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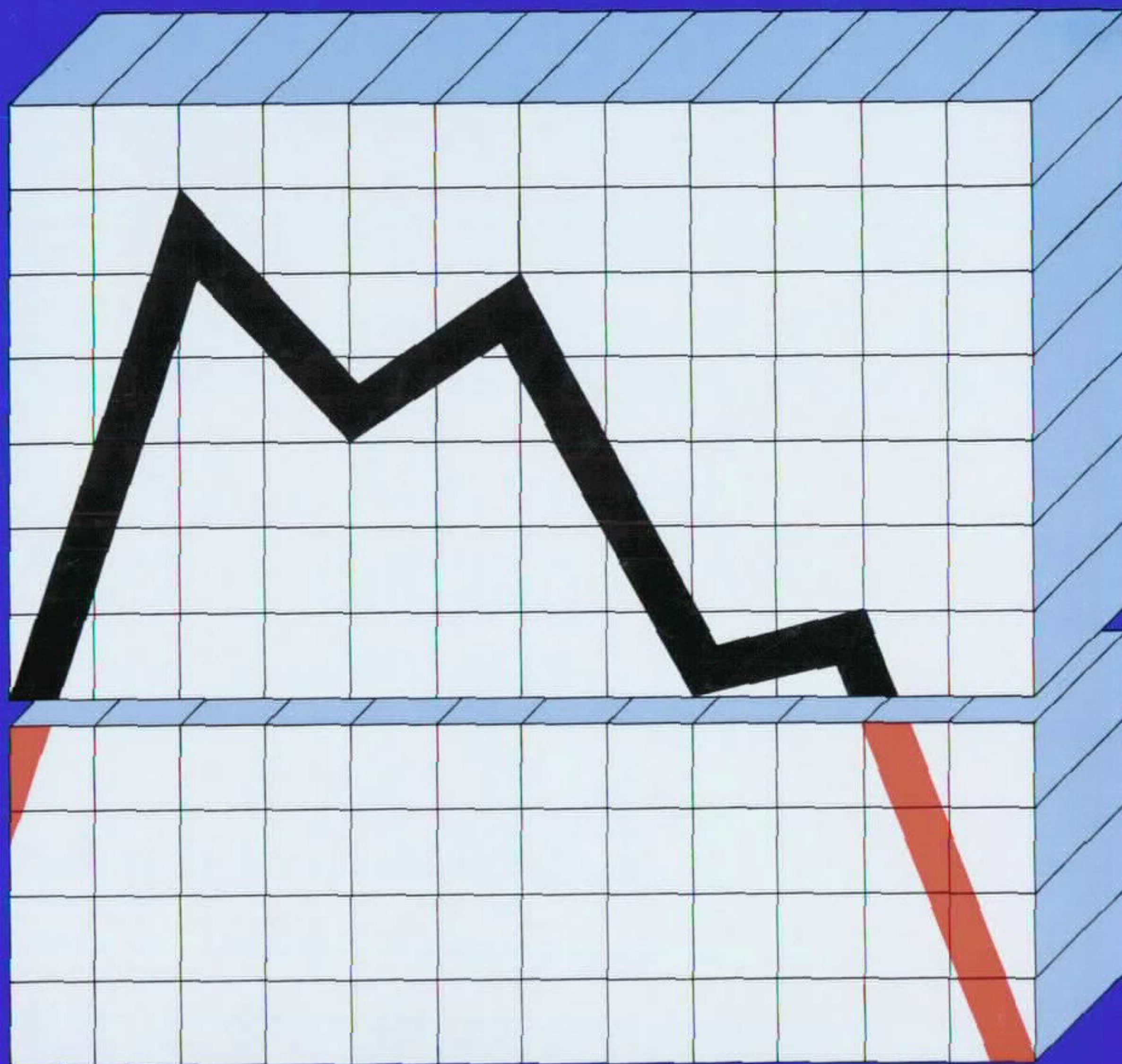

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INSOLVENCY BULLETIN

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Industry Canada.

The objective of the Insolvency Bulletin is to promote communication and strengthen ties between the Office of the Superintendent of Bankruptcy and insolvency professionals. The Bulletin is aimed particularly at trustees, jurists, registrars, accountants, credit managers and to those with a general interest in bankruptcy and insolvency.

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Table of Contents

Bill C-5
Excerpts of the Recommendations by the Bankruptcy and Insolvency Advisory Committee 23

- Notice to Readers 23
- I. Consumer Bankruptcies 24
- II. Consumer Proposals 31
- III. Reorganization and Commercial Bankruptcies 33
- IV. Companies' Creditors Arrangement Act 51
- V. Securities Firm Bankruptcies 52
- VI. Miscellaneous Administrative Amendments 54

Address of Offices of the Superintendent of Bankruptcy A-1

Notice to Publisher of Change of Address A-2

Bill C-5
Excerpts of the Recommendations by the Bankruptcy and Insolvency Advisory Committee

The *Insolvency Bulletin* for the fourth quarter 1995 outlined the main amendments to the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* contained in Bill C-109, which has been re-named as Bill C-5.

The vast majority of the proposed amendments are based on the recommendations of the Bankruptcy and Insolvency Advisory Committee (BIAC). A description of the origins, mandate, objectives, structure and composition of the BIAC can be found on pages 124, 342 and 381 of the 1993 *Insolvency Bulletins*.

At this time, it is appropriate to outline for our readers the rationale underlying the proposed amendments. Accordingly, this issue contains excerpts of the BIAC's proceedings, which will provide a better understanding of the context in which the Committee issued its recommendations.

Although the vast majority of the recommendations can be found in the Bill, expert analysts may occasionally find some differences. Readers must also keep in mind that the excerpts have been taken from discussions going back to December 1994; since that time the facts and case law cited may have changed. It should be kept in mind that we are publishing the excerpts not from an analytical viewpoint, but rather for the purpose of sharing information with our readers.

It is important to remember that Bill C-5 is currently being studied by the House of Commons Standing Committee on Industry, and Parliament may make changes to the proposed amendments. If such changes are made, we will inform you in a subsequent edition of the *Bulletin*.

In closing, and to make it easier to read and understand the following excerpts, please note that every subject studied by BIAC can be found under the same topic and in the same order as that appearing in our issue on the Summary of the Proposed Amendments. As well, each excerpt is presented using the same format: subject, issue, and comments.

Happy reading!

HMM

I. Consumer Bankruptcies

1. Exempt Property

Subject:

Benefits ensuring a debtor's essential needs .

Issue:

Should a bankrupt's goods and services tax (GST) credit refund be exempted? What other property, if any, should be exempted as benefits that would ensure a debtor's essential needs?

Comments:

The *Income Tax Act* grants taxpayers a GST credit. This credit is based on the number of dependents, marital status and the taxpayer's income.

At its last meeting, the main Committee of BIAC referred back the issue to the Working Group for further information gathering and verification with Revenue Canada if exempting GST refunds would have any effects on their operations.

Revenue Canada has advised that exempting GST refunds would have no effects on the income tax refunds as both refunds are treated separately.

It is recommended to exempt the benefits that ensure the debtor's essential needs. It is proposed that the nature (identification) of these benefits and their conditions be established in the General Rules. The exemption would include, but should not be limited to GST credits; it may be extended to other essential benefits, such as property tax and sales tax credits.

However, some trustees felt that GST credits provided access to bankruptcy services for many debtors. This type of "asset" means, in some cases, that their fees and disbursements would be paid.

It is therefore further recommended that, where the costs of administration are at stakes, the debtor could specifically assign GST refunds. This would also be done in the General Rules. They would provide, as a condition for exempting these amounts, that costs of administration would be paid. In addition,they would provide that, where these refunds have been assigned to the trustee, any surplus amount over and above the costs of administration would be returned back to the debtor.

The exemption would not prejudice any federal or provincial legislation declaring some benefits exempt.

It would enable the debtor to use these funds for the purposes for which they were intended and it would facilitate bankruptcy administration.

These benefits consist of small amounts that are funded by all taxpayers and are intended to benefit needy people, not their creditors.

2. Surplus Income

Subject:

Consumer bankruptcy: surplus income.

Issue:

Whether the present surplus income provisions should be strengthened.

Comments:

It is the intention of the *Bankruptcy and Insolvency Act* that a portion of a debtor's surplus income after living expenses become the property of the estate for distribution to creditors.

Presently, the Act does not address the bankrupt's obligation to deposit surplus income with the trustee, it only provides for a court order to force the bankrupt to act. Situations, therefore, arise where funds owed to the estate are dissipated by the bankrupt and a court order is not sought as the resources required to carry out the proceeding would outweigh the return.

The Working Group recommends that the provisions be strengthened to ensure that surplus income, according to Standards (under development), is brought into the estate with little or no court involvement.

The Insolvency Institute expressed concern over expanding Official Receiver involvement as it would be impractical. However, consensus was reached on the Canadian Bar Association's recommendation that the Official Receiver involvement remain informal and take on a mediation role only.

Consumer groups expressed a concern that debtors may not be fully aware of the agreement on surplus

income being made between themselves and the trustee, and that hardship may occur if the debtor is not fully aware of its rights. Official Receiver mediation when there is variance from the Standards and/or disagreement, and Court involvement when there is disagreement between interested parties at the discharge stage, provide checks and balances to ensure that debtors receive equitable and fair treatment.

The Canadian Bankers' Association and Caisses Populaires expressed concern over the protection of creditor interest in the proposed process. The recommendation addresses this concern by ensuring that the surplus income calculation and budget information is made available to creditors up front, at which point creditors could better assess the individual case. The creditor then has four avenues to pursue if it is felt that their interests are not being served, they are: contact the trustee in the beginning to bring information forward; call a meeting of creditors; request an Official Receiver mediation; or, oppose the discharge of the debtor or the trustee at the end of the process.

BIAC therefore recommended amending section 68 of the Act stipulating the bankrupt's obligation to deposit a portion of the surplus income with the trustee and to allow for the establishment of Standards.

Details of the Standards (exemptions, thresholds and ratios) should be left in the Directives for flexibility. The Standards should also have the flexibility to vary by region.

A written agreement between the Debtor and Trustee would oblige the Debtor to pay surplus income to the estate, the amount of which must fall within the Standard. Details of the surplus income calculation and the debtor's budget will be forwarded to interested creditors.

The Trustee and the Debtor would have some discretion in applying the Standards in order to prevent undue hardship and remain flexible for special circumstances. Variance from the Standards or if there is no consensus on the debtor's and trustee's agreement would require Official Receiver mediation and the notification of interested creditors. If there is no consensus reached through Official Receiver mediation, the case is referred to Court. Provisions will ensure that, in cases where there is a change of status (change in living expenses or income), the surplus income payments could be adjusted.

The task force will examine how the Directives will be developed with consideration to be given to the following: income, expenses, family responsibilities, hardship, socio-economic factors etc.

As a point of clarification, following the *Marzetti* case, Section 68 should be modified, in order to:

- allow the conclusion of an agreement between the bankrupt and the trustee in order to pay to the trustee the amount of the bankrupt's income exceeding personal and family responsibilities. If no agreement is concluded the Trustee may, on the Trustee's own initiative or, if directed by the inspectors or the creditors, shall, make an application to the court for an order directing the payment to the Trustee of such part of the money as the court may determine, having regard to the family responsibilities and personal situation of the bankrupt.
- in assessing the bankrupt's income, include all fiscal, family and social benefits that are paid to the bankrupt to ensure essential needs, in addition to all sums received as salary, commissions, fees, and other remuneration.

This amendment will ensure that surplus income as deemed by the ability-to-pay principles is directed toward the estate. There will also be less need for court involvement.

This recommendation will affect the debtor's decision to opt for bankruptcy or proposal particularly if the assessment of the ability-to-pay surplus income is reduced to an administrative exercise.

3. Opposition to Discharge

Subject:

Consumer bankruptcy: discharge considerations .

Issue:

Whether to give the Court and stakeholders expanded guidelines to follow when considering a discharge.

Comments:

An insolvent debtor, while having surplus income, may choose to file a bankruptcy rather than a proposal. This choice is often exercised in the case of a first time bankrupt because of the relatively short period of time

before a discharge is granted (nine months). The stakeholders do not want to inhibit a debtor's choice to file for bankruptcy when the circumstances warrant it. However, creditors feel that the BIA should carry provisions to allow for the refusal or suspension of a discharge, or the issuance of a conditional discharge, based on the consideration of ability-to-pay and/or ability to file a proposal.

The provisions should be elaborated further to ensure that, even if the bankrupt may not have had the ability to pay surplus income in the beginning, discharge could be opposed if, during bankruptcy, the conditions have so changed that surplus income became available.

The Working Group agreed with this recommendation but there were some reservations with respect to including the ability to have filed a proposal as a consideration at discharge.

This recommendation, would enable the Superintendent's Directive on surplus income to be linked with the statutory proceeding, particularly the discharge process, and will encourage contributions to the estate.

This may result in the filing of more consumer proposals as opposed to bankruptcies, because debtors may feel that if they have to contribute a portion of their income, they may as well avoid bankruptcy; and increased contributions to the estate may result in increased dividends to creditors.

Finally, BIAC believes that an individual with ability and surplus income should consider making a consumer proposal rather than opting for an assignment in bankruptcy as the latter should be used only as a last resort. In addition, performance against a budget is an effective rehabilitation exercise.

* * *

Subject:

Consumer bankruptcy: opposition and discharge.

Issue:

The opposition and discharge processes for consumer bankruptcies require streamlining.

Comments:

The Registrar presently hears oppositions and decides the conditions to be placed on an individual's discharge from bankruptcy. The BIA's streamlining was designed to reduce the courts' workload, but there appears to be a backlog of cases in some provincial courts where some opposition hearings are delayed for over one year. There also appears to be a lack of consistency in the decisions taken given that a great number of both judges and registrars hear discharge cases. A difficulty also arises in the opposition process as it remains cumbersome and expensive. As a result, some valid oppositions are not being made. The lack of Court resources requires that the opposition and discharge processes be streamlined.

At the November 1993 Working Group meeting, Caisse Populaires suggested that an alternative dispute resolution mechanism, such as arbitration, would be worthwhile as it would increase consistency and efficiency. ACEF suggested introducing a mechanism whereby the creditor could more easily oppose the discharge. The Insolvency Institute and the Canadian Insolvency Practitioners' Association suggested that trustees provide guidance to the court by stipulating a conditional order.

At the November 1994 Working Group meeting and at the June BIAC meeting, all members agreed on the recommendation presented below that trustees determine the terms of the conditional order based on the Superintendent's Standards for Surplus Income and that creditors and debtors would review and appeal to the Official Receiver if so desired for a mediated agreement. Official Receiver mediation would also be required if there was any variance from the Standards. In the event of any disagreement among parties the case would be referred to Court.

The consumer groups were concerned that without proper checks and balances, debtors may agree to the terms of conditional order without fully understanding the ramifications and that this may lead to hardship. The consumer groups were also concerned that an agreement of payments during the bankruptcy, made at the outset, could be subject to change prior to discharge and that this could lead to uncertainty for the debtor. This practice is what occurs in the present system and would be further entrenched if the Working Group recommendation on "Discharge Considerations" is accepted.

The Insolvency Institute expressed concern over expanding Official Receiver involvement as it would be impractical. However, consensus was reached on the Canadian Bar Association's recommendation that the

Official Receiver involvement remain informal and take on a mediation role only.

BIAC recommended drafting a new sub-section to empower the trustee to set the terms of conditional order of discharge upon consent of the bankrupt and creditors without need for registrar approval. Trustees would set the terms of conditional orders based on the debtor's performance against both the Superintendent's Standards (currently under review) and Sections 172/173 (under review) and report them to the creditors through the 170 report. The intent is that this procedure would be aimed, primarily, at those debtors who are not paying surplus income into the estate. All other cases requiring adjudication would be referred to court.

These measures will reduce the Courts' (including Registrars') workload and further streamline the process. This will keep judicial decisions for the Court and transfer administrative decisions to the Official Receiver.

The mediation approach, of informal setting of terms and review by the creditors, could lead to more equitable and meaningful results in addition to simplification.

Furthermore, decreased opposition costs will encourage participation from creditors.

The application of conditions on discharge would be made more consistent as a set of criteria for the Official Receivers to follow would be developed. This would also introduce flexibility as the criteria could be readily changed.

* * *

Subject:

Priority for the costs of a creditor who successfully opposes a discharge.

Issue:

Whether to provide for and recognize cost awards to creditors who successfully opposing discharges which are more in line with the actual costs incurred by the opposing creditor.

Comments:

A creditor may object to a bankrupt's discharge, and convince the court that a discharge application should be refused and that the debtor should be required to make further contributions to creditors. All creditors would benefit from these contributions. The courts have authority under s.197 to award costs to an opposing creditor. However, these awards, when made, tend to be quite small — the objecting creditor may receive only nominal compensation for the substantial costs that may have been incurred in pursuing the objection at discharge proceedings.

The Working Group recommends that explicit reference should be made in the BIA to the court's authority to award costs to a creditor who opposes a discharge.

Costs awarded to an opposing creditor should be given preferred status for up to the amount brought into the estate as a result of the opposition less the increase in administration fees resulting from the opposition.

Cost awards are often inadequate now, even though the authority to award them exists. This regime would encourage more adequate awards.

4. Meeting of Creditors and Information to Creditors

Subject:

Consumer bankruptcy: meeting of creditors in summary administration estates.

Issue:

Whether the requirement for creditors' meetings in summary administration estates should be mandatory.

Comments:

Creditors' meetings are a forum where creditors consider the affairs of the bankrupt, affirm the appointment of the trustee or substitute another in place thereof, appoint inspectors, and give such direction to the trustee as the creditors may see fit.

Creditors' meetings are an essential part of the checks and balances of business bankruptcies but their relevance in summary administration consumer estates is not clear. These consumer estates are, for the most part, neither complex nor contentious.

Insolvency Institute (October 1993 submission) requested that the meeting of creditors for summary administrations be made consistent with that of consumer proposals (i.e., where a meeting is not mandatory).

The members (May 1994 meeting) would accept the removal of the meeting requirement on the condition that

- a portion of the debtor's surplus income is remitted *to the trustee (the Superintendent's Standards will* be reviewed);
- creditors have accurate summarized information on revenues and expenses up front (the information should remain meaningful and not too summarized); and
- creditors retain the right to request a meeting based on the same test as for consumer proposals.

All members of the Working Group and the BIAC Steering Committee agreed with these conditions and the recommendation.

Dissenting creditors would be required to state the reason why the meeting was requested. This may help avoid the calling of a meeting because of a misunderstanding or for reasons that could have been alleviated by the trustee.

It is often the case that creditors do not attend these meetings which may be indicative of their lack of relevance. Trustees represented at the Working Group indicate that fewer than ten percent of creditors participate in summary administration proceedings.

The business bankruptcy model of holding creditor meetings is not entirely appropriate for low or zero asset summary administration consumer estates.

This would improve the internal consistency of the Act to make it reflect the provisions regulating consumer proposal estates.

BIAC therefore recommended introducing provisions *(section 155) requiring a meeting of creditors in* circumstances identical to that under Consumer Proposals, Part 3, Division II. The provisions would include conditions to ensure that a portion of the debtor's surplus income is remitted to the trustee, and that creditors have adequate summarized information and retain the right to request a meeting.

* * *

Subject:

Consumer bankruptcy: disclosure.

Issue:

Creditors require information to make sound decisions in the insolvency process.

Comments:

All Working Group and BIAC Steering Committee members agreed that the creditors should have improved access to trustee information, and all agreed on the recommendation.

The representative from the Canadian Bar Association is strongly opposed to keeping any part of the information confidential. The issue of confidentiality requires further examination by the task force.

BIAC therefore recommended that subsection 168.1 (a) to read as follows, "...file a report prepared under subsection 170(1) with the Superintendent **and to any creditor upon its request**".

Amend section 170 (2) to add, "**the report should be forwarded to creditors upon request**."

Because of the private and sensitive nature of some of the information in debtor's file, precautions would have to be taken to maintain confidentiality, otherwise, debtors may not be entirely forthcoming with information and trustees may be liable for any misinterpretation of the debtor's condition. This matter of confidentiality will be forwarded to the JCB for consideration. One suggestion coming from the task force was to split the section 170 report into two parts where one is for public use and *the other for designated parties.*

All members agreed that the full document should be made available if the case proceeds to court. It would then be in the court's discretion to use this information. The full information would also be available to the Office of the Superintendent of Bankruptcy, where aggregate *and anonymous information could then be made avail*able to creditors and the community at large. This would allow creditors to make more informed decisions.

5. Claim for support

Subject:

Consumer bankruptcy: limited provability of support claims.

Issue:

Arrears of spousal or child support should, to a *limited extent, be categorized as provable claims in* bankruptcy, without prejudicing other support remedies.

Comments:

Presently, spousal or child support orders, and most agreements, are considered non-provable claims which are not affected by the bankruptcy but do not entitle the claimant to a dividend. Section 178 further ensures that the discharge from bankruptcy does not prejudice such support claims. However, there is no reason in principle why support claimants should not be entitled to a dividend in bankruptcy so long as other support remedies, both during the bankruptcy and after discharge, are not prejudiced.

The Working Group and BIAC members agreed with the recommendations, subject to clarification of details and appropriate drafting.

The recommendation is intended to accomplish the following: to allow a claim to be lodged for the specified portion of support arrears, thereby creating a new and additional remedy for collection of support arrears; to do so without prejudicing any other support remedies; and to have no effect whatsoever on the quantum of support arrears or on the collection of arrears and ongoing payments.

These recommendations reflect society's heightened recognition of the importance of support obligations. The recommendations also do not alter existing priority rules. Unlike existing provincial legislation, which grants support claimants priority for support arrears over other creditors, the recommendation would not grant any priority to support arrears; the support claimant would only obtain the right to share pro rata. As such, remaining unsecured creditors would not be unduly prejudiced and diluted in their recovery.

This would also clarify and codify the respective rights of the support claimant, the bankruptcy estate, and the property of the bankrupt under existing law.

The non-provability rule gives the support claimant certain benefits. However, it runs contrary to Canadian social policy to impose on the spouse the concomitant disadvantages that accompany the rule. These disadvantages can lead to injustice and impoverishment.

Provincial legislation already places support arrears on a substantially higher plane than commercial and other debts. This would harmonize bankruptcy practice with provincial policy.

The "one year plus lump sum" formulation has been adopted in Australia, which suggests that a jurisdiction similar to our own has considered this an appropriate compromise. This formulation also corresponds to the priority period provided in most provinces' creditors' distribution schemes. The one year time limitation recognizes the practical difficulties facing a trustee who must assess a long claim; the risk of historical support claims "swamping" other creditors' claims; the fact that some family courts discharge long-outstanding support arrears; and the risk of collusion.

6. Claims for Student Loans

Subject:

Canada and Provincial Student Loans.

Issue:

Whether the *Bankruptcy and Insolvency Act* should be amended so that Canada and Provincial Student Loans become non-dischargeable under section 178.

Comments:

The 1992 amendments to the BIA removed preferred creditor status for most Crown claims, including claims under the Canada and Provincial Student Loan Programs. As a result, these claims are now ranked as ordinary, unsecured claims.

In the two years ending in December 1993, one out of every ten individuals declaring bankruptcy had a liability for a Canada Student Loan. A sampling of Canada Student Loans bankruptcies revealed that there were no funds available to be distributed to ordinary unsecured creditors. Given the recent rise in Canada Student Loan bankruptcies, significant losses have been experienced, $61.3 million in 1993–94 (or 3.15% of the total loans entering or in the repayment phase) up from $33.5 million in 1992–93 (1.94% of the total repayable), $29.9 million in 1991–92 (1.84%) and $20.5 million in 1990–91 (1.35%).

The Canada and Provincial Student Loan Programs are not in the same position as private credit granters, since they are required by law to provide loans to qualified students without an assessment of their risk.

The Alberta government recently signed a deal with the Canadian Imperial Bank of Commerce (CIBC) to

finance the provincial student loan scheme. Similar deals were struck with Nova Scotia and New Brunswick last year. Negotiations involving the Royal Bank and the CIBC are continuing with the federal government on a deal to finance and administer the Canada Student Loans Program. However, under any deal, a $4 billion portfolio of loans would still be guaranteed by the federal government. In addition, the federal government would be also be responsible for guaranteeing loans during the student's study period.

In the United States, all government guaranteed student loan debt is exempt from a bankruptcy discharge unless the debt has been due and owing for a minimum of five years.

The recently released discussion paper on Social Security Reform proposes that monies currently going to the provinces for post-secondary education be transferred directly to students in the form of loans. The loans would be repayable after graduation, based on a formula linked to the graduate's income.

The BIA would be amended so that "educational loans" would not be dischargeable in bankruptcy immediately following a student's graduation. The courts would be given the discretion to allow the discharge of educational loan debts in hardship and other special cases.

II. Consumer Proposals

1. Distribution of Dividends

Subject:

Consumer Proposals; Amend the requirement for administrators and trustees to distribute funds every quarter.

Issue:

The obligation under the Act, per subsection 66.26(1), for administrators to distribute funds on hand every quarter impedes or eliminates the flexibility and creativity in preparing terms of proposals as well as increasing costs for administrators.

Comments:

Subsection 66.26(1) of the Act was enacted on the premise that quarterly remittances would ensure expeditious and orderly payments to creditors. It would seem that this provision may be an impediment to the proposal of certain arrangements and/or the use of consumer proposals on the basis of costs involved. The explanation papers of Bill C-22 mentioned that this provision would mirror a similar provision [i.e.: subsection 60(2)] of Division I proposals. However, that provision does not require quarterly remittances to the creditors.

At the Working Group meeting in May 1994, the issue was discussed and it was agreed that an acceptable solution would be to accept that payment be made on the basis of the terms of the proposals with a proviso.

Creditor representatives agreed that such an amendment may mean less costs to the trustee/administrator. However, they are concerned about situations whereby the terms of proposal may provide for distribution after an extended period. They feel that this period may jeopardize what ever asset base existed at the time of the proposal. In fact, if the consumer debtor was to default on the terms of his proposal, probabilities exist that the assets could have been liquidated before they are advised of the annulment of the proposal by the trustee/administrator.

Accordingly, it was suggested, notwithstanding the terms of the proposal, and in order to maintain the creditors' state of readiness to resume their collection, that the trustee/administrator advises creditors, in a reasonable delay, of any breach of whatever arrangement may have been concluded with the consumer debtor to comply with the terms of the proposal, or of any situation affecting the debtor's asset base, or of any pertinent information.

Even though, per section 66.2 of the BIA, this kind of request may form part of the proposal, in order to maintain the streamlining effect of the deeming acceptance provisions of the consumer proposals, another provision could be added to satisfy the creditors' request, adding minimal obligation on the trustee/administrator, and at the same time maintain the streamlined process.

BIAC recommended amending subsection 66.26(1) to read: "All moneys payable under the consumer proposal shall be paid to the administrator and, after payment of all fees and expenses mentioned in paragraph 66.12(6)(b), the administrator shall distribute available moneys to the creditors as prescribed by the terms of the proposal." Also, BIAC recommended amending current section 66.2 to make it 66.2(1) and introducing subsection (2) which would contain the following features:

- When a consumer proposal is approved or deemed approved by the court and its terms does not provide, at a minimum, for quarterly distributions and requires from the consumer debtor to make regular installments with the administrator/trustee;
- the consumer debtor shall file with the administrator/trustee monthly budgets; and
- if the consumer debtor defaults on a regular installment, the administrator/trustee shall forthwith report to the creditors the most current information on file; or if any adverse material change in the debtor's financial situation should occur at any time during the proposal period, the above information shall be transmitted forthwith to the creditors by the administrator/trustee.

These amendments would eliminate some of the costs in administering consumer proposals (e.g.: consider the issuance of possibly 1 payment for the duration of a consumer proposal as oppose to 4 per year for three years with the existing legislation); payments would be

made on the basis of the terms of the proposals; could allow for greater flexibility and creativity in arrangements; will provide some security to creditors; payments to creditors would not be made on a regular basis as contemplated under the existing legislation; will create an additional duty for the consumer debtor, if he chooses so. It will re-assure creditors when the terms of the proposal provide for distributions based on extended periods of time. It does not create more obligations to the trustee/administrator then what would happen in Division I proposal (50.4(7) of the BIA). All in all, they represent a shared compromise by the various stakeholders in consumer proposals.

2. Changes in Limitation Periods

Subject:

Deemed acceptance of consumer proposals by the creditors.

Issue:

Extending the waiting period from 30 to 45 days before a consumer proposal is deemed accepted.

Comments:

During the Task Force discussions, some creditors have indicated that, although they agree with the deemed acceptance provisions, it was felt that many large creditors may never have a say because of the short period involved in order to indicate whether they accept or reject the consumer proposal. Although suggestions were made to increase the 30 day period before a creditor accepts or rejects the terms of a consumer proposal, it was recognized that caution should be exercised not to impede the streamlined process already in existence. A review of the time period that exists before a consumer proposal is finally deemed approved or approved by the court amounted to 60 days.

Subsection 66.18(l) of *the Bankruptcy and Insolvency Act* provides that 30 days after the filing of a proposal and were no creditor has opposed the proposal, a deemed acceptance occurs. Furthermore, subsection 66.22(2) provides that if an official receiver or any other interested party does not require that the consumer proposal be approved by the court within 30 days after the proposal has been accepted or deemed accepted, then at the expiration of the thirtieth day, the consumer proposal is deemed approved by the court.

Accordingly, it was suggested that the time period for creditors to indicate their approval or disapproval of a consumer proposal be increased from 30 to 45 days. Along with the above suggestion, and in order to eliminate time constraints rather than add to it, it was felt that the thirty day holding period in which an official receiver or any other interested party can require that the accepted or deemed accepted consumer proposal be approved by the court, be reduced to 15 days. The end result will not change the 60 days required to see consumer proposals accepted or deemed accepted by the creditors and approved or deemed approved by the court and will ensure, it seems, a greater creditor participation.

3. Proposal by a Bankrupt

Subject:

Definition of a "Consumer Debtor" in Consumer Proposals.

Issue:

To allow a "bankrupt natural person" the opportunity to make a consumer proposal.

Comments:

Members of the Insolvency Community have identified instances where consumer bankrupts, because of a change in their personal financial situations, may have been in a position to make a proposal to their creditors. Since Division I proposals address mainly commercial reorganizations and because of the impossibility for a bankrupt to make a consumer proposal, attempts by bankrupts to rehabilitate through such an option have been denied.

The Task Force recommends therefore that Section 66.11 be amended to include the word "bankrupt natural person" in the "Consumer Debtor" definition.

1. Liability of Trustees, Receivers and Interim Receivers

Subject:

Trustee liability for claims against a debtor, or for other matters or conditions in connection with a debtor, which arose before the trustee's appointment.

Issue:

Whether the trustee should be given clear and explicit protection against personal liability in respect of claims or other matters or conditions in connection with a debtor which arose before his appointment.

Comments:

A trustee, as trustee, generally has no prior connection with the debtor or his property, and no connection with claims which may have arisen against the debtor or with matters or conditions in connection with the debtor, such as for example environmental damages or health and safety problems on or connected with his property, which arose before his appointment.

Given that a trustee has no prior connection with the debtor and stood to make no gain from the debtor's activities, it is generally agreed that he ought not to have any personal responsibility to pay claims against the debtor or to pay claims arising out of pre-existing matters or conditions in connection with the debtor.

Despite the wide spread agreement that trustees should not be held responsible or personally liable for pre-bankruptcy claims or matters, trustees have been exposed to personal liability for such claims or other matters and conditions in some circumstances.

In some cases, claims of this type are given the status of costs of administration, which, while it does not impose personal liability on the trustee to pay them out of his own pocket, does rank them ahead of unsecured claims.

A major concern in this respect has been trustee exposure to liability under federal or provincial environmental protection law in connection with pre-bankruptcy environmental damages on the debtor's property. The legislation may impose personal liability on the person in current possession of contaminated property (the trustee) for past environmental damages or claims against previous owners or possessors of the property. The legislation may also make the current possessor subject to clean up orders and personally responsible for carrying them out. Amendments to the BIA in 1992 attempted to address this problem in the environmental area by providing explicitly that a trustee shall not be personally liable, notwithstanding any federal or provincial law, in respect of an environmental condition which arose prior to his appointment.

The St. Marys case provides an example of liability for a different type of pre-bankruptcy claim being imposed on a trustee, in this case as a statutory employer. In St. Marys, the trustee continued operating the company and hired employees of the bankrupt, but on condition that he was not obligated to pay for past under funding of pensions. The court held that the trustee was an employer under the applicable pension legislation and therefore subject to the statutory employer obligations to pay the under funded amounts, which could not be waived.

The Working Group realizes that there is an important and difficult policy consideration here, as to whether the assets in the estate are to be fully protected from public policy type claims when no other resources are available to deal with them. A line has to be drawn between protecting trustees and creditors and facilitating pursuit of some public policy goals.

Note: There is another important class of claims for which a trustee could be held personally liable, namely those arising in the post- bankruptcy period, after his appointment. Here the trustee's conduct may be a factor. He may have deliberately undertaken an obligation personally. Even where he did not, he is in control of the property and could be the cause of a new problem or could have worsened a pre-existing problem. It is generally agreed therefore that he ought not be given absolute protection against liability for these types of claims.

The 1992 amendments to the BIA tried to fix the extent of potential liability in respect of environmental claims arising post-bankruptcy, by providing that the trustee was not personally liable for such claims unless he did not exercise due diligence.

The Working Group is aware that there may be issues regarding trustee exposure to personal liability for post-bankruptcy claims outside the environmental area. However, those issues are not explored in this issue paper, which limits its examination to issues of liability for pre-bankruptcy claims and matters and makes recommendations relating to pre-bankruptcy claims only.

Note: The Working Group is aware that there are important issues relating to a receiver's exposure to personal liability for these types of claims, but has not addressed them here. It does see them as a legitimate and important issue for phase III.

The Working Group recommends that a provision be added to the BIA, that would, subject to any provisions respecting trustee liability for environmental claims, protect a trustee and interim receiver against personal liability, irrespective of whether or not the liability is limited to the trustee's proceeds of realization, in respect of the following, none of which would constitute costs of administration:

Note: The intent, in referring to liability limited to proceeds of realization, is to block attempts to obtain costs of administration status for claims, frustrating the intent of s.136.

(a) Any claims provable or claims which would be claims provable if such law did not impose personal liability upon a trustee or interim receiver;

Note: The second part of this phrase may be necessary to cover successor employer situations, where the successor becomes the employer, and subject to the employer's obligations, so that the claims may no longer be regarded as claims on the original employer (the debtor) and so may not be claims provable.

(b) Any contingent or unliquidated claims against the debtor, whether or not they are claims provable;

Note: As indicated in para.(a), where an obligation of the debtor is shifted, by law, to another, it could be argued that the liability to pay on the obligation is no longer that of the debtor, and so not a claim provable; hence, the second part of the phrase.

(c) Any statutory requirements for the collection of funds for which the debtor may be liable, or which the debtor is obliged to remit; or

(d) Any matter or condition arising or existing before or at the date of the appointment of the trustee or interim receiver, or any matter or condition, to the extent to which it is attributable to such period, for which liability would, except for this subsection, be imposed upon the trustee or interim receiver by operation of law as a result of his appointment or of the performance of any of his duties under this Act, including without limitation any liability as a successor of the bankrupt or insolvent person.

Note: This provision is intended to protect against liability in a St. Marys type of situation.

To protect an interim receiver where no bankruptcy occurred, the provisions should be made applicable as if bankruptcy had occurred on the date of appointment of the interim receiver.

The Working Group recommends that this general protection against liability be subject to the provisions in the BIA protecting the trustee against liability in respect of environmental damages. (The Working Group is aware that a Task Force of BIAC is currently considering possible changes to the provisions relating to environmental liability, but is of the view that the general provisions recommended here should be subject to the environmental provisions in whatever form they might take.)

The recommended solution would give the trustee clear and strong protection against exposure to liability for claims pre-dating his appointment and for matters or conditions which arose before his appointment, which were not caused by him and over which he had no control.

* * *

Subject:

Environmental Liability of Trustees, Receivers and Interim Receivers.

Issues:

Whether Section 14.06 of the BIA should be amended:

(1) to exempt a trustee from personal liability for remediation costs associated with environmental damage which is not caused by the gross negligence or willful misconduct of the trustee;

(2) to provide that the bankrupt estate is not required to incur remediation costs associated with environmental damage which arose prior to the appointment of the trustee or while the trustee has custody of the property solely for the purposes of protecting it and investigating the environmental condition of the property;

(3) to require a trustee who utilizes the property of the bankrupt to exercise due diligence to prevent the creation or aggravation of an adverse environmental condition and to provide that any costs relating thereto shall be paid out of the property utilized in priority to any other claims, including claims of secured creditors;

(4) to limit the environmental liability of a trustee who utilizes property of the bankrupt to the net proceed realized from the sale or other realization of the contaminated property and the tangible property owned by the bankrupt located thereon;

(5) to require a trustee to report environmental site contamination and to provide the government authorities with reports of any adverse environmental condition of the property obtained by the trustee;

(6) to permit the courts to give directions to a trustee relating to compliance with environmental laws which would be binding upon governmental authorities;

(7) to extend the protection afforded to trustees of bankrupt estates in the BIA to interim receivers, trustees acting under proposals and receivers as defined in Part XI of the BIA, and

(8) to provide that, notwithstanding sections 86 and 87 of the Act, any secured claim of the Crown in Right of Canada or of any province for remediation costs relating to environmental damages should rank as secured creditor against the net proceeds realized from the contaminated property and any tangible property owned by the bankrupt located thereon.

Comments:

Section 14.06(2) which was enacted in the 1992 amendments to the BIA was intended to provide a trustee with protection from personal liability for environmental damage or conditions which (i) occurred before the trustee's appointment and (ii) after the trustee's appointment except where the environmental damage or condition arose as a result of the trustee's failure to exercise "due diligence". It was hoped that section 14.06(2) would permit trustees to professionally administer bankrupt estates without the fear of attracting personal liability for environmental damage or conditions for which they were not responsible, particularly in circumstances where clean-up costs exceeded the realizable value of the estate's

The concept of "due diligence" introduced in section 14.06(2) is not defined i the statute. The trustee is required to rely on jurisprudence which has established due diligence as a negligence standard based on the actions of a reasonable person in a given set of circumstances. Acceptable standards of due diligence defined in case law stipulate that a person must take all reasonable steps necessary to ensure that a discharge of a contaminant to the environment will not occur. Whether due diligence has been exercised is very much determined by the facts of a particular situation and involves the determination of whether a person has taken all reasonable steps necessary to ensure that an environmental incident will not occur.

In any particular situation the determination of whether or not there has been compliance with the due diligence standard is uncertain. Rather than take the risk of assuming liability, many trustees have refused to accept assignments which would involve taking possession of environmentally sensitive properties without an indemnity from a financially strong party. When the extent of the environmental liability is uncertain and the cost of remediation unquantifiable, such an indemnity is often unavailable. As a result, the trustee does not take possession of the property and it is left unprotected. Such a property may pose a hazard to neighbours and to children who may frequent the property when it is unattended. Also, any environmental condition may be aggravated when no one is responsible for informing the public authorities of the problem.

At the present time there are many provincial and federal reporting requirements relating to adverse environmental conditions. The complexity of these reporting requirements has also discouraged trustees from accepting assignments relating to environmentally sensitive properties. The difficulty of ascertaining which reporting requirements apply to a particular situation could be significantly reduced if the Superintendent of Bankruptcy were authorized to issue directives specify-

ing the nature and extent of environmental reporting requirements for trustees.

To assist the government authorities with the remediation of environmental problems, trustees should be required to provide the governmental authorities with copies of environmental site reports obtained by the trustee.

When a trustee is appointed, the business of the bankrupt may be located on properties which are environmentally sensitive. Rather than incur a risk of liability for the remediation of the property, the trustee may decide not to operate the business and terminate the employment of all persons working on the site. In many cases, the trustee would be prepared to continue a viable business operation on an environmentally sensitive property if the trustee's liability for environmental remediation was limited to the net proceeds realized from the sale of the property. The trustee would be prepared to accept the risk of no recovery from the problem property but would not be prepared to pay for the cost of remediation from other assets of the bankrupt estate.

Many courts have recognized the necessity of protecting trustees and receivers from the risk of environmental liability. Court orders to this effect have been made in many receivership actions but there is considerable uncertainty as to the extent that such orders are enforceable and binding upon governmental authorities.

The 1992 amendments to the BIA also established a code for the enforcement of security by secured creditors. Many insolvent situations are administered by receivers (as defined in Part XI of the BIA). They are appointed by a secured creditor or by the court. A receiver has the same concerns as a trustee relating to liability for environmental conditions. In certain situations a receiver will not take possession of an environmentally sensitive property or will terminate operations rather than incur unquantifiable liability for environmental clean-up. To avoid property being left unprotected or the termination of viable business operations and the resulting loss of employment, receivers should be granted the same protection as trustees under the BIA.

In addition, interim receivers and trustees acting under proposals perform important roles with respect to the protection of creditors and restructuring of businesses. Both these roles have been excluded from the protection provided in section 14.06 and, thus, they are left with a risk of responsibility for remediation of environmental conditions. Recognizing the importance of their roles, these persons should be provided with the same protection afforded to trustees under section 14.06.

Sections 86 and 87 of the BIA provide that in relation to a bankruptcy or a proposal, all secured claims of Her Majesty in the Right of Canada or a province for remediation costs relating to environmental damage are unsecured claims unless registered and if registered, are only valid in respect of amounts owing at the time of registration. The report of a Task Force on contaminated site liability to the Canadian Council of Ministers of the Environment (the "CCME") which was approved on May 12, 1993, recommended that the costs of environmental remediation should constitute a first charge on all the assets of the debtor,

including assets which are not located on the contaminated site. This recommendation would result in a Crown lien for environmental clean-up costs ranking in priority to:

(a) municipal taxes;

(b) claims of employees for unpaid wages, vacation pay and other entitlements;

(c) claims of unpaid suppliers of inventory, and

(d) security granted to lenders for loans to finance the debtor's business and equipment.

Similar provisions are found in the federal legislation in the United States dealing with the clean-up of contaminated sites, the *Comprehensive Environmental Response, Compensation and Liability Act* (CERCLA) which have created a vary chaotic situation. A commentator has advised that 75% of all amounts spent by the Superfund established by CERCLA has been used to pay consultants' and lawyers' costs rather than the remediation of environmental conditions.

2. Disclaimer of Commercial Leases

Subject:

Disclaimer of leases in proposals.

Issue:

Whether s.65.2 of the BIA should be amended to (1) tighten the eligibility requirement for disclaimer of a lease, and (2) provide for more equitable treatment of claims of landlords arising out of disclaimed leases, relative to the claims of other creditors.

Comments:

Under section 65.2, enacted by the 1992 amendments to the BIA, an insolvent tenant who intends to make or has made a proposal under Part III of the Act can repudiate a lease, provided repudiation is necessary to make his proposal viable or to make a viable proposal, and provided he pays the landlord up to a maximum of 6 months' rent compensation upon approval of the proposal. The landlord cannot vote on any claim for loss in respect of future rent or other damages caused by the repudiation.

There have been only a few cases involving s.65.2 so far. However, it appears that s.65.2 has in some cases resulted in a disproportionate share of the losses involved in a reorganization being imposed on landlords. The requirement that repudiation be shown necessary for the tenant to make a viable proposal, which was intended to limit repudiations to cases where the only realistic alternative was bankruptcy, has not been entirely effective. Some tenants, not facing imminent bankruptcy, have been able to obtain disclaimers by producing a financing commitment which makes disclaimer of specific leases necessary for viability. Also, compensation is fixed at 6 months' rent, which may not cover actual losses incurred. As a result, some tenants have been able to repudiate leases and pay much less compensation to landlords relative to their actual losses than was paid to other creditors.

Appendix
Report by the Task Force on Leases

A. Introduction

The Task Force submits its issue paper on lease disclaimer, revised to take into account comments made by BIAC members on June 16 and by Working Group #2 members at meetings held in May, August and October.

B. Task Force Recommendations

Having reviewed its recommendations, taking into consideration Working Group #2 and BIAC members' comments, the Task Force has decided as follows:

1. The Task Force makes no change to its previous recommendations on changing "repudiation" to disclaimer or landlords' claims in post-bankruptcy proposals, both of which were accepted by the Working Group and BIAC.

2. The Task Force holds to its recommendation on eligibility to disclaim, that a disclaimer, if challenged, must be shown to be necessary for the tenant to make a viable proposal. This recommendation was endorsed by the Working Group and was not adversely received by BIAC at its June meeting, except to the extent the right to challenge together with the right to vote may be too favourable to landlords.

   Note: the Task Force did consider the U.S. approach to eligibility, under which a lease, like any other executory contract, may be rejected (disclaimed) subject to court approval. The U.S. courts have ruled that the lease must be burdensome to the estate for rejection to stand and have ruled that whether or not a lease is burdensome is a question of business judgment. The Task Force concluded that the eligibility rule which it has proposed is more clear and definite than the U.S. rule and less likely to cause dispute and litigation, although both tend to the same general test, as to whether the tenant can carry on under the lease. Hence it has decided to hold to its previous recommendation.

3. On the compensation question, the Task Force recommends that the current provisions for payment of 6 months' rent up front be replaced by provisions which would give a disclaiming tenant three options: (1) to offer the landlord compensation, based on his actual damages, on the same terms as he offers to ordinary unsecured creditors on their claims, in which case the landlord could file a claim for his actual damages, and would be treated as an ordinary unsecured creditor for both voting and receiving dividends under the proposal, (2) to make a different offer to the landlord, in which case the landlord could file a claim for an estimate of his damages as determined by formula, which would be used for voting purposes, or (3) to make no offer to the landlord, in which case the landlord could file for his formula damages and would be treated as an ordinary unsecured creditor for voting and receiving dividends.

Specifically, the Task Force recommends that a disclaiming tenant be given the options,

(1) to provide in his proposal that the landlord may file a proof of claim for his actual damages and to provide also that the claim shall be treated in the same way as ordinary unsecured claims, in which case the landlord's only option would be to file such a proof, and to vote and receive dividends as an ordinary unsecured creditor.

   Note 1: An example of a clause in a proposal making such an offer might be as follows:

   > "Unsecured creditors will be paid 75 % of their claims in equal monthly installments over three years. Landlord X may claim as an unsecured creditor for the actual damages sustained by him as a result of the debtor's disclaimer of lease Y and shall be paid rateably with other unsecured creditors on the above-mentioned terms."

   Note 2: This might assist a disclaiming tenant where the real damages to the landlord caused by the disclaimer were less than the formula derived amount (as might be the case where rents have gone up, for example).

(2) to make an offer for compensation to the landlord in his proposal other than an offer as described in para. (1), in which case the landlord would be able to file a proof of claim for damages in an

amount determined by formula. The permitted claim would be 100% of the rent provided for in the lease for the first year after disclaimer, plus 15 % of rent for any term remaining in the lease after the first year up to an overall maximum of three years' rent. The landlord would be able to vote on that claim. Dividends payable to him would be as specified in the offer.

Note 1: The possible types of offer in this category are myriad, being restricted only by the limits of the debtor's imagination. One example of a clause might be,

> "Landlords X and Y will each be paid the first three months' rent, after two months, and 20% of rent remaining to the end of their leases' respective terms, after two years."

Note 2: Classification of the landlord's claim would depend on the nature of the offer made. No specific provisions on classification would have to be added. Claims would be classified by the application of general principles of creditor classification.

Should the offer treat the landlord differently from other creditors, the landlord would probably be in a class of his own. Further, should several landlords be involved and the offers made to each treat them differently as between themselves, then each landlord would be in a separate class. On the other hand, should the offers treat the landlords equally so that there was commonality of interest between them as regards the proposal, then they might all be included in one class of landlords. Should the offers to landlords treat them in the same way as other ordinary unsecured creditors (which would presumably involve offers to pay the same percentage on their claims as is offered on other unsecured creditors' claims in the proposal), then landlords could be included in the general unsecured class. (In the above example, an argument could be made for including landlord X's and Y's claims in the same class. However, the details of their respective situations would have to be studied before making a final determination.

The importance of the size of the landlord's claim in the proposal proceedings would depend largely on the class of claims into which the landlord's claim falls. Where the tenant made an offer to a landlord and the landlord was in a class by himself, then, of course, the landlord would have a veto irrespective of the size of his claim, which would be irrelevant for voting purposes. As an unsecured class, rejection by the landlord would entail failure of the proposal and bankruptcy. Presumably, a tenant would only make such an offer to a landlord after negotiations indicated that such an offer would be acceptable. Where the landlord was included in a class with other landlords, or in the general unsecured class, the size of his claim as derived from the formula would be very relevant. It would determine the landlord's voting power.

Note 3: The Task Force is aware that, while a regime which sets damages claims by formula has the advantage of enabling claims to be determined quickly and definitively, it has certain disadvantages. Its disadvantages of being arbitrary and of quite inaccurately estimating damages in some circumstances have been pointed out before. Another disadvantage of formula regime based on "rent" only is that it ignores other cost factors associated with the lease, such as costs incurred by a landlord on fixtures provided as an inducement to the tenant, rent abatements and the like. The *Stephenson's Rent-All* case, where the lease provided for full rent abatement in the early months, shows what can happen where a formula based on rent only (in this case the current 6 months' rent formula) is applied to a lease with rent inducements — the court awarded no compensation, since the nominal 6 months' rent was zero. The task force considered measures to subsume rent inducements into "rent" under the formula and to provide that other costs be added in separately, but decided that such a regime would lose the main benefits sought after in a formula — quick and definitive determination of claims. The Task Force decided to go with a formula based only on rent and to let lessors and lessees tailor their agreements around this if need be, perhaps through side contracts governing other services provided, or by clauses specifying what "rent" is to include in various circumstances (e.g. where the lease is terminated before term for any reason).

The formula proposed here is that which was adopted by Working Group #2 at its meeting of August 30.

(3) to make no offer to the landlord, in which case the landlord would automatically be entitled to file a proof of claim for the formula amount and to vote and receive dividends as an ordinary unsecured creditor. This, of course, would yield the same result as if the tenant had made an offer to him to pay the formula damages on the same terms as its offer to the unsecured creditors on their claims.

It should be noted that task force members were not unanimous on these recommendations. The Urban Development Institute (UDI) remains concerned that the formula for calculating a landlord's claim for compensation, which is based on rent only, without provision for the cost of rent inducements, may lead to serious understating of the real losses involved in some cases. The UDI is of the view that quantifying the cost of rent inducements would not be overly difficult or likely to give rise to litigation. The UDI representative has pointed out that in the *Telesat* case the unamortized cost of rent inducements alone was substantially more than the formula amount and that the total actual damages were many times greater again. The UDI views this as unequal treatment for landlords.

C. Comparison of Claims for Lost Future Rent under the Recommended Formula and Other Formulae

The table attached to this report compare, for a sample lease, the claims for lost future rent that would be permitted under the recommended solution and under three other formula options.

For all options, the over all maximum claim (three years' rent) dominates where the lease has a long time to run, as would be expected. Where the percentage of rent claimable in respect of any year is relatively low (15%), the three year cut-off will not kick in until later (not until the 15th year under the recommended solution). Lower percentages claimable would entail even later cut-off dates. For example, lowering the formula 1 (recommended solution) percentage to 10% would yield a cut-off date of 21 years. Where the percentage claimable is higher (25 %), the cut-off date is much earlier (after 12 years in formula 4). These numbers are quite arbitrary and could be adjusted depending on the assumptions as to the landlord's ability to mitigate.

D. Task Force Consideration of Working Group and BIAC Concerns and its Reasons for its Recommendations

1. Improving the compensation formula

The Task Force views the appropriate measure of a landlord's claim as being the actual damages he sustains as a result of disclaimer. If this view is accepted, then a compensation formula will be good to the extent that it approximates actual damages.

The Task Force recognizes that changes in lease market conditions are an important factor in determining what actual damages are. If rents have gone up, a landlord stands to lose little or nothing from a disclaimer. If they go down substantially, disclaimer could be very costly to him. However, the Task Force sees no way to account for market conditions in a formula. No index of market conditions is available — they vary from place to place over the same time period. Therefore this important factor must be ignored in any formula. Nevertheless, the Task Force scheme does take account of market conditions in one important sense. The recommendation that a disclaiming tenant be enabled to make an offer to pay on actual damages, in effect to make a non-formula based offer, recognizes that landlords' damages are less if market conditions have improved, and would allow disclaiming tenants to benefit in such circumstances.

Another important factor in determining damages is the time left to run in the lease and the landlord's increasing ability to mitigate by re-renting as time passes. All the formulas studied take this into account. Some (those with lower percentages claimable) presume a relatively greater ability to mitigate.

All formulas discussed in the attachment to this note have the same maximum on claims (three years' rent). Such a ceiling on claims implies a presumption that in the more remote years the landlord will be able to re-let. If it was assumed that landlords could mitigate more effectively than this the maximum could be reduced, e.g. to two years' rent.

The Task Force has no data to indicate whether the particular numerical coefficients chosen for its formula, i.e. the three year cut-off date and the 15 % of rent to term claim allowance after the first year, provide a better approximation of real costs to the landlord than other figures. It does view the recommended solution as providing as reasonable as can be expected estimate of the actual cost to the landlord of the disclaimer.

2. Landlord's vote

In response to the concern that the formula for determining claims may give landlords an inordinate vote, the Task Force would point out that the norm in reorganizations is for creditors to be given votes proportionate to their claims against the debtor and that the claim derived from the formula is intended to be as good an approximation as can be obtained of the landlord's damages, which, the Task Force suggests, are the appropriate measure of his claim against the debtor. The scheme would put landlords on equal footing with other creditors, so far as this can be achieved in a reasonable time and at reasonable cost. This is not to say that a landlord would not have a relatively high claim, even a dominant claim, in some circumstances. However, it seems only reasonable to the Task Force that a landlord who stands to sustain big losses should have a correspondingly big claim and big vote.

3. Giving the landlord both a vote and the right to challenge the disclaimer

All creditors have a vote on their claims in a proposal. The Task Force believes that it could not be fair to deny a vote to landlords under a scheme where their claims stand to be treated in the proposal in the same manner as other creditors' claims made (unlike under the current scheme where landlords are guaranteed a fixed amount up front).

As regards the right to challenge disclaimers, the Task Force notes that only leases among executory contracts can be unilaterally disclaimed in a proposal at present. Unless and until a new regime is introduced, applicable to executory contracts generally, which would provide more generous disclaimer rights in respect of such contracts, the Task Force believes that there should be constraints on a tenant's ability to disclaim in a proposal, that the constraints it recommends are fair, and that they should be retained.

4. The recommended scheme as a model for other executory contracts

The Task Force sees the recommended eligibility test as capable of being applied to other types of executory contracts. The compensation formula may be more narrowly applicable to leases. However, the Task Force believes that the principle behind the formula, that claims of a landlord should be set equal to a reasonable approximation of his actual damages, taking into account the measurable factors, including his ability to mitigate, is one capable of application to executory contracts generally.

5. Objective of promoting reorganizations

As indicated in its issue paper, the Task Force is aware of the important objective behind the s.65.2 lease disclaimer provisions of enabling tenants to successfully reorganize. The Task Force believes that its recommended solution does recognize this objective, by giving tenants the right to disclaim and to have their disclaimers upheld in the appropriate circumstances. While the compensation formula proposed would in many circumstances require tenants to offer more to landlords than they need to under the current regime, the Task Force has concluded that this should not compromise tenants' ability to reorganize in those situations where a successful reorganization can be carried out on a fair and equitable basis, in which landlords and other creditors share the costs of reorganizations equally.

E. Additional Considerations

The Task Force has been asked to consider whether a disclaiming tenant should be given an additional option, to undertake to pay six months' rent up front, as is provided for under the current regime. Under this option, the landlord would not be able to file a claim for lost future rent or vote on it, but he would be able to apply to the court to have further compensation awarded on grounds that six months' rent would not treat the landlord equitably in comparison with other creditors. The Task Force advises against this option. It agrees that there may be situations where an undertaking to pay six months' rent would be less burdensome to a disclaiming tenant than paying dividends on a large claim for actual

or formula damages, making it easier for him to develop a proposal that would be attractive to most creditors, if not landlords. It also agrees that the right to apply for further compensation on equitable grounds would give landlords better protection than they have now. However, the Task Force falls to see how limiting compensation to six months' rent in situations where it would be a genuine advantage to the tenant would ever be equitable. In its view, equitable compensation would be compensation which gives the landlord about the same return on a claim for a reasonable estimate of its damages as other creditors get on their claims. This is already provided for in the other options. From this perspective, the six months' rent option would be either superfluous or would result in inequitable treatment for the landlord. The Task Force notes that the tenant would have the option of offering six months' rent under the existing Task Force recommendations. It does not believe there is justification for giving the court the discretion to force such a settlement on landlords.

F. Addendum

At a meeting on November 1, Working Group #2 approved the recommendations presented in this report. However, the Working Group noted that the question of disclaimer of executory contracts generally, of which leases are but one type, is currently under study by a task force of Working Group #2, and agreed that if policy recommendations on disclaimer of executory contracts generally emerge in time to be included in the phase 2 package, then the recommendations on lease disclaimer should be reconsidered in light of the recommendations on executory contracts generally.

Formulae for Landlord's Claim for Future Rent

Formula 1 — Recommended solution

Permitted claim = 100% of rent for the first year left in the term, plus 15% of rent for the remainder of the term, to a maximum of three years' rent.

Formula 2 — Variation of the recommended solution.

Permitted claim = 100% of rent for the first three months left in the term, 75% of the next three months, 50% of the next three, 25% of the next three, and 15% of the remainder, to a maximum of three years' rent.

Formula 3 — Based on the formula for damages in respect of a disclaimed lease contained in the U.S. Bankruptcy Code

Permitted claim = the lesser of:

(A) rent to end of term, and

(B) the greater of:

(i) one year's rent, and

(ii) 15 % of rent to term to a maximum of three years' rent.

Formula 4 — Variation of formula 3

Permitted claim = the lesser of:

(A) rent to end of term, and

(B) the greater of:

(i) 6 months' rent, and

(ii) 25 % of rent to term to a maximum of three years' rent.

Permitted Claim for Future Rent

Time Left in Lease	Total Contracted Rent	Formula 1 Recommended Solution	Other Formula Options		
			Formula 2	Formula 3	Formula 4
3 Months	$100	$100	$100	$100	$100
6 Months	$200	$200	$175	$200	$200
9 Months	$300	$300	$225	$300	$200
1 Year	$400	$400	$250	$400	$200
2 Years	$800	$460	$310	$400	$200
3 Years	$1200	$520	$370	$400	$300
4 Years	$1600	$580	$430	$400	$400
5 Years	$2000	$640	$490	$400	$500
6 Years	$2400	$700	$550	$400	$600
7 Years	$2800	$760	$610	$420	$700
8 Years	$3200	$820	$670	$480	$800
9 Years	$3600	$880	$730	$540	$900
10 Years	$4000	$940	$790	$600	$1000
15 Years	$6000	$1200	$1090	$900	$1200
20 Years	$8000	$1200	$1200	$1200	$1200
25 Years	$10000	$1200	$1200	$1200	$1200

Rent: $100/Quarterly, $400/Year

3. Liability of Directors

Subject:

Stay of Proceedings during reorganization.

Issue:

Whether the BIA should be amended to permit directors to obtain a temporary stay of proceedings with respect to liabilities they incur in their capacity as directors of a company which files a notice of intention or a proposal under the BIA?

Comments:

Members of the working group have discussed in great detail the need to encourage directors to stay on or accept appointments during reorganization. It is at the time of reorganizations, when potential liabilities for directors are the greatest, that the best directors are needed.

One potential problem that directors face is that, during reorganization, they may be subject to law suits from individuals or government agencies in respect of debts owed by the corporation and not paid. The corporation is entitled to a stay of proceedings in respect of these liabilities, but directors are not. The purpose of a stay of proceedings would be to permit directors to obtain temporary relief with respect to liabilities arising out of the failure of the corporation. This period of protection would hopefully encourage directors to stay and work towards a successful reorganization. The proposed change would not affect any substantive rights of creditors, only delay any action that they may take on them.

Some members remain unsure that there is in fact any problem in practice. However, while this may not be a big problem area, the proposed change may provide some comfort to directors and encourage them to stay.

* * *

Subject:

Civil liability arising under section 101 for payment of dividends or redemption of shares when corporation is insolvent.

Issue:

Whether the section 101 of the BIA should be amended to provide directors with a due diligence defence?

Comments:

Section 101 provides that directors are liable where a corporation has within twelve months proceeding bankruptcy paid a dividend or redeemed shares of the corporation at a time when the corporation was insolvent or where the dividend or redemption made the corporation insolvent. The burden of proof is placed on the directors to prove that the corporation was not insolvent at the time of the dividend or redemption or was not made insolvent by the payment.

This section was enacted in 1966 because at that time federal and provincial laws did not adequately allow trustees to attack certain financial transactions (particularly where preferred shares of a corporation had been redeemed shortly before bankruptcy). This provision was part of a whole package of amendments designed to take action against fraudulent activity occurring during insolvencies. Section 101 is not a commonly used provision and does not cause the same serious problems for directors as wage liability.

Members of the working group agree that it should be clear to directors that, when they pay dividends or redeem shares, they must be careful to ensure that the corporation is solvent. However, the section as currently drafted effectively imposes absolute liability on directors in that no matter how carefully they act to ensure that the corporation is solvent when monies are paid to shareholders as dividends or for the redemption of shares, directors may still be liable. Currently, directors can only avoid liability if they prove that the corporation was solvent at the time of the payment or that they protested against the payment. The amounts involved could potentially be very large and could bankrupt the directors themselves, even when they have acted with reasonable care.

Section 101 be amended to provide directors with a due diligence defence, while placing the burden of proof on directors. These amendments would specify that a director is not liable if he or she had reasonable grounds for believing that the corporation was not insolvent when a dividend was paid or shares were redeemed, except to the extent that the director personally benefits from

the payment (i.e., as a shareholder). The amendments would also give a court some guidance as to what constitutes reasonable belief, including reliance in good faith on financial statements, on expert reports or on information presented by officers and other employees. The amendments would place the burden of proof on the directors to show that they had reasonable grounds to believe the corporation was solvent. A possible draft of amendments to the section is attached for further clarification.

The expansion of directors' liability over the last 20 years under federal and provincial laws and through court decisions may be leading some qualified people to refuse board appointments. For a corporation to be successful, qualified people must be willing to serve on boards and, once on them, to take bold steps in order to compete in a global marketplace.

Directors of corporations have indicated that, while they are willing to accept responsibility and liability for their actions, absolute liability (imposed also for employee wages and benefits under labour standards legislation) is objectionable. Liability without fault is seen as unfair and its usefulness is questionable. If the purpose of the legislation is to ensure directors act properly, absolute liability may not encourage this but rather only influence them to resign.

The amendments would only provide a due diligence defence for directors in respect of their liability as directors, not shareholders. The section also imposes liability on shareholders and it is not appropriate that shareholders be given a due diligence defence. They are simply required to return moneys that were paid to them when the corporation was insolvent. This money should be returned. This is different than liability of directors for potentially huge sums paid to others.

* * *

Subject:

Compromise of directors' liability.

Issue:

Whether the BIA should be amended to permit a reorganization proposal of an insolvent corporation to compromise (settle\release) potential liabilities of its directors? If so, what liabilities should the proposal be able to include?

Comments:

Members of the working group have discussed the need to encourage directors to stay on during reorganization and ensure that the corporation succeeds in its restructuring. While the corporation itself is protected by the proposal, the directors may still be subject to liability, potentially for enormous amounts, unless separate releases are negotiated with every creditor who has a potential claim against the directors.

Essentially, a proposal can be viewed as a contract between the debtor and its creditors and the debtor should be able to insert any terms in the proposal which could lawfully be included in a contract. This is the view of Mark Meland in his article "Extending 'Protection' to Third Parties in a Restructuring Plan — An Overview", 20 C.B.R. (3d) 61. Mr. Meland argues (p. 64):

> "Since a bankruptcy proposal or a CCAA plan (hereinafter collectively referred to as a "Restructuring Plan") is, in essence, merely a contract between a debtor and its creditors, there appears to be no reason, either from a public policy perspective or an "equity" perspective, why the Restructuring Plan cannot provide for the granting of certain releases in favour of third parties as long as the rights being released are not personal to any one or more creditors and that such releases are fair and reasonable in the circumstances."

Types of claims against directors

If there are no overriding objections from "a public policy perspective or an equity perspective" to allowing the proposal to also settle claims against directors, the issue then is what types of claims may be settled.

Directors' liability for debts of the corporation may arise in several ways. A director may have guaranteed the debts of the corporation. Seeking releases for guarantors is not permitted under the BIA currently (s. 179) and as a claim "personal" to one of the creditors it would not be included.

Directors' liability for a debt of a corporation might also arise by operation of statute, either on absolute basis (i.e., whether a director acted carelessly or not) or where a due diligence defence is available to the

director. Liability for employee wages, vacation pay and in some instances severance pay, imposed by corporate and employment standards legislation is the major type of absolute liability that a director may face for debts of the corporation. Liability for source deductions under the *Income Tax Act* and other federal and provincial statutes is the main type of due diligence liability arising on bankruptcy. Liability may be owed to individuals (employees) or to the Crown (for taxes or as the subrogee of the employee wage claims).

Directors' liability for debts of the corporation may also arise in a less direct manner. Such claims may be formulated in several ways. If the proposal is not successful and the company fails, the creditors who take control of the bankrupt may seek to have the trustee sue the directors in the name of the corporation for breach of their duties of care or fiduciary duties. The damages claimed will be the amounts lost be the creditors and investors.

Creditors and investors are also now claiming that directors owe them duties of care and even fiduciary duties to ensure that financial information is accurate and that the company is run efficiently. The validity of such claims has not yet been decided by the courts. Directors' liability in the insolvency setting has also been imposed by means of corporate law oppression remedies.

There is also some question about whether directors may be liable for certain obligations of an insolvent corporation. For example, there has been considerable discussion about who should be the "responsible persons" liable for the cost of the clean-up of contaminated sites owned by insolvent companies. The law is currently in a state of flux. The search for responsible persons has focused on those who have had management and control of contaminated sites and therefore on directors and officers, among others.

"Fair and Reasonable"

The issue is what claims would be it be "fair and reasonable" to allow to be included in a proposal. On the one hand, the debtor corporation settling potentially huge amounts of liability may have an enormous bargaining power to force a settlement — «release our corporation's directors from any claims or the restructuring plan will fail.» On the other hand, creditors must approve the proposal, either individually or, where they are a member of a class, by class vote and requisite majority. Creditors can reject the plan, petition the corporation into bankruptcy, replace and sue the old management.

Subsequent failure of corporation

Another difficult issue is whether the BIA should allow a release (of claims against directors) which would hold even if the company failed (and its own release became ineffective). While this would be very attractive to directors, it might be going too far in protecting directors. The statute could either say that the directors' release is only effective if the proposal is fully performed, or in the alternative, this could be left to negotiations between parties.

The BIA should be amended to permit a reorganization proposal of an insolvent corporation to compromise (settle/release) certain liabilities its directors may face.

4. Deemed Refusal of a Proposal

Subject:

Termination of a reorganization attempt after a proposal has been filed.

Issue:

The issue is whether provision should be made in the BIA to allow creditors to apply for termination of a reorganization attempt after a proposal is filed and before the meeting of creditors.

Comments:

The BIA allows creditors to apply to have reorganization proceedings terminated and the debtor put immediately into bankruptcy at any time during the period between the filing of a notice of intention and a proposal. However, once a proposal is filed, there is no mechanism for immediate termination of the process — the first available occasion when creditors are explicitly given the opportunity under the BIA to terminate the process is the meeting of creditors (required to be held within 21 days after the proposal is filed.

In the case of *Triangle Drugs* the debtor had filed a reorganization proposal under the BIA. Creditors did seek termination and the court terminated despite the lack of any explicit authority to do so, on grounds that

the case could be treated as a *Companies' Creditors Arrangement Act* case.

The Working Group recommends that the court be authorized in the BIA to terminate a proposal, on application by a creditor, the trustee or an interim receiver if

(a) the debtor has not or is not acting in good faith and with due diligence;

(b) the proposal that the debtor has filed will likely be rejected by the creditors, or

(c) the creditors as a whole would be materially prejudiced if the proceedings continued.

The recommended solution would allow termination only in exceptional circumstances, where immediate termination of proceedings and bankruptcy is clearly the best course. It would provide a reasonable and proper remedy in those circumstances.

5. Substitution of the Trustee

Subject:

Substitution of a trustee preferred by creditors when a reorganization attempt is terminated.

Issue:

The issue is whether creditors should be given, in the BIA, a means of substituting their preferred trustee at the time of an application to terminate, either during the period following the filing of a notice of intention, or after a proposal is filed, if the BIA is amended to provide for termination at that time.

Comments:

The BIA does not, in the provision for application to terminate reorganization proceedings after the filing of a notice of intention, provide a means for creditors to have a trustee of their choice appointed at that time. Rather, the trustee named by the debtor is required to call a meeting within five days, at which time creditors can substitute a new trustee by ordinary resolution.

In the *Triangle Drugs* case, the court did substitute the trustee preferred by creditors for the trustee named in the proposal.

The Working Group recommends that the court terminating proposal proceedings be also authorized, in the BIA, to substitute a trustee preferred by creditors for the trustee named by the debtor, if it is satisfied that the creditors prefer the new trustee.

The trustee's main concern is to protect creditors. Creditors already have the right to install their own trustee by simple resolution when a proposal fails and bankruptcy occurs. The solution would merely advance the date when creditors could make the substitution. Where their preferences are clear, as would be required for substitution upon termination, there would be no need to delay the substitution.

6. Claims by a Workers' Compensation Body

Subject:

Workers Compensation Boards (WCBs)

Issue:

Whether the BIA should be amended to re-address the treatment of WCBs claims in light of recent judgments which undermined the intention of the 1992 amendments to reduce Crown priorities.

Comments:

WCBs are established at the provincial/territorial level. The system is financed by premiums which provincial legislation obliges employers (but not employees) to pay. The legislation usually establishes statutory security covering WCB claims for unpaid premiums and gives that security priority over private sector security.

The 1992 BIA amendments changed the provisions governing the priorities of WCB claims in two respects: 1) para.136(1)(h) which gave preferred status to WCB claims against a bankrupt was repealed and 2) sections 86 and 87 were added which recognize Crown statutory securities, but only if they are registered. The legislation also provided that the registration could be made only in respect of existing debt and that it would be subordinate to previously registered security.

Prior to the 1992 amendments, the status of WCB claims in bankruptcy was clear. The Supreme Court, in its 1985 decision in *Jac's Jackets*, ruled that WCB

claims had only preferred status, by virtue of para.136(1)(h), and that the statutory securities established under the provincial legislation to protect their claims did not operate in bankruptcy.

The 1992 repeal of para.136(1)(h) effectively removed the basis on which *Jac's Jackets* was decided. WCBs in at least two provinces, Alberta and Quebec, have since pursued their claims in court, arguing that since the BIA no longer specifies that WCB claims have only preferred status, it is now open to provinces to give these claims secured status by setting up statutory securities. The courts have come to conflicting conclusions. In the Alberta case, *Richmac*, the court upheld the provincial statutory security. The same result was obtained in the Quebec case *Clement Glode Inc.*. However, in another Quebec case, *Les entreprises Michel Lepage*, the court ruled that the provincial statutory security did not operate in bankruptcy, being unsympathetic to the argument that the federal government, in taking preferred status away from WCB claims, intended that they be able to obtain another priority of a different kind. (A note summarizing these cases is attached.)

It should be noted that in neither of these provinces, Alberta or Quebec, are WCBs regarded as Crown bodies. Hence their securities were held not to be subject to the registration requirements and the priority limitations in s.86 and 87. The 1992 BIA amendments, therefore, have resulted in varying treatment of WCB claims in different provinces, due to the fact that WCBs are regarded as Crown agents in some provinces and non-Crown entities in other provinces, (and due to differing interpretations by the courts as to the impact of the repeal of para.136(1)(h).)

The WCBs, not surprisingly, argue that the statutory securities covering their claims should be recognized in bankruptcy. When Bill C-22 containing the 1992 amendments was put together, the WCBs, like the department, were of the view that the restrictions on recognition of statutory priorities set out in s.86 and 87 would apply to WCB claims. The WCBs argued that those restrictions would reduce the value of their securities and that they would require WCBs to be continually registering new securities, which would be subordinate to most private sector securities in any case.

The WCBs asked at the time of the 1992 amendments that their claims be treated in the same way as UI and CPP claims. The WCBs argue that their program and the CPP and UI programs have similar roles — they are income support programs. They also argue that WCB premium defaults must be recouped from solvent employers and are imposing an additional burden on them.

It should also be noted that in discussions with the WCB's it was discovered that the annual losses they face due to bankruptcy and other factors, while large in absolute terms ($66.3M in 1993, is a relatively small percentage (1.1%) of the total annual revenue.

It is therefore recommended to put WCB Claims on Equal Footing with Crown Claims. (This is the result that the department had intended in 1992.) It would involve making s.86 and 87 applicable to WCBs, whether or not they were Crown bodies.

Failure to act in this area would confirm the present situation (i.e. non-crown WCBs able to use statutory securities and Crown WCBs having to use s.86 and 87). The recommendation proposal would ensure the result that the department had intended in 1992, that s.86 and 87 would be applicable to all WCBs, whether or not they were Crown bodies. The powerful statutory securities of non-Crown WCBs would be removed, thus moving WCBs more into line with other creditors and resolving conflicts in the case law.

7. International Insolvencies

Subject:

The need for change in international insolvencies

Issue:

Should international insolvencies be addressed or is the status quo sufficient?

Comments:

The internationalization of business activity requires responsive public policy. Business transactions now commonly transcend political boundaries. With this globalization of markets, there are an increasing number of complex international insolvencies. However, the system of insolvency regulation in most jurisdictions, including Canada, is still directed at domestic business failure, not at insolvencies with cross-border ramifications. The structure of regulation in this field needs to be harmo-

nized with the structure of modem economic activities. The significance of international trade to the Canadian economy is sufficient reason to be concerned with this issue. As the structure of insolvency law is an important factor considered by international investors in assessing the risk of capital investments, a stable, predictable regime for international insolvency regulation in Canada will help encourage direct foreign investment in Canada, as well as ensure the accessibility of foreign capital for Canadian business enterprises.

Presently, there is no Canadian legislation specifically directed at the management of international insolvencies. For example, Canadian legislation does not facilitate the bringing of proceedings in Canada which are ancillary to existing foreign proceedings.

The courts offer innovative but not fully predictable solutions to such dilemmas, although it is not always clear that all competing interests are dealt with equitably. Moreover, as the present regime for the management of international insolvencies is so heavily dependent on judicial creativity, increased administrative costs are inevitably incurred that would be avoidable if such events were governed by a more clearly articulated set of rules. Codification of existing court practices would bring greater certainty to the administration of trans-border insolvencies.

The members of the Working Group agreed that international insolvencies should be addressed.

Business transactions regularly transcend political boundaries, yet the laws governing insolvency are focused on domestic business activity. Addressing this issue would make Canadian laws consistent in their goals and would increase the predictability of international insolvency processes with a Canadian element.

* * *

Subject:

General approach to international insolvencies.

Issue:

Which approach should be chosen to address the issue of international insolvencies?

Comments:

The status quo as described above is no longer desirable. There are three approaches that could be taken to deal with this issue: (i) unilateral legislative reform; (*ii*) bilateral treaties; or (iii) multilateral treaties.

The primary focus of reform should be unilateral (domestic) legislative reform. As discussed below, legislative reform could proceed concurrently with a bilateral (trilateral) treaty process involving the United States (and Mexico).

This recommendation represents the most realistic opportunity for tangible progress in the short term, and it would be in line with the approach already taken by Canada's major trading partners (U.S. and Great Britain).

At the April 1994 INSOL International Insolvency Colloquium in Vienna, it was agreed that multilateral treaty remained the ultimate goal. However, the unilateral legislative approach provides the only realistic chance for progress in this area.

Impact of NAFTA on Unilateral Approach

Article 1109 (4) of NAFTA has some application and needs to be considered in adopting unilateral legislation. Generally, article 1109 requires that all transfers relating to an investment by a US or Mexican investor in Canada be made freely and without delay. Article 1109 (4) provides that Canada is entitled to prevent such a transfer through:

> "the equitable, non-discriminatory and good faith application of its laws relating to:
>
> > (a) bankruptcy, insolvency, or the protection of the rights of creditors; ..."

Technically, these words may relate primarily to the application by the Canadian courts of whatever insolvency regime Canada chooses to enact. If this article is read as a limit on the substantive content of unilateral legislation, it does not preclude unilateral legislation, but any such legislation would be required by NAFTA to comply with these standards. The unilateral legislative scheme proposed below is designed to comply with these standards.

In addition, unilateral in this topic would have to comply with Article 1110 of NAFTA — the prohibition on indirect expropriation except in compliance with the international legal standard of treatment. Ordinarily, bankruptcy and insolvency processes are not conceived of as confiscatory, but certain types of

non-consensual reorganizations might be argued by foreign creditors to be characterizable as such, as might the application of Canadian laws in relation to priorities or preferences where they deprive US or Mexican creditors of certain advantages obtainable under American law. In any event, the legislative proposals are framed so as not to be confiscatory.

IV. Companies' Creditors Arrangement Act

Subject:

Reform.

Issue:

Whether a number of discrete reforms should be made to the *Companies' Creditors Arrangement Act*, including measures to tighten access requirements, to improve disclosure and procedural requirements and to limit the scope for staying creditors.

Comments:

The CCAA, enacted in 1934, was little used until recent years. It has since become an important legislative regime for reorganizing corporate debtors, especially in the larger, more complex cases. Some well known CCAA cases include Olympia and York, Quintette Coal, Algoma Steel and Bramalea.

The Act contains few guidelines; it gives very wide discretion to the court as regards both procedural and substantive rights respecting stays, disclosure, termination or continuation of contracts and other matters. This appears to have led to some variation in the way courts handle CCAA cases in the different Canadian jurisdictions, although a body of case law precedents seem to be emerging which may produce a more uniform, consistent approach in future.

The Working Group recognizes that there is a fundamental issue which eventually will have to be addressed, as to whether Canada should have one or two statutory regimes for reorganizations. However, it is clear that this issue cannot be decided in the upcoming, second phase of insolvency amendments. For the immediate future, both the BIA and CCAA regimes will have to be retained, and as regards the CCAA, the current task is to identify improvements which can be incorporated into the Act now. The Working Group recommends that a number of discrete reforms be made to the CCAA to provide for clarity as to the rights and obligations of the parties involved, and for uniform, consistent and equitable treatment of creditors and debtors under the Act.

V. Securities Firm Bankruptcies

Subject:

Introduction of a special scheme.

Issue:

Whether the BIA should be amended to establish a special scheme governing securities firm bankruptcies providing for the pooling of the bulk of securities in the hands of a bankrupt firm and their allocation among investors pro rata based on the equity in their account(s) with the firm.

Comments:

There are no special provisions in the BIA respecting securities firm insolvencies, and general bankruptcy rules apply. Under these rules, securities held by a bankrupt firm for its customers do not vest in the trustee and are to be traced and returned to their owners. (The courts, in receiverships [there are no recent bankruptcy cases], have departed from traditional tracing principles in allocating securities among customers where some have been sold or otherwise converted, and consequently there are insufficient securities to meet the total claims. They have adopted the American doctrine of "sharing the burden of the loan", which provides that even if some securities holders can specifically trace and identify their securities, they must share pro rata with others holding the same securities whose shares have been sold. Aside from this, tracing applies and must be carried out.)

The process of tracing customers' rights to securities and determining how securities are to be allocated among customers is very complex, lengthy and inefficient. This complexity is a direct result of the securities business itself. Securities are traded in large volume, on volatile markets, for many customers and may also be traded concurrently on the securities firm's own behalf. Securities may be pledged to secure loans to the firm whether they are the firm's securities, customers' margin account securities or cash account securities that have not been paid for. Securities may be held in various locations (depositories, in transit, in the box, etc.) and in various forms (in the name of the firm, or the depository, or in street form [normally restricted to bearer debt securities and non-dividend paying equities] or in the name of the customer [either endorsed and negotiable or unendorsed and non-negotiable]). Securities firms may also hold cash balances for customers arising from sales of shares or dividend receipts or from deposit by the customer with a view to investment later. When a firm gets into serious financial difficulty it often fails to comply with the *Securities Acts* or the By Laws and Regulations of Stock Exchanges or the Investment Dealers Association (IDA), otherwise referred to as the Self Regulatory Organizations (SROs), or even the customers' instructions, and as a result the right of creditors and customers to specific securities and to free cash balances become extremely complicated and individual entitlement may be more of a function of good luck than good management.

The results of the tracing process are inequitable because how a customer is treated in a bankruptcy depends on how customers' shares were held and what the firm did with them (e.g. pledged them to a bank, sold them without authorization, or used them to pay an outstanding debt). The returns to customers under the current scheme can be quite random and potentially devastating to the customer.

The Canadian Investor Protection Fund (CIPF), which acts as the insurer of customers of a bankrupt firm that is a member of an SRO, does operate within the current system, compensating investors for up to $500,000 (maximum $60,000 in cash claims) in claims unpaid after securities are allocated. However, CIPF finds the current bankruptcy rules so costly and constraining to efficient process, to the point that it makes every effort to avoid bankruptcy proceedings and have the such insolvencies administered under a receivership.

The omnibus bankruptcy bill, Bill C-17 of 1984, contained a scheme for handling securities firm insolvencies that would have reduced the need to trace customer rights to securities in the possession of the firm by providing for pooling of securities and distributing them among customers rateably. However, it would have created a quite wide category of property, called "specifically identifiable property" which would not be pooled and which individual investors would still have had the right to trace and obtain separately. Securities in a depository (a very large portion of securities now) would qualify as specifically identifiable property and

would not go in the pool. The need to trace rights in securities would only be avoided if the trustee elected with the support of an insurer such as CIPF, to provide all such securities claimed. (The insurer would have to undertake to provide the full amount or value of securities required, which CIPF would not do, since it does not compensate investors above the set $500,000 maximum). Hence, tracing would remain a serious burden under this system.

Also, keeping specifically identifiable property out of the pool would have entailed continued randomness in the amounts received by investors, depending on how their securities were held.

The Bill C-17 model was based on the very preliminary experience in the U.S. under the Securities Investor Protection Act (SIPA), which was promulgated in 1970 but extensively revised in 1978 following experience gained from the first 100 bankruptcies. The C-17 proposal with respect to securities firms was substantially unchanged from the proposal set out in Bills S-9 and C-60 which were based on SIPA model before the 1978 revisions.

SIPA in its current form provides for pooling of the great bulk of securities in the hands of a bankrupt firm and their pro rata allocation among customers. Under SIPA, all securities, except "customer name securities", defined as securities registered in the customer's name and not endorsed or other wise negotiable, are pooled. SIPA establishes a statutory body, the Securities Investor Protection Corporation (SIPC), to carry out the functions which CIPF carries out in Canada, in particular its role as insurer. SIPA provides for funding of SIPC through mandatory securities firm contributions and provides for a measure of control over its operations " certain board members are government appointments and SIPC must report to the Securities and Exchange Commission. (CIPF is funded by assessments on its SRO members as determined by the CIPF board, and its registrants are required by the *Securities Acts* to contribute to and have their members covered by CIPF. CIPF has a Memorandum of Agreement with the Canadian Securities Administrators, which oversee CIPF's activities.)

Commodities futures transactions are not covered by SIPA in the United States, and are dealt with separately. The main features of the U.S. Code relating to commodities futures broker liquidation appear to be as follows:

a) Commodity brokers (futures commissions merchants) cannot reorganize but rather must be liquidated;

b) Customers of the brokers (futures commissions merchants) have a preferred claim with respect to all funds segregated;

c) Before any pro-rata sharing, open commitments are transferred to a solvent futures commission merchant, where feasible, provided margins are current or are brought current within a stipulated time;

d) Specific identifiable customer name securities are returned to the customer;

   Note: In connection with paras c) and d), the U.S. Bankruptcy Code provides explicitly that trustees shall, so far as is practicable, comply with customer instructions regarding disposal of contracts and "return" contracts to customers or transfer them to solvent brokers.

e) The balance of property which cannot be transferred expediently is liquidated and divided pro-rata on a pooling arrangement amongst the customers under the aforementioned preference.

There are currently no special provisions in the Canadian Bankruptcy and Insolvency Act relating to commodities or financial futures contracts. In particular there is no provision, as in the U.S.A., requiring the trustee to seek to comply with customer instructions regarding the disposition of contracts or to return contracts to customers or transfer them to solvent brokers.

Therefore, the Working Group recommends that the BIA be amended to provide a scheme governing securities firm insolvencies.

1. Date of Bankruptcy

Subject:

Fixing the time in provisions containing time references in relation to the bankruptcy.

Issue:

Whether the Act should be amended to specify precisely which time is intended in provisions containing time references in relation to the bankruptcy.

Comments:

The BIA contains upwards of fifty provisions which refer to times of important events relating to bankruptcy, including provisions with the following expressions: "became (or becomes) bankrupt", "date of the bankruptcy", "time of the bankruptcy", "on the bankruptcy", "until the bankruptcy", "preceding (or prior to) the bankruptcy", "before the bankruptcy", "after the bankruptcy" and, "following the bankruptcy".

Just what times are actually referred to in these provisions is sometimes ambiguous. A bankruptcy may involve several events in sequence. An example would be a case where a petition is filed followed later by a receiving order which confirms that the debtor is bankrupt. In applying some of the BIA provisions containing time references in such a case, the later time (receiving order) may be intended. However, in other cases the earlier (petition) date may be intended. The BIA has relating back provisions which deem the bankruptcy to have occurred on a date prior to the event which confirms the bankruptcy, which are intended to apply in some, but not all provisions with time references in relation to the bankruptcy. It is not always clear from the provisions containing the time references, which simply refer to the "bankruptcy", when the relating back provisions are supposed to apply and when not.

The Working Group recommends that the precise times intended in provisions with time references in relation to the bankruptcy be clearly specified by adding defined phrases describing the later time and the earlier time respectively to the definitions section of the Act and incorporating the appropriate defined phrase into each section containing a time reference. For example, a definition of the phrase "date of putting into bankruptcy" indicating it to be the later date could be added to the definitions section and then that phrase could be inserted in the appropriate time reference provisions, e.g. by replacing "following the bankruptcy" with "following the date of putting into bankruptcy", where the later date is appropriate.

The Working Group has surveyed provincial legislation making reference to bankruptcy and has concluded that the changes proposed here would not adversely impact on that legislation. To ensure no adverse impact, the Working Group advises that the defined phrases signifying the earlier and later dates be structured so as to ensure that phrasing used in provincial legislation is not repeated.

The Working Group recommends that the anti-preference and anti-settlement provisions of the BIA (s.91 to 102), for which the appropriate time references are to the earlier date, should be amended to clarify that they apply during the interim period between the earlier date and the later date. For example, the anti-preference provision, s.95, should be made applicable to transactions made after the earlier date (petition) up to the later date (receiving order) as well as those made within the three months before the petition date.

This would clarify the time intended in sections containing time references relating to the bankruptcy and remove the current ambiguity as to time.

2. Assignment of Wages and Assignment of Debts

Subject:

Application of s.68.1 to assignments of wages and book debts.

Issue:

Whether the BIA should be amended to clarify that s.68.1 does not affect assignments of wages earned before bankruptcy, even if the wages or book debts are not payable until after bankruptcy and to clarify that s.68.1 does not affect assignments of wages and book debts earned prior to the date on which the bankruptcy becomes bankrupt, be that the date of granting of a

receiving order or making of an assignment in bankruptcy or the date a deemed assignment is triggered by the failure of a Part III proposal.

Comments:

S.68.1 provides that an assignment of wages or book debts (which a lender may take to secure a loan to a wage earner or a self-employed person respectively) has no effect as regards wages or book debts which become receivable after bankruptcy.

The intent behind this provision, which was added to the *Bankruptcy and Insolvency Act* (BIA) as part of the 1992 amendments, is to limit the amount of wages and book debts which can be made subject to a security interest and increase the amounts available to unsecured creditors.

Wages or book debts receivable after bankruptcy may have been earned some time before bankruptcy occurred (particularly in the case of book debts, which may not be paid for as much as 90 days). Hence, the provision, as worded, may render an assignment ineffective as regards substantial pre-bankruptcy earnings.

S.68.1 provides that an assignment of wages or book debts does not apply to wages or book debts received "after the bankruptcy". If the date of bankruptcy is held to be retroactive to the date of a petition or filing of a proposal, by nature of the relating back provision in s.71, wages and book debts earned before the bankrupt actually becomes bankrupt (before the receiving order is granted) would be affected.

The Working Group recommends that s.68.1 be amended to clarify that only wages earned after the bankrupt becomes bankrupt are affected by it, that an assignment of wages or book debts would be effective as regards wages or book debts earned before that date, and that be relating back provisions in s.71 do not apply to back date the date at which these assignments cease to be effective.

The proposed amendment would clarify the application of s.68.1 and carry out, to the extent originally intended and not more, the limitation on the amounts of wages and book debts that can be effectively secured.

3. Margin Deposits

Subject:

Application of BIA s.95 anti-preference provisions to margin deposits.

Issue:

Whether margin deposited by a futures, options, or other derivatives customer with a clearing member, or margin deposited by a clearing member with a clearing house should be exempted from the full application of the anti-preference rules in s.95 of the BIA.

Comments:

Margin is deposited by a customer or by a clearing member as a form of performance guarantee that he will complete his end of the transaction. Initial margin must be deposited before or when the transaction is first made. If the price of the derivative moves against the customer or clearing member, he must deposit additional margin. The amounts of margin which must be deposited are specified in the rules of the exchanges and/or clearing houses involved.

S.95 provides that a payment made by an insolvent person to a creditor within the three months prior to his bankruptcy with the intent to prefer that creditor is void against the trustee. Where a payment has the effect of giving a creditor a preference, s.95 presumes an intent to prefer and puts the onus on the payee creditor to show that there was no intent to prefer.

The case law interpreting s.95 holds that the presumption of intent to prefer may be rebutted by showing that the payment was made in the ordinary course of business or was made to enable the payer to stay in business.

There is only one case on record in Canada involving a s.95 challenge to a margin payment, that of *re Consolidated Seed*, which involved margin paid by a customer to a clearing member. In that case, the court found exceptional circumstances which took the deposit of margin out of the ordinary course of business, but upheld the deposit on grounds that the dominant intent of the customer was to be able to stay in business.

Under the *U.S. Bankruptcy Code*, margin deposits, both in derivative transactions and in share purchases, and both from the customer to the clearing member and from the clearing member to the clearing house, are

protected against the full application of the anti-preference provisions in the Code. They are exempted without qualification from the anti-preference provisions in s.547 of the Code. They are subject to avoidance under s.548 of the Code, if the deposit was made with intent to hinder, delay or defraud creditors and the payee did not receive the payment in good faith.

The Task Force recommends that s.95 continue apply fully, without change, to margin deposited by a customer with a clearing member, but that subs.95(2), which puts the primary onus on the payee to rebut the presumption of preference if the transaction has the effect of giving any creditor a preference over other creditors or over any one or more of them, be made not to apply to margin deposited by a clearing member with a clearing house. This would place the primary onus of proof in these situations on the person alleging fraudulent preference, requiring that person to bring evidence to satisfy the court that the margin deposit was made with a view to giving the clearing house a preference. It is intended that any existing defences available to a clearing house be maintained.

The recommended solution would provide the minimum of protection to margin deposits needed in the derivative markets to ensure that the integrity of those markets is maintained. It would avoid making overly broad exemptions from the anti-preference provisions, ensuring that the rights of other creditors would not be compromised.

While there would be little likelihood that a court would find a deposit of margin with a clearing house to be preferential under s.95 as it is, and the recommended solution would do no more than, in effect, codify the existing law, the consequences of such a finding would be sufficiently serious to warrant the protection recommended. In fact, the mere threat of litigation involving an allegation of preference, and the uncertainty during the period of litigation if a clearing house was to be sued under s.95 could in itself have an undesirable effect on the functioning of derivative markets, especially if the litigation was prolonged. The recommended solution would reduce that uncertainty.

4. Proof of claim for unpaid wages

Subject:

Class proofs of claim for wages and other debts.

Issue:

Whether specified persons other than a bankrupt employer or someone on his behalf should be able to make a class proof of claim for wages on behalf of employees, and whether wider use of class proofs of claim should be permitted, allowing filing of class proofs in respect of claims for other than wages.

Comments:

There is limited provision in the BIA for the filing of proofs of claim by one person on behalf of a number of creditors. A person can file for another if expressly authorized by the other to do so. Also, subs.126(2) provides that a proof of claim for wages can be filed on behalf of the employees of a bankrupt by the bankrupt or his or her agent. No authorization is required in this case. The proof of claim must set out the names of the employees and the amounts owed to them. Subs.126(2) explicitly states that such a class proof does not disentitle an individual employee to file a proof of claim for himself.

There is no authority in the Act at present for making class proofs of claim other than for wages.

The Working Group recommends that subs.126(2) be expanded to authorize federal and provincial labour ministries and labour unions to make proofs of claim for wages of employees of a bankrupt, provided that the conditions of subs.126(2) apply: The person filing the proof would be required to file with it a schedule setting out the names and addresses of the employees and the amounts due to them and the proof would not disentitle an employee to file a separate proof on his own behalf.

The Working Group considered two options for allowing class proofs for unspecified types of claims other than wages; one authorizing the court to permit a class proof to be made, on application, by such persons, in such circumstances as it deemed appropriate; the other providing for class proofs in circumstances specified in Superintendent's directives. It decided not to recommend either option at this point. However, the Working Group is aware of the importance of class actions claims in some bankruptcies and advises that the possibility of incorporating a mechanism in the BIA for accommodating and recognizing such claims should be explored. The Working Group would welcome comments and suggestions from BIAC members on this point.

This proposal would increase the efficiency and convenience of processing wage claims in bankruptcies.

5. Petition for a Receiving Order against Fishermen and Farmers

Subject:

Protection for farmers and fishermen against petitioning in bankruptcy provided by s.48 of the BIA.

Issue:

Whether s.48 should be retained in its current form, amended to extend the protection against petitioning now provided to individuals solely engaged in farming and fishing to cover farmers and fishermen who, while still primarily engaged in farming or fishing, have taken outside employment, or amended to remove the protection, putting farmers and fishermen on the same footing as other creditors.

Comments:

Section 48 provides that an individual who is solely engaged in farming and fishing cannot be petitioned into bankruptcy. Recent case law has held that the requirement that the individual be solely engaged in farming is to be interpreted quite strictly — any off farm activity will expose a farmer to petitioning.

In 1991, when the Bill C-22 amendments were before Parliament, Saskatchewan and Manitoba requested that s.48 be amended to extend the protection to farmers who obtain some of their income off farm. They indicated a concern that many farmers were forced to seek off farm income given the current difficult conditions in the farm sector and were being exposed to petitioning. The Government at the time was inclined to extend protection to individuals primarily engaged in farming, but it was too late at that point to add an amendment to s.48 to Bill C-22. S.48 was added to BIAC's agenda when it was established in May 1993.

Taking outside employment is widespread among farmers in Canada. It occurs among all income classes of farmers, not just the lowest, although it is most common among low-income farmers. Farm financial conditions have improved in recent years, as evidenced by trends in farmers' cash flow and net equity as a percentage of assets and by a substantial decrease over the last six years in the number of farmers in arrears.

The s.48 issue was raised again last year in Saskatchewan in connection with a program in that province intended to enable farmers to stay on their land. The program provides for the lease back of farm land from the mortgage lender to a farmer who has encountered financial problems and has deeded his land back to the lender, and gives the farmer a right of first refusal in the re-sale of the land. The Saskatchewan Court of Appeal held that the lease back right does not revert to a bankrupt farmer on his discharge from bankruptcy. In ensuing debates in the Saskatchewan Legislature, it was suggested that the appropriate way of resolving the problem might be to amend s.48 to provide stronger protection against petitioning. However, a means of protecting the lease back program through amendments to provincial legislation was found and implemented.

The s.48 issue has also been raised recently in connection with a Saskatchewan program providing for mediation between a farmer and the lender holding a mortgage on his land. Saskatchewan has expressed concern that the threat of petitioning could have an adverse effect on the negotiations taking place between the parties involved in the mediation.

The Task Force considered the impact of s.48 on the functioning of Saskatchewan's mediation program, but reached no consensus view. Some Task Force members question whether the availability of petitioning has any impact, given that the mediation program involves only the mortgagee on the creditors' side, who as a secured creditor, is not affected by bankruptcy proceedings. Others, including Saskatchewan, remain concerned that the threat of petitioning upsets the balance in the negotiations between the parties in mediation and skews the negotiations.

Fishermen's groups, invited to join the task force discussions when the option of removing s.48 protection for farmers and fishermen entirely was taken up, have generally expressed concern about removing the existing protection for individuals solely engaged in fishing.

After lengthy discussions, the task force members have been unable to reach any common view as to which of the three available options merits support. There is no clear cut, obvious choice. All options have their advantages and disadvantages, and members'

views differ as to their relative importance. In fact, assessment of the impact of different policies is difficult and inevitably conjectural to a degree. Members differ as to the probable outcomes of the various options.

Most members fell into one of two broad schools of thought. Those supporting the expansion of protection to cover farmers and fishermen with outside employment focused on the social goals of enabling farmers and fishermen to stay in their current employments, on the need to protect them in the current economic climate and against future downturn in the economy, and on the need to support provincial efforts to assist farmers. Those in favour of removing the current protection attached primary importance to the principle of equal treatment of all types of debtors, to making the process of liquidation and reallocation of assets applicable to the farm and fish sectors, for efficiency purposes, and to protect creditors in those sectors against abuse.

6. Section 97

Subject:

Section 97: protection for transactions entered into by a debtor after bankruptcy or reorganization proceedings start.

Issue:

Whether transactions entered into after bankruptcy or proceedings start should be better protected, by removing the requirement from section 97 that the persons dealing with the debtor must not have been aware of any acts of bankruptcy on his part.

Comments:

Section 97 provides that payments made by or to a bankrupt, or conveyances or transfers made by a bankrupt for adequate valuable consideration, or contracts, dealings or transactions by or with a bankrupt for valuable consideration, made during the period after the filing of a notice of intention or proposal by the bankrupt, or of a petition against the bankrupt, are valid, provided the person dealing with the bankrupt had no knowledge of any act of bankruptcy committed by him or her.

The BIA contains relating back rules which provide that bankruptcy is deemed to have occurred on the date of filing of a notice of intention or proposal if a reorganization attempt fails later, and is deemed to have occurred on the petition date if a receiving order is later granted. Hence, a debtor could be found retroactively to have been bankrupt during the post-notice of intention, proposal or petition period, potentially casting doubt on his ability to enter transactions during that period. Section 97 is intended to ensure that the validity of transactions entered into by a debtor during that period is not put in doubt if the debtor goes bankrupt later.

In a reorganization, persons dealing with the debtor will usually be aware that he has committed acts of bankruptcy, since his insolvency will have been admitted. Some persons dealing with a debtor following a petition may also be aware of this insolvency. These debtors will not be able to meet the conditions required for protection under this section, and transactions entered into by them will be subject to a attack as invalid transactions.

The Working Group recommends that paragraph 97 (1) (f), which requires that the other party to the transaction have had no notice of any act of bankruptcy committed by the bankrupt be removed.

The Working Group further recommends that s.97 be amended to clarify that it is subject to the provisions on settlements, preferences and reviewable transactions. The requirements that parties dealing with the debtor have no knowledge of acts of bankruptcy on his or her part make the protection ineffective. It jeopardizes a reorganizing debtor's ability to make transactions and carry on business. The recommended amendments will protect such transactions, provided they are made in good faith.

7. Eligibility of Certain Types of Corporations to go Bankrupt

Subject:

Eligibility of certain types of corporations including building societies, railways, municipal corporations and non-business corporations generally to go bankrupt.

Issue:

Whether building societies, railways, municipalities and non-business corporations generally should be brought clearly within the purview of the BIA.

Comments:

The BIA excludes certain entities from eligibility to go bankrupt, including financial institutions such as

banks, insurance companies, trust and loan companies and building societies having a capital stock, and railways.

Liquidation of insolvent banks, insurance companies and trusts and loans are governed by provisions in the *Winding-Up Act* (WUA) and in the incorporations acts governing these companies *(Bank Act*, etc.) which lie within the responsibility of the Department of Finance, and are under review by that Department

Building societies are precursors of present day mortgage companies. Provision for their liquidation was also made in the 'WUA, apparently because they are financial institutions. At one time these businesses were governed under their own legislation (building societies acts). However, these acts have long since been repealed.

There is no legislative scheme in place for liquidating insolvent railways, although there are provisions authorizing a Federal Court judge to order the foreclosure of the interests of the owners of an insolvent railway, the sale of its assets, or that it be placed in receivership.

There are no provisions in the BIA explicitly indicating whether or not municipal corporations are eligible to go bankrupt. However, in cases where this question has come up, the courts have held that municipalities are not eligible to be made bankrupt under the BIA. Provincial legislation is in place to regulate the administration of insolvent municipalities.

The Working Group recommends that the BIA be amended to bring non-business corporations and building societies under the Act. However, the Working Group does not recommend that railways or municipal corporations be brought in under the BIA now. The Working Group plans to consult with railway regulators and provincial authorities regarding the possible future eligibility of these types of corporations, with a view to assessing whether they should be made eligible in a later phase of reform.

The recommended solution would provide greater uniformity in liquidating insolvent debtors.

8. Banks and Trust Companies

Subject:

"Bank" as an entity excluded from the definition of "corporation."

Issue:

Whether "bank" as it is referred to in the definition of "corporation" in the BIA should be defined in a limited sense as pertaining only to banks proper.

Comments:

The definition of "corporation" in the BIA excludes "banks" by explicit reference (along with other types of financial institutions) making all entities which fall within the definition of "bank" ineligible to go bankrupt under the Act.

The 1992 amendments to the BIA extended the definition of bank for the purposes of the Act to include other types of financial institutions, including some credit unions. Without specific provision otherwise, this expanded definition of "bank" would apply where "bank" is referred to in the definition of "corporation", potentially excluding some credit unions from coverage by the BIA.

The Working Group recommends that "bank", where it is referred to in the definition of "corporation" be given a restricted meaning, covering only banks proper.

The proposed change would only restore the pre-1992 status quo. No change had been intended.

* * *

Subject:

First and third references to "bank" in subs. 25(1.1).

Issue:

Whether the first and third references to "bank" in subs. 25(1.1) should be replaced by a generic term for "bank".

Comments:

Subs. 25(1.1) was added to the BIA by the 1992 amendments. "Bank" is given a specific meaning by s.2 of the BIA. The first and third references to "bank" in subs. 25(1.1) uses "bank" in a generic sense.

The Working Group recommends that the first and third references to "bank" in subs. 25(1.1) be replaced by a more generic term, such as "financial institution".

The recommended solution would correct a purely technical defect in the wording.

* * *

Subject:

Federal trust companies as financial institutions eligible for depositing under the BIA.

Issue:

Whether the BIA should be amended to clarify that federal trust companies are eligible for depositing under the Act.

Comments:

The 1992 *amendments* expanded the definition of "bank" in s.2 and *enacted* subs. 25(1.1) to include other insured deposit taking institutions among eligible depositories. However, federal trust companies could in some instances be excluded from eligibility. They need not be members of the Canadian Payments Association, thereby not falling within the category of "bank" set out in para. (b) of the definition of "bank" in s.2, and they are federally, not provincially insured, so would not be covered by subs. 25(1.1).

The Working Group therefore recommends that the BIA be amended to clarify that federal trust companies are eligible for depositing. The failure of the 1992 amendments to do this was an oversight which should be corrected. The obvious way to do this would be to expand subs. 25(1.1) to cover financial institutions whose deposits are federally insured.