Paul Halucha Director-General
Marketplace Framework Policy Branch
Industry Canada 235 Queen Street,
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Dear Mr. Halucha;

RE: Statutory Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act

I am responding to the Industry Canada's call for submissions regarding the review of the Bankruptcy and Insolvency Act.

Industry Canada is undertaking this consultation in order to support the Minister of Industry's statutorily-mandated report to Parliament regarding the provisions and operation of the BIA and the CCAA and to ensure that the Acts remain effective, efficient, foster competitiveness, support entrepreneurial activity and instil investor and business confidence.
The Department is interested in receiving views and comments on the full range of insolvency policy matters, including those outlined in the Discussion paper.

The issues that I will address include the need for reform regarding:

- Fundamental conflicts of interest between the Crown and the Office of the Superintendent of Bankruptcy;
- the funding mechanism of the OSB by the industry and accounting of the use of those funds;
- the powers of enforcement of the Office of the Superintendent of Bankruptcy (OSB); and
- the use of surplus funds from estates / creditors.

My expertise derives from over 30 years of work within regulatory agencies and as the former Superintendent of Bankruptcy.

CONFLICTS OF INTEREST WITH THE CROWN:

Parliament established the Office of the Superintendent of Bankruptcy (OSB) more than 75 years ago to combat corruption and to instil integrity and ethical behaviour within the Canadian insolvency system. Parliament has continued to expand OSB's mandate during several periods of legislative reforms over the past five decades. During these profound reforms, the government has not taken the opportunity to also review and ensure that there is appropriate structural independence of the OSB given its jurisdiction and the added duties and responsibilities.

An exception was the very recent amendment which recognised the need to elevate the level of security of the Governor-in-Council appointment of the Superintendent of Bankruptcy to a position appointed based on good behaviour rather than at pleasure. Although this provided a level of protection for the independence of the Superintendent, the OSB's management and staff remain under the direct control of the Industry Canada. This has led to the department issuing instructions contrary to the directions of the Superintendent.

The Superintendent is the sole body authorised by Parliament to supervise Canada's insolvency system and the behaviours of debtors, creditors, trustees and receivers. The Superintendent's jurisdiction includes any government institution or department (federal or provincial) acting as a creditor under the BIA. Clearly this broad scope of responsibility has caused conflicts and ethical issues between the actions of the Superintendent and the behaviour of Justice / Crown that have not been resolved in a transparent manner.

1. There is an inherent conflict that derives from the legislated mandate set by Parliament that provides the Superintendent with the responsibility for regulating the behaviour of all stakeholders as they relate to compliance with the requirements of the *Bankruptcy and Insolvency Act, (BIA)* and regulations. The Crown is clearly subject to the oversight of the Superintendent when a department acts as a creditor in any bankruptcy proceeding under the *BIA.*

For the integrity of the insolvency system, there must be a transparent and arm's length protection for management and staff of the OSB who from time to time carry out the Superintendent's directions to oppose the actions of the Crown / department(s) when the Superintendent deems the actions to be unlawful and seeks to intervene in a court matter or to initiate a court action.

Insolvency Professionals have complained about the unfettered actions by the Crown when acting as a creditor and in the past had asked the OSB to intercede. This could involve reviewing the actions by Crown creditors such as the Canada Revenue Agency, Industry Canada and other federal departments that seek to prove their claims or to enforce it by other means. The Office of the Superintendent of Bankruptcy and the BIA are under the direct authority of Industry Canada who also happened to be one of the largest lenders (creditor) involving government funds through its various grant and subsidy programs that become repayable.

2. Justice Canada is also in a conflict of interest position as it has refused to properly withdraw from or address clear conflicts of interest with respect to providing legal advice to the Superintendent while at the same time Justice is representing the interests of the Crown as a party in an insolvency proceeding. The following examples are provided to demonstrate these conflicts.

a. Representing the Crown in proceedings under the *BIA*

Conflict of interests arises when Justice Canada lawyers from Industry Canada act as counsel and represents the OSB in all three steps of a professional conduct proceeding involving compliance actions against a licensed Trustee in Bankruptcy. Justice lawyers are involved in the investigation process regarding unlawful activity by a trustee. Justice lawyers will then prepare the case and act as the prosecutor on behalf of the Crown. Under the authorities of the *BIA*, the Superintendent or his delegate will then hear the matter and preside over the case as the neutral adjudicator of the matter. Justice believes that it has the sole right to provide counsel to the Superintendent even in legal proceedings where Justice has been involved in the investigation, prosecution and sees no problems with also providing counsel to the Superintendent in the adjudication process.

The Superintendent and his delegates must have the right to independent counsel when adjudicating a proceeding under the BIA in which Justice Canada represents a party to the case. This right, if given, should not then be subject to Justice Canada control and discretion.
The professional conduct process under the *BIA* is subject to Charter based requirements whereby the Superintendent must exercise his quasi judicial duties in an independent and unbiased fashion.
b. Court proceedings

A conflict of interest arises each and every time Justice Canada represents the interests of a government department that is a creditor subject to the *BIA*. Justice Canada is of the view that it can represent the interests of the Crown in an insolvency proceeding while at the same time believing it should continue to represent the regulatory interests of the Superintendent who may be opposing the position of a department. When the Superintendent determines it is necessary to exercise his legislative powers to intervene in a court case in which Justice Canada lawyers are representing the interests of the Crown as a creditor, this power should not be interfered with by delays and refusals in allowing the Superintendent to engage independent counsel at his discretion. This power delegated to the Superintendent by Parliament must not then be controlled by Justice.

Furthermore, Justice Canada places itself in a conflict of interest position when it participates as a party in a court case and in which it submits Justice's interpretation of the *BIA* without providing notice to the Superintendent of the case or informing the Superintendent of their intended position as to their interpretation of the *BIA*. It appears that Justice Canada has taken on the role of interpreting the BIA on behalf of the

Superintendent while representing the interest of the Crown and does not need to inform the Superintendent of its position.

The fundamental question raised by this behaviour is how is it possible that Justice Canada can take self-interest positions under the BIA to protect the interest of the Crown and still be able to provide the Superintendent's with independent advice in court cases in which the Superintendent may wish to take a contrary view to protect the integrity of the insolvency system, not just the Crown?

Clearly Justice Canada is severely tainted with conflict and it must at a minimum be transparent with the Superintendent when it seeks to take a position in a court of law regarding the interpretation of the *BIA*. It is also clear that the crown lawyers that are members of their Bar Associations should comply with their Bar's conflict of interest rules.

By not notifying the Superintendent of the court cases in which Justice is making representations on the *BIA*, Justice is demonstrating a basic lack of respect as to the role, responsibilities, authorities and the statutory obligations that Parliament has placed upon the Superintendent.

3. Appointment process

When appointments are made of public servants to independent Governor-in-Council positions that have duties involving jurisdiction over the Crown, like that of the position of the Superintendent of Bankruptcy, the Crown should disclose any "contract" between the Crown and the appointee including any promises / guarantees of employment after the end of the term of the GIC appointment. It is my belief that the public servant should resign from the core public service on the appointment to any position that may require oversight of the federal government. Clearly it makes sense to avoid any perception of undue influence, bias or control in matters involving the Crown. Such a relationship may cause doubts as to how vigorous an appointee may be in pursuing the Crown (government) for potential breaches of the law.

The BIA legislation should be amended to require proper disclosure of all contracts and obligations that an appointee may have with any potential stakeholder. It would appear that the scope of the Conflict of Interest legislation does not address the above mentioned matter.

4. Accountability for the use of Creditor Funds by the Crown

The current funding formula for OSB provides for levies (fees) to be collected from creditor funds and paid to the OSB by the Trustees.
The method set by legislation and over the years has provided millions of dollars in surplus funds beyond the operational needs of the OSB and consideration of services provided by Industry Canada. These surplus creditors' funds are taken away from the control of OSB and placed under the control of the Deputy Minister of Industry Canada with no accountability or reporting to creditors regarding their use.

When funds are not used in accordance with the legislative intent, I would argue that it is an indirect and unauthorised taxation on all creditors the OSB levy is applied to their dividends (payments), yet those funds are redirected to Industry Canada's discretionary spending.

The legislation should be amended that ensures OSB has accountability for collection and use of **all funds** collected in fees. OSB should be allowed to maintain a set reserve to allow access to funds in years when the revenues decline and a deficit occurs (a financial cushion); or to adequately fund unexpected expenses caused by litigation and court interventions which can also cause a deficit situation for OSB. The excess funds could also ensure the OSB has a well-funded criminal investigation program to deter abuse.

MODERNIZE OSB'S REGULATORY POWERS

1. Administrative Monetary Penalties (AMP)

The regulatory tool box for the OSB has not been updated in decades which have limited the options available to the OSB to correct a range of compliance and due diligence situations. In dealing with licensed Trustees, aside from moral suasion, the enforcement tools that OSB has are time consuming and expensive to use. OSB does have a mechanism to intervene each time a trustee goes to court for his discharge in an estate and argue that the court should reduce the trustee's fees due to compliance or due diligence issues; but this is on an estate by estate basis. The OSB can also resort to a formal misconduct investigation and hearing proceeding in order to deal with its concerns. The trustee professional misconduct process allows the OSB to take the trustee's license away for a set time period or permanently from the trustee. This is regulatory "overkill" for when trying to correct minor but significant problems with the administration of an estate or trustee business practices. When OSB launches a misconduct process, the trustee becomes defensive immediately given the potential of having his licence removed for an unknown period of time. This results in a litigious and adversarial process. The tools that OSB has are expensive, legalistic and time consuming and are clearly not appropriate for less serious issues.

Many modern regulatory bodies have been given the authority to apply administrative monetary penalties (AMPS) which allow the regulator to apply a measured response with appropriate range of monetary penalties that equate to the issue. The AMP process should still respect the concept of natural justice but it allows the regulator to properly measure its response to the gravity of the problem. It can also address a systemic problem rather than having to proceed on an estate by estate basis.

In the case of many other regulators, the use of an AMP has reduced litigation and improved cooperation by the regulated community in correcting problems quickly. This tool will make the OSB's regulatory toolbox more efficient and effective.

2. Risk based licensing fees

To address more persistent problems with the quality of work by a trustee, another regulatory tool that should be provided to the OSB is the ability to adjust the trustee's annual license fee within a range based on a risk profile of the trustee. Currently all trustees pay the same amount in an annual fee to renew their licence.

OSB has developed a process that uses risk categories to rank the risk profile of each trustee which applies various risk criteria. This process allows the OSB to more effectively focus its on-site inspection program on higher risk rated trustees.

The OSB's regulatory intelligence that is gathered in order to complete a risk profile of each trustee should be translated into consequences on the trustees. It is recommended that the risk profiles be used to set the annual cost of a trustee's licenses based on his risk classification. This revenue would offset the regulatory costs of more frequent and in depth inspections as well as the costs associate with closer supervision of the day-today administration of estates by higher risk trustees.

Trustees should be given notice of the proposed increase for the annual fee and be allowed time to take corrective action before the fees is imposed.

This regulator tool will assess a cost to high risk behavior while at the same time it offers an economic incentive to comply and apply a proper level of due diligence that will put into place the appropriate mechanisms to lower the risks.

This concept is no different from an insurance policy that is priced based on risk; an example in a regulatory setting would be the Canada Deposit Insurance Corporation that assesses premiums based on the risk profile of a financial institution. Improve the organization's risk profile and the costs to the regulator go down.

OTHER PROPOSED CHANGE

Unclaimed Dividends And Surplus Funds

The OSB has responsibility to maintain "in trust" the funds remitted to it by Trustees who have closed the administration of estates. The funds are from the balances of funds from unclaimed creditor dividend payments and from surplus funds from liquidated estates. There are millions of dollars of funds in this "trust" that have not been claimed for decades.

The legislation should be amended to allow for the productive use of the unclaimed dividends and surplus funds derived from the insolvency system after a stated period of time (10 years) and allow for re-investment in the insolvency system. After 10 years, the funds would be available to fund projects that improve the integrity of the insolvency system. The fund would be used to support financial literacy programs; improvements to the quality of the curriculum of debtor counselling programs required under the BIA; and /funding to pursue investigations by trustees in cases of significant debtor abuse where there are no funds in the estate to pay for the investigation.

It is recommended that proposals for access to the funds be made to a representative stakeholder committee (the current OSB Stakeholder Committee) that would recommend to the Superintendent approval of the proposed use of the funds. The Superintendent would have the responsibility for approvals of the recommendations and accounting for results.

CONCLUSION:

Parliament established the Office of the Superintendent of Bankruptcy (OSB) more than 75 years ago to combat corruption and to instil integrity and ethical behaviour within the Canadian insolvency system. In that spirit, I ask that the Ministry and Parliament consider undertaking a transparent and public review regarding the update of the *Bankruptcy and Insolvency Act* that include a focus on strengthening the OSB's regulatory framework that would:

- Update and clearly define Parliament's intent as to the independent role, organization, funding, reporting and structure of the Superintendent and the supporting Office of the Superintendent of Bankruptcy;

- Act in the public interest rather than the interest of the Crown by addressing and mitigating the conflicts of interest which exist with between the Crown and the Superintendent by providing the Superintendent with the direct power to engage the resources and independent legal counsel when Justice and the Crown are conflicted;

I am providing copies of my submission to the relevant profession associations regarding proposed changes.

Sincerely
James Callon
(former Superintendent of Bankruptcy)

c.c.
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