THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN
The Voice of the Legal Profession
La voix de la profession juridique

March 2, 2005

Mr. Brent St. Denis, M.P.
Chair
Standing Committee on Industry, Natural Resources,
Science and Technology
House of Commons
Ottawa ON K1A 0A6

Dear Mr. St. Denis:

RE: Bill C-281: *Bankruptcy and Insolvency Act*

I am writing on behalf of the National Bankruptcy and Insolvency Section of the Canadian Bar Association (CBA Section) concerning Bill C-281.[1] 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.

INTRODUCTION

Bill C-281 seeks in part to amend the *Bankruptcy and Insolvency Act* (BIA) to provide workers with a super priority for unpaid wages, severance and unfunded pension liabilities. The CBA Section respectfully submits that the proposed amendments would disrupt and pre-empt the reforms contemplated by the recent Senate review of the BIA, and may not be effective as drafted. We recommend that Parliament not proceed with Bill C-281 but await Industry Canada's comprehensive amendments to the BIA, which should address wage protection and other issues. Section 216 of the BIA mandates Parliament to carry out a five-year review on the administration and operation of the BIA. Initiated by Industry Canada, lengthy consultations were carried out with stakeholders through a process involving in-depth discussion papers and numerous regional forums.

1 *Bankruptcy and Insolvency Act*, *Canada Business Corporations Act*, *Employment Insurance Act* and *Employment Insurance Regulations Amendments.*

500 - 865 Carling, Ottawa, ONTARIO Canada K1S 5S8
Tel/Tél. : (613) 237-2925 Toll free/Sans frais : 1-800-267-8860 Fax/Télécop. : (613) 237-0185
Home Page/Page d'accueil : www.cba.org E-Mail/Courriel : info@cba.org

The culmination of this process was a review by the Standing Senate Committee on Banking, Trade and Commerce (the Senate Committee). In its report,[2] the Senate Committee compiled 53 recommendations including specific protection for unpaid wages. Industry Canada is in the process of responding to the report by preparing draft legislative amendments.

The CBA Section believes that it would be beneficial for unpaid employees to have better protection in insolvency situations. Wage earners are in a particularly vulnerable position — economically dependent upon regular paycheques — and unable to protect themselves adequately when an employer becomes insolvent. The CBA has historically supported prudent legislative initiatives to provide wage protection. However, Bill C-281 fails to accomplish this result and would negatively impact the administration and operation of the bankruptcy regimes in this country.

SPECIFIC CONCERNS

1. Merely enhancing the priority for unpaid wages into a super priority does not put money in the hands of the employee when it is most needed (i.e., immediately upon bankruptcy). For example, if there are no realizations from the insolvent employer's assets (which is possible in small business situations) there is nothing available for distribution to unpaid employees. Furthermore, even if there are assets, the time required to liquidate and administer the bankruptcy will significantly delay distribution to those in need. While an unpaid wages super priority may ultimately be enacted, it must be part of a structured solution that finds a way to put funds in the hands of displaced workers when most needed.

2. The language in Bill C-281 may not be effective in providing the super priority it intends to create. For example, the Bill deals with situations where a bankruptcy trustee realizes on the assets and makes distribution to creditors under BIA section 136. Most realizations are effected either directly by the secured creditor, a receiver or interim receiver appointed outside of bankruptcy and therefore few, if any, assets remain to be distributed as "property of a bankrupt".

3. The language in Bill C-281 may be too broad in scope, for example, trumping fixed mortgage charges on land and seriously disrupting current lending practices, without excluding prescribed security interests. Because this proposed legislation applies to individual as well as corporate employers, it would adversely affect the residential mortgage market. Any mortgagee with a charge over the family home will risk losing its mortgage priority to the wage, termination and pension obligations of the mortgagor's employees. The mortgagee will be unable to assess its risk at the time the mortgage is granted since it cannot prevent the mortgagors from starting up a business in the future.

---

2 "Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and *the Companies Creditors Arrangement Act*" (November 2003).

4. The proposed amendments potentially impact family law orders or agreements, as the proposed super priority would supersede the existing priority granted for spousal support arrears under BIA. Potentially any security which may have been provided to the spouse of a bankruptcy for support, including security granted under court orders perhaps even many granted in years past. This would allow opportunities for unscrupulous or malicious spouses to defeat their spouses' matrimonial claims. The family will be harmed in other ways. Since the new priority trumps the mortgage over the bankrupt's matrimonial home, the non-bankrupt spouse's half of the matrimonial home would have to bear the full brunt of that mortgage. For example, if the jointly owned house is worth $200,000 and is subject to a $120,000 mortgage, the bankrupt's half of the property (worth $100,000) would go to the new super priority, leaving the spouse's half (worth $100,000) to bear the burden of a $120,000 mortgage). This would result in the spouse losing all his or her equity and owing another $20,000. This may lead to the spouse's own insolvency. The potential impact on the family is very serious.

5. For "proposals" under the BIA, Bill C-281 may negatively affect the ability of companies in financial difficulty to restructure. In particular, the proposed amendment to section 60 (1.3)(a) would require the employer, as a condition to making a proposal, to provide for payment of wages due on termination or severance as well as unfunded pension liabilities — even though the employer may be endeavouring to continue to operate and provide continued employment.

6. The experience with the administration and enforcement of the existing super priority afforded to Canada Revenue Agency (CRA) for unremitted source deductions has been harshly criticized by stakeholders to be a disruptive remedy, causing uncertainty, delay, inefficiency and increased costs.

7. Recognition and enforcement of statutory super priorities has a long and unsatisfactory history of litigation. The Supreme Court of Canada has identified that "[i]t has been unfortunate that the development of the case law, to this point, has not inspired the degree of certainty which is so manifestly desirable in this area of commercial law."[3] Gauthier J. also noted that Professor Wood summarized "the general view" when he wrote: "[i]t is somewhat of an embarrassment that after more than two decades we still cannot confidently predict the outcome of a priority dispute between a deemed trust and a security interest".[4] Moreover recent case law has eroded the purported priority, insofar as leases, conditional sales contracts and factoring arrangements are concerned. Accordingly, considerable care and skill must be taken in drafting the proposed amendments to ensure the objectives are accomplished with a minimum of interference.

---

3 Per Gonthier J., in dissent, in *Royal Bank v Sparrow Electric Corp.* (1997) 44 CBR (3d) 1 at 20 (SCC).

4 "Revenue Canada's Deemed Trust Extends Its Tentacles: *Royal Bank v Sparrow Electric Corp.*" (1995), 10 *B.F.L.R.* 429 at 430.

CREATION OF A WAGE PROTECTION FUND

The desirability and method of providing adequate wage protection has been canvassed by Parliament on numerous previous occasions. More recently, the Coulter Report (1986) the Advisory Committee on Adjustment (1989) and Bill C-22 (1991) involved thorough parliamentary investigations as to the best means with which to remedy this problem. All concluded that the creation of a wage protection fund, rather than a super priority, was the fair and effective solution. Unlike a super priority imposed by statutory lien, a wage fund provides direct and immediate compensation to employees of a bankrupt company when most needed (i.e., upon bankruptcy). Although the wage fund provisions were removed from Bill C-22 in 1992, it was on the understanding and intention that the matter would ultimately be referred to a special joint committee of the Senate and House of Commons for reconsideration.

CONCLUSION

The Senate Committee made specific recommendations on wages and pensions. Various stakeholders including the CBA are reviewing these. Industry Canada is in the process of drafting amendments to the BIA, which should provide adequate protection for wage earners in a fashion consistent with the efficient administration of the bankruptcy regime.

The CBA Section recommends that Parliament not proceed with Bill C-281 but await Industry Canada's proposed amendments to the BIA to address wage protection and other issues.

Yours truly,

(*Original signed by Trevor Rajah on behalf of Deborah Grieve*)

Deborah Grieve
Chair,
National Bankruptcy and Insolvency Section

cc: Pat Martin, M.P.
cc: James Rajotte, M.P., Industry Critic, Conservative Party
cc: Paul Crête, M.P., Industry Critic, Bloc Québécois
cc: Brian Masse, M.P., Industry Critic, New Democratic Party
cc: Louise M. Thibault, Clerk, Standing Committee on Industry, Natural Resources, Science and Technology