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

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1. INTRODUCTION

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

At this early stage of legislative review, the mandate of the JTF is to provide objective non-partisan comments on the various issues raised in Industry Canada's ("**IC**") discussion paper entitled "*Statutory Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*" (the "**Discussion Paper**") in the context of the public consultation process launched by IC in May 2014. The JTF's mandate also encompasses the identification of issues which may not be addressed in the Discussion Paper but which, in the JTF's view, should be considered in the next round of legislative reform of the Bankruptcy and Insolvency Act ("**BIA**")[1] and the Companies' Creditors Arrangement Act ("**CCAA**")[2].

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

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

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

2. EXECUTIVE SUMMARY

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

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1 RSC 1985, c. B-3, as amended.

2 RSC 1985, c. C-36, as amended.

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

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

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

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

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

JTF Comments

The treatment of intellectual property rights in the context of insolvency is, in the JTF's view, a very important topic which needs to be addressed in the next round of legislative reform. Existing provisions of the BIA regarding the rights of the holders of patents[3] and of copyrights[4] were adopted early in the twentieth century and are clearly outdated in a market place where intellectual property rights such as software licenses constitute assets of significant value.

Furthermore, although changes were made in the last round of reforms (the "**2009 Amendments**")[5] that seek to protect intellectual property licensees in the face of an insolvency of the licensor while maintaining the ability of the licensor to restructure or preserve value,[6] there has been some criticism of the provisions, as the protection they afford is thought to be scant, in particular considering that the acquisition and maintenance of the intellectual property by the licensee may be very expensive, and its continued accessibility, without restriction, may be crucial to the licensee's business.

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

The following section addresses various issues considered by the JTF to be worthy of consideration and further research in order to improve the treatment of intellectual property rights in a context of insolvency.

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3 Section 82 BIA.

4 Section 83 BIA.

5 *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts,* S.C. 2005, c 47 as amended and complemented by *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada*, 2005, S.C. 2007, c 36

6 Sections 65.11(7) and 84.1 BIA and sections 11.3 and 32(6) CCAA.

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

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

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

The Intellectual Property Owners Association[7] has recently adopted a resolution supporting the inclusion of trademarks, service marks and trade names in the definition of IP in the *American Bankruptcy Code*. Some recent US caselaw[8] has navigated around the existing exclusion of trade-marks in the United States. An examination and consideration of the American experience and jurisprudence in this regard may be a good starting point for considering how the definition of IP should be developed.

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

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

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

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

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

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

The JTF is of the view that the effectiveness of the 2009 Amendments with respect to the consequences of terminating contracts regarding the use of IP is worthy of consideration.

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7 https://www.ipo.org/index.php/advocacy/board-resolutions/2014-board-resolutions/

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3.1.4 IP rights of licensees upon the insolvency of a licensor

The 2009 Amendments were aimed at reducing uncertainty faced by IP licensees in an insolvency restructuring, in a manner similar to the protection afforded to licensees under the *US Bankruptcy Code*[9].

While the debtor can unilaterally disclaim most agreements under the CCAA and BIA, there is a carve-out which limits the consequences of such disclaimer when it relates to a contract for the "use" of IP (such as license agreements).[10].

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

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

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

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

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

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

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

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

9 See section 365(m) of the *US Bankruptcy Code*.

10 See section 32(6) CCAA and 65.11(7) BIA.

3.1.5 IP rights of licensors upon the insolvency of a licensee

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

Under existing provisions, the court may order an assignment of the license provided, *inter alia*, that the assignee will be able to perform the assigned obligations and, more broadly, provided that it is appropriate to allow such assignment[11].

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

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

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

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

3.1.6 Formal protection of trade-marks.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

3.2 Streamlining CCAA proceedings and Initial Orders

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

JTF Comments

The JTF is of the view that eventual legislative reform of CCAA should be mindful of measures to be adopted to increase the efficiency and reduce the costs involved in the restructuring process. In Canada and in other jurisdictions[12], it has indeed become evident that restructuring costs have become a source of preoccupation for creditors, debtor companies, practitioners and stakeholders in general.

The JTF believes that some research should be made to assess whether the current preoccupation of creditors, debtor companies, practitioners and stakeholders regarding excessive costs is a matter of real concern or of perception. Some have argued that restructuring costs, which are essentially transactional costs, are no higher and may even be lower than similar costs incurred in other transactional activities in the marketplace. They may appear to be higher because they are perceived to remove returns from creditors' claims rather than enhance value for stakeholders as a whole by preserving a going concern.[13] The practical principle-based approach and role of the monitor as court officer embodied in the CCAA statute does serve to facilitate what is generally a more efficient, less litigious and less costly restructuring process in Canada than in other jurisdictions such as the United States. Further, a number of initiatives have been put into practice by the restructuring profession with the objective of streamlining the CCAA process and keeping costs down. However, the JTF agrees that efforts have to continue to be made to improve efficiency and cost-effectiveness.

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

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

The JTF is of the view that restricting the breadth of initial order to "lights on" protection of the debtor company, limited both in scope and in time, could serve to postpone "out of the gate" litigation as to the breadth of the initial order sought by the debtor company. This

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

[13] 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. The authors quote studies by Stephen Lubben in the U.S.

approach would afford stakeholders necessary time to seek to resolve these issues through negotiations. This being said, limited automatic "lights on" protection should not unduly modify present practice in respect to the use of model initial orders which provide necessary flexibility as to the required degree of protection based upon the circumstances of each case, particularly in the most vulnerable situations where greater clarity to stakeholders and affected parties at the outset may be critically important.

3.3 Claims Process

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

JTF Comments

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

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

The JTF also notes that there is no clear rationale to justify existing differences between the treatment of claims in a BIA restructuring and the treatment of claims in a CCAA restructuring. It may thus be relevant to consider adopting or, *inter alia*, model proof of claim in CCAA similar to the model generally used under the BIA.[14]

3.4 Court Applications

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

JTF Comments

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

Measures to be considered in this regard include the following:

- implementing initial order mechanisms which provide for a short automatic stay period and "lights on" protection of the debtor company[15];

[14] See form 31 BIA.

[15] See Section 3.2 hereinabove.

- providing that renewal of CCAA protection be granted automatically where due prior notice has been given to creditors and relevant stakeholders and no objection has been filed;

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

Balancing competing interests

3.5 **Role of unsecured creditors**

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

JTF Comments

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

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

The existing legislative scheme under BIA and CCAA whereby the court may provide that the fees of certain professionals will be covered by a prior ranking charge[16] provides adequate judicial discretion and authority in this respect.

3.6 **Acting in Good Faith**

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

JTF Comments

As presently drafted, BIA and CCAA impose a duty to act in good faith upon the insolvent debtor[17], upon the trustee[18] and the monitor[19] but does not impose a broader duty to act in good faith upon all stakeholders involved in a restructuring process. It is perceived that

[16] See 11.52 CCAA and 64.2 BIA.

[17] Section 50.4(9) BIA and 11.02 CCAA.

[18] Section 50.4(5) BIA.

[19] Section 25 CCAA.

the codification of a duty to act in good faith could bolster the courts' authority to protect the integrity and efficiency of the insolvency system, without limiting the right of creditors to protect their own rights and interests in a restructuring process. While the JTF believes that the codification in the CCAA and in BIA of an overarching duty of stakeholders to act in good faith is worthy of consideration, eventual legislative reform should be mindful of not distorting common law or civil law principles or possibly creating fundamental divergences in the way BIA and CCAA process could be managed in Québec and in the rest of Canada. The JTF considers that additional research is warranted to assess differences existing between common law and civil law jurisdictions in this regard with a view to avoiding a legislative change that may result in creating undue legal uncertainty and differences in approach across Canada.

It should also be borne in mind that under CCAA, the court has very broad discretion to render any order it deems appropriate in the circumstances[20].. The CCAA court may thus adjudicate matters equitably without the formal codification of a duty of good faith.

3.7 **Eligible Financial Contracts**

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

JTF Comments

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

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

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

The current treatment of EFCs under the Canadian insolvency regime does not always strike a right balance between the objectives of protecting against systemic risk and allowing insolvent commercial enterprises to restructure. Current law may in some cases impede the restructuring of insolvent enterprises and prevent the insolvent estate from realizing value for its

[20] See section 11 CCAA.

creditors by placing too much emphasis on attempting to reduce systemic risk. Further, the safe harbours may delay or prevent certain liabilities of the insolvent estate from being crystallized.

The JTF believes that changes are warranted to provide a better balance between the systemic risk reduction objective and the insolvency objectives, i.e. promoting restructuring of insolvent debtors with an opportunity for a fresh start, avoiding bankruptcy, preserving value and providing predictability of results.

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

- Allowing the insolvent estate to terminate EFCs after the expiry of an appropriate period during which the solvent counterparty has the unilateral right to terminate EFCs;

- Allowing the insolvent estate or the court to assign EFCs while permitting the solvent counterparty to terminate the EFCs until the assignment occurs;

- Prohibiting or rendering ineffective walk-away clauses that reduce amounts owed under EFCs because of an insolvency;

- Increasing the priority of financial collateral posted in respect of collateral which is segregated from the insolvent's other assets;

- Protecting the central clearing of over-the-counter derivatives; and

- Ensuring that the safe harbours apply consistently in receiverships.

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

3.8 **Professional Fees in CCAA Proceedings**

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

JTF Comments

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

The JTF believes that further consultation and polling of the respective members of IIC and CAIRP and of other interested stakeholders such as secured lenders shall be essential to

identify appropriate measures to reduce or otherwise monitor more efficiently professional fees incurred in CCAA proceedings. It should indeed be borne in mind that certain practical measures for the efficient management of professional fees may be implemented without being formally addressed under federal legislation.

Enhancing Transparency

3.9 Creditor Lists

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

JTF Comments

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

3.10 Empty Voting and Disclosure of Economic Interests

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

JTF Comments

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

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

- granting the court necessary authority to compel the disclosure of all economic interests of a creditor;
- granting the monitor or trustee necessary authority to compel the disclosure of all economic interests of a creditor;
- consider use of a broader duty of good faith[21] which would be incumbent upon all stakeholders involved in a restructuring process.

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

With respect to the potential impact of distressed debt trading, the JTF cautions that any inherent statutory limitations as to the assignability of claims against an insolvent debtor company may negatively affect the debt market and related secondary distressed debt market. As a general principle, creditors should be allowed to purchase and sell claims against an insolvent debtor (even for the admitted purpose of acquiring a majority or blocking position) and should be able to vote for the full amount of such claims even though they may have been purchased at a discount. Such general principle, which underpins the distressed debt market, should only be subject to limited exceptions, namely where it can be demonstrated that the creditor having purchased distressed debt is not acting in good faith or otherwise unduly seeking to impair the restructuring. Any legislative solution in this regard should preserve broad judicial discretion essential to the evaluation of the consequences on a case by case basis. Judicial intervention in a debt trading context has been justified, *inter alia*, by the general principle pursuant to which the powers conferred upon a majority of creditors must be exercised *bona fide* for the interests of the class of creditors and not for the benefit of individual interests[22].

Role of the monitor

3.11 Pre-filing reports

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

JTF Comments

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

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

- to allow pre-filing reports, the court should be satisfied, *inter alia*, that such reports have been prepared impartially and objectively by the prospective court-appointed monitor;

- when allowed, pre-filing reports should benefit from the same protection as that afforded to other reports prepared by the monitor under Section 23(2) CCAA.

3.12 Conflict of Interest

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

JTF Comments

The JTF is of the view that significant checks and balances are already in place concerning the status, conduct and role of the monitor and, accordingly, the implementation of

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

additional protective measures to address potential conflicts of interest where the monitor has a pre-filing relationship with a debtor company is not worthy of consideration in the next round of legislative reform. Section 25 CCAA imposes broad duties upon the monitor to act honestly, in good faith and in accordance with the *BIA Code of Ethics*, which are meant, *inter alia*, to avoid monitors being placed in a conflict of interest position. Most monitors are also subject to CAIRP Guidelines in this regard.

Asset Sales

3.13 Credit Bidding and Stalking Horse Bids

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

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

JTF Comments

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

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

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

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

Regarding sales of assets in general, the JTF notes that the current provisions of the BIA and CCAA direct that all sales outside the normal course of business be subject to approval of the court, regardless of the importance of the sale or value of the assets. The JTF believes that some thought should be given to allowing discretion to the professionals involved in monitoring the activities of an insolvent business, to avoid a requirement for an approval in a situation where the sale could be considered immaterial to the restructuring process, to increase

efficiency by removing the necessity of a court involvement in a matter that the court would consider *de minimis*. The JTF is mindful however that such discretion should be framed so as to provide an objective standard regarding the value of a contemplated transaction, and to maintain a degree of protection for the claims of employees.[23]

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

3.14 **Applicability of Asset Sale Test**

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

JTF Comments

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

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

3.15 **CBCA Arrangements**

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

[23] Section 65.13(8) BIA and section 36(7) CCAA. The JTF points out that section 36(7) CCAA contains an incorrect reference to sections 6(4) and 6(5) CCAA that should be corrected. The correct reference should be to sections 6(5) and 6(6) CCAA.

JTF Comments

The *Canada Business Corporations Act*[24] ("**CBCA**") was not originally intended to be used to restructure an insolvent enterprise. With time, a practice has evolved whereby the CBCA provisions dealing with arrangements, namely section 192 CBCA, have been used to restructure an insolvent entity, notwithstanding the apparent prohibition in section 192(3) CBCA. This practice has evolved from an interpretation of the provisions to mean that the relief in section 192 CBCA is available to a corporate group provided that at least one of the entities in a corporate group is not insolvent and that the corporation which emerges from the arrangement must not be insolvent.

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

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

3.16 **A Streamlined Small Business Proposal Proceeding**

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

JTF comments

The JTF supports the implementation of a simplified restructuring process under the BIA designed to allow small and medium sized enterprises to restructure under a streamlined, less expensive process. The JTF believes that legislative amendments in this regard could be inspired by the existing simplified rules applicable under the BIA with respect to consumer proposals[25]. Such simplified rules could include deemed proposal acceptance and deemed ratification by the court where no creditors objections are filed and automatic revival[26] of proposals that are in default, for example.

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

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

[25] See sections 66.11 to 66.4 BIA.

[26] See section 66.31(6) BIA.

3.17 **Division I Proposals Extension**

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

JTF comments

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

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

3.18 **Liquidating CCAA Proceedings**

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

JTF comments

Canadian courts have increasingly allowed the use of the CCAA for the purpose of proceeding to the sale or liquidation of an insolvent debtor company. Such use of CCAA is essentially premised on the maximization of value for creditors where going concern sales are conducted under court supervision[27], outside of a receivership proceeding.

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

This being said, because of its origins as a restructuring tool, the CCAA is not presently drafted to address certain issues which necessarily arise in the context of the sale and distribution of proceeds of an insolvent business. The JTF is thus of the view that various amendments to the CCAA should be envisaged, namely to incorporate a scheme of distribution similar to that contained under the BIA[28] in order to provide greater clarity as to the order in which creditors are to be paid from the proceeds resulting from a sale or a liquidation conducted under the CCAA. The absence of such statutory scheme of distribution under the CCAA has led to significant controversy before the courts, namely in matters such as *Indalex*, *Grant Forest Products, Timminco* and *White Birch*.

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[27] Recent examples include *Nortel Networks Corporation (Re)*, 2012 ONSC 1213 and *Aveos Fleet Performance Inc. (Arrangement of),* 2012 QCCS 6796.

[28] See Sections 136 to144 BIA.

Enhancing Equity

3.19 Employees' Claims

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

JTF Comments

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

The JTF is aware that when discussing the topic of protection of the claims of employees, the issues that are most often raised are the possibility of increasing the maximum amount for a claim made under section 81.3 or 81.4 BIA, the possibility of expanding the claim under section 81.3 and 81.4 BIA to cover severance or termination, treating the claims of employees as a separate class, introducing a protection for long term disability and other similar benefits, expanding the statutory security provided for in section 81.5 and 81.6 BIA to cover amounts due for special payments and actuarial deficits and enhancing the protection available to employees by way of an indemnity payable though the Wage Earner Protection Program ("**WEPP**") established under the provisions of the *Wage Earner Protection Program Act* ("**WEPPA**")[29]. These issues are addressed in greater detail hereunder.

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

  The JTF is concerned that an increase in the priority charge will have a negative impact on, *inter alia*, the availability of credit and the value of existing debt instruments. Any increase in the priority charges created upon a bankruptcy or receivership raises the very real risk that those who lend against a borrower's assets will increase the reserves taken against the borrowing base for all borrowers that are employers.

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

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

while the maximum claim under section 81.3 and 81.4 BIA is $2,000 (subject to the possibility of an additional $1,000 for expenses incurred by a travelling salesperson).

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

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

  However, the JTF perceives some practical problems with the suggestion that severance or termination be included in the priority under section 81.3 or 81.4 BIA. To the extent that the expansion of the priority claim is accomplished by increasing the statutory security cap of $2,000 referred to in sections 81,3 and 81.4 BIA, the issue is the same as that described hereinabove in the discussion of a possible increase of a maximum amount of a claim. The concern in this situation is that the increased statutory secured claim could affect access to credit, which may trigger additional insolvencies of employers. The JTF points out that in the past, when a suggestion was made to expand the claim under section 81.3 and 81.4 BIA to cover severance or termination, the legislative provisions drafted in connection with the proposed change did not include any maximum amount in respect of this aspect of the employees' claim[30]. In separate submissions made by CAIRP and the IIC in connection with the review of such proposed legislative changes[31], both CAIRP and IIC indicated their concern that the suggested legislative provisions may significantly curtail credit availability for employers, in view of the fact that the potential secured claim would be difficult or impossible to quantify. The potential impact on the reserves against the borrowing base calculations established by lenders to extend credit for such an un-quantified charge are significant, particularly if lenders take a conservative view of what the amount of the priority claim might be. The risk of increased reserves is significant as a result of the fact that the majority (approx. 62%) of the amounts paid to employees under the WEPP payments represent termination and severance pay, leaving a minority (38%) of the amounts paid on the WEPP actually subject to the subrogated claim.

  Furthermore, the JTF points out that since the calculation of severance and termination can vary widely from one province to another, and whether the

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

[31] The submissions were made in respect of Bills C-476, C-487, C-501, S-214 and S-216 (40th Parliament, 3rd session). CAIRP's submission is dated June 25, 2010 and can be found at www.cairp.ca/_files/file.php?fileid=filebcCsVntZzD&filename=file_CAIRP_commentary_on_proposed_new_legislation.pdf. IIC's submission is dated August 2010 and can be found at www.insolvency.ca/en/iicresources/resources/Pension_Reform_TF_Report_Final_2010.pdf.

calculation is made based solely on the statutory notice provisions found in labour standard legislation or based on a common law approach, the expansion of the protection to cover severance and termination could lead to inequitable results for individual employees, in the absence of a national standard to value the severance or termination claims.

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

- Treating the claims of employees as a separate class:

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

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

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

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

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

The issue of a wide ranging new super-priority for amounts due to employees for LTD and other similar benefits was addressed in proposed new legislation[32] and both the IIC and CAIRP, in separate submissions, outlined a number of practical problems with this proposed legislation. The JTF believes the comments made by IIC and CAIRP through their submissions in 2010 are still relevant in this respect[33].

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

  The issue of a wide ranging new super-priority for amounts due to pension plans on account of special payments and for an eventual loss on liquidation or wind down of a plan as estimated by an actuarial deficit calculation, was addressed in proposed new legislation[34] and both the IIC and CAIRP, in separate submissions, outlined a number of practical problems with this proposed legislation. The JTF believes the comments made by IIC and CAIRP through their submissions in 2010 are still relevant in this respect[35].

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

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

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

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

[32] See note 30.

[33] See note 31.

[34] See note 30.

[35] See note 31.

weaknesses have been noted in its application. The more fundamental issues that the JTF believes should be addressed at this time are the following:

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

- Some improvement could be made to make the program more efficient. The JTF notes that one of the objectives of the WEPP is to accelerate payment ot employees in connection with the amounts they would be entitled to receive under section 81.3 and 81.4 BIA, while it may in fact take a significant period of time before the indemnities are paid to displaced employees.

- Employees who work for a receiver may have their claim relating to severance or termination affected by continuing employment to assist the receiver in winding down the business.

- There appears to be an inequity that creeps in the program when there is an interaction between the provisions of the *Employment Insurance Act*[36] and the WEPPA. More specifically, it appears that employees that are entitled to EI benefits may see these benefits curtailed as a result of the benefits paid under WEPPA. No equivalent loss of benefit is experienced by en employee who immediately finds other employment.

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

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

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

- And most importantly, the WEPP is only available in situations where the employer is bankrupt or in receivership, and, as a result, does not allow

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

any protection for employees who are displaced as a result of the insolvency of their employers, if the restructuring process is successful[37].

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

Finally, the JTF believes it would be remiss if it did not comment on the changes implemented in the 2009 Amendments which specify that, while a court may in certain circumstances order that the parties enter into a renegotiation of a collective bargaining agreement, the court may not compel a termination, change or suspension of the provisions of the collective bargaining agreement[38]. The JTF believes there is some risk that this provision may, in certain circumstances, hinder the presentation of a viable proposal or plan. However, the JTF acknowledges that the legislator has decided to trust the collective goodwill of employees and employers to come up with a solution that will avoid a loss of employment. While the JTF believes that in certain cases the slow pace of collective bargaining negotiations could put a restructuring process at risk, the JTF is not aware of any situation where a viable plan was possible but was thwarted as a result of the currently existing provisions. As such the JTF considers that the provision should not be changed, but should continue to be closely monitored.

3.20 **Employees Claims in Asset Sales**

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

JTF Comments

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

The JTF is not however aware of instances where sales conducted under the CCAA[39] or BIA[40] were authorized by the court to the detriment or prejudice of employees' claims for wages or normal cost contributions owed to a pension plan. Perhaps this is because both the CCAA[41] and BIA[42] expressly provide that the court may only authorize a sale conducted outside the

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

38 See section 33 CCAA and 65.12 BIA.

39 Section 36 CCAA.

40 Section 65.13 BIA.

41 Section 36(7) CCAA.

42 Section 65.(8) BIA.

ordinary course of business if it is satisfied that such payments can and will be made to employees.

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

3.21 **Hardship Funds**

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

JTF Comments

The JTF does not believe that it is essential to codify a CCAA court's authority to authorize the payment of interim dividends in certain circumstances, as is otherwise provided under the BIA[43].

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

3.22 **Third Party Releases**

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

JTF Comments

The JTF believes that the criteria developed by the courts[44] to authorize the implementation of a plan of arrangement filed under the CCAA which includes releases against third parties (i.e. parties other than the debtor or a director of the debtor) are satisfactory.

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

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

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[43] See Section 136(2) and 148(1) BIA.

[44] See *Metcalfe and Mansfield Alternative Investments II Corp., (Re)*, 2008 ONCA 587.

3.23 **Key Employee Retention Bonuses**

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

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

JTF Comments

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

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

- existing criteria developed by the courts to allow for the payment of KERBs;
- necessary monitor approval of the proposed payment of KERBs;
- due prior notice to likely affected creditors of the proposed KERBs;
- the need for disclosure to affected creditors of the terms of the proposed KERBs.

The JTF also feels that any potential legislative reform in respect to KERBs should involve further study and analysis of the status of US law in this regard, insofar as this issue is statutorily addressed in the United States.[45]

3.24 **Oppression remedy**

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

JTF Comments

The JTF is of the view that it is not necessary to consider legislative amendments to CCAA or BIA in order to address issues relating to the availability of the oppression remedy in a context of insolvency proceedings. There does not appear to be sufficient evidence of improper use of the oppression remedy in context of insolvency proceedings to justify a legislated solution. Furthermore, the broad discretion otherwise available to the courts should be sufficient to adequately resolve issues of this nature. It should also be noted that potential amendments to impose an overarching "good faith" obligation upon stakeholders participating in a restructuring[46] may bolster judicial discretion in this regard.

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

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

3.25 **Interest Claims**

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

JTF Comments

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

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

3.26 **Unpaid Suppliers**

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

JTF Comments

The JTF is of the view that the limited protection afforded to unpaid suppliers at Section 81.1 BIA should be repealed. In this regard, the JTF shares the views and comments expressed by the Standing Senate Committee on Banking, Trade and Commerce in its November 2003 report[47]. The rationale for repealing Section 81.1 may be essentially summarized as follows:

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

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

- Even though the protection is largely ineffective, it adversely affects the availability of credit, as secured creditors who provide operating credit based

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

upon margin calculations and asset based lenders tend to curtail availability of funds based on a theoretical maximum claim by unpaid suppliers of "30 day goods".

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

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

While this issue is not directly addressed in the Discussion paper, the JTF also believes that the treatment of post-filing suppliers in a context of restructuring is worthy of consideration. Canadian insolvency statutes do not include provisions similar to those found in *US Bankruptcy Code* pursuant to which post-filing creditors benefit from a priority status as administrative claims[48]. Hence, at present, under Canadian law, post-filing creditors and suppliers are treated as unsecured creditors should the restructuring process under either the BIA or CCAA be interrupted. It should thus be considered to afford some degree of protection for post-filing creditors, by allowing a higher priority status to the claims of creditors who have supported the debtor through a restructuring attempt by providing credit, as compared with the claims of pre-commencement creditors.

3.27 **Fruit and Vegetables Suppliers**

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

JTF Comments

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

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

Deterring Fraud and Abuse

3.28 **Directors' disqualification**

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

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

JTF Comments

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

It should also be borne in mind that the BIA[49] and CCAA[50] were amended in 2009 to grant to the court statutory authority to remove the director of an insolvent debtor where the court is satisfied that such director is unreasonably impairing or is likely to impair the possibility of a viable compromise or proposal.

3.29 **Related Party Subordination and Set-off**

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

JTF Comments

The JTF is of the view that legislative amendments to provide that debts among related parties are, *ipso facto*, subordinated would raise significant problems and could lead to inequitable results. Existing provisions of the BIA and CCAA already provide for the subordination of the claims of silent partners[51] and of creditors holding "equity claims"[52]. It is feared that broader court authority to subordinate the debts of parties related to the insolvent debtor or the *ipso facto* subordination of the debts of related parties could lead to judicial controversy similar to that prevalent in the United States in respect to the "re-characterization of debt" in a context of insolvency.

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

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

Cross-border Insolvencies

3.30 **Foreign Claims under "Long-Arm" Legislation**

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

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49 See Section 64 BIA.

50 See Section 11.5 CCAA.

51 See 139 BIA.

52 See 140.1 BIA and 6(8) CCAA.

JTF Comments

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

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

The JTF further notes that a broader consideration of the enforceability in Canada of foreign law based claims (such as, for example, avoidance actions under Chapter 11 proceedings and ERISA[53] claims) may be warranted.

3.31 **Set-off for claims in multiple jurisdictions**

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

JTF Comments

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

3.32 **Allocation of Proceeds**

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

JTF Comments

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

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

3.33 **Treatment of Enterprise Groups**

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

JTF Comments

The JTF believes that, with respect to the treatment of enterprise groups in insolvency, the avenue of enquiry and analyses should be reframed. Whether and, if so, on what conditions corporate groups filings should be permitted in Canada is worthy of consideration. In other

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

words, it is relevant to determine on what basis, if any, Canadian insolvency laws should permit making foreign subsidiaries direct applicants in a Canadian proceeding.

3.34 **"Center of Main Interests"**

IC has requested submissions regarding the need for procedural protections in cross-border recognition matters.

JTF Comments

The JTF is of the view that issues related to the identification of the proper center of main interests ("**COMI**") of a debtor company should be left to the judicial discretion of the judge overseeing the restructuring, with reference to the UNCITRAL guidelines. It may thus not be necessary to adopt specific amendments under which courts would be instructed to ensure that creditors have been given sufficient disclosure with respect to the identification of the COMI of a debtor company.

3.35 **Unsecured Creditors' Committees**

IC has requested input as to whether it is appropriate to develop principles and criteria for the recognition of foreign UCCs and to define the scope of UCC participation in Canadian insolvency proceedings.

JTF Comments

Given the role of the monitor in Canadian restructuring proceedings led under the CCAA, the JTF believes that it may not be necessary to consider specific amendments to define the scope of foreign unsecured creditors' committees in insolvency.

This said, more broadly, the JTF believes that it would be valuable to have some clear legislative guidelines to address whether or not the filing of a claim or otherwise appearing in Canadian restructuring proceedings constitutes attorning to the Canadian court's jurisdiction for any matters related to the restructuring being supervised by the Canadian court.

Administrative Issues

3.36 **Renaming the *Bankruptcy and Insolvency Act***

IC has requested submissions regarding the potential social stigma associated with "bankruptcy" and whether Canadians may be better served if that term is downplayed in the legislation.

JTF Comments

The JTF notes that the term "bankruptcy" is used in numerous jurisdictions to refer to legislation in respect to insolvency and is generally perceived to refer to the liquidation of the assets of a person who cannot meet his or her obligations as and when they become due. Conversely, the term "bankrupt" refers to the legal status of a person whose assets are liquidated for the benefit of his or her creditors.

While there is social stigma associated with the term "bankrupt", the JTF believes that this issue has greater implications for practitioners in the field of consumer insolvency rather than corporate insolvency. However, the JTF perceives that the term "bankruptcy" creates some confusion in public perception where the BIA is used for restructuring purposes (as opposed to liquidation). The media often report that a company or individual has been placed under "bankruptcy protection" thus creating confusion as to whether or not the assets of such company or individual are being liquidated. This topic is addressed in greater detail in the submission by CAIRP related to consumer insolvency.

A Unified Insolvency Law

3.37 Merger of the BIA and CCAA

IC has requested submissions regarding a unified insolvency statute.

JTF Comments

The JTF does not believe that it is essential that the BIA and CCAA be merged into a single act. Both statutes were effectively harmonized by the 2009 Amendments and, while it may seem peculiar to have a two-tier statutory restructuring regime, the co-existence of the BIA and CCAA has not led to unfavourable results nor inequity.

As mentioned hereinabove[54], the JTF however notes that where the CCAA is used to proceed to the sale of a debtor company's assets and undertakings, legislated changes to the CCAA could be envisaged to provide for the eventual bankruptcy of the debtor company once all of its assets and undertakings have been sold or otherwise liquidated. In effect, legislated change in this regard could seek to implement a "bridge to the BIA"[55] to allow the monitor necessary authority to transition to the bankruptcy of a debtor company having completed the liquidation of its assets under the CCAA.

3.38 *Winding-up and Restructuring Act*

JTF Comments

With respect to the *Winding-Up and Restructuring Act* ("**WURA**")[56], the JTF believes that limiting the scope of WURA to financial institutions only is an issue worthy of consideration. In its report dated June 14, 2000 entitled *"The Winding-Up and Restructuring Act: Recommendations for Reform*", the IIC made various suggestions regarding potential reform of WURA which include, *inter alia*, limiting its scope to financial institutions.

3.39 *Canada Transportation Act*

JTF Comments

With respect to the provisions of the *Canada Transportation Act* [57] which relate to schemes of arrangement to be made by insolvent railway companies, the JTF is of the view that

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54 See *Liquidating CCAA Proceedings, section 3.18* hereinabove.

55 See *Century Services Inc. v. Canada (General Attorney)*, 2010 CSC 60.

56 RSC 1985, c. W-11, as amended.

57 SC 1996, c. 10.

there is no evident rationale for submitting railway companies to a different liquidation or restructuring regime than that which are set out in the BIA and CCAA. It may thus be worthy to consider necessary amendments to provide that railway companies be included in the respective definitions of "person" and "debtor company" under the BIA and CCAA to effectively provide that railway companies are subject to restructuring (or liquidation) under these statutes.

3.40 **Restricting Consumer Proposals**

IC has requested submissions as to whether the consumer proposal process should be amended to ensure that it is not used with respect to business debt.

JTF Comments

The JTF is unaware of instances where the use of consumer proposal mechanisms set out in the BIA in connection with commercial debts of a very small business has resulted in an unfair treatment for the creditors. The $250,000 threshold for consumer proposals makes it such that the amount of business debts subject to consumer proposals remains reasonable, on a relative scale. In the absence of evidence of abuse in the use of consumer proposals to settle business debts, the JTF does not believe that amendments should be contemplated to the consumer proposal provisions of the BIA in this regard.

3.41 **Special Purpose Entities**

IC has requested input on whether to expand the application of the BIA and CCAA to trusts used as special purpose entities.

JTF Comments

The JTF is of the view that the expansion of the term "person" (as used in the BIA) and "debtor company" (as used in the CCAA) to allow other types of business entities to be subject to proceedings under BIA or CCAA is an issue worthy of consideration.

Such expansion should not only cover trusts used as special purpose entities but all trusts used for business purposes[58]. Moreover, the somewhat limited definition of "debtor company" used in CCAA should perhaps include other corporate entities such as, *inter alia*, limited partnerships and other types of partnerships to avoid restricting the use of CCAA to incorporated business entities. At the same time, the rules regarding the treatment of partnerships should be reviewed, to ensure that these entities are treated under the CCAA and BIA as separate persons in their own right and not merely an extension of the partners.

Receiverships

3.42 **Codification of receiverships**

IC has requested input as to whether it is appropriate to amend the insolvency legislation to clarify the role and authority of a receiver appointed under section 243 of the BIA; and whether it is appropriate to standardize a set of rules regarding the authority of a receiver to act across all insolvencies statutes.

[58] The JTF notes that the potential inclusion of all trusts as entities subject to BIA and CCAA will necessarily trigger reflection as to the contents of « bankruptcy remoteness » opinions traditionally given with respect to trusts subject to Canadian legislation.

JTF Comments

The JTF notes that the receiver provisions as codified in section 243 and following of the BIA under the 2009 Amendments seem to be working efficiently and do not warrant substantive change. Many jurisdictions have implemented model "receivership orders" to standardize the powers and duties of the receiver appointed under section 243 BIA.

This being said, the JTF believes that some other receiver related issues should be eventually addressed, namely the following:

- where a receiver proceeds to a sale of an insolvent person's assets, it should be specified that the proceeds of sale shall be paid to creditors in accordance with the BIA priority scheme. It is unclear under existing provisions whether such priority scheme applies or whether the provincial priority scheme applies;

- it should be specified that the receiver, like the trustee in bankruptcy, is not bound to obtain tax clearance certificates which must otherwise be obtained from tax authorities[59] before distribution where assets are disposed of or otherwise liquidated. Present uncertainty in this regard causes legitimate concerns for receivers who may incur liability for having failed to obtain such tax clearance certificates before proceeding to distribution.

3.43 **No Action Against Receivers Without Leave of the Court**

IC has requested input as to whether it would be appropriate to amend the insolvency legislation to require leave of the court before taking any action against the Receiver.

JTF Comments

The JTF supports an amendment to section 215 BIA to provide that leave of the court be obtained prior to taking any action against a receiver appointed under section 243 BIA. Like the trustee in bankruptcy and the interim receiver, the receiver appointed under section 243 BIA is a court officer who should benefit from similar protection from frivolous or abusive judicial claims.

3.44 **Marshaling of Charges**

IC has requested input as to whether it would be appropriate to amend the insolvency legislation to codify the doctrine of marshaling charges.

JTF Comments

The codification of the common law doctrine of "marshalling" in respect to the various charges created under BIA and CCAA is an issue worthy of consideration. Legislative clarification in this regard would be helpful to guide the courts and to allow for the equitable distribution of proceeds subject to charges created under BIA and CCAA.

[59] See for instance section 159 of the *Income Tax Act* and section 14 of the *Quebec Tax Administration Act*, and section 270 of the *Excise Tax Act*.

The JTF notes that this doctrine could also be of use in relation to the enforcement of various Crown Claims (namely deemed trust claims) which purport to charge all of the assets of the insolvent person.

3.45 **Tax Issues**

IC has requested input on several tax-related issues that have been raised by stakeholders in the insolvency context, to solicit information regarding the nature of concerns and the extent to which such issues potentially affect insolvency proceedings.

JTF Comments

The JTF believes that further study of the interaction of tax laws and insolvency laws is worthy of consideration, as the JTF considers that tax issues presently exist that impede restructuring opportunities for insolvent businesses or delay or cause inefficiencies in the administration of insolvent estates. The more significant areas where some legislative reform is considered to be desirable, in dealing with the interaction between fiscal and insolvency laws are outlined below:

- Clearance Certificates: The JTF believes that the exemption from obtaining clearance certificates available to trustees should be extended to any court officer distributing funds under supervision of a court where notice is given to creditors, as there is no known public policy reason to treat a court officer differently from another court officer acting in a similar capacity under a different statute;

- Final Tax Returns: The JTF perceives a problem relating to the final tax return required to be filed after the final distribution. The JTF believes that trustees, receivers, monitors, or debtors should be dispensed from a requirement to file final tax returns subsequent to effecting a final distribution, when the final distribution occurs in a context of a legal process monitored by the court, with notice to the creditors;

- Unfiled Tax Returns: The JTF believes there is a need for clarification in the legislation regarding the responsibility for filing tax returns with respect to periods more than one year before the commencement of the year in which a person becomes bankrupt, to better coordinate the provisions of Section 22 BIA with the provisions of the *Income Tax Act* ("**ITA**")[60] and the *Excise Tax Act* ("**ETA**")[61] or other similar provincial or federal legislation that provides for an obligation on the part of legal representatives to complete tax returns;[62]

- Jurisdiction over tax claims: The JTF believes that there presently exists some confusion regarding the jurisdiction of each of the court (acting as a designated tribunal under the CCAA or acting in matters of bankruptcy and insolvency) and the tax court in dealing with the acceptance or rejection of claims against an estate, the right to issue assessments and the characterization of such assessments as an administrative gesture or a "proceeding" that may be stayed

[60] RSC 1985, 1 (5th Supp.), as amended.

[61] RSC 1985, c. E-15, as amended.

[62] Section 265 and 266 ETA, sections 128 ITA.

under the provisions of the BIA or CCAA, the manner in which claims based on an assessment are dealt with for voting purposes, appeal periods and the mechanics of asserting the claim (proofs of claims/assessments). The JTF believes it would be worthwhile to investigate the possibility of having a single forum to deal with all claims made against an insolvent debtor or an insolvent estate, and as a consequence the JTF believes some research should be done on the possibility of attributing all responsibility for dealing with tax claims to the court seized with the supervision of the insolvent estate administration or restructuring process, rather than having a shared responsibility between the court and the tax court, as there is no known public policy reason to reserve the right to determine claims of tax authorities to the tax court in insolvency proceedings, give the text of section 4.1 BIA and section 40 CCAA.;

- Delay in asserting tax claims: The JTF believes it may be useful to provide for a legislative mechanism to compel the Crown in right of Canada or a province to file a proof of claim within a specified period, in order to expedite the administration of an estate and the distribution of funds. The JTF recognizes that such a mechanism exists through Section 149 BIA, but notes that an equivalent provision does not exist in the CCAA, although harmonization might be advisable;

- Discharge of court officer: The JTF believes there is an inconsistency in the provisions of the BIA and of the fiscal laws, as relates to obligations of professionals and how these are discharged, and considers that this inconsistency could be clarified through a legislative change. More specifically, the provisions of the BIA provide that when a trustee has fully administered an estate to the court's satisfaction, the trustee may obtain a discharge,[63] however the fiscal laws that provide for a joint and several obligation to report or remit do not provide for any "sunset" provision that terminates this joint and several obligation when the trustee is discharged.[64] The JTF points out the issue is not limited to an order discharging a trustee, but would equally apply to an order of discharge in respect of a receiver appointed by a court or a monitor appointed pursuant to the CCAA;

- Fresh start / tax consequences arising out of an insolvency or restructuring proceeding: The JTF believes that tax consequences arising from the realization of property in an insolvent estate, or arising as a result of a restructuring process, is an issue that needs clarification as the current treatment can impede the ability of a debtor to restructure, or in the alternative may result in an unclear treatment of potential tax liabilities. Under the current regime, if taxable capital gains or recapture or some other taxable gain arises as a result of the realization process in a bankrupt estate, such income is attributed to the estate, whether or not the trustee collected the proceeds of realization of the assets (as the proceeds may have been collected by a secured creditor that has a charge that encumbers the property), and in such a circumstance the law is unclear as to the characterization of the income tax liability that arises from the realization

63 Section 41(8) BIA.

64 See for example section 265 ETA and sections 128 and 159 ITA.

process.[65] In the same manner, the gain on settlement of debt that arises after the implementation of a CCAA plan or a BIA proposal, or the capital gains or recaptured depreciation that arise due to a liquidation of assets in a context of a restructuring process, may result in an income tax liability without recourse to any recovery (in the case of a liquidating BIA proposal or liquidating CCAA plan) or a residual debt that endangers the ability of the debtor to continue in business (in the case of a compromise or settlement proposal or plan). The JTF believes that the issue of the tax treatment of transactions that arise in the context of a bankruptcy or restructuring and/or the reassessment of tax attributes needs to be further studied to avoid an unfair result to creditors or an impediment to a restructuring process.

- Deemed period end: The JTF notes that in BIA proposals and CCAA restructurings, because there is no deemed period end on filing, income and sales taxes that were with respect to the pre-filing period could be considered post-filing liabilities that must be paid in full. This is inconsistent with the bankruptcy regime and the *pari passu* principle, and accordingly the JTF believes that consideration should be given to a legislative change that would ensure that the provisions of section 121 BIA and 19 CCAA are applied consistently by all creditors, including the Crown;

- Claims made under Section 296(1)(b) ETA and Section 25 of the Quebec Tax Administration Act ("**QTAA**")[66]: The JTF notes that the Canada Revenue Agency ("**CRA**") and the Quebec Revenue Agency ("**QRA**") have implemented a policy of assessing debtors directly for the goods and services tax ("**GST**"), harmonized sales tax ("**HST**") and/or Quebec sales tax ("**QST**") that is payable on purchases made from suppliers who are unpaid at the date of the inception of an insolvency proceeding, without relieving the supplier from the obligation to collect and remit the tax on the taxable supply. The JTF observes that this practice results in duplicative claim for the tax on purchases as such amounts are also claimed by unpaid suppliers of the debtor who are agents of the Crown for the purpose of collecting GST/HST/QST. The duplicative claim implies that the Crown is collecting proceeds of distributions made in an estate twice, on what is essentially the same claim, which results in a higher recovery for the Crown than the other similarly situated ordinary unsecured creditors. The JTF believes that a legislated solution may be required to ensure observance of the *pari passu* principle, while addressing some legitimate concerns of CRA and QRA;

- Set-off claims: The JTF identified the issue of set off of claims in general as being worthy of consideration and in particular the issue of set off as it relates to the Crown. More specifically, the JTF is questioning whether it should be appropriate for taxing authorities to set-off pre-filing tax liabilities as against post-

[65] In a situation where a secured creditor takes possession and realizes on encumbered property, resulting in recaptured depreciation for the estate, the income tax arising from the recaptured depreciation would not be a cost of administration of the estate, nor a claim provable in bankruptcy. However, section 128 of the ITA provides that the trustee is jointly liable with the bankrupt for the payment of such income taxes to the extent of the property of the bankrupt in the trustee's possession. It is unclear what priority this liability for taxes would have as compared with the fees and costs of the trustee, and why the taxes arising from the realization of property that is not available for distribution to creditors would reduce the amount otherwise available for distribution.

[66] RSQ, c. A-6.002.

filing refunds given the involuntary nature of taxation obligations, the fact that the Crown can invoke a right of set off but the taxpayer is not allowed to do so, and the fact that the set off of Crown claims may extend beyond debts that are truly mutual between the Crown and the debtor;[67]

- Garnishment rights: The JTF believes there is an uncertainty that arises in a situation where the government has issued garnishment notices pursuant to section 317 ETA in the context of a restructuring process, in view of a recent judgment of the Supreme court of Canada.[68] In this decision, the Supreme court found that a garnishment notice issued pursuant to s. 317 ETA is not stayed by the filing of a notice of intention to make a proposal (or a proposal) under the BIA, because the related account receivable is no longer part of the estate of the debtor due to the transfer of property effect of s. 317 ETA, when the garnishment notice has been served onto the account debtor before the filing of the notice of intention. This decision appears to create an inconsistency in the treatment of garnishment notices issued by CRA under various fiscal laws in a context of a restructuring process, since the BIA and ITA suggest that a garnishment notice sent in respect of unpaid source deductions would be suspended by the stay of proceedings, while in virtue of the decision of the Supreme court of Canada, the equivalent notice sent pursuant to the ETA is not. This inconsistent treatment is a cause of concern, given that the legislator has sought, at least since the revisions made to the *Bankruptcy Act* (as it was then known) in 1992, to provide the highest degree of protection to the unremitted source deductions but to allow an opportunity for an insolvent debtor's restructuring to occur. The JTF believes it would be appropriate to clarify the rights of the Crown in a context of a restructuring proceeding, for all of the Crown's debts.

- Claims for payroll source deductions in a proposal or plan of arrangement: The JTF notes that in a context of a proposal under the BIA or a plan of arrangement under the CCAA, there exists a pre-condition to obtaining the approval of the court, that the claims of the Crown that could form the basis of a demand under section 224(1.2) ITA (or a provision of the *Canada Pension Plan* or the *Employment Insurance Act* that refers to section 224(1.2) ITA, or a substantially similar provision of a provincial law) be paid in full within 6 months of the date of ratification, unless the Crown agrees to a longer timeframe. The JTF notes that the claim of the Crown that could form the basis of a demand under section 224(1.2) ITA includes interest and penalties and the employer's portion of some payroll levies, and the JTF is not aware of any public policy reason why the claims of the Crown for interest, penalties and levies might warrant a priority treatment as compared to the claims of ordinary unsecured creditors. Furthermore, the JTF notes that there is uncertainty regarding the requirement of this provision, considering that the demand under section 224(1.2) ITA can only affect accounts receivable of an insolvent person. The uncertainty arises, for example, in a situation where the insolvent person is a retailer who does not customarily have any accounts receivable, or where the collectible value of accounts receivable is lower than the amount due in respect of unremitted payroll source deductions, interest, penalties and levies, as it is then unclear whether the amount that must be remitted within the 6 months (or longer) period must be the

[67] For example, see section 31.1 and 31.1.1 of the QTAA.

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

entire amount due or be limited to the collectible value of accounts receivable. The JTF believes that additional consideration should be given to the treatment of claims of the Crown in a restructuring process, to further clarify the extent of the priority that should attach to a claim of the Crown for unremitted payroll source deductions.

Technical issues

3.46 Disallowance of claims

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

JTF Comments

The JTF does not believe that amendments to BIA to grant necessary court authority to extend the 30 day delay within which an appeal may be launched[69] are warranted. Such potential "open ended" appeal period would create uncertainty in many regards as trustees and stakeholders could no longer assume that the disallowance of a claim is final where no appeal nor leave for extension has been filed within 30 days from the disallowance of the claims.

3.47 Securities firm Bankruptcies

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

JTF Comments

The JTF concludes that this issue appears to be satisfactorily addressed under section 256 BIA and is unaware of recent cases which would justify further amendments in this regard.

3.48 Preview of proposals by the trustee

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

JTF Comments

The JTF believes that this issue is worthy of consideration, principally because of the fact that the BIA provides that the proposal trustee is deemed to be trustee in bankruptcy where the proposal process is unsuccessful. The BIA should thus be mindful of the fact that proposal trustees should be able to take informed decisions when they decide to accept an engagement. Further reflection should also be had with regard to a proposal trustee's right to resign from acting in such capacity in certain circumstances.

[69] See sections 135(4) BIA.

4. COMMENTS OF THE JTF WITH RESPECT TO OTHER COMMERCIAL ISSUES THAT ARE NOT RAISED IN THE DISCUSSION PAPER, BUT THAT THE JTF BELIEVES SHOULD BE ADDRESSED IN LEGISLATIVE REFORM

Although these topics are not addressed specifically in the Discussion Paper, the JTF has identified certain issues which, in its view, are worthy of consideration in the context of a review of the BIA and the CCAA, or in the context of a review of the statutes that regularly interact with the insolvency statutes, such as the WEPPA. These issues are outlined briefly hereunder.

4.1 Critical suppliers

Under the 2009 Amendments, provisions regarding payments to critical suppliers of a debtor company were only codified in the CCAA[70]. The JTF believes that the inclusion of similar provisions in the BIA is worthy of consideration as there appears to be no underlying rationale to justify that the critical supplier mechanisms, as codified in the CCAA, be restricted to debtor companies seeking to restructure under the CCAA. It may also be of interest to further reflect upon the allowance of pre-filing payments to critical suppliers while nonetheless maintaining the broad judicial discretion set out in section 11.4 of the CCAA.

4.2 Environmental claims

The treatment of environmental claims made against a debtor company or its directors in the context of a CCAA restructuring has been the object of significant controversy in recent case law, namely in the matters of *Abitibi*[71]*, Northstar*[72] and *Nortel*[73].

The JTF is of the view that various issues related to the definition and treatment of environmental claims made against a debtor company and its directors are worthy of consideration. Such issues include the following:

- a definition of what constitutes an "environmental claim" subject to compromise which may not involve reference or evidence regarding environmental authorities' intention to proceed to decontamination;
- a clearer distinction between environmental authorities status as regulator or creditor in a restructuring process;
- jurisdiction of the CCAA court in respect to all environmental claims against the company and its directors;
- adequate stay of proceedings protection for the directors of a debtor company where the CCAA process is used to proceed to the sale of assets and where it becomes evident that no plan of arrangement will be filed[74]

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70 See section 11.4 CCAA.

71 See *Newfoundland and Labrador* v. *AbitibiBowater Inc.,* 2012 SCC 67.

72 See *Re Northstar Aerospace*, 2012 ONSC 4546.

73 See *Re Nortel Networks*, 2010 ONSC 1708.

4.3 Set off of pre-filing claims against post-filing claims

In a restructuring context, a creditor's capacity to operate set-off of post-filing claims with pre-filing claims may lead to inequitable treatment of creditors in certain circumstances. Certain courts[75] have broadly interpreted set-off rights to allow for the set-off of post-filing claims with pre-filing claims in a restructuring context.

The JTF believes that it may be worthy of consideration to implement amendments which would restrict set-off rights otherwise available under BIA and CCAA to preclude a creditor from operating set-off between post-filing claims owing to the debtor company and pre-filing claims owing to such creditor by the debtor company except with leave of the court, where the preclusion would lead to an inherently inequitable result..

4.4 Application and implementation issues with respect to sections 38 and 95-101 of the BIA in the context of restructurings under CCAA and BIA

The JTF is of the view that, in a restructuring context, a debtor company's right to include or exclude recourses otherwise available under sections 38 and 95 to 101 of the BIA raises implementation issues which may be worthy of consideration. Without limitation, the debtor's right to exclude, in a proposal[76] or plan of arrangement, sections 38 and 95 to 101 of the BIA is perhaps overreaching, namely insofar as sections 95 to 101 of the BIA include, *inter alia*, section 97(3) of the BIA which sets out applicable set-off principles. It may thus be worthy to determine whether or not it is appropriate that a proposal or plan of arrangement expressly exclude principles of set-off otherwise applicable under section 97(3) of the BIA.

4.5 The extent of director protection under the BIA and the CCAA

The JTF is of the view that the requirement to demonstrate that it is impossible to obtain indemnification insurance for directors and officers at a reasonable cost, before a charge can be ordered to protect directors and officers,[77] should be reconsidered. In a situation where the debtor company is insolvent and a proceeding is looming, it is quite obvious that insurance will not be available or will only be available at a prohibitive cost, unless the insurance contract is pre-existing. As such, the requirement to demonstrate that insurance at a reasonable cost cannot be obtained is quite often an exercise in futility. The JTF believes that the provision could be modified to ensure that any existing insurance protection cannot be terminated or curtailed by reason of the insolvency of the debtor or by reason that an alternative protection is available through the court ordered charge, and to ensure that it serves to complement the indemnity that may otherwise be payable under any existing insurance contract.

The provisions that allow for a court ordered charge to protect directors and officers against liability refer to a liability that is incurred after the filing of the notice of intention or proposal under the BIA or after the commencement of proceedings under the CCAA. The JTF is of the view that the provision could perhaps be clarified to differentiate when the obligation is triggered from when the liability is incurred.

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74 Under section 11.03 of the CCAA, the stay of proceedings undertaken or to be undertaken against the directors is, in theory, only valid « until a compromise or an arrangement in respect of the company is filed ».

75 See *Re Industries Davie Inc.,* 2000 CarswellQue 7 (C.A.)*, Re Industries Portes Mackie Inc.,* 2000 CarswellQue 431 (C.A.) and *Re Air Canada,* (2003 CarswellOnt 4016 (Ont. S.C.)).

76 See 36.1 of the BIA.

77 See section 11.51(3) CCAA and section 64.1(3) BIA.

SCHEDULE A

Legislative review task force (commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals

Methodology

Set-out below is a description of the methodology followed by the Joint Legislative Review Task Force (Commercial) of the Insolvency Institute of Canada ("**IIC**") and the Canadian Association of Insolvency and Restructuring Professionals ("**CAIRP**") (the "**JTF**").in the preparation of the report addressed to Industry Canada ("**IC**") and to its sponsoring organizations, IIC and CAIRP.

Composition of the JTF

Membership of the JTF was established as follows:

Philippe H. Bélanger - **McCarthy Tétrault LLP** - (IIC Co-chair)
Jean-Daniel Breton - **Ernst & Young Inc.**
Sean F. Collins - **McCarthy Tétrault, LLP**
Stephen Ferguson - **Alvarez & Marsal Canada ULC**
Craig J. Hill - **Borden Ladner Gervais, LLP**
Jonathan Krieger - **Grant Thornton Limited** - (CAIRP Corporate Practice Committee Chair)
Todd M. Martin - **Alvarez & Marsal Canada ULC**
Sylvain Rigaud - **Norton Rose Fulbright**
Martin P. Rosenthal - **Ernst & Young Inc.**
John R. Sandrelli - **Dentons Canada LLP**
Robin B. Schwill - **Davies Ward Phillips & Vineberg, LLP**
Steve Weisz - **Blakes, Cassels & Graydon, LLP**
Mitch Vininsky - **Duff & Phelps Canada Restructuring Inc.**
Mark Wentzell - **Grant Thornton Limited**

Methodology

For the purpose of preparing the report, the JTF held weekly or bi-weekly conference calls between February and July 2014 to identify, discuss and analyze the various topics and issues thought to be worthy of consideration in the context of the next legislative round of reform to the *Bankruptcy and Insolvency Act* ("**BIA**") and the *Companies Creditors' Arrangement Act* ("**CCAA**"). From May onwards, the JTF's weekly conference calls dealt primarily with the review and analysis of the topics and issues identified in the Discussion Paper.

In light of the fact that certain issues raised in the Discussion Paper were seen to be more complex and deserving of more detailed analysis, it was decided to form sub-committees to handle such issues. The following sub-committees were thus formed:

Issues relating to intellectual property rights:	Steven Weisz (Chair) John Sandrelli Josef Kruger Michael Creber Sharon Hamilton Nigel Meakin Ashley Taylor Shayne Kukulowicz Jean Fontaine
Issues relating to employee rights:	Craig Hill (Chair) Jean-Daniel Breton Mark Wentzell Bridget Van Wyk
Issues relating to credit bidding and stalking horse bids	Sylvain Rigaud (Chair) Jean-Daniel Breton Sean Collins Neil Narfasson Martin Rosenthal Mark Wasserman
Issues relating to Cross-border insolvencies	Robin B. Schwill (Chair) Mark Wentzell Kibben Jackson Natasha MacParland Prof. Stephanie Ben-Ishai
Tax issues	Aubrey Kauffman (Chair) Peter Farkas Paul Bishop Grant Moffat Robin Schwill Jean-Daniel Breton
Issues relating to eligible financial contracts	Rupert Chartrand Jean-Daniel Breton Patrick Riesterer

No formal consultation of the members of CAIRP and IIC

Because of the short timeframe within which comments were to be provided to IC with respect to the Discussion Paper, the JTF did not have the opportunity to formally poll or otherwise consult respective members of CAIRP and IIC as to the various issues and topics discussed in the report. The report of the JTF may thus not be seen as reflective of the collective views of the membership of each of IIC and CAIRP. It is envisaged that the report shall serve as a template for further reflection, research and discussion with the members of CAIRP and IIC with a view to eventually formulating formal recommendations as to suggested legislative changes to the Canadian insolvency statutes.

SCHEDULE B

Detailed report prepared by the IIC's Derivatives Task Force previously submitted by the IIC to Industry Canada

SCHEDULE B

Detailed report prepared by the IIC's Derivatives Task Force previously submitted by the IIC to Industry Canada

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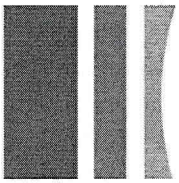
Detailed report prepared by the IIC's Derivatives Task Force previously submitted by the IIC to Industry Canada



Insolvency Institute of Canada
L'Institut d'insolvabilité du Canada

REPORT OF

THE TASK FORCE ON DERIVATIVES

The Insolvency Institute of Canada ("**IIC**") Task Force on Derivatives (the "**Task Force**") respectfully submits this report on behalf of the leading organization of insolvency professionals in Canada. A brief description of the IIC is attached to this Report as Schedule "A". The Report is based on the volunteer efforts of many members of the IIC.

The Task Force was convened to examine the treatment of derivatives and other eligible financial contracts (together, "**EFCs**") under Canadian insolvency law in response to the heightened international scrutiny directed at some derivatives as a result of the 2008 global financial and liquidity crisis. The Task Force has undertaken a comprehensive review of Canadian insolvency statutes. The Report is primarily focused on the EFC provisions of the *Bankruptcy and Insolvency Act*[1] ("**BIA**") and the *Companies' Creditors Arrangement Act*[2] ("**CCAA**"), the two main Canadian insolvency statutes that apply to the insolvencies of commercial enterprises. The Report also considers the EFC provisions under the *Winding-up and Restructuring Act*[3] ("**WURA**").

OVERVIEW

Canadian commercial insolvency law is part of the national framework legislation which is designed to minimize the impact of an insolvency event upon the Canadian economy and to promote a successful restructuring of business enterprises undergoing financial difficulties. A successful restructuring (whether under the same corporate structure, a new legal entity or through a sale of business operations as a going concern) optimizes value for stakeholders, saves jobs, supports communities that rely on local industries, protects the public from losing vital services and encourages the survival of more competitive industries. In the case of financial institutions, the restructuring is also effected to protect special stakeholders such as depositors or policyholders and minimize potential "runs on the bank" which would create instability in financial markets, impair overall liquidity in the financial world and increase systemic risk.

Insolvency law promotes a going concern restructuring of a viable business entity's affairs. When a business entity is brought under insolvency protection, the BIA and CCAA provide a broad stay of rights and remedies against the insolvent entity to encourage a going-concern restructuring of the business where possible. This broad stay is a fundamental tool of Canadian

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

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

[3] R.S.C. 1985, c. W-11, as amended.

restructuring insolvency laws. The stay in part prevents a forced liquidation of a struggling business by staying (a) secured and unsecured creditors from realizing on the assets of the insolvent entity and (b) solvent counterparties from terminating contracts with the insolvent entity. Similarly, the *Canada Deposit Insurance Corporation Act*[4] ("**CDIC Act**") provides a broad stay of proceedings and a process to allow the Canada Deposit Insurance Corporation ("**CDIC**") to attempt to restructure a deposit-taking financial institution.

The legislative reforms regarding EFCs under Canadian insolvency law have been piecemeal. EFC protection was introduced into the BIA beginning in 1992, followed by more extensive amendments to the Canadian insolvency laws which generally came into force in 1997 and 2009. Amendments were also made to the CDIC Act and the *Payment Clearing and Settlement Act*[5] ("**PCSA**") to deal with EFCs entered into by certain financial institutions.

The insolvency regime for EFCs consists of a series of exemptions from the law that ordinarily applies to contracts upon the commencement of insolvency proceedings. The EFC "safe harbours" primarily provide an exemption from the stay of proceedings to permit the termination of EFCs by the solvent counterparty, the determination of the net amount owing under the terminated EFCs, the realization upon financial collateral posted in respect of EFCs and protect the priority thereof.

At the outset, the exemptions under insolvency law for the termination and netting of EFCs were in part promulgated on the basis of concerns for certainty in financial markets and competitiveness vis-à-vis the United States and other global markets. After the safe harbour provisions were added to the United States *Bankruptcy Code*,[6] similar protections were added in Canada to ensure that the Canadian market kept pace with global markets. In addition, it was felt that an exemption from stays against termination of EFCs would provide solvent parties with certainty in their dealings, with the anticipated result of encouraging the availability of risk-hedging derivatives for all Canadian enterprises, including those in financial distress.[7]

EFC protection is a significant exception to the stay of proceedings under the CCAA and BIA. There are two main purposes of the EFC safe harbours: (i) to protect non-defaulting counterparties from the risk of increasing exposure to the insolvent counterparty under the EFC and (ii) to reduce systemic risk in Canadian and global financial markets. Non-defaulting counterparties may be at risk because, in certain instances, the amounts under the EFCs are very substantial and the value of the underlying products subject to EFCs are volatile in nature and can change dramatically during an insolvency proceeding. If the solvent counterparty to an EFC is subject to a stay of proceedings and therefore unable to terminate its EFCs with the insolvent counterparty, there is a risk that the value of such EFCs could deteriorate sufficiently (from the

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

[5] S.C 1996, c. 6, Sch., as amended.

[6] *U.S. Code*, title 11.

[7] Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations respecting Order of Reference from the House of Commons dated Tuesday June 18, 1991 – pre-study of Bill C-22, *An Act to enact the Wage Claim Payment Act, to amend the Bankruptcy Act and to amend other Acts in consequence thereof*, House of Commons, 3rd Sess, 34th Parl, Issue No. 5, September 3, 1991, Chairman Felix Holtmann, at 1017–1018. [CBA Submissions].

insolvent counterparty's perspective) to put the solvent counterparty at risk. Systemic risk may arise where the solvent counterparty is a systemically important institution or where the solvent counterparty has entered into EFCs with one or more other counterparties. In extreme cases, the failure of one counterparty could have a domino effect, where the failure of one counterparty, particularly a derivatives dealer, triggers the failure of a second counterparty who is also a derivatives dealer and the failure of the second counterparty could trigger the failure of others. Multiple insolvencies may cause a lack of liquidity in the financial sector and unavailability of credit to solvent enterprises and, ultimately, systemic risk. The systemic risk could spread to global markets and lead to world-wide financial instability and, in extreme cases, recession.

The 2008 global financial and liquidity crisis precipitated recognition by governments and regulators of the need for a better understanding and more comprehensive regulation of derivatives. At the Pittsburgh Summit in 2009, the G20, including Canada, committed to strengthening the regulation, supervision and infrastructure of the global financial system (the "**G20 Commitments**"). The G20 Commitments include a commitment to attempt to mitigate systemic risk, particularly in the area of over-the-counter ("**OTC**") derivatives, by increasing the transparency of the OTC derivatives market and ensuring more consistent treatment of derivatives in different jurisdictions. To limit systemic risk, the G20 committed in part to the development of an internationally coordinated and comprehensive regulatory framework to facilitate the central clearing of most OTC derivatives according to internationally accepted standards, including insolvency rules.

Recent Canadian federal legislative amendments have focused on meeting the G20 Commitments. Amendments to the PCSA and the CDIC Act were enacted in 2012 primarily to facilitate the clearing and settlement of OTC derivatives by central counterparties and to further facilitate the restructuring of insolvent financial institutions by CDIC.[8] At the provincial level, the Canadian Securities Administrators are introducing rules to regulate more closely the OTC derivatives market and to provide for the central clearing of OTC derivatives.

Combating systemic risk is an important goal. However, the goal of reducing systemic risk has to be balanced against important Canadian insolvency principles which encourage restructuring. The Task Force has considered the treatment of derivatives in Canadian insolvency law in this light. The Task Force is of the view that the current treatment of EFCs in the Canadian insolvency regime does not always strike the right balance between protecting against systemic risk and allowing insolvent commercial enterprises to restructure. The current regime may in some cases impede the restructuring of insolvent enterprises by placing too much emphasis on attempting to reduce systemic risk.

In other cases, the protections against systemic risk may be improved and the Task Force supports strengthening some of the EFC safe harbours. In particular, additional protections should be provided to ensure that EFC counterparties have better priority to financial collateral. This protection against systemic risk can be granted without impeding a restructuring.

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[8] On June 27, 2012, the Task Force submitted to the Department of Finance its *Preliminary Review of Federal Legislative Changes to Accommodate Central Clearing of Over the Counter Derivatives*, which expressed its views on a preliminary outline of these amendments that was provided by the Department of Finance to the Task Force and other stakeholders for comment.

As currently drafted, the EFC safe harbours may in some cases deprive the insolvent estate of value to which the estate and its creditors should be entitled. Further, the EFC safe harbours may delay or prevent certain liabilities of the insolvent entity from being crystallized. The Task Force has made certain recommendations aimed at maximizing the value of the estate and enhancing the prospects of a restructuring of an insolvent enterprise without unduly increasing the potential for systemic risk.

In making its recommendations, the Task Force is cognizant of the fact that the global and Canadian regulators have reached a broad consensus that the EFCs entered into by most commercial enterprises pose little or no risk to major financial institutions and therefore do not give rise to systemic risk on a global scale. Global and Canadian regulators have accordingly determined that EFC transactions with commercial enterprise "end-users" of EFCs should be exempt from the mandatory central clearing regime that is being developed primarily for financial institutions.[9] The Task Force recognizes that there is still a potential for systemic risk arising as a result of the failure of a commercial enterprise. However, the Task Force is of the view that the emphasis solely on the potential for systemic risk, however remote, may in some instances be disproportionate given the impact that the EFC safe harbours may have on the ability of a commercial enterprise to restructure and on the recoveries of other creditors of the insolvent counterparty.

As noted above, EFCs receive special protection because (i) liabilities under EFCs are often based upon large notional amounts and (ii) the values of the underlying reference items and the financial collateral securing EFC obligations are highly volatile and significant fluctuation of these values can occur during an insolvency proceeding.

In addition, the EFC exemptions were introduced to make Canadian institutions competitive in the global derivatives market and to ensure Canadian enterprises have access to the global derivatives markets.

For these reasons, the Task Force does not recommend a repeal of the fundamental EFC safe harbour provisions under the BIA, the CCAA and, to the extent they are available in respect of a trading company, the WURA, but rather recommends a series of modifications to alleviate the EFC safe harbour provisions with a view to achieving a better balance between the objectives of insolvency legislation and financial risk.

The Task Force is making recommendations regarding the following broad categories:

A. Allow the termination of EFCs by the insolvent entity or its court appointed officer.

B. Allow the assignment of EFCs by the insolvent entity or its court appointed officer.

C. Prohibit walk-away clauses in EFC contracts.

D. Increase the priority of EFC financial collateral.

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[9] See Basel Committee on Banking Supervision & Board of the International Organization of Securities Commissions, *Margin requirements for non-centrally cleared derivatives* (Bank for International Settlements: September 2012) at p. 9; see also Canadian Securities Administrators, *CSA Consultation Paper 91-405, Derivatives End-User Exemption* (Canadian Securities Administrators Derivatives Committee: April 13, 2012).

E. Protect the central clearing of OTC derivatives.

F. Protect EFCs in receiverships.

The Report is presented from an insolvency point of view. The recommendations are primarily meant to promote restructurings and to preserve value for an insolvent commercial enterprise and its stakeholders. The recommendations should, however, be considered in light of the impact, if any, which they would have on the ability of Canadian financial institutions and solvent enterprises to access the global derivatives markets. Canadian EFC protections under insolvency law should be periodically reviewed in light of ongoing international legal developments.

RECOMMENDATIONS

Termination of EFCs

1. The prohibition on disclaimer or resiliation[10] of EFCs by the insolvent party in section 32(9) of the CCAA and section 65.11(10)(a) of the BIA should be repealed. If the solvent party does not terminate the EFC, the insolvent party should have the power to do so on the following basis:

   (a) the insolvent party should not be able to disclaim EFCs until 30 days after the insolvency filing.

   (b) at the end of the 30 day period, the same regime for disclaimer of agreements found in section 32 of the CCAA and section 65.11 of the BIA should apply to the disclaimer of an EFC, including a 30-day notice period and a 15-day objection period.

   (c) cherry-picking of EFCs during the disclaimer process should be expressly forbidden.

2. A receiver appointed under Part XI of the BIA, a trustee in bankruptcy and a liquidator appointed under the WURA should also have the power to disclaim EFCs 30 days after their appointment by the Court on the following basis:

   (a) a trustee in bankruptcy should have the authority under section 30 of the BIA, with the permission of the inspectors of the bankrupt estate, to disclaim an EFC in the same manner as an insolvent debtor can disclaim other contracts under section 65.11 of the BIA.

   (b) a receiver under Part XI of the BIA or a liquidator under the WURA should be able to apply to court on notice to the solvent counterparty to disclaim an EFC on providing 30 days' notice to the solvent counterparty. The solvent counterparty should be able to object in court to the disclaimer on the same grounds as for the disclaimer of other contracts under section 65.11 of the BIA.

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[10] To simplify the text, the terms disclaimer and disclaim will be used throughout this text to also mean resiliation and resiliate.

(c) cherry-picking of EFCs should also be expressly forbidden.

Assignment of EFCs

1. The prohibition on assignment of EFCs by the insolvent party in section 11.3(2)(b) of the CCAA and section 84.1(3)(b) of the BIA should be repealed.

2. An insolvent entity, a trustee in bankruptcy, receiver under Part XI of the BIA and a liquidator of an insolvent insurance company under Part III of the WURA should be able to apply to the Court for an order assigning an EFC pursuant to the process provided for the assignment of other contracts in the CCAA and BIA on notice of the court motion seeking the assignment to the non-defaulting counterparty and other affected parties which, except in the case of insurance company insolvencies, is not less than 30 days.

3. The non-defaulting counterparty should not be permitted to terminate an EFC from the date the court makes an order assigning the EFC or such later date as may be set by the court.

4. Cherry-picking of EFCs to be assigned should be expressly forbidden and all contracts associated with an assigned EFC should be required to be assigned as well.

Walk-Away Clauses

The solvent counterparty should not be able to refuse to make net termination payments to the insolvent party on termination of an EFC because of the commencement of insolvency proceedings or any steps taken during the insolvency proceedings, such as a disclaimer of an EFC by the insolvent counterparty. The BIA, CCAA and WURA should be amended to render ineffective any provisions in an EFC that have the effect of providing for or permitting anything on termination, disclaimer or assignment of an EFC that is, in substance, equivalent to a walk-away clause.

Financial Collateral

1. Financial collateral should have priority over the super-priority liens for (i) certain wages pursuant to sections 81.3 and 81.4 of the BIA, (ii) certain pension amounts pursuant to sections 81.5 and 81.6 of the BIA and (iii) the deemed trusts pursuant to section 227 of the *Income Tax Act* ("**ITA**"),[11] section 23 of the *Canada Pension Plan*[12] ("**CPP**"), section 86 of the *Employment Insurance Act*[13] ("**EIA**"), and substantially similar provisions of provincial legislation.[14]

2. Financial collateral should be limited to those listed assets that are posted with, pledged to or specifically assigned to the solvent counterparty or under the control of an entity other than the insolvent counterparty or its related entities or that are subject to set-off or

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

[12] R.S.C. 1985, c. C-8, as amended.

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

[14] For example, section 20 of the Quebec *Tax Administration Act* ("**QTAA**"), R.S.Q. c. A-6.002, as amended.

netting rights with the solvent counterparty or where title to the assets has been transferred by the insolvent debtor pursuant to a title transfer credit support agreement.

OTC Derivatives

1. The definitions of "clearing house", "clearing member" and "margin deposit" in Section 95(3) of the BIA should be expanded to cover derivatives clearing houses clearing derivatives transactions.

Receiverships

1. The receivership provisions in the BIA should be amended to ensure that a court does not have the power to stay a solvent counterparty from terminating an EFC in accordance with its terms, calculating net termination values of an EFC and netting or setting-off and dealing with financial collateral in accordance with the terms of an EFC. Such an amendment would make the provisions in certain Model Receivership Orders mandatory rather than discretionary. The amendment would result in standard treatment of EFCs in all receivership proceedings across Canada, as well as harmonizing receiverships with bankruptcies.

2. Section 88 of the BIA should be amended to apply to receiverships under Part XI of the BIA. The BIA should protect financial collateral to ensure that financial collateral posted with or pledged to secure an EFC is not primed by charges granted pursuant to a receivership order, including provisions granting a super-priority charge to a receiver in respect of the receiver's borrowings and the receiver's and other professional's fees.

DISCUSSION OF RECOMMENDATIONS

A. Termination of EFCs by Insolvent Estate

In the context of amendments to the BIA and CCAA codifying the process by which an insolvent debtor may disclaim agreements, provisions came into force in 2009 to prevent the debtor from terminating an EFC. Section 65.11(10) of the BIA was introduced to prohibit an insolvent debtor seeking to restructure under the BIA proposal provisions from disclaiming certain types of contracts, including EFCs. Similarly, section 32(9) of the CCAA was introduced to prohibit a debtor company from disclaiming an EFC. The reason for including EFCs in the list of contract types exempted from the disclaimer power was to permit the solvent counterparty to control the timing of termination so that it is able to effectively rehedge its exposure on derivatives transactions. As currently drafted, there is no time limit imposed on the solvent counterparty's unilateral right to terminate an EFC, which has the potential to create problems during a restructuring.

The EFC exemption from the disclaimer power can create an impediment to a successful restructuring and does little, if anything, to minimize systemic risk. To restructure successfully, a business operation needs to be cleared of burdensome contracts, including EFCs, and be able to crystallize and compromise claims of creditors. Further, if the insolvent party is "in the money" on a net basis on its EFCs with a counterparty, it should also have the opportunity to benefit from the net termination values. The permanent stay on termination of an EFC by the insolvent

counterparty and the possibility of a reliance by the solvent counterparty on walk-away clauses in the EFC (as discussed below) impede both these goals.

The inability to disclaim an EFC can create uncertainty for the insolvent party and may prevent it from realizing value, which is counterproductive to the objectives of the insolvency legislation. If no action is taken by the solvent party and the insolvent party is not allowed to take action, then the insolvent party may lose a valuable asset because of changes in the market. The products underlying an EFC are often volatile. Furthermore, the fact that the solvent party may take action at any time with little prior notice creates uncertainty for the insolvent party, as the extent of its debt load cannot be known with certainty until all contracts have been terminated or have expired. This situation can affect the chances of success of a restructuring proceeding.

The solvent counterparty's unilateral right to terminate the EFC need not be indefinite to protect against systemic risk. It is important that the insolvent enterprise be given an opportunity to attempt to restructure and emerge from the insolvency process as a viable business. The Task Force is therefore of the view that the insolvent counterparty should have the right to terminate the EFC after an appropriate period.

The Task Force is of the view that giving the debtor a right to terminate EFCs in accordance with the general contract disclaimer regime under the BIA and CCAA will balance the rights of the solvent counterparty and the potential for systemic risk with the need to facilitate a restructuring. The same process for the disclaimer of contracts by an insolvent debtor should apply to EFCs. This process requires the insolvent party to give 30 days' notice of its intent to disclaim a contract. Upon the commencement of the 30 day notice period, the other party to the contract has a 15 day period to object to the disclaimer of the contract by applying to the court for an order that the contract not be disclaimed. Since the termination of EFCs is not stayed, a 30 day notice period will also allow the solvent counterparty a relatively lengthy period of time during which it may terminate the EFC on a date of its own choosing.

Termination of certain derivatives contracts may require the solvent counterparty to rehedge its position. To facilitate re-hedging, the Task Force is of the view that the insolvent debtor should not be able to give notice of its intent to disclaim EFCs until 30 days after the date of the insolvency filing.

Further, the solvent counterparty would have an additional 30 days to re-hedge under the existing notice regime for the disclaimer of contracts. This would give the solvent counterparty a total of at least 60 days before an EFC can be terminated by an insolvent debtor. In section 32(4) of the CCAA and section 65.11(5) of the BIA, when deciding whether to allow a disclaimer, the court is to consider, among other things, whether the disclaimer would likely cause significant financial hardship to a party to the agreement. The court has the discretion to refuse to allow the disclaimer or to extend the 30 day notice period to protect the solvent counterparty from the disclaimer of any contract if financial hardship is an issue. Financial hardship could arise where a solvent counterparty to an EFC may experience difficulty in rehedging its position during the 60 day time period. In such circumstances, the court could refuse to allow the disclaimer or could extend the time period to minimize the financial hardship.

In addition to businesses attempting to restructure, the right to disclaim EFCs should also be available to a trustee in bankruptcy under the BIA, a receiver appointed under the BIA, and the

liquidator appointed under the WURA.[15] An insolvent estate, even if not restructuring, should not, as a matter of policy, lose value merely because of the commencement of insolvency proceedings. This is contrary to the general goal of maximizing value for all stakeholders. Further, there is a need to crystallize claims against the estate where the solvent counterparty has an in-the-money position to allow for a timely distribution to the creditors.

A trustee in bankruptcy should have the authority under section 30 of the BIA, with the permission of the inspectors of the bankrupt estate, to disclaim an EFC in the same manner as an insolvent debtor can disclaim other contracts under section 65.11 of the BIA.

A receiver under Part XI of the BIA or a liquidator under the WURA should be able to apply to court on notice to the solvent counterparty to disclaim an EFC on providing 30 days' notice to the solvent counterparty. The solvent counterparty should be able to object in court to the disclaimer on the same grounds as for the disclaimer of ordinary contracts under section 65.11 of the BIA.

The right to disclaim would not apply to any EFC transactions that have been cleared.

Members of the Task Force are of the view that the disclaimer regime should not permit an insolvent entity, trustee in bankruptcy, receiver or liquidator to cherry-pick valuable EFCs. Cherry-picking is unfair to the solvent counterparty and has the potential to provide certain creditors of the estate with an undeserved windfall at the solvent counterparty's expense. The disclaimer of EFCs should be permitted only where all EFCs with the same solvent counterparty are also disclaimed. This will prevent the insolvent entity from terminating only in-the-money contracts with the solvent party and impair the netting of obligations under other EFCs with the same counterparty. The Task Force recommends that the language used in section 39.15(7.2) of the CDIC Act be used as a guide to prevent cherry-picking.[16]

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[15] The IIC has previously recommended significant amendments to the WURA, including restricting its application to financial institutions. For a detailed review of the WURA recommendations, see the Insolvency Institute of Canada's *Winding-Up and Restructuring Act: Recommendations for Reform* (June 14, 2002).

[16] Section 39.15(7.2) of the CDIC Act provides as follows:

> The Corporation may assign to a bridge institution eligible financial contracts — including any claim under such contracts — that are between a federal member institution and an entity or any of the following entities provided that the Corporation assigns all of those eligible financial contracts to the bridge institution:
>
> (a) another entity that is controlled — directly or indirectly — by the entity;
>
> (b) another entity that controls — directly or indirectly — the entity; or
>
> (c) another entity that is controlled — directly or indirectly — by the entity referred to in paragraph (b).

Recommendations on Termination of EFCs

1. The prohibition on disclaimer of EFCs by the insolvent party in section 32(9) of the CCAA and section 65.11(10)(a) of the BIA should be repealed. If the solvent party does not terminate the EFC, the insolvent party should have the power to do so on the following basis:

   (a) the insolvent party should not be able to disclaim EFCs until 30 days after the insolvency filing.

   (b) at the end of the 30 day period, the same regime for disclaimer of agreements found in section 32 of the CCAA and section 65.11 of the BIA should apply to disclaimer of an EFC, including the requirement that 30 days' notice be given and the right of a solvent counterparty to object within 15 days of the provision of such notice.

   (c) cherry-picking of EFCs during the disclaimer process should be expressly forbidden.

2. A receiver appointed under Part XI of the BIA, a trustee in bankruptcy and a liquidator under the WURA should also have the power to disclaim EFCs 30 days after their appointment by the Court on the following basis:

   (a) a trustee in bankruptcy should have the authority under section 30 of the BIA, with the permission of the inspectors of the bankrupt estate, to disclaim an EFC in the same manner as an insolvent debtor can disclaim other contracts under section 65.11 of the BIA.

   (b) a receiver under Part XI of the BIA or a liquidator under the WURA should be able to apply to court on notice to the solvent counterparty to disclaim an EFC on providing 30 days' notice to the solvent counterparty. The solvent counterparty should be able to object in court to the disclaimer on the same grounds as for the disclaimer of ordinary contracts under section 65.11 of the BIA.

   (c) cherry-picking of EFCs should also be expressly forbidden.

B. Assignment of EFCs

In the context of amendments to the BIA and CCAA codifying the process by which an insolvent debtor may assign agreements, provisions also came into force in 2009 to prevent an insolvent debtor from assigning an EFC. Section 84.1(3)(b) of the BIA was introduced to prohibit a trustee in bankruptcy (and, by virtue of section 66 of the BIA, an insolvent debtor seeking to restructure under the BIA proposal provisions) from assigning an EFC. Similarly, section 11.3(2)(b) of the CCAA was introduced to prohibit a debtor company from assigning an EFC. The reason for including EFCs in the list of contract types exempted from the forced assignment power was to permit the solvent counterparty to control who is the new counterparty in a derivatives transaction.

The ability to assign EFCs would preserve and maximize value for the insolvent estate and may increase recoveries to creditors. The right to apply to court for an order assigning an EFC would most likely be used in the context of a sale of an entire book of business or a sale of a whole business, including EFCs entered into by the previous owner to hedge certain risks faced in that industry.

The right to assign EFCs is particularly important for Canadian insurance companies. Many Canadian insurance companies are major financial institutions. These companies have significant derivative books of business, particularly in their "dynamic hedging" programs for interest rates, equities and other risks. A major task of a liquidator of an insurance company appointed under Part III of the WURA is to seek to restructure the insolvent company's business portfolio so that it can be acquired by another insurance company. This maximizes value and protects policyholders. This objective is very similar to a restructuring of other financial institutions such as banks.

The court motion seeking an assignment of EFCs should be subject to the normal assignment provisions in the BIA and the CCAA, including evidence of the ability of the assignee to perform under the EFC, the assignee being an appropriate person to be assigned the rights and obligations under the EFC and the assignee curing any outstanding monetary defaults[17] under the EFC within the time fixed by the court.

To allow the solvent counterparty ample time to consider the proposed assignment and determine whether it can accept the proposed assignee, the notice of motion seeking an order assigning the EFC should be made on at least 30 days' notice to the solvent counterparty. During that period, the solvent counterparty will be able to terminate the EFC if it is not satisfied with the information provided to it and the court or if it does not accept the proposed assignee as the new counterparty. This termination right would survive until the court makes an order assigning the EFC or such later date as may be set by the court.

In the case of insurance company insolvencies, the liquidator need not be limited to a 30-day notice period. The treatment of the sale of assets, including derivatives, in proceedings in respect of an insolvent insurance company should be similar to the treatment of such sales in insolvency proceedings in respect of other regulated financial institutions. To protect policyholders and the stability and confidence in financial markets, a liquidator may need to sell the whole book of business early in the liquidation process.

The right to seek court approval of an assignment of an EFC would not apply to any EFC transactions that have been cleared.

For the same reasons as for the termination of EFCs, there should not be any cherry-picking on the assignment of EFCs with the same counterparty and all contracts associated with an assigned EFC should be required to be assigned as well.

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[17] Other than monetary defaults triggered by the debtor's insolvency, failure to meet financial covenants, accessing the relief provided by an insolvency statute, or other similar default.

Recommendations on the Assignment of EFCs

1. The prohibition on assignment of EFCs by the insolvent party in section 11.3(2)(b) of the CCAA and section 84.1(3)(b) of the BIA should be repealed.

2. An insolvent entity, a trustee in bankruptcy, receiver under Part XI of the BIA and a liquidator of an insolvent insurance company under Part III of the WURA should be able to apply to the Court for an order assigning an EFC pursuant to the process provided for the assignment of other contracts in the CCAA and BIA on notice of the court motion seeking the assignment to the non-defaulting counterparty and other affected parties which, except in the case of insurance company insolvencies, is not less than 30 days.

3. The non-defaulting counterparty should not be permitted to terminate an EFC from the date the court makes an order assigning the EFC or such later date as may be set by the court.

4. Cherry-picking of EFCs to be assigned should be expressly forbidden and all contracts associated with an assigned EFC should be required to be assigned as well.

C. Prohibition of Walk-Away Clauses

In a typical derivatives contract, when the contract is terminated, the party who is "out of the money" must pay the party who is "in the money." However, clauses are sometimes, though rarely, included in EFCs which override the typical provision by affording one counterparty the right to walk away from a termination payment that would otherwise be due to the other counterparty when the second counterparty commits certain specified defaults, including becoming subject to insolvency proceedings (such provision a "**walk-away clause**").

The EFC safe harbours were not intended to create a benefit for solvent counterparties. The EFC safe harbours were first suggested as a means to facilitate the termination of EFCs on a timely basis where one counterparty has become the subject of insolvency proceedings and were intended to benefit both the solvent and insolvent counterparties. The provision permits the solvent counterparty to terminate an EFC at market price, and gives rise to a net amount that may well be payable to the insolvent counterparty, rather than to the solvent counterparty. The exemption from the stay facilitates the determination of a fixed and certain value to the EFC and the right of both counterparties to collect such amount, just like an amount owed under any other contract at the time of the stay.[18]

Walk-away clauses have the potential to create significant windfalls for the counterparties that have the benefit of such clauses while causing significant harm to defaulting (insolvent) counterparties and their creditors. Walk-away clauses are disproportionately favourable to the non-defaulting counterparty and do not protect against systemic risk. The BIA, CCAA and WURA should be amended to render ineffective any provisions in an EFC that have the effect of providing for or permitting anything that is, in substance, equivalent to a walk-away clause.

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[18] CBA Submissions, *supra* note 7.

Certain provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*[19] ("**Dodd-Frank Act**") recently enacted in the United States provide that no walk-away clauses shall be enforceable with respect to certain covered financial companies.[20]

Walk-away clauses should be prohibited under the BIA, CCAA and WURA. The capital adequacy requirements published by the Office of the Superintendent of Financial Institutions require certain financial institutions to disregard EFCs that include walk-away clauses for purposes of measuring the financial institution's regulatory capital and for calculating netting in respect of same.[21] Even if the capital adequacy rules are sufficient to prevent certain financial institutions from inserting walk-away clauses in their EFCs, many derivatives dealers and other persons carrying on business through trading or entering into derivatives may not be subject to the same or similar capital adequacy rules. A standard rule for all EFCs should apply.

Prohibiting walk-away clauses will make the EFC safe harbours more consistent with Canadian insolvency law principles and the initial justification for the EFC safe harbours.

Recommendation on Prohibition of Walk-Away Clauses

1. The solvent counterparty should not be able to refuse to make net termination payments to the insolvent party on termination of an EFC because of the commencement of insolvency proceedings or any steps taken during the insolvency proceedings, such as a disclaimer of an EFC by the insolvent counterparty. The BIA, CCAA and WURA should be amended to render ineffective any provisions in an EFC that have the effect of providing for or permitting anything on termination, disclaimer or assignment of an EFC that is, in substance, equivalent to a walk-away clause.

D. Financial Collateral

The EFC safe harbours in the BIA, CCAA and WURA permit a solvent counterparty to realize upon financial collateral notwithstanding any stay resulting from the commencement of insolvency proceedings.[22] The protection for financial collateral came into force in September 2009.

Canadian insolvency law purports to give a solvent counterparty almost unlimited rights to enforce on its interests in financial collateral. The EFC safe harbours permit "any dealing with financial collateral" including sale, foreclosure and set off. Further, section 88 of the BIA provides that no order may be made under the BIA in relation to a bankruptcy or a proposal if the

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[19] Pub. L. 111-203; H.R. 4173.

[20] Dodd-Frank Act, s. 210(c)(8)(F). The U.S. courts have also not supported clauses which are in effect walk-away clauses: *Lehman Bros. Holding Inc. v BNY Corporate Trustee Servs. Ltd.*, 2010 BL 14861 (2010, U.S. Brtcy. Ct., S.D.N.Y.); *In Re Lehman Brothers Special Finance Inc. v Ballyrock ABS CDO 2007-1 Limited et al.*, 452 B.R. 31 (2011, U.S. Brtcy. Ct., S.D.N.Y.).

[21] Office of the Superintendent of Financial Institutions Canada, *Guideline: Capital Adequacy Requirements* (Effective Date: January 2013).

[22] The CDIC Act also provides solvent counterparties with a similar right to realize on financial collateral, subject to the one day stay that may result if CDIC is appointed receiver of the insolvent financial institution.

order would have the effect of subordinating financial collateral. Section 34(11) of the CCAA similarly provides that no order may be made under the CCAA if the order would have the effect of subordinating financial collateral.

Despite these clear pronouncements, the current provisions in Canadian insolvency law do not always clearly delineate who has priority over financial collateral. Section 81.3 of the BIA attributes an absolute priority to certain employee wage claims against current assets, subject only to certain deemed trusts in favour of the Crown[23] ("**Crown**"); and section 81.5 of the BIA attributes an absolute priority to certain pension claims against all the assets of the bankrupt, subject only to the employees' wage claims under section 81.3 of the BIA and certain of the Crown's deemed trusts. The assets potentially encumbered by the super-priority statutory lien for wage and pension claims against the insolvent could include financial collateral. Further, the Crown's deemed trust provisions could have priority over the solvent counterparty's rights to financial collateral.

The Task Force is of the view that the solvent counterparty should have a first ranking right to the financial collateral, ahead of the various statutory priorities for employees, pension plans and unremitted source deduction and withholding taxes, and that the above-mentioned statutory priorities should not affect the solvent counterparties' set-off or netting rights under EFCs. Unlike other security interests, financial collateral is one of the fundamental building blocks to protect against the potential for systemic risk arising in respect of EFCs.

The Task Force is also of the view that the definition of financial collateral as it relates to the type of security taken is too broad given the enhanced priority recommended for solvent counterparties with respect to financial collateral. To ensure that the Task Force's recommendation regarding the increased priority to financial collateral for solvent counterparties does not have a negative impact on employees, pension plans or the Crown, the scope of the security over financial collateral should be limited to collateral that is posted with or pledged to the solvent counterparty or in the control of an entity other than the insolvent counterparty, either as it exists on the date of the initial insolvency event or thereafter. These limits on the scope of the priority for the security over financial collateral will appropriately protect the interests of employees, pension plans and the Crown without the potential for increasing systemic risk.

One potential problem that the Task Force has identified with the current broad definition of financial collateral arises because a charge on financial collateral could resemble a floating charge on cash and securities which come into existence after an insolvency filing. In current banking practice, it is not unusual for a lender to offer an interest rate and/or foreign exchange swap as part of the financial arrangements under a credit agreement. These swaps qualify as EFCs. Generally, a lender will enter into a separate swap agreement with the borrower, but the swap will be secured by the same general security agreement or hypothec on the universality of the borrower's assets that also secures the credit facility. The collateral relied on for the general loan is mainly bank accounts, inventory and accounts receivable, which generate or provide the cash for repayment of the general loan. Allowing the borrower to use the same collateral for the swap as for the general loan improves the borrower's liquidity as the borrower does not need to

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[23] The deemed trusts pursuant to section 227 of the ITA, section 23 of the CPP, section 86 of the EIA, and substantially similar provisions of provincial legislation. See *supra* note 14.

separately post cash or securities as collateral for the swap. The amounts owing from time to time under the swap generally do not reduce the credit line by the full amount of the swap.

Problems could arise in an insolvency where there the same general security agreement secures both the general loan and the EFCs granted pursuant to that loan. Upon the insolvency of the borrower, a lender that provides a swap that is secured by a general security agreement or an hypothec on the universality of a borrower's assets may take the position that the cash in the borrower's operating account or certain other current asset collateral under the general security agreement or hypothec is financial collateral. Interpreting the assets subject to the general security agreement as financial collateral could mean that the general lender, in its capacity as swap counterparty, is allowed to realize on the assets of the debtor including assets acquired by the debtor after the insolvency filing notwithstanding the stay that would normally apply to it in its capacity as secured creditor. Further, if the assets are financial collateral, the general lender in its capacity as swap counterparty potentially has priority over any charge to secure interim financing (colloquially, "**DIP**" financing) as well as over all assets acquired by the debtor after the insolvency filing (including any DIP financing drawn after the insolvency filing).

The current broad definition of financial collateral therefore has the potential to undermine many insolvent entities' restructuring efforts. The current definition of financial collateral could be interpreted in a way that would allow a solvent counterparty that has security under a general security agreement to seize the operating bank accounts or other securities of the insolvent counterparty at any time following default and, if the operating account is not seized, the solvent counterparty could require post-filing cash received by the borrower to be swept into an account controlled by the solvent counterparty to which the insolvent counterparty would not have access. The solvent counterparty could also argue that a court cannot grant a charge over the assets securing the swap (relying on CCAA s. 34(11)) and that these assets must be used to satisfy EFC obligations. This could have a serious impact on the restructuring efforts of the insolvent counterparty. The insolvent counterparty will need cash and current assets to operate and will likely need the ability to give security over its current assets in order to obtain interim financing.

The Task Force is particularly concerned about the scope of financial collateral given its recommendation that claims of a solvent counterparty to financial collateral be given priority over the claims of wage earners for unpaid wages, pensioners for unremitted pension contributions and taxing authorities for unremitted source deductions.

However, the limitation on the type of security or arrangement over financial collateral which can be given first ranking security status may lead some lenders to require from the borrower, in addition to a general security agreement or hypothec on the universality of the undertaking, a posting of collateral which could affect the liquidity needs of a solvent or insolvent party. Adoption of this recommendation should take this market risk factor into account.

Recommendations for Financial Collateral

1. Financial collateral should have priority over the super-priority liens for (i) certain wages pursuant to sections 81.3 and 81.4 of the BIA, (ii) certain pension amounts pursuant to sections 81.5 and 81.6 of the BIA and (iii) the deemed trusts in favour of the Crown

pursuant to section 227 of the ITA, section 23 of the CPP, section 86 of the EIA, and substantially similar provisions of provincial legislation.[24]

2. Financial collateral should be limited to those listed assets that are posted with, pledged to or specifically assigned to the solvent counterparty or under the control of an entity other than the insolvent counterparty or its related entities or that are subject to set-off or netting rights with the solvent counterparty or where title to the assets has been transferred by the insolvent debtor pursuant to a title transfer credit support agreement.

E. Central Clearing of OTC Derivatives

The Canadian regulators, in conjunction with other foreign regulators, are establishing international standard rules to require that the more standard OTC derivatives be cleared through derivatives clearing houses. The clearing houses will require their participating members to post collateral and make margin deposits to secure the obligations of the participating members to the clearing house.

Section 95 of the BIA deems bodies which clear securities and its members to be dealing at arm's length and exempts a securities clearing house from the rebuttable presumption that a payment has been made or that security has been taken with an intent to give the clearing house a preference over other creditors of the clearing member.

The Task Force is of the view that derivatives clearing houses should benefit from the same exemption under the BIA preference rule.

Recommendation for OTC Derivatives

1. The definitions of "clearing house", "clearing member" and "margin deposit" in Section 95(3) of the BIA should be expanded to cover derivatives clearing houses clearing derivatives transactions.

F. Receiverships under Part XI of the BIA

The provisions dealing with national receiverships and the appointment of a receiver by the Court pursuant to the BIA were introduced as part of the amendments that came into force in September 2009. Previously, the BIA did not provide for the appointment of a receiver by the Court, although it provided for the appointment of interim receivers in the context of a proposal, an application for a bankruptcy order or an intention by a secured creditor to enforce its security. Prior to 2009, courts in some provinces had given an expansive interpretation to the interim receivership provisions exercising their inherent jurisdiction such that interim receiverships were effectively full receiverships. In 2009, interim receivers were returned to their original role with limited powers and the ability to act only on an interim basis.

The amendments that came into force in 2009 did not deal with EFCs and no safe harbours apply in the receivership context. As such, while the CCAA and BIA contain exemptions for certain remedies in respect of EFCs in bankruptcy and restructuring situations, there is no mention of EFCs in the context of receiverships.

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[24] For example, section 20 of the QTAA.

Prior to the amendments to the BIA, receivership was an equitable remedy which relied upon the broad jurisdiction of the courts in common law jurisdictions. The *Civil Code of Quebec*[25] and *Code of Civil Procedure*[26] do not specifically provide for the appointment of a receiver by the Court as an equitable remedy. Over time, receiverships have evolved. Courts outside of Quebec have used their inherent jurisdiction to impose a very broad stay of proceedings in a receivership to stay the termination of contracts, similar to a stay imposed by a court in a CCAA proceeding. This practice has continued to develop since 2009. The Quebec courts are sometimes reticent to grant a stay in such circumstances.

The Task Force has concluded that EFC safe harbours should be expressly provided in a receivership in the same fashion as elsewhere in the BIA and CCAA. Currently, protection of EFCs is solely at the discretion of the court exercising its inherent powers. Some provinces have developed Model Receivership Orders. Several Model Receivership Orders provide that the receivership stay does not apply in respect of an EFC,[27] but this protection is not uniform. For example, the Saskatchewan Model Receivership Order does not exempt EFCs from the receivership stay. In addition, Model Orders are discretionary. A court can choose to grant a broader stay in certain circumstances. The discretionary nature of the stay and the lack of uniformity among the provinces should be addressed to ensure that systemic risk is appropriately curtailed. Further, EFC safe harbours should be added to receiverships to ensure that regulators and market participants have the level of legal certainty they require for these types of rights.

The BIA provides that no order can be made in the context of a bankruptcy or proposal which has the effect of subordinating financial collateral. The BIA is silent on the effect of receiverships on financial collateral. The Model Receivership Orders developed, however, provide for a super-priority charge for the Receiver's and the Receiver's other professional fees over all the property of the debtor and a super-priority charge for the Receiver's borrowings over all the property of the debtor (collectively, the "**Receiver's Charges**"). The Receiver's Charges in the Model Receivership Orders generally have priority over every lien, charge, encumbrance and security interest except the environmental lien (BIA, s. 14.06(7)), the wages charge (BIA, s. 81.4(4)) and the pension charge (BIA, s. 81.6(2)).[28] Accordingly, the Receiver's Charges granted by a court generally prime financial collateral. The Receiver's Charges are therefore generally broader than the charges in the CCAA in favour of the monitor and DIP lenders. The

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[25] S.Q. 1991, c. 64, as amended.

[26] R.S.Q. c. C-25, as amended.

[27] See section 9 of the Ontario Model Receivership Order, available on the webpage of the Ontario Court of Superior Justice, Commercial List, http://www.ontariocourts.ca/scj/en/commerciallist/; section 8 of the British Columbia Model Receivership Order, available on the website of the British Columbia Supreme Court, http://www.courts.gov.bc.ca/supreme_court/practice_and_procedure/practice_directions/civil/PD%20-%2016%20Model%20Receivership%20Order.pdf; and section 10 of the Alberta Model Receivership Order, available on the webpage of the Alberta Court of the Queen's Bench, http://www.albertacourts.ab.ca/LinkClick.aspx?fileticket=SI1sMgHbIXw%3d&tabid=324&mid=839.

[28] See sections 17 and 20 of the Ontario Model Receivership Order; sections 16 and 19 of the British Columbia Model Receivership Order; sections 16 and 19 of the Saskatchewan Model Receivership Order; and section 16 and 19 of the Alberta Model Receivership Order. Note that the Alberta Model Receivership Order does not explicitly state that the statutory liens and charges for the environment, unpaid wages and unpaid pension amounts have priority over the Receiver's Charges.

Task Force is of the view that Receiver's Charges should not be permitted to prime financial collateral.

Recommendations for Receiverships

1. The receivership provisions in the BIA should be amended to ensure that a court does not have the power to stay a solvent counterparty from terminating an EFC in accordance with its terms, calculating net termination values of an EFC and netting or setting-off and dealing with financial collateral in accordance with the terms of an EFC. Such an amendment would make the provisions in certain Model Receivership Orders mandatory rather than discretionary. The amendment would result in standard treatment of EFCs in all receivership proceedings across Canada, as well as harmonizing receiverships with bankruptcies.

2. Section 88 of the BIA should be amended to apply to receiverships under Part XI of the BIA. The BIA should protect financial collateral to ensure that financial collateral posted with or pledged to secure an EFC is not primed by charges granted pursuant to a receivership order, including provisions granting a super-priority charge to a receiver in respect of the receiver's borrowings and the receiver's and other professional's fees.

September 26, 2013

SCHEDULE "A"

The Insolvency Institute of Canada/L'institut d'insolvabilité du Canada

The Insolvency Institute of Canada is Canada's premier private sector insolvency organization. The Institute is a non-profit organization dedicated to the recognition and promotion of excellence in the field of insolvency. Its members are drawn from the most senior experienced members of the insolvency community in Canada. Membership is by invitation and is limited to 135 insolvency practitioners (trustees and lawyers) who are joined by representatives of regulatory and compensation bodies, major financial institutions and prominent members of the academic community.

The Institute provides a forum for leading members of the insolvency community to exchange ideas and share experiences with other members, senior representatives of the federal and provincial governments and members of the judiciary. The Institute supports and encourages research studies and analysis of restructuring, insolvency and creditors' rights issues. Since its inception, members of the Institute have always had prominent roles in the review and reform of Canada's insolvency legislation.

The Institute publishes papers on insolvency related topics in the annual Journal of the Insolvency Institute of Canada. Members regularly prepare and deliver presentations on technical, academic and professional matters at the Institute's Annual General Meetings. The Institute has commissioned research projects on important issues in Canada's insolvency and restructuring system. The Institute has established links with Canada's leading bankruptcy and insolvency judges. The Institute, in association with one of Canada's leading publishers, makes its collection of insolvency cases and materials available electronically.

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