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Paul Halucha
Director-General
Marketplace Framework Policy Branch
Industry Canada
235 Queen Street, 10th Floor, East Tower
Ottawa, Ontario
K1A 0H5
Via email: insolvency-insolvabilite@ic.gc.ca

Dear Mr. Halucha,

Re: Response of Canadian Bond Investors' Association (the "CBIA") to the Notice of Statutory Review of the Bankruptcy and Insolvency Act (the "BIA") and the Companies' Creditors Arrangement Act (the "CCAA") (the "Statutory Review Document")

The CBIA was established in 2011 and represents 34 of the largest fixed income institutional investor organizations in Canada, including those from the insurance, asset manager (including bank-owned), pension and investment counsel sectors. Those institutions represent more than $650 billion of fixed income assets under management. As such, the CBIA is the voice of Canadian institutional bond investors, and hence of millions of pensioners, policyholders and retail investors who depend on CBIA members and other similar industry participants for the sound management of these investments.

The purpose of this letter is to provide Industry Canada with the CBIA's feedback on the public consultation and review of the BIA and the CCAA. Our comments are outlined below. *Please note though that, as previously agreed, we have not repeated below our feedback with respect to the use of the arrangement provisions of the Canada Business Corporations Act (the "CBCA") to restructure insolvent corporations, which can be found in our submission to Industry Canada dated May 13, 2014 in response to the Notice of Consultation of the CBCA.*

Overview of General Concerns

It is not uncommon these days to see articles and news stories in the media vilifying the position of bondholders relative to a particular borrower or the borrower's other stakeholders. Most often, those articles and stories are the work of self-serving competing creditor or shareholder constituencies trying to advance their cause in a relative sense with regard to a particular situation. Bondholders have been relatively easy prey for such tactics, since they are by no means a homogeneous group and, unlike banks, most Canadians do not seem to realize that they and their financial well-being are indeed very interconnected with institutional bondholders and their various investments in Canadian debt markets. The bondholders to which we refer are primarily the insurance companies, the pension funds, the RRSP and RESP asset administrators, the charities and foundations and many other types of financial companies upon whom average Canadians depend and the success of which matters significantly to the insurance costs and payouts, annuity payments, retirement funds and education funds of Canadians everywhere.

These bondholders are also key players in the Canadian financial markets. We dare say that, without properly functioning debt markets, the Canadian economy would be a small fraction of its current size. There may be various inequities or other problems that need to be fixed in the legislation affecting insolvent borrowers; however, it is important to remember that every change in the law has consequences for the financial markets and for the costs of borrowing of those companies that fuel the growth of our economy and the individual earnings of Canadians. Accordingly, although a relatively small, but vocal, group of Nortel pensioners might believe that it will benefit personally in the Nortel insolvency from certain legislative changes being made, if the effect of those changes is to increase the cost of borrowing and decrease the availability of borrowing for virtually any Canadian company with a pension plan, there must be a serious examination of the costs and benefits associated with such a change, no matter how personally compelling the story of an individual pensioner may be. Indeed, for every one such pensioner who might gain a bit from a change (although they probably will not gain, due to timing – i.e. any amendments to the law would presumably not apply retroactively), there are likely thousands of other Canadians depending on their pension plans' investments, their annuities, RRSPs and RESPs, who will suffer an overall much larger detriment because of various changes proposed by activist pensioner groups.

This will be the case especially if the result of these changes is to raise the cost for, and reduce the access of, various borrowers to the Canadian debt markets. Bondholders are sophisticated financial institutions that will adapt their practices and their risk assessments to virtually any change in the law. If those risk assessments change, both pricing and availability of borrowing can be expected to be affected. Accordingly, it is borrowers and the Canadians that rely on those borrowers in all different capacities that will ultimately be adversely impacted by any short-sighted amendments to Canadian insolvency legislation.

The CBIA has chosen to respond only to a very few of the issues raised in the Statutory Review Document. For the most part, the CBIA will defer to the views of the various government and industry professionals that have devoted a very significant time and effort to the Statutory Review. However, the CBIA and its members remain very concerned that the tail not wag the dog and, in particular, that the views of small groups

of activist retirees, pensioners and terminated employees of companies such as Nortel not wreak havoc on the Canadian debt markets. Those views seem to have permeated many areas of the Statutory Review Document, although the CBIA recognizes that they have not necessarily been adopted by the Department.

Interest Claims - Should the CCAA be Amended to Create an "Interest Stops Rule" upon the Initiation of CCAA Proceedings?

It is important to be clear with respect to the current state of the law in this regard. There are both Supreme Court of Canada (Canada 3000) and Ontario Court of Appeal (Stelco) cases that say that there is no so-called "interest stops rule" in the CCAA at present. Although it is clear that the Nortel pensioners, retirees and ex-employees would prefer that there be such a rule, there are very serious potential consequences to such a change. The issues are much larger than those presumably presented to Industry Canada on behalf of those interests groups. For example:

(a) Secured Debt: The Statutory Review Document refers only to the concept of interest-stopping in a general way. It does not distinguish between interest on secured debt and interest on unsecured debt. Even in a bankruptcy pursuant to the BIA, no one suggests that a secured creditor is not entitled to its interest to the date of ultimate payment. Indeed, the very suggestion that there could be a stoppage in the accrual of interest on secured claims under the CCAA or the BIA would be tantamount to a re-ordering of legal priorities. That could be expected to have a huge detrimental effect on the markets in terms of the issuance of secured debt. The purpose of a stay of proceedings is simply to relieve a debtor of the immediate obligation to make those payments for a certain amount of time. However, the obligations continue to accrue and they must. If debtors were able to relieve themselves of the ongoing obligations to secured creditors simply by filing for creditor protection under the CCAA, one can easily envisage situations in which CCAA proceedings would be initiated solely as a lever against secured creditors, for the benefit of equity or unsecured creditors, even where no compromise is ever intended to be brought forward. In other words, CCAA proceedings could be utilized solely to stop the interest clock running on secured obligations. As referred to above, currently that is not even possible under the BIA - for very good reason.

(b) Subordinations: Before proceeding to focus on the absolute rights of unsecured creditors in this regard, it is important to look at another market issue that could be expected to create a significant negative impact on the markets if the law were changed from its current state and an "interest stops rule" were imported into the CCAA. Indeed, this issue was the underpinning of the Stelco case.

In the Stelco case, the issue was one of contractual subordination of one unsecured bond issue to another, a very common tool in the Canadian debt markets. Those buying subordinated bonds (i.e. the subordinated lenders) understand very well that they are subordinating their priority of repayment to the senior unsecured lenders. They are making a different credit decision and are rewarded specially for doing so. In Stelco, the Ontario Court of Appeal made it very clear that there would be no stoppage in accrual rights with respect to

interest on the senior unsecured debt relative to the subordinated unsecured debt, so that the subordinated unsecured debt would not realize a windfall and the reasonable expectations of the senior unsecured debt would not be subverted simply because the borrower company engaged CCAA proceedings.

Accordingly, it can be seen that the introduction of an "interest stops rule" in CCAA would undermine the current workings of the Canadian financial markets, provide significant potential for abuse by debtors and certain of their unsecured creditors and would likely make it more expensive for the Canadian borrowers to issue senior unsecured debt. Indeed, there is no policy reason for making so fundamental a change to the workings of the credit markets. It would not benefit employees or pensioners. It would only benefit holders of subordinated debt and shareholders; in both cases by windfall.

(c) Unsecured Debt: With respect to the issue of an "interest stops rule" being inserted into the CCAA from the perspective of unsecured lenders, as between them and their borrowers only, there are many reasons why such a change should not be implemented. First, please remember the reason why this is being urged upon you. Nortel is a completely anomalous case of a five-plus-year insolvency that has been run for most of that time as a disputed liquidation in circumstances that are highly unlikely to be repeated any time soon. Because of the time that has elapsed, the issue of whether or not contractual interest continues to run after the initiation of CCAA proceedings appears to make a large difference, but, in reality, it is not nearly as significant an issue as certain parties would have Industry Canada believe.

It is important to remember that the CCAA is a restructuring statute. It is meant for larger enterprises and for situations in which more flexibility than that afforded by the BIA Proposal provisions is considered to be useful and desirable. CCAA proceedings are almost always initiated by debtors and the debtors often control the timing, subject of course to court supervision. Unlike in the case of a bankruptcy under the BIA, the amounts of claims filed in a CCAA proceeding are not determinative of dividends or distributions from the proceedings. Indeed, the entire purpose of filing claims in a CCAA is to establish relativity among the creditors in a particular class of claims (i) for purposes of voting on the Plan of Arrangement and (ii) for purposes of receiving their pro rata distributions of that which is ultimately distributed pursuant to the Plan. Where there is no Plan or settlement envisaged, the CCAA should not be used, since it contains no provision for distribution otherwise and because the BIA serves as a full and complete statute governing non-restructuring insolvencies (and even some restructuring insolvencies (Proposals)). It is not uncommon for there to be two claims processes in a given CCAA proceeding - one to establish claims for voting, and a second, more rigorous process, to establish claims for distribution. However, in both cases, all that is being established is the relativity of the various creditors in a particular class of claims.

In both the CCAA and Proposals under the BIA, the true determinant of ultimate realization by any creditor is the Plan or Proposal that is proposed and approved by the requisite majorities of the creditors and the court. Many Plans under the CCAA and even some Proposals under the BIA have provided for post-filing

interest accrual on unsecured claims. That makes sense regardless of claim amount, because a restructuring statute such as the CCAA or the Proposal section of the BIA is all about the creditors and their debtor coming to a consensual arrangement, albeit one that can be imposed by vote upon dissenting minorities.

Different creditors of a particular debtor are creditors in different ways and for various reasons, usually involving lending or interacting commercially. Based on those different relationships, those creditors are by contract compensated at different rates for different risks and different arrangements. Indeed, the interest rates chargeable by trade suppliers often well outstrip the rate at which interest accrues on funded debt. There are sound policy reasons for stopping all interest accrual in the case of a bankruptcy, where the only outcome is a distribution pursuant to a statutory priority scheme, usually a distribution that takes place within months of the initiation of the bankruptcy proceedings. There is no similarly compelling reason to alter and/or interfere with the contractual arrangements that have been made between a debtor and its creditors when the goal (as is the case in the CCAA) is a Plan of Arrangement.

Contractual debt, such as bonds, is a staple of our financial markets and the contractual terms are not to be discarded lightly. While there certainly must be provision in our law for stays of proceedings and supermajority voting for restructuring arrangements in order to give debtors some breathing space and an opportunity to convince their creditors to alter the agreed arrangements, the imposition of a stoppage of accrual of interest in such circumstances is at best an unfair confiscation of value for the benefit of equity holders and subordinate creditors. If this change is made, we expect it to have a profound effect upon the Canadian debt markets and it will largely have been made because of the complaints of two specific creditor groups in an anomalous insolvency (Nortel) that cannot be addressed by any legislative change in any event. Such a change will also open up the CCAA to even more potential abuse and loss of certainty, both of which will be detrimental to the financial markets.

Set-off for Claims in Multiple Jurisdictions

Once again, it seems quite clear that this issue has been raised by the aforementioned Nortel employee/pensioner groups, since it is a live issue in the Nortel proceedings and has been the subject of lobbying efforts by those groups. Similarly, however, it would be extremely dangerous and would constitute a distinct change in the law if these changes were made.

There are many instruments issued on the Canadian financial markets that involve recourse (through guarantees and otherwise) to entities in other jurisdictions as inducements to the lenders/buyers, often with the result of lowering the cost of borrowing or raising the amount that can be borrowed. Notwithstanding that there are legal restrictions preventing creditors from recovering more than 100¢ on the dollar of their full entitlement from the same debt through a combination of multiple sources, that is a far cry from the suggestion in the Statutory Review Document that an amount recovered in a foreign jurisdiction be deducted from the claim of a creditor in Canadian proceedings.

First of all, that negates the whole value and essence of guarantees and the way they are used in our financial markets. It is a fundamental principle of law in Canada (and in many other countries) that a creditor with claims against a principal debtor and guarantor is entitled to pursue the full amount of the claim against both, and thereby to increase its chances of full recovery. That is at the very essence of why guarantees are sought and offered. In the proposal that is mentioned in the Statutory Review Document, a creditor/lender holding such a guarantee would actually be deprived of part of the benefit thereof, despite having contracted for it, with a resulting windfall benefit to other creditors of the Canadian debtor, a benefit which they have no right or expectation to receive. Indeed, such a change might be seen as tantamount to a provision in Canadian law actually giving preference to Canadian creditors over foreign creditors (since it would almost certainly also require a negation of the rightful subrogation claims of the foreign guarantors), such as we sometimes see in jurisdictions such as certain Central and South American jurisdictions. The CBIA doubts that Canada wishes to develop such a practice or reputation, in light of the obvious impact that could have on its economy.

Not only is it likely that the insertion of the provision such as this into Canadian law would cause problems for our markets and for Canada's reputation internationally, on a practical level it is also likely to create a situation in which the completion of insolvency/restructuring proceedings will be delayed, often on purpose. After all, if such a provision exists, then the incentive on those administering the CCAA proceedings will be to delay any type of distribution until it is clear whether or not payments will be received from another jurisdiction, because doing so will be to the distinct disadvantage of the creditors with claims in both jurisdictions if the Canadian proceedings are delayed, thereby creating more value for other creditors and possibly even shareholders. In many ways, it could be a fight to see who can delay the longest – the foreign payor or the Canadian CCAA debtor. Surely, that is not a policy that Industry Canada wishes to promote.

Moreover, the law in Canada is clear that if a creditor has a claim against two related Canadian companies – one as borrower and the other as guarantor – that creditor could properly assert a claim against, and recover from, both companies. There seems to be no suggestion to change the law in connection with that scenario, and it therefore simply does not make sense to change the law where one of the debtors is not Canadian. The legal principle is the same regardless of which jurisdictions the debtors reside in.

In the end, this suggestion should be denied for a number of good reasons, including:

(i) It is just plain wrong. It takes a situation in which a lender has bargained for additional rights and security in the way of back-up payment from another source and actually reduces that lender's claim in the Canadian proceeding to its detriment for having done so. That is absolutely backwards logic.

(ii) It constitutes a confiscation of such value from the party that bargained for it for the benefit of others who would be receiving a windfall as a result; namely, the other unsecured creditors and equity holders of the Canadian debtor.

(iii) It will not provide any greater chance of successfully restructuring a company or keeping people employed; it will simply redistribute value in an unfair and uncalled-for way and unnecessarily delay the restructuring process.

(iv) It will require additional legislative or judicial changes to remove the right of subrogation from the payor in the other jurisdiction in order to make any difference whatsoever, since otherwise such payor would simply step into the shoes of the creditor denied the additional claim pursuant to such a provision.

(v) It is reasonable to expect that if such a change was made to Canadian insolvency law, other jurisdictions would implement similar rules requiring the set-off of distributions received from Canadian debtors. The proposed set-off may have helped the Nortel pensioners in that particular case, but it is easy to conceive of examples where retaliatory set-off would be harmful to Canadian stakeholders.

(vi) Finally, it is nothing more than a continuation of the "interest stops" change promoted by the aforementioned Nortel constituents, except, in this case, not only do they wish to have Canadian legislation impose an "interest stops" rule under the CCAA, they want it to effectively impose that rule upon the foreign jurisdictions. After all, if post-filing interest is legitimately recoverable under U.S. law by a Canadian creditor holding a U.S. entity's guarantee of a primary debt, such a provision would effectively leave both the creditor and the guarantor without any recourse against the primary debtor, even though, under the governing law, such interest was properly payable and recoverable.

Disclosure of Economic Interests

The CBIA is very concerned with any changes, legislative or otherwise, that could undermine the secondary markets that have developed and are continuing to develop in Canada, and which provide important and valuable liquidity to the benefit of all relevant stakeholders in the markets, including debtors, employees and shareholders.

First, it is important to point out that the majority of the members of the CBIA are not primarily distressed investors; they are however active in both the primary issuance and secondary markets. There is a specialized market for distressed debt, which can be considered a sub-set of the secondary market. That is important to understand because one would also naturally expect major players in the distressed markets to be opposed to changes of the type referred to in the Statutory Review Document.

Please understand that the secondary and distressed debt markets are extremely important to both issuers of debt and bond purchasers/lenders, among others. The distressed debt markets do much more than, in the words of the Statutory Review Document, give "initial creditors an opportunity to fix their losses at an early stage and exit the insolvency proceeding". The ability to access liquidity with respect to a bond position is essential to those of us who may be forced to sell a bond upon the issuer's filing for insolvency protection. These forced sells may be a result of policy statement restrictions, or in some cases as a result of legislation, where defaulted debt is not permitted to be held in a portfolio. The availability of distressed debt buyers is therefore crucial to the efficient functioning of credit markets. Where a bond investor makes a bad investment decision in a company that subsequently defaults, it will likely suffer a loss through a forced sale of the security. The proposed changes are likely to make the losses for these investors even more pronounced, thereby altering the risk profile and

likely limiting lending and/or raising cost for borrowers. What is the incentive for distressed debt investors to buy defaulted or troubled debt if their claim is to be capped at that price they paid for the bond? There is no return or upside for that distressed debt investor. In fact the proposed changes could make the Canadian distressed debt market disappear altogether, which would be highly detrimental to the Canadian credit markets and would make Canada an outlier among other highly developed economies.

With respect to the secondary markets, our members are the main ones that keep the debt markets open and available for borrowers in Canada. Thriving secondary markets allow us to afford issuers access to greater amounts of credit at lower prices by helping with the management of risk and other issues such as the need to match investments to cash requirements for the various businesses of institutional bondholders.

The secondary market also increases the likelihood of a successful restructuring as secondary market participants are parties most willing to accept a compromise of their debt by accepting less than they are owed. We believe that if there were no efficient secondary market, which could be the result if the changes of the type referred to in the Statutory Review Document were implemented, there would be far fewer successful restructurings, which would be to the detriment of all stakeholders, including employees/pensioners.

If buyers in the secondary markets are not entitled to the full value and rights associated with the debt instruments they have purchased, clearly they will either withdraw from that market or they will pay much less, thereby undermining liquidity. That in turn will make original issue purchasers and par bond buyers much less likely to maintain the same levels of exposure, generally in the market and also to individual borrowers. The effect of that can only be to reduce the access of Canadian borrowers to capital.

Beyond the market reasons for this position, there is one of simple fairness. Why is it that a buyer of anything in this country should have its rights, enjoyment and value limited by legislation simply based on the amount paid? One of the key concepts in our entire society and economy is that of free markets. If two people purchase the same make model and year of car, but one buys it at a much lower price because it is dealing with a motivated seller, one would not expect that the purchaser for the lower price would be any less entitled to the enjoyment of the car, to the use of the roads, to the benefit of the warranty or to the benefit of the full price he/she could command upon resale. Why should it be that the purchaser of a financial instrument for less than original cost should be any less entitled to the full benefit of that instrument? The reason appears, from the Statutory Review Document, to be that other stakeholders wish to realize a windfall benefit from the fact that someone else was able to convince a debt holder to sell its debt for a discount.

It is important to look at the big picture to understand the ridiculous and unfair nature of the assertion referred to in the Statutory Review Document that a voting position in such circumstances could be "more significant…than warranted by their economic exposure".

A given borrower has entered into contractual arrangements and/or conducted its business so as to create a situation in which it has, for example, $50 million of secured debt, $100 million of unsecured bond debt and shares currently trading for a market

value of $10 million. It also has obligations totaling $40 million to its employees and pension plan. As it gets into trouble financially, the market value of its shares falls substantially, and the market value of its debt falls by a much lesser amount. Secondary market players buy up half of the unsecured bond debt for 60 cents on the dollar.

Nothing has changed in the financial structure of the borrower. It still owes the same amounts to its creditors; there is even the same bond trustee in place for the $100 million. However, parties are urging upon Industry Canada a legislative change to reduce the value of the unsecured debt to $80 million, a reduction of $20 million, simply because the identity of some of the holders of that debt has changed significantly. How can that blatant confiscation be justified legally or morally? Doing so would only deliver a $20 million windfall to the other unsecured creditors or shareholders. Why do they deserve that windfall? On what basis does it make sense to reduce the rights available to holders of such debt simply because the previous holder sold it to them for less than original value? By that reasoning, even if there were no problems with the borrower to speak of, but its bonds fell in value because of a huge rise in interest rates, a purchaser of those bonds at a discount solely because of the interest rate issue would lose certain of its rights in those bonds. Therefore, the original holder of those bonds wishing liquidity would suffer a loss from the interest rate issue and another from the diminution in rights urged by the employee-pensioner groups.

A financial party that buys a bond or other type of loan must be entitled to the full benefit of that which it has bought, regardless of price paid. The very essence of that bond or loan is that the borrower has contracted to repay the full amount according to its terms. How can it ever be justified that the borrower should be relieved of all or part of its contractual obligation (and that others thereby realize a windfall benefit) simply because the identity of the lender has changed? Any such attempt, aside from being unlawful confiscation, would also wreak havoc on the markets and the ability of debtors to successfully restructure, to the ultimate detriment of borrowers and their stakeholders (including employees and pensioners) all across Canada.

Employee Claims

The CBIA strongly opposes any material changes to Employees' Claims under the BIA or the CCAA, other than a clarification that unfunded pension plan solvency deficiencies do not constitute a priority over other unsecured creditors. It must be remembered that employees already have very significant priorities under existing insolvency legislation, all of which transfer value to those Employees away from otherwise equally situated unsecured creditors. The CBIA understands the rationale of providing certain priorities (such as for wages and vacation pay) to certain stakeholders that are thought to be more vulnerable, but it would be a wholly unfair result to provide employees with priorities for all of their claims. In particular, we do not believe that severance payments or unfunded pension claims (beyond the priority for ongoing current funding unrelated to deficiencies), should be granted a priority over other unsecured creditors. To do so would be to unduly and unfairly benefit one class of unsecured creditor over another.

Creditors such as bondholders, unlike secured bank lenders and the employees themselves and their unions, have very little visibility into their borrower's pension plans. They are actually less well-equipped to deal with these risks than are the employees and their pension administrators. With respect to unfunded pension claims, we believe

the focus of the Canadian government should be to ensure that defined benefit pension plans are adequately funded.

While the deficit positions of many defined benefit pension plans have improved in the past 1-2 years as a result of the improved equity markets, many plans were previously allowed to run with significant deficit positions in the years following the credit crisis. Poor asset returns coupled with ballooning actuarial liabilities combined to materially increase solvency deficits beginning in 2008. We also note that many of the largest Canadian companies have been permitted to continue to pay dividends to their common shareholders during periods of significant pension deficits to the detriment of all creditors, including pensioners, employees and bondholders. Furthermore, in many cases, the administrators of the pension plans have not been required to be independent of the companies and their management. We believe the worthwhile objective of ensuring the safety and soundness of employee pension plans should be focused on the adequacy of the funding of the pension plan itself, not a change in priority in the event of liquidation.

Unsecured bondholders' interests are aligned with those of pensioners when it comes to the solvency of the underlying issuer. We believe the right response by the Canadian government is to focus on ensuring pension plans are adequately funded; not to focus on redistributing the losses experienced by creditors in the context of insolvency.

We appreciate the opportunity to participate in this consultation and would be pleased to meet with the Department of Finance to address any questions you may have.

Sincerely,

Joe Morin
Chair