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Background Papers for the BANKRUPTCY AND INSOLVENCY BILL (1979)

Consumer and Corporate Affairs Canada
Consommation et Corporations Canada

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BACKGROUND PAPERS
FOR THE BANKRUPTCY AND INSOLVENCY BILL

INTRODUCTION

The present Bankruptcy Act was enacted in 1949. Although substantially amended in 1966 to increase the Superintendent's investigatory powers, to make more strict the rules relating to fraudulent preferences and to add a new Part X concerning consumer arrangements by way of extension, the present Bankruptcy Act has become seriously outdated because of fundamental changes in the overall credit system.

In February 1966 the Government established a Study Committee to review the Bankruptcy Act and to recommend to the Government any changes required to improve both substantive standards and the administrative procedures of the Act. The Committee submitted a report to the Government in late 1970, which recommended that a new Bankruptcy Act be prepared to abrogate the present Bankruptcy Act and to integrate all federal bankruptcy laws into one comprehensive statute that can deal better with the problems that arise in the contemporary credit system. The Government published the report of the Study Committee on 18 December 1970, indicating that it was in general accord with the Committee's recommendations, that the views and suggestions of interested groups and individuals would be welcome, and that steps were being taken to prepare a Bill generally in accordance with the recommendations of the Report.

Concurrently with the preparation of a new Bill, to keep abreast of demands for services under the present Bankruptcy Act, the Bankruptcy Branch implemented a number of policy and administrative changes recommended in the Study Committee Report that could be effected under existing law. The Branch set up field offices across Canada in order to decentralize administration, completed its program to substitute full-time bankruptcy officials as official receivers in place of court officials, and introduced a new program to make it possible for consumer debtors having few assets to invoke the bankruptcy process as a solution to their debt problems.

Moreover, between 1966 and 1972 the Bankruptcy Branch acted to improve the quality of administration of the private sector trustees in bankruptcy, which was achieved through three techniques: (1) weeding out those trustees who were demonstrably incompetent; (2) setting up an objective examination procedure to qualify applicants for trustee licences; and (3) implementing audit procedures to maintain surveillance of private sector trustee operations.

The number of commercial bankruptcy cases has remained almost static over the past decade. But reflecting the increase in outstanding consumer credit from $835 million in 1947 to $8 billion in 1967 and to more than $35.76 billion in 1978, the number of over-burdened consumer debtors has increased dramatically in recent years.

To resolve this problem the Study Committee recommended introduction of a comprehensive part dealing exclusively with consumer arrangements. They empowered a consumer debtor to opt for straight bankruptcy or, if he sought to avoid the stigma of bankruptcy, to make an arrangement to repay his debtors in part or in whole over an extended period of time.

Bill C-60, which was tabled in the House of Commons on 5 May 1975, set out most of the substantive recommendations of the Study Committee Report. The principal difference between the Committee Report and Bill C-60 related to the status of trustees in bankruptcy. The Committee Report had recommended that the private sector trustees in bankruptcy be replaced by public servant trustees, whereas Bill C-60 continued the policy of the present Bankruptcy Act of administering most bankruptcy estates through private sector trustees, who are required to qualify for a trustee licence under the Bankruptcy Act and to administer estates under the surveillance of the Superintendent of Bankruptcy.

Bill C-60 did not proceed beyond first reading in the House of Commons. Instead, at the request of the Minister of Consumer & Corporate Affairs, the Senate Committee on Banking, Trade & Commerce agreed to hold a number of hearings on the Bill during the fall of 1975. The Senate Committee received briefs from and heard witnesses representing a number of professional and business organizations. On 10 December 1975 the Senate approved publication of the Committee's Report on Bill C-60, which recommended a number of changes to the Bill. The Government agreed in principle with most of the major recommendations made by the Senate Committee and the persons who submitted briefs to that Committee.

After the Senate's report was published, a modified Bill was drafted taking into account the changes suggested by the Senate, and Bill S-11 was introduced in the Senate on 21 March 1978.

The Senate Committee on Banking, Trade & Commerce held a few days of hearings on that Bill but the Third Session of the Thirtieth Parliament was prorogued before the Senate published its report.

On 27 February 1979, Bill S-14 was introduced in the Senate. That Bill, which was substantially the same as its predecessor, except for a few minor amendments, was also considered by the Senate Committee on Banking, Trade & Commerce, but the Thirtieth Parliament was dissolved before the Senate's report was published.

Since then, a committee of the Canadian Bar Association recommended to officials of the Department of Consumer and Corporate Affairs that a few minor changes of a technical nature be made to the proposed legislation. These recommendations are incorporated in the proposed legislation.

The policies set out in the Bill are described and compared part by part with the present law in the following summary.

PART I - INTERPRETATION AND APPLICATION
(Sections 2-10)

PRESENT LAW

Because it touches on all aspects of the law, the bankruptcy law includes within its scope a great many concepts and necessarily employs an extensive, specialized vocabulary. Although the present Bankruptcy Act contains some twenty-five definitions and a number of rules concerning related persons, because of a lack of precision in the language used, many of its substantive provisions remain unclear.

PROPOSED LAW

Part I of the Bill sets out roughly twice as many defined terms as the present Act with a view to reconciling a number of related civil law and common law concepts, clarifying a number of ambiguities that exist under present law, and condensing considerably the text of the Bill. The Bill also attempts to simplify and clarify the complicated rules defining related persons that are contained in the present Act.

Although a conscious effort was made not to embody substantive rules in defined terms, for the sake of drafting brevity - and to minimize ambiguity - it was found necessary to describe expressly in Part I a number of concepts. An important example is the refinement of the concepts "insolvent", and "ceased to pay his debts generally as they become due", which have been cast to make clear that it is a debtor's state of insolvency alone that makes the bankruptcy law applicable. Thus there will be no need, as under present law, to prove in addition to insolvency an "act of bankruptcy", an archaism in the law carried over from the time when application of the bankruptcy law connoted punishment for a specified breach of commercial morality. To underline both their complexity and their importance throughout the Bill these concepts are set out in distinct sections.

The Bill also includes a definition of the concept of "security interest", which in effect abrogates the title or lien theories that still exist in a number of Canadian jurisdictions, and substitutes instead a functional test, similar to that of the Ontario Personal Property Security Act, which, to determine a creditor's rights in property of a debtor, requires a court to scrutinize the real nature of the transaction between the debtor and secured creditor irrespective of any reservation of ownership in the creditor. The generic concept of a security interest will render it impossible for creditors to escape the application of the bankruptcy law simply by characterizing their transactions with the debtor as leases or conditional sales.

The Bill includes a number of new definitions required by the introduction of new concepts. For example, the words "consumer bankrupt" and "consumer debtor" are new defined words, required because the Bill includes a number of simplified rules applicable only in the case of consumers, such as consumer debtor arrangements (Part III) and consumer bankruptcies (Part V, section 163). Other definitions or concepts have been added to this Part of the Bill, such as the words "claim" and "receiver".

The Bill also clarifies that an arrangement may not be made or a petition filed in respect of agents of governments or municipalities. Finally, the Bill includes a statement to the effect that its provisions prevail over any other law but is not deemed to abrogate the substantive provisions of other laws relating to property and civil rights that are not in conflict with the Bill.

PART II - ADMINISTRATION
(Sections 11-62)

General

The specific objectives of the federal bankruptcy law are quite straightforward: to provide an effective means to collect and liquidate a debtor's assets; to ensure equitable distribution of the proceeds realized from those assets among the creditors of the debtor; and, where feasible, to rehabilitate the debtor as a useful member of the community. In short, the bankruptcy law aims to maintain a reasonable balance of interests among debtors, creditors and the public generally. But in order to achieve these objectives the bankruptcy law may affect legal institutions that exist in both the civil and common law systems and modify them to a certain extent.

The bankruptcy law is therefore inherently complicated. It sets out a large number of substantive rules concerning the respective property and contractual rights of creditors among themselves and in relation to the debtor. These rules are, however, only ancillary to the central purpose of the bankruptcy law, which is to set up a uniform, effective administrative system to deal with the affairs of insolvent debtors. It is for this reason that the administrative structure embodied in the bankruptcy law is correctly characterized as the foundation of the bankruptcy system.

The five principal elements of this administrative structure are the Superintendent of Bankruptcy, the official receiver (called the "administrator" in the Bill), the courts, the trustees, and the creditors.

PRESENT LAW

Superintendent of Bankruptcy

At the centre of the administrative structure is the Superintendent of Bankruptcy who is responsible to make recommendations with respect to the licensing of trustees, to direct audits and to evaluate the performance of trustees, to maintain surveillance over estates, to detect any improper or unlawful acts and to investigate suspected offences against the Bankruptcy Act or any other federal statute. Finally, the superintendent must make sure that over-burdened consumer debtors may avail themselves of the provisions of the Act even if they cannot afford the trustee's fees. The Department of Consumer and Corporate Affairs has set up regional and local bankruptcy offices in major centres across Canada through which the Superintendent carries out most of his estate surveillance, detection, investigation and consumer debtor administration functions.

Official Receiver

Although an insolvent debtor may initially seek advice from a trustee or a lawyer, his first formal contact with the administrative process is with the official receiver. Official receivers are appointed by the Governor-in-Council for each bankruptcy division (province) and are officers of the court. The duties of the official receiver are to accept the debtor's assignment, to appoint the trustee in the estate and to set an estate bond to be filed by the trustee, to chair the first meeting of creditors in bankrupt estates and to examine the debtor in respect of his affairs.

Courts

In addition to the judicial function of resolving conflicts in adversary proceedings, the Act imposes responsibility on the Court to distinguish between the unfortunate debtor and the conniving one, and accordingly to exercise its power to release or discharge the debtor from his debts and from his status of bankrupt. The Court is also required to tax the accounts of trustees and solicitors acting for the estate and, upon application, to give directions with respect to estate administration. Generally, the registrar of the Court conducts most of the non-contentious business.

Trustee

The Bankruptcy Act requires that the property of each bankrupt estate be vested in and administered by a licensed trustee, a legal structure that is analogous to the common law system for the administration of the estate of a deceased person. To qualify as a licensed trustee, a candidate must demonstrate a thorough knowledge of bankruptcy law and its application, have substantial business experience, and have satisfactory financial and other resources available to administer estates under the Bankruptcy Act.

The statutory responsibility of the trustee is to administer the affairs of the bankrupt estate. This administration includes the preparation of an inventory, gathering in and realizing assets, liquidating assets, distributing the proceeds in accordance with the Bankruptcy Act, and rendering a final account of the administration to the creditors and the court.

Creditors

Finally, the Act envisages an important role for creditors who, at the first meeting, normally nominate a board of inspectors. Like the directors of a corporation, these inspectors are required to maintain policy control over the administrative decisions of the trustee. With the exception of the larger estates, it generally is found that creditors tend to ignore the first meeting of creditors and so impose upon the trustee nominated by the official receiver the duty to administer the estate without the benefit of effective creditor direction.

PROPOSED LAW

General

Part II introduces a number of policies that are reflected repeatedly throughout the Bill. It sets out an administrative structure that better reflects the real exercise of functions and permits greater administrative efficiency, particularly by dealing with specific issues on an exceptions basis wherever possible; e.g., by requiring the bankrupt to apply formally for discharge only where a caveat is filed. Part II also facilitates a broad delegation of authority from the Superintendent to local administrators to ensure closer contact with the interested parties and greater sensitivity to local conditions.

One of the important changes in the present Bill compared to present law is the possibility of delegation to a province of the administration of consumer debtor arrangements and bankruptcies. This change will permit better use of existing provincial personnel and facilities and should furnish better service at the local level.

Part II sets out rules concerning conflicts of interest and the bonding of trustees. The conflict rules in effect constitute a conflict of interest code to govern the qualification and conduct of trustees, inspectors, solicitors and others involved in the administration of an estate. Certain persons are rendered ineligible to be appointed or to act as trustees. Generally these persons include those who were closely related to the debtor during the two years immediately preceding the bankruptcy or arrangement, e.g., partners, officers, employers and employees of the debtor; those related to an officer of the debtor where the debtor is a corporation; auditors, accountants and solicitors of the debtor; and persons acting as trustees or related to a trustee acting under a trust indenture.

The Bill requires a trustee to make full disclosure to the creditors in any event of the potential conflict of interest. In addition, a trustee may act for a secured creditor while he is the trustee of an estate only if he meets two conditions: 1) he must obtain an opinion of a solicitor who does not act for the secured creditor as to the validity of the security interest as against the estate; and 2) he must make full disclosure of his involvement to the creditors or the inspectors.

At present a trustee is required to put up three kinds of security to ensure that he faithfully performs his duties as trustee. First, upon receiving a licence, a trustee is always required to deposit with the Superintendent of Bankruptcy a fidelity bond issued by an insurance company. In addition, the trustee is required to deposit with the Superintendent government or government guaranteed bonds in an amount that is fixed by policy and that varies according to the number and size of the estates the trustee administers.

Finally, the official receiver also requires a trustee to furnish a fidelity bond in respect of each estate he administers. This bonding system has proved to be expensive. Moreover, the Superintendent has experienced difficulties when attempting to recover under the fidelity bonds where a trustee is found to be in breach of his fiduciary duty.

To overcome these difficulties an Indemnity Account is proposed, which would be financed by fees paid by trustees and moneys recovered in satisfaction of any claim paid out of the Indemnity Account. Any person who obtains a judgment against a trustee on grounds of a breach of fiduciary duty will be entitled to be indemnified out of the Account.

Superintendent

The present functions of the Superintendent continue substantially unchanged. He will, however, have more direct and broader responsibilities in a number of areas. Instead of making licensing recommendations to the Minister, the Superintendent is empowered to decide issues concerning the licensing of trustees, subject only to judicial review of that particular administrative action under the Federal Court Act. Consonant with the general policy of administration on an exceptions basis, under the Bill trustees will be issued permanent licences instead of annual licences, subject to the payment of an annual fee and to cancellation of licence for cause.

The Superintendent's powers of detection and investigation are expanded to encompass arrangements as well as bankruptcies and may be exercised before or after a proceeding under the Bill has been filed.

Bankruptcy Administrator (former Official Receiver)

The local bankruptcy official is called the "administrator" in the Bill, first because that name is more descriptive of his functions, and second because the phrase "official receiver" wrongly connoted that property vested in the bankruptcy official. In fact, the property of a bankrupt's estate vests only in a trustee.

The bankruptcy administrator continues under the Bill to be responsible to carry out what were the functions of the official receiver, particularly those administrative functions such as accepting copies of and recording petitions, examining debtors, and chairing first meetings of creditors. In addition, under the Bill, the bankruptcy administrator has a duty, where he is of the opinion that a debtor caused his bankruptcy by rash or hazardous speculation, reckless business conduct or other abuses of the credit system, to file a caveat within six months after the date of bankruptcy.

The bankruptcy administrator will also be empowered to prepare and administer consumer debtor arrangements. Also, he will be required to administer consumer bankruptcies where no private trustee is willing to act and may administer a commercial bankruptcy where no private sector trustee will undertake administration of the particular estate and there are allegations of facts that may require further investigation.

Courts

The main responsibilities of the registrar will be in the passing of estate accounts submitted by trustees, solicitors and accountants; he will continue, as under the present Act, to exercise important judicial or quasi-judicial functions under the authority of the court.

Consistent with the general administration policy of the Bill, a bankrupt will cease to be a bankrupt six months after the date of bankruptcy except where a bankruptcy administrator on his own or at the request of the trustee or a creditor files a caveat. The bankrupt may apply to court to have the caveat set aside or removed on the ground that he has rehabilitated himself. Thus application to court is necessary only in exceptional cases.

Trustee

Although the Bankruptcy Committee Report had recommended substituting public sector trustees for private trustees, after considering comments on the Report, the Government concluded that the Bill should continue to assign responsibility for the administration of commercial bankruptcies to private sector trustees because private sector trustees are better equipped to adjust to a variable work load and to react to emergency situations. There are a number of provisions in the Bill that are intended to clarify the rights, duties, liabilities and powers of trustees, but in general their functions and responsibilities under the Bill are the same as under the present law.

Also, public sector trustees, i.e. administrators, will be restricted mostly to certain cases involving consumer debtors or other debtors where no private trustee is willing to accept an appointment as trustee and certain facts should be investigated.

Creditors

Because ordinary unsecured creditors actually realize, on average, only a small percentage of their claims against bankrupt estates, they are reluctant to commit further resources directly to administer those estates. As a result, the administration is left almost entirely to the trustee, subject only to the surveillance of the Superintendent. Although the Bill cuts down the number of claims of preferred creditors, ordinary unsecured creditors will continue to be reluctant to participate. Nevertheless by making the functions of creditors and inspectors clearer and by rendering administration more efficient, the Bill thus further attempts to induce the unsecured creditors to play a more active role.

PART III - ARRANGEMENTS FOR THE CONSUMER DEBTOR
(Sections 63-97)

PRESENT LAW

The commonplace use of revolving accounts, credit cards and institutional consumer lending services made available during the past twenty years has made virtually every Canadian a user of credit and, as a corollary, has led to an enormous growth in the aggregate amount of consumer debt outstanding, that is from about $0.8 billion in 1947 to $8 billion in 1967 and to more than $35.76 billion in 1978. Given the aggressive efforts of lenders to promote their credit services, it is not surprising that an increasingly large number of householders become seriously overburdened by debts they cannot repay, particularly where the household is affected by some unforeseen catastrophe.

Under the present Bankruptcy Act an insolvent consumer or wage earner debtor may resort to bankruptcy for relief from his debts, but until mid-1972, this remedy was often illusory, since in many cases he did not have sufficient funds (approximately $500) to secure the services of a licensed private trustee to administer the estate as required by the Bankruptcy Act. In 1972 the government, by a decision of Cabinet, introduced the Small Debtor Program to assist wage earner debtors with low income and little property who are unable to obtain the services of a private trustee. Under this program, a public servant administered the estate for a nominal fee or even, in specific cases of hardship, without receiving any fee. The program proved to private sector trustees that all consumer estates could be handled on a profitable basis and this area was turned back to the private sector.

An insolvent consumer or wage earner debtor who wishes to avoid the social stigma of bankruptcy may choose to make a proposal to his creditors under Part III of the present Act in the same way as a commercial debtor. This remedy, again, was largely illusory because most consumers who are in financial difficulty could not afford the services of a private trustee. Furthermore, the mandatory procedures of the present Act, which were designed for insolvent businesses, are too cumbersome to permit efficient administration of arrangements for consumer debtors.

A third remedy available to the insolvent consumer debtor is debt consolidation under Part X of the present Act. That Part was enacted in 1966 as a result of a decision of the Supreme Court of Canada that similar legislation enacted by Alberta in 1956 was not valid because it was primarily bankruptcy and insolvency legislation and therefore exclusively a federal matter. Part X provides for a simple and inexpensive procedure whereby specified insolvent debtors may apply to the clerk of the Court for a consolidation order. The debtor undertakes to pay fixed amounts to the Court for distribution among creditors until all his debts are paid in full. In sum, this Part legitimates only an extension of time to repay, not a composition that effects a rateable reduction of creditors' claims. Morever, Part X is only in force in those Provinces which request it. Only six Provinces, not including Ontario and Quebec, have implemented Part X. Thus a large number of Canadians are denied access even to this limited form of relief.

PROPOSED LAW

Arrangements

Although the main objective of Part III of the present law is to provide overburdened debtors with an alternative remedy to their financial difficulties, the present Bill differs substantially from the present law.

Scope of Part

Only individuals, whether in business or not, whose liabilities do not exceed $20,000, or such greater amount as may be prescribed, may avail themselves of the arrangement provisions of Part III. In the computation of this amount no account is taken of debts secured by real property, where such property is the principal residence of the debtor. The maximum duration of a consumer arrangement remains 3 years, but in special circumstances the term may be extended by one year. No debtor can be compelled to choose an arrangement instead of seeking complete discharge through bankruptcy proceedings.

Stay of Proceedings

The filing by a debtor of a request to formulate a proposed arrangement does not bar any creditor, whether secured or unsecured, from exercising a remedy against the debtor or his property. The stay of proceedings begins only after a proposed arrangement has been formulated. If there are compelling reasons requiring a stay of proceedings prior to the formulation of the proposed arrangement, the debtor may, before filing a request, file a notice of intention stating his intention to file a request; the filing of such notice grants to the debtor a ten-day stay of proceedings to allow him to formulate a feasible arrangement free from the pressure of proceedings taken against him. In order to prevent abuses, the stay of proceedings would not apply where a notice is filed within six months of the filing of any previous notice of intention.

Administration

The proposed arrangement is sent to the creditors to be affected by the arrangement and unless 50% in value of those creditors request a meeting, no meeting will be held and the arrangement, as formulated, is deemed to be approved. If a meeting of creditors is requested, the administrator will call a meeting where the creditors may accept, reject or amend (with the concurrence of the debtor and administrator) the proposed arrangement. Unless rejected or amended by a majority of the creditors entitled to vote, whether or not they are present or represented at the meeting, the proposed arrangement is deemed to be approved as formulated. The same procedure would apply where variations to the arrangement are proposed during the term of the arrangement.

This streamlined and simplified procedure should facilitate the administration of consumer debtor arrangements by the administrator. A conscious effort was also made to integrate in Part III all sections required to administer consumer debtor arrangements. This integration is especially important since the Bill contemplates the delegation of the administration of these arrangements to provincial administrators and administrators from the private sector who might not be involved in the administration of any other parts of the Bill.

Another feature of the Bill that should facilitate the administration of consumer arrangements is the introduction of what is commonly referred to as a "basket" proposed arrangement. Under this approach the debtor would offer to pay a stated amount of money out of his future income without specifying the portion of each debt that would be paid.

Secured Creditors

With the exception of creditors whose claims are secured by real property, all secured creditors are bound by a consumer arrangement. However, a creditor who has a security interest in personal property, if more than one-third of the original purchase price is outstanding, may elect within 25 days after a notice has been sent to him by the bankruptcy administrator not to participate in the arrangement. If he does elect not to participate, his rights are confined to his security interest and his claim against the debtor or his estate for any deficiency balance is barred. It must also be noted that with respect to a collateral security interest in real property, a claim may be admissible and therefore subject to the arrangement if the value of the property subject to the security interest is less than the amount of the debt. In those circumstances the secured creditor may be required to assess the value of the real property subject to his security interest and to relinquish the amount of his security interest that exceeds the value of the pertinent property.

Finally, the Bill provides that the administrator may request from the secured creditor the filing of a proof of security interest; in addition, the court may postpone the right of a secured creditor to realize the property subject to his security interest if such postponement does not materially adversely affect the secured creditor.

Rehabilitation of the Debtor

The Bill, by creating a strong incentive to enter into an arrangement instead of bankruptcy, emphasizes debtor rehabilitation through better financial planning. In any case, the Bill requires the administrator to exercise such supervision and give such advice to the debtor as will assist him to rehabilitate himself financially and carry out his financial obligations. The administrator may refer the debtor to guidance and counselling agencies in the community. As one of the rehabilitative measures, he may also permit the debtor, after an arrangement has been in effect for at least 6 months, to make payments directly to the creditors if the administrator is satisfied that the debtor is able to manage his financial affairs.

Consequences of Default

Where a debtor fails to comply with the terms of an arrangement the Court may annul it. If he defaults in his payments in an amount equal to the total of three months payments, or if the debtor does not make his payment within ten days after a payment becomes payable where such payments are due on longer basis than a monthly basis, the arrangement is deemed to have been set aside and all the rights of creditors revive, including any right to repossess or seize in execution the assets of the debtor. There is no automatic bankruptcy, but of course a defaulting debtor may petition himself into bankruptcy. In addition, the Bill introduces a short form petition granting to any creditor or creditors having claims of $1,000 or more the right to file a petition in bankruptcy with the administrator as an alternative to filing it with the court according to the usual procedure. After a debtor defaults under an arrangement, he is not entitled, without leave of the Court, to make another proposal for an arrangement unless all debts which were part of the previous arrangement are paid.

If an arrangement is not a satisfactory solution, any debtor has a right to go into voluntary bankruptcy. The administrator will continue to assist those debtors who elect bankruptcy but cannot afford the services of a private trustee.

PART IV - COMMERCIAL ARRANGEMENTS
(Sections 98-133)

PRESENT LAW

Bankruptcy and insolvency laws have long recognized that a firm may get into short-term financial difficulties because of a general economic crisis or a sudden change of market conditions that is clearly beyond the control of the firm. If a firm cannot survive the rigours of competition in the long run, then the bankruptcy law should make it possible to liquidate and dissolve that firm with a minimum of formality and cost, freeing its capital to be used by another enterprise. But where a firm is viable, if bankruptcy were the only solution to short-term difficulties, then the bankruptcy law itself would tend to be forcing a less than optimal use of economic resources. The present federal laws therefore facilitate and even encourage proposals for commercial arrangements.

Proposals, more properly called proposals for an arrangement, may be made at present under one or more of several federal statutes. Most proposals relating to unregulated business corporations are made under Part III of the present _Bankruptcy Act_, but such corporations may also make a proposal under the _Winding-Up Act_ or the _Companies Creditors' Arrangement Act_. The _Bankruptcy Act_ does not apply to banks and other financial intermediaries, which can therefore make proposals only under the _Winding-Up Act_ or the _Companies Creditors' Arrangement Act_. Railway companies may make an arrangement only under certain vestigial provisions of the _Exchequer Court Act_.

A proposal under the present _Bankruptcy Act_ may be filed by a debtor before or after he is bankrupt. When a debtor files a proposal, no creditor affected by it may institute or continue any action or proceeding to enforce a claim. However, secured creditors are not affected by the proposal, and creditors whose debts are not dischargeable, such as suppliers of necessaries, are not bound by it. Furthermore, the proposal must provide for payment in priority of the claims of creditors having a priority under the Act and for the payment of the trustee's fees and disbursements. In order to bind unsecured creditors, the proposal must be accepted by a majority of them representing three-fourths in value of claims and must also be approved by the Court. In sum, under the present _Act_, a proponent of a proposal must overcome a number of formidable obstacles.

One of the great merits of a proposal is that the debtor continues to manage his business unless the proposal states otherwise or the creditors, with the consent of the debtor, impose conditions. Unlike bankruptcy, the debtor's property does not automatically vest in the trustee.

If a proposal is rejected by the creditors or by the Court, or if after it has been accepted and approved it is annulled by the Court for default or for other reasons, the debtor is deemed to be bankrupt. To ensure that debtors do not abuse the privilege of making proposals and thus stall inevitable bankruptcy, the Bankruptcy Act was amended in 1966 to make the automatic bankruptcy retroactive to the date of filing a proposal (except where the proposal is annulled by the Court). The aim of this retroactive provision is to enable the trustee to recover fraudulent dispositions, including preferential transfers, made by the debtor within the prescribed delay periods which are calculated retrospectively from the filing date.

Proposals under the Companies Creditors' Arrangement Act are generally made with respect to creditors who hold debentures issued under a trust indenture. The now obsolete Farmers Creditors' Arrangement Act authorized the Court to formulate a proposal for a farmer. In contrast, under the Bankruptcy Act no person other than the debtor can make a proposal.

The Bankruptcy Act requires the trustee with whom the proposal is lodged to make an appraisal and investigation of the affairs and property of the debtor, in order to enable the trustee to estimate with reasonable accuracy the financial situation of the debtor and the cause of his financial difficulties or insolvency, and to report the result of his enquiry to the meeting of creditors. The debtor must also submit a copy of the trustee's report to the Court when he seeks the required court approval of the proposal. But the present Act does not require the debtor to disclose details of payments made or promised to be made by him to the trustee for future services or to other parties outside of the terms of the proposal itself.

PROPOSED LAW

The primary object of Part IV of the Bill is to provide a new, integrated and flexible procedure to facilitate a wide variety of arrangements. However, banks and other financial intermediaries such as trust companies and credit unions are not permitted to take advantage of this Part. This prohibition reflects the policy conclusion that if a financial intermediary is in such serious trouble that it must resort to an arrangement with creditors it should not, in the public interest, be permitted to continue in business. The Bill has been modified, however, to allow an insurance company to make an arrangement under Part IV, subject to the prior approval of the Superintendent of Insurance.

Notice of Intention

The Bill recognizes that it is in the interest of creditors that the debtor has reasonable time to prepare a carefully considered and workable proposal for an arrangement, free from pressure or harassment. It therefore allows the debtor to file a notice of intention with the administrator stating that he proposes to file a proposed arrangement with a view to preventing bankruptcy. If the debtor files this notice, all legal proceedings against him by creditors, including secured creditors, are automatically stayed for a period of 10 days or for such longer period as the court may determine. However, on the filing of a notice, an interim receiver is automatically appointed in order to protect the interests of creditors.

To obtain further immunity from legal proceedings, the debtor must file a proposed arrangement within the stipulated time. If he fails to do so within ten days after the notice is filed or within such longer period of time as the court may determine, the notice is deemed withdrawn and the proceedings on any petition filed for a bankruptcy order may continue.

Persons Entitled to Make a Proposed Arrangement

In addition to the debtor himself, where a bankruptcy order has been made against a debtor or where a corporation is being dissolved, the Bill permits the bankruptcy trustee or the liquidator of the corporation, as the case may be, to make a proposed arrangement in respect of the debtor. Furthermore, any creditor, a trustee appointed under a trust indenture, or a receiver of a corporation is entitled to make a proposed arrangement for a debtor who is bankrupt.

Required Provisions of a Proposed Arrangement

The Bill makes it mandatory for the debtor to disclose all payments made or promised to be made by him to the trustee and others in connection with the proposed arrangement, including payments to be made outside of the proposed arrangement. The debtor must also clearly set out the amount and terms of payment, including the grant of any security interest to secure payment that he proposes to make. If the proposed arrangement is to be guaranteed, it must also set out the terms of the guarantee.

Possible Additional Provisions of a Proposed Arrangement

Any provision that is reasonable in the circumstances may be included in a proposed arrangement. The present Bill specifically provides that a proposed arrangement may alter the order of payment of claims and that the arrangement provisions supersede the order of priority determined under section 265 of the Bill; in addition, a debtor is granted the right to terminate uncompleted contracts, subject to the control of the court to prevent abuses. The Bill also impliedly gives the proponent of an arrangement broad powers to define classes. And he may also apply to a court to determine if a creditor affected by the arrangement has been properly placed in a class of creditors. This application may be made even before the first meeting of creditors, enabling the proponent to minimize technical problems at the meeting of creditors, particularly by constraining the need for exercise of the chairman's discretion to designate classes, which is a decision that may be reviewed by a court and therefore may engender substantial delays.

Duties of the Trustee

The Bill places additional duties on a trustee who agrees to carry out a proposed arrangement. His investigation into the debtor's affairs must be adequate to enable him to arrive at an opinion and to report to the creditors that the debtor has dealt fairly with them and that the debtor has not entered into transactions or disposed of property in fraud of his creditors. In sum, the trustee must exercise the same vigilance in respect of preferential and reviewable transactions as he would if a bankruptcy order had been made against the debtor and bring any such facts to the notice of the creditors.

Formulation of Arrangements by Court

The Bill also permits Court formulated arrangement, adopting a feature of the Farmers Creditors' Arrangement Act. Recognizing that a firm may be the life blood of a community, the Bill empowers the Court to formulate a proposed arrangement in respect of a debtor whose debts exceed one million dollars, if the Court is of the opinion that in the public interest all efforts should be made to continue the firm in business rather than dissolve it through the bankruptcy process. The Court, may, however, decline to formulate an arrangement where the proposed arrangement would not be just and equitable to the creditors.

PART V - BANKRUPTCY
(Sections 134-234)

PRESENT LAW

The law applicable to insolvent debtors is now set out in several federal statutes. The Bankruptcy Act applies to all individual and corporate debtors other than financial intermediaries and railway companies, which are subject to specific insolvency provisions set out in the respective regulatory acts that apply to them. The Winding-Up Act applies mainly to the liquidation and dissolution of solvent business corporations but can also apply to any insolvent corporation, whether incorporated federally or provincially. An insolvent corporation, however, can be compelled to be wound up under the Bankruptcy Act. These repetitive and frequently overlapping insolvency laws engender much uncertainty and confusion.

Commencement of Bankruptcy Proceedings

The present Bankruptcy Act does not give any practical relief to a small debtor whose total liabilities are relatively small. Nor does it permit anyone who is not a creditor to initiate any action when he becomes aware that a debtor is in financial difficulties. This exclusive reliance on creditors often defeats the purposes of bankruptcy law, especially where, on the one hand, creditors are unaware that the debtor is attempting to save himself from utter ruin or, on the other hand, to preserve for himself, at their expense, as many of the unencumbered assets as possible. As a result, it does not adequately protect the public interest.

Stay of Proceedings

To prevent a scramble among creditors, the Bankruptcy Act, upon the bankruptcy of a debtor, automatically stays any legal proceedings against a bankrupt except where a Court expressly permits such proceedings to be initiated or continued. But this automatic stay generally does not affect secured creditors whose rights may be postponed only by an order of the Court and then only for a period not exceeding six months. A secured creditor may often realize his security interest by prompt repossession and disposal of the debtor's property even before being restrained by Court order, thus leaving little or nothing for other creditors. In contrast, the Winding-Up Act stays all legal proceedings by creditors to enable the liquidator to obtain a complete overview of the debtor's affairs.

Discharge of the Bankrupt

The filing of an assignment by and the making of a receiving order against an individual automatically operates as an application for his discharge from his status as a bankrupt, but in order that debts and liabilities may be released, the Court must make a formal order of

discharge. Upon hearing an application for discharge, a Court has power to suspend a discharge or to impose conditions on the bankrupt. The practice of granting discharges varies widely across the country. Debtors often fail to obtain an unqualified discharge, and as a result they continue to have the status of bankrupt and to be subject to a bankrupt's civil disabilities, particularly the bar against carrying on business on credit. Corporate bankrupts must apply formally for discharge which is granted only if creditors' claims are paid in full, a case that rarely occurs.

The status of bankrupt to which a corporation is subject, however, does not affect the human agents - the directors and officers - who control it; they are free to embark on new ventures almost unblemished by the status of the corporation they managed. The only exception is the report, introduced by the 1966 amendments, that is prepared by the trustee and filed with the Superintendent of Bankruptcy and with the official receiver, which may impute blame for the bankruptcy to named directors and officers.

Although the report is available to the public, it is seldom effective to restrain the activities of persons who were responsible for the bankruptcy of a corporation, and it is grossly inadequate to cope with the problem of "planned bankruptcies".

Avoidance and Review of Transactions

Both the <u>Bankruptcy Act</u> and the <u>Winding-Up Act</u> contain provisions designed to enable the Court to set aside gifts, settlements and fraudulent preferences occurring within certain time periods before a bankruptcy or corporate dissolution.

PROPOSED LAW

The <u>Bill</u> sets out a comprehensive bankruptcy and insolvency system, integrating in one statute the usual insolvency provisions, which will now apply not only to ordinary business firms but also to insolvent financial intermediaries, insurance and railway companies, thus obviating the repetitive and overlapping provisions that now exist in the federal laws. In addition, the <u>Bill</u> introduces a number of important innovations relating to bankruptcies that are designed to render the proposed law clearer, fairer, and easier to administer.

Commencement of Bankruptcy Proceedings

Any person or corporation, without limitation as to the nature of his occupation or the amount of debt, may apply for a bankruptcy order in respect of himself. One or more unsecured creditors having aggregate claims in excess of $1,000 may also petition a debtor other than a farmer or fisherman into bankruptcy. A corporation found to be insolvent when it is being wound up under any other legislation, for example, a corporation law, must be brought within the framework of the bankruptcy statute. Specific rules apply to partnerships, stockbrokers and insurance companies.

Also, where a department or agency of the federal or a provincial government exercises regulatory or supervisory authority over the financial affairs of a debtor, it may initiate bankruptcy proceedings in respect of the debtor through the appropriate Attorney General where necessary for the protection of the public interest.

Stay of Proceedings

The present Bill modifies substantially the provisions regarding stay of proceedings. With respect to claims of unsecured creditors, the stay is absolutely binding on the creditor as of the date of filing of a petition for a bankruptcy order, unless the creditor is expressly excepted by Court order. With respect to a secured creditor's claim, many innovations are set out in the Bill to enable the trustee better to evaluate the overall condition of the debtor's affairs and to plan his administration accordingly without unduly interfering with the rights of a secured creditor. First, where a petition is filed, the stay does not apply against a secured creditor unless the court expressly states otherwise. Second, where a bankruptcy order is made, a secured creditor's rights to deal with property of the debtor are, subject to certain exceptions, stayed until ten days after the date of the first meeting of creditors or after the filing of a proof of security interest, whichever is the later. This limited stay should give the trustee time to elect whether he should redeem or require the property to be realized or surrender it to the creditor. Specific rules govern the conduct of the trustee, depending upon the election he makes. Where a trustee needs more time to determine the course of action he should take in the best interest of the estate, he may apply to a court for a further stay where this can be done without materially adversely affecting the secured creditor.

Whenever a stay applies with respect to a secured creditor, the Bill provides that he may nevertheless exercise a number of remedies of a protective nature, such as disposing of property that is perishable or likely to depreciate rapidly in value. On the other hand, the Bill imposes certain duties on the secured creditor where he realizes property subject to a security interest; the secured creditor must act honestly and in good faith, realize property in a timely and commercially reasonable manner, and make full disclosure to the trustee of any action taken in respect of the property.

Government creditors, whether the Crown in right of Canada or a province or a subordinate agency, are in nearly all circumstances treated like all other creditors. If a government creditor makes a claim as a secured creditor it must file a proof of security interest showing that it has perfected its security interest in the same manner - by registration or otherwise - as any other secured creditor is required to perfect his security interest.

Exempt Property

Continuing the policy of the present Act, property held in trust, property that is exempt from seizure under a provincial law, disablement benefits, and amounts payable under a retirement savings plan registered under the Income Tax Act do not vest in the trustee. Also, as a general rule, wages and property acquired by a bankrupt before he is discharged do not automatically vest in the trustee; but where the bankrupt earns an income in excess of $500 per month or acquires by gift or otherwise property in excess of his reasonable requirements the trustee may apply to the Court for an order vesting the excess in him for distribution among the creditors.

Consumer Bankruptcies

Another feature of the Bill is to provide simplified procedures in the case of consumer bankruptcies. For the purpose of the Bill, a consumer is defined to include any individual whose debts do not exceed twenty thousand dollars, excluding debts secured by the principal residence of the debtor. Some of the special procedures include the following: income tax refunds resulting from the over-deduction of taxes at source do not vest in the trustee; no meeting of creditors will be held unless the majority of creditors expected to be paid. These simplified procedures should accelerate the proceedings and cut down on costs without depriving the creditors of their right to control the administration of these estates.

Discharge of the Bankrupt

When a bankruptcy order is made in respect of a debtor, the debtor is released from all his debts except a fine, an obligation in respect of a bail bond or recognizance, an obligation to pay family maintenance, or any debt arising out of fraud where the debtor has been convicted of such fraud under the Criminal Code. Also, he is not released from a debt he failed to disclose to the trustee, but his continuing liability is limited to the amount the creditor would have received had the trustee known about the claim.

Consonant with the administration by exception policy of the Bill, a debtor is not required to apply to a Court for a discharge. A corporate bankrupt can be discharged only if it pays all its debts in full. An individual bankrupt is automatically discharged when the bankruptcy order is made and will cease to be a bankrupt six months after the date of the bankruptcy order affecting him unless the administrator files, within that six-month period, a caveat stating he has reasons to believe that the bankrupt substantially aggravated his insolvency by reckless business conduct, gross incompetence, carelessness or similar means, or that he has committed specified bankruptcy offences. The trustee of the estate as well as any creditor of the bankrupt may apply to the Court for an order directing the administrator to file a caveat. The Court may also set aside a caveat that has been filed. If not set aside the caveat has effect for 5 years or such shorter period of time as may be ordered by the Court, thus hindering the bankrupt from obtaining credit to carry on business and continuing his liability to the estate for wages or after-acquired property in excess of his reasonable needs.

The procedure described above also applies to an "agent" or "former agent" of a bankrupt. A caveat may be filed within one year of the bankruptcy of a corporation against an agent or former agent by the administrator or on an application to a court by the trustee of the estate or a creditor of the bankrupt. With a view to promoting the integrity of the credit system, the Bill empowers the Court to revive all debts from which a bankrupt has been released within 5 years of his current bankruptcy, if the Court is of the opinion that the bankrupt has abused the bankruptcy process to the detriment of his creditors.

Directors and Officers of Corporations - Liability and Discharge

The Bill introduces several new provisions concerning the status and personal liability of directors and officers of corporations. First, the Bill prohibits a bankrupt from continuing to act or from being elected or appointed as a director of a corporation. Second, the Bill imposes personal liability on directors and officers and former directors and officers (within 2 years before the bankruptcy) for debts of the corporation that remain outstanding as claims against the estate, where the director or officer has in his own interest - and hence in breach of his fiduciary duty to the corporation - continued to carry on a business that was not in the interest of the corporation, continued to carry on business by resorting to sales below cost or similar improper means, conducted business with a view to delaying or defrauding creditors, or committed specified bankruptcy offences. Third, a director or officer is also personally liable for outstanding corporate debts if he fails to keep accounts that enable the trustee to distinguish between the corporation's property and the property of the director or officer. Finally, where a bankruptcy order is made in respect of a corporation, the directors and former directors of the corporation are jointly and severally liable to employees of the corporation for unpaid wages not exceeding $2,500 for each employee.

Avoidance and Review of Transactions

The Bill sets out a comprehensive code in respect of fraudulent transfers and preferential payments in respect of both arm's length and non-arm's length transactions. The purpose of the code is to include, as far as possible, those transactions that have the effect of defeating the legitimate expectations of honest creditors. It attempts to achieve this purpose by extending the provisions in the present Bankruptcy Act and by bringing the law more into conformity with prevailing business practices.

The proposed Bill includes a specific section designed to render inoperative, unless otherwise ordered by the Court, provincial laws on fraudulent preferences and conveyances in the case of insolvency because of the decision of the Supreme Court of Canada in the case of _Robinson v. Countrywide Factors Ltd_. (1977) 23 C.B.R. (n.s.) 97. In that case the Supreme Court, by a majority decision, decided that the Saskatchewan _Fraudulent Preferences Act_ is not ultra vires and that sections 3 and 4 of that _Act_ are not specifically in conflict with the fraudulent preference provisions of the _Bankruptcy Act_. As implied by the Chief Justice, who wrote the minority judgment, there is in fact an overall conflict between the two systems: the bias of the _Act_ is to encourage creditors to keep a debtor alive, for example,

by supplying inventory without great risk until bankruptcy is imminent; the bias of some provincial laws is to favour the mass of the creditors at the expense of the creditor who took the risk of continuing to supply inventory while the debtor was in financial trouble. Because there is a clear and sharp conflict between policy objectives, the Bill expressly provides for federal occupation of the preferences field where a bankruptcy order is made.

With respect to gifts, a court may set aside any transfer of a gratuitous nature or with a merely nominal consideration where the interest of the donor does not pass irrevocably at least six months before the filing of a bankruptcy petition; this time period is extended to one year where the gift is made between related persons. In addition, the court may set aside a gift where, at the time the interest of the donor passes irrevocably, the donor is insolvent or unable to pay his debts without the aid of the property comprised in the gift. These rules are based on the basic principle that before being generous with his property a debtor must provide for the payment of his debts.

With respect to transfers that have the effect of giving a preference to a creditor, the Bill distinguishes between a transfer made by persons who deal with each other in an accepted business manner and a transfer made by persons who do not so deal with each other. In the first case, which is known as a preference at arm's length, the court may set aside the transfer only if the trustee can prove that it was made less than six months before the filing of the petition and with the intent of the insolvent debtor to give a preference. In the case of a non-arm's length preference, the burden of proof that the transfer was not a preference is normally on the creditor. The Bill deals specifically with preferences granted by a debtor to a person who had previously guaranteed his debts.

The proposed Bill reintroduces the common law intent to prefer test. However, it clarifies that proof of the intent of a debtor to give a preference is normally sufficient and declares that evidence that a transfer was made under pressure is not receivable to substantiate such transfer.

In addition to the above provisions, the Bill deals specifically with the problems created when a debtor makes a lump sum payment of premium on an insurance policy, assigns accounts receivable due to him, or substitutes other property previously released or returned by a creditor. It also sets out the powers of the Court where a transfer is set aside and deals specifically with the recovering of property or its value where such property has been reconveyed to another person.

As a general defence, the Bill provides that a Court may not set aside a transfer if the creditor proves that at any time after the transfer was made the debtor was solvent. In any case, proceedings to avoid transfers caught by the code must be brought by the trustee within 3 years of the date of bankruptcy.

Leases of Real Property

To deal with a frequent and particularly intractable problem the Bill sets a number of provisions to specify the respective rights, duties and powers of a lessor, lessee and the trustee where a lessee becomes bankrupt. In particular, the Bill makes clear the trustee's right to occupy the leased property and to retain or disclaim the lease and also the lessor's right to receive rent. In addition, the Bill contains provisions to clarify the rights of a sub-lessee and of a mortgagee of the leasehold.

PART VI -- ARRANGEMENTS AND BANKRUPTCY
(Sections 235-317)

PRESENT LAW

Part V of the present Bankruptcy Act sets out the substantive rules that govern the most important aspects of estate administration, including rules relating to filing proofs of claim, staying of creditor proceedings, priorities among creditors and the resulting scheme of distribution, creditors and inspectors meetings, and the powers of boards of inspectors. These rules also apply, in most circumstances, to a proposal made by a debtor under Part III.

Claims Against an Estate

Any creditor, whether secured or unsecured, may file a claim with the trustee if his claim arose before the date of bankruptcy. Where a claim is merely contingent or is for an unliquidated amount, the trustee has to apply to the Court for directions. The Court may value the claim or, where damages have to be assessed, direct that the issue be tried.

The Act empowers the trustee to reject or reduce any claim that a creditor cannot prove, but he cannot reject or reduce it on the ground that the underlying transaction was harsh or unconscionable or that the cost of borrowing was excessive. In Provinces having legislation against unconscionable transactions, the trustee must apply to a Court to rule on the validity of the claim under the applicable law.

Release of Debts

When a bankrupt obtains his discharge from the Court, he is released from all debts and liabilities except those within a small category, such as a fine or penalty, debts incurred fraudulently, family maintenance, and debts for necessaries. Despite this release from his debts, it is possible for a creditor to take advantage of the discharged debtor's financial plight and induce him to pay the released debt. Whether a subsequent promise to pay a released debt is valid is not clear under existing law, but if a creditor gives further credit to the debtor on condition that the debtor also repays the released debt, it appears that the obligation in effect revives, unless it can be repudiated as an unlawful penalty or unconscionable under provincial law.

Scheme of Distribution

Although not immediately clear from the text of the present Act, the law in fact divides creditors into four classes: secured, preferred, ordinary unsecured, and deferred creditors. Except as mentioned above, the secured creditor remains essentially outside of the statutory scheme of distribution, free to exercise his rights against the debtor's property unless the trustee intervenes. And even then the secured creditor has absolute priority to the extent of his security interest. Preferred creditors are creditors to whom

Parliament has given special priority to ensure the administration of the estate or to achieve greater equity among claimants. These preferred claims include funeral expenses, costs of administration, the Superintendent's levy, arrears of wages, arrears of municipal taxes, three months rent arrears, U.I.C. and Workmen's Compensation withholdings and so on. After these preferred claims are paid in full, the ordinary unsecured creditors share any balance rateably. If, after unsecured creditors are paid, a further balance remains, it is paid rateably to the deferred creditors. Any remaining surplus is paid to the debtor. All creditors in a specific category are paid rateably. But the order of priority is strict: no payment is made to a lower priority creditor until all higher priority creditors are paid in full.

Meetings of Creditors

The present Act requires the trustee to call the first meeting of creditors of an estate within 5 days of his appointment and hold it within 15 days after the notices have been mailed. It sets out the procedure at meetings, including quorum, voting and proxies. The purpose of the meeting is to inform the creditors of the financial affairs of the bankrupt, to appoint inspectors, to affirm the trustee's appointment or to substitute another trustee, and to obtain directions from the creditors. Because under the present Act the secured and preferred creditors claims rarely leave any residue to satisfy the claims of ordinary unsecured creditors, a recurring problem in recent years has been the difficulty of obtaining a quorum at the first meeting of creditors in almost all but large estates. This is especially true of summary administration cases (individual bankrupt having less than $500.00 assets after deducting secured creditors claims). As a result, the administration of an estate during the first, and often critical weeks, is delayed and the checks on the powers of the trustee that the meeting is designed to provide are generally ineffective.

PROPOSED LAW

Part VI of the Bill introduces a number of significant changes to the present law. It applies to commercial arrangements under Part IV and to all bankruptcies including consumer bankruptcies unless expressly stated otherwise.

Claims Against the Estate

The Bill empowers the trustee summarily to set aside or reduce any claim, priority or security interest on property. His decision may be appealed to the Court. The Bill also requires the trustee to value contingent and unliquidated claims filed with him. Again, his valuation may be appealed to the Court.

Release of Debts

A bankruptcy order has the effect of releasing the debtor from all debts and liabilities except (a) a fine or penalty imposed by a Court, (b) a debt arising out of a recognizance or bail bond, (c) a liabiliby to maintain a spouse or child for a period subsequent to an arrangement or bankruptcy and (d) a debt arising out of fraud where the debtor has been convicted of such fraud under the Criminal Code. A debt thus released cannot be revived by agreement even if the creditor furnishes new consideration.

Scheme of Distribution

The Bill sets out an order of priority that reduces considerably the classes of preferred creditors (certain administrative costs, wage arrears, lessor's claim for three months arrears of rent, and Crown claims for moneys deemed held in trust up to a maximum of the cash on hand or on deposit), clarifies the position of ordinary unsecured creditors, and particularizes the rights of deferred creditors. Although long, the order of priorities provisions of the Bill, which are necessarily the nucleus of a bankruptcy law, attempt to clear up what is an unnecessarily archaic and complicated area of the law.

Meetings of Creditors

Although it varies time periods slightly, the Bill essentially continues the basic policies of the present law: the trustee is required to call the first meeting of creditors, which must be held within 30 days of the date of the bankruptcy order; and the trustee may call any subsequent meeting of creditors and is required to do so when directed by the Court, the board of inspectors, or a specified number of creditors.

One of the policies of the Bill is to encourage creditors to participate more actively in estate administration, therefore the Bill sets out a fairly detailed code of procedures to govern meetings of creditors, the election of inspectors, and the rights and duties of inspectors. To make possible improved representation for minority creditors the Bill permits a creditor to cumulate his votes and cast all of them for one inspector.

Because creditors have little interest in estates with few assets, they frequently neglect to attend meetings, even to elect a board of inspectors. The Bill therefore empowers the Superintendent to appoint inspectors where the creditors fail to do so and to appoint an inspector where the Crown is a creditor.

International Insolvencies

The Bill sets out flexible international insolvency provisions that will give a court broad discretion to permit coordination of insolvency proceedings in Canada with concurrent bankruptcy proceedings in another jurisdiction.

PART VII -- SECURITIES FIRMS
(Sections 318-330)

PRESENT LAW

The present Bankruptcy Act contains no special provisions concerning the bankruptcy of securities firms, notwithstanding that such bankruptcies have proved to be especially complicated and problematical.

These bankruptcies are inherently complicated because a securities firm's business is complicated. It trades securities in large volume on volatile markets on its own behalf and for customers. It pledges its own or customers' securities with banks to secure operating loans and purchase money loans for its customers. It holds securities in various ways for customers. Many are in the name of the securities firm or another securities firm, endorsed, and bear a bank guarantee of signature ("street form"). Some are in the customer's name but endorsed so that the securities firm may trade at its discretion or for the customer's convenience. Some are in the customer's name and endorsed, but segregated and identified as belonging to the named customer. Some are in the customer's name and both unendorsed and segregated. Complicating matters further, the securities firm frequently holds free cash balances for customers that arise from securities sales and dividend receipts.

Frequently, when a securities firm gets into serious financial difficulty it fails to comply with either the Securities Act or regulations, stock exchange or IDA rules, or even the customer's instructions, and as a result the rights of creditors and customers to specific securities and to free cash balances become completely confused. Under the present law, when a bankruptcy occurs, the trustee is required to unravel what is usually a tangled mess in order to identify and distinguish between ownership rights in specific property and mere creditors' claims. To do this he must apply complicated common law rules concerning the identity of the owner of a security and even more complicated equitable tracing rules based on the idea that a broker holds securities, if fully paid, as constructive trustee for his customer, entitling a customer to recover that quantity of securities from the assets of the estate, in effect with priority over other creditors, even where he cannot be specifically identified as owner of the securities. As a result, a particular customer's priority usually is determined as a matter of pure chance, depending on the degree of the securities firm's misconduct, the form of the security, its status on the corporate securities register, the manner in which the securities firm segregated or identified it, or the way the securities firm dealt with it (e.g., permitting recovery of a gift or a preference).

PROPOSED LAW

In its Report, the Bankruptcy Study Committee recommended that the proposed bankruptcy law contain a separate part dealing with the bankruptcy of securities firms, following generally the model set out in the current United States Bankruptcy Act §60e.

Further study by the policy analysts revealed that although the U.S. statutory model is more refined than the present Canadian common law, it is not clear that it is either fairer or more efficient. In order to establish priority among claimants, the U.S. statute continues to distinguish among the nature of a customer's claim against the broker (dividends received for the customer, cash received in connection with securities trades, securities held for a customer), the manner in which a broker keeps his customer accounts (cash or securities clearly allocated to a customer, securities kept in segregated bulk, securities clearly earmarked as a customer's property, etc.), and the form of the securities certificate (in a broker's name--"street form", in a customer's name and not endorsed, etc.). While clearer than the common law, this particular statutory model leads to a myriad of legal complications and, consequently, to great administrative delays and demonstrable inequities among customers and other creditors of a stockbroker.

The analysts, therefore, considered a wide range of possible alternative models.

(1) Ordinary commercial bankruptcy, subject to identification and tracing rules, that is, the present common law.

(2) Customer preference over trade creditors but no limit on the securities identification and tracing rules.

(3) Customer's preference over trade creditors with constraints on the identification and tracing rules, limiting those remedies to the recovery of money or securities a claimant can "...specifically identify as allocated to a customer", which is in essence the U.S. model as set out in the Chandler Act of 1938 (now §60e of the U.S. Bankruptcy Act).

(4) Customer preference over trade creditors to the extent of cash and securities held by the stockbroker, and customers and trade creditors sharing the other assets rateably.

(5) No customer preference and, instead, all assets placed in a common fund that customers and trade creditors share rateably.

From an administrative point of view, the fifth model is the most attractive alternative because it is unambiguous, efficient and arbitrary. But like most arbitrary systems it would sacrifice fairness to efficiency, for when a bankrupt securities firm has substantial trade creditors it could be grossly unfair to customers, who perceive themselves more as passive depositors of a financial intermediary rather than as ordinary creditors.

In response to this perception, the draftsmen of the first Bankruptcy Bill (which died on the Order Paper at the end of the 1st Session of the 30th Parliament), recommended model (4) above, which was designed to give customers a substantial priority over other creditors but, at the same time, to bar customers from claiming so-called, "specifically identifiable" money or securities. Generally, the proposed system worked as follows: (1) all monies and securities of customers are placed in one asset pool and all other assets are placed in a second asset pool; (2) customers claim rateably against the first asset pool; (3) customers having unsatisfied claims claim

rateably with ordinary unsecured creditors against the second asset pool; and (4), any remaining assets are distributed to deferred creditors and then deferred customers. Although a reasonably efficient system, it too was widely criticized as being excessively arbitrary, in particular because it would force a customer, who had carefully instructed a securities firm to keep his money and securities segregated, to place his assets in the common customer asset pool and to make a rateable claim against that pool. More specifically, securities firms argued cogently that a customer would be most reluctant to leave money or securities in the possession or under the control of a securities firm if he was aware he would not be entitled to claim his specifically identifiable property in the event the firm became bankrupt.

Persuaded by this argument and two other factors-- first, the existence of the securities industry's contingency fund (an analogue of a deposit insurance fund to protect customers), and second, the closer surveillance of securities firms by the securities commissions and self-regulatory organizations, which largely preclude a firm from losing control over its records-- the Government decided to abandon in part the proposed model and to set out in Part VII, instead, a variation on model (3) above. This is, in essence, an adaptation of the U.S. Bankruptcy Act §60e, modified to tighten the definitions of "specifically identifiable property" with a view to minimizing the interpretation problems that have rendered §60e largely ineffective.

But the proposed Part VII does not abandon completely the model proposed in the first Bill. The major difference is that where the claims of customers of a bankrupt securities firm are not paid in full by the estate or an "insurer", customers are entitled to recover their specifically identifiable property. But where the customers' claims are paid in full, the model originally proposed obtains, creating separate pools of customer assets and creditor assets, distinguishing among arm's length customers, non-arm's length customers ("related customers"), and persons who caused or contributed materially to the bankruptcy of the securities firm ("deferred customers"), and relegating the related customers to a second priority and the deferred customers to a last priority.

In brief summary, the proposed model operates as follows. A "self-regulatory organization" or a creditor may initiate bankruptcy proceedings in respect of a securities firm. In any event, a petitioner must give pre-notice of the proceedings to each relevant securities commission. The general rules concerning the vesting of the bankrupt's property in the trustee (which exclude a customer's specifically identifiable property), the broad powers of the trustee to continue the bankrupt firm's business, and the fraudulent transfer and fraudulent preference rules apply to the bankruptcy of a securities firm.

More specifically, the trustee is empowered to elect, within 30 days of the date of bankruptcy, to satisfy all or part of any claim of a customer against the estate by delivering to the customer securities of the same class to which he was entitled on the date of bankruptcy, irrespective of any change in value of the securities after that date. In other words, the trustee has discretion to keep the customer at risk during that 30-day period. If during that 30-day period the trustee is able to pay all customers' claims, either because the bankrupt firm owns sufficient money and securities or because an "insurer" undertakes to furnish sufficient money or securities to the estate,

the issue of identifying or tracing a customer's "specifically identifiable property" becomes completely irrelevant. And because an insurer is not specifically subrogated to the rights of the customers, the insurer is not entitled to claim specifically identifiable property in order to establish its priority over related customers, secured creditors, ordinary unsecured creditors, deferred creditors and deferred customers. The insurer only acquires the priority rank of customers when claiming the aggregate amount it paid to the estate. This model therefore continues some of the undesirable characteristics of the U.S. Chandler Act of 1938, but nevertheless, where an insurer steps in, it resolves the central problem: it obviates customer reliance on the identification and tracing concepts and thus reduces the customers' recovery costs and, even more important, eliminates recovery on the basis of chance.

Where, however, an insurer does not step in to cover customer losses, each customer is entitled to claim his specifically identifiable property, compelling the trustee to scrutinize with great care each bank account, each cheque and each security certificate, and relegating the customer to a claim that is based more on luck than on prudence or law.

In either case, after returning any specifically identifiable property or delivering any securities to a customer in payment of the customer's claim, the trustee is required to divide the remaining assets of the broker into two funds: (1) a "general fund" made up of all property of the securities firm as of the date of bankruptcy; and (2) a "customers' fund" made up of all money and securities held for customers other than any customer's specifically identifiable property. In the course of processing proofs of claim against an estate, in addition to distinguishing among secured creditors, preferred creditors, ordinary unsecured creditors and deferred creditors, the trustee must also distinguish among arm's length customers, "related customers" who are associates or affiliates of the bankrupt firm, and "deferred customers" who caused or materially contributed to the bankruptcy of the firm.

Generally, out of the customers' fund the trustee pays the claims of arm's length customers (or of an insurer) and related customers. And out of the general fund the trustee pays the costs of administration, the claims of preferred customers, any remaining claims of arm's length customers (or of an insurer) rateably with the claims of ordinary unsecured creditors, any claims of related customers, the claims of deferred creditors and, finally, the claims of deferred customers.

Although not mentioned, the Bill presumes that the appropriate securities commission and self-regulatory organizations ("SRO") will cooperate fully with the trustee in bankruptcy to enable him to administer the estate of a securities firm with the least possible amount of regulatory delay. Indeed, in the typical case of a securities firm insolvency, it is probably that an SRO will initiate the bankruptcy proceeding, the contingency fund ("insurer") will act at once to satisfy the claims of arm's length customers, and then the contingency fund will press the trustee for recovery from the estate, thus ensuring expert intervention to press customer claims and to maintain oversight of the trustee's administration of the estate. In such a case the contingency fund

is declared to be a creditor of the estate to the extent it furnished money or securities to satisfy customer's claims and entitled to vote accordingly. Thus it is only where an insurer does not intervene to pay customers' claims in full that customers have claims as creditors. Where an insurer does intervene, the customers are treated essentially as passive depositors, much like depositors of a bank who are protected by deposit insurance.

PART VIII -- INSURANCE COMPANIES
(Sections 331-353)

PRESENT LAW

The present Bankruptcy Act does not apply to insurance companies. An insolvent insurance company may be wound up only under the Winding-up Act, which applies to insurance companies that are incorporated or carry on business in Canada.

The common insolvency tests--excess of liabilities over assets or inability to pay debts as they become due--do not apply to determine whether an insurance company is insolvent. Instead, specific rules set out in the Winding-Up Act deem an insurance company to be insolvent if it fails to pay a claim for which it is clearly liable within 90 days, if the Superintendent of Insurance refuses to renew its registration because the company is not in a position to meet its liabilities, or if its registration is withdrawn under an Act that deems such withdrawal to constitute insolvency.

Where an insurance company is insolvent, the company itself, a creditor or the Attorney General of Canada upon the request of the Minister of Finance may apply to a Court for an order to liquidate the company.

Upon making the liquidation order the Court may appoint one or more liquidators--who may be but are not required to be licensed trustees in bankruptcy--to administer the liquidation. Under the general scheme of the Winding-Up Act, however, the liquidator's functions are largely formal since the Court is required to approve in advance almost every administrative act. The creditors have no role in the liquidation other than to express their views when so requested by the Court. The inspectors, too, are appointed by the Court; their function is to advise the liquidator rather than to represent the creditors' interests. The Superintendent of Insurance, although he may initiate the winding-up by refusing to renew registration of an insurance company, has little or no power to control the liquidation.

Reflecting the special character of the insurance business, the Winding-Up Act empowers the liquidator to reinsure policies issued by the company instead of returning unearned premiums to the policy-holders, in effect transferring the insurance coverage to another insurer. Otherwise the liquidation of an insurer is presumed to be comparable to that of any business corporation. The liquidator gathers in and liquidates the assets, identifies the claimants and qualifies their claims, and distributes the assets to the claimants in accordance with the following order of priority set out in the Winding-Up Act: (1) liquidation costs; (2) wage earner claims for 3 months arrears of wages; (3) claims under policies and unearned premiums; and (4) claims of other creditors.

The present law applicable to the winding-up of insurance companies is defective in several respects. Administration is excessively legalistic, resulting in unnecessary costs and delays. The administrative system largely ignores the strategic role of the appropriate superintendent of insurance as regulator of the insurance industry. And finally, the substantive rules relating to what constitutes insolvency, the distinctions between different

kinds of insurance, and the treatment of persons holding life policies as distinct from health and accident, liability, and property policies are demonstrably inadequate.

PROPOSED LAW

The principal policy goals of the Bill are to bring insurance company bankruptcies as far as possible into the mainstream of bankruptcy law, to involve the appropriate superintendent of insurance directly in the insolvency process, to streamline administrative procedures, and to clarify a number of substantive issues that are ambiguous in or absent from the present law.

Under the Bill, much as under the present law, the Attorney General of Canada or of a province on his own initiative or upon the request of the Minister responsible for the law applicable to insurance companies, the company itself or a creditor may initiate bankruptcy proceedings. In addition to the general insolvency tests of the Bill--excess of liabilities over assets or cessation to pay debts generally as they become due--there are a number of specific tests that apply to insurance companies, relating generally to the non-renewal or cancellation of the insurer's licence and, in the case of a foreign company, failure to maintain sufficient assets in Canada.

The major changes effected by the Bill concern administration. As in any other bankruptcy, the trustee is required to be a licensed trustee (each superintendent of insurance is deemed to be a licensed trustee) and the creditors maintain policy control over the liquidation through inspectors they appoint. In addition, however, specific rules empower the appropriate superintendent of insurance to attempt a rescue operation. A petition for a bankruptcy order affecting an insurer must be served on the superintendent before being filed in Court. The bankruptcy proceedings are automatically suspended for 60 days (unless the superintendent consents to a shorter delay) to give the superintendent time to determine whether the company has enough assets to enable it to reinsure its outstanding policies with other insurers or, alternatively, whether some other company will amalgamate with or buy the business of the insolvent company. Reinforcing this policy, the Bill provides that policies issued by the insolvent company subsist 45 days after the date of the bankruptcy or for such longer period as may be agreed on between the trustee and the insurer in order to give each insured adequate time to seek coverage elsewhere. Moreover, during this period of time reinsurance policies issued in favour of the insolvent company are deemed to subsist. For any premium deficiency the reinsurer ranks as an ordinary creditor. In sum, great emphasis is placed on protecting the insured, part of the cost of which is borne by the insurance industry as a whole.

In order to promote maximum rescue attempts of an insolvent insurance company, the proposed Bill allows a proposed arrangement to be filed in respect of such company under Part IV where the filing is authorized by a superintendent of insurance. If all rescue attempts prove unsuccessful, the bankruptcy order is made as in any other case. Unless he declines appointment, the appropriate superintendent of insurance automatically becomes trustee. If he declines, a licensed trustee is appointed and confirmed by the creditors, and the superintendent of insurance maintains surveillance by becoming automatically a member of the board of inspectors.

The general administration rules of the Bill apply to insurance company bankruptcies. Special substantive rules are added, however, to distinguish between holders of life policies and holders of non-life policies, particularly to make possible special orders of priority relating to life insurance (or life and other classes of insurance) on the one hand and other classes of insurance business on the other and to integrate these with the general priority rules of the Act. More specifically, the Bill provides for distribution in accordance with the following orders of priority:

(1) Life insurance (or mixed life and other insurance) companies.

  (a) Costs of administration.

  (b) Payable rateably, the net amount payable to beneficiaries because of the death of the insured, the value of the policy where no claim has been made, and the proceeds of agreements to settle claims deposited with the company.

  (c) Claims of other creditors in accordance with the usual bankruptcy rules.

(2) Non-life insurance companies.

  (a) Costs of administration.

  (b) Claims under non-life policies.

  (c) Claims for the value of subsisting policies.

  (d) Claims of other creditors in accordance with the usual bankruptcy rules.

  (e) Expenses of the federal Superintendent of Insurance.

Although more detailed and seemingly more complicated than the rules that apply to insolvent insurance companies under existing law, Part VIII, recognizing the special nature of the insurance business, sets out a system that is fairer to third party claimants and policy-holders, better integrated with the regulatory scheme, and certainly easier to administer.

PART IX -- RECEIVERSHIPS
(Sections 354-359)

PRESENT LAW

The appointment of a sequestrator or receiver is an ancient legal institution designed to empower a creditor, acting through the receiver as an independent third party, to take possession of the debtor's property in which the creditor has a security interest with a view to preserving the property, collecting rents, or even liquidating the property to realize his claim. In all jurisdictions in Canada other than Quebec, a receiver may be appointed either by the court, in which case he is an officer of the court, or by the creditor in accordance with the express terms of a mortgage or trust indenture, in which case he is usually characterized as an agent of the debtor and not of the creditor. In Quebec, the same ends may be achieved by the judicial appointment of a sequestrator to manage property pending resolution of a dispute or the extra-judicial appointment of an agent for a creditor in possession pursuant to the terms of a trust indenture. For convenience the Bill covers both a receiver and an agent of a creditor in the definition "receiver".

A receiver may be appointed by a court or extra-judicially by a creditor because the debtor is in default in respect of one of a great many possible conditions stipulated in the agreement creating the security interest; for example, failure to insure, failure to pay property taxes, improper sale of inventory covered by a floating charge, improper assignment of accounts receivable, improper conversion of the proceeds arising from the sale of secured assets, and so on. More frequently however, a receiver is appointed because the debtor is insolvent or becomes bankrupt.

Under the present Bankruptcy Act, because the bankruptcy administration is generally subject to the prior rights of secured creditors, a receiver may be appointed before or after the date of bankruptcy to take possession of all the assets of the estate, leaving few if any assets to be administered by a trustee in bankruptcy. This is particularly true where the creditor has a very comprehensive security interest under a trust indenture. Such a security interest can include a specific charge on identifiable assets, and also a floating charge on present and future-acquired revolving assets, such as inventories and accounts receivable, which floating charge crystallizes as a fixed charge at the moment of bankruptcy or even before bankruptcy upon the appointment of a receiver.

That is not to say, however, that a trustee in bankruptcy should always be involved in the administration of assets of a debtor subject to a secured creditor's security interest, for frequently the assets can be realized more effectively by a receiver. Under present law, however, there is no mechanism to permit either the unsecured creditors or the Superintendent of Bankruptcy to maintain any surveillance over the receiver's conduct to ensure that the receiver acts fairly, keeping in mind the residual claims of all subordinate creditors.

PROPOSED LAW

Recognizing that the appointment of a receiver is an effective remedy to protect legitimate creditor interests, the Bill does not attempt to displace receivers in all cases where a bankruptcy occurs. But a court may, upon the application of an interested person, impose additional duties upon a receiver, terminate the appointment of a receiver and appoint another person in his place or make some ancillary order, where it appears that there might be a surplus left after the secured creditor realizes his security, unless the receiver proves to the satisfaction of the court that a court order would materially adversely affect the creditor or that any surplus is improbable.

Thus instead of setting out rules to govern the conduct of a receiver in case of insolvency, the Bill empowers a court, where it decides to intervene, to give directions to the receiver or his successor with respect to all dealings with the debtor's property. And in any case the receiver is required, upon demand, to furnish specified information about the receivership to a bankruptcy administrator or a trustee in bankruptcy. In sum, these procedures ensure, on an exceptions basis, that the interested parties will have the right to know by what authority a receiver acts and what he is doing and also to apply to have a court intervene where it appears there might be a surplus available for distribution among the subordinate secured creditors, the persons having claims against the debtor's estate, and the debtor, particularly where there are grounds for believing a receiver is not acting honestly or in good faith or is not dealing with the property of the debtor under his control in a commercially reasonable manner.

The Bill sets out statutory standards relating to a receiver's duty to act in good faith and duty of care. Although probably only declaratory of present law, the good faith standard serves as a constant reminder to a receiver that he is, like a corporate director or officer, a fiduciary and therefore must not only act honestly but must also avoid any material conflict of interest or duty that might prejudice the debtor. The standard of care, which requires that a receiver deal with a debtor's property in a commercially reasonable manner, is probably also largely declaratory of existing law, but it makes clear that a receiver, when realizing property of a debtor, has a statutory duty to use reasonable care or, in other words, a duty not to sacrifice negligently the interests of the debtor to the interests of the creditor for whom the receiver acts. Like the corporation law provisions relating to the fiduciary duty and duty of care of directors and officers, these duty provisions do not attempt to establish any static rules or even specific standards of conduct, reflecting the reality that both the fiduciary duty and duty of care concepts are relativistic by nature and therefore depend largely on the circumstances or factors of each case. Nevertheless, this statutory provision should dispel any doubts about a receiver's duty in relation to an insolvent debtor, irrespective of whether the receiver is appointed by a court or under a contract or whether he is characterized as an agent of the debtor or of the secured creditor.

PART X -- OFFENCES
(Sections 360-380)

PRESENT LAW

The principal purposes of the penal provisions set out in the present Bankruptcy Act are to promote commercial honesty and to ensure that the estate of a bankrupt is lawfully administered. These offences complement the offences set out in the Criminal Code and can be invoked as a basis for prosecution only after a bankruptcy actually occurs. Some provisions, however, reach back to cover offences--e.g., fraudulent transfer or receiving of property--that occurred before the date of bankruptcy.

In general, these penal provisions promote commercial morality by making it an offence for a debtor alone or acting in concert with one or more of his creditors to conceal or misappropriate property that should have fallen into the debtor's estate. And these penal provisions ensure honest administration by making it an offence for any unqualified person to act as trustee, for a creditor to make a false claim, for an inspector to accept an unlawful fee, or for a trustee to commit a breach of specified statutory duties.

The various offences set out in the present Act, depending upon their relative seriousness, are punishable on indictment or on summary conviction. Prosecution of an indictable offence must be commenced within 5 years and prosecution of a summary conviction offence must be commenced within 3 years of the commission of the offence. In most cases, the applicable penalty is mandatory imprisonment.

The 1966 amendments to the present Act increased considerably the Superintendent's powers to undertake or to direct the detection and investigation of suspected bankruptcy offences, enabling him to initiate investigations instead of simply urging the appropriate provincial Attorney General to act. Also in 1966 the Superintendent established detection and investigation divisions in regional offices across Canada, staffed by auditors and trained investigators who are better able to detect and investigate local cases. Contemporaneously, the R.C.M.P. established special bankruptcy squads in major centres to assist the Superintendent in his investigations.

In sum, therefore, a person suspected of a bankruptcy offence may be investigated and charged under the Bankruptcy Act, and, if the misconduct is also a general crime, may also be investigated and charged under the Criminal Code.

PROPOSED LAW

The proposed law essentially continues the substantive offences and the investigative procedures of the present Act. The Bill does, however, add several modifications: its scope is extended to include arrangements as well as bankruptcies; it authorizes an investigation to begin at once upon the commencement of insolvency proceedings; it removes the time limit on prosecuting indictable offences and reduces the time limit on summary conviction

offences to 2 years; it extends the bribery rules to include all persons involved in a bankruptcy administration--a bankruptcy administrator, trustee, inspector, solicitor or auctioneer; and it adds a new offence concerning the failure of a director of a corporation who becomes bankrupt to resign as director. The Bill also introduces new sentencing provisions, giving the Court greater discretion to impose a fine instead of imprisonment or to impose fine and imprisonment, rather than impose mandatory imprisonment, which is now the general rule.

PART XI -- COURTS AND EVIDENCE
(Sections 381-409)

PRESENT LAW

The present Bankruptcy Act, in contrast to the pre-1949 statute, does not create a separate bankruptcy court. Instead, in line with the general policy of Parliament not to establish a duality of Courts, it vests original jurisdiction with respect to bankruptcy matters in the Superior Court of each province. Generally, however, the Chief Justice of the province specifically assigns one or more judges to exercise judicial powers conferred by the Act and appoints or designates the registrar, clerks and other officers to transact the business of the court. Proceedings before the court are instituted and conducted in accordance with the General Rules enacted pursuant to the Act, or, in cases where the Act or the Rules make no provision, in accordance with the ordinary rules of procedure of the Court that apply to civil matters. In addition, in respect of bankruptcy matters, the Act requires the court to have a seal, makes each court auxiliary to each other court, and makes an order of one court enforceable by another court anywhere in Canada.

PROPOSED LAW

Part XI of the Bill proposes to continue the basic structure and authority of the court; but in addition it provides for the transfer to the court of any proceedings taken in any court if they affect the rights and interests of a bankrupt or his estate with a view to eliminating jurisdictional conflicts.

Under the Bill, estate accounts would continue to be passed by the registrar, subject to appeal to the court. The bankrupt is automatically discharged when the bankruptcy order is made and will cease to be a bankrupt 6 months after the date of the bankruptcy order unless a caveat is filed within that period, shifting the onus to the debtor to apply to the court to have the caveat removed.

Two other important innovations are included in this Part of the Bill. First, wherever the words "upon application" are used throughout the Bill, these words mean, under subsection 386, that any interested person has the right to apply to a court, unless the Bill otherwise states expressly who may apply. Second, a court is granted the power to shorten or extend the period of time during which a proceeding must be taken or an act or thing done under the Bill, either before or after the expiration of the prescribed time.

Part XI of the Bill also deals with rules of evidence in bankruptcy proceedings. It includes provisions clarifying in what circumstances and under what conditions a document made in the course of a proceeding or the evidence of any person examined pursuant to the Act is admissible. The Bill also simplifies the rules that apply where property of a debtor is seized and held as evidence of an offence under the Bankruptcy Act or the Criminal Code by providing that an order of a judge containing a description of the seized property is receivable as evidence, instead of the property itself or a sample of it, as is presently the case.

PART XII -- GENERAL AND TRANSITIONAL
(Sections 410-420)

PRESENT LAW

The four statutes proposed to be repealed or in effect abrogated by the Bill--the Bankruptcy Act, the Winding-Up Act, the Companies' Creditors Arrangement Act, and the Farmers' Creditors Arrangement Act--contain a number of miscellaneous provisions of general application and also relatively broad rule-making powers to prescribe regulations governing administration, court practice and procedure, and tariffs of fees.

PROPOSED LAW

The Bill, in Part XII, attempts to consolidate these general rules in one Part. These general rules are designed to resolve on a Canada-wide basis specific problems that recur frequently: e.g., rules concerning the estate of a deceased bankrupt, the continuance of a statutory limitation or prescription period while a proceeding is stayed under the Bill, and the capacity of married persons.

This Part also consolidates all the pertinent regulation-making powers which under the present Winding-Up Act are vested in the courts and under the Bankruptcy Act are vested in the Governor-in-Council but supplemented by rules of court. Under the Bill all regulation-making powers vest in the Governor-in-Council. These include power to make regulations authorized or required to be "prescribed", to determine the form and time of notice, to establish fees for specific services, and to establish the amount the Superintendent may levy against each estate to recover his administrative costs.

Consistent with the overall concern of the Bill to adhere to exacting administrative law standards--for example, administration by exception to minimize unnecessary paper work, express licensing criteria to guide judicial review of licensing decisions, express right of appeal to a court in respect of the taxation of accounts, and judicial control over many investigative powers--the Bill subjects the regulation-making powers exercised under it to close public scrutiny, particularly by requiring pre-publication of proposed rules and forms.

The Bill sets out a number of transitional provisions to make clear that existing proceedings will continue under the former law, and also to ensure that a cross reference in the statutes or corporate constitutions to a predecessor Act such as the Winding-Up Act is deemed to be reference to the new act. Finally, the Bill provides that, unless he receives an earlier discharge under the present Act, each individual who became bankrupt under the present Act is automatically released from his debts within five years from the date of his bankruptcy, a transition policy that is consonant with the automatic discharge provisions of the proposed law.