The IC report suggests that the standard of liability assumed by a trustee that takes on the role of successor employer should be re-examined. In particular, trustees, receivers and other insolvency administrators who take on this role may be held personally liable for some obligations of a bankrupt or insolvent debtor, including wage, vacation, severance, termination and pension claims, even if the obligations were unknown to them when they accepted the position of trustee, receiver or administrator.

There is some concern that individuals may not be prepared to accept these positions if the risks associated with successor employer obligations are too great. Moreover, they may not be able to assess the risks adequately and quickly when they first accept the positions. The IC report proposes that limits on exposure to liability would encourage individuals to accept such positions, although it would give employees and pensioners fewer options for recourse and would thereby shift the risk from the trustee, receiver or administrator to employees and pensioners.

C. Consumer Insolvency Issues

A range of consumer insolvency issues were identified by stakeholders in the Industry Canada-sponsored consultations, and consensus was reached on a number of concerns, including consumer liens, the growth in consumer bankruptcies, student loans and wage assignments. Significant or extreme differences of opinion, however, existed among stakeholders with respect to: federal exempt property; exemptions for Registered Retirement Savings Plan (RRSPs) and Registered Education Savings Plans (RESPs); reaffirmation agreements; the streamlining of summary administration; the enforcement of security on a bankrupt's household property; and mandatory counselling.

1. Federal Exempt Property and Exemptions for RRSPs and RESPs

At the present time, provinces/territories are responsible for determining the property that is exempt from seizure in bankruptcy; this responsibility, which they have had since 1919, exists with respect to both the nature and the value of the property. Consequently, exempt property varies across Canada. This variability may be of concern, since exemptions play an important role in ensuring that bankrupts receive a fresh start. While some believe that a list of federal exempt property would ensure equitable treatment of bankrupts across Canada, those who support a list of provincial/territorial exempt property suggest that these more accurately reflect local realities and the cost of living.

The IC report notes the suggestion made about an optional list of federal exempt property, periodically adjusted to reflect changes in the cost of living. According to this proposal, bankrupts would be able to select either the list of federal exempt property or the applicable list of provincial/territorial exempt property upon filing for bankruptcy; allowing this choice would not, however, necessarily achieve consistent treatment of exempt property across the country. Other options noted include: a list of federal exempt property as a minimum standard that would apply when provincial/territorial standards were lower; and a list of federal exempt property to replace existing lists of provincial/territorial exempt property. The notion of monetary limits – whether in a list of federal or provincial/territorial exempt property – received support during Industry Canada’s consultations.

Regarding Registered Retirement Savings Plans, the IC report notes that certain retirement savings vehicles – including registered pension plans, locked-in RRSPs and life insurance RRSPs – are exempt from seizure in bankruptcy. Other vehicles – including non-locked-in RRSPs held by banks, brokerages or in self-directed accounts – are not, however, exempt. Stakeholders have suggested that, for reasons of equity, all retirement savings vehicles should be treated in the same manner; from this perspective, non-insurance RRSPs should be exempt from seizure in bankruptcy if they are locked in.

The IC report identifies arguments against this treatment of non-insurance RRSPs: it would reduce returns to creditors; RRSPs can be used for reasons unrelated to retirement; and RRSP holders currently have the option of protecting their RRSPs through the purchase of life insurance RRSPs. Nevertheless, a specified number of options for change are identified in the report: exempt RRSPs provided they are locked in and only available at retirement; ensure that contributions made by the debtor in a specified number of years before bankruptcy would not be exempt from seizure; stipulate that income from an RRSP payable following retirement would be treated as income and subject to surplus income standards; impose a cap on the exemption, bearing in mind the bankrupt’s age and the maximum RRSP contribution limit available in the year of bankruptcy; and no exemption for RRSPs, since they are identical to other investments.

A final exemption raised in the IC report’s examination of consumer insolvency issues is the treatment of Registered Education Savings Plans. In particular, the report questions whether amounts contributed to an RESP should be exempt from seizure if the person in whose name the account is held becomes bankrupt. At the present time, bankruptcy by the plan holder results in the existing balance being seized to pay creditors and in the contributions made by the federal government being returned to the government.

The main issue regarding RESPs appears to be the balance between the fairness of exempting another asset from seizure in bankruptcy, and thereby reducing the returns to creditors, and the promotion of education in the public interest. The IC report also notes the concern that additional exemptions and prioritizing of claims reduce the fundamental premise on which Canadian insolvency law has been drafted: the fair and efficient redistribution of assets. The parallel between RESPs and RRSPs – and the public interest in both – was identified. Stakeholders have suggested options similar to the proposals for RRSPs, including: locking-in requirements and a clawback of contributions made in the

previous year. Another proposal was for RESPs to meet the formal requirements of a trust, which would make the funds exempt from seizure, although the flexibility of the plans would be reduced.

2. Reaffirmation Agreements

The IC report identifies concerns by stakeholders about whether reaffirmation agreements, which re-establish a debt that has been discharged by bankruptcy, should be legal; at present, such agreements are not regulated by the BIA. Some stakeholders believe that the existence of these agreements undermines the fresh start principle, although it may be the only means by which a bankrupt can obtain credit.

One proposal noted in the report would disallow reaffirmation agreements concerning unsecured transactions, but would allow some payments under two circumstances: if approved by the Official Receiver or the Court or made voluntarily to a relative, and in respect of secured transactions in limited circumstances. Another proposal identified in the report is a prohibition on reaffirmation agreements in all circumstances, which would support the fresh start principle but perhaps affect the availability and cost of credit; it would also prohibit such agreements even in situations where reaffirmation might be in the best interest of both parties.

3. Summary Administration

For debtors with limited assets and a modest income, simplified procedures for consumer bankruptcies might be desirable. Historically, Canadian insolvency legislation was designed to resolve bankruptcies by companies, and a streamlined process for debtors with limited assets was not available until 1949 when summary administration provisions were added to the *Bankruptcy Act*. At present, these provisions apply to non-corporate bankruptcies with realizable assets no greater than \$10,000. The IC report notes that the process, nevertheless, is still relatively complex; moreover, with consumer bankruptcies rising – particularly among debtors with few or no assets and low income – it would be efficient to process these cases as quickly and inexpensively as possible.

Options for reform suggested by stakeholders include: modifying the process to eliminate procedures that add no value; allowing creditors, the Office of the Superintendent of Bankruptcy and trustees to get involved in bankruptcies selectively; and performing select administrative tasks only if requested by creditors. With such changes, however, there would be a need to ensure that the integrity of the system is protected and abuse is prevented; one means for achieving these goals might be to delay discharge for up to three years.

4. Household Property

The IC report questions whether the current provision allowing the enforceability of security agreements on a debtor's household property following bankruptcy should be changed. In most provinces/territories, creditors can take, as security, the personal property found in a debtor's home. There is a concern that, in the event of bankruptcy or insolvency, creditors could take advantage of the debtor's desire to keep this property by demanding – and obtaining through the threat of seizure – more than the property is worth.

Some stakeholders believe that the provisions allowing this practice result in bankrupt individuals and their families being abused. One proposal identified in the report would make all non-purchase money security interests granted by the debtor against exempt personal property unenforceable in bankruptcy and proposals; it would also enhance protection for assets that are exempt from seizure and require a secured creditor to pay the exempt amount to the debtor prior to enforcement. A suggestion has also been made that motor vehicles might be treated differently than other household belongings. Limitations on security interests in household furnishings could, however, affect the availability of credit for the purchase of these assets.

5. Mandatory Counselling

Since amendments to the BIA in 1992, mandatory counselling has been required for first-time bankrupts before receiving an automatic discharge from bankruptcy; counselling is also required for debtors making consumer proposals. The IC report suggests that counselling is beneficial in a number of ways and appears to have had only a limited impact on operating costs, with the result that creditors are not being unduly disadvantaged by the fact that counselling is financed by the bankrupt's estate.

Nevertheless, some believe that counselling should be optional and at the discretion of the debtor, the trustee or the Office of the Superintendent of Bankruptcy. Others have suggested more counselling, earlier counselling and counselling as a requirement in all cases. The notion of a comprehensive education program on personal finance for youth was also identified in the report.

Those who are opposed to mandatory counselling have argued that it occurs too late in the process, with the result that it is not effective, and that bankruptcy is often the result not of financial mismanagement but instead of such situations as business failure, job loss or change in marital status.

6. Consumer Liens

At present, consumers who place deposits with vendors for goods or services, but who do not receive those goods or services as a consequence of bankruptcy by vendors, are unprotected by the law. As unsecured claims, these consumers have few opportunities for recovery; in the majority of cases, they do not view themselves as creditors and did not intend to incur any risk.

The IC report notes that a consumer lien would increase the likelihood of recovery for these consumers, although it would give statutory protection to a specific group of creditors at the expense of other creditors and might affect the availability of credit. The report also presents the relatively weaker option of giving such consumers preferred status, behind secured creditors but ahead of claims by ordinary creditors; any negative effects on credit availability would likely be smaller with this option. Alternatively, this issue could be resolved through provincial/territorial commercial/consumer legislation, although constitutional issues might be raised where a provincial/territorial law of this nature purports to be applicable in a bankruptcy.

7. Student Loans

Amendments to the BIA in 1998 provide that any outstanding student debt and interest owing on those debts will not be discharged by bankruptcy should the debtor become bankrupt while a student or within ten years after completing his or her studies; prior to this change, the restriction was two years after the completion of studies. The amendment occurred as a consequence of the 1998 federal Budget, which made several changes to the federal student assistance program and provided students with an incentive to take advantage of relief measures as an alternative to bankruptcy.

The IC report questions whether this ten-year restriction on the ability of bankrupt students to obtain a discharge should be modified. Stakeholders believe that the restriction is too harsh and unfair, and that student loans should be treated in the same manner as other consumer debt. Options for change include reducing the ten-year period to five years and/or making student loan debt a preferred claim but still discharged by the bankruptcy.

8. Wage Assignments

Wage assignments, which are permitted in some provinces, are a form of security for consumer loan granted by credit unions in which the collateral is a portion of the future wages of the debtor. With amendments to the BIA in 1992, assignments of future or existing wages made before bankruptcy do not apply to post-bankruptcy wages, with the result that other creditors are receiving moneys that previously were received by the credit

unions; prior to the change, wage assignments were enforceable against wages earned after bankruptcy but before discharge.

The IC report notes that some stakeholders would like the effectiveness of wage assignments to be restored; this view is held particularly by those in the financial community. It suggests, however, that the fresh start principle may be undermined if the collateral in a wage assignment consists of a substantial portion of the debtor's future earnings, and that the availability of wage assignments reduces the amounts available to other creditors since surplus income would likely fall. Nevertheless, such assignments may be the only collateral available to the debtor. As well, since wage assignments reduce the risk for credit unions, the availability and cost of credit may be positively affected.

APPENDIX D: AN INTERNATIONAL PERSPECTIVE ON INSOLVENCY LAW

A. The United States

In the United States, the *Bankruptcy Reform Act* of 1978 – commonly referred to as the *Bankruptcy Code* – is the major bankruptcy statute. Since it became effective in November 1979, it has been amended a number of times, including by the *Bankruptcy Amendments and Federal Judgeship Act* of 1984, the *Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act* of 1986 and the *Bankruptcy Reform Act* of 1994. Chapter 11 of the *Bankruptcy Code* is the major insolvency procedure, and is often used in preference to Chapter 7. Chapter 11 involves reorganization, while Chapter 7 involves liquidation and is used mostly by those wishing to free themselves of debt; as well, Chapters 12 and 13 involve reorganization.

A voluntary petition for bankruptcy can occur under Chapters 7, 11, 12 or 13, although involuntary petitions – which involve a petition by creditors – are limited to Chapters 7 and 11. Most Chapter 11 actions involve corporate debtors and are voluntary; insolvency is not required for a Chapter 11 filing to be initiated. Reorganizations can also occur under Chapter 12 – which applies to farmers – and Chapter 13 – which is typically used by consumer debtors with regular income. While insolvent consumers can file under Chapter 7 only once every six years, there is no limit on the number of times they can file under Chapter 13, provided the pre-established percentages of debt have been repaid.

Unlike a number of other developed countries, except Canada, during reorganizations under Chapter 11 the company usually retains control and management functions, subject to certain restrictions. The Court must approve any disposals outside of the normal course of business, and provision is made for the appointment of a trustee and/or an examiner by the Court, although it rarely occurs. Proceedings under Chapters 12 and 13 typically involve the appointment of a trustee to supervise the debtor's assets, although the debtor retains control of them.

Under reorganization, the debtor – whether a consumer or a corporation – is required to present any debt reorganization proposal to class meetings of creditors, and those whose rights have been impaired by the proposal are permitted to vote. As well, the proposal must be approved by the Court, which considers fairness criteria and must be satisfied both that the proposal is feasible and that dissenting creditors will receive at least as much under the proposal as they would if the company were liquidated. The Court may disregard a creditors' vote rejecting the proposal, and instead confirm it if it determines that creditors

would be treated fairly. In Chapter 13 filings, the maximum period of debt adjustment is five years.

Chapter 7 proceedings – which can be initiated voluntarily or by creditors – require the appointment of a trustee who seizes the non-exempt property of the debtor, liquidates the assets and distributes the proceeds to creditors; the *Bankruptcy Code* establishes the priority of creditors' interests.

As well, the *Bankruptcy Code* contains federal exemptions, although individual states are free to establish their own exemptions and can preclude their residents from using the federal exemptions. If their state of residence has not established its own exemptions and has not precluded its residents from using the federal exemptions, the bankrupt can choose to apply either the state or the federal exemptions.

In particular, the federal exemptions include:

- a homestead consisting of real property, to a maximum value;
- alimony and child support payments;
- pension and retirement benefits;
- household goods and furnishings, to a maximum value;
- health aids;
- jewellery, to a maximum value;
- lost earnings payments;
- a motor vehicle, to a maximum value;
- personal injury compensation payments, to a maximum value;
- wrongful death and crime victims' compensation payments;
- public assistance, social security, unemployment compensation and veterans' benefits;
- trade tools, to a maximum value;
- property, to a maximum value; and
- other exemptions related to insurance policies.

Exemptions vary relatively widely from state to state, which means that debtors are subject to significantly different treatment depending on their state of residence.

A bankruptcy proceeding ends when the Bankruptcy Court enters a discharge order regarding dischargeable debts. This action generally occurs no later than six months after the debtor files the bankruptcy petition, and coincides with the expiration of the time fixed for filing a complaint objecting to discharge and the time fixed for filing a motion to dismiss the case for substantial abuse. A complaint may be filed by a creditor, the trustee or the

United States trustee; the filing begins a lawsuit, referred to as an “adversary proceeding,” in which the objecting party bears the burden of proof. A discharge can be revoked under certain circumstances. The bankruptcy remains on the debtor’s credit record for up to ten years. Finally, a discharged debtor may voluntarily repay any debt that has been discharged.

At present, comprehensive bankruptcy reform legislation is before Congress. Proposed Chapter 15 of the legislation would enact, insofar as possible, the UNCITRAL Model Law on Cross-Border Insolvency. As currently drafted, proposed Chapter 15, like the Model Law itself, contains no reciprocity requirement.

B. The United Kingdom

In the United Kingdom, insolvent debtors have a number of options available to them, including: administration orders; individual voluntary arrangements; and bankruptcy. An administration order may occur where a creditor(s) obtains a Court judgment against a debtor who has no more than £5,000 in debt. Administration is a Court-based procedure whereby the debtor makes regular payments to the Court for payment to creditors.

With an individual voluntary arrangement, the debtor makes a formal proposal to creditors to pay his or her debts in whole or in part. The debtor applies to the Court for an interim order and selects an authorized insolvency practitioner; the practitioner presents the Court with the details of the proposal and an indication of whether a meeting of creditors should be convened to consider the proposal. If more than 75% in value of the creditors who vote are in favour of the proposal, then the proposal is accepted and is binding on all creditors who are entitled to vote. The insolvency practitioner then supervises the arrangement and pays the creditors in accordance with the proposal.

The Court will make a bankruptcy order after a bankruptcy petition has been presented by the debtor or by one or more unsecured creditors who are owed £750. An Official Receiver – who is an officer of the Court – is responsible for administering the bankrupt’s estate and acts as trustee unless an insolvency practitioner is appointed; as a consequence, he or she examines the bankrupt’s financial affairs prior to and during the bankruptcy, and reports to the Court and to creditors.

With certain exceptions, the Official Receiver/Trustee controls the bankrupt’s assets – subject to exemptions – and disposes of them, with the proceeds used to pay the fees, costs and expenses of the bankruptcy as well as creditors. There are two broad categories of exemptions: one for the property required to earn a living, the other for household possessions needed to meet basic needs. In particular, the exemptions – which contain no limits on value, but rather allow the trustee to determine the value based on individual and family situation – are:

- tools, books, vehicles and other equipment needed for the bankrupt’s personal use in employment, business or vocation; and

- clothing, bedding, furniture, household equipment and provisions needed to satisfy basic domestic needs of the bankrupt and his or her family.

Moreover, the trustee generally cannot claim a pension as an asset if the bankruptcy petition was presented on or after 29 May 2000, provided the pension scheme has been approved by the Inland Revenue; trustees can claim some kinds of pensions for petitions presented before that date. The trustee can usually claim any interest the bankrupt has in a life assurance policy. Moreover, the trustee may apply to the Court for an income payments order which would require the bankrupt to make contributions to the bankruptcy debt from his or her income until the discharge from bankruptcy; such an order would not be made if it would leave the debtor without sufficient income to meet his or her reasonable domestic needs and those of his or her family.

At present, discharge from bankruptcy generally occurs automatically after three years, although if the bankruptcy order refers to a certification of summary administration – where a bankrupt has filed his or her own petition and the unsecured debts are less than £20,000 – the discharge occurs after two years; if the order is cancelled, discharge is automatic. These provisions will change as a consequence of the *Enterprise Act 2002*, as indicated below. Nevertheless, if the bankrupt has not fulfilled his or her duties under the bankruptcy proceedings, the Official Receiver may apply to the Court for the discharge to be postponed. As well, discharge is currently not automatic if the bankrupt has been an undischarged bankrupt at any time during the previous 15 years; however, the bankrupt may apply to the Court for discharge any time after five years from the date of the current bankruptcy order, and the Court may refuse or delay the discharge or grant it conditionally. The *Enterprise Act 2002* will also change this provision.

In the United Kingdom, companies in financial distress have a number of options: administration; Company Voluntary Arrangements; receivership; liquidation; and dissolution. Since 1985, there have been two forms of rescue procedure for organizations. An administration order – a Court order – can be made by petition of the company's directors, the company itself or creditors. It must be demonstrated that the company is – or is nearly – insolvent, and that one or more of four purposes would be served by the order, one of which is related to the Company Voluntary Arrangement procedure introduced in 1985; the other three are: survival of the company as a going concern; a Court-sanctioned composition or arrangement; or there is likely to be a better realization of assets than would be the case with a liquidation.

The Company Voluntary Arrangement was conceived as a compromise procedure whereby a debtor company could make a proposal to creditors, and an independent insolvency practitioner would report to the Court on the viability of the proposal. The Court has the discretion whether to make an administration order.

Finally, the *Enterprise Act 2002* – designed to enhance enterprise and productivity – made relatively significant changes to insolvency law in parts of the United Kingdom. The changes related to individual insolvency will come into force on 1 April 2004, while corporate insolvency changes have been in effect since 15 September 2003. While most of

the provisions will apply throughout the United Kingdom, the bankruptcy reforms related to discharge will apply in England and Wales only, and the corporate insolvency reforms do not apply in Northern Ireland.

One area of change is automatic discharge from bankruptcy; people made bankrupt on or after 1 April 2004 will receive an automatic discharge after one year, rather than the current two- or three-year period. Moreover, for those who have been an undischarged bankrupt at any time in the previous 15 years, a discharge will occur at the earlier of: 1 April 2009 or a date ordered by the Court; bankrupts may apply to the Court for discharge five years after the date of their present bankruptcy order and if this date is before 1 April 2009, they may apply to the Court to be discharged then. Regarding corporate insolvency, the *Enterprise Act 2002* abolishes the Crown's preferential right to recover certain unpaid taxes ahead of other creditors and provides that unsecured creditors will share in essentially 20% of the proceeds of the liquidation of debenture security (inventory and accounts receivable), to a maximum of £600,000.

C. Australia

In Australia, the *Bankruptcy Act 1966* addresses personal bankruptcy and alternative arrangements with creditors, while the *Corporations Law* deals with corporate insolvencies. Although this latter statute is uniform across the country, for constitutional reasons state and territorial statutes have been enacted.

Options available to insolvent consumers who are unable to pay their debts as they are due to be paid include:

- under Parts IX and X of the *Bankruptcy Act*, debtors can enter into arrangements with creditors that may involve payment of less than the full amount of debt, a moratorium on payments of debt, transfers of property to one or more creditors in full or partial payment of debt, or periodic payments to creditors out of the debtor's income; or
- debtors can have their estate administered in bankruptcy, whether the bankruptcy occurs voluntarily or – more rarely – involuntarily pursuant to a creditor's petition.

A Part IX debt agreement requires that the debtor:

- not have been bankrupt, used a debt agreement or given an authority under Part X of the *Bankruptcy Act* in the previous ten years;
- have after-tax income of less than approximately A\$50,000;
- have unsecured debts of less than approximately A\$67,000; and

- have property not exempt under bankruptcy valued at less than approximately A\$67,000.

Options available under Part X arrangements include:

- a deed of assignment, pursuant to which a debtor assigns all divisible property for the benefit of creditors;
- a composition, pursuant to which creditors accept repayment over time or partial payment in full satisfaction; or
- a deed of arrangement, pursuant to which the debtor repays debts, either in whole or in part, but in a manner that does not fall within the definition of either a composition or a deed of assignment.

In most situations, after-acquired property is unaffected and the debtor is under no obligation to make contributions from income to creditors.

To avoid bankruptcy, a debtor may enter into alternative arrangements with his or her creditors and may present a proposal at a meeting of creditors. To conclude an arrangement that is binding on all creditors with provable debts, the proposal must be approved by a majority in number and at least 75% in value of the creditors who vote at the meeting.

Low-income debtors with limited – if any – property, few creditors, low viability and financial resources too low to enable them to take advantage of a deed of assignment, a deed of arrangement or a composition because of an inability to meet set up costs, can enter into a debt agreement provided they meet asset, liability and after-tax income stipulations. With this procedure, the debtor submits a proposal and a Statement of Affairs to the Official Trustee. After determining that the debtor meets the eligibility requirements for this process, the Official Trustee advises creditors of the proposal, provides them with a summary of the debtor's Statement of Affairs and allows the creditors to vote on the proposal. The degree of acceptance required for the debt agreement to be binding is a majority in number and at least 75% in value of the creditors who vote on the proposal.

A debtor who voluntarily seeks bankruptcy presents a debtor's petition to an Official Receiver together with a Statement of Affairs providing his or her personal details as well as details of his or her assets, liabilities and income. The debtor becomes a bankrupt when the petition is accepted, and the Official Receiver becomes the trustee, unless the debtor nominates a private registered trustee.

Involuntary bankruptcy involves the presentation of a creditor's petition in the Federal Court or the Federal Magistrates Court. This action requires that the following circumstances be met: an act of bankruptcy within the previous six months; a specific jurisdictional link with Australia; and a liquidated sum of A\$2,000 owed by the debtor to the creditor. At the hearing of the petition, the creditor is required to prove: the matters stated in the petition; the service of the petition; and the outstanding nature of the debt owed. The

Court has discretion in deciding whether to make a sequestration order, which is an order making a person or persons bankrupt.

A bankrupt receives automatic discharge from bankruptcy three years after the date on which the Statement of Affairs is filed, unless an objection is lodged; for example, a trustee's objection may prolong bankruptcy by as much as five years under certain circumstances. The bankrupt may be able to apply for an early discharge six months after the filing date, although this provision applies only to bankruptcies registered with the Official Receiver prior to 5 May 2003. Bankrupts with relatively high incomes must make contributions to their bankrupt estates from their income, with the amount determined on the basis of net income after tax and any child support. Creditors are prohibited from recovering money from a bankrupt, other than secured creditors with whom the bankrupt has made an arrangement to retain secured property, such as might occur with a mortgage.

Australia makes provision for exempt property in the case of bankruptcy, and these exemptions are uniform throughout the country; Australia does not have inter-state differences with respect to exemptions, either in type or value. Principal exemptions include:

- property held by the bankrupt in trust for another person;
- the bankrupt's household property, to reasonable limits given current social standards or that is exempted under regulations or by agreement of the creditors;
- property used by the bankrupt in earning income, to a prescribed limit or as increased by creditors or the Court;
- property used by the bankrupt primarily for transportation, to a prescribed limit or as approved by creditors;
- prescribed interests in life or endowment assurance and in regulated superannuation funds or approved deposit funds;
- compensation for personal injuries and property purchases with such protected money; and
- amounts paid to the bankrupt as loan assistance for rehabilitation, household or re-establishment support under a variety of state and federal rural support schemes.

Insolvent companies have a number of options: a Court-sanctioned arrangement; appointment of a receiver or other controller; voluntary administration; winding-up/liquidation; or provisional liquidation. Since mid-1993, Australia has had a voluntary administration procedure by which a company or its directors can initiate the procedure, and secured creditors with charges over all – or substantially all – of the assets may initiate the appointment of an administrator. Once appointed, the administrator controls the company's business, its property and its affairs, and acts as the company's agent. He or she must hold a meeting of creditors, and creditors will meet to decide the company's future; the

creditors will receive a report about the business and its property, affairs and financial circumstances, as well as an assessment of whether it would be in the creditors' interests for the company to execute a deed of company arrangement, for the company to be wound up or for the administration to end.

In September 2002, the Attorney General of Australia announced that the government would conduct a comprehensive review of Part X of the *Bankruptcy Act 1966*, which provides a mechanism for debtors to reach arrangements with creditors without becoming bankrupt. The review was initiated in response to concerns that some debtors are abusing the provisions. Conducted by the Insolvency and Trustee Service Australia (ITSA) – which is responsible for the administration and regulation of the personal insolvency system – and the Attorney General's Department, in consultation with the Bankruptcy Reform Consultative Forum, the ITSA released an issues paper describing proposed legislative changes for public comment.

The Bankruptcy Legislation Amendment Act Bill 2002 was introduced in order to address concerns that the system was biased toward the debtor, to correct unfairness and anomalies, and to streamline the administration of bankruptcies by trustees. In particular, the Bill was designed to:

- give Official Receivers the discretion to reject a petition made by a debtor where it appears that, within a reasonable period of time, the debtor could pay all debts listed in his or her Statement of Affairs and that the petition is an abuse of the system, or where the debtor has been bankrupt previously – on his or her own petition – either at least three times in all or at least once in the previous five years;
- abolish early discharge from bankruptcy;
- make it easier for trustees to lodge objections to a person's discharge from bankruptcy and make it harder for bankrupts to sustain challenges to objections;
- make clear that a bankruptcy can be annulled by the Court whether or not the bankrupt was insolvent when the petition for bankruptcy was accepted; and
- increase the income threshold for debt agreements.

Amendments to the *Bankruptcy Act 1966* and regulations came into effect on 5 May 2003, and increased the debt agreement threshold to more than a A\$50,000 (after taxes), thereby increasing the number of debtors eligible to participate in debt agreements.

D. New Zealand

In New Zealand, bankruptcy and insolvency are addressed primarily through the *Insolvency Act 1967* (personal insolvency), the *Companies Act 1993* (corporate liquidations) and the

Receiverships Act 1993 (corporate receiverships). The *Corporations (Investigations and Management) Act 1989* may be used in situations where the government wishes to place a complex group of companies into statutory management. The New Zealand Insolvency and Trustee Service – through the office of Official Assignee (Ministry of Commerce) – is the only agency with authority to administer personal bankruptcies, and the High Court has jurisdiction over all insolvency matters.

New Zealand insolvency law provides a number of options to individuals in financial difficulty, including:

- a creditors' pool, where all of the debtor's creditors agree to receive payment in reduction of debt through regular instalments;
- a compromise with creditors, where an agreement is reached regarding payment of a portion of debt in full settlement;
- a Summary Instalment Order, which involves an order by a District Court Judge that allows a person with debts less than a certain amount to pay those debts in regular instalments without further legal action being taken while the order is in force; and
- bankruptcy, which can be initiated either by the debtor or by the creditor.

A debtor who selects bankruptcy as the preferred option files a Debtor's Petition with the High Court; alternatively, bankruptcy can be initiated by the creditor applying to the High Court, which then must decide if the debtor should be declared bankrupt on the basis of evidence supplied by the creditor and the debtor (or his or her representative). The Official Assignee, an officer of the High Court, is trustee and must administer equitably and independently the affairs of the bankrupt, with the non-exempt assets sold and the proceeds distributed fairly among the creditors; he or she may also provide for rehabilitation of the bankrupt, if appropriate.

Exempt assets include furniture and personal effects, money, and tools of a tradesperson's trade, up to a maximum amount in each case. The Official Assignee will decide whether the debtor will retain his or her vehicle, with that decision based on the vehicle's value and the debtor's personal circumstances. As well, life insurance policies become the property of the Official Assignee and may be surrendered for the benefit of creditors, and superannuation policies with a surrender value may also be included. Bankrupts remain responsible for a number of debts, including Court-imposed fines, maintenance payments and child support obligations.

In general, the bankrupt will receive an automatic discharge on the third anniversary of his or her bankruptcy, although an application may be made to the High Court for an earlier discharge. The Official Assignee or a creditor may, however, object to a discharge or seek a conditional discharge; in the event of an objection to an automatic discharge, the High Court will decide the date of discharge. Finally, bankrupts may apply for an annulment of bankruptcy, which would involve the High Court cancelling the bankruptcy order; this

situation may occur if: the bankruptcy order should not have been made; all of the debtor's debts, fees and expenses of bankruptcy have been paid in full; or creditors accept a composition.

In terms of corporate bankruptcy, there are several means by which a company may be put into liquidation: by a special resolution of the organization's shareholders; by the company's board of directors when an event specified in the constitution has occurred; or by the Court, on application of the company, a director, a shareholder or a creditor. A liquidator is appointed who then has custody and control of the organization's assets. A report indicating the company's assets and liabilities is prepared and provided to creditors, and the assets are sold for the benefit of those creditors who have lodged a claim in the liquidation. A dividend is paid to creditors in the order of priority given in the *Companies Act 1993*.

In May 1999, New Zealand launched a review of insolvency law in order to:

- provide a predictable, simple regime that: can be administered quickly and efficiently; imposes the minimum necessary compliance and regulatory costs on users; and does not stifle innovation, responsible risk taking and entrepreneurship by excessively penalizing business failure;
- distribute the proceeds to creditors consistent with their relative pre-insolvency entitlements, unless the public interest requires otherwise;
- maximize returns to creditors;
- enable bankrupt individuals again to participate fully in the economic life of the community; and
- provide international cooperation in relation to cross-border insolvency.

Public discussion documents were released beginning in February 2001, and since that time the Ministry of Economic Development has indicated that the law will be changed in a number of areas. In particular, the following initiatives have been announced:

- continued responsibility by the state for bankruptcy administration;
- a business rehabilitation system, which will resemble that which operates in Australia and will provide an alternative to liquidation through which a debtor organization or individual can reach a binding arrangement with creditors;
- as an alternative to bankruptcy, a "no asset" procedure for low-income debtors with limited – if any – realizable assets;
- criminal penalties to be imposed on directors who have acted in bad faith to defeat creditors' legitimate interests;
- increases in the maximum amount to which employees will be entitled – for unpaid wages, salary and vacation pay – in the event of insolvency by their

employer and the introduction of redundancy payments as an employee entitlement;

- an increase in the cap for Summary Instalment Orders; and
- adoption of the UNCITRAL Model Law on Cross-Border Insolvency.

It is anticipated that, following public consultation on draft legislation, the changes will become law no later than 2004.

APPENDIX E:

Witnesses and Submissions:

Advocis

- Mr. Steve Howard, CA, President and Chief Executive Officer (Wednesday, May 14, 2003)
- Mr. Edward Rothberg, General Counsel (Wednesday, May 14, 2003)

Alberta Law Reform Institute

- Professor C. R. B. (Dick) Dunlop, Special Counsel (Thursday, September 18, 2003)
- Mr. Peter J. M. Lown, Director (Thursday, September 18, 2003)

Mr. Ryan Bailey

- Manager - Government Relations and Regulatory Affairs, Ontario Society of Professional Engineers (Submission)

Mr. David E. Baird, Q.C.

- Counsel, Torys LLP (Thursday, September 25, 2003)

Professor Douglas Barbour

- Department of English, University of Alberta (Submission)

Me H el ene Beaulieu

- Barrister and Solicitor (Submission)

Professor Vaughan Black

- Professor of Law, Dalhousie University (Submission)

Canadian Association of Insolvency and Restructuring Professionals

- Mr. Larry Prentice, Chair CAIRP, Trustee in bankruptcy, CIRP (Chartered Insolvency and Restructuring Professionals) and CA-CIRP (CA specialist in insolvency and restructuring) (Thursday, May 8, 2003)
- Mr. Jean-Yves Fortin, President, IIC, Lawyer (Thursday, May 8, 2003)
- Mr. Andy Kent, IIC Board member, Lawyer (Thursday, May 8, 2003)
- Mr. William Courage, Vice-Chair CAIRP, Trustee in bankruptcy, CIRP (Chartered Insolvency and Restructuring Professionals) and CA-CIRP (CA specialist in insolvency and restructuring) (Thursday, May 8, 2003)
- Mr. Alan Spergel, Co-Chair CAIRP – Personal Insolvency Practice Committee, Trustee in bankruptcy, CIRP (Chartered Insolvency and Restructuring Professional) and CA-CIRP (CA specialist in insolvency and restructuring) (Thursday, May 8, 2003)

Canadian Association of Insolvency and Restructuring Professionals (Cont'd)

- Mr. Stéphane LeBlond, Vice-Chair CAIRP – Personal Insolvency Practice Committee, Trustee in bankruptcy, CIRP (Chartered Insolvency and Restructuring Professional) and CA (Thursday, May 8, 2003)
- Mr. George Lomas, member of IIC Personal Insolvency Committee, Trustee in bankruptcy, FCA, FCIRP (Chartered Insolvency and Restructuring Professional) and CA-CIRP (CA specialist in insolvency and restructuring) (Thursday, May 8, 2003)

Canadian Alliance of Students Associations

- Mr. Rob South, Government Relations Officer (Wednesday, May 14, 2003)

Canadian Bankers Association

- (Submission)

Canadian Bar Association

- Mr. David F. W. Cohen, Chair, National Bankruptcy and Insolvency Law Section (Wednesday, June 4, 2003)
- Mr. Robert A. Klotz, Executive Member and Past Chair, National Bankruptcy and Insolvency Law Section (Wednesday, June 4, 2003)
- Mr. E. Patrick Shea, Member, National Bankruptcy and Insolvency Law Section (Wednesday, June 4, 2003)
- Mrs. Tamra L. Thomson, Director, Legislation and Law Reform, Canadian Bar Association (Wednesday, June 4, 2003)

Canadian Federation of Independent Business

- Mr. Garth Whyte, Executive Vice President (Wednesday, October 1, 2003)
- Mr. André Piché, Director, National Affairs (Wednesday, October 1, 2003)

Canadian Federation of Students

- Mr. Michael Conlon, Director of Research (Wednesday, May 14, 2003)

Canadian Labour Congress

- Mr. Hassan Yussuff, Secretary-Treasurer (Wednesday, September 17, 2003)
- Mr. Bob Baldwin, Director, Social and Economic Policy (Wednesday, September 17, 2003)
- Mr. Murray Gold, Partner, Koskie Minsky (Wednesday, September 17, 2003)

CAW-Canada

- Mr. Lewis Gottheil, Counsel (Wednesday, September 17, 2003)

Consumers Association of Canada

- Mr. Mel Fruitman, President and Chief Executive Officer (Wednesday, September 17, 2003)

Consumers' Union

- Mrs. Hélène Talbot, Budget Counsellor, Canadian Tax Foundation (Wednesday, May 14, 2003)
- Mr. Luc Rochefort, Analyst, Policy and Legislation in Personal Budgeting, Credit and Debts (Wednesday, May 14, 2003)

Credit Counselling of Canada

- Mr. Pran Bahl, President (Wednesday, September 17, 2003)
- Mr. Pierre R. Ouellette, Executive Director (Wednesday, September 17, 2003)

Credit Union Central of British Columbia

- (Submission)

Professor R.C.C. Cuming

- Professor of Law, University of Saskatchewan (Submission)

Mr. Jean-Claude Delorme

- Chairman of the Management Advisory Board of the Office of the Superintendent of Bankruptcy (Thursday, September 25, 2003)

Ms. Viola Doucet

- (Wednesday, May 14, 2003)

Professor Elizabeth Edinger

- Associate Dean of Law, University of British Columbia (Submission)

Equifax Canada Inc.

- Mr. Mel Zwaig, President & Chief Executive Officer, Zwaig Consulting Inc. (Wednesday, October 1, 2003)
- Mr. E. Bruce Leonard, Cassels Brock & Blackwell LLP (Wednesday, October 1, 2003)
- Mr. David S. Ward, Cassels Brock & Blackwell LLP (Wednesday, October 1, 2003)

Mrs. Lori K. Gravestock

- Submission

Human Resources Development Canada

- Mr. Andrew Treusch, Assistant Deputy Minister, Human Investment Programs (Wednesday, October 1, 2003)
- Mr. Dave Cogliati, Director General, Canada Student Loans Program Directorate (Wednesday, October 1, 2003)

Industry Canada

- Marie-Josée Thivierge, Director General, Marketplace Framework Policy Branch (Wednesday, May 7, 2003)
- Marc Mayrand, Superintendent of Bankruptcy, Office of the Superintendent of Bankruptcy (Wednesday, May 7, 2003)
- Jim Buchanan, Senior Project Leader, Policy Sector (Wednesday, May 7, 2003)
- Dave Stewart, Senior Project Leader, Office of the Superintendent of Bankruptcy (Wednesday, May 7, 2003)

Insolvency Institute of Canada

- Mr. Larry Prentice, Chair CAIRP, Trustee in bankruptcy, CIRP (Chartered Insolvency and Restructuring Professionals) and CA-CIRP (CA specialist in insolvency and restructuring) (Thursday, May 8, 2003)

Insolvency Institute of Canada (Cont'd)

- Mr. Jean-Yves Fortin, President, IIC, Lawyer (Thursday, May 8, 2003)
- Mr. Andy Kent, IIC Board member, Lawyer (Thursday, May 8, 2003)
- Mr. William Courage, Vice-Chair CAIRP, Trustee in bankruptcy, CIRP (Chartered Insolvency and Restructuring Professionals) and CA-CIRP (CA specialist in insolvency and restructuring) (Thursday, May 8, 2003)
- Mr. Alan Spergel, Co-Chair CAIRP – Personal Insolvency Practice Committee, Trustee in bankruptcy, CIRP (Chartered Insolvency and Restructuring Professional) and CA-CIRP (CA specialist in insolvency and restructuring) (Thursday, May 8, 2003)
- Mr. Stéphane LeBlond, Vice-Chair CAIRP – Personal Insolvency Practice Committee, Trustee in bankruptcy, CIRP (Chartered Insolvency and Restructuring Professional) and CA (Thursday, May 8, 2003)
- Mr. George Lomas, member of IIC Personal Insolvency Committee, Trustee in bankruptcy, FCA, FCIRP (Chartered Insolvency and Restructuring Professional) and CA-CIRP (CA specialist in insolvency and restructuring) (Thursday, May 8, 2003)

Intellectual Property Institute of Canada

- Mr. John Baker, Immediate Past President (Wednesday, September 24, 2003)
- Mr. Warren Sprigings, Chairman of the Licensing Committee (Wednesday, September 24, 2003)
- Mr. Rodney Kyle, Member of the Licensing Committee (Wednesday, September 24, 2003)
- Mr. Michel Gérin, General Director (Wednesday, September 24, 2003)

International Insolvency Institute

- E. Bruce Leonard, Chairman (Wednesday, June 4, 2003)

Mr. Andrew J.F. Kent

- McMillan Binch LLP (Submission)

Mr. Robert A. Klotz

- Executive Member and Past Chair, National Bankruptcy and Insolvency Law Section, Canadian Bar Association (Wednesday, June 4, 2003) (Submission)

Mr. Bert van Leeuwen

- President, BVL Industrial Design Ltd. (Submission)

Mr. Bob van Leeuwen

- President, van Leeuwen Engineering Limited (Wednesday, June 4, 2003)

Mr. E. Bruce Leonard

- Chairman, International Insolvency Institute; Cassels Brock & Blackwell LLP (Wednesday, June 4, 2003 & Wednesday, October 1, 2003) (Submission)

Mrs. Nancy May

- (Submission)

Mr. Max Mendelsohn

- Chairman of the Firm and Head of the Reorganizations & Insolvency Group of Mendelsohn, G.P. (Thursday, September 25, 2003)

Mr. Brian P. O’Leary

- Burnet, Duckworth & Palmer LLP (Submission)

Omega One Ltd.

- Mr. Bob Gilmour, Manager, Asset Recovery, Sears Canada Inc. (Wednesday, May 14, 2003)
- Mr. John D. Owen, Principal (Wednesday, May 14, 2003)

Ontario Securities Commission

- (Submission)

Periodical Writers Association of Canada

- (Submission)

Personal Insolvency Task Force

- Mr. Saul Schwartz, School of Public Policy and Administration, Carleton University (Wednesday, September 24, 2003)
- Mr. Dave Stewart, Special Project Leader, Office of the Superintendent of Bankruptcy (Wednesday, September 24, 2003)
- Mrs. Guylaine Houle, Litwin Boyadjian Inc. (Wednesday, September 24, 2003)

Mr. Michael Petrasek

- Rights Manager, Playwrights Guild of Canada (Submission)

A.C. Poirier & Associates

- Mr. Paul A. Stehelin, Trustee in Bankruptcy (Wednesday, May 14, 2003)

Professor Iain D.C. Ramsay

- Professor of Law, Osgoode Hall Law School (Submission)

RESP Dealers Association of Canada

- Mrs. Doreen G. Johnston, Chairman, Securities Regulation (Wednesday, September 17, 2003)

Professor Janis Sarra

- University of British Columbia (Thursday, September 18, 2003)

Professor Thomas Telfer

- Associate Professor of Law, University of Western Ontario (Thursday, May 29, 2003)

United Steelworkers of America

- Mr. Lawrence McBrearty, National Director (Wednesday, September 17, 2003)

Professor Roderick J. Wood

- Professor of Law, University of Alberta (Submission)

Workers’ Compensation Boards

- Mr. John Solomon, Chair, Saskatchewan Workers’ Compensation Board (Thursday, May 15, 2003)
- Mr. Jim Lee, Chair, P.E.I. Workers’ Compensation Board (Thursday, May 15, 2003)

Workers' Compensation Boards (Cont'd)

- Mr. Douglas Mah, General Counsel, Alberta Workers' Compensation Board (Thursday, May 15, 2003)
- Mr. Maurice Cloutier, General Counsel, Quebec Commission of Occupational and Health and Safety (Thursday, May 15, 2003)

Writers' Union of Canada

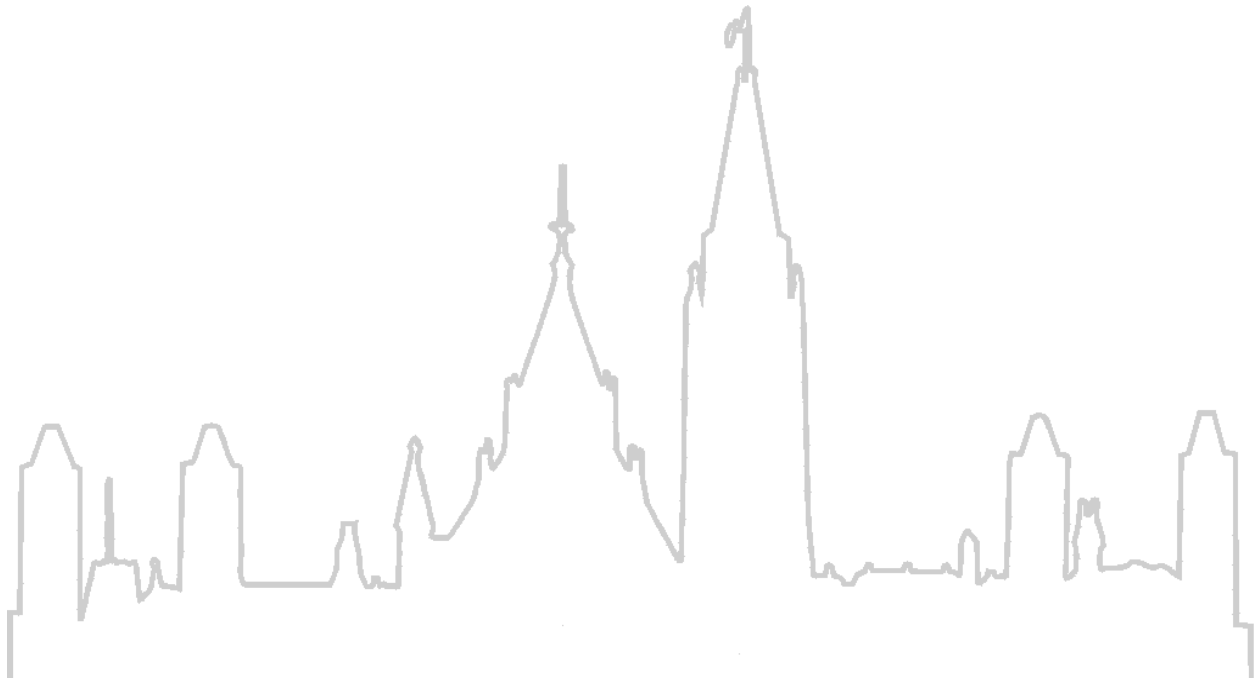
- Mrs. Marian Dingman Hebb, Counsel (Thursday, May 15, 2003)
- Mrs. Deborah Windsor, Executive Director (Thursday, May 15, 2003)

Professor Jacob Ziegel

- University of Toronto (Thursday, May 29, 2003)

Professor Keith Yamauchi

- University of Calgary (Wednesday, October 1, 2003)



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