# Insolvency Law Reform: Submission to Industry Canada

NATIONAL BANKRUPTCY AND INSOLVENCY SECTION
CANADIAN BAR ASSOCIATION

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## Insolvency Law Reform: Submission to Industry Canada

# 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 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 Section of the Canadian Bar Association.

# Insolvency Law Reform:
# Submission to Industry Canada

## I. EXECUTIVE SUMMARY

The National Bankruptcy and Insolvency Section of the Canadian Bar Association (the CBA Section) is pleased to present this submission in response to the report of the Senate Standing Committee on Banking, Trade and Commerce (the Senate Committee) on its mandated five-year review of the *Bankruptcy and Insolvency Act* (the BIA) and the *Companies' Creditors Arrangement Act* (the CCAA).[1]

### A. Commercial Insolvency Summary

**Compensation Protection: Wages and Pensions:** The CBA Section opposes the creation of a super-priority for wage claims. Our Section recommends the adoption of a wage earner protection fund administered under the present employment insurance regime. The fund's mandate would be to pay up to 90 percent of unpaid wages outstanding from the pay period (up to a maximum of $2,000) immediately following an employer's bankruptcy. The fund could be sourced from a levy on employers and employees.

We believe that the BIA should not be amended to alter the treatment of pension claims.

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1 Report of the Standing Senate Committee on Banking, Trade and Commerce: "Debtors and Creditors: Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*".

**Unpaid Suppliers Rights:** The CBA Section is concerned that unpaid suppliers may be subject to a practice known as "juicing the trades", wherein a failing business substantially increases its stock of inventory shortly before bankruptcy/receivership in an effort to increase recovery by the secured creditors and thereby minimize the guarantors' exposure for a shortfall at the expense of the trade suppliers. We recommend that consideration be given to inserting provisions in the BIA that will provide unpaid suppliers with some protection against wrongful actions by the directors and officers of insolvent companies on the eve of bankruptcy or receivership.

**UNCITRAL Model Law on Cross-Border Insolvencies:** The CBA Section recommends that Canada adopt the UNCITRAL Model Law of Cross-Border Insolvency (Model Law). The CBA Section does not, however, believe that the Model Law as adopted by Canada should include a reciprocity provision or provisions that would require the creation of a Canadian creditors' committee. Instead, the Model Law as adopted be modified to ensure that the interests of Canadian stakeholders are not prejudiced by the commencement of a foreign proceeding and, in particular should: (a) require that Canadian stakeholders be notified of any proceeding to recognize a foreign representative or foreign proceeding and be provided with the opportunity to commence proceedings under the BIA or the CCAA; and (b) ensure that the fact that the debtor may not have to admit insolvency in the foreign proceeding does not present a barrier to the commencement of proceedings under the BIA and the CCAA.

**Executory Contracts:** The CBA Section supports amendment to the BIA to permit: (a) the disclaimer of executory contracts in existence on the date of the commencement of the proceedings; and (b) permit debtors, trustees, court-appointed receivers and monitors, if authorized by judgment, to assign executory contracts.

Our Section has a number of specific procedural and substantive recommendations with respect to how these recommendations should be implemented.

**Directors Liability:** The CBA Section supports any initiative to encourage directors to see an insolvent company through a reorganization. We believe, however, that the due diligence defence proposed by the Senate Committee is overly broad, and raises a number of significant policy and constitutional issues that may result in the proposed amendment being unworkable. Our Section recommends that any directors' liability defences added to the BIA and the CCAA be: (a) limited to reorganizations; and (b) limited to debts of the corporation for which the directors are made secondarily liable.

**Transfers at Undervalue and Preferences:** The CBA Section recommends:

- The CCAA be amended to include the same avoidance provisions as are contained in the BIA. Under the CCAA, the reference date for attacking transactions would be the date of the initial order.
- Provisions be included in the BIA and the CCAA to allow for a remedy in the BIA where a debtor disposes of property to hinder, delay or defeat his creditors, with a *prima facie* presumption of debtor's main intent when debtor was rendered insolvent by transaction.
- The trustee or monitor should continue to be permitted to use provincial or territorial laws to challenge transactions and that the BIA and the CCAA provide that all proceeds from attacks be paid into court and the court shall have the discretion to make a decision as to the entitlement to the funds.
- The expansion of the definition of a "related person" for the purposes of the avoidance provision of the BIA and the CCAA to include parties who have not dealt with the debtor at arms' length in the one-year period prior to the date of the transaction and that the length of look-back period for attacking preferences be extended to one year if the transaction was with a related person.
- The BIA be amended to restore the ability of the trustee to attack transactions using a summary procedure. The ultimate decision of establishing that the transaction ought to be avoided or a remedy provided should, however, remain that of the trustee.

- That the court ought to have the ability to fashion an appropriate remedy such as the ability to make orders awarding damages, requiring a re-conveyance of the asset, directing a sale of the asset, etc.

**Debtor-in-Possession Financing (DIP):** On an initial application for DIP financing, the CBA Section recommends that the BIA and the CCAA provide that the debtor be required to: (a) give at least 24 hours' notice to secured creditors who will find their security interests subordinated as a result of the granting of priority to the new borrowing by the debtor; and (b) provide a 120-day cash flow projection with a favourable opinion from the monitor or trustee with respect to the reasonableness of the cash flow and the assumptions upon which it is based.

The CBA Section recommends that the DIP financing the court is permitted to authorize on an initial application be restricted to an initial period of thirty days and be tied to the cash flow projections filed by the debtor.

The CBA Section is of the view that during the term of the DIP financing, the monitor or trustee ought to be required to closely monitor the cash flow and report to the court if there are any material adverse deviations from the cash flow projections filed with the court. The consequence of such a deviation would be the subject of a further mandated proceeding to determine the appropriateness of continuing to permit new advances under the DIP facilities.

***Companies' Creditors Arrangement Act* (CCAA):** The CBA Section believes that there is some value to maintaining the CCAA as a distinct statute to preserve this flexibility, but that amendments should be made to the CCAA with a view to adding some structure to the CCAA process.

We recommend that: (a) a debtor be able to obtain a limited stay of proceedings for a period not to exceed thirty days by making an administrative filing; (b) notice of the commencement of a CCAA reorganization be available on a searchable database; and (c) the debtor should be required to prepare a list of creditors and this list should be available to all creditors.

The CBA Section recommends that the CCAA be amended to provide for a claims procedure. The claims procedure ought to establish: (a) how and when claims against the debtor company must be proven for voting purposes and for distribution purposes; (b) who is responsible for reviewing and determining the validity of claims filed against the debtor; and (c) the procedure for disputing decisions made with respect to whether a claim is provable and the quantum of that claim. The procedure should also provide for a bar date after which stakeholders are prohibited from filing proofs of claim.

Our Section also submits that the CCAA include established procedures for the calling and the conducting of meetings of creditors. The court ought to be able to vary the procedure on the application of the debtor.

**Scope of the Stay of Proceedings:** The CBA Section is of the view that a stay of proceedings imposed in the context of BIA and CCAA reorganizations ought not to impact the "health, safety and security" jurisdiction of regulators save and except for the enforcement of monetary penalties. If the debtor wishes to stay a regulator from exercising its "health, safety and security" jurisdiction, it should be obligated to establish to the court that: (a) the requested stay is essential to the success of the reorganization; and (b) the requested stay will not give rise to health, safety or security concerns, and the stay should be limited to what is necessary in the circumstances to permit the debtor to reorganize.

We believe that the stay of proceedings in a reorganization should not have the effect of inhibiting securities regulators from performing their duties and taking action against a debtor company when appropriate.

**Role of Monitors or Trustees:** The CBA Section recommends that: (a) the CCAA be amended to clarify that the monitor owes its obligations to creditors generally and unsecured creditors in particular; (b) debtors be required to make full true and plain disclosure whenever they communicate with creditors or file information with the court; and (c) the CCAA require that in connection with putting forth a plan of compromise or arrangement, the debtor (whether or not it is a public company) make readily available to all creditors an information package that meets with the standards required for an Information Circular under the provincial securities legislation.

**Going Concern Sales:** The CBA Section recommends that the BIA and the CCAA be amended to permit the debtor, subject to prior approval of the court, to sell part or all of its assets out of the ordinary course of business, during reorganization and without complying with bulk sales legislation. Similarly, the debtor should be permitted to sell all or substantially all of its assets on a going concern basis. We further recommend, however, that the BIA and the CCAA require that the debtor provide all stakeholders with an interest in the assets being sold, and whose interests are being vested out, with reasonable notice of the proposed sale. All interests in the property sold should vest in the proceeds. The monitor or trustee be required to deliver a report with respect to the proposed sale.

**Interim Receivers:** The CBA Section was unable to come to a consensus with respect to the proper role of interim receivers appointed under the BIA. Our Section does, however, agree that if the scope of interim receiverships is not limited to preserving and protecting the debtor's estate or assets subject to a secured creditor's security, then the definition of "receiver" in Part XI of the BIA ought to be amended so to include interim receivers.

***Winding-Up and Restructuring Act (WRA)*****:** The CBA Section believes that the application of the WRA should be restricted and that the provisions of the WRA should be consistent with the BIA and the CCAA and be reviewed regularly to ensure that it is effective and efficient.

**Securities' Firm Bankruptcies:** The CBA Section recommends the amendment of Part XII of the BIA to clarify the status of cash in the accounts of bankrupt securities firms; and the applicability of Part XII of the Act to electronic transactions, but does not support any amendment to the definition of "net equity". The definition of "net equity" clearly states that it is to be determined as at the date of bankruptcy, and we do not see any reason to amend the definition.

## B. Personal Insolvency Summary

The CBA Section supports the Senate Committee's recommendations in the personal insolvency area, subject to the following specifics which are elaborated in our submission:

**Optional Federal Exemptions:** The CBA Section is in qualified agreement with the Senate Committee recommendation, subject to concerns regarding the complexities this proposal will introduce.

**RRSP Exemption:** The CBA Section supports the Senate Committee recommendation, save that we propose a 2-year, rather than the Senate's 1-year, automatic clawback; and we are in qualified agreement with a cap on the exemption.

**RESP Exemption:** The CBA Section supports the Senate Committee recommendation, save that we propose a 2-year, rather than the Senate Committee's 1-year, automatic clawback.

**Reaffirmation agreements:** The CBA Section strongly opposes the proposed regulation and criminalization of reaffirmation agreements, for which insufficient benefit, evidence or justification has been demonstrated.

**Streamlining Summary Administration:** The CBA Section supports this general recommendation, subject to our concern that the moral gravity of bankruptcy, and the role of effective anti-abuse mechanisms, not be overlooked.

**Non-Purchase Money Security Interests in Exempt Property:** The CBA Section supports this Senate Committee recommendation, subject to policy concern over the inclusion of motor vehicles in this category, and technical concern over the effect of this proposal on farm lending practice in some Western provinces under the *Bank Act*.

**Student Loans:** The CBA Section strongly supports the Senate Committee's recommendation, as in our view the current provisions are incompatible with Canadian values of fairness and equality.

**Definition of Consumer Debtor:** The CBA Section agrees with the proposed increased debt ceiling for consumer proposals, subject to our concern that the enhanced availability of consumer proposals should be accompanied by a provision entitling the administrator to obtain, and pay for, legal advice if necessary.

**Non-Arm's Length Creditor Voting Rights:** The CBA Section agrees with the Senate Committee recommendation, save that the 40% requirement be eliminated. There is no need for a 40%, or any, threshhold.

In all other respects, the CBA Section unqualifiedly supports the Senate Committee recommendations.

# II. INTRODUCTION

The National Bankruptcy and Insolvency Section of the Canadian Bar Association (the CBA Section) is pleased to present this submission in response to the report of the Senate Standing Committee on Banking, Trade and Commerce (the Senate Committee) on its mandated five-year review of the *Bankruptcy and Insolvency Act* (the BIA) and the *Companies' Creditors Arrangement Act* (the CCAA).[2]

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 CBA Section Executive in all parts of Canada that builds on our past submissions on bankruptcy and insolvency reform.

# III. COMMERCIAL INSOLVENCY

## 1. Compensation Protection: Wages and Pensions

**SENATE COMMITTEE RECOMMENDATIONS**

### A. Wage Claims

**The *Bankruptcy and Insolvency Act* be amended to provide that unpaid claims for wages and vacation pay arising as a result of an employer's bankruptcy be payable to an amount not to exceed the lesser of $2,000.00 or one pay period per employee claim. The funding of these claims should be assured by creating a super priority over secured claims to inventory and accounts**

2 Report of the Standing Senate Committee on Banking, Trade and Commerce: "Debtors and Creditors: Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*".

**receivable. The secured creditor or creditors should be able to assume the rights of the employees as against the director.**

### B. Pension Claims

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

## CBA SECTION RESPONSE

### A. Wage Claims

The CBA Section submits that the creation of a super-priority for wages and vacation pay is not a fair or efficient means of protecting employees in the event of a bankruptcy. The reasoning behind the CBA Section's opposition to the creation of a super-priority for wage claims is:

1. Unless an effective means for enforcing and administering the super-priority claim is included as part of the amendment, it is unlikely to provide the desired protection to employees. Until there are realizations from the insolvent employer's 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 i.e., immediately upon the bankruptcy.
2. Stakeholders have harshly criticized the experience with the administration and enforcement of the existing super-priorities afforded to the Canada Revenue Agency (CRA) for unremitted source deductions as being an ineffective remedy. Moreover, recent jurisprudence has eroded the purported priority when it comes to leases, conditional sales contracts and factoring arrangements.
3. Recognition and enforcement of super-priorities has a long and unsatisfactory judicial history. The Supreme Court of Canada has

identified the jurisprudence in this area to be an "embarrassment" and an "unfortunate area of the law".[3]

4. A super-priority for wage claims places the entire burden of those claims on creditors (particularly secured creditors) instead of spreading the risk among the interested stakeholders, and, in particular, employers and employees.

The CBA Section recommends the adoption of a wage earner protection fund administered under the present employment insurance regime. The fund's mandate would be to pay up to 90 percent of unpaid wages outstanding from the pay period (up to a maximum of $2,000) immediately following an employer's bankruptcy. The fund could be sourced from a levy on employers and employees. The merits of a wage earner protection fund, particularly when it comes to the speed and efficiency in directing payment to unpaid employees has been recognized repeatedly by previous Parliamentary committees including the Landry Committee (1981), the Coulter Committee (1986) and the Advisory Council on Adjustment.

When it was originally introduced in 1991, Bill C-22 proposed a wage earner protection program pursuant to the *Wage Claim Payment Act* to be financed by a payroll tax of 0.024 percent of an employee's weekly insurable earnings on all employers. This would have provided direct and immediate compensation to employees of companies that became bankrupt, liquidated or placed in receivership. This was removed from the Bill with the intention that it be referred to a special joint committee of the Senate and the House of Commons for reconsideration. This special joint committee was, however, not established.

It is the CBA Section's position that before any steps be taken to legislate the super-priority recommended by the Senate Committee, Parliament complete the

3 *Royal Bank v. Sparrow Electric Corp.* (1997) 44 CBR (3d) 1 at 20 (SCC).

reconsideration by referring the matter to the special joint committee in order to properly assess the effectiveness of such a wage fund.

Alternatively, if it is determined that a super-priority is to be enacted, the CBA Section believes that the amendments must include some mechanism to ensure not only prompt and efficient payment to the unpaid employees but also an effective means for enforcement of the super-priority claim which would not unduly prejudice the interests of the stakeholders. For example, the unpaid employees should be entitled to be paid by Employment Insurance immediately upon bankruptcy whereupon their individual rights would be subrogated to Employment Insurance. Employment Insurance could then administer and enforce the super-priority within the bankruptcy. It should be clear that:

- the administrator has the right to take the steps traditionally available to secured creditors to enforce their rights; and
- any enforcement costs incurred by the administrator could be added to the super-priority claim.

### B. Pension Claims

The CBA Section agrees with the Senate Committee's recommendation that the BIA not be amended to alter the treatment of pension claims.

## 2. Unpaid Suppliers Rights

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

The CBA Section did not take a strong position with respect to section 81.1 of the BIA in our submissions to the Senate Committee. The CBA Section is, however, concerned that unpaid suppliers may be subject to a practice known as "juicing the trades", wherein a failing business substantially increases its stock of inventory shortly before bankruptcy or receivership in an effort to increase recovery by the secured creditors and thereby minimize the guarantors' exposure for a shortfall at the expense of the trade suppliers.

There is some issue as to whether unpaid suppliers currently have access to effective remedies against the directors of insolvent companies who engage in trading practices that are injurious to suppliers on the eve of bankruptcy or receivership. In the absence of such remedies, there is nothing to deter the directors of insolvent companies from engaging in practices that are detrimental to the interests of unpaid suppliers, such as ordering goods for which the company will not be able to pay.

The CBA Section recommends that consideration be given to inserting provisions in the BIA to give unpaid suppliers some protection against wrongful actions by the directors and officers of insolvent companies on the eve of bankruptcy or receivership. Care must be taken in the wording of the remedy to prevent a possible chilling effect on reorganizations of insolvent companies if directors and officers can be held liable for their actions during the reorganization period.

## 3. UNCITRAL Model Law on Cross-Border Insolvencies

### SENATE COMMITTEE RECOMMENDATION

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

## CBA SECTION RESPONSE

The CBA Section concurs with the Senate's recommendation that Canada adopt the UNCITRAL Model Law of Cross-Border Insolvency (Model Law). The CBA Section does not, however, believe that the Model Law as adopted by Canada should include a reciprocity provision that would require the creation of a Canadian creditors' committee.

The recognition in Canada of a foreign insolvency proceeding is beneficial to the interests of the debtor's Canadian stakeholders insofar as it provides stability and a level playing field for stakeholders. In the absence of recognition, assets of the foreign debtor located in Canada may be subject to seizure by creditors not subject to the foreign proceeding. This may have an adverse impact on the recoveries for other stakeholders who are, for jurisdictional reasons, subject to the foreign insolvency law or bound by order made in the foreign insolvency proceeding.

The CBA Section appreciates that the recognition of foreign insolvency proceedings should not result in unfair prejudice to Canadian stakeholders.However, in the view of the CBA Section, the adoption of reciprocity as a condition for recognition of foreign insolvency proceedings would represent a major step backwards for cross-border insolvency in Canada. The inclusion of such provisions may also prevent foreign insolvency proceedings from being recognized in Canada. This will be detrimental to the interests of Canadian stakeholders.

Canadian courts have never required reciprocity as a condition to the recognition of foreign insolvency proceedings. When determining whether to extend recognition to a foreign insolvency proceedings, the courts in Canada have tended to focus on the connection between the debtor and the jurisdiction in which the insolvency proceeding was commenced and have not considered whether the foreign jurisdiction would recognize a Canadian insolvency proceeding.

The Supreme Court of Canada has found that the impact on a Canadian stakeholder of recognizing a foreign insolvency order when compared to that stakeholder's rights under Canadian law is something that Canadian courts should consider when deciding whether to enforce that order. However, the Canadian courts have never required that special treatment be afforded to Canadian creditors in the foreign insolvency proceeding.

It is also important to note that creditors' committees are not a typical part of the Canadian domestic insolvency regime. While the courts have exercised their jurisdiction in a few instances to provide for creditors' committees in large CCAA restructurings, the BIA and the CCAA do not provide for creditors' committees.

In *Holt Cargo Systems v. ABC Containerline N.V. (Trustees of),*[4] the Supreme Court of Canada had the opportunity to consider the preferred approach in an insolvency involving multiple jurisdictions. In that case, the Supreme Court of Canada sanctioned what it referred to as the more pragmatic "plurality" approach. This approach is described by the Supreme Court of Canada (quoting from the leading Canadian conflict of laws text)[5] as follows:

> "[E]ach country has the right, if it deems it advisable, to allow bankruptcy proceedings to begin in its territory by virtue of its bankruptcy law. The court applies its own substantive law. Thus, bankruptcies may be initiated in a number of countries with respect to the same debtor. In Canada, this rigid doctrine is partially tempered by close cooperation with foreign courts."[6]

The CBA Section believes that Model Law reflects the pluralist approach endorsed by the Supreme Court of Canada. While the Model Law mandates recognition of foreign insolvency proceedings, the remedies provided in Canada must be consistent with Canadian insolvency law and any insolvency proceedings commenced in Canada would, under the Model Law, take precedence over any foreign proceedings with respect to assets in Canada.

4 [2001] 3 S.C.R. 907.

5 Castel, J.-G. *Canadian Conflict of Laws*, 4th ed. Toronto: Butterworths, 1997.

6 *Supra* note 5, at 554-55.

The Model Law begins with the assumption that, subject to public policy in Canada, foreign insolvency proceedings ought to be recognized. Provided that the foreign representative can establish that the proceeding is a "foreign proceeding" and is the foreign representative appointed in that foreign proceeding, the Canadian court would be required to recognize the foreign proceeding, unless the effect of recognition would be "manifestly contrary to public policy". In this respect, a foreign proceeding is essentially a court-supervised judicial or administrative proceeding under a law relating to insolvency for the purpose of reorganization or liquidation.

Once a foreign proceeding has been recognized, the Canadian court would determine if it is a “foreign main proceeding” or a “foreign non-main proceeding”. A foreign main proceeding is a proceeding commenced in a jurisdiction where the debtor has the centre of its main interest. A foreign non-main proceeding is a proceeding commenced in a jurisdiction where the debtor has an establishment.

Where a proceeding is recognized as a foreign main proceeding, subject to there already being a plenary proceeding pending in Canada under the BIA or the CCAA, a stay would automatically arise which would prevent:

- commencement or continuation of proceedings against the debtor;
- execution against the debtor's assets; and
- transfer, encumbering or disposition of assets by the debtor.

The automatic stay that arises upon the recognition of a foreign main proceeding would, however, be subject to the BIA and the CCAA. The Canadian court would not be recognizing a foreign stay but imposing an automatic domestic stay under the BIA or the CCAA in aid of the foreign stay.

In addition to the automatic stay that arises when a foreign proceeding is recognized as a foreign main proceeding, the Model Law provides for various forms of relief to be provided at the request of the foreign representative in connection with a foreign main proceeding or a foreign non-main proceeding. This relief, which would be provided at the discretion of the Canadian courts, includes:

- staying the proceedings (foreign non-main proceedings);
- examination of witnesses; and
- turning over assets to be administered by the foreign representative.

All of the relief that may be provided under Article 21 of the Model Law is consistent with what is currently available under Part XIII of the BIA, except turning over assets to be administered by the foreign representative. Under the Model Law, all foreign representatives would have standing to commence avoidance actions under defined Canadian statutes and the right to intervene in proceedings in which the debtor is a party.

The Model Law would require Canadian courts to co-operate in the administration of cross-border insolvency proceedings. However, the Model Law makes it clear that the relief granted in Canada in connection with any foreign proceeding is subject to the discretion of the Canadian court and does not require the Canadian court to make orders that would violate public policy in Canada. Moreover, the Model Law would preserve the ability to commence proceedings under the BIA or the CCAA. Those proceedings would trump any foreign proceeding recognized by the Canadian courts.

The Model Law is very explicit in terms of the protection of the interests of Canadian stakeholders. In exercising its discretion to provide relief in connection with a foreign proceeding, the Canadian court would have to be satisfied that the interests of Canadian stakeholders were adequately protected. Moreover, the relief could be granted subject to conditions the court considered appropriate and be modified or terminated at the request of any interested person. The Model Law would also require that foreign representatives keep the Canadian court advised of significant developments in the cross-border insolvency and permit the courts to vary or terminate the relief they provide at their own initiative.

The Model Law is consistent with the pluralist approach endorsed by the Supreme Court of Canada and, arguably, embodied in Part XIII of the BIA and section 18.6 of the CCAA. The Model Law would, for the most part, not restrict the ability to commence plenary proceedings under the BIA or the CCAA. The Model Law is explicit that the relief to be provided in connection with a foreign main proceeding would not prevent the commencement of proceedings under the BIA or the CCAA. It is also significant that the "automatic" stay does not prevent creditors from taking action to preserve claims against the debtor. Concerning coordination of proceedings, any proceeding commenced under the BIA or the CCAA in respect of the debtor would trump foreign proceedings notwithstanding whether the proceedings were foreign main or non-main proceedings.

The Model Law would specifically provide that where a proceeding was already pending in Canada when a proceeding to recognize a foreign proceeding commenced and the foreign proceeding was recognized as a foreign non-main proceeding, the "automatic stay" would not operate. If the BIA or CCAA proceeding were commenced after the recognition of the foreign main proceeding, the Model Law would mandate that the "automatic stay" be modified or terminated if it was inconsistent with the BIA or CCAA proceedings. However, after a foreign main proceeding had been recognized, the Model Law would only permit the initiation of what would amount to a purely domestic proceeding and only if the debtor had assets in Canada. This would represent a restriction on both the criteria for commencing proceedings and the scope of those proceedings. Currently, both the BIA and the CCAA permit proceedings on the basis of conduct of business as well as the presence of assets in Canada and do not restrict the BIA or CCAA proceedings to dealing with assets in Canada. It is, however, important to appreciate that the restriction imposed by the Model Law arises only where the Canadian courts have recognized a foreign proceeding as taking place in the centre of the debtor's main business interest. Moreover, the practical impact of the restriction is unclear – it would only create a problem in the event that the debtor carried on business in Canada without having any assets in Canada. If the Model Law is adopted, it should be clear that if there is an establishment in Canada then local proceedings can be commenced even if there is a foreign main proceeding already recognized.

The CBA Section recommends that the Model Law be adopted, but modified to ensure that the interests of Canadian stakeholders are not prejudiced by the commencement of a foreign proceeding. Provisions ought to be included to:

- require that Canadian stakeholders be notified of any proceeding to recognize a foreign representative or foreign proceeding and be provided with the opportunity to commence proceedings under the BIA or the CCAA; and
- ensure that the fact that the debtor may not have to admit insolvency in the foreign proceeding does not present a barrier to the commencement of proceedings under the BIA and the CCAA.

## 4. Executory Contracts

**SENATE COMMITTEE RECOMMENDATIONS**

### A. Disclaimer

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

**negotiations have been carried on, in good faith, for relief of too onerous aspects of the collective agreement and should establish in Court that the disclaimer is necessary in order to allow for a viable restructuring.**

### B. Assignment

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

## CBA SECTION RESPONSE

### A. Disclaimer

#### (i) Availability in a Liquidation

Any provisions of the BIA permitting the debtor to disclaim executory contracts should apply to bankruptcy trustees and court-appointed receivers. This would codify existing law rather than expand it.

#### (ii) The Test

The test applicable to disclaimers should be expanded to include "impairment of liquidation value" as well as "inability or serious hardship in restructuring the enterprise".

#### (iii) Protection for Licensees

Where the executory contract being disclaimed is a license (or other right to use intellectual property), the disclaimer may have a serious detrimental effect on the ability of the licensee to carry on its business. The BIA and the CCAA should recognize this and should permit the licensee to continue to use the licensed intellectual property (subject to the payment of royalties and without service support or other rights granted by the license) provided that it can establish that the disclaimer of the license will have serious detrimental effects on its ability to continue to carry on business. This issue could also be addressed by providing that a co-party can object to the disclaimer on the basis that the disclaimer would unreasonably impair its ability to carry on business.

### (iv) Rights/Obligations of Other Parties

It should be clear that the disclaimer of an executory contract does not affect the obligations of any other parties to the contract.

### (v) The Process

In order to streamline the process for disclaiming executory contracts (other than collective agreements) in reorganization, the debtor should be able to provide notice to the contract party of its intention to disclaim. The co-party should, within a defined time (15 days) be able to apply to the court for a determination as to whether the disclaimer of the contract meets the standard imposed. The debtor should bear the burden of establishing that the disclaimer of the contract meets the standard imposed.

A particular issue arises in the case of bankruptcy or receivership. In reorganization, the debtor is required to continue to make payments due under executory contracts from the date of the commencement of the reorganization. In the case of bankruptcy or receivership, however, the trustee has the option of either adopting and performing the executory contract or disclaiming it. There is, however, no prescribed time period within which the trustee/receiver must exercise its election. As a result, the co-party can be left in the position of not knowing whether its executory contract will be assumed or disclaimed.

In the case of a bankruptcy or court-appointed receivership, all executory contracts should be deemed to be disclaimed 90 days after the commencement of the proceeding (unless a longer or shorter period is otherwise ordered by the court) if the trustee or receiver does not deliver a notice to the other party to the contract electing to perform under the contract.

## B. Assignment

### (i) The Test

The requirement that the proposed assignee be as credit worthy as the existing co-party is likely to be difficult to apply and may be too narrow a test. The fundamental issue is, arguably, whether there are any reasonable grounds for the co-party to reject the proposed assignee aside from issues arising between the debtor and the co-party as a result of the debtor's financial situation. A proposed assignee may be capable of performing the financial obligations under the contract, but there may be other legitimate reasons for the co-party to object to the assignment. The test ought to be whether:

- the proposed assignee will be able to perform its obligations under the contract (this would include credit worthiness); and
- there are any other reasons that would make the proposed assignee an inappropriate party to assume the contract.

### (ii) The Process

In order to assign an executory contract over the objection of the co-party, the debtor ought to be required to apply to the court, on notice to the co-party, seeking an order authorizing the assignment.

### (iii) Requirement to Cure

It is not clear that it is appropriate to require that monetary defaults under an executory contract be cured as a condition to forcing the assignment. All amounts owing up to the date of the initiation of the insolvency proceedings are provable in the insolvency proceeding. Depending on the terms of the contracts, these amounts may be secured or unsecured. Curing monetary defaults may amount to a preference to the co-party.

In the limited number of cases dealing with the assignment of executory contracts in insolvency proceedings, the court has not required that the assignor or the proposed assignee cure defaults under the assigned contracts as a condition to forcing the assignment. Moreover, subsection 83(2) of the BIA – which contemplates that a trustee may assign an interest in a copyright granted to the bankrupt without the consent of the owner – does not require that the trustee or the proposed assignee cure monetary defaults as a condition to assignment. The requirement to cure does arise in cases where commercial leases are assigned. However, the requirement to cure in those situations is not created by the BIA. It is provincial or territorial landlord and tenant legislation that imposes the requirement to cure.

If the requirement to cure is included:

1. It should be restricted to liquidated amounts owing by the debtor to the co-party. To require unliquidated amounts to be paid would put an unwarranted chill on the ability of debtors and trustees/receivers to assign contracts. Any claim for unliquidated damages would be provable in the insolvency proceeding.

2. The obligation to cure should be that of the debtor, not the proposed assignee. Requiring that the proposed assignee deal with this issue directly with the co-party outside of the insolvency proceeding is likely to be a disincentive to assignment and is likely to have a cooling effect on the price that a proposed assignee is willing to pay for the assignment.

3. A process must be put in place to allow the cure amount to be determined in an efficient manner. The debtor should be required to establish the cure amount proposed to be paid and the co-party should then have an opportunity to object.

### (iv) Role of the Monitor or Proposal Trustee

In reorganization proceedings the debtor generally remains in possession of its assets and in control of its business. Unless the role of the monitor or proposal trustee is enhanced by the court, the monitor or proposal trustee has no direct role in the management of the reorganizing debtor's business. While the monitor or proposal trustee might, as an officer of the court, have a role to play should a disclaimer or assignment of an agreement by a debtor become controversial, the monitor or proposal trustee's role in a reorganization should remain supervisory in nature and the monitor or proposal trustee should not be involved in the disclaimer or assignment of executory contracts. In reorganization the debtor rather than the monitor or proposal trustee ought to be the party to assign executory contracts.

### C. Personal Service Contracts

Employment contracts and other personal service contracts should be excluded from the definition of executory contracts. A strong public policy objective underlies the common law rule that personal service contracts are not assignable and that rule should be preserved in insolvency proceedings. It may be the case that the personal nature of a contract could be raised as an "other basis" for refusing the assignment, but it is appropriate to exclude personal service contracts specifically from the application of the executory contract provisions of the BIA and the CCAA.

### D. Commercial Leases

If the BIA and the CCAA are to be amended to include provisions with respect to the disclaimer and assignment of executory contracts, the issue arises as to whether these new provisions will apply to commercial leases. As matters currently stand, the disclaimer and assignment of commercial leases in the context of insolvency are not matters that are uniform across Canada or across the spectrum of insolvency proceedings.

The BIA contemplates that a reorganizing debtor will be able to disclaim commercial leases. In bankruptcy, the ability of the trustee to disclaim commercial leases is governed by provincial or territorial law. In a CCAA reorganization or receivership, the ability to disclaim commercial leases is typically provided for in an order. In a bankruptcy, the ability of a trustee to assign commercial leases is governed by provincial or territorial law. In a reorganization or receivership proceeding, the ability to assign commercial leases is governed by provincial or territorial law, but has recently been dealt with by the court. There should be uniform treatment of the disclaimer and assignment of commercial leases across the country and across the spectrum of insolvency proceedings. Any new provisions respecting the disclaimer and assignment of executory contracts should apply to commercial leases to the exclusion of provincial or territorial laws.

### E. Collective Agreements

While the CBA Section recognizes that the ability of a reorganizing debtor to terminate or suspend the operation of collective agreements has become a high profile and important issue, we were not able to reach a consensus on if or how the BIA and the CCAA ought to deal with collective agreements.

### F. Stay of Right to Terminate in Bankruptcy

The BIA should provide that, notwithstanding anything in an executory contract, the commencement of a bankruptcy prevents the termination of agreements on the basis only that the debtor is insolvent, has commenced a proceeding, or has not made payments owing for the pre-filing period.

## 5. Directors' Liability

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

While the CBA Section supports any initiative to encourage directors to see an insolvent company through a reorganization, we believe that the due diligence defence proposed by the Senate Committee is overly broad, and raises significant policy and constitutional issues that may result in the proposed amendment being unworkable.

### A. Scope of the Recommendation

Personal liability for the directors of a corporation arises under a variety of federal, provincial and territorial legislation as well as at common law. These liabilities can be divided into two broad categories:

- secondary liabilities; and
- direct liabilities.

Secondary liabilities are those where the primary obligation is that of the corporation. The law that creates the corporate obligation makes the directors secondarily liable to pay the corporation’s obligation. These secondary liabilities are limited to employee remuneration, source deductions and other corporate remittances.

Direct liabilities are obligations not necessarily related to the corporation’s financial obligations. These arise as a result of the director’s conduct or status as a director. These direct liabilities include liability for regulatory or criminal offences, for environmental harm or remediation costs, and for conduct relating to the management of the business and affairs of the corporation.

The Senate Committee recommendation appears to address secondary liabilities. The concern is that directors’ liability for corporate obligations results in directors resigning rather than staying on the board to see the corporation through financially difficult times.

### B. Purpose of Directors’ Liability

Directors’ liability serves a policy purpose. Liabilities are imposed on the directors because enterprise liability does not induce corporations to act in a socially optimum fashion. The limited liability principle results, so the argument goes, in a situation where there is increased incentive on management to engage in behaviour that may be prejudicial to the interests of certain stakeholders. Directors' liability supplements enterprise liability by encouraging those in control of the corporation to ensure that the corporation acts in an appropriate manner *vis à vis* these stakeholders.

### C. Need for Incentive to Remain on the Board

It ought not to be necessary to provide an incentive for corporate directors to remain on the board to see a financially troubled company through a reorganization. Directors of insolvent corporations who resign rather than see the company through a reorganization do so on the false assumption that resignation has a favourable impact on their liability exposure. While resignation may result in certain limitation periods beginning to run in favour of the director, it does not reduce or otherwise affect liability incurred prior to resignation. Seeing the corporation through a reorganization is, in fact, more likely to reduce the directors' liability exposure. Many of the liabilities facing the directors of an insolvent company are most effectively dealt with by the successful restructuring of the company.

### D. Directors' Liability and Insolvency

Providing directors with a due diligence defence may encourage them to continue in office during the reorganization, but it may also reduce the incentive for them to increase scrutiny of the corporation's business as its financial situation worsens. Moreover, a due diligence defence applicable upon the commencement of an insolvency proceeding will not necessarily encourage directors to remain in office to see the corporation through the reorganization. The inclusion of a generally applicable due diligence defence will likely provide an incentive for directors facing personal liability to place a company into an insolvency proceeding for the purpose of triggering the defence and then resign from the board.

## E. CBA Section Recommendations

### (i) Limit to Reorganizations

The rationale for dealing with directors' liability in insolvency proceedings – to encourage the directors to remain on the board while the company attempts to reorganize – applies only to reorganization proceedings. In a liquidation, there is no need to have the directors of the company remain in place. The board of directors plays no active role in the liquidation proceeding and a functional board of directors is not necessary.

### (ii) Scope

The liability of the directors for transactions undertaken by the debtor company in the course of its reorganization is closely linked to the insolvency proceeding. The BIA and the CCAA provide for the ability of the corporate debtor to carry on business and incur obligations during the reorganization. It would be appropriate to provide directors with a due diligence defence to personal liability for these obligations.

However, with respect to directors' liabilities for corporate obligations existing at the commencement of a reorganization proceeding, adding a due diligence defence to the BIA and the CCAA is problematic. Aside from the fact that the directors of the corporate debtor are not party to the insolvency proceedings, insolvency legislation does not typically provide for substantive defences. Insolvency legislation provides procedures for establishing, quantifying and, in the case of reorganizations, compromising claims. The issue of substantive defences to liability is left to the proper law of the obligation underlying the claim. Giving a substantive defence to an obligation created by provincial or territorial legislation raises constitutional issues.

#### (iii) BIA and CCAA

If a due diligence defence is to be added, it should be added to both the CCAA and the BIA.

### F. Wrongful Trading

As we noted in the discussion of unpaid suppliers, above, the CBA Section has concerns over the protection afforded to suppliers. The CBA Section believes that it should be replaced by a provision making directors liable for inventory purchased by the debtor within 30 days of the commencement of a filing when the company was insolvent. Care must be taken in wording the remedy, to avoid a possible chilling effect on reorganizations of insolvent companies if directors and officers can be held liable for their actions during the reorganization period.

## 6. Transfers at Undervalue and Preferences

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

### A. Transfers at Undervalue

Two sections of the BIA deal with undervalue transactions, sections 91 and 100. The most evident problem is that section 91 deals with settlements where the property is to be held and enjoyed by the donee. Section 100, on the other hand, only applies to non-arm's length transactions. There is no equivalent to the provisions of provincial or territorial fraudulent conveyance statutes, namely where a debtor disposes of property to hinder, delay or defeat creditors, with a *prima facie* presumption of debtor's main intent when debtor was rendered insolvent by transaction.

The CBA Section recommends that the BIA be amended to allow for a remedy in the BIA where a debtor disposes of property to hinder, delay or defeat creditors, with a *prima facie* presumption of debtor's main intent when debtor was rendered insolvent by transaction.

### B. Preferences

Section 95 of the BIA deals with preferences. The CBA Section recommends that section 95 remain essentially the same and rejects any suggestion that the provision be amended, as suggested by some, to provide for an "effects-based" regime to determine whether there has been a preference. Replacing the "intent to prefer" regime with an effects-based regime would create a number of problems. It would likely generate much litigation, as the courts would have to grapple with the new provisions. Trustees would spend considerably more time examining each transaction to determine whether it fell within an exception; it is more efficient for a trustee to simply identify whether transactions were suspicious and to address the suspicious transactions. An effects-based regime would also penalize diligent creditors. This could negatively affect parties willing to continue to deal with a debtor in financial difficulty. It is contrary to commercial sensibility that creditors be discouraged from persistently seeking payment of debts because the payment or security would likely be set aside. The intent to prefer is a fairer test and promotes certainty in upholding concluded transactions.

The CBA Section recommends, however, the look-back period, currently 90 days, be extended to one year if the transaction was with a related person.

## C. Uniformity between BIA and CCAA

The CCAA does not currently contain any provisions respecting undervalue transactions or preferences.

The CBA Section believes that the CCAA ought to be amended to include the same avoidance provisions as the BIA. Under the CCAA, the reference date for attacking transactions would be the date of the initial order. The debtor should have the ability to exclude the application of these provisions in a plan. If provisions excluding the ability to attack transactions are included in a plan, the debtor should be required to disclose to creditors all material transactions that may be reasonably considered to be attackable.

The CBA Section recommends that both BIA and the CCAA be clarified to provide that any recoveries from the exercise of avoidance powers in the context of a BIA or CCAA reorganization are, subject to the terms of the proposal or plan, to be added to the pool of funds to be distributed to creditors in addition to any other distributions provided for by the plan or proposal.

## D. Use of Provincial or Territorial Legislation

The CBA Section believes that the trustee or monitor should continue to be permitted to use provincial or territorial laws to challenge transactions. In the case of fraudulent conveyances, there should not be much difference from many provincial or territorial statutes. The BIA and the CCAA should be amended to provide that the trustee or monitor is entitled to stand in the shoes, and use for the benefit of all creditors, bulk sales legislation, business corporations acts and any other provincial or territorial statutes that allow creditors to attack transactions.

A number of “private” fraudulent conveyance remedies have proliferated in recent years. These include:

- spousal remedies in matrimonial property statutes against conveyances intended to defeat equalization or division claims;
- remedies in enforcement statutes against transactions intended to defeat enforcement of child and spousal support; and
- remedies in federal, provincial and territorial tax legislation against under-valued conveyances done by tax debtors.

Unlike the general provincial or territorial fraudulent conveyance and fraudulent preference statutes, which operate as class proceedings on behalf of all creditors, these private remedies favour only one specified kind of creditor. The matrimonial claimant, and no other, benefits under the matrimonial anti-collusion remedies. The tax collector, and no other, benefits from the fraudulent conveyance provisions in tax legislation. The transactions challenged under these provisions are usually precisely the same as those that can be challenged by the trustee on behalf of all creditors. This has the potential of bringing the “private” creditor into conflict with the trustee. It raises the question of who has the right to control or settle such proceedings, and who obtains the benefit. It is often a matter of tactics only as to whether the “private” creditor challenges the transaction under the private remedy, under the general fraudulent conveyance remedy, or under both.

The CBA Section recommends that the BIA and the CCAA provide that notwithstanding this legislation, all such proceeds from attacks be paid into court and the court shall have the discretion to make a decision as to the entitlement to the funds. This will ensure that the other party to the transaction is not in jeopardy of paying twice.

### E. Definition of Related Person

The difficulty in defining contemporary family relationships has led to the recommendation that all presumptions regarding “related persons” be eliminated in the avoidance provisions of the BIA. The CBA Section disagrees with this recommendation. As challenging as it may be to define the modern family, this ought not to lead the government to reject the usefulness of familial relatedness as a marker of presumptive collusive intention. Even if these definitions are fuzzy on their borders, the incidence of collusive transfers and agreements between spouses and partners is significant enough to warrant special rules and presumptions for this category of cases. The social change in family structures should not lead to scrapping a useful presumption.

The CBA Section supports the expansion of the definition of a “related person” for the purposes of the avoidance provision of the BIA (and the CCAA) to include parties who have not dealt with the debtor at arms’ length in the one-year period prior to the date of the transaction.

### F. Summary Procedure

The *General Rules* under the BIA previously contained Rule 89, which provided for avoidance actions to proceed by way of a summary procedure. Under this procedure, the trustee had the power to decide that the avoidance section of the BIA applied to a transaction and to estimate the amount payable to the estate by the other party to the transaction. The trustee’s decision in this regard was final unless the other party appealed. This provision was removed from the BIA. As a result, trustees must now commence actions or applications to attack transactions. This increases the cost of the administration of the estate and deters trustees from taking avoidance actions.

The CBA Section recommends that the BIA be amended to restore the ability of the trustee to attack transactions using a summary procedure. The ultimate decision of establishing that the transaction ought to be avoided or a remedy provided should, however, remain that of the trustee.

### G. Remedies

Rather than having the ability to declare a transaction void, the CBA Section recommends that the court have the ability to fashion an appropriate remedy. The court should, for example, have the ability to make orders awarding damages, requiring a re-conveyance of the asset, or directing a sale of the asset.

## 7. Debtor-in-Possession Financing

**SENATE COMMITTEE RECOMMENDATIONS**

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

**CBA SECTION RESPONSE**

The CBA Section generally supports the recommendations of the Senate Committee in the area of Debtor-in-Possession (DIP) financing, but would prefer to see the name of this type of financing changed to reflect that there is no "debtor-in-possession" as the term is used in the United States.

### A. Factors

The CBA Section believes that, for drafting purposes, the seven factors identified by the Joint Task Force should be distilled down to three or four essential factors.

### B. Initial Order

On an initial application for DIP financing, the CBA Section recommends that the BIA and the CCAA provide that that debtor be required to:

- give at least 24 hours' notice to secured creditors who will find their security interests subordinated as a result of the granting of priority to the new borrowing by the debtor; and

- provide a 120-day cash flow projection with a favourable opinion from the monitor or trustee with respect to the reasonableness of the cash flow and the assumptions upon which it is based.

The CBA Section also recommends that the DIP financing the court can authorize on an initial application be restricted to an initial period of 30 days and be tied to the cash flow projections filed by the debtor. Any extension of the DIP financing should be made only on proper notice to all affected parties.

### C. Supervision

The CBA Section is of the view that during the term of the DIP financing, the monitor or trustee ought to be required to monitor the cash flow closely and report to the court if there are material adverse deviations from the cash flow projections filed with the court. The consequence of a deviation would be the subject of a further proceeding to determine the appropriateness of continuing to permit new advances under the DIP facilities. Until the proceeding was heard and a judgment to continue such financing, there would be a mandatory block on further advances under the DIP facilities. This would promote a proactive rather than a reactive approach, in that the debtor would require court permission to obtain further advances (rather than having to go to the court to obtain forgiveness of deviations from cash flow projections). This approach would also give secured creditors – normally the parties most affected by cash flow deviations – the opportunity to challenge the appropriateness of the DIP financing.

## *8. Companies' Creditors Arrangement Act*

**SENATE COMMITTEE RECOMMENDATION**

**The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* remain as separate and distinct statutes, with, perhaps, certain modifications concerning, for instance, reporting and statistics and harmonization between the two laws.**

**CBA SECTION RESPONSE**

The CBA Section agrees that the BIA and the CCAA should remain as distinct statutes. The judicially-driven nature of reorganizations under the CCAA is generally considered to be more flexible than proposals under the BIA. The CBA Section believes that there is some value to maintaining the CCAA as a distinct statute to preserve this flexibility.

The CBA Section also agrees that the CCAA should be amended with a view to adding some structure to the CCAA process. In addition to the recommendations elsewhere in this document, the CBA Section recommends amendments to the CCAA in the following areas:

### A. Commencement of the Reorganization

The CCAA currently requires that the debtor apply to the court to commence a reorganization and obtain a stay. Applications to commence CCAA reorganization are typically on an *ex parte* basis or with limited notice to the affected parties. The initial orders made by the court on these applications are, generally speaking, fairly standard in form.

The CBA Section recommends that the procedure for commencing a CCAA reorganization be streamlined. In particular, the CBA Section recommends that a debtor be able to obtain a limited stay of proceedings for a period not to exceed 30 days by making an administrative filing. Should the reorganizing debtor wish to obtain more extensive stay, unusual relief such as super-priority financing, or an extension of the stay period, the debtor should be required to apply to the court.

The ability of stakeholders to move, on notice, to vary the initial relief provided to the reorganizing debtor ought to be preserved.

### B. Publication of Proceedings

Currently, there is no effective way of determining whether CCAA proceedings have been commenced. CCAA reorganizations are commenced by filing applications in the superior court in the province or territory where the debtor carries on business. Stakeholders have no effective means to search the records of the superior courts to locate a CCAA application. The CCAA requires that the monitor deliver copies of the initial order, but there is no effective means of ensuring that all stakeholders get notice.

The CBA Section recommends that notice of the commencement of a CCAA reorganization be available on a searchable database in addition to the requirement that the initial order under the CCAA be delivered by the monitor to all known creditors.

### C. List of Creditors

One of the major concerns of stakeholders in a CCAA reorganization is the ability to organize themselves. The ability to organize is dependent on being able to identify the other stakeholders in the reorganization. There is currently no requirement that the debtor prepare or circulate a list of creditors.

The CBA Section recommends that the debtor should be required to prepare a list of creditors and this list should be available to all creditors. This list should identify the creditor, the address and the amount owing.

### D. Claims Procedure

Currently, the procedure to establish claims against the debtor in a CCAA reorganization is determined by order of the court on a case-by-case basis. While a number of well-defined procedures are used in CCAA reorganizations, the CCAA does not mandate any one procedure and there can be wide variances across Canada with respect to the "preferred" procedure to establish the claims against the reorganizing debtor.

The CBA Section recommends that the CCAA be amended to provide for a claims procedure. The claims procedure ought to establish:

- how and when claims against the debtor company must be proven for voting purposes and for distribution purposes;
- who is responsible for reviewing and determining the validity of claims filed against the debtor; and
- the procedure for disputing decisions made with respect to whether a claim is provable and the quantum of that claim. The procedure should also provide for a bar date after which stakeholders are prohibited from filing proofs of claim.

In order to preserve the flexibility of the CCAA procedure, the CBA Section recommends that the court have the jurisdiction to vary the claims procedure on the application of the debtor, the monitor or any stakeholder.

### E. Meetings of Creditors

Similar to the situation with claims, the current practice under the CCAA is that the procedure for the calling and conducting of creditors' meetings be determined by the court on a case-by-case basis. The CBA Section recommends that the CCAA establish procedures for calling and conducting meetings of creditors. The court ought to be able to vary the procedure on application of the debtor.

## 9. Scope of the Stay of Proceedings

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

The scope of the statutory automatic stay of proceedings that arises upon the commencement of a reorganization proceedings under the BIA is limited to restricting:

- the exercise of remedies against the property of the debtor;
- the commencement of continuation of proceedings to recover claims provable against the debtor; and
- the termination of agreements on the basis of insolvency, the commencement of the proceedings or, in some cases, the fact that amounts owing by the debtor were not paid prior to the commencement of the proceedings.

The scope of the stay customarily granted by the court in the context of CCAA reorganizations is much broader. In many cases, the stay can be interpreted to prevent agencies from exercising their regulatory powers over the debtor or its business. As a result, regulators are often faced with having to review and consider how each individual CCAA order impacts their powers.

### A. Health, Safety and Security

The CBA Section is of the view that a stay of proceedings imposed in the context of BIA and CCAA reorganizations ought not to impact the "health, safety and security" jurisdiction of regulators except for the enforcement of monetary penalties. If the debtor wishes to stay a regulator from exercising its "health, safety and security" jurisdiction, it should be obligated to establish to the court that:

- the requested stay is essential to the success of the reorganization; and
- the requested stay will not give rise to health, safety or security concerns.

The stay should be limited to what is necessary in the circumstances to permit the debtor to reorganize.

## B. Securities Regulators

The CBA Section agrees that the stay of proceedings in a reorganization should not have the effect of inhibiting securities regulators from performing their duties and taking action against a debtor company when appropriate.

Securities regulators have legitimate interests to pursue during insolvency processes. As long as a company is listed and its shares are trading, management has a continuing responsibility to make full, true and plain disclosure under relevant securities laws. Securities regulators need to oversee that continuing process. Securities regulators also have important investigative and prosecutorial functions from which incumbent management should not be shielded and which have in recent high profile North American insolvencies played an important part of the creditor protection and recovery process.

There are also good reasons not to routinely allow companies to be de-listed without considering the impact on the reorganization process. A reorganization can save some of the equity value of a company. The public listing itself may be an important part of the process by which creditors can recover value. Creditors are frequently converted to equity, and restructuring companies often re-capitalize with new equity offerings.

While it is sensible to exempt a reorganizing debtor company from compliance with securities compliance during a "cooling off" period while the affairs of the debtor are stabilized, this exemption should not continue indefinitely. Sixty days after the filing is reasonable, subject to the discretion of the court.

When 60 days after the filing has elapsed, the burden should be on the debtor company to seek to continue the exemption from securities regulatory compliance. Moreover, the exemption should only be from enforcement steps by the regulator.

The company should not be exempted from the duty to continue to meet its continuous disclosure requirements under securities laws.

There is no reason to limit the recommendation to CCAA reorganizations.

The CBA Section recommends that both the CCAA and the BIA be amended to provide that any stay of proceeding will not bind securities regulators after 60 days from the date of the initial filing unless the debtor satisfies the court that:

- there is a realistic prospect that stakeholder value will be materially enhanced by continuing the stay;
- the company's obligation to make timely disclosure will continue to be performed in accordance with applicable securities laws;
- third parties will not be unduly prejudiced by the stay; and
- investigations by securities regulators will not be impaired by the stay.

## 10. Role of Monitors/Trustees

**SENATE COMMITTEE RECOMMENDATIONS**

### A. Governance

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

### B. Conflicts of Interest

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

**CBA SECTION RESPONSE**

The CBA Section generally agrees with the principles underlying the Senate Committee's recommendation in the areas of governance and conflicts of interest, but believes that more can be done in the area of disclosure to protect stakeholders.

### A. Governance/Conflicts of Interest

Stakeholders often express some confusion over the role of the monitor in a CCAA reorganization. This is particularly so in cases where the monitor is affiliated with the debtor's auditor or is engaged by the debtor to assist in negotiations with creditors and other stakeholders.

The CBA Section recommends that the CCAA be amended to clarify that the monitor owes its obligations to creditors generally and unsecured creditors in particular. Unsecured creditors are, generally speaking, the most vulnerable stakeholder group in CCAA reorganizations. Unsecured creditors are often required to continue to supply goods or services to the reorganizing debtor. At the same time, these creditors have access to only limited information concerning the debtor or the debtor's financial situation and often do not have the financial resources necessary to retain professionals to assist them in dealing with the debtor.

In order to preserve the flexibility of CCAA reorganizations, the CBA Section does not believe that the role of the monitor should be narrowly defined, but it should be clear that whatever secondary role is assigned to the monitor, its primary obligation is to protect and speak for the interests of creditors.

### B. Disclosure Standards in Insolvency

The CBA Section recommends that debtors should be required to make full true and plain disclosure whenever they communicate with creditors or file information with the court. The decision-making process in restructurings is deeply reliant on that disclosure, and the interest of all stakeholders hang in the balance, and yet there is no clear standard for what must be provided. The CCAA does require the monitor to report on material changes, but in addition to that management should be required to disclose them in the first place, a requirement missing in the BIA and CCAA at present.

The CBA Section recommends that the CCAA require that in connection with putting forth a plan of compromise or arrangement, the debtor (whether or not it is a public company) make readily available to all creditors an information package that meets with the standards required for an Information Circular under the provincial or territorial securities legislation. The case law developed in early CCAA reorganizations required that this type of disclosure be provided by the reorganizing debtor, but the requirement has never been included as part of the CCAA. The monitor is required to file a report in connection with the plan, but the contents of this report are not specified and often fall short of what would be required in an Information Circular.

## 11. Going Concern Sales

### SENATE COMMITTEE RECOMMENDATIONS

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

### CBA SECTION RESPONSE

The CBA Section agrees with the Senate Committee's recommendation. The CBA Section recommends, however, that the BIA and the CCAA require the debtor to provide all stakeholders with an interest in the assets being sold, and whose interests are being vested out, with reasonable notice of the proposed sale. All interests in the property sold should vest in the proceeds.

The CBA Section also recommends that the monitor or trustee be required to deliver a report with respect to the proposed sale.

## 12. Interim Receivers

**SENATE COMMITTEE RECOMMENDATIONS**

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

**CBA SECTION RESPONSE**

The CBA Section was unable to reach a consensus with respect to the proper role of interim receivers appointed under the BIA. There is a wide variance of opinion as to whether the relatively recent expansion of the role of the interim receiver is in accordance with the spirit and intent of the BIA.

The CBA Section does, however, agree that if the scope of interim receiverships is not limited to preserving and protecting the debtor's estate or assets subject to a secured creditor's security, then the definition of "receiver" in Part XI of the BIA ought to be amended so to include interim receivers. As currently drafted, the definition of receiver in Part XI excludes interim receivers appointed under sections 46, 47 and 47.1 of the BIA.

## 13. *Winding-Up and Restructuring Act*

**SENATE COMMITTEE RECOMMENDATION**

**The *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act*, the *Winding-up and Restructuring Act* and the *Farm Debt Mediation Act* be reviewed by Parliamentary Committee at least once every five years.**

**CBA SECTION RESPONSE**

The *Winding-up and Restructuring Act* (WRA) is the primary insolvency legislation governing financial institutions, such as banks, trust companies, loan companies and insurance companies. Although portions of the WRA have been revised fairly recently, the statute as a whole has generally been neglected while the BIA and the CCAA have been updated.

As a result, the WRA has not been reviewed as a whole to ensure that it meets its objectives. It remains somewhat archaic, with provisions in the statute and omissions from it that are inconsistent with other Canadian insolvency legislation, without apparent purpose.

The CBA Section believes that all Canadian insolvency statutes, including the WRA, should be reviewed regularly to ensure that they are effective and efficient.

The CBA Section believes that application of the WRA should be restricted and that the provisions of the WRA should be consistent with the BIA and the CCAA.

## 14. Securities' Firm Bankruptcies

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

Part XII was added to the BIA to provide a regime for bankruptcy by securities firms. Although a securities firm holds securities and cash in trust for its clients who have ownership rights in that property, Part XII provides that only "customer name securities", i.e. securities registered or in the process of being registered in the customer's name and not otherwise in negotiable form, are to be given to the clients who own them. In practice, securities firms generally do not hold securities expressly registered in the name of the customer but rather in negotiable form. In practice, almost all securities and cash held by a bankrupt securities firm are to be pooled and distributed *pro rata* amongst its clients in accordance with Part XII. The objective of Part XII is to dispose of property and trust interests and pool the available assets for distribution.

## A. Definition of "net equity"

The CBA Section supports the proposed clarifications of Part XII of the BIA to facilitate the efficient administration of a bankrupt securities firm, with the exception of clarifications to the definition of "net equity".

The definition of "net equity" in section 253 of the BIA is:

> "net equity" means, with respect to the securities account or accounts of a customer, maintained in one capacity, the net dollar value of the account or accounts, equal to the amount that would be owed by a securities firm to the customer as a result of the liquidation by sale or purchase at the close of business of the securities firm on the date of bankruptcy of the securities firm, of all security positions of the customer in each securities account, other than customer name securities reclaimed by the customer, including any amount in respect of a securities transaction not settled on the date of bankruptcy but settled thereafter, less any indebtedness of the customer to the securities firm on the date of bankruptcy including any amount owing in respect of a securities transaction not settled on the date of bankruptcy but settled thereafter, plus any payment of indebtedness made with the consent of the trustee after the date of bankruptcy.

"Net equity" is determined on the basis of the net dollar value of the accounts "on the date of bankruptcy of the securities firm". Industry Canada suggests the definition of "net equity" be clarified to make sure that customers benefit from any "increase" in the value of securities occurring between the "date of bankruptcy" and the "distribution date". The definition of "net equity" clearly states that it is to be determined at the date of bankruptcy, so we do not see any reason to amend the definition.

The issue appears to have been raised as a result of section 262(2) which states that, to the extent that securities of a particular type are available in the customer pool, the trustee shall distribute them to customers with claims to such securities, in proportion to their claims to such securities, up to the appropriate portion of their net equity. There is no suggestion that a customer would suffer any decrease based on the performance of the securities after the date of bankruptcy.

All customers are unable to deal with the securities in their accounts after bankruptcy and all bear the risk of the rise and fall of the value of the securities while being administered by the trustee. However, the recommendation seems to suggest that one group of customers would receive different treatment.

That result would be directly contradictory to the overall structure of Part XII, which removes concepts of "trust" and "ownership" and pools all securities and cash for the benefit of all customers and permits the trustee to sell any securities at any time.

### B. Status of Cash

Pursuant to section 261 of the BIA, where a securities firm becomes bankrupt, cash held by or for the account of the securities firm or a customer, other than customer name securities, vest in the trustee. The trustee is required to establish a "customer pool fund" including:

- specified securities;
- cash, including cash obtained after the date of the bankruptcy, certain dividends, interest, other income and proceeds; and
- any investment of the securities firm in its subsidiaries.

The trustee is also required to set up a "general fund", including all the remaining vested property.

Section 262 of the BIA provides for the distribution of the cash and securities in the customer pool fund. The customer pool fund shall be allocated:

- to the costs of administration, to the extent that sufficient funds are not available in the general fund to pay such costs;
- to customers, other than deferred customers, in proportion to their net equity; and
- to the general fund.

Property in the general fund is then distributed in accordance with section 262(3).

It is not clear from the report of Industry Canada what problems require clarification. Earlier considerations of Industry Canada raise the following issues. Section 261(1) collapses all cash accounts, including trust accounts, and vests the money in the trustee, overriding section 67(1)(a). Subsection 261(2)(a)(ii) seems to put a narrower range of cash into the pool, restricting it to cash in securities accounts, implying that cash in other types of accounts is not in the pool. Industry Canada suggests that the section be clarified so that cash in any customer accounts and in any securities accounts of the firm, as well as in any non-securities accounts of the firm other than trust accounts meeting all the requirements of a trust, are included in the pool.

The CBA Section supports such clarifications to the status of cash in the accounts of securities firms.

### C. Electronic Transactions

Securities firms conduct virtually all transactions electronically. The definition of “security” in section 253 refers to any document, instrument or written or electronic record commonly known as a security.

This recommendation appears to result from issues encountered in the bankruptcy of Vantage Securities, a firm that dealt mainly in mutual funds, units of which were held in RRSP accounts. The practice in the mutual fund industry is not to issue certificates but to show both legal and beneficial ownerships on an electronic register.

Although the definition of "security" in section 253 of the BIA includes the concept of "electronic record" and "mutual fund share or unit", there are other references in Part XII to securities "held by" a securities firm, and references to "registered", "endorsement" and "negotiable form".

The CBA Section supports amendments, as appropriate, throughout Part XII to clarify the application to electronic transactions and electronic records.

# IV. PERSONAL INSOLVENCY

## 1. Optional Federal Exemptions

### SENATE COMMITTEE RECOMMENDATION

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

### CBA SECTION RESPONSE

In our submission to the Senate, the CBA Section agreed with the concept of optional federal exemptions, but without any consensus in the CBA Section as to the specific recommendation now advanced by the Senate. The CBA Section noted that most provinces now have fairly modern exemption laws, particularly since Ontario's reforms in 2001. The CBA Section expressed its concern about the complexities that would be introduced through the availability of two exemption schemes.

The CBA Section considers some of these complexities to include the following:

1. Most provinces incorporate, with their personal exemptions, detailed provisions as to how those exemptions are to be applied (in the case of personal possessions of disputed value), and how the exemption may be preserved for a time following a sale (in the case of residence exemptions). The federal exemption scheme will have to address these points.
2. Some provinces exempt specified provincial or territorial subsidies and grants having a welfare nature. These items do not clearly fall within "income" under BIA section 68 as they are not earned through labour. Does the federal exemption list include them? Perhaps these items ought to be included in the definition of section 68.

## 2. Exemption for RRSPs

### SENATE COMMITTEE RECOMMENDATION

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

### CBA SECTION RESPONSE

With some small variations, the CBA Section supports the Senate Committee's recommendation regarding RRSPs.

The CBA Section recommended to the Senate Committee[7] that the appropriate claw-back period for pre-bankruptcy RRSP contributions be two years, rather than

7 Canadian Bar Association: Submission on the Five-Year Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* (May 2003).

three years as recommended by the PITF Report. In the CBA Section's view, a two-year period is sufficient to accomplish the necessary balance of policy goals, provided, as the PITF recommends, that provincial or territorial fraudulent conveyance remedies remain available for contributions outside that period. The Senate Committee has recommended that this period be reduced to one year. The CBA Section believes this is too short to accomplish the purpose of effectively, and demonstrably, preventing abuse of the RRSP exemption. The CBA Section views as absolutely necessary the implementation of an effective anti-abuse mechanism to the new exemption. It will be too easy to artificially defer a bankruptcy filing until the one-year period has lapsed.

The CBA Section does not believe that a two-year mandatory claw-back will result in unfairness. If the debtor has been regularly contributing to an RRSP over the years, with the compounding interest that such contributions entail, then the two-year claw-back 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 to an 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. A one-year clawback period, that is easily evaded, is too short.

The CBA Section's view is strengthened by a recent Alberta decision, Re *Perry*,[8] where the bankrupt had contributed approximately $10,000 to an RRSP, exempt

8 [2003] A.J. No. 1168 (Alberta Q.B., Registrar Quinn, September 19, 2003).

under the *Insurance Act*, some seven weeks before his bankruptcy. The trustee's summary motion, based on affidavit evidence, to have the contribution declared to be a fraudulent conveyance, was rejected. The court concluded that a trial was needed to determine the issue of fraud. This ensured that the cost of the trial would likely exceed the benefit of success; after all, there is little expectancy of collecting, within any reasonable time, on any cost order made against a litigant who is already bankrupt. In other words, fraudulent conveyance legislation, with its requirement of a fraud finding, is an inefficient and expensive means of deterring strategic use of the proposed exemption. An effective and inexpensive method, namely a clawback of two years duration, is needed.

The CBA Section indicated to the Senate Committee that it was not convinced that the RRSP exemption should be capped. The CBA Section noted that, if a cap were implemented, the PITF proposal had the benefits of simplicity, self-adjustment for inflation, responsiveness to the age of the bankrupt and consistency across the country. It is unclear whether the Senate Committee recommendation is consistent with this formula, particularly as to whether the cap increases with the age of the bankrupt. In our view, if a cap is to be imposed, the PITF formula ought to serve as a guideline.

## 3. Exemption of RESPs

### SENATE COMMITTEE RECOMMENDATION

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

**CBA SECTION RESPONSE**

The CBA Section did not specifically comment on RESPs in our submission to the Senate Committee.

For the reasons discussed in the section regarding RRSPs, the CBA Section views the one-year clawback period as too short. A two-year period draws a more appropriate balance between the beneficial policy goal of saving for education costs, and the policy goal of avoiding strategic behaviour and ensuring the integrity of the system. In all other respects, the CBA Section agrees with the Senate Committee recommendation.

## 4. Reaffirmation Agreements

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

In our submission to the Senate Committee, the CBA Section supported the recommendation that the case law upholding reaffirmation by conduct, be statutorily overruled. Reaffirmation should not occur through unconscious or unknowing acts.

However, the CBA Section strongly objected to the recommendation that express reaffirmation be prohibited, as follows:

> We are unaware of any abuse problem that needs remediation, particularly given other proposals in the PITF report (Sections 2.4 [now Senate Recommendation No. 6, Non-Purchase Money Security Interests in Exempt Personal Property] and 3.12 [now Senate Recommendation No. 16, Ipso Facto Clauses]). 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 ... In our view, there is insufficient benefit, evidence, or justification at this time to warrant regulating voluntary reaffirmations at all.[9]

The CBA Section continues to hold this view. In particular, the CBA Section strongly objects to the criminalization of voluntary post-bankruptcy payments by a discharged bankrupt. It has always been considered moral to repay one's debts, even if the legal obligation to do so has been extinguished by bankruptcy. By implementing such a change, we would move conduct that has historically been regarded as highly moral into the criminal sphere. This step is proposed despite any evidence that there is a problem in Canada, and without any statistical basis. The recommendation targets all creditors, despite the alleged future abuse apparently coming from only one kind of creditor, the finance or credit industry. In the focus against the credit industry on this point, neither the PITF, nor the Senate Committee, has considered any of the myriad situations outside of that setting where it may be in the debtor's interest to make a modest voluntary payment as a condition of obtaining future service (i.e., a dentist, a grocer, the phone company to obtain continued use of a desired telephone number, a professional to preserve a desired professional relationship, a friend to preserve a desired social relationship). There are many other examples. The proposal would criminalize all of this conduct. Voluntary, consensual post-bankruptcy conduct would be under "big brother's" control, through the Official Receiver's office or the court.

This significant departure from generally understood morality by criminalizing voluntary ethically-based conduct between consenting adults would bring the BIA into disrepute. Forcing creditors to reject payment that is voluntarily offered by a discharged bankrupt, on pain of criminal prosecution, imposes an unrealistic standard. There has been no study of less intrusive alternatives (for example, proscribing post-bankruptcy solicitation to repay a discharged debt, as in the U.S.,

9 *Supra* note 7 at 24-25.

or implementing specific debtor education or counselling processes regarding reaffirmation). Given that this change is so remarkable and so fundamental, one would expect studies, or at least significant anecdotal evidence. Instead, the anecdotal evidence suggests that the abuse will actually be prevented by other proposals the Senate Committee has recommended, such as voiding non-purchase money security against exempt assets, eliminating implied reaffirmations, and voiding "ipso facto" clauses that trigger automatic default in consumer security agreements upon bankruptcy. Unlike reaffirmation, these other recommendations do not reverse the ethical underpinnings of our law, nor do they limit the individual autonomy of Canadians. They are both preferable, and sufficient, and they are based on the evidence and good policy.

In the CBA Section's view, there is insufficient benefit, evidence, or justification at this time to warrant regulating voluntary reaffirmations at all. If a remedy is required at this time, in the CBA Section's view the proper course is to prohibit, with appropriate sanctions, the post-bankruptcy solicitation to repay a discharged debt.

## 5. Streamlining Summary Administration

### SENATE COMMITTEE RECOMMENDATION

**The *Bankruptcy and Insolvency Act* be reviewed in order to eliminate all unnecessary procedural requirements and to provide parties to a bankruptcy with an opportunity - to the extent possible - to choose their level of involvement in accordance with a "by exception rather than by rule" approach.**

**Moreover, the use of electronic communication should be encouraged in order to simplify and expedite the insolvency process.**

## CBA SECTION RESPONSE

The CBA Section supports the ongoing effort to streamline the administration of both bankruptcies and proposals and to reduce the administrative costs.

The CBA Section suggests, however, that 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, the CBA Section resists 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. The CBA Section believes 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.

The CBA Section believes 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 the CBA Section's view, these elements form a structure that adequately manages the inherent conflicts of interest to which the trustee is subject in a personal bankruptcy file.

## 6. Non-Purchase Money Security Interests in Personal Exempt Property

### SENATE COMMITTEE RECOMMENDATION

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

### CBA SECTION RESPONSE

As our submission to the Senate Committee indicated, the CBA Section agrees with the PITF recommendation to avoid non-purchase money security interests in exempt personal property. The CBA Section is aware of the abuses in this area in connection with household furniture and appliances, which typically have minimal resale value, and the vulnerability of consumer debtors to coercion. This recommendation, if implemented, will significantly remediate the reaffirmation concern noted elsewhere in the PITF report.

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

The CBA Section questions whether motor vehicles ought to be included in this recommendation. We are uncertain about the credit impact of this step, and we wonder whether the abuse problem extends to motor vehicles. It may be too intrusive to debtors to prevent them from using their cars as collateral.

Finally, the CBA Section notes that the proposal may conflict with farm lending practice in Saskatchewan, and perhaps other jurisdictions, under section 427 of the *Bank Act*. The interaction between this proposal and section 427 ought to be further examined.

## 7. Mandatory Counselling

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

The CBA Section agrees.

## 8. Consumer Liens

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

The CBA Section agrees.

## 9. Student Loans

**SENATE COMMITTEE RECOMMENDATIONS**

**The *Bankruptcy and Insolvency Act* be amended to reduce, to five years following the conclusion of full or part time studies, the length of time prior to permitting the potential discharge of student loan debt. As well, the Act should allow the Court the discretion to confirm the discharge of all or a**

**portion of student loan debt in a period of time shorter than five years where the debtor can establish that the burden of maintaining the liability for some or all of the student debt creates undue hardship.**

**CBA SECTION RESPONSE**

The CBA Section supported the PITF proposal to ameliorate the current bankruptcy treatment of student loans, which has been adopted by the Senate Committee. While the CBA Section fully accepts 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, the CBA Section has 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 the CBA Section's view, this restriction is not compatible with Canadian values of fairness and equality.

The CBA Section agrees, therefore, with the recommendation to reduce the non-dischargeability period to five years. The CBA Section further agrees that the bankrupt ought to have the right to seek a mercy hearing well before the end of that period. Finally, the CBA Section supports clarification of these provisions to allow the mercy hearing to result in a partial or conditional discharge of the student loan. In short, the CBA Section fully supports the Senate recommendation.

## 10. Discharge from Bankruptcy and Treatment of Second-Time Bankrupts

### SENATE COMMITTEE RECOMMENDATION

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

### CBA SECTION RESPONSE

The CBA Section agrees.

## 11. Contributions of Surplus Income to Bankrupt's Estate

### SENATE COMMITTEE RECOMMENDATION

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

**CBA SECTION RESPONSE**

The CBA Section agrees.

## 12. Voluntary Agreements to Make Post-Discharge Payments

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

The CBA Section agrees.

## 13. Non-Dischargeable Credit Card Purchases

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

The CBA Section agrees.

## 14. International Personal Insolvency

**SENATE COMMITTEE RECOMMENDATION**

**The *Bankruptcy and Insolvency Act* be amended to recognize the effect of a foreign discharge or compromise of debt with respect to an individual,**

**provided certain conditions are met. The conditions should be: the bankrupt foreign resident Canadian has a real and substantial connection with the foreign jurisdiction; the foreign procedure is fair and non-prejudicial to creditors; and the personal exemptions used by the bankrupt foreign resident Canadian in the foreign proceedings are substantially similar to those in Canada.**

**CBA SECTION RESPONSE**

The CBA Section indicated in the submission to the Senate Committee its support to create a remedy for cross-border personal insolvency. The CBA Section believes that the recommendation will accomplish the necessary objectives without offending any bankruptcy policy issues. For clarity, the CBA Section notes that the recognition order must be granted only upon proper application to the court on notice to the affected creditors.

## 15. Debt Forgiveness by Canada Revenue Agency

**SENATE COMMITTEE RECOMMENDATIONS**

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

**CBA SECTION RESPONSE**

The CBA Section agrees with this recommendation. The anomalous treatment of section 80 debt forgiveness rules under bankruptcy proposals drives many deserving debtors into bankruptcy — where these rules do not apply — in spite of their desire and ability to file a proposal. This starkly conflicts with the legislative policy goals favouring rehabilitation. As the number of proposals has increased, so has the desirability of greater certainty in the tax treatment of proposals, and greater harmonization between the tax treatment of bankruptcies and proposals.

## 16. Ipso Facto Clauses

### SENATE COMMITTEE RECOMMENDATION

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

### CBA SECTION RESPONSE

The CBA Section agrees. A provider of basic services ought not to be able to terminate an agreement with a consumer on the basis only that the consumer is insolvent, or has become bankrupt or attempted to reorganize.

## 17. Credit Reporting

### SENATE COMMITTEE RECOMMENDATION

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

### CBA SECTION RESPONSE

The CBA Section agrees.

## 18. Inadvertent Discharge of Selected Claims in Proposals

### SENATE COMMITTEE RECOMMENDATION

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

### CBA SECTION RESPONSE

As indicated in our Senate Committee submission, the CBA Section agrees with this recommendation. We note that this issue arose in a recent case, *Slaney*,[10] in connection with a student loan creditor. The court concluded that the creditor's section 178 debt survived the debtor's bankruptcy proposal despite the creditor having voted for the proposal. The court noted that "if a proposal is to have the effect of releasing the bankrupt from a section 178 debt, it should do so explicitly, rather than pursuant to an implication read into a statute which can arguably be construed to be ambiguous."[11] This result is consistent with the Senate's recommendation.

## 19. Bankruptcy and Family Law

### SENATE COMMITTEE RECOMMENDATIONS

**The *Bankruptcy and Insolvency Act* be amended to:**

**(a) ensure that bankruptcy does not prevent a claimant from recovering the total amount of support arrears from a bankrupt spouse;**

**(b) clarify that only Court orders made under Section 68 of the Act have priority over enforcement of spousal and child support against the bankrupt's income during the period of bankruptcy;**

10 [2004] B.C.J. No. 566 (B.C.S.C., Master Bolton, March 23, 2004).

11 *Ibid.* at para. 12.

**(c) provide that bankruptcy does not stay or release any claim for equalization or division against exempt assets under provincial/territorial legislation regarding equalization and/or the division of marital property;**

**(d) exclude, from assets vesting in the trustee, the right to sue the bankrupt's spouse for equalization or division of property under provincial/territorial matrimonial property law; and**

**(e) add, to the debts that survive bankruptcy, a debt for equalization or division of property under provincial/territorial matrimonial property law, to the extent that the debt arises from malicious or fraudulent dissipation or concealment of property by the bankrupt.**

**CBA SECTION RESPONSE**

The CBA Section agrees. As to (a) and (b), the CBA Section notes that the 1997 support amendments to the BIA were never intended to impair the enforcement or collection of support in any way. These two recommendations give effect to that intended purpose.

Recommendation (c) comports with the common law expressed in numerous reported cases, and eliminates an unnecessary expense and risk that spouses currently face in having to obtain, before the bankrupt's discharge, a court order granting leave to pursue their equalization claim against pensions or other exempt assets.

As to (d) and (e), the CBA Section agrees.

## 20. Definition of Income

**SENATE COMMITTEE RECOMMENDATIONS**

**The *Bankruptcy and Insolvency Act* be amended in order to clarify the meaning of the term "total income." As well, clarity in the form of guidelines contained in a directive of the Superintendent of Bankruptcy - should be**

**provided to trustees regarding the manner in which lump-sum settlements received after bankruptcy and before discharge should be divided between debtors and creditors. Finally, a bankrupt's tax refunds received during a period to be determined by statute should be made available to the trustee for distribution to creditors.**

**CBA SECTION RESPONSE**

As noted in our Senate Committee submission, the CBA Section supports the proposal on the treatment of income in PITF 3.1, which the Senate Committee has adopted. Recent case law has rendered reform necessary, and we see this proposal as a practical solution that reflects the direction of the jurisprudence.

## 21. Definition of Consumer Debtor

**SENATE COMMITTEE RECOMMENDATION**

**The *Bankruptcy and Insolvency Act* be amended to raise the indebtedness threshold contained in the definition of "consumer debtor" to $100,000, with annual increases thereafter to reflect increases in the cost of living as measured by the Consumer Price Index. Moreover, two years after the new indebtedness threshold comes into force, the federal government should initiate a review of the degree to which insolvent debtors are using the consumer proposal option rather than pursuing a commercial reorganization.**

**CBA SECTION RESPONSE**

As noted in our Senate Committee submission, the CBA Section agrees 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, the CBA Section wishes to address one implication of enhanced eligibility that has not been otherwise noted. The consumer proposal scheme does not provide for payment of legal services rendered to the administrator. Presumably this was to reflect an intention to keep proceedings simple. At present, administrators needing legal advice must pay for the advice out of their fixed fee, and therefore suffer reduced earnings.

When the debt ceiling rises, 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. Consumer proposals are now beginning to generate case law, which can only increase concomitantly as the debt ceiling rises.

## 22. Selection of Bankruptcy Trustee

**SENATE COMMITTEE RECOMMENDATION**

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

**CBA SECTION RESPONSE**

The CBA Section agrees.

## 23. Non-Arm's Length Creditor Voting Rights

**SENATE COMMITTEE RECOMMENDATION**

**The *Bankruptcy and Insolvency Act* be amended to provide voting rights to non-arm's length creditors who have been dealing with the debtor at non-arm's length in the year prior to the bankruptcy, if they represent together**

**more than 40% of the value of the total claims. In the event that the non-arm's length creditors vote changes the outcome of the vote, any interested party should then seek leave of the Court to have the vote included.**

## CBA SECTION RESPONSE

In our Senate Committee submission, the CBA Section supported the PITF proposal to maintain the prohibition against voting by non-arms length creditors, but to allow complete judicial discretion to override such prohibition by court order. Currently, such an order can be obtained only if non-arms length creditors hold more than 80% of all claims.

The Senate Committee has recommended that the prohibition against voting be maintained, but a court may override the prohibition if non-arms length creditors hold more than 40% of all claims. In other words, judicial voting permission will be unavailable if non-arms length creditors hold less than 40% of all claims.

The Senate is apparently concerned about the number of applications that may be brought before the court if the threshold is eliminated. In our view, that is extraordinarily unlikely. The cost of litigation alone will discourage such applications, which in any event will only be necessary if the non-arms length creditor's vote changes the outcome. The likelihood that the creditor's vote will make a difference diminishes commensurately as the percentage of non-arms length claims drops. Finally, neither the PITF, whose members included at least half a dozen trustees with extensive personal bankruptcy experience, nor the Canadian Association of Insolvency and Restructuring Professionals, raised any concern about the volume of anticipated court applications. These two groups would be in the best position to ascertain the extent of the problem. In our view, the Senate Committee's concern is unwarranted.

An alternative, perhaps not considered by the Senate Committee, is to specify the applicable percentage by regulation. The percentage could initially be set at zero. If floodgate problems arise, however unlikely, a simple regulation could increase the percentage.

## 24. Debts Not Released by an Order of Discharge

### SENATE COMMITTEE RECOMMENDATION

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

### CBA SECTION RESPONSE

As indicated in our Senate Committee submission, the CBA Section agrees with this recommendation, which is in part based on the growing importance of the service sector in the Canadian economy.