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BY E-MAIL insolvency-insolvabilite@ic.gc.ca July 14, 2014

Mr. Paul Halucha
Director-General
Marketplace Framework Policy Branch
Industry Canada
235 Queen Street, 10th Floor, East Tower
Ottawa, Ontario K1A 0H5

Re: Discussion document on the statutory review of the *Bankruptcy and Insolvency Act* ("BIA")[1] and the *Companies' Creditors Arrangement Act* ("CCAA")[2]

Mr. Halucha,

I am writing to you today in response to your request for submissions in connection with the discussion paper on the statutory review of the BIA and the CCAA. First, by way of introduction, I am a chartered professional accountant, chartered insolvency and restructuring professional, member of the Canadian Association of Insolvency and Restructuring Professionals ("**CAIRP**") and of the Insolvency Institute of Canada ("**IIC**"). I am also the holder of a license to act as trustee under the BIA. I have been practising in the field of insolvency since 1983, and I am fairly involved in professional matters for CAIRP and IIC, in particular in the education area, since I have been the chair of the CIRP Qualification Program Committee of CAIRP, the main committee overseeing CAIRP's professional qualification program, since 2010. I have attached as Appendix A, a recent copy of my CV for your information on my background.

Although my practice is almost exclusively in the area of commercial insolvency and restructuring mandates, I am interested in all aspects of the insolvency field, probably due to my interest and involvement in the education program. I will therefore be commenting on both the consumer and commercial areas, although admittedly my level of familiarity with consumer issues is sometimes superficial. As a last word of caution, I point out that the comments herein are mine alone, and do not necessarily reflect the opinions of CAIRP, the IIC, my colleagues at my firm or my professional colleagues in general.[3]

As is suggested by the text of the discussion paper, the comments herein address a preliminary position on the issues, to address broad principles. Specific recommendations regarding some of the issues may depend on a more fulsome discussion of the stakes and the objectives sought in implementing changes to the legislation and could be formulated later in the legislative review process.

For purposes of my comments, I propose to follow the same order as that in which issues are presented in your discussion paper. My comments, then, are as follows:

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[1] R.S.C. 1985, c. B-3, as amended.

[2] R.S.C. 1985, c. C-36, as amended.

[3] I point out that I participated in the Joint Task Force ("**JTF**") formed by IIC and CAIRP to prepare their submission and as a result, there could at times be similarities between my comments and those expressed by the JTF, although this document was developed separately from the JTF process.

CONSUMER ISSUES

Protection of Consumer Interests

1. Consumer Deposits

Stakeholders are invited to make submissions regarding whether, and how, Canada could enhance protection for consumer deposits either through consumer liens or, alternatively, through other mechanisms within the insolvency regime.

The insolvency process deals with an allocation of limited resources, in what is very often a zero sum game. The consumers who have left deposits with an enterprise have effectively lent money to the enterprise on an unsecured basis, unless the industry in which the enterprise operates (such as the retail furniture industry and travel industry) has rules, often established by provincial law, requiring these deposits to be kept in a trust account until the merchandise is delivered or service is rendered.

It is obvious that in dealing with an enterprise, the consumer is at a disadvantage, in the absence of regulations requiring that the funds be placed in trust, as the consumer is not well placed to assess the creditworthiness of the enterprise, or the risk inherent with the transaction and to protect himself/herself[4] against that risk. It is possible to correct the imbalance in negotiating positions by creating a scheme to protect the consumers' deposits in the event of insolvency. Typically, this protection could take the following forms:

- Creating a lien on the property of the bankrupt or insolvent person;
- Creating a super-priority in the distribution of the proceeds of liquidation of the assets, similar to the rights of employees or pension plans under sections 81.3 to 81.6 of the BIA;
- Allocating a priority status for the claims related to consumer deposits, in the distribution of the proceeds to unsecured creditors; or
- Creating an indemnity fund to indemnify consumers against these losses.

From my perspective, the third option does not provide much protection, as the assets are customarily encumbered by the security in favor of secured lenders, and there is usually little or no equity left for unsecured creditors after the secured claims have been paid.

As well, the fourth option is likely to be impractical, as such an indemnity fund would have to be managed by the government, from resources that are already stretched, or would require a lot of organization and coordination by the market participants themselves (the retailers), in each industry.

This leaves the first two options that are roughly equivalent. The main question for discussion would where to situate these rights in the list of priorities that already exist against the assets of an enterprise that is bankrupt or in receivership. If the right is made junior to the rights of existing secured creditors, the protection give to the consumers for their claims would be of little value, for the reason given

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[4] In the present text, I shall use the masculine gender to describe an individual, for ease of drafting, but the reader should understand that the comments apply equally to a person of any gender.

above regarding the possibility of providing a priority right ahead of unsecured creditors but after secured creditors – there likely will not be sufficient resources to pay the claims of consumers.

If however the right is made senior to the rights of existing secured creditors, then the right could potentially affect the availability of credit for all enterprises in Canada, as lenders will take some provision for this potential priority right in calculating the amount that a borrower may draw. Restricting access to credit for Canadian enterprises could have an adverse impact on the economy, and cause the insolvency of enterprises which might otherwise be viable.

I know that some banks, in calculating the availability of credit for an enterprise, take into consideration such potential prior claims as the amounts due to the government for the goods and services tax or harmonized sales tax ("**GST**"), the Quebec sales tax ("**QST**") and payroll source withholdings ("**DAS**"), the potential claims of employees for unpaid salaries and vacation pay under section 81.3 and 81.4 BIA, and the potential right of suppliers of recently delivered merchandise under section 81.1 BIA, and sometimes other provisions as well. The concern is that the amounts due to consumer deposits may not be readily ascertainable, and this could lead to conservatively established arbitrary provisions that could significantly curtail access to funding.

Another issue that needs to be addressed would be which types of consumer deposit claims would be protected by the new provision. The consumer deposits could come from several different transactions, such as making a deposit in contemplation of a specific purchase (which is typically the case for retail furniture and travel), to "purchasing" gift cards to give as a present, to being issued a store credit as a goodwill measure because merchandise purchased in a "final sale" was returned when it was considered unsatisfactory. While the first two transactions are quite similar and may warrant protection, the last transaction would not appear as worthy of a high degree of protection, yet all of these transactions will likely appear in the same reserve account in the enterprises recordkeeping.

I would point out that oftentimes, if the business is viable, the purchaser of the business will factor in some provision to honor the customer deposits, in order to preserve the enterprise's goodwill. I would suggest that before any change is made that could multiply the number of super-priority claims against the assets of an insolvent person and potentially affect access to funds, it would be usefully to research the extent to which the consumer deposit issue is dealt with and resolved consensually by the subsequent acquirer of the business, as described above, to assess whether the consumer deposit issue is truly a situation that needs to be addressed from a fairness perspective.

2. Responsible Lending

Stakeholders are invited to make submissions regarding whether, and how, the BIA could take into account creditors' conduct that has contributed to the financial difficulties or insolvency of a debtor.

I believe this issue is worthy of consideration, but I think that additional research is required to see if this is a major factor in Canada. I can't remember one instance throughout my career where I asked an insolvent person or a bankrupt about the causes of its financial difficulties, and did not receive as an answer that "the bank lent me too much money". I did not then, and do not now, believe that this was really the root cause of the financial problems, but rather an easy "cop out" answer that absolves the insolvent person from responsibility and blame for the failure.

I think that trying to instill a responsible lending behavior through punitive provisions in the BIA creates a risk of interfering with free market forces. As such, I think that if a punitive provision is introduced in the BIA to discourage irresponsible lending practices, it should be reserved for the most egregious of cases, and after a particular robust assessment of the case facts. In such a circumstance,

the penalty could take the form of a postponement of that creditor's claim until the claims of other creditors have been paid in full.

Coming back to my own experience and the answer I customarily receive from insolvent persons and bankrupts regarding their problems stemming from the fact that lending institutions gave them too much money, if responsible lending is a desirable objective, it can never be a replacement for responsible borrowing. The funds may have been available, but there was nothing that compelled the borrower to use them. As such, I believe that the efforts would be much better placed on educating debtors before they experience financial difficulties, so that they learn to make the proper choices when offered easy credit.

The "Fresh Start" Principle

3. Licence Denial Regimes

Submissions are invited as to whether amendments are required to the BIA to address the apparent conflict between the "fresh start" principle and the objectives of licence denial regimes.

The issue of licence denial has come to the forefront in particular in the recent past, with some key decisions emanating from the courts in Saskatchewan[5] and in Ontario[6]. However, I believe that this issue is a bit wider than how it was framed in the submission document, as it may not be limited to driving privileges, but could also include a person's right to practice his profession, when the licence to practice is granted by a professional order[7]. The three cases referred to above, *Moore*, *Moloney* and *Hoover*, ask us to consider the following questions:

1. Should 407 ETR be able to cause the Ministry of Transport to deny the renewal of a driving licence to a discharged (or undischarged) bankrupt because there is an $89K claim for unpaid tolls?

2. Should the Ministry of Transport be able to deny a licence to someone who drove so recklessly that he had an award of damages for personal injuries of $195K against him?

3. Should an Order of dentists be able to deny a licence to practice to a discharged (or undischarged) dentist who was guilty of misconduct and incurred fines payable to the Order of $44K?

The rationale for arriving at an answer to these questions (aside from a paramountcy issue, that will have to be dealt with) will hinge around the fresh start principle, the issue of rights and privileges, the issue of the authority of a regulatory body to regulate others, the necessity for an enterprise to be able to count on its revenues to ensure that others in society do not shoulder an undue burden, and the legal effect of discharge on the existence of a debt.

To answer yes to the above questions, I figure we would have to come to the conclusion that in all of the above cases, the fresh start principle is not offended because the bankrupt is not really compelled to pay, as long as we acknowledge that what he has is a privilege that he could do without (one always

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5 *Re Moloney*, 2014 CarswellAlta 225 (C.A.), affirming 2012 CarswellAlta 1757 (Q.B.).

6 *Re Moore*, 2013 CarswellOnt 17670 (C.A.), reversing 2011 CarswellOnt 15701 (S.C.). This case is often referred to as the "**407 ETR**" case.

7 See for example *re: Hoover*, 2005 CarswellAlta 267 (C.A.), reversing CarswellAlta 879 (Q.B.).

has options), that the creditor has to be able to count on his revenues to avoid placing an undue burden on others, and the debt has not disappeared out of the bankruptcy discharge (or proposal) process.

If we are prepared to answer yes to the above questions, then I am not too sure how far the slippery slope goes, when we try to answer the following questions:

1. Should a dentist Order be able to deny a right to practice to a discharged (or undischarged) dentist who has not paid his yearly dues to the Order for the past several years? The same question could be asked for any professional order, nurses, doctors, lawyers, accountants, engineers. The same question could be asked from any regulated trade, such as real estate brokers.

2. Should a bar association be able to deny a right to practice to a lawyer who was found guilty of dipping into his trust funds?

3. Should a PetroCanada (or any other supplier) be able to deny services to a former bankrupt for delivery of furnace oil (or any other supply), on the basis that the former debt has not been paid? I am sure the creditor can argue that their services are not essential (the bankrupt could collect branches to burn in a wood oven, after all), that purchasing from them is not a right but a privilege, that their internal rules provide that they are no allowed to deliver goods or services to someone that has a delinquent account, that they are not trying to collect their account but merely applying their own rules, and that all of their other customers have to pay more as a result of some people not paying their debts.

I think no matter how you package the fact pattern, it comes out as offending the fresh start principle if the end result is a requirement to pay a dischargeable debt in order to get goods or services that any ordinary 18 year old person leaving the family nest could have without a similar payment. As such, I agree with the judgments of the Court of Appeal in *re: Moore* and *re: Moloney*, and I have difficulty accepting the reasoning of the Court of Appeal in *re: Hoover*. From my perspective, if the "regulator" is trying to get money, he is acting as a creditor trying to recover a debt provable and working against the purpose of BIA.

In my examples given above, if the Order of dentists wants to censure a dentist for bad practices, it should require him to take and pass special courses to counter his shortcomings. The same thing applies for the lawyer who dipped into his trust funds (although in that case I think the right to practice could be suspended until the non-dischargeable debt has been repaid). If the Ministry of Transport thinks someone is a bad driver, the solution is not to make him pay $195K, but to require him to requalify as a competent driver. It is unfortunate that 407 ETR has bad debts, but so does everybody who is in business.

I think there are always options (such as burning wood instead of oil), but some of these options are not really in the realm of acceptable possible choices. Not having a right to drive a car because of a discharged debt falls in that category.

In view of the above, I would agree that changes are required to the BIA to ensure that a regulator does not use a denial regime to enhance its position as a creditor, thus offending both the fresh start principle and the equal treatment among creditors principle.

4. Reaffirmation Agreements

Stakeholders are invited to make submissions regarding whether reaffirmation agreements should be regulated under the BIA, either through the mechanisms discussed above or through other mechanisms within the insolvency regime.

I believe that debtors need to be better protected against reaffirmation agreements. The BIA should invalidate a reaffirmation by conduct, and allow only specific reaffirmation. A specific reaffirmation should be in writing, with a disclosure of the reason for the reaffirmation, and a confirmation by the debtor that the consequences of the reaffirmation have been explained to him by the trustee, or by a lawyer or notary who does not work for the creditor seeking the reaffirmation.

Consumer Exemptions

5. Registered Savings Products

Stakeholders are invited to make submissions regarding the treatment of registered savings products in bankruptcy.

The issue of exemptions for individuals brings into light two conflicting but equally important objectives of the bankruptcy legislation in Canada, namely the objective to optimize realization for creditors, and the objective to provide an honest but unfortunate debtor the possibility to obtain a discharge from his debts subject to reasonable conditions. In order to benefit from a fresh start, the bankrupt should not be expected to live in squalor, but should be able to retain sufficient income and property to live under reasonable conditions.

This is particularly true and relevant where the bankrupt or his family is subject to an additional challenge as a result of a disability that impairs his ability to accumulate wealth, or where the property that is held by the bankrupt was acquired in connection with a prudent, socially responsible objective (for example, savings in a RRSP for security in retirement years).

With that perspective in mind, I see no issue at all with creating an exemption against seizure for funds set aside for the care of a disabled individual through a registered disability savings plan (“**RDSP**”). To ensure a proper balance between the aforementioned conflicting objectives of the BIA, I believe it would be appropriate to ensure that the exemptions are controlled, and limited to funds allocated to a specific purpose, that are not retrievable except for the stated purpose.

6. Federal Exemption Lists

Submissions are invited as to whether the introduction of a federal list of exemptions should be considered.

I believe that developing a federal list of exemptions would be a worthwhile exercise, to replace the presently existing provincial exemptions. There is presently a wide variation between the exemptions available in each province, and a single set of federally defined exemptions would ensure a result that is fairer, more consistent and more predicable for creditors.

Protecting Families

7. Equalization Claims

Submissions are invited as to whether, and how, bankruptcy legislation could be amended so as to improve the status of equalization payments in bankruptcy.

Family type claims should be better protected. Bankruptcy should not be a tool to avoid family responsibilities. The case of *Schreyer v. Schreyer*, referred to in the discussion paper, highlights how differences in law in each province can create distinctions in the legal characterization of fact patters that are essentially similar. To the extent that claims are essentially of the same nature, their treatment should be the same in bankruptcy. The problem raised in *Schreyer v. Schreyer* could be resolved by making modifications to the description of a claim for alimony or support payment, to ensure that it is conceptual rather than specific and encompass all claims that are essentially the same.

8. Family Support Claims and the Levy

Submissions are invited as to the treatment of section 178 creditors with respect to the Superintendent's levy.

The levy as contemplated in section 178 BIA is an amount paid by the creditors, out of moneys they receive. The payment is made by deducting the levy from the payments to the creditors, when the trustee makes the payments. All creditors with claims that are non dischargeable under section 178 BIA may file a claim with the trustee and receive a dividend, from which the levy is deducted, or they could wait until the trustee is discharged and continue claiming the amount from the bankrupt directly, or conceivably request that the stay of proceedings be lifted in respect of them and continue claiming the amount from the bankrupt. This leads to a difference in treatment between similarly situated creditors, as some creditors will see their payments reduced as a result of the levy, while others will receive a payment in full.

It should be noted that this problem may be largely academic in files under summary administration, due to the relatively low amount of the levy (i.e. limited to a single payment of $200 for all creditors), but is more of a problem in files under ordinary administration.

That is not the only anomaly that arises from the application of section 147 of the BIA. The decreasing rate of levy depending on the size of the payment can cause inefficiencies in the administration of an estate if the proceeds that will ultimately become available for distribution cannot be estimated with some accuracy, as the subsequent payment of dividends will trigger minute adjustments on the claims of creditors, in respect of amounts already paid. That is not an issue when dealing with a homogeneous distribution to a single class of creditors, but it could be an issue when distributing funds to secured creditors, preferred creditors and unsecured creditors, when the subsequent distributions cause an adjustment on the claims of creditors who should already have been paid in full (the secured and preferred creditors, in this example).

Another anomaly is with the treatment of the claims of employees and pension plans, as the outcome for the employees and pension plans will be different (because of the levy) depending upon whether the payment to employees of their claims pursuant to section 81.3 to 81.6 BIA is made by the trustee or by the receiver.

Perhaps the problem can be resolved by changing the nature of the levy, from an amount payable by the creditors to an amount payable by the estate, based on net realizations after fees and costs. The advantage would be that the levy would no longer trigger small distributions to preferred creditors when the distribution is large enough to change the rate of levy, and would not cause a reduction in the claims of creditors with non-dischargeable debts, when a dividend is paid. The inconvenience however is that the levy then becomes entirely borne by ordinary unsecured creditors, who already do not receive much by way of distributions from a bankrupt estate.

It should be noted that this suggested possible change in the levy is not difficult to implement. In fact, the Office of the Superintendent of Bankruptcy ("**OSB**") is treating the levy pretty much as an amount payable by the estate, rather than an amount payable by the creditors, when dealing with summary administration files, by setting the levy at 100% of the first $200 in amounts available for distribution and 0% thereafter.

9. Vesting of Family Property Claims

Stakeholders are invited to make submissions regarding 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.

The complaint appears to be that the trustee sometimes settles a family property claim in an amount that the bankrupt spouse considers insufficient, and in a manner that may leave very little money for the creditors. The suggested solution appears to be that the right to sue remain with the former spouse (i.e. the bankrupt) but that proceeds therefrom be considered property to be distributed to creditors.

With respect, I can't see how the proposed solution resolves any part of the perceived problem or provides a measure of relief that is not already available in the BIA, for the following reasons:

- It is difficult to see what interest the former spouse (i.e. the bankrupt) has in the quantum of the settlement, if the proceeds of the settlement are entirely affected to the payment of the creditors. The only real interest would likely be the possibility of an incremental distribution to creditors that have a non-dischargeable claim, but that would likely not be a significant factor.

- In the event that there is indeed some interest on the part of the bankrupt in the quantum of the settlement, then the BIA already contains provisions that allow any interested party to ask the court to intervene and direct the trustee to do or not to do something[8]. If the bankrupt considers it appropriate, either because the settlement decreases the amount otherwise available to creditors, or affects future rights that will exist after the bankruptcy, or is patently unreasonable, or for whatever proper reason, the bankrupt has an opportunity to address the court to have the decision set aside or modified.

- In the event that the creditors are dissatisfied with a decision or strategy of the trustee, the creditors have a wide range of recourses, from replacing the trustee altogether[9], to addressing the court to have the trustee's decision set aside or modified[8], or even to disinterest the estate and adopt the proceedings in their own name[10].

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[8] Section 37 BIA.

[9] Section 14 BIA.

[10] Section 38 BIA.

- In the proposed solution, the bankrupt would retain the right to sue, and thus would have to incur the risk of the proceedings and bear the cost of litigation, without having the benefit of the proceedings if they are successful, as the proceeds therefrom would still be distributed to the creditors. Essentially, as is the case with proceedings where the trustee refuses or neglects to act[10], fairness dictates that the person that pays the cost and assumes the risk should have the benefit of the proceedings.

Based on the above, I can't see how the proposed solution improves on the current situation, or how the safeguards are not already in place to avoid the problem complained of. I can appreciate the counterargument that creditors or the bankrupt may not know of the trustee's decision to settle until the settlement has been implemented, but that is only indicative of a lack of interest in the administration, and there is no point in setting up safeguards to protect against a situation unless a party is interested in the outcome, and there cannot be an interest in the outcome if the estate is so unimportant as to elicit no interest on the part of the creditors or bankrupt to keep apprised of the trustee's administration.

Perhaps, out of an abundance of caution, a change could be made to require that family property claims may not be settled by the trustee unless notice of the proposed settlement is given to the bankrupt and the creditors. In this situation, the existing safeguards should be sufficient to protect against a settlement that any of the stakeholders would characterize as improvident.

10. Joint Debts

Submissions are invited as to whether s.142 should be amended to restrict its application to business partnerships.

I agree that section 142 BIA should not be used to replace family law. From that perspective, if there is doubt as to the scope of section 142 BIA, the section should be clarified. I would caution however that the clarification should be done by specifying which types of partnerships are not addressed in the provisions of section 142 BIA, rather than having a limitative provision that restricts the use of 142 BIA to business situations, as conceivably the provisions of section 142 BIA could apply to partnerships that are not *per se* a business venture, such as a co-ownership of a residential property, a partnership established for charitable or philanthropic purposes, etc.

On a related note, it would be appropriate at this time to review all of the provisions of the BIA that deal with partnerships, to clarify the rules in view of the conflicting jurisprudence regarding the treatment of partnerships[11]. Based on the definition of a partnership in section 2 BIA, a partnership should be treated as a person in its own right, independent of the partners. Essentially, the provisions of section 142 BIA are consistent with this treatment, by requiring a separate assessment of the partnership's and partners' assets and liabilities. However, sections 43(15) and 85(1) BIA appear to treat the partnership as merely an extension of the partners.

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[11] See for example *Re: Ferme C.G.R. Enr.*, 2010 CarswellQue 3386 (C.A.) and *Re: Gottingen Street Food Market*, 2002 CarswellNS 52 (S.C.).

Treatment of Student Loans in Bankruptcy

11. Discharge of Student Loan Provisions

Stakeholders are invited to make submissions regarding whether the current provisions regarding the release of student loan debts should be amended.

Firstly, I would like to comment a statement made in the discussion paper, with which I disagree. The discussion paper states that "since the loans are granted on need rather than ability to repay in the event of bankruptcy, they are treated differently than other debts under the BIA". With respect, if the criterion were that debts incurred based on need have to be treated differently, the list of non-dischargeable debts would be much longer than it presently is, and the non-dischargeable nature of debts incurred for "necessaries of life" would not have been removed from the legislation in the 1992 revisions. The only basis on which student loan debts could be made non-dischargeable for some period of time, is one of social responsibility.

With this in mind, I would suggest that the reasoning for making student loan debts non-dischargeable be reviewed, and if the reasoning is based on the fact that the loans were granted based on need, then my opinion would be that the provision that renders the student loans non-dischargeable for a time should be removed altogether.

If however the objective of the provision is to promote social responsibility, then I believe that the present system of making the debts non-dischargeable for a period of time (that can be reduced in the case of hardship), is sound. I will only comment on the principles and not make a recommendation on the actual time periods for which the debt would have to remain non-dischargeable, as I must confess that I am not sufficiently aware of the financial circumstances of today's students to comment on the timelines. I will point out however that the workplace has become increasingly competitive and difficult for young people who want to begin a career, in particular in some fields where there is a low demand, and as a result it is very possible that an adjustment would be warranted, that would seek to shorten the timelines for the debt to become dischargeable.

12. Hardship Discharge

Stakeholders are invited to make submissions regarding the current hardship discharge provisions.

I refer you to my comments in the previous section regarding this issue.

13. Partial Release of Debts

Stakeholders are invited to makes submissions regarding possible flexibility for court-ordered partial discharges on hardship grounds, including any factors the court should consider in exercising its discretion.

Since the hardship provision is itself discretionary (the court may … if it is satisfied that the debtor cannot repay…) I see no useful purpose in curtailing the discretion of the court by making it an all or nothing decision. The court should take into consideration income potential, efforts made and ability to repay in order to fix an amount that the debtor will be able to repay without undue hardship.

COMMERCIAL ISSUES

Encouraging Innovation through Intellectual Property Rights

1. Copyright and Patented Items, 2009 Amendments

Submissions are invited regarding how to improve the existing rules to support the objective of encouraging innovation, while also balancing the competing interests in an insolvency proceeding.

1.1. **Disclaimers of agreements[12]:** This is an issue of balancing interests of parties that have opposing interests. While the current rules do not provide a very wide protection for the licensees, it would be difficult to enhance the protection without effectively removing the licensor's right to disclaim. As such, increasing protection for licensees would remove restructuring opportunities for the licensor. If the licensor still has an obligation to provide maintenance on the intellectual property ("**IP**"), it is the same as if he were still bound by the agreement. The right to continue to use and to enforce exclusivity should be sufficient protection for the licensee, if the licensee has sufficient access to the IP.

One measure of protection that has not been introduced in the 2009 Amendments and that might be warranted has to do with this issue of sufficient access to the IP. While the licensee can continue to use and enforce exclusive use of the IP, such right might be illusory if the IP is not being maintained, and there is no assurance that the IP can be maintained if the licensor or owner of the IP does not have to deliver sufficient material to the licensee to enable him to effectively maintain the IP. For example, if the license is a right to use specialized software, the right to use and force exclusive use of the software has a very short useful life span, unless the licensee can have access to the software's source codes and documentation.

More thought and research is required on this issue, as undoubtedly introducing an obligation for the licensor to deliver to the licensee all of the material necessary to maintain the IP would have disastrous consequences on a licensor that intends to continue developing and marketing the IP.

1.2. **Assignment of agreements[13]:** Considering the 2009 Amendments from the perspective of an insolvent licensee, the provisions may sometimes be problematic for the non insolvent licensor. The 2009 Amendments make it possible to compel an assignment to a third party that is thought to be capable of performing the obligations and that is found by the court to be a fit and proper assignee, if the court deems it advisable for an assignment to take place, over the prohibitions that may exist in the agreement that granted the license. Such a provision means that the licensor can be compelled to continue an agreement with a party he finds objectionable, which could even be a direct competitor who wants to acquire the rights under the contract for strategic competitive purposes. The provisions that allow for the transfer of agreements, as presently drafted, leave the discretion to the court to decide whether it is appropriate to assign the rights under the contract. Perhaps it would be worthwhile to modify slightly the relevant provisions of the BIA and CCAA to specify that before an assignment can be made, notice thereof must be given to the co-contracting party, who may make such representations as are necessary before the court regarding the appropriateness of making the assignment, and that the court may take into consideration the potential impact of an assignment on the business of the co-contracting party, in deciding whether it is appropriate to make the assignment.

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[12] Section 65.11 BIA, section 32 CCAA.

[13] Section 84.1 BIA, section 11.3 CCAA.

1.3. **General comments:** The IP provisions in the BIA were introduced a long time ago, and are now of little or no relevance in the current marketplace, and an initiative of looking at IP rights and contemplating rules in the BIA and CCAA that are relevant for today's business world is more than welcome. IP is often the most valuable asset of an enterprise, and at the same time the most volatile asset. The IP may be owned, partially owned or jointly owned by several enterprises in different countries, and coordinating the rights of each enterprise to the IP can be a real challenge. As such, more research and thought is required to design and implement rules regarding IP that are fair, transparent, and enforceable, that can be used both in a domestic and cross-border context and that will remain relevant in a changing marketplace.

Encouraging Restructuring

2. CCAA Initial Orders

Stakeholders are invited to make submissions regarding the breadth of initial orders and potential options for streamlining the process.

Initial orders have evolved over time, starting when the CCAA was truly skeletal, by continuously adding provisions and never removing any, to grow into a monster of provisions addressing all imaginable situations. Some effort has been made in the recent past by the courts in the various provinces to curtail the breadth of these orders by introducing a court approved[14] model order, however the model orders are still a lengthy document that orders things that are already specifically provided for in the CCAA.

Rightly so, attorneys representing the debtor company tend to have a conservative approach and ask more rather than less in an initial order that is presented on very short notice, to avoid having to return to court for every minute request or change in circumstances, to avoid long debates on the first day orders that might paralyze the debtor company, and to avoid having to try to undo situations of fact that may have occurred because co-contracting parties had ample advanced notice of a proceeding (for example, to avoid the possibility of having an insurance company declare that insurance has lapsed due to a change in risk before an order can be made).

The suggestion made in the discussion paper, that the CCAA could provide for an automatic stay of proceeding on filing, for a short period of time, should alleviate some of the concerns and allow a more serene forum to discuss the terms of the eventual initial order, and should provide an opportunity to give notice so that all interested stakeholders may make representations from the outset.

3. CCAA Claims process

Stakeholders are invited to make submissions regarding the existing claims process and whether consideration should be given to a default process.

The suggestion of introducing a standard, default claims process within the CCAA is worthy of consideration. The design or redesign of a claims process should not, however, be limited to the CCAA, as I consider there is no fundamental reason why the process adopted under the CCAA should

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[14] The term court approved should not be interpreted to mean that the court will necessarily accept the provisions of the model order or any one of them, it merely means that the court is familiar with the text, which saves time by avoiding a necessity to explain each individual provision of the order and allowing the attorneys and the judge seized with the supervision of the proceedings to focus on important concerns and deviations from the model order.

be different from the process under the BIA. The monitor is an officer of the court who has a right of access to the books and records of the debtor company[15], and as such is well placed to examine and accept or reject claims. In this aspect of its mandate, the role of the monitor could be substantially the same as the role of a trustee acting in proceedings under the BIA.

I consider that some weaknesses presently exist in respect of the claims process under the BIA that should be corrected contemporaneously with the implementation of a statutorily defined claims process under the CCAA, so that there is a high degree of harmonization between the two statutes on this issue. Some consideration should be given to designing a claims process that is similar in the BIA and CCAA, with the following characteristics:

- The creditor should have the obligation to prove its claim, although the debtor should have the option of specifically acknowledging certain claims, which would then be deemed proven subject to the right of the trustee or monitor to contest the claim, and subject to the right of the stakeholders to have the claims expunged by order of the court.

- The monitor/trustee should have the right to examine and accept or disallow claims;

- The monitor and trustee should be required to give a notice of intention to disallow a claim with reasons, prior to issuing a disallowance, to allow the creditor an opportunity to respond to deficiencies in the claim.

- There should be a common definition for what constitutes a claim provable. At present, a contingent or unliquidated claim is not a claim provable under the BIA unless and until it has been the object of a determination under s. 135(1.1) BIA, while a contingent or unliquidated claim could be a claim for purposes of proceedings under the CCAA. In both cases, a contingent or unliquidated claim should be a claim provable, but it should have a special treatment for voting purposes, as outlined below.

- There should be an assessment of the contingent or unliquidated claims for voting purposes only, i.e. an assessment of the claim that does not preclude the monitor or trustee from performing a further review of the claim and accept or reject same. Furthermore, the votes of contingent or unliquidated claimants should be treated in a manner similar to that described in section 109(6) BIA. In effect, the claimants with contingent or unliquidated claims should be entitled to vote, but their vote should be disregarded in the total of the claims on any vote, if their vote would determine the outcome, subject to the right of the court to reconsider the right to vote at a later time, on application to be made within a short time frame. This would allow the court to enquire in the merit of the contingent or unliquidated claim and ensure that the claimant does not have an improper motive, before allowing its vote to determine the outcome, and prevent a situation where a bankruptcy is deemed to have occurred and needs to be "undone".

- There should be a clarification of the standard of review of trustees' and monitors' determination of the claims that takes into consideration the complexity of the claim and how well the creditor fulfilled its obligation to prove the claim. The objective being to limit *de novo* trials to complex situations only.

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[15] Section 24 CCAA.

4. CCAA Court Applications

Stakeholders are invited to make submissions regarding the existing role of court appearances in CCAA proceedings and whether consideration should be given to possible approaches to reduce the number and cost of such court appearances.

The objective of making the court process more streamlined and efficient is a worthwhile endeavor that should be pursued, although from my perspective this is not an issue that is specific to the CCAA, but equally applicable to the proceedings under the BIA. Possible ways in which the court system could be alleviated are set out below:

- The implementation of a standard, default claims process, such as was described above, should help enhance efficiency.

- There should be a possibility for the court to delegate some of its discretionary powers, although this should be done on a case by case basis, if it is not *de minimis non curat lex.*

- Currently, proceedings in court are often attended by all parties, based on motions filed on an expedited basis. This can often lead to attendance at court by attorneys solely as a cautionary measure, as the attorneys are not certain what will be discussed and whether their clients' rights might be affected, and/or requests for postponements because the parties have not had an opportunity to properly consider the motions material and seek instructions from their clients. Greater efficiency could be achieved if there were more rigor in giving notice of the proposed motions, so that *ex parte* or short notice motions are reserved for only the truly urgent matters. This could be done by requiring the preparation of an agenda by the attorneys well in advance of the court hearings, indicating the orders that will be sought and matters to be discussed, circulation of the motions material well in advance of the hearings, requesting advanced notice of intentions to contest with an outline of the reasons, allowing attendance at the hearings by way of conference telephone conversation, waiving the requirement for attendance on matters that are routine, purely administrative or uncontested.

I am certain that further discussions amongst stakeholders should be able to identify several more ways to make the process lighter, more expedient and more efficient.

5. Balancing Competing Interests - Role of Unsecured Creditors

Stakeholders are invited to make submissions regarding the effectiveness of the existing provisions and other potential mechanisms to ensure an effective voice for unsecured creditors in restructuring proceedings.

The current provisions are sufficient. A debtor paid representation for the unsecured creditors is the system that exists in the US, and it leads to an adversarial stance and additional costs and inefficiencies. Unless there is a category of creditors that needs to be represented and that clearly does not have the means to organize and pay for representation, each party should pay its own professionals. The legislation as it presently exists has the flexibility to allow a court to establish a charge and thus cause the payment of fees for professionals to represent a specific group that is not represented, if that group is unable to pay for representation and that group is essential to the formulation of a viable plan

or proposal.[16] These rules are fair in the circumstances, appear to have been applied correctly by the courts to date, and as a result I see no reason to depart from the currently existing rules.

6. Balancing Competing Interests - Acting in Good Faith

Stakeholders are invited to make submissions regarding whether the CCAA should expressly address whether parties to proceedings have a duty to act in good faith.

The CCAA and BIA already have provisions that address a duty to act in good faith, on the part of the debtor, and the monitor or trustee, but no specific obligation on the part of other stakeholders. Since restructurings are intended to be not a renegotiation of a contract, but a transparent process for relief because of financial hardship, it would seem that good faith is a must, on the part of all parties. I would therefore consider it appropriate if specific provisions in the CCAA made reference to this obligation on the part of all stakeholders. I would point out however that I see no reason why there should be a difference between the provisions of the BIA and CCAA on this issue, and as such I consider that the change, when introduced, should apply both to the CCAA and BIA.

While I think that the provision is warranted, I would also point out that some additional research and discussion is necessary to assess how such a provision requiring good faith could be monitored and enforced, as it is likely that if stakeholders are not acting in good faith because of a collateral, hidden motive, such situation may not be readily apparent. It may be very difficult for instance to assess whether an aggressive position taken by a creditor in respect of a restructuring proceeding is taken because the creditor has lost all faith in the ability of the insolvent debtor or its management to carry on operations, or because there is a secret agreement between the creditor and an undisclosed third party to try and eliminate competition. One of the objectives of insolvency legislation (both the CCAA and BIA) is to favor compromises, settlements and restructuring over liquidation for an enterprise that could be viable – it is not to restructure every enterprise regardless of how undeserving it might be. There unfortunately are some enterprises that no longer have a role to play in the economy or in the marketplace, and it is not the role of the insolvency statutes to keep these enterprises in business to simply postpone what is eventually unavoidable. Typically, it is the creditors, as the insolvent person's main business partners, who are the most apt at gauging whether an enterprise is viable, given the market and how the business is managed. As a result, one cannot presume that because a vote is unfavorable, or because a creditor takes an aggressive position regarding the insolvent person, that the creditor is not acting in good faith. I would therefore consider that the monitoring and enforcement of the provision is likely to be a challenge, when the provision is implemented.

7. Balancing Competing Interests - Eligible Financial Contracts

Stakeholders are invited to make submissions regarding eligible financial contracts, and their impacts on insolvency and restructuring proceeding, as well as potential policy responses.

The discussion document makes reference to a report prepared by the IIC on derivatives, which addresses situations where the insolvent person is a party or counterparty to an eligible financial contract ("**EFC**"). I participated as a member of the task force that considered the issues and drafted the report for IIC, and I fully agree with the report and its conclusions.

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[16] Section 64.2 BIA and 11.52 CCAA. The court may order a charge to protect the fees of any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings.

At the present time, the insolvency legislation provides an exemption from the relief available in respect of other contractual agreements. This exemption is provided in respect of EFCs, on the assumption that the exemption is necessary to avoid a systemic risk issue, where the insolvency of one person can have far reaching adverse consequences on capital markets and on the economy as a whole. Obviously, if the systemic risk assumption were found to be invalid, there would be no need or justification for the exemption from the relief provisions, which relief provisions are designed to provide an opportunity for a debtor to restructure. In view of the above, the systemic risk (which is assumed to exist) and restructuring objectives come in conflict and work at cross purposes in an insolvency situation. It was considered that the present provisions exempting EFCs from much of the relief that is available for debtors under insolvency laws does not strike a proper balance between the right of insolvent persons to restructure and the systemic risk, and the IIC report is an attempt at rebalancing the contradictory objectives. The main recommendations made in the IIC report are:

- Removing the current exemption in respect of the termination of agreements[17], to replace it with a partial exemption, whereby the insolvent debtor could terminate an agreement, but only after an initial period in which only the solvent counterparty would have a right to terminate the EFC.

- Removing the current exemption in respect of assignment of agreements[18], to replace it with a partial exemption, whereby the insolvent person could assign the EFC, but only after notice and court authorization, and without a restriction on the part of the counterparty to terminate the EFC until after the assignment has taken place (this would effectively make the assignment available only with the consent of the counterparty);

- Invalidating provisions such as *ipso facto* forfeiture provisions that may reduce or eliminate amounts owed under an EFC because of the occurrence of an insolvency or event of default.

- Clarifying the priority status of financial collateral[19], in view of the number of other conflicting potential claims to assets that could be considered as financial collateral, such as claims of employees under section 81.3 and 81.4 BIA or claims of the Crown for unremitted source deductions. Essentially, the recommendation of IIC clarifies the existing provision that the solvent counterparty has a first ranking charge over financial collateral, but only inasmuch as the collateral is clearly defined and segregated.

- Ensuring that the provisions of the BIA apply consistently in receiverships, in the same way as they would apply in a bankruptcy.

As mentioned above, the IIC derivatives report deals with situations where the insolvent person is a party or counterparty to an eligible financial contract, from an insolvency point of view, but the IIC report does not deal with derivatives from an economic interest point of view. For situations where derivative contracts create a disparity between the legal interest and the economic interest of a creditor, these situations are not really addressed in the EFC provisions of either the BIA or CCAA. Transparency would require that disclosure be made of situations where because of a side contract (such as a credit default swap ("**CDS**") or other agreement, derivative or not), there is a divergence between a legal and economic interest. The lack of economic interest could be taken into consideration by the court in the context of motions or votes, where the individual creditor's best interest (as opposed to the creditors' collective best interest) is the failure of the restructuring debtor.

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[17] Section 32(9) CCAA and section 65.11(10) BIA.

[18] Section 84.1(3) BIA and 11.3(2) CCAA.

[19] Sections 65.1(9) and 88 BIA, and sections 34(8) and 34(11) CCAA.

8. Professional Fees in CCAA Proceedings

Stakeholders are invited to make submissions regarding the impact of professional fees on insolvency proceedings, including the utility of greater disclosure practices.

The discussion paper refers to measures implemented in other countries such as the United States, to control the level of professional fees, which are considered by regulators, such as the OSB and some stakeholders to be excessive and to harm creditors' recoveries.

In this respect, I believe that additional research and discussion is required regarding the controls that should or could be put in place to control professional fees in insolvency engagements. I suggest that before this discussion takes place, the members of the group tasked with discussing this issue should study the article published in the 2009 Annual Review of Insolvency Law, on this topic[20]. The authors of this article quote studies in the U.S. that suggest that the professional fees may vary from one proceeding to another, whether or not the fees are subject to approval by the court overseeing the proceeding. Some of the studies indicate that the jurisdiction in which the proceeding are taken may be a correlating factor, which would suggest that there could be a competition between jurisdictions to become the location of choice for bankruptcy filings, and that some of this competition is exercised by having some jurisdictions that may be "friendlier" for professionals, in assessing the fees for work performed[21].

As well, the authors cite studies comparing the professional fees incurred in large insolvency engagements, with the professional fees that would be generated in a similarly large corporate finance transaction (i.e. a merger or acquisition), which conclude that the fees generated in the large insolvency engagements are rather modest as compared with the fees generate in similar corporate finance transactions[22]. This would suggest that to a certain extent, the complaint from regulators and stakeholders regarding excessive fees is not based on fact, but rather perception. Indeed, in a corporate finance transaction where a business is continued because one enterprise has acquired another one, the professional fees incurred are seen as adding value for all stakeholders, because they are necessary in order for the merged entity to continue in business and generate wealth for the stakeholders from future cash flows that are expected to be enhanced because of synergies. In an insolvency context, however, the equivalent fees, also generated in order to enhance value for the stakeholders by preserving a going concern and providing enhanced cash flows as a result of the restructured activities, are not perceived as adding value, but rather as taking value away from the creditors and harming their recoveries.

Perhaps the first stage of the exercise should be to address the perception problem. Another factor that plays heavily in the determination of the level of professional fees that will be incurred in a case is the amount of work that is required from the professionals, and this factor is particularly important in smaller estates, as the work that must be done in any file notwithstanding its size takes on a much greater proportion when the assets are limited.

This said, all professionals involved in an insolvency engagement should strive towards continuous improvement and efficiency, and this includes the amount of professional fees that must be invested in order to complete the engagement.

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[20] *A "Cost"-Benefit Analysis: Examining Professional Fees in CCAA Proceedings*, by Stephanie Ben Ishai and Virginia Torrie in 2009 Annual Review of Insolvency Law (Janis P. Sarra, ed.), Thomson Reuters Canada Limited.

[21] Note 20, *supra*, citing a book written by the U.S professor Lynn LoPucki.

[22] Note 20, *supra*, citing studies by the U.S professor Stephen Lubben.

From my perspective, the judge having responsibility for the supervision of the proceedings is best able to assess the reasonableness of the fees in the circumstances. There should be a more stringent disclosure requirement, as right now there is no firm requirement to disclose the amounts paid, and the practice in this regard varies significantly from one region to another.

In terms of possible ways in which professional fees could be reduced or monitored, the following (non exhaustive list) could be considered:

- Request that the court approve fees for all parties whose legal or other costs are paid by the debtor, or in the alternative implement a disclosure requirement, together with a right of access to the court to review the fees, at the request of an interested party.

- Require monitor involvement to supervise the legal fees and disbursements being paid for by the debtor.

- Award significant costs as a punitive measure against a party whose behaviour is unreasonable or otherwise impairs a viable arrangement.

- In appropriate circumstances, allow the monitor to facilitate alternate dispute resolution mechanisms, or have the court direct parties to participate in a mediation process.

- Streamline some of the court processes, by dispensing attorneys from appearances where the matters under consideration are uncontested or administrative in nature, by requiring sufficient notice to parties (except where a matter arises that is truly urgent), and by allowing appearances by phone or videoconference where the issues under consideration are simple or routine.

9. Enhancing Transparency - Creditor Lists

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

The discussion paper suggests that transparency might be enhanced if there was an obligation on the debtor to continuously maintain and disclose a list of creditors. Before considering this issue, it is important to assess why the list of creditors might have changed. In view of the stay of proceedings that is ordered through the initial order, the only way in which the claims of creditors may change, as compared with the list that needs to be posted on the monitor's website shortly after the initial order is made, are the following:

- The initially provided list was erroneous, because it had not been reconciled.

- The debtor is not paying for post commencement purchases or has incurred additional credit, notwithstanding the right of creditors to request payment on a "cash on delivery" basis.

- The debtor has paid pre-commencement debts, notwithstanding the stay order.

- The creditors are trading claims amongst themselves, or are selling their claims in a secondary market.

To the extent that the change in the creditor population make up comes from the first three of the above factors, the change is controllable and attributable to the debtor, and the debtor could produce an

updated list. I believe however that in most cases, the changes that relate to the above factors are not sufficient to cause a change to the lists of creditors that would affect behavior, and as a result the additional transparency would not provide any substantial benefit. Furthermore, to the extent that the change in creditor listings come from the second or third factor, the information should be made available to the creditors by the monitor, through its obligation to monitor the debtor's activities, and in any event would only be useful to determine creditor behavior if the plan is likely to be unsuccessful. As a result, I believe that the original requirement should be largely sufficient in most cases, and the originally posted list of creditors should be updated only if it is subsequently found to be incorrect by a significant amount.

To the extent, however, that the change in the creditor population make up comes from the fourth factor outlined above, the change may not be known to the debtor at all, as there is no requirement for creditors that are selling or trading their claims to report that fact to the debtor. A good example of this dynamic is a debenture, where the only point of contact that the debtor has is the administrative agent or trustee. Placing a responsibility on the debtor to maintain and disclose a list of creditors in this circumstance is illusory, as the transactions are not known or controlled by the debtor, but are made by private agreements amongst third parties. The only manner in which such a provision could be implemented would be to compel creditors to report all claims traded or sold to the debtor so that the debtor may update a list, and such a compelling provision would be difficult or impossible to monitor or enforce, given that the trade of claim is a private ownership matter between the parties, and it is difficult to imagine what could be the punitive provision that would incite the parties to report immediately.

In short, I believe the provision warrants further consideration and discussion, but its implementation may be difficult or impossible.

One provision that may help, however, would be an obligation to post lists of creditors who have already filed claims, since the claimants need to identify themselves in order to have their claims recognized. The provision would not be perfect, as parties could bypass the recording of the claims assignment by agreement amongst themselves, there could be a significant time lag between the change in ownership of a claim and the disclosure of that change to the person responsible to maintain the claims register (because there is really no need to disclose unless there is a vote or a distribution that is imminent), and the claims process may not be engaged right at the beginning of the file. While not perfect, this process could improve transparency as compared with the present situation.

10. Enhancing Transparency - Empty Voting and Disclosure of Economic Interests

Stakeholders are invited to provide input on whether courts should be empowered to require greater disclosure of creditors' actual economic interests or to take account of those interests.

I refer you the comments I made earlier in this text, in section no 7 on page 15. Transparency would require that disclosure be made of situations where because of a side contract (such as a credit default swap ("**CDS**"), option, voting agreement or other agreement, derivative or not), there is a divergence between a legal and economic interest. The lack of economic interest could be taken into consideration by the court in the context of motions or votes, where the individual creditor's best interest (as opposed to the creditors' collective best interest) is the failure of the restructuring debtor.

11. Role of the Monitor - Pre-Filing Reports

Stakeholders are invited to make submissions regarding whether pre-filing reports should be permitted and, if so, in what circumstances.

A pre-filing report, or report of the proposed monitor, should be permissible where thought to be relevant, but the court should discourage monitors from writing pre-filing reports that are merely a re-packaging of the affidavit in support of the motion for an initial order, as most are. Such a pre-filing report might be useful, for example, in a situation where there is a pressing need for interim financing from the outset, the monitor has been involved with the process by which the proposed interim lender has been selected, and can explain the process, the fee structure and the likely impact on creditors and on the debtor company's on-going operations, so that the court can assess whether the process to identify and select the interim lender was sound, and whether the proposed terms of the interim borrowings are reasonable in the circumstances.

12. Role of the Monitor -Conflict of Interest

Stakeholders are invited to make 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.

The discussion paper refers to situations where the monitor has a pre-existing relationship with the debtor company, as it might have acted as financial advisor before the motion for an initial order is filed, and the possible threat to the monitor's independence that arises because of this pre-existing relationship.

From my perspective, a pre-existing relationship with the debtor is not an undesirable situation, but rather an advantage, provided that the relationship is not a longstanding relationship that bears no relation to the restructuring process. An involvement by the proposed monitor before the presentation of a motion for an initial order will have the advantage or providing the monitor with much needed intelligence about the key issues faced by the company in the early stages of the restructuring process, allows for preparation time to "hit the ground running" so that information can flow to creditors quickly and the process of stabilizing the business can commence immediately, and allows for input from the proposed monitor on key strategies, to decrease the likelihood of the process being sidetracked by an opposition by the monitor or the creditors to decisions made early in the process.

With respect, I believe that the real concern is not with the lack of independence that may result from a pre-existing relationship, as described above, as much as a concern that the selection process put in place to retain a proposed monitor may by itself cause a conflict of interest problem. This situation would arise for example where the proposed monitors being interviewed are requested to disclose their preliminary position on various key decisions, before they are retained or at a time where their appointment might still be vacated. In such a situation, the proposed monitor would not benefit from any protection against his appointment being vacated since the appointment has not yet been confirmed by the court. The concern would be that this process, in the absence of a statutory protection, could cause a conflict of interest (rather than an independence issue) to arise, if the requests for preliminary positions are interpreted as "monitor shopping", i.e. where the preliminary positions might affect the selection decision.

Unfortunately, the possibility that this type of conflict could exist will always be present, and it is impossible to set up a safeguard mechanism that would prevent this possibility, unless prospective monitors are precluded from discussing any aspect of the engagement with the debtor or its advisers

until after the appointment is confirmed and cannot be vacated. However, this would necessitate that the appointment is no longer made by the court through the initial order, or a loss of the benefit that can arise from having a pre-existing involvement, as described earlier in this section.

From a practical point of view, the monitors must be trustees licensed by the OSB and most are members of CAIRP. As such, they are bound to a code of ethics for trustees as provided in sections 34 to 53 of the Bankruptcy and Insolvency General Rules[23] which are incorporated by reference in the CCAA[24], and to the extent that they are members of CAIRP are subject to the rules of professional conduct of CAIRP. These rules of ethics and codes of professional conduct require, *inter alia*, that the professional remain free of conflict or influence that may impair his professional judgment or objectivity. The codes of conduct, rules of ethics and supervision by the court are sufficient safeguards. The market should eliminate monitors that lack independence and objectivity, in time.

To address more specifically the request formulated by IC in the discussion paper, I believe there should always be a disclosure by the professional of a pre-existing relationship and the extent of this relationship, for transparency. This positive disclosure requirement should be introduced in the statute.

13. Asset Sales - Credit Bidding and Stalking Horse bids

Stakeholders are invited to comment on whether credit bidding should be permitted and, if so, what limitations may be appropriate.

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

Credit bidding should be allowable, but safeguards should be put in place to ensure that the credit bid can only be in respect of the encumbered assets (i.e. that the secured creditor cannot skew the allocation of funds to acquire unencumbered assets using the credit bid in respect of the secured claims.

The process has to be fair to ensure there is no possibility of “gaming” to eliminate competitive bids or to give an unfair advantage to a bidder over the others.

From my perspective, there is no need to have specific legislative provisions to address credit bidding or stalking horse bidding processes. The current provisions provide the court with sufficient discretion to supervise the process and prevent inequities – all that is required is a continuing vigilance on the part of the court and the monitors to ensure that the sale processes remain fair and sound, without possibility of chilling out other prospective purchasers or providing a party with an unfair advantage competitively as a result of a privileged position as lender that might give the prospective purchaser more insight in the sale process as an insider.

14. Asset Sales - Applicability of Asset Sale Test

Stakeholders are invited to comment on whether a materiality test is required to determine when asset sales will be subject to court approval.

Even though this is not contemplated in the CCAA (actually, even though this is actually prohibited by the CCAA), the present practice is to set a materiality amount in the initial order, to set an amount

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[23] C.R.C, c. 368.

[24] Section 25 CCAA.

under which the sales of assets do not require a specific court authorization. Typically, the provision in the initial order will indicate that court authorization is not required for sales of property where the proceeds are less than a specified amount, provided the monitor consents to the sale.

The concept of having a materiality amount before a sale requires the authorization of the judge charged with supervising the proceedings is sound, in particular considering the *de minimis non curat lex* principle. I would therefore favor a system where some of the court's discretion to approve sales out of the normal course of business can be delegated, although I believe that the threshold should be set by the judge responsible to supervise the proceedings, on a file by file basis.

In discussing a materiality threshold, it is important to note that the proceeds of the sale may not always be the proper measure of materiality – the proper measure should be the value of the assets, and the monitor should thus have some obligation to determine whether the proceeds of the sale reasonably reflect the value of the assets, before consenting to a sale. Recognizing that it may not always be practical to obtain an independent valuation of the assets, however, this obligation should provide for some discretion based on professional judgment, and/or a consultative process with some of the significant stakeholders who may have some appreciation of the value of the assets.

As well, some safeguards would then need to be designed to ensure that the rights of employees are properly protected when one or more sales are carried out[25].

15. CBCA Arrangements

Stakeholders are invited to provide input as to whether CBCA arrangements involving insolvent companies are appropriate.

The discussion paper indicates that some stakeholders have expressed concern with the *Canada Business Corporations Act* ("**CBCA**")[26] arrangement provisions because it is skeletal, providing the court broad discretion to make any interim or final order it thinks fit.

It is not the skeletal nature of the statute that is problematic, as this is how the initial complaints were formulated in respect of the CCAA. What is problematic is the possibility that a lack of transparency and independent advice and oversight could lead to potential negotiating imbalances.

I have heard from stakeholders that the restructuring provisions of the CBCA can be a useful tool and are definitively superior to one alternative, which is an unstructured private negotiation with bondholders while the debtor is in crisis mode. I can understand the concern and wish to preserve as many restructuring tools as possible in the toolkit, to cover all imaginable restructuring opportunities. It is entirely possible that the CBCA could provide a better remedy in a situation where the only restructuring that is required is with respect to bonds, debentures or other securities, without affecting trade suppliers and employees.

However, inasmuch as the recourse is available for an insolvent debtor, the provisions should be fleshed out to ensure proper oversight and transparency, including an accounting of the losses and reasons therefor, a review of the financial position, the appointment of an independent professional to monitor the proceedings and inform the court on issues, and a requirement that the party that provides a fairness opinion in the context of a proposed arrangement be free from any conflict of interest.

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[25] Section 36(7) CCAA and section 65.13(8) BIA. It should be noted that the references in section 36(7) BIA to sections 6(4) and 6(5) CCAA are incorrect and should be modified to sections 6(5) and 6(6) CCAA.

[26] R.S.C. 1985, c. C-44, as amended.

16. A Streamlined Small Business Proposal Proceeding

Stakeholders are invited to make submissions regarding whether a simplified, less expensive proposal process for SMEs would be warranted.

Reducing administrative steps that are near automatic would assist in making the process more efficient. Reducing the number of reports, court attendance, etc. would also help.

When considering the possibility of a more streamlined process for proposals made by small businesses, stakeholders often make references or comparisons with the provisions contained in Division II of Part III of the BIA, namely the proceedings referred to as "consumer proposals". The consumer proposal provisions provide much streamlining of the process, by removing the necessity to hold meetings of creditors unless the creditors specifically request one, having a deemed approval of the proposal unless a meeting is held and the required majority vote is not met, and having a deemed ratification of the proposal by the court unless there is a specific request for a court hearing. These are all very interesting characteristics that promote efficiency and facilitate restructurings.

One word of caution is necessary, however. The consumer proposal provisions contained in Division II of Part III of the BIA provide that if the proponent fails to obtain the required positive vote (deemed or actual) or fails to obtain the court's ratification (deemed or actual), the proponent is not bankrupt (unless the consumer proposal had been formulated by a bankrupt). I would consider that adopting a similar approach in a streamlined small business proposal process would be dangerous, as it might encourage abuse. In dealing with enterprises, no matter how big or how small, the restructuring process through an insolvency statute is not intended to be a renegotiation of the terms of existing agreements, but rather a but a transparent process for relief because of financial hardship, where the debtor puts its best foot forward, explains candidly its financial position and difficulties to the creditors, and asks for voluntary concessions in the collective interest of the debtor and creditors. There is a real risk that this candid disclosure of the full extent of the financial difficulties, value of assets and strategy to return the business to a viable operation and this obligation of the debtor to put its best foot forward may not occur if there is not a serious downside risk if the creditors cannot be convinced of the merit of making the concessions.

17. Division I Proposals Extension

Stakeholders are invited to provide input on extending the time for filing a Division I proposal following the filing of a notice of intention to file a proposal.

The more streamlined process for smaller debtors in the US under the *U.S. Bankruptcy Code*[27] allows a delay of up to 6 months (180 days), but the failure to meet the delay does not result in bankruptcy, and the delay can be extended further with court's authorization[28]. All that is lost if the delay is not met is the exclusive right to file a plan.

Our process requires court attendance every 45 days, and can result in an automatic bankruptcy.

The process could be made more efficient if some of the requirements were relaxed. I am not suggesting removing the automatic bankruptcy in the event of failure – the consequence is required to make sure the debtors negotiate with full transparency and a sense of urgency. But the extensions should be granted automatically unless a creditor objects, and the court should be able to extend the 6

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[27] *U.S. Code*, Title 11.

[28] *U.S. Bankruptcy Code*, section 1121(e).

month deadline for cause, if the court believes the debtor is likely to make a proposal that will be acceptable to the creditors and there is a cogent reason why the proposal could not have been formulated within the 6 month timeframe.

As well, independently of the right of the court to extend the deadline, as outlined above, I believe that the creditors, at a properly constituted meeting, should be able to allow additional delays to file a proposal, for such period and subject to such extension of the period as the creditors might authorize. I believe this provision would not be incompatible with the intention of the legislator, which I have always interpreted to mean that the 6 months delay is not necessarily a delay in which the restructuring must be completed, but rather a delay within which the decision regarding the viability of the business and likelihood of a proposal is take away from the court and put in the hands of the creditors. The initial delay controlled exclusively through the exercise of the court's discretion is necessary as a cooling off period, after which the debtor should have had sufficient opportunity to at least formulate an outline of a plan and communicate information to its creditors on its financial position, causes of difficulties, operational restructuring measures and business plan or strategy. After that initial delay has expired, there is no compelling reason why the decision regarding the merit of continuing the restructuring attempts cannot be made by the creditors.

I would therefore consider it appropriate to allow a two pronged process to obtain an extension beyond the 6 month period, namely either making an application to the court, explaining with compelling reasons why a proposal could not be made within the required timeframe and providing convincing arguments why a viable proposal is likely to be made, or in the alternative calling a general meeting of creditors to obtain a further extension beyond the 6 month period, at the creditor's will.

18. Liquidating CCAA Proceedings

Stakeholders are invited to provide input on whether the CCAA should be amended to codify protections for stakeholders and principles for the courts to consider in liquidating CCAA proceedings.

The important concept in restructuring is preserving value that could be lost. A transfer of assets that results in a going concern solution will preserve value for stakeholders (creditors, employees, etc.) and can therefore be an acceptable solution.

The only concern is with having a proper oversight process to ensure that the sale process is reasonable in the circumstances (on criteria similar to those developed in *re: Soundair*[29]), and that creditors who are interested can make representations to the court on the fairness of the process or consideration. The current provisions, both in the BIA and CCAA, seek to achieve these objectives, and we do not have evidence that the process is flawed, so there is no currently compelling reason to tamper with the present provisions.

I am aware that concern has been expressed by several lawyers that a liquidating plan in the context of the CCAA may result in uncertainty, due to the lack of a properly defined scheme of distribution within the CCAA, or a provision that would state that in certain circumstances the scheme of distribution that would apply would be that specified under the BIA[30]. This lack of certainty arises because of the recent jurisprudence, particularly relating to obligations under pension plans.[31]

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[29] *Royal Bank v. Soundair Corp*, 1991 CarswellOnt 205 (C.A.).

[30] Section 136 and ssq of the BIA.

[31] *Re Indalex*, 2013 CarswellOnt 733 (SCC), *Re: Timminco Ltée.*, 2014 CarswellQue 384 (S.C.), *Re: White Birch Paper Holding Co.*, 2012 CarswellQue 3901 (S.C.).

I would caution that the CCAA should remain very flexible, allowing for any scheme of distribution that is considered by the creditors and the court as fair in the circumstances, as otherwise there may be difficulties in coordinating proceedings with other proceedings in other jurisdictions. One of the interesting features of the CCAA is its relatively skeletal nature which provides it with a great deal of flexibility. This flexibility is very useful when a requirement arises to coordinate proceedings with another jurisdiction that may have a more rigid legal framework. That is the case for instance with proceedings under the *U.S. Bankruptcy Code*, as a coordinated plan would necessarily have to meet the absolute priority rule under the *U.S. Bankruptcy Code* in order to be implemented in the U.S.[32]

As such, if it is considered appropriate to introduce a scheme of distribution within the CCAA consistent with that of the BIA in order to clarify the possible distributions on a liquidation carried out in the context of a CCAA proceeding, it would be important to ensure that such introduction of a scheme of distribution does not remove the flexibility of the debtor to fix any scheme of distribution as may be appropriate in developing a plan.

Enhancing Equity

19. Employees' Claims

Stakeholders are invited to make submissions regarding whether, and how, Canada could enhance protection of employee claims in insolvency proceedings.

I wrote two articles for the Annual Review of Insolvency Law, the first was published in 2010 and a follow up article, dealing more particularly with the *Wage Earner Protection Program Act* (but also with rights of employees in insolvency situations) was published in 2012.[33] The two articles are attached to the present document as Appendices B and C, for ease of reference. I consider that the comments made in these articles are still relevant and should be considered as if reproduced here.

Undoubtedly, we need to review the protection available to employees and in particular to former employees (deferred compensation through pension plans and protection arising from long term disability benefits), as they are most vulnerable stakeholders who cannot protect their position. However, this additional protection cannot be put in place in a manner that endangers the very existence of employers, through increased credit costs or decreased credit availability (or both). I think the submissions made by CAIRP in connection with proposed Bills C-476, C-487, C-501, S-214 and S-216 (40th Parliament)[34] are still very relevant. There have to be solutions for employees and retirees, but the solutions cannot be "insolvency" based, they have to be based on a mutualisation of risk (i.e. by spreading the risk and loss over all employers and employees) and more prudent approaches to on-going funding requirements (i.e. eliminating funding holidays when there is a surplus, more frequent revision of the deficit calculation, etc.). The solutions have to be designed so that there is not a direct hit in a period of recession that makes restructuring impossible, because of a condition that is only temporary.

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[32] *U.S. Bankruptcy Code*, section 1129.

[33] *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.

[34] 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 accessed through www.cairp.ca/publications/submissions-to-government/index.php.

20. Employees' Claims – collective bargaining agreements

Although this topic is not addressed in the discussion paper, I feel it would be wrong not to comment on this key provision of the 2009 Amendments that was the object of much debate before it was adopted. The positions that were presented at the time were highly polarized, with some people maintaining that the possibility of breaching the sanctity of the collective bargaining agreement ("**CBA**") would create havoc in the workplace, and the other people maintaining that it would be impossible to restructure businesses unless the court were entitled to set aside and annul a CBA.

The 2009 Amendments provide that the CBA may not be set aside by the court, although the court may authorize the debtor to serve a notice to bargain to the collective bargaining agent, if certain specific conditions are met, it being understood that at no point in time can the court interfere with the terms of the CBA itself which remains in force unless and until it is modified by the parties.[35]

It appears that in developing the provisions regarding the treatment of CBAs, the legislator chose to leave the decision regarding the ability of the debtor to restructure and present a viable proposal or plan in the collective wisdom of the people most affected by the decision, namely the employees and the employer. I believe this is a patently reasonable approach, as it is apparent to me that the workforce is one of the key components of an enterprise's ability to succeed. It seems to me that there is very little that capital can accomplish without labour, and there is very little that labour can accomplish without capital. One of the main characteristics of successful enterprises is the ability to recognize the symbiotic relationship between capital and labor, develop the proper level of respect on the part of each party for the input of the other, foster communications so that each party is aware and understands the challenges faced by the other, create an environment where the employees understand the business strategy and become engaged in achieving the goals of the enterprise in a collaborative process.

The 2009 Amendments are consistent with these principles by requiring a high degree of transparency in the communication of information and negotiations towards a mutually acceptable settlement of the terms of employment set through the CBA. There is every reason to believe that reasonable people, when provided with all relevant information, will understand what is or is not possible, and will work collaboratively towards a settlement of the CBA that will preserve employment for the employees, if the business can be viable.

The only drawback to the provisions, from my perspective, is that they may not do enough to accelerate the negotiation process. While I believe that the people can settle the differences relating to the CBA, I am unsure whether the system as it presently exists allows the negotiation to take place with the sufficient level of a sense of urgency. There is a risk that the typically slower pace of negotiations in employment related matters could jeopardize a restructuring process, as an enterprise facing financial difficulties must be able to eliminate uncertainty and resolve problems quickly in order to return the business to profitable levels.

While I am not aware of any situation where the renegotiation or negotiation of a CBA has prevented a restructuring process that should otherwise have occurred, I believe that the risk thereof exists. Accordingly, while I believe that the presently existing provisions should not be changed, I consider that the provision should continue to be monitored closely, keeping in mind that it may require some adjustment in the future.

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[35] Sections 32(9) and 33 CCAA, sections 65.11(9) and 65.12 BIA.

21. Employees' Claims in Asset Sales

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

Perhaps a requirement should be introduced that all sales of assets other than in the normal course should be approved by the court or the Monitor. Although in the current provisions all such sales must be approved by the court, the initial order often delegates the decision on smaller sales to the debtor, and smaller sales are usually computed based on proceeds instead of value or other measure of relative size to the estate.

Furthermore, while the present provisions contemplate that the court should only give an authorization where the court is satisfied that the company can and will make certain payments that it would be required to make as a precondition to the approval by the court of a proposal or a plan[36], I have not yet heard any query or expression of concern from the court on this issue. The concern would be properly addressed, for example if there were a requirement that the proceeds of the sale be kept in trust by the monitor to protect the employees' claims until a plan is formulated, but I have not yet encountered or heard of such a request.

This however is likely only an issue in smaller files, as in the larger files the stakeholders often see the merit of paying the employees without interruption, to ensure there is no disruption to the business.

In considering the provision that aims at protecting the employees in the context of a restructuring, when there is a sale of assets outside of the normal course of business, I have to question the breath of the provision that was introduced in the 2009 Amendments. The requirement introduced at section 65.13(8) BIA and section 36(7) CCAA was put in place to ensure that the rights of the employees would not be frustrated by having an unscrupulous debtor (and, presumably, an unscrupulous trustee or monitor) conspire with a secured lender to liquidate assets in the context of a restructuring process to avoid the obligation of paying the claims that would otherwise have been prior ranking claims under sections 81.3 to 81.6 of the BIA, if the debtor had been bankrupt instead of attempting a restructuring. From that perspective, it would appear that the obligation under sections 65.13(8) BIA and section 36(7) CCAA, as it relates to the employees, should be limited to the extent of the value of current assets that are disposed of in the context of a sale out of the ordinary course of business, as the rights of employees under sections 81.3 and 81.4 BIA would be limited to the net proceeds from the realization of current assets. As such, unless there are unresolved claims pertaining to pension plans which could benefit from the application of sections 81.5 or 81.6 BIA if the debtor were bankrupt, the remainder of the proceeds that relates to sales of assets other than current assets should be available to be used by the debtor in its operations without restriction, or remitted to the secured creditors that had rights over these assets, as the case may be.

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[36] Section 65.13(8) BIA and section 36(7) CCAA. It should be noted that the references in section 36(7) BIA to sections 6(4) and 6(5) CCAA are incorrect and should be modified to sections 6(5) and 6(6) CCAA.

22. Hardship Funds

Stakeholders are invited to make submissions regarding whether express authorization for interim dividends in certain circumstances is required and, if so, any potential limitations on the courts' discretion.

I would consider that this issue falls in the category of "if it is not broken, don't fix it". The court has used its discretion when required or appropriate, and there should not be any guidelines or limits to this discretion.

23. Third Party Releases

Stakeholders are invited to make submissions regarding whether third party releases are appropriate and, if so, whether the identified criteria are sufficient to prevent potential abuse.

The discussion paper indicates that the Acts are silent regarding the issue of releases in favour of third parties. I believe that only the CCAA is silent on this issue. The BIA has a provision[37] that suggests that a release of a third party should not be the norm, although the Superior Court in Ontario has interpreted this provision differently.[38]

I believe that third party releases are appropriate in certain circumstances and should be allowable in both the CCAA and BIA (i.e., for greater clarity, s. 63(3) BIA should be changed), however the court should act as gatekeeper to prevent abuse. The criteria listed in the Sarra report appear to be the proper standard.

24. Key Employee Retention Bonuses

Stakeholders are invited to make submissions regarding whether employee bonuses should be permitted in an insolvency proceeding and, if so, whether terms and conditions should be codified.

It seems appropriate to set up control over key employee retention bonuses or key employee retention plans ("**KERPs**"), to avoid the conflict of interest situation that is likely to arise where managers establish their own bonuses to take advantage of their informational capital.

I don't think that the KERPs should be abolished, as they may be necessary to retain employees to help with the restructuring or liquidation. I don't even think that it is appropriate to limit them to situations where the plan existed before the proceedings, or to situations where the employee has already found alternative employment. In part, the KERP serves to compensate the employee for the opportunity cost of not actively seeking alternative employment, so restricting the KERP to situations where an employee has another job offer is unfair (and by that time, the cost of the KERP would likely be higher, as it has to compensate the employee for the opportunity cost of turning down employment, instead of just not actively seeking).

That said, some discussion has to be held to limit the incidence and quantum of the KERPs so that they do not become an opportunistic way to reallocate wealth from the company or creditors to the managers. Still, I would avoid a legislated solution that may remove flexibility by preventing the setting up of KERPs in situations where they are truly warranted. A legislated solution was attempted

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[37] Section 63(3) BIA.

[38] *Re: Kitchener Frame Ltd.* 2012 CarswellOnt 1347 (S.C.).

in the U.S. in the context of proceedings under the *U.S. Bankruptcy Code*,[39] and anecdotal evidence suggests that the process is overly cumbersome and may lead to a loss of talent.

25. Key Employee Retention Bonuses – directors' liability

Stakeholders are also invited to make submissions regarding whether director and officer liability could be imposed for bonus programs created during an insolvency proceeding in appropriate circumstances.

The general principle to date has been to limit the post commencement director and officer ("**D&O**") liability to encourage talented D&Os to remain in their positions and help with the restructuring – this would be counterproductive to that principle. The KERPs should be reviewed and approved by the monitor and the court, and if they are so approved, the responsibility of the D&Os should cease, except for the responsibility to see to it that the KERPs are implemented as approved, the same way as D&Os remain responsible to see to it that on-going wages are paid and payroll source deductions are remitted (and with the same protection against post-commencement D&O liability as the court may have granted).

26. Oppression Remedy

Stakeholders are invited to make submissions regarding whether restrictions on the availability of the oppression remedy should be imposed in the insolvency context.

I have not encountered the problem to date, and I am not sure I completely understand the issue. To the extent that an oppression remedy is sought in respect of the insolvent debtor corporation, I would think that the stay of proceedings that is ordered in the context of the CCAA or that is automatic as a result of the provisions of the BIA would prevent this proceeding from progressing, except with the court's authorization, and it would seem to me that the court would rapidly stop the progress of such proceeding if there is any indication that it was taken in a way that is abusive, for a collateral purpose, or to derail the progress of the restructuring process.

To the extent that the oppression remedy is sought in respect of a director of officer of the insolvent corporation, again the BIA and CCAA provide for a stay of proceedings against directors, except for proceedings that are in the nature of an injunctive relief, or with the court's permission. Since injunctive relief needs to be dealt with expeditiously, it would again appear unlikely that an attempt to use an oppression remedy to gain a negotiating advantage or to derail negotiations would get much traction, before the court has an opportunity to stop the progress of such a proceeding.

Perhaps, if there is a concern that even a short disruption could affect the progress of the restructuring process, a provision could be introduced that would cause a punitive consequence for someone who uses the court system abusively to derail or hinder the progress of the restructuring process for an improper purpose.

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[39] *U.S. Bankruptcy Code*, section 503(c), and section 101(31) for the definition of the term "insider".

27. Interest Claims

Stakeholders are invited to make submissions regarding the existing rules regarding interest claims.

Effective on the date of commencement of the proceedings, all creditors lose the ability to recover their claims, and must await the progress of the insolvency proceedings. The time value element is no more or less onerous for a claimant, depending on whether his/her contract provides for an interest accrual or not. Allowing an interest claim for a bank loan for instance, while denying a post commencement interest to other claimants, would place the Bank in a situation where the Bank's claim is not limited to a present value of the claim at the date of the proceeding, but a present value at the date of distribution while all other claims are based on a present value at the date of the proceedings.

I am in favour of an interest stop rule, based on fairness. In fact, the interest stop rule should also apply across legislation, and across proceedings. At present, the Canada Revenue Agency ("**CRA**") considers[40] that its claim has changed, if (all other things being otherwise equal) a debtor that files a notice of intention subsequently becomes bankrupt. That is caused by the change made in 1997 to differentiate between the initial bankruptcy event and date of bankruptcy. Because the date of bankruptcy is different from the date of filing of the NOI, CRA believes it is allowed to charge penalties and interest in the interim period. I am not suggesting reintroducing a retroactivity factor in the date of bankruptcy, but the claim should not change just because of a natural progress in what is essentially the same proceeding, such as if a proceeding commenced under the BIA is continued under the CCAA, or if a restructuring process fails and the debtor becomes bankrupt. I am also not suggesting that the claim of creditors should never change after the date of an initial bankruptcy event, as it is possible that a valid payment could be made on account of a pre-commencement debt after the proceedings under the BIA or CCAA have been filed, or that a creditor delivers additional merchandise on credit after the date of a NOI, and that the amount remains unpaid at the date of the bankruptcy. I believe the nature and amount of the claim of the creditors should be determined as of the date of the initial bankruptcy event, subject to adjustment for transactions that would be considered as proper transactions or protected transactions in virtue of section 97 BIA.

28. Unpaid suppliers

Stakeholders are invited to make submissions regarding the treatment of supplier claims for goods delivered in the period immediately prior to insolvency proceedings.

The discussion paper refers to the rights that exist in favor of unpaid suppliers under the *U.S. Bankruptcy Code*, by way of repossession rights or a right to an administrative priority. The repossession right is for 45 days but must be exercised within 20 days of the proceedings, the goods must still exist (be identifiable, on hand), and the creditor must be able to demonstrate that the goods were delivered while the debtor was insolvent [41]. The administrative priority is for goods delivered in the 20 days before the proceedings, and identification is not necessary.[42] My understanding is that in view of the difficulties inherent with the identification of the goods and proof of insolvency, the repossession right is rarely used, but creditors tend to opt for the administrative priority instead.

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[40] Note that I am not commenting the merit of this assertion, to agree or disagree therewith. I am merely stating a fact, from my previous discussions with representatives of CRA.

[41] *U.S. Bankruptcy Code*, section 546(c)(1). Note that some sections of the *U.S. Bankruptcy Code* (for example section 547) provide for a presumption of insolvency for a stated period before the commencement of a case, but this provision is not reproduced or referred to in section 546.

[42] *U.S. Bankruptcy Code*, section 503(b)(9).

The repossession or reclamation right that presently exists in the BIA is illusory as right now, there seldom are goods available to be recovered. A priority right is illusory, as there seldom are funds available to distribute, after the secured creditors' claims and other prior ranking claims (employees, governments for payroll source deductions, pension plans, landlords, etc.).

From my perspective, the current provisions of section 81.1 BIA should be repealed, for the following reasons:

- They are likely working at cross purposes with the restructuring objectives of the BIA[43] as creditors having their individual interest in mind rather than the collective interest of creditors might be tempted to cause the restructuring proceedings to fail rapidly in order to recover recently delivered merchandise.

- These provisions tend to restrict access to funds for the businesses, as lenders usually factor in a provision for the potential loss of merchandise from claims for recently delivered merchandise, when assessing the borrower's value of assets for margin purposes, or asset backing for lending purposes. This provision is usually set conservatively, even though the rights of suppliers to recover merchandise are often more academic than real, in view of the fact that it would be difficult or impossible for a debtor to compile every month a list of the merchandise on hand that is unpaid and in the same state as when it was received.

- The provisions provide little or no protection to the creditors, as the merchandise tends to have been sold or used before the insolvent person becomes bankrupt or in receivership. Most often, the inexistence of the merchandise to which the claim pertains is not due to some nefarious occurrence, but is merely a result of the fact that companies in financial difficulties, or debtors with cash flow problems, do not tend to purchase merchandise to keep it in stock, but rather because they have an immediate need for this merchandise, either to keep production lines going or to deliver goods to customers.

- The provisions tend to create different rights amongst similarly situated creditors, as suppliers of merchandise could conceivably have a right, while suppliers of services cannot benefit from an equivalent protection.

Arguably, the presently existing provisions could be replaced by a preferred claim in favour of suppliers of goods and services, which could be applicable both in restructuring and liquidation files, and which would not require a complicated demonstration of the existence of the goods or the insolvency of the debtor. For example, the suppliers of unpaid goods delivered or unpaid services rendered in the 15 to 30 days prior to the inception of the insolvency proceedings could see their right to recovery elevated to a higher rank, above the other ordinary unsecured creditors, in the event of a distribution in a bankruptcy or under a proposal or plan of arrangement. This provision would have the advantage that it would provide a higher degree of recovery for recently delivered merchandise or services, without affecting behaviour on a choice between the restructuring and liquidation option. This preferred claim would likely be of limited usefulness in a bankruptcy liquidation or receivership scenario, however, due to the fact that the funds available for distribution to unsecured creditors are usually modest or inexistent, due to the secured creditors' claims and the other existing prior ranking rights (such as the rights of employees, pension plans, and governments for unremitted payroll source deductions).

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[43] and the CCAA, as a practice has developed in the past to introduce a suspension of the count of days for purposes of section 81.1 BIA, while the initial order is in effect, to create a situation similar as that which would prevail if the proceeding were a notice of intention or proposal pursuant to the BIA.

It is important to note that the right was originally introduced on the theory that debtors were "stocking up" with merchandise in contemplation of insolvency, to avoid the personal guarantees given to bankers. To the extent that this is still the concern that is sought to be addressed, the provision as it presently exists would not be very effective to prevent this occurrence, and I believe that the potential occurrence would be better corrected through dissuasion, by pursuing the potential bankruptcy offenses when this situation is encountered.

29. Fruit and Vegetable Suppliers

Stakeholders are invited to make submissions regarding the existing farmers' super-priority in section 81.2 of the BIA.

The discussion paper mentions that the BIA provides that farmers in Canada, fishers and aquaculturists are entitled to a super-priority over the entire inventory of a bankrupt for unpaid amounts related to farming, fishing or aquaculture products delivered within 15 days of a bankruptcy or the appointment of a receiver.

I was surprised by this statement, since I never thought that the claim referred to in section 81.2 BIA was dependant on the nationality of the claimant, as I never saw the term "Canadian" besides the word farmer or in the definition of farmer. To the extent that the provision was created to protect farmers and fishermen because they are vulnerable creditors who are important to the food processing industry and have difficulty in monitoring and enforcing their right to payment once the seeds, seedlings, grain, feed, products of agriculture, products of the sea, etc. have been delivered, I see no principled reason why the protection should only be available to Canadian farmers.

I cannot comment on the suggestion to change the provision from 15 days' to 30 days' worth of deliveries. The nature of the right created by section 81.2 BIA is a superpriority over and above the rights of a secured lender that has security over the inventories, and as a result the proper timeframe for the length of time over which the superpriority might apply must be based on a careful consideration of the real need for protection of the farmer or fisherman, and the risk that the superpriority will affect access to funding for the borrowing purchaser of products that may be subject to a right under section 81.2 BIA.

Deterring Fraud and Abuse

30. Director Disqualification

Stakeholders are invited to make 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.

I am in favour of a disqualification for directors that are guilty of misconduct. The thorny issue is defining what constitutes misconduct, and what degree of proof will be required before the disqualification is imposed (beyond a reasonable doubt, preponderance?). As an example, the corporate statutes impose a liability to directors for non-payment of employment related claims, however this non-payment may not be related to misconduct at all.

The threat of sanctions related to misconduct could conceivably deter talented individuals from acting as directors or officers.

As a result, it would seem to me that disqualification should be a measure that can be imposed, but only in the most egregious circumstances, and the relief/deterrent effect should likely come from a better use of the provisions already in place (bankruptcy offenses, joint liability for certain transactions, etc.).

31. Related Party Subordination and Set-Off

Stakeholders are invited to provide 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.

The *U.S. Bankruptcy Code* has provisions that allow for the subordination of claims in certain circumstances, based on a principle of equitable subordination[44]. Anecdotal evidence suggests that the provisions give rise to litigation that can be costly and time consuming.

I am not in favour of a systematic subordination of debts of related parties, as this may affect rights of the creditors of the related party. There is already a provision in the BIA that allows for subordination of debts in cases of non arm's length transactions unless the transaction was proper (section 137 BIA), and that provision should provide a fair result. That provision could be extended to the CCAA.

With regards to set off, the legislation should not prohibit a proper, warranted set off on the same basis as what is available to an arm's length third party, but should prohibit "three way" set offs, and other set-offs that offend the insolvency principles and that should be prohibited for all creditors, such as a pre/post set off save for exceptional circumstances.[45].

With regards to both subrogation and set-off, my thoughts are as follows: We expect related parties to deal with each other on the same basis as if they were dealing at arm's length, and try to penalize them when they are not – as such, they should expect not be penalized just because of their relationship, if their behavior is proper.

Cross-Border Insolvencies

32. Foreign Claims under "Long-Arm" Legislation

Submissions are invited regarding an appropriate response to long-arm legislation.

"Retribution" measures such as adopting long arm legislation to counter the effect of other countries' long arm legislation, could lead to an unfair result, such as a resulting claim against a company in a jurisdiction that has no long arm legislation. As well, the "retribution" provision may be unenforceable if the claim ends up being denied by the other jurisdiction.

The issue of long arm legislation is one of sovereignty – it should be dealt with domestically by making such legislation unenforceable in Canada, if the Canadian policy objectives do not provide for the type of claim recovery sought to be recovered through the long arm legislation.

The provisions need to be drafted carefully, so that the long arm recourse does not end up being introduced surreptitiously through a foreign proceedings recognition order, thereby creating an unfavorable impact on domestic creditors in favour of foreign creditors. The concern is that a measure

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[44] *U.S. Bankruptcy Code*, section 510(c).

[45] See comments later in this text.

causing a skewed entitlement to proceeds may not hit the "contrary to public policy" safeguard in the cross border provisions of the BIA and CCAA.[46]

33. Set-Off for Claims in Multiple Jurisdictions

Stakeholders are invited to make submissions regarding the set-off of interest claims from another jurisdiction against principal.

I agree with the suggestion made in the discussion paper. The Canadian legislation should be promoting equal treatment of similarly situated creditors, so a creditor should not gain an advantage because he/she can boost his/her claim in another jurisdiction. All creditors are equally affected by the time value of money factor.

34. Allocation of Proceeds

Submissions are invited regarding access to, and conveyance and allocation of, assets in cross-border insolvencies.

It would seem to me that this issue is very much fact and circumstances dependant, such that a single rule applicable in all circumstances could not be fair. The allocation principles should be chosen with a view to efficiency, while preserving fairness of results when taking into consideration the market value of assets and creditors' rights in each jurisdiction.

It would seem that in a lot of cases, a substantive consolidation of sorts may be an efficient way to bypass the allocation problem, and may return a satisfactory result due to heightened efficiency and lower costs. If the operations of the businesses is so intertwined as to make the identification of who owns what asset (or part of asset) impossible, then perhaps it would be appropriate to recognize substance over form, namely that while the business may be legally structured as different legal persons, the intermingled business is in fact a single economic entity, for which the asset allocation is irrelevant, and for which there should be a single common pool of creditors that benefit from the proceeds of realization of the assets.

It is important to note that the concept of relative value will be difficult to pinpoint, as a highly profitable enterprise may not be worth much without another component of the corporate entity that may be key to its operations (for example, the owner of intellectual property). While it is likely that the whole is greater than the sum of the parts, it is also most likely that the whole will be less than the perceived value of all the parts taken individually and aggregated, and much good faith will always be necessary to reconcile the two.

35. Treatment of Enterprise Groups

Stakeholders are invited to provide input regarding the treatment of enterprise groups in insolvency legislation.

The discussion paper refers to the work performed by the insolvency working group of UNCITRAL, in connection with the treatment of enterprise groups in insolvency. The report from the working group (titled "Part three: Treatment of enterprise groups in insolvency") is well developed and appears sound, relevant and deserving of consideration.

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[46] Section 284(2) BIA and section 61(2) CCAA.

36. Centre of Main Interests

Stakeholders are invited to make submissions regarding the need for procedural protections in cross-border recognition matters.

I am not aware of any situation where the Canadian Court made a finding regarding the location of the center of main interests ("**COMI**") that could be considered premature or overly expeditious, or made the finding in a manner that would be considered overly accommodating or subservient to the wishes of a foreign court.

I am certain that in certain specific isolated circumstances, some stakeholders could feel that the court's finding regarding the COMI was erroneous, if these stakeholders feel strongly that the COMI should have been found to be in Canada rather than in the U.S. I am also certain that the same argument can be made in connection with proceedings taken to recognize the Canadian proceedings as a foreign main proceeding in virtue of the provisions of Chapter 15 of the *U.S. Bankruptcy Code*. If I recall properly, the recognition of the proceedings in the *Muscletech*[47] file were hotly debated for several reasons, one being the location of the COMI and the other being a fundamental philosophical problem with the possibility that liability claims would not be determined through a jury trial in the U.S., and in that case there certainly was a marked preference by some stakeholders in the U.S. for a finding that the COMI was in the U.S., although in that particular case the U.S. court eventually was satisfied that the COMI was in Canada. Individual interests are such that someone will always be dissatisfied with a court's finding, but the knife cuts both ways.

The cross border provisions of the BIA and CCAA are intended to be an efficient process, with a high degree of cooperation amongst jurisdictions. In order for the relief to be useful, it has to be applied expediently. From that perspective, I don't think that setting up a process that slows down the recognition of foreign proceedings is likely to be an improvement.

The courts in Canada (and in the U.S.) are aware of the requirements to issue an order recognizing foreign proceedings as a foreign main or non main proceeding, are aware of the stakes and interests of the various creditors, and have a wide discretion to make an order that the court considers appropriate. I see no compelling reason to modify this process.

37. Unsecured Creditors' Committees ("UCC")

Stakeholders are invited to provide 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.

International cooperation and transparency require that the UCCs be allowed to intervene and gain status, where there is an interest in the domestic proceedings. The supervising judge needs to control the interventions with a view to ensure efficiency and control over costs, inasmuch as is possible. In order to limit costs, the court should avoid making orders that compel the debtor to pay for other people's representation, except in the most dire of circumstances, where warranted.

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[47] *Re: Muscletech Research and Development Inc.*, 2006 CarswellOnt 264 (S.C.). See also the discussion in *Re: Grant Forest Products Inc.*, 2010 CarswellOnt 2445 (S.C.) at par. 77.

ADMINISTRATIVE ISSUES

1. Renaming the Bankruptcy and Insolvency Act

Stakeholders are invited to make submissions regarding the potential social stigma associated with "bankruptcy" and whether Canadians may be better served if that term is downplayed in the legislation.

I doubt very much that this is anything other than perception. The "stigma", if there is one, is attached to financial difficulties, and as a result will resurface no matter what is the name of the statute.

I am aware that some CAIRP members have fairly strong views on this topic, as I am told that the "bankruptcy" label can have a greater impact in the mind of consumers. As such, the issue of the renaming of the BIA may be more important for smaller practitioners who deal in the consumer and personal bankruptcy market, than for enterprises.

2. A Unified Insolvency Law

Stakeholders are invited to make submissions regarding a unified insolvency statute.

The issue of the multiplicity of statutes is more an issue of form over substance or vice versa. The important issue is not whether there are one or two statutes, but rather that the insolvency laws as a whole provide vehicles that are flexible, predictable and transparent.

At present, there are two statutes, and stakeholders appear satisfied with this situation. There is a definite advantage in having restructuring provisions in both the BIA and the CCAA, as one statute is more rule based and will therefore provide structure, while the other is a bit more flexible and can accommodate more specific problems.

With the majority of problems that arise in a restructuring under the CCAA, it is unclear in my mind whether it is the provisions of the CCAA themselves that provide the flexibility and ability to deal with complex situations, or whether it is instead the mere fact that the court takes a keen interest in supervising the proceedings and ensuring that the process progresses. Perhaps the same results could be achieved if the court were as involved in a proceeding under the BIA. Perhaps it is merely a matter of perception that the problems under the CCAA are more deserving of the court's attention, but the direct involvement of the court in supervising the proceedings is helpful to the restructuring process in the larger files.

One area where there is a definitive advantage to the existence of the CCAA is where there is a need to coordinate a plan of compromise or arrangement in the context of cross border proceedings. Most of the cross border proceedings involve proceedings in the U.S. The *U.S. Bankruptcy Code* is highly structured, as is the BIA. For example, attempting to coordinate a plan to distribute funds in order to meet the requirements of both the BIA and *U.S. Bankruptcy Code* would likely be difficult, as there is a risk that in doing so, the plan would breach the very strict absolute priority rules of the *U.S. Bankruptcy Code*, or would not respect the scheme of distribution provided for under the BIA. However, it becomes much easier to coordinate proceedings under the *U.S. Bankruptcy Code* with proceedings under the CCAA, in view of its flexibility.

In view of the above, I think that it would be preferable to maintain the two statute structure that presently exists.

That said, it would be useful to ensure that the provisions in the BIA and CCAA that preclude access by certain legal persons (such as railway companies) be reviewed, to ensure that access to the BIA and CCAA be granted to the widest possible range of companies, persons, partnerships, trusts, or other vehicle through which a business is carried. The exceptions should be limited to very narrow specific types of enterprises, where there is a significant reason why the relief under the BIA or CCAA would not be appropriate.

3. Restricting Consumer Proposals

Submissions are invited as to whether the consumer proposal process should be amended to ensure that it is not used with respect to business debt.

Having a highly streamlined process for very tiny files is not an objectionable result. I am not aware of any situation where the use of the consumer proposal process has led to an abuse by the debtor or an inequitable result for the creditors. As such, I see no fundamental reason to specifically prohibit the use of the provisions to deal with the debts of a very small unincorporated business.

4. Special Purpose Entities

Stakeholders are invited to provide input on whether to expand the application of the BIA and CCAA to trusts used as special purpose entities.

The definition of a debtor who can seek and obtain relief under the provisions of the BIA and CCAA is antiquated and should be reviewed, with a view to make it wider. As mentioned earlier in this document, the relief under the BIA and CCAA should be made available to the widest possible range of companies, persons, partnerships, trusts, or other vehicle through which a business is carried. The exceptions should be limited to very narrow specific types of enterprises, where there is a significant reason why the relief under the BIA or CCAA would not be appropriate.

From my perspective, there is no public policy objective that would explain why a trust could not become a bankrupt, or restructure, except if it is an income trust. Or why a partnership or limited partnership would be precluded from using the recourse available in the CCAA, or why a railway company would be precluded from access to the relief under the BIA or CCAA.

5. Receiverships – Codification of receiverships

Stakeholders are invited to provide input as to whether it is appropriate to amend the insolvency legislation to clarify the role and authority of a receiver appointed under s. 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 insolvency statutes.

I think that before clarifying the role and authority of receivers, it would be necessary to obtain a consensus over what security realization processes of secured lenders give rise to a receivership. By and large, the receivership provisions of the BIA are ignored because lenders believe they are inapplicable to the realization recourses they implement, unless the lender feels it is necessary for the court to appoint a receiver.

That said, I know there has been criticism in the past from insolvency practitioners, who thought it might be useful to appoint an interim receiver in certain instances, in the context of a CCAA proceeding. That criticism or perceived shortcoming could be alleviated by specifying that a receiver appointed in the context of section 243 BIA could act across all insolvency statutes, as if there is a

need for greater control over the assets and operations of a debtor in a context of a proceeding under the CCAA, this could be accomplished by the appointment of a receiver. As the receiver is appointed by the court, the order appointing it could be as wide or as restricted as the court deems it advisable in the circumstances.

I don't believe that the BIA should codify all elements of the appointment of a court appointed receiver, such as would be the case if the codification addressed all of the elements that might be contemplated in an appointment or engagement letter. On the contrary, I believe that the court has to retain full discretion on the terms of the appointment of its receiver, so that the appointment can be adjusted to fit the specific circumstances of the file, as needed. For situations that are more routine, the courts have developed standard receivership orders that appear to work quite well.[48]

It may however be appropriate to clarify certain issues regarding the applicability of certain provisions of the BIA to the receivership orders made in connection with section 243 of the BIA. The principal ones that come to mind are the following:

- There seems to be a lack of clarity regarding whether the court has an absolute discretion to make an appointment under section 243 BIA, or whether the court must first assess whether the secured creditor has exercised its hypothecary recourses under the *Quebec Civil Code*. The situation is not widespread, but I have heard that in at least one jurisdiction, the court asks that there be an expiry of the notice required before exercising a hypothecary recourse, as a precondition to the appointment of a receiver.

- The court is sometimes reticent to order a stay of proceedings and an order compelling third party suppliers to continue the agreements that the receiver may want to continue. A general stay of proceedings that applies upon the making of a receivership order, subject to the right of the court to vary or remove the stay of proceedings subsequently at the request of an affected party, would be a welcome change. As well, a general prohibition against the termination or amendments to contracts, except with the monitor's consent, would be an improvement.

- There is presently a lack of clarity regarding the distribution of the funds in the hands of the receiver, namely whether or not the scheme of distribution provided for in the BIA would apply to such a distribution, or in the alternative whether the scheme of priority contemplated in provincial legislation would apply, notwithstanding the fact that in view of the receivership order, the distribution occurs in an insolvency context.[49]

- The provisions of the BIA do not presently specifically require that the final report of the receiver be submitted to the court, in order for the receiver to obtain a discharge. Given that the receiver is appointed by the court, a discharge process should require a report to the court, through which the receiver satisfies the court that the mandate has been completed.

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[48] As is the case with standard initial orders made for use in proceedings under the CCAA, the standard receivership order does not mean that the court will necessarily accept all of the provisions referred to in the order, but rather that the court is familiar with the provisions, which saves time by avoiding a necessity to explain each individual provision of the order and allowing the attorneys and the judge seized with the supervision of the proceedings to focus on important concerns and deviations from the model order.

[49] Section 243 BIA: the receiver is appointed in respect of an insolvent person.

6. Receiverships - No Action against Receivers without Leave of Court

Stakeholders are invited to provide input as to whether it is appropriate to amend the insolvency legislation to require leave of the court before taking any action against a receiver.

There is no public policy reason why a receiver should be treated differently from an interim receiver or a trustee, if the receiver is court appointed.

Given that the threshold chosen to decide whether proceedings can be taken against a trustee or receiver is based on the *Mancini (trustee of) vs. Falconi* case[50], the bar to authorize proceedings is set very low, so from my perspective it would not be very difficult to apply the same standard as well to all receivers, including a privately appointed receiver.

7. Marshalling of Charges

Stakeholders are invited to provide input as to whether it would be appropriate to amend the insolvency legislation to codify the doctrine of marshalling charges.

The discussion paper makes reference to marshalling as being an equitable concept that allows courts to arrange the assets of a debtor to ensure that all creditors are paid to the greatest extent possible. In view of the fact that insolvency distribution is a zero sum game, this is not the objective, since the marshalling results in some creditors being paid to the greatest extent possible, at the expense of ordinary unsecured creditors.

Notwithstanding the fact that unsecured creditors may be affected, I believe that in a lot of cases the secured creditors who may be affected by a prior ranking secured creditor's choices regarding the realization process, may be able to prevent the prior ranking creditor from enforcing is security over the commonly pledged assets, or delay the realization, or cause additional expenditures. As such, I believe that a statutorily defined marshalling process could help improve efficiency, and the concept is thus worthy of consideration.

I would point out as well that a marshalling process would be very useful to deal with statutorily created charges that affect all assets, without a manner to properly compensate the secured creditors that are affected by the statutory charge. Examples where this may occur are the payment of the Crown's deemed trust for unremitted payroll source deductions, the payment of employee claims under sections 81.3 and 81.4 BIA and the payment of claims related to a pension plan pursuant to sections 81.5 and 81.6 BIA.

8. Tax Issues

Without addressing any specific issue, the discussion paper is soliciting information regarding the nature of concerns and the extent to which such issues potentially affect insolvency proceedings. The points of interaction between the insolvency laws and the tax laws are so numerous that it would be difficult to come up with a comprehensive list and explanation of the issues. The principal issues that come to mind, however, are outlined below (in no particular order).

Please note that my comments are not limited to problems that arise from the application of the *Income Tax Act* ("**ITA**"),[51] but include problems that can surface in the application of the *Excise Tax Act*

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[50] *Re: Mancini (trustee of) vs. Falconi* 1993 CarswellOnt 1861 (C.A.).

[51] R.S.C. 1985, c. 1 (5th Suppl), as amended.

("**ETA**")[52], in provincial legislation such as the Quebec *Income Tax Act* ("**QITA**"),[53] the Quebec *Tax Administration Act* ("**QTAA**"),[54] the Quebec *Financial Administration Act* ("**QFAA**")[55] and the Quebec *Retail Sales Tax Act* ("**QRSTA**"),[56] in dealing with the Canada Revenue Agency ("**CRA**") and the Quebec Revenue Agency ("**QRA**"), both in the context of proceedings under the BIA or under the CCAA**.**

8.1. **Deemed period end:** This is a problem that affects primarily restructuring files, although there can be some impact on receivership files as well. The problem is primarily prevalent in dealing with federal tax laws and much less when dealing with provincial tax laws, in view of the decisions of the Federal Court of Appeal in *re Marchessault*[57] and the decisions of the Quebec Court of Appeal in *re: Bernier*.[58]

The problem surfaces in both income tax and sales tax matters. For commercial files, the problem is more significant in sales tax matters, given that generally speaking insolvent enterprises have little or no taxable income.[59]

The problem stems from the fact that while there is a deemed period end in tax laws in the event of bankruptcy[60] (and sometimes in the event of a receivership[61]), there is no equivalent provision that applies to the filing of a proposal under the BIA or of an application for an initial order under the CCAA.

The position taken by CRA (and that has been taken in the past by the QRA, although that position is now pretty moot given the decision in *re Bernier*) is that since there is no deemed period end, and since the tax position is calculated as of the date of the period end, the taxes (GST, HST or income taxes) that may pertain to pre-commencement transaction are in fact post-commencement obligations that must be paid in full.

CRA is prepared to ignore this official position in respect of income tax matters, and thus tolerate a treatment that allows for a settlement of the income taxes that pertain to pre-commencement taxable income, but this is conditional upon strict application of the provisions of CAIRP's Standard of Professional Practice ("**SPP**") no 03-1. The problem with that position is that the SPP is difficult or impossible to apply for a corporation, applies only to proceedings under the BIA, and addresses only claims arising from taxable income under the ITA and not from GST or HST under the ETA. Income taxes on taxable income are rarely a big concern for insolvent corporate debtors. The problem is more prevalent in respect of claims under the ETA and DAS arising out of the ITA.

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[52] R.S.C. 1985, c. E-15, as amended.

[53] R.S.Q. c. I-3, as amended.

[54] R.S.Q. c. A-6.002, as amended.

[55] R.S.Q. c. A-6.001, as amended.

[56] R.S.Q. c. T-0.1, as amended.

[57] *Marchessault v. R.*, 2007 CarswellNat 5447 (F.C.A.)

[58] *Re: Bernier, Le Sous Ministre du Revenu du Québec v. Leblond Buzetti & Associés Inc.*, 2000 CarswellQue 375 (Q.C.A.)

[59] Note however that the income tax problem is significant for individual debtors, as they generally have taxable income notwithstanding the fact that they may be insolvent.

[60] See for instance s. 128(1)(d) ITA and s. 265 ETA

[61] See for instance s. 266 of the ETA.

8.2. **Claims made under s. 296(1)(b) ETA and s. 25 of the QTAA:** This is a problem that affects all files, whether restructuring, bankruptcy or receivership, but the problem is more serious in a restructuring file.

The dynamics and reasons for these types of claims are explained in my article written for IIC.[62] The article is attached as Appendix D for ease of reference. Essentially, CRA and QRA assess the debtor for the taxes due in respect of its purchases of goods and services on the basis of the debtor being a consumer of the goods and services.[63] This effectively duplicates the tax on the purchases, since the accounts payable of the debtor include a tax component. This effectively results in CRA and QRA benefitting from a duplicative claim, since they benefit from the claim formulated against the debtor under s. 296(1)(b) ETA and s. 25 QTAA, as well as benefitting from the claim made through the suppliers who are the agents of the Crown for the purposes of collecting the GST/HST/QST.

CRA and QRA use the newly created duplicative claim made using the provisions of s. 296(1)(b) ETA and s. 25 QTAA to set off amounts that would otherwise be due to the debtor, and/or to collect more money on distributions through the duplicative claim.

CRA and QRA will assert that they can adjust the assessment made under s. 296(1)(b) ETA and s. 25 QTAA such that they cannot collect more than 100% of the amount that would be due to the Crown through the suppliers (their agents), once all distributions are known, however this implies such a tedious reconciliation process that recovery is pretty much illusory, and presupposes that the Crown has been repaid in full, contrary to the equal treatment principles of the insolvency legislation. Unless and until all creditors are paid in full (and the reconciliation is properly performed), the Crown receives a higher distribution than other ordinary unsecured creditors on account of its claims for GST and QST, as it is receiving a dividend through the suppliers (agents of the Crown for purposes of the GST/HST/QST) and through its own claims made pursuant to section 296(1)(b) ETA and section 25 QTAA.

8.3. **Set-off of claims:** This is a problem that affects all files, but is more serious in a restructuring file. The problem is more prevalent in personal insolvency files, as is illustrated by the class action that was authorized this year against QRA,[64] but is also an issue in commercial files.

Essentially, the problem stems from the setoff of pre-commencement amounts payable with post-commencement refunds due to the debtor,[65] which is a problem as it affects the cash flow of the debtor in a period where cash resources preservation is of key importance, and it offends the equal treatment principles of the insolvency legislation.

Set-off is a problem in and of itself, independent of tax issues, as set-off of pre-commencement debts with post commencement amounts due to the debtor is problematic in every circumstance in a restructuring file. However, the set-off issue is more acute when dealing with tax claims, since the debtor could always limit the opportunity for pre/post set-off in normal on-going business transactions by choosing to enter or not enter into an agreement with a customer who is also a supplier, but the debtor can never make this decision as regards the government.

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[62] *Crown claims in Insolvency Proceedings, Die Unendliche Geschichte* (2009) 24 B.F.L.R. at 193.

[63] See policy statement P-112R, issued in March 2000 by CRA in connection with the application of the ETA.

[64] *Brisebois v. Agence du Revenu du Québec*, 2014 QCCS 83. The class action has since been settled.

[65] A setoff could also be operated between a pre-commencement amount payable with a pre-commencement refund due to the debtor, but that is not an issue.

8.4. **Extended set off of claims:** This is a problem that affects all files. Simply put, this problem arises from the application of s. 30.1 of the QTAA and s. 33 to 36 of the QFAA, and relates to the ability of the Quebec government to order that an amount that would otherwise be due by a school commission, a college (CEGEP), a hospital or CLSC, Hydro Quebec or other like public enterprise who is subject to oversight through the QFAA, be paid to the government instead of being remitted to the debtor, to set off an amount that is due to the government.

8.5. **Garnishment rights:** A strange result arises out of the decision of the Supreme Court of Canada ("**SCC**") in *re: Banque Toronto Dominion*,[66] in which the SCC 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 contemplated by s. 317 ETA, provided of course that the garnishment notice has been served onto the account debtor before the filing of the notice of intention.

It has always been my belief that in view of the combined effect of s. 224(1.2) ITA and s. 69(1) BIA (or s. 11.09(1) CCAA), an enhanced garnishment issued under the ITA would become suspended when a restructuring proceeding is initiated, provided that the requirements of s. 69 BIA (or 11.09 CCAA) are met (i.e., the secured creditors do not have the right to enforce their security against accounts receivable, post-commencement amounts are not in arrears, etc.). The judgment of the SCC in *re: Banque Toronto Dominion* effectively puts claims made under the ETA in a better position than the sacrosanct claims for DAS, which is nonsensical. This issue would need to be clarified or corrected.

8.6. **Determination of tax claims:** There are several issues that come under this caption, all of which affect all types of files. The issues include:

8.6.1. The exclusive jurisdiction of the Federal Tax Court to deal with the determination of a tax claim.[67]

8.6.2. The presumed validity of an assessment issued by CRA or QRA, unless and until it is contested in the manner provided in the tax laws.[68]

8.6.3. The use of an arbitrary provisional assessment to estimate a claim against a debtor.[69]

8.6.4. The necessity to contest an assessment within the deadlines mentioned in the tax laws, failing which the debtor or trustee is precluded from contesting an assessment.[70]

These issues are also discussed in my article written for the IIC.[71]

The problem stems from the tax statutes and the *Tax Court of Canada Act*, and the jurisprudence that supports the principle that the tax laws provide a comprehensive statutory scheme for relief.[72]

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[66] *Banque Toronto Dominion v. R*, 2012 CarswellNat 8 (SCC) and 2010 CarswellNat 2936 (F.C.A.).

[67] *Tax Court of Canada Act*, R.S.C. 1985, c. T-2.

[68] Section 299(3) ETA, s. 152(8) ITA.

[69] *Re: 2713250 Canada Inc.*, 2011 CarswellQue 12732 (C.S.Q.).

[70] Section 165 ITA, sections 301 and 302 ETA.

[71] See note 62 above.

The difficulty is that while it is true that the fiscal laws may provide a comprehensive statutory scheme for relief, there is an implicit contradiction between the manner in which the insolvency laws deal with the admission and contestation of claims, and the manner in which the tax laws deal with the same issue, and the contradiction is irreconcilable and leads to strange results, with the court sometimes allowing a trustee to ignore a claim filed by the Crown on the basis that is it is contingent, unliquidated or not properly determined[73] (usually in a case of perceived miscarriage of justice[74]), and sometimes indicating that it has no jurisdiction to give relief in a case where a claim is thought to be incorrect.

The fiscal laws may provide a comprehensive scheme for statutory relief, but this scheme is not well suited for insolvency situations, as it does not provide for an expeditious resolution of the claims, it requires the assessments to be paid before they can be contested, and it forces the insolvency professional or the debtor to take proceedings on a schedule that may be inopportune, for fear of losing rights. At the time of the trustee's appointment, the appeal period may have expired or be about to expire. If the appeal period has expired, it is unfair that a claim should be admitted solely because the insolvent person did not have the resources to dispute the claim. If the appeal period has not yet expired, the trustee may not have enough of the remaining delay to properly evaluate the merit of opposing the assessment, both in terms of the substantive reasons why the assessment may be incorrect, and the practical reasons (i.e. there is no purpose in appealing an assessment if the ultimate dividend will be nil).

Also, because of the fact that the exclusivity of the jurisdiction to hear tax appeals resides in a federal law, the *Tax Court of Canada Act*, the treatment of the claims of a Crown in right of a province for amounts due under fiscal laws may very well be different from the treatment of an essentially identical claim of the Crown in right of Canada, which is a nonsense.

8.7. **Delays in filing tax claims:** It may be useful to have a way to compel the government to file its claims, as the normal delays under the tax laws may unduly postpone the administration of certain files and the distribution of funds.

8.8. **Statutory deemed trusts:** This issue affects all files, although the problem seems more acute for restructuring files under the CCAA.

The issue of statutory deemed trusts may seem like a moot point since the changes made to sections 67(2) and 67(3) BIA and section 37 CCAA, in particular since the SCC clarified the last significant question mark through the judgement rendered in *re Ted Leroy Trucking Ltd*.[75]

However, if the decision of the SCC seems to have definitively closed the door on statutory deemed trusts in favor of the Crown, the language of s. 67 BIA and s. 37 CCAA is not sufficient to definitively deal with statutory deemed trusts, as the language restricts their application to statutory deemed trusts in favour of the Crown. While this does not seem to be a problem in BIA files because of the existence of s. 136 BIA, it seems to still be an issue in CCAA files, as is

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72 *Re: Jones*, 2012 CarswellBC 2339 (BCSC); *Taylor Ventures Ltd. (Trustee of) v. Canada (Attorney General)*, 2005 CarswellBC 2289 (B.C.S.C.). See also *Re: Roper v. R.*, 2000 CarswellNat 1064 (T.C.C.).

73 *Re: 2713250 Canada Inc.*, 2011 CarswellQue 12732 (C.S.Q.).

74 *Re: EnerNorth Industries Inc.*, 2009 CarswellOnt 3886 (O.C.A.).

75 *Re: Ted Leroy Trucking [Century Services] Ltd.*, 2010 CarswellBC 3419 (SCC).

illustrated by the decision of the Quebec Superior Court in *re: Timminco*,[76] and the decision of the Ontario Court of Appeal in *re: Indalex*.[77]

This is not strictly a tax issue, because by definition the tax problems are dealt with in s. 67 BIA and s. 37 CCAA, but it is closely related, and there should be a way to deal definitively with statutory trusts in favor of whomever (employees under the Ontario *Employment Standards Act*, pension plans, etc.), if the trusts would not be a real trust in the absence of the deeming provision.

8.9. **Claims in proposals or plans of arrangement:** The legislator made it clear since 1992 that the amounts withheld and not remitted from salaries paid should be considered as a sort of a sacred trust that should be well protected in the event of bankruptcy and receivership. That protection takes the form of a deemed trust that is protected through clear language in all of the BIA, CCAA and ITA. However the legislator decided at the same time that the restructuring objective of the insolvency laws is also an important principle that must take precedence, and accordingly the legislator has provided that the deemed trust of the Crown and the garnishment rights do not apply while a debtor is attempting to restructure under the BIA or CCAA, as long as the debtor is respecting its obligations to make remittances for the period subsequent to the commencement of the proceedings, and that the secured creditors who would have rights against the accounts receivable are not enforcing those rights. The deemed trust claim and garnishment rights in this situation is replaced by an obligation to remit amounts to the Crown within 6 months of the date of ratification of the proposal or plan (unless the Crown agrees to a longer delay)[78].

These provisions are fair and sound, inasmuch as the principles that are sought to be preserved are the social responsibility associated with making remittances of amounts withheld from the employees' salaries and promoting the restructuring of viable enterprises.

What is strange however is that in implementing the provisions, the amount that is sought to be paid at the expiry of the 6 month delay is not the amount which is considered should benefit from a higher priority because of the social responsibility aspect of the debt, but rather an amount that includes both the statutory deemed trust for unremitted source deductions, employer portion of levies under the *Employment Insurance Act*,[79] employer portion of levies under the *Canada Pension Plan*,[80] and interest and penalties on unremitted amounts for all of the above. The obligation to pay entirely the employer portion of levies together with the interest and penalties creates an inequity, as the Crown is thus entitled to receive payment in full on these specific debts, even though they are ordinary unsecured debts,[81] while other ordinary unsecured creditors receive less than their entire claim as a distribution.

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[76] *Re: Timminco Ltée*, 2014 CarswellQue 384 (Q.S.C.).

[77] *Re: Indalex Ltd.*, 2011 CarswellOnt 2458 (O.C.A.).

[78] Section 60(1.1) BIA and section 6(3) CCAA.

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

[80] R.S.C. 1985, c. C-8, as amended. Note that the amount required to be paid would also include the employer (and employee) portion of the levies under the *Quebec Pension Plan*, R.S.Q. c. R-9.

[81] Section 86 BIA and section 38 CCAA. These sections indicate that the claims of the Crown are ordinary unsecured claims, subject to the exceptions mentioned therein. One of the exception is the rights under section 224(1.2) ITA, together with provisions of the EIA and CPP that refer to section 224(1.2) ITA and provisions of provincial fiscal laws that are substantially similar. In view of the fact that section 224(1.2) ITA refers to a garnishment right that purports to create an ownership interest for the Crown after the garnishment notice has been given, the related claim of the Crown represents an ordinary unsecured claim, unless and until a notice has been issued under section 224(1.2) ITA (or section 15 of the QTAA).

As well, the provisions regarding the payment in full of claims as a precondition of the ratification of a proposal or a plan do not address the fact that the right under section 224(1.2) ITA is strictly a garnishment right that can be exercised if there are accounts receivable, although the provision is applied at large, whether or not the debtor has accounts receivable or collectible accounts receivable. In certain instances (for example, if the debtor is a retailer), the debtor may not have accounts receivable, or the accounts receivable may not be collectible or may not be sufficient to cover the claim for payroll deductions withheld at source, employer's portion of levies, interest and penalties. In these circumstances, it is difficult to find any justification for the requirement to pay in full the source deductions, levies, interest and penalties as a precondition to the approval of a proposal or plan by the court. The issue of the reference to section 224(1.2) ITA within the text of section 60(1.1) BIA and 6(3) CCAA should be reviewed, to consider changing same to a reference to the deemed trust provisions found at section 227(4) and 227(4.1) ITA (and provincial equivalent at section 20 QTAA).

8.10. **Necessity for filing returns:** There is a wide range of views on who is responsible for filing returns and for what period, which might warrant clarification. For example, the BIA indicates that the trustee is not responsible to file returns that the bankrupt was responsible to file more than one year before the commencement of the year in which the person became bankrupt[82], however the ITA and ETA suggest that there is no such limitation for prior years' returns.[83]

As well, there is no exemption for the obligation to file returns for a receiver, for instance, while the receiver should be in the same position as a trustee.

The fiscal laws have provisions that preclude the possibility of obtaining refunds due to the debtor or bankrupt, unless all returns have been filed.[84] While it may be entirely reasonable to require that all pre-bankruptcy returns be filed before issuing a pre-bankruptcy refund, the requirement to file post-bankruptcy returns in order to obtain the pre-bankruptcy refunds is overly cumbersome.

8.11. **Final tax returns:** In addition to the problem relating to who is responsible to file returns for what period, there is an inherent difficulty with the necessity to file a final return after a final distribution has taken place. While a provision may have been made to cover the professional fees relating to the preparation of the returns, it is impossible to forecast what queries, investigation or audit CRA or QRA may wish to do in connection with a final return, at a time when the resources to pay professionals to help in this process no longer exist. As well, if the final return is filed after the final distribution is made or contemporaneously therewith, there would likely be no resource with which to pay an assessed amount in any event. Conversely, the requirement to file a final return and await the expiry of the assessment, reassessment and appeal periods before making a final distribution may lead to long delays before a final distribution can be made, and the possibility that as a result of these delays, another return may have to be filed.

8.12. **Clearance certificates:** It has been my experience that clearance certificates are difficult to obtain and delays can be significant, even if returns are properly filed, and the necessity to obtain certificates can hinder or delay administration of estates and distributions of proceeds, in view of the potential liability issue of distributing amounts without obtaining a certificate prior thereto.

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[82] Section 22 BIA.

[83] Section 150(3) ITA and section 265 ETA. Similar obligations exist under provincial fiscal laws.

[84] Section 164(2.01) ITA, sections 229(2) and 230(2) ETA, sections 30.1 and 30.3 QTAA.

It is totally unclear whether a monitor distributing proceeds in the context of a plan under the CCAA would be required to obtain a clearance certificate, however the statutory provision appears fairly wide and might encompass a monitor, or even a notary distributing proceeds from the same of an immovable, or an attorney distributing trust funds arising from the sale of a business. While the objective of ensuring that people distributing funds enquire as to the status of unpaid taxes prior to distribution is laudable, there does not seem to be any significant policy reason why an officer of the court distributing funds under authority of a court order should be in a position different from another officer of the court distributing funds. As such, it seems to me that the exemption from obtaining clearance certificates should apply to trustees, receivers, and monitors, provided their mandate compels them to notify creditors.

8.13. **Settlement of debt:** An interpretation bulleting of Revenue Canada states that in a restructuring proceeding, the gain on settlement of debt occurs when the last payment is made. This seems to be premised upon the provisions of s. 122 BIA, which effectively "revives" claims in a proposal, in the event the proposal is not completed and the debtor becomes bankrupt. This interpretation seems sound in respect of proceedings under the BIA, but since there is no equivalent to s. 122 BIA in the CCAA, I am not sure that the interpretation bulleting is correct on that point, and it seems to me that the CCAA plan should be capable of defining when the settlement occurs (and it will usually be upon emergence or implementation of the plan, rather than on completion). I am not sure this is an issue for legislative review, however.

8.14. **Fresh start:** There is a possibility (albeit remote) for the gain on settlement of debt to create taxable income in the period subsequent to the commencement of the proceedings, and the obligation to pay taxes at that time could conceivably affect the ability of the debtor to continue in business, which is counterproductive to the fresh start objective of the insolvency legislation. The insolvency process should enable the insolvent debtor to emerge free from debts attributable to the pre-commencement period, and that would include income taxes on the gain on the settlement of debt.

TECHNICAL ISSUES

Bankruptcy and Insolvency Act

1. Section 197 - Costs Against the Debtor

Submissions are invited as to whether subsection 197(6.1) should be amended to permit costs to be awarded against the debtor.

The court should have latitude to order costs where there is a perception of abuse. However, given that the right to receive a discharge subject to reasonable conditions is an underlying principle of our insolvency laws, an order of costs against the debtor should be made only where there is clear abuse, and an order of costs against creditors who oppose should also be a possibility if the opposition is abusive.

2. Section 204.3 – Losses Due to Bankruptcy Offences

Submissions are invited as to whether s.204.3 should be broadened to capture all losses resulting from the BIA offence.

I don't have a great deal of sympathy for people who would be convicted of an offence under the BIA. There is an on-going perception that the incidence of fraud is increasing and the mere perception of improprieties can affect confidence in the credit system, which is a much needed cogwheel in the economy.

To the extent that it is believed that such a change could have a deterrent effect, I believe the change is worthy of consideration.

3. Disallowance of Claims

Submissions are invited as to whether it is appropriate to provide the court with the authority to extend the period for appealing the disallowance of a claim.

There needs to be finality in the process. The court can order an extension of the 30 day delay in appropriate circumstances, but only where the request is made within 30 days. There should be no reason why the creditor cannot formulate a request for an extension, with reasons, in 30 days. There is no need for a change.

However, I refer you as well to my comments made earlier in this document, regarding desirable changes to the process of admission and contestation of claims, and appeals, in both the BIA and CCAA.[85]

4. Securities Firms Bankruptcies

Submissions are invited as to whether securities regulators or customer compensation bodies should be able to apply for a bankruptcy order.

I do not understand the concern, as I thought that section 256 BIA was sufficient to address this particular concern. Section 256(1)(a) BIA allows a securities commission to make an application for a bankruptcy order, without the need for the commission to have to prove a debt of $1,000 or more, if the securities broker committed an act of bankruptcy or if the broker's right to sell securities was suspended, or if the broker's membership was suspended, for failure to meet a capital requirement. As well, section 256(1)(c) BIA provides the same opportunity to a customer compensation body, in the same circumstances.[86]

5. Preview of Proposals by the Trustee

Submissions are invited as to whether proposal trustees should be provided with a mechanism to preview the size and complexity of a BIA proposal file before they accept it.

Right up front, I have to point out it would be difficult for any trustee to argue against this possibility, given its attractiveness from a business risk perspective.

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[85] See section 3 at page 12.

[86] Section 256(2) BIA.

The discussion document refers to a suggestion that the trustee should have the right to examine the size and complexity of a BIA proposal file before accepting an engagement. The problem is not the size or complexity of the BIA proposal, it is the depth of the financial difficulties, and the level of uncertainty regarding the assets that would be available to fulfill the proposal or pay costs in a bankruptcy, due to the multiplicity of priority and superpriority claims and the increased administrative work demanded of the trustee (such as work under WEPPA and tax legislation).

The problem is not related to the proposal itself, but rather to the business risk that automatically arises if the proposal is unsuccessful and the debtor becomes bankrupt, due to the deemed assignment provisions of the BIA.

While the possibility of "backing out" of a high risk engagement is certainly an attractive feature that should be researched further, due consideration has to be given to the implementation problems that are likely to be associated with such a provision. From my perspective, since the problem is not the proposal itself but the possible subsequent bankruptcy at a time where the assets are insufficient to cover the costs, the implementation of the provision would most likely involve removing the automatic deemed assignment in the event that the proposal is unsuccessful, to give an opportunity for the trustee to resign in view of the fact that the financial situation is worse than expected. The removal of the automatic deemed assignment removes an important feature of the proposal process under the BIA, as a debtor who does not have a threat of drastic consequences might not "put its best foot forward" in the negotiation process, with all due disclosure and transparency, which could be counterproductive to the restructuring process.

6. Section 173 - Facts for which Discharge will be Suspended

Stakeholders are invited to make submissions regarding whether the list of facts for which a bankrupt's discharge will be refused, suspended or granted conditionally needs to be updated.

Without guidance as to how the assets and liabilities are to be valued and calculated, the requirement that the assets be of a value of at least 50% of unsecured liabilities appears outdated and near impossible to reach, if the amount is calculated to be total assets less secured claims, divided by unsecured liabilities, in view of the increasing presence of secured claims. I believe this test, which also applies to proposals in virtue of section 59(3) BIA,[87] is almost never met, and the requirement is largely ignored by the court and practitioners.

In view of the above, I consider that the facts in s. 173 BIA should be reviewed and brought up to date.

7. Treatment of RRSPs in Bankruptcy

Stakeholders are invited to make submissions regarding the treatment of RRSPs in bankruptcy and potential mechanisms to protect the integrity of the insolvency regime.

I see no reason why the funds invested by bankrupts in RRSPs should be subject to tighter restrictions than for the rest of the population. Circumstances change, and sometimes access to the funds is necessary. The former bankrupts should not be put in a position where all flexibility is removed because of a perceived possibility of abuse, which in any event would have to be planned 1 year in advance.

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[87] In virtue of section 59(3) BIA, if any of the facts provided in section 173 BIA are proved, the court cannot ratify the proposal, unless if provides reasonable security for the payment of no less than 50% of the claims of unsecured creditors, or such other percentage that the court considers advisable.

If there is a perception of abuse with the provisions that were implemented regarding the designation of RRSPs as exempt property, I suggest the concern would be better addressed by ensuring that the funds cannot be sheltered in contemplation of bankruptcy, if they are to be considered as exempt property. This could be accomplished by limiting the exempt property to any amount that was accumulated in RRSPs in compliance with tax laws in a period that extends beyond 5 years before the bankruptcy, plus the lower of actual amount contributed and maximum amount allowable based on the income earned in each of the 5 years preceding the bankruptcy, plus all income accrued thereon in the RRSPs.

It should be noted however that this provision, which would ensure that the objective is met of encouraging debtors to make prudent budgeting decisions to set aside funds for their retirement, would not in itself limit the possibility of abuse, since it would always be possible for a debtor to shelter the funds in an insurance product such as a single premium whole life policy, that could be exempt from seizure under provincial laws.[88] To deal definitively with the perception of abuse in RRSPs, it would be necessary to have a single code to define what is or is not exempt property, which would apply notwithstanding provincial legislation dealing with exemptions from seizure.

8. Secured Creditors Calling Proposal Meetings

Stakeholders are invited to make submissions regarding the basis upon which a meeting of creditors may be called in the case of a consumer proposal.

I think the issue is not only who can cause a meeting of creditors to be called, but also who may vote in respect of the consumer proposal. The issue of a right to vote is far more important in my view than the issue of in what circumstances a meeting can be called, as in my view there is little harm that can result from creating more opportunities for a meeting to be held. Creditors who are interested in the process should express their intentions - this should happen whether or not a meeting is called. If the concern is that provoking the holding of a meeting of creditors can decrease the chances of success of the proposal because there is more of an opportunity for creditors who disagree to cause the proposal to fail, we can question whether it is appropriate in the proposal process to give a higher weight to persons who are disinterested in the process than to the people who have a genuine interest.

Regarding the issue of the right to vote of secured creditors, there is conflicting jurisprudence on the issue,[89] and I believe the provision should thus be clarified.

From my perspective, the decision on the proposal should be made only by the unsecured creditors and the secured creditors who are voting the unsecured portion of their claim (i.e. a declared unsecured claim that will be settled, compromised and will disappear in the context of the proposal). To the extent a creditor is unaffected by a consumer proposal, he/she should not be entitled to vote. This interpretation is not inconsistent with the provisions of the BIA, although the courts in certain jurisdictions have allowed secure creditors to vote their entire claim, secured and unsecured.[90]

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[88] *Re: Ramgotra*, 1996 CarswellSask 418 (SCC) affirming 1994 CarswellSask 22 (C.A.).

[89] *Re: Schryburt*, 2011 CarswellOnt 881 (S.C.) and *re: Fournier (Proposition of)*, 2012 CarswellQue 6856 (S.C.).

[90] *Re: Fournier (Proposition of)*, 2012 CarswellQue 6856 (S.C.).

OTHER UNADDRESSED ISSUES

There are some topics I feel require some consideration in the context of a revision of the insolvency laws, which are not addressed in the discussion paper circulated by Industry Canada. Some of these issues have been addressed or alluded to as part of my comments above. The more significant of these additional issues, from my perspective, are outlined below:

1. **Right of set-off or compensation:** The right to claim and apply set-off should stop at the date of bankruptcy, notice of intention to make a proposal, proposal, receivership or initial order, except with leave of the court. Leave of the court would be required to allow a setoff or compensation in a situation where a fundamental inequity would result if the right of set-off is forbidden, such as a situation where the claims that are to be set off are so closely connected that denying a set off would yield an injustice. An example of this would be setting off a payment obligation for the purchase of durable goods with a warranty obligation.

2. **Harmonization of CCAA and BIA:** While there is no reason for the two statutes to be identical or even to merge the two statutes (as mentioned earlier in this text at page 36), there should be a high degree of harmonization between the rules applicable for each of the statutes, to enhance predictability and transparency. A part of the discussion paper addresses changes that might be required to the CCAA, while I believe that in most of the situations, the changes should apply equally to the provisions of the BIA.

3. **Critical supplier:** There is one particular topic where there presently is a marked difference between the provisions of the BIA and CCAA, namely the issue of the critical supplier provisions of the CCAA,[91] which have not been introduced in the BIA when the last amendments were implemented in September 2009. I can think of no reason why the critical supplier provision should not exist in the BIA, if they are considered to be a useful component of the restructuring process under the CCAA. I would suggest however that the key supplier provisions be revised in both statutes, as the jurisprudence seems to have interpreted the provisions as being a codification of the practice that had evolved through the use of the court's judicial discretion before 2009,[92] while it is my understanding that is not what the legislator had contemplated. It was my understanding that section 11.4 CCAA is intended to be a provision to compel a critical supplier to deliver goods or services to the insolvent debtor, on such terms as the court considers advisable, even on credit, without a need to pay arrears, provided that if the order of the court requires the critical supplier to deliver on credit, the court must order a charge to protect the critical supplier's unpaid account exposure.

   I do not suggest that a critical supplier should never be paid its arrears, as I can imagine situations where this may be required, but these situations should be an exception that rarely arises in practice, so that the critical supplier provisions do not become a means to exempt suppliers from the impact of a restructuring and thus leave the providers of funds be the only parties affected by the restructuring. A situation where a payment of the arrears might be warranted could include, for instance, a situation where the critical supplier, being intrinsically key to the debtor's business, is in such a precarious financial position itself that a failure to pay the arrears would cause it to become bankrupt and thus prevent him from continuing deliveries. Another situation would be where the supplier is in a foreign jurisdiction, and because of practical issues it is not possible to start a concurrent foreign proceeding to have the initial order

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[91] Section 11.4 CCAA.

[92] *Re: Canwest Global Communications Corp*, 2009 CarswellOnt 6184 (S.C.) at paragraph 41.

recognized in the foreign jurisdiction, perhaps because the cost to do so would be out of proportion with the payment sought by the foreign supplier.

In these instances, a payment of the arrears would be warranted, and as a result the discretion to pay arrears when proper circumstances arise should be maintained (in both the BIA and CCAA), however these are practical reasons to pay arrears, distinct from the critical supplier issue referred to in section 11.4 CCAA. As such, I believe that the critical supplier provisions should be imported in the BIA, and the provisions should be clarified in both the BIA and CCAA to avoid the payment of arrears, save for exceptional circumstances.

4. **Claims process:** This issue was addressed in part in the context of the discussion on the CCAA claims process, at page 12 above. There are several issues relating to the claims process under the BIA and CCAA, some of which pertain to a lack of harmonization between the statutes.

The CCAA provides that a claim may be admitted for purposes of voting, without prejudice to the right to contest the claim at a later date, for any other purpose, such as in the context of a distribution under a plan. This provision is quite useful, as it would allow the debtor company and/or monitor (if the monitor is given this power in the context of the claims process order) to allow a claim for voting purposes, if the claim relates to damages sustained by a co-contracting party as a result of the disclaimer or resiliation of a contract.[93]

There is no equivalent provision in the BIA. Rather, the claim arising from a disclaimed contract would most likely constitute a contingent or unliquidated claim in most circumstances. In virtue of the BIA, a contingent or unliquidated claim is not a provable claim until it <u>after</u> the trustee has determined it to be a claim <u>and</u> has valued it.[94] There is no provision in the BIA for a preliminary valuation – the only process is that contemplated in section 135 BIA which requires a decision, the communication of this decision in writing, and finality in the process unless the creditor appeals the decision.[95] Some people argue that the co-contracting party could be entitled to vote at a meeting of creditors in virtue of the provisions dealing with procedures at meeting, which allow the person who chairs the meeting to admit a claim in whole or in part for purposes of voting,[96] however in my view this practice is incorrect, as the chair is not necessarily the trustee (and if the chair is the trustee, he is not acting in that capacity in any event), and the discretion given to the chair is only inasmuch as the claim is a provable claim to begin with.[97] In my view, there is presently an inherent, irreconcilable contradiction in the provisions of the BIA, as the provisions dealing with the resiliation of agreements specifically state that the co-contracting party shall have a claim provable for the amount of the damages sustained by reason of the disclaimer,[98] while the BIA provides elsewhere that a contingent or unliquidated claim is not provable unless the trustee determines that it is a claim provable and values it.[99]

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93 Section 32 CCAA.

94 Section 135(1.1) BIA.

95 Section 135 BIA.

96 Section 108(1) BIA.

97 Section 106(1) and section 109(1) BIA specify that the creditors in attendance at a meeting, to form quorum and to vote thereat, must be creditors entitled to vote, and section 109(1) BIA further specifies that the right to vote arises only when a claim provable in bankruptcy has been proven. In virtue of section 135(1.1) BIA, this cannot occur until after the trustee has determined the claim to be provable and has valued it.

98 Section 65.11(8) BIA and section 32(7) CCAA.

99 Section 135(1.1) BIA.

The entire treatment of contingent or unliquidated claims is problematic, as the chair of a meeting may not always be able to appreciate from the claim whether it is contingent/unliquidated or not, if it is the object of a legal proceeding, which could lead to the possibility of denying a right to vote to a creditor who does not have in fact a contingent or unliquidated claim. As well, the issue of the contingent or unliquidated claim may cause difficulties in assessing whether the debtor has reached the threshold to be able to access the relief available under the CCAA,[100] or whether a creditor is able to apply for a bankruptcy order.

On the other hand, it is important to note that contingent or unliquidated claims need to be treated differently from other "run of the mill" trade claims, as they tend to arise from litigation, and the litigants may have an agenda that is vastly different from the best interest of the creditors in mind when voting, either because of an improper purpose such as unfairly eliminating competition, or because of basic human sentiments such as anger, revenge or spite due to the litigation itself. This does not mean that the creditor should not be entitled to vote, but rather that his motives in voting should be held to a higher degree of scrutiny.

In view of the above, I would suggest that in both the BIA and CCAA, contingent or unliquidated claims be redefined to be putative provable claims, which are subject to a preliminary valuation for purposes of voting, defining access to the relief provided under the CCAA[101] or making an application for a bankruptcy order.[102] The right to vote should also be subject to a further test, similar to the one that exists in respect of the claims of persons who have dealt with the insolvent person other than at arm's length,[103] namely that the vote should be computed both taking into consideration the claim of the creditor with a contingent or unliquidated claim and, if the claim determines the issue of the vote, without taking into consideration the claim, and the official vote would be the one determined without taking into consideration the claim of the creditor with a contingent or unliquidated claim, unless the court decides otherwise on a motion made within a few days of the meeting at which the vote was held.

5. **Changes in claims during a restructuring process:** The provisions of the BIA and CCAA aim at preserving a *status quo*, inasmuch as is possible, during the pendency of the notice of intention, from the time a proposal is filed until it is approved by the court, or from the time an initial order is made under the CCAA until a plan is approved by the court. This is accomplished primarily by allowing the creditors to demand that all post-commencement transactions be on a "cash on delivery" basis, by forbidding co-contracting parties from cancelling or amending agreements during the pendency of the proceedings solely for reason of the insolvency or non-payment of the debts, and requiring an on-going monitoring by the trustee or monitor. In certain cases, there is a departure from the *status quo*, where it is thought to be necessary to implement a viable plan or proposal (for example, by allowing the borrowing of funds and granting of security on a priority basis for interim financing).

   There are instances however where the rights of the creditors may be adversely affected, inadvertently. One such example is the claim of the landlord, who might see its claim modified substantially from a preferred claim for arrears and accelerated rent to an ordinary unsecured claim. If the lease is a commercial lease that is vacated in the context of a restructuring proceeding under the BIA or CCAA, and the restructuring proceeding is unsuccessful and the

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[100] *Re: MEI Computer Technology Group Inc.*, 2005 CarswellQue 4494 (S.C.).

[101] Section 3 CCAA.

[102] Section 43(1) BIA.

[103] Section 109(6) BIA.

debtor becomes bankrupt, then the landlord would not have a preferred claim because there would be no asset in the premises under lease at the date of the bankruptcy. In this situation, the landlord who would likely have had a preferred claim if the debtor had become bankrupt at the date of the notice of intention or initial order, would be an ordinary unsecured creditor solely because the assets were removed from the premises during the restructuring attempt.

This is an unfortunate consequence of the removal of the retroactive effect of the deemed assignment in the revisions made in 1997. Not to be misunderstood, I am not advocating a return to a retroactive bankruptcy effect. I would suggest however that some thought be given to preserving rights of creditors during the pendency of the proceedings, perhaps by establishing the date on which the rights of creditors are determined to be the date of the initial bankruptcy event, with an adjustment to the quantum of the claim for any "real" transaction that occurs between the initial bankruptcy event and the date of bankruptcy, such as the transactions that are permissible under section 97(1) BIA.

6. **Partnerships:** The comments addressing the suggested changes for partnerships were made earlier in this document, in the section titled "Joint debts", at page 9.

7. **Deemed trusts:** The comments addressing deemed trusts were made earlier in this document, in the section titled "Tax issues", at page 43, although that issue is not, strictly speaking, a tax issue since the legislation is now quite clear that deemed trusts in favour of the Crown are inapplicable in proceedings under the BIA or CCAA, except for the very specific deemed trusts for payroll source deductions under the ITA, EIA, CPP and the similar provisions in provincial laws. Section 67(2) BIA and section 37(1) CCAA work well to invalidate deemed trusts, but only where the beneficiary of the trust is the Crown. It leads to uncertainty, as demonstrated in the Indalex and Timminco decisions. The sections should be expanded to invalidate all deemed trusts or statutorily created trusts, except such that would be valid trusts in the absence of a deeming provision.

8. **Employee rights in proposals:** This topic was addressed or alluded to earlier in this text, in the 3 sections dealing with employee claims, under the caption "Enhancing equity", beginning on page 25. From my perspective, in addition to discussing ways to better protect the employees' claims in the event of bankruptcy and receivership (while being mindful of the possibility of a perverse effect on access to credit for employers), some more thought has to be given to the protections given to employees in a proposal or plan of arrangement context. For example:

   8.1. The requirement that the claims of employees that could be formulated under section 81.3 or 81.4 BIA be paid or provided for in the event of any sale outside the normal course of business, seems overreaching, as the assets sold may include assets that would not be encumbered by the security under section 81.3 or 81.4 BIA, and the provision restricts the debtor's access to cash that may be needed to carry out the restructuring.

   8.2. As well, the requirement that the employees' claims that could be made pursuant to section 136 BIA be paid concurrently or immediately after the approval by the court of a proposal or plan is unrealistic, as typically the claims that remain on the date of ratification relate to unpaid vacations, which should be taken in the normal course rather than paid up front. From my experience, this requirement is most often largely ignored.

   8.3. More importantly however, is the need to protect employees that have lost their employment as a result of a successful restructuring process, by expanding the provisions of the WEPPA to cover not only bankruptcies and receiverships., but also proposals and plans of

arrangements, where employees are unfortunately displaced in order to decrease costs and return operations to profitable levels.

9. **Environmental issues:** Clarification is required regarding when an environmental condition might be a monetary claim and when it may be a regulatory issue in an insolvency context, further to the *AbitibiBowater* decision.[104] From my perspective, the issue of whether the government intends to perform the environmental remedial work and claim it from the debtor, to determine whether the environmental condition is a "claim" or a problem that must be dealt with by the debtor by implementing and paying for a remedial plan, does not necessarily deal with the entire issue of what to do with a contaminated property in the context of a restructuring process. In view of the decision in *AbitibiBowater*, it is pretty obvious that every future decision and communication by the environmental regulatory authorities will be drafted as a requirement to perform remedial work and not as a threat of undertaking the work and charging it back to the debtor. What will likely result is litigation to address whether the requirement to perform remedial work is *bona fide*, or a disguised attempt to collect money from the debtor in full, as was the case in the AbitibiBowater litigation, were the court found that although the provincial environmental ministry had required the debtor to perform remedial work, there was no real expectation that this would be done, as the delays in which to undertake the remedial work were unrealistic and the debtor no longer had access to the properties.[105]

   It would seem to me that the issue of whether or not the environmental regulatory authority will undertake the work is not the best criterion to decide the outcome of the claim. If the environmental condition puts in danger the health and welfare of the local population, for instance, I would expect the environmental regulatory authority to demand that the remedial work be undertaken immediately, and if the debtor is unable (because of its financial circumstances) or unwilling to do so, the regulatory authority should be expected to step in and perform the remedial work that is necessary to protect the population. This action should not affect the right of recovery of the regulatory authority, as otherwise the regulator might be tempted (due to budgetary constraints) to delay an intervention, which would be deplorable.

   If the remedial work is undertaken by the regulatory authority, then a claim automatically exists in virtue of section 14.06 BIA or section 11.8 CCAA, and the claim is secured and encumbers the real property to which the damage relates, and any contiguous real property, whether the environmental condition arose before or after the commencement of proceedings under the BIA or CCAA. That is not an issue, although the BIA and CCAA should specify that the claim, to the extent of the security that secures it, is not susceptible to be compromised in any plan or proposal, unless the claimant specifically agrees.

   If the remedial work is not undertaken by the regulatory authority, this does not necessarily mean that the work must be undertaken or paid for in full by the debtor. It is possible for instance that the property has been disposed of before the proceedings commenced, and the claim of the regulatory authority is addressed jointly to all people who are or were owners of the property. In such a case, the current owner might have the ultimate responsibility to carry out the remedial work, and may have a claim against former owners of the property. To the extent that the claim of the current owner is addressed to the debtor, it should essentially be a contingent or unliquidated claim for the portion of the debtor's responsibility for the damage, and be subject to compromise with the other claims against the debtor.

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[104] *Re: AbitibiBowater Inc.*, 2012 CarswellQue 12490 (SCC).

[105] *Re: AbitibiBowater Inc.*, 2012 CarswellQue 12490 (SCC), at paragraphs 51 to 54.

From the above, it would appear to me that a better gauge of how to deal with an environmental claim might start with a determination of whether the property that is the object of the environmental problem is necessary in the context of the continuing activities of the debtor and is being kept. If the property is retained, then the debtor should be responsible for the whole of the remediation problem, whether the remedial work is undertaken by the debtor or the regulator. If the property is not retained (as was the case in *AbitibiBowater*, albeit apparently not due to the debtor's preference), then the only right would be to file a claim for the portion of the damages that were caused by the debtor in its operation of the property.

10. **Secured creditors' vote in consumer proposals:** The comments addressing secured creditors' votes in proposals were made earlier in this document, in the section titled "Secured creditors calling proposal meetings", at page 49.

CONCLUSION

By way of conclusion, I want to congratulate the personnel at the policy directorate of Industry Canada, for its work in preparing the submission document. The issues identified for feedback are certainly, from my perspective, the more relevant issues in dealing with the 5 year review process, and all of the issues identified require more thought and discussion amongst stakeholders, in order to achieve a further reform that will keep our insolvency laws relevant in the current economy. I can assure you that I would be happy to participate in such further discussions, if you wish.

Please do not hesitate to contact me if you have questions on the contents of this submission, or if you want to discuss same in greater detail.

Yours truly,

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