CAIRP
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Submission of
Canadian Association of Insolvency and Restructuring Professionals

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Report on the Statutory Review of the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA)

To Industry Canada

July 15, 2014

"CAIRP and its members are committed to professionalism, trustworthiness and objectivity."

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July 15, 2014

I. Introduction and Acknowledgements

The Canadian Association of Insolvency and Restructuring Professionals ("CAIRP") is the national professional organization representing some 950 dedicated insolvency practitioners, notably trustees in bankruptcy. CAIRP's mission is twofold – it aims to educate and support its members in providing insolvency advisory services and to advocate a fair, transparent and effective system of insolvency to inspire the highest degree of public trust throughout Canada. As such, we support Industry Canada's activities relating to the statutory review of the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA) and we appreciate the opportunity to offer our recommendations in this regard.

CAIRP recognizes the efforts and commitment of all those individuals at Industry Canada who participated in this consultative process to result in meaningful Canadian insolvency law reform. In particular, CAIRP wishes to thank its two Task Forces made up of numerous trustees from across the country who played a leadership role in developing the ideas contained in this submission.

As a sign of our own commitment to ensuring that the legislation be thoroughly examined and modified every five years, nearly two years ago CAIRP established two Task Forces, one to review priorities for consumer insolvency reform and the other to identify those commercial issues that need to be explored and further discussed. The commercial group, furthermore, has worked as part of a Joint Task Force ("JTF") with the Insolvency Institute of Canada ("IIC") in order to ensure the most comprehensive possible review of commercial matters. Our submission is therefore divided into two parts.

Over the past many months, these Task Forces have met on a regular basis, to identify issues, review their impact on stakeholders and examine the experience of other jurisdictions where relevant and develop policy options. More precisely, members of the Task Forces were asked to:

- Identify those issues which CAIRP put forward in preparation for the 2009 amendments which were not accepted by the government and which remain relevant to improving the insolvency and restructuring system;
- Identify those aspects of the 2009 reforms which have not worked according to expectations and which need to be adjusted; and
- Identify new issues that have arisen since the 2009 reforms which need to be addressed in order to ensure an effective, fair and transparent insolvency and restructuring system.

The last statutory review, with amendments that came into effect in 2008 and 2009, resulted in a substantial reform of Canada's insolvency legislation. After five years of experience, however, we

feel that further amendments are needed in order for the legislation to remain modern, effective and efficient.

Our members, in addition to our nearly 300 articling associates and 200 corporate and life associates, are strongly committed to participating in the five-year statutory review and would be pleased to provide the government with further information or analysis in order to help prepare the Minister's report to Parliament.

II. Issues Being Considered for Amendment

Consumer Issues

Notes to Readers

The masculine form is used in our submission to simplify the text. No discrimination is intended.

"Debtor" refers to "a bankrupt, a consumer debtor under a consumer proposal, or an individual under a Division I proposal".

"Consumer" refers to "any member of the general public".

Executive Summary of Consumer Issues

CAIRP established the Consumer Advocacy Task Force in January 2013 to identify the high-priority consumer issues that need to be developed in preparation for the 2014 report on amendments to Canada's insolvency legislation. The members of the Task Force are listed in Schedule A of the Consumer Issues section of our submission.

In addition to the research conducted by members of the Consumer Advocacy Task Force, CAIRP commissioned outside research to expand our understanding on certain of the issues and to support our own policy development efforts.

We are confident that the analysis and recommendations we have put forward will make the consumer provisions of Canada's insolvency legislation more modern and better adapted to changes in the insolvency environment. Nevertheless, we recognize that more work needs to be done to further develop the details of any legislative reform proposals. As such, we are committed to continuing with this work in order to assist further in the policy development process.

Recommendations

Protection of Consumer Interests

Consumer Deposits

1. CAIRP does not recommend that consumer liens or other priorities be provided for consumer deposits in the BIA. We are of opinion that consumer deposits would be better protected, in both insolvency and non insolvency situations, if these were instead addressed through the respective consumer protection legislation of the various provinces and territories.

Responsible Lending

2. CAIRP recommends the regulation of responsible lending in Canada be done through standalone legislation or alternatively that it be addressed by provincial and territorial consumer protection legislation, as opposed to being included within the BIA. This would also ensure that responsible lending is applicable in all lending situations and not just situations involving BIA proceedings.

The "Fresh Start" Principle

Licence Denial Regimes

3. CAIRP recommends the addition of a provision to the BIA to forbid licence denial regimes. In order to respect both the “fresh start” principle and fair distribution amongst creditors principle, federal, provincial and territorial governments, or any other regulatory body, should be prohibited from denying, revoking, suspending or refusing to renew a license, permit or similar grant of a debtor, based solely on the grounds that the debtor has not paid a debt that is discharged under the BIA.

Reaffirmation Agreements

4. CAIRP recommends that the BIA be amended to provide that reaffirmation of unsecured debt that is discharged by insolvency proceedings is prohibited and unenforceable.

5. CAIRP recommends that the BIA be amended to provide that reaffirmation of secured debt by conduct is unenforceable.

6. CAIRP recommends that the BIA be amended to provide that reaffirmation of secured debt be allowed by express agreement only provided that a) the reaffirmation be done within a prescribed period of time and b) that the debtor must continue to make payments according to the original agreement.

7. CAIRP recommends that the prescribed period of time to reaffirm secured debt be nine (9) months from the start of insolvency proceedings and, in the event that the debtor does not

elect to reaffirm the secured debt within that prescribed period, that sections 66.34, 65.1 and 84.2(1) of the BIA would cease to apply which would allow the affected secured creditor the ability to deal with its security.

Consumer Exemptions

Registered Savings Products

8. CAIRP recommends that the BIA be amended to exempt from seizure property held in a Registered Disability Savings Plan and that any contributions in the 12 months prior to the date of the initial bankruptcy event be clawed-back and form part of the property divisible among creditors.

Federal Exemption Lists

9. CAIRP does not recommend the introduction of a list of federal exempt property at this time, as we believe the case in Canada to be substantially different than of other jurisdictions where insolvency legislation contains a federal list of exempt property.

Protecting Families

Equalization Claims

10. CAIRP recommends that section 178(1) of the BIA be amended to provide that debts related to equalization and division of property against exempt property not be released by order of discharge.

11. CAIRP further recommends that the stay of proceedings under sections 69, 69.1, 69.2 and 69.3 of the BIA remain unchanged and continue to apply to all matrimonial litigation matters, including claims for equalization or division of property against exempt assets.

Family Support Claims and the Levy

12. CAIRP recommends that the BIA be amended to require section 178 creditors to provide debtors with a credit for the levy paid under BIA rules 123(1) and 123(2), given that the levy should be shared by all creditors who benefit from the proceedings.

Vesting of Family Property Claims

13. CAIRP does not recommend that the vesting of the bankrupt's right to sue a former spouse for equalization or division of property under provincial/territorial matrimonial property law be excluded as property vesting in the trustee.

Joint Debts

14. CAIRP recommends that section 142 of the BIA be amended to provide that it applies to partners in a business partnership and that the term "partnership" be defined under section 2 of the BIA as a relationship between two or more individuals, organizations or groups

who carry on business together.

Treatment of Student Loans in Bankruptcy

Discharge of Student Loan Provisions

15. CAIRP recommends that the time period during which a student loan may not be discharged pursuant to section 178(1) (g) be reduced from seven (7) to five (5) years after the date on which the bankrupt ceased to be a full- or part-time student. This would ensure that all debtors receive consistent treatment for student loans across Canada.

16. CAIRP recommends that section 178(1.1) be clarified to provide that the time period for relief must be calculated from the date when the debtor was last a student in the program for which the government-funded student loan relief is sought. CAIRP further recommends that if a debtor takes a leave from studying for over a year, or some other prescribed time, the time period for relief should not restart. This ensures consistent and fair application of section 178(1) (g) for government-funded student loans.

17. CAIRP recommends that the time period under Sections 178(1)(g)(i) and (ii) which limit the dischargeability of government-funded student loans be removed from the BIA and be prescribed in the Bankruptcy and Insolvency General Rules instead. This would facilitate future changes should they be required due to changes in provincial student loan relief measures or other changes.

Hardship Discharge

18. CAIRP recommends that the waiting period for a hardship application under section 178(1.1) of the BIA be changed from five (5) years to the date of the debtor' s automatic discharge or the date of the debtor's actual discharge hearing.

Partial Release of Debts

19. CAIRP recommends that section 178(1.1) of the BIA be amended to provide the courts with discretion to grant partial relief with respect to some or all of the student loans of a debtor. CAIRP further recommends that the factors to be considered in granting relief to debtors on student loan be expanded in order to provide better guidance to the courts in determining the terms of the relief.

Administrative Issues

Renaming the Bankruptcy and Insolvency Act

20. CAIRP recommends that the name of the BIA be changed to the "Insolvency and Restructuring Act" and that the term "Trustee in Bankruptcy" which trustees are required to use in the OSB's Advertising Directive be changed to a term that better reflects the broad range of services that trustees offer under the BIA.

Restricting Consumer Proposals

21. CAIRP does not recommend restricting consumer proposals to debtors that have no business debts as there is no evidence of abuse in the use of consumer proposals to settle business debts. In cases involving Canada Revenue Agency and its efforts to collect its deemed trust claims in the consumer proposals, trustees have since adapted their practices by recommending those individuals file Division I proposals where the deemed trust is a material issue.

Technical Issues

Costs Against The Debtor

22. CAIRP does not recommend that section 197(6.1) be amended to award costs against the debtor.

Losses Due to Bankruptcy Offences

23. CAIRP recommends that section 204.3 be amended to capture all losses resulting from BIA offences rather than only those relating to loss of or damage to property as we believe that this will provide a better balance between creditors' and debtors' rights and better serve the public interest.

Disallowance of Claims

24. CAIRP does not recommend that the BIA be amended to provide the court with the authority to extend the 30-day period for appealing the disallowance of a claim.

Facts for Which Discharge Will Be Refused, Suspended or Granted Conditionally

25. CAIRP recommends that no substantial changes be made to the facts listed under 173 of the BIA for which discharge may be refused, suspended or granted conditionally , as these facts remain relevant in ensuring that the fundamental purposes of the BIA are respected and that the integrity of the Canadian insolvency system are maintained.

Treatment of RRSPs in Bankruptcy

26. CAIRP does not recommend introducing a provision to section 67 that would lock-in Registered Retirement Savings Plans, which are currently exempt under the BIA due to the absence of any evidence that there is any widespread abuse which would threaten the

integrity of the Canadian bankruptcy and insolvency system.

Secured Creditors' Right to Request a Meeting and to Vote in a Consumer Proposal

27. CAIRP recommends that sections 66.15(2)(b), 66.16(2), 66.17(1) and 66.19(1) of the BIA be amended to apply to unsecured creditors only as opposed to creditors generally.

28. CAIRP recommends that the BIA be amended to clarify that section 112 applies to secured creditors that wish to vote on the consumer proposal as part of the unsecured creditor class.

Criminal Proceedings – Section 205 of the BIA

29. CAIRP recommends that section 205 of the BIA be amended to provide that a trustee and the official receiver cannot be compelled to prosecute criminal proceedings by virtue of sections 504 and 507 of the Criminal Code or any other similar laws.

Third Time Bankrupts

30. CAIRP recommends that section 169(2) of the BIA be amended to increase the delay to apply to the court for an appointment for a discharge hearing from no later than one year to no later than three years after the date of bankruptcy.

31. CAIRP also recommends that the OSB issue a directive to trustees indicating when a hearing date under section 169(2) should be obtained. For third time or more bankrupts, CAIRP further recommends that the directive should mirror the provisions dealing with second time bankrupts, where the trustee would be required to obtain a hearing date in 24 months for a third time or more bankrupt with no surplus income or 36 months in the case of a third time or more bankrupt with surplus income.

Deemed Annulment of Consumer Proposals after Bankruptcy

32. CAIRP recommends amending section 66.31 of the BIA to include the filing of a bankruptcy as an event that results in the deemed annulment of a consumer proposal.

Publication in Local Paper

33. CAIRP recommends amending section 102(4) of the BIA to provide for publication of the notice of bankruptcy for corporate estates only and in the case of consumer estates only when it is required by the official receiver.

34. CAIRP further recommends that the requirement for publication in a local newspaper be removed from section 102(4) of the BIA and instead be prescribed in the BIA rules or in an OSB directive. This would allow the OSB to quickly adapt to any changes in marketplace should the use of newspapers for publication become obsolete.

Review of Prescribed Threshold Amounts in the BIA for Summary Administration and Consumer Proposals

35. CAIRP recommends that the prescribed amount for summary administration bankruptcies under subsections 49(6) & (8) and rule 130 of the BIA be increased to $20,000

36. CAIRP recommends that the prescribed amount under the definition of a consumer debtor under section 66.11 be increased to $325,000 for consumer proposals.

1. Consumer Deposits

Current Issue

When a retailer becomes insolvent, consumers who have provided deposits or pre-payments before receiving the contracted goods or services have no specific priority under the BIA. In 2003, the Senate Committee considered the merits of adding consumer liens to the BIA but recommended that the issue should continue to be governed by provincial legislation.[1] CAIRP considers whether, and how, Canada could enhance protection for consumer deposits either through consumer liens or, alternatively, through other mechanisms within the insolvency regime.

Impacts on Stakeholders

Consumers

The current regime often results in the consumers' total loss of their deposit due to their ranking as unsecured creditors in the retailer's bankruptcy. That being said, consumers who have made their deposit by credit card are often protected by the credit card issuer through chargeback provisions.

Creditors

Since there are no special provisions for claims with respect to consumer deposits under the BIA, there is no impact on the unsecured and secured creditors at the present time. If amendments to the BIA were to provide an enhanced status to consumer deposit claims, then the unsecured and/or secured creditors could be disadvantaged by getting lower recoveries on their claims.

Analysis

Defining Consumer Liens

Consumer liens provide consumer depositors with a priority or security over the assets of a retailer or business in the event that goods or services are not delivered.

Understanding the Canadian Background

Consumer deposits hold no specific priority or lien under the BIA. In some cases where a consumer has used a credit card to pay the deposit, he may be protected by the credit card issuer through the chargeback provision which protects the consumer when goods or services are not delivered. This protection is outside the realm of insolvency legislation.

The rights of buyers of prepaid goods and services are regulated to some extent by provincial consumer protection legislation, but in the absence of an insurance fund or other compensation, the consumer will be an unsecured creditor in the retailer's bankruptcy. As such, he must compete with all the other unsecured creditors, which often results in little or no recovery being available for these consumers.

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

The loss of a consumer deposit can also occur when companies simply close their doors without filing for bankruptcy or any other types of formal insolvency proceedings. In those specific situations where the consumer may not take advantage of credit card chargeback provisions, consumers are left with no recourse other than legal proceedings. The cost to initiate legal proceedings can be prohibitive for the consumer and if he does obtain a judgment against the retailer, he is unlikely to be able to execute on it as, more often than not, there are no assets left to execute against and the consumer will not receive anything.

Examination of What Other Jurisdictions Are Doing

- Australia
  The *Consumer Credit Code* provides chargeback protections on credit card purchases or consumer deposits in the case of the bankruptcy of the retailer. There are no specific provisions for consumer deposits under the *Australian Bankruptcy Code*.

- United Kingdom
  Section 75 of the *Consumer Credit Act* provides a mechanism with respect to chargeback protections which is similar to the US system. There are no specific provisions relating to consumer deposits under the insolvency legislation of the UK.

- United States
  Section 507(a)(7) of the *US Bankruptcy Code* establishes a priority for unsecured claims of individuals arising from consumer deposits towards the purchase of goods or services for personal, family or household use. The priority ranks just below secured creditors and bankruptcy lawyers fees. Through the Federal *Fair Credit Billing Act*[2], consumers are allowed to dispute charges with credit card issuers for unshipped merchandise and to have the charges removed from their account[3]. To protect themselves from the chargeback, credit card processors may reserve or withhold other funds due to the retailer.

Options

There are four (4) options to be considered with respect to consumer deposits in the context of insolvency legislation.

1. Amend the BIA such that claims with respect to consumer deposits would rank within the order of priorities set out under section 136.
   It is CAIRP's opinion that giving a priority for consumer deposits in the bankruptcy of a retailer is unlikely to yield much recovery for consumers and therefore afford them very little protection.

2. Amend the BIA to provide security for consumer deposits by way of a consumer lien on the assets of the retailer.

[2] 15 USC 1601 and following; similarly, a number of states has introduced *Fair Credit Billing* legislation.
[3] 15 USC, section 1666.

It is our opinion that giving security for consumer deposits in the bankruptcy of a retailer is unlikely to yield much recovery for consumers and therefore afford them very little protection. This is assuming that the consumer lien or security would rank after all other pre-existing secured creditors and any other pre-existing deemed trust claims both at the federal and provincial levels.

3. Ensure that credit card companies continue to offer chargeback protection. Legislation that ensures that consumers are entitled to chargeback protection in the event that goods or services are not delivered would protect those consumers who make deposits with their credit cards. This would also protect consumers in situations where the retailer is not subject to insolvency proceedings. Many consumers already protect themselves through the use of credit cards that offer chargeback protection when goods or services are not delivered.

4. Protection through provincial/territorial consumer protection legislation. There are already some provinces that offer protection of consumer deposits for certain industries[4][5]. If additional consumer protection is desired in other industries where there is a history of abuse, then provinces and territories could add provisions to their consumer protection legislation to address these situations.

CAIRP's Recommendation

CAIRP does not recommend that consumer liens or other priorities be provided for consumer deposits in the BIA. We are of the opinion that consumer deposits would be better protected, in both insolvency and non insolvency situations, if these were instead addressed through the respective consumer protection legislation of the various provinces and territories.

2. Responsible Lending

Current Issue

In the wake of the 2008 financial crisis, creditors' conduct has received increasing international attention and there have been calls for legislative intervention in several countries for "responsible lending" regimes that would impose certain duties on creditors before they extend credit and restrict the insolvency remedies available to those who did not meet these duties. CAIRP debates whether, and how, the BIA could take into account creditor's conduct that has contributed to the financial difficulties or insolvency of a debtor.

[4] Ontario Travel Industry Act, 2002 and Ontario Regulation 26/05 and the Travel Industry Counsel of Ontario, http://www.tico.ca/about-tico/who-we-are.html.
[5] BC Business Practices and Consumer Protection Act and the Travel Industry Regulation, http://www.consumerprotectionbc.ca/consumers-travel-services/travel-assurance-fund.

Impacts on Stakeholders

Creditors

The enforcement of responsible lending legislation in Canada would lead to a tightening or possible elimination of lending options offered to higher risk borrowers, considering that an interest rate high enough to compensate the additional risk taken on by creditors due to increased regulation could violate the usury provisions of the *Canadian Criminal Code*[6].

Consumers

Enacting responsible lending legislation in Canada could negatively impact low-income consumers, who often depend on credit to cover basic household needs, such as food and payment of lodging and utilities, when they experience interruptions in income due to unstable employment or sickness. Because of the reduced access to credit, these higher risk borrowers would likely be charged higher rates of interest to mitigate the increased risk of the lender due to increased regulation.

Analysis

Defining Responsible Lending

Responsible lending is defined as a lender's duty to not knowingly nor recklessly extend more credit to a consumer than he or she can reasonably carry and can be expected to be able to pay off considering their existing and future financial circumstances[7].

Understanding the Canadian Background

Over the last three decades, consumption has dramatically increased through credit in most industrialized countries, including Canada[8]. During the same period, the number of consumer insolvencies has seen an important increase as well. The rising number of consumer insolvencies[9] may be explained by the ease with which consumers can access credit[10], in Canada and elsewhere.

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[6] Section 347 *Criminal Code,* RSC 185, c. C-46, describes and sanctions what is considered as criminal interest rates.

[7] Jacob Ziegel ,*Consumer Insolvencies, Consumer Credit and Responsible Lending,* Research paper prepared in fulfillment of the Lloyd Houlden Fellowship Award 2007 Canadian insolvency Foundation , p. 7, online http://www.cairp.ca/.

[8] Michael J. Bray, Q.C. and Micheline Gleixner: *Differing Climates of Bankruptcy: A question of Latitude?* Annual Insolvency Review (ARIL) 2011 p. 288.

[9] CGA, *Where is the Money Now: The State of Canadian Household Debt as Conditions for Economic Emerge* (British Columbia: May 2010) at p. 16 online: Certified General Accountants Association of Canada. http://www.cga-canada.org/en-ca/ResearchAndAdvocacy/Areaof Interest/Debt and Consumption/2010Report/Pages/ca.debt_index.aspx.

[10] Dr. Janis Sarra: *At What Cost? Access to Consumer Credit in a Post-Financial Crisis Canada,* Annual Insolvency Review, (ARIL) 2011 p. 415 "…one reason for the increase was that credit was extended to higher risk borrowers, but a higher interest rate was charged to compensate for any increase in risk to the lender…".

Even if bankruptcy and insolvency are of federal legislative competence, the Canadian federal government has given considerable leeway to the provinces in the consumer credit area[11].

Although the BIA contains provisions to prevent abusive behaviour by debtors, there is no regulation of the creditors' conduct. Advocates for responsible lending in Canada believe that such regulation should be incorporated within the Canadian lending and credit system as well as the Canadian insolvency system[12].

Examination of What Other Jurisdictions Are Doing

- Australia
  The concept of responsible lending was introduced in 2010 to the *National Consumer Credit Protection Act (NCCPA)* which requires that all lenders and credit grantors provide a written assessment of the suitability of the loan to the consumer. If the credit provider does not comply with responsible lending conduct obligations, he could be held liable to a civil penalty, which is payable to the consumer or to a government fund.

- United Kingdom
  Various measures to promote responsible lending are already in place, such as the sharing data within the lending industry and the scoring of credit prior to its extension. A new section has recently been introduced to the *Consumer Credit Act of 1974* mandating the Office of Fair Trading to consider any business practices that appear to involve irresponsible lending.

- United States
  Congress passed the *National Consumer Credit Protection Act 2009* to ensure that lenders assess the suitability of loans to the consumer. A financial ombudsman service was also created to hear disputes between consumers and lenders and claims of maladministration in lending. The *Credit Card Accountability Responsibility and Disclosure (CARD) Act (2009)* was adopted to amend the *Truth in Lending Act (TILA)* and to secure limits on fees, protection of young consumers and limits on re-pricing.

Options

CAIRP considers that there are three (3) options that can address the issue of responsible lending; specifically, creditors' conduct and its possible effects on a debtor's financial difficulties or insolvency.

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[11] In 2006, the *Criminal Code of Canada* was amended to give power to the provinces to regulate payday loans. See section 247.1 of the *Criminal Code*, RSC 185 c. C-46.

[12] Pre-bankruptcy measures would consists of duties imposed on creditors, such as examining the debtor's income and living expenses to satisfy themselves that the consumer debtor is in a financial position to meet the new commitments and the duty of full disclosure to the consumer debtor of all the terms of the agreement, cost of credit and fees; and
Post-bankruptcy measures, would consists of provisions contained in the BIA that would penalize creditors who have granted credit irresponsibly, these provisions could conceivably be as important as empowering the trustee or the court to disallow claims of a creditor who has granted credit irresponsibly or requiring such creditors to reimburse the bankruptcy estate payments made by the consumer on these credits or loan in the period leading up to a consumer insolvency.

1. Regulate responsible lending within the BIA.
   Taking into consideration the constitutional power of the federal government in the consumer credit area, the BIA could contain provisions to sanction creditors who lend irresponsibly. Nevertheless, in order to protect all consumers, responsible lending should apply to all lending and not just to situations that involve BIA proceedings.

2. Regulate responsible lending through standalone legislation.
   In November 2013, Consumer International published a report on responsible lending and its application throughout the world[13]. All of the 14 participating countries have sanctions to assure responsible lending but not as part of their bankruptcy or insolvency legislation. Rather, responsible lending is regulated by standalone legislation or consumer protection legislation. Accordingly, sanctions for irresponsible lending in Canada could be contained in standalone legislation, instead of in the BIA, or within provincial and territorial consumer protection legislation.

3. Maintain the status quo.
   Both consumers and lenders have responsibilities with respect to credit and debt; consequently, creditors' behaviour should arguably be regulated as much as debtors' behaviour. That being said, even though legislation on responsible lending exists in many industrialized countries, finding the resources needed to support its enforcement remains a challenge.

CAIRP's Recommendation

CAIRP recommends the regulation of responsible lending in Canada be done through standalone legislation or alternatively that it be addressed by provincial and territorial consumer protection legislation, as opposed to being included within the BIA[14]. This would also ensure that responsible lending is applicable in all lending situations and not just situations involving BIA proceedings.

[13] Jami Hubbard-Solli, Editor *Responsible Lending: An International Landscape* November 2013 online http:www.consumersinternational.org. Consumer International is the world federation of consumer rights groups. It is a registered UK charity and it has 240 member organisations spanning 120 countries. There are six Canadian consumer groups which are members of Consumer International. Fourteen member organisations from 14 different countries participated in the writing of the report, each authors choosing an aspect relevant to consumers in their country including actual lending practices.

[14] The question as to whether this would raise constitutional issues is beyond the scope of this submission.

3. Licence Denial Regimes

Current Issue

As the financial rehabilitation of debtors and equitable distribution among creditors are fundamental goals of the Canadian bankruptcy and insolvency regime, the refusal to renew driving licences, vehicle registrations and other similar grant of debtors, whose debts have been discharged by the insolvency process, unless they pay the debts associated with the said licences or permits go against these fundamental purposes. CAIRP debates whether amendments are required to the BIA to address the apparent conflict between the "fresh start" principle and the objectives of licence denial regimes.

Impacts on Stakeholders

Debtors

Denying debtors the possibility of obtaining or renewing a permit or a licence unless they make payments on a debt which was released by insolvency proceedings goes against the fresh start principal. In fact, some debtors with large debts may never be able to pay that debt which is offensive in light of the fresh start principle. Lastly, this could lead debtors with such indebtedness to choose to file an assignment in bankruptcy rather than a consumer proposal, as their focus will be on allocating all their resources to reimburse the debt related to the licence or permit as opposed to providing some recovery to the remaining creditors.

Creditors

Licence denial regimes effectively create a separate class of debts that survive bankruptcy outside of what is already provided for under section 178 of the BIA. Consequently, not all unsecured creditors are treated equally.

Analysis

Defining Licence Denial Regimes

Licence denial regimes relate almost exclusively to claims resulting from the use of motor vehicles; however, it also has application to other types of licences and permits such as professional licences.[15] Although a debt was stayed and then discharged through the insolvency process, under licence denial regimes, creditors can continue collection efforts (e.g. by refusing to renew a debtor's permit to operate a vehicle or refusing to renew his driver's licence) until arrangements are made to pay the debt.

Understanding the Canadian Background

In Canada, the determination of the rights of licence denial regimes to collect released debts has been left to the court, whereas in the United States these practices are explicitly barred by the *Bankruptcy Code*. Canadian advocates for the status quo argue that they only encourage voluntary payment since the licence or permit is not a right and that debtors may choose to forgo the privilege of using the licence or permit should they not be able to pay the debt in full. In addition,

[15] Hover v. Dental Assn. (Alberta) 2006 ABCA 134, 2006 CarswellAlta 736

they argue that in certain situations (e.g. a dangerous or unsafe driver), there are valid public policy reasons for not granting a licence or a permit. Opponents of the current regime argue that licence denial regimes thwart the debtor's "fresh start" principle and interfere with the insolvency process. Furthermore, the BIA already provides for a mechanism under section 178 to determine which debts survive a discharge from bankruptcy.

Options

There are two (2) ways to address the conflicting objectives of licence denial regimes and the "fresh start" principle.

1. Amend the BIA to prohibit licence denial regimes.
   Prohibiting licence denial regimes in the BIA would enable an honest but unfortunate debtor to obtain a discharge from his debts and ensure the orderly and fair distribution of his property among his creditors on a *pari passu* basis. It should also be noted that, under the current provisions of the BIA, creditors already have remedies available to them to ensure they receive a fair recovery either by way of an opposition to the discharge of the bankrupt or by exercising their right to vote on proposals. Lastly, section 178 of the BIA already provides for a number of debts that are not released by discharge which includes fines[16] which already provide governing bodies with the ability to hold debtors accountable for offences.

2. Maintain the status quo.
   Licence denial regimes frustrate two of the fundamental purposes of the BIA which are to ensure the equitable distribution of a bankrupt debtor's assets among his creditors and the financial rehabilitation of insolvent individuals. Maintaining the status quo would only favor those few creditors who can take advantage of licence denial regimes to collect debts after they have been discharged.

CAIRP's Recommendation

CAIRP recommends the addition of a provision to the BIA to forbid licence denial regimes. In order to respect both the "fresh start" principle and fair distribution amongst creditors principle, federal, provincial and territorial governments, or any other regulatory body, should be prohibited from denying, revoking, suspending or refusing to renew a license, permit or similar grant of a debtor, based solely on the grounds that the debtor has not paid a debt that is discharged under the BIA.

4. Reaffirmation Agreements

Current Issue

[16] Subsection 178(1)(a) of the BIA.

The variety of ways by which reaffirmation agreements are dealt with by Canadian provinces and territories suggests that there is a need to revisit this issue. In certain jurisdictions, the debtor may inadvertently reaffirm debt by conduct simply by continuing payment without realizing that he has done so (e.g. through automatic withdrawals from a bank account for example) while in other jurisdictions reaffirmation by conduct is not recognized.

In the last statutory review of the BIA, the PITF Report recommended limiting the availability of reaffirmation agreements and in particular that reaffirmation agreements in respect of unsecured debts be prohibited[17]. In light of the current landscape and historical treatment of reaffirmation agreements at the provincial, national and international levels, CAIRP explains whether, and how, reaffirmation agreements should be regulated under the BIA.

Impacts on Stakeholders

Unsecured Creditors

With the exception of debts under section 178 of the BIA, unsecured debts are discharged and any reaffirmation of unsecured debts effectively results in the unsecured creditors getting a windfall.

Secured Creditors

For secured debts, there are many instances where it may be beneficial for both the debtor and the creditor to reaffirm the debt. Examples are a car lease or house mortgage where the bankrupt requires the use of those assets and the amount of the secured debt is reasonable in light of the underlining value of the asset it secures.

Debtors

In the case of a secured debt, it may be beneficial for the debtor to continue payments in situations where the debt is secured by a mortgage on the debtor's home or a vehicle lease. In the case of a reaffirmation of an unsecured debt that has been discharged, there is no apparent benefit for the debtor and this offends the "fresh start" principle.

Analysis

Defining Reaffirmation Agreements

A debt reaffirmation occurs when a debtor revives or reaffirms personal responsibility for liabilities which have been released by insolvency proceedings. Reaffirmation can occur through conduct or through express agreement.[18] Reaffirmation by conduct occurs when the debtor continues to make payments to creditors even though the relevant debts have been discharged by insolvency proceedings. Reaffirmation by express agreement occurs when debtors enter into written agreements with creditors to repay debts although the debts were discharged by insolvency proceedings.

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[17] Personal Insolvency Tax Force, *Final Report* (Ottawa: Industry Canada, Office of the Superintendent of Bankruptcy, 2002) at 29.

[18] Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa, 2003) at 33.

Understanding the Canadian Background

In Canada, certain provinces and territories – Alberta, British Columbia, Manitoba, Northwest Territories, Saskatchewan and Yukon – have "seize or sue" legislation for secured debt over consumer collateral that, with some variation, may provide some safeguard on reaffirmation agreements. This legislation operates to give creditors the right to repossess the secured consumer collateral and retain the proceeds realized as a result of the asset sale. Under "seize or sue" legislation, the secured creditor is not allowed to collect a portion of the deficiency or his unsecured claim in addition to the asset value.

The leading reaffirmation case in Canada is *Seaboard Acceptance Corp. v. Moen* which was decided in 1986.[19] In this case, Seaboard Acceptance Corporation Ltd. ("Seaboard") entered into a standard form written contract with the defendant, Moen, where the latter agreed to lease a motor vehicle for three years. Later, Moen made a voluntary assignment into bankruptcy but did not inform the trustee of the lease. He continued payments throughout the bankruptcy but defaulted after he obtained his discharge. Seaboard made demand for the balance owing after return of the vehicle. The British Colombia Court of Appeal upheld the trial judgment in favor of Seaboard on the basis that the contract was reaffirmed by conduct.

Canadian case law appears to have followed the *Moen* line of cases until recently. In March 2014, the Quebec Court of Appeal reviewed a judgment granted by the Superior Court of Quebec in July 2012 ("*Day*")[20] and determined that the mere payment of an obligation by the debtor does not create a legal relationship between the debtor and creditor. Consequently, concluding that reaffirmation by conduct was not recognized in the province of Québec.

Examination of What Other Jurisdictions Are Doing

- Australia
  There are no provisions dealing specifically with reaffirmation agreements in Australia.

- United Kingdom
  Although there is no concept of reaffirmation agreements explicitly stated in the UK legislation, there is a similar concept in the "Deed of Acknowledgment", a document signed by the debtor who declares his responsibility for the debt and any shortfall resulting from the sale of the secured asset. This agreement may be requested from a bankrupt by the secured creditor when the sale of the property results in a shortfall in order for the bankrupt to take responsibility for it. Since the agreement is voluntary, there is no formal protection from abuse.

- United States
  Reaffirmation agreements are included under Chapter 7 of the *US Bankruptcy Code*. When an individual debtor receives a discharge from his debt but wishes to keep certain secured property, he may decide to "reaffirm" the debt by entering into a reaffirmation agreement with

[19] *Seaboard Acceptance Corp. v. Moen* (1986), 36 ACWS (2d) 382, 62 CBR (NS) 143, [*Moen*].
[20] *Day c. Laurentian Bank of Canada*, 2014 QCCA449, March 10, 2014.

the secured creditor.[21] The reaffirmation process is set out in the *Bankruptcy Code* which requires court review and approval.

According to the 2011 Report of Statistics required by BAPCPA, 311,717 reaffirmation agreements were reported as filed out of a total 1,086,919 Chapter 7 consumer cases terminated during the 12-month period ending December 31, 2011.[22] Nationwide, 21 percent of Chapter 7 closed cases had at least one reaffirmation agreement filed.[23] The American Bankruptcy Institute analysis of 314 cases from various jurisdictions revealed that motor vehicles account for 78 percent of all reaffirmation agreements while mortgages account for 19 percent and personal property such as tools and furniture account for 2 percent.[24]

Options

CAIRP considers that there are three (3) options to examine with respect to reaffirmation agreements.

1. Amend the BIA to provide that reaffirmation of unsecured debt is prohibited and unenforceable.
   These types of agreements offend the "fresh start" principle and are of no apparent value to debtors. Having such a provision in the BIA would protect debtors from liability if they reaffirm any unsecured debt released by insolvency proceedings.

2. Amend the BIA to provide that reaffirmation of secured debt by conduct is unenforceable and that reaffirmation of secured debt can only occur by express agreement within a prescribed period of time and where the debtor must continue to make payments according to the original agreement.
   Similar requirements to take positive action are placed on corporate debtors in the context of executory contracts. By requiring that the original agreement is maintained, the transaction costs associated with negotiating a new agreement are saved and the fresh start problems associated with reaffirmation are cured.

3. Maintain the status quo.
   Maintaining the status quo is not a desirable option as the conflicting case law and various statutes in the different provinces and territories suggest that reaffirmation of debt will continue to be an issue which is detrimental to debtors for the foreseeable future.

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[21] Bankruptcy Judges Division Administrative Office of the United States Courts, *Bankruptcy BASICS* (Administrative Office of the United States Courts, November 2011) at 19.
[22] US, Office of Judges Programs Statistics Division, *2011 Report of Statistics Required by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2055, (Washington DC: Administrative Office of the United States Courts, 2012)* at 12.
[23] US, Office of Judges Programs Statistics Division, *2011 Report of Statistics Required by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2055, (Washington DC: Administrative Office of the United States Courts, 2012)* at 12.
[24] Daniel A. Austin & Donald R. Lassman, *Reaffirmation Agreements in Consumer Bankruptcy Cases,* 2d ed (Alexandria: American Bankruptcy Institute, 2009) at 32.

CAIRP's Recommendation

CAIRP recommends that the BIA be amended to provide that reaffirmation of unsecured debt that is discharged by insolvency proceedings is prohibited and unenforceable.

CAIRP recommends that the BIA be amended to provide that reaffirmation of secured debt by conduct is unenforceable.

CAIRP recommends that the BIA be amended to provide that reaffirmation of secured debt be allowed by express agreement only provided that a) the reaffirmation be done within a prescribed period of time and b) that the debtor must continue to make payments according to the original agreement.

CAIRP recommends that the prescribed period of time to reaffirm secured debt be nine (9) months from the start of insolvency proceedings and, in the event that the debtor does not elect to reaffirm the secured debt within that prescribed period, that sections 66.34, 65.1 and 84.2(1) of the BIA would cease to apply which would allow the affected secured creditor the ability to deal with its security.

5. Registered Savings Products

Current Issue

The last statutory review of the BIA thoroughly examined two types of registered savings products: Registered Retirement Savings Plans (RRSPs) and Registered Education Savings Plans (RESPs). As a result of this review, RRSPs were then made exempt from seizure under the BIA, subject to a claw back of any contributions made in the 12 months prior to filing, while the status quo was maintained with respect to RESPs, which were not made exempt under the BIA. This amendment to the RRSP legislation was based on public policy ground which is to support and encourage prudent retirement planning.

In the current statutory review, CAIRP looks at the treatment of Registered Disability Savings Plans (RDSPs) in bankruptcy.

Impacts on Stakeholders

Debtors

Not exempting RDSPs from seizure in bankruptcy potentially compromises the financial security of disabled debtors who are beneficiaries of such registered savings products, which is property that currently vests in the trustee for the benefit of unsecured creditors. These RDSPs may also include contributions from third parties and government matching programs which were meant to assist disabled debtors.

Creditors

RDSPs are assets currently available to creditors to increase their recoveries from bankruptcy. Creditors may even get a windfall if third-party and government funds form part of the seized RDSP. If exempted from seizure, RDSPs would decrease the funds available for distribution to creditors.

Analysis

Defining Registered Disability Savings Plans (RDSPs)

RDSPs are long-term savings plans intended to assist individuals with disabilities and their families to create greater financial security and to receive government assistance grants and bonds where available. Eligible parties may contribute any amount per year up to a lifetime contribution limit of $200,000.

RDSPs are arrangements between issuers and holders[25], where the holder makes or authorizes contributions to an RDSP and irrevocably designates a beneficiary. Contributions to an RDSP are deposits made by the holder or any entity granted written permission from the holder[26] and automatically become the property of its beneficiary.

Understanding the Canadian Background

Introduced by legislation in 2008, there are now 68 833 RDSP accounts as of May 2013,[27] meaning that 14% of Canadians with severe disability have signed up.[28] It has been suggested that RDSPs should be exempted from creditor claims in bankruptcy, similar to the protection provided to RRSP funds. Advocates note that the significant differences between RESPs and RDSPs reduce the potential for abuse. Unlike RESPs, only individuals who claim the disability credit under the *Income Tax Act* qualify for an RDSP and there can only be one account per qualifying individual.

Options

There are two (2) possible options for the treatment of RDSPs in bankruptcy.

1. Exempt RDSPs from seizure under certain conditions.
   Due to the nature of RDSPs which is to assist Canadians with disabilities and their families save for the future, exempting RDSPs from seizure appears to be desirable from a public policy perspective. Stakeholders opposed to the granting of this exemption have argued that there is a risk of abuse in two specific situations.

[25] Government of Canada, Registered Disability Savings Plan, Introduction.
[26] Ibid, Chapter 2-1 section 10.1, *What is a Contribution*.
[27] Number of RDSP accounts in Canada over the years according to Human Resources and Skills Development Canada: 20,598 (2009); 18,144 (2010); 12,099 (2011); 13,103 (2012); 4,979 (May 2013).
[28] Amber Hildebrandt, CBC News Posted: May 30, 2013 5:10 AM ET, *Canada's disability savings fund called a 'fiasco'*.

Firstly, there is a risk of abuse when a debtor makes contributions to his RDSP on the eve of his bankruptcy in order to shelter non-exempt assets from creditors. In order to counter this potential abuse, CAIRP believes that there should be a claw-back of any contributions made within the 12 months prior to the date of bankruptcy such that those contribution would not be exempted from seizure and would form part of the assets divisible among creditors.

Secondly, considering that the RDSP rules allow for the rollover of RRSPs and RESPs into an RDSP, there is the possibility that a debtor, who is a contributor, could rollover non exempt assets into the RDSP of a third party beneficiary thus sheltering and depriving creditors from the aforementioned assets. CAIRP strongly believes that the current provisions of the BIA for transfers at undervalue seem to already provide a mechanism to challenge this potential area for abuse.[29]

2. Maintain the status quo.
   CAIRP believes that maintaining the status quo appears to go against public policy of providing long term financial independence for the disabled.

CAIRP's Recommendation

CAIRP recommends that the BIA be amended to exempt from seizure property held in a Registered Disability Savings Plan and that any contributions to such a plan in the 12 months prior to the date of the initial bankruptcy event be clawed-back and form part of the property divisible among creditors.

6. Federal Exemption Lists

Current Issue

The debate on whether a list of federal exemptions should be created within the BIA[30] has been put forward a number of times over the years.[31] Drawing on international experience and considering regional differences and challenges in Canada, CAIRP examines several possible courses of action.

Impacts on Stakeholders

Creditors

The current regime provides certainty to creditors in terms of what the exemptions are for each province or territory. Introducing a federal list of exemptions in the BIA would likely require

[29] Section 96(1) of the BIA.
[30] R.S.C. 1985, c. B-3, as amended (BIA).
[31] Thomas G. W Telfer, *The Evolution of Bankruptcy Exemption Law in Canada 1867-1919: The Triumph of the Provincial Model*, (CIF-FCI) at p. 38.

adjustments to the criteria used to make personal lending decisions depending on whether the use of the federal list would be at the discretion, or not, of the debtors who uses it.

Debtors

Regional differences in the cost of living and property use are taken into account under the current regimes. To minimize the impact of introducing a federal list of exemptions for debtors who live in a province where exemptions are high,[32] the PITF Report had recommended that the use of a federal exemption list, if adopted, should be at the individual debtors' discretion.[33]

Governments

In light of the great diversity of exemptions between provinces and territories, a federal list would only establish a minimum level of exempt property matching the lowest level allowed by provincial legislation within Canada. Adopting a federal list of exemptions could also arouse opposition from the provinces who may interpret it as a violation of their constitutional exclusivity on property and civil rights matters.

Analysis

Defining Exempt Assets

Exempt assets are consistent with the fresh start principle as they enable the bankrupt to continue to service his basic needs.[34] The purpose of these exemptions is to provide a social safety net for the bankrupt and his family.

Understanding the Canadian Background

Canadian Bankruptcy and Insolvency legislation has always relied on provincial exemption laws to determine the types and values of personal and real property rights that a debtor may retain. In the last statutory review, the adoption of a federal list of exemptions, which the debtor could elect to choose in lieu of provincial or territorial exemptions, was recommended by both the Senate Report and the PITF Report.[35] Parliament still chose to maintain the *status quo*.

Examination of What Other Jurisdictions Are Doing

- Australia
  The Australian Bankruptcy and Insolvency Legislation has an exemption regime which applies throughout the country[36]. There are no fixed amounts for each exemption but, rather, it is based on a determination of what is reasonably necessary in light of social standards or as agreed by regulations or with creditors.

[32] All western provinces offer a homestead exemption which varies from province to province, which can range from as low as 9000$ in British Columbia and as high as 40,000$ in Alberta.
[33] *Personal Insolvency Task Force Final Report* (2002) at p. 25.
[34] David Brown, *Property and the Insolvent "Estate"*, Journal of South Pacific Law (2007) 11(1) at p. 90.
[35] Standing Senate Banking Committee on Bankruptcy and Insolvency Act and Companies Creditors Arrangements Act, *Debtors and Creditors: Sharing the Burden* (2003) (The Kroft Report).
[36] *Bankruptcy Act 1966* (Australia), as amended, section 116(2).

- United Kingdom
  The United Kingdom has two separate bankruptcy legislations, one for England and Wales and one for Scotland. Both legislations are extremely similar and include a list of exempt property[37]. Historically, there have been financial limits on specific categories of exempt property but these were removed during the last round of amendments.

- United States
  The U.S. Bankruptcy Code provides a list of exempt property. The list is at the discretion of each state, which may, by passing a law, determine whether the federal exemptions will apply as an alternative to state exemptions in bankruptcy cases. To date more than thirty two (32) states have opted for state-only exemptions in bankruptcy cases and sixteen (16) individual states have given their debtors the option of using the federal exemptions in lieu of the state exemptions.

Options

The ongoing debate over whether or not a federal list of exemptions is desirable raises three (3) possible alternatives.

1. Introducing a list of federal exempt property in the BIA with opt-in and opt-out options.
   This option is similar to the US model where a list of federal exemptions would allow the provinces and territories to choose whether they wish to opt out of the federal exemptions or give their debtors the discretion to choose the alternative federal exemptions over their provincial exemptions. Considering the US experience, where the provided opt-out provision was chosen by more than sixty percent (60%) of states, if Canadian provinces or territories were given such option, it would likely lead to an unfair treatment of debtors and creditors across the country. As for debtors who reside in provinces with lower exemption amounts, they would presumably choose the proposed federal exemptions, which would cause inconsistencies and inequalities across the country.

2. Introducing a list of federal exempt property without options.
   Similar to the U.K. and Australia legislation, this alternative is meant to guarantee consistency and equality within the Canadian Insolvency system. However, although there are no constitutional barriers to this legislative action, it is unlikely that a province or territory where property exemptions are more generous would agree to such a change.

3. Maintain the status quo.
   The current regime of provincial and territorial list of exempt property arguably recognizes regional differences and ensures that individuals in each of the provinces and territories are treated fairly and equitably.

   There has been no evidence to date that the rights that are meant to be protected when filing for insolvency proceedings have been frustrated because of the lack of a federal list

[37] Section 283(2) *Insolvency Act 1986* (UK).

of exemptions. It is both fair and efficient to maintain the current regime in order to ensure consistency within each province and territory and to allow for regional differences in the cost of living and property to be reflected in the exemptions in each of these jurisdictions.

CAIRP's Recommendation

CAIRP does not recommend the introduction of a list of federal exempt property at this time, as we believe the case in Canada to be substantially different than of other jurisdictions where insolvency legislation contains a federal list of exempt property.

7. Equalization Claims

Current Issue

The intersection between bankruptcy law and family law is often complex. The 2011 decision released by the Supreme Court of Canada in *Schreyer v. Schreyer* ("*Schreyer*")[38] highlighted one such complexity where a non-bankruptcy spouse's entitlement to an equalization claim was released by bankruptcy while the bankrupt was entitled to keep the exempt property which gave rise to the equalization claim.

Although Parliament had made positive steps in the past several years in addressing the economic effects of divorce by recognizing the special nature of some family law debts in insolvency law[39], the *Schreyer* case suggested that legislators should pay more attention to ensure that the principles of bankruptcy law and family law are compatible rather than being at cross-purposes[40].

Shedding light on Canadian legislation and case law, CAIRP debates whether, and how, the BIA should be amended so as to improve the treatment of equalization payments in bankruptcy.

Impacts on Stakeholders

Creditors – Non-Bankrupt Spouses

In a bankruptcy where the division of property or equalization has not been completed prior to the bankrupt's discharge, the non-bankrupt spouse loses the ability to pursue his equalization claim against exempt assets, which do not form part of the assets available to the creditors.

In addition to the right that the non-bankrupt spouse has to file a claim and participate in the bankruptcy proceedings, the non-bankrupt spouse has two additional remedies available to him under the BIA to preserve his interest in exempt assets, which are: to apply for an order lifting the stay of proceedings which allows the non-bankrupt spouse to pursue his equalization claim against

[38] *Schreyer v. Schreyer*, 2011 SCC 35.
[39] *Bankruptcy and Insolvency Act*, sections 136 (1)(d.1) and 178(1)(b).
[40] *Schreyer v. Schreyer*, 2011 SCC 35.

the exempt assets;[41] and/or to oppose the bankrupt's discharge[42] and request that any order of discharge granted be granted notwithstanding the non-bankrupt spouse's right to pursue equalization against the exempt property. That being said, the issue with these additional remedies is that they require action from the non-bankrupt spouse who may be self-represented and may not be well versed to deal with these matters within the prescribed delays.

The other issue, as seen in *Schreyer*, is that if the non-bankrupt spouse is not notified of the bankruptcy, either intentionally or not, then he does not even get an opportunity to exercise any of these two additional remedies.

Debtors

In cases where the non-bankrupt spouse has a claim for division of property or equalization, there are substantial exempt assets in the name of the debtor and the debtor obtains a discharge prior to these claims being resolved, then the debtor stands to obtain a windfall if he succeeds in keeping all of these exempt assets.

Analysis

Defining Equalization Claims

Equalization claims entitle separating spouses to keep property held in their own names but to share in the increase in value of marital property that occurred during marriage. This approach generally translates into one spouse having to make an equalization payment to the other spouse.

Equalization claims are treated as unsecured claims in insolvency proceedings, thus non-bankrupt spouses are typically in no better position than other unsecured creditors.

In *Schreyer*, where the non-bankrupt spouse was initially prevented from pursuing her equalization claim related to exempt property, the Supreme Court of Canada noted that equalization payments are released in bankruptcy proceedings and further noted that there should be better protection for equalization claims in the event of bankruptcy in order to avoid such inequitable results[43].

Understanding the Canadian Background

The provincial legislatures in Canada have chosen between two different models to address the inequities or difficulties arising out of the distribution of family assets after the breakdown of a marriage: equalization and division of property[44].

In *Schreyer*, the Supreme Court of Canada decision was not the final chapter in this as Mrs. Schreyer subsequently applied to the Manitoba Court of Queen's Bench to rescind the bankrupt's discharge[45] and for leave to proceed with her claim[46] against the exempt asset which was the

[41] Section 69.4of the BIA.
[42] Section 168.2(1) or 170(7) of the BIA.
[43] In the case, the non-bankrupt spouse successfully had the bankrupt spouse's discharge annulled and she received payment from the exempt assets.
[44] R. A. Klotz, Bankruptcy, *Insolvency and Family Law* (2nd ed. (loose-leaf)), at pp. 4-29 to 4-30.
[45] Pursuant to section 187(5) of the BIA.
[46] Pursuant to section 69.4 of the BIA.

family farm. In the end, Mrs. Schreyer's application was allowed and the Court ordered that the bankrupt's absolute order of discharge be set aside, that Mrs. Schreyer be granted leave to continue her equalization claim with respect to the exempt property and that the bankrupt be granted a new order of discharge without prejudice to Mrs. Schreyer continuing to realize her equalization claim notwithstanding the bankrupt's bankruptcy and discharge[47]. This decision was appealed and the appeal was dismissed which demonstrates that the current provisions of the BIA do provide some remedies for creditors (e.g. non-bankrupt spouses) that can be used to protect creditors from bankrupts who mislead the trustee or the creditors.

Options

In light of the issue raised by the Supreme Court of Canada decision in *Schreyer*, two (2) sections of the BIA could be amended to ease the burden on non-bankrupt spouses.

1. Amend section 178(1) of the BIA to provide that debts related to equalization or division of property against exempt assets are not released by order of discharge. There is a risk for abuse where a non-bankrupt spouse could seek to obtain an unequal share of the bankrupt's exempt assets after bankruptcy, which could have a negative impact on the debtor's right to a fresh start. That being said, there has been no evidence of such widespread abuse under the current regime, where non-bankrupt spouses have been successful in lifting the stay of proceedings and/or have obtained authorization to pursue exempt property subsequent to discharge.

2. Amend section 69 of the BIA to provide that the stay of proceedings does not apply to any claim for equalization or division of property against exempt assets. Such amendment would relieve non-bankrupt spouses from having to go to bankruptcy court in order to apply for the lifting of the stay of proceedings where most trustees probably consent to such applications in any event. Nevertheless, matrimonial proceedings are rarely limited to just exempt assets as they frequently include other matters such as equalization or division against non-exempt assets, spousal support and child support. This means that removing the stay of proceedings from equalization or division claims could encourage non-bankrupt spouses to circumvent the bankruptcy process by attempting to improperly obtain other relief through the family law courts. There is also some merit in having section 69 stay in application as it provides a cooling-off period where the bankrupt may not be in a position to continue marital litigation in what is usually a very charged situation, especially when an insolvency is co-mingled with martial litigation.

CAIRP's Recommendation

CAIRP recommends that section 178(1) of the BIA be amended to provide that debts related to equalization and division of property against exempt property not be released by order of discharge.

[47] *Schreyer*, Re 2013 CarswellMan 364, 2013 MBQB 179, 231 A.C.W.S. (3d) 307, 295 Man. R. (2d) 127, 34 R.F.L. (7th) 498.

CAIRP further recommends that the stay of proceedings under sections 69, 69.1, 69.2 and 69.3 of the BIA remain unchanged and continue to apply to all matrimonial litigation matters, including claims for equalization or division of property against exempt assets.

8. Family Support Claims and the Levy

Current Issue

In Canada, creditors in insolvency proceedings rely mostly on the collective remedies available to the trustee to satisfy their claims by receiving a dividend out of the estate, minus the levy due to the Office of the Superintendent of Bankruptcy. Family support claimants can generally expect to ultimately receive a greater recovery than other unsecured creditors as family support claims survive the insolvency process [48] and often benefit of a priority over other unsecured creditors[49]. Following the *Cameron* decision, in which the court held that the levy is to be shared by all creditors who benefit from the proceedings and that family support creditors must give the bankrupt credit for amounts paid in respect of the levy, CAIRP elaborates on the treatment of section 178 creditors with respect to the Superintendent's levy.

Impacts on Stakeholders

Debtors

Because certain section 178 creditors provide credit to the bankrupt for the levy while others do not, the current situation creates uncertainty for bankrupts as they may be paying more to settle debts pertaining to section 178 creditors who do not provide credit for the amount of the levy paid.

Creditors

It is not equitable for section 178 creditors who provide bankrupts with a credit for the levy to receive a lesser recovery than section 178 creditors who do not. This inequity is particularly troublesome for family support creditors, who arguably consist in one of the most vulnerable section 178 creditors.

Analysis

Defining the Superintendent's Levy

The Office of the Superintendent of Bankruptcy's levy is typically five percent[50] of all payments made by a trustee[51] the purpose of which is to offset the costs of the OSB as the regulator responsible for protecting the integrity of the bankruptcy system.

[48] Section 178(1)(b) and (c) of the *Bankruptcy and Insolvency Act*.
[49] Section 136 (1)(d.1) of the *Bankruptcy and Insolvency Act*.
[50] In summary administration bankruptcies, the levy is capped at $200 in accordance with Rule 123(3) of the BIA General Rules.
[51] Sections 60(4), 66.26(3) and 147 of the BIA.

Defining Family Support Claims

A claim in respect of a debt or liability for alimony or alimentary pension or debt or liability arising under a judicial decision establishing affiliation or respecting support or maintenance, or under an agreement for maintenance and support of a spouse, former spouse, former common-law partner or child living apart from the bankrupt, is a claim provable under the BIA[52]. As family support claims may be prioritized over the claims of other unsecured creditors, family support claimants may receive preferential treatment[53]. When the bankrupt receives his discharge, family support claims are not released[54].

Understanding the Canadian Background

In the *Cameron* decision pronounced in 2003, the Alberta Court of Appeal held that "the levy is to be shared by all creditors who benefit from the proceedings"[55], which required family support creditors to provide the bankrupt with a credit for amounts paid with respect to the levy. Some stakeholders have implied that not all section 178 creditors credit the bankrupt for the amount of the levy, leading to an unfair situation where not all section 178 creditors obtain full payment.

Options

There are arguably three (3) ways to amend the BIA on the treatment of section 178 creditors with respect to the Superintendent's levy.

1. Require section 178 creditors to provide the bankrupt with a credit for the amount of the levy paid.
   Such a requirement would ensure that the levy is shared by all section 178 creditors who benefit from the proceedings; thus, treating them equally. We note that this requirement would not be applicable to summary bankruptcies[56] as the levy, which is capped at $200, is a first charge on the total amount available to creditors prior to any distributions being made to them and that the levy is not allocated to specific creditors.

2. Clarify that section 178 creditors are not obligated to provide the bankrupt with a credit for the amount of the levy paid.
   The results of such an amendment would be that the bankrupt would have to effectively pay the amount of the levy twice, which is punitive in nature. We note this would not be applicable to summary bankruptcies either, as the levy, which is capped to $200, is a first charge on the total amount available to creditors prior to any distributions being made to them and the levy is not allocated to specific creditors.

3. Remove the Superintendent's levy on dividends paid to any or all of section 178 creditors based on social and/or policy reasons.
   Removing the Superintendent's levy on the payment of dividends pertaining to any or all of the section 178 creditors would ensure that the recovery of 178 creditors that are deemed

[52] Section 121(4) of the BIA.
[53] BIA paragraph 136(1)(d.1).
[54] BIA paragraphs 178(1)(b) and (c).
[55] Re *Cameron* 2003 CarswellAlta 624 (Alberta Court of Appeal).
[56] Section 155 of the BIA.

more vulnerable (i.e. any debt or liability for alimony or alimentary pension) or that are considered more important for social or policy reasons are not reduced. That being said, this option would reduce the amount of funding available to the Superintendent of Bankruptcy to defray the expenses of supervising the BIA[57] and it would shift the burden to the other creditors to fund the insolvency regime despite the fact that the section 178 creditors benefit from the same insolvency regime.

CAIRP's Recommendation

CAIRP recommends that the BIA be amended to require section 178 creditors to provide debtors with a credit for the levy paid under BIA rules 123(1) and 123(2), given that the levy should be shared by all creditors who benefit from the proceedings.

9. Vesting of Family Property Claims

Current Issue

The last statutory review of the BIA called into question the right to sue a former spouse for an equalization claim or the division of property as property vesting in the trustee. Claiming that confidence in the insolvency system may be undermined by this situation[58], the Senate Committee heard that non-bankrupt spouses often retain most of their bankrupt spouse's share of the family assets and that creditors receive very little from the settled claim. Drawing on the Senate Report, CAIRP notes pros and cons of the right to sue to a former spouse remaining with the bankrupt instead of vesting in the trustee.

Impacts on Stakeholders

CAIRP is not aware of any significant impacts on stakeholders on this issue.

Analysis

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

One of the fundamental purposes of the BIA is to provide a regime whereby the creditors of the bankrupt can pursue their claims by collective action through the trustee, so that the assets of the bankrupt can be realized and distributed on an equitable basis subject to the priorities of preferred

[57] Section 147 of the BIA.
[58] Senate Report, supra note 22, p. 84.

creditors and the rights of secured creditors[59]. Allowing a bankrupt who has likely no resources or ability to pursue an action for equalization or division of property frustrates this fundamental purpose. Furthermore, there is no apparent incentive for the bankrupt to pursue such an action as it would benefit his creditors and it is unlikely to be of any benefit to him.

Options

The treatment of the right to sue a former spouse for an equalization claim or the division of property as property vesting in the trustee can be dealt in two (2) ways.

1. Amend the BIA to exclude the right to sue a former spouse for an equalization claim or the division of property from property vesting in the trustee.
   Amending the BIA in this fashion seems unnecessary as there can hardly be a scenario where a bankrupt with limited means, no incentives to recover monies for the creditors and no oversights by creditors would recover more for the creditors for equalization or division of property than would a trustee.

2. Maintain the status quo.
   Creditors are generally responsible for monitoring and providing direction to the trustee in the discharge of his duties, including pursuing any equalization or division of property claims. If it appears to creditors that a trustee is not pursing equalization or division of property claims in a fashion that they approve of then they can instruct the trustee to take a different cause of action that is more suitable for them and they can also provide funding to the trustee if necessary. Alternatively, any interested party may apply to court to review the actions of the trustee if they are not satisfied with a decision made by the trustee[60] and in the event that a trustee refuses to pursue an action the creditors can step in the shoes of the trustee and pursue the matter themselves.[61] In light of the above there is no rational to support any changes to the current regime on this issue.

CAIRP's Recommendation

CAIRP does not recommend that the vesting of the bankrupt's right to sue a former spouse for equalization or division of property under provincial/territorial matrimonial property law be excluded as property vesting in the trustee.

[59] Lloyd W. Houlden, Geoffrey B. Morawetz & Janis P. Sarra, *the 2014 Annotated Bankruptcy and Insolvency Act*. p.2.
[60] Section 37 of the BIA.
[61] Section 38 of the BIA.

10. Joint Debts

Current Issue

Section 142 of the BIA is intended to apply to partners in a business partnership but some stakeholders have suggested that this section could be interpreted as being applicable to marital situations. CAIRP discusses whether any changes are required to restrict the application of section 142 to business partnerships.

Impacts on Stakeholders

CAIRP is not aware of any impact on stakeholders as it appears that section 142 of the BIA has been used as intended by the legislators.

Analysis

Summarizing section 142 of the BIA

Section 142 of the BIA addresses the distribution of property when partners go bankrupt. We understand that this section was intended to deal with business situations involving business partnerships and not matrimonial situations.

Understanding the Canadian Background

In Canada, some stakeholders have raised the concern that parties may attempt to apply section 142 of the BIA in matrimonial situations which could have the effect of distorting the distribution of property that should otherwise take place.

Examination of What Other Jurisdictions Are Doing

- Australia
  The term “partnership” is not specifically defined in the *Bankruptcy Act 1966*.

- United Kingdom
  In England and Wales, the *Insolvency Act 1986* governs the *Insolvent Partnerships Order 1994*. The term “partnership” is not specifically defined; however, “partnership property” is referred to in the *Partnership Act 1890* as:
  (1) The relation which subsists between persons carrying on a business in common with a view of profit.
  (2) But the relation between members of any company or association which is—
  (a) Registered as a company under the *Companies Act 1862*, or any other act of Parliament for the time being in force and relating to the registration of joint stock companies; or
  (b) Formed or incorporated by or in pursuance of any other act of Parliament or letters patent, or Royal Charter is not a partnership within the meaning of this Act.

- United States

The term “partnership” is not specifically defined in the *U.S. Bankruptcy Code*.

Options

CAIRP reviews two (2) ways to deal with the potential confusion about the application section 142 of the BIA.

1. Amend section 142 to apply to partners in a business partnership and define “partnership” in the BIA.
   Even if most legal definitions of partnership specify that it is two or more persons engaged in a “business enterprise for profit”, defining “partnership” in the BIA would avoid any potential confusion in interpreting section 142.

2. Maintain the status quo.
   As the BIA does not specifically define the term “partnership” nor specify that section 142 applies to business partners only, the section could be incorrectly interpreted as applying to matrimonial partnerships as opposed to business partnership as was intended.

CAIRP’s Recommendation

CAIRP recommends that section 142 of the BIA be amended to provide that it applies to partners in a business partnership and that the term “partnership” be defined under section 2 of the BIA as a relationship between two or more individuals, organizations or groups who carry on business together.

11. Discharge of Student Loan Provisions

Current Issue

Government-funded student loans have been treated differently from other unsecured debts since 1997. In 1997, amendments were made to the BIA which served to make government-funded student loans non-dischargeable in insolvency proceedings if the debtor filed the proceeding before ceasing full-time or part-time studies or within two years after completing their studies. In 1998 the non-dischargeability period was increased to ten (10) years and in 2009, this period was reduced from ten (10) to seven (7) years or, in the case of significant financial hardship, from ten (10) to five (5) years.[62]

Drawing on international experience and considering the variety of federal and provincial student loan relief measures, CAIRP debates whether the current provisions regarding the discharge of government-funded student loan debts should be amended.

[62] Section 178(1) (g) and 178 (1.1) of the BIA.

Impacts on Stakeholders

Debtors

The imposition of a non-dischargeability period can be detrimental to debtors who have unpaid student loans and find themselves in financial difficulty. There are loan and interest relief measures, both federally and provincially available to assist former students in financial difficulty but a number of these former students are still required to file proceedings under the BIA in order to deal with their financial burden[63].

Governments

Students typically benefit from the educational opportunities that are facilitated by government-funded student loans. If the discharge of student loans were not regulated in some manner, the burden on the public purse could be significant.

Analysis

Understanding the Canadian Background

Individuals that have government-funded student loans are eligible for interest relief, debt forgiveness and other relief under a combination of federal and provincial relief measure. An analysis of the various government-funded student loan relief measures are summarized by province in Schedule B.

Due to the unique nature of government-funded student loans, stakeholders have come to recognize that the discharge of student loans in insolvency proceedings requires special provisions in the BIA. One such provision in the BIA is the non-dischargeability period during which government-funded student loans cannot be discharged.[64] Given the debtor's access to various federal and provincial relief measures, the rationale for this non-dischargeability period was to allow debtors time to obtain suitable employment in order to repay their debts and prevent abuse where an individual could file a bankruptcy immediately after graduation, discharge his government-funded student loans, and only then look for well-paying employment. That being said, there are still situations where debtors that suffer from a heavy financial burden, which may not be limited to government-funded student loans, are left unfairly exposed due to the rigidity of the current student loan provisions. One example of this is in the province of Quebec where the maximum interest relief period is five (5) years and where debtors have no access to any federal or provincial debt relief measure on their student loans for the last two (2) years of the seven (7) years non-dischargeability restriction in the BIA.

Examination of What Other Jurisdictions Are Doing

- Australia
  Students can apply to the Australian Tax Office to have the government-funded student debt

[63] All Canadian provinces, except for Quebec, offer up to a maximum of fifteen (15) years of interest and debt relief, while Quebec only offers a maximum of five year of interest relief (refer to *Schedule B* of this submission).
[64] Section 178(1)(g) of the BIA

repayments deferred or amended. The Commissioner may grant the request under the *Higher Education Support Act 2003* if satisfied that there is serious hardship or other special reasons that make it fair and reasonable to defer making the assessment[65]. Legislation in Australia has no stipulations regarding private student loans, which are discharged in bankruptcy provided that they meet the conditions of a provable claim.

- United Kingdom
  Debt repayment is based on income prescribed under the *Higher Education Act 2004.* If the annual pre-tax income of the debtor is £21,000 or less, there is no repayment required. Where the income is greater than this, the monthly installments are 9% of the difference between their income and the £21,000 threshold[66]. Similarly to Australia, the UK offers relief through its tax offices. The UK legislation has no stipulations regarding private student loans, which are discharged in bankruptcy provided that they meet the condition of a provable claim.

- United States
  The *US Bankruptcy Code*[67] exempts both government-funded and private student loans from discharge.

Options

Whether the current provisions regarding the non-dischargeability of government-funded student loan debts should be amended raises four (4) possibilities.

1. Amend section 178(1) (g) of the BIA to reduce the time period during which a student loan may not be discharged from seven (7) to five (5) years.
   Amending section 178(1) (g) in this fashion would resolve the issue in the province of Quebec where debtors have no access to interest or debt relief measures in the final two (2) years of the seven (7) year non-dischargeability period. Hence this would ensure that all debtors with government-funded student loans in Canada receive some kind of protection either through federal and provincial relief measures or the BIA. We note that this recommendation follows the recommendation of both PITF and the Senate Committee. [68] We further note that, where a government-funded student loan provider believes that a debtor is abusing the system or the debtor's discharge should be subject to conditions, the provisions under the BIA for objection to the discharge of the bankrupt remain available. [69]

[65] *Higher Education Support Act 2003* (Cth), s.154.45-154.50.
[66] *Higher Education Act 2004* (UK), c.8.
[67] *Bankruptcy Code*, USC tit 11 (1978).
[68] Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa: Senate of Canada, 2003) at 49. Personal Insolvency Task Force, *Final Report* (Ottawa: Industry Canada Office of the Superintendent of Bankruptcy, 2002) at 13.
[69] Sections 168.2(1) and 170(7) of the BIA.

2. Amend the BIA to ensure that the time period for relief be calculated from the date at which the debtor was last a student of the program to the date at which the loan has been allocated.
   The time period for relief should be calculated from the date at which the debtor was last a student of the program for which the government-funded student loan relief is sought. If a debtor ceases to be a student for a prescribed period of time and subsequently returns to being a student in another program the non-dischargeability period for relief on the original program should not restart.

3. Remove the time period for relief from the exception to discharge for government-funded student loans from the BIA to include it in the *Bankruptcy and Insolvency General Rules*.
   The current non-dischargeability period in the BIA should generally match the provincial and federal loan relief measures and this would ensure that, if these measures are changed, the BIA rules can more easily updated to reflect these changes rather then having to wait for a subsequent BIA legislative review.

4. Maintain the status quo.
   Maintaining the status quo is not a desirable option as this would fail to address the issue faced by debtors in the province of Quebec where they have no access to interest or debt relief measures in the final two (2) years of the seven (7) year non-dischargeability period. Furthermore, the status quo would fail to address the inconsistent treatment that debtors who attend multiple school programs or take leaves from studying are receiving under section 178(1) (g).

CAIRP's Recommendations

CAIRP recommends that the time period during which a student loan may not be discharged pursuant to section 178(1) (g) be reduced from seven (7) to five (5) years after the date on which the bankrupt ceased to be a full- or part-time student. This would ensure that all debtors receive consistent treatment for student loans across Canada.

CAIRP recommends that section 178(1.1) be clarified to provide that the time period for relief must be calculated from the date when the debtor was last a student in the program for which the government-funded student loan relief is sought. CAIRP further recommends that if a debtor takes a leave from studying for over a year, or some other prescribed time, the time period for relief should not restart. This ensures consistent and fair application of section 178(1) (g) for government-funded student loans.

CAIRP recommends that the time period under Sections 178(1)(g)(i) and (ii) which limit the dischargeability of government-funded student loans be removed from the BIA and be prescribed in the *Bankruptcy and Insolvency General Rules* instead. This would facilitate future changes should they be required due to changes in provincial student loan relief measures or other changes.

12. Hardship Discharge – Student Loans

Current Issue

Under the BIA, release of government-funded student loans can be granted on grounds of hardship provided that certain conditions are met. Besides satisfying the court that he has made good-faith efforts to repay the loan, the bankrupt must experience and be likely to continue to experience financial difficulty that prevents repayment of his student loan debt. An application for discharge on the basis of hardship may only be made after at least five years have elapsed from when the student ceased to be a full- or part-time student.

It has been suggested that, despite relief measures available under the Canada Student Loan Program and other similar provincial programs, the five-year waiting period in the case of hardship is unwarranted due to the difficulty that some debtors experience in obtaining debt relief, as well as the fact that debtors must still convince the court of the merits of their hardship.

In light of the government-funded student loan landscape in Canada, CAIRP reviews the merits of the five-year waiting period that must elapse before a debtor can make a hardship application.

Impacts on Stakeholders

Debtors

Debtors with government-funded student loans experiencing financial hardship may apply to the repayment assistance program under their applicable student loans for interest relief. However, based on the Canada Repayment Assistance Plan, the onus is on the student to make the application prior to any default on the loan and to reapply for such relief every six months.

Analysis

Understanding the Canadian Background

Currently, a debtor with government-funded student loans may obtain at least five years of relief from paying interest on their government-funded student loans in all provinces.[70] Debtors who have government funded students loans also have the ability to make an assignment in bankruptcy or a consumer proposal. If it has been seven years from the last day they attended an educational program, the loan can be discharged by a bankruptcy or released pursuant to a fully performed consumer proposal. Based on this, it appears that the interest relief programs under the government student loans programs and the BIA work well together. However, in many cases,

[70] A Summary of the Government-Funded Student Loan Relief Measures by Province is attached as *Schedule B*.

particularly those where there is extreme hardship, the funds to pay for a lawyer to file such an application stand as a barrier to relief[71].

Examination of What US Jurisdiction Is Doing

There is a hardship provision in the *US Bankruptcy Code*[72] where exemption of the student loans from discharge would impose an undue hardship on the debtor or the debtor's dependents[73]. The application of the test for "undue hardship" varies from jurisdiction to jurisdiction; however, the dominant test applied by the courts is the *Brunner* test[74], which consists in a three-part analysis showing:

- The debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for himself and his dependents if forced to repay the loans;
- The additional circumstances indicate that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and
- The debtor has made good faith efforts to repay the loans.

Empirical studies in the US have demonstrated that approximately 57 % of debtors receive some sort of hardship relief.[75] Partial or discretionary relief from one or more student loans in the US appears possible but is a matter that divides courts.

Options

The current hardship discharge provisions under the BIA call for two (2) possible courses of action.

1. Amend the BIA to reduce the waiting period for a hardship application from five years to the date of the automatic discharge or the date of the actual discharge hearing.
   Reducing the waiting period to date of automatic discharge or the date of the actual discharge hearing would assist the often self-represented debtor by allowing him to deal with all discharge issues at the same time therefore reducing the costs and inconvenience of making a separate application at a future time

2. Maintain the status quo.

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[71] *Hardship: An Objective Approach to Discharging Federal Student Loans in Bankruptcy* (2012) Saint Louis U Legal Studies Research Paper Series, p.52.
[72] Bankruptcy Code, USC tit 11 (1978).
[73] Bankruptcy Code, USC tit 11§ 523(8) (1978).
[74] Aaron N Taylor, "Undo Undue Hardship: An Objective Approach to Discharging Federal Students Loans in Bankruptcy" (2012) Saint Louis U Legal Studies Research Paper Series at, 47 and Feather D Baron, "The Nondischargeability of Student Loans in Bankruptcy: How the Prevailing "Undue Hardship" Test Creates Hardship of Its Own" (2007) 42 USF L Rev 265 at 266.
[75] Rafael I. Pardo & Michelle R. Lacey, "Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt" (2005) 74 U Cin L Rev 405 at 479. Referenced in Aaron Taylor, "Undo Undue Hardship: An Objective Approach to Discharging Federal Student Loans in Bankruptcy" (2012) Saint Louis U Legal Studies Research Paper Series at 52.

Any hardship application worth considering generally means that the debtor in question is in a difficult situation. Once again, one of the fundamental purposes of the Canadian insolvency system, the notion of the ***unfortunate but honest debtor***, means that the longer it takes for this unfortunate but honest debtor to be heard, the farther away this individual will be from ***the fresh start***. In other words, maintaining the waiting period for a hardship application frustrates two of the fundamental purposes of the BIA.

CAIRP's Recommendation

CAIRP recommends that the waiting period for a hardship application under section 178(1.1) of the BIA be changed from five (5) years to the date of the debtor' s automatic discharge or the date of the debtor's actual discharge hearing.

13. Partial Release of Debts – Student Loans

Current Issue

Under the hardship discharge provision,[76] the courts have found that they do not have the authority to order a release of part of the student loan debt; either all or none of the debt is to be released by court order.[77] Some stakeholders have suggested that it may be appropriate to give the courts more discretion to release a portion of student loan debt where warranted, thereby balancing the rights of both the debtor and the creditor.

Considering there may be inconsistent interpretations from one jurisdiction to another, CAIRP reviews this issue and makes recommendations on giving the courts more discretion to release a portion of student loan debt where warranted.

Impacts on Stakeholders

Students

A student is entitled to apply under the hardship provision[78] for discharge of his government student loan debt five years after a debtor ceases to be a full- or part-time student. The hardship provision is effective if a debtor clearly meets the hardship tests. However, this provision is not as effective where the debtor has some ability to pay but such ability is not sufficient to service the total student loan debt.

Governments

[76] Section 178(1.1) of the BIA.
[77] Re *Lowe* (2004) 2 C.B.R. (5th) 277 (Alta. Q.B.) where the Court indicated that section 178 (1.1) did not allow the court to do anything more than grant, dismiss or adjourn an application.
[78] Section 178(1.1) of the BIA.

Students typically benefit from the educational opportunities that are facilitated by government-funded student loans. If the discharge of student loans is not better regulated in some manner, the burden on the public purse could be significant.

Analysis

We reviewed all reported case law after the September 2009 BIA amendments up to May 2013 which reference section 178(1.1) and found eleven (11) cases. In six (6) of those cases the application for relief was granted and in the other five (5) cases the relief was not granted. A summary of these cases is attached as *Schedule C*.

Overall, even the small number of reported decisions suggests a high degree of uncertainty and inconsistency in the judicial application of section 178(1.1). A few examples illustrate this point. First, the use of the surplus income measure as set by OSB Directive is unclear and inconsistent. Some courts have relied on this measure to determine if financial hardship exists, while others have not. Second, the importance and role of a disability or medical condition suffered by the Applicant or the Applicant's family is inconsistent. Third, the role that the government lender's consent to the application for relief should play is also inconsistent. On the other hand, one area where one may expect that the courts would be granted discretion and the potential for variation – partial relief or the ability to discharge part of one loan – does not exist. Further, there are inconsistent judicial decisions on whether only one government funded student loan may be discharged, while the other is not.

The small number of reported decisions also suggests one of two possibilities. First, decisions may be made by endorsement, in which case they may not be reported. Second, they may be infrequent, suggesting there are difficulties inherent in filling such an application for relief and in accessing the justice system.

Options

There are three (3) discussion points with respect to court-ordered partial release of student debts on hardship grounds.

1. Amend section 178 (1.1) of the BIA to give discretion to the courts to provide partial relief on the discharge of student loans and where there are multiple student loans the courts should be provided with discretion with respect to which loans they wish to provide that relief.
   Such amendment would ensure that the courts have the authority to provide relief which properly balance the rights of both the debtor and the creditors.

2. In concert with the first option, the BIA should provide the factors to be considered by the courts in providing relief on student loan debts such as:

   - The extent to which the bankrupt has sought relief under debt reduction or repayment assistance programs available under the BIA or enactments referred to in paragraph 178(1)(g);

- The good faith efforts of the debtor to pay the loan;
- The bankrupt's present financial situation using the Superintendent's standards as a guideline for the determination of surplus income to assess financial hardship with the explicit direction to take the applicant or the applicant's dependents' disability or medical condition into account;
- The bankrupt's future earning capacity, including long-term employment prospects and expected increases in income such that they can reasonably be expected to make payments on the loan;
- Other factors as needed to streamline and ensure consistency in s.178 (1.1) decisions.

3. Maintain the status quo.
   CAIRP believes that maintaining the status quo is not a preferred option insofar as the introduction of clear criteria for considering an application under section 178(1.1) of the BIA and providing discretion for partial relief would assist the courts in rendering consistent and fair decisions.

CAIRP's Recommendation

CAIRP recommends that section 178(1.1) of the BIA be amended to provide the courts with discretion to grant partial relief with respect to some or all of the student loans of a debtor. CAIRP further recommends that the factors to be considered in granting relief to debtors on student loan be expanded in order to provide better guidance to the courts in determining the terms of the relief.

14. Renaming the Bankruptcy and Insolvency Act

Current Issue

Some stakeholders have expressed concern that the term "bankruptcy" in the title of the legislation and the required use of the "trustee in bankruptcy" title by trustees may create an unintended social stigma that may prevent some Canadians from seeking much needed professional assistance in order to obtain debt relief.

Exposing how the stigma of "bankruptcy" impacts stakeholders, CAIRP discusses whether the public would be better served if the term "bankruptcy" was downplayed in the legislation.

Impacts on Stakeholders

Debtors

A large number of debtors who file a consumer proposal are stigmatized by "bankruptcy" despite the fact they are not filing a bankruptcy. Because the consumer proposals provisions are under the

BIA, many of the prescribed BIA forms, as well as the credit reports compiled by credit rating agencies, will make mention of the BIA which often leads certain stakeholders to interpret that the debtor filed something akin to a bankruptcy. As a result of this stigma, debtors may seek help from unlicensed debt management companies or consultants and, as a result, these debtors may suffer greater economic and social consequences than would otherwise be the case.

Creditors

Due to the simple mention of the BIA or the Office of the Superintendent of Bankrupt on a debtor's credit report, some creditors tend to equate a consumer proposal with bankruptcy. Hence, the stigma associated with bankruptcy may have an impact on credit decisions.

Trustees

Replacing "bankruptcy" in the name of the BIA and modifying the requirement for trustees to advertise themselves as "Trustee in Bankruptcy" in the OSB advertising directive would help alleviate the issue of debtors who avoid seeking the assistance of a trustee simply because of the stigma of "bankruptcy".

Analysis

Defining the Stigma Associated with "Bankruptcy"

Media stories about the increased consumer reliance on credit, the rising debt levels facing individuals, corporations and even countries, and the growing number of fraud-related insolvencies have multiplied lately. Rarely do these media stories highlight situations where individuals benefited from a "fresh start".

In an article entitled *Stigma, Public Disclosure and Bankruptcy*, Barry Scholnick suggests that "individuals for whom avoiding the stigma is important will be more likely to choose an option where there will be less public disclosure about their default." We agree as Mr. Scholnick's finding is consistent with what trustees observe on a daily basis in their practices.[79]

Accordingly, it is not uncommon for many debtors to choose alternative debt management companies or consultants, which are often not regulated, because they perceive this option to be less detrimental to their credit score and more socially acceptable than those options made available by a trustee in bankruptcy acting under the BIA, even though it is rarely the case. In fact, various alternative debt management companies and consultants use this perception to their advantage, stressing the negative stereotypes associated with bankruptcy to discourage debtors from consulting a trustee, even where a consumer proposal or a bankruptcy may be the only viable option.

Understanding the Canadian Background

When the name of the legislation changed in 1992 from *The Bankruptcy Act* to *The Bankruptcy and Insolvency Act*, the change was viewed by stakeholders as a reflection of the changing

[79] Barry Scholnick, *Stigma, Public Disclosure and Bankruptcy*, December 2011.

nature of the Act. It was in 1992 that changes were introduced in the BIA to make it possible for debtors to avoid bankruptcy and instead work out arrangements with their creditors through a consumer proposal.

The nature of insolvency filings has changed significantly since the introduction of the consumer proposal provision in 1992 and subsequent reforms to the BIA in 1997, 2003 and 2009, which went further to encourage the filing of consumer proposals. An analysis of the Canadian insolvency statistics maintained by the Office of the Superintendent of Bankruptcy[80] reveals the following:

- 42% of all new insolvency filings are proposals, up from 24% in 2009.
- Total proposals filings have increased by 38% since 2009.
- Total bankruptcy filings have decreased by 69% since 2009.

Based on this current trend, CAIRP expects the number of proposal filings in Canada will soon exceed the number of bankruptcy filings.

Options

Whether Canadians may be better served if "bankruptcy" is downplayed in the legislation translates into two (2) possibilities.

1. Renaming the BIA to *the Insolvency and Restructuring Act*.
   The name of the legislation should reflect its intended use and it should also reflect the important shift in Canadians' preference for the restructuring of their debts as opposed to declaring bankruptcy. Considering the expected continued growth of proposal filings in Canada and the stigma associated with "bankruptcy", renaming the BIA would be in the best interests of all stakeholders.

2. Maintain the status quo.
   Even though the BIA is increasingly being used for restructuring debt and political policy continues to encourage debtor to file proposals, the public still has a negative perception of any proceedings filed under the BIA due to the stigma of "bankruptcy" and the fact that it is prominently used in the name of the legislation.

CAIRP's Recommendation

CAIRP recommends that the name of the BIA be changed to the "Insolvency and Restructuring Act" and that the term "Trustee in Bankruptcy" which trustees are required to use in the OSB's Advertising Directive be changed to a term that better reflects the broad range of services that trustees offer under the BIA.

[80] http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02347.html and http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/h_br03219.html.

15. Restricting Consumer Proposals

Current Issue

Following the 2009 amendments to the BIA, the consumer proposal threshold increased from $75,000 to $250,000[81]. Stakeholders, including trustees, have noticed a greater number of consumer proposals that encompass business debts such as trade suppliers, HST and deemed trust claims related to source deductions[82].

The introduction of consumer proposals was intended to provide consumer debtors with the possibility of filing a proposal to their creditors in an expeditious and simple way[83]. Considering the increase in the number of consumer proposals with debts of a commercial nature, CAIRP debates whether the consumer proposal provisions should be further restricted to apply to debtors with consumer debts only.

Impacts on Stakeholders

Debtors

Excluding individuals with any types of business debt from filing consumer proposals would potentially force most self-employed individuals and sole proprietors to file Division 1 proposals which are more costly and more complex. Given that upfront costs and fees associated with Division I proposals are higher, more debtors will forego filing proposals and they will instead choose to file for bankruptcy.

Creditors

Creditors' recovery would be reduced due the higher administrative costs of Division I proposals and more debtors choosing to go bankrupt instead of filing a proposal.

Analysis

Sections 66.11 and 66.12 of the BIA states that a natural person who is bankrupt or insolvent and who owes $250,000 or less, excluding debts owing on mortgages on the person's principle residence may make a consumer proposal. Such a person is called a "consumer debtor". The original indebtedness ceiling of $75,000, which was introduced in 1992, resulted in many self-employed individuals and higher-income debtors having to file Division 1 proposals which are more costly and more complex. The increase in the indebtedness ceiling from $75,000 to $250,000 in

[81] 2005, R.S. chapter 47, art.46.

[82] Section 60(1.1) of the BIA provides a specific scheme of distribution for deemed trust claims in Division I proposals; however, there is no such treatment in the case of consumer proposal provisions. That said, Canada Revenue Agency, through their agent, have been requesting that the same provisions be applied to consumer proposals.

[83] In reviewing consumer proposals Justice Mayrand stated (translation) " After reading the authors on the subject, we feel that the legislation's intent was to minimize expenses, avoid bankruptcy . . . and provide an alternative or other procedure for people to avoid filing for bankruptcy. . . .'' In Re. *Cournoyer c. Raymond Chabot inc et le Sous-ministre du Revenu du Québec* C.S. Richelieu 765-11000635-016, 27 novembre 2001

2009 was aimed at making the simpler and more cost-effective consumer proposal scheme available to a greater number of debtors. [84]

A recent issue has arisen where Canada Revenue Agency (CRA) has been requesting that the deemed trust provisions contained in section 60(1.1) of the BIA be applied to consumer proposals. These deemed trust claims relate to payroll source deductions and payroll taxes. In cases where debtors have been unable to comply with CRA's request and where CRA has held the majority of votes, CRA has been voting against the proposal which has caused the refusal of a number of consumer proposals.

Options

The debate whether the consumer proposal process should be amended to ensure that it is not used with respect to business debt provides us with two (2) options.

1. Restrict consumer proposals to consumer debtors who have no business debt.
   Such amendment would mostly benefit the Crown in very specific circumstances where there is a deemed trust claim under section 60(1.1) of the BIA and would be to the detriment of the other creditors including other Crown claims. It would also force most self-employed and sole proprietor debtors to file Division 1 proposals at an increased cost to the debtor thus limiting accessibility to the insolvency system. Bankruptcy would likely occur in greater proportions and monies available to the unsecured creditors would generally be reduced.

2. Maintain the status quo.
   By maintaining the status quo, there will continue to be issues in negotiations with CRA on the terms of a consumer proposal where there are deemed trust claims. That being said, in cases where there are substantial deemed trust amounts, CRA has used its voting leverage to demand that these debtors file Division I proposals, which is a request that we understand that trustees have generally been complying with. Hence, there is already a mechanism in place under the BIA to allow individuals to file a Division I proposal in lieu of a consumer proposal where required.

CAIRP's Recommendation

CAIRP does not recommend restricting consumer proposals to debtors that have no business debts as there is no evidence of abuse in the use of consumer proposals to settle business debts. In cases involving Canada Revenue Agency and its efforts to collect its deemed trust claims in the consumer proposals, trustees have since adapted their practices by recommending those individuals file Division I proposals where the deemed trust is a material issue.

[84] Lloyd W. Houlden, Geoffrey B. Morawetz & Janis P. Sarra, *The 2014 Annotated Bankruptcy and Insolvency Act*, E94.

16. Costs against the Debtor

Current Issue

Following the recommendation of PITF, section 197 (6.1) of the BIA was amended to clarify its original intention that an award of costs "…should compensate creditors who were successful in an opposition to the bankrupt's discharge…"[85]. At the time, the members of PITF felt strongly that the lack of appropriate compensation for a successful opposing creditor would lead to a decline in the number of oppositions and so the integrity of the bankruptcy system would suffer.

There are, however, certain circumstances where debtors have demonstrated unacceptable behaviour with respect to their discharge and stakeholders have suggested that granting the court the authority to order costs against debtors in the appropriate circumstances.

CAIRP discusses whether subsection 197(6.1) should be amended to permit costs to be awarded against the debtor.

Impacts on Stakeholders

Debtors

If costs were awarded against debtors, this could have the impact of unfairly penalizing them twice for conduct issues; firstly, by the granting of a conditional discharge order and, secondly, by awarding costs against them.

Creditors

CAIRP is not aware of any widespread abuse and as such we believe that there has been minimal impact on the creditors.

Analysis

Currently, any costs awarded to opposing creditors are limited to the amount realized by the estate under the conditional order or consent to judgment. It is customary for the Court to order costs of the opposing creditor be paid out of the money received by the trustee, and usually the Court will fix the amount of costs[86]. There is very little case law on this matter.

Options

[85] Personal Insolvency Task Force, Final Report, August 2002, page 60.
[86] Lloyd W. Houlden, Geoffrey B. Morawetz & Janis P. Sarra, *The 2014 Annotated Bankruptcy and Insolvency Act*, p. 962.

There are arguably two (2) options to consider with respect to costs awarded against consumer debtors.

1. Amend section 197 to allow awards for costs against the debtor.
   The section could be amended to provide discretion to the court to award a separate order for costs in circumstances where the behaviour of the debtor has created unnecessary expenses to either the trustee or creditors. Awarding additional costs on top of the order would seem punitive and it goes against the "fresh start" principle.

2. Maintain the status quo.
   Maintaining the status quo would not harm stakeholders, as the court already has the ability to award costs to opposing creditors under section 196(6.1) of the BIA. The courts can also use the conditional order of discharge as a tool to sanction any offensive behaviour by the debtor.

CAIRP's Recommendation

CAIRP does not recommend that section 197(6.1) be amended to award costs against the debtor.

17. Losses Due to Bankruptcy Offences

Current Issue

Section 204.3 provides a mechanism for persons convicted of an offence under the BIA to provide compensation for the loss they have caused, but only where that loss is a result of damage to property. CAIRP discusses whether section 204.3 should be broadened to capture all losses resulting from BIA offences and reviews the inconsistency between the English and French versions of the section since the adoption of the last round of legislative amendments.

Impacts on Stakeholders

Creditors
Other than its general impact on the protection of the integrity of the Canadian insolvency system, the current section has very little impact on creditors.

Bankrupts
If section 204.3 is extended to all losses, bankrupts could be ordered to compensate victims for any of the offence under the BIA for any type of damage which considerably increases the bankrupts' potential liability.

Victims

Broadening section 204.3 to include all losses resulting from BIA offences could potentially increase the number of victims entitled to compensation, especially in English speaking jurisdictions where the application of this section is currently limited by its wording and the interpretation that the courts have given to it.

Analysis

Understanding the Canadian Background

Since the amendments of 1997, victims of an offence under the BIA no longer need to request a compensation order, as the Court is now empowered to award the compensation on its own volition. However, the revised French version of section 204.3 simply states that the court can order a compensatory amount to the victim, without specifically mentioning that the loss must be for loss of or damage of property[87], while the updated English version limits the compensatory amount to the damage or loss of property[88].

Options

The ongoing juridical debate over whether s.204.3 should be broadened to capture all losses resulting from the BIA offence translates into two (2) possible courses of action.

1. Amend section 204.3 to capture all losses resulting from BIA offences.
   Broadening the application of section 204.3 by allowing victims to be compensated for all losses is fairer for the victims as it ensures that a bankrupt who commits an offence under the BIA is sanctioned appropriately.

2. Maintain the status quo.
   Maintaining the status quo means keeping competing versions of section 204.3 which do not say the same thing in French and in English, thus making the compensation process more complex for victims.

CAIRP's Recommendation

CAIRP recommends that section 204.3 be amended to capture all losses resulting from BIA offences rather than only those relating to loss of or damage to property as we believe that this will provide a better balance between creditors' and debtors' rights and better serve the public interest.

[87] French version of section 204.3 of the BIA: « *Lorsqu'une personne a été reconnue coupable d'une infraction à la présente loi et qu'une personne subit un préjudice ou une perte de ce fait, le tribunal peut, lors de l'infliction de la peine, condamner le coupable à payer un montant compensatoire à la personne lésée ou au syndic*. ».
[88] Section 204.3 of the BIA.

18. Disallowance of Claims

CAIRP's Consumer Advocacy Task Force shares the same views as JTF regarding whether it is appropriate to provide the court with the statutory authority to extend the period for appealing the disallowance of a claim. We do not believe that amendments to the BIA to grant necessary court authority to extend the 30-day delay within which an appeal may be launched are warranted.

CAIRP's Recommendation

CAIRP recommends that the waiting period for a hardship application under section 178(1.1) of the BIA be changed from five (5) years to the date of the debtor' s automatic discharge or the date of the debtor's actual discharge hearing.

19. Section 173 – Facts for Which Discharge Will Be Refused, Suspended or Granted Conditionally

Current Issue

Further to the 1997 legislative reform, minor changes were made to section 173 of the BIA but that section has never been reviewed thoroughly with a view to modernize it. CAIRP examines whether the facts for which the discharge of a bankrupt may be refused, suspended or granted conditionally are out of date and require modifications.

Impacts on Stakeholders

Debtors

Any discharge depends directly on the facts mentioned in section 173 of the BIA. Potentially all debtors would be affected by changes to this section and non-compliant debtors would likely be affected to a larger degree.

Courts

Other than the facts mentioned in section 173, the BIA contains little guidance for the courts when rendering a decision on the discharge of a debtor. Consequently, those facts should reflect the current reality in order to maintain the viability and the integrity of the Canadian insolvency system.

Creditors

In order for the economy and the credit system to remain robust, creditors must have confidence in the insolvency system.

Analysis

Understanding the Canadian Background

One of the fundamental purposes of the BIA is to provide for the financial rehabilitation of the debtor and to allow an ***honest but unfortunate debtor*** to obtain a discharge from his debts so he can make a fresh start.[89] As there may be some dishonest or not so unfortunate debtors, the facts contained in section 173 of the BIA are necessary to help deal with any conduct that is detrimental to the Canadian insolvency system. Subject to sections 172 and 173 of the BIA, an order of discharge is a matter of judicial discretion. However, a discharge from a bankruptcy is not a matter of right, as indicated by the Supreme Court of Canada[90].

Examination of Facts for Which Discharge May Be Suspended, Refused or Conditionally Granted

(a) *the assets of the bankrupt are not of a value equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities, unless the bankrupt satisfies the court that the fact that the assets are not of a value equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities has arisen from circumstances for which the bankrupt cannot justly be held responsible;*[91]

In most cases, the bankrupt's assets are not of a value equal to fifty cents on the dollar of his unsecured liabilities, which the court will take into consideration if the debtor is held to be responsible for such circumstances.

(b) *the bankrupt has omitted to keep such books of account as are usual and proper in the business carried on by the bankrupt and as sufficiently disclose the business transactions and financial position of the bankrupt within the period beginning on the day that is three years before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included;*[92]

This fact remains current and is very important. Unless all information is provided by the bankrupt to the trustee this can seriously hinders the bankruptcy process and the duties that the trustee is required to perform.

(c) *the bankrupt has continued to trade after becoming aware of being insolvent;*[93]

This fact is a protective provision for creditors who continue to supply on credit while the debtor is clearly not capable of paying the debt. This fact is still necessary to address the debtor's behaviour prior to filing for bankruptcy and to safeguard the credit system.

(d) *the bankrupt has failed to account satisfactorily for any loss of assets or for any deficiency of assets to meet the bankrupt's liabilities;*[94]

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[89] Houlden Morawetz, p.2.
[90] Industrial Acceptance Corp. et al. v. *Lalonde* et al., (1952) 3 D.L.R . 348 (S.C.C.) p. 356.
[91] Section 173(1)(a) of the BIA.
[92] Section 173(1)(b) of the BIA.
[93] Section 173(1)(c) of the BIA.
[94] Section 173(1)(d) of the BIA.

A bankrupt must be able to account to his creditors and to the trustee for any loss or deficiency in assets or when those assets have been sold to account for the proceeds of liquidation. This fact is crucial in helping the trustee uncover transactions that could be challenged under the BIA.

(e) the bankrupt has brought on, or contributed to, the bankruptcy by rash and hazardous speculations, by unjustifiable extravagance in living, by gambling or by culpable neglect of the bankrupt's business affairs;[95]

Such a behavior is reprehensible and must continue to be considered by the court when rendering discharge orders. Clearer directions on dealing with gambling would be helpful where a bankrupt suffers more from a gambling addiction rather than dishonesty.

(f) the bankrupt has put any of the bankrupt's creditors to unnecessary expense by a frivolous or vexatious defense to any action properly brought against the bankrupt;[96]

(g) the bankrupt has, within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, incurred unjustifiable expense by bringing a frivolous or vexatious action;[97]

Creditors should generally be dealt with in a straightforward manner, thus they should not have to face additional or unjustifiable expenses when the debtor knows or should know that his actions are frivolous or vexatious, as stated by facts (f) and (g).

(h) the bankrupt has, within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, when unable to pay debts as they became due, given an undue preference to any of the bankrupt's creditors;[98]

(i) the bankrupt has, within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy, both dates included, incurred liabilities in order to make the bankrupt's assets equal to fifty cents on the dollar on the amount of the bankrupt's unsecured liabilities;[99]

Facts (h) and (i) are essential to the integrity of the Canadian insolvency system as any attempt to improperly dispose of assets that should be available for distribution among creditors and/or incur liabilities to unjustifiably increase the value of assets should be sanctioned.

[95] Section 173(1)(e) of the BIA.
[96] Section 173(1)(f) of the BIA.
[97] Section 173(1)(g) of the BIA.
[98] Section 173(1)(h) of the BIA.
[99] Section 173(1)(i) of the BIA.

(j) the bankrupt has on any previous occasion been bankrupt or made a proposal to creditors;[100]

Despite the eligibility of second time bankrupts to obtain an automatic discharge from bankruptcy[101], previous insolvencies should continue to be a factor to be considered for the discharge of a bankrupt.

(k) the bankrupt has been guilty of any fraud or fraudulent breach of trust;[102]

(l) the bankrupt has committed any offence under this Act or any other statute in connection with the bankrupt's property, the bankruptcy or the proceedings thereunder;[103]

Facts (k) and (l) are basic considerations contained not only in the BIA but which also contribute to a fair and equitable judicial system and these must continue to be considered when rendering an order for the discharge of a bankrupt as such behaviour indicate neither rehabilitation nor good faith on the part of the bankrupt.

(m) the bankrupt has failed to comply with a requirement to pay imposed under section 68;[104]

Monthly payments required from the debtor under section 68 are an obligation that lies at the heart of the consumer insolvency system and must be respected in order to avoid creditors having to unfairly bear the sole burden of the bankruptcy process.

(n) the bankrupt, if the bankrupt could have made a viable proposal, chose bankruptcy rather than a proposal to creditors as the means to resolve the indebtedness; and;[105]

Bankruptcy should be the last resort to consider and there is an expectation that debtors who have the ability to file a viable proposal should do so.

(o) The bankrupt has failed to perform the duties imposed on the bankrupt under this Act or to comply with any order of the court.[106]

This consideration is a newer addition to section 173 and is remains current and necessary. A bankrupt who does not cooperate with the trustee and/or fails to perform the duties imposed under the BIA should not obtain an absolute discharge.

CAIRP's Recommendation

[100] Section 173(1)(j) of the BIA.
[101] Section 168(1)(b) of the BIA.
[102] Section 173(1)(k) of the BIA.
[103] Section 173(1)(l) of the BIA.
[104] Section 173(1)(m) of the BIA.
[105] Section 173(1)(n) of the BIA.
[106] Section 173(1)(o) of the BIA.

CAIRP recommends that no substantial changes be made to the facts listed under 173 of the BIA for which discharge may be refused, suspended or granted conditionally, as these facts remain relevant in ensuring that the fundamental purposes of the BIA are respected and that the integrity of the Canadian insolvency system are maintained.

20. Treatment of RRSPs in Bankruptcy

Current Issue

During the 2008 legislative reform, section 67 of the BIA was amended to add Registered Retirement Savings Plans ("RRSPs") to the list of assets exempt from seizure, except for any contributions made within 12 months of the date of the bankruptcy[107]. This amendment was recommended by both the PITF[108] and the Standing Senate Committee on Banking Report,[109] subject to claw-back and locked-in provision,[110] however the locked-in provision was not accepted by Parliament.

The debate on the need for a locked-in mechanism has resurfaced where some stakeholders claim that a locked-in provision would help better maintain and guarantee the integrity of the insolvency regime. CAIRP discusses whether there is a need for a locked-in provision on RRSPs.

Impacts on Stakeholders

Consumer Debtors

Any changes to the current RRSP exemption could have an important impact on debtors, especially those with low-income, as some also consider an RRSP an emergency fund. A locked-in provision would no longer allow them to access their RRSP until retirement.

Creditors

The locked-in provision would have no significant impact on creditors.

Analysis

Defining Registered Retirement Savings Plans (RRSPs)

[107] Section 67 (1) (b.3) of the BIA.
[108] Personal Insolvency Task Force Final Report – August 2002 online https://strategis.ic.gc.ca/eic/site/bsf-osb.nsf/vwapj/pitf/eng/pitf.pdf.
[109] Debtors and Creditors sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies Creditors Arrangement Act – Report of the Standing Senate Committee on Banking Trade and Commerce – November 2003 online www.parl.gc.ca/end/committeereprts.aspx?comm_id=3.
[110] Both PITF and the Senate Committee recommended that locked-in provisions be conditional for the exemption to apply and PITF recommended a three year claw back provision and the Senate Committee recommended a two year claw back provision.

A Registered Retirement Savings Plan is a legal trust registered with the Canada Revenue Agency used to save for retirement and where contributions are tax-deductible.

Understanding the Canadian Background

When the recommendation to amend section 67 of the BIA to make RRSPs an exempt asset was made, there were some concerns from the PITF and the Senate Committee that creditors' confidence in the insolvency system would be greatly diminished if debtors were able to cash all or some of their contributions to an RRSP immediately after their discharge from bankruptcy.

Examination of What Other Jurisdictions Are Doing

The following common law regime jurisdictions have full exemption with respect to retirement savings plans without requiring any claw back provisions or locked-in mechanisms.

- Australia
  Section 116(2) of the *Bankruptcy Act 1966* was amended to provide a specific exemption with respect to retirement funds.

- United Kingdom
  Government-approved pensions are exempted as per the amendment of sections 11 and 12 of the *Welfare Reform and Pensions Act 1999*.

- United States
  Section 552 (b)(3)(c) of the US *Bankruptcy Code* has a specific exemption with respect to the equivalent for RRSPs.

Options

CAIRP foresees two (2) alternatives regarding the treatment of RRSPs in bankruptcy.

1. Amend section 67 of the BIA to include a locked-in mechanism for RRSPs that are exempt.
   Amending section 67 to include a locked-in mechanism similar to the one recommended in the PITF Report would ensure that contributions to RRSPs are used for their true intent which is for retirement purposes.

2. Maintain the status quo.
   CAIRPs research of the case law and discussions with CAIRP's members have not revealed any abuse of the RRSPs' exemption and so the concerns expressed by the PITF and the Senate Committee have not materialized. Furthermore, it is CAIRP's view that the current provisions of the BIA[111] are sufficient to deal with any potential abuse that could occur in the use of the RRSP exemption during the course of bankruptcy proceedings.

[111] Pursuant to a hearing on an application of a bankrupt for discharge, the debtor's discharge may be refused, suspended, granted conditionally. as per Section 173 BIA.

CAIRP's Recommendation

CAIRP does not recommend introducing a provision to section 67 that would lock-in Registered Retirement Savings Plans, which are currently exempt under the BIA due to the absence of any evidence that there is any widespread abuse which would threaten the integrity of the Canadian bankruptcy and insolvency system.

21. Secured Creditors' Right to Request a Meeting and to Vote in a Consumer Proposal

Current Issue

Although not mandatory, a meeting of creditors may be called in the case of a consumer proposal if the Office of the Superintendent of Bankruptcy or creditors who make up at least 25 percent of all proven claims request one.[112] At the meeting, creditors may vote to accept or refuse the consumer proposal. There are two reported cases in Quebec[113] where secured creditors were allowed to vote on their secured claim as part of a single class of creditors which included unsecured creditors and, on the opposite side of the spectrum, there is one reported case in Ontario[114] which determined that secured creditors were not allowed to vote as part of a single class. Due to the significant difference in interpretation of the secured creditors' rights between Ontario and Quebec, CAIRP analyzes and makes recommendations on the classes of creditor who should have the right to request the calling of a meeting of creditors and to vote on a consumer proposal.

Impacts on Stakeholders

Creditors

Justice Linhares de Sousa summed up well the impact to unsecured creditors in the *Schryburt* decision where he stated that the current line of Quebec cases is not equitable and that "to conclude otherwise would mean that secured creditors could vote to approve or refuse consumer proposals with impunity, despite the serious financial consequences for the debtors and unsecured creditors involved without any substantial detriment to themselves."[115]

Analysis

Further to the *Laforge* and *Fournier* decisions[116] in Quebec, secured creditors in that province are allowed to vote on the secured portion of their claim as part of a single class of creditors which includes the unsecured creditors. On the other hand, further to the *Schryburt* decision[117] in Ontario,

[112] Art. 66.15 of the BIA.
[113] *Laforge*, Re, 2007 QCCS 1074 and *Fournier*, Re, 2012 QCCS 3071 decisions.
[114] *Schryburt*, Re, 2011 ONSC 880 decision.
[115] *Schryburt*, Re, 2011 ONSC 880 decision.
[116] *Laforge*, Re, 2007 QCCS 1074 and *Fournier*, Re, 2012 QCCS 3071.
[117] *Schryburt*, Re, 2011 ONSC 880.

secured creditors in that province are not allowed to vote on the secured portion of their claim. Consequently, the situation in Quebec is such that secured creditors can often not only control whether a meeting of creditors is convened or not, but they can control the vote on the acceptance or refusal of the consumer proposal, despite the fact that they likely have no economic interest in the outcome of the vote since they have collateral to secure their debt.

Options

CAIRP is of the opinion that there are two (2) possible courses of action with respect to the rights of secured creditors to request a meeting and to vote in a consumer proposal.

1. Amend the consumer proposal sections of the BIA to restrict the rights to request a meeting and to vote to unsecured creditors.
   Amending the BIA to clarify whether a secured creditor can request a meeting of creditors and/or vote on the secured portion of his claim is necessary to avoid any further confusion and inconsistent interpretation between provincial and territorial jurisdictions. CAIRP firmly believes that the current situation in Quebec is erroneous as section 66.19(1) clearly stipulates that the voting is subject to the rights of secured creditors. CAIRP further believes that sections 112 and 127 of the BIA are applicable to consumer proposals in a similar fashion than they are applicable to a bankruptcy.[118] Lastly, the Tassé Report (1970)[119] and the Coulter Report (1986)[120], which were precursors to the 1992 introduction of the consumer proposal provisions in the BIA, clearly outline that the intent of the consumer proposals provisions in the BIA were meant to provide a fair and equitable means for insolvent consumer debtors to avoid bankruptcy and compromise their unsecured debts only.

2. Maintain the status quo.
   CAIRP respectfully submits that the status quo is not an acceptable option as this conflicting interpretation of secured creditors' rights in a consumer proposal unjustly prejudices the rights of unsecured creditors in the province of Quebec.

CAIRP's Recommendation

CAIRP recommends that sections 66.15(2)(b), 66.16(2), 66.17(1) and 66.19(1) of the BIA be amended to apply to unsecured creditors only as opposed to creditors generally.

CAIRP recommends that the BIA be amended to clarify that section 112 applies to secured creditors that wish to vote on the consumer proposal as part of the unsecured creditor class.

[118] Section 66.4 of the BIA stipulates that: All the provisions of this Act, except Division I of this Part, insofar as they are applicable, apply with such modifications as the circumstances require, to consumer proposals.
[119] Tassé Committee Report, 1970, pages 93, 175, 176.
[120] Coulter Committee Report, 1986, page 69.

22. Criminal Proceedings – Section 205 of the BIA

Current Issue

The provisions of section 205 of the BIA provide that the court may authorize the trustee to initiate criminal proceedings for prosecution when a BIA offence is believed to have been committed. In a recent decision,[121] where the court had ordered a trustee to initiate criminal proceedings against a debtor, the court went even further by charging the trustee to actually prosecute the indictment against the debtor pursuant to the *Criminal Code*.[122] CAIRP wishes to bring forth this important issue and to discuss the appropriateness of using section 205 in such a fashion.

Impacts on Stakeholders

Trustees

Generally speaking, trustees do not have a background in the prosecution of criminal offences and they are generally not equipped to pursue such matters. As a result, trustees tasked with such a burden must retain legal counsel to pursue these matters whether or not there are funds in the estate.

Official Receiver

The wording of section 205 implies that the official receiver could also be ordered by a court to initiate criminal proceedings and consequently be charged with the burden and costs of prosecuting an indictment, pursuant to the *Criminal Code*.

Creditors

In the event that a trustee is charged with prosecuting criminal offences, estate funds, to the extent that they are available, would be used to fund these proceedings and, because these matters are criminal in nature, it is unlikely to result in any net recoveries for the creditors.

Analysis

According to section 205, the court may authorize the trustee to initiate proceedings for prosecution if it is satisfied that a person has committed an offence under the BIA. The impact of such an order is to require the trustee to initiate proceedings by providing the Crown attorney or the agent of the Crown with a copy of the order together with a copy of all reports or statements of facts on which the order is based. In *Cowan*[123], the Court went further than what is provided under section 205 by ruling that, when the Crown does not intervene, the trustee should be charged, using sections 504 and 507.1 of the *Criminal Code*, with the burden and costs of prosecuting the indictment.

[121] In re *Cowan*, 2009 ONSC 38519 (CanLII).
[122] Pursuant to sections 504 and 507.1 of the *Criminal Code*.
[123] *Cowan*, Re, 2009 CarswellOnt 4332, 56 C.B.R. (5th) 133 (Ont. S.C.J. Jul 21, 2009).

Most trustees do not have sufficient legal training to prosecute criminal proceedings and, in Canada, it is Crown attorneys who are tasked with the prosecution of criminal offences and, as such, it should be Crown attorneys that prosecute criminal proceedings, including those under the BIA.

Options

There are two (2) ways to approach the issue of prosecuting criminal proceedings under section 205 of the BIA.

1. Amend section 205 of the BIA to stipulate that trustees and official receivers cannot be compelled to prosecute criminal proceedings.
   Amending section 205 to explicitly provide that trustees and official receivers cannot be compelled to prosecute criminal proceedings by virtue of sections 504 and 507 of the *Criminal Code* or any other similar laws would seem to be in the best interest of the public and the judicial system, given the lack of expertise and resources by trustees and the official receivers to pursue these types of matters. Canada has a long history of criminal proceedings being the responsibility of the Crown and its prosecutors[124] and the prosecution of section 205 matters should be no different. We further note that the trustee would still maintain his duty and responsibility of providing the appropriate reports and information to the Crown attorneys.

2. Maintain the status quo.
   CAIRP does not believe that it is the intent of section 205 to charge trustees or the official receivers with the burden of prosecuting criminal offences. As such, the status quo would require that stakeholders wait for this issue to occur again and hope that a higher court would reverse the precedent set by the *Cowan* case.

CAIRP's Recommendation

CAIRP recommends that section 205 of the BIA be amended to provide that a trustee and the official receiver cannot be compelled to prosecute criminal proceedings by virtue of sections 504 and 507 of the *Criminal Code* or any other similar laws.

[124] *Rex v Chamandy*, 1934 Can LII 131 (ONCA), 193 O.R. 208.

23. Third Time Bankrupts

Current Issue

According to the current provisions of the BIA, a debtor who is bankrupt for a third time or more is eligible for a discharge from bankruptcy sooner than a second time bankrupt. Section 168.1(1)(b) of the BIA provides that a second time bankrupt is only eligible for an automatic discharge after the expiry of 24 months after the date of bankruptcy, if there is no surplus income or 36 months where there is surplus income. In the case of a bankrupt who is bankrupt for a third time or more, the trustee must apply to the court for an appointment for a hearing on the application of the bankrupt's discharge no later than 12 months after the date of bankruptcy. CAIRP would like to direct attention to this inconsistency although it does not appear in Industry Canada's discussion paper to review the BIA.

Impacts on Stakeholders

Bankrupts

At present, a third time or more bankrupt is eligible to obtain a discharge hearing sooner than when a second time bankrupt is eligible to obtain an automatic discharge from bankruptcy.

Creditors

If third time or more bankrupts were to obtain their discharge earlier than second time bankrupts, recovery to creditors would likely be reduced where a third time or more bankrupt would not be required to pay surplus income for the same period of time than a second time bankrupt.

Analysis

CAIRP understands that most of the courts in the various Canadian jurisdictions recognize the inconsistency between section 168.1(1)(b) and section 169(2) of the BIA. CAIRP further understands that the orders of discharge awarded in the recent past have mirrored the provisions dealing with second time bankrupts, in terms of the length of suspension and requirements to pay surplus income, such that third time or more bankrupts do not generally receive any preferential treatment.[125]

Options

The current inconsistency in the BIA with respect to the treatment of third time or more bankrupts over second time bankrupts gives rise to two (2) possible courses of action.

[125] *In Re Dennison, 2013 CarswellSask 514, 6 C.B.R. (6th) 226 and* In *Re Kusch* (2007), 2007 CarswellBC 1089, 33 C.B.R. 611 (Sask. Q.B.), where the Court refused the discharge of a fourth time bankrupt and declared that when an individual has entered a third time bankruptcy, the purpose and intent of the BIA shifts from its remedial purpose of assisting well intentioned but unfortunate debtors o one of protecting society.

1. Amend section 169(2) of the BIA to provide that the delay to apply for a discharge hearing can be up to 3 years after the date of bankruptcy.
   In addition to this amendment, directions should be provided to trustees through a formal directive from the OSB as to when it is appropriate to apply to the court for the bankrupt's discharge.

2. Maintain the status quo.
   Even though most of the courts in Canada already acknowledge the inconsistency with section169(2), maintaining the status quo could potentially mislead stakeholders about the intention of Parliament by giving the impression that third time or more bankrupts are looked upon more favorably than second time bankrupts when it comes to their discharge.

CAIRP's Recommendation

CAIRP recommends that section 169(2) of the BIA be amended to increase the delay to apply to the court for an appointment for a discharge hearing from no later than one year to no later than three years after the date of bankruptcy.

CAIRP also recommends that the OSB issues a directive to trustees indicating when a hearing date under section 169(2) should be obtained. For third time or more bankrupts, CAIRP further recommends that the directive should mirror the provisions dealing with second time bankrupts, where the trustee would be required to obtain a hearing date in 24 months for a third time or more bankrupt with no surplus income or 36 months in the case of a third time or more bankrupt with surplus income.

24. Deemed Annulment of Consumer Proposals after Bankruptcy

Current Issue

There are no provisions in the BIA which specify that filing for bankruptcy is an event that results in the deemed annulment of a consumer proposal. CAIRP wishes to highlight this issue for consideration in the statutory review of the BIA.

Impacts on Stakeholders

Generally speaking, the impact on any of the stakeholders is minimal. However, it is important to ensure that inconsistencies, as they are noticed within the Act, are corrected. Section 66.3 (1) lists the events which lead to the annulment of a consumer proposal and section 66.31 (1) determines the conditions necessary for the deemed annulment of a consumer proposal.

Analysis

Understanding the Canadian Background

Although the administrator of the consumer proposal is authorized to apply to court under section 66.3(1)(b)[126] to have a consumer proposal annulled when a debtor files for bankruptcy, such procedure rarely takes place. The current practice is either to:

(a) wait three months for the consumer proposal to be deemed annulled pursuant to 66.31(1) and the administrator will issue its required notice at that time, or;
(b) for the trustee to advise the creditors and the OSB that a bankruptcy has been filed and our understanding is that the OSB will immediately update its records to show that the consumer proposal is deemed annulled based on the assumption that it will eventually be deemed annulled pursuant to section 66.31(1) of the BIA.

Options

There are two (2) possible courses of action to deal with this issue.

1. Amend section 66.31 of the BIA to include the filing of a bankruptcy as an event that results in a deemed annulment.
   The simplest option to resolve this issue would be to amend section 66.31 of the BIA to include the filing of a bankruptcy as an event that results in the deemed annulment of a consumer proposal.

2. Maintain the status quo.
   Although the impact on stakeholders is minimal, the status quo should not be maintained where a simple technical amendment to the BIA would simplify the administration of the BIA and help ensure that the public records maintained by the Office of the Superintendent of Bankruptcy be as accurate as possible.

CAIRP's Recommendation

CAIRP recommends amending section 66.31 of the BIA to include the filing of a bankruptcy as an event that results in the deemed annulment of a consumer proposal.

[126] Section 66.3(1)(b) of the BIA provides that where it appears to the court that the consumer proposal cannot continue without injustice or undue delay, the court may annul the consumer proposal.

25. Publication in Local Paper

Current Issue

Section 102(4) of the BIA requires that a notice of bankruptcy be published in a local newspaper on all ordinary administration bankruptcies.[127] In light of the declining readership of newspapers and the personal nature of many of the ordinary administration bankruptcies, CAIRP questions the need for and the effectiveness of these local newspaper notices.

Impacts on Stakeholders

Debtors

It seems unfair to consumer debtors in ordinary administration estates to have a notice of their bankruptcy published in a local newspaper while there is no such requirement for summary administration estate matters. The requirement to publish a notice of bankruptcy also increases the upfront administration cost of ordinary estate which may be an additional barrier to access to the insolvency system as the consumer debtors may be required to advance a larger deposit or make arrangement for a larger third-party retainer.

Creditors

Notices of bankruptcy serve as an additional notice to those creditors who may not be known by the bankrupt or might have been otherwise omitted. The publication of a notice in the local newspaper increases the administration cost of the estate which may then reduce the recovery to the creditors.

Analysis

Understanding the Canadian Background

The requirement to place a notice in a local paper in Canada dates back to 1919 and it is debatable whether this requirement is still necessary today considering the advent of the internet and the rapid decline of traditional newspapers readership. The BIA should be modernized and, at the very least, provide for alternative means of providing notice of bankruptcies to the public.

Options

CAIRP reviews two (2) possible courses of action regarding the requirement to publish a notice of bankruptcy in a local newspaper.

1. Amend section 102(4) of the BIA to restrict the obligation of publication in the local paper to corporate estates and in the case of consumer estates only when it is required by the official receiver.
   The publication of a notice of bankruptcy would apply to corporate matters only and to consumer matters only when required by the official receiver. The Estate Information

[127] Summary administration bankruptcies are exempted from this requirement under section 155(c) of the BIA, which results in this section only applying to ordinary administration bankruptcies.

Summary that is filed by the trustee at the time of filing the bankruptcy could be used by the official receiver to determine if a publication is necessary. The Estate Information Summary could also include a section to be completed by the trustee where the need for publication of a notice of bankruptcy could be addressed.

2. Maintain the status quo.
   The maintaining of the status quo is of limited value, considering that a large number of ordinary administration matters are simple consumer matters with known institutional creditors (e.g. banks and credit card companies) and that the publication in the local paper is becoming less and less relevant in light of declining newspaper readership.

CAIRP's Recommendation

CAIRP recommends amending section 102(4) of the BIA to provide for publication of the notice of bankruptcy for corporate estates only and in the case of consumer estates only when it is required by the official receiver.

CAIRP further recommends that the requirement for publication in a local newspaper be removed from section 102(4) of the BIA and instead be prescribed in the BIA rules or in an OSB directive. This would allow the OSB to quickly adapt to any changes in marketplace should the use of newspapers for publication become obsolete.

26. Review of Prescribed Threshold Amounts in the BIA for Summary Administration and Consumer Proposals

Current Issue

Prescribed threshold amounts in the BIA have not been reviewed since last round of legislative amendments in 2009 despite the fact that the inflation rate has noticeably risen, and that debtors' total indebtedness has also increased. Failure to adjust the prescribed amounts presents the risk that an increasing number of debtors will not be able to benefit from the summary administration bankruptcy and consumer proposal proceedings offered under the BIA. CAIRP examines whether prescribed amounts for the filing of summary bankruptcies and consumer proposals should be updated.

Impacts on Stakeholders

Debtors

The summary administration of a bankruptcy estate is a simplified procedure in which there are generally no inspectors, no mandatory meetings of creditors and where the costs are lower. The upfront costs of an ordinary administration bankruptcy are more onerous and, where the debtor is required to bear these, this can be an additional barrier to timely access to the insolvency system.

Similarly, it will cost more for a consumer debtor to file a Division I proposal as opposed to a consumer proposal as the compliance requirement are more stringent (e.g. mandatory meeting of creditors, a court approval process and greater reporting requirements).

Creditors

Creditor recoveries are likely to be less due to increased administration costs involved in ordinary administration bankruptcies and Division I proposals.

Justice System and the Courts

Summary bankruptcy and consumer proposal proceedings tend to be more effective as they are more streamlined and the involvement of the courts is minimized. Having fewer individuals qualify for these proceedings means a heavier workload for the justice system and the courts.

Analysis

Defining Prescribed Amounts in the BIA

Two of the most commonly used prescribed amounts in the BIA are found under sections 49(6) and (8) for summary administration bankruptcies and section 66.11 for consumer proposal proceedings. These prescribed amounts are used to determine which debtors are eligible to use the simplified procedure for bankruptcies and proposals to creditors.

Understanding the Canadian Background

Prescribed amounts in the BIA pertaining to sections covering summary administration bankruptcy and consumer proposal proceedings were last updated in 2009. The inflation rate in Canada has increased 9.68 from May 2009 until May 2014[128], which suggests that the prescribed amounts in the BIA could benefit from a review.

Section 49 (6) and (8) and Rule 130 of the BIA allow the filing and administration of estates in a summary fashion, provided that the realizable assets of the bankrupt, after the claims of secured creditors are deducted, will not exceed $15,000. Section 66.12 (1) of the BIA allows a consumer debtor to file a consumer proposal and section 66.11 of the BIA defines a consumer debtor as “an individual who is bankrupt or insolvent and whose aggregate debts, excluding any debts secured by the individual’s principal residence, are no more than $250,000 or any other prescribed amount”.

Options

CAIRP foresees two (2) possible courses of action to address the issue presented by the current prescribed amounts in the BIA.

1. Increase the prescribed threshold amounts for summary bankruptcies and consumer proposals to at least reflect the inflation rate.
   Prescribed amounts under sections 49 (6), (8) and 66.11 of the BIA could be raised to at least reflect the inflation rate in order to ensure that the number of individuals that have

[128] http://www.bankofcanada.ca/rates/related/inflation-calculator/.

access to summary administration and consumer proposal proceedings does not gradually erode.

2. Maintain the status quo.
   By maintaining the status quo, a greater number of debtors will gradually not qualify for summary administration bankruptcy and consumer proposal proceedings, which will not benefit the debtors, the creditors nor the courts.

CAIRP's Recommendation

CAIRP recommends that the prescribed amount for summary administration bankruptcies under subsections 49(6) & (8) and rule 130 of the BIA be increased to $20,000.

CAIRP recommends that the prescribed amount under the definition of a consumer debtor under section 66.11 be increased to $325,000 for consumer proposals.

Schedule A: Composition of the Consumer Advocacy Task Force

André Bolduc, CPA, CA, CIRP (Chair)
Ottawa

Leah Drewcock, CIRP
Prince George

Chantal Gingras, CIRP
Gatineau

Stan Hopkins, CA, CIRP
Dartmouth

Guylaine Houle, BCL, FCIRP
Montreal

Debora Kwasnicky, CA, CIRP
Coquitlam

Susan Robinson Burns, QC
Calgary

David Wood, CIRP
Vancouver

Schedule B: Summary of Government-Funded Student Loan Relief Measures

NB: The following information covers the combination of provincial and federal relief on a province by province basis.

Province(s)	When Interest and Repayments Are Due	Eligibility for Repayment Assistance	Maximum Relief Period
Quebec	• Students are not required to repay the principal on their student loan for six months after the conclusion of full-time studies (the partial exemption period). • During the six month partial exemption period, students become responsible for interest charges; students can pay the interest during this period or capitalize it. • After the conclusion of the partial exemption period, students must begin to pay off the student loan.	• Students may apply under the Deferred Payment Plan (DPP) to defer the repayment of their student debt. • To be eligible for the DPP, a student must prove that for a period of four consecutive months, her gross monthly income was below the eligibility threshold determined for her family situation. • For an individual without dependent children, the maximum gross income allowed to be eligible for the DPP is $1,586.[129] • This maximum income amount increases if the debtor has dependent children and/or is the head of a single-parent family.[130]	• 5 years.
All Other Canadian Provinces (Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Ontario, Prince Edward Island, and Saskatchewan)	• Students have a six month grace period after the conclusion of their studies, during which time students are not responsible for making payments and interest does not accumulate. • However, interest does accumulate on Canada Student Loans during this time (most students have a federal portion and provincial portion of	• Each province administers a Repayment Assistance Plan (RAP). • Ontario, Saskatchewan, New Brunswick, Newfoundland and Labrador, British Columbia, Alberta, and Nova Scotia administer their RAPs in conjunction with the federal RAP. • Manitoba and Prince Edward Island administer their RAPs independently. • Each province's RAP and the	• 10 or 15 years (15 years of potential relief for a student without a permanent disability; 10 years for a student with a permanent disability) • The debt is extinguished at the end of the relief period

[129] Ministère de L'Éducation, du Loisir et du Sport, *Table relating to the maximum monthly income according to family situation***,** online: Aide financière aux études Québec, http://www.afe.gouv.qc.ca/en/autresProgrammes/tableau_revenus.asp for specific maximum income amounts.

[130] Ministère de L'Éducation, du Loisir et du Sport, *Table relating to the maximum monthly income according to family situation***,** online: Aide financière aux études Québec, http://www.afe.gouv.qc.ca/en/autresProgrammes/tableau_revenus.asp for specific maximum income amounts.

Province(s)	When Interest and Repayments Are Due	Eligibility for Repayment Assistance	Maximum Relief Period
	their loan). • After the conclusion of the six month grace period, students must begin to make payments on their loan.	federal RAP are substantially the same in terms of relief offered and eligibility. • Borrowers are eligible for the RAP if their affordable monthly payment (which will not exceed 20% of the borrower's income) is calculated to be less than their current required payment.[131]	provided the student progresses through the full RAP program.

[131] This is quoted from the Canada RAP program: CanLearn, *Repayment Assistance Plan*, online: Government of Canada, http://www.canlearn.ca/eng/after/repaymentassistance/rpp.shtml. However, all provincial RAPs use the same or similar eligibility requirements.

Schedule C: Summary of Canadian Case Law Following the 2009 Amendments to the Treatment of Student Loans in Bankruptcy

1. Applications Denied

1.1 *Christensen* (Re), 2011 NBQB 364, NBJ no 464 (QL).

The Applicant obtained a Risk-Shared Canada Student Loan in the amount of $6765 in order to finance a two-year Business Technology program at New Brunswick Community College. He withdrew prior to the completion of the program and returned to his former employment. The Applicant had not made any voluntary payments on the loan, but income tax and GST refunds had been applied directly to the loan. The Applicant made an assignment in bankruptcy on September 16, 2004 and was discharged nearly four years later on August 6, 2008. The student loan was not discharged. At the time of the section 178(1.1) application, the Applicant was employed and living in a household of two persons. His partner had been unemployed for several months and the amount of surplus income in the household budget was quite limited. The Applicant testified that his partner's return to employment was sought and that this would contribute to the household income. The Applicant argued that he could not predict the future and that, although there may be a surplus, other unforeseen expenses were possible.

The Court held that adverse contingencies are always possible but that the evidence did not demonstrate the impossibility of repayment given the potential household income and the amount of monthly payments. The motion for relief under section 178(1.1) was denied, but the court ruled that the Applicant could make another application after January 1, 2013 upon proof of the following:

(a) that reasonable efforts have been made to furnish required payments on the student loan debt; and
(b) that payments required have been in excess of $121.00 per month; or
(c) that financial circumstances in the household have substantially changed for the worse since the rendering of this decision.

1.2 *Cunningham* (Re), 2012 NBQB 352, NBJ no 380 (QL).

The Applicant, between 2003 and 2008, obtained Canada New Brunswick Integrated Student Loans to attend the University of New Brunswick to obtain a Bachelor of Arts in Anthropology and Women's Studies. The degree was granted in May 2007. The Applicant was employed in a variety of contractual positions in 2007. In October 2007, she commenced a business course at CompuCollege which was successfully completed in February 2009. Since then, the Applicant had been employed at positions of administrative support in the medical field. An accumulation of consumer debt compounded by relationship issues led to assignment in bankruptcy in August 2010.

The Canada Revenue Agency argued that the date for identifying the elapsed period for the purposes of section 178(1.1) should be the completion of studies at CompuCollege. Because that did not occur until February 2009, the Applicant was short of the required five years in her section 178(1.1) application. The Court considered varied authorities regarding the time at which the

elapsed period commences. Ultimately, the crucial fact in this case was the lack of a significant separation of time between the completion of the first program and the commencement of the second program. The court held that this "scarcely [gave] any reasonable period to try to realize on the asset obtained from these loan financed studies." With no real separation between the two study periods, the elapsed time period for the purposes of section 178(1.1) should be computed from the time of completion of the second program of study. Thus, this application was premature and could not receive disposition at the time.

1.3 *Duffy v. Canada*, 2010 NBQB 278, NBJ no 284 (QL).

The Applicant attended the University of Prince Edward Island from 1991-1996, obtaining a degree in Sociology. He then attended Holland College from 1997-1998, obtaining a Certificate for the Police Science program. The Applicant accumulated $6,534 in private loans and $9,601 of risk-shared loans under the *Canada Student Financial Assistance Act*. The Applicant applied for and was granted interest relief at three different times between 1996 and 1999, but later requests were refused due to his income level. The decline in the Applicant's financial situation commenced with his wife's medical condition which, following childbirth in 2000, deteriorated to the point that she was unable to work and received government benefits. He filed an assignment into bankruptcy on August 14, 2006 and received his discharge nearly three years later on May 26, 2009. The Applicant obtained employment with a police force after completion of his studies, earning $36,000/annum, increasing to $73,000/annum in 2010 (the time of the decision). Upon commencing employment, the Applicant made payments on his student loans; although there was uncertainty about the balance remaining, the Court settled on the amount of $6,104.22.

The Court noted that the income of the Applicant and his wife had to be evaluated with reference to a household of four persons. The respondent raised the Applicant's purchase of a new home and subsequent extensive renovations which occurred subsequent to his wife's illness and while he still owed payments on the student loans. However, the Court declined to take this as evidence of any bad faith on the part of the Applicant in dealing with his student debts and merely found that this may merely be indicative of careless financial management. The Court found that there was no history of deliberate attempts on the part of the Applicant to escape the student debt and that the analysis thus turned on the question of the Applicant's ability to pay. The Court considered that the Applicant did have some surplus income; the surplus income was over $600 per month if one viewed only regular expenses, but that amount could be reduced to $250 to $300 per month if one averaged out certain large but less frequent costs.

The Court ultimately determined that the Applicant had the ability to make moderate payments over an extended period during which it was reasonable to assume that his salary would increase. In the short term, however, the Court found that large monthly payments would cause financial hardship. Therefore, the section 178(1.1) application was dismissed but the Applicant was given leave to make a new application for relief on or after September 1, 2011, contingent upon his providing proof that:

(a) that the payments demanded exceeded $250.00 per month; and
(b) that he has made every reasonable effort to manage the household budget in order to make the requested payments.

1.4 *Hayden* (Re), 2012 NBQB 214, NBJ no 215 (QL).

The Applicant obtained student loans to finance a Bachelor of Business Administration degree at the University of New Brunswick. He completed the degree in 2002. At that time, he began working with the Royal Bank of Canada as an account manager and received promotions and advances until 2007, during which period he made the required payments on his student loans. The Applicant filed an assignment in bankruptcy in 2007 following financial difficulties associated with marital separation. He received a discharge on October 22, 2009. In 2007, the Applicant was dismissed by the Bank. He worked irregularly at various jobs until May 2011 when he was appointed branch manager by Progressive Credit Union. His annual salary was $53,000. The Applicant testified that he was left with only $140 per month after paying essential expenses and that this amount is sometimes reduced due to extra expenses for visitation with his children.

The Court did not engage in a good faith analysis, stating that there was no issue of lack of good faith in this case. Therefore, the analysis turned solely on the financial difficulty test. The Canada Revenue Agency did not oppose the application with regard to the Canada Student Loans. The Province of New Brunswick opposed the application, arguing that the liability owed to them was only $1,209.72 and that this amount should be payable with small payments over time, even if the Applicant doesn't bring in a great deal of income. However, the Court noted that although this was a reasonable argument with regard to the provincial portion of the Applicant's student loans, when the federal loans owed were added, the Applicant may cross into the hardship boundary where relief should be granted.

The Court, therefore, moved the analysis to the issue of whether the relief granted pursuant to section 178(1.1) must apply to the totality of the Applicant's student loans or whether the portions related to the provincial government and federal government may be treated independently. The Court noted that although the Canada Revenue Agency had consented to its portion being forgiven, consent does not confer jurisdiction and that the Court can only grant such relief if allowed by statute. In analyzing section 178(1.1) and 178(1)(g), the Court indicating that the use of the singular article "a" in section 178(1.1) and the coordinating conjunction "or" in section 178(1)(g) indicated that the portions of the student loan debt may be treated independently and relief can be granted with respect to one portion only. Accordingly, the Court granted relief with respect to the federal student loans but declined to provide relief with regards to the provincial student loans.

1.5 *Fritz* (Re), 2012 NBQB 213, NBJ no 217 (QL).

The Applicant received Direct Financed Canada Student Loans totalling $15,540 for a period of study that ended on December 31, 2006. The Applicant commenced three different programs using these funds: one in hairstyling, one in business, and one in finance. None of these programs was completed, allegedly due to difficulties with childcare. According to the Canada Revenue Agency, the Applicant applied for and was granted interest relief from July 31, 2007 to December 31, 2007. The Applicant received more than one period of interest relief, but she may have had arrangements with provincial student loan authorities in Nova Scotia (from which there was no representation at the application). The Applicant testified that she had attempted to make some payments but that growing debt and marital problems caused by emotional issues prevented her

from making any substantial repayment. These problems were also cited as the grounds for her assignment in bankruptcy in 2009. The Applicant's husband had also declared bankruptcy but no details were available. At the time of the application, the Applicant was working for CIBC and, with her spouse's revenue, their household income was $5,662.95 per month. However, the Applicant pointed to some recent treatment for stress which may further constrain her full time employment in the future. There were four children in the household ranging in age from nineteen months to thirteen years.

In regards to the section 178(1.1)(a) good faith requirement, the Court held simply that given the attempts made to obtain interest relief during the Applicant's somewhat chaotic household period prior to bankruptcy, the good faith requirement was met. With respect to the section 178(1.1)(b) financial difficulty requirement, the Canada Revenue Agency pointed to the Applicant's surplus income, calculated using the Superintendent's Guidelines for surplus income, and equity held in retained real property and vehicles as indications that the financial difficulty portion of section 178(1.1) had not been met by the Applicant. The Court noted that the Superintendent's Guidelines should not be viewed as an absolute benchmark as the debtor moves toward financial rehabilitation. The Court stated that in this instance, the situation required balancing; according to the Court, "the circumstances of financial rehabilitation are not only those of the quantum of present income but also the family's emotional environment that can affect long-term earning potential."

Ultimately, the section 178(1.1) hearing was adjourned for one year, at which point the Applicant was required to provide proof of the following:

(a) that efforts have been made to furnish reasonable voluntary payments according to household income on the student loan debt; and
(b) detailed statements of the household finances and the health of the family members; or
(c) the financial conditions in the household have substantially changed for the worse since the giving of this decision.

However, the Court held that the hearing may be resumed before the end of the one year period upon application by the Applicant if she provides proof of the following:

(a) Collection measures that are incompatible with her medical condition have been undertaken with regard to the student loan debt.

2. Applications Granted

2.1 *Halford* (Re), 2011 ONSC 2509, OJ no 1805 (QL).

In this decision, very few background facts about the Applicant were provided. The Applicant had obtained student loans pursuant to the provisions of both the Ontario and Canada student loan programs. The Canada Revenue Agency did not respond to the application. On this basis, the Court inferred that the Canada Revenue Agency did not oppose the section 178(1.1) application and, implicitly, agreed that the Applicant had met the test set out in section 178(1.1). As a result, the Court ordered that the Canada Loan(s) were no longer affected by the operation of section

178(1)(g). In contrast, the Province of Ontario vigorously opposed the application and the court conducted a section 178(1.1) analysis in regards to the Ontario Loan(s).

In regards to the requirement of good faith, the Court noted that the only evidence of a lack of good faith on part of the Applicant was that loan payments had not been made since 2002 or 2003. However, the Court found as credible the Applicant's evidence that she had tried, to no avail, to obtain information from the two loan programs about her debts and payment options. The Court found that the Applicant had acted in good faith in regards to her student loans generally and the Ontario Loan(s) specifically.

With respect to the financial difficulty requirement, the Court accepted the evidence of the Applicant that she suffered from Carpal Tunnel Syndrome and that this negatively impacted her ability to work, such that she had and would continue to experience financial difficulty to such an extent that she would be unable to pay the Ontario Loan(s). The Court noted that although the Applicant could work, her ability to do so was greatly reduced, therefore reducing her earning ability. Further, surgical treatment for the Carpal Tunnel Syndrome could not be undertaken until it worsened. This led the Court to conclude that her ability to work and earn an income would be further reduced before any chance of her condition ever getting better again. The Court held that this condition was not foreseen or even foreseeable and represented a sufficient change in her circumstances, such that it was appropriate that the Applicant be granted relief under this section. The Court also indicated that the Applicant's impending delivery of a child, would remove her from the work force for at least another year, even in the absence of her medical condition. Therefore, the Applicant met the test for relief under section 178(1.1) and the Applicant's student loans were no longer bound by section 178(1)(g).

2.2 *Dunn* (Re), 2012 NSSC 240, NSJ no 338 (QL).

The Applicant was 31 years old and had obtained a Bachelor of Arts degree from University College of Cape Breton which she attended for three years from 2001 to 2004. She then obtained a Bachelor of Education degree in December 2006 from the University of Maine, Fort Kent. To finance her education, the Applicant obtained two student loans, a federal loan with an outstanding balance of $31,928 and a provincial loan with an outstanding balance of approximately $14,000. The Applicant made an assignment into bankruptcy on January 23, 2008 and was discharged nine months later on October 24, 2008.

After receiving her degrees, the Applicant was employed as a substitute teacher, averaging three days a week of work for which she was paid $150 per day. She then secured a term position from October 2009 to May 2010 for which she was paid approximately $1,400 biweekly. However, at the end of the term she returned to substitute teaching and joined the on call list of an additional school board, averaging three work days a week at $160 per day. To supplement her income, the Applicant took a real estate course which she completed in September 2009 and worked part time as a real estate agent. She made $5,000 as a part time real estate agent one year, but could not continue the work effectively during the school year. At the time of the section 178(1.1) application, she was employed as a fill-in for a teacher who was on stress leave. She received $1,400 biweekly for this work, but the position could end at any time and the Applicant had no tenure.

The Applicant's husband was a carpenter and worked for a small construction company. He had periods of unemployment. The couple had two children, ages five and seven. During periods of unemployment, they each receive Employment Insurance and the Applicant also receives Family Allowance. Her husband owned a mini home in which they had previously lived. It had been rented, but since the tenant left, they had been fixing it up with a view to selling it. The expenses of carrying it were $463 per month. The Applicant and her family had been living in a house owned by her husband's aunt. The Court noted that its impression was that this living arrangement was temporary. The Applicant and her husband owned a 2008 automobile purchased less than a year earlier for $6,000. The Applicant's weekly travel to and from school totals at least 500 km. The Applicant was specifically concerned with the expenses relating to her children's recreational activities and considered these to be very important for her children's development. However, the Court noted that there has been no suggestion of extravagance on the part of the Applicant.

The Applicant had made student loan payments of varied amounts on a monthly basis, the amount depending on her employment status at the time. The Applicant made use of interest relief on both loans, but did not make use of any other debt relief programs, stating that she had no knowledge of these programs. The Applicant made regular credit card payments, presumably relating to current expenses (the Court stated that these credit cards may be in arrears). The Applicant and her husband spent $550 per month on childcare when the Applicant and her husband were working.

In regards to the section 178(1.1)(a) analysis, the Court noted that the Applicant had used the funds to become a teacher and had become a respected teacher who took all of the supply and term work available to her. The Court was satisfied that the money had been well used. The Court also noted that she had done what she could with her real estate qualifications. The Applicant's difficulty did not result from a lack of effort on her part, but rather from an inability to fully utilize her education nor to establish herself sufficiently to have assurances of full employment in the foreseeable future. In addition, the Applicant had payment arrangements in place for both loans and the Court ruled that, despite an argument that she should have been paying more, she was acting responsibly considering the uncertainty of her work, the expenses of her children, and other contingencies. The Applicant had acted honestly and neither she nor her family engaged in extravagancies. The Court also noted that the family was entitled to a reasonable amount of recreation. Overall, the Court was satisfied that the Applicant had acted in good faith.
In regards to section 178(1.1)(b), the Court stated that unless the Applicant's income significantly increased in the near future, she would not be able to afford the interest on the loans, let alone the principal. For guidance, the court relied on the Superintendent's Guidelines for surplus income which help trustees determine the proper amount, consistent with the purposes of the BIA, bankrupts should be expected to pay into their estates, but allowing to them what is needed to maintain a reasonable lifestyle. Based on financial projections, the Court held that the Applicant would be unable to pay back her student loans within a reasonable amount of time, if at all, while also providing a reasonably basic standard of living for her family. The Court noted that teaching opportunities in Nova Scotia were limited and the success needed as a real estate agent to address these debts was elusive. The Court noted that an additional ten years was too long to burden the Applicant with these debts and that it was satisfied that the Applicant would continue to experience financial difficulty so as to be unable to pay the debts. Therefore, the application was granted.

2.3 *Jackson* (Re), 2012 NBQB 306, NBJ no 325 (QL).

The Applicant received Direct Financed Canada Student Loans totalling $7,024.64 for a period of study ending on July 31, 2005. In addition, the Applicant had an unpaid balance of provincial student loans totalling $4,588.42. The Applicant used these funds in order to attend a Dental Assistant Certificate program at Oulton College, a program completed between August 2004 and August 2005. In October 2007, the Applicant was finally able to work in her field; she began working at a local dental office in the rural area in which she lives. In January 2009, she left that job due to a personal problem with her employer resulting in her doctor advising her to take a medical stress leave. At the time of the application, she worked full time at McCain International where she had worked since April 2009, having been employed previously at a call centre for a brief period of time.

The Applicant was the only member of her household. Her monthly net income was approximately $1,900. The Applicant testified that she did not expect her income to increase with her current employer, although the employer offered yearly incentives. As a dental assistant, she earned a higher income at $11.50 per hour. The Applicant also testified that there were only two dental offices within a 50 mile radius of her residence, one of whom was her previous employer, for whom she did not wish to work given her reasons for leaving previously. In addition, she gave evidence that she had been given medical advice not to go back to being a dental assistant. Lastly, the Applicant testified that in May 2012 she underwent heart surgery and that this had caused her some physical limitations. In addition, prior to her employment as a dental assistant she was in a car accident leaving her with vertebrae problems.

The Applicant testified that she had obtained interest relief for one period of time and had reapplied later but was rejected. The Applicant had also made some payments towards her loans up until the spring of 2008. In addition, the Applicant had attempted to find work as a dental assistant within a 50 kilometer radius of her home without success. These factors satisfied the Court that the good faith requirement had been satisfied.

The Court, therefore, focused its analysis on the financial difficulty test. The Canada Revenue Agency argued that the Applicant could travel up to an hour and a half to find employment in her field or move to obtain employment as a dental assistant. However, the Applicant testified that moving was not an option as the mortgage payment she had on her home was very modest ($230 per month) and she would not likely be able to obtain a similar small payment if she moved. The Court stated that traveling up to an hour and a half for employment was simply unrealistic. After reviewing the budget of the Applicant, the Court held that it was modest, included only basics, and essentially left no room for any additional expenditure that may come along. The Court held that there was no surplus and certainly not one of the amount required to repay the student loans. In addition, the Court considered the value that the Applicant was able to derive from her education:

> A student loan gives the individual a valuable asset, that of education. In theory the individual should be able to utilize the asset for their working life and this financial benefit is one for which repayment is justified. In the given situation, the Applicant, based on her health and physical location, is not likely to return to the career for which she was trained.

Ultimately, the Court held that relief under section 178(1.1) should be granted and that section 178(1)(g) no longer applied to the Applicant's student loans.

2.4 *Lagace* (Re), 2011 NBQB 325, NBJ no 409 (QL).

The Applicant obtained a Canada Student Loan in 2003 to finance a medical secretary certification program. The course was successfully completed and the Applicant ceased to be a student in June 2004. As a result of the loss of employment and maternity leave, the Applicant became insolvent and made an assignment in bankruptcy on May 5, 2008. The Applicant received a discharge less than a year later on February 6, 2009. The Applicant's husband did not declare bankruptcy but filed a proposal on which payments of $250.00 per month are still being made and would continue to be made for approximately 17 months. The Applicant's daughter, four years old at the time of the application, had special needs requiring ongoing medical and psychological care. As of December 2010, the Applicant had surplus income of $68.97 after expenses were paid. The Applicant testified that, at the time of the application and during the preceding three months, she and her husband had been relying on a payday loan company which charged $60 for a $300 monthly advance, eliminating the small surplus that she previously had.

The Canada Revenue Agency consented to the relief sought by the Applicant under section 178(1.1). However, the Province of New Brunswick opposed the application, with the loan balance amounting to $8,664.05. The Province, although sympathetic to the Applicant, informed the Court that the provincial government had issued a strong mandate that debts owed to the Province must be collected. The Province argued that there was no evidence that the Applicant's reliance of payday loan companies would continue indefinitely. In addition, the Province questioned clothing expenses of $75 per month. The Province suggested that the Court grant an adjournment and reconsider the application at a later date when there might be an ability by the Applicant to make at least a minimal payment. The Court did not explicitly discuss good faith. However, in regards to the financial difficulty test and summarizing its decision, the Court stated:

> Defining the situation of a family, obliged to care for a special needs child with negligible discretionary income for a further period of more than three and a half years, as not constituting financial difficulty such as the debt cannot be repaid is a postulate requiring an imagination more fertile than mine.

The court granted relief under section 178(1.1).

2.5 *Mullin* (Re), 2012 NBQB 212, NBJ no 216 (QL).

The Applicant obtained Direct Financed Canada Student Loans totalling $8,257 for a period of study ending in 2007. In addition, the Applicant obtained provincially guaranteed loans with an unpaid balance of $27,451.90. The Applicant used these funds for two programs: a Bachelor of Science degree at Mount Allison University which was not completed and a course in massage therapy which resulted in certification. The Applicant began working in Montreal between 1997 and 1999 where she apprenticed as a massage therapist. After 2000, she worked in Fredericton and in 2004 became a biology tutor at the Atlantic College of Massage Therapy on a part-time basis as

well as at another clinic. According to the Applicant, her annual income in 2005 and 2006 was approximately $24,000. In 2006, she commenced a home-based practice as well as consulting with her husband's firm while she attempted to continue studies on her uncompleted degree. This ended for medical reasons due to her second pregnancy. The Applicant testified that she had made sporadic payments before 2006 and a few more recent small payments to a collection agency. The Applicant received a bankruptcy discharge on February 27, 2010.

There were two children in the household, aged four and one half years and slightly over two years at the time of the application. The older son had been diagnosed with a pervasive development disorder which required special attention. The Applicant testified that her involvement in her son's intervention program prevented her from seeking employment because to work herself while hiring a professional to do that which she now does in regards to her son's care would be cost-ineffective to the point of being prohibitive. The Applicant's husband was completing a consumer proposal at the time of the application, the details of which were unavailable at the hearing.

With respect to the good faith requirement, the Court found that the efforts made and the attempts to find education-related employment were sufficient to meet this aspect of the test, despite the fact that the details of repayments were not absolutely clear.

In regards to the financial difficulty requirement, The Canada Revenue Agency argued that the Applicant's monthly household income indicated that there would be a surplus over the Superintendent's Guidelines which would permit monthly payments of $189 on the federal student loan. However, the Court indicated that the Superintendent's Guidelines were not to be viewed as an absolute benchmark but may serve as a general point of reference when the household income substantially exceeds the guidelines.

The Court noted that the situation involving a special needs child was one that required comment. The Court stated that a student loan provides an asset of an education which should endow the borrower with a lifelong financial benefit for which repayment is justified and that difficulties in making payments during the early years of career development if one chooses to commence a family at that time are understandable. The Court noted that this is not, under ordinary circumstances, a reason for non-payment. However, the Court explicitly stated that having a special needs child falls outside of this general rule and that this is normally an unforeseen event, which requires an unanticipated expenditure of time and funds over a significantly longer term than that of caring for a healthy infant. In addition, the Court noted that financial pressures could have a more pronounced impact on the emotional well-being of the family in these instances. Although this did not mean that relief under section 178(1.1) was automatic, the Court indicated that it would be a major consideration. The court referred to Re *Legace* (summarized above), which took the same stances with regards to households with special needs children. The Court, however, also pointed to another decision, Re *Naida* (2012 NBQB 40) that took a different stance on this issue; however, the Court pointed out that the Applicant in this case owed over double the amount owed by the Applicant in Re *Naida*.

Although the Canada Revenue Agency argued that their debt could be retired with 41 payments of $189 per month, the Court noted that this ignored the fact that this would only constitute less than 25% of the total outstanding student debt of the Applicant. The Court held that they could not

discharge the debt of one government agency while maintaining that of the other and that there was no jurisdiction to vary or make pro rata payments. Even with payments of $300 per month on the total debt owed, the Applicant would be paying off these loans for ten years even if interest were not accruing which it would be, all while caring for her children. Ultimately, the Court ruled that all of the Applicant's student debts should be discharged and relief granted under section 178(1.1).

2.6 *St-Pierre* (Syndic de), 2012 QCCS 4635, JQ no 9300 (QL).

Reasons and details were not provided for this decision where the Applicant's student debts were discharged and relief granted under section 178(1.1).

Report on the statutory review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* by the legislative review task force (Commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals.

July 15, 2014

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1. INTRODUCTION

The joint legislative review task force (Commercial) of the Insolvency Institute of Canada ("IIC") and the Canadian Association of Insolvency and Restructuring Professionals ("CAIRP") (the "JTF") respectfully submits this report to Industry Canada ("IC") and to its sponsoring organizations, IIC and CAIRP. The JTF was appointed jointly by these two (2) leading national organizations, represented regionally across Canada in terms of diversity and type of practice. A detailed account of the composition and methodology of the JTF is attached hereto as Schedule A to this report.

At this early stage of legislative review, the mandate of the JTF is to provide objective non-partisan comments on the various issues raised in Industry Canada's ("IC") discussion paper entitled *"Statutory Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act'* (the "Discussion Paper") in the context of the public consultation process launched by IC in May 2014. The JTF's mandate also encompasses the identification of issues which may not be addressed in the Discussion Paper but which, in the JTF's view, should be considered in the next round of legislative reform of the Bankruptcy and Insolvency Act ("BIA")[132] and the Companies' Creditors Arrangement Act ("CCAA")[133].

At the outset, it is important to note the following in regard to the scope of the JTF's mandate and related report:

- like the Discussion Paper, this report does not contain formal recommendations with respect to eventual legislative reform of the BIA and CCAA. Although some of the comments may suggest a direction in legislative changes, these should be considered as a starting point for further research on legislated solutions. Recommendations will be made at a later stage of legislative reform and will involve, *inter alia,* additional research, collective reflection on certain issues considered worthy of reform as well as the polling of members of IIC and CAIRP.

- this report focuses on corporate and commercial issues and topics raised in the Discussion Paper which are related to commercial and corporate bankruptcy and restructuring. Issues related to consumer bankruptcy and insolvency are addressed in a distinct report prepared by the CAIRP Consumer Advocacy Task Force.

2. EXECUTIVE SUMMARY

The majority of issues and topics raised in the Discussion Paper are relevant and worthy of further consideration in the context of the eventual reform of the Canadian statutory insolvency regime. While the 2009 global reform of the BIA and CCAA resulted in significant improvement and modernization of these statutes, the JTF wholeheartedly supports periodic Parliamentary review of the BIA and CCAA with a view to improving the statutory regime and ensuring that it remains relevant and functions effectively in a changing market place. Each of the issues raised in the Discussion Paper in respect of commercial restructuring or insolvency is commented in greater detail hereunder, in section 3.

[132] RSC 1985, c. B-3, as amended.
[133] RSC 1985, c. C-36, as amended.

The JTF has also identified certain issues and topics not otherwise raised in the Discussion Paper which are, in its view, worthy of consideration in the next round of legislative reform of the BIA and CCAA. Such additional issues and topics are raised, when relevant, in the comments made with respect to commercial issues contained in the Discussion Paper and are also outlined in section 4 of the present report.

3. COMMENTS OF THE JTF WITH RESPECT TO THE COMMERCIAL ISSUES RAISED IN THE DISCUSSION PAPER

Commercial issues raised in the Discussion Paper are hereafter addressed in the order in which they appear therein.

3.1. Encouraging innovation through Intellectual Property Rights - Copyrights and Patented Items, 2009 Amendments in respect of the rights of IP licensees

IC has requested submissions regarding how to improve the existing rules to support the objective of encouraging innovation, while also balancing the competing interests in an insolvency proceeding.

JTF Comments

The treatment of intellectual property rights in the context of insolvency is, in the JTF's view, a very important topic which needs to be addressed in the next round of legislative reform. Existing provisions of the BIA regarding the rights of the holders of patents[134] and of copyrights[135] were adopted early in the twentieth century and are clearly outdated in a market place where intellectual property rights such as software licenses constitute assets of significant value.

Furthermore, although changes were made in the last round of reforms (the "2009 Amendments")[136] that seek to protect intellectual property licensees in the face of an insolvency of the licensor while maintaining the ability of the licensor to restructure or preserve value,[137] there has been some criticism of the provisions, as the protection they afford is thought to be scant, in particular considering that the acquisition and maintenance of the intellectual property by the licensee may be very expensive, and its continued accessibility, without restriction, may be crucial to the licensee's business.

The JTF considers additional research is warranted to assess ways to modernize the provisions of the legislation that deal with intellectual property, and to assess whether the 2009 Amendments strike the proper balance between the rights of licensees to enjoy the intellectual property they have a contractual right to use and the rights of licensors to restructure.

The following section addresses various issues considered by the JTF to be worthy of consideration

[134] Section 82 BIA.
[135] Section 83 BIA.
[136] *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c 47 as amended and complemented by *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada*, 2005, S.C. 2007, c 36
[137] Sections 65.11(7) and 84.1 BIA and sections 11.3 and 32(6) CCAA.

and further research in order to improve the treatment of intellectual property rights in a context of insolvency.

3.1.1. Issue raised by IC: Proposals for the reform of Section 82 and 83 of BIA:

The modernization of the treatment of intellectual property ("IP") rights in a context of bankruptcy is, in the JTF's view, worthy of consideration.

The concept of "intellectual property" is much broader than traditional forms of intellectual property such as patents and copyright in respect of manuscripts, which presently benefit from limited protection under sections 82 and 83 of the BIA. BIA and CCAA should perhaps be amended to include a broader, detailed and flexible definition of intellectual property as such non-inclusive definition of IP would provide greater clarity to practitioners and stakeholders. Any definition of IP should remain flexible and non-exhaustive in order to take into account concerns arising from the rapid change in IP and laws relating to IP.

The Intellectual Property Owners Association[138] has recently adopted a resolution supporting the inclusion of trademarks, service marks and trade names in the definition of IP in the *American Bankruptcy Code.* Some recent US caselaw[139] has navigated around the existing exclusion of trade-marks in the United States. An examination and consideration of the American experience and jurisprudence in this regard may be a good starting point for considering how the definition of IP should be developed.

Reliability of the insolvency system and the protection of IP rights play a vital role in attracting domestic and foreign investment as well as promoting entrepreneurship and innovation.

In the context of balancing these interests, insolvency laws should provide a clearer indication of how various types of IP will be affected upon insolvency. The following guidelines should be considered in this regard:

- Consider developing a definition of IP which provides descriptions of various IP rights and interests that is not static and is capable of evolving with the rapid evolution of IP and IP law.

- Consider whether different types of IP should attract different treatment and whether that treatment will be different depending on the outcome of the insolvency process (restructuring vs liquidation).

- Reform on these issues should be cautious and mindful when considering statutory definitions, classifications and differences in the treatment of IP to avoid a result which may be too "rule based" and categorical and which does not sufficiently provide flexibility and judicial discretion to interpret and apply the provisions on a principled, organic and evolutionary manner.

3.1.2. Issue raised by IC: Effectiveness of the 2009 Amendments regarding the limited consequences of termination of contracts

The JTF is of the view that the effectiveness of the 2009 Amendments with respect to the

[138] https://www.ipo.orq/index.php/advocacy/board-resolutions/2014-board-resolutions/

[139] "See *Re Interstate Bakeries Corporation v. Interstate Brands Corporation,* 2014 U.S. App. Lexis 10537 (8th Cir. 2014); *Re Exide Technologies,* 607 F. 3d 957 (3d Cir. 2010).

consequences of terminating contracts regarding the use of IP is worthy of consideration.

Some of the related issues to be considered in this respect are the following:

- Should there be distinctions in how IP rights are treated depending on the statute under which proceedings are commenced and/or the type of proceedings which are commenced?

- Different treatment of IP rights may result in statute shopping for debtors whose principal assets are IP, such as technology, content and branding businesses. To promote harmony and certainty, IP rights should be treated similarly whether the process chosen is under the BIA, CCAA or receivership.

- Some of the licensee protections introduced in 2009 apply if the licensor restructures but not in a bankruptcy or receivership context. The 2009 Amendments do not address a receiver's ability to disclaim agreements whereas an insolvent person is explicitly permitted to disclaim agreements under section 65.11 BIA.

- The outcome of the proceedings (liquidation vs. restructuring) ought to be the primary factor to influence the manner in which IP rights are treated, rather than the choice of statute or proceeding. For example, IP rights should be treated the same regardless of whether a liquidation takes place under the BIA or the CCAA. Similarly, IP rights should be treated similarly where the end result of a process is a restructured company which continues to operate. Furthermore, it may be advisable to consider whether there should be a defined period during which trustees must decide how to treat IP rights in a bankruptcy.

3.1.3. Treatment of IP rights subject to a sale through insolvency proceedings

While this related issue is not specifically addressed in the Discussion Paper, the JTF believes that the manner in which IP rights are treated where asset sales are conducted in the context of insolvency proceedings is worthy of consideration.

Depending on the type of underlying IP at issue, an insolvent licensor may be able to sell IP free and clear of current licenses in certain circumstances to maximize value of the estate. This creates uncertainty and may be detrimental to the interests of licensees.

A more certain approach which has the flexibility to accommodate unique situations should be considered. Protecting IP rights and maximizing value for the estate can produce competing tensions and the difficulty is finding the appropriate balance between those tensions.

Currently, parties that rely on the IP assets of another person (such as a licensee and franchisees reliant on the trade-marks of franchisors) are not explicitly required to receive notice of a sale of IP.

The following questions thus deserve further reflection and consideration in this regard:

- Should there be a notice regime or claims process whereby IP holders who may be affected are given an opportunity to participate in the process and be recognized as a stakeholder entitled to further notice in the proceedings?

- Should licensees be provided a right of first refusal to purchase the licensor's IP?

- To the extent that IP rights are negatively affected, should the parties so affected be provided with an opportunity to appear in court and object to the relief that may affect their IP rights?

- Should it depend on whether there may be a material negative impact or should there be another threshold or test?

3.1.4. IP rights of licensees upon the insolvency of a licensor

The 2009 Amendments were aimed at reducing uncertainty faced by IP licensees in an insolvency restructuring, in a manner similar to the protection afforded to licensees under the *US Bankruptcy Code*[140].

While the debtor can unilaterally disclaim most agreements under the CCAA and BIA, there is a carve-out which limits the consequences of such disclaimer when it relates to a contract for the "use" of IP (such as license agreements).[141]

However, these carve-outs apply only with respect to the "use" of IP. While IP licensees whose licenses have been disclaimed may continue to use the IP as long as they continue to perform their obligations under the license, they are unable to obtain the benefits of other covenants under the license such as access to source codes or further updates or service/maintenance.

Forcing licensors to honour the terms of otherwise disclaimed licenses may unduly hamper the restructuring process and place onerous restrictions on debtor licensors or potential purchasers. Furthermore, there is currently no definition of "use" and this term is used in different contexts with reference to IP.

A definition of "use" which references the exploitation of licensed IP will, at the very least, reduce uncertainty and the accompanying litigation associated with a lack of clarity towards what can and cannot be done with IP.

The following questions are thus worthy of further reflection and consideration:

- Should licensees be able to exploit IP in accordance with the terms of their license?

- How should situations where a licensee has access to IP but is not "using" it *per se* be addressed?

- Should the meaning of "use" be defined in relation to the rights granted in the underlying license?

In each instance, the affected rights should be considered from both the licensee and licensor perspective in an attempt to develop the most appropriate and equitable balance between the parties.

[140] See section 365(m) of the *US Bankruptcy Code*.
[141] See section 32(6) CCAA and 65.11(7) BIA.

3.1.5. IP rights of licensors upon the insolvency of a licensee

The JTF believes that the treatment of licensors of IP rights upon the insolvency of licensees is also an issue worthy of consideration.

Under existing provisions, the court may order an assignment of the license provided, *inter alia,* that the assignee will be able to perform the assigned obligations and, more broadly, provided that it is appropriate to allow such assignment[142].

Currently, IP license agreements may be subject to a forced assignment under the BIA and CCAA such that the consent of the licensor is no longer required. Accordingly, licenses may be assigned to competitors of licensors or others who may for valid reasons be objectionable for the licensor on an ongoing basis.

The following questions are thus worthy of further reflection and consideration:

- What is the appropriate balance to strike in this circumstance?
- What factors should the court consider in exercising its discretion to approve the assignment of IP over the objections of the licensor?
- Should good faith be a consideration in approving sales and/or transfers of licenses?

In each instance, the affected rights should be considered from both the licensee and licensor perspective in an attempt to promote a balance between protecting IP rights and maximizing value in the estate through the insolvency process.

3.1.6. Formal protection of trade-marks.

The JTF believes that the protection of trade-marks in the context of insolvency is an issue worthy of consideration. The exclusion of trade-marks protection in the *US Bankruptcy Code* has been the object of controversy in the US and further research in this regard is warranted to determine whether or not trade-marks should benefit from protection similar to that afforded to other types of IP.

3.1.7. "Patent-trolls" and IP litigation in insolvency proceedings

There is currently no statutory obligation to act in good faith under the BIA or the CCAA. This allows for licensors and licensees to take positions during the bargaining process that they know have little merit but may provide them with a temporary advantage in the marketplace or leverage in the insolvency process.

In the US, concerns have been raided about "Patent-trolls" who purchase patents and other IP rights in insolvencies or otherwise for the purpose of pursuing litigation against parties who may have had dealings in the past with the debtor or who may allegedly be using the debtor's IP. A similar concern can be raised in Canada and if so, consideration has to be given as to whether this is IP law issue generally or whether it is a problem that may arise specifically in an insolvency context and thus requires an insolvency solution.

[142] See Sections 84.1 and 66 BIA and 11.3 CCAA.

Some additional concerns and questions which might be considered in this regard include:

- In the IP context, should concerns be addressed or reviewed under a good-faith or public policy consideration when the court is being asked to approve the sale of IP assets?

- What obligations should trustees and monitors have to investigate and assess motives or *bona fide* of potential purchasers?

- Should the insolvency courts consider and assess any intentions or motives of IP purchasers?

3.1.8. Cross-border IP and intermingled IP during an insolvency proceeding.

The treatment of cross-border rights in the context of the restructuring of corporate group enterprises is, in the JTF's view, an issue worthy of consideration.

When corporate group enterprises face insolvency, there are regularly issues as to the treatment of cross-border IP rights. Many issues of this nature have arisen in the context of the liquidation of the Nortel IP rights for instance.

Sometimes, IP is owned by one entity in one jurisdiction but used in multiple jurisdictions. There should be a level of consistency in these circumstances and Canadian legislation should strive to deal with IP in a manner that is compatible with the treatment of IP in other major jurisdictions. Furthermore, IP may be co-owned by multiple entities as it may have been developed using the resources of more than one party (i.e. in joint ventures).

The following questions are thus worthy of further consideration and reflection:

- How should IP rights be treated when IP is located globally or in more than one jurisdiction?

- What law should govern the treatment of IP in those scenarios and should there be legislative guidance to deal with those situations?

- How should IP be dealt with if it is subject to a complex web of ownership whereby different parties have made varying contributions to its creation?

Different types of IP will require different treatment and considerations. Some form of IP such as patents and trademarks are inherently easier to protect since they are registered to a legal owner in a specific jurisdiction. In those circumstances, it may make sense for the law of the jurisdiction where the IP is registered to govern.

Consideration should also be given to what extent it may be appropriate for there to be harmony between the treatment of IP in Canada and the treatment of IP in other jurisdictions such as the United States and England. Coordination in this regard with other jurisdictions may reduce costs and uncertainty and provide greater incentives for innovation and creativity with respect to IP.

3.2. Streamlining CCAA proceedings and Initial Orders

IC has requested submissions regarding the breadth of Initial Orders and potential options for streamlining the process.

JTF Comments

The JTF is of the view that eventual legislative reform of CCAA should be mindful of measures to be adopted to increase the efficiency and reduce the costs involved in the restructuring process. In Canada and in other jurisdictions[143], it has indeed become evident that restructuring costs have become a source of preoccupation for creditors, debtor companies, practitioners and stakeholders in general.

The JTF believes that some research should be made to assess whether the current preoccupation of creditors, debtor companies, practitioners and stakeholders regarding excessive costs is a matter of real concern or of perception. Some have argued that restructuring costs, which are essentially transactional costs, are no higher and may even be lower than similar costs incurred in other transactional activities in the marketplace. They may appear to be higher because they are perceived to remove returns from creditors' claims rather than enhance value for stakeholders as a whole by preserving a going concern.[144] The practical principle-based approach and role of the monitor as court officer embodied in the CCAA statute does serve to facilitate what is generally a more efficient, less litigious and less costly restructuring process in Canada than in other jurisdictions such as the United States. Further, a number of initiatives have been put into practice by the restructuring profession with the objective of streamlining the CCAA process and keeping costs down. However, the JTF agrees that efforts have to continue to be made to improve efficiency and cost-effectiveness.

The suggestion made that initial order mechanisms under the CCAA provide for a short automatic stay period as well as limited "lights on" protection of the debtor company is worthy of consideration. Such automatic limited protection, similar to that resulting from the filing of a notice of intent to file a proposal under the BIA could reduce litigation and costs related to the issuance of the initial order and increase the efficiency of the CCAA process.

It should be borne in mind however that in all Canadian provinces, model initial orders have been adopted through the combined effort and collaboration between insolvency practitioners and the judiciary. Such model initial orders have been instrumental in improving the efficiency of the restructuring process and the stakeholders' ability to foresee the protection mechanisms usually made available to a debtor company seeking to restructure under the CCAA. Such model initial orders generally contain a "comeback" clause pursuant to which interested stakeholders may address the court within a certain delay to seek to have the terms of the initial order modified or rescinded.

The JTF is of the view that restricting the breadth of initial order to "lights on" protection of the debtor company, limited both in scope and in time, could serve to postpone "out of the gate" litigation as to the breadth of the initial order sought by the debtor company. This approach would afford stakeholders necessary time to seek to resolve these issues through negotiations. This being said, limited automatic "lights on" protection should not unduly modify present practice in respect to the use of model initial orders which

[143] For example, in the US, in 2013, the Executive Office for United States Trustees adopted *"Guidelines for Reviewing Applications for compensation and reimbursement of expenses filed under United States Code by Attorneys in Larger Chapter 11 Cases"* (see Federal Register, Vol. 78, No. 116, June 17, 2013.

[144] A "Cost"-Benefit Analysis: Examining Professional Fees in CCAA Proceedings, by Stephanie Ben lshai and Virginia Terrie in 2009 Annual Review of Insolvency Law (Janis P. Sarra, ed.) Thomson Reuters Canada Limited. The authors quote studies by Stephen Lubben in the U.S.

provide necessary flexibility as to the required degree of protection based upon the circumstances of each case, particularly in the most vulnerable situations where greater clarity to stakeholders and affected parties at the outset may be critically important.

3.3. Claims Process

IC has requested submissions regarding the existing claims process and whether consideration should be given to a default process.

JTF Comments

The JTF believes that the reduction of costs associated with a claims process in a CCAA restructuring is an objective worthy of consideration in the next round of legislative reform. However, reform in this regard should not unduly restrict the flexibility of existing practice in CCAA restructurings to adapt the court approved claims process to the specific factual context at hand.

In certain circumstances, namely where the books and records of the debtor company are not accurate or otherwise reliable, a default mechanism for determining claims may not be appropriate. Reform should thus encourage cost effective claims processes while preserving the flexibility and discretion of the courts given the varying factual circumstances of each CCAA restructuring.

The JTF also notes that there is no clear rationale to justify existing differences between the treatment of claims in a BIA restructuring and the treatment of claims in a CCAA restructuring. It may thus be relevant to consider adopting or, *inter alia,* model proof of claim in CCAA similar to the model generally used under the BIA.[145]

3.4. Court Applications

IC has requested submissions regarding the existing role of court appearances in CCAA proceedings and whether considerations should be given to possible approaches to reduce the number and cost *of such court appearances.*

JTF Comments

As previously mentioned, the JTF supports that legislative changes be considered to improve the efficiency and cost effectiveness of the CCAA restructuring process and necessary court appearances related thereto.

Measures to be considered in this regard include the following:

- implementing initial order mechanisms which provide for a short automatic stay period and "lights on" protection of the debtor company[146];
- providing that renewal of CCAA protection be granted automatically where due prior notice has been given to creditors and relevant stakeholders and no objection has been filed;

[145] See form 31 BIA.
[146] See Section 3.2 hereinabove.

- increasing attendance at hearings by phone, where appropriate, to avoid court costs associated with "watching briefs".

Balancing competing interests

3.5. Role of unsecured creditors

IC has requested submissions regarding the effectiveness of the existing provisions and other potential mechanisms to ensure the effective voice for unsecured creditors and restructuring proceedings.

JTF Comments

The JTF believes that the due and efficient representation of unsecured creditors in CCAA proceedings is an issue worthy of consideration.

The JTF cautions however that the creation of "unsecured creditors' committees" whose professionals are to be paid for by the debtor should remain exceptional and subject to broad judicial discretion dependent on the factual context of each case. It is generally perceived that the US practice of having the debtor pay for counsel and financial advisors mandated to protect the interests of unsecured creditors, may lead to unnecessary litigation, increased costs and inefficiencies. It must be borne in mind that in the context of CCAA proceedings, the monitor acts as a court officer and exercises a degree of supervision which is beneficial to the interests of unsecured creditors of a debtor company. The role played by the monitor (and the proposal trustee) in CCAA proceedings constitutes an essential difference between the US and the Canadian restructuring systems and justifies that unsecured creditors' committees remain an exception in CCAA proceedings.

The existing legislative scheme under BIA and CCAA whereby the court may provide that the fees of certain professionals will be covered by a prior ranking charge[147] provides adequate judicial discretion and authority in this respect.

3.6. Acting in Good Faith

IC has requested submissions regarding whether the CCAA should expressly address whether parties to the proceedings have a duty to act in good faith.

JTF Comments

As presently drafted, BIA and CCAA impose a duty to act in good faith upon the insolvent debtor[148], upon the trustee[149] and the monitor[150] but does not impose a broader duty to act in good faith upon all stakeholders involved in a restructuring process. It is perceived that the codification of a duty to act in good faith could bolster the courts' authority to protect the integrity and efficiency of the insolvency system, without limiting the right of creditors to protect their own rights and interests in a restructuring process. While the JTF believes that the codification in the CCAA and in BIA of an overarching duty of stakeholders to act in

[147] See 11.52 CCAA and 64.2 BIA.
[148] Section 50.4(9) BIA and 11.02 CCAA.
[149] Section 50.4(5) BIA.
[150] Section 25 CCAA.

good faith is worthy of consideration, eventual legislative reform should be mindful of not distorting common law or civil law principles or possibly creating fundamental divergences in the way BIA and CCAA process could be managed in Quebec and in the rest of Canada. The JTF considers that additional research is warranted to assess differences existing between common law and civil law jurisdictions in this regard with a view to avoiding a legislative change that may result in creating undue legal uncertainty and differences in approach across Canada.

It should also be borne in mind that under CCAA, the court has very broad discretion to render any order it deems appropriate in the circumstances[151]. The CCAA court may thus adjudicate matters equitably without the formal codification of a duty of good faith.

3.7. Eligible Financial Contracts

IC has invited submissions regarding Eligible Financial Contracts and their impact on insolvency and restructuring proceedings, as well as potential policy responses.

JTF Comments

The JTF believes that the treatment of eligible financial contracts ("EFCs") in respect of an insolvent estate is worthy of consideration.

The Canadian insolvency regime protects EFCs by exempting them from the treatment that contracts ordinarily receive upon the commencement of insolvency proceedings. The core components of the EFC protection, commonly known as "safe harbours", primarily provide an exemption from the stay of proceedings, thus allowing the termination of EFCs by the solvent counterparty, the determination of a net amount owing under the terminated EFCs and the realization upon financial collateral posted in respect of EFCs. The EFC safe harbours also provide solvent counterparties with a higher priority to financial collateral posted in respect of EFCs. Further, the insolvent estate is forbidden from terminating or assigning EFCs upon its insolvency.

EFCs receive special protection to reduce systemic risks in Canadian and global financial markets where the failure of parties to EFCs on a large scale can create a chain reaction which can lead to a global liquidity crisis. The obligations under EFCs are often based upon substantial notional amounts and the value of the underlying reference items and of the financial collateral securing EFCs obligations can be highly volatile. In addition, the EFC safe harbours were introduced to ensure certainty in global financial markets and to provide Canadian institutions with access to the global derivatives markets and make them competitive in these markets.

The current treatment of EFCs under the Canadian insolvency regime does not always strike a right balance between the objectives of protecting against systemic risk and allowing insolvent commercial enterprises to restructure. Current law may in some cases impede the restructuring of insolvent enterprises and prevent the insolvent estate from realizing value for its creditors by placing too much emphasis on attempting to reduce systemic risk. Further, the safe harbours may delay or prevent certain liabilities of the insolvent estate from being crystallized.

The JTF believes that changes are warranted to provide a better balance between the systemic risk reduction objective and the insolvency objectives, i.e. promoting restructuring of insolvent debtors with

[151] See section 11 CCAA.

an opportunity for a fresh start, avoiding bankruptcy, preserving value and providing predictability of results.

The JTF believes that consideration should be given to implementing the recommendations made by IIC regarding the treatment of EFCs under Canadian insolvency law. The recommendations are mainly as follows:

- Allowing the insolvent estate to terminate EFCs after the expiry of an appropriate period during which the solvent counterparty has the unilateral right to terminate EFCs;
- Allowing the insolvent estate or the court to assign EFCs while permitting the solvent counterparty to terminate the EFCs until the assignment occurs;
- Prohibiting or rendering ineffective walk-away clauses that reduce amounts owed under EFCs because of an insolvency;
- Increasing the priority of financial collateral posted in respect of collateral which is segregated from the insolvent's other assets;
- Protecting the central clearing of over-the-counter derivatives; and
- Ensuring that the safe harbours apply consistently in receiverships.

The recommendations are set out and discussed in a detailed report prepared by the IIC's Derivatives Task Force. The report has previously been submitted by the IIC to Industry Canada and is attached as schedule B to this report.

3.8. Professional Fees in CCAA Proceedings

IC has requested submissions regarding the impact of professional fees on insolvency proceedings, including the utility of greater discloser practices.

JTF Comments

The JTF is of the view that professional fees and their impact upon the efficiency and cost-effectiveness of the Canadian insolvency regime are issues worthy of consideration. While there presently are no known reliable statistics in this regard and while the issue does not appear to have arisen in a significant number of Canadian restructurings, it is perceived that the high professional costs involved in CCAA restructurings may sometimes be a deterrent to efficient restructuring. Such potential negative impact of professional fees is a source of concern in other jurisdictions such as the United States, the United Kingdom and Australia and should also be a source of concern in Canada.

The JTF believes that further consultation and polling of the respective members of IIC and CAIRP and of other interested stakeholders such as secured lenders shall be essential to identify appropriate measures to reduce or otherwise monitor more efficiently professional fees incurred in CCAA proceedings. It should indeed be borne in mind that certain practical measures for the efficient management of professional fees may be implemented without being formally addressed under federal legislation.

Enhancing Transparency

3.9. Creditor lists

IC has invited submissions regarding imposing an obligation on the debtor company to maintain a creditors' list during a CCAA proceeding.

JTF Comments

The JTF is of the view that codifying a debtor company's obligation to maintain and update a creditors' list during a CCAA proceeding is an issue worthy of consideration. Greater clarity and disclosure in this regard would allow other stakeholders to adequately organize and develop bargaining positions. Any legislative amendment in this regard should however be mindful of the costs to be incurred to maintain and update such creditors' list.

3.10. Empty Voting and Disclosure of Economic Interests

IC has invited submissions and input on whether courts should be empowered to require greater disclosure of creditors' actual economic interests or to take account of those interests.

JTF Comments

The JTF believes that, in a restructuring context, the disclosure of a stakeholder's true economic interests and related means to compel such disclosure is an issue worthy of consideration in an eventual reform of the BIA and CCAA. This issue was of significant concern in the ABCP restructuring under the CCAA, namely in respect of creditors benefiting from credit default swaps which necessarily affect such creditors' economic interest in the restructuring. The rationale for compelling a stakeholder to disclose all of its economic interests in a restructuring context is intrinsically related to the transparency of the process as a restructuring may be unduly impaired where creditors with undisclosed economic interests seek to profit from a failed restructuring process.

The means to be considered to achieve necessary disclosure of actual economic interests of stakeholders could include the following:

- granting the court necessary authority to compel the disclosure of all economic interests of a creditor;
- granting the monitor or trustee necessary authority to compel the disclosure of all economic interests of a creditor;
- consider use of a broader duty of good faith[152] which would be incumbent upon all stakeholders involved in a restructuring process.

With respect to the potential impact of distressed debt trading, the JTF cautions that any inherent statutory limitations as to the assignability of claims against an insolvent debtor company may negatively affect the debt market and related secondary distressed debt market. As a general principle, creditors should be allowed to purchase and sell claims against an insolvent debtor (even for the admitted purpose of acquiring a

[152] See «*Acting in Good Faith*» in section 3.6 hereinabove.

majority or blocking position) and should be able to vote for the full amount of such claims even though they may have been purchased at a discount. Such general principle, which underpins the distressed debt market, should only be subject to limited exceptions, namely where it can be demonstrated that the creditor having purchased distressed debt is not acting in good faith or otherwise unduly seeking to impair the restructuring. Any legislative solution in this regard should preserve broad judicial discretion essential to the evaluation of the consequences on a case by case basis. Judicial intervention in a debt trading context has been justified, *inter alia,* by the general principle pursuant to which the powers conferred upon a majority of creditors must be exercised *bona fide* for the interests of the class of creditors and not for the benefit of individual interests[153].

Role of the monitor

3.11. Pre-filing reports

IC has requested submissions regarding whether pre-filing reports should be permitted and if so, in what circumstances.

JTF Comments

The JTF believes that use of pre-filing reports should be authorized in certain circumstances. In light of the fact that this issue has been dealt with unevenly by Canadian courts, (i.e. certain courts refuse to allow pre-filing reports while others have allowed same), the JTF concludes that this issue is worthy of consideration in the next round of legislative reform.

Legislative amendments with respect to pre-filing reports should be mindful of the following safeguards and protection:

- to allow pre-filing reports, the court should be satisfied, inter alia, that such reports have been prepared impartially and objectively by the prospective court-appointed monitor;
- when allowed, pre-filing reports should benefit from the same protection as that afforded to other reports prepared by the monitor under Section 23(2) CCAA.

3.12. Conflict of Interest

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

JTF Comments

The JTF is of the view that significant checks and balances are already in place concerning the status, conduct and role of the monitor and, accordingly, the implementation of additional protective measures to address potential conflicts of interest where the monitor has a pre-filing relationship with a debtor company is not worthy of consideration in the next round of legislative reform. Section 25 CCAA imposes broad duties upon the monitor to act honestly, in good faith and in accordance with the *BIA Code of Ethics,* which are meant, *inter alia,* to avoid monitors being placed in a conflict of interest position. Most monitors are also subject

[153] See *British America Nickel Corporation, Limited* vs. *MJ O'Brien,* [1927] AC 473.

to CAIRP Guidelines in this regard.

Asset Sales

3.13. Credit Bidding and Stalking Horse Bids

IC has invited comments on whether credit bidding should be permitted and if so, what limitations may be appropriate.

IC has invited comment on whether stalking horse bids should be expressly permitted under Canadian insolvency legislation and, if so, what limitations may be appropriate.

JTF Comments

The JTF considers that reviewing and possibly expanding the scope of Sections 65.13 BIA and 36 CCAA to better deal with asset sales in general and more specific issues, including credit-bidding and stalking horse bids, is worthy of consideration.

The JTF believes that changes implemented in sale processes in the context of a restructuring exercise, if any, should be made with a view to retaining a high degree of harmony between the provisions of the CCAA and the equivalent provisions of the BIA.

Whenever judicial approval is sought, the BIA/CCAA should direct the court to consider a non-exhaustive set of criteria and provide for the filing of a report by the trustee or monitor. Such a report should disclose and analyse all circumstances which could materially affect the fairness and competitiveness of the proposed court supervised process.

The JTF is of the view that credit bidding is permissible at law in Canada subject to contractual restrictions, if any, and does not support introducing specific statutory authority to limit credit bidding, subject to the already existing general grant of jurisdiction under Section 11
CCAA and the court's discretion to approve a sale or disposition of assets outside the ordinary course of business, or when requested by the parties, to approve a sale transaction. Possible options to better deal with credit bidding include increased focus on the issue at the time of selecting and approving a court supervised sale process and imposing additional factors at the time of court approval if the proposed sale or disposition is to be made to a purchaser/creditor relying on a credit bid to acquire the assets. The JTF recommends and supports increased input of trustees and monitors at all stages of a court supervised sale process, including at the time of designing a sale process to ensure its fairness and competitiveness and avoid possible chilling effects posed by credit bidding.

Regarding sales of assets in general, the JTF notes that the current provisions of the BIA and CCAA direct that all sales outside the normal course of business be subject to approval of the court, regardless of the importance of the sale or value of the assets. The JTF believes that some thought should be given to allowing discretion to the professionals involved in monitoring the activities of an insolvent business, to avoid a requirement for an approval in a situation where the sale could be considered immaterial to the restructuring process, to increase efficiency by removing the necessity of a court involvement in a matter that the court would consider *de minimis.* The JTF is mindful however that such discretion should be framed so as to provide an objective standard regarding the value of a contemplated transaction, and to

maintain a degree of protection for the claims of employees.[154]

Regarding stalking horse bidding processes, the JTF considers that this method of selling assets has its place in insolvency proceedings in Canada, although the JTF is not convinced there presently exists a need to frame the stalking horse bidding process in a legislative provision. The JTF believes that to date, the court has supervised the stalking horse bidding processes and has developed principles that sufficiently frame their continued use. The JTF is mindful that the stalking horse bidding process could be used to upset the free market equilibrium that can allow for a transaction to take place at fair market value, by creating a chilling effect for prospective buyers who are not the stalking horse bidder. However the JTF believes that this is also true of other methods of selling assets. The JTF is concerned that legislating a strict framework for stalking horse bidding processes might adversely impede the opportunities to sell assets at fair market value, and as a consequence the JTF believes that the current system of court supervision, with guidelines developed by jurisprudence, should remain for such sales. The JTF believes the use of stalking horse credit bidding processes should continue to be monitored, to ensure that the guidelines developed in jurisprudence, together with the court approval process required in virtue of Sections 65.13 BIA and 36 CCAA, continue to protect against the possibility of removing competitiveness in the process of seeking a purchaser for the assets of an insolvent business.

3.14. Applicability of Asset Sale Test

IC has *invited comments on whether a materiality test* is *required to determine when* assets sales *will be subject to court approval.*

JTF Comments

The JTF believes that the codification of a materiality test with respect to necessary court approval of sales made outside the ordinary course of business is an issue worthy of consideration.

The JTF notes however that in CCAA proceedings, a "materiality" threshold is usually introduced through the initial order which customarily allows the debtor company to proceed with sales under a certain amount without the necessity of court approval (subject however to monitor consent). The JTF also notes that in a court appointed receivership proceedings, there are typically provisions for the receiver to proceed with certain assets sale without formal court approval. The codification of a "materiality test" should not unduly restrict judicial discretion in this regard.

3.15. CBCA Arrangements

IC has *requested input regarding the practice of CBCA arrangements involving insolvent companies.*

JTF Comments

The *Canada Business Corporations Act*[155] ("CBCA") was not originally intended to be used to restructure an insolvent enterprise. With time, a practice has evolved whereby the CBCA provisions dealing

[154] Section 65.13(8) BIA and section 36(7) CCAA. The JTF points out that section 36(7) CCAA contains an incorrect reference to sections 6(4) and 6(5) CCAA that should be corrected. The correct reference should be to sections 6(5) and 6(6) CCAA.
[155] R.S.C. 1985, c. C-44, as amended.

with arrangements, namely section 192 CBCA, have been used to restructure an insolvent entity, notwithstanding the apparent prohibition in section 192(3) CBCA. This practice has evolved from an interpretation of the provisions to mean that the relief in section 192 CBCA is available to a corporate group provided that at least one of the entities in a corporate group is not insolvent and that the corporation which emerges from the arrangement must not be insolvent.

The Discussion Paper correctly identifies the issues regarding the use of the CBCA provisions to restructure an insolvent enterprise, and the JTF fully agrees with the issues as framed in the Discussion Paper. The JTF considers that the issues regarding the use of the CBCA to restructure enterprises and the safeguards and protections that should be available in so doing, as the case may be, can lead to a highly polarized debate, with some parties believing that the statute should never be used in an insolvency context and others believing that it can be a very useful and efficient tool, subject however to the introduction of additional safeguards.

As such, the JTF believes that the use of the CBCA as a restructuring tool, and the safeguards and protections that may be appropriate in this context are worthy of additional debate and analysis.

3.16. A Streamlined Small Business Proposal Proceeding

IC has invited submissions regarding whether a simplified, less expensive proposal process for SME's would be warranted.

JTF comments

The JTF supports the implementation of a simplified restructuring process under the BIA designed to allow small and medium sized enterprises to restructure under a streamlined, less expensive process. The JTF believes that legislative amendments in this regard could be inspired by the existing simplified rules applicable under the BIA with respect to consumer proposals[156]. Such simplified rules could include deemed proposal acceptance and deemed ratification by the court where no creditors objections are filed and automatic revival[157] of proposals that are in default, for example.

The JTF however cautions that it would be advisable to conduct further research and data analysis to adequately identify the level of debt which would constitute the threshold for a small or medium seized enterprise to be eligible for restructuring under the simplified restructuring process. The JTF also notes that the simplified process could potentially lead to abuse by insolvent smaller enterprises if it provides, as is the case for consumer proposals, that refusal of the proposal by creditors does not lead to automatic bankruptcy.

3.17. Division I Proposals Extension

IC has requested input on extending the time for filing a Division I proposal following the filing of a notice of intention to file a proposal.

JTF comments

[156] See sections 66.11 to 66.4 BIA.
[157] See section 66.31(6) BIA.

The JTF believes that the potential extension of the 6 month time limit to file a BIA proposal following the filing of a notice of intention to file a proposal is an issue worthy of consideration in the next round of legislative reform.

Any reform in this respect should however be mindful that the BIA is meant to provide for a more rapid restructuring process and that most restructurings under the BIA are traditionally completed by the filing of a proposal within the existing 6 month time frame. The courts could thus be statutorily authorized to extend the 6 month delay in certain circumstances but the criteria to be met by the insolvent person to benefit from such extension should not be overly permissive as to encourage longer and more costly restructurings under the BIA.

3.18. Liquidating CCAA Proceedings

IC has requested input on whether the CCAA should be amended to codify protection for stakeholders and principles for the courts to consider in liquidating CCAA proceedings.

JTF comments

Canadian courts have increasingly allowed the use of the CCAA for the purpose of proceeding to the sale or liquidation of an insolvent debtor company. Such use of CCAA is essentially premised on the maximization of value for creditors where going concern sales are conducted under court supervision[158], outside of a receivership proceeding.

The JTF believes that the courts have developed adequate criteria to determine the circumstances in which the CCAA may be used to allow for the sale or liquidation of insolvent debtor companies. It is thus suggested that the CCAA should not be amended to disallow use of the CCAA to proceed to sales or liquidation, namely as court supervision sale process under the CCAA generally yield better results and more effective protection for stakeholders than if the assets were otherwise disposed of in a receivership context.

This being said, because of its origins as a restructuring tool, the CCAA is not presently drafted to address certain issues which necessarily arise in the context of the sale and distribution of proceeds of an insolvent business. The JTF is thus of the view that various amendments to the CCAA should be envisaged, namely to incorporate a scheme of distribution similar to that contained under the BIA[159] in order to provide greater clarity as to the order in which creditors are to be paid from the proceeds resulting from a sale or a liquidation conducted under the CCAA. The absence of such statutory scheme of distribution under the CCAA has led to significant controversy before the courts, namely in matters such as *Indalex, Grant Forest Products, Timminco* and *White Birch.*

Enhancing Equity

3.19. Employees' Claims

IC has *requested submissions regarding whether, and how, Canada could enhance protection of employee claims in insolvency proceedings.*

[158] Recent examples include *Nortel Networks Corporation (Re}*, 2012 ONSC 1213 and *Aveos Fleet Performance Inc. (Arrangement of)*, 2012 QCCS 6796.
[159] See Sections 136 to144 BIA.

JTF Comments

The JTF believes that further study of the rights of employees in insolvency proceedings is worthy of consideration. Employees represent a vulnerable group of creditors that is wholly dependent on their employer as their principal, if not only source of income and this group has limited means to monitor its credit exposure and protect against financial losses. While the JTF believes it is important to create meaningful and adequate protection for the employees, the JTF is mindful that a proper balance needs to be achieved, to ensure that the granting of protection does not have a perverse effect and unintended consequences of triggering insolvencies or adversely impacting economic performance and overall levels of employment in Canada by restricting access to credit and funding to all companies.

The JTF is aware that when discussing the topic of protection of the claims of employees, the issues that are most often raised are the possibility of increasing the maximum amount for a claim. made under section 81.3 or 81.4 BIA, the possibility of expanding the claim under section 81.3 and 81.4 BIA to cover severance or termination, treating the claims of employees as a separate class, introducing a protection for long term disability and other similar benefits, expanding the statutory security provided for in section 81.5 and 81.6 BIA to cover amounts due for special payments and actuarial deficits and enhancing the protection available to employees by way of an indemnity payable though the Wage Earner Protection Program ("WEPP") established under the provisions of the *Wage Earner Protection Program Act* ("WEPPA")[160]. These issues are addressed in greater detail hereunder.

- Increasing the maximum amount for a claim made under section 81.3 or 81.4 BIA:

  The JTF is concerned that an increase in the priority charge will have a negative impact on, *inter alia,* the availability of credit and the value of existing debt instruments. Any increase in the priority charges created upon a bankruptcy or receivership raises the very real risk th?t those who lend against a borrower's assets will increase the reserves taken against the borrowing base for all borrowers that are employers.

  As well, in view of the fact that the WEPP was put in place to indemnify employees against losses incurred as a result of the bankruptcy or receivership of an employer, and to advance to the employees the payments that they would be entitled to receive under sections 81.3 or 81.4 BIA, the JTF believes it is likely that the stakeholders would perceive an increase in the maximum claim amount as an indirect manner of introducing a super-priority claim for the Crown, without any real benefit to employees, unless the indemnity payable under the WEPP is increased commensurately. This comes from the fact that the amount of the indemnity available to employees under the WEPP is approximately $3,600, while the maximum claim under section 81.3 and 81.4 BIA is $2,000 (subject to the possibility of an additional $1,000 for expenses incurred by a travelling salesperson).

- Expanding the claim under section 81.3 and 81.4 BIA to cover severance or termination:

  The JTF does not see any fundamental problem with the principle of including severance or termination in the definition of wages, to ensure that claims for severance or termination can benefit from the statutory security contemplated in sections 81.3 or 81.4 of the BIA. The JTF points out that some rewording would then be required to remove the requirement that the claim be in respect of work performed or services rendered in the 6 months before receivership or bankruptcy..., but the

[160] S.C. 2005, c. 47 and S.C. 2007, c. 36, as amended.

problem is not conceptual.

However, the JTF perceives some practical problems with the suggestion that severance or termination be included in the priority under section 81.3 or 81.4 BIA. To the extent that the expansion of the priority claim is accomplished by increasing the statutory security cap of $2,000 referred to in sections 81.3 and 81.4 BIA, the issue is the same as that described hereinabove in the discussion of a possible increase of a maximum amount of a claim. The concern in this situation is that the increased statutory secured claim could affect access to credit, which may trigger additional insolvencies of employers. The JTF points out that in the past, when a suggestion was made to expand the claim under section 81.3 and 81.4 BIA to cover severance or termination, the legislative provisions drafted in connection with the proposed change did not include any maximum amount in respect of this aspect of the employees' claim[161]. In separate submissions made by CAIRP and the IIC in connection with the review of such proposed legislative changes[162], both CAIRP and IIC indicated their concern that the suggested legislative provisions may significantly curtail credit availability for employers, in view of the fact that the potential secured claim would be difficult or impossible to quantify. The potential impact on the reserves against the borrowing base calculations established by lenders to extend credit for such an un-quantified charge are significant, particularly if lenders take a conservative view of what the amount of the priority claim might be. The risk of increased reserves is significant as a result of the fact that the majority (approx. 62%) of the amounts paid to employees under the WEPP payments represent termination and severance pay, leaving a minority (38%) of the amounts paid on the WEPP actually subject to the subrogated claim.

Furthermore, the JTF points out that since the calculation of severance and termination can vary widely from one province to another, and whether the calculation is made based solely on the statutory notice provisions found in labour standard legislation or based on a common law approach, the expansion of the protection to cover severance and termination could lead to inequitable results for individual employees, in the absence of a national standard to value the severance or termination claims.

Finally, the JTF believes that since at present, the employees are indemnified, at least in part, for the severance and termination claims through the WEPP, it is likely that the stakeholders would perceive an increase in the maximum claim amount as an indirect manner of introducing a super-priority claim for the Crown, without any real benefit to employees, unless the indemnity payable under the WEPP is increased commensurately. This issue is essentially the same as that described earlier herein, in the discussion of the possibility of increasing the maximum amount for a claim made under section 81.3 or 81.4 BIA.

- Treating the claims of employees as a separate class:

The JTF believes that this concept runs against the principles that have been developed with respect to the reasons to create fewer classes in a restructuring in order to increase the

[161] Examples of such legislative provisions are found in Bills C-476, C-501 and S-214 (40th Parliament, 3rd session).

[162] The submissions were made in respect of Bills C-476, C-487, C-501, S-214 and S-216 (40th Parliament, 3rd session). CAIRP's submission is dated June 25, 2010 and can be found at www.cairp.ca/files/file.php?fileid=filebcCsVntZzD&filename=file CAIRP commentary on proposed new legislation.pdf. IIC's submission is dated August 2010 and can be found at www.insolvency.ca/en/iicresources/resources/Pension_Reform TF Report Final 201O.pdf.

likelihood of success. Granting employees a separate class status may have the effect of extending an automatic veto to the employees on any restructuring plan. The employees are important stakeholders whose views must be taken into account in order to achieve a successful restructuring, as there is very little that an enterprise can accomplish without effective cooperation of its employees and their buy in to the enterprise's business strategy. However, the JTF believes it would be ill advised to give the employees, as a group, (or other groups of unsecured creditors such as trade suppliers for that matter) a right of veto, considering that this veto might be exercised inadvertently, without any intention of doing so, if the employees neglect to express a favorable vote on a proposal or abstain from voting. The BIA and CCAA require for a positive vote in order for a proposal or plan to be accepted. This is particularly important in the context of a proposal under the BIA, since an abstention from the employee group would result in a deemed assignment in bankruptcy, as the BIA provides that the debtor becomes bankrupt if the proposal is not accepted by the required majority of creditors in each class of unsecured claims.

The JTF considers that the legislation presently allows sufficient flexibility for employees to be able to seek the benefit of a separate class in situations where they can show the court supervising the restructuring that they should be placed in a separate class using the same test that other creditors must meet.

- Introducing a protection for long term disability ("LTD") and other similar benefits:

The JTF believes that this issue stems primarily from the Nortel proceedings. New legislation has been created in response to the problem that surfaced in the Nortel file, to require federally regulated employers that offer LTD plans to have the plans carried by a third party insurer rather than self-funding.

Nortel appears to be somewhat anomalous – typically, LTD plans are not self-funded but are placed with a third party insurer.

The issue of a wide ranging new super-priority for amounts due to employees for LTD and other similar benefits was addressed in proposed new legislation[163] and both the IIC and CAIRP, in separate submissions, outlined a number of practical problems with this proposed legislation. The JTF believes the comments made by IIC and CAIRP through their submissions in 2010 are still relevant in this respect[164].

- Expanding the statutory security provided for in section 81.5 and 81.6 BIA to cover amounts due for special payments and actuarial deficits:

The issue of a wide ranging new super-priority for amounts due to pension plans on account of special payments and for an eventual loss on liquidation or wind down of a plan as estimated by an actuarial deficit calculation, was addressed in proposed new legislation[165] and both the IIC and CAIRP, in separate submissions, outlined a number of practical problems with this proposed legislation. The JTF believes the comments made by IIC and CAIRP through their submissions in 2010 are still relevant in this respect[166].

[163] See note 30.
[164] See note 31.
[165] See note 30.
[166] See note 31.

Perhaps most importantly, from a policy perspective, targeting pension treatment and/or priority by amending the BIA or CCAA is ineffective to achieve the objective of protecting pension rights of employees. Enhancing employee protection is better implemented via changes to the federal and/or provincial Pensions Act(s) to ensure that the majority of pensions (those whose employers/sponsors will not be subject to insolvency proceedings) are properly funded.

The JTF also queries whether some method of mutualisation of the loss might be an appropriate way of providing added protection for amounts payable under a defined benefit plan in the event of insolvency, however the JTF believes this discussion may not be wholly relevant in the context of reform to the insolvency statutes. The JTF is convinced that IIC and CAIRP would welcome an opportunity to participate in discussions to alleviate the pension deficit problem in order to avoid insolvency related problems or minimize the impact of insolvency, if requested.

- Enhancing the protection available to employees by way of an indemnity payable though the WEPP:

The JTF acknowledges that the current request for submissions does not address proposed changes to the WEPPA, as this legislation is subject to its own review process, separately from the one conducted by IC. However, there is such a large degree of interaction between the insolvency statutes and the WEPPA that some discussion is warranted. The JTF believes that the WEPP is a valuable program to protect employees when they lose employment as a result of their employers' bankruptcy or receivership, although the JTF believes the program should be reviewed, expanded and improved, as some flaws and weaknesses have been noted in its application. The more fundamental issues that the JTF believes should be addressed at this time are the following:

  - The WEPP is costly to administer and the processing fees of the trustee/receiver are not covered by those who benefit. As a result, the program causes some inequity for stakeholders, such as secured or unsecured creditors, by allocating some of the resources that would otherwise be available to pay dividends to the administration of the WEPP. To be clear, the JTF is not suggesting that the costs to administer the WEPP should be deducted from the employees' entitlement, as this would be counterproductive to the objectives of the program itself. The JTF considers that to the extent that the program is an indemnity program set up by the government, its costs should be borne by the program.

  - Some improvement could be made to make the program more efficient. The JTF notes that one of the objectives of the WEPP is to accelerate payment to employees in connection with the amounts they would be entitled to receive under section 81.3 and 81.4 BIA, while it may in fact take a significant period of time before the indemnities are paid to displaced employees.
  - Employees who work for a receiver may have their claim relating to severance or termination affected by continuing employment to assist the receiver in winding down the business.

  - There appears to be an inequity that creeps in the program when there is an interaction between the provisions of the *Employment Insurance Act*[167] and the WEPPA. More specifically, it appears that employees that are entitled to EI benefits

[167] S.C. 1996, c. 23, as amended.

may see these benefits curtailed as a result of the benefits paid under WEPPA. No equivalent loss of benefit is experienced by en employee who immediately finds other employment.

- The current provisions of the WEPPA create some uncertainty in the application of the provisions, when there is a concurrent bankruptcy and receivership.

- The system for reporting information for purposes of the program can be inefficient, as it can only accommodate a manual record-by-by record entry of data.

- Some of the provisions of the WEPPA and of the BIA that refer to the same concept are misaligned, which may result in a loss of benefit for affected employees.

- And most importantly, the WEPP is only available in situations where the employer is bankrupt or in receivership, and, as a result, does not allow any protection for employees who are displaced as a result of the insolvency of their employers, if the restructuring process is successful[168].

In short, the JTF believes that additional thought needs to be given to protection of the claims that are customarily referred to as employee claims, which would include claims of former employees for severance and termination and claims of pension plans. However the JTF believes that in addressing possible changes, a comprehensive consultation process be undertaken to assess the possible impact of the added protection if the added protection results in additional statutorily secured charges against the assets of an insolvent company. The JTF is concerned that any additional charge could affect the access to capital and thus precipitate insolvencies of employers who might otherwise have a viable enterprise.

Finally, the JTF believes it would be remiss if it did not comment on the changes implemented in the 2009 Amendments which specify that, while a court may in certain circumstances order that the parties enter into a renegotiation of a collective bargaining agreement, the court may not compel a termination, change or suspension of the provisions of
the collective bargaining agreement[169]. The JTF believes there is some risk that this provision
may, in certain circumstances, hinder the presentation of a viable proposal or plan. However, the JTF acknowledges that the legislator has decided to trust the collective goodwill of employees and employers to come up with a solution that will avoid a loss of employment. While the JTF believes that in certain cases the slow pace of collective bargaining negotiations could put a restructuring process at risk, the JTF is not aware of any situation where a viable plan was possible but was thwarted as a result of the currently existing provisions. As such the JTF considers that the provision should not be changed, but should continue to be closely monitored.

3.20. Employees Claims in Asset Sales

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

[168] See Jean-Daniel Breton, *Employee protection in insolvency proceedings- Reviewing the performance and setting the objectives,* in 2010 Annual Review of Insolvency Law (Janis P. Sarra, ed.) and WEPPA- *What ails it and can it be fixed?,* in 2012 Annual Review of Insolvency Law (Janis P. Sarra, ed.), Thompson Reuters Canada Limited.
[169] See section 33 CCAA and 65.12 BIA.

JTF Comments

The JTF is of the view that adequate protection of employees' claims where sales are conducted under the CCAA or BIA is an issue worthy of consideration in the next round of legislative reform.

The JTF is not however aware of instances where sales conducted under the CCAA[170] or BIA[171] were authorized by the court to the detriment or prejudice of employees' claims for wages or normal cost contributions owed to a pension plan. Perhaps this is because both the CCAA[172] and BIA[173] expressly provide that the court may only authorize a sale conducted outside the ordinary course of business if it is satisfied that such payments can and will be made to employees.

The JTF also notes that it may be difficult to codify a "materiality test" in respect of the sales conducted under the CCAA or BIA which justify court authorization. Under the CCAA, the initial order customarily contains clauses setting out the maximum value of sales which may be conducted by the debtor company without the need for judicial authorization.

3.21. Hardship Funds

IC has requested submissions regarding whether express authorization for interim dividends in certain circumstances is required and, if so, any potential limitations on the court's discretion.

JTF Comments

The JTF does not believe that it is essential to codify a CCAA court's authority to authorize the payment of interim dividends in certain circumstances, as is otherwise provided under the BIA[174].

In this regard, the JTF concludes that the broad discretion conferred upon the court under section 11 CCAA constitutes sufficient statutory authority to allow the court to allow for the payment of interim dividends to creditors where circumstances justify same.

3.22. Third Party Releases

IC has invited submissions regarding whether the Third Party Releases are appropriate and, if so, whether the identified criteria are sufficient to prevent potential abuse.

JTF Comments

The JTF believes that the criteria developed by the courts[175] to authorize the implementation of a plan of arrangement filed under the CCAA which includes releases against third parties (i.e. parties other than the debtor or a director of the debtor) are satisfactory.

Because of the fact that the courts' capacity to authorize third party releases in the context of

[170] Section 36 CCAA.
[171] Section 65.13 BIA.
[172] Section 36(7) CCAA.
[173] Section 65.(8) BIA.
[174] See Section 136(2) and 148(1) BIA.
[175] See *Metcalfe and Mansfield Alternative Investments II Corp., (Re),* 2008 ONCA 587.

the implementation of a CCAA plan results from broad judicial discretion under the CCAA, it is uncertain as to whether such third party releases may be granted by the court in the context of the ratification of a proposal filed under the BIA. The JTF believes that the court's authority to allow the release of third parties who have made a reasonable contribution to a creditor approved proposal or plan of arrangement is an important restructuring tool which should be available both under the CCAA and BIA. There is no satisfactory rationale for allowing third party releases in certain circumstances under the CCAA and not under the BIA.

The JTF is also of the view that potential codification of the existing criteria developed by the courts to allow third party releases is worthy of consideration. Any codification in this regard should however be mindful of preserving judicial flexibility and judicial discretion.

3.23. Key Employee Retention Bonuses

IC has requested submissions regarding whether employee bonuses should be permitted in an insolvency proceeding and, if so, whether terms and conditions should be codified.

IC has also requested submissions regarding whether director and officer liability could be imposed for bonus programs created during an insolvency proceeding.

JTF Comments

The JTF is of the view that, in certain circumstances, Key Employee Retention Bonuses or Key Employee Retention Plans ("KERB" or "KERP") should be authorized by the courts in order to ensure that going concern operations are maintained and valuable employees are retained during the restructuring process.

Potential codification of the courts authority to allow the payment of employee retention bonuses should take into consideration the following:

- existing criteria developed by the courts to allow for the payment of KERBs;
- necessary monitor approval of the proposed payment of KERBs;
- due prior notice to likely affected creditors of the proposed KERBs;
- the need for disclosure to affected creditors of the terms of the proposed KERBs. The JTF also feels that any potential legislative reform in respect to KERBs should involve further study and analysis of the status of US law in this regard, insofar as this issue is statutorily addressed in the United States.[176]

3.24. Oppression remedy

IC has requested submissions regarding whether restrictions on the availability of the oppression remedy should be imposed in the insolvency context.

JTF Comments

[176] As *Bankruptcy Code* 11 USC, Section 503(c).

The JTF is of the view that it is not necessary to consider legislative amendments to CCAA or BIA in order to address issues relating to the availability of the oppression remedy in a context of insolvency proceedings. There does not appear to be sufficient evidence of improper use of the oppression remedy in context of insolvency proceedings to justify a legislated solution. Furthermore, the broad discretion otherwise available to the courts should be sufficient to adequately resolve issues of this nature. It should also be noted that potential amendments to impose an overarching "good faith" obligation upon stakeholders participating in a restructuring[177] may bolster judicial discretion in this regard.

3.25. Interest Claims

IC has requested submissions regarding the existing rules regarding interest claims.

JTF Comments

The JTF believes that the treatment of post-filing interest claims in the context of CCAA proceedings is an issue worthy of consideration in the context of eventual reform. More broadly, this issue also encompasses various types of post-filing debts which may be the object of claims in the context of restructuring proceedings, namely for the payment of yield maintenance penalties, make whole payments, prepayment premiums, default interest rates and other similar types of charges. Any legislative amendments in this regard should be mindful of the potential impact thereof upon the distressed debt and venture capital markets where debt instruments frequently contain such types of penalties and premiums.

The JTF believes that the treatment of post-filing interest claims should also be analyzed in the context of the BIA, to avoid situations where the relative claims of the creditors may change solely as a result of a change of proceedings from one restructuring statute to the other (CCAA vs. BIA), or from a change in status during the pendency of a restructuring proceeding (restructuring vs. bankruptcy).

3.26. Unpaid Suppliers

IC has invited submissions regarding the treatment of supplier claims for goods delivered in the period immediately *prior to insolvency proceedings.*

JTF Comments

The JTF is of the view that the limited protection afforded to unpaid suppliers at Section 81.1 BIA should be repealed. In this regard, the JTF shares the views and comments expressed by the Standing Senate Committee on Banking, Trade and Commerce in its November 2003 report[178]. The rationale for repealing Section 81.1 may be essentially summarized as follows:

- The protection is largely ineffective at protecting unpaid suppliers, and provides little more than an illusory right of recovery, due to the requirement that the merchandise be still unsold and identifiable at the time the claim is made, and the requirement that the debtor be bankrupt or in

[177] See above « Acting in good faith », in section 3.6 hereinabove.

[178] *Debtors and creditors sharing the burden: A review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act: of the Standing Senate Committee on Banking, Trade and Commerce,* (November 2003), pp. 105-111.

receivership;

- In view of the fact that the right can only be exercised when the debtor is bankrupt or in receivership, the legislative provision may be counterproductive to promoting restructuring and compromises, as it may force the creditors to make decisions aimed at maximizing individual recovery rather than maximizing value for all stakeholders;

- Even though the protection is largely ineffective, it adversely affects the availability of credit, as secured creditors who provide operating credit based upon margin calculations and asset based lenders tend to curtail availability of funds based on a theoretical maximum claim by unpaid suppliers of "30 day goods".

- The provision is essentially unfair as it seeks to protect one class of creditors, the suppliers of goods, without providing an equivalent protection to similarly situated creditors such as the suppliers of services, in a context where there is no known policy rationale for providing this protection to one group and not the other.

This being said, the JTF believes that more limited supplier protection could be introduced by granting unpaid suppliers of goods and services limited protection as preferred creditors under section 136 BIA for very recent supplies of goods and services (with the appropriate period to be determined), without a need for specific identification.

While this issue is not directly addressed in the Discussion paper, the JTF also believes that the treatment of post-filing suppliers in a context of restructuring is worthy of consideration. Canadian insolvency statutes do not include provisions similar to those found in *US Bankruptcy Code* pursuant to which post-filing creditors benefit from a priority status as administrative claims[179]. Hence, at present, under Canadian law, post-filing creditors and suppliers are treated as unsecured creditors should the restructuring process under either the BIA or CCAA be interrupted. It should thus be considered to afford some degree of protection for post-filing creditors, by allowing a higher priority status to the claims of creditors who have supported the debtor through a restructuring attempt by providing credit, as compared with the claims of pre-commencement creditors.

3.27. Fruit and Vegetables Suppliers

IC has requested submissions regarding the existing farmers' superpriority in section 81.2 of the BIA.

JTF Comments

The JTF is of the view that the adequate protection of suppliers of farming, fishing or agricultural products is an issue worthy of consideration in the context of eventual reform.

The potential amendment of Section 81.2 of the BIA to expand the superiority to products delivered within 30 days of a bankruptcy or the appointment of a receiver should however take into consideration the potential negative impact on the credit market as such expansion would limit access to credit where financed inventory includes inventory relating to farming, fishing or agricultural products.

[179] *US Bankruptcy Code*, section 503(b)(9).

Deterring Fraud and Abuse

3.28. Directors' disqualification

IC has requested submissions regarding whether directors of a corporation that has become subject to insolvency proceedings should be disqualified from acting as a director due to misconduct.

JTF Comments

The JTF is of the view that the issue as to whether directors of an insolvent corporation should be broadly disqualified from acting as directors should be addressed under the CBCA, not under the BIA or CCAA. An individual's capacity to act as director of a Canadian corporation is an issue of corporate governance which exceeds the scope of insolvency statutes.

It should also be borne in mind that the BIA[180] and CCAA[181] were amended in 2009 to grant to the court statutory authority to remove the director of an insolvent debtor where the court is satisfied that such director is unreasonably impairing or is likely to impair the possibility of a viable compromise or proposal.

3.29. Related Party Subordination and Set-off

IC has requested input as to whether debts of related parties should be allowed to be subordinated and whether set-off among related parties should be expressly prohibited.

JTF Comments

The JTF is of the view that legislative amendments to provide that debts among related parties are, *ipso facto,* subordinated would raise significant problems and could lead to inequitable results. Existing provisions of the BIA and CCAA already provide for the subordination of the claims of silent partners[182] and of creditors holding "equity claims"[183]. It is feared that broader court authority to subordinate the debts of parties related to the insolvent debtor or the *ipso facto* subordination of the debts of related parties could lead to judicial controversy similar to that prevalent in the United States in respect to the "re-characterization of debt" in a context of insolvency.

It is thus suggested that the nature and rank of the claims of related parties continue to be governed by existing provisions of the BIA and CCAA.

With respect to the issue of prohibiting set-off of debts among related parties, the JTF is of the view that this issue is worthy of consideration as part of a broader review of set-off mechanisms under the BIA and CCAA. This being said, insofar as the nature of the respective claims of related parties would necessarily vary depending on the factual circumstances of each case, there appears to be no clear rationale for broadly disallowing set-off as between the claims of related parties.

Cross-border Insolvencies

[180] See Section 64 BIA.
[181] See Section 11.5 CCAA.
[182] See 139 BIA.
[183] See 140.1 BIA and 6(8) CCAA.

3.30. Foreign Claims under "Long-Arm" Legislation

IC has requested submissions regarding an appropriate response to Long Arm legislation.

JTF Comments

The JTF believes that denying "long arm" claims based upon foreign legislation is an issue worthy of consideration, namely as long arm legislation seeks to adversely affect distribution to Canadian stakeholders of the proceeds of assets held by Canadian corporations.

The JTF notes however that denying the enforceability of "long arm" claims in Canada while adopting similar long arm legislation in Canada appears inconsistent.

The JTF further notes that a broader consideration of the enforceability in Canada of foreign law based claims (such as, for example, avoidance actions under Chapter 11 proceedings and ERISA[184] claims) may be warranted.

3.31. Set-off for claims in multiple jurisdictions

IC has requested submissions regarding the set-off of interest claims from another jurisdiction against principal.

JTF Comments

The JTF believes that this issue is not worthy of further consideration. This is a very particular issue that is seldom, if at all, subject to litigation. Most often, it is dealt with inside of a CCAA plan and the flexibility of dealing with such issues should be maintained rather than put at risk by any legislated restrictions or requirements on how such matters can be dealt with.

3.32. Allocation of Proceeds

IC has invited submissions regarding access to, and conveyance and allocation of, assets in cross-border insolvencies.

JTF Comments

The JTF is of the view that the question of whether and, if so, under what conditions Canadian courts can permit a substantive consolidation of foreign assets subject to a foreign proceeding with Canadian assets subject to a Canadian proceeding is worthy of consideration.

Whether and, if so, under what conditions a sale of assets located in Canada as part of a foreign proceeding should be permitted is also worthy of consideration.

[184] *Employee Retirement Income Security Act,* found at *U.S. Code,* Title 29, chapter 18.

3.33. Treatment of Enterprise Groups

IC has requested input regarding the treatment of enterprise groups in insolvency.

JTF Comments

The JTF believes that, with respect to the treatment of enterprise groups in insolvency, the avenue of enquiry and analyses should be reframed. Whether and, if so, on what conditions corporate groups filings should be permitted in Canada is worthy of consideration. In other words, it is relevant to determine on what basis, if any, Canadian insolvency laws should permit making foreign subsidiaries direct applicants in a Canadian proceeding.

3.34. "Center of Main Interests"

IC has requested submissions regarding the need for procedural protections in cross-border recognition matters.

JTF Comments

The JTF is of the view that issues related to the identification of the proper center of main interests ("COMI") of a debtor company should be left to the judicial discretion of the judge overseeing the restructuring, with reference to the UNCITRAL guidelines. It may thus not be necessary to adopt specific amendments under which courts would be instructed to ensure that creditors have been given sufficient disclosure with respect to the identification of the COMI of a debtor company.

3.35. Unsecured Creditors' Committees

IC has requested input as to whether it is appropriate to develop principles and criteria for the recognition of foreign UCCs and to define the scope of UCC participation in Canadian insolvency proceedings.

JTF Comments

Given the role of the monitor in Canadian restructuring proceedings led under the CCAA, the JTF believes that it may not be necessary to consider specific amendments to define the scope of foreign unsecured creditors' committees in insolvency.

This said, more broadly, the JTF believes that it would be valuable to have some clear legislative guidelines to address whether or not the filing of a claim or otherwise appearing in Canadian restructuring proceedings constitutes attorning to the Canadian court's jurisdiction for any matters related to the restructuring being supervised by the Canadian court.

Administrative Issues

3.36. Renaming the *Bankruptcy and Insolvency Act*

IC has requested submissions regarding the potential social stigma associated with "bankruptcy" and

whether Canadians may be better served if that term is downplayed in the legislation.

JTF Comments

The JTF notes that the term "bankruptcy" is used in numerous jurisdictions to refer to legislation in respect to insolvency and is generally perceived to refer to the liquidation of the assets of a person who cannot meet his or her obligations as and when they become due. Conversely, the term "bankrupt" refers to the legal status of a person whose assets are liquidated for the benefit of his or her creditors.

While there is social stigma associated with the term "bankrupt", the JTF believes that this issue has greater implications for practitioners in the field of consumer insolvency rather than corporate insolvency. However, the JTF perceives that the term "bankruptcy" creates some confusion in public perception where the BIA is used for restructuring purposes (as opposed to liquidation). The media often report that a company or individual has been placed under "bankruptcy protection" thus creating confusion as to whether or not the assets of such company or individual are being liquidated. This topic is addressed in greater detail in the submission by CAIRP related to consumer insolvency.

A Unified Insolvency Law

3.37. Merger of the BIA and CCAA

IC has requested submissions regarding a unified insolvency statute.

JTF Comments

The JTF does not believe that it is essential that the BIA and CCAA be merged into a single act. Both statutes were effectively harmonized by the 2009 Amendments and, while it may seem peculiar to have a two-tier statutory restructuring regime, the co-existence of the BIA and CCAA has not led to unfavourable results nor inequity.

As mentioned hereinabove[185], the JTF however notes that where the CCAA is used to proceed to the sale of a debtor company's assets and undertakings, legislated changes to the CCAA could be envisaged to provide for the eventual bankruptcy of the debtor company once all of its assets and undertakings have been sold or otherwise liquidated. In effect, legislated change in this regard could seek to implement a "bridge to the BIA"[186] to allow the monitor necessary authority to transition to the bankruptcy of a debtor company having completed the liquidation of its assets under the CCAA.

3.38. *Winding-up and Restructuring Act*

JTF Comments

With respect to the *Winding-Up and Restructuring Act* ("WURA")[187], the JTF believes that limiting the scope of WURA to financial institutions only is an issue worthy of consideration. In its report dated June 14, 2000 entitled *"The Winding-Up and Restructuring Act: Recommendations for Reform",* the IIC made various suggestions regarding potential reform of WURA which include, *inter alia,* limiting its scope to financial

[185] See *Liquidating CCAA Proceedings, section* 3.*18* hereinabove.
[186] See *Century Services Inc. v. Canada (General Attorney}*, 2010 CSC 60.
[187] RSC 1985, c. W-11, as amended.

institutions.

3.39. *Canada Transportation Act*

JTF Comments

With respect to the provisions of the *Canada Transportation Act*[188] which relate to schemes of arrangement to be made by insolvent railway companies, the JTF is of the view that there is no evident rationale for submitting railway companies to a different liquidation or restructuring regime than that which are set out in the BIA and CCAA. It may thus be worthy to consider necessary amendments to provide that railway companies be included in the respective definitions of "person" and "debtor company" under the BIA and CCAA to effectively provide that railway companies are subject to restructuring (or liquidation) under these statutes.

3.40. Restricting Consumer Proposals

IC has requested submissions as to whether the consumer proposal process should be amended to ensure that it is not used with respect to business debt.

JTF Comments

The JTF is unaware of instances where the use of consumer proposal mechanisms set out in the BIA in connection with commercial debts of a very small business has resulted in an unfair treatment for the creditors. The $250,000 threshold for consumer proposals makes it such that the amount of business debts subject to consumer proposals remains reasonable, on a relative scale. In the absence of evidence of abuse in the use of consumer proposals to settle business debts, the JTF does not believe that amendments should be contemplated to the consumer proposal provisions of the BIA in this regard.

3.41. Special Purpose Entities

IC has requested input on whether to expand the application of the 81A and CCAA to trusts used as special purpose entities.

JTF Comments

The JTF is of the view that the expansion of the term "person" (as used in the BIA) and "debtor company" (as used in the CCAA) to allow other types of business entities to be subject to proceedings under BIA or CCAA is an issue worthy of consideration.

Such expansion should not only cover trusts used as special purpose entities but all trusts used for business purposes[189]. Moreover, the somewhat limited definition of "debtor company" used in CCAA should perhaps include other corporate entities such as, *inter alia,* limited partnerships and other types of partnerships to avoid restricting the use of CCAA to incorporated business entities. At the same time, the

[188] SC 1996, c. 10.

[189] The JTF notes that the potential inclusion of all trusts as entities subject to BIA and CCAA will necessarily trigger reflection as to the contents of « bankruptcy remoteness » opinions traditionally given with respect to trusts subject to Canadian legislation.

rules regarding the treatment of partnerships should be reviewed, to ensure that these entities are treated under the CCAA and BIA as separate persons in their own right and not merely an extension of the partners.

Receiverships

3.42. Codification of receiverships

IC has requested input as to whether it is appropriate to amend the insolvency legislation to clarify the role and authority of a receiver appointed under section 243 of the BIA; and whether it is appropriate to standardize a set of rules regarding the authority of a receiver to act across all insolvencies statutes.

JTF Comments

The JTF notes that the receiver provisions as codified in section 243 and following of the BIA under the 2009 Amendments seem to be working efficiently and do not warrant substantive change. Many jurisdictions have implemented model "receivership orders" to standardize the powers and duties of the receiver appointed under section 243 BIA.

This being said, the JTF believes that some other receiver related issues should be eventually addressed, namely the following:

- where a receiver proceeds to a sale of an insolvent person's assets, it should be specified that the proceeds of sale shall be paid to creditors in accordance with the BIA priority scheme. It is unclear under existing provisions whether such priority scheme applies or whether the provincial priority scheme applies;

- it should be specified that the receiver, like the trustee in bankruptcy, is not bound to obtain tax clearance certificates which must otherwise be obtained from tax authorities[190] before distribution where assets are disposed of or otherwise liquidated. Present uncertainty in this regard causes legitimate concerns for receivers who may incur liability for having failed to obtain such tax clearance certificates before proceeding to distribution.

3.43. No Action Against Receivers Without Leave of the Court

IC has requested input as to whether it would be appropriate to amend the insolvency legislation to require leave of the court before taking any action against the Receiver.

JTF Comments

The JTF supports an amendment to section 215 BIA to provide that leave of the court be obtained prior to taking any action against a receiver appointed under section 243 BIA. Like the trustee in bankruptcy and the interim receiver, the receiver appointed under section 243 BIA is a court officer who should benefit from similar protection from frivolous or abusive judicial claims.

[190] See for instance section 159 of the *Income Tax Act* and section 14 of the *Quebec Tax Administration Act,* and section 270 of the *Excise Tax Act.*

3.44. Marshaling of Charges

IC has requested input as to whether it would be appropriate to amend the insolvency legislation to codify the doctrine of marshaling charges.

JTF Comments

The codification of the common law doctrine of "marshalling" in respect to the various charges created under BIA and CCAA is an issue worthy of consideration. Legislative clarification in this regard would be helpful to guide the courts and to allow for the equitable distribution of proceeds subject to charges created under BIA and CCAA.

The JTF notes that this doctrine could also be of use in relation to the enforcement of various Crown Claims (namely deemed trust claims) which purport to charge all of the assets of the insolvent person.

3.45. Tax Issues

IC has requested input on several tax-related issues that have been raised by stakeholders in the insolvency context, to solicit information regarding the nature of concerns and the extent to which such issues potentially affect insolvency proceedings.

JTF Comments

The JTF believes that further study of the interaction of tax laws and insolvency laws is worthy of consideration, as the JTF considers that tax issues presently exist that impede restructuring opportunities for insolvent businesses or delay or cause inefficiencies in the administration of insolvent estates. The more significant areas where some legislative reform is considered to be desirable, in dealing with the interaction between fiscal and insolvency laws are outlined below:

- Clearance Certificates: The JTF believes that the exemption from obtaining clearance certificates available to trustees should be extended to any court officer distributing funds under supervision of a court where notice is given to creditors, as there is no known public policy reason to treat a court officer differently from another court officer acting in a similar capacity under a different statute;

- Final Tax Returns: The JTF perceives a problem relating to the final tax return required to be filed after the final distribution. The JTF believes that trustees, receivers, monitors, or debtors should be dispensed from a requirement to file final tax returns subsequent to effecting a final distribution, when the final distribution occurs in a context of a legal process monitored by the court, with notice to the creditors;

- Unfiled Tax Returns: The JTF believes there is a need for clarification in the legislation regarding the responsibility for filing tax returns with respect to periods more than one year before the commencement of the year in which a person bec0mes bankrupt, to better coordinate the provisions of Section 22 BIA with the provisions of the *Income Tax Act* ("ITA")[191] and the *Excise*

[191] RSC 1985, 1 (5th Supp.), as amended.

Tax Act ("ETA")[192] or other similar provincial or federal legislation that provides for an obligation on the part of legal representatives to complete tax returns;[193]

- Jurisdiction over tax claims: The JTF believes that there presently exists some confusion regarding the jurisdiction of each of the court (acting as a designated tribunal under the CCAA or acting in matters of bankruptcy and insolvency) and the tax court in dealing with the acceptance or rejection of claims against an estate, the right to issue assessments and the characterization of such assessments as an administrative gesture or a "proceeding" that may be stayed under the provisions of the BIA or CCAA, the manner in which claims based on an assessment are dealt with for voting purposes, appeal periods and the mechanics of asserting the claim (proofs of claims/assessments). The JTF believes it would be worthwhile to investigate the possibility of having a single forum to deal with all claims made against an insolvent debtor or an insolvent estate, and as a consequence the JTF believes some research should be done on the possibility of attributing all responsibility for dealing with tax claims to the court seized with the supervision of the insolvent estate administration or restructuring process, rather than having a shared responsibility between the court and the tax court, as there is no known public policy reason to reserve the right to determine claims of tax authorities to the tax court in insolvency proceedings, give the text of section 4.1 BIA and section 40 CCAA.;

- Delay in asserting tax claims: The JTF believes it may be useful to provide for a legislative mechanism to compel the Crown in right of Canada or a province to file a proof of claim within a specified period, in order to expedite the administration of an estate and the distribution of funds. The JTF recognizes that such a mechanism exists through Section 149 BIA, but notes that an equivalent provision does not exist in the CCAA, although harmonization might be advisable;

- Discharge of court officer: The JTF believes there is an inconsistency in the provisions of the BIA and of the fiscal laws, as relates to obligations of professionals and how these are discharged, and considers that this inconsistency could be clarified through a legislative change. More specifically, the provisions of the BIA provide that when a trustee has fully administered an estate to the court's satisfaction, the trustee may obtain a discharge,[194] however the fiscal laws that provide for a joint and several obligation to report or remit do not provide for any "sunset" provision that terminates this joint and several obligation when the trustee is discharged.[195] The JTF points out the issue is not limited to an order discharging a trustee, but would equally apply to an order of discharge in respect of a receiver appointed by a court or a monitor appointed pursuant to the CCAA;

- Fresh start / tax consequences ans1ng out of an insolvency or restructuring proceeding: The JTF believes that tax consequences arising from the realization of property in an insolvent estate, or arising as a result of a restructuring process, is an issue that needs clarification as the current treatment can impede the ability of a debtor to restructure, or in the alternative may result in an unclear treatment of potential tax liabilities. Under the current regime, if taxable capital gains or recapture or some other taxable gain arises as a result of the realization process in a bankrupt estate, such income is attributed to the estate, whether or not the trustee collected the proceeds

[192] RSC 1985, c. E-15, as amended.
[193] Section 265 and 266 ETA, sections 128 ITA.
[194] Section 41(8) BIA.
[195] See for example section 265 ETA and sections 128 and 159 ITA.

of realization of the assets (as the proceeds may have been collected by a secured creditor that has a charge that encumbers the property), and in such a circumstance the law is unclear as to the characterization of the income tax liability that arises from the realization process.[196] In the same manner, the gain on settlement of debt that arises after the implementation of a CCAA plan or a BIA proposal, or the capital gains or recaptured depreciation that arise due to a liquidation of assets in a context of a restructuring process, may result in an income tax liability without recourse to any recovery (in the case of a liquidating BIA proposal or liquidating CCAA plan) or a residual debt that endangers the ability of the debtor to continue in business (in the case of a compromise or settlement proposal or plan). The JTF believes that the issue of the tax treatment of transactions that arise in the context of a bankruptcy or restructuring and/or the reassessment of tax attributes needs to be further studied to avoid an unfair result to creditors or an impediment to a restructuring process.

- Deemed period end: The JTF notes that in BIA proposals and CCAA restructurings, because there is no deemed period end on filing, income and sales taxes that were with respect to the pre-filing period could be considered post-filing liabilities that must be paid in full. This is inconsistent with the bankruptcy regime and the *pari passu* principle, and accordingly the JTF believes that consideration should be given to a legislative change that would ensure that the provisions of section 121 BIA and 19 CCAA are applied consistently by all creditors, including the Crown;

- Claims made under Section 296(1)(b) ETA and Section 25 of the Quebec Tax Administration Act ("QTAA")[197]: The JTF notes that the Canada Revenue Agency ("CRA") and the Quebec Revenue Agency ("QRA") have implemented a policy of assessing debtors directly for the goods and services tax ("GST"), harmonized sales tax ("HST") and/or Quebec sales tax ("QST") that is payable on purchases made from suppliers who are unpaid at the date of the inception of an insolvency proceeding, without relieving the supplier from the obligation to collect and remit the tax on the taxable supply. The JTF observes that this practice results in a duplicative claim for the tax on purchases as such amounts are also claimed by unpaid suppliers of the debtor who are agents of the Crown for the purpose of collecting GST/HST/QST. The duplicative claim implies that the Crown is collecting proceeds of distributions made in an estate twice, on what is essentially the same claim, which results in a higher recovery for the Crown than the other similarly situated ordinary unsecured creditors. The JTF believes that a legislated solution may be required to ensure observance of the *pari passu* principle, while addressing some legitimate concerns of CRA and QRA;

- Set-off claims: The JTF identified the issue of set off of claims in general as being worthy of consideration and in particular the issue of set off as it relates to the Crown. More specifically, the JTF is questioning whether it should be appropriate for taxing authorities to set-off pre-filing tax liabilities as against post-filing refunds given the involuntary nature of taxation obligations, the fact

[196] In a situation where a secured creditor takes possession and realizes on encumbered property, resulting in recaptured depreciation for the estate, the income tax arising from the recaptured depreciation would not be a cost of administration of the estate, nor a claim provable in bankruptcy. However, section 128 of the ITA provides that the trustee is jointly liable with the bankrupt for the payment of such income taxes to the extent of the property of the bankrupt in the trustee's possession. It is unclear what priority this liability for taxes would have as compared with the fees and costs of the trustee, and why the taxes arising from the realization of property that is not available for distribution to creditors would reduce the amount otherwise available for distribution.

[197] RSQ, c. A-6.002.

that the Crown can invoke a right of set off but the taxpayer is not allowed to do so, and the fact that the set off of Crown claims may extend beyond debts that are truly mutual between the Crown and the debtor;[198]

- Garnishment rights: The JTF believes there is an uncertainty that arises in a situation where the government has issued garnishment notices pursuant to section 317 ETA in the context of a restructuring process, in view of a recent judgment of the Supreme Court of Canada.[199] In this decision, the Supreme Court found that a garnishment notice issued pursuant to s. 317 ETA is not stayed by the filing of a notice of intention to make a proposal (or a proposal) under the BIA, because the related account receivable is no longer part of the estate of the debtor due to the transfer of property effect of s. 317 ETA, when the garnishment notice has been served onto the account debtor before the filing of the notice of intention. This decision appears to create an inconsistency in the treatment of garnishment notices issued by CRA under various fiscal laws in a context of a restructuring process, since the BIA and ITA suggest that a garnishment notice sent in respect of unpaid source deductions would be suspended by the stay of proceedings, while in virtue of the decision of the Supreme Court of Canada, the equivalent notice sent pursuant to the ETA is not. This inconsistent treatment is a cause of concern, given that the legislator has sought, at least since the revisions made to the *Bankruptcy Act* (as it was then known) in 1992, to provide the highest degree of protection to the unremitted source deductions but to allow an opportunity for an insolvent debtor's restructuring to occur. The JTF believes it would be appropriate to clarify the rights of the Crown in a context of a restructuring proceeding, for all of the Crown's debts.

- Claims for payroll source deductions in a proposal or plan of arrangement: The JTF notes that in a context of a proposal under the BIA or a plan of arrangement under the CCAA, there exists a pre-condition to obtaining the approval of the court, that the claims of the Crown that could form the basis of a demand under section 224(1.2) ITA (or a provision of the *Canada Pension Plan* or the *Employment Insurance Act* that refers to section 224(1.2) ITA, or a substantially similar provision of a provincial law) be paid in full within 6 months of the date of ratification, unless the Crown agrees to a longer timeframe. The JTF notes that the claim of the Crown that could form the basis of a demand under section 224(1.2) ITA includes interest and penalties and the employer's portion of some payroll levies, and the JTF is not aware of any public policy reason why the claims of the Crown for interest, penalties and levies might warrant a priority treatment as compared to the claims of ordinary unsecured creditors. Furthermore, the JTF notes that there is uncertainty regarding the requirement of this provision, considering that the demand under section 224(1.2) ITA can only affect accounts receivable of an insolvent person. The uncertainty arises, for example, in a situation where the insolvent person is a retailer who does not customarily have any accounts receivable, or where the collectible value of accounts receivable is lower than the amount due in respect of unremitted payroll source deductions, interest, penalties and levies, as it is then unclear whether the amount that must be remitted within the 6 months (or longer) period must be the entire amount due or be limited to the collectible value of accounts receivable. The JTF believes that additional consideration should be given to the treatment of claims of the Crown in a restructuring process, to further clarify the extent of the priority that should attach to a claim of the Crown for unremitted payroll source deductions.

[198] For example, see section 31.1 and 31.1.1 of the QTAA.
[199] *Toronto Dominion Bank v. R*, 2012 CarsweliNat 8 (SCC) and 2010 CarsweiiNat 2936 (F.C.A.).

Technical issues

3.46. Disallowance of claims

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

JTF Comments

The JTF does not believe that amendments to BIA to grant necessary court authority to extend the 30 day delay within which an appeal may be launched[200] are warranted. Such potential "open ended" appeal period would create uncertainty in many regards as trustees and stakeholders could no longer assume that the disallowance of a claim is final where no appeal nor leave for extension has been filed within 30 days from the disallowance of the claims.

3.47. Securities firm Bankruptcies

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

JTF Comments

The JTF concludes that this issue appears to be satisfactorily addressed under section 256 BIA and is unaware of recent cases which would justify further amendments in this regard.

3.48. Preview of proposals by the trustee

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

JTF Comments

The JTF believes that this issue is worthy of consideration, principally because of the fact that the BIA provides that the proposal trustee is deemed to be trustee in bankruptcy where the proposal process is unsuccessful. The BIA should thus be mindful of the fact that proposal trustees should be able to take informed decisions when they decide to accept an engagement. Further reflection should also be had with regard to a proposal trustee's right to resign from acting in such capacity in certain circumstances.

4. COMMENTS OF THE JTF WITH RESPECT TO OTHER COMMERCIAL ISSUES THAT ARE NOT RAISED IN THE DISCUSSION PAPER. BUT THAT THE JTF BELIEVES SHOULD BE ADDRESSED IN LEGISLATIVE REFORM

Although these topics are not addressed specifically in the Discussion Paper, the JTF has identified

[200] See sections 135(4) BIA.

certain issues which, in its view, are worthy of consideration in the context of a review of the BIA and the CCAA, or in the context of a review of the statutes that regularly interact with the insolvency statutes, such as the WEPPA. These issues are outlined briefly hereunder.

4.1. Critical suppliers

Under the 2009 Amendments, provisions regarding payments to critical suppliers of a debtor company were only codified in the CCAA[201]. The JTF believes that the inclusion of similar provisions in the BIA is worthy of consideration as there appears to be no underlying rationale to justify that the critical supplier mechanisms, as codified in the CCAA, be restricted to debtor companies seeking to restructure under the CCAA. It may also be of interest to further reflect upon the allowance of pre-filing payments to critical suppliers while nonetheless maintaining the broad judicial discretion set out in section 11.4 of the CCAA.

4.2. Environmental claims

The treatment of environmental claims made against a debtor company or its directors in the context of a CCAA restructuring has been the object of significant controversy in recent case law, namely in the matters of *Abitibi*[202] *Northstar*[203] and *Nortel*[204]*.*

The JTF is of the view that various issues related to the definition and treatment of environmental claims made against a debtor company and its directors are worthy of consideration. Such issues include the following:

- a definition of what constitutes an "environmental claim" subject to compromise which may not involve reference or evidence regarding environmental authorities' intention to proceed to decontamination;
- a clearer distinction between environmental authorities status as regulator or creditor in a restructuring process;
- jurisdiction of the CCAA court in respect to all environmental claims against the company and its directors;
- adequate stay of proceedings protection for the directors of a debtor company where the CCAA process is used to proceed to the sale of assets and where it becomes evident that no plan of arrangement will be filed[205]

4.3. Set off of pre-filing claims against post-filing claims

[201] See section 11.4 CCAA.
[202] See *Newfoundland and Labradorv. AbitibiBowater Inc.,* 2012 SCC 67.
[203] See *Re Northstar Aerospace,* 2012 ONSC 4546.
[204] See *Re Nortel Networks,* 2010 ONSC 1708.
[205] Under section 11.03 of the CCAA, the stay of proceedings undertaken or to be undertaken against the directors is, in theory, only valid « until a compromise or an arrangement in respect of the company is filed ».

In a restructuring context, a creditor's capacity to operate set-off of post-filing claims with pre-filing claims may lead to inequitable treatment of creditors in certain circumstances. Certain courts[206] have broadly interpreted set-off rights to allow for the set-off of post-filing claims with pre-filing claims in a restructuring context.

The JTF believes that it may be worthy of consideration to implement amendments which would restrict set-off rights otherwise available under BIA and CCAA to preclude a creditor from operating set-off between post-filing claims owing to the debtor company and pre- filing claims owing to such creditor by the debtor company except with leave of the court, where the preclusion would lead to an inherently inequitable result..

4.4. Application and implementation issues with respect to sections 38 and 95-101 of the BIA in the context of restructurings under CCAA and BIA

The JTF is of the view that, in a restructuring context, a debtor company's right to include or exclude recourses otherwise available under sections 38 and 95 to 101 of the BIA raises implementation issues which may be worthy of consideration. Without limitation, the debtor's right to exclude, in a proposal[207] or plan of arrangement, sections 38 and 95 to 101 of the BIA is perhaps overreaching, namely insofar as sections 95 to 101 of the BIA include, *inter alia,* section 97(3) of the BIA which sets out applicable set-off principles. It may thus be worthy to determine whether or not it is appropriate that a proposal or plan of arrangement expressly exclude principles of set-off otherwise applicable under section 97(3) of the BIA.

4.5. The extent of director protection under the BIA and the CCAA

The JTF is of the view that the requirement to demonstrate that it is impossible to obtain indemnification insurance for directors and officers at a reasonable cost, before a charge can be ordered to protect directors and officers,[208] should be reconsidered. In a situation where the debtor company is insolvent and a proceeding is looming, it is quite obvious that insurance will not be available or will only be available at a prohibitive cost, unless the insurance contract is pre-existing. As such, the requirement to demonstrate that insurance at a reasonable cost cannot be obtained is quite often an exercise in futility. The JTF believes that the provision could be modified to ensure that any existing insurance protection cannot be terminated or curtailed by reason of the insolvency of the debtor or by reason that an alternative protection is available through the court ordered charge, and to ensure that it serves to complement the indemnity that may otherwise be payable under any existing insurance contract.

The provisions that allow for a court ordered charge to protect directors and officers against liability refer to a liability that is incurred after the filing of the notice of intention or proposal under the BIA or after the commencement of proceedings under the CCAA. The JTF is of the view that the provision could perhaps be clarified to differentiate when the obligation is triggered from when the liability is incurred.

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[206] See *Re Industries Davie Inc.,* 2000 CarswellQue 7 (C.A.), *Re Industries Portes Mackie Inc.,* 2000 CarswellQue 431 (C.A.) *and Re Air Canada,* (2003 CarswellOnt 4016 (Ont. S.C.)).

[207] See 36.1 of the BIA.

[208] See section 11.51(3) CCAA and section 64.1(3) BIA.

SCHEDULE A

Legislative review task force (commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals

Methodology

Set-out below is a description of the methodology followed by the Joint Legislative Review Task Force (Commercial) of the Insolvency Institute of Canada ("IIC") and the Canadian Association of Insolvency and Restructuring Professionals ("CAIRP") (the "JTF").in the preparation of the report addressed to Industry Canada ("IC") and to its sponsoring organizations, IIC and CAIRP.

Composition of the JTF

Membership of the JTF was established as follows:

Philippe H. Belanger- McCarthy Tetrault LLP - (IIC Co-chair) Jean-Daniel Breton - Ernst & Young Inc.
Sean F. Collins - McCarthy Tetrault, LLP
Stephen Ferguson - Alvarez & Marsal Canada ULC
Craig J. Hill - Borden Ladner Gervais, LLP
Jonathan Krieger - Grant Thornton Limited - (CAIRP Corporate Practice Committee Chair)
Todd M. Martin - Alvarez & Marsal Canada ULC
Sylvain Rigaud - Norton Rose Fulbright Martin P. Rosenthal - Ernst & Young Inc. John R. Sandrelli - Dentons Canada LLP
Robin B. Schwill - Davies Ward Phillips & Vineberg, LLP
Steve Weisz - Blakes, Cassels & Graydon, LLP
Mitch Vininsky - Duff & Phelps Canada Restructuring Inc.
Mark Wentzell - Grant Thornton Limited

Methodology

For the purpose of preparing the report, the JTF held weekly or bi-weekly conference calls between February and July 2014 to identify, discuss and analyze the various topics and issues thought to be worthy of consideration in the context of the next legislative round of reform to the *Bankruptcy and Insolvency Act* ("BIA") and the *Companies Creditors' Arrangement Act* ("CCAA"). From May onwards, the JTF's weekly conference calls dealt primarily with the review and analysis of the topics and issues identified in the Discussion Paper.

In light of the fact that certain issues raised in the Discussion Paper were seen to be more complex and deserving of more detailed analysis, it was decided to form sub-committees to handle such issues. The following sub-committees were thus formed:

Issues relating to intellectual property rights:	Steven Weisz (Chair) John Sandrelli Josef Kruger Michael Greber

	Sharon Hamilton Nigel Meakin Ashley Taylor Shayne Kukulowicz Jean Fontaine
Issues relating to employee rights:	Craig Hill (Chair) Jean-Daniel Breton Mark Wentzell Bridget Van Wyk
Issues relating to credit bidding and stalking horse bids	Sylvain Rigaud (Chair) Jean-Daniel Breton Sean Collins Neil Narfasson Martin Rosenthal Mark Wasserman
Issues relating to Cross-border insolvencies	Robin B. Schwill (Chair) Mark Wentzell Kibben Jackson Natasha MacParland Prof. Stephanie Ben-Ishai
Tax issues	Aubrey Kauffman (Chair) Peter Farkas Paul Bishop Grant Moffat Robin Schwill Jean-Daniel Breton
Issues relating to eligible financial contracts	Rupert Chartrand Jean-Daniel Breton Patrick Riesterer

No formal consultation of the members of CAIRP and IIC

Because of the short timeframe within which comments were to be provided to IC with respect to the Discussion Paper, the JTF did not have the opportunity to formally poll or otherwise consult respective members of CAIRP and IIC as to the various issues and topics discussed in the report. The report of the JTF may thus not be seen as reflective of the collective views of the membership of each of IIC and CAIRP. It is envisaged that the report shall serve as a template for further reflection, research and discussion with the members of CAIRP and IIC with a view to eventually formulating formal recommendations as to suggested legislative changes to the Canadian insolvency statutes.

SCHEDULE B

Detailed report prepared by the IIC's Derivatives Task Force previously submitted by the IIC to Industry Canada

Insolvency Institute of Canada
L'Institut d'insolvabilité du Canada

REPORT OF

THE TASK FORCE ON DERIVATIVES

The Insolvency Institute of Canada ("**IIC**") Task Force on Derivatives (the "**Task Force**") respectfully submits this report on behalf of the leading organization of insolvency professionals in Canada. A brief description of the IIC is attached to this Report as Schedule "A". The Report is based on the volunteer efforts of many members of the IIC.

The Task Force was convened to examine the treatment of derivatives and other eligible financial contracts (together, "**EFCs**") under Canadian insolvency law in response to the heightened international scrutiny directed at some derivatives as a result of the 2008 global financial and liquidity crisis. The Task Force has undertaken a comprehensive review of Canadian insolvency statutes. The Report is primarily focused on the EFC provisions of the *Bankruptcy and Insolvency Act*[1] ("**BIA**") and the *Companies' Creditors Arrangement Act*[2] ("**CCAA**"), the two main Canadian insolvency statutes that apply to the insolvencies of commercial enterprises. The Report also considers the EFC provisions under the *Winding-up and Restructuring Act*[3] ("**WURA**").

OVERVIEW

Canadian commercial insolvency law is part of the national framework legislation which is designed to minimize the impact of an insolvency event upon the Canadian economy and to promote a successful restructuring of business enterprises undergoing financial difficulties. A successful restructuring (whether under the same corporate structure, a new legal entity or through a sale of business operations as a going concern) optimizes value for stakeholders, saves jobs, supports communities that rely on local industries, protects the public from losing vital services and encourages the survival of more competitive industries. In the case of financial institutions, the restructuring is also effected to protect special stakeholders such as depositors or policyholders and minimize potential "runs on the bank" which would create instability in financial markets, impair overall liquidity in the financial world and increase systemic risk.

Insolvency law promotes a going concern restructuring of a viable business entity's affairs. When a business entity is brought under insolvency protection, the BIA and CCAA provide a broad stay of rights and remedies against the insolvent entity to encourage a going-concern restructuring of the business where possible. This broad stay is a fundamental tool of Canadian

[1] R.S.C. 1985, c. B-3, as amended.

[2] R.S.C. 1985, c. C-36, as amended.

[3] R.S.C. 1985, c. W-11, as amended.

restructuring insolvency laws. The stay in part prevents a forced liquidation of a struggling business by staying (a) secured and unsecured creditors from realizing on the assets of the insolvent entity and (b) solvent counterparties from terminating contracts with the insolvent entity. Similarly, the *Canada Deposit Insurance Corporation Act*[4] ("**CDIC Act**") provides a broad stay of proceedings and a process to allow the Canada Deposit Insurance Corporation ("**CDIC**") to attempt to restructure a deposit-taking financial institution.

The legislative reforms regarding EFCs under Canadian insolvency law have been piecemeal. EFC protection was introduced into the BIA beginning in 1992, followed by more extensive amendments to the Canadian insolvency laws which generally came into force in 1997 and 2009. Amendments were also made to the CDIC Act and the *Payment Clearing and Settlement Act*[5] ("**PCSA**") to deal with EFCs entered into by certain financial institutions.

The insolvency regime for EFCs consists of a series of exemptions from the law that ordinarily applies to contracts upon the commencement of insolvency proceedings. The EFC "safe harbours" primarily provide an exemption from the stay of proceedings to permit the termination of EFCs by the solvent counterparty, the determination of the net amount owing under the terminated EFCs, the realization upon financial collateral posted in respect of EFCs and protect the priority thereof.

At the outset, the exemptions under insolvency law for the termination and netting of EFCs were in part promulgated on the basis of concerns for certainty in financial markets and competitiveness vis-à-vis the United States and other global markets. After the safe harbour provisions were added to the United States *Bankruptcy Code*,[6] similar protections were added in Canada to ensure that the Canadian market kept pace with global markets. In addition, it was felt that an exemption from stays against termination of EFCs would provide solvent parties with certainty in their dealings, with the anticipated result of encouraging the availability of risk-hedging derivatives for all Canadian enterprises, including those in financial distress.[7]

EFC protection is a significant exception to the stay of proceedings under the CCAA and BIA. There are two main purposes of the EFC safe harbours: (i) to protect non-defaulting counterparties from the risk of increasing exposure to the insolvent counterparty under the EFC and (ii) to reduce systemic risk in Canadian and global financial markets. Non-defaulting counterparties may be at risk because, in certain instances, the amounts under the EFCs are very substantial and the value of the underlying products subject to EFCs are volatile in nature and can change dramatically during an insolvency proceeding. If the solvent counterparty to an EFC is subject to a stay of proceedings and therefore unable to terminate its EFCs with the insolvent counterparty, there is a risk that the value of such EFCs could deteriorate sufficiently (from the

[4] R.S.C. 1985, c. C-3, as amended.

[5] S.C 1996, c. 6, Sch., as amended.

[6] *U.S. Code*, title 11.

[7] Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations respecting Order of Reference from the House of Commons dated Tuesday June 18, 1991 – pre-study of Bill C-22, *An Act to enact the Wage Claim Payment Act, to amend the Bankruptcy Act and to amend other Acts in consequence thereof*, House of Commons, 3rd Sess, 34th Parl, Issue No. 5, September 3, 1991, Chairman Felix Holtmann, at 1017–1018. [CBA Submissions].

insolvent counterparty's perspective) to put the solvent counterparty at risk. Systemic risk may arise where the solvent counterparty is a systemically important institution or where the solvent counterparty has entered into EFCs with one or more other counterparties. In extreme cases, the failure of one counterparty could have a domino effect, where the failure of one counterparty, particularly a derivatives dealer, triggers the failure of a second counterparty who is also a derivatives dealer and the failure of the second counterparty could trigger the failure of others. Multiple insolvencies may cause a lack of liquidity in the financial sector and unavailability of credit to solvent enterprises and, ultimately, systemic risk. The systemic risk could spread to global markets and lead to world-wide financial instability and, in extreme cases, recession.

The 2008 global financial and liquidity crisis precipitated recognition by governments and regulators of the need for a better understanding and more comprehensive regulation of derivatives. At the Pittsburgh Summit in 2009, the G20, including Canada, committed to strengthening the regulation, supervision and infrastructure of the global financial system (the "**G20 Commitments**"). The G20 Commitments include a commitment to attempt to mitigate systemic risk, particularly in the area of over-the-counter ("**OTC**") derivatives, by increasing the transparency of the OTC derivatives market and ensuring more consistent treatment of derivatives in different jurisdictions. To limit systemic risk, the G20 committed in part to the development of an internationally coordinated and comprehensive regulatory framework to facilitate the central clearing of most OTC derivatives according to internationally accepted standards, including insolvency rules.

Recent Canadian federal legislative amendments have focused on meeting the G20 Commitments. Amendments to the PCSA and the CDIC Act were enacted in 2012 primarily to facilitate the clearing and settlement of OTC derivatives by central counterparties and to further facilitate the restructuring of insolvent financial institutions by CDIC.[8] At the provincial level, the Canadian Securities Administrators are introducing rules to regulate more closely the OTC derivatives market and to provide for the central clearing of OTC derivatives.

Combating systemic risk is an important goal. However, the goal of reducing systemic risk has to be balanced against important Canadian insolvency principles which encourage restructuring. The Task Force has considered the treatment of derivatives in Canadian insolvency law in this light. The Task Force is of the view that the current treatment of EFCs in the Canadian insolvency regime does not always strike the right balance between protecting against systemic risk and allowing insolvent commercial enterprises to restructure. The current regime may in some cases impede the restructuring of insolvent enterprises by placing too much emphasis on attempting to reduce systemic risk.

In other cases, the protections against systemic risk may be improved and the Task Force supports strengthening some of the EFC safe harbours. In particular, additional protections should be provided to ensure that EFC counterparties have better priority to financial collateral. This protection against systemic risk can be granted without impeding a restructuring.

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[8] On June 27, 2012, the Task Force submitted to the Department of Finance its *Preliminary Review of Federal Legislative Changes to Accommodate Central Clearing of Over the Counter Derivatives*, which expressed its views on a preliminary outline of these amendments that was provided by the Department of Finance to the Task Force and other stakeholders for comment.

As currently drafted, the EFC safe harbours may in some cases deprive the insolvent estate of value to which the estate and its creditors should be entitled. Further, the EFC safe harbours may delay or prevent certain liabilities of the insolvent entity from being crystallized. The Task Force has made certain recommendations aimed at maximizing the value of the estate and enhancing the prospects of a restructuring of an insolvent enterprise without unduly increasing the potential for systemic risk.

In making its recommendations, the Task Force is cognizant of the fact that the global and Canadian regulators have reached a broad consensus that the EFCs entered into by most commercial enterprises pose little or no risk to major financial institutions and therefore do not give rise to systemic risk on a global scale. Global and Canadian regulators have accordingly determined that EFC transactions with commercial enterprise "end-users" of EFCs should be exempt from the mandatory central clearing regime that is being developed primarily for financial institutions.[9] The Task Force recognizes that there is still a potential for systemic risk arising as a result of the failure of a commercial enterprise. However, the Task Force is of the view that the emphasis solely on the potential for systemic risk, however remote, may in some instances be disproportionate given the impact that the EFC safe harbours may have on the ability of a commercial enterprise to restructure and on the recoveries of other creditors of the insolvent counterparty.

As noted above, EFCs receive special protection because (i) liabilities under EFCs are often based upon large notional amounts and (ii) the values of the underlying reference items and the financial collateral securing EFC obligations are highly volatile and significant fluctuation of these values can occur during an insolvency proceeding.

In addition, the EFC exemptions were introduced to make Canadian institutions competitive in the global derivatives market and to ensure Canadian enterprises have access to the global derivatives markets.

For these reasons, the Task Force does not recommend a repeal of the fundamental EFC safe harbour provisions under the BIA, the CCAA and, to the extent they are available in respect of a trading company, the WURA, but rather recommends a series of modifications to alleviate the EFC safe harbour provisions with a view to achieving a better balance between the objectives of insolvency legislation and financial risk.

The Task Force is making recommendations regarding the following broad categories:

A. Allow the termination of EFCs by the insolvent entity or its court appointed officer.

B. Allow the assignment of EFCs by the insolvent entity or its court appointed officer.

C. Prohibit walk-away clauses in EFC contracts.

D. Increase the priority of EFC financial collateral.

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[9] See Basel Committee on Banking Supervision & Board of the International Organization of Securities Commissions, *Margin requirements for non-centrally cleared derivatives* (Bank for International Settlements: September 2012) at p. 9; see also Canadian Securities Administrators, *CSA Consultation Paper 91-405, Derivatives End-User Exemption* (Canadian Securities Administrators Derivatives Committee: April 13, 2012).

E. Protect the central clearing of OTC derivatives.

F. Protect EFCs in receiverships.

The Report is presented from an insolvency point of view. The recommendations are primarily meant to promote restructurings and to preserve value for an insolvent commercial enterprise and its stakeholders. The recommendations should, however, be considered in light of the impact, if any, which they would have on the ability of Canadian financial institutions and solvent enterprises to access the global derivatives markets. Canadian EFC protections under insolvency law should be periodically reviewed in light of ongoing international legal developments.

RECOMMENDATIONS

Termination of EFCs

1. The prohibition on disclaimer or resiliation[10] of EFCs by the insolvent party in section 32(9) of the CCAA and section 65.11(10)(a) of the BIA should be repealed. If the solvent party does not terminate the EFC, the insolvent party should have the power to do so on the following basis:

   (a) the insolvent party should not be able to disclaim EFCs until 30 days after the insolvency filing.

   (b) at the end of the 30 day period, the same regime for disclaimer of agreements found in section 32 of the CCAA and section 65.11 of the BIA should apply to the disclaimer of an EFC, including a 30-day notice period and a 15-day objection period.

   (c) cherry-picking of EFCs during the disclaimer process should be expressly forbidden.

2. A receiver appointed under Part XI of the BIA, a trustee in bankruptcy and a liquidator appointed under the WURA should also have the power to disclaim EFCs 30 days after their appointment by the Court on the following basis:

   (a) a trustee in bankruptcy should have the authority under section 30 of the BIA, with the permission of the inspectors of the bankrupt estate, to disclaim an EFC in the same manner as an insolvent debtor can disclaim other contracts under section 65.11 of the BIA.

   (b) a receiver under Part XI of the BIA or a liquidator under the WURA should be able to apply to court on notice to the solvent counterparty to disclaim an EFC on providing 30 days' notice to the solvent counterparty. The solvent counterparty should be able to object in court to the disclaimer on the same grounds as for the disclaimer of other contracts under section 65.11 of the BIA.

[10] To simplify the text, the terms disclaimer and disclaim will be used throughout this text to also mean resiliation and resiliate.

(c) cherry-picking of EFCs should also be expressly forbidden.

Assignment of EFCs

1. The prohibition on assignment of EFCs by the insolvent party in section 11.3(2)(b) of the CCAA and section 84.1(3)(b) of the BIA should be repealed.

2. An insolvent entity, a trustee in bankruptcy, receiver under Part XI of the BIA and a liquidator of an insolvent insurance company under Part III of the WURA should be able to apply to the Court for an order assigning an EFC pursuant to the process provided for the assignment of other contracts in the CCAA and BIA on notice of the court motion seeking the assignment to the non-defaulting counterparty and other affected parties which, except in the case of insurance company insolvencies, is not less than 30 days.

3. The non-defaulting counterparty should not be permitted to terminate an EFC from the date the court makes an order assigning the EFC or such later date as may be set by the court.

4. Cherry-picking of EFCs to be assigned should be expressly forbidden and all contracts associated with an assigned EFC should be required to be assigned as well.

Walk-Away Clauses

The solvent counterparty should not be able to refuse to make net termination payments to the insolvent party on termination of an EFC because of the commencement of insolvency proceedings or any steps taken during the insolvency proceedings, such as a disclaimer of an EFC by the insolvent counterparty. The BIA, CCAA and WURA should be amended to render ineffective any provisions in an EFC that have the effect of providing for or permitting anything on termination, disclaimer or assignment of an EFC that is, in substance, equivalent to a walk-away clause.

Financial Collateral

1. Financial collateral should have priority over the super-priority liens for (i) certain wages pursuant to sections 81.3 and 81.4 of the BIA, (ii) certain pension amounts pursuant to sections 81.5 and 81.6 of the BIA and (iii) the deemed trusts pursuant to section 227 of the *Income Tax Act* ("**ITA**"),[11] section 23 of the *Canada Pension Plan*[12] ("**CPP**"), section 86 of the *Employment Insurance Act*[13] ("**EIA**"), and substantially similar provisions of provincial legislation.[14]

2. Financial collateral should be limited to those listed assets that are posted with, pledged to or specifically assigned to the solvent counterparty or under the control of an entity other than the insolvent counterparty or its related entities or that are subject to set-off or

[11] R.S.C. 1985, c. 1 (5th Supp), as amended.

[12] R.S.C. 1985, c. C-8, as amended.

[13] S.C. 1996, c. 23, as amended.

[14] For example, section 20 of the Quebec *Tax Administration Act* ("**QTAA**"), R.S.Q. c. A-6.002, as amended.

netting rights with the solvent counterparty or where title to the assets has been transferred by the insolvent debtor pursuant to a title transfer credit support agreement.

OTC Derivatives

1. The definitions of "clearing house", "clearing member" and "margin deposit" in Section 95(3) of the BIA should be expanded to cover derivatives clearing houses clearing derivatives transactions.

Receiverships

1. The receivership provisions in the BIA should be amended to ensure that a court does not have the power to stay a solvent counterparty from terminating an EFC in accordance with its terms, calculating net termination values of an EFC and netting or setting-off and dealing with financial collateral in accordance with the terms of an EFC. Such an amendment would make the provisions in certain Model Receivership Orders mandatory rather than discretionary. The amendment would result in standard treatment of EFCs in all receivership proceedings across Canada, as well as harmonizing receiverships with bankruptcies.

2. Section 88 of the BIA should be amended to apply to receiverships under Part XI of the BIA. The BIA should protect financial collateral to ensure that financial collateral posted with or pledged to secure an EFC is not primed by charges granted pursuant to a receivership order, including provisions granting a super-priority charge to a receiver in respect of the receiver's borrowings and the receiver's and other professional's fees.

DISCUSSION OF RECOMMENDATIONS

A. Termination of EFCs by Insolvent Estate

In the context of amendments to the BIA and CCAA codifying the process by which an insolvent debtor may disclaim agreements, provisions came into force in 2009 to prevent the debtor from terminating an EFC. Section 65.11(10) of the BIA was introduced to prohibit an insolvent debtor seeking to restructure under the BIA proposal provisions from disclaiming certain types of contracts, including EFCs. Similarly, section 32(9) of the CCAA was introduced to prohibit a debtor company from disclaiming an EFC. The reason for including EFCs in the list of contract types exempted from the disclaimer power was to permit the solvent counterparty to control the timing of termination so that it is able to effectively rehedge its exposure on derivatives transactions. As currently drafted, there is no time limit imposed on the solvent counterparty's unilateral right to terminate an EFC, which has the potential to create problems during a restructuring.

The EFC exemption from the disclaimer power can create an impediment to a successful restructuring and does little, if anything, to minimize systemic risk. To restructure successfully, a business operation needs to be cleared of burdensome contracts, including EFCs, and be able to crystallize and compromise claims of creditors. Further, if the insolvent party is "in the money" on a net basis on its EFCs with a counterparty, it should also have the opportunity to benefit from the net termination values. The permanent stay on termination of an EFC by the insolvent

counterparty and the possibility of a reliance by the solvent counterparty on walk-away clauses in the EFC (as discussed below) impede both these goals.

The inability to disclaim an EFC can create uncertainty for the insolvent party and may prevent it from realizing value, which is counterproductive to the objectives of the insolvency legislation. If no action is taken by the solvent party and the insolvent party is not allowed to take action, then the insolvent party may lose a valuable asset because of changes in the market. The products underlying an EFC are often volatile. Furthermore, the fact that the solvent party may take action at any time with little prior notice creates uncertainty for the insolvent party, as the extent of its debt load cannot be known with certainty until all contracts have been terminated or have expired. This situation can affect the chances of success of a restructuring proceeding.

The solvent counterparty's unilateral right to terminate the EFC need not be indefinite to protect against systemic risk. It is important that the insolvent enterprise be given an opportunity to attempt to restructure and emerge from the insolvency process as a viable business. The Task Force is therefore of the view that the insolvent counterparty should have the right to terminate the EFC after an appropriate period.

The Task Force is of the view that giving the debtor a right to terminate EFCs in accordance with the general contract disclaimer regime under the BIA and CCAA will balance the rights of the solvent counterparty and the potential for systemic risk with the need to facilitate a restructuring. The same process for the disclaimer of contracts by an insolvent debtor should apply to EFCs. This process requires the insolvent party to give 30 days' notice of its intent to disclaim a contract. Upon the commencement of the 30 day notice period, the other party to the contract has a 15 day period to object to the disclaimer of the contract by applying to the court for an order that the contract not be disclaimed. Since the termination of EFCs is not stayed, a 30 day notice period will also allow the solvent counterparty a relatively lengthy period of time during which it may terminate the EFC on a date of its own choosing.

Termination of certain derivatives contracts may require the solvent counterparty to rehedge its position. To facilitate re-hedging, the Task Force is of the view that the insolvent debtor should not be able to give notice of its intent to disclaim EFCs until 30 days after the date of the insolvency filing.

Further, the solvent counterparty would have an additional 30 days to re-hedge under the existing notice regime for the disclaimer of contracts. This would give the solvent counterparty a total of at least 60 days before an EFC can be terminated by an insolvent debtor. In section 32(4) of the CCAA and section 65.11(5) of the BIA, when deciding whether to allow a disclaimer, the court is to consider, among other things, whether the disclaimer would likely cause significant financial hardship to a party to the agreement. The court has the discretion to refuse to allow the disclaimer or to extend the 30 day notice period to protect the solvent counterparty from the disclaimer of any contract if financial hardship is an issue. Financial hardship could arise where a solvent counterparty to an EFC may experience difficulty in rehedging its position during the 60 day time period. In such circumstances, the court could refuse to allow the disclaimer or could extend the time period to minimize the financial hardship.

In addition to businesses attempting to restructure, the right to disclaim EFCs should also be available to a trustee in bankruptcy under the BIA, a receiver appointed under the BIA, and the

liquidator appointed under the WURA.[15] An insolvent estate, even if not restructuring, should not, as a matter of policy, lose value merely because of the commencement of insolvency proceedings. This is contrary to the general goal of maximizing value for all stakeholders. Further, there is a need to crystallize claims against the estate where the solvent counterparty has an in-the-money position to allow for a timely distribution to the creditors.

A trustee in bankruptcy should have the authority under section 30 of the BIA, with the permission of the inspectors of the bankrupt estate, to disclaim an EFC in the same manner as an insolvent debtor can disclaim other contracts under section 65.11 of the BIA.

A receiver under Part XI of the BIA or a liquidator under the WURA should be able to apply to court on notice to the solvent counterparty to disclaim an EFC on providing 30 days' notice to the solvent counterparty. The solvent counterparty should be able to object in court to the disclaimer on the same grounds as for the disclaimer of ordinary contracts under section 65.11 of the BIA.

The right to disclaim would not apply to any EFC transactions that have been cleared.

Members of the Task Force are of the view that the disclaimer regime should not permit an insolvent entity, trustee in bankruptcy, receiver or liquidator to cherry-pick valuable EFCs. Cherry-picking is unfair to the solvent counterparty and has the potential to provide certain creditors of the estate with an undeserved windfall at the solvent counterparty's expense. The disclaimer of EFCs should be permitted only where all EFCs with the same solvent counterparty are also disclaimed. This will prevent the insolvent entity from terminating only in-the-money contracts with the solvent party and impair the netting of obligations under other EFCs with the same counterparty. The Task Force recommends that the language used in section 39.15(7.2) of the CDIC Act be used as a guide to prevent cherry-picking.[16]

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[15] The IIC has previously recommended significant amendments to the WURA, including restricting its application to financial institutions. For a detailed review of the WURA recommendations, see the Insolvency Institute of Canada's *Winding-Up and Restructuring Act: Recommendations for Reform* (June 14, 2002).

[16] Section 39.15(7.2) of the CDIC Act provides as follows:

> The Corporation may assign to a bridge institution eligible financial contracts — including any claim under such contracts — that are between a federal member institution and an entity or any of the following entities provided that the Corporation assigns all of those eligible financial contracts to the bridge institution:
>
> (a) another entity that is controlled — directly or indirectly — by the entity;
>
> (b) another entity that controls — directly or indirectly — the entity; or
>
> (c) another entity that is controlled — directly or indirectly — by the entity referred to in paragraph (b).

Recommendations on Termination of EFCs

1. The prohibition on disclaimer of EFCs by the insolvent party in section 32(9) of the CCAA and section 65.11(10)(a) of the BIA should be repealed. If the solvent party does not terminate the EFC, the insolvent party should have the power to do so on the following basis:

   (a) the insolvent party should not be able to disclaim EFCs until 30 days after the insolvency filing.

   (b) at the end of the 30 day period, the same regime for disclaimer of agreements found in section 32 of the CCAA and section 65.11 of the BIA should apply to disclaimer of an EFC, including the requirement that 30 days' notice be given and the right of a solvent counterparty to object within 15 days of the provision of such notice.

   (c) cherry-picking of EFCs during the disclaimer process should be expressly forbidden.

2. A receiver appointed under Part XI of the BIA, a trustee in bankruptcy and a liquidator under the WURA should also have the power to disclaim EFCs 30 days after their appointment by the Court on the following basis:

   (a) a trustee in bankruptcy should have the authority under section 30 of the BIA, with the permission of the inspectors of the bankrupt estate, to disclaim an EFC in the same manner as an insolvent debtor can disclaim other contracts under section 65.11 of the BIA.

   (b) a receiver under Part XI of the BIA or a liquidator under the WURA should be able to apply to court on notice to the solvent counterparty to disclaim an EFC on providing 30 days' notice to the solvent counterparty. The solvent counterparty should be able to object in court to the disclaimer on the same grounds as for the disclaimer of ordinary contracts under section 65.11 of the BIA.

   (c) cherry-picking of EFCs should also be expressly forbidden.

B. Assignment of EFCs

In the context of amendments to the BIA and CCAA codifying the process by which an insolvent debtor may assign agreements, provisions also came into force in 2009 to prevent an insolvent debtor from assigning an EFC. Section 84.1(3)(b) of the BIA was introduced to prohibit a trustee in bankruptcy (and, by virtue of section 66 of the BIA, an insolvent debtor seeking to restructure under the BIA proposal provisions) from assigning an EFC. Similarly, section 11.3(2)(b) of the CCAA was introduced to prohibit a debtor company from assigning an EFC. The reason for including EFCs in the list of contract types exempted from the forced assignment power was to permit the solvent counterparty to control who is the new counterparty in a derivatives transaction.

The ability to assign EFCs would preserve and maximize value for the insolvent estate and may increase recoveries to creditors. The right to apply to court for an order assigning an EFC would most likely be used in the context of a sale of an entire book of business or a sale of a whole business, including EFCs entered into by the previous owner to hedge certain risks faced in that industry.

The right to assign EFCs is particularly important for Canadian insurance companies. Many Canadian insurance companies are major financial institutions. These companies have significant derivative books of business, particularly in their "dynamic hedging" programs for interest rates, equities and other risks. A major task of a liquidator of an insurance company appointed under Part III of the WURA is to seek to restructure the insolvent company's business portfolio so that it can be acquired by another insurance company. This maximizes value and protects policyholders. This objective is very similar to a restructuring of other financial institutions such as banks.

The court motion seeking an assignment of EFCs should be subject to the normal assignment provisions in the BIA and the CCAA, including evidence of the ability of the assignee to perform under the EFC, the assignee being an appropriate person to be assigned the rights and obligations under the EFC and the assignee curing any outstanding monetary defaults[17] under the EFC within the time fixed by the court.

To allow the solvent counterparty ample time to consider the proposed assignment and determine whether it can accept the proposed assignee, the notice of motion seeking an order assigning the EFC should be made on at least 30 days' notice to the solvent counterparty. During that period, the solvent counterparty will be able to terminate the EFC if it is not satisfied with the information provided to it and the court or if it does not accept the proposed assignee as the new counterparty. This termination right would survive until the court makes an order assigning the EFC or such later date as may be set by the court.

In the case of insurance company insolvencies, the liquidator need not be limited to a 30-day notice period. The treatment of the sale of assets, including derivatives, in proceedings in respect of an insolvent insurance company should be similar to the treatment of such sales in insolvency proceedings in respect of other regulated financial institutions. To protect policyholders and the stability and confidence in financial markets, a liquidator may need to sell the whole book of business early in the liquidation process.

The right to seek court approval of an assignment of an EFC would not apply to any EFC transactions that have been cleared.

For the same reasons as for the termination of EFCs, there should not be any cherry-picking on the assignment of EFCs with the same counterparty and all contracts associated with an assigned EFC should be required to be assigned as well.

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[17] Other than monetary defaults triggered by the debtor's insolvency, failure to meet financial covenants, accessing the relief provided by an insolvency statute, or other similar default.

Recommendations on the Assignment of EFCs

1. The prohibition on assignment of EFCs by the insolvent party in section 11.3(2)(b) of the CCAA and section 84.1(3)(b) of the BIA should be repealed.

2. An insolvent entity, a trustee in bankruptcy, receiver under Part XI of the BIA and a liquidator of an insolvent insurance company under Part III of the WURA should be able to apply to the Court for an order assigning an EFC pursuant to the process provided for the assignment of other contracts in the CCAA and BIA on notice of the court motion seeking the assignment to the non-defaulting counterparty and other affected parties which, except in the case of insurance company insolvencies, is not less than 30 days.

3. The non-defaulting counterparty should not be permitted to terminate an EFC from the date the court makes an order assigning the EFC or such later date as may be set by the court.

4. Cherry-picking of EFCs to be assigned should be expressly forbidden and all contracts associated with an assigned EFC should be required to be assigned as well.

C. Prohibition of Walk-Away Clauses

In a typical derivatives contract, when the contract is terminated, the party who is "out of the money" must pay the party who is "in the money." However, clauses are sometimes, though rarely, included in EFCs which override the typical provision by affording one counterparty the right to walk away from a termination payment that would otherwise be due to the other counterparty when the second counterparty commits certain specified defaults, including becoming subject to insolvency proceedings (such provision a "**walk-away clause**").

The EFC safe harbours were not intended to create a benefit for solvent counterparties. The EFC safe harbours were first suggested as a means to facilitate the termination of EFCs on a timely basis where one counterparty has become the subject of insolvency proceedings and were intended to benefit both the solvent and insolvent counterparties. The provision permits the solvent counterparty to terminate an EFC at market price, and gives rise to a net amount that may well be payable to the insolvent counterparty, rather than to the solvent counterparty. The exemption from the stay facilitates the determination of a fixed and certain value to the EFC and the right of both counterparties to collect such amount, just like an amount owed under any other contract at the time of the stay.[18]

Walk-away clauses have the potential to create significant windfalls for the counterparties that have the benefit of such clauses while causing significant harm to defaulting (insolvent) counterparties and their creditors. Walk-away clauses are disproportionately favourable to the non-defaulting counterparty and do not protect against systemic risk. The BIA, CCAA and WURA should be amended to render ineffective any provisions in an EFC that have the effect of providing for or permitting anything that is, in substance, equivalent to a walk-away clause.

[18] CBA Submissions, *supra* note 7.

Certain provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*[19] ("**Dodd-Frank Act**") recently enacted in the United States provide that no walk-away clauses shall be enforceable with respect to certain covered financial companies.[20]

Walk-away clauses should be prohibited under the BIA, CCAA and WURA. The capital adequacy requirements published by the Office of the Superintendent of Financial Institutions require certain financial institutions to disregard EFCs that include walk-away clauses for purposes of measuring the financial institution's regulatory capital and for calculating netting in respect of same.[21] Even if the capital adequacy rules are sufficient to prevent certain financial institutions from inserting walk-away clauses in their EFCs, many derivatives dealers and other persons carrying on business through trading or entering into derivatives may not be subject to the same or similar capital adequacy rules. A standard rule for all EFCs should apply.

Prohibiting walk-away clauses will make the EFC safe harbours more consistent with Canadian insolvency law principles and the initial justification for the EFC safe harbours.

Recommendation on Prohibition of Walk-Away Clauses

1. The solvent counterparty should not be able to refuse to make net termination payments to the insolvent party on termination of an EFC because of the commencement of insolvency proceedings or any steps taken during the insolvency proceedings, such as a disclaimer of an EFC by the insolvent counterparty. The BIA, CCAA and WURA should be amended to render ineffective any provisions in an EFC that have the effect of providing for or permitting anything on termination, disclaimer or assignment of an EFC that is, in substance, equivalent to a walk-away clause.

D. Financial Collateral

The EFC safe harbours in the BIA, CCAA and WURA permit a solvent counterparty to realize upon financial collateral notwithstanding any stay resulting from the commencement of insolvency proceedings.[22] The protection for financial collateral came into force in September 2009.

Canadian insolvency law purports to give a solvent counterparty almost unlimited rights to enforce on its interests in financial collateral. The EFC safe harbours permit "any dealing with financial collateral" including sale, foreclosure and set off. Further, section 88 of the BIA provides that no order may be made under the BIA in relation to a bankruptcy or a proposal if the

[19] Pub. L. 111-203; H.R. 4173.

[20] Dodd-Frank Act, s. 210(c)(8)(F). The U.S. courts have also not supported clauses which are in effect walk-away clauses: *Lehman Bros. Holding Inc. v BNY Corporate Trustee Servs. Ltd.*, 2010 BL 14861 (2010, U.S. Brtcy. Ct., S.D.N.Y.); *In Re Lehman Brothers Special Finance Inc. v Ballyrock ABS CDO 2007-1 Limited et al.*, 452 B.R. 31 (2011, U.S. Brtcy. Ct., S.D.N.Y.).

[21] Office of the Superintendent of Financial Institutions Canada, *Guideline: Capital Adequacy Requirements* (Effective Date: January 2013).

[22] The CDIC Act also provides solvent counterparties with a similar right to realize on financial collateral, subject to the one day stay that may result if CDIC is appointed receiver of the insolvent financial institution.

order would have the effect of subordinating financial collateral. Section 34(11) of the CCAA similarly provides that no order may be made under the CCAA if the order would have the effect of subordinating financial collateral.

Despite these clear pronouncements, the current provisions in Canadian insolvency law do not always clearly delineate who has priority over financial collateral. Section 81.3 of the BIA attributes an absolute priority to certain employee wage claims against current assets, subject only to certain deemed trusts in favour of the Crown[23] ("**Crown**"); and section 81.5 of the BIA attributes an absolute priority to certain pension claims against all the assets of the bankrupt, subject only to the employees' wage claims under section 81.3 of the BIA and certain of the Crown's deemed trusts. The assets potentially encumbered by the super-priority statutory lien for wage and pension claims against the insolvent could include financial collateral. Further, the Crown's deemed trust provisions could have priority over the solvent counterparty's rights to financial collateral.

The Task Force is of the view that the solvent counterparty should have a first ranking right to the financial collateral, ahead of the various statutory priorities for employees, pension plans and unremitted source deduction and withholding taxes, and that the above-mentioned statutory priorities should not affect the solvent counterparties' set-off or netting rights under EFCs. Unlike other security interests, financial collateral is one of the fundamental building blocks to protect against the potential for systemic risk arising in respect of EFCs.

The Task Force is also of the view that the definition of financial collateral as it relates to the type of security taken is too broad given the enhanced priority recommended for solvent counterparties with respect to financial collateral. To ensure that the Task Force's recommendation regarding the increased priority to financial collateral for solvent counterparties does not have a negative impact on employees, pension plans or the Crown, the scope of the security over financial collateral should be limited to collateral that is posted with or pledged to the solvent counterparty or in the control of an entity other than the insolvent counterparty, either as it exists on the date of the initial insolvency event or thereafter. These limits on the scope of the priority for the security over financial collateral will appropriately protect the interests of employees, pension plans and the Crown without the potential for increasing systemic risk.

One potential problem that the Task Force has identified with the current broad definition of financial collateral arises because a charge on financial collateral could resemble a floating charge on cash and securities which come into existence after an insolvency filing. In current banking practice, it is not unusual for a lender to offer an interest rate and/or foreign exchange swap as part of the financial arrangements under a credit agreement. These swaps qualify as EFCs. Generally, a lender will enter into a separate swap agreement with the borrower, but the swap will be secured by the same general security agreement or hypothec on the universality of the borrower's assets that also secures the credit facility. The collateral relied on for the general loan is mainly bank accounts, inventory and accounts receivable, which generate or provide the cash for repayment of the general loan. Allowing the borrower to use the same collateral for the swap as for the general loan improves the borrower's liquidity as the borrower does not need to

[23] The deemed trusts pursuant to section 227 of the ITA, section 23 of the CPP, section 86 of the EIA, and substantially similar provisions of provincial legislation. See *supra* note 14.

separately post cash or securities as collateral for the swap. The amounts owing from time to time under the swap generally do not reduce the credit line by the full amount of the swap.

Problems could arise in an insolvency where there the same general security agreement secures both the general loan and the EFCs granted pursuant to that loan. Upon the insolvency of the borrower, a lender that provides a swap that is secured by a general security agreement or an hypothec on the universality of a borrower's assets may take the position that the cash in the borrower's operating account or certain other current asset collateral under the general security agreement or hypothec is financial collateral. Interpreting the assets subject to the general security agreement as financial collateral could mean that the general lender, in its capacity as swap counterparty, is allowed to realize on the assets of the debtor including assets acquired by the debtor after the insolvency filing notwithstanding the stay that would normally apply to it in its capacity as secured creditor. Further, if the assets are financial collateral, the general lender in its capacity as swap counterparty potentially has priority over any charge to secure interim financing (colloquially, "**DIP**" financing) as well as over all assets acquired by the debtor after the insolvency filing (including any DIP financing drawn after the insolvency filing).

The current broad definition of financial collateral therefore has the potential to undermine many insolvent entities' restructuring efforts. The current definition of financial collateral could be interpreted in a way that would allow a solvent counterparty that has security under a general security agreement to seize the operating bank accounts or other securities of the insolvent counterparty at any time following default and, if the operating account is not seized, the solvent counterparty could require post-filing cash received by the borrower to be swept into an account controlled by the solvent counterparty to which the insolvent counterparty would not have access. The solvent counterparty could also argue that a court cannot grant a charge over the assets securing the swap (relying on CCAA s. 34(11)) and that these assets must be used to satisfy EFC obligations. This could have a serious impact on the restructuring efforts of the insolvent counterparty. The insolvent counterparty will need cash and current assets to operate and will likely need the ability to give security over its current assets in order to obtain interim financing.

The Task Force is particularly concerned about the scope of financial collateral given its recommendation that claims of a solvent counterparty to financial collateral be given priority over the claims of wage earners for unpaid wages, pensioners for unremitted pension contributions and taxing authorities for unremitted source deductions.

However, the limitation on the type of security or arrangement over financial collateral which can be given first ranking security status may lead some lenders to require from the borrower, in addition to a general security agreement or hypothec on the universality of the undertaking, a posting of collateral which could affect the liquidity needs of a solvent or insolvent party. Adoption of this recommendation should take this market risk factor into account.

Recommendations for Financial Collateral

1. Financial collateral should have priority over the super-priority liens for (i) certain wages pursuant to sections 81.3 and 81.4 of the BIA, (ii) certain pension amounts pursuant to sections 81.5 and 81.6 of the BIA and (iii) the deemed trusts in favour of the Crown

pursuant to section 227 of the ITA, section 23 of the CPP, section 86 of the EIA, and substantially similar provisions of provincial legislation.[24]

2. Financial collateral should be limited to those listed assets that are posted with, pledged to or specifically assigned to the solvent counterparty or under the control of an entity other than the insolvent counterparty or its related entities or that are subject to set-off or netting rights with the solvent counterparty or where title to the assets has been transferred by the insolvent debtor pursuant to a title transfer credit support agreement.

E. Central Clearing of OTC Derivatives

The Canadian regulators, in conjunction with other foreign regulators, are establishing international standard rules to require that the more standard OTC derivatives be cleared through derivatives clearing houses. The clearing houses will require their participating members to post collateral and make margin deposits to secure the obligations of the participating members to the clearing house.

Section 95 of the BIA deems bodies which clear securities and its members to be dealing at arm's length and exempts a securities clearing house from the rebuttable presumption that a payment has been made or that security has been taken with an intent to give the clearing house a preference over other creditors of the clearing member.

The Task Force is of the view that derivatives clearing houses should benefit from the same exemption under the BIA preference rule.

Recommendation for OTC Derivatives

1. The definitions of "clearing house", "clearing member" and "margin deposit" in Section 95(3) of the BIA should be expanded to cover derivatives clearing houses clearing derivatives transactions.

F. Receiverships under Part XI of the BIA

The provisions dealing with national receiverships and the appointment of a receiver by the Court pursuant to the BIA were introduced as part of the amendments that came into force in September 2009. Previously, the BIA did not provide for the appointment of a receiver by the Court, although it provided for the appointment of interim receivers in the context of a proposal, an application for a bankruptcy order or an intention by a secured creditor to enforce its security. Prior to 2009, courts in some provinces had given an expansive interpretation to the interim receivership provisions exercising their inherent jurisdiction such that interim receiverships were effectively full receiverships. In 2009, interim receivers were returned to their original role with limited powers and the ability to act only on an interim basis.

The amendments that came into force in 2009 did not deal with EFCs and no safe harbours apply in the receivership context. As such, while the CCAA and BIA contain exemptions for certain remedies in respect of EFCs in bankruptcy and restructuring situations, there is no mention of EFCs in the context of receiverships.

[24] For example, section 20 of the QTAA.

Prior to the amendments to the BIA, receivership was an equitable remedy which relied upon the broad jurisdiction of the courts in common law jurisdictions. The *Civil Code of Quebec*[25] and *Code of Civil Procedure*[26] do not specifically provide for the appointment of a receiver by the Court as an equitable remedy. Over time, receiverships have evolved. Courts outside of Quebec have used their inherent jurisdiction to impose a very broad stay of proceedings in a receivership to stay the termination of contracts, similar to a stay imposed by a court in a CCAA proceeding. This practice has continued to develop since 2009. The Quebec courts are sometimes reticent to grant a stay in such circumstances.

The Task Force has concluded that EFC safe harbours should be expressly provided in a receivership in the same fashion as elsewhere in the BIA and CCAA. Currently, protection of EFCs is solely at the discretion of the court exercising its inherent powers. Some provinces have developed Model Receivership Orders. Several Model Receivership Orders provide that the receivership stay does not apply in respect of an EFC,[27] but this protection is not uniform. For example, the Saskatchewan Model Receivership Order does not exempt EFCs from the receivership stay. In addition, Model Orders are discretionary. A court can choose to grant a broader stay in certain circumstances. The discretionary nature of the stay and the lack of uniformity among the provinces should be addressed to ensure that systemic risk is appropriately curtailed. Further, EFC safe harbours should be added to receiverships to ensure that regulators and market participants have the level of legal certainty they require for these types of rights.

The BIA provides that no order can be made in the context of a bankruptcy or proposal which has the effect of subordinating financial collateral. The BIA is silent on the effect of receiverships on financial collateral. The Model Receivership Orders developed, however, provide for a super-priority charge for the Receiver's and the Receiver's other professional fees over all the property of the debtor and a super-priority charge for the Receiver's borrowings over all the property of the debtor (collectively, the "**Receiver's Charges**"). The Receiver's Charges in the Model Receivership Orders generally have priority over every lien, charge, encumbrance and security interest except the environmental lien (BIA, s. 14.06(7)), the wages charge (BIA, s. 81.4(4)) and the pension charge (BIA, s. 81.6(2)).[28] Accordingly, the Receiver's Charges granted by a court generally prime financial collateral. The Receiver's Charges are therefore generally broader than the charges in the CCAA in favour of the monitor and DIP lenders. The

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[25] S.Q. 1991, c. 64, as amended.

[26] R.S.Q. c. C-25, as amended.

[27] See section 9 of the Ontario Model Receivership Order, available on the webpage of the Ontario Court of Superior Justice, Commercial List, http://www.ontariocourts.ca/scj/en/commerciallist/; section 8 of the British Columbia Model Receivership Order, available on the website of the British Columbia Supreme Court, http://www.courts.gov.bc.ca/supreme_court/practice_and_procedure/practice_directions/civil/PD%20-%2016%20Model%20Receivership%20Order.pdf; and section 10 of the Alberta Model Receivership Order, available on the webpage of the Alberta Court of the Queen's Bench, http://www.albertacourts.ab.ca/LinkClick.aspx?fileticket=SI1sMgHbIXw%3d&tabid=324&mid=839.

[28] See sections 17 and 20 of the Ontario Model Receivership Order; sections 16 and 19 of the British Columbia Model Receivership Order; sections 16 and 19 of the Saskatchewan Model Receivership Order; and section 16 and 19 of the Alberta Model Receivership Order. Note that the Alberta Model Receivership Order does not explicitly state that the statutory liens and charges for the environment, unpaid wages and unpaid pension amounts have priority over the Receiver's Charges.

Task Force is of the view that Receiver's Charges should not be permitted to prime financial collateral.

Recommendations for Receiverships

1. The receivership provisions in the BIA should be amended to ensure that a court does not have the power to stay a solvent counterparty from terminating an EFC in accordance with its terms, calculating net termination values of an EFC and netting or setting-off and dealing with financial collateral in accordance with the terms of an EFC. Such an amendment would make the provisions in certain Model Receivership Orders mandatory rather than discretionary. The amendment would result in standard treatment of EFCs in all receivership proceedings across Canada, as well as harmonizing receiverships with bankruptcies.

2. Section 88 of the BIA should be amended to apply to receiverships under Part XI of the BIA. The BIA should protect financial collateral to ensure that financial collateral posted with or pledged to secure an EFC is not primed by charges granted pursuant to a receivership order, including provisions granting a super-priority charge to a receiver in respect of the receiver's borrowings and the receiver's and other professional's fees.

September 26, 2013

SCHEDULE "A"

The Insolvency Institute of Canada/L'institut d'insolvabilité du Canada

The Insolvency Institute of Canada is Canada's premier private sector insolvency organization. The Institute is a non-profit organization dedicated to the recognition and promotion of excellence in the field of insolvency. Its members are drawn from the most senior experienced members of the insolvency community in Canada. Membership is by invitation and is limited to 135 insolvency practitioners (trustees and lawyers) who are joined by representatives of regulatory and compensation bodies, major financial institutions and prominent members of the academic community.

The Institute provides a forum for leading members of the insolvency community to exchange ideas and share experiences with other members, senior representatives of the federal and provincial governments and members of the judiciary. The Institute supports and encourages research studies and analysis of restructuring, insolvency and creditors' rights issues. Since its inception, members of the Institute have always had prominent roles in the review and reform of Canada's insolvency legislation.

The Institute publishes papers on insolvency related topics in the annual Journal of the Insolvency Institute of Canada. Members regularly prepare and deliver presentations on technical, academic and professional matters at the Institute's Annual General Meetings. The Institute has commissioned research projects on important issues in Canada's insolvency and restructuring system. The Institute has established links with Canada's leading bankruptcy and insolvency judges. The Institute, in association with one of Canada's leading publishers, makes its collection of insolvency cases and materials available electronically.

The Institute, through its members, brings a wealth of judgment and experience to its activities and projects and is becoming increasingly recognized as the most authoritative multidisciplinary insolvency organization in Canada.