Submission on Bill C-501 *Bankruptcy and Insolvency Act* amendments (pension protection)

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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 Pensions and Benefits Law & Bankruptcy, Insolvency and Restructuring Law Sections 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 Pensions and Benefits Law & Bankruptcy, Insolvency and Restructuring Law Sections of the Canadian Bar Association.

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Submission on Bill C-501
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I. INTRODUCTION

The Canadian Bar Association's National Bankruptcy, Insolvency and Restructuring Law and Pensions and Benefits Law Sections (CBA Sections) appreciate this opportunity to comment on Private Members' Bill C-501, *Bankruptcy and Insolvency Act* amendments (pension protection).

II. SECURITY FOR SEVERANCE AND TERMINATION PAY

Bill C-501 would amend sections 81.3 and 81.4 of the *Bankruptcy and Insolvency Act* (BIA) to create a new statutory priority charge to secure amounts owing in respect of severance and termination pay by a charge against the debtor's current assets. The Bill would not impose a cap on the amount of the termination and severance pay to be secured.

Currently, sections 81.3 and 81.4 of the BIA create a charge over a debtor's current assets in favour of employees (the Employee Remuneration Charge, or ERC) to secure wages, salaries, commissions, or other compensation up to $2,000, and disbursements of up to $1,000 owing to travelling salespeople by a person who is subject to a receivership or is bankrupt. The ERC covers amounts owing:

(a) in the case of a receivership, during the six months before the date the receiver was appointed; or

(b) in the case of a bankruptcy, the period beginning on the day that is six months before the date of the initial bankruptcy event and ending on the date of the bankruptcy.[1]

The *Wage Earner Protection Program Act* (WEPPA) established a government-administered program – the Wage Earner Protection Program (WEPP) – to provide compensation for amounts owed to employees in the case of the bankruptcy or receivership of their employer.

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[1] BIA, s. 81.3 and 81.4.

Employees are entitled to claim under the WEPP for compensation where their employment is terminated in the context of the bankruptcy or receivership. Termination pay and severance pay are not currently secured by the ERC – the definition of "compensation" in sections 81.3(9) and 81.4(9) of the BIA specifically excludes termination and severance pay. Termination and severance pay are, however, covered by the WEPP. While the WEPP did not initially provide coverage for termination and severance pay owed to employees, the WEPPA and the Wage Earner Protection Program Regulations (WEPP Regulations) were amended in 2009 to include such coverage.

While the CBA Sections appreciate the importance of protecting employees, it is also important to secure the right balance between employees and other creditors. In our view, a more appropriate balance between the interests of employees and other creditors with respect to termination and severance pay can be accomplished by amending the WEPP Regulations to remove the provision that reduces the amount of an employee's WEPP claim by any amounts recovered by employees under the ERC. That provision has the effect of reducing an employee's WEPP coverage for termination and severance pay by the amount of any outstanding employee remuneration.

When the WEPPA was first enacted, the WEPP provided coverage just for outstanding remuneration owed to an employee. To avoid "double recovery" by an employee, the WEPP Regulations provided that any amount an employee received as a result of the ERC would reduce the employee's entitlement under the WEPP.[2] For example, if an employee was owed $5,000 in remuneration and recovered $2,000 from a bankruptcy trustee or receiver as a result of the ERC, the employee's claim under the WEPP would be limited to $1,000, for a total recovery from ERC and the WEPP of $3,000.

When the WEPPA was amended to cover termination pay and severance pay, the WEPP Regulations were not amended to remove the provision requiring any amount recovered by the employee under the ERC to be applied to reduce the employee's entitlement under the WEPP. It is not clear whether this was intended. However it has the practical effect of reducing the employee's recoveries in an insolvency if the employee recovers under the ERC first.

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[2] Wage Earner Protection Program Regulations, SOR/2008-222 s. 6(a).

For example, if an employee is owed $3,000 in unpaid remuneration and $5,000 in termination pay, the employee's current recoveries would be $3,000 – $2,000 under the ERC and $1,000 under the WEPP because the $2,000 recovered by the employee under the ERC reduces the employee's entitlement under the WEPP. Amending the WEPP Regulations to remove the requirement that amounts received under the ERC reduce the employee's WEPP entitlement would, in many circumstances, increase the total recovery for employees. Assuming the facts described above, the employee would recover a total of $5,000 – $2,000 under the ERC, $1,000 from the WEPP in respect of unpaid remuneration in excess of the $2,000 secured by the ERC and $2,000 from the WEPP in respect of termination pay and severance pay.

RECOMMENDATION

1. **The CBA Sections recommend that the WEPP Regulations be amended to remove the requirement that amounts received by an employee in respect of wages or vacation pay after the date of bankruptcy or the appointment of a receiver be deducted from the amount that the employee is entitled to claim under the WEPP.**

Amending the WEPP Regulations that mandate that payments under the WEPP be allocated to unpaid remuneration first may increase employee's recoveries in an insolvency, particularly where the employee recovers under the WEPP before payments are made under the ERC.

RECOMMENDATION

2. **The CBA Sections recommend that the WEPP Regulations be amended to reverse the allocation of payments to provide that payments under the WEPP will be allocated to termination pay and severance pay prior to being allocated to remuneration.**

III. EMPLOYEE CLAIMS AGAINST DIRECTORS

Under section 119 of the *Canada Business Corporation Act*[3] (CBCA) the directors of a CBCA corporation are, subject to certain conditions and limitations, jointly and severally liable to each of the employees of the corporation for up to six months' wages for services performed while they were directors. To enforce that liability, employees must commence proceedings

[3] R.S.C. 1985, c. C-44.

against the directors of a corporate employer to recover a judgment against the directors for employee remuneration for which the director might be liable.

Bill C-501 would amend the CBCA to provide for:

(a) the appointment of an adjudicator to determine the liability of the directors of a corporate employer for employee remuneration; and

(b) the order made by an adjudicator against a director to be filed with the Federal Court and, once filed, to have the same effect as a judgment of the Federal Court.

The CBA Sections do not oppose a summary procedure to determine a director's liability for employee remuneration for the purposes of the CBCA, provided that proper due process is provided. While not common in corporate legislation, there is precedent for summary procedures to determine a director's liability for employee remuneration. For example, the Ontario *Employment Standards Act, 2000*[4] permits an employment standards officer to order that the directors of a corporate employer pay employee remuneration. In addition, the *Canada Labour Code* permits an inspector to issue a payment order to the directors of a corporate employer subject to the *Code*.[5]

A summary procedure for enforcing claims against corporate directors may enhance net recoveries for the Crown and reduce the cost of the WEPP. Where the WEPP pays an employee remuneration claim, the Crown subrogates to, *inter alia*, the employee's claim against the directors of a corporate employer.

The proposed amendments in Bill C-501 do not provide for appeal from a decision by an adjudicator. To ensure due process is provided to directors, a right of appeal should be provided. The *Canada Labour Code* provides an appeal to a referee appointed by the Minister from a payment order made by an inspector.[6] To protect employees in the context of an appeal, the *Canada Labour Code* requires that a director who wishes to appeal a payment order post the amount for which the director may be liable.[7]

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[4] S.O. 2000, Chap 41, s. 106. See also *Employment Standards Code*, C.C.S.M. c. E110, s. 91(1).

[5] R.S.C. 1985, c. L-2, s. 251.1.

[6] *Canada Labour Code*, s. 251.11(1).

[7] *Canada Labour Code*, s. 251.11(2).

The proposed amendments to the CBCA do not protect employees where the corporation initiates reorganization provisions under the BIA or the *Companies' Creditors Arrangement Act* (CCAA). The CBCA makes directors liable for employee remuneration only where the corporation:

(a) has commenced liquidation and dissolution proceedings or has been dissolved; or
(b) has made an assignment or a bankruptcy order has been made against the company.

Part III of the BIA and the CCAA ensure that remuneration owing of up to $2,000 per employee is paid as part of the restructuring. For example, both the BIA and the CCAA provide that where a reorganizing company applies to the court to sell assets out of the ordinary course, the court must be satisfied that the debtor company can and will pay pre-filing employee remuneration up to $2,000 per employee and all post-filing employee remuneration.[8] The BIA and the CCAA also require that the debtor's plan or proposal provides for payment in full of pre-filing employee remuneration up to $2,000 and all post-filing employee remuneration.[9]

The CBA Sections do not oppose amending the CBCA to expand the circumstances where directors of a corporate employer are liable for employee remuneration. Provisions of the *Canada Labour Code* that make directors of a corporate employer liable for employee remuneration are wider than those in the CBCA. The *Canada Labour Code* provides that directors are jointly and severally liable for employee remuneration to a maximum amount equivalent to six months' wages to the extent recovery of the amount from the corporation is impossible or unlikely.[10]

The proposed amendments to the CBCA would only apply to companies incorporated under the CBCA, not companies incorporated under other legislation. The summary procedure in the *Canada Labour Code* would apply only to non-CBCA companies subject to the *Canada Labour Code*.

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8 BIA, s. 65.13(8)and CCAA, s. 36(7).

9 BIA, s. 60(1.3) and CCAA, s. 6(5).

10 *Canada Labour Cod*e, s. 251.18. Note that the "trigger" on a directors' liability for employee remuneration differs from statute to statute. For example, under the *Employment Standards Act*, 2000 (ON) the liability triggers are not limited to situations where the corporate employer is being liquidated or is bankrupt.

IV. DEFINED BENEFIT PENSION PLANS

The essence of a defined benefit pension plan is an agreement between the employee and the employer that, in return for services rendered during the employee's employment, the employer will pay for benefits to the employee for life, following the employee's retirement.[11] Pension legislation has attempted to address the risk of the employer's insolvency by, *inter alia*:

(a) requiring pre-funding of benefits;

(b) requiring that the assets used for funding the promised benefits be legally separated from the general assets of the employer; and

(c) creating a deemed trust and a statutory lien on the employer's assets.

These requirements have mitigated to some extent the risk to employees of an employer's insolvency. However, some risk of underfunding of a pension plan remains, if the fund set aside to pay for benefits is insufficient to cover the full amount required to provide accrued benefits if the plan is terminated because of the employer's insolvency.

To mitigate the risk of insufficient funds on a plan's termination and employer insolvency, pension legislation requires that a defined benefit pension plan meet a solvency funding standard. Periodic solvency valuations of the plan by an actuary are required.[12] A solvency valuation aims to determine whether a defined benefit pension plan is sufficiently funded to meet its solvency liabilities at the date of valuation. The solvency funding standard is designed to require periodic[13] funding of the plan sufficient to be able to annuitize the cost of all or most[14] benefits promised under the plan.

If required special payments are not made and the employer becomes bankrupt or commences reorganization proceedings under the BIA or the CCAA,[15] a claim for unpaid solvency

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11 In a defined benefit pension plan, benefits are paid from the plan for life. In a defined contribution plan, accumulated contributions and investment returns can be used to purchase an annuity or, more typically, transferred into a locked-in version of a Registered Retirement Income Fund.

12 These funding requirements do not apply to defined contribution pension plans because the benefits under a defined contribution plan are determined by the contributions and the investment returns.

13 Usually, deficits are amortized over 5 years with equal monthly payments. Many jurisdictions have permitted an employer to extend the schedule to 10 years on conditions. These funding requirements do not apply to defined contribution pension plans.

14 Certain aspects of benefits may be excluded from the solvency funding standard such as the cost of indexing or grow-in benefits.

15 R.S.C. 1985, c. B-3 and R.S.C. 1985, c. C-36, respectively.

contributions may be unsecured in the insolvency proceedings. The status of special payments where a receiver is appointed in respect of the employer depends on:

(a) the applicable pension legislation; and
(b) whether the employer is bankrupt.

If the pension legislation creates a deemed trust for unpaid special payments, that trust will remain enforceable against the employer's assets and property. However, generally if the employer is bankrupted, the deemed trust has not been enforced against the employer's assets and property.

The BIA currently provides for a charge (Pension Charge) over all a debtor's assets to secure:

(a) unremitted employee pension contributions;
(b) unpaid employer contributions under a defined contribution plan; and
(c) unpaid employer normal costs to a defined benefit pension plan as required by the applicable pension legislation, owing as at the date the debtor becomes bankrupt or a receiver is appointed in respect of the debtor.[16]

The Pension Charge ranks in priority to every other claim, right, charge or security except the rights of unpaid suppliers and the charge created by the BIA in favour of employees for unpaid remuneration and, in a bankruptcy, statutory deemed trust claims in respect of employee source deductions. The Pension Charge does not secure special payments owing in respect of a solvency deficiency in a defined benefit pension plan.

While the Pension Charge arises when reorganization proceedings begin under the BIA and the CCAA, each Act requires that a proposal or plan of compromise provide for payment of the amounts subject to the Pension Charge unless all the relevant parties agree otherwise.[17] The proposal or plan must be approved by the court.

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[16] BIA, ss. 81.5 and 81.6.

[17] BIA, ss. 60(1.5) and (1.6), and CCAA, ss. 6(6) and (7). Note that: (a) it is implicit in the BIA and CCAA provisions that the amounts that are to be paid are all unpaid amounts up until the proposal or plan is sanctioned and not just amounts outstanding as at the date the reorganization proceedings were commenced; and (b) there is no requirement that the amounts that would be subject to the Pension Charge be paid at a specific time or within a specified period of time, only that the plan or proposal provide for them to be paid in full.

A. Special Payments

Bill C-501 would:

(a) amend the provisions of the BIA that create the Pension Charge to secure any special payments that are not made by an employer that becomes bankrupt or in respect of whom a receiver is appointed; and

(b) amend the BIA and the CCAA to require that any unpaid special payments be made by a debtor as part of any proposal or plan of compromise or arrangement made by the employer to creditors.

Bankruptcy and Liquidations

Bill C-501 proposes expanding the Pension Charge to secure unpaid special payments for a solvency deficiency on the date the employer becomes bankrupt or a receiver is appointed in respect of the employer. While the proposal would erode the position of secured creditors in a bankruptcy, the CBA Sections believe that secured lenders can mitigate that risk by taking steps to enforce their security where the debtor fails to make required special payments.

The CBA Sections question the impact that the proposed amendments would have on the ability of insolvent employers with defined benefit pension plans to secure financing to reorganize. Securing special payments may also cause lenders concerned with the erosion of the security position to enforce their security earlier than they might otherwise, resulting in difficulties for companies with defined benefit pension plans to secure financing. This is particularly problematic considering that the proposed amendments to Part III of the BIA and the CCAA may make it more difficult for an employer required to make large special payments to successfully reorganize.

The proposed amendments would ensure that special payments will be current to the date bankruptcy proceedings begin or a receiver is appointed, but would likely not eliminate the entire solvency deficiency on plan wind-up.

Corporate Reorganizations

The CBA Sections do not oppose amending the BIA to require that a proposal or plan of compromise provides for outstanding special payments owing at the date the proposal or plan is sanctioned. However, the proposed amendments may restrict the restructuring of some companies required to make significant special payments. Amendments to the BIA that expand the Pension Charge to include special payments may result in secured lenders, whose security

will be eroded by the Pension Charge, to be motivated to terminate reorganization proceedings to curtail the erosion of their security. Every missed special payment during the course of a reorganization would increase the amount that must be provided in the employer's proposal or plan, and the amount secured by the Pension Charge if the reorganization ultimately fails.

The CBA Sections believe that the interests of employees of insolvent employers with defined benefit pension plans with solvency deficiencies can sometimes be better protected by restructuring, allowing the employer to carry on business and administer the pension plan. The failure of an employer with a defined benefit pension plan generally leads to winding-up the plan and the crystallization of any solvency deficiency. A restructuring may result in reduced pension benefits, but can sometimes result in a more favourable outcome for current and former employees than a liquidation of the employer and winding-up of the pension plan.

B. Solvency Deficiencies

While the Bill is unclear on this point, it appears intended to:

(a) amend the provisions of the BIA that create the Pension Charge to secure the solvency deficiency in an employer's defined benefit pension plan; and

(b) amend the BIA and the CCAA to require that an employer's proposal or plan of compromise or arrangement provide for the payment of the amount required to fund any solvency deficiency in the employer's defined benefit pension plan.

To summarize the CBA Sections concerns:

1. Securing a solvency deficiency in a liquidation may cause lenders concerned with the potential erosion of their security position to refuse to lend to companies with defined benefit pension plans. Without modifications, it would be difficult, if not impossible, for a secured lender to mitigate against the risk of a solvency deficiency eroding its collateral position. Solvency deficiencies are determined on an actuarial basis using prescribed assumptions. However, the secured lender might be able to mitigate risk if legislation provided sufficient flexibility to allow a lender and representatives of pension plan members to negotiate priorities as part of a restructuring.
2. While securing the solvency deficiency might reduce the amount of the solvency deficiency on plan wind up, it will not necessarily fully address the underlying issue – the fact that the pension plan will, if wound-up at a defined point in time, be under-funded. Securing a solvency deficiency in a pension plan will ensure that the pension plan is fully funded only if the value of the debtor's assets is sufficient to satisfy the actual deficiency in the pension plan when it is wound-up.

3. In a successful reorganization under the BIA or the CCAA, where the employer continues to carry on business and does not wind-up a defined benefit pension plan, there is no need for immediate payment of the amount required to fund a solvency deficiency in the pension plan. Requiring the payment may prevent otherwise viable companies from being restructured. Alternatively, an immediate payment required on bankruptcy, but not before, could provide an incentive for restructuring a company prior to bankruptcy.

V. CONCLUSION

The CBA Sections trust that our comments will be helpful during consideration of Bill C-501. We note that several related Private Members' bills are currently before Parliament, and suggest that any legislative changes as a result be coordinated to avoid potential duplication, confusion or legislative gaps. .