THE CANADIAN BAR ASSOCIATION
L'ASSOCIATION DU BARREAU CANADIEN

Study of the Senate Banking Committee on Bankruptcy and Insolvency Legislation

NATIONAL BANKRUPTCY AND INSOLVENCY LAW SECTION
CANADIAN BAR ASSOCIATION

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500-865 Carling, Ottawa, Ontario, Canada K1S 5S8
tel/tél. : 613.237.2925 toll free/sans frais : 1.800.267.8860 fax/téléc. : 613.237.0185 info@cba.org www.cba.org

TABLE OF CONTENTS

Study of the Senate Banking Committee on Bankruptcy and Insolvency Legislation

PREFACE

The Canadian Bar Association is a national association representing 37,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

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

Study of the Senate Banking Committee on Bankruptcy and Insolvency Legislation

EXECUTIVE SUMMARY

The National Bankruptcy and Insolvency Law Section of the Canadian Bar Association (the CBA Section) is pleased to present this submission to the Senate Committee on Banking, Trade and Commerce for its study of bankruptcy and insolvency law following passage of Bill C-12 (now chapter 36, S.C. 2007). It hopes that its submission, which uses the provisions of chapter 36 as its starting point, will assist the Senate Committee in making recommendations that will correct current legislative deficiencies. In our view, some of these deficiencies should be addressed immediately.

Commercial Insolvency Summary

Wage and Pension Priority: To eliminate the present uncertainty for stakeholders, the pension charge securing unpaid pension contributions should be proclaimed in force. However, the effective administration of WEPP and the assets subject to the charges depends upon the professional services provided by insolvency administrators. Therefore, a similar priority charge should be created for the reasonable fees and disbursements of the insolvency administrator incurred in administering the WEPP and realizing on assets subject to the pension charge.

Disclaimer of Agreements: As the disclaimer of agreements is essentially a commercial issue between the debtor and the other party, the role of the trustee/monitor should be limited to reporting on the proposed disclaimer in a court application disputing the disclaimer.

Intellectual Property: Chapter 36 will now include protecting a licensee's right of exclusive use of intellectual property notwithstanding a disclaimer of the license. However, protecting exclusive use potentially eliminates the utility of disclaiming the license, and therefore the rights of exclusive use should not be preserved.

Assignment of Agreements: As a trustee/monitor will now be required to approve of an assignment, this may unduly increase the costs of a reorganization. The CBA Section recommends that the role of the trustee /monitor be limited to reporting on the assignment in circumstances where the other party to the agreement opposes the assignment. In the context of reorganizations under the BIA, the debtor and not the trustee/monitor should be the party applying to the court seeking the assignment of an agreement.

Avoidance of Transactions under CCAA: The incorporation by reference of provisions in the BIA relating to preferences and transactions at undervalue into the CCAA creates confusion. There does not appear to be a "start" date for the period within which the transactions are subject to attack. Accordingly, the CBA Section recommends that s.36.1 of the CCAA should define "date of initial bankruptcy event" as the commencement of proceedings under the CCAA and "date of bankruptcy" as the earlier of: (a) the date the debtor becomes bankrupt or a receiver is appointed in respect of the debtor; and (b) the implementation date under the debtor's plan.

Incorporation by reference: Incorporating sections of the BIA into the CCAA by reference may give rise to a lack of clarity in the law. The CBA Section recommends that the CCAA include self-contained provisions.

Independence, Disclosure, and Creditor Participation in the Insolvency Process: The CCAA and BIA reorganization processes, and the court receivership process, presently provide inadequate systems for the fair participation of unsecured creditors. Without administrators that are independent of other stakeholders, full disclosure to all creditors, and mandated initial meetings of unsecured creditors, there is a risk that the interests of these creditors will be prejudiced. A transparent process with full disclosure and opportunity for creditors to express their views is key to the proper functioning of an insolvency system. Accordingly, the CBA Section recommends a package of changes aimed at facilitating the participation and information flow to unsecured creditors.

Section 243 Receivers: The CBA Section supported the creation of a "national" receiver in chapter 47. Section 243 of the BIA, as amended, should provide a uniform receivership model adapted to current commercial reality and increasing inter-provincial and international transactions. Chapter 36 incorporated most of the CBA Section's recommendations on the Bill C-55 version of the s.243 amendments. With a view to fostering the development of a uniform receivership model, the CBA Section has a few further recommendations, including some that are outstanding from its 2005 comments on Bill C-55. Subsection 243(1) should provide that:

- a secured creditor may not seek the appointment of a receiver before the expiry of the delay provided by subsection 244(2) unless it is shown that it is necessary to prevent the commission of fraud during the ten day waiting period, or that there is a likelihood during the ten day waiting period of substantial and avoidable deterioration of the assets or the business.

- a receiver may be appointed while a CCAA or BIA proposal process is pending when criteria equivalent to those in s.50.4 (11) of the BIA are met.

- any interested person may apply for the appointment of a receiver under subsection 243(1).

Personal Insolvency Summary

RRSPs and RRIFs: The CBA Section supports an exemption for RRSP contributions, however, in designing the exemption, it is essential to take into consideration the key differences between RRSPs and pensions, and the policy goal that underlies the exemption of retirement funds. The new RRSP exemption in s.67 violates bankruptcy policy on many levels, lacks adequate anti-abuse controls and, as enacted, will quickly become irrelevant. The PITF scheme requiring mandatory lock-in and an effective claw-back is necessary to address the important differences between pensions and RRSP and to ensure public respect for the administration of justice.

Undervalued Transactions and Preferences: The new non-arm's length provisions in ss.95 (preferences) and 96 (undervalued transactions), specifically the trustee's ability to overturn pre-bankruptcy transfers in satisfaction of matrimonial claims following separation, will have an immediate and significant adverse impact on the practice of family law in Canada. The new provisions are wholly inappropriate in the family law context, and may constitute a *Charter* breach.

With respect to undervalued transactions, these provisions should not apply to transfers made pursuant to separation agreements or matrimonial court orders. Such transfers ought to be governed by either provincial fraudulent conveyance legislation, or by a bankruptcy remedy that is designed to apply specifically in the context of marital breakdown. Further, the government should consider clarifying the applicability of the section to non-arms-length transfers intended for family support in accordance with legal and moral norms.

Similarly, the non-arms-length remedy with respect to preferences should not apply in the personal bankruptcy setting. Alternatively, as recommended in the case of undervalued transactions, the new preference remedy ought not to apply to transfers made pursuant to separation agreements or matrimonial court orders. Such transfers ought to be governed by either provincial fraudulent conveyance legislation, or by a bankruptcy remedy that is designed to apply specifically in the context of marital breakdown.

Student Loans: The CBA Section recommends that: (a) a hardship hearing be permitted for student loan debt within a year of the date of bankruptcy, or at the time of the discharge hearing; and (b) partial discharges of student loans be permitted at the hardship hearing, where appropriate. Finally, and particularly if these two previous recommendations are not adopted, the seven-year non-dischargeability period should be reduced.

Surplus Income: The definition of total income (and therefore what is included in the property of the estate under s.67) should refer to revenues "earned before discharge that have not been received before the date of bankruptcy", and should include "the lost component of any amounts received as damages or compensation in respect of a contract, tort, or statutory entitlement". Otherwise, the definition risks being both under and over-inclusive.

Sale of Assets in a Proposal: We agree with extending the prohibition against debtors selling or disposing of assets outside the ordinary course of business without court approval to include individuals as well as corporate debtors. However, a flaw in the wording of s.65.13 could preclude a court ordering, in the case of individual debtors, the sale of assets not acquired for or used in relation to the business. This unintended result should be rectified, and s.65.13 should not prevent the court from approving the sale or disposition of any asset by an individual debtor in a proposal.

Consumer Proposals: The significant increase in the dollar limit for consumer proposals from $75,000 to $250,000 should be accompanied by a change in the fee schedule or tariff applicable to consumer proposal to permit the administrator to recover any necessary disbursements for legal fees.

Regulatory Bodies: Section 69.6, which addresses the impact of a commercial proposal on federal or provincial regulatory proceedings, should be extended to all bankruptcy proposals.

Senate Recommendations: The legislation omits several beneficial recommendations in the 2003 Senate Report that ought to have been enacted, namely those governing implied reaffirmation agreements, non-purchase money security interests in exempt personal property, and the suite of recommendations in the family law area. The CBA Section recommends that these be enacted.

Study of the Senate Banking Committee on Bankruptcy and Insolvency Legislation

I. INTRODUCTION

The National Bankruptcy and Insolvency Law Section of the Canadian Bar Association (the CBA Section) is pleased to present this submission to the Senate Committee on Banking, Trade and Commerce for its study of bankruptcy and insolvency law following passage of Bill C-12 (now chapter 36, S.C. 2007).[1]

The CBA Section has a long history of contributions to government reform initiatives on insolvency law. It was involved with amendments arising from the last mandated five year review of the *Bankruptcy and Insolvency Act* (BIA) and the *Companies Creditors Arrangement Act* (CCAA), beginning with submissions to this Committee. This submission is the culmination of a national consultative process with members of the CBA Section Executive in all parts of Canada and builds on our past submissions on bankruptcy and insolvency reform.

The CBA Section is concerned that both chapter 47 and chapter 36 have been passed without the relevant Parliamentary Committees having the opportunity to conduct an extensive review of the Bills. It hopes that its submission, which uses the provisions of chapter 36 as its starting point, will assist the Senate Committee in making recommendations that will correct current legislative deficiencies. In our view, some of these deficiencies should be addressed immediately.

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[1] Bill C-12 amends the *Bankruptcy and Insolvency Act* (the BIA) and the *Companies' Creditors Arrangement Act* (the CCAA), the *Wage Earner Protection Program Act* (the WEPP Act), and chapter 47 of the Statutes of Canada, 2005.

II. COMMERCIAL INSOLVENCY

A. Wage and Pension Priority

Chapter 36

Chapter 36 does not amend the pension charge, or the Wage Earner Protection Program (WEPP), created in chapter 47. The WEPP provides that certain employees will be paid any unpaid wages and vacation pay up $3,000 in the event of a receivership or bankruptcy, from a fund established by the government. This pension charge over all the assets of a debtor secures: (a) unremitted employee pension contributions; (b) unpaid employer contributions in respect of defined contribution pension plans; (c) unpaid normal costs as required by the applicable pension legislation in respect of a defined benefit plan (the unpaid pension contributions).

The pension charge is not assigned to any person to enforce, however, if an insolvency administrator realizes on any assets subject to the pension charge, that insolvency administrator will become personally liable for the amounts secured by the pension charge up to the amount realized and will be subrogated to any rights that the pension plan might have to recover those amounts.

Also untouched in chapter 36 is chapter 47's amendment to the BIA and the CCCA to require that a proposal or plan provide for the payment in full amounts subject to the pension charge unless an agreement approved by the pension regulator is in place with respect to the payment of any unpaid pension contributions.

All of these provisions in chapter 47 have not been proclaimed into force.

CBA COMMENTARY

The CBA Section understands the reason for utilizing statutory super priority charges is to provide further protection for employees, in line with the purposes behind the WEPP, in the event of un-remitted pension contributions. In our previous submission on Bill C-55, we expressed concerns about the effectiveness of a pension charge. However, the CBA Section and the Pension and Benefits Law Section recognize that proclaiming the pension charge in force could assist plan administrators, and ultimately pension plan members. We expect this would eliminate the present uncertainty for all stakeholders involved.

The effective administration of the WEPP and the assets subject to the charges will depend on the professional services provided by insolvency administrators. The failure of chapter 47, and now chapter 36, to amend the BIA to ensure payment of the insolvency administrators' fees will jeopardize the proper administration of the charged assets.

RECOMMENDATION:

> **The sections of chapter 47 creating the pension charge should be proclaimed in force. A similar priority charge should be created for the reasonable fees and disbursements of the insolvency administrator incurred in administering the WEPP and realizing on assets subject to the pension charge.**

B. Disclaimer of Agreements

Chapter 36

Chapter 36 expands the role of the trustee/monitor that was established in chapter 47 in relation to the disclaimer of agreements after the commencement of reorganization. A reorganizing debtor may give notice of intent to disclaim an agreement, but only with the consent of the trustee/monitor.

In response to a notice received from the reorganizing debtor, the other party to a disclaimed agreement will have 15 days to apply to the court for an order that the agreement cannot be disclaimed. A reorganizing company also has the ability to apply to court for an order that an agreement be disclaimed, should the trustee/monitor not consent.

The other party to a disclaimed agreement will be able to file a proof of claim in the reorganization in respect of any damages resulting from the disclaimer.

CBA COMMENTARY

The CBA Section is concerned that the requirement that the trustee/monitor consent to the disclaimer of an agreement will unnecessarily increase the cost of reorganizations. The disclaimer of agreements is a commercial issue between the debtor and the other party to the agreement being disclaimed.

RECOMMENDATION:

> **The role of the trustee/monitor should be limited to reporting on the proposed disclaimer in a court application disputing the disclaimer.**

C. Intellectual Property

Chapter 36

Chapter 47 provided that in the case where the debtor gives another party use of intellectual property, the BIA and the CCAA will protect their continued use of the intellectual property notwithstanding the disclaimer, so long as the party continues to abide by its obligations for the use of intellectual property. However, chapter 36 now adds that the right to exclusive use of licensed intellectual property is preserved during the term of the license and any permitted extensions, notwithstanding a disclaimer.

CBA COMMENTARY

The main reason to terminate a license is often to allow the insolvent company to re-license the intellectual property to a new licensee, and to release themselves from obligations relating to a bad licensing agreement. If the licensee's exclusive right cannot be disclaimed, then in practice, there is likely little purpose to disclaim the licence. This significantly reduces the utility of this provision for a reorganizing company with ownership of intellectual property.

RECOMMENDATION:

> **The CBA Section recommends that the licensee's right to use licensed intellectual property, save and except for rights of exclusive use, be preserved.**

D. Assignment of Agreements

Chapter 36

Similar to disclaimers of agreements, chapter 36 will increase the role that the trustee/monitor plays in the assignment of agreements in the context of reorganization under the BIA and CCAA. On an application to force the assignment of an agreement, the court will be required to consider whether the trustee/monitor has approved the proposed assignment. In addition, chapter 36 will also amend the provisions of the BIA to provide that an application seeking to force the assignment of an agreement in the context of reorganization is to be made by the trustee/monitor rather than the debtor.

CBA COMMENTARY

Again, the CBA Section is concerned that the requirement that the trustee/monitor consent to the assignment of an agreement will unnecessarily increase the cost of reorganizations. The assignment of agreements is, essentially, a commercial issue between the debtor and the other party to the agreement being assigned. There does not appear to be a reason to require intervention of the trustee/monitor.

RECOMMENDATION:

> **The role of the trustee/monitor should be limited to reporting on the assignment in circumstances where the other party to the agreement opposes the assignment. In the context of reorganizations under the BIA, the debtor and not the trustee/monitor should be the party applying to the court seeking the assignment of an agreement.**

E. Avoidance of Transactions under CCAA.

Chapter 36

Chapter 36 will make provisions in the BIA relating to preferences and transactions at undervalue (ss.38 and 95 to 101) applicable in reorganizations under the CCAA unless a plan of compromise or arrangement provides otherwise.

These avoidance provisions of the BIA operate on the basis of two dates:

a. The "initial bankruptcy event";
b. The "date of bankruptcy".

Transactions undertaken within the period that begins on the date that is a fixed number of days prior to the "initial bankruptcy event" and ending on the "date of bankruptcy" are subject to attack.

For the purposes of application to the CCAA, this second date will be the date CCAA proceedings are commenced.

CBA COMMENTARY

The proposed provisions of the CCAA provide for the equivalent of "date of bankruptcy", but not "initial bankruptcy event". The result is that the provisions will not operate as intended. The failure to define "initial bankruptcy event" results in there being no "start" date for the period within which the transactions are subject to attack.

RECOMMENDATION:

The CBA Section recommends that s.36.1 of the CCAA should define "date of initial bankruptcy event" as the commencement of proceedings under the CCAA and "date of bankruptcy" as the earlier of:

a) the date the debtor becomes bankrupt or receiver is appointed in respect of the debtor; and
b) the implementation date under the debtor's plan.

F. Issues with Incorporation by Reference

Chapter 36

There are a number of provisions where sections of the BIA are incorporated into the CCAA. Chapter 36 does not address how to interpret the former if there are conflicts with terms of the CCAA.

CBA COMMENTARY

Incorporating sections of the BIA into the CCAA by reference may give rise to a lack of clarity in the law. For example, BIA s.97(3), which indicates that the law of set-off applies to claims made against the estate of the bankrupt, is incorporated by reference into the CCAA. The CCAA does not currently permit the debtor to exclude the application of set-off, in a plan of compromise or arrangement. It now is unclear, by the manner in which s.97(3) is incorporated by reference whether the debtor will be able to exclude the application of set-off in the plan.

RECOMMENDATION:

The CBA Section recommends that, rather than incorporating the BIA provisions by reference, the CCAA includes self-contained provisions.

G. Independence, Disclosure, and Creditor Participation in the Insolvency Process.

CBA COMMENTARY

The CCAA and BIA reorganization processes, and the court receivership process, presently provide inadequate systems for the fair participation of unsecured creditors. Without administrators that are independent of other stakeholders, full disclosure to all creditors, and mandated initial meetings of unsecured creditors, there is a risk that the interests of these creditors will be prejudiced. A transparent process with full disclosure and opportunity for creditors to express their views is key to the proper functioning of an insolvency system.

Accordingly, the CBA Section recommends the package of changes as set out in the points below, which are all aimed at facilitating the participation and information flow to unsecured creditors.

RECOMMENDATIONS:

Independence Standard for Insolvency Administrators

> **The CCAA and BIA should be amended to provide that the CCAA monitor/BIA proposal trustee shall be independent of the debtor and of any creditor owed more than 5% of the debtor's total debts (based on its initial creditors list as of the date of filing).**

Disclosure of Information to Creditors in Insolvency Proceedings

> **A creditors list should be provided to the creditors in every insolvency proceeding, in accordance with the procedure followed in formal bankruptcies under the BIA. Such list should contain the name, address, amount owed, and initial classification of each creditor's claim according to the books and records of the company as at the date of the initial filing/initial bankruptcy event.**

> **The CCAA and BIA should provide that an insolvent person should make "full, true and plain" disclosure in every material document it issues to creditors, an insolvency administrator, the Official Receiver, or the court in an insolvency proceeding, and provide "timely disclosure" of any material changes in the affairs of the estate under administration.**

> **Insolvency administrators appointed in any insolvency proceeding should make "full, true and plain" disclosure in every material document they issue in an insolvency proceeding, and provide "timely disclosure" by way of report of any material changes in the affairs of the estate under administration. Insolvency administrators should not be liable for the contents of their reports**

absent gross negligence, but the adequacy of its reports shall be a factor that may be taken into account in any review of the professional fees charged to the estate for its services.

Every insolvency administrator appointed under the CCAA or BIA should establish a website for the case containing all creditors lists, service lists, court materials, reports and creditor communications on it pertaining to the case, and should be required to advise creditors at the outset of the case as to how to access that website and how to get on the service list for the proceeding.

The CCAA should require that in connection with putting forth a plan of compromise or arrangement, the debtor should provide the creditors with an information package that meets the minimum standards required for "Information Circulars" under the applicable corporate law under which the company is incorporated and regulated;

If management solicits proxies from creditors (e.g. votes in favour of a restructuring plan), dissenting creditors circulars should be circulated by management, upon the request of any creditor or group of creditors holding at least 5% of the company's indebtedness in any class of the creditors.

Insolvency administrators should not be permitted to solicit proxies directly or indirectly.

Initial Meeting of Unsecured Creditors in Every Insolvency Proceeding

It is recommended that in a reorganization, a meeting of creditors be called 60 days after the commencement of any BIA or CCAA reorganization or court receivership process, to permit the

creditors to approve or replace the directors, and to approve or substitute the insolvency administrators (debtor's counsel, CAA monitor, and the CRO). The meeting should receive the same disclosure mandated under the BIA to be provided to first meetings of creditors in bankruptcies, mutatis mutandis.

In receiverships, the meeting should also be able to appoint inspectors who would exercise powers over the receivership to the same extent that inspectors exercise powers over a bankruptcy process.

Investigation Powers in Inchoate Bankruptcies

Unsecured creditors should be permitted to initiate bankruptcy proceedings upon a CCAA or court receivership filing, but the bankruptcy should be suspended in all respects pending the conclusion of the CCAA filing or court receivership with the exception of the right of the trustee named in the application to exercise the following investigative powers conferred on a trustee to obtain information under the BIA (but without recourse to the estate for funding unless the court orders otherwise): (i) reviewing and reporting on the conduct of management and the insolvency administrators; (ii) investigating preferences and pre-filing misconduct as well as the causes of the debtor's failure to the extent such investigations are determined by the trustee acting in good faith to be commercially reasonable; and (iii) reviewing and reporting to the unsecured creditors on the reasonableness of any restructuring steps taken by the debtor, including any interim sale or restructuring plan; (iv) Such other powers as the unsecured creditors in meeting request the court to confer.

H. Section 243 Receivers

CBA Commentary

The CBA Section supported the creation of a "national" receiver in chapter 47. Section 243 of the BIA, as amended, should provide a uniform receivership model adapted to current commercial reality and increasing inter-provincial and international transactions. The CBA made comments on the Bill C-55 version of the s.243 amendments. The 2007 amendments have taken account of most of those. With a view to fostering the development of a uniform receivership model, the CBA Section has a few further recommendations, including some that are outstanding from its comments in 2005 which were not addressed in the 2007 amendments.

RECOMMENDATIONS:

The CBA Section recommends that subsection 243(1) should provide that a secured creditor may not seek the appointment of a receiver before the expiry of the delay provided by subsection 244(2) unless it is shown that it is necessary to prevent the commission of fraud during the ten day waiting period, or that there is a likelihood during the ten day waiting period of substantial and avoidable deterioration of the assets or the business.

The CBA Section recommends that subsection 243(1) provide that a receiver may be appointed while a CCAA or BIA proposal process is pending where criteria equivalent to those in s.50.4(11) of the BIA are met.

The CBA Section recommends that chapter 47 be amended to provide that any interested person may apply for the appointment of a receiver under subsection 243(1).

III. PERSONAL INSOLVENCY

A. RRSPs and RRIFs

Chapter 36

Chapter 36 renders exempt from distribution all RRSPs and RRIFs, without precondition, qualification or constraint, except for contributions made in the last 12 months for those RRSPs or RRIFs not otherwise already exempted under provincial law (the "clawback").

CBA COMMENTARY

The CBA Section supports exemptions for RRSPs in accordance with the scheme developed by the Personal Insolvency Task Force (PITF), approved by the Senate in its 2003 Bankruptcy and Insolvency Review, and incorporated with minor variation into chapter 47. Self-employed individuals and non-pensioned employees often lose their retirement savings upon bankruptcy, whereas pensioned employees do not. In designing the RRSP exemption however, it is essential to take into consideration the key differences between RRSPs and pensions, and the policy goal that underlies the exemption of retirement funds. The CBA acknowledges that chapter 36 is the result of high-level federal-provincial negotiation. However, we must point out that the proposed RRSP exemption is deeply flawed and violates bankruptcy policy on many levels. First, it deprives the trustee and creditors of any practical means to control strategic pre-bankruptcy conduct by the debtor, since apart from the clawback; there is no practical way to reverse most debtor contributions to a provincially exempt RRSP before bankruptcy. Indeed, strategic conduct is encouraged by eliminating the court's ability to extend the clawback beyond one year in an appropriate case. Since most provinces, if not all, will undoubtedly revise their RRSP exemption policies to accord with the federal RRSP exemption, the one-year clawback will soon lose any relevance, as it is expressly inapplicable to RRSPs already exempted by provincial law.

Second, chapter 36 eliminates the mandatory lock-in as a condition of the exemption. Therefore, debtors can withdraw exempted RRSPs at any time before their retirement. An exemption policy based on retirement savings should not extend to funds that may be utilized at any time for any other purpose. The new provisions will permit debtors to exempt what is, in effect, a tax-aided, tax-deferred bank account, without any commensurate obligation to preserve those funds until retirement. An exemption fashioned in this way ignores the significant extent to which Canadians access their RRSPs long before retirement.

While we are not convinced that the exemption should be capped, we do have some concerns that the absence of a cap may lead to a reduction in public confidence in the administration of justice if debtors are permitted to proceed through bankruptcy with unusually large RRSP savings.

Last, the exemption will not even accomplish its aims, because under existing case law, a bankruptcy court may impose discharge conditions that require the bankrupt to utilize accessible exempt assets such as exempt RRSPs (as distinguished from pensions or locked in RRSPs) to fund substantial discharge orders. The case law has established that such orders would not be made, and thus the policy behind a retirement-based exemption would be preserved, if the RRSP were locked in as part of the exemption process.

The requirement of a mandatory lock-in as a condition of the exemption, would allow the policy objective of preserving funds for the debtor's retirement to be achieved. Furthermore, those provinces currently without blanket RRSP exemptions, would have the opportunity of incorporating this mechanism into their own exemption schemes, if they so wished. Because RRSPs are established through federal legislation, the provinces have had limited options in fashioning their own provincial exemptions. It is quite unfortunate that the government has now foreclosed, for all the remaining provinces, the lock-in option that is the key to a sensible exemption policy. In our view, the political impasse could and ought to have been resolved by retaining the Senate recommendation adopted in chapter 47 and permitting the objecting provinces to opt out. This would at least have permitted the remaining provinces to choose a lock-in exemption policy for RRSPs if they so wished.

RECOMMENDATION:

The CBA Section recommends adoption of the PITF scheme for exemption of RRSPs and RRIFs, recommended by the Senate and adopted in chapter 47, be restored.

B. Undervalue Transactions

Chapter 36

Chapter 36 creates a new s.96 (formerly chapter 47 s.96.1), that replaces existing BIA ss. 91 and 100, which provide for settlements and reviewable transactions. These two terms will no longer be used in the BIA. Under this section, the Trustee may apply to court to inquire whether a transaction with the debtor was a "transfer at an undervalue" (defined as a transaction where the consideration received is conspicuously less than the fair market value of the property or services sold or disposed of), and whether the transaction was at arms-length. If this definition is met:

- **Arms-length** transactions: The court may give judgment for the difference if:
  - (i) the transaction was within one year before bankruptcy; <u>and</u>
  - (ii) the debtor was insolvent or rendered insolvent; <u>and</u>
  - (iii) the debtor intended to defeat the interests of creditors.
- **Non-arms-length** transactions: The court may give judgment for the difference if:
  - (i) the transaction was within one year before bankruptcy, <u>or</u>
  - (ii) within five years and debtor was insolvent or rendered insolvent, <u>or</u>
  - (iii) within five years and the debtor intended to defeat the interests of creditors.

The Trustee shall state the fair market value; the onus lies on the other party to prove otherwise. Related parties are presumed to be non-arms-length, although the presumption is rebuttable.

CBA COMMENTARY

The CBA Section has some concerns about transactions at undervalue in the personal insolvency context.

Application to Separation Agreements: The CBA Section has concerns with the application of the undervalue transaction provisions to property transfers under separation agreements. The proposed amendment will make these transfers vulnerable despite good faith and lack of knowledge of a spouse's insolvency. It will risk overturning negotiated family property resolutions despite a clear policy trend toward encouraging mediated resolution of family disputes. The proposed standard of review, fair market value of the consideration, is often highly subjective in family law cases, and does not assist in determining whether an agreement ought to pass muster. For example, what is the fair market value of a release of support claims? The new provision represents a significant departure from existing case law (which largely ignores arithmetical calculations of consideration), but without any articulated purpose. The CBA Section believes that the absence of any reference to the recipient's knowledge, intent, or good faith, is a deep flaw in the proposed test. It proposes that separation agreements, as in the case of s.160 of the *Income Tax Act*, be excluded from s.96.

Further, the use of "arms-length" as the differentiating factor between the two sets of rules is not suitable for separated spouses. Even spouses who despise one another and have separate lawyers, may nonetheless agree that the family's money be kept within the family at the expense of creditors. In other words, they may be at arms-length in some respects, and not in other respects. It is the content of the agreement, the good faith of the spouses and all of the circumstances that should govern, not an arms-length test that obscures the subtle and multifarious nature of the spousal relationship.

Impact on Intact Families: The non-arms-length provisions may have an unintended effect on intact families, specifically in the provision of family support. Section 96 may jeopardize payments made to support a debtor's family in the five years before bankruptcy. Such payments, when they are intended for consumption or spending, are excluded from the definition of "settlement" in the current s.91. By eliminating this exclusion, many ordinary and appropriate transactions will be jeopardized. For example, if a married or common-law debtor gives money to his or her spouse while insolvent, the transferee spouse may become liable to the trustee even if the amounts were reasonable, in good faith, and for the transferee's consumption. Some of our members disagree, arguing that the element of judicial discretion reserved by the use of the word "may" in s.96 is sufficient to allow the judiciary to control, circumscribe and define the appropriate ambit of this remedy.

RECOMMENDATION:

> **The undervalued transactions provision should not apply to transfers made pursuant to separation agreements or matrimonial court orders. Such transfers ought to be governed either by provincial fraudulent conveyance legislation, or by a bankruptcy remedy that is designed to apply specifically in the context of marital breakdown. Further, the government should consider clarifying the applicability of the section to non-arms-length transfers intended for family support in accordance with legal and moral norms.**

C. Preferences

Chapter 36

Chapter 36 replaces the former fraudulent preference provisions and, in the new s.95, creates a new way of attacking preferences. A preference is broadly defined to include a property transfer, a provision of services, a charge on property, an obligation incurred, or a judicial proceeding taken or suffered by an insolvent person in favour of a creditor. Like the new undervalued transaction remedy in s.96, the grounds of attack depend on whether or not the creditor who received the alleged preference is at arms-length:

- **Arms-length** transactions are void if:
  - (i) the transaction occurred within *three months* of the bankruptcy or proposal; <u>and</u>
  - (ii) the transaction was effected with a *view* to giving that creditor a preference over another creditor. The "view to prefer" is presumed if the transaction had the effect of

giving the creditor a preference, even if it was done under pressure.

- **Non-arms-length** transactions are void if:
  (i) the transaction occurred within *one year* of the bankruptcy or proposal; <u>and</u>
  (ii) the transaction has the *effect* of giving that creditor a preference over another creditor.

CBA COMMENTARY

The arms-length provision is acceptable in the personal insolvency setting. However the CBA Section has strong misgivings about the non-arms-length provision. In our view, it unacceptably detaches statute law from underlying public policy. Our society wants its members to act morally or ethically in our society, and one of the ways we encourage this is by ensuring that our laws reflect and encourage this underlying morality. However, good faith and honesty will not matter under the non-arms-length provision, nor will it matter whether the debtor was insolvent at the time the transaction occurred. While economic and efficiency considerations might justify this approach in the corporate setting, it is inappropriate and unnecessary in the personal insolvency setting.

The preference remedy in s.95 significantly exacerbates the problem we have identified above in relation to undervalued transactions and separation agreements or matrimonial court-ordered transfers. For related creditors — as married spouses are presumed to be — any transaction within 12 months of the date of bankruptcy that has the effect of giving a preference to a related party, is void. The "related creditor" test does not refer to any mental element: it is purely a matter of timing and effect, without reference to good faith, bona fides, or valuable consideration. This will have a significant impact on separation agreements, even those made under the specter of an impending matrimonial trial. Any such agreement, and presumably even a consent or unopposed order, will be vulnerable if the opposing party declares bankruptcy within one year after the agreement. Neither good faith, nor legal advice, nor need, will be sufficient to defend the transaction. The impact of the revision will be to force matrimonial disputes to trial, and to undercut the crucial importance of finality in matrimonial litigation. Again, this effect conflicts with the clear judicial and legislative trend favouring consensual or mediated resolution of matrimonial disputes.

We have also identified a potential *Charter* problem in relation to these provisions. Under chapter 36, ss.4(5) of the BIA will provide that married spouses who have separated are reputably presumed to be non-arms-length for the purposes of preferences and undervalued transactions. This presumption does not, however, apply to common law partners who have separated. Separation agreements between common law partners are therefore treated more favourably than those between married spouses. No rational justification exists for this arbitrary discrimination. There is no rational reason for utilizing the date of divorce as the dividing line between arms-length and non-arms-length transactions. Separating spouses, whether they are married or common law partners should be treated the same under these provisions.

A further concern is the differential effect this provision will have among the provinces. There are essentially two types of matrimonial property regimes in Canada: *equalization* of net family property (Manitoba, Ontario, Québec, Prince Edward Island, Northwest Territories and Nunavut) and *division* (sometimes “distribution”) of family property (British Columbia, Alberta, Saskatchewan, New Brunswick, Newfoundland and Labrador, Nova Scotia and Yukon). In the equalization provinces, the structure of the legislation and the case law, establish that the matrimonial property legislation creates a “debtor-creditor” remedy. The court must first establish the quantum of the equalization “debt”, and only then can family law remedies be applied such as vesting, creating a trust, directing the transfer of half the home, etc. Because of the debtor-creditor relationship, transfers or payments made to satisfy an equalization claim are essentially transactions that satisfy a creditor's claim, and this engages the proposed s.95 preference provision.

In the division provinces, the legislation allows the family court to “divide” family property. There is normally no debtor-creditor relationship, simply a distribution of the assets *in specie* in a way established by the judge (or by the parties themselves). Since there is no creditor and no debtor, the preference remedy in s.95 will normally not be engaged, even though the actual transaction, i.e. transfer of a half interest in the home, may be identical.

This means that a separation agreement or court order made in, say, Manitoba, is profoundly more vulnerable to the effects of bankruptcy than one done in, say, Saskatchewan. There is no good reason why this should be so. The treatment of this issue should be uniform across the country, as it has a significant impact on public policy. This treatment should be intentional and carefully designed, rather than an unintended by-product of broad language.

RECOMMENDATION:

> **The non-arms-length remedy in s.95 should not apply in the personal bankruptcy setting. Alternatively, as recommended in the case of undervalued transactions, the new preference remedy ought not to apply to transfers made pursuant to separation agreements or matrimonial court orders. Such transfers ought to be governed either by provincial fraudulent conveyance legislation, or by a bankruptcy remedy that is designed to apply specifically in the context of marital breakdown.**

D. Student Loans

Chapter 36

Chapter 36 reduces the non-dischargeability provision for student loans from 10 years from ceasing to be a student to seven. It also shortens the date for the availability of a hardship hearing from 10 years of ceasing to be a student to five (ss.178(1)(g) and (1.1)).

CBA COMMENTARY

The CBA Section agrees with the direction of this amendment. The CBA Section has previously advocated the PITF position that the non-dischargeability period for student loans be reduced to five years, with the hardship hearing available after one year. The CBA Section acknowledges that any change in this legislation must be accompanied by commensurate changes in the student loan rules. While we prefer a non-dischargeability period that is significantly shorter than seven years, the more significant problem with chapter 36 is the continued lengthy unavailability of a hardship hearing, along with the restrictions on the range of judicial remedies available when hardship is proven. A hardship hearing should be available within a year of bankruptcy, or alternatively at the time of the discharge hearing. Further, it is very difficult for the courts to administer justice when, as the jurisprudence now suggests, the only relief that may be granted is the extinction of the entire student loan. The court should be empowered to grant a partial discharge of the student loan in an appropriate case.

RECOMMENDATION:

The CBA Section recommends that: (a) a hardship hearing for student loan debt be permitted within a year of the date of bankruptcy, or at the time of the discharge hearing; and (b) partial discharges of student loans be permitted at the hardship hearing, where appropriate. Finally, and particularly if these two previous recommendations are not adopted, the seven-year non-dischargeability period should be reduced.

E. Surplus Income

Chapter 36

Chapter 36 defines total income to include all revenues earned or received while the debtor is bankrupt, including damages for wrongful dismissal, a pay equity settlement, or workers' compensation, but does not include any gift, legacy, inheritance or other windfall received in this period (s.68(2)).

CBA COMMENTARY

The PITF recommendation was to define total income to include all revenues earned at any time before discharge that have not been received before the date of bankruptcy. The revised wording in chapter 36 largely adopts the PITF recommendation, but has altered its wording in a way that leaves a gap. The legislation now defines total income in s.68(2) to include revenues that are "earned or received" during the bankruptcy. This excludes from total income - and therefore from the property of the estate under s.67 - revenues earned before bankruptcy but received after discharge. For example, with respect to a wrongful dismissal claim arising out of a pre-bankruptcy dismissal, if the bankrupt receives the damage award before his or her discharge, it will fall within total income. But if it is received after discharge, it falls outside total income. How should it be treated? The cash is not "after-acquired property", since it was received after discharge. The cause of action itself existed before bankruptcy, and hence, is "property of the estate". This leads to confusion in the law. Can the bankrupt even settle the lawsuit after his or her discharge, or does title to the cause of action vest in the trustee? In short, the definition should refer to revenues earned before discharge that have not been received before the date of bankruptcy.

The second problem with chapter 36's treatment of surplus income is that the definition of total income is both under-inclusive and over-inclusive. It is under-inclusive since the definition excludes, by inference, the lost income component of a *tort damages award*. The definition defines total income to include "any amounts received as damages for wrongful dismissal, as a pay equity settlement, or under any Act of Parliament or Act of the legislature of a province that relates to workers' or workmen's compensation". By the interpretive principle of *expressio unius est exclusio alterius*, this list excludes, by implication, the items left off the list. There is no policy reason why s.68 should be restricted only to litigation damages for wrongful dismissal, and exclude the lost income component of all other kinds of claims that can generate lost income awards.

The over-inclusiveness results by virtue of the statute incorporating into s.68 items that should not be there, such as mental distress damages in a wrongful dismissal claim (which are personal to and should remain with the bankrupt), but not in any other tort claim. It includes punitive damages in a wrongful dismissal claim, though not in any other tort claim. The definition of total income should include no more and no less than "the lost income component of any amounts received as damages", which would incorporate, for example, the lost income component of personal injury damages suffered in motor vehicle accident, wrongful dismissal damages, and a human rights award.

RECOMMENDATION:

> **The definition of total income should refer to revenues "earned before discharge that have not been received before the date of bankruptcy", and should include "the lost income component of any amounts received as damages or compensation in respect of a contract, tort or statutory entitlement".**

F. Sale of Assets in a Proposal

Chapter 36

Chapter 36 amends the BIA to provide that corporate debtors in a proposal cannot sell or dispose of assets outside the ordinary course of business without court approval (s.65.13)). It addresses a shortcoming in chapter 47 by extending this prohibition to individuals as well, but states that, "In the case of an individual who is carrying on a business, the court may authorize the sale or disposition only if the assets were acquired for or used in relation to the business" (s.65.13(2)).

CBA COMMENTARY

We agree with the extension of this provision to individual debtors, however, the wording of the provision is flawed. It would prevent the court from approving, for example, the sale or mortgage of a home owned by a self-employed professional unless the home was acquired for or used in relation to his or her profession. This is presumably a drafting error, as there is no conceivable policy reason to prevent debtors from accessing, with court approval, their non-business assets to fund a proposal.

RECOMMENDATION:

> **Section 65.13(2) should not prevent the court from approving the sale or disposition of any asset by an individual debtor in a proposal.**

G. Consumer Proposals

Chapter 36

Chapter 36 increases the dollar limit for consumer proposals from $75,000 to $250,000 or other prescribed amount (s.66.11)).

CBA COMMENTARY

The CBA Section agrees that the limit for consumer proposals should rise. However, the consumer proposal scheme, unlike a bankruptcy or commercial proposal, does not permit an administrator to recoup disbursements for legal fees. Administrators are likely to encounter more complex legal issues with the increased dollar value of proposals. They should not suffer reduced fees if they need to retain counsel.

RECOMMENDATION:

The CBA Section recommends that the fee schedule or tariff applicable to consumer proposals to permit the administrator to recover any necessary disbursements for legal fees.

H. Regulatory Bodies

Chapter 36

Chapter 36 includes a new section, s.69.6, to address the impact of a commercial (Division I) proposal on federal or provincial regulatory proceedings. It provides that the automatic stay in a commercial proposal does not affect a regulatory body's investigation in respect of the debtor, or any proceeding taken by a regulatory body in respect of the debtor. The only regulatory steps that are stayed are those where the regulatory body is attempting to enforce its rights as a creditor (making orders for payment or applying to the court for such an order). The court may determine whether the stay on enforcement action by a regulatory body is applicable in the circumstances. With respect to all others steps, the proposal debtor may apply to the Bankruptcy Court for a stay, which may be granted if the regulatory proceedings jeopardize the viability of the proposal and it is not otherwise contrary to the public interest to grant the stay.

CBA COMMENTARY

We agree with this change. However, we believe that the provision should include a reference to consumer proposals. An individual debtor may, depending on the circumstances, file a consumer proposal or a commercial proposal. Why should it be left ambiguous as to whether this provision should be applied in a consumer proposal by analogy, or not at all?

RECOMMENDATION:

Section 69.6 should apply to all bankruptcy proposals.

I. Senate Recommendations not Included in chapters 47 and 36

A number of the personal insolvency-related recommendations in the 2003 Senate Banking Committee report were not included in either chapter 47 or chapter 36. The CBA Section believes that some of these should be adopted, and urge the Senate Committee to again raise the below issues when its issues its report on the study it is currently conducting.

Reaffirmation Agreements: The CBA Section supports eliminating implied reaffirmation agreements, which can cause serious injustice.

Non-Purchase Money Security Interests in Exempt Property: The CBA Section agrees (with reservations on the inclusion of motor vehicles) with the PITF and Senate Banking Committee recommendation to void 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 would significantly remediate the reaffirmation concern noted elsewhere in the Senate Committee Report.

Family Law Issues: In its February 2005 Submission, the Section noted its agreement with the five family law recommendations in the Senate Committee Report. Two of these recommendations address technical deficiencies in the 1997 support amendments to the BIA, which were never intended to impair the enforcement or collection of support. The recommendation that bankruptcies not stay or release any claim for equalization or division of exempt assets comports with judicial policy expressed in reported cases. It eliminates the unnecessary expense and risk that spouses in "equalization" jurisdictions 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. The fourth recommendation fixes a distortion in the case law that permits a bankruptcy trustee to intervene in matrimonial litigation in circumstances that result in substantial injustice. The final recommendation creates a new bankruptcy remedy against fraudulent or malicious dissipation or concealment of property to defeat family property claims.

All of these recommendations were omitted from both chapter 47 and chapter 36. We recommend the adoption of the Senate's recommendations in this area.