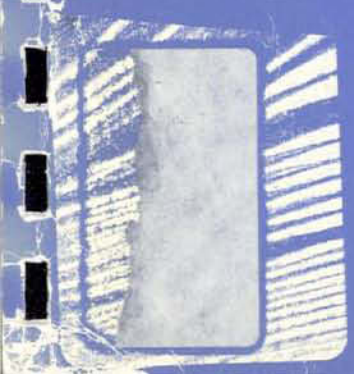
Bureau de la
coordination
des politiques

Bureau
of Policy
Coordination

BANKRUPTCY ACT AMENDMENTS

Consommation
et Corporations
Canada

Consumer and
Corporate Affairs
Canada



BANKRUPTCY ACT AMENDMENTS

PROPOSALS FOR DISCUSSION

Legislative Review Branch
Bureau of Policy Coordination
Consumer and Corporate Affairs

September 1986

Bankruptcy Act Amendments

Proposals for Discussion

TABLE OF CONTENTS

	Page
Introduction	i
Wage-Earner Protection	1
Secured Creditors and Receivers	4
Commercial Reorganizations	9
Consumer Arrangements and Bankruptcies	10
Preferred Claims	13
Technical Amendments	14

INTRODUCTION

1. The basic purposes of the Bankruptcy Act are to provide for the orderly and fair distribution of a bankrupt's property among his creditors and to permit an honest but unfortunate debtor to obtain a discharge from debt, subject to reasonable conditions.

2. The present Bankruptcy Act was enacted in 1949. Within a few years numerous complaints began to arise that the Act had become inefficient, obsolete and incapable of coping with fraudulent bankruptcies. As a result, the Act was amended in 1966, expanding the investigatory powers of the Superintendent of Bankruptcy, tightening the rules regarding fraudulent preferences, incorporating the concept of "related persons", and enabling trustees to deal more effectively with improper transactions by a debtor, and providing for the orderly payment of debt system in Part X.

3. The Study Committee on Bankruptcy and Insolvency Legislation (known as the Tassé Committee) was also appointed in 1966 to review bankruptcy and insolvency legislation in Canada. The Tassé Committee undertook an in-depth study of Canadian bankruptcy law and in 1970 published its report, recommending the enactment of a completely new bankruptcy and insolvency statute that would establish an integrated and comprehensive bankruptcy system.

4. From 1970 to 1984, a prolonged effort was made to enact a new bankruptcy statute. Six bankruptcy bills, largely inspired by the Tassé Committee report, were introduced into Parliament over that period. The first was Bill C-60, introduced in 1975; succeeding revisions to Bill C-60 incorporated recommendations made by the Senate Standing Committee on Banking, Trade and Commerce as well as various interested private groups. The most recent proposal, Bill C-17, was introduced in January 1984. None of these bills was enacted.

5. In March 1985, the previous Minister of Consumer and Corporate Affairs appointed a special Advisory Committee composed of trustees and lawyers from across Canada. Its mandate was to examine the bankruptcy system, assess possible reforms and recommend to the Minister amendments to the Act that would make it more flexible and bring it more into line with current conditions. The Report of the Advisory Committee on Bankruptcy and Insolvency was tabled in January 1986.

6. In view of the failure of six previous attempts to reform bankruptcy law by way of omnibus legislation, it was decided to amend the Bankruptcy Act in phases, beginning with an initial package of amendments in six areas, namely:

   a) Wage-Earner Protection
   b) Secured Creditors and Receivers
   c) Commercial Reorganizations
   d) Consumer Arrangements and Bankruptcies
   e) Preferred Claims
   f) Technical Amendments

7. The proposals that are presented in this document are based upon an examination of the Committee's Report by the Department of Consumer and Corporate Affairs and extensive consultations held with interested groups and the Provinces. These proposals are for the purposes of discussion and do not represent final positions. The proposals address the six above mentioned issues.

8. The basic aims of the present revision are to promote the rehabilitation of financially troubled, but viable businesses and to improve protection for wage earners. The sections on secured creditors and receivers, commercial reorganizations and preferred claims provide measures that would enhance such rehabilitation. In addition, a comprehensive scheme to improve wage-earner protection is proposed.

1. WAGE-EARNER PROTECTION

A. Nature of the Protection

I. Issue

The requirement that secured claims be satisfied first causes two major problems. Few assets are left for unpaid wage earners and the payment of dividends, if any, is very slow.

II. Proposal

To overcome these problems, it is proposed that a wage-earner protection fund be established.

III. Rationale

The creation of a fund is the best way of ensuring prompt and certain payment of wages.

B. Scope of the Protection

I. Issue

The current Bankruptcy Act provides very limited protection in the sense that only bankruptcy situations are covered and that the existing monetary limits are out of date and much too low.

II. Proposals

It is proposed that the fund cover not only bankruptcies but also receiverships (when due to insolvency) and that the employee should be entitled to a maximum amount of $2,000 (net of taxes) for arrears of wages (including statutory fringe benefits) and to $1,000 for arrears of expenses incurred on behalf of the employer. These amounts would be prescribed by regulations. Moreover, this protection would not be subject to any time constraint. Consideration is being given to covering other fringe benefits that are part of the employment contract.

III. Rationale

Studies indicate that receiverships are a very significant source of unpaid wages both in terms of the number of employees that are affected and amounts involved.

Considering net, rather than gross wages would avoid penalizing employees having a high rate of taxation and therefore would result in a more equal treatment of all employees. Furthermore, a monetary cap is required not only

to prevent abuses but also to keep the contributions to a reasonable level. Without a limit, employees might continue to work for long periods without being paid, knowing that the fund would reimburse them. To prevent abuses against the fund, an option would be to have a scheme under which employees would receive full compensation for a portion of their claims. However, the other portion would be subject to only partial payment.

Given that the scope of protection is subject to monetary limits, there would be no need to impose time constraints.

As regards fringe benefits, it is proposed that neither termination pay nor severance pay should be covered. Although these are payments made by employers, they are not debts in the same sense as earned but unpaid wages. Also, the payment by the fund of severance pay and termination pay would defer an individual's entitlement to U.I. benefits. Consequently, contributors to the fund would have to bear the costs which otherwise would be assumed by the federal government through the U.I. program. Covering severance and termination pay could increase very substantially the claims filed with the fund and would certainly increase the risk of an employer deliberately not giving employees notice of termination, knowing that a fund would provide them with payment in lieu of notice.

As regards monetary entitlement, after a close examination of the data provided in an Ontario report ("The Brown Report"), it would seem that a $2,000 monetary limit would be satisfactory. Average per employee claims for wages in both bankruptcies and receiverships was $985, according to data presented in the report, while the figure was $385 for vacation pay. Although Brown's data are a few years old, the figures suggest that the $2,000 monetary limit would be adequate.

C. The Financing of the Fund

I. Issue

Existing estimates reveal that wage-earner claims filed with the fund would likely be in the range of $30 to $50 million annually. Although it is hard to come up with precise estimates on potential costs of a fund, a scheme to generate substantial funds is needed to make the fund self-financing.

II. Proposal

It is proposed that the fund be financed through contributions. In this regard, there is a preference for having all employers and employees, including governments, contribute to the fund.

III. Rationale

A system of contributions would allow for the fund to be self-financing and for the rate of contributions to be easily adjusted to meet the fluctuating demands upon such a fund. No government funding would be required.

Since the responsibility for paying wages lies with employers, it seems fair that they should have to contribute to the financing of the fund. On the other hand, as the beneficiaries of the fund, it seems justifiable to have wage earners contribute to the fund.

Finally, in order to minimize the impact on any particular employer or employee, the Department contemplates the possibility of requiring all employers and employees, including governments, to contribute to the fund.

D. The Administration of the Fund

I. Issue

Assuming that the fund would be financed through contributions, the fund administrator would likely have to set the rate of contributions, verify indemnification requests, ask for enquiries when needed and, more importantly, ensure prompt payment of wage claims. The question is who would be most appropriate to carry out these tasks.

II. Proposal

It is proposed that the Office of the Superintendent of Bankruptcy be entrusted with the administration of the fund.

III. Rationale

The Superintendent's Office has the general expertise in insolvency matters needed to detect abuses of the system. Also, the close links already developed between the Office and trustees would facilitate communication with trustees and receivers. Finally, the administration of the

fund would vest with the Department which is responsible for the Bankruptcy Act, permitting quick intervention to remedy the possible weaknesses of the system. For these reasons, the Office of the Superintendent should be able to handle the administration of the fund efficiently.

E. Other questions

I. Issue

Two other questions regarding the fund which warrant consideration are:

- the status of existing provincial legislation
- the right of subrogation.

II. Proposals

It is proposed that the federal legislation regarding the fund should have priority over provincial legislation. However, the provinces should be able to supplement the federal legislation.

It is proposed that the fund be subrogated to the rights of the employees and rank as a preferred creditor.

III. Rationale

Provinces would be free to legislate if they wish to provide additional protection. However, since this is an insolvency matter, the legislation creating the fund would have precedence over provincial legislation.

The subrogation right would help the fund to recuperate some of its expenses. Making the fund a preferred creditor would increase its rate of recovery and therefore limit the required amount of contributions. Furthermore, as creditors, the administrators of the fund would be able to attend creditor meetings and act as inspectors.

2. SECURED CREDITORS AND RECEIVERS

A. No Restraint on Enforcement of Security

I. Issue

Upon default by the debtor, a receiver accompanied by a bailiff can take possession of the security and can move quickly to liquidate it with the result that debtors are denied the opportunity to rectify financial problems or work out arrangements with their creditors before secured creditors act to liquidate.

II. Proposals

To remedy this lack of restraint on enforcement of security we propose a two-part scheme of statutory stays of proceedings which would work as follows:

Part I (to be initiated by the debtor)

a) A debtor would be able, at any time, to file a notice of stay with the Official Receiver indicating his desire to negotiate a reorganization plan with his creditors. Upon filing such notice, proceedings of all creditors secured or unsecured would be stayed for 30 days. At any time during this 30 day period, the secured creditor would be able to apply for the appointment of an interim receiver to protect his security.

b) During this 30 day period, the debtor would work out the details of his reorganization plan. The preparation of his plan might involve negotiating with his main creditors.

c) Upon filing the reorganization plan, a meeting of the debtor's creditors would have to be convened within 21 days (which corresponds to the period provided in the present Act).

Part II (to be initiated by the secured creditor)

d) Where no notice of stay had been filed by a debtor, a secured creditor wishing to appoint a receiver or realize his security would have to give 10 days notice of his intention to appoint a receiver or realize the security.

e) There would be no automatic stay of proceedings upon the appointment of a receiver.

f) On application from the secured creditor, an interim receiver could be appointed during the 10 day period to take conservatory measures.

g) If, after the expiration of 10 days, the debtor has not acted to regularize his loan situation, nor filed a notice of stay (see (h) below), the secured creditor would be able to realize his security. However, the debtor would retain the right to file a proposal for reorganization as long as the secured creditor did not realize his security.

h) If, within this initial 10 day period from the secured creditor's notice, the debtor filed a notice of stay, proceedings would be stayed for 30 days and the procedure in paragraphs a) to c) above would apply.

III. Rationale

This proposal would avoid court involvement in receiver appointments with its attendant costs and delays. It would provide for sufficient stays of proceedings to enable debtors to effectively negotiate arrangements. By requiring debtors to take the initiative in seeking stays, it would help to ensure that stays take effect only where debtors are serious about rectifying their situations. By allowing a debtor to initiate proceedings, it would enable him to cope with creditor pressure apart from action by secured creditors to appoint receivers or realize their security.

The provisions for interim receivership would protect creditors during the stay periods.

This proposal would strike a fair balance between the interests of debtors in having sufficient opportunity to rectify their affairs and those of secured creditors in preserving the value of their securities and protecting their investments.

B. Conduct of Receivers and Secured Creditors

I. Issue

The law gives secured creditors little incentive to respect debtor interests or to obtain the best surplus possible over the amount of the loan when they do liquidate.

II. Proposal

To remedy this lack of incentive, it is proposed:

a) that the courts should be empowered to give directions that the secured party comply with statutory obligations, that the asset not be disposed of or that an accounting be taken;

b) that secured creditors and receivers be required to notify trustees of their intention to realize the security; and

c) that statutory duties be imposed on secured creditors and receivers to act in good faith to realize the property in a timely and commercially reasonable manner, and to report on conservatory measures taken.

III. Rationale

These proposals would provide added protection against abusive secured creditor action at little or no extra cost to creditors.

C. Lack of Information

I. Issue

The Act imposes no obligations on secured creditors to consult unsecured creditors and debtors prior to the liquidation of the assets or to provide relevant information concerning the receivership. Some receivers do not even notify the creditors of their appointment.

II. Proposals

To remedy the lack of information, it is proposed that receivers be required to give notice of their appointments and to provide specified additional information including the particulars of the appointment, the amount of the debt, the nature of the security and the proposed action, within 10 days of their appointment, that they be required to provide semi-annual reports of their administration and that, upon request, they be required to provide to a trustee, official receiver or creditor, a report on the realization of the security.

III. Rationale

These requirements would not impose heavy costs on creditors and would ensure that debtors receive full and timely information about the progress of the receiverships.

D. Lack of a Summary Method for Review of Account

I. Issue

The Act does not provide for a prompt and inexpensive method for review of a secured creditor's accounts.

II. Proposal

To remedy this, it is proposed that a secured creditor or receiver be required to pass his accounts before the Court upon the request of the debtor or another creditor. The secured creditor would have to give notice to the debtor and other creditors of the passing of the accounts.

III. Rationale

This would ensure that debtors and other creditors would have the opportunity to obtain a full accounting of the secured creditor's administration.

E. Conflicts of Interest

I. Issue

The Act does not preclude persons involved in bankruptcies or receiverships, in particular trustees and receivers, from putting themselves in positions of conflict of interest.

II. Proposal

For more effective prevention of conflict of interest situations in bankruptcy practice it is proposed that directors, officers, employers, employees, creditors, accountants and solicitors of debtors and related persons, as well as trustees under trust indentures issued by debtors, be forbidden from acting as trustees without court approval; that trustees of persons related to debtors and receivers of property of related persons be forbidden to act as trustees without notifying other creditors and that trustees be forbidden to act for secured creditors claiming against the estate without obtaining a solicitor's opinion as to the validity of the security and notifying the creditors regarding their receiverships.

III. Rationale

These proposals would be flexible, and yet would address adequately the perceived need for better regulation of conflicts of interest.

F. Receiver Qualifications

I. Issue

The Act does not ensure that persons who act as receivers are qualified to carry out their responsibilities.

II. Proposal

It is proposed that the status quo be maintained and that no formal requirements be imposed.

III. Rationale

This proposal would avoid depriving capable persons from acting as receivers; it would avoid lessening of competition with the attendant higher costs.

G. Receivers' Fees

I. Issue

The Act does not ensure that the actions of a receiver and the fees he imposes may be expeditiously reviewed.

II. Proposal

It is proposed that receivers be required to tax their accounts at the trustee's request, and where there is no bankruptcy, that debtors or creditors be allowed to obtain an accounting, providing court leave is obtained.

III. Rationale

In reviewing accounts, the Court would have the right to revise unreasonable fees.

3. COMMERCIAL REORGANIZATIONS

A. No Stay of Proceedings by Secured Creditors

The proposals regarding stays were presented in the previous section on Secured Creditors and Receivers.

B. No Application of Proposals to Secured Claims

I. Issues

The Bankruptcy Act does not provide that the affirmative vote of the requisite majority of secured creditors in the same class binds all secured creditors in that class. Therefore, some businesses could not be reorganized without the unanimous agreement of all secured creditors. Also at issue is whether the requirement of acceptance by three-fourths (3/4) in value is higher than necessary to safeguard creditors' interests.

II. Proposals

In order to counter the present requirement of unanimous agreement of secured creditors and to ensure their participation in reorganization proposals, it is proposed that voting on proposals by class be established and that a 2/3 vote in value instead of 3/4 be required for proposals to be accepted. It is also proposed that clear and specific criteria regarding classes and class membership be developed. The U.S. experience could be examined in this regard.

III. Rationale

This proposal would ensure participation of secured creditors in proposal negotiations, a measure which hopefully would improve their chances of success. At the same time, class voting would protect the different interests of various classes of creditors.

C. Variation and Repudiation of Executory Contracts

I. Issue

The existing Act does not provide for variation or termination of executory contracts, such as leases and collective agreements, where these are so onerous as to impede or prevent reoganizations.

II. Proposal

We do not propose providing for judicial variation or repudiation of executory contracts. However, contractors would be induced to open contracts and to negotiate in good faith so that reorganizations could take place.

III. Rationale

Settlements on executory contracts, like other debts or obligations, can and usually would be worked out through negotiation.

4. CONSUMER ARRANGEMENTS AND BANKRUPTCIES

A. Consumer Arrangements

I. Issue

At present, there is no expeditious and inexpensive procedure whereby an individual debtor may avoid bankruptcy by making a proposal to his creditors to settle his debts by paying less than their full amount.

II. Proposal

It is proposed that a new streamlined system be installed. This system would require creditors to submit a proof of claim only where the amount of debt indicated by the debtor was incorrect. It would provide that a meeting of creditors to consider a proposal need be held only where creditors holding 25% in value of all claims have so requested. Finally the system would provide that the rejection of a proposal made by a consumer debtor would not automatically result in bankruptcy. It is proposed that the above changes be incorporated into Part X of the Bankruptcy Act.

Under the proposed system the provinces would be able to assume responsibility for the administration of consumer proposals. In those provinces that decide not to take up such offer, licensed trustees or counselling agencies would be given responsibility for their administration.

III. Rationale

These proposals would promote the rehabilitation of debtors without the stigma and expense of formal bankruptcy proceedings and would permit the repayment of outstanding debts in accordance with consumers' ability to pay either by extended terms, reduction of principal, forgiveness of service charges or by a combination of these elements.

B. Consumer Bankruptcies

a) Administration of Consumer Bankruptcies

I. Issue

The Bankruptcy Act now provides for two types of administration depending on the value of assets to be distributed to creditors: summary where it is anticipated that such amount will not exceed $500 and otherwise ordinary.

II. Proposal

It is proposed that the applicable type of administration be determined on the basis of the bankrupt's assets and, in particular, that summary administration apply when the debtor's assets are less than $5,000 or such other amount as may be prescribed.

III. Rationale

Debtors would be subject to the same statutory examination regardless of the amount of their liabilities so there would be no question of a bankrupt debtor using summary procedures to escape a thorough examination of his affairs. The important factor is the amount of assets available for distribution, since this determines the level of creditors' interest in the administration of a bankruptcy. The current $500 criterion which was set in 1949 and has never been adjusted and is now much too low. Examination of a sample of bankruptcy files by the Department reveals that under the proposed scheme, over 80% of consumer bankruptcies would be subject to summary administration.

b) Discharge of Bankrupt

I. Issue

In a large majority of cases, the proceedings relating to the bankrupt's discharge are routine and cause additional unnecessary expenses.

II. Proposal

It is recommended that a consumer bankrupt be automatically discharged nine months after the date of bankruptcy unless an opposition is filed, regardless of his earnings.

III. Rationale

Automatic discharge of a bankrupt would diminish procedural delays and costs in the administration of bankruptcies. Court hearings would only be required in cases where abuse or fraud was suspected.

c) Release of debts

I. Issue

One of the objects of the Bankruptcy Act should be to release the insolvent debtor from as many liabilities as possible. The purpose of not releasing debts for necessaries was to ensure that individuals would be able to purchase necessaries on credit without their creditors being concerned that such debts would be discharged if a bankruptcy occurred. Given the current extensive use of credit, individuals are able to obtain credit for the purchase of necessaries whether or not such debts are released in case of bankruptcy.

II. Proposal

As regards debts or liabilities which remain undischarged after bankruptcy, it is proposed that the Bankruptcy Act (i.e. Section 148) be amended to delete the reference to debts or liabilities for goods supplied as necessaries of life and also that the onus on the creditor opposing the discharge be somewhat increased.

III. Rationale

Given the current extensive use of credit and competition among credit-granting institutions, there is no longer a need to provide special protection for debts incurred to obtain necessaries of life. Also, increasing the burden of proof might prevent credit abuses.

5. PREFERRED CLAIMS

A. Crown Priority

I. Issue

The priority given to Crown claims, either by way of statutory deemed trusts and liens or under Section 107 of the Bankruptcy Act, has reduced the ability of a debtor to make a proposal to his creditors. Frequently, the requirement that claims of the Crown be paid in full before there is any distribution to the unsecured creditors prevents an effective reorganization. Also, unsecured creditors often do not take an active interest in the administration of a bankruptcy because all the proceeds of any recovery will go to the Crown as a preferred creditor.

II. Proposals

It is proposed that the priority in favour of all Crown corporations, federal or provincial be abolished. It is also proposed that a study be made of the possibility of varying the creditor status of the Crown depending on whether a bankruptcy situation or commercial reorganization situation is involved. Under this proposal, the status quo (i.e. preferred status for the Crown) would be maintained in a bankruptcy situation while the Crown would be given the status of unsecured creditor where a commercial reorganization was involved.

III. Rationale

Since most Crown corporations are in competition with private sector corporations in the market place, there is no apparent justification to give the former any preference over the latter.

One of the objectives of the present revision is to promote commercial reorganizations as a workable alternative to bankruptcy. The requirement that claims of the Crown be paid in full before any distribution to the unsecured creditors works against this objective. The proposed changes would encourage the making of commercial reorganizations. Also, in the longer run, governments would make up some of the losses resulting from the proposals as businesses continued, employment was maintained, etc.

B. Other Preferred Claims

I. Issue

It has been claimed that the preferred creditor status now given to certain claims other than Crown claims, in particular the legal costs of the first seizing creditor and a landlord's claim for rent is no longer warranted.

II. Proposal

It is proposed that the status quo with regard to all non-Crown preferred claims under the existing Act be maintained.

III. Rationale

Non-Crown preferred claims do not cause significant problems. The Advisory Committee recommended that the priority granted to landlords be abolished; however this would leave them exposed and could lead to disruption of the leasing market.

6. TECHNICAL AMENDMENTS

A. Trustees' Licensing

I. Issue

No person may act as a trustee of an estate without obtaining a licence. The present Bankruptcy Act states that the licence is to be issued and renewed annually by the Minister upon recommendation of the Superintendent. The procedure is long, costly and somewhat repetitive.

II. Proposal

It is proposed that a trustee licence be issued, renewed, suspended or cancelled by the Superintendent of Bankruptcy, with the right of appeal to the Federal Court.

III. Rationale

The cancellation or suspension of a trustee's licence is a decision of a quasi-judicial nature. Involving the Minister in such a decision unnecessarily would expose him to undue pressures.

B. Payments from Income of Bankrupt

I. Issue

The court has held that the provisions of Section 48 of the present Act do not apply to a self-employed person as a professional. Accordingly, an undischarged professional person earning a large income cannot be required to make any payments to creditors.

II. Proposal

It is proposed that the scope of Section 48 of the Act which enables a court to direct an undischarged bankrupt who is an employee to pay to the trustee part of his salary, be expanded to cover self-employed individuals.

III. Rationale

Individual bankrupts should be subject to the same obligations regardless of whether or not they are self-employed.

C. Housekeeping Amendments

The Department is presently working on a set of housekeeping amendments which will clarify and streamline certain administrative sections of the Bankruptcy Act.