Submission on the Five-Year Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*

NATIONAL BANKRUPTCY AND INSOLVENCY LAW SECTION
CANADIAN BAR ASSOCIATION

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PREFACE

The Canadian Bar Association is a national association representing 38,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Bankruptcy and Insolvency Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Bankruptcy and Insolvency Law Section of the Canadian Bar Association.

Submission on the Five-Year Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*

I. INTRODUCTION

The National Bankruptcy and Insolvency Law Section of the Canadian Bar Association (the CBA Section) is pleased to present this submission to the Senate Standing Committee on Banking, Trade and Commerce (the Senate Banking Committee) for consideration in its mandated five-year review of the *Bankruptcy and Insolvency Act* (the "BIA") and the *Companies' Creditors Arrangement Act* (the "CCAA").

The CBA Section has a long history of contributions to government reform initiatives on these subjects. This submission is the culmination of a national consultative process with members of the Section Executive in all parts of Canada that builds on our past submissions on bankruptcy and insolvency reform.

The submission is divided into six main parts:

- Priorities-Related Issues
- Participation (Governance)
- Cross-Border Insolvency
- DIP Financing
- Interim Receivers
- Personal Insolvency

II. PRIORITIES-RELATED ISSUES

1. Wage Protection

We acknowledge that unpaid employees are in need of better protection in insolvency situations. Wage earners are in a vulnerable position – they are economically dependent upon weekly or biweekly pay cheques but unable to protect themselves adequately as creditors when an employer becomes insolvent. Industry Canada's report entitled *Statutory Priorities in Business Insolvencies* identifies a number of potential options for protecting wage earners:[1]

- A super priority on the employer's assets, similar to the Canada Customs and Revenue Agency (the CCRA) super priority for unremitted source deductions;
- Recognition of existing provincial priorities within the BIA regime;
- A wage protection fund; and
- Waiver of the two week waiting period from employment insurance.

The authors of the report conclude that a "super priority was preferred … (though) strict limitations be imposed, including a dollar cap, a short protection period (one pay period) and limiting coverage to wages only - not vacation, severance or termination pay."

The CBA Section submits that a super priority is neither a fair nor an efficient means of protecting the wage earner. In particular:

a) It places the entire cost burden on the creditors (particularly secured creditors) instead of spreading the risk amongst other interested stakeholders, in particular, employers and employees.

b) Adding super priorities to the existing CCRA super priority will negatively affect lenders' margining calculations and reduce the availability of credit.

c) Recognition and enforcement of super priorities has had a long and unsatisfactory judicial history. In *Royal Bank v. Sparrow*, the Supreme Court of Canada identified the jurisprudence in this area to be an

1 Corporate Law Policy Directorate, Industry Canada, *Statutory Priorities in Business Insolvencies* (2001)

"embarrassment" and an "unfortunate area of the law".[2] Subsequent legislative attempts to clarify and enhance the CCRA super priority have not created the certainty desirable for commercial purposes.[3]

d) The experience with the administration and enforcement of CCRA's super priority has been harshly criticized by stakeholders.[4]

e) Collecting funds from a super priority and paying them to employees will be long and difficult. Currently unpaid wage claims are adjudicated and administered by provincial employment standards regimes. Unless employment standards agencies obtain proceeds from the insolvent employers' assets, nothing is available to distribute to the unpaid employees. Enhancing the existing priority for unpaid wages into a super priority does not put money in the hands of the employee when it is most needed.

The issue of adequate protection for unpaid employees in bankruptcy has been canvassed by Parliament on several previous occasions. The Coulter Report (1986), the Advisory Committee on Adjustment (1989) and Bill C-22 (1991) each concluded that a wage earner protection fund provided a fair and administratively efficient solution.[5]

A wage protection fund administered under the Employment Insurance regime would provide a fair, efficient and prompt means of cushioning the blow to wage earners of an insolvent employer. The Employment Insurance regime already adjudicates the entitlement of employees relatively promptly. It is recommended that each employee would receive, upon an employer's cessation of business, up to 90 percent of unpaid wages for one pay period to a maximum of $2,000. The fund from which the Employment Insurance regime could draw should be sourced from those stakeholders with the largest interest: employees and employers themselves. On payment to the employees, the Fund would be subrogated to the

2 *Royal Bank v. Sparrow* (1997), 44 C.B.R. (3d) 1 (S.C.C). at 20.

3 *Minister of Finance v. Schwab* [2002] S.J. No. 16; *Royal Bank v. Tuxedo Transport* (2000) DTC 6501 (B.C.C.A.); *Daimler Chrysler v. Mega Pets* (2002) B.C.J. No. 808 (B.C.C.A.); *First Vancouver Finance v. M.N.R.* (2002) 212 D.L.R. (4th) 615 (S.C.C.).

4 See Industry Canada, *Summary of Comments Received at Consultations*, 2002 and "Forced Collectivization CCRA Style? Creditors' Response to the Latest Source Deduction Priority" (2002) 17 N.C.D. Rev. 1.

5 Report of the Advisory Committee on Bankruptcy and Insolvency (1986); Report of the Advisory Committee on Adjustment (1989); Bill C-22, 3rd Sess. 34th Parl., 1991.

claims of the employees.

RECOMMENDATION:

The CBA Section recommends the adoption of a Wage Earner Protection Fund whereby each employee would be entitled to receive up to 90 percent of unpaid wages outstanding from one pay period up to a maximum of $2,000. The fund shall be administered and distributed under the Employment Insurance regime and sourced from a levy on employers and employees.

2. Unpaid Pension Contributions

Many of the same considerations discussed under wage protection apply to the problem of unremitted pension contributions. Industry Canada's report concluded that a super priority was the preferred solution, provided that it was restricted by a dollar cap and by coverage for contributions only (not unfunded liabilities) and was limited to the losses accruing from one pay period.[6]

For the same reasons set out under Wage Protection, above, the CBA Section submits that creation and implementation of another super priority will not provide an efficient or fair solution. If it is the intention of Parliament to provide some further protection for unremitted pension contributions, this matter should be dealt with in the same fashion as the unpaid wages.

RECOMMENDATION:

The CBA Section recommends that, if Parliament wishes to provide protection for contributors of unremitted pension contributions in bankruptcy, it do so as part of the Wage Earners Protection Fund.

6 *Supra* note 1.

3. Unpaid Suppliers

After many years of attempted reform and input from various interest groups, Parliament amended the BIA in 1992 to provide limited protection for unpaid suppliers of goods.

Section 81.1 of the BIA has been difficult to apply in practice and is largely illusory. In particular, the timing requirement that the supplier's right to repossess must be exercised by notice within 30 days of delivery of the goods creates administrative and fairness problems. The notice requirement is not the 30 days immediately preceding bankruptcy but rather a 30-day period from the date the goods were actually delivered. Thus, for example, if the goods were delivered on November 1 and the debtor assigned into bankruptcy on November 30, the supplier's demand must be given to the trustee/receiver by December 1. Considering the supplier's right to demand repossession does not occur until either bankruptcy or receivership, the timing of the demand provided in the statute is problematic. Furthermore, there still remains a concern from a policy perspective that suppliers of goods are receiving a preference not otherwise legislatively afforded to suppliers of services or credit.

The CBA Section submits that in the event Parliament wishes to maintain the unpaid suppliers' right of repossession, the timing provisions of section 81.1 of the BIA should be amended such that the notice be given to the trustee/receiver within 15 days of the effective date of bankruptcy/receivership for goods delivered in the 30 days prior to bankruptcy/receivership. This would provide a measure of certainty as to the time periods utilized by all stakeholders in the process.

RECOMMENDATION:

The CBA Section recommends that, in the event Parliament wishes to maintain the unpaid suppliers' right of repossession, then section 81.1 of the BIA should be amended to provide that the right may be

exercised by notice on the trustee/receiver within 15 days immediately following the effective date of bankruptcy or receivership for goods delivered during the 30 days immediately preceding the effective date. The balance of the conditions of enforcement contained in section 81.1 should remain.

III. PARTICIPATION (GOVERNANACE)

1. Introduction

Under this heading we group a number of recommendations aimed at improving the functioning of the insolvency system from the perspective of participants or stakeholders, and removing barriers that currently exist to participation in the insolvency system.

Insolvency plays a much larger role in commercial life than it once did, with the development of a "reorganization" culture and the loss of the stigma that used to be attached to the initiation of insolvency proceedings. Although the role of the insolvency process in the economy has increased stakeholder participation, the process has not developed to keep track of the results of such participation. This may result in a loss of confidence among stakeholders. We believe that there are key aspects of the current insolvency regime that could be amended to increase stakeholder confidence.

2. Independence Standard for Insolvency Administrators

The insolvency process currently operates through the appointment by debtors, creditors or the court of parties to oversee the financial affairs of reorganizing debtors and parties to manage and realize upon the assets of liquidating debtors. All court appointees are officers of the court and therefore accountable to all stakeholders. However, aspects of the current standard for appointment may lead to the perception that the insolvency administrator is not truly independent. For example, in a CCAA reorganization, the debtor's auditor is permitted to act as

monitor. While we recognize that the officers of the court act as independent parties and have no vested interest in the debtor, we also believe that the appearance of independence is important. We believe that the insolvency process might be better served by incorporating a general standard of independence for all insolvency administrators, including licensed trustees, receivers, interim receivers, and monitors. This would eliminate any conflict of interest and avoid a situation wherea duty is owed both to the debtor and to the creditors.

RECOMMENDATION:

The CBA Section recommends that a general standard of independence of insolvency representatives be adopted, requiring that all insolvency administrators be independent.

3. Full, True and Plain Disclosure Standard

Information – both access to information and the accuracy of the information received – is extremely important to participants in the insolvency process. In the context of a reorganization or liquidation, stakeholders are called upon to make important decisions which impact upon their own economic interests as well as on the interests of other stakeholders. In the area of securities regulation, where access to and the accuracy of information are also of fundamental importance, market participants are subject to the rule that all disclosure must be "full, true and plain". We believe that a statutory requirement that insolvency administrators and the debtor provide full, true and plain disclosure in every material document they issue in an insolvency proceeding would facilitate informed decision making on the part of stakeholders.

RECOMENDATION:

The CBA Section recommends that the BIA and the CCAA require that insolvency administrators and the debtor provide full, true and plain disclosure in every material document they issue in an insolvency proceeding.

4. Publication of the List of Creditors in CCAA Proceedings

The unsecured creditors are one of the major stakeholders in an insolvency. While the individual claims of unsecured creditors may be small, as a group they often represent one of the largest interest groups in an insolvency. We believe it is important that unsecured creditors be given the opportunity to participate actively in the insolvency to protect their interests. The most effective way for these creditors to participate is as a group.

While the CCAA requires that the monitor notify creditors of the commencement of proceedings, a list of creditors is not required to be prepared or published in CCAA proceedings. As a result, unsecured creditors are unable to organize themselves into groups to ensure that their voices are heard in the reorganization. On the other hand, lists of creditors are prepared and distributed in BIA reorganizations.

RECOMMENDATION:

The CBA Section recommends that the CCAA be amended to require the preparation and distribution of a creditor list at the commencement of CCAA reorganization, and that the list be distributed to all creditors owed in excess of $10,000 and to any other creditor upon their written request.

5. Lawyers as Licensed Trustees

Currently, there is an administrative restriction on practicing lawyers acting as bankruptcy trustees. A lawyer who wishes to become a licensed trustee is required to undertake not to practise law. The basis for this restriction is the perception that the role of a practicing lawyer is not compatible with that of a licensed trustee. We are of the view that this restriction ought to be removed, and that any person who completes the course of study and passes the required examinations be permitted to practise as a licensed trustee. We are not aware of any conflict between the role of a lawyer and that of a licensed trustee, provided

the lawyer does not act in both capacities in respect of the same matter. Moreover, there is no restriction on the ability of a practicing lawyer to act as a privately appointed or court-appointed receiver or as a monitor in CCAA proceedings.

RECOMMENDATION:

The CBA Section recommends that the restriction against practicing lawyers acting as licensed trustees be removed.

6. Creditor Representative

The CBA Section has no comments on the matter of creditor committee(s) and inspectors in the context of a BIA proposal or CCAA reorganization.

IV. CROSS-BORDER INSOLVENCY

1. Introduction

We recognize that increasing globalization has resulted in a dramatic increase in cross-border insolvencies. A cross-border insolvency arises in any situation where a business enterprise operating in more than one jurisdiction commences (or is forced into) an insolvency proceeding. In recent years many mid to large sized insolvencies in Canada have involved stakeholders in at least one country other than Canada.

We also recognize that cross-border insolvencies present unique challenges to the 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. While in some cases it is possible to deal with foreign assets without commencing a proceeding in the various jurisdictions where the assets are located, more often than not a cross-border insolvency will involve proceedings in multiple jurisdictions. In such situations, a fundamental concern is

the extent to which a domestic insolvency regime can be used to facilitate the efficient and effective administration of the insolvency proceeding.

A cross-border insolvency may be administered on the basis that "full" or "plenary" proceedings take place in each jurisdiction. These stand-alone proceedings under the jurisdiction's domestic insolvency regime then coordinate with each other to administer the liquidation or reorganization. Rather than commencing plenary or full proceedings in various jurisdictions, it is possible for one insolvency administration under foreign law to seek the assistance of the courts in the various jurisdictions where the debtor has assets without commencing full insolvency proceeding in those jurisdictions. These ancillary proceedings supplement the single, full or plenary proceeding.

2. Current Canadian Regime

Historically, Canadian courts have recognized and granted comity to insolvency proceedings initiated in a foreign jurisdiction, provided that the debtor had sufficient connection to the jurisdiction in which the proceedings were initiated. The relief granted by the Canadian courts in connection with cross-border insolvency proceedings has included the recognition of insolvency representatives appointed in the foreign proceeding, the granting of a stay of Canadian proceedings on the basis of a stay granted in the foreign proceedings, and turning over personal property to be administered in the foreign proceeding.

In 1997, both the BIA and the CCAA were amended to include specific provisions to deal with cross-border insolvencies. These provisions – Part XIII of the BIA and section 18.6 of the CCAA – are substantially similar in their approach to the administration of a cross-border insolvency. However, the CCAA has recently been interpreted more broadly by the courts.

The essential aspects of the current Canadian cross-border insolvency regime can be summarized as follows:

a) **Stay of Proceedings:** Section 269 of the BIA provides that a stay of proceedings that operates against creditors of a debtor in a foreign

proceeding does not apply in respect of creditors who reside or carry on business in Canada *with respect to property in Canada*.

b) **Commencement of Canadian Proceedings:** There are no restrictions on the ability of a foreign company to initiate insolvency proceedings in Canada, and both the BIA and the CCAA recognize the presence of assets in the jurisdiction as a sufficient basis to commence proceedings. Section 2(1) of the BIA, for example, defines "corporation" to include "any incorporated business, wherever incorporated, that is authorized to carry on business in Canada or that has an office or property in Canada…" The fact that a proceeding has been commenced in another jurisdiction is no barrier to a proceeding being commenced in Canada.

c) **Foreign Representative/Foreign Proceedings:** The Canadian insolvency regime permits a "foreign representative" to appear before a Canadian court to seek various remedies in relation to the Canadian assets or operations of a foreign debtor, including the imposition of a stay of proceedings, the right to conduct examinations, and the appoint of an interim receiver, etcetera.

A "foreign representative" is defined as a person who is assigned functions in a foreign insolvency proceeding that are similar to those performed in Canada by a trustee, liquidator, administrator or receiver. The term "foreign proceeding" is, in turn, defined to mean a judicial or administrative proceeding under foreign bankruptcy or insolvency legislation that deals with the collective interests of creditors generally.

d) **Discretion in the Court:** The provisions of Part XIII of the BIA and section 18.6 of the CCAA are not exhaustive of the remedies available in respect of a foreign insolvency proceeding and are not required to defer to any foreign proceeding. Nothing in Part XIII of the BIA or section 18.6 of the CCAA prevents the Canadian court from applying legal or equitable rules governing the recognition of foreign insolvencies, and the courts are not required to enforce a foreign order or make an order that is not in compliance with the laws of Canada.

e) **Use of Cross-Border Insolvency Protocols:** Both the BIA and the CCAA provide the court with the explicit jurisdiction to communicate with foreign courts. The court can also make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in a coordination of proceedings under the BIA or the CCAA with any foreign proceeding. Based upon this jurisdiction, the courts have approved cross-border insolvency protocols to coordinate Canadian insolvency proceedings under the BIA and the CCAA with insolvency proceedings under the *United States Bankruptcy Code*.

3. The Holt Cargo Systems Case

The Supreme Court of Canada recently considered the Canadian approach to cross-border insolvency in the context of a request to stay Canadian proceedings in deference to a foreign bankruptcy proceeding. In *Holt Cargo Systems Inc. v. ABC Containerline N.V. (Trustee of)*, the Supreme Court of Canada endorsed what is sometimes referred to as a "plurality" or "modified territorial" approach to cross-border insolvency.[7] This approach favours the initiation of domestic insolvency proceedings to ensure protection of the interests of parties before the Canadian court and cooperation between the various jurisdictions.

The Supreme Court found that this approach "recognizes that different jurisdictions may have a legitimate and concurrent interest in the conduct of an international bankruptcy, and that the interests asserted in Canadian courts may, but not necessarily must, be subordinated in a particular case to a foreign bankruptcy regime. The general approach reflects a desire for coordination rather than subordination, with deference being accorded only after due consideration of all the relevant circumstances…". The Supreme Court found that where the Canadian courts are, in the context of a cross-border insolvency, called upon to extend recognition to a foreign insolvency proceeding, they ought to be mindful of the difficulties confronting the foreign insolvency representatives in the fulfillment of their public mandate to bring order out of financial disorder, but must have due regard to the need to do justice to the parties who come before the Canadian courts.

7 *Holt Cargo Systems Inc. v. ABC Containerline N.V. (Trustees of),* [2001] 3S.C.R. 907, 30 C.B.R. (4th) 6.

4. The UNCITRAL Model Law

At the same time that Part XIII of the BIA and section 18.6 of the CCAA were being developed in Canada, the problem of international insolvencies was being addressed at the international level. Between 1995 and 1997, the United Nations Commission on International Trade Law (UNCITRAL) Working Group on Insolvency Law developed a model law of cross-border insolvency. Canada was an active participant in the UNCITRAL Working Group and supported the adoption of the Model Law by UNCITRAL. UNCITRAL adopted the Model Law on Cross-Border Insolvency in May 1997.

The key aspects of the Model Law are summarized in a background paper prepared for Industry Canada by Professor Marvin Baer, as well as in the report submitted by the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform (the JTF Report) to the Senate Banking Committee as a part of these proceedings.[8]

To date, the Model Law has been adopted by South Africa, Mexico and Eritrea. Japan has recently passed legislation that parallels the Model Law, and legislation currently pending in the United States would amend the *United States Bankruptcy Code* to include the adoption of the Model Law. The New Zealand Law Commission prepared a 1999 report that recommended the adoption of the Model Law.[9]

5. Adoption of UNCITRAL Model Law

While it appears to be generally accepted that Part XIII of the BIA and section 18.6 of the CCAA function well in practice, the CBA Section believes that the adoption of the Model Law is something to which Canada should aspire.

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8 Baer, M., *The Impact of Part XIII of the BIA and the UNCITRAL Model Law of Cross-border Insolvency* (1998)); Insolvency Institute of Canada and Canadian Association of Insolvency and Restructuring Professionals, *Report of the Joint Task Force on Business Insolvency Law Reform.* (2003)

9 New Zealand Law Commission, *Cross Border Insolvency – Should New Zealand adopt the UNCITRAL Model Law on Cross-*

Canada played a key role in the development of the Model Law. We agree with Professor Baer's assessment that the impact of adopting the Model Law will not be large, but that adoption would help to further international harmonization in the treatment of international insolvencies that should facilitate the administration of cross-border insolvencies. We believe that the Canadian cross-border insolvency regime should reflect the plurality or modified territorial approach (the Canadian approach) to cross-border insolvencies endorsed by the Supreme Court in *Holt Cargo Systems*, and should ensure that the interests of Canadian stakeholders are not detrimentally impacted by foreign insolvency proceedings.[10] Certain modifications to the Model law would be necessary to achieve these objectives. The Model Law does not, for example, require that notification be given of an application made in respect of foreign insolvency proceedings.

RECOMMENDATION:

The CBA Section recommends the adoption of the UNCITRAL Model Law as part of the BIA and/or the CCAA (subject to modifications that may be necessary coordinate the provisions of the Model Law with the BIA and the CCAA). The CBA Section also recommends that the Model Law, as adopted, be modified to ensure that interests of Canadian stakeholders are not prejudiced by the recognition of a foreign proceeding.

Provisions should be included: (i) requiring that Canadian stakeholders be notified of any proceeding to recognize foreign proceedings; (ii) providing Canadian stakeholders with the opportunity to commence proceedings under the BIA or the CCAA on the basis of the existence of the foreign proceeding; and (iii) providing that the recognition of a foreign proceeding or the granting of an order in connection with a foreign proceeding is a matter of discretion

Border Insolvency? (1999).

10 *Supra* note 7.

on the part of the Canadian court.

V. DIP FINANCING

This portion of our submission addresses the proposals respecting debtor-in-possession ("DIP") financing contained in the JTF Report.[11] We endorse its recommendations, except with respect to the ability to obtain DIP financing in the context of the BIA proposal, and the burden of proof on the debtor to establish that DIP financing is appropriate under the BIA and the CCAA.

1. DIP Financing in BIA Proposals

The apparent concerns behind the recommendation that DIP financing not apply in BIA proposals are that: DIP financing should be relatively exceptional; it may result in the wasteful continuation of restructuring proceedings that are doomed to fail; and it can be used abusively. In contrast, we believe that the same factors that lead to the need for DIP financing in a CCAA reorganization also exist in BIA proposals. The question of eligibility for DIP financing should be left to the application of the criteria proposed in the JTF Report to the facts of the particular debtor.[12]

We recommend that the BIA be amended to provide for DIP financing in a way consistent with the amendments to the CCAA proposed in the JTF Report.[13] It may be that, in practice, debtors will be less often successful in obtaining orders for DIP financing under the BIA than under the CCAA. Nevertheless, we would prefer that this determination be made on the basis of each case.

11 *Supra,* note 8.

12 *Ibid.*

13 *Ibid.*

RECOMMENDATION:

The CBA Section recommends that the proposals with respect to DIP financing in the JTF Report be adopted and that DIP financing be available on a consistent basis both in BIA proposals and CCAA reorganizations.

2. Burden of Proof

The granting of DIP financing has a fundamental impact on the interests of the debtor's stakeholders. We believe that it is appropriate to assign the burden of establishing that DIP financing to the debtor.

RECOMMENDATION:

The CBA Section recommends that the debtor be expressly charged with the burden of proof on an application for DIP financing.

VI. INTERIM RECEIVERS

1. Introduction

The increasing use of interim receivers appointed under section 47 of the BIA as a method of conducting what amounts to a liquidation of the debtor's assets to the benefit of secured creditor has caused some national debate. Areas of concern include: the scope of the 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 a court determining the need for such liquidations before judgment. The national experience with such orders varies widely. The more expansive orders are generally granted in Ontario, and to some lesser extent, in Quebec, while a more traditional approach to the interim receiver's function prevails in the Western and Atlantic Provinces.

Prior to the 1992 amendments to the BIA, the interim receiver's role was straightforward and well understood. The interim receiver was a temporary watchdog of the debtor's property, appointed, where necessary, to protect the estate or the interest of the creditors pending the making of a receiving order. This would be done without interfering with the operation of the debtor's business and without the interim receiver being given possession and control over the debtor's property. However, since the 1995 case of *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.*, the role of the interim receiver has been considerably expanded.[14] The interim receivership under the BIA is now regularly utilized in certain jurisdictions to permit the interim receiver to take possession of the debtor's assets, operate the debtor's business and, in many cases, sell those assets and distribute the proceeds to secured creditors before judgment.

As a result, interim receivers have all, or nearly all, of the attributes of a trustee in bankruptcy or a court-appointed receiver (such as stays of proceedings, suspension of contractual rights, environmental immunity, procedural immunity, ability to conduct bulk sales without complying with bulk sales legislation, and national enforcement), without any of the incidental duties and responsibilities that arise in those circumstances.

Typically, the interim receiver is appointed at the behest of a secured creditor, with wide powers. These powers include the ability to take possession and negotiate a sale of all or substantially all of the debtor's assets, while staying proceedings against the debtor or the assets, and preventing third parties from terminating their contracts with the debtor during the stay period. Once a satisfactory offer for the assets has been obtained, often by tender, the receiver applies for court approval of the sale and an order which purports to be enforceable across all provincial Canadian jurisdictions.

14 *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc*., (1995) 27 C.B.R. (3rd) 148 (Ont. Gen. Div.).

It appears that this expanded role has been gradually adopted in certain jurisdictions without significant debate as to its merits. While advantageous to secured creditors, it does not afford the protection to the debtor, to ordinary creditors or to affected third parties, whose rights are much more limited than they would be in a bankruptcy context or in the context of a traditional court-appointed receivership. Consequently, in some recent cases, notably *Re Big Sky Living Inc.*, courts have refused to grant the wide power sought.[15]

2. Jurisdiction of the Court

Section 47 of the BIA allows the appointment of an interim receiver, where it is necessary to protect the property of the debtor or the interest of the secured creditor. Section 47(2)(b) allows an interim receiver to exercise such control over that property and over the debtor's business as the court considers advisable. The BIA then goes on in section 47(2)(c) to state broadly that the interim receiver may be directed to "... take such other action as the court considers advisable". There is, however, no specifically enumerated authority in the BIA for the orders that are frequently granted in the context of an interim receivership. We believe that if the developing role of interim receivers is deemed appropriate, then the jurisdiction of the courts with respect to interim receivers needs to be more
clearly defined, and the BIA needs to provide specific authority to make the orders sought.

RECOMMENDATION:

The CBA Section recommends that the role of the interim receiver be more clearly defined in the BIA, to reflect how the office is being used in practice, to harmonize the application of the provisions across Canada.

15 *Re Big Sky Living Inc.* (2002), 37 C.B.R. (4th) 42 (Alta. Q.B.).

3. Impact on Affected Third Party Rights

Orders appointing interim receivers under section 47(1) of the BIA are typically made on an *ex parte* basis and they provide very little protection to ordinary unsecured creditors and other affected third parties. As matters currently stand, the definition of "receiver" in section 243 of the BIA does not include an interim receiver. As a result:

- Interim receivers are not required to give notice of their appointment to creditors or to prepare and file the reports required to be filed by receivers under Part XI of the BIA.
- Interim receivers are not subject to the statutory obligation to act honestly and in good faith, and to deal with the property of the debtor in a commercially reasonable manner
- The appointment of an interim receiver does not trigger the unpaid supplier's right to repossess goods under section 81.1 of the BIA.

We believe it is essential that if interim receivers are going to play a role analogous to the role played by court-appointed receivers (which includes taking possession and control of the assets of the debtor, and marketing and selling assets), they ought to be subject to the same reporting and other requirements as court-appointed receivers. This can be accomplished by amending the definition of "receiver" in section 243 of the BIA to include interim receivers who have been assigned such powers. As a consequence of this amendment, suppliers' section 81.1 rights would arise when an interim receiver is appointed.

RECOMMENDATION:

The CBA Section recommends that the definition of receiver in section 243 of the BIA be amended to specifically include interim receivers when they operate in a role analogous to that played by court-appointed receivers (such as taking possession and control of the assets of the debtor, or marketing and selling assets).

VII. PERSONAL INSOLVENCY

1. Introduction

This portion of our submission addresses the reform proposals outlined in the Final Report of the Personal Insolvency Task Force (PITF Report).[16] We have cross-referenced this submission to the relevant section of that report. In general, we view the PITF Report as a very useful guide to reform of personal insolvency under the BIA. We urge that its recommendations be acted upon, with the exception of certain issues noted below.

2. Discharge of Student Loans [PITF 2.1]

The CBA Section supports the PITF proposal to ameliorate the current bankruptcy treatment of student loans. While we fully accept the importance of the student loan program and the necessity of preventing abuse of that program, Canadian bankruptcy laws must strive to balance this objective with individual fairness.

When Bill C-36 was introduced in 1998, extending the non-dischargeability period for student loans from two years to ten years, the CBA Section appeared before the Senate Banking Committee to express concern that this treatment was too harsh.

Since 1998, we have been aware of the hopelessness of some former students, whose circumstances demonstrate that they ought to be eligible for a "mercy" hearing. There are instances of young people with disabilities or experiencing marital separation, unforeseen illness or injury, or chronic unemployment. These people are unable to have any consideration of their circumstances for a full ten years after ending their education. In our view, this restriction is not compatible with Canadian values of fairness and equality.

We agree, therefore, with the proposal to reduce the non-dischargeability period to five years. We further agree that the bankrupt ought to have the right to seek a mercy hearing well before the end of that period. Finally, we support clarification of these provisions to allow the mercy hearing to result in a partial or conditional discharge of the student loan.

RECOMMENDATION:

The CBA Section recommends that the ten year non-dischargeability bar for student loan debts be reduced to five years, and that the non-dischargeability of student loans during the five year period be subject to the right of the bankrupt to a "mercy" hearing, with the possibility for partial or unconditional discharges of the student loan debt.

3. RRSP Exemptions in Bankruptcy [PITF 2.2]

With some small variations, we support the PITF Report's proposal regarding RRSP's.

Self-employed individuals and non-pensioned employees often lose their retirement savings upon bankruptcy, whereas pensioned employees do not.

We agree that it is appropriate to impose, as a suitable condition for RRSP exemption, the requirement that the RRSP be locked-in until retirement. We note that according to a 1997 government study, almost two-thirds of all RRSP withdrawals in that year were made by individuals under age 55, namely before retirement age.[17] Of all the withdrawals by people under age 65, 75% were made by people under age 55. These statistics suggest that a significant use of RRSPs is for reasons other than retirement income. A policy that helps to discourage withdrawals prior to retirement would be socially beneficial. More significantly,

16 Final Report of the Personal Insolvency Task Force (2002).

17 Chris D'Iorio, *The Treatment of Retirement Savings in Bankruptcy: Survey and Analysis,* (2000).

there is no policy justification for exempting savings accounts not earmarked for retirement. The concept of a lock-in as a condition of exempt status ties these policy goals together.

We also agree with the concept of an irrebuttable clawback of recent RRSP contributions. In our view, the existing anti-collusion remedies available to creditors or the trustee will not assist in preventing strategic or fraudulent abuse of the exemption. Litigation is too uncertain and expensive a remedy for the dollar amounts involved. We query what test would be imposed to differentiate retirement saving (a public good in itself) from fraudulent pre-bankruptcy conduct. The impracticality of litigation, and the normally modest amount involved, together ensure that the only practical protective remedy is one not based on intention or historical conduct.

The consensus of the CBA Section, however, is that the appropriate clawback period is two years, rather than three years as recommended by the PITF Report. In our view, a two year period is sufficient to accomplish the necessary balance of policy goals, provided, as the PITF recommends, that provincial fraudulent conveyance remedies remain available for contributions outside that period.

We do not believe that the mandatory clawback will result in unfairness. If the debtor has been regularly contributing to his or her RRSP over the years, with a compounding of interest that such contributions entail, then the two year clawback will catch at most a very small percentage of the total value of the RRSP.

If, on the other hand, contributions are only a recent development, one must question why, shortly before an insolvency, the debtor would have commenced such behaviour. Insolvency is hardly ever a sudden thing, nor normally is a judgment in the non-bankruptcy setting. There does not appear to be any good policy reason to provide protection when a debtor voluntarily contributes moneys

into his or her own exempt retirement vehicle at a time that liabilities, or an insolvency, are looming on the horizon. That money ought to have gone, or should now go, to creditors.

We also note an issue regarding financial institutions that have loaned the debtor money to purchase the RRSP. The clawback would ensure that the RRSPs purchased with such loans would be available to creditors generally, with some consequent return to the RRSP lender. It would be unfair for these RRSPs to be exempted outright without recourse by the lender who financed them, even if only to a proportionate share of the proceeds.

We are not convinced that the RRSP exemption should be capped. We do recognize that an unlimited exemption might bring the system into disrepute in the same manner as unlimited residence exemptions have been criticized in some U.S. states. If a cap is implemented, we note that the PITF proposal has the benefits of simplicity, self-adjustment for inflation, responsiveness to the age of the bankrupt and consistency across the country. Such a cap could be adjusted by regulation on a regular basis.

RECOMMENDATION:

The CBA Section recommends that the PITF Report recommendations on the treatment of RRSP exemptions in bankruptcy (PITF Report Section 2.2) be adopted, with a clawback period of two years. Further, the CBA Section recommends that the RRSP exemption not be capped. If capped, the exemption should be adjusted from time to time.

4. Optional Federal Exemptions [PITF 2.3]

We agree with the concept of optional federal exemptions, but without any consensus within the CBA Section as to the specific proposal advanced by the PITF Report. It appears that most provinces now have fairly modern exemption

laws, particularly since Ontario's reforms in 2001. We are concerned about the complexities that will be introduced through the availability of two exemption schemes.

5. Non-Purchase Money Security Interests in Exempt Personal Property [PITF 2.4]

We agree with the PITF recommendation to avoid non-purchase money security interests in exempt personal property. We are aware of the abuses in this area, and the vulnerability of consumer debtors to coercion. This recommendation, if implemented, will significantly remediate the reaffirmation concern noted elsewhere in the PITF report.

We note, for clarity, that this recommendation does not affect security interests in favour of those who sell or finance the purchase of exempt personal assets.

RECOMMENDATION:

The CBA Section recommends that the proposal in the PITF Report section 2.4, relating to the avoidance of non-purchase money security interests in exempt personal property, be adopted.

6. Reaffirmation of Discharged Debts [PITF 2.5]

We support recommendation (a) of the PITF Report, that implied reaffirmation by conduct should be statutorily overruled. Reaffirmation should not occur through unconscious or unknowing acts. The recent jurisprudence outlined in the PITF report does not adequately reflect the rehabilitative goals of the BIA.

However, we object to the balance of the PITF recommendation on reaffirmation. We are unaware of any abuse problem that needs remediation, particularly given other proposals in the PITF report (Sections 2.4 and 3.12). We are concerned about limiting the individual autonomy of Canadians without exploring other less intrusive measures to control the alleged abuse. We have not seen any evidence

that such drastic reform is needed, nor that the proposed solution is the appropriate one.

We concur with the dissent to this PITF recommendation. In our view, there is insufficient benefit, evidence, or justification at this time to warrant regulating voluntary reaffirmations at all.

RECOMMENDATION:

The CBA Section recommends that recommendation (a) of Section 2.5 of the PITF Report be adopted, to statutorily overrule implied reaffirmation by conduct. The CBA Section does not support the regulation of voluntary reaffirmation.

7. International Personal Insolvency [PITF 2.6]

We support the PITF recommendation to create a remedy for cross-border personal insolvency. We believe that the proposal will accomplish the necessary objectives without offending any bankruptcy policy issues.

RECOMMENDATION:

The CBA Section recommends the PITF Report proposal for cross-border personal insolvency in Section 2.6 be adopted.

8. Structural Recommendations [PITF Chapter 3]

We agree with the structural recommendations generally in Section 3 of the PITF Report. In particular, we agree with the technical recommendations in sections 3.8 (Non-arm's length creditor voting rights), 3.10 (Modernizing s.178(1) (d) and 178(1)(e)), 3.11 (Inadvertent discharge of s.178 claims in proposals) and 3.12 (*Ipso facto* clauses in consumer bankruptcies).

We support the PITF recommendation on the treatment of income in Section 3.1. Recent case law has rendered reform necessary, and we see this proposal as a rational and practical solution that reflects the direction of the jurisprudence.

With respect to recommendation 3.2, we agree 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.

However, we wish to address one implication of such enhanced eligibility that has not been otherwise noted. There is no provision in the consumer proposal scheme for payment of legal services rendered to the administrator. Presumably this was to reflect an intention to keep such proceedings simple. At present, when administrators need legal advice in such matters, they must pay for the advice out of their fixed fee, and therefore suffer reduced earnings. This treatment may be acceptable so long as consumer proposals fall below a fixed amount of debt, on the basis that the dollars involved are unlikely to generate complex legal issues. However when the debt ceiling rises, or is eliminated for certain kinds of debt, this assumption no longer holds true. Some 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.

We support the PITF Report's recommendation 3.5 regarding the tax treatment of proposals. Section members have expressed considerable frustration with the problems presented by the discrepant tax treatment of proposals as opposed to bankruptcy, which discrepancy has no apparent foundation in policy. The discrepancy 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.

RECOMMENDATION:

The CBA Section recommends adoption of the recommendations in Section 3 of the PITF Report.

9. Procedural Changes Relevant to Personal Bankruptcies and Consumer Proposals [PITF Chapters 4 and 5]

We support the ongoing effort to streamline the administration of both bankruptcies and proposals and to reduce the administrative costs. We view the recommendations advanced by the PITF report in Sections 4 and 5 as reasonable and appropriate.

We suggest, however, that such streamlining should not make it more difficult for creditors or trustees to discover, challenge or investigate collusive or fraudulent behaviour. While most bankruptcies are legitimate, and most debtors are honest but unfortunate, the procedure must remain sufficiently substantive to catch the small percentage of cases that constitute abuses of the system. If abuses can slip through the cracks too easily, the Canadian public will lose confidence in the bankruptcy system.

For this reason we resist any reduction in the duties of the trustee, or any reorientation of the personal bankruptcy system that might erode the formality or moral weight associated with the act of bankruptcy. We believe that administrative mechanisms are necessary, even if in most individual cases they prove not to be needed. The detection of abuses, and public awareness that there are effective controls that facilitate such detection, are absolutely necessary to ensure public confidence.

We believe that the significant and central role played by the trustee in bankruptcy is one of the key elements in maintaining this public confidence. The checks and balances to which the trustee is subject include the Code of Ethics incorporated into the BIA, the licensing requirements of the Superintendent of Bankruptcy, the discipline process, the review of bankruptcy files by the Superintendents, the role of trustee as officer of the court, and the Bankruptcy Court's supervisory

jurisdiction. In our view, these elements form a structure that adequately manages the inherent conflicts of interest to which the trustee is subject.

RECOMMENDATION:

The CBA Section recommends adoption of the recommendations advanced by the PITF Report in Sections 4 and 5 as reasonable and appropriate.

VIII. SUMMARY OF RECOMMENDATIONS

- The CBA Section recommends the adoption of a Wage Earner Protection Fund whereby each employee would be entitled to receive up to 90 percent of unpaid wages outstanding from one pay period up to a maximum of $2,000. The fund shall be administered and distributed under the Employment Insurance regime and sourced from a levy on employers and employees.
- The CBA Section recommends that, if Parliament wishes to provide protection for contributors of unremitted pension contributions in bankruptcy, it do so as part of the Wage Earners Protection Fund.
- The CBA Section recommends that, in the event Parliament wishes to maintain the unpaid suppliers' right of repossession, then section 81.1 of the BIA should be amended to provide that the right may be exercised by notice on the trustee/receiver within 15 days immediately following the effective date of bankruptcy or receivership for goods delivered during the 30 days immediately preceding the effective date. The balance of the conditions of enforcement contained in section 81.1 should remain.
- The CBA Section recommends that a general standard of independence of insolvency representatives be adopted, requiring that all insolvency administrators be independent.
- The CBA Section recommends that the BIA and the CCAA require that insolvency administrators and the debtor provide full, true and plain disclosure in every material document they issue in an insolvency proceeding.

- The CBA Section recommends that the CCAA be amended to require the preparation and distribution of a creditor list at the commencement of CCAA reorganization, and that the list be distributed to all creditors owed in excess of $10,000 and to any other creditor upon their written request.
- The CBA Section recommends that the restriction against practicing lawyers acting as licensed trustees be removed.
- The CBA Section recommends the adoption of the UNCITRAL Model Law as part of the BIA and/or the CCAA (subject to modifications that may be necessary coordinate the provisions of the Model Law with the BIA and the CCAA). The CBA Section also recommends that the Model Law, as adopted, be modified to ensure that interests of Canadian stakeholders are not prejudiced by the recognition of a foreign proceeding.

  Provisions should be included: (i) requiring that Canadian stakeholders be notified of any proceeding to recognize foreign proceedings; (ii) providing Canadian stakeholders with the opportunity to commence proceedings under the BIA or the CCAA on the basis of the existence of the foreign proceeding; and (iii) providing that the recognition of a foreign proceeding or the granting of an order in connection with a foreign proceeding is a matter of discretion on the part of the Canadian court.
- The CBA Section recommends that the proposals with respect to DIP financing in the JTF Report be adopted and that DIP financing be available on a consistent basis both in BIA proposals and CCAA reorganizations.
- The CBA Section recommends that the debtor be expressly charged with the burden of proof on an application for DIP financing.
- The CBA Section recommends that the role of the interim receiver be more clearly defined in the BIA, to reflect how the office is being used in practise, in order to harmonize the application of the provisions across Canada.
- The CBA Section recommends that the definition of "receiver" in section 243 of the BIA be amended to specifically include interim receivers when they operate in a role analogous to that played by court-appointed receivers (such as taking possession and control of the assets of the debtor, marketing and selling assets, etc).
- The CBA Section recommends that the ten year non-dischargeability bar for student loan debts be reduced to five years, and that the non-dischargeability of student loans during the five year period be subject to the right of the bankrupt to a "mercy" hearing, with the possibility for partial or unconditional discharges of the student loan debt.

- The CBA Section recommends that the PITF Report recommendations on the treatment of RRSP exemptions in bankruptcy (PITF Report Section 2.2) be adopted, with a clawback period of two years. Further, the CBA Section recommends that the RRSP exemption not be capped. If capped, the exemption should be adjusted from time to time.
- The CBA Section recommends that the proposal in the PITF Report section 2.4, relating to the avoidance of non-purchase money security interests in exempt personal property, be adopted.
- The CBA Section recommends that recommendation (a) of Section 2.5 of the PITF Report be adopted, to statutorily overrule implied reaffirmation by conduct. The CBA Section does not support the regulation of voluntary reaffirmation.
- The CBA Section recommends the PITF Report proposal for cross-border personal insolvency in Section 2.6 be adopted.
- The CBA Section recommends adoption of the recommendations in Section 3 of the PITF Report.