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BANKRUPTCY LAW UPDATE

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BANKRUPTCY LAW UPDATE*

ISSUE DEFINITION

Over the last two decades there have been many attempts to amend Canada's bankruptcy laws. Six omnibus reform bills were introduced in Parliament between 1975 and 1984, none of which became law. As well, no fewer than three different advisory committees have made recommendations for change. In 1988, the then Department of Consumer and Corporate Affairs published proposed revisions to eight key areas of the *Bankruptcy Act*. Many of these proposals made their way into Bill C-22, which was introduced in the House of Commons on 13 June 1991 and received Royal Assent on 23 June 1992.

The *Bankruptcy Act*, which after the passage of Bill C-22 became known as the *Bankruptcy and Insolvency Act* (the "Act" or the "BIA"), was further amended with the enactment of Bill C-5 on 25 April 1997.

This paper outlines the changes to Canada's bankruptcy laws made under Bill C-22 and Bill C-5.

BACKGROUND AND ANALYSIS

The movement in favour of revisions to the *Bankruptcy Act* began in 1970 with the publication of the Report of the Study Committee on Bankruptcy and Insolvency Legislation (known as the Tassé Report). The Committee urged the adoption of a revised statute in light of the many economic and social changes since the passage of the *Bankruptcy Act* in 1949. Bill C-60 was introduced in 1975 to implement the Report's recommendations. The Senate Committee studying the bill subsequently recommended many changes and the bill was allowed to lapse. Three more

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* The original version of this Current Issue Review was published in November 1988; the paper has been regularly updated since that time.

bills introduced in the Senate between 1978 and 1979 also died on the Order Paper. The Government introduced Bill C-12 in the House of Commons in 1980; however, second reading was delayed until 1983 and Parliament was dissolved before the Commons Committee completed its hearings. Bill C-12 was re-introduced as Bill C-17 in 1984, only to die on the Order Paper after second reading.

In June 1988, the Government published a document entitled "Proposed Revisions to the *Bankruptcy Act*." In this document, the Government opted for reforms to certain key areas of bankruptcy law rather than to continue to present a completely new statute containing far-reaching reforms.

Bill C-22 followed this lead and brought forward changes to selected areas of bankruptcy law. Among these were: wage claims, secured creditors and receivers, commercial reorganizations, consumer proposals, consumer bankruptcies, Crown priority and unpaid suppliers.

Bill C-22 required that the BIA be reviewed by a parliamentary committee after three years.

In anticipation of the review, the government set up the Bankruptcy and Insolvency Advisory Committee (BIAC). The BIAC, which was composed of government and private-sector participants, examined various areas of bankruptcy law and made a number of recommendations for change. Many of the BIAC recommendations made their way into Bill C-5.

Bill C-5 refined many aspects of bankruptcy law and contained new provisions relating to international insolvencies and securities firm insolvencies. The bill also made significant changes to the *Companies' Creditors Arrangement Act* (CCAA).

In the following text, a number of key areas of the BIA will be outlined. In some cases, previous attempts at reform will also be reviewed.

A. Wage Claims

A major new revision in Bill C-22 was the proposed creation of a wage claim payment program, a fund to provide direct compensation for unpaid wages to terminated employees of companies which are bankrupt, being liquidated, or in receivership.

Under the *Bankruptcy Act*, unpaid wage claims in a bankruptcy were preferred to a maximum of $500 over the claims of general creditors. This form of priority status for wage earners was largely illusory since secured creditors ranked ahead of them in any distribution of property. Furthermore, even if moneys were available, they were normally paid some time after the date of bankruptcy. Another problem was that the amount of the priority was inadequate in light of current wage levels.

The idea for a government-administered fund dates back to 1975 and the first attempt to amend the Act. Bill C-60 had proposed to implement a Tassé Report proposal by conferring a "super priority" status on unpaid wage claims up to $2,000, binding secured creditors as well as general creditors. Secured creditors objected to the proposal as a potentially serious dilution of their protected status and the Senate Banking, Trade and Commerce Committee, was of the opinion that super priority status for wages would be detrimental to a borrower's ability to obtain financing, especially in labour-intensive industries. Instead, the Committee recommended the creation of a government wage protection fund, made up of contributions from employers and employees, out of which outstanding wages of employees to a maximum of $2,000 could be paid immediately upon bankruptcy.

In 1980, Mr. André Ouellet, then Minister of Consumer and Corporate Affairs, appointed a small task force of bankruptcy experts to investigate the problem anew. The Landry Committee reported in 1981 that it was unable to determine the seriousness of the problem of unpaid wages, in view of the scarcity and incompleteness of reliable data on the number and value of unpaid wage-earner claims. The evidence they were able to collect, however, did verify that a problem existed. Committee members noted that five West European countries -- the U.K., France, West Germany, Belgium and Denmark -- had all introduced a wage-earner protection scheme; this was also their recommended solution for Canada. They believed, however, that a permanent legislative solution could not be formulated until the size of the problem had been determined, and federal and provincial policies coordinated. Their final recommendation was an interim three-year solution during which unpaid wages should be covered by the Consolidated Revenue Fund up to a maximum of $1,000. To arrive at a permanent comprehensive wage protection system, the Committee recommended that federal-provincial meetings should take place.

The Committee's recommendations were not immediately accepted. The next bankruptcy bill, in 1984, had basically the same provisions for wage earners as Bill C-12 in 1980. In the event of a bankruptcy or receivership, Bill C-17 provided that a claim for wages up to a maximum of $4,000 would rank in priority over the claims of all secured creditors. The then Minister did not endorse the idea of a wage protection fund because of the lack of statistical data on the cost and the fear it would operate as a disincentive to employers to pay wages on time.

The Progressive Conservative Minister Michel Côté decided to proceed with bankruptcy reform by amending the existing Act rather than by enacting sweeping reforms through a new statute. In March 1985 he appointed an Advisory Committee, chaired by Gary Colter of Peat Marwick Limited, to examine the bankruptcy system, assess possible reforms and recommend amendments. The Committee tabled its report in January 1986. It made the following recommendations with respect to wage-earner protection.

> 1. A fund should be established for the purpose of paying the arrears of wages of employees whose employers have been either declared bankrupt or put into receivership. Such a fund would be the best method of ensuring that employees of insolvent companies were promptly paid their arrears of wages.
>
> 2. The wage earner protection fund should be financed by contributions from employers and employees.
>
> 3. Employees related to the insolvent employer should not be entitled to any payments out of the fund.
>
> 4. Employees should be entitled to be paid the following:
>
> - arrears of gross wages and commission earned within the six months preceding the insolvency;
> - arrears of vacation pay earned within the 12 months preceding the insolvency;
> - arrears of all amounts withheld from the employee such as pension benefits, and union dues;
> - provided that the maximum payment should not exceed $2,000 per employee; and

- arrears of expenses incurred by the employee on behalf of the employer to a maximum of $1,000 per employee in the two months preceding the insolvency.

5. The Fund should be administered by the Unemployment Insurance Section of the Department of Employment and Immigration.

6. Payments to employees should be made by the trustee or receiver.

7. The fees and expenses of the trustee or receiver resulting from processing the special preferred claims of the wage earners should also be paid by the fund.

8. Any amounts paid by the fund should be subrogated as special preferred status claims under section 107 of the *Bankruptcy Act* ranking immediately after the costs of administration.

9. Any amounts due to employees for severance pay should remain as unsecured claims ranking with other unsecured claims against the employer.

The Department's June 1988 proposals differed from these recommendations of the Colter Committee in several respects. First of all, the program was to be financed entirely by the federal government rather than by employer and employee contributions. The Department also proposed that the Superintendent of Bankruptcy of the Department of Consumer and Corporate Affairs, rather than the Unemployment Insurance Section of Employment and Immigration, administer the fund.

The Department accepted the Colter Report's recommendation on monetary limits. The fund was to guarantee 90% of unpaid wages and vacation pay earned in the previous six months, to a maximum of $2,000, and up to $1,000 for arrears of expenses incurred on behalf of the employer.

The purpose of a wage-earner protection program was to alleviate the immediate hardship experienced by unpaid wage earners upon the insolvency of their employer. Through expeditious payment of claims within prescribed limits, employees could meet their most immediate expenses until there was a cash flow from alternative employment or unemployment insurance. The certainty and the timeliness of a wage-earner protection program was lacking in the super priority proposal of previous bills. The available assets of the bankrupt might not have covered the amount claimed and there might have been a significant delay in payment pending the sale of the bankrupt's assets. In addition, serious difficulties might have arisen in the administration of the super priority proposal since it would have been a complicated task to allocate the burden of paying claims among the various secured creditors. It has also been argued that the creation of a super priority would have imposed an unexpected burden on a secured creditor and reduced the credit available to a labour-intensive industry.

The Report of the Advisory Council on Adjustment (the de Grandpré Report) endorsed the creation of a national wage earner protection fund to make payments of up to $4,000 to cover unpaid amounts owing to employees. The Council was of the opinion that the federal government should assume this obligation when the employer cannot pay. The Council went on to recommend that in the event the wage earner protection fund is not created, claims of wage earners should be given priority over all other claims in the disposition of assets of insolvent employers.

A working document prepared for, but not endorsed by, the Economic Council of Canada, favoured an expanded unemployment insurance program rather than the proposed protection fund. The author suggested that if UI eligibility was based on loss of wages, rather than loss of employment, it would encourage adjustment through the active involvement of employees. A wage protection fund, on the other hand, would be like a subsidy paid to the debtor firm and would enter into its adjustment decisions as a possible source of wage payments.

Bill C-22, as introduced at first reading, would have established a wage claim protection program pursuant to a new statute, the Wage Claim Payment Act (“WCP Act”). The bill would have created a fund, financed by contributions from employers, from which employees could claim unpaid wages, vacation pay and salesperson's expenses in the event that an employer had become bankrupt, had been liquidated or had gone into receivership.

The amount of the benefit to be paid out of the fund would have been set at 90% of an employee's unpaid wages and vacation pay earned within the preceding six months, up to a maximum of $2,000 and 90% of salesperson's expenses unpaid during the same period, up to a maximum of $1,000. Pension contributions, severance and termination pay would not have been included. The program would have been administered by the Superintendent of Bankruptcy and benefits would have been paid out of the Consolidated Revenue Fund.

The program would have been financed by a payroll tax on employers equal to 0.024% of an employee's weekly insurable earnings under the *Unemployment Insurance Act*. The tax, which would have been imposed as of 1 January 1992, would have been collected jointly with the unemployment insurance program and was expected to cost employers about 10 cents per employee per week.

The concept of a wage protection fund was generally well received; however, the method of financing the fund was not. Business and institutions such as municipalities, hospitals, and school boards, whose employees would likely never have occasion to benefit from the fund, opposed the imposition of a payroll tax.

In its pre-study report on Bill C-22, the Standing Committee on Consumer and Corporate Affairs and Government Operations rejected the concept of a wage protection fund and recommended that workers' claims for unpaid wages be given priority over the claims of all other creditors, in the event of an employer's bankruptcy, liquidation or placement in receivership.

During clause-by-clause consideration of the bill in late 1991, the government proposed that the WCP Act be amended to defer the imposition of the tax for a period of one year and to allow the Governor in Council to adjust the percentage of the payroll tax to cover the payment of benefits under the program.

After procedural concerns in the Standing Committee, the government reconsidered its position on the WCP Act and, in May 1992, the Minister of Consumer and Corporate Affairs announced that it would be withdrawn.

Amendments to the existing preferred creditor provisions were put forward. Thus, the *Bankruptcy and Insolvency Act* maintains preferred creditor status for unpaid wage claims and salesperson's expenses where an employer is bankrupt, but the amount of the claim was raised from $500 to $2,000 for wages and from $300 to $1,000 for salesperson's expenses. Where an insolvent employer makes a proposal to reorganize his or her business, unpaid wages up to $2,000 and salesperson's expenses up to $1,000 are to be paid immediately after court approval of the proposal.

When Bill C-22 received Royal Assent on 23 June 1992, the Minister of Consumer and Corporate Affairs announced that he intended to refer the matter of wage claims for reconsideration by a special Joint Committee of the House of Commons and the Senate, which would report by the summer of 1993. This Committee was never established.

Bill C-5 made no changes with respect to the overall amount of wage claims. The bill, however, allows a representative of a federal or provincial ministry of labour or a union to file a proof of claim on behalf of all employees.

B. Secured Creditors and Receivers

An amendment to regulate receivers has been part of bankruptcy reform proposals since 1975. In the common law provinces, a receiver is a person who, by agreement or court order, has taken possession of all or substantially all of the debtor's assets. Under the usual terms of commercial financing agreements, which include debentures, loans under the *Bank Act*, floating charges and conditional sales contracts, on default of payment the secured creditor may appoint a receiver to take possession of the debtor's assets and sell them in order to pay off the debt.

There were no provisions in the *Bankruptcy Act* to govern the conduct of secured creditors and receivers, even though the interests which the receiver represented were in conflict with those of the debtor and the unsecured creditors. Because the bankruptcy administration is generally subject to the prior rights of secured creditors, a receiver could be appointed to take possession of all the assets of the estate before or after the date of bankruptcy, leaving few if any assets to be administered by a trustee in bankruptcy. There was no mechanism to permit either the unsecured creditors or the Superintendent of Bankruptcy to maintain any surveillance over the receiver's conduct to ensure that the receiver acted fairly, given the residual claims of all subordinate creditors. To remedy this, the reforms in the Act are aimed at disclosure, accountability and preventing conflicts of interest in a receivership situation.

The BIA requires receivers of insolvent debtors to act in good faith and to deal with the insolvent person's property in a commercially reasonable manner. This standard of conduct was first suggested in the 1975 Senate committee report on Bill C-60 and has been part of all subsequent bills.

Notice of the receiver's appointment has to be given to the debtor, other creditors and the Superintendent within ten days. Additional information in the form of a receiver's statement has to be furnished to the insolvent person or trustee, and on request, to creditors. Interim reports of the receiver's administration and a copy of his or her final report and statement of accounts has to be provided to the Superintendent, the trustee, or insolvent person and to creditors.

A secured creditor wishing to enforce a security has to give at least ten days' prior notice. This gives the debtor an opportunity to file a notice of intention to file a proposal, thus providing a 30-day breathing space to try to negotiate a reorganization plan with creditors and avoid bankruptcy.

To ensure accountability, the Act empowers a court to order that a receiver pass his or her accounts. To avoid conflicts of interest, it prohibits a person who was a director, officer, employer, employee, auditor, accountant, or solicitor of a debtor within the two preceding years from acting as a trustee without court approval. Nor can persons related to those persons be permitted to act without court approval. A person who is a trustee, receiver or liquidator for a person related to the debtor cannot act as a trustee in bankruptcy unless he or she makes full disclosure of that fact and of the potential conflict of interest. Trustees cannot act as receivers of the property unless they first obtain an independent opinion on the validity of the security and then inform creditors of this and of the basis of their remuneration as receivers. These accountability and conflict of interest proposals have been a part of every bill since C-60, implementing the Tassé Report's recommendation in this regard.

C. Commercial Proposals

The Act allows a business debtor to make a “proposal” to creditors, thus effectively freezing the enforcement remedies of secured and unsecured creditors while attempts are made to reorganize the business.

1. Stays of Proceedings

The BIA gives debtors a certain amount of time to prepare and negotiate reorganization proposals. A 30-day statutory stay of proceedings binding on both secured and unsecured creditors is established. This period can be extended by court order for periods of up to 45 days each, provided that all extensions do not exceed five months. Then, upon the filing of the proposal, a further stay is imposed on all creditors pending a creditors' meeting to be held within 21 days. Should the debtor fail to file a reorganization plan within the 30-day or the extended time period as the case may be, the debtor is deemed to have made an assignment in bankruptcy.

In its pre-study report on Bill C-22, the Standing Committee on Consumer and Corporate Affairs and Government Operations supported the concept of allowing a debtor to extend the stay period beyond six months, subject to creditor approval. This, however, was rejected by the government.

2. Liability of Directors and Stays of Action against Directors during Reorganizations

Corporate directors may be liable for certain debts of a corporation, such as wages, vacation pay, source deductions from employees' salaries and GST remittances. When a corporation seeks to reorganize under the BIA to stave off bankruptcy, the directors continue to be liable unless they can negotiate releases with the relevant creditors. There has been concern that directors' inability to settle such claims in the course of a reorganization may dampen their commitment to rebuilding the insolvent company.

With the enactment of Bill C-5, the BIA addresses this concern by proposing that a reorganization proposal be allowed to include provisions for compromising claims against directors that arise before the commencement of proceedings under the BIA and that relate to liabilities for corporate obligations that are imposed on directors by statute. Claims against directors that relate to contractual rights of creditors or that are based on allegations of misrepresentation made by directors to creditors or on wrongful or oppressive conduct by directors cannot be included in a proposal. Where a notice of intention or proposal had been filed by a corporation, the BIA will now stay all proceedings against directors in relation to their statutory obligations.

3. Protection for Creditors

To protect creditors during the stay period, the court has authority to appoint an interim receiver of the debtor's estate. The court can direct the interim receiver to take possession of the debtor's property and exercise control over such property and business.

A creditor can also apply to the court to have a stay lifted where he or she is materially prejudiced by its continuance.

4. Voting

The 1992 revisions lowered the required majority from 75% of the value of claims to 66 2/3% in order to allow more proposals to succeed. The secured creditors covered in a proposal can vote by class and no one secured creditor class can defeat a proposal. Secured creditors can be segregated into classes for the purpose of voting on a proposal. They will be included in the same class if their interests are sufficiently similar to give them a commonality of interest, taking into account: (a) the nature of the debts; (b) the nature and priority of the security;

(c) the remedies available to the creditors in the absence of the proposal and the extent to which they would recover their claims by exercising those remedies; and (d) the treatment of the claims under the proposal and the extent to which the proposal would satisfy those claims. For the purpose of voting, all unsecured creditors constitute one class unless otherwise designated. A proposal will be deemed to be accepted if a majority in number and two-thirds in value of all unsecured creditors voting on the proposal vote for acceptance. Where a class of secured creditors votes against the proposal, the proposal will go forward but will not apply to those classes of secured creditors who opposed it. Automatic bankruptcy will follow only where unsecured creditors reject the proposal.

5. Approval by the Court

All commercial proposals must be approved by the court. However, the court will not approve a proposal unless it includes full payment within six months of all outstanding arrears of source deductions for federal income tax, Canada Pension Plan and employment insurance, and similar provincial liabilities. In addition, the debtor cannot have defaulted in paying any of these amounts that become due after the proposal is filed. A proposal will also have to provide for the payment of outstanding wage claims up to the maximum amounts provided in the Act.

6. Limitations to Certain Rights

The Act also contains protections designed to enable the debtor to carry out the proposal successfully. Where proceedings are ongoing or the proposal is in effect, no person can claim an accelerated payment, terminate an agreement or a lease, or discontinue public utility services to a debtor merely on the grounds the debtor is insolvent, has filed a proposal or that a proposal is in effect, or because rent or utility charges were in arrears prior to the filing. A creditor, landlord, or public utility can apply to the court for an order that the prohibition be lifted. A debtor has the right to repudiate a commercial lease subject to the right of the landlord to apply to the court for an order refusing termination.

During the stay period and the first-six months that a proposal is in effect, the Crown cannot enforce a statutory garnishment right under the *Income Tax Act* so long as current remittances are kept up to date. Repayment of any arrears of source deductions will be provided for in the proposal so that such amounts will be fully paid at the end of the six months following the stay periods.

D. Consumer Proposals

Since 1975, proposed bankruptcy law amendments have included a separate system for consumer proposals.

The BIA generally adopts the recommendations of the Colter Report. A "consumer debtor" is defined as a natural person who is bankrupt or insolvent whose debts are less than $75,000 (excluding a mortgage on his principal residence). A consumer debtor can present a proposal to all his creditors applicable to all his debts, providing for their extension or reduction, or both. Joint consumer proposals are permitted where the financial affairs of the debtors are intertwined.

A consumer debtor who wishes to make a proposal has to obtain the assistance of an administrator, defined in the Act as a trustee or a person designated by the Superintendent of Bankruptcy to administer consumer proposals. The administrator prepares the proposal, investigates the consumer debtor's property, and financial affairs and provides counselling to the debtor in accordance with directives issued by the Superintendent.

On the filing of a consumer proposal, actions by all unsecured creditors are stayed until the proposal is fully performed, withdrawn, refused or annulled, as the case may be. Secured creditors, however, are able to realize on their securities.

After a proposal has been filed, either the official receiver, or creditors having at least 25% in value of the claims against the debtor, can call a meeting of creditors to vote on the proposal. If neither the official receiver nor the creditors requires a meeting, the proposal is deemed accepted. If a meeting of creditors is held, voting to accept or refuse a proposal is by ordinary resolution with all creditors voting as one class on the basis of one dollar equals one vote.

The necessity of having court approval for a proposal once it has been accepted by the creditors is waived. It is still available, however, should any interested party wish to make application to the court.

During the proposal period a consumer debtor is protected against public utility shut-offs, termination of leases and agreements, and employee dismissals based only on the fact that the consumer or employee has made a proposal.

E. Consumer Bankruptcies

1. Summary Administration

Under the BIA, two types of administration are applicable to the estates of individual bankrupts: summary administration and ordinary administration. Summary administration applies where the assets available for distribution to the unsecured creditors do not exceed $5000 or such other amount prescribed by statutes. Summary administration procedures are more streamlined and less expensive than those for ordinary administrations.

2. Automatic Discharge

Nine months after the bankruptcy takes place, first-time consumer bankrupts are entitled to an automatic discharge unless the discharge is opposed by the trustee, a creditor, or the Superintendent or the bankrupt fails to obtain counselling. Automatic discharge was recommended by the Colter Committee to eliminate the expense of discharge proceedings. In its pre-study report, the Standing Committee on Consumer and Corporate Affairs and Government Operations supported the concept of automatic discharge but recommended that all consumer bankrupts be required to receive financial counselling before being discharged from bankruptcy. The Act reflects this recommendation.

Previous bills provided for an automatic discharge of the consumer debtor after either ninety days (Bill C-60) or six months (Bills S-9, S-11, C-12, C-17) from the date of the bankruptcy order.

3. Application for a Discharge from Bankruptcy

The BIA sets out the types of orders that a court may make on an application for discharge from bankruptcy. If certain facts are proven, however, the court may refuse, suspend or order a conditional discharge. The BIA, as amended by Bill C-5, gives the court the power to refuse, suspend or order a conditional discharge where a bankrupt has not complied with an order to pay his or her surplus income to the trustee for distribution to the creditors or where a bankrupt who could have made a viable proposal has chosen bankruptcy rather than a proposal to creditors as a means of resolving his or her indebtedness.

4. Property Exempt from a Bankruptcy

Subject to certain exceptions, all property of a bankrupt person vests in the trustee for the benefit of the creditors. These exceptions are found in section 67 of the BIA and include property held in trust by the bankrupt for others and property that is exempt from execution or seizure under provincial law.

With the enactment of Bill C-5, the exceptions have been broadened to exclude from a bankruptcy any property that is exempt from execution and seizure under any laws applicable in a province (this would include federal laws) and GST credits and income support payments necessary to meet the essential needs of an individual.

5. Payment of "Surplus Income"

The BIA establishes a framework to encourage bankrupt individuals to reimburse their creditors. Trustees will have the authority to establish an amount of money that a bankrupt person will be required to pay to recompense creditors after taking into account the bankrupt's total income and the income required to allow the bankrupt to maintain a reasonable standard of living.

6. Family Support Claims

Prior to the enactment of Bill C-5, spouses were not considered creditors for the purposes of proving claims for spousal and child support in bankruptcy proceedings. Bill C-5 amends the BIA by providing that claims for alimony payments or for spousal or child support required under a court order or an agreement made prior to bankruptcy and when the spouse or child was living apart from the bankrupt are claims provable in bankruptcy proceedings. In addition, claims for alimony, spousal and child support payments that accrue during the year before a bankruptcy as well as any lump sum payable rank as preferred claims for the purposes of payment under the Act.

7. Non-Dischargeable Debts

An order discharging a person from bankruptcy does not affect certain kinds of debts. Such debts remain outstanding even though all other debts are wiped out by a discharge.

Among the debts that currently fall into this category are fines imposed by a court, alimony, maintenance and support payments, and debts and liabilities arising out of fraud.

To the list of non-dischargeable debts Bill C-5 added an award of damages by a court in civil proceedings in relation to intentionally inflicted bodily harm or sexual assault or wrongful death resulting from those actions.

Under changes to the Act that came into force on 18 June 1998, student loan debts are non-dischargeable if the bankruptcy occurs before a person ceases being a full or part-time student or within ten years after studies end; before the amendments of June 1998, the Act referred to a period of two years after the end of studies, rather than ten. The court can, however, order a student loan debt to be discharged after ten years where the bankrupt acted in good faith and is not able to repay the loan due to genuine financial difficulty.

F. Crown Priority

Prior to the passage of Bill C-22, section 136 the *Bankruptcy Act* gave a preferred ranking to the federal and provincial governments in the distribution of the proceeds realized from the property of the bankrupt. To add to this statutory priority, the federal government and most provincial governments had created statutory deemed trusts or deemed security interests intended to rank in priority over the claims of secured creditors. The deemed trust device effectively circumvents section 136(1) because section 67 of the *Bankruptcy Act* excludes from a bankruptcy all property held by the bankrupt in trust for any other person. The federal government has used this legal fiction in respect of claims for amounts deducted from employees for Canada Pension Plan premiums, employment insurance and withholding under the *Income Tax Act*.

Under the 1992 amendments, all Crown claims except for Canada Pension Plan, unemployment insurance (now employment insurance) and income tax withholdings became ordinary unsecured claims. The Crown, however, can obtain a secured position by registering its claim.

G. Unpaid Suppliers

The idea of providing protection to unpaid vendors is not a new concept in Canadian law. A provision relating to unpaid suppliers can be found in the *Civil Code* of Quebec and was proposed in the 1970 Tassé Report.

The recommendations of the Tassé Report were acted upon in 1980 when the Honourable Judy Erola, then Minister of Consumer and Corporate Affairs, stated that unpaid suppliers of merchandise should be allowed to recover their goods. The Minister discussed a proposed amendment to Bill C-12 which would have allowed unpaid suppliers to recover any merchandise delivered within 10 days prior to a bankruptcy if a claim was made within 30 days of the triggering event.

Bill C-17 in 1984 would also have given unpaid suppliers the right to repossess their goods. An unpaid supplier could have demanded the return of the goods if they were delivered within 10 days of the insolvency and if the demand was made within 30 days of the insolvency. The goods would have had to be identifiable and not re-sold, or subject to any agreement for sale or a conditional sales agreement.

The Colter Committee considered protecting unpaid suppliers, but felt that this would be inequitable and prejudicial to other unsecured creditors. If unpaid suppliers were to receive any special protection, the Committee was of the opinion that it was for the provinces to legislate and not the federal government.

The 1988 Departmental proposals contained a repossession right. The Department was of the view that unpaid suppliers required special protection as they were often small businesses, which generally had only ordinary creditor status in the bankruptcy of their customers. A right to repossess unpaid-for goods would also remedy the inequity which results when debtor-businesses, just before bankruptcy, receive inventory which they use to pay secured creditors at the expense of the business that supplied the merchandise.

In its pre-study, the Standing Committee on Consumer and Corporate Affairs and Government Operations favoured a priority for unpaid suppliers but recommended that the priority should apply in cases where goods were delivered within the 15 days prior to the purchaser's bankruptcy or placement in receivership and where the demand for repossession was made within 15 days after such an event.

The BIA gives unpaid suppliers the right to repossess merchandise delivered to a purchaser who becomes bankrupt or goes into receivership. A number of conditions would apply to this right. First, the supplier has to make a written demand for the goods within 30 days after delivery. Second, the purchaser has to be bankrupt or in receivership at the time the demand is made. Third, the goods have to be in the possession of the receiver, trustee or purchaser, and must be identifiable and not fully paid for, in the same state as they were on delivery and not resold at arm's length or made subject to any agreement for sale. The right to repossess the goods expires if not exercised within 10 days after it has been confirmed by the trustee, receiver or purchaser.

Where the goods have been partly paid for, a supplier has the right to repossess a portion of them, proportional to the amount owing, or to repossess all the goods after repaying the amount of any partial payment previously received.

The supplier's right to repossession ranks ahead of any other claim in respect of those goods and a supplier is not precluded from exercising any rights available under provincial law.

The BIA also provides a special right for farmers, fishermen and aquaculturists who deliver their farm and fisheries products to a purchaser who subsequently becomes bankrupt or is placed in receivership. Where such products are delivered within 15 days prior to the bankruptcy or receivership and the farmer, fisherman or aquaculturist files a claim for any unpaid amount in respect of those products within 30 days thereafter, the claim is secured by a charge on all of the inventory held by the purchaser. This charge takes priority over all other rights or charges against that inventory except a supplier's right of repossession.

H. Securities Firms

Prior to the enactment of Bill C-5, the BIA did not contain specific provisions dealing with the bankruptcy of securities firms. Under the general bankruptcy rules, securities held by a bankrupt firm for its customers do not vest in the trustee and are traced and returned to their owners. The process of tracing the securities is complex, lengthy and costly and the results can be inequitable.

Bill C-5 added new provisions to the BIA to deal with securities firm bankruptcies. The need to trace and identify the ownership of securities was avoided by pooling securities and allocating them in proportion to a customer’s equity with the firm.

Securities firms can be petitioned into bankruptcy by a creditor, a securities commission, an industry-regulated compensation body or a securities exchange, among others. Trustees have extensive powers to deal with the assets of the firm. They can buy and sell securities, discharge security interests, complete open contractual commitments, maintain customers' securities accounts and meet margin calls, distribute cash and securities to customers and liquidate securities accounts.

On the bankruptcy of a securities firm, the securities it owns and securities and cash held for customers vest in the trustee. Securities registered in the name of a customer ("customer name securities") do not become the property of the trustee, however. The trustee is required to establish two funds: a "customer pool fund," which includes securities (other than customer name securities and eligible financial contracts to which the firm is a party) and cash obtained through dividends, interest, the settlement of securities and customer accounts, and a "general fund," which includes all other vested property.

The BIA now provides for a scheme for allocating these funds. Generally, securities and cash in the customer pool fund are allocated to pay costs of administration that the general fund cannot pay and to pay customers in proportion to their net equity. Customer name securities are delivered to their owners. The general fund is to be used to pay preferred creditors, to make up any shortfall to customers who had claims remaining after the distribution of property from the customer pool fund, and to pay relevant compensation bodies and creditors.

I. International Insolvencies

Canadian insolvency legislation is directed at domestic business failure, rather than at insolvencies with cross-border implications. With the globalization of international markets, there are increasing numbers of international insolvencies.

The BIA, as amended by Bill C-5, seeks to harmonize Canadian bankruptcy proceedings with those of other countries and reduce the number of jurisdictional conflicts when insolvencies involve assets located in more than one country. Canadian bankruptcy courts will be able to limit the property to which the authority of a trustee extends and to make orders to coordinate proceedings under the BIA with foreign proceedings. These provisions codify much of the jurisprudence with respect to cross-border insolvencies.

Foreign stays of proceedings will not apply to Canadian creditors with respect to Canadian property unless the stay arises from proceedings taken in Canada. Foreign representatives (persons who carry out duties similar to those performed in Canada by a trustee, liquidator, administrator or receiver), however, will be able to commence or continue certain proceedings under the BIA. They can apply for a receiving order, stays of proceedings against creditors, or the appointment of an interim receiver and can commence proposal proceedings.

J. *Companies' Creditors Arrangement Act*

Canadian companies have two statutes under which they can reorganize in the event of financial difficulty: the BIA and the *Companies' Creditors Arrangement Act.* Unlike the BIA, the CCAA is a relatively short statute that contains few guidelines and confers considerable discretion on the courts with respect to commercial reorganizations. It is often used in large, complex arrangements.

Bill C-5 amends the CCAA to align procedures under that statute more closely with those under the BIA. Only corporations with liabilities in excess of $5 million are eligible to reorganize under the CCAA.

Among the changes to the CCAA contained in Bill C-5 are: the inclusion of claims against corporate directors as part of a reorganization; providing for the appointment of a "monitor" to oversee the business and financial affairs of a corporation; making Crown claims subject to the same stays of proceedings, priorities and rights to distribution as under the BIA; providing for a two-thirds voting proportion by creditors with respect to a reorganization proposal, as is the case under the BIA; including provisions relating to international insolvencies; precluding the courts from staying the termination of eligible financial contracts; and providing for a short first stay of proceedings against creditors with a requirement that another court order be sought for a further stay.

Aligning the CCAA more closely with the BIA removes many of the differences between the statutes. However, the continuing existence of two reorganization statutes has not been fully addressed. Some commentators have recommended that the CCAA be repealed. The fate of the CCAA is likely to be examined during the next review of the CCAA and the BIA which should begin in 2002.

CHRONOLOGY

1869 - The first bankruptcy legislation was enacted by the Parliament of Canada.

1919 - The *Bankruptcy Act* was enacted by Parliament in the session of 1919 (9-10 Geo. V, c. 36), and came into force on 1 July 1920. The Act and amendments thereto were consolidated and revised and approved as R.S.C. 1927, c. 11.

1949 - A new *Bankruptcy Act* was enacted.

1966 - The Act was amended by *An Act to Amend the Bankruptcy Act*, S.C. 1966-67, c. 32 to increase the Superintendent's investigatory powers, to make stricter the rules relating to fraudulent preferences and to add a new Part X concerning consumer arrangements by way of extension.

1966 - The Study Committee on Bankruptcy and Insolvency Legislation (the Tassé Committee) was appointed to undertake an in-depth study of Canadian bankruptcy law.

1970 - The Tassé Report was published, recommending the enactment of a completely new bankruptcy and insolvency statute that would establish an integrated and comprehensive bankruptcy system.

5 May 1975 - Bill C-60 was tabled by the Hon. Herbert Gray, then Minister of Consumer and Corporate Affairs. After first reading in the House of Commons, the bill was referred to the Senate Committee on Banking, Trade and Commerce. The Committee recommended 139 changes to the bill.

21 March 1978 - Bill S-11 was introduced in the Senate. It contained 128 of the amendments recommended by the Senate Committee reviewing Bill C-60. Second reading followed on 4 April 1978 but the bill was not passed.

27 February 1979 - Bill S-11 was re-introduced in the Senate as Bill S-14. It progressed to second reading on 13 March 1979 and died on the Order Paper with the dissolution of the 30th Parliament on 26 March 1979.

8 November 1979 - Bill S-14 was re-introduced in the Senate as Bill S-9 during the 31st Parliament. It died on the Order Paper on 13 December 1979 after first reading.

16 April 1980 - Bill C-12 was introduced in the House by then Minister of Consumer and Corporate Affairs, André Ouellet. The bill received second reading on 26 September 1983 and was referred to the Commons Committee on Finance, Trade and Economic Affairs. Parliament was prorogued before the Committee completed its hearings.

1981 - A committee chaired by Raymond Landry of the University of Ottawa was asked to make recommendations on wage protection. The report of the Committee on Wage Protection in Matters of Bankruptcy and Insolvency was published in October 1981.

31 January 1984 - Bill C-17 was introduced in the House by then Minister of Consumer and Corporate Affairs, Judy Erola. It was essentially the same as the previous bill except for some technical amendments. Further amendments were tabled on 28 May. The bill died on the Order Paper after second reading.

March 1985 - An Advisory Committee composed of trustees and lawyers was appointed by the then Minister of Consumer and Corporate Affairs, Michel Côté, to examine the bankruptcy system, assess possible reforms and recommend amendments. The report of the Committee (the Colter Report) was tabled in January 1986.

September 1986 - A discussion paper on Bankruptcy Act Amendments was published by the Legislative Review Branch of the Department of Consumer and Corporate Affairs, indicating its recommendations based on the findings of the Colter Report and its own consultations with interest groups and with the provinces.

1988 - A document entitled "Proposed Revisions to the *Bankruptcy Act*" was published by the Department. It proposed an initial package of selected reforms in eight areas of the law.

March 1989 - The Report of the Advisory Council on Adjustment (the de Grandpré Report) recommended that the Department expedite amendments to the *Bankruptcy Act* to create a national wage earner protection fund. The Advisory Council was created in January 1988 to examine adjustment issues arising from the Free Trade Agreement.

March 1990 - A working document prepared for the Economic Council of Canada by B.-M. Papillon did not support the idea of a wage earner protection fund but instead proposed changes to the unemployment insurance program. It also advocated a "first in, first out" rule for all creditors (secured and unsecured), except for supplier and Crown claims.

13 June 1991 -	Bill C-22, containing amendments to eight key areas of bankruptcy law, was introduced in the House by the Minister of Consumer and Corporate Affairs, Pierre Blais.
7 October 1991 -	The House of Commons Standing Committee on Consumer and Corporate Affairs and Government Operations tabled its report on the pre-study of Bill C-22.
23 June 1992 -	Bill C-22 received Royal Assent. It will come into force on proclamation.
30 November 1992 -	Provisions of the *Bankruptcy and Insolvency Act* came into force.
24 November 1995 -	Bill C-109, containing amendments to the *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act* and the *Income Tax Act*, was introduced in the House of Commons. It died on the Order Paper after first reading.
4 March 1996 -	Bill C-5, which is essentially the same as Bill C-109, was introduced in the House of Commons.
February 1997 -	The Standing Senate Committee on Banking, Trade and Commerce issued a report on Bill C-5 in which it recommended a number of amendments to the bill.
13 February 1997 -	Bill C-5, as amended, received third reading by the Senate.
15 April 1997 -	The House of Commons concurred in the Senate amendments to Bill C-15.
25 April 1997 -	Bill C-5 received Royal Assent.
30 September 1997 -	All sections of Bill C-5 came into force except for paragraph 67(1)(b.1), section 68, subsection 102(3), paragraph 168.1(1)(e), section 170.1, paragraph 173(1)(m), and paragraph (n).
30 April 1998 -	The final portions of Bill C-5, including major amendments requiring new regulations and the introduction of mediation services, came into force.
18 June 1998 -	Bill C-36, An Act to implement certain provisions of the budget, tabled in Parliament on 24 February 1998, received Royal Assent. The Act provides that a student loan debt will not be discharged where bankruptcy occurs within 10 years after the end of studies. Prior to this change, the period was two years.

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