Industry Canada Industrie Canada

Corporate, Insolvency and Competition Law Policy

Statutory Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*

Canada

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Discussion Paper

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Cat. No. Iu173-5/2014E-PDF
ISBN 978-1-100-23479-3

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Aussi offert en français sous le titre *Direction de l'entreprise, de la concurrence et de l'insolvabilité*.

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Executive Summary

Pursuant to a statutorily-mandated review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*, Industry Canada is conducting public consultations to obtain submissions from interested Canadians regarding Canada's insolvency legislation. The discussion paper, which sets out numerous issues identified from key stakeholder input and an environmental scan of the insolvency marketplace, is intended to provide a framework for the public consultations.

The discussion paper is divided into four sections: first, an introduction; second, consumer insolvency issues; third, commercial insolvency issues; and, finally, administrative and technical issues.

The introduction provides general information regarding Canada's insolvency regime and the policy objectives that underlie it, as well as recent marketplace changes and insolvency trends.

The sections on consumer and commercial issues set out broad themes under which specific issues may be found. For example, the consumer insolvency themes include protection of consumer interests, the "fresh start" principle, consumer exemptions, protecting families, and treatment of student loans in bankruptcy. The commercial insolvency themes include encouraging restructuring, protecting vulnerable creditors and enhancing equity, deterring fraud and abuse, and cross-border insolvencies.

The section on administrative and technical issues sets out a number of discrete matters, including renaming the *Bankruptcy and Insolvency Act*, creating a unified insolvency Act, and marshalling of charges.

Pursuant to the statutory review provisions contained in both Acts, the Minister of Industry is to table a report in Parliament on the "provisions and operations" of the Act by September 2014. The report would then be

referred to a Parliamentary committee for study and report within 12 months of the initial tabling. Any decisions regarding possible legislative or regulatory reforms as part of the statutory review would be taken following consideration of the Parliamentary committee's study and report.

Introduction

The Importance of Insolvency Law

Insolvency laws have a significant impact on the economy. Insolvency rules offer security for investors and lenders in both consumer and commercial borrowing transactions. This, in turn, influences credit market risks, which can affect the cost and availability of credit. In the commercial sphere, the reliability of the insolvency system plays a role in attracting domestic and foreign investment, as well as in promoting entrepreneurship and innovation.

One of the principal considerations in an era of increased globalization and competitiveness is how to make the insolvency process as efficient as possible, while maintaining fairness. By facilitating corporate restructuring and directing assets to productive use, the insolvency system contributes to Canada's economic competitiveness and performance.

Rules governing personal insolvency play an important socio-economic role. They allow honest but unfortunate individuals who experience difficult financial distress to release their debts and obtain a fresh start. The consumer insolvency provisions are aimed at balancing the interests of debtors with the interest of creditors who extended credit in the expectation of repayment.

As such, insolvency laws contribute in a meaningful way to the effective and efficient functioning of the marketplace.

Canada's Insolvency Regime

Legislative Framework

The insolvency regime makes up part of Canada's fundamental marketplace framework laws and relies on two main statutes: the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA).

The BIA provides a legislative framework to address both consumer and commercial insolvency situations. In bankruptcy, the Act provides for the liquidation of the bankrupt's assets by a trustee and the distribution of the proceeds in a fair and orderly way among the creditors. Alternatively, the Act provides a mechanism for insolvent consumers or commercial debtors to avoid bankruptcy by negotiating settlements with their creditors to reorganize the debtor's financial affairs.

The CCAA provides a legislative framework for the reorganization of insolvent commercial debtors under the court's supervision. It enables an insolvent business to seek a court order staying its creditors from taking action against it while it negotiates an arrangement with them for the rescheduling or compromise of its debts. The CCAA provides a more flexible, court-driven process than the BIA. Businesses reorganizing under the Act must have more than $5 million in debt.

Administrative Framework

Canada's insolvency regime's administrative framework is supported by three pillars:

- **Office of the Superintendent of Bankruptcy** (OSB): regulator with oversight responsibilities for the insolvency system;
- **Trustees-in-Bankruptcy**: licensed by the Superintendent, they are responsible for administering estates and performing various roles under the BIA and CCAA; and
- **Courts** (including registrars in bankruptcy): supervise CCAA proceedings and adjudicate matters under both the BIA and CCAA.

The OSB has statutory responsibility to supervise the administration of all estates and matters under the BIA. Additionally, the OSB has certain functions under the CCAA, including maintaining a public record of CCAA proceedings and investigating complaints regarding the conduct of monitors. In fulfilling its mandate, the OSB sets standards and provides guidance to stakeholders regarding expected conduct through Directives, notices, position papers and programs.

Trustees-in-bankruptcy are responsible for administering insolvencies and can often be engaged to provide advice to financially distressed individuals and businesses. They work with the debtor to complete necessary steps in a bankruptcy, proposal to creditors or restructuring. This involves filing documents with the OSB and ensuring the debtor fulfills the requirements under the BIA or CCAA. Where the debtor fails to fulfill the requirements, as an officer of the court, the trustee is to bring the issues to the attention of the creditors and the court.

The role of the courts varies depending upon the nature of the proceeding. Most individuals who file for bankruptcy will not be required to go to court. Instead, they will obtain a discharge from bankruptcy after the specified period of time through an automatic process. If a trustee or creditor opts to oppose a bankrupt's discharge, the matter is brought to the courts. In other proceedings, the courts are involved at various stages. For example, the courts may be required to resolve disputes or sanction specific actions proposed by the debtor or creditors. In CCAA proceedings, the court plays a key role. Court approval is required to commence a proceeding and it may make various other orders, including approving interim financing, the process for sale of assets, and the disclaimer of contracts. Courts are also responsible for sanctioning any plan of arrangement or compromise.

Objectives of Insolvency Law

Insolvency laws aim to minimize the impact of a debtor's insolvency on all stakeholders. They do this by pursuing the key objectives of equitable distribution of the debtor's assets, and, where possible, by rehabilitation of the debtor.[1] As noted by the Supreme Court of Canada:

> The very design of insolvency legislation raises difficult policy issues for Parliament. Legislation that establishes an orderly liquidation process for situations in which reorganization is not possible, that averts races to execution and that gives debtors a chance for a new start is generally viewed as a wise policy choice. Such legislation has become part of the legal and economic landscape in modern societies. But it entails a price, and those who might have to pay that price sometimes strive mightily to avoid it. Despite the proven wisdom of the policies underpinning the insolvency legislation, it is understandable that few appreciate the "haircuts" or even outright losses that bankruptcies trigger.[2]

It is generally accepted that the objectives of insolvency law may be achieved through legislation that does the following:

- provides certainty in the market to promote economic stability and growth;
- maximizes value of assets;
- strikes a balance between liquidation and reorganization;
- ensures equitable treatment of similarly situated creditors;
- provides for timely, efficient and impartial resolution of insolvency;
- preserves the insolvency estate to allow equitable distribution to creditors;
- ensures a transparent and predictable insolvency law that contains incentives for gathering and dispensing information; and
- recognizes existing creditor rights and establishes clear rules for ranking of priority claims.[3]

It is in this context that Canada's insolvency laws have been developed by Parliament and have evolved through court decisions.

Marketplace Changes

Since the last public consultations on insolvency laws conducted in 2001-2002, which resulted in the legislative reforms of 2008 and 2009, the characteristics of the Canadian consumer marketplace have changed. The ratio of consumer debt to personal disposable income in Canadian households has increased from approximately 110 percent in 2000 to 160 percent in 2012.[4] The increase can be attributed to higher mortgage debt levels and an increase in home equity extraction, both associated with elevated housing prices.[5] Higher mortgage debt levels are a potential source of risk as Canadians may be more vulnerable to a decline in housing prices or an increase in interest rates.

In the commercial context, marketplace changes include the growing importance of intellectual property to Canadian companies, the use of more complex corporate structures, a shift by lenders away from relationship lending, significant growth in the use of derivatives to hedge risk and in the practice of distressed debt trading, and an increasing number of cross-border insolvency proceedings. At the same time, the cost and complexity of restructuring proceedings, particularly under the CCAA, continues to grow, resulting in a shift towards other types of workout arrangements such as private workouts and arrangements under the *Canada Business Corporations Act*.

Insolvency Trends

National Insolvency Rates

Figure 1 illustrates the national consumer and business insolvency rates between 2000 and 2012.[6] An overview of insolvency rates provides a clearer picture of trends than does the total volume alone, because it takes into account changes in population sizes over time. As shown in Figure 1, consumer and business insolvency rates have trended in opposite directions during the past decade. The consumer insolvency rate remained relatively steady from 2002 to 2007 before increasing to 5.8 during the economic downturn in 2009 and declining in subsequent years. In 2000 and 2012, the national consumer insolvency rates were 3.7 and 4.4, respectively. This represents an 18 percent increase in the insolvency rate over this period. On the other hand, other than a small increase during the 2001 economic downturn, business insolvency rates have trended downward throughout the decade. In 2000 and 2012, the national business insolvency rates were 5.7 and 1.8 respectively, representing a 68.4 percent decrease.

Figure 1: Consumer and Business Insolvency Rates

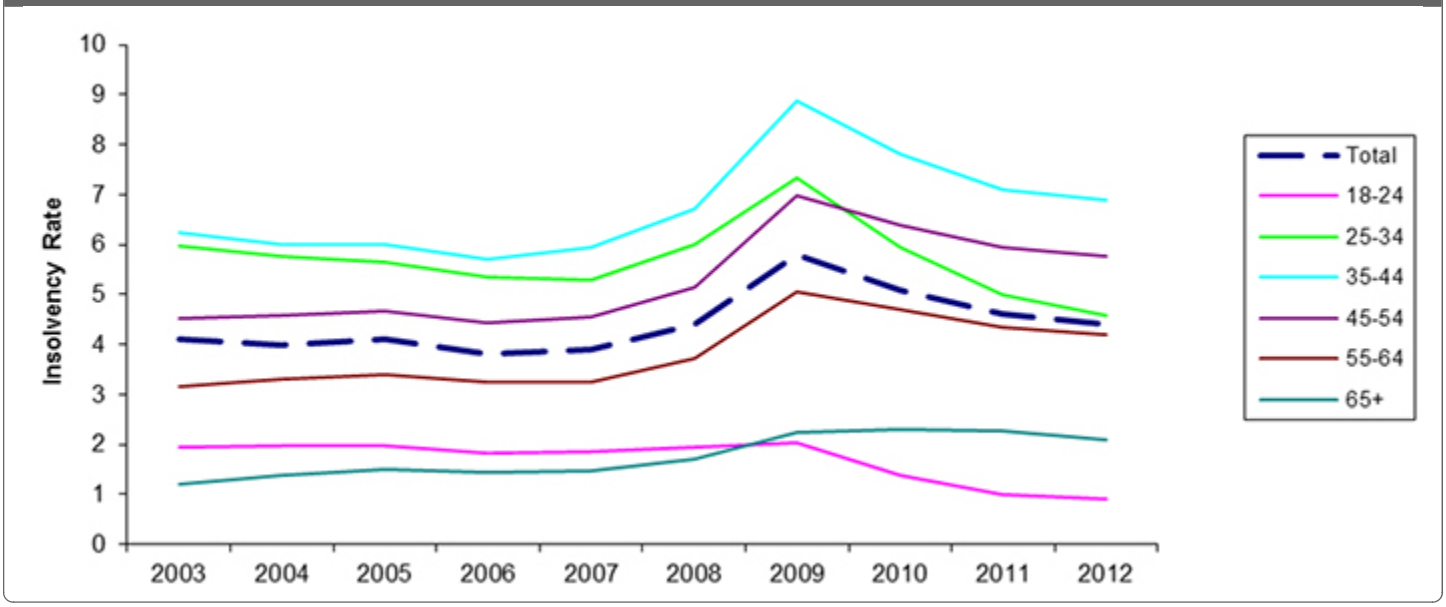
Consumer Insolvency Rate - by Age and Regional Breakdowns

Insolvency does not affect all segments of society equally. Variations in the rates of insolvency by age cohort and by geographic region provide important information regarding insolvency trends in Canada.

Figure 2 shows the national consumer insolvency rate by age cohort. During the past decade, younger Canadians (those between 18 and 34) became significantly less likely to commence insolvency proceedings. On the other hand, Canadians aged 35 and older become more likely to enter insolvency proceedings. This demographic trend is consistent with anecdotal reports that delayed transitions to adulthood among younger Canadians may be placing a greater financial burden on the parents of adult offspring.[7]

It is also important to note that while the insolvency rate of individuals over the age of 65 has increased over the past decade, it still remains well below the national average.

Figure 2: Insolvency Rates by Age Group



There is also significant regional variation in consumer insolvency rates. Between 2000 and 2012, the consumer insolvency rate has increased in Atlantic Canada, Quebec, and Ontario. There has been a better experience in Western Canada as the insolvency rates in Alberta and British Columbia have remained relatively constant while in Saskatchewan and Manitoba they have decreased slightly. Furthermore, the Atlantic Provinces, Quebec, and Ontario continue to have insolvency rates that are higher than the national rate, while the Western provinces and the Prairie provinces have rates that are lower than the national average.

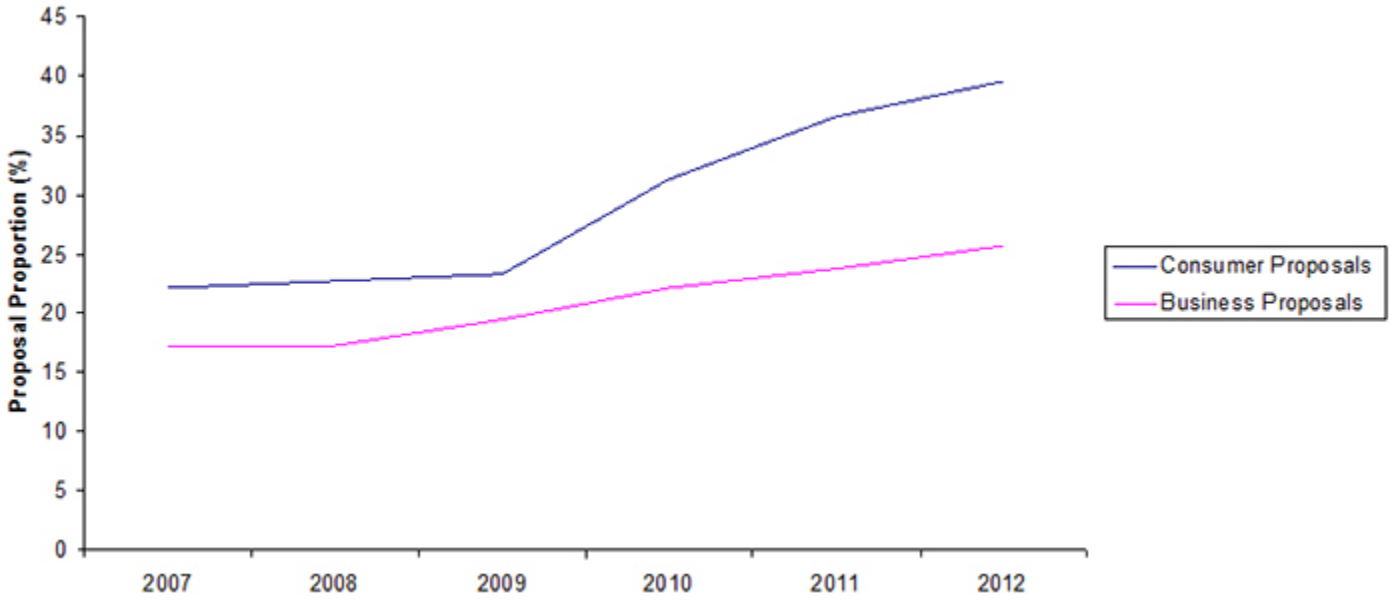
The higher insolvency rates in Atlantic Canada, Quebec, and Ontario may reflect the underlying economic conditions compared to Western Canada. There is empirical support for the hypothesis that unemployment rates and the growth rates are significant in explaining the variation in insolvency filings.[8] For example, in recent years economic growth rates in Alberta, Saskatchewan, and Manitoba have been higher than the national average, while growth rates in Ontario, Quebec, and Atlantic Canada have been lower.[9] Additionally, Western Canada's unemployment rates are lower than the national average, while Atlantic Canada's unemployment rate is higher.[10]

Figure 3: Consumer Insolvency Rates of Insolvency by Region

Growth in Consumer Proposals and Business Proposals

In recognition of the benefits of proposals for insolvent Canadians and their creditors, the 2008-2009 reforms were intended to encourage their use. Figure 4 illustrates the growth in consumer and business proposals under the BIA, as a percentage of total insolvency filings, since 2007. During the same period, the proportion of business proposals as a percentage of total business insolvency filings increased from 17.3% to 25.7%.

Figure 4: Proposal Growth - Consumer and Business Insolvencies



Conclusion

Insolvency laws touch on all aspects of economic life, both for consumers and businesses. They affect the ability of borrowers to access credit, the decisions of investors, and the level of disruption produced by the exit of inefficient firms from the marketplace. They also provide over-indebted consumers with an opportunity to obtain a fresh start and renewed financial health. As a result, it is important to Canada's overall economic performance that its insolvency legislation remains modern, effective and efficient.

In the consumer insolvency context, growing consumer debt levels and changes in demographic insolvency trends – which show that younger Canadians are less likely, and those between the ages of 45 and 54 are more likely, to become insolvent – suggest potential areas for policy focus. Emerging trends in commercial debt markets, including the growth in distressed debt trading and the use of derivatives to hedge economic risk, also suggest areas for policy consideration.

As Canada reviews its insolvency legislation, the overarching objectives of maximizing value, providing a balanced and equitable regime, and ensuring efficient and effective processes will form a base for the policy discussion.

Consumer Issues

Introduction

Individuals who encounter financial distress and are unable to service their debts may resort to insolvency proceedings (*i.e.*, bankruptcies or proposals) under the BIA. The consumer insolvency provisions are aimed at balancing the interests of debtors and their creditors.

In bankruptcy, the debtor's property, subject to certain limitations,[11] is liquidated by a trustee and the proceeds are distributed to his or her creditors. In return, a bankrupt is released from most types of debts.[12] Where the bankrupt has the financial means to contribute a portion of his or her income towards the outstanding debts ("surplus income"), the legislation requires them to do so. First-time bankrupts without surplus income are eligible for discharge from bankruptcy after nine months. The period before being eligible for discharge is longer for those bankrupts with surplus income and for those who have previously been bankrupt.[13]

Alternatively, the BIA provides insolvent debtors with the option of making a proposal to their creditors to repay, over a period of up to five years, all or a portion of what is owed. Proposals have the advantage of allowing the debtor to achieve financial rehabilitation while permitting them to retain assets that would otherwise be liquidated in a bankruptcy. For creditors, successful proposals typically offer a greater recovery than would be available in a bankruptcy.

Protection of Consumer Interests

Consumer Deposits

A retailer may receive payment before providing the contracted goods or services to the consumer. Questions of fairness arise if that retailer then becomes insolvent. The rights of buyers of prepaid goods and services are regulated to some extent by provincial consumer protection legislation, but in the absence of an insurance fund or other compensation, the consumer may become an unsecured creditor in the retailer's bankruptcy.

A consumer lien on the assets of insolvent retailers may protect consumers who have provided deposits or pre-payments. The Senate Committee in 2003 considered the merits of adding consumer liens to the BIA but recommended that the issue should continue to be governed by provincial legislation.[14] In the United States, consumer deposits are treated as preferred claims in bankruptcy for up to approximately US$2,250. The claims rank ahead of unsecured creditors' claims but behind secured claims.

Advocates for consumer liens assert that it is not possible for consumers to determine the financial condition of a retailer before making a deposit and that a consumer lien would provide protection similar to that given to unpaid suppliers. However, a preferred claim may not result in any meaningful recovery for the consumer as

the retailer's assets may be subject to an existing secured charge. If the consumer lien ranked ahead of secured creditors, it would be more effective but lenders would likely react by reducing the availability, or increasing the cost, of credit to retailers to take into account the possibility of such liens ranking ahead of their security.

Stakeholders are invited to make submissions regarding whether, and how, Canada could enhance protection for consumer deposits either through consumer liens or, alternatively, through other mechanisms within the insolvency regime.

Responsible Lending

The BIA provides that debtors' conduct can be subject to scrutiny in order to ensure fairness and integrity of the system. However, creditor behaviour may also contribute to financial difficulty for some Canadians. For example, credit granting practices such as extending credit on onerous terms to individuals who are unable to meet their existing financial obligations can lead to higher rates of insolvency. This may impact on existing creditors, whose recovery would likely be reduced due to the increased claims.

In the wake of the 2008 financial crisis, there have been increased calls for legislative intervention in the United States and other countries for "responsible lending" regimes that would impose certain duties on creditors before they extend credit and restrict the insolvency remedies available to those who did not meet these duties. Possible responses could include empowering the trustee or court to disallow the claim of a creditor where credit was extended improvidently or on unconscionable terms. Additionally, the lender could be required to disgorge payments made on such loans in the period leading up to a bankruptcy or proposal, similar to the treatment of preferences.

Stakeholders are invited to make submissions regarding whether, and how, the BIA could take into account creditors' conduct that has contributed to the financial difficulties or insolvency of a debtor.

The "Fresh Start" Principle

One of the key objectives of the BIA is to enable an honest but unfortunate debtor to obtain a discharge from his or her debts, subject to such conditions as the court may see fit to impose. This is referred to as the "fresh start" principle. Limiting the fresh start principle are specified classes of debt that are not released by an order of discharge.[15] The exceptions are based on overriding public policy concerns[16] because the nature of the debt outweighs the benefit of the bankrupt being relieved of them.

Licence Denial Regimes

Licence denial regimes are used by certain creditors to continue collection efforts even though the debt was stayed and then released through the insolvency process.[17] For example, the regimes may permit a creditor to deny a driver's licence or vehicle registration unless full payment is received. The regimes relate almost exclusively to claims arising from the use of motor vehicles.[18] Creditors that rely on these regimes include insurance companies, provincial insurance regimes, electronic toll-highway operators and rental car companies.

Proponents of these regimes argue that they only encourage voluntary payment since driving is not a right and that debtors may choose to forgo the privilege of driving should they not be able to pay the debt in full. On the other hand, it has been argued that once insolvency proceedings are commenced these special collection tools are replaced with those available through the collective insolvency process. They may no longer be used as they interfere with the insolvency process and frustrate the debtor's ‘fresh start'.

There is greater clarity in the United States as the *Bankruptcy Code* expressly bars the use of these special collection tools to collect released debts.[19] In Canada, it has been left up to the courts.[20] In order to ensure consistent national treatment, Industry Canada is interested in the views of Canadians regarding this issue.

Submissions are invited as to whether amendments are required to the BIA to address the apparent conflict between the "fresh start" principle and the objectives of licence denial regimes.

Reaffirmation Agreements

Reaffirmation agreements between a bankrupt and a creditor are those where the bankrupt agrees to pay a debt that was or will be released by a bankruptcy. Courts have recognized that bankrupts may reaffirm an obligation in one of two ways: 1) by conduct, where the bankrupt continues to make payments to a creditor under an agreement, or 2) by express agreement where the bankrupt enters into a written agreement with the creditor to repay an otherwise released debt.

There is no statistical evidence regarding the extent to which reaffirmation is taking place in Canada or whether the practice is being abused. Some commentators have called for greater regulation of reaffirmation on the grounds that it undermines the "fresh start" principle in insolvency. Reaffirmation by conduct (*i.e.*, continued payments) is of particular concern since bankrupts may reaffirm an agreement without realizing he or she is doing so. On the other hand, there may be compelling reasons why a bankrupt may want to voluntarily continue to pay a debt obligation (a common example is a car lease agreement, where the bankrupt requires the use of a car).

Reaffirmation of debts was raised during the last statutory review. The Personal Insolvency Task Force (PITF) in its 2002 report[21] recommended that reaffirmation agreements in respect of unsecured transactions be prohibited because they offend the "fresh start" principle and have the effect of giving one creditor preference over other creditors. However, the PITF recommended that reaffirmation be permitted for secured transactions on the ground that it allows the bankrupt to retain the assets covered by the security agreement and the secured creditor would be in the same position as they would have been if they had to enforce the security. Other stakeholders indicated the need for greater study into the scope and frequency of reaffirmation agreements before making any legislative changes on this issue.

> *Stakeholders are invited to make submissions regarding whether reaffirmation agreements should be regulated under the BIA, either through the mechanisms discussed above or through other mechanisms within the insolvency regime.*

Consumer Exemptions

Registered Savings Products

Successive governments have created initiatives intended to encourage Canadians to create long-term savings for various purposes. For example, Canadians may save for retirement through registered retirement savings plans (RRSPs), for children's post-secondary education expenses through registered education savings plans (RESPs) or for disabled persons' future financial security through registered disability savings plans (RDSPs).

In 2009, RRSPs were exempted from seizure in bankruptcy, subject to a clawback of contributions made in the 12 months before the filing. The goal was to protect retirement savings in a similar way to the protections afforded to registered pension plans, which are exempt from seizure in the event of bankruptcy of the holder of the pension. The exemption of RESPs was also examined in the last review. The Senate Report recommended that the BIA be amended to exempt RESPs from seizure in bankruptcy if: the RESP is locked in; and, RESP contributions in the one-year period prior to bankruptcy are paid to the trustee for distribution to creditors.[22] Largely because these conditions could not be met, which created a significant potential for abuse, RESPs were not exempted from seizure in an insolvency proceeding.

An RDSP is a long-term savings plan intended to assist Canadians with disabilities and their families to save for the future. Eligible parties may contribute any amount per year up to a lifetime contribution limit of $200,000. Government matching grants and bonds are also available to supplement the RDSP, depending on the amount contributed and the family income of the beneficiary.

RDSPs serve the public interest by encouraging savings for the support of people with disabilities. As a result, it has been suggested that they could be exempted from creditor claims in bankruptcy, similar to the protection provided to RRSP funds. Supporters of an exemption for RDSPs note that there are significant differences between RESPs and RDSPs that reduce the potential for abuse in bankruptcy. Unlike an RESP, only individuals who claim the disability tax credit under the *Income Tax Act* qualify for an RDSP and there can only be one account for that person. Furthermore, only a parent, legal guardian or trust institution may open and

contribute to the RDSP and only the beneficiary can access the funds. It is possible, however, that exempting RDSPs could create the potential for abuse that adversely impacts other creditors' interests.

Stakeholders are invited to make submissions regarding the treatment of registered savings products in bankruptcy.

Federal Exemption Lists

Generally, a bankrupt's property is liquidated by a trustee and the proceeds are distributed among the creditors according to the distribution scheme set out in the BIA. Certain property is, however, exempt from distribution to creditors. The exemptions are set by provincial/territorial law.

Stakeholders have questioned whether it would be more appropriate to have a federal exemption list that would apply to all personal bankruptcies regardless of the bankrupt's province of residence or, alternatively, would permit the bankrupt to choose between the federal and provincial exemption list.

In the last statutory review, the Senate Report and the PITF Report recommended that there be a federal exemption list that the debtor can select in preference to the otherwise applicable provincial or territorial exemptions. The issue of whether to develop a federal exemption list was not addressed in the 2008 and 2009 insolvency reforms.

A federal exemption list could create a minimum standard available to all bankrupts. On the other hand, if it varies significantly from existing provincial/territorial exemption lists, it could create uncertainty for creditors who would not know which list a bankrupt would select.

Submissions are invited as to whether the introduction of a federal list of exemptions should be considered.

Protecting Families

Equalization Claims

Marriage breakdown and insolvency are often closely linked as marriage breakdown can often be a trigger for insolvency proceedings.[23] The special nature of some family law debts has been recognized in insolvency law. Under the BIA, a specified portion of unpaid child and spousal support is treated as a preferred claim and is paid ahead of the claims of unsecured creditors.[24] Also, family support obligations are not released by the bankrupt's discharge.[25]

With respect to family assets, most provinces use the "division of property" approach. Divorcing spouses are deemed to have an inchoate claim to half of the family assets which are then divided between the spouses. In the case of exempt assets, bankruptcy has no impact on such divisions as the inchoate claim is not a money claim that would be stayed or released by the bankruptcy.

Ontario, Manitoba and Prince Edward Island use an "equalization" approach under which spouses are entitled to keep property held in their own names but share any increase in the value of marital property that occurred during marriage. Usually this means one spouse must make an equalization payment to the other spouse. Under provincial law, such a payment is considered to be a debt owed by one spouse to the other and is treated as an unsecured claim in an insolvency proceeding.

In *Schreyer*[26], the Supreme Court of Canada found that if the paying spouse becomes bankrupt, an equalization payment may be released in the bankruptcy. As a result, the non-bankrupt spouse was not entitled to payment of the equalization claim while the bankrupt spouse was entitled to keep the exempt property, which was the family farm. The Court noted the apparent injustice and suggested there should be better protection for equalization payments in the event of bankruptcy to avoid such inequitable results.[27]

Submissions are invited as to whether, and how, bankruptcy legislation could be amended so as to improve the status of equalization payments in bankruptcy.

Family Support Claims and the Levy

Bankruptcy provides an efficient collection mechanism for creditors as they may rely on the collective remedies available to the trustee to satisfy their claims. In order to offset the costs of the OSB, the regulator responsible for protecting the integrity of the bankruptcy system, a levy is applied to all payments made by a trustee.[28] The levy is typically five percent of payments.[29]

Subject to certain conditions, family support claims are provable claims under the BIA.[30] This means that a creditor may file a proof of claim and receive a dividend out of the estate. Family support claimants may receive treatment that is preferential to other creditors, to a specified extent, as a portion of their claims may be paid in priority to the claims of other unsecured creditors.[31] The claims also survive the bankruptcy process, meaning that they are not released when the bankrupt receives his or her discharge.[32] The practical impact is that family support claimants can expect to receive greater recovery through the BIA process than other unsecured creditors and they are also entitled to collect the remaining indebtedness post-bankruptcy without competing with creditors whose claims have been released.

As a result of the *Cameron* decision, in which the court held that "the levy is to be shared by all creditors who benefit from the proceedings,"[33] family support creditors must give the bankrupt credit for amounts paid in respect of the levy. Some stakeholders have suggested, however, that not all section 178 creditors credit the bankrupt for the amount of the levy, resulting in an inequitable situation where some section 178 creditors obtain full payment and others do not.

> *Submissions are invited as to the treatment of section 178 creditors with respect to the Superintendent's levy.*

Vesting of Family Property Claims

Upon bankruptcy, all property of the bankrupt at that date and any property that may be acquired by or devolve on the bankrupt before his or her discharge, with certain exceptions, vests in the trustee for distribution among the bankrupt's creditors. Property can include the bankrupt's right to sue a former spouse for an equalization claim or for the division of matrimonial property.

In the last statutory review, the Senate Report recommended that the right to sue the bankrupt's spouse for equalization or division of property under provincial/territorial matrimonial property law be excluded from property vesting in the trustee.[34] The Senate Committee heard that the trustee often settles the claim at a significant discount. As a result, the non-bankrupt spouse retains most of the bankrupt spouse's share of the family assets and the creditors receive very little from the settled claim. Moreover, confidence in the insolvency system may be undermined.[35]

Stakeholders have recommended that the right to sue remain with the former spouse but that any proceeds obtained from the action be considered property to be distributed among the creditors.

> *Stakeholders are invited to make submissions regarding the treatment of the right to sue a former spouse for an equalization claim or the division of property as property vesting in the trustee.*

Joint Debts

Section 142 of the BIA addresses the distribution of property when partners become bankrupt. The section is intended to deal with business situations involving partnerships, not matrimonial situations. Some stakeholders have raised the concern that parties may attempt to apply s.142 in matrimonial situations which could have the effect of distorting the distribution of property that would otherwise take place.

> *Submissions are invited as to whether s.142 should be amended to restrict its application to business partnerships.*

Treatment of Student Loans in Bankruptcy

Discharge of Student Loan Provisions

The federal and provincial governments have implemented student loan programs intended to assist full- and part-time post-secondary students pay for higher education and training. Since these loans are granted on need rather than ability to repay in the event of bankruptcy they are treated differently than other debts under the BIA. In 1997, the BIA was amended to create a two-year waiting period from the time a student ceased to be a full- or part-time student before the loan could be released in bankruptcy. In 1998, the waiting period was increased to 10 years. It has been noted that students typically benefit from the educational opportunities that are facilitated by the government student loans and that the loans are eligible for interest relief, debt forgiveness and other relief under the terms of the student loan program. Accordingly, many stakeholders recognize that the release of student loans in bankruptcy should be subject to special rules, including a waiting period.

The Senate Report recommended a waiting period of five years or, in the case of hardship, a waiting period of less than five years. The Senate heard from stakeholders that the 10-year waiting period created "a period of social atrophy" as the debtor could neither afford to pay the debt, nor to move on from it through the normal means of bankruptcy.[36] In 2009, the BIA was amended to reduce the waiting period from 10 to seven years or, in the case of significant financial hardship, from 10 to five years. Some stakeholders suggest that the seven- and five-year waiting periods still impose too high of a burden.

Stakeholders are invited to make submissions regarding whether the current provisions regarding the release of student loan debts should be amended.

Hardship Discharge

Under the BIA, release of government-funded student loans can be granted on grounds of hardship if the debtor satisfies the court of good faith towards repayment of the loan and that the bankrupt is experiencing and is likely to continue to experience financial difficulty that prevents repayment of the student loan debt. An application for discharge on the basis of hardship may only be made after at least five years have elapsed from when the student ceased to be a full- or part-time student.

In an effort to assist those who demonstrate financial need, however, the Canada Student Loan Program offers several repayment assistance measures. For example, it offers eligible students relief measures such as (a) the Repayment Assistance Plan, (b) the Repayment Assistance Plan for Borrowers with a Permanent Disability, and (c) the Severe Permanent Disability Benefit.[37]

Some stakeholders have suggested that, despite relief measures available under student loan programs, the five-year waiting period in the case of hardship is unwarranted. They argue that obtaining debt relief can be difficult and that, in any event, a hardship discharge is only available if the debtor convinces a court that the hardship is a continuing event that will prevent payment in the future. In their view, this removes the need for a waiting period.

Stakeholders are invited to make submissions regarding the current hardship discharge provisions.

Partial Release of Debts

Under the hardship discharge provision,[38] the courts have found that they do not have the authority to order a release of part of the student loan debt; either all or none of the debt is to be released by court order. Some stakeholders have suggested that it may be appropriate to give the courts more discretion to release a portion of debt where warranted.

Stakeholders are invited to makes submissions regarding possible flexibility for court-ordered partial discharges on hardship grounds, including any factors the court should consider in exercising its discretion.

Commercial Issues

Introduction

In the commercial insolvency context, debtors and creditors have numerous options for dealing with severe financial distress. The BIA provides a rules-based framework for bankruptcy and proposals (e.g. restructuring) by businesses of any size. The CCAA provides a more flexible court-driven framework for reorganizations by companies with at least $5 million in debt. Secured creditors may also opt to put in place a receivership in many circumstances. Corporations have also increasingly been turning to arrangement provisions under corporate legislation, such as the *Canada Business Corporations Act*.

The 2008-2009 reforms were designed to encourage restructurings of viable but financially-distressed firms because the benefits of a successful reorganization include the likelihood of greater returns to creditors than in bankruptcy, preservation of jobs and relationships with suppliers and lenders, and ensuring that assets remain productive to the overall benefit of the Canadian economy.

The Sarra Report

During summer 2011, Dr. Janis Sarra[39] conducted eleven public hearings regarding Canada's commercial insolvency regime. This work was supported by the Canadian Insolvency Foundation. Based on the hearings, Dr. Sarra published a report titled "Examining the Insolvency Toolkit: Report of the Public Meetings on the Canadian Commercial Insolvency Law System"[40] (the "Sarra Report").

Industry Canada greatly appreciates the contribution made to the Canadian public policy debate by Dr. Sarra and all of those who participated in the public hearings.

Encouraging Innovation through Intellectual Property Rights

Creating an economic climate that encourages innovation is considered a vital component of a country's long-term competitiveness. Intellectual property (IP) rights, such as patents and copyrights, play an important role in promoting innovation. IP statutes promote innovation through the incentive of a temporary monopoly and at the same time ensure reasonable access to users, and preserve marketplace integrity (e.g. trade-marks). IP laws focus on the rights of creators and licensees, while insolvency laws focus on the interests of debtors and creditors. However, as economic framework legislation, both IP law and insolvency law can promote innovation and marketplace integrity by mitigating entrepreneurial risks. Insolvency law can provide investors with commercial certainty in the case of default, which facilitates investment in the development of innovative ventures, as well as businesses that rely on the authorized use of IP through licences.

Copyright and Patented Items

There are existing provisions in the BIA regarding rights of holders of patents[41] and copyrights.[42] It has been suggested that these provisions should be modernized, to better reflect the importance of IP rights in the Canadian economy. For example, the provisions related to copyright speak of "manuscripts" that have been "put into type". The archaic language creates difficulties when the copyright in question is software, for example.

Additionally, some stakeholders have called for greater rights for IP producers and creators in insolvency proceedings, enhancing the limited rights that currently exist. For example, it has been suggested that the protection for patentees could be extended to other IP, such as trade-marks. It has also been suggested that the bankruptcy provisions be extended to CCAA restructurings and receiverships.

2009 Amendments – Rights of IP Licensees

Effective licensing rights are essential to a robust IP marketplace, as licensing gives innovators a way to monetize their works and release the innovation into the marketplace during the IP's period of statutory protection. Legislative amendments in 2009 were aimed at reducing the uncertainty faced by IP licencees in an insolvency restructuring. The reforms expressly permit the disclaimer of IP licences, in order to give debtors

and the courts the flexibility to restructure. However, IP licencees may preserve their rights to use the IP as long as they continue to perform their obligations under the licence.

The reforms were viewed as a positive step forward but some commentators have observed that there are outstanding issues regarding IP licences in insolvency. For example, the licencee protection only applies if the licensor restructures but not in bankruptcy or receivership. Others have noted that the new provisions only refer to the licensee's "right to use" the IP in question and do not require the licensor to provide upgrades or maintenance of the technology that may have been included in the IP licencing agreement. It has been noted that, while the amendments protect a licensee against a disclaimer, an insolvent licensor could sell IP free and clear of current licenses. Some commentators have called for additional legislative guidance to assist in this judicial balancing of interests.

> *Submissions are invited regarding how to improve the existing rules to support the objective of encouraging innovation, while also balancing the competing interests in an insolvency proceeding.*

Encouraging Restructuring

Streamlining *Companies' Creditors Arrangement Act* Proceedings

The CCAA sets out a court-driven insolvency proceeding. In order to commence a CCAA proceeding, an initial court order is required. Typically, the order provides for a stay of proceedings against the debtor company, appoints a monitor and sets out the rights and powers of the debtor company during the proceeding, including the ability to carry on business, sell assets and terminate employees. It may also provide for interim financing in order to provide liquidity to fund operations during the proceedings. The debtor company typically returns to the court for approval of various steps in the restructuring process, such as the sale of assets, settling contentious claims or dealing with out-of-the-ordinary-course transactions. Finally, court sanction of a plan of arrangement and distribution of assets to creditors is required.

Concerns have been expressed by stakeholders regarding the complexity and cost of CCAA proceedings. The following issues have been raised as areas of concern in existing practice.

Initial Orders

Some stakeholders have expressed the concern that initial orders can be too broad, which can negatively affect creditors since it may be difficult to successfully challenge decisions that have been acted upon (*e.g.*, where interim financing has been accessed by the debtor). Some stakeholders have suggested that a short automatic stay period (*i.e.*, five to 15 days) followed by an initial court appearance may provide more creditors with the opportunity to appear before the court. The automatic stay could provide limited authority to ensure the debtor company is able to "keep the lights on". Alternatively, the statute could restrict an initial order to what is necessary to allow the debtor to carry on business for a short period until there is a court hearing or notice to creditors.

> *Stakeholders are invited to make submissions regarding the breadth of initial orders and potential options for streamlining the process.*

Claims process

In CCAA restructurings, the time and cost associated with resolving claims can be prohibitive. Some stakeholders have suggested that a default mechanism for determining claims may be appropriate, particularly in smaller CCAA proceedings. The Sarra Report notes that in Alberta the monitor or a court-appointed claims officer determines the amount of claims owing and that amount is accepted unless the creditor objects within a specified period.[43]

> *Stakeholders are invited to make submissions regarding the existing claims process and whether consideration should be given to a default process.*

Court Applications

Significant resources can be dedicated to court applications in many larger CCAA proceedings. The consequence is increased cost for all parties and potentially reduced recovery for creditors. Some stakeholders have suggested that the debtor company could be statutorily authorized to take specified actions or the monitor could be authorized to approve certain actions by the debtor without requiring court sanction. It has also been suggested that the monitor could be granted more authority to mediate or settle disputes.

> *Stakeholders are invited to make submissions regarding the existing role of court appearances in CCAA proceedings and whether consideration should be given to possible approaches to reduce the number and cost of such court appearances.*

Balancing Competing Interests

Role of Unsecured Creditors

Unsecured creditors can be diverse and unorganized, making it difficult for them to have an effective voice in a corporate restructuring. Some stakeholders have suggested that a mandated committee, with professionals paid for by the debtor, could create a more balanced playing field. Other stakeholders, however, have suggested that unsecured creditors' committees would simply create further delays and increase costs (see, for example, Professional Fees in CCAA proceedings below). Some view the existing provisions, which authorize the court to appoint professionals to represent specific creditors, as sufficient.

> *Stakeholders are invited to make submissions regarding the effectiveness of the existing provisions and other potential mechanisms to ensure an effective voice for unsecured creditors in restructuring proceedings.*

Acting in Good Faith

The Sarra Report suggests that since there is no obligation on parties in a CCAA proceeding to act in good faith, creditors may take positions during the bargaining process that they know have little chance of being approved but that will improve their position relative to other creditors. It is suggested that such strategies have the potential to undermine the integrity of the insolvency system and a constructive bargaining process.[44]

> *Stakeholders are invited to make submissions regarding whether the CCAA should expressly address whether parties to proceedings have a duty to act in good faith.*

Eligible Financial Contracts

Under the BIA and CCAA, eligible financial contracts (EFCs) enjoy "safe harbour" provisions that permit them to be terminated, netted and have collateral realized despite the stay of proceedings that may be ordered by the court. These "safe harbours" were implemented in order to ensure a proper functioning derivatives market and to reduce systemic risk. Protections were also put in place in the BIA and CCAA to prevent an insolvent debtor from terminating or assigning an EFC as they could potentially do with other contracts.

The Insolvency Institute of Canada issued a report on derivatives[45] that recommended several actions be taken with respect to EFCs. First, it was recommended that the insolvent party, the trustee, the receiver or the liquidator be permitted to terminate or assign EFCs, subject to certain restrictions. It was also recommended that "walk-away" clauses, which permit a solvent counterparty to refuse to make net termination payments owing to the insolvent party in the event of an insolvency, should be rendered ineffective. The report also recommended that financial collateral securing an EFC be exempted from the existing deemed trusts (e.g. for employee withholdings) and super-priorities (e.g. for unpaid wages, pension contributions). At the same time, the report recommended that financial collateral should be limited to assets that are no longer under the control of the insolvent party, either through assignment or pursuant to a title transfer credit support agreement. The report also recommended that similar rules be applied in receiverships.

On this issue, the Sarra Report suggested EFCs, such as credit default swaps (CDS), may lead to an uncoupling of legal and economic interests and may change creditor behaviour. The Sarra Report also suggests

that consideration be given to new types of derivatives that have emerged in recent years that do not fit within the original intention of the EFC safe harbour provisions.[46] The Sarra Report noted that derivatives could be made subject to the CCAA stay of proceedings, except with leave of the court, and that a process could be put in place to determine whether particular EFCs should be stayed or disclaimed.[47]

> *Stakeholders are invited to make submissions regarding eligible financial contracts, and their impacts on insolvency and restructuring proceeding, as well as potential policy responses.*

Professional Fees in CCAA Proceedings

The issue of professional fees in large corporate insolvencies has received increased attention from stakeholders and insolvency professionals in Canada and elsewhere. Reliable data regarding professional fees in Canadian insolvency proceedings are not currently available. Concerns have been raised that the expense of CCAA proceedings has been growing and may deter businesses use of insolvency proceedings in favour of alternatives that may not properly protect the interests of all creditors and stakeholders. Some stakeholders have also raised concerns that elevated professional fees can harm creditors' recoveries.

Under the CCAA, the court is responsible for reviewing fees charged to the debtor company to ensure they are "fair and reasonable". Parties to the proceeding are entitled to challenge fee applications and the court may reduce or reject fees where warranted. There is no obligation to report professional fees to the OSB or other parties, although they are available in the court record.

Other countries are examining the impact of professional fees on their respective insolvency systems, and the potential role of regulators and professional bodies. For example, in the United States, a guideline regarding attorneys' fees in larger Chapter 11 cases came into force on November 1, 2013.[48] Among other things, legal firms must disclose their non-bankruptcy blended hourly rate, hours and fees per task, and make their billing data available to the court, the U.S. Trustee and major parties to the proceeding. The guideline also sets out approaches for examining fees to ensure they are appropriate. The United Kingdom[49] and Australia[50] are also examining this issue.

> *Stakeholders are invited to make submissions regarding the impact of professional fees on insolvency proceedings, including the utility of greater disclosure practices.*

Enhancing Transparency

Creditor Lists

Currently, the CCAA requires the monitor, within five days after an initial order is made, to prepare a list of creditors and to make it publicly available.[51] The Sarra Report raised the idea of requiring the debtor company to continuously maintain and disclose a creditor list in order to provide more transparency regarding interested parties in the proceeding.[52] Unsecured creditors, such as trade creditors and suppliers, may be able to use the information to better organize. It could also provide information about creditors that can assist in formulating bargaining positions. However, some stakeholders noted that developing and updating a creditor list can be time consuming and expensive, especially if there is active debt trading. This could have the effect of distracting the debtor company from its primary objective of achieving a successful restructuring.

> *Stakeholders are invited to make submissions regarding imposing an obligation on the debtor company to maintain a creditors' list during a CCAA proceeding.*

Empty Voting and Disclosure of Economic Interests

Under the CCAA, creditors have the right to vote on a plan of arrangement or compromise, based on the expectation that they have an economic interest in the success of the restructuring. Stakeholders, however, have raised concerns that as a result of changes in the marketplace, not all creditors may have the same incentives to support a restructuring. In particular, stakeholders have raised concerns regarding the impact of the trading in distressed debt and the potential effects of credit default swaps on creditor incentives and decision making.

Distressed debt trading, in which existing debt is sold at a discount by initial creditors to speculative purchasers, has played an increasingly prominent role in CCAA restructurings. On a positive note, the distressed debt market gives initial creditors an opportunity to fix their losses at an early stage and exit the insolvency proceeding. On the other hand, through purchases of debt at a discount, the purchaser can acquire a more significant voting position than warranted by their economic exposure. At the same time, distressed debt purchasers may hold short-term objectives that run counter to the objective of restructuring the debtor.

Credit derivatives are a form of financial instrument that allow creditors to hedge against credit exposure and that may allow speculators to bet against a particular firm. Credit default swaps (CDS) are a common form of derivative to protect against credit loss, in which a buyer obtains protection from the seller in case of a "credit event", such as default, restructuring or bankruptcy, for a fixed period. Unlike traditional credit insurance, the amount of compensation that can be claimed under a CDS is not limited to the actual loss suffered, there is no automatic right of subrogation and the CDS buyer or seller is not required to hold an actual interest in the hedged debt. It has been suggested that given these characteristics of a CDS, a creditor who holds CDS positions may have disincentives to support a workout or restructuring. Alternatively, a CDS holder may have different incentives in a restructuring proceeding than an unhedged creditor. The lack of transparency with respect to CDS holdings can mean that the restructuring company and unhedged creditors may be unaware of the motives of hedged creditors and their incentives with respect to the outcome of the restructuring process.

It has been suggested that the potential for misalignment of creditors' interests caused by distressed debt trading and credit derivatives, including CDS, may be mitigated by empowering the court to take account of actual economic interests when considering approval of a restructuring plan. Additionally, increased disclosure requirements could provide other creditors with vital information to understand and respond to the incentives of hedged creditors. Others have stated that disclosure and consideration of true economic interests instead of nominal debt holdings could lead to potential negative repercussions in the distressed debt and credit derivative markets.

> *Stakeholders are invited to provide input on whether courts should be empowered to require greater disclosure of creditors' actual economic interests or to take account of those interests.*

Role of the Monitor

Under the CCAA, an insolvency professional is appointed to monitor the business and financial affairs of the debtor (the "monitor").[53] As described in the Sarra Report:[54]

> *"Monitors are relied on by the courts and the parties to provide information and their views on the financial condition of the debtor, the efficacy and fairness of sales processes or DIP financing arrangements, and their impartial opinion on a host of other issues that arise during the proceeding. Integrity and independence are hallmark attributes of a good monitor."*

In 2009, the role of the monitor received statutory clarification, with particular focus on the duty to provide notice to stakeholders and informed guidance to the court.[55] The Superintendent of Bankruptcy also became the regulator for monitor conduct, and a detailed professional conduct regime was added to the CCAA.[56] As noted in the Sarra Report, the role of the monitor is continuing to evolve.[57]

Pre-Filing Reports

A relatively new development is the monitor's "pre-filing report", which is a description of the debtor company's affairs up to the date of a CCAA filing. The report is prepared for the purposes of the initial application and, hence, prior to the monitor's appointment. Pre-filing reports have been found by the courts and insolvency professionals to be beneficial, as they provide timely information to the court. It has been suggested, however, that the monitor's ability to exercise the requisite attribute of independence, prior to receiving a court appointment, is debatable. It has also been suggested that monitors be precluded from introducing evidence in pre-filing reports.

> *Stakeholders are invited to make submissions regarding whether pre-filing reports should be permitted and, if so, in what circumstances.*

Conflict of Interest

The court, creditors, and other stakeholders rely on the monitor to maintain an impartial perspective when providing information on the restructuring process. However, in some CCAA restructurings, the monitor has a pre-existing relationship with the debtor company, for example having acted as the debtor company's financial advisor, which can raise questions as to the monitor's independence.[58] In larger CCAA cases, the debtor company often has separate financial advisors who act independently of the monitor, thereby reducing the potential for real or perceived conflicts of interest. In small- to medium-sized CCAA cases, however, the monitor has often acted as the debtor company's financial advisor pre-filing, raising concerns as to the monitor's impartiality. Some commentators have suggested that such a pre-filing relationship can facilitate a successful restructuring and reduce costs, as the monitor already has knowledge of the debtor company's financial situation. Further, the risks of conflicts are mitigated by the fact that monitors are professionals that are subject to various forms of oversight: they must comply with professional codes of conduct,[59] are subject to appointment restrictions,[60] and are also subject to oversight by the OSB and the court.[61] Others have noted that while a monitor that has acted as a financial advisor to the debtor company may improve the efficiency and reduce the costs of a CCAA restructuring, further measures such as disclosure of the monitor's relationship with the debtor company may be necessary in addition to OSB and court oversight.

> *Stakeholders are invited to make submissions regarding whether additional measures are necessary to address the potential for conflicts of interest where a monitor has a pre-filing relationship as financial advisor to a debtor company.*

Asset Sales

Credit Bidding

Credit bidding refers to the ability of a creditor to use a claim as a form of currency during asset sales in an insolvency proceeding. Canadian legislation is silent regarding credit bidding, but courts have permitted it.[62] The *United States Bankruptcy Code* specifically provides that a lien holder may bid its allowable claim in a sale of the property unless the court orders otherwise.[63]

The Sarra Report notes concerns inherent to credit bidding, particularly with respect to imbalances of power in favour of, and information available to, secured creditors. Such imbalances could reduce the likelihood of competing bids, thereby reducing the potential value of the assets being sold.[64]

> *Stakeholders are invited to comment on whether credit bidding should be permitted and, if so, what limitations may be appropriate.*

Stalking Horse Bids

A stalking horse bid is an initial bid that sets a minimum floor for the eventual sale of assets. While insolvency legislation is silent regarding such bids, Canadian courts permit this type of sales process regularly.

The Sarra Report suggests that stalking horse bids deliver "the message day one to customers, suppliers, employees and other key stakeholders that the business will carry on, and that there is an informed party that has faith in and is committed to the business."[65] It also notes that courts have considered four criteria in assessing a stalking horse bid process: the degree of control exercised over the initial stage to determine the stalking horse bidder; the need for a stalking horse bid as opposed to a traditional sales process; the economic incentives (break fees and other protections) granted to the bidder; and, whether sufficient time is permitted for other bidders to consider topping the credit bid.[66]

> *Stakeholders are invited to comment on whether stalking horse bids should be expressly permitted under Canadian insolvency legislation and, if so, what limitations may be appropriate.*

Applicability of Asset Sale Test

Asset sales are subject to court approval if they are made outside of the ordinary course of business.[67] Some stakeholders have suggested that it is unclear when sales are material enough to become exposed to the court approval process. Because court approval of sales outside the ordinary course of business must take into account how the sale could impact on the payment of wage and pension claims,[68] stakeholders have suggested a materiality test should be created to ensure court approval is sought when appropriate.

> *Stakeholders are invited to comment on whether a materiality test is required to determine when asset sales will be subject to court approval.*

CBCA Arrangements

The *Canada Business Corporations Act* (CBCA) permits a corporation to undertake an "arrangement" in order to effect a corporate change that would not be feasible under any other provision of the Act.[69] Typically, an arrangement is used to conduct a series of changes to a corporation's structure, including mergers, amalgamations and divestitures. In recent years, arrangements have been used to restructure the affairs of insolvent corporations.

The reasons for choosing to restructure under the CBCA rather than insolvency legislation may include the speed and flexibility under which an arrangement can be accomplished; that the debtor's management remains in control of the corporation; that there is no oversight by an independent party such as a monitor; that there are no reporting or other requirements to creditors; and, that it avoids the stigma associated with insolvency.

The CBCA requires that the corporation effecting an arrangement be solvent. Courts have interpreted this to mean that the applicant corporation need be solvent but other affected corporations may be insolvent. As such, some corporations have bypassed the solvency requirement by creating a solvent shell company that is then used as the applicant.[70]

The Director under the CBCA has published a policy statement regarding the use of CBCA arrangement provisions by financially distressed corporations which indicates that corporations must be in compliance with the solvency provisions of the legislation.[71]

Stakeholders have expressed concern with the CBCA arrangement provision because it is skeletal, providing the court broad discretion to make "any interim or final order it thinks fit".[72] As a result, there may be insufficient protections for creditors and a general lack of safeguards compared to insolvency legislation, which strives to balance the competing interests of various affected parties. It has been suggested that insolvency-type protections could be incorporated into the CBCA arrangement provisions. Alternatively, the Sarra Report suggested that it may be appropriate to consider changes to the CCAA in order to respond to the issues that drive parties to use the CBCA.[73]

> *Stakeholders are invited to provide input regarding the practice of CBCA arrangements involving insolvent companies.*

A Streamlined Small Business Proposal Proceeding

The cost of the existing Division I proposal process may be significant and can be prohibitive in the context of small- and medium-sized enterprises (SMEs). It may be appropriate to consider creating a simplified and less expensive proposal process intended to make it easier for SMEs to restructure. Some stakeholders have suggested that certain steps in the process could take place automatically (e.g., 45-day extension of the stay of proceedings), subject to creditors' rights to object.[74]

> *Stakeholders are invited to make submissions regarding whether a simplified, less expensive proposal process for SMEs would be warranted.*

Division I Proposals Extension

A Division I proposal must be filed within six months of the filing of a notice of intention.[75] It has been suggested that the time limit may hinder the debtor's ability to obtain creditor approval, particularly in more complex commercial proceedings.[76] Some stakeholders have suggested permitting the court to extend the time limit in exceptional circumstances where clear criteria exist for granting an extension.[77] On the other hand, other stakeholders have expressed concern that it could lead to abuse of the stay if the length of proceedings is too long.

> *Stakeholders are invited to provide input on extending the time for filing a Division I proposal following the filing of a notice of intention to file a proposal.*

Liquidating CCAA Proceedings

The CCAA was originally envisioned as a restructuring tool. In recent years, courts have noted an increase in the number of liquidating CCAA filings,[78] meaning that the Act is used to sell the assets – typically as a going concern business – and proceeds are distributed among the creditors. Stakeholders have expressed concern with the appropriateness of liquidating CCAAs because there is often no opportunity for creditor approval. Additionally, there can be pressure on the court to approve sales as there is no other going-forward solution. The sales may avoid many of the checks and balances provided by the plan approval process.

Some stakeholders have expressed the view that if liquidating CCAA proceedings are to continue, the CCAA should provide protections and add principles for the court to consider in determining whether to approve the sales processes. Other stakeholders have strongly supported maintaining judicial flexibility to permit the tailoring of appropriate solutions in the particular circumstances of the case.

> *Stakeholders are invited to provide input on whether the CCAA should be amended to codify protections for stakeholders and principles for the courts to consider in liquidating CCAA proceedings.*

Enhancing Equity

Employees' Claims

Notable commercial insolvencies, including Nortel Networks and AbitibiBowater, have raised concerns about debts and obligations owed to employees, former employees and pensioners (together referred to as "employees"). Employees' claims can include unpaid wages, vacation pay, severance and termination pay, long-term disability benefits, pension obligations as well as other employment benefits, such as dental, drug and extended healthcare plans.

Currently, employees benefit from numerous legislative and regulatory protections, as well as government programs, not available to other creditors:

- In bankruptcy and receivership:
  - **Pre-filing unpaid wages and vacation pay** are granted a super-priority over cash, accounts receivable and inventory for up to $2,000 per employee,[79] plus up to $1,000 super-priority for disbursements incurred as part of their employment:[80]
    - To the extent such claims are unfulfilled by the super-priority, they are granted a preferred claim over all of the debtor's remaining property;[81]
  - **Unremitted normal cost pension contributions** are granted a priority over secured creditors without limit;[82]
- In restructuring proceedings, a proposal or plan of arrangement or compromise must provide for the payment of:
  - **Pre-filing unpaid wages and vacation pay** of up to $2,000 per employee;[83]

- **Post-filing wages, vacation pay and disbursements**;[84]
- **Unremitted normal cost pension contributions**;[85]

- The federal Wage Earner Protection Program (WEPP) pays eligible workers up to approximately $3,600 for **unpaid wages, vacation pay, and severance and termination pay**. The WEPP is subrogated to the employees' claim for up to the amount of the super-priority;
- The BIA and the CCAA both respect the **pension fund trust** created under federal or provincial pension legislation, meaning that the amounts held in that pension fund trust are only available to pensioners and are not available to other creditors;
- The federal government announced as part of Budget 2012 that federally-regulated employers that offer **long-term disability plans** will need to do so pursuant to insurance rather than self-funding, meaning that an employer's failure would not affect such benefits.

In recent years, there have been calls to increase protections for employees. For example, it has been suggested that severance and termination could be included in the definition of wages, as they are currently excluded. It has also been suggested that the existing cap of $2,000 on unpaid wages could be increased or removed entirely, permitting employees to obtain priority for the entirety of their claim. With respect to pensions, some stakeholders have suggested that defined benefit pension plan deficits be prioritized, either ahead of secured creditors (i.e. a super-priority) or ahead of unsecured creditors (i.e. a preferred claim). With respect to employee benefit plans, it has been suggested that amounts owed with respect to these plans be prioritized or that the company be barred from terminating such plans without court approval.

International comparisons are imperfect due to differences in employees' claims and how such claims are treated in insolvency proceedings. Industry Canada research[86] found that, of the member countries of the Organisation for Economic Co-operation and Development (OECD) for which information was ascertainable, most – like Canada – provide some form of priority for employees' remuneration in insolvency proceedings. In almost all cases, the insolvency priority is capped either in amount, by a specified time period, or both. Many countries also offer a wage guarantee fund similar to the WEPP. With respect to pensions, many OECD countries with private pension plans provide a preferred claim in insolvency for outstanding contributions. Canada exceeds this by providing a super-priority. Pension deficits are by and large treated as unsecured claims in OECD countries, as is the case in Canada.[87] Finally, with respect to employee benefit plans, the *United States Bankruptcy Code* provides that retiree benefit plans cannot be modified or terminated in a restructuring proceeding without court approval.[88]

Concerns haved been expressed by some stakeholders, however, that any enhancement in the existing super-priority or preferred claims could result in lenders reducing credit available to employers and change behaviour of unsecured creditors, such as suppliers who may impose more restrictive trade credit practices (e.g. shorter payment terms). Industry Canada understands that some manufacturers experienced a reduction in credit availability in 2008, when the $2,000 super-priority was first introduced. Any increase in the amount of the priorities could be anticipated to further negatively impact on credit availability, particularly for small and medium-sized enterprises which have fewer assets against which to apply the super-priority. The House of Commons Standing Committee on Industry, Science and Technology considered Bill C-501 that proposed prioritizing pension claims. The Committee heard from numerous witnesses and decided to oppose the Bill's pension-related provisions due to concerns about their potential negative impact on the Canadian economy.

> *Stakeholders are invited to make submissions regarding whether, and how, Canada could enhance protection of employee claims in insolvency proceedings.*

Employees' Claims in Asset Sales

Under the CCAA, a plan of arrangement or compromise may not be sanctioned by a court unless it provides for the payment of unpaid wages of up to $2,000 per employee and all unremitted normal cost contributions owed to a pension plan.[89] In recent years, however, the Act has been used more often to affect a liquidation of the debtor company (see discussion of "Liquidating CCAAs" above). In these circumstances, there is no plan of arrangement or compromise. In order to ensure that the asset sales that occur in a liquidation scenario do not

defeat the requirement that these claims be paid, the Act provides safeguards.[90] As noted above at "Asset Sales", however, not all sales are conducted under the safeguard provisions, and for those that are it may be difficult to determine if they satisfy the safeguard provisions.

Stakeholders are invited to make submissions regarding whether the existing provisions adequately protect the employees' claims.

Hardship Funds

The BIA permits the payment of interim dividends.[91] The CCAA, on the other hand, is silent on the matter. Courts have exercised their discretion to order interim distributions to vulnerable creditors in certain CCAA cases, however, it is done on a case-by-case basis.

Stakeholders are invited to make submissions regarding whether express authorization for interim dividends in certain circumstances is required and, if so, any potential limitations on the courts' discretion.

Third Party Releases

A "third party release" refers to the discharge of a claim or claims against someone other than the debtor, or a director of a debtor, as part of an insolvency proceeding. The Acts are silent regarding such releases but courts have exercised their discretion "to compel the implementation of a release of the claims against third parties as part of the compromise."[92]

According to the Sarra Report, the criteria for permitting a third party release include: (1) there are special circumstances warranting the release; (2) the release is reasonably connected to the restructuring; (3) the third parties are essential to the restructuring; (4) the arrangement cannot succeed without the releases; (5) the third parties are offering a tangible, realistic contribution to the arrangement; (6) creditors generally must benefit from the arrangement; (7) creditors approve of the plan knowing the nature and effect of the releases; and, (8) the releases are fair and reasonable (*i.e.* not overly broad or offensive to public policy).[93]

Stakeholders are invited to make submissions regarding whether third party releases are appropriate and, if so, whether the identified criteria are sufficient to prevent potential abuse.

Key Employee Retention Bonuses

The CCAA is silent regarding the payment of employee retention bonuses during insolvency proceedings but courts have exercised their discretion to approve bonuses on a case-by-case basis.

The payment of bonuses may be merited in some circumstances, for example, where the employees' contributions during the course of the insolvency proceedings serve to produce beneficial results for stakeholders such as encouraging restructuring, retaining valuable employees, and increasing asset recovery for creditors. On the other hand, it may be perceived as inequitable should certain employees – particularly executives and management – receive bonuses while other employees are dismissed and/or do not receive full compensation for their unpaid wages, severance and termination or pension benefits.

The Sarra Report noted concerns that bonus programs created early in a CCAA proceeding may not be properly monitored or evaluated.[94] It also suggested that some practitioners have concerns that managers may be improperly proposing such programs to benefit from their "information capital".[95]

The *United States Bankruptcy Code*[96] permits the payment of bonuses if the bonus plan was in place prior to the commencement of insolvency proceedings, the employee has an alternative employment offer, he or she is required for the restructuring and the bonus would have the effect of retaining that employee.

Stakeholders are invited to make submissions regarding whether employee bonuses should be permitted in an insolvency proceeding and, if so, whether terms and conditions should be codified.

Stakeholders are also invited to make submissions regarding whether director and officer liability could be imposed for bonus programs created during an insolvency proceeding.

Oppression Remedy

Corporate statutes provide for an 'oppression remedy' to protect complainants from oppressive conduct by a corporation or its directors.[97] Some stakeholders have suggested that in insolvency scenarios the oppression remedy is sometimes used for improper purposes, such as venue shopping or to skew negotiations, and therefore there needs to be clearer direction as to when the remedy is available in an insolvency context.[98]

Stakeholders are invited to make submissions regarding whether restrictions on the availability of the oppression remedy should be imposed in the insolvency context.

Interest Claims

Stakeholders have raised concerns about the treatment of interest claims in insolvency proceedings. Although some guidance may be taken from the treatment of post-filing interest claims in bankruptcy, no clear rule exists for the treatment of such claims in CCAA proceedings.[99]

Stakeholders have suggested that interest stop accruing upon the commencement of insolvency proceedings (e.g. CCAA proceedings) in the event there is a subsequent bankruptcy. It has also been suggested that it be consistent across all insolvency legislation that no creditor be entitled to recovery post-filing interest unless all other creditors have received full payment on their claims. Finally, it has been suggested that the applicable interest rate should be the prime rate proclaimed by the Bank of Canada on the commencement of insolvency proceedings.

Stakeholders are invited to make submissions regarding the existing rules regarding interest claims.

Unpaid Suppliers

The BIA provides a supplier of goods with the right to repossess those goods, subject to certain conditions.[100] In the 2008-2009 reforms, the provision was amended to provide suppliers a longer period in which to make their claim to repossess goods. The provision remains contentious, however, because the conditions have been strictly interpreted by the courts, making it difficult to use this remedy successfully.

The *United States Bankruptcy Code* grants suppliers a repossession right[101] or an administrative priority for goods delivered in the 20 days prior to commencement of insolvency proceedings.[102]

Stakeholders have suggested that s. 81.1 of the BIA be repealed as it runs contrary to the general rule that unsecured stakeholders be treated similarly. However, other stakeholders view the provision as the only protection for suppliers.

Stakeholders are invited to make submissions regarding the treatment of supplier claims for goods delivered in the period immediately prior to insolvency proceedings.

Fruit and Vegetable Suppliers

On February 4, 2011, the Canada-United States Regulatory Cooperation Council (RCC) was created to better align the two countries' regulatory approaches, where possible. The RCC Joint Action Plan included a commitment to "develop comparable approaches to financial risk mitigation tools to protect Canadian and U.S. fruit and vegetable suppliers from buyers that default on their payment obligations."

In the United States, the *Perishable Agricultural Commodities Act* creates a number of financial risk mitigation tools specific to the fruit and vegetable marketplace, including information services, arbitration, temporary restraining orders and a statutory trust over the debtor's assets that were obtained from trading in produce. The statutory trust is available to any participant in the market, including farmers, packers, dealers, and wholesalers.

The BIA provides that farmers in Canada, fishers and aquaculturalists are entitled to a super-priority over all of the inventory of a bankrupt for unpaid amounts related to farming, fishing or aquaculture products delivered within 15 days of a bankruptcy or the appointment of a receiver.[103]

Under the RCC auspices, efforts were made to find solutions that would enhance the comparability between the Canadian and U.S. systems of financial risk mitigation in the fresh produce industry. For example, market-based solutions, such as credit insurance and bonding, were studied. Many fresh produce industry participants instead advocated for a legislative solution so that fresh produce claims would be paid ahead of most other creditors, including secured creditors (i.e. a super-priority). The proposed super-priority was to be paid out of any property of the bankrupt that was obtained from trading in fresh produce.

Industry Canada is interested in stakeholder views regarding the existing super-priority, including potentially expanding it to benefit U.S.-based fresh produce farmers and extending the delivery period from 15 days to 30 days, which is more consistent with practices in the marketplace.

> *Stakeholders are invited to make submissions regarding the existing farmers' super-priority in section 81.2 of the BIA.*

Deterring Fraud and Abuse

Director Disqualification

Given their key role in corporate governance, misconduct by directors both before and during insolvency proceedings attracts considerable attention. Various statutory restrictions and obligations are placed on directors to prevent, reduce and remedy misconduct (e.g. corporate, tax, environmental and employment legislation). Further, insolvency law imposes liability on directors for repayment of corporate dividends paid before bankruptcy.[104] In corporate restructuring proceedings, their misconduct or negligence is not covered by the protective indemnification charge,[105] claims against them personally for wrongful conduct may survive,[106] and they can be removed from their positions if they are unreasonably impairing or acting inappropriately with respect to the proceeding, or are likely to do so.[107] The concern about directors using 'quick flips' to strip a company of valuable assets is addressed by mandated court scrutiny of purchases of corporate assets by directors.[108] Finally, if a corporation commits a bankruptcy offence – for example failing to comply with its duties as a bankrupt[109] – a director may be fined or jailed.[110]

However, directors are not disqualified from being a director of, or from incorporating another business, even if guilty of misconduct. The issue has been addressed in various reports, articles and proposed bills, but a disqualification regime has never become law in Canada.[111] This is in contrast with the United Kingdom, where a detailed disqualification regime is in place.[112]

The concept of a disqualification regime raises interesting questions regarding the need for and efficacy of such a regime. Important issues regarding the manner of implementing, the costs of implementing and maintaining, its constitutionality, and the impact on both directors' decision making and retention both before and during an insolvency proceeding must be considered.

> *Stakeholders are invited to make submissions regarding whether directors of a corporation that has become subject to insolvency proceedings should be disqualified from acting as a director due to misconduct.*

Related Party Subordination and Set-Off

Stakeholders have suggested that the legislation be amended to allow debts among related parties to be subordinated, particularly with respect to those parties from the same corporate group. Similarly, stakeholders have suggested that the legislation be amended to prohibit set-off of debts among related parties.

> *Stakeholders are invited to provide input as to whether debts of related parties should be allowed to be subordinated, and whether set-off among related parties should be expressly prohibited.*

Cross-Border Insolvencies

Foreign Claims under "Long-Arm" Legislation

Foreign jurisdictions, including the United States and the United Kingdom, have implemented legislation that imposes liabilities on corporate group members for the pension deficits of companies located within those jurisdictions.[113] This long-arm pension legislation has the potential to put the assets of Canadian corporations at risk if an associated corporate entity cannot meet its pension obligations in that foreign jurisdiction.

In order to protect the assets of Canadian corporations from long-arm pension legislation, some stakeholders have suggested amending Canadian insolvency legislation to provide that claims from foreign long-arm legislation, unless based on claims in Canada, are not enforceable in Canada.[114]

Alternatively, stakeholders have suggested that Canada should adopt long-arm legislation similar to that in the United States and the United Kingdom that would allow Canadian creditors to pursue the assets of corporate group members in foreign jurisdictions.[115]

> *Submissions are invited regarding an appropriate response to long-arm legislation.*

Set-Off for Claims in Multiple Jurisdictions

The BIA and CCAA contain provisions regarding cross-border insolvencies that state that payments made to creditors in foreign proceedings must be taken into account by the Canadian court in determining the payment that may be made in the Canadian proceeding.[116] Some stakeholders have suggested these provisions should be more prescriptive. In situations where a creditor has claims in multiple jurisdictions for the same debt, and that creditor has successfully recovered amounts for post-filing interest in the foreign jurisdiction, such amounts should be deducted from amounts owing on account of principal from the Canadian estate.

> *Stakeholders are invited to make submissions regarding the set-off of interest claims from another jurisdiction against principal.*

Allocation of Proceeds

It has been suggested that insolvency professionals face a myriad of challenges where assets and creditors of an insolvent entity are located in multiple jurisdictions. Stakeholders have recommended that Canadian insolvency legislation be clarified in order to provide insolvency professionals with guidance as to how to access and convey assets in cross-border insolvencies, as well as to clarify how to equitably allocate the liquidated value of assets among interested parties and jurisdictions.[117]

> *Submissions are invited regarding access to, and conveyance and allocation of, assets in cross-border insolvencies.*

Treatment of Enterprise Groups

Stakeholders have raised concerns that the current insolvency legislation does not sufficiently address enterprise groups. The result is that the processes and procedures undertaken during the course of an insolvency proceeding may be driven by the most sophisticated parties.[118] The United Nations Commission on International Trade Law (UNCITRAL) has made recommendations regarding the treatment of enterprise groups in insolvency.[119] Stakeholders have suggested that Canadian insolvency legislation build on the work of UNCITRAL.

> *Stakeholders are invited to provide input regarding the treatment of enterprise groups in insolvency.*

"Centre of Main Interests"

Concerns have been raised that Canadian courts have been quick to recognize foreign jurisdictions, particularly the United States, as a debtor's centre of main interest (COMI). This may have the effect of reducing the

ability of smaller creditors from effectively participating in the proceeding.[120]

Some stakeholders have suggested that Canadian courts should ensure that Canadian creditors have been given sufficient notice, disclosure and the opportunity to make submissions where an application has been made to recognize a U.S. or other foreign jurisdiction as the COMI of a Canadian debtor.[121]

> *Stakeholders are invited to make submissions regarding the need for procedural protections in cross-border recognition matters.*

Unsecured Creditors' Committees

Canadian insolvency legislation is silent regarding unsecured creditors' committees (UCCs). Nonetheless, UCCs from the United States are increasingly using cross-border protocols to gain standing in Canadian insolvency proceedings leading to increased costs for Canadian creditors who find themselves before the court on a greater number of motions and contested positions.[122]

Stakeholders have suggested that the courts should be authorized to limit the participation of UCCs in Canadian insolvency proceedings. This may be accomplished by developing principles and criteria for the recognition of a UCC and by defining the scope of participation of a UCC in order to ensure better alignment with the objectives of Canadian insolvency legislation.[123]

> *Stakeholders are invited to provide input as to whether it is appropriate to develop principles and criteria for the recognition of foreign UCCs and to define the scope of UCC participation in Canadian insolvency proceedings.*

Administrative Issues

Renaming the *Bankruptcy and Insolvency Act*

Some stakeholders have expressed concern that the term "bankruptcy" in the title of the legislation and for "trustee in bankruptcy" may create an unintended social stigma that may prevent some Canadians from seeking much needed professional assistance to obtain debt relief. As a result, these debtors may suffer greater economic and social consequences than would otherwise be the case. It has been suggested that the term "bankruptcy" be removed from use.

> *Stakeholders are invited to make submissions regarding the potential social stigma associated with "bankruptcy" and whether Canadians may be better served if that term is downplayed in the legislation.*

A Unified Insolvency Law

The federal government has constitutional jurisdiction over bankruptcy and insolvency, and has exercised this mandate through several statutes targeting different entities:

- The BIA governs liquidations and proposals for individuals and businesses;
- The CCAA applies to corporations with debts exceeding $5 million;
- The *Winding-up and Restructuring Act* (WURA) applies to financial institutions as well as certain corporations;
- The *Canada Transportation Act* (CTA) contains provisions relating to insolvent railroads.

This fragmented approach has led to criticism that it creates uncertainty for both debtors and creditors, and that a merger of some or all of the statutes or relevant provisions into one comprehensive insolvency Act could increase transparency, fairness, consistency and efficiency. Others have noted that the separate insolvency statutes provide debtors and creditors with additional flexibility to achieve a successful solution to an insolvency.

Merger of the BIA and CCAA

It has been suggested that the BIA and CCAA could be merged into a single Act, similar to the *United States Bankruptcy Code* that contains various insolvency proceedings under a single statute. This would reduce the potential for "statute-shopping". It has been stressed, however, that the flexibility of the CCAA should be maintained in such a case.

Winding-up and Restructuring Act

WURA is the primary insolvency statute available for financial institutions. It applies, however, to some non-financial enterprises as well.[124] Part I of WURA, which provides the general insolvency regime, is under the mandate of the Minister of Industry. It has not been modernized recently and stakeholders have expressed concerns that it contains a large number of outdated provisions. Parts II and III, which provide specialized rules relating to insurance companies, are under the mandate of the Minister of Finance.

There are at least two options available for dealing with WURA. First, WURA could be amended to apply only to financial institutions. In such an event, the criticisms relating to uncertainty would be addressed as all non-financial corporations would be limited to the BIA or CCAA. The stakeholder concerns regarding Part I would remain. Alternatively, WURA could be merged into a unified insolvency Act while maintaining the specialized rules relating to insurance companies.

Canada Transportation Act

The CTA includes provisions for schemes of arrangements to be made by insolvent railway companies.[125] Neither the BIA nor the CCAA apply to "railway companies".[126]

Courts have, however, permitted companies that operate a railway to commence insolvency proceedings under the BIA and the CCAA.[127] The courts have, for example, differentiated between a company, incorporated under ordinary corporate legislation, that happens to operate a railway and a company incorporated specifically for the purpose of carrying on a railway.

It has been suggested that the policy rationales for a separate, railway companies legislative regime under the CTA should be re-examined.

> *Stakeholders are invited to make submissions regarding a unified insolvency statute.*

Restricting Consumer Proposals

The BIA provides for proposals to be made by consumer debtors.[128] In 2009, the debt threshold for consumer proposals was increased from $75,000 to $250,000, excluding any debts secured by the individual's principal residence. Stakeholders have raised the concern that, with this increase, it is more likely that business debt will be captured under consumer proposals. It has been proposed that the consumer proposal provisions be further restricted to ensure that business debt is dealt with under Division I proposals.

> *Submissions are invited as to whether the consumer proposal process should be amended to ensure that it is not used with respect to business debt.*

Special Purpose Entities

Special purpose entities (e.g. corporations, limited partnerships, trusts) are used by corporations for specific, limited business purposes. For example, assets could be transferred to a special purpose entity to achieve a particular objective while insulating the parent corporation from risk. If the special purpose entity is created as a corporation or partnership, it could qualify to commence proceedings under the BIA and CCAA. Neither the BIA nor the CCAA, however, apply to a special purpose entity created as a trust

It has been suggested that trusts operating as special purpose entities should qualify for relief under the BIA and CCAA. There may, however, be issues with defining what constitutes a special purpose entity and the proposed change may trigger other consequences.

Stakeholders are invited to provide input on whether to expand the application of the BIA and CCAA to trusts used as special purpose entities.

Receiverships

Codification of Receiverships

Part XI of the BIA allows a court to appoint a receiver with the power to act nationally over all, or substantially all, of the property of an insolvent person or bankrupt. Although stakeholders have suggested that receiverships are generally an effective tool in insolvency proceedings, further codification of the rules relating to receivers appointed under insolvency legislation may improve the receivership process.[129]

Other stakeholders have suggested that standardization of the rules regarding the authority of a receiver to act under the BIA, CCAA and provincial receivership legislation, including the creation of a standard set of appointment and engagement letters for receivers, would provide greater clarity and certainty in the insolvency process.[130]

Stakeholders are invited to provide input as to whether it is appropriate to amend the insolvency legislation to clarify the role and authority of a receiver appointed under s. 243 of the BIA; and whether it is appropriate to standardize a set of rules regarding the authority of a receiver to act across all insolvency statutes.

No Action against Receivers without Leave of Court

Some stakeholders have suggested that the reduction in the authority of interim receivers that resulted from the 2009 legislative amendments has led to an increase in the number of receivers appointed under s. 243 of the BIA. As such, these receivers face increased liability and therefore actions against them should not be allowed without leave of the court under s. 215 of the BIA.

Stakeholders are invited to provide input as to whether it is appropriate to amend the insolvency legislation to require leave of the court before taking any action against a receiver.

Marshalling of Charges

The doctrine of marshalling is an equitable concept that allows courts to arrange the assets of a debtor to ensure that all creditors are paid to the greatest extent possible. For example, where a senior creditor has recourse to two or more assets from which to satisfy its debt, and a junior creditor has access to only one asset, the senior creditor would be required to satisfy its debt first out of the asset in which the junior creditor has no interest.

The BIA does not currently include the concept of marshalling. It has been suggested that it may be beneficial if the Act expressly provided for marshalling of charges to ensure greater fairness and efficiency.

Stakeholders are invited to provide input as to whether it would be appropriate to amend the insolvency legislation to codify the doctrine of marshalling charges.

Tax Issues

The following tax-related issues have been raised by stakeholders in the insolvency context. The issues are included to solicit information regarding the nature of concerns and the extent to which such issues potentially affect insolvency proceedings:

- Whether a restructured tax debtor with prior tax obligations should be allowed "fresh start accounting" for tax purposes – specifically those resulting from debt forgiveness – being dealt with as "pre-filing claims";
- Whether tax authorities should be required to send a notice in accordance with section 244 of the BIA before issuing enhanced requirements to pay;
- Whether account receivables that are the object of pre-filing enhanced requirements to pay should "re-vest" in the estate; and
- Whether debt forgiveness rules should apply in consumer proposals.

Technical Issues

Bankruptcy and Insolvency Act

Section 197 - Costs Against the Debtor

Sometimes the conduct of the debtor with respect to his or her discharge hearing creates unnecessary expenses for the trustee or creditors. Stakeholders have suggested that one remedy for this could be granting the court the explicit authority to order costs against the debtor in the appropriate circumstances.

> *Submissions are invited as to whether subsection 197(6.1) should be amended to permit costs to be awarded against the debtor.*

Section 204.3 – Losses Due to Bankruptcy Offences

Section 204.3 provides a mechanism for persons convicted of an offence under the BIA to provide compensation for the loss they have caused, but only where that loss is as a result of damage to property. Stakeholders have suggested that this be extended to all losses, not just those relating to damage to property.

> *Submissions are invited as to whether s.204.3 should be broadened to capture all losses resulting from the BIA offence.*

Disallowance of Claims

One of the roles of a trustee is to assess creditor claims. If the claim cannot be supported, the trustee will disallow it. The impact is that the creditor may no longer participate in the BIA process and will receive no dividend out of the estate. This may be a significant impact on the creditor. The existing provision permits 30 days to appeal a disallowance or to seek an extension of the 30-day period.[131] Stakeholders have suggested that the court be granted the authority to permit an appeal beyond the 30-day period in appropriate circumstances.

> *Submissions are invited as to whether it is appropriate to provide the court with the authority to extend the period for appealing the disallowance of a claim.*

Securities Firms Bankruptcies

Part XII of the BIA provides a streamlined procedural framework for the administration of the bankruptcies of securities firms. Stakeholders have noted that Part XII does not empower securities regulators or customer compensation bodies to petition insolvent securities firms into bankruptcy, and have called for BIA amendments to provide for this power and clarify the conditions under which it may be exercised.

> *Submissions are invited as to whether securities regulators or customer compensation bodies should be able to apply for a bankruptcy order.*

Preview of Proposals by the Trustee

There have been anecdotal reports that proposal trustees, after having accepted an engagement, discover that the debtor's financial situation is worse than expected. It has been suggested that a trustee should have the right to examine the size and complexity of a BIA proposal file before accepting an engagement.[132]

> *Submissions are invited as to whether proposal trustees should be provided with a mechanism to preview the size and complexity of a BIA proposal file before they accept it.*

Section 173 - Facts for Which Discharge Will be Suspended

Section 173(1) of the BIA sets out a list of facts for which the discharge of the bankrupt may be refused, suspended, or granted conditionally by the court. Some stakeholders have questioned whether the list of facts is out of date and needs to be updated.

> *Stakeholders are invited to make submissions regarding whether the list of facts for which a bankrupt's discharge will be refused, suspended or granted conditionally needs to be updated.*

Treatment of RRSPs in Bankruptcy

In 2008, the BIA was amended to exempt registered retirement savings plans (RRSPs) from seizure in bankruptcy, subject to a clawback of contributions made in the 12 months immediately prior to a bankruptcy.[133] Some stakeholders criticized the measure because it creates a potential for abuse since a bankrupt may put funds into the RRSP prior to a bankruptcy and then have access to the funds immediately following their discharge for non-retirement purposes.

Stakeholders have suggested that a lock-in mechanism, which would require the bankrupt to keep the funds in the RRSP until retirement, would fulfill the policy intent of the measure.

> *Stakeholders are invited to make submissions regarding the treatment of RRSPs in bankruptcy and potential mechanisms to protect the integrity of the insolvency regime.*

Secured Creditors Calling Proposal Meetings

The administrator of a consumer proposal must call a meeting of creditors in two circumstances: (1) where directed to do so by the official receiver or (2) where, at the expiration of the 45-day period following the filing of the consumer proposal, creditors having in the aggregate at least 25 percent in value of the proven claims have requested a meeting.[134] If neither of these circumstances arises the administrator is not obliged to call a meeting of creditors and the consumer proposal is deemed to be accepted by the creditors.[135]

In situations where the claims of unsecured creditors do not amount to at least 25 percent in value of the proven claims, the unsecured creditors would not be able to ensure that a meeting of creditors is called. As such, some stakeholders have advised that whether the consumer proposal is accepted or not in these situations can be controlled by secured creditors who may have little or no economic interest in the outcome of the proposal since they maintain their right to realize their security.

> *Stakeholders are invited to make submissions regarding the basis upon which a meeting of creditors may be called in the case of a consumer proposal.*

Footnotes

1 *Husky Oil Operations Ltd.* v. *Minister of National Revenue*, 1995 CanLII 69 (SCC), [1995] 3 SCR 453, at paragraph 7.

2 *Schreyer* v. *Schreyer*, 2011 SCC 35 (CanLII), [2011] 2 SCR 605.

3 R.J. Wood, *Bankruptcy and Insolvency Law* (Toronto: Irwin Law Book, 2009) at page 4 (referring to UNCITRAL Legislative Guide on Insolvency Law at page 14).

4 Allan Crawford and Umar Faruqui, "What Explains Trends in Household Debt in Canada?" in *Bank of Canada Review* (Winter 2011) find that the aggregate debt-to-income ratio of Canadian households has trended upward over the past 30 years utilizing data collected from Ipso Reid's *Canadian Financial Monitor*. This trend has been documented by a 2011 TD Bank study "Assessing the Financial Vulnerability of Households Across Canadian Regions" and by Statistics Canada.

5 Bailliu *et al*. "Household Borrowing and Spending in Canada," in *Bank of Canada Review* (Winter 2011) find that the sizable increase in the ratio of household debt to income in Canada over the past decade has coincided with a period of sustained strong growth in house prices. They conclude that the main driver of the rise in household debt has been home-equity extraction—household borrowing against equity in existing homes through increases in mortgage debt and draws on home-equity lines of credit. The authors speculate that home equity may serve as a substitute for other types of consumer debt.

6 Source: The Office of the Superintendent of Bankruptcy. The consumer insolvency rate is defined as the number of consumer insolvencies per one thousand residents aged 18 years or above. The business insolvency rate is defined as the number of business insolvencies per one thousand businesses.

7 In recent years, economists and social scientists have found that the transition to adulthood is taking longer to complete. For example, using Statistics Canada survey data, Clarke (2007) finds that in "the transition to adulthood is now delayed and elongated. It takes today's young adults longer to achieve their independence: they are leaving school later, staying longer in their parents' home, entering the labour market later, and postponing conjugal unions and childbearing" (pp. 14). It is important to note that the implications of this trend for the financial situations of older cohorts and for insolvency trends have not been demonstrated conclusively. Clark, Warren. "Delayed transitions of young adults." *Canadian Social Trends 84 (2007)*: 14-22.

8 David Fieldhouse, Igor Livshits and James MacGee (2012), "Income Loss and Bankruptcies over the Business Cycle." Office of the Superintendent of Bankruptcy. The authors investigate factors that drive cyclical fluctuations in consumer insolvency filings, using an aggregate analysis using historical data at the national, provincial and city levels, and micro-level analysis which makes use of a unique dataset of Canadian filers.

9 In 2012, the GDP growth rate among the Atlantic Provinces ranged from negative to low (4.4 percent in Newfoundland and Labrador, to -1.1 percent in New Brunswick, and -0.1 percent in Nova Scotia), while Alberta (3.8 percent), Manitoba (2.6 percent) and Saskatchewan (1.9 percent) saw the highest levels of economic growth.

10 According to Statistics Canada, in 2012, Canada's unemployment rate was 7.2 percent. Newfoundland and Labrador had the highest unemployment rate in the country at 12.5 percent. Prince Edward Island and New Brunswick had the second and third highest unemployment rates at 11.3 percent and 10.2 percent, respectively. Alberta (4.6 percent) and Saskatchewan (4.7 percent) had the lowest unemployment rates. See Provincial and Territorial Economic Accounts, 2012 (Accessed on January 10, 2014).

11 Provincial exemption regimes are respected in the BIA, permitting bankrupts to keep certain property as set out in provincial legislation (e.g., work tools, a vehicle, personal belongings).

12 Section 178(1) of the BIA contains a list of debts that are not released upon discharge. Corporate bankrupts do not receive a discharge unless all debts are paid in full.

13 Section 168.1 of the BIA.

14 Standing Senate Committee on Banking, Trade and Commerce, 2003 report, *Debtors and Creditors Sharing the Burden: A Review of the* Bankruptcy and Insolvency Act *and the* Companies' Creditors Arrangement Act.

15 Classes of non-releasable debts include fines or penalties related to criminal or quasi-criminal offences, debts owed in respect of fraud, embezzlement or misappropriation of funds, and alimony or family support orders. See BIA s.178(1) for the full list.

16 For example, see *Simone* v. *Daley*, 1999 CanLII 3208 (ON CA).

17 For a review of the issues raised by these regimes, see: "Section 270 of the *Highway Traffic Act*," Manitoba Law Reform Commission, 1997.

18 E.g., *Traffic Safety Act*, R.S.A. 2000, C. T-6, ss 102(1); *Highway Traffic Act*, R.S.O. 1990, c. H.8, ss.198(1); *Highway 407 Act*, 1998, S.O. 1998, c.28, s.22.

19 *Bankruptcy Code,* 11 U.S.C. §525(a).

20 For example, see *Canada (Superintendent of Bankruptcy)* v. *407 ETR Concession Company Limited*, 2013 ONCA 769; *Gorguis* v. *Saskatchewan Government Insurance*, 2011 SKQB 132, *Moloney* v. *Alberta (Administrator, Motor Vehicle Accident Claims Act)*, 2012 ABQB 644, and *Ontario (Finance)* v. *Clarke and Superintendent of Insurance for Ontario,* 2013 ONSC 1920.

21 Personal Insolvency Task Force: Final Report (2002).

22 Senate Report, *supra* note 22.

23 Janis Sarra and Susan B. Boyd, "Competing Notions of Fairness: A Principled Approach to the Intersection of Insolvency Law and Family Property Law in Canada," in J. Sarra ed., *Annual Review of Insolvency Law* 2011 (2012), 207 at 208 – citing a study that marital breakup accounts for approximately 10 percent of individual bankruptcies each year.

24 Section 136(1)(d.1) of the BIA.

25 Section 178(1)(b) and (c) of the BIA.

26 *Schreyer* v. *Schreyer*, 2011 SCC 35.

27 In the case, the non-bankrupt spouse successfully had the bankrupt spouse's discharge annulled and she received payment from the exempt assets.

28 BIA ss.60(4), 66.26(3) and s.147.

29 In summary administration bankruptcies, the levy is capped at $200 in accordance with Rule 123(3) of the BIA General Rules.

30 BIA ss. 121(4).

31 BIA paragraph 136(1)(d.1).

32 BIA paragraphs 178(1)(b) and (c).

33 *Re Cameron* 2003 CarswellAlta 624 (Alberta Court of Appeal).

34 Senate Report, *supra* note 22 at p. 86.

35 Senate Report, *supra* note 22 at p. 84.

36 *Ibid*., at p. 52.

37 Repayment Assistance.

38 Section 178(1.1) of the BIA.

39 Dr. Janis Sarra is the Director of the Peter Wall Institute for Advanced Studies and Professor of Law, Faculty of Law, University of British Columbia.

40 Examining the Insolvency Toolkit: Report of the Public Meetings on the Canadian Commercial Insolvency Law System.

41 BIA section 82 permits a patent holder the right to repurchase patented goods from a trustee for the original invoice price, less any depreciation.

42 BIA section 83 provides limited protection to copyright authors.

43 Sarra Report at p. 23.

44 Sarra Report at p. 12.

45 Insolvency Institute of Canada, Report of the Task Force on Derivatives (Nov. 2013).

46 Sarra Report at pp. 58-60.

47 *Ibid*.

48 U.S. Department of Justice, Appendix B: Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed under United States Code by Attorneys in Larger Chapter 11 Cases. *Federal Register*, Vol. 78, No. 116, June 17, 2013.

49 See Elaine Kempson, "*Review of Insolvency Practitioner Fees Report to the Insolvency Service*," July 2013.

50 See "*Proposal paper: A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia*," Australian Government, December 2011.

51 Section 23(1)(a)(ii)(C) of the CCAA.

52 Sarra Report, p.13.

53 CCAA s.11.7.

54 Sarra Report, p. 73.

55 CCAA s.23-25.

56 CCAA s.25 and 28 to 31.

57 Sarra Report, p. 74.

58 Sarra Report, p. 76.

59 E.g., CCAA s.25.

60 CCAA subparagraph 11.7(2)(a)(iii).

61 CCAA sections 11.7, and 28 – 30.

62 *Re White Birch Paper Holding Co.*, 2010 CarswellQue 1780 (Que. S.C.J.); *Re Canwest Global Communications Corp.* (2009), 2009 CarswellOnt 6184 (Ont. S.C.J. [Commercial List]).

63 *United States Bankruptcy Code*, 363 k.

64 Sarra Report, p. 26.

65 Sarra Report, p. 32.

66 Sarra Report, pp. 31-32.

67 CCAA s.36.

68 BIA s.65.13(8); CCAA s.36(7).

69 CBCA s.192.

70 Sarra Report, p. 69.

71 Policy Concerning Arrangements Under Section 192 of the CBCA.

72 CBCA subsection 192(4).

73 Sarra Report, p. 71.

74 Sarra Report, p. 115.

75 Subsection 50.4(9) of the BIA.

76 Sarra Report, page 112.

77 Sarra Report, page 123.

78 Sarra Report, page 16.

79 BIA, s.81.3 and s.81.4.

80 E.g. section 81.3(3).

81 BIA, s.136(1)(d).

82 BIA, s.81.5 and s.81.6.

83 BIA, s.60(1.3); CCAA, s.6(5)(a)(i).

84 BIA, s.60(1.3); CCAA, s.6(5)(a)(ii).

85 BIA, s.60(1.5); CCAA, s.6(6).

86 Departmental researchers relied significantly on "Employee and Pension Claims During Company

Insolvency: A Comparative Study of 62 Jurisdictions," by Dr. Janis Sarra, June 2008.

87 Many OECD countries, including the United States, the United Kingdom and Germany, provide pension benefit guarantee funds that will pay pensions (capped) in the event the employer is not able to do so. Ontario is the only jurisdiction in Canada that offers a pension benefits guarantee fund.

88 Section 1114 sets out detailed requirements that must be met prior to the court being permitted to modify or terminate such plans.

89 CCAA ss.6(5) and (6); See also BIA 60(1.3) and (1.5).

90 CCAA ss.36(7); See also BIA ss.65.13(8).

91 BIA ss.136(2) and ss.148(1).

92 Sarra Report, p. 90.

93 Sarra Report, p. 92.

94 Sarra Report, p. 105.

95 Sarra Report, p. 105-106.

96 *Bankruptcy Code* 11 USC §503(c).

97 E.g. CBCA s.241.

98 Sarra Report, p. 108.

99 Carfagnini, J.A. and C. Costa, *Claims for Post-Filing Interest and Prepayment Premiums in a CCAA Proceeding*, Annual Review of Insolvency Law 2011 (J. Sarra, Editor)

100 BIA section 81.1.

101 USBC section 546(c)(1).

102 USBC section 503(b)(9).

103 BIA section 81.2.

104 BIA s.101.

105 BIA ss.64.1(4); CCAA ss.11.51(4)

106 BIA ss.50(14) and (15); CCAA ss.5.1(2) and (3)

107 BIA s.64; CCAA s.11.5.

108 BIA ss.30(4), ss.30(5), ss.65.1(5), ss.65.1(6); CCAA ss.36(4), ss.36(5)

109 BIA ss.198.

110 BIA s.204.

111 Tasse Report; Bill C-60 (1975); Bill C-17 (1976); Colter Committee; Girgis, Jasmine, "Corporate Directors' Disqualification: The New Canadian Regime?" (2009) Alberta Law Review 46:3.

112 *Company Directors Disqualification Act 1986* (U.K.), 1986, c. 46.

113 Sarra Report, pp. 40, 42.

114 Sarra Report, p. 42.

115 Sarra Report, p. 45.

116 BIA s. 283; CCAA s. 60.

117 Sarra Report, p. 23.

118 Sarra Report, p. 48.

119 UNCITRAL Legislative Guide on Insolvency Law—Part three: Treatment of enterprise groups in insolvency.

120 Sarra Report, p. 47.

121 Sarra Report, p. 51.

122 Sarra Report, p. 50.

123 Sarra Report, p. 51.

124 See section 6, WURA, R.S.C., 1985, c. W-11.

125 CTA sections 106-110.

126 BIA section 2, definition of "corporation"; CCAA section 2(1), definition of "company."

127 Cases in which the courts have accepted the filing involving a "railway" include: Quebec Southern Railway Co. (2001), Quebec C.A. 500-11-017184-017, Kelowna Pacific Railway Ltd. (2013), and Montreal, Maine & Atlantic Canada Co. (2013).

128 BIA s.66.12.

129 Sarra Report, p. 132.

130 Sarra Report, p. 132-133.

131 BIA subsection 135(4).

132 Sarra Report, p. 130-132.

133 BIA subsection 67(1)(b.3).

134 BIA section 66.15(2).

135 BIA section 66.18.