SUBMISSIONS ON BILL C-55, 2005:
THE WAGE EARNER PROTECTION PROGRAM ACT,

AND

AMENDMENTS TO THE BANKRUPTCY AND INSOLVENCY ACT
AND THE COMPANIES’ CREDITORS ARRANGEMENT ACT

Presented to

THE HOUSE OF COMMONS STANDING COMMITTEE ON
INDUSTRY, NATURAL RESOURCES, DEVELOPMENT AND
TECHNOLOGY

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I. Who We are

Each of the authors of these submissions, with the partial exception of Prof Black and Prof Ben-Ishai, has taught one or more of the following subjects at a Canadian law school for a long period of years: commercial law, consumer law, insolvency law and debtors’ and creditors’ rights and remedies. Prof Ben-Ishai has only been teaching for three years. Each of us (again with the exception of Prof Black) has written extensively in his or her area of specialization. So far as the subject matter of these submissions are concerned, Professors Ziegel and Cuming have for many years written widely and done extensive research on problems of commercial and consumer insolvencies. Professors Cuming and Ziegel have also written background research papers for Industry Canada in preparation for the current round of amendments to the BIA and the CCAA.

Five of us also made joint submissions to this Committee in August 1996 on the consumer insolvency aspects of Bill C-5, 1996. Prof. Ziegel made a separate and concurrent submission on the commercial insolvency aspects of Bill C-5 affecting the BIA and CCAA provisions.

Prof Black wishes to make it clear that he is not an insolvency specialist and that because of this his support for these Submissions is limited to the parts dealing with consumer insolvencies.
II. Summary of Submissions and Recommendations

A. Support for Bill C-55’s Objectives

[1] We support many of Bill C-55’s objectives. In particular, in the commercial insolvency and CCAA areas, we support:

a. establishment of a Wage Earners’ Protection Programme for unpaid wages;

b. filling in of many gaps and resolving ambiguities in the CCAA;

c. the proposed provisions covering:

i. extension of legislation to income trusts

ii. rejection and assignment of executory contracts (BIA ss 65.11, 84.1, 84.2, CCAA ss.11.3, 32);

iii. the disallowance of ipso facto clauses (BIA s 65.1, CCAA s 34);

iv. debtor in possession financing (BIA s 65.1, CCAA s 34);

v. subordination of equity claims and the treatment of equity claims for voting purposes (BIA s 140.1, CCAA s 22).

d. Revision and expansion of the transfer at undervalue (TUV) provision in s.100 of the BIA and repeal of the settlements provision in s.91.

e. Revision of the preferences provisions in BIA, ss 95 and 96 (BIA ss 96, 96.1, 97);

f. New provisions involving plan approval and establishment of bar date for claim (CCAA s 12);

g. Adoption of UNCITRAL Model Law provisions for cross-border insolvencies (BIA new Part XIII; CCAA new Part IV);
h. Expanded administrative and supervisory roles of the Superintendent of Bankruptcy with respect to CCAA proceedings (CCAA ss 26-31) and the establishment and expansion of research facilities in the bankruptcy and insolvency areas.

[2] In the consumer insolvency area, we support:

a. exclusion of RRSP and similar individual private pension plans from the scope of the debtor’s estate but subject to prescribed ceilings and other conditions (BIA s 67(1)(b)-(b 3);

b. raising of the monetary ceiling for consumer proposals (though not necessarily up to $250,000 (BIA s.66.11);

c. clarification of meaning of ‘total income’ for purposes of s 67;

d. avoidance of ipso facto clauses (BIA s 65.1);

e. revival of lapsed consumer proposals (BIA s 66.31);

f. in the case of student loans, reduction in the periods required (i) for general eligibility to apply for discharge, and (ii) to apply for an early discharge on grounds of hardship (BIA s 178 (1.1).

B. Disagreement with Drafting of Provisions and/or Underlying Policies

[3] We disagree with the implementation of many of the above measures either on policy grounds or because of ambiguities or other drafting difficulties. In particular,

a. With respect to the Wage Earner Protection Program Act, we believe that claims on the Wage Earner Protection Programme should be met not out of the Consolidated Revenue Fund, as is proposed, but out of a newly created self financing insurance fund or (possibly out of an enlarged Canada Employment insurance programme;
b. With Respect to the Commercial Insolvency Provisions, we are concerned about the duplication of many of the new proposed provisions in the BIA and CCAA and believe it to be unnecessary.

[4] We have particular concerns about the proposed provisions governing:

a. the disclaimer, affirmation and assignment of executory contracts;
b. priorities;
c. transfers at undervalue;
d. preferences;
e. adoption of the UNCITRAL Model Law on cross-border insolvencies.

[5] We also believe that there is no longer any justification for a separate CCAA and that the provisions that are special to and appropriate to the reorganization of large insolvent entities can be accommodated in a revised BIA, just as has been done in the British and US insolvency legislation.

[6] With respect to the CCAA Amendments, we oppose on grounds of principle:

a. the Court’s power under CCAA proposed new s11. to make “any” order it sees fit in relation to the proceedings that the Court “considers appropriate in the circumstances”; and
b. the power to remove a director from the debtor corporation’s board if the court is satisfied that the director “is unreasonably impairing or is likely to unreasonably impair the possibility of a viable compromise” (CCAA s 11.5).

[7] Consumer Insolvency Provisions. We are opposed to the following provisions in Bill C-55:
a. Proposed new s.168.1(ii) postponing from 9 months to 21 months a consumer bankrupt’s entitlement to an automatic discharge where the debtor has surplus income and regardless of the size of the surplus;

b. Giving trustees the power to enforce surplus income payment obligations against exempt property of the debtor;

c. Permitting trustees to enter into enforceable fee contracts with indigent consumer bankrupts who have no surplus income and making such contracts enforceable even after the debtor’s discharge; and

[8] We are concerned about the exclusion from Bill C-55 of the following recommendations in the PITF Report and urge the implementation of the recommendations in an amended Bill C-55:

a. an optional federal list of property exempt from the trustee’s reach that may be invoked by bankrupt individuals;

b. avoidance of non-purchase money security interests in exempt consumer goods given by a bankrupt debtor;

c. regulation of express and implied reaffirmation of a debtor’s prebankruptcy obligations after the bankrupt’s discharge or completion of the terms of a consumer proposal.

[9] We are also concerned about Bill C-55’s failure to address the following significant consumer issues:

a. the conflict of interests to which trustees are regularly exposed in seeking to serve the interests of both debtors and the debtors’ creditors;

b. the absence of low cost simple bankruptcy and discharge facilities for indigent debtors without surplus income;
c. removal of the terminological stigma attaching to the word “bankrupt” when applied to individual debtors resorting to liquidation insolvency proceedings under the BIA;

d. the failure to recognize that the easy availability of consumer credit to most Canadians and a general consumption culture are substantially responsible for Canada’s record high consumer insolvency rates and, consequently, Bill C-55’s failure:

e. to require the credit industry to absorb a higher share of the cost of administering consumer insolvencies and providing assistance to insolvent individuals;

f. to require the credit industry to adopt much stronger measures to prevent consumers from overcommitting themselves;

g. to ensure that consumer representatives, academics knowledgeable in these areas and other qualified independent individuals, are included as advisors in the drafting and administration of the consumer insolvency provisions of the BIA and other federally administered legislation and in the drafting of directives by the Superintendent of Bankruptcy under the BIA.

C. Adoption of Bill C-55 Should Be Postponed

[10] For all of the above reasons, with the exception of adoption of a Wage Earner Protection Program, we believe that adoption of Bill C-55 should be postponed for a sufficiently long period to allow the above drafting and policy issues to be properly addressed and resolved. In our view, it unrealistic to expect the INDU Committee to be able to address the issues adequately in the short time at its disposal. In our respectful opinion, it would be equally unacceptable for this Committee simply to endorse Bill C-55 because it seems expedient to do so. We believe the detailed review of the Bill C-55 provisions should be assigned to a
newly constituted committee or subcommittee of INDU consisting of members of INDU, insolvency experts, economists and sociologists, and representatives of the major constituencies affected by commercial and consumer insolvencies.

D. Need for a Revised BIA and CCAA

[11] The BIA has not been revised (as distinct from being amended) since 1949; the CCAA has not been revised (as distinct from being amended) since its adoption in 1933. Both tasks are very much overdue. The old and new provisions are often not properly integrated; the old provisions contain obsolete concepts; and the old and new provisions often do not follow a logical order so that the reader does not obtain a clear view of the total picture. We recommend that revision of the two Acts (assuming, contrary to our recommendation, that the CCAA is retained as a separate measure) be undertaken in conjunction with the in-depth review of Bill C-55 that we have also recommended.

E. Change in Title of Act

[12] We also believe the current name of the Bankruptcy and Insolvency Act is unnecessarily cumbersome and that it should be simplified. We recommend adoption of the name, Insolvency Act. This would be consistent with 19th century pre-Confederation usage and with the title of the English Insolvency Act 1986 as amended. It would also, as we have indicated above, avoid an indvidious terminological distinction between those debtors who opt for, or are subjected to involuntary, liquidation proceedings and those debtors who make a commercial or consumer proposal to their creditors.
III. Detailed Submissions and Recommendations

A. General Considerations

1. Long Road to Reform

[13] It is now 35 years since the Tassé Committee presented its blue print for reforming Canada’s bankruptcy laws. The Committee’s recommendations were converted to bill form and six efforts were made between 1975 and 1984 to enact the bills. None of them succeeded.

[14] As a result, the incoming Mulroney administration abandoned further efforts in 1984 to adopt a new Bankruptcy Act and decided instead to aim for incremental changes to the existing insolvency legislation. The Colter Committee was established for this purpose and issued its report in 1986. Its recommendations were well received and resulted in the adoption of the 1992 amendments to the newly named BIA. The major amendments were the following:

a. Adoption of a new Part III.1 of the Act dealing with commercial proposals and a new Part III.2 of the Act concerned with consumer proposals;

b. A new Part X of the Act regulating the enforcement of general security interests on the debtor’s insolvency and imposing a code of conduct on privately appointed receivers and receiver-managers;

c. Establishment of deemed trusts for deductions at source of tax payments, revamping of ranking of creditor claims in s 136, and demotion of tax claims to ordinary creditor status
unless declared to be secured claims in which case perfection of security interest required under ss 86-88;

d. Introduction of simplified discharge provisions for first time bankrupts and automatic discharge for such debtors unless discharge opposed by trustee, the Superintendent of Bankruptcy (SOB), or the debtor’s creditors.

e. No amendments were adopted to the CCAA because, in light of the introduction of new Part III.1 commercial proposals, the House of Commons Committee reviewing the 1992 amendments recommended repeal of the CCAA at the end of a three year period.

[15] Phase II Amendments. The 1992 amendments required the federal government to report within five years on the operation of the amendments and to recommend any further changes to the legislation. To this end, the federal government established the Bankruptcy and Insolvency Act Committee (BIAC). BIAC established subcommittees to examine those aspects of the BIA that had not been reviewed by the Colter Committee and to consider the future of the CCAA. BIAC’s recommendations led inter alia to the enactment of the following amendments to the BIA in 1997: mandatory surplus income payment requirements for consumer bankrupts (BIA s 68) and the adoption of Part XIII provisions for cross-border insolvencies. The BIAC members strongly opposed repeal of the CCAA and recommended instead various non-exhaustive amendments to the CCAA. These too were enacted in 1997.

[16] Phase III Amendments and Bill C-55. Like its 1992 predecessor, the 1997 amendments also required the federal government to report back to Parliament within five years on the operation of the 1997 amendments together with suggestions for further amendments. However, on this occasion the federal government chose not to appoint a new BIAC. Instead,
Industry Canada held consultative meetings across Canada to solicit views on the operation of the current BIA and suggestions for further changes. Industry Canada also commissioned various in-depth studies of specific aspects of the insolvency legislation. In 2000, the Superintendent of Bankruptcy established a *Personal Insolvency Task Force* (PITF) with a broad remit to review all aspects of the federal legislation involving personal (primarily consumer) insolvencies. The Task Force reported in 2002. Similarly, the Insolvency Institute of Canada (IIC) and the Canadian Association of Insolvency and Restructuring Professionals (CAIRP) established joint task forces to examine and make recommendations with respect to further desirable changes in the BIA and the CCAA. The changes approved by the membership of these organizations were incorporated in a joint report that was forwarded to Industry Canada in 2001.

[17] All these reports were made available to the Senate’s Standing Committee on Trade and Commerce, which was convened in the late spring of 2003 to hold hearings and make recommendations with respect to the Phase III amendments to the BIA and further amendments to the CCAA. The Committee issued its report in November 2003. The Committee’s recommendations followed closely (though not invariably) the joint IIC/CAIRP recommendations and the majority recommendations in the PITF report. Clearly, the Senate Committee’s report greatly influenced the contents of Bill C-55. However, it is difficult to determine the exact scope of that influence since the federal government has not issued an explanatory document to explain the source and purpose of the Bill C-55 provisions and the reasons for departing from the Senate Committee’s recommendations where this was the case.
[18] As indicated in the Summary of our submissions (above Part A), Bill C-55 includes the following important new features:

   a. Provisions for the adoption of a Workers Employment Protection Program (sic) Act (WEPPA)
   b. Introduction of a large number of parallel provisions in BIA III.1 and the CCAA to fill important gaps in both spheres
   c. New provisions dealing with the adoption, rejection and assignment of executory contracts
   d. New provisions with respect to priority of Crown claims and employee pension plans in court approval of CCAA reorganizations and commercial proposals
   e. New provisions involving preferential payments and undervalue transactions to replace existing ss 91-101 of the BIA
   f. Adoption of UNCITRAL Model Law for Cross-border Insolvencies to replace existing provisions in the BIA and the CCAA
   g. Large number of other amendments of varying importance in the consumer bankruptcy and consumer proposal provisions of the BIA

2. Why We Disagree in Principle or in Detail with a Substantial Number of the Bill C-55 Provisions

[19] As indicated in the Summary of our Submissions, while we support many of the proposed amendments in the commercial area, we disagree with many of the detailed provisions for reasons explained in later parts of these Submissions. In the commercial insolvency area, our disagreement is often based on the fact that the Senate recommendations were expressed in general terms which, in our view, were not converted by the Bill C-55
drafters into acceptable detailed provisions. *In the consumer insolvency* area, our disagreement is based on two principal grounds. The first is that the consumer’s voice was seriously underrepresented on PITF with the result that many of the Task Force’s recommendations are heavily skewed in favour of trustees in bankruptcy and creditors. The second ground is that Bill C-55 fails to implement an important number of consumer oriented PITF recommendations that were endorsed in the Senate Report. We therefore believe that consumer debtors are adversely affected in Bill C-55 at both ends of the continuum.

3. **The Need for detailed Study of Bill C-55**

[20] Bill C-55 is a long and complex bill, comprising several hundred provisions, that require detailed study. We appreciate that this House of Commons Committee may lack the time and expertise to do justice to the bill. Nevertheless, we do not believe this is a sufficient reason why the Committee should simply approve the bill as is or focus its attention on a few politically high profile provisions. We urge instead the appointment of a special committee made up of members of INDU and independent insolvency experts to study Bill C-55 in detail in light of the submissions made to this Committee and to report back with the Special Committee’s recommendations. We would make an exception with respect to the WEPPA provisions in Bill C-55 and adopt that Act now (but subject to the modification recommended hereafter) if early adoption of WEPPA is regarded as deserving of high priority.

4. **Incorporation of or merger of CCAA Provisions with BIA Provisions**

[21] As previously explained, the House of Commons Committee recommended in its 1991 report the repeal of the CCAA at the end of a three year period. This was because the Committee felt the CCAA was no longer needed given the new commercial proposal
provisions in BIA Part III.1. The recommendation was not adopted by the Mulroney government or by its successor the Chrétien administration. Instead, the CCAA was given a new lease of life in the 1997 amendments to the CCAA.

[22] Insolvency practitioners’ opposition to repeal of the CCAA was based on the argument that the commercial proposal provisions in the BIA were too rule oriented and were not suitable for the reorganization of large insolvent enterprises. In such cases, it was, argued, the courts needed discretionary powers to adapt the CCAA rules to meet the exigencies of individual cases and to fill the many gaps in the CCAA. These arguments may have been persuasive at the time but, in our view, have now been turned on their head because of the following features of Bill C-55:

a. With the support of the IIC and CAIRP many of the gaps in the CCAA have been filled in Bill C-55. As a result, the CCAA will become as rule oriented as the BIA commercial proposal provisions.¹

b. Parallel provisions to those in the CCAA have been adopted in Bill C-55 with respect to the commercial proposal provisions in the BIA.² This undermines the argument that commercial proposals are fundamentally different from CCAA reorganizations, and not merely different in degree and complexity

c. Some important gaps will remain in the CCAA even if Bill C-55 is adopted in full. These will need to be filled by analogy with the BIA provisions unless the BIA provisions are expressly extended to cover CCAA reorganizations³;

¹ We exclude from this observation some amending CCAA provisions in Bill C-55 which we find objectionable in principle. See below Part IIIB.6 of these Submissions.
² See Table of Concordance of BIA and CCAA Provisions, infra, Appendix Table 2.
³ E.g., provisions dealing with preferential payments and undervalue transactions.
d. As recommended in the Senate Report, Bill C-55 confers important supervisory and information gathering powers on the Superintendent of Bankruptcy, thereby again recognizing the common roles of commercial proposals and CCAA reorganizations

B. Recommendations

1. Integration of the BIA and CCAA Provisions

[23] In the light of these developments, we respectfully urge that in the next round of amendments high priority be given to integrating the CCAA provisions with the BIA provisions while retaining for large reorganizations those CCAA features that are important for this purpose and applying the BIA III.1 provisions (or a revised set of provisions) to those that are common to large, medium size, and small reorganizations. This is the approach adopted in the US Bankruptcy Code and the British Insolvency Act as amended in 2002. We are confident this approach will also work in the Canadian context and that it will not adversely affect the parties’ interests. It will not deprive litigants in large reorganizations of access to the courts or diminish the important role of insolvency judges in supervising the successful reorganization of large enterprises. The merger of the CCAA and BIA provisions should however greatly improve the efficiency, rationality and administration of insolvency reorganizations in Canada.

[24] As an interim measure, we also recommend, that the threshold figure in section 3 of the CCAA of claims against a debtor company be raised from $5 million to $10 million as a more realistic recognition of the minimum dividing line between large reorganizations and those falling outside the CCAA.
2 Revision of the BIA

[25] For the following reasons, we believe it equally important for the federal government to embark promptly on a complete revision of the BIA once the Bill C-55 amendments have been adopted:

a. The BIA and CCAA provisions do not follow a logical sequence and it is difficult even for experienced insolvency practitioners to negotiate their way successfully through the complex combination of old and new dense provisions and the bewildering number of decimal numbered sections and subsections;

b. A substantial number of the BIA and CCAA definitions, terminology and concepts are obsolete or incompatible with the amendments adopted in 1992 and 1997 and contemplated in Bill C-55;*

c. Other industrialized countries in the Western hemisphere – England, Germany and the US are preeminent examples – have found it preferable to adopt completely revised insolvency legislation instead of relying on a paste and scissors job.

3. Need for Better Funded and More Permanent Research, Legislative and Administrative Facilities

[26] In our respectful view, the existing federal facilities for meeting the above challenges are quite inadequate given the range and magnitude of the social and economic changes that have occurred in Canada. The number of personal insolvencies alone has exploded over the past 35 years from about 10,000 a year in 1980 to over 100,000 in 2004 and is now ten times larger than the number of commercial insolvencies. The BIA’s recognition of this social and economic transformation is at best grudging and at worst seriously lagging in reality.
Commercial insolvencies too frequently involve large enterprises and raise complex legal and factual questions that require closer study than they have received up to now. Industry and professional groups – notably the IIC and CAIPR – have done a commendable job of gathering data and making recommendations for changes. So have the Corporate Policy Section in Industry Canada and the SOB officials.

[27] These are important building blocks. However, in our view, more needs to be done to ensure that Canada’s insolvency legislation adequately reflects evolving social and economic conditions and to avoid basing legislative changes on hunches and unsuccessful lobbying by influential groups and individuals.

C. Commercial Insolvencies, including Reorganizations

1. Wage Earner Protection

[28] The need for better protection for unpaid wage earner wage claims than that provided in existing s 136 of the BIA has been discussed for 35 years or more. We fully agree with those who argue that it is time to put the problem to rest. Bill C-55 provides for the enactment of a Wage Earner Protection Program Act (WEPPA) that would establish a fund for the payment of unpaid wages and earned vacation pay where the employer is bankrupt or is in receivership. However, we also think it is important to stress that wage earner protection is only one of many important issues addressed in Bill C-55 and it would be a mistake to focus on WEPPA to the exclusion of everything else.

[29] The Wage Earner Protection Program (WEPP) would provide payment of up to $3,000 to unpaid employees, except for employees employed for less than 90 days at the date of the employer’s bankruptcy or receivership. The payments would be funded from general federal

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4 A good example is the treatment of union contracts in insolvency reorganizations, a difficult and delicate topic that Bill C-55 has carefully skirted around. See Bill C-55, ss. 65.12(6), 65.13, CCAA s 33.
revenues. However, the federal government would be able to recoup a portion of these funds from secured lenders: proposed BIA, ss 81.3 and 81.4 give an unpaid employee a super-priority claim for up to $2,000 secured on the employer’s current assets. WEPPA, s.36 provides that if a payment is made to an employee, the Crown is entitled to be subrogated to any rights the employee may have had against the employer.

[30] Unlike the 1991 proposal for a wage protection fund, the WEPP scheme would not be funded out of a payroll tax. This has two potential drawbacks. First, reliance on the general revenue may make the WEPP politically vulnerable in times of economic downturn and, secondly, demoting (and, in some cases at least, probably making worthless) the security on current assets pledged by the employer to a secured party may affect the cost and availability of credit to employers. Bearing these points in mind, it may be worth giving consideration to other alternatives. One possibility would be to pay for the WEPP out of a newly created self-financing insurance fund. Another possibility might be to fund the WEPP out of an enlarged Canada Employment Insurance program. The 2004 Report of the Auditor General disclosed that the accumulated surplus in the Employment Insurance Account increased by $2 billion to reach $46 billion in 2003–04. A portion of this revenue could be used to fund WEPP. There is reason to believe that the extension of the Canada Employment Insurance program to cover WEPP would be constitutionally valid, first, because of the federal government’s broad constitutional power to legislate on matters involving unemployment (Reference re Employment Insurance Act (Can.) [2005] SCC 56 (CanLII) and, second, because of the federal government’s exclusive power to legislate in matters relating to bankruptcy and insolvency (Constitution Act 1867-1982, s 91(17).
2. Executory Contracts

[31] Bill C-55 would enact the following new provisions governing the disclaimer, prohibition of *ipso facto* clauses and assignment of contracts:

a. BIA, ss 65.11 and 65.12 and CCAA, ss 32 and 33 (disclaimer);

b. BIA, s. 84.2 and CCAA, ss 11.4 and 34 (prohibition of *ipso facto* clauses);

c. BIA, ss 66.1 and 84.1 and CCAA, s.11.3 (assignment).

The prohibition of *ipso facto* clauses is tantamount to giving the trustee or debtor in possession a right to affirm the contract because it necessarily follows that if the counterparty cannot terminate the contract, the trustee has the option of either keeping it on foot or disclaiming it.

[32] The reforms are welcome because the current law is piecemeal. The aim should be to achieve a set of provisions that are coherent, comprehensive and consistent. The reforms are a step in the right direction, but they do not go far enough. In the interests of coherence, comprehensiveness and consistency, the following prescriptions should be observed.

[33] The rules should be the same for all kinds of proceedings:

a. Straight bankruptcy proceedings;

b. BIA proposal proceedings; and

c. CCAA plan proceedings

except if there are good reasons to justify differences.

[34] The rules should be the same for all kinds of contracts unless there are good reasons to justify differences.

[35] The procedures to be followed in relation to the three courses of action:

a. Disclaimer;
b. Affirmation; and

c. Assignment;

should be the same except if there are good reasons to justify differences.

[36] The provisions governing the three courses of action:

a. Disclaimer;

b. Affirmation; and

c. Assignment;

should be located together in the same part of the statute.

[37] As far as possible, duplication of provisions should be avoided.

[38] The Bill C-55 provisions fall short on all these fronts. For example:

In relation to the point made in para.[33]:

a. Bill C-55 makes provision for the disclaimer of contracts in BIA proposal proceedings and CCAA plan proceedings, but there is no corresponding provision for straight bankruptcy proceedings;

b. The Bill incorporates a critical supplier provision in the CCAA (s.11.4), but there is no corresponding provision for BIA proposal proceedings.

[39] In relation to the point made in para.[34], the Bill C-55 assignment provisions treat commercial landlord and tenant agreements differently from other kinds of contracts;

[40] In relation to the point made in para. [35], the Bill C-55 affirmation (prohibition of *ipso facto* clauses) provisions do not require court approval but they do allow the counterparty to apply to the court for an order to terminate the contract. On the other hand, the assignment provisions require the trustee or debtor-in-possession to apply to the court for approval.
[41] In relation to the point made in para. [36], the proposed BIA disclaimer provisions are in ss 65.11 and 65.12, but the proposed assignment and affirmation provisions are in ss 84.1 and 84.2; 

[42] In relation to the point made in para. [37]:

a. BIA, ss 65.11 and 65.12 duplicate CCAA, ss 32 and 33;

b. BIA, s.84.2 duplicates CCAA, s.34; and 

c. BIA, s.84.1 duplicates CCAA, s.11.3.

This duplication is wasteful and unnecessary. It is impossible for the reader to be sure whether the rules are in fact the same for BIA and CCAA proceedings without a close reading of both texts. Often enough, a close reading reveals differences which may or may not have been intended. This duplication could be avoided if the BIA and CCAA were combined in a single statute because then it would be possible to enact an omnibus set of provisions for all the different type of proceedings.

[43] A fuller discussion of the points raised above together with a detailed set of submissions can be found in Appendix A, Memorandum 1.

3. Priorities

i. Crown claims

[44] The proposed new CCAA, s.37, replacing CCAA, s.18.3, duplicates BIA, ss 67(2) and (3). The proposed new CCAA, ss 38 and 39, replacing CCAA, ss 18.4 and 18.5, duplicate BIA, ss 86-87. The proposed new CCAA, s.6(2) and (3), replacing CCAA, s.18.2, duplicates BIA, s.60(1.1). The duplication is wasteful and unnecessary. In our view, the BIA and CCAA
should be combined in a single statute. Then it would be possible to deal with Crown claims in a single set of provisions.

[45] The current law governing Crown claims is complex and fragmented and it fails to address the underlying policy concerns in a coherent way. Adoption of our recommendation for combining the BIA and CCAA provisions would go some way towards addressing the problem, but only in so far as the bankruptcy laws themselves are concerned. The Crown claims provisions in the bankruptcy laws are only part of the total picture. Other laws, federal and provincial, impact on Crown priorities as well. Separate legislation is needed to deal systematically and comprehensively with the Crown priorities question. The government should set up some kind of consultative mechanism to consider the relative merits of proposals already on the table and to develop a blueprint for reform.

[46] For a fuller discussion of the points raised in paras [44]-[46], see Appendix A, memorandum 2, paras 2.1-2.4 and also Academics’ Submissions on Amendments to the Bankruptcy and Insolvency Act and the Companies Creditors Arrangements Act Presented To The Senate Standing Committee on Banking, Trade and Commerce (May 23, 2003), pp 19-20.

ii. Employee wage claims and pension fund contributions

[47] The following comments supplement our comments on the Wage Earner Protection Program, above. The wage earner priority provisions involve a substantial amount of duplication. Proposed BIA, s.81.3 applies in formal bankruptcy proceedings. Proposed s.81.4 will apply in receiverships and it is in almost the same terms as s.81.3. Proposed new BIA, s.60(1.3)(a) duplicates proposed CCAA, s.6(4). Likewise in relation to unpaid pension fund contributions, proposed BIA, s.81.5 applies in formal bankruptcy proceedings. Proposed
s.81.6 will apply in receiverships and it is in almost the same terms as s.81.5. Proposed new BIA, s.60(1.4) duplicates proposed CCAA, s.6(5). Efforts should be made to reduce or limit this duplication, in the interests of comprehensibility. For a fuller discussion of these points, see Appendix A, Memorandum 2, paras 3.1-4.3.

iii. Subordination of claims

[48] Proposed CCAA, s.22(3) provides that a creditor who has an equity claim against the debtor must be in the same class of creditors in relation to those claims and it may not vote on the proposal. The provision presupposes a subordination rule for equity claims, equivalent to the rule in proposed BIA, s.140.1. However, proposed BIA, s.140.1 has no counterpart in the CCAA. The omission should be rectified.

[49] Proposed CCAA, s.22(3) corresponds with proposed BIA, s.54(2)(a)(i). The aim of both provisions is to make sure that subordinated creditors do not have a voice in the creditors’ meeting that is disproportionate having regard to their subordinated status. The same concern arises in relation to voluntary or contractual subordinations but neither BIA, proposed s.54(2)(a)(i) nor CCAA, proposed s.22(3) addresses this case. Both provisions should be expanded so that they apply to all subordinated claims, however arising.

[50] For a fuller discussion of the points raised in paras [48] and [49], see Appendix A, Memorandum 2, paras 5.1-5.4.

4. Gifts and Transfers at Undervalue

i. Non-application to gifts and related matters

[51] Bill C-55 will repeal the settlement provision (BIA, s.91), but it puts nothing in its place. Proposed s.96.1 applies to a “transfer at undervalue”. “Transfer at undervalue” means a transaction in which the consideration received by a person is conspicuously less than the fair
market value of the property or services sold or disposed of by the person in the transaction. The new provisions appear to presuppose some consideration moving from the counterparty. If there is no consideration at all, the courts may say that the provisions do not apply. It would be a major shortcoming if s.96.1 does not apply to settlements and gifts at large. The aim should be to catch all transactions that diminish the value of the debtor’s estate and that may affect the value of creditors’ realizable claims. A gift by the debtor to the counterparty may have this effect at least as much as a transfer at undervalue. A simple way of addressing the problem would be to amend the definition of “transfer at undervalue” to make it clear that the term includes a gift.

[52] Even with this adjustment, however, proposed s.96.1 arguably does not go far enough. The objective is to reach all transactions that diminish the value of the debtor’s estate and that may affect the value of creditors’ realizable claims. Gifts and transfers at undervalue have this effect, but they are not the only transactions that do so. Proposed s.96.1 should be expanded to cover other transactions as well.

   ii. Fraudulent intention and related matters

[53] In the case of an arm’s length transaction, proposed s.96.1 requires the trustee to prove that:

   a. The debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction; and

   b. The debtor intended to defeat the interests of creditors: s.96.1(2)(b).

[54] It should be sufficient for the trustee to prove either that the debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction or that the debtor intended to defeat the interests of creditors. This is the approach taken in s.548 of the United
States Bankruptcy Code and ss 423-425 of the United Kingdom Insolvency Act 1986. Requiring the trustee to prove the debtor’s fraudulent intention would substantially diminish the chances of a successful action. Section 96.1(2)(b) should be amended by replacing “and” with “or”.

[55] In the case of a non-arm’s length transaction occurring within one year before the date of the initial bankruptcy event, the trustee must prove neither that:

a. The debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction; or
b. The debtor’s intention was to defeat the interests of creditors: s.96.1(3)(a).

These requirements are too stringent. There is no good reason for setting aside a transaction if the debtor was solvent at the time and there was no intention to defeat creditors. What s.96.1(3) should say is that any transaction within the relevant 5 year period is subject to review if the trustee proves either that:

a. The debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction; or
b. The debtor intended to defeat the interests of creditors.

Again, a provision along these lines would be consistent with the position taken in other countries, including the United States and the United Kingdom.

[56] If the debtor’s intention is to defeat creditors, the bankruptcy court should have the power to set aside a transaction occurring at any time prior to the date of the initial bankruptcy event whether or not the debtor was insolvent or on the point of insolvency at the time of the transaction. Proposed s.96.1 is too lenient on the fraudulent debtor in this regard.

In the case of an arm’s length transaction, the review period is one year before the date of the
initial bankruptcy event even if the trustee proves fraud while in the case of a non-arm’s length transaction, the review period is 5 years regardless of fraud on the debtor’s part. It is true that, as matters presently stand, a trustee may use the provincial fraudulent conveyances laws to reach transactions that took place earlier than the review periods s.96.1 prescribes. However, there is a strong case for limiting the application of the provincial laws to proceedings outside the debtor’s bankruptcy. If provincial laws were no longer to apply in bankruptcy, the review periods proposed s.96.1 prescribes would become crucial.

iii. Remedies and defences

[57] The remedy proposed s.96.1 provides for is a money claim for the difference between the fair market value of the property or services in question and the actual consideration the debtor gave or received. The trustee does not have the option of avoiding the transaction and claiming back the property in question from the counterparty. A money claim may not be the appropriate one in cases where the transaction is not a transfer at undervalue but, rather a gift or settlement, a dividend payment or redemption of capital or a beneficiary nomination in an insurance policy. Even in the case of a transfer at undervalue, the trustee may prefer the option in some cases of avoiding the transaction rather than keeping it on foot and claiming the value shortfall from the counterparty. In short, s.96.1 should provide for a flexible system of remedies which is responsive to the range of transactions the provision covers (or ought to cover).

[58] There should be defences to protect the interests of:

a. an innocent purchaser for value;

b. an innocent donee who changed position in reliance on the transaction; and
c. any third party to whom the transferee transfers the property if it is proved that the third party:
   • acted in good faith;
   • did not know that the debtor was insolvent; and
   • provided valuable consideration or changed position in reliance on the transaction.

iv. Application in BIA proposal and CCAA proceedings

[59] Proposed s.96.1 will apply in straight bankruptcy proceedings. It will also apply in BIA proposal proceedings, by virtue of BIA, s.101.1. However, it will not apply in CCAA proceedings and Bill C-55 makes no provision for the enactment of a corresponding provision in the CCAA. The omission should be rectified.

v. Application of provincial laws

[60] Proposed new s.96.1 should apply in straight bankruptcy proceedings, BIA proposal proceedings and CCAA proceedings to the exclusion of the fraudulent conveyance laws. The concurrent operation of the provincial laws adds an unnecessary layer of complexity and, to the extent that the provincial laws are non-uniform, an element of arbitrariness. The provincial laws should continue to apply in cases where the debtor is not bankrupt or insolvent.

[61] A fuller discussion of the points raised in paras [51]-[60] above matters and a summary of our submissions in relation to them can be found in Appendix A, Memorandum 3. C.

5. Preferences

[62] Bill C-55 will enact a new BIA, s.96. The new provision extends the s.95 review period from 3 months to one year if the transaction “has the effect of giving a creditor who is not at
arm’s length a preference over other creditors”. The current provision extends the review period from 3 months to one year if the transaction “is in favour of a person who is related to the insolvent person”. The definition of “related person” in s.4 makes it clear that the reference to parties who are not at arm’s length includes, but is not limited to, related persons. The new provision is broader than the current one in this respect. Subject to this amendment, however, Bill C-55 leaves the BIA preference provisions effectively untouched.

[63] The BIA preference provisions are in need of a complete overhaul, not just tinkering. The provisions are drafted on the outdated assumption that the reason for avoiding a preference is because it amounts to fraudulent conduct on the debtor’s part. According to modern thinking, the reason for avoiding a preference is to discourage creditors from jumping the gun on the eve of the debtor’s bankruptcy. Seen in this light, the preference provisions are similar in function to the stay provisions: both facilitate the transition from the individual system of debt collection that operates outside bankruptcy to the collective system the bankruptcy laws represent. The difference in emphasis matters: the current BIA preference provisions depend on proof of the debtor’s fraudulent intention. This limitation makes sense if the appropriate focus is the debtor’s conduct in giving the preference. However, it does not make sense if the appropriate focus is the creditor’s conduct in receiving it. In that case, it is more relevant to ask whether the creditor knew or ought to have known that the debtor was insolvent or near insolvent but s.95 has been interpreted as not requiring proof of the creditor’s state of mind. Likewise, if the focus is on the debtor’s fraud, proof that the creditor pressured the debtor into making the payment should be admissible to support the transaction. On the other hand, if the focus is on the creditor’s conduct, proof of pressure supports avoidance. BIA, s.95(2) says that proof of pressure is inadmissible to
support the transaction, but this is inconsistent with the emphasis in s.95(1) on the debtor’s fraudulent intent.

[64] In short, meaningful reform in this area involves going back to basics and settling the underlying objectives. Only when this has been done will it be possible to determine what the trustee must prove in order to avoid a transaction and what the counterparty creditor should have to prove if it wants to stave off the challenge. The government should refer the matter to an appropriate body of experts for resolution.

[65] A fuller discussion of the preferences question is contained in Appendix A, Memorandum 4.

6. **Controversial Discretionary Court Powers under CCAA Amendments**

[66] In the Summary of our Submission (above) we expressed our support in principle for the amendments to the CCAA in Bill C-55 designed to fill many of the gaps in the existing Act. However, our support does not apply to the proposed new CCAA, s.11 (court’s power to make any order) or proposed new CCAA, s.11.5 (court’s power to remove director).

[67] *Court’s Power to make “any” order.* CCAA new s 11 will confer on the Court the power to make *any* order in relation to the CCAA proceedings that the Court considers “appropriate in the circumstances”. We understand the provision was inserted at the request of some Quebec insolvency practitioners because Quebec law does not recognize the inherent powers doctrine used by common law courts to fill gaps in the CCAA. Nevertheless, we believe the new provision is very unwise for the following reasons:

a. Leading members of the Insolvency Institute of Canada have complained about the uncertainty and abuses to which the ‘inherent powers’ doctrine has led in the past.
Similarly, the Ontario Court of Appeal in its judgment in the *Stelco* case earlier this year (March 18, 2005)\(^5\) made it clear that previous courts (including Farley J in the present case) had greatly misunderstood the inherent powers doctrine and that the doctrine was only meant to serve a procedural purpose and not to confer substantive powers on a court;

b. The thrust of the IIC recommendations to the Senate Committee, and overwhelmingly adopted by the Senate Committee, was to fill the gaps in the CCAA and therefore to dispense with the courts having to play a legislative role;

c. Revised s 11 contradicts the Court of Appeal’s interpretation of the proper role of the inherent powers doctrine and undermines the IIC’s objective to put the doctrine to rest.

d. Not only does s 11 revive the doctrine but it also authorizes the court to make “any” order the court considers appropriate. It is difficult to conceive of a broader grant of power – a power that may adversely affect the rights of many parties to an insolvency proceeding – and it is quite incompatible with the certainty and predictability of outcomes which parties to reorganization proceedings should be entitled to expect.

[68] *Court’s Power to Remove Director* (CCAA s.11.5). This power is conferred on the court where the court is satisfied that a director “is unreasonably impairing or is likely to unreasonably impair the possibility of a viable compromise”. Our objection to this provision is based on the following grounds:

a. if there is to be a power to remove persons involved in the reorganization of a company it is not clear why the power should be restricted to directors;

b. the criteria to be applied under the proposed amendment by the court in determining whether the director should be removed are elusive and highly subjective; and

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\(^5\) *Stelco Inc. (Re.)* [2005] O.J. No. 1171
c. the Canada Business Corporations Act (CBCA) and the provincial business
corporations acts already contain ample powers entitling shareholders to remove a
director and authorizing courts to remove a director under the so-called ‘oppression’
remedy provisions. In the Stelco case, supra, the Court of Appeal drew attention to
these provisions and gave this as one of its reasons for reversing Farley J’s decision
to invoke the inherent powers doctrine to remove directors from Stelco because their
appointment was objected to by the Canadian Steelworkers’ Union. We believe the
court’s reasoning applies just as much to s.11.5 as it did in the Stelco context.

D. Cross-border Insolvencies and Adoption of UNCITRAL Model Law

[69] Cross-border insolvency issues arise in Canada where an insolvent debtor resides
or carries on business in Canada and has assets in Canada and elsewhere, or where a
foreign individual or enterprise has assets and creditors in and outside Canada or where
a foreign enterprise has a branch plan, office, or a subsidiary company carrying on
business in Canada.

[70] Up to now jurisdictional and choice of law questions in such cross-border cases
have usually been resolved in Canada by agreement of the parties through their lawyers
or trustees, by resort to common law or civil law conflict of law rules and, in a small
number of cases, by the provisions in Part XIII of the BIA and s 18 of the CCAA. The
reported cases over the past 25 years have predominantly involved Canadian and US
businesses and Canadian and US counsel, with the support of cooperative Canadian and
US bankruptcy judges, have usually been able to reach agreement on the effective
disposition of the issues.
The Model Law was adopted by the United Nations Commission on International Trade Law (UNCITRAL) in 1997 to create a more friendly environment among states for the recognition of foreign insolvency proceedings involving foreign businesses and to provide assistance to foreign insolvency representatives with respect to assets located in other countries. A growing number of countries (including, we understand, the European Union) have now adopted the Model Law and these include the US, Canada’s closest trading partner. As a country strongly committed to improving trading relations among nations, insolvency lawyers and the federal government felt that Canada should also adopt the Model Law as a gesture of good will and that Canada would benefit from doing so. This was because Canadian law and practice already meet – and indeed surpass – the level of cooperation aimed for under the Model Law.

We fully support adoption of the Model Law in new Part XIII of Bill C-55 and in new Part IV of the CCAA provisions. Similarly, we endorse Bill C-55’s drafters’ decision not to make recognition of the status of a foreign insolvency representative in Canada contingent on the foreign jurisdiction extending reciprocity to Canadian insolvency proceedings as recommended in the Senate Report. We do so because we regard the condition as unnecessary and because the imposition of a reciprocity requirement would not be consistent with Canada’s conflict of laws tradition. However, we do have concerns about Bill C-55’s omission of relevant provisions in the Model Law and, in other cases, of changes made by the Canadian drafters to the Model Law text without any apparent justification for the changes. In particular, our concerns encompass the following Bill C-55 and Model Law provisions:

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6 See Bankruptcy Abuse and Consumer Protection Act 2005 adding new chapter 15 to the US Bankruptcy Code.
a. *Public Policy Exceptions.* ML article 6 is omitted in Part XIII. We know of no good reason for the exclusion, particularly since inclusion of the provision would favour Canada in a case where a Canadian party wishes to argue before a Canadian court that recognition of the foreign insolvency proceedings would be contrary to Canadian public policy.

b. Art 22: *Protection of Interests of Creditors and Other Interested Parties.* The reason for the exclusion of this article is also not obvious. It is very common for creditors to seek court assistance in domestic insolvency proceedings. It is therefore reasonable to expect that foreign creditors whose claims arise under foreign insolvency proceedings will be accorded the same opportunity in Canadian proceedings though it is unlikely that foreign creditors will often avail themselves of this access in practice.

c. Art 23: *Avoidance of acts detrimental to estate.* This is an important issue that frequently arises in domestic insolvency proceedings. Again, therefore, there appears to be a strong case for allowing a foreign representative to seek a Canadian court’s assistance to enjoin or set aside a voidable transaction without the need to initiate separate BIA proceedings. (The issue of which law governs such transactions is a separate question that is not addressed in the ML).

d. Article 24: *Intervention by foreign representative in domestic proceedings in forum state.* Again, it is not clear why this useful provision was omitted and we favour its reinstatement. Omitting the provision suggests that Canada is less comity minded than other states but the inference is surely not correct.

e. Part XIII, s 268(1). We recommend reinstatement of the wording in art 2(c) of the Model Law.
f. S 268(2). Status of Foreign Debtor and Presumption re Location of Debtor’s Foreign Main Interests. We recommend reinstatement of the ML provision for the following reasons: (a) to avoid the impression that Part XIII applies to non-business debtors, and (b) to avoid the presumption that the place of the debtor’s registered office is the centre of the debtor’s main interests.

g. S 272 (ML art 21). We recommend the reinstatement of ML 21(2) allowing a Canadian court to authorize distribution (read ‘release’?) of local assets to the foreign representative.

h. S 273 (no ML counterpart). We recommend the omission of this section. The section is redundant since Canadian courts can already impose conditions under s 272 in extending assistance to a foreign representative.

i. Section 275 (ML arts 25-27). (Forms of cooperation between Canadian and foreign courts). Sec 275 is not as explicit as is the ML in spelling out the available forms of cooperation between the Canadian and foreign courts. It is not obvious what objections the Canadian drafters found in the more detailed ML provisions. We recommend reinstatement of the ML provisions.

j. Section 284. (No ML counterpart). S 284 re-enacts s.268(5) of the current BIA and authorizes the Canadian court to continue to apply legal and equitable rules for the recognition of foreign insolvency proceedings and the extension of assistance to foreign representatives. In our view, s 284 is redundant and we recommend its deletion. Its retention will cause confusion and will give rise to the suggestion that the ML provisions are not sufficient to enable Canadian courts to dispose of the issues covered in the Model Law in an expeditious and equitable manner.
E. Consumer Insolvency Issues

[73] Bill C-55 contains a large number of consumer insolvency provisions. We list the more important of them below. Some are helpful to consumers. Some are neutral in their effect but a significant number, in our view, will have a very adverse impact on consumer debtors. Our overriding concern however is that Bill C-55 does not come to grips with the magnitude of and the social, legal and economic importance that consumer insolvencies occupy in Canada today.

1. Some Basic Facts

[74] To put the Bill C-55 consumer provisions in perspective, it is appropriate to start with some basic statistics. As recently as 1972, the number of non-business bankruptcies (3,642) was smaller than the number of business bankruptcies. In 2004, the number of individual insolvency filings in Canada was *ten times larger* than the number of business bankruptcies. The number of non-business bankruptcies grew from 21,025 in 1980 to 108,080 in 2004. Next to the US, Canada has the dubious distinction of having the highest rate of personal insolvencies in the Western hemisphere.  

[75] 90 per cent of consumer bankruptcies involve summary administration estate, i.e., those where the net value of the debtor’s estate is below $10,000 and usually consists of assets exempt from seizure under applicable provincial law. Few consumer bankrupts have a meaningful equity in a home; in fact, the proportion of home ownership among

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7 This section of the Submission borrows heavily from the draft paper on Bill C-55 presented by Prof Ziegel at the Annual Workshop on Commercial and Consumer Law held at the University of Toronto Law School on October 21-22, 2005.

8 Medically related debts account for about 50% of personal bankruptcy filings in the US. If these were excluded from the comparison with Canada, the Canadian insolvency rate would be about the same or even higher than the US rate, a conclusion that should give Canadian policy makers keen grounds for concern.
consumer bankrupts, like their median income, is much below the level of ownership in the general population. Mention has been made earlier of the important amendments to the treatment of consumer bankruptcies in the 1992 and 1997 BIA amendments. The fact remains that about 80 per cent of the bankrupt persons have no surplus income as measured by the LICO standards and the LICO standards, it is important to remember, are based on the consumption and expenditure pattern of lower income Canadian individuals and families. Equally relevant is the fact that the median monthly payment of those debtors with surplus income is only $180 compared with a median indebtedness that is well over $25,000.

[76] Just as troubling as these figures is the well documented evidence that Canadian consumer indebtedness continues to grow, at 10 per cent per annum, at a much faster rate than the GDP or inflated adjusted average income of Canadian families, which has remained static for the past four years. As a result, the ratio of household debt to net disposable income has risen from 86% in 1980 to 125% in 2004. Similarly, the savings rate among families has dropped to zero compared to a savings rate of 20% of income in 1985.

[77] Given these basic facts, one might have expected Bill C-55 to focus its attention on how to restrain this excessive accumulation of debt – the consume now, pay later syndrome – that characterizes contemporary Canadian society and creditors’ role in contributing to the dangerously high debt levels. England and other EU countries have turned their attention to this problem in recent years. Not so Bill C-55. Bill C-55’s acknowledgment of the problem (if it can be so characterized) is to extend mandatory

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counseling requirements to individuals making a consumer proposal to their creditors (s 66.37). The requirement is imposed even though there is persuasive evidence that counselling requirements in the BIA are little more than a fig leaf, first, because they leave the false impression that poor budgeting practices are the – or at least a – major source of consumer overindebtedness and, second, because it is quite unrealistic to expect that two or three hours of counselling and some reading materials will change the spending habits of the debtors. Nevertheless, creditors strongly support counselling requirements because it diverts attention from creditors’ responsibility for making credit available too readily. If counselling requirements are retained, at a minimum they should be balanced with provisions requiring creditors to act responsibly in the granting of credit and applying sanctions to those creditors who act irresponsibly.

2. **Major Bill C-55 Consumer Insolvency Amendments**

[78] The most important amendments are the following:

a. exclusion of RRSP and similar personal pension plans from the trustee’s reach but subject to prescribed limits in amount and possible clawbacks if ordered by the court (s 67(1)(b.3));

b. Definition of surplus income for the purpose of section 68 to ensure that it includes one time gains;

c. Conferment of powers on the trustee to enforce surplus income payment requirements on any assets owned by the debtor, including exempt assets;

d. Enlargement of the monetary ceiling for consumer proposals from $75,000 to $250,000 (s 66.11);
e. Avoidance of ipso facto clauses in consumer agreements where the debtor has made a consumer proposal;

f. Extending the automatic discharge period for first-time bankrupts from 9 months to 21 months where the debtor has surplus income during the 12 months’ period (s 168.1);

g. Subject to any directives issued by the OSB, permitting trustees to enter into binding contracts with debtors for payment of the trustee’s fees for up to a year following the debtor’s discharge even where the debtor has no surplus income;

h. Ameliorating the discharge periods for consumer bankrupts with student loans by permitting the debtor to apply for a discharge after seven years (in place of the current 10 years) and to apply for a discharge on hardship grounds after five years (in place of the current 7 years (s 178(1)(g)(ii), 178(1.1).

3. Objections to Amendments (e) and (f)

[79] Of these eight amendments, only two can be said to be debtor friendly. Even then, the first of these amendments (avoidance of *ipso facto* clauses) is likely to have a limited effect in consumer proposals. The second amendment, exclusion of RRSP assets from the trustees’ reach, will also only benefit a small percentage of consumer debtors. In summary administration estate, at best only 10 per cent of the debtors have a RRSP or life insurance policy of any kind and the median value of those assets is equally low. In short, the RRSP amendment is a striking example of a middle class bias of what constitute important issues in the contemporary consumer insolvency scene.
[80] With respect to the other amendments, item f. in the above list (extension of the period before debtors are entitled to an automatic discharge) is particularly objectionable on several grounds. The first is that it was inspired by the wrong motives – to discourage debtors from shopping among trustees to see which trustee is least likely to recommend extension under the existing BIA provisions of the debtor’s obligation to continue to make surplus income payments beyond the basic twelve months’ period. The second objection is that the proposed automatic extension of the nine months’ period to 21 months is only likely to result in many debtors defaulting in their payment obligations before the end of the 21 months’ period and thus forfeiting their entitlement to a discharge.  

[81] The objection to the proposed amendment in item g. allowing trustees to sue for their fees after the debtor’s discharge is that it focuses on the wrong question. The question is not whether trustees deserve to be paid for their services; obviously they do. The real questions ought to be whether prebankruptcy fee agreements between a trustee and the debtor should be given preferred treatment over other prebankruptcy obligations of the debtor which are discharged on bankruptcy, and whether a good case has been for overriding the Manitoba Court of Appeal’s ruling in In re Berthelette.  

The second question is whether the contract should be enforceable even though the debtor has no surplus income as defined in the Surplus Income directive, and a third is whether enforcing a private trustee’s contract against indigent debtors will deflect

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10 This prediction is based on the close to 38% failure rate in consumer proposals made in 2000. See J Ziegel, Commentary, Globe and Mail, August 29, 2005, p A13.

11 (1999) 174 D.L.R. (4th) 577. The Court of Appeal held that a prebankruptcy fee agreement between the trustee and the debtor are, like all other agreements, discharged on the debtor’s discharge from bankruptcy. The decision caused much anxiety among trustees because it jeopardized their chances of being able to recover their full fees and expenses once the debtor had secured her discharge. In a substantial number of cases, the debtor’s exempt property and surplus income payable under s 68 are not sufficient to cover the trustee’s fees and expenses.
attention from the need to revive a federally supported bankruptcy service for low income consumers comparable to the FITA programme operated by the federal government in the late 1960s.

4. Omitted PITF Recommendations in BILL C-55

[82] Bill C-55 is not even handed in its treatment of the PITF recommendations. While adopting PITF recommendations that were adverse to consumer debtors or only likely to benefit a small percentage of debtors, it omitted three PITF recommendations that had also won the Senate Committee’s support and that favoured the debtor’s position. These were (a) the inclusion in section 67 of the BIA of an optional list of federal exemptions designed to ensure that all bankrupts would be entitled to a reasonable level of exemptions regardless of what provincial law provides; (b) avoidance of prebankruptcy non-purchase security interests in exempted assets; and (c) the regulation of post-bankruptcy reaffirmation agreements entered into by debtors.

[83] The (unofficial) reasons given by federal officials for omitting these recommendations are unpersuasive. It was said that no need had been shown for an optional list of federal exemptions.12 The refusal to avoid non-purchase money security interests, we have been told, was based on the fact that it would been an interference with provincial law.13 So far as the regulation of reaffirmation agreements was concerned, the explanation given was that no problem had been shown to exist and therefore (presumably) there was nothing that needed to be regulated. Although the

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13 Curiously, the same objection did not prevent the federal officials from excluding RRSP assets from the trustee’s reach in the Bill C-55 amendments even though the assets may not be exempt under provincial law.
evidence is admittedly fragmentary, what is known about current position with respect to such agreements does not support Industry Canada’s position.

5. Treatment of Student Loans\textsuperscript{14}

\textit{i. Background}

[84] The eligibility for discharge of unpaid student loans is another controversial insolvency issue on which there is a strong division of opinion and whose resolution is of particular importance to young adults under the age of 30.

[85] Between 1992 and 1997, the legal position was that unpaid student loans were treated like other unsecured debts and were therefore automatically discharged at the end of 9 months following the debtor’s first time bankruptcy unless the discharge was opposed. The position was changed in the 1997 amendments because of federal and provincial government concerns about the large number of student borrowers who were going bankrupts and were therefore relieved of further obligations to repay the unpaid parts of the loan.

[86] The 1997 amendments to the BIA (s.178(1)(g) provided that no discharge relief from student loans was available before 2 years had elapsed after completion of the full or part-time programme of studies in respect of which the loan had been made and only then if the court was satisfied that non-discharge of the loan would cause the student hardship. A further significant change was made to s 178(1)(g) as a result of the 1998 Budget Resolutions. This increased the period before the student borrower was entitled to apply for relief from 2 years to 10 years. However, the Budget Resolution

\footnote{\textsuperscript{14} For an excellent recent comparative treatment of the topic see Stephanie Ben-Ishai, Government Student Loans, Government Debts and Bankruptcy: A Comparative Study, a research paper prepared under the auspices of the research progogramme of the Office of the Superintendent of Bankruptcy (October 2005).}
also provided for other non-insolvency forms of relief being made available to borrowers in the form of interest relief and deferment of time for repayment of the loan.

[87] While we have no hard data about the effects of the main 1998 amendment, it seems to have succeeded in cutting off student applications for discharge on grounds of hardship. In her search of reported decisions, Prof Ben-Ishai found only 13 such applications between 1998 and the summer of 2005.

[88] Nevertheless, student concerns have not abated nor have those of trustees and others concerned to advise students about the debt position. Importantly, a study by Schwartz and Anderson of debtors who sought bankruptcy protection between mid-March and May of 1997 found that bankrupts with student loans among their debts were “in a worse economic position than the average debtor seeking bankruptcy protection. They had lower median income, were more likely to have received social assistance and had jobs that were similar to other bankrupts.”

[89] The current position involving student loans was carefully reviewed by PITF and the Task Force recommended the following changes:

- A reduction in the standard discharge period for student loans from 10 years to 5 years
- The availability of a discharge on hardship grounds after 1 year
- Relief in a hardship hearing should include partial relief and the discharge order could be made conditional
- The recommended changes should apply to consumer proposals as well as to bankruptcy cases

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15 PITF Report, p 16.
16 Ibid., p 17.
ii. Rationales of Special Treatment of Student Loans

[90] The following reasons are often given to justify the special treatment of student loans. 1. Such loans are not commercial loans, are not profit centres for the federal or provincial governments, and are designed for the benefit of the student borrowers. 2. Such loans enhance the borrowers’ human capital which, unlike physical assets, cannot be used as collateral. It is also pointed out that, unlike physical assets, which usually yield results quickly, human capital often takes several and, in the case of professional training, many years to generate material results. 3. Contrary to common assumptions, current student loan programmes are not heartless and provide various forms of relief to students not able to make repayment.

[91] We do not find these reasons very persuasive. The first reason strikes us as irrelevant since the issue is not whether government lenders can diversify the risks of non-repayment but whether there is a reasonable prospect of the student borrower being able to repay in a reasonable time frame. So far as the second reason is concerned, the difficulty is that many degree and diploma programmes at institutions of higher learning and at vocational institutes do not ensure that the student will be able to find profitable employment using her new knowledge and skills, and may in fact not be designed to do so. With respect to the third reason, while the forms of relief may be helpful to some students with good job and earning prospects, as the Schwartz/Anderson findings show, they appear to do little for a large number of other students with delinquent debts.
iii. Our Recommendations

[92] We support the PITF recommendations for the reasons given by the Task Force. In addition, we recommend that:

1. The insolvent student should be given the option of applying for debt relief in writing to a national independent debt relief committee. This would replace the need for a hearing before a bankruptcy judge or registrar and would have the following advantages: (i) it would ensure greater uniformity in the disposition of such applications; (ii) the application would be heard by a committee knowledgeable about student loans and better able to assess the credibility of the application; and (iii) it would be cheaper for applicants than the cost of hiring a lawyer to argue the case before a court and, in some cases, the cost of having to travel a considerable distance to the nearest bankruptcy court.

2. The federal and provincial governments should consider giving closer scrutiny to student loan applications than is now the case and giving applicants advice on the job prospects in the area in which the applicant is seeking to acquire special skills or knowledge.

[93] We have considered the feasibility of returning to the position as it obtained between 1992 and 1997 and imposing on federal and provincial loan agencies the burden of opposing the discharge of a student loan as part of the standard discharge procedure. We have decided against it on the ground that, in the present environment, the solution is not realistic politically and that the 1 year/5 year solution proposed by the Task Force strikes the best compromise.
6. **Need for New Approaches**

[94] In our view, Bill C-55’s treatment of consumer insolvency issues points to the need for a new and more realistic approach to the problems, including adoption of the following measures:

a. the need for an ongoing advisory committee, comprising a majority of members knowledgeable in the area and sympathetic to the consumer’s perspective, to study and recommend changes in Canada’s law governing consumer insolvencies and the administration of the BIA provisions;

b. the need for ongoing empirical studies of all aspects of consumer insolvencies; and

c. the need for cheaper and simpler methods of handling summary administration estates and especially those where the debtor has no surplus income;

d. the need for a new terminology for bankrupt debtors.\(^\text{17}\). Bankrupt debtors in Canada continue to be stigmatized by use of the term ‘bankrupt’ when they adopt a Part II BIA liquidation procedure to seek relief from creditor claims and seek a discharge from their debts without the creditors’ approval and are not in a position to make a proposal to their creditors.\(^\text{18}\). Those making a consumer proposal are simply referred to in the BIA as consumer debtors. The distinction is quite arbitrary and rests on dubious historical foundations. Morally, consumer bankrupts are indistinguishable from debtors making a proposal, especially given the fact that s 68 of the BIA requires consumer bankrupts to make payments to the trustee if they have surplus income before their discharge. Although our concern is primarily with the

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\(^{17}\) See also our Submission to the Senate Trade and Commerce Committee, May 23, 2003, Part III.C7, pp 32-33.

\(^{18}\) Note importantly however that the debtor’s creditors are still entitled to object under the current BIA provisions and that the discharge is subject to the court’s overall supervision.
stigmatizing of individual bankrupts, logically, we believe, no distinction can be drawn in the nomenclature applied to individual and corporate bankruptcies.

e. Accordingly, we recommend: (i) adoption of the term ‘debtor’ in the BIA to describe all persons who are the subject of insolvency proceedings, and (ii) changing the name of the Bankruptcy and Insolvency Act to the simpler and more appropriate title ‘Insolvency Act’. Adoption of the first recommendation would bring Canadian usage in line with the terminology in the US Bankruptcy Code. Adoption of the second recommendation would revert Canadian terminology to that in use before Confederation and would also align Canada with the title of ‘Insolvency Act’ adopted in the English legislation of 1986 and subsequent amendments thereto.

RESPECTFULLY SUBMITTED

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November 9, 2005
IV. Appendices

A. Memoranda

October 26, 2004

Anthony Duggan

Executory Contracts

1. Introduction

1.1 “Executory contract” is the expression the United States Bankruptcy Code, s.365 uses to describe a contract that remains partly unperformed on both sides at the date of the debtor’s bankruptcy. The following are some examples:

(1) an uncompleted construction contract under which
   (a) the customer (debtor) agrees to pay the builder (counterparty) as the work progresses; or
   (b) the customer (counterparty) agrees to pay the builder (debtor) as the work progresses;
(2) a distribution agreement or other contract for the supply of goods or services from time to time for which
   (a) the supplier (debtor) customarily bills the customer (counterparty); or
   (b) the supplier (counterparty) periodically bills the customer (debtor);
(3) a real estate lease or a lease of personal property under which
   (a) the lessee (debtor) pays periodical rentals to the lessor (counterparty); or
   (b) the lessee (counterparty) pays periodical rentals to the lessor (debtor);
(4) a technology licensing agreement under which
   (a) the licensor (debtor) agrees to provide maintenance and updating facilities to the licensee (counterparty); or
   (b) the licensor (counterparty) agrees to provide maintenance and support facilities to the licensee (debtor);
(5) an employment contract between an employer (debtor) and employee (counterparty).
1.2 The issue that executory contracts in the bankruptcy sense raise is this: how does the debtor’s bankruptcy affect the debtor’s and counterparty’s respective rights and obligations under the contract? Or, more particularly:

(1) Can the debtor or the debtor’s trustee disclaim the contract (i.e., can the debtor or the debtor’s trustee terminate the contract even though the counterparty wants to keep it going?)
(2) Can the debtor or the debtor’s trustee affirm the contract (i.e., can the debtor or the debtor’s trustee keep the contract going even though the counterparty wants to terminate it?)
(3) Can the debtor or the debtor’s trustee assign the contract to a third party contrary to a provision in the agreement and without the counterparty’s consent?

The debtor or the debtor’s trustee may want to take one or other of measures (1)-(3) in order to maximize the value of the estate for the benefit of the debtor’s creditors. In Canada currently there is a relatively detailed set of rules in the provincial landlord and tenant statutes (except Quebec) governing the disclaimer, affirmation and assignment of commercial tenancy agreements in the tenant’s bankruptcy. BIA, s.146 incorporates these provisions by reference into the BIA. However, there are no corresponding rules for other kinds of contracts. In the case of other kinds of contract, the common law applies, subject to a few statutory modifications in the case of BIA proposal proceedings and CCAA proceedings. By contrast, the United States Bankruptcy Code, s.365 enacts a comprehensive set of rules that covers all kinds of executory contracts and (with some exceptions) applies in the same way regardless of the nature of the bankruptcy proceedings.
The main elements of s.365 are as follows:

1. A trustee may reject (disclaim), assume (affirm) or assign any executory contract or lease subject to the court’s approval.

2. The debtor or the debtor’s trustee may not assume the contract unless the debtor or trustee:
   (a) cures the default;
   (b) compensates the counterparty for any loss resulting from the debtor’s default; and
   (c) provides adequate assurance of future performance.

3. The debtor or the debtor’s trustee may assign an executory contract notwithstanding any provision in the contract that prohibits or restricts assignment.

4. The debtor or the debtor’s trustee may assign an executory contract only if:
   (a) the debtor or trustee assumes the contract in accordance with the rules in s.365 governing assumption; and
   (b) adequate assurance of future performance by the assignee is provided.

5. The debtor or the debtor’s trustee may not assume or assign an executory contract if applicable State law excuses the counterparty from dealing with a person other than the debtor and the counterparty does not consent to the assumption or assignment.

6. The counterparty has no right to terminate an executory contract solely on the ground of the debtor’s insolvency or financial condition, notwithstanding any provision in the agreement to the contrary but subject to any applicable State law that excuses the counterparty from dealing with the debtor or the debtor’s trustee.

7. As a general rule, a court-approved rejection by the debtor or the debtor’s trustee becomes a breach of contract and the counterparty can claim in the debtor’s bankruptcy for contract damages. However, the counterparty cannot normally sue for specific performance or the like.

8. The debtor or the debtor’s trustee must make an all-or-nothing choice between assumption and rejection. The debtor or trustee cannot assume part of a non-
severable executory contract and reject the rest. Nor does the debtor or trustee have any unilateral right of variation.

1.4 The Code does not say what standard the courts should apply in deciding whether to approve the debtor’s or trustee’s course of action. This means the courts have had to develop their own rules. The courts have taken different approaches from State to State, but in most States the courts apply a business judgment test. The business judgment test defers to the debtor’s or trustee’s decision on whether the rejection, assumption or assignment, as the case may be, is beneficial to the debtor’s estate.

1.5 Code, s.365 has been widely criticized (e.g.: Michael T. Andrew, “Executory Contracts in Bankruptcy: Understanding Rejection” (1988) 59 University of Colorado Law Review 845; Jay L. Westbrook, “A Functional Analysis of Executory Contracts” (1989) 74 Minnesota Law Review 227), but the provision has at least the virtue of consistent treatment for all kinds of contracts and, so far as we are aware, it has not been the subject of criticism on that score. In summary, the positive features of s.365 are that:

1. By contrast, the current laws in Canada governing the disclaimer, affirmation and assignment of executory contracts are piecemeal. The amendments Bill C-55 proposes address the problem to some extent, but they do not go far enough. The proposed new provisions are scattered and fragmented and, therefore almost inevitably, there are gaps and inconsistencies. There is also far too much unnecessary duplication of provisions. We develop these points below. In our view, Canada should enact a single comprehensive provision for executory contracts, as the United
States has done in s.365. This is not to say that the content of the new provision should necessarily be the same as s.365, but in relation to form, s.365 provides a useful model. To fully implement this suggestion, it would be necessary to abandon the current two statute regime for commercial reorganizations. We support this move, as indicated in the main part of our submission. However, even if the two statute regime is retained, it would still be feasible to enact a comprehensive executory contracts provision in the BIA, applicable in both formal bankruptcy and proposal proceedings. A mirror-image provision could then be enacted in the CCAA. This bifurcated approach would not be optimal, but it would still be an improvement on both the present law and the amendments Bill C-55 proposes.

2. The Bill C-55 amendments

(a) Introduction

2.1 Bill C-55 would enact the following new provisions:

- BIA, ss 65.11 and 65.12 and CCAA, ss 32 and 33 (disclaimer)
- BIA, ss 84.2 and CCAA, ss 11.4 and 34 (affirmation); and
- BIA, ss 66.1 and 84.1 and CCAA, s.11.3 (assignment).

We will address each of these sets of provisions in turn.

(b) Disclaimer: Introduction

2.2 Proposed new BIA, ss 65.11 and 65.12 provide for disclaimer of contracts in BIA proposal proceedings. Proposed new CCAA ss 32 and 33 provide for disclaimer in CCAA proceedings. BIA, ss 65.11 and 65.12 and CCAA, ss 32 and 33 are parallel provisions. BIA, s.65.11 and CCAA, s.32 apply to contracts generally. BIA, s.65.12 and CCAA, s.33 apply to collective agreements in particular. There is no corresponding provision in Bill C-55 for disclaimer of contracts in formal
bankruptcy proceedings. The omission may have been accidental. If so, it should be rectified.

(c) Disclaimer in BIA proposal proceedings

2.3 The governing provisions are BIA, ss 65.11 and 65.12. Both provisions are limited to the case where the debtor is “other than an individual”, in other words, a corporation. The commercial proposal provisions in BIA, Part III, Div. 1 apply not only to corporations, but also to individuals if the individual debtor’s aggregate debt exceeds the amount s.66.11 prescribes. We cannot see why the right of disclaimer should be limited to debtors who are corporations.

2.4 Section 65.11 does not apply to a lease referred to in s.65.2(1): s.65.11(2)(b). The upshot is that there will be one set of rules for the disclaimer of commercial lease agreements (s.65.2) and another set of rules for the disclaimer of contracts at large (s.65.11). As it happens, the provisions of ss 65.2 (1)-(3) coincide with the provisions of ss 65.11(1)-(4) and there is no inconsistency between the two sets of provisions. However, the duplication is both unnecessary and wasteful. It would be better to roll both provisions into one.

2.5 Section 65.11 does not apply if the debtor is a borrower. We cannot see the reason for this exclusion. The effect of a disclaimer on a loan contract would be to bring the contract to an end. The debtor would become liable for the outstanding balance of the loan together with accrued interest and other charges and the lender would have a claim for this amount in the debtor’s proposal proceedings. There is no obvious inefficiency or unfairness in these outcomes to justify treating loan agreements differently from other kinds of contract in general and other kinds of credit agreement in particular. Consider the following cases: (1) Debtor borrows $100 from Counterparty Bank to finance the purchase of goods from Supplier. (2) Debtor purchases goods from Counterparty Supplier for $100 plus charges
pursuant to a conditional sales agreement. There is no obvious reason why the
debtor should have a right of disclaimer in Case (2), but not Case (1).

2.6 Section 65.11 gives the counterparty the right to challenge a disclaimer and the test
the court must apply is whether “a viable proposal could be made in respect of the
debtor without the disclaimer”. Disclaimer and affirmation are related concepts.
They are two sides of the same coin. BIA, s.84.2 governs the debtor’s right of
affirmation in BIA proposal proceedings. As in the case of disclaimer, the
counterparty has a right to object. The test the court must apply is whether the
disclaimer would be likely to cause the counterparty “significant financial
hardship.” It is unclear why there should be different tests for disclaimers and
affirmations. It is true that in exercising its discretion under s.65.11, a court will
probably take financial hardship to the counterparty into account and in exercising
its discretion under s.84.2, a court will probably take into account the importance of
the contract in question to the viability of the proposal. Nevertheless, the courts may
feel the need to weigh the viability of the proposal more heavily in the case of a
disclaimer and to weigh the counterparty’s financial hardship more heavily in the
context of an affirmation, given the way the statute is expressed. The difference
does not make sense. The governing considerations should be the same in both
cases.

(d) Disclaimer in CCAA proceedings

2.7 The governing provisions are CCAA, ss 32 and 33. CCAA, ss 32 and 33 parallel
BIA, ss 65.11 and 65.12. The observations we make in paras 2.4-2.7, above, about
BIA, ss 65.11 and 65.12 apply mutatis mutandis to CCAA, ss 32 and 33.

2.8 BIA, ss 65.11 and 65.12 and CCAA, ss 32 and 33 are in almost the same terms. In other
words, Bill C-55 applies consistent rules to disclaimers in BIA proposal proceedings and
CCAA proceedings. This is an improvement on the present law. However, the Bill achieves
consistency by duplication. The duplication is wasteful and unnecessary. It would be much
better if the two provisions were rolled into one. This raises the larger question of whether it continues to make sense for Canada to have two separate commercial reorganization statutes. We have already indicated our views on this question.

(e) Affirmation: Introduction

2.10 Proposed new BIA, s.84.2 prohibits *ipso facto* clauses and the like in the context of formal bankruptcy proceedings. This is tantamount to giving the trustee a right of affirmation because it necessarily follows that if the counterparty cannot terminate the contract the trustee has the option of either keeping the contract on foot or disclaiming it. Section 84.2 parallels the current BIA, s.65.1, which applies in the context of BIA proposal proceedings. Proposed new CCAA, s.34 is another parallel provision. It applies in the context of CCAA proceedings. Proposed new CCAA, s.11.4, concerning critical suppliers, is a related measure.

(f) Affirmation in formal bankruptcy proceedings

2.11 The governing provision is BIA, s.84.2. The provision is limited to the case where the bankrupt is an individual. The BIA formal bankruptcy provisions apply not only to individual bankrupts but also to corporations. We cannot see why the trustee should have a right of affirmation in one case but not the other.

(g) Affirmation in BIA proposal proceedings

2.12 The governing provision is BIA, s.65.1. BIA, ss 65.1 and 84.1 are in almost the same terms. In other words, there will now be consistent rules for affirmations in formal bankruptcy and BIA proposal proceedings. This is an improvement on the present law. However, Bill C-55 achieves consistency by duplication. The duplication is wasteful and unnecessary. It would be much better if the two sets of provisions were rolled into one.

2.13 BIA, s.65.1 gives the counterparty a right to challenge an affirmation and the test the court must apply is whether the affirmation would “likely cause the [counterparty] significant
financial hardship”. A different test applies for disclaimers and we do not see the justification for the discrepancy: see para. 2.6, above.

(h) Affirmation in CCAA proceedings

2.14 The governing provisions are CCAA, ss 34 and 11.4. Section 34 is in almost the same terms as BIA, ss 84.1 and 65.1 In other words, there will now be consistent affirmation rules for all three main kinds of insolvency proceedings. However, Bill C-55 achieves consistency by duplicating the affirmation provisions, not once, but twice. We do not see the sense in enacting three separate provisions which all say the same thing. It would be much better if all three sets of provisions were rolled into one. This again raises the one statute or two question for commercial reorganization proceedings.

2.15 Section 11.4 allows the debtor to apply for an order declaring a person to be a critical supplier and ordering the person to supply goods or services to the debtor. Sections 11.4 and 34 are both aspects of the debtor’s right of affirmation and they should be grouped together in the same part of the statute. Their current location in different parts of the Act obscures the relationship between them, as the following discussion will show.

2.16 CCAA, s.11.4 has no counterpart in BIA, Part III, Div.1. We do not understand why a critical supplier provision should be thought necessary for CCAA proceedings, but not BIA proposal proceedings.

2.17 CCAA, s.11.01 provides that no s.11 order has the effect of prohibiting a person from requiring immediate payment for goods or services supplied after an order is made. It is not clear whether s.11.4 is meant to override s.11.01. Section 11.4(3) suggests that it might be. If so, then it has to be asked what is the point of s.11.01? On the other hand, if s.11.01 takes precedence over s.11.4, it has to be asked what is the point of s.11.4? Assuming a supplier is entitled to demand immediate payment for post-petition supplies to the debtor, it is hard to see why it would refuse.
2.18 CCAA, s.11.4 overlaps with s.34. Section 34 prohibits termination of an existing contract on the ground of the CCAA proceedings alone. It goes on to make special provision for landlords and public utilities, presumably on the basis that these are critical suppliers. It is unclear to us why there should be two provisions dealing with critical suppliers. Moreover, the provisions are both overlapping and inconsistent. In a case of overlap, for example where the counterparty is a landlord or a public utility, it may be necessary to determine which provision takes precedence. The question matters because if s.34 applies, the counterparty can apply to the court for relief on the significant financial hardship ground. There is no corresponding provision in s.11.4: see further, para.2.19, below.

2.19 There is no provision in s.11.4 for the counterparty supplier to object on the ground that the order would cause it financial hardship. Contrast s.34 in this respect. The sole consideration for the court is whether the goods or services are critical to the debtor’s continued operation. The courts have a discretion under s.11.4 and they will probably take the supplier’s financial circumstances into account when deciding whether to make an order. However, the express reference s.11.4 makes to the debtor’s interests may affect the weight the courts feel they can give to the countervailing interests of the supplier. Section 34 raises the reverse problem: see paras 2.6 and 2.13, above.

(i) Assignment: Introduction

2.20 Proposed new BIA, s.84.1 governs assignment of contracts in formal bankruptcy proceedings. The same provision applies in BIA proposal proceedings by virtue of BIA, s.66(1). Proposed new CCAA, s.11.3 is a parallel provision.

(j) Assignment in formal bankruptcy proceedings

2.21 Section 84.1 requires the trustee to apply for court approval. Contrast the rules governing affirmation in s.84.2, which do not require court approval, but which allow the counterparty to apply for an order to terminate the contract. It is unclear why the burden should be on the trustee to apply in one case, but on the counterparty to apply in the other case. The thinking
behind s.84.2 is perhaps that it would be wasteful to require court approval in every case and that judicial involvement should be limited to cases of actual controversy between the trustee and the counterparty. However, this thinking would apply equally to proposed assignments under s.84.1.

2.22 Section 84.1 does not apply to a lease referred to in BIA, s.65.2(1): s.84.1(3)(b). In other words, commercial lease agreements are not subject to the provision. The upshot is that the assignment provisions in provincial landlord and tenant laws will continue to apply. These provisions vary from province to province and there are no relevant provisions at all in Quebec. This is an unsatisfactory outcome for at least three reasons:

(1) it makes no sense to have one set of assignment rules for commercial tenancy agreements and a different set of rules for other kinds of contracts;

(2) section 84.1 is inconsistent with s.84.2 in its treatment of commercial lease agreements. Section 84.2 does not discriminate between commercial lease agreements and other kinds of contract in relation to affirmation. Why, then, should s.84.1 discriminate between commercial lease agreements and other kinds of contracts in relation to assignments?

(3) The parties’ respective entitlements should be the same from province to province. The application of non-uniform provincial laws in insolvency proceedings is unfair and inefficient. The Standing Senate Committee made this point forcefully in relation to the preference laws (at p.122). The committee’s argument applies with equal force in the present context.

(k) Assignment in BIA proposal proceedings

2.23 Section 84.1 applies in BIA proposal proceedings by virtue of s.66(1). Proposed new s.66(1.1) provides that, in deciding whether to approve an assignment, the court must consider, in addition to the other factors s.84.1 mentions, whether the insolvent person would not be able to make a viable proposal without the assignment. The objective is to make sure that the rules for assignments are the same in formal bankruptcy proceedings and BIA proposal proceedings. This is an improvement on the present position. However, Bill C-
achieves consistency using the device of incorporation by reference. This is preferable to repeating the relevant provision in full, as the Bill does in other areas (see above). However, incorporation by reference is not an optimal solution because it forces the reader to look in several parts of the Act to find a full statement of the law: incorporation by reference is a trap for the unwary. The best solution, as we have indicated several times already, would be to enact an omnibus provision which applied regardless of the nature of the insolvency proceedings.

Section 84.1 does not apply to a lease referred to in BIA, s.65.2(1). In other words, a commercial lease is not subject to the provision: see para.2.22, above. This means that there are no statutory assignment rules for commercial lease agreements in BIA proposal proceedings. In Ontario, at any rate, the assignment provision in the landlord and tenant legislation does not apply because it is limited to formal bankruptcy proceedings: Commercial Tenancies Act R.S.O. 1990, c.L-7, s.38. In the absence of statutory provisions, the common law rules apply. At common law, an assignment may be unenforceable if there is an anti-assignment provision in the contract subject to assignment. There can be no rational explanation for facilitating the assignment of a commercial lease agreement in formal bankruptcy proceedings and CCAA proceedings but not BIA proposal proceedings, or for facilitating the assignment of most contracts in BIA proposal proceedings, but not commercial lease agreements.

(l) Assignment in CCAA proceedings

Section 11.3 is the governing provision. Section 11.3 parallels BIA, s.84.1, but there is no exception for commercial tenancy agreements. This reinforces the point we make in para.2.24, above: it makes no sense to facilitate the assignment of commercial lease agreements in one kind of insolvency proceeding but not another. The rules should be the same in both cases.
2.26 In the case of BIA proposal proceedings, the court must consider whether the assignment is necessary for a viable proposal: see para. 2.23, above. There is no corresponding provision in s. 11.3. The discrepancy is unjustifiable.

2.27 Subject to the foregoing, CCAA, s. 11.3 duplicates BIA, s. 84.1. Therefore, the point we make in para. 2.21, above, about the requirement for court approval applies, mutatis mutandis, to s. 11.3.

2.28 The duplication between BIA, s. 84.1 and CCAA, s. 11.3 is wasteful and unnecessary. It would be much better if the two provisions were rolled into one.

3 Summary of submissions

3.1 Bill C-55 makes no provision for the disclaimer of contracts in formal bankruptcy proceedings. The omission should be rectified (para. 2.2)

3.2 BIA, ss 65.11 and 65.12 (disclaimers in BIA proposal proceedings) only apply if the debtor is a corporation. The limitation should be removed (para. 2.3)

3.3 BIA, s. 65.11 applies to the disclaimer in BIA proposal proceedings of contracts other than commercial lease agreements. BIA, s. 65.2 applies to the disclaimer of commercial lease agreements. The provisions substantially duplicate one another and they should be rolled into one (para. 2.4)

3.4 BIA, s. 65.11 does not apply if the debtor is a borrower. The exception should be removed (para. 2.5)

3.5 There is a discrepancy between the considerations BIA, s. 65.11 requires the court to take into account for disclaimers and the considerations BIA, s. 84.2 requires the court to take into account for affirmations. The discrepancy should be explained or removed (paras 2.6 and 2.13).
3.6 The rules governing disclaimer in BIA, ss 65.11 and 65.12 and CCAA, ss 32 and 33 involve unnecessary duplication. The rules should be rolled into one as part of the larger exercise of combining the BIA and the CCAA in a single statute (para. 2.8).

3.7 BIA, s.84.2 (affirmation in formal bankruptcy proceedings) applies only where the debtor is an individual. The limitation should be removed (para.2.11).

3.8 BIA, s.65.1 (affirmation in BIA proposal proceedings) and s.84.2 (affirmation in formal bankruptcy proceedings) involve unnecessary duplication. The provisions should be rolled into one (para. 2.12).

3.9 BIA, ss 65.1 and 84.2 and CCAA, s.34 involve unnecessary duplication. CCAA, s.34 should be rolled in with the other provisions as part of the larger exercise of combining the BIA and CCAA in a single statute (para.2.14).

3.10 CCAA, ss 11.4 and 34 are both aspects of the debtor’s right to affirm. They should be located together in the same part of the statute (para.2.15).

3.11 CCAA, s.11.4 has no counterpart in BIA, Part III, Div.1. The rules should be the same in BIA proposal proceedings and CCAA proceedings (para.2.16).

3.12 The relationship between CCAA, ss.11.01 and 11.4 needs to be clarified and any inconsistencies between the two provisions should be removed (para.2.17).

3.13 The relationship between CCAA, ss.11.4 and 34 needs to be clarified and any inconsistencies or overlap between them should be removed (paras 2.18 and 2.19).

3.14 BIA, s.84.1 requires court approval for contract assignments in formal bankruptcy proceedings. By contrast, for affirmation there is no need for court proceedings unless the counterparty applies. The discrepancy should be either justified or removed (para.2.21).
3.15 BIA, s.84.1 does not apply to a commercial lease agreement. The exception should be removed (paras. 2.22, 2.24 and 2.25)

3.16 BIA, s.66(1) incorporates s.84.1 by reference into BIA, Part III, Div.1. A better solution would be to enact an omnibus provision which applied regardless of the nature of the insolvency proceedings (para. 2.23).

3.17 CCAA, s.11.3 should state expressly that in considering whether to approve an assignment, the court must consider the importance of the assignment to the viability of the reorganization (para. 2.26)

3.18 CCAA, s.11.3 requires court approval for the assignment of a contract in CCAA proceedings. By contrast, under ss 32 (disclaimer) and 34 (affirmation), there is no need for court proceedings unless the counterparty applies. The discrepancy should be either justified or removed (para. 2.27).

3.19 BIA, s.84.1 applies to contract assignments in formal bankruptcy proceedings and, by force of s.66(1), in BIA proposal proceedings as well. CCAA, s.11.3 applies to assignments in CCAA proceedings. The provisions substantially duplicate one another and they should be rolled into one as part of the larger exercise of combining the BIA and the CCAA in a single statute (para.2.28).
1. Introduction

1.1 Bill C-55 addresses the following priorities-related topics:

- Crown claims
- Employee wage claims
- Unpaid pension fund contributions
- Subordination of equity claims.

Paragraphs 2.1-5.3, below deal with the proposed amendments topic by topic.

2. Crown claims

2.1 As a consequence of the deemed trust provisions in BIA, s.67(2) and (3) read in conjunction with the federal and provincial laws s.67(3) refers to, the Crown has absolute priority over unsecured creditors in relation to claims for unremitted source deductions payable under the Income Tax Act and its provincial equivalents and unpaid contributions payable under the Employment Insurance Act and the Canada Pension Plan and their provincial equivalents. The Crown’s priority over secured creditors in relation to each of these types of claim depends on the provisions of the statute which governs the claim. In relation to claims other than those BIA, s.67(3) refers to, the Crown’s priority turns on BIA, ss 86 and 87 read in conjunction with the federal or provincial statute which governs the claim.

2.2 BIA, ss 67(2) and (3) and 86-87 apply in BIA proposal proceedings by virtue of BIA, s.66(1). BIA, s.60(1.1) supplements ss 67(2) and (3) in relation to certain Crown claims. It provides in effect that no proposal shall be approved unless it provides for
payment in full within 6 months of claims of the kind to which BIA, s.67(3) refers and that are deemed to be held in trust. The consequence is to give these Crown claims super-priority status in BIA proposal proceedings.

2.3 CCAA, proposed s.37, replacing s.18.3, duplicates BIA, s.67(2) and (3). CCAA, proposed ss 38 and 39, replacing ss 18.4 and 18.5, duplicate BIA, ss 86-87. CCAA, proposed s.6(2) and (3), replacing s.18.2, duplicates BIA, s.60(1.1). The duplication is wasteful and unnecessary. The provisions should be rolled into one as part of the larger exercise of combining the BIA and the CCAA in a single statute.

2.4 The current law governing Crown claims is complex and fragmented and it fails to address the underlying policy concerns in a coherent way. Adoption of the recommendation we make in para.2.3, above would go some way towards addressing the problem, but only so far as the bankruptcy laws themselves are concerned. However, the Crown claims provisions in the bankruptcy laws are only part of the total picture. Other laws, federal and provincial, impact on Crown priorities as well: see para. 2.1, above. Separate legislation is required to deal comprehensively and systematically with the Crown priorities question. There are at least two possible models for reform:

- The Cuming model (Ronald C.C. Cuming, An Approach to the Rationalization and Enforcement of Federal and Provincial Crown Claims (paper prepared for Industry Canada, October, 1999)); and

The government should set up some kind of consultative mechanism to determine the relative merits of the two proposals and to develop a blueprint for reform.

3. Employee wage claims
3.1 Bill C-55 will enact BIA, s.81.3 creating a new super-priority for wage claims and the like subject to a ceiling of $2,000 per claim. The claim will be secured by a security on all the bankrupt’s current assets and it will rank above every other claim on those assets except unpaid suppliers’ claims and the Crown claims BIA, s.67(3) refers to and that are deemed to be held on trust. Section 81.3 will apply in formal bankruptcy proceedings. Proposed s.81.4 is a corresponding provision applicable in receiverships. Proposed s.136(1)(d) will give employees a preferred claim for any shortfall in their s.81.3 or 81.4 entitlement. The outdated references in ss 81.3 and 81.4 “clerks”, “servants” and “traveling salespersons” should be modernized.

3.2 BIA, ss 81.3 and 136(1)(d) will apply in formal bankruptcy proceedings. They will also apply in BIA proposal proceedings by virtue of BIA, s.66(1). New s.60(1.3)(a) will supplement the scheme by providing that no proposal shall be approved unless it provides for payment to employees of the amount they would have been qualified to receive under s.136(1)(d) if the employer had been bankrupt at the date of the filing together with wages and other entitlements that have accrued since. There seems to be a drafting error in proposed s.60(1.3)(a). Section 136(1)(d) gives employees a preferential claim for any shortfall in their s.81.3 or 81.4 entitlement. The reference in s.60(1.3)(a) surely should be to the amount of the s.81.3 or 81.4 claim itself and not simply to the shortfall.

3.3 Proposed CCAA, s.6(4) corresponds with BIA, s.60(1.3)(a). The consequence is to incorporate by reference into the CCAA the super-priority scheme for wage claims which the BIA provides for. CCAA, s.6(4) is subject to the same drafting query as BIA, s.60(1.3)(a): see para. 3.2, above. The duplication between BIA, ss 81.3 and CCAA, s.6(4) is wasteful and unnecessary. The provisions should be rolled into one as part of the larger exercise of combining the BIA and the CCAA in a single statute.

4. **Unpaid pension fund contributions**
4.1 BIA, proposed s.81.5 will create a new super-priority in respect of unpaid pension plan contributions. The claim will be secured by a security on all the bankrupt’s assets and it will rank above every other claim on those assets except unpaid suppliers’ claims, the Crown claims BIA, s.67(3) refers to and that are deemed to be held on trust and the super-priority claim for unpaid wages. Section 81.5 will apply in formal bankruptcy proceedings. Proposed s.81.6 is a corresponding provision applicable in receiverships.

4.2 Proposed s.81.5 will apply in formal bankruptcy proceedings. It will also apply in BIA proposal proceedings by virtue of BIA, s.66(1). New s.60(1.4) will supplement the scheme by providing that no proposal shall be approved unless: (1) it provides for payment of the amounts in question and the court is satisfied that the debtor can and will make the payments; or (2) the relevant parties have entered into an agreement for payment approved by the pension regulator.

4.3 Proposed CCAA, s.6(5) corresponds with BIA, s.60(1.4). The consequence is to incorporate by reference into the CCAA the super-priority scheme for unpaid pension fund contributions which the BIA provides for. The duplication in BIA, s.60(1.4) and CCAA, s.6(5) is wasteful and unnecessary. The provisions should be rolled into one as part of the larger exercise of re-enacting the BIA and the CCAA as a single statute.

5. **Subordination of equity claims**

5.1 Standing Senate Committee Recommendation 40 said that the BIA should be amended to provide for the subordination of equity claims, such as the claim of a seller or purchaser of equity securities for damages or rescission. Proposed BIA, s.140.1 implements the recommendation. The amendment in effect codifies the decision in *Re Blue Range Resource Corp.* [2000] A.J. No.14 (Alta Q.B.)

5.2 Proposed BIA, s.140.1 will apply in formal bankruptcy proceedings. It will also apply in BIA proposal proceedings by virtue of BIA, s.66(1). Proposed BIA, s.54(2)(a)(i)
provides, in effect, that a creditor whose claim is subordinated pursuant to s.140.1 may not vote on the proposal. Section 54(2)(a)(i) supplements s.140.1. Without the provision, subordinated creditors might end up with a power of veto over the proposal, particularly if they are placed in a separate class from the other unsecured creditors. The consequence would be to enhance their entitlements rather than subordinate them. This is what happened in *Menegon v. Philips Services Corp.* [1999] O.J. No.4080 (Ont. S. Ct. Just.) and the proposed amendments in effect reverse the decision. The same concern arises in relation to voluntary (or contractual subordinations). If a subordinated creditor is placed in a separate class for voting purposes and allowed to vote, it may end up with a power of veto over the proposal which would be inconsistent with its subordinated status. Proposed s.54(2)(a)(i) should be expanded so that it applies to all subordinated claims, however arising.

5.3 Proposed CCAA, s.22(3) is similar to BIA, s.54(2)(a)(i), but there will be no counterpart in the CCAA to BIA, s.140.1. There are two issues at stake:

(1) Should equity claims be subordinated to general unsecured creditors’ claims?
(2) Should equity claim holders be disqualified from voting?

An affirmative answer to Question (2) depends on an affirmative answer to Question (1). As matters presently stand, Bill C-55 leaves Question (1) to be determined by inference from CCAA, s.22(3). For greater certainty, there should be a provision equivalent to proposed BIA, s.140.1 applicable in CCAA proceedings.

5.4 For the reasons discussed in para.5.2 above, CCAA, s.22(3) should be expanded so that it applies to all subordinated claims, however arising.

6. **Summary of submissions**

6.1 The BIA and CCAA provisions relating to Crown claims should be rolled into one as part of the larger exercise of re-enacting the BIA and the CCAA as a single statute (para.2.6).
6.2 The government should set up some kind of consultative mechanism to determine the relative merits of the proposals which are currently on the table for a Crown Priorities Act and to develop a blueprint for reform (para. 2.4).

6.3 The wording of proposed BIA, ss 81.3 and 81.4 should be modernized (para. 3.1).

6.4 The reference in BIA, s.60(1.3)(a) and CCAA, s.6(4) should be to the amount BIA, ss 81.3 and 81.4 refer to, not the amount referred to in BIA, s.136(1)(d) (paras 3.2 and 3.3).

6.5 Proposed BIA, s.60(1.3)(a) and proposed CCAA, s.6(4) (employee wage claims and proposal/plan approvals) should be rolled into a single provision as part of the larger exercise of re-enacting the BIA and the CCAA as a single statute (para. 3.3).

6.6 BIA, s.60(1.4) and CCAA, s.6(5) (unpaid pension fund contributions and proposal/plan approvals) should be rolled into one as part of the larger exercise of re-enacting the BIA and the CCAA as a single statute (para. 4.3).

6.7 BIA, s.54(2)(a)(i) and CCAA, s.22(3) (no voting rights for holders of subordinated equity claims) should be expanded to cover all subordinated claims however arising (paras 5.2 and 5.4).

6.8 The rule in BIA, s.140.1 (subordination of equity claims) should also apply in CCAA proceedings (para. 5.2).
Gifts and Transfers at Undervalue

1. Introduction

1.1 The current BIA provisions relating to gifts and transfers at undervalue are ss 91, 100 and 101. BIA, s.91 deals with settlements. It says that a settlement of property made within one year, or in some cases 5 years, before the settlor became bankrupt is void against the trustee. A settlement is a kind of gift. Courts have held that the term “settlement” implies an intention on the part of the debtor that the transferred property be retained for the benefit of the recipient in a form that it can be identified. BIA, s.100 deals with reviewable transactions. A reviewable transaction is a transfer at undervalue by the debtor to a counterparty where the debtor and the counterparty are not at arm’s length (for example, where they are related to one another). Section 100 provides that where the debtor enters into a reviewable transaction within one year before bankruptcy, the trustee may apply to the court for an order requiring the counterparty to pay the value shortfall. BIA, s.101 deals with the purchase or redemption by a corporation of its own shares in a bankruptcy context. These transactions are the functional equivalent of a gift because they do not return value to the corporation and so they have the potential to defeat creditors. BIA, s.101 supplements federal and provincial corporations statutes which, generally speaking, prevent a corporation from purchasing or redeeming its shares if it is insolvent. BIA, s.101 also catches the declaration of a dividend at a time when the corporation is insolvent on the theory that this, too, is the functional equivalent of a gift by the corporation to its shareholders.

1.2 BIA, ss 91, 100 and 101 are all aspects of fraudulent conveyances law. The origins of fraudulent conveyances law lie in the Statute of Elizabeth (The Statute of Fraudulent Conveyances 1571). The Statute of Elizabeth was received into Canadian provincial
law at the time of settlement and it still applies in most parts of Canada. Four provinces (British Columbia, Manitoba, Newfoundland and Ontario) have enacted fraudulent conveyances laws. It is not settled whether the Statute of Elizabeth still applies in these provinces. However, the question may not matter because the fraudulent conveyances statutes are in substance the same as the Statute of Elizabeth. The provincial assignments and preferences laws (in all provinces except Manitoba, Newfoundland and the Northwest Territories) also contain fraudulent conveyances provisions, but these apply only if the debtor is insolvent or near insolvency at the date of the transaction. Neither the Statute of Elizabeth nor the fraudulent conveyances laws are limited to cases of insolvency. Outside the debtor’s bankruptcy, any creditor may sue under the fraudulent conveyances laws to have the transaction set aside. Inside bankruptcy, the right of action passes to the debtor’s trustee, acting on behalf of the creditors collectively. The provincial laws operate concurrently with the BIA provisions and the trustee may proceed on either basis. For example, a trustee may use the provincial laws to challenge a transaction that took place before the start of the review period the relevant BIA provision prescribes.

1.3 The current BIA provisions are open to criticism in the following main respects:

(1) They are piecemeal. The aim should be to catch all transactions that diminish the value of the debtor’s estate and that “affect the value of creditors’ realizable claims” (Standing Senate Committee Report, Recommendation 26). However, the current provisions apply only to gifts and transfers at undervalue, and not all gifts and transfers at that. For example:

- BIA, s.91 applies to settlements, but it does not apply to a gift that is not a “settlement” in the narrow sense of that term;
- Section 100 applies to a transfer of property or services at undervalue, but only if the parties are not “at arm’s length”;
- Neither s.91 nor s.100 applies to the gratuitous provision of services by the debtor.
(2) The review periods vary arbitrarily from one provision to another.
(3) There is no consistent remedy structure. In particular:
   - Under s.91, the trustee’s remedy is to have the transaction set aside. The trustee does not have the option of keeping the transaction on foot and claiming from the counterparty the money value of the property in question.
   - Under s.100, the trustee’s remedy is to sue for the difference between the property’s fair market value and the actual consideration the debtor gave or received. The trustee does not have the option of avoiding the transaction and claiming back the property the debtor transferred.

2. The Bill C-55 amendments

(a) Introduction

2.1 Bill C-55 would amend the law by:

   - Repealing the settlements provision in BIA, s.91; and
   - Replacing BIA, s.100 with a new s.96.1 governing transfers at undervalue.

2.2 The main features of proposed s.96.1 are as follows:

(1) It applies to both arm’s length and non-arm’s length transactions;
(2) In the case of an arm’s length transaction, the review period is one year before the date of the initial bankruptcy event and in the case of a non-arm’s length transaction, the review period is 5 years.
(3) In the case of an arm’s length transaction, the trustee would need to prove that:
   - The debtor was insolvent at the time of the transaction or the transaction rendered the debtor insolvent; and
   - The debtor intended to defeat the interests of creditors.
(4) In the case of a non-arm’s length transaction occurring within one year before the date of the initial bankruptcy event, the trustee would need to prove neither that:

- The debtor was insolvent at the time of the transaction or the transaction rendered the debtor insolvent; or
- The debtor intended to defeat the interests of creditors.

(5) In the case of a non-arm’s length transaction occurring between 2-5 years before date of the initial bankruptcy event, the trustee would need to prove that:

- The debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction; or
- The debtor intended to defeat the interests of creditors.

(6) The remedy is a money order for the difference between the fair market value of the property or services in question and the actual value the debtor gave or received.

2.3 The apparent objective of the Bill C-55 amendments is to address the concerns summarized in para. 1.3, above. The amendments appear to derive from two sources:

- An IIC submission in 2004, following publication of the Standing Senate Committee Report, to supplement the IIC and CAIRP Joint Task Force Report on Business Insolvency Law Reform (the “IIC Model”).

The proposed amendments fall short of either or both the Cuming Model and the IIC Model in a number of critical respects, as the following discussion will show.
(b) Non-application to gifts and related matters

2.4 Bill C-55 will repeal the settlement provision (BIA, s.91), but it puts nothing in its place. Proposed s.96.1 applies to a “transfer at undervalue”. “Transfer at undervalue” means a transaction in which the consideration received by a person is conspicuously less than the fair market value of the property or services sold or disposed of by the person in the transaction. The new provisions appear to presuppose some consideration moving from the counterparty. If there is no consideration at all, the courts may say that the provisions do not apply.

2.5 It would be a major shortcoming if s.96.1 does not apply to settlements and gifts at large. The aim should be to catch all transactions that diminish the value of the debtor’s estate and that may affect the value of creditors’ realizable claims: see para.1.3, above. A gift by the debtor to the counterparty may have this effect at least as much as a transfer at undervalue. A simple way of addressing the problem would be to amend the definition of “transfer at undervalue” to make it clear that the term includes a gift.

2.6 Even with this adjustment, however, proposed s.96.1 arguably does not go far enough. The objective is to reach all transactions that diminish the value of the debtor’s estate and that may affect the value of creditors’ realizable claims. Gifts and transfers at undervalue have this effect, but they are not the only transactions that do so. A transaction under which the debtor incurs an obligation to the counterparty, such as a contract of guarantee, is a possible case in point. Section 96.1 is limited to the transfer of property and services at undervalue. “Services” is not defined and the term may or may not include the incurring of an obligation. Contrast the fraudulent transfers provision in s.548 of the United States Bankruptcy Code, which applies not only to the transfer by the debtor of an interest in property, but also to “any obligation incurred by the debtor” within the prescribed review period.
2.7 Under the Cuming Model, the provision would catch any transaction under which the debtor:

- transfers or agrees to transfer property to another person for no value or for value that is “conspicuously less” than the market value of the property; or
- incurs an obligation for no value or for value that is conspicuously less than the monetary value of the obligation;
- performs services for no value or for value that is conspicuously less than the market value of the services;
- in the case of a corporation, purchases or redeems shares of that corporation or pays a dividend other than a dividend in the form of shares of that corporation;
- makes or agrees to make payments under a contract of insurance or annuity where the beneficiary is a person other than the debtor himself or a dependant of the debtor and the contract is property to which BIA, section 67(1)(b) applies; or
- for a fraudulent purpose, grants or agrees to grant a security interest or the like to another person.

In our view, the reach of s.96.1 should be expanded along the lines the Cuming Model proposes. Note that the Cuming Model dispenses with the need for a separate BIA, s.101. It rolls all the current provisions into one.

(c) Fraudulent intention and related matters

2.8 In the case of an arm’s length transaction, proposed s.96.1 requires the trustee to prove that:

- The debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction; and
- The debtor intended to defeat the interests of creditors: s.96.1(2)(b).

The requirement for proof of the debtor’s intention to defeat creditors apparently derives from the IIC Model. However, it is inconsistent with the Cuming Model. In our view, the Cuming Model is to be preferred on this point. Under the Cuming
Model, it is sufficient for the trustee to prove either that the debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction or that the debtor intended to defeat the interests of creditors. This is also the approach taken in s.548 of the United States Bankruptcy Code and ss 423-425 of the United Kingdom Insolvency Act 1986. Requiring the trustee to prove the debtor’s fraudulent intention would substantially diminish the chances of a successful action. Section 96.1(2)(b) should be amended by replacing “and” with “or”.

2.9 In the case of a non-arm’s length transaction occurring within one year before the date of the initial bankruptcy event, the trustee must prove neither that:

- The debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction; or
- The debtor’s intention was to defeat the interests of creditors: s.96.1(3)(a).

This aspect of s.96.1 also appears to derive from the IIC Model. Again, it is inconsistent with the Cuming Model. We prefer the Cuming Model on this point, for the reasons Cuming himself gives. Speaking of BIA, s.91, which is similar in this respect, he says:

“To the extent that s.91 arbitrarily allows the trustee to set aside any settlement occurring within one year of the date of the initial bankruptcy event, it is hard to justify. At the date of the transaction, the person who later becomes a bankrupt may have very significant resources and may want to share some of those resources with friends or relatives. At that time the chances might be small that any dealing with those resources would have a negative effect on the ability of existing or future creditors to enforce payment of the debts owing to them. Indeed, there may be no such creditors in existence. Why should the fact that a fall in the stock market, a serious illness or some other unforeseen event leads to the debtor’s bankruptcy result in the transfer being set aside? Why should it make a difference (in the context of ss 91 or 100) if one of these events took place 13 months rather than 11 months before bankruptcy? ((2002) 37 Canadian Business Law Journal 5 at 15).

What s.96.1(3) should say is that any transaction within the relevant 5 year period is subject to review if the trustee proves either that:

- The debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction; or
• The debtor intended to defeat the interests of creditors.

Again, a provision along these lines would be consistent with the position taken in other countries, including the United States and the United Kingdom.

2.10 If the debtor’s intention is to defeat creditors, the bankruptcy court should have the power to set aside a transaction occurring at any time prior to the date of the initial bankruptcy event whether or not the debtor was insolvent or on the point of insolvency at the time of the transaction: Cuming, (2002) 37 Canadian Business Law Journal 5 at 18. Proposed s.96.1 is too lenient on the fraudulent debtor in this regard. In the case of an arm’s length transaction, the review period is one year before the date of the initial bankruptcy event even if the trustee proves fraud while in the case of a non-arm’s length transaction, the review period is 5 years regardless of fraud on the debtor’s part. It is true that, as matters presently stand, a trustee may use the provincial fraudulent conveyances laws to reach transactions that took place earlier than the review periods s.96.1 prescribes. However, for the reasons we give below, there is a strong case for limiting the application of the provincial laws to proceedings outside the debtor’s bankruptcy: see para. 2.14. If provincial laws were no longer to apply in bankruptcy, the review periods proposed s.96.1 prescribes would become crucial.

(d) Remedies and defences

2.11 The remedy BIA, s.91 provides for in relation to a settlement is the avoidance or setting aside of the transaction. The remedy s.100 provides for in relation to a reviewable transaction is not avoidance but, rather, a money claim for the difference between the fair market value of the property or services in question and the actual consideration the debtor gave or received. The trustee does not have the option of avoiding the transaction and claiming back the property in question from the counterparty. The proposed s.96.1 remedy is the same as the s.100 remedy. The s.100 remedy may not be the appropriate one in cases where the transaction is not a transfer at undervalue but, rather a gift or settlement, a dividend payment or redemption of
capital or a beneficiary nomination in an insurance policy: see para.2.7 above. Even in
the case of a transfer at undervalue, the trustee may prefer the option in some cases of
avoiding the transaction rather than keeping it on foot and claiming the value shortfall
from the counterparty. In short, s.96.1 should provide for a flexible system of remedies
which is responsive to the range of transactions the provision covers (or ought to
cover). The Cuming Model provides for a range of remedies including, as appropriate,
the following:

- The setting aside of the transaction and the restoration of the parties to their
  previous positions; or
- A requirement for the counterparty to pay to the trustee an amount equivalent to
  the value shortfall the counterparty gave the debtor; or
- In the case of a contract of insurance or annuity, termination of the contract
  subject to adjustment for the rights of the insurer; or
- In the case of the purchase or redemption of shares, a requirement for the
  counterparty to pay the trustee any amounts received from the debtor corporation
  under the transaction.

The IIC Model likewise envisages a range of remedies. We support both sets of
proposals in this regard.

2.12 If the trustee’s remedies are expanded to include a right to avoid the transaction,
defences will be necessary to protect the interests of innocent transferees and
donees. Section 588FG of the Australian Corporations Act 2001 is a possible model
for reform. It provides in effect that the trustee may not set aside a transaction if it is
proved that:

- the transferee became a party to the transaction in good faith;
- at the time when the transferee became such a party -
  - the transferee had no reasonable grounds for suspecting that the
debtor was insolvent or would become insolvent as a result of the
transaction;
  - a reasonable person in the transferee’s circumstances would have had
no such grounds for so suspecting; and
• the transferee either—
  o provided valuable consideration under the transaction; or
  o changed their position in reliance on the transaction.

There should also be a defence in favour of any third party to whom the transferee transfers the property if it is proved that:
• the third party acted in good faith;
• did not know that the debtor was insolvent and had no reasonable grounds for suspecting the debtor’s insolvency; and
• provided valuable consideration or changed their position in reliance on the transaction.

(e) Application in BIA proposal proceedings and CCAA proceedings

2.13 Proposed s.96.1 applies in formal bankruptcy proceedings. It will also apply in BIA proposal proceedings, by virtue of BIA, s.101.1. However, it will not apply in CCAA proceedings and Bill C-55 makes no provision for the enactment of a corresponding provision in the CCAA. The IIC Model envisages a single, comprehensive provision in the BIA governing the transfer of property or services at undervalue and the enactment of a corresponding provision in the CCAA. The provision would apply in BIA proposal proceedings and CCAA proceedings unless excluded by the terms of the reorganization proposal. The provision would give standing to sue in the case of formal bankruptcy proceedings to the bankruptcy trustee, in the case of BIA proposal proceedings to the proposal trustee and in the case of CCAA proceedings to the plan monitor subject to the right of creditors to take over the proceedings if the trustee or monitor failed to act. We support this aspect of the JTF Model except that we favour rolling BIA, Part III, Div. 1 and the CCAA into a single set of provisions: see paras . This would avoid the need for the duplication the JTF Model envisages.

(f) Application of provincial laws
2.14 The Cuming Model and the IIC Model both envisage a single, comprehensive provision governing gifts and transfers at undervalue and the like. The provision would be a code and it would apply in formal bankruptcy proceedings, BIA proposal proceedings and CCAA proceedings to the exclusion of provincial laws. The reasons Professor Cuming gives for the exclusion of provincial laws are as follows:

While in principle the concepts of the Statute [of Elizabeth] should be part of a bankruptcy regime, the current method of implementing the principle is objectionable for two reasons. Several provincial legislatures have “codified” the 1571 statute in provincial legislation. Other provinces simply treat the 1571 Statute as part of their common law. This results in some differences in wording and application of fraudulent conveyances laws among the provinces; consequently, there is potential for differential application where the legislation is invoked by the trustee depending upon the province in which the bankrupt resides.

A much more serious objection is that, over the more than four hundred years of its existence, the courts have given a significant judicial gloss to the Statute. This adds an additional layer of complexity to bankruptcy law and runs counter to the principle stated above that this aspect of bankruptcy law should be accessible to persons affected by it. It is very difficult for persons to arrange their affairs so as not to violate bankruptcy law if to do so they must be acquainted with laws not set out in the Bankruptcy and Insolvency Act but contained in four hundred years of case law that has given the [Statute] a meaning that, in some situations, is quite different from what is conveyed by its wording.

The Bankruptcy and Insolvency Act should be the applicable source of law to address fraudulent conveyances being attacked by a trustee in bankruptcy. The circumstances in which a transaction made with the intention of interfering with the rights of creditors under the Act should be specified in the Act and not by reference to non-uniform and uncertain provincial law. All that is necessary is to include provisions under which a court is empowered to set aside transfers made by a debtor who has as his or her main objective placing impediments in the way of existing or potential creditors. As noted earlier in this Report, this is the approach that is contained in United Kingdom and Australian bankruptcy legislation.”
We agree with these observations. So, implicitly, did the Standing Senate Committee (Report, p.122 and Recommendation 26). Proposed s.96.1 should be amended to make it clear that the provision applies to the exclusion of provincial laws in bankruptcy and reorganization proceedings. The provincial laws would continue to apply outside bankruptcy.

3. Summary of submissions

3.1 The definition of “transfer at undervalue” should be amended to make it clear that s.96.1 applies to gifts (paras 2.4 and 2.5).

3.2 Section 96.1 should be expanded to cover not only gifts and transfers at undervalue, but any transaction that diminishes the value of the debtor’s estate and that may affect the value of creditors’ realizable claims (paras 2.6 and 2.7).

3.3 Section 96.1(2) should be amended so that in the case of an arm’s length transaction it is sufficient for the trustee to prove either that the debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction or that the debtor intended to defeat the interests of creditors (para.2.8).

3.4 Section 96.1(3)(a) should be amended so that in the case of a non-arm’s length transaction occurring within one year before the date of the initial bankruptcy event, the trustee must prove either that the debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction or that the debtor intended to defeat the interests of creditors (para. 2.9).

3.5 Section 96.1 should be amended to allow the trustee to challenge a transaction occurring before the one year period for arm’s length transactions and the 5 year period for non-arm’s length transactions if the trustee can prove actual fraud on the debtor’s part (para. 2.10).

3.6 Section 96.1 should provide for a range of remedies that is responsive to the kinds of transaction the provision covers (or should cover), including avoidance of the transaction or, alternatively, affirmation subject to a money claim against the counterparty for the value shortfall (para. 2.11).
3.7 In the case where the trustee elects to avoid the transaction, there should be defences to protect innocent transferees for value and donees (para. 2.12).

3.8 Section 96.1 should apply not only in formal bankruptcy proceedings, but also in BIA proposal proceedings and CCAA proceedings unless the terms of the reorganization plan displace it (para. 2.13).

3.9 Section 96.1 should be a code. It should apply to the exclusion of provincial laws in formal bankruptcy proceedings, BIA proposal proceedings and CCAA proceedings (para. 2.14)
1. Introduction

1.1 BIA, s.95(1) provides that every payment made by an insolvent person in favour of any creditor with a view to giving that creditor a preference over the other creditors shall, if the person making it becomes bankrupt within three months after the date of making it, be deemed fraudulent and void as against the trustee in bankruptcy. Subsection (2) provides that where any payment mentioned in subsection (1) has the effect of giving a creditor a preference over other creditors, or over any one or more of them, it shall be presumed, in the absence of evidence to the contrary, to have been made with a view to giving the creditor a preference over other creditors. BIA, s.96 extends the review period to 12 months in the case of non-arm’s length transactions.

1.2 The provincial assignments and preferences statutes also contain anti-preference provisions. These are similar to the BIA provisions, but there are a number of differences including the following.

- The courts have read the provincial statutes as requiring proof of concurrent intention (in other words, there must be proof of both the debtor’s intention to give a preference and the counterparty’s intention to receive it). BIA, s.95 requires proof of the debtor’s intention only.
- Under both BIA, s.95 and the provincial statutes, if a transaction has the effect of giving the counterparty a preference, the debtor’s intention is presumed. However, under the provincial statutes, the presumption only applies if an action to set aside the transaction is brought within 60 days after the date of the transaction or the date of the debtor’s bankruptcy.
• BIA, ss 95 and 96 set a 3 month review period extended to a year if the transaction is not an arm’s length one. The provincial statutes do not specify a review period.
• The payment of money by the debtor to the counterparty cannot be attacked under the provincial statutes.

1.3 The preference provisions are subject to much the same criticisms as the transfer at undervalue provisions. In particular, the Standing Senate Committee’s concerns about “lack of fairness, uniformity and predictability” apply equally to both. So does its call for a single set of nationwide rules.

2. The Bill C-55 amendments

2.1 Bill C-55 will enact a new BIA, s.96. The new provision extends the s.95 review period from 3 months to one year if the transaction “has the effect of giving a creditor who is not at arm’s length a preference over other creditors”. The current provision extends the review period from 3 months to one year if the transaction “is in favour of a person who is related to the insolvent person”. The definition of “related person” in s.4 makes it clear that the reference to parties who are not at arm’s length includes, but is not limited to, related persons. The new provision is broader than the current one in this respect. Subject to this amendment, however, Bill C-55 leaves the BIA preference provisions effectively untouched. The government had available to it at least two sets of detailed submissions making the case for the modernization and rationalization of the preference laws:

• An IIC submission in 2004, following publication of the Standing Senate Committee Report, to supplement the IIC and CAIRP Joint Task Force Report on Business Insolvency Law Reform (the “IIC Model”).

2.2 The main features of the Cuming Model are as follows:

(1) The new preference provision would proscribe “unfair preferences”, not “fraudulent preferences”. “Unfair preference” would be defined to mean:

• a transfer made when the debtor was insolvent or near insolvency
• during a specified period
• to or for the benefit of a creditor
• of an interest in property of the debtor that would otherwise have vested in the trustee
• made in full or partial satisfaction of an obligation that was owing by the debtor to the creditor and that would have been a claim provable in the bankruptcy if the transfer had not been made.

(2) The specified period (the review period) would be the period beginning 90 days before the date of the initial bankruptcy event. If the creditor knew or ought reasonably to have known about the debtor’s insolvency or near insolvency, the review period would be the period beginning one year before the date of the initial bankruptcy event.

(3) There would be some exceptions, for example:

• Payment of a business debt if made within 35 days from the date the debtor received the property or service for which the payment was made;
• Payment under a running account if the interval between the payment and the earlier payments is not appreciably out of line with the pattern of earlier payments;
• Payment of a loan where the period between the date the obligation was incurred and the date of the payment is not greater than 35 days.

(4) There would be a range of remedies, including the following:

• the setting aside of the transfer and the restoration of both parties to their previous positions; and

• a requirement for the counterparty to pay the trustee an amount equivalent to the value of the property transferred.

(5) The trustee would have power in the first instance to assert a remedy against the counterparty. The trustee’s determination would stand unless the counterparty challenged it in court.

2.3 The main features of the IIC Model are as follows:

• The current laws would be replaced by a new provision in the BIA and also in the CCAA. The new provision would be a complete code and the provincial statutes would no longer apply. The provision would apply in reorganization proceedings unless excluded by the terms of the proposal.

• The provision would give standing to the bankruptcy trustee in the case of formal bankruptcy proceedings, the proposal trustee in the case of BIA reorganization proceedings and the plan monitor in the case of CCAA reorganization proceedings, subject to the right of creditors to take over a claim if the trustee or monitor failed to act.

• There would be a limitation period of 3 years running from the date of the initial bankruptcy event or the date of the initial reorganization application.

• In the case of a non-arm’s length transaction, the review period would be five years before the date of the initial bankruptcy event, while in the case of an arm’s length transaction the review period would be one year.

• In the case of a non-arm’s length transaction occurring within one year before the date of the initial bankruptcy event, the trustee would need to prove only that the transaction amounted to a preference in fact.
• In the case of a non-arm’s length transaction occurring between 1 and 5 years before the date of the initial bankruptcy event, the trustee or monitor would need to prove that: (a) the transaction amounted to a preference in fact; and (b) the debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction.

• In the case of an arm’s length transaction, the trustee or monitor would need to prove that: (a) the transaction amounted to a preference in fact; and (b) the debtor intended to prefer the counterparty. There would be a rebuttable presumption of intention to prefer in the 3 months preceding the date of the initial bankruptcy event or the date of the initial application.

• It would be a defence for the counterparty to prove that: (a) the debtor was solvent on the transaction date and not rendered insolvent by the transaction; or (b) the counterparty was entitled to receive the transfer in priority to other creditors.

• The court would have power to set aside the transaction and to award additional or alternative remedies, including compensation.

• There would be specific safe harbour provisions for certain transactions involving financiers unrelated to and dealing at arm’s length with the debtor, including eligible financial contracts and sales pursuant to securitizations.

2.4 The IIC Model envisages different preference tests, depending on whether or not the parties are at arm’s length. If the parties are not at arm’s length, it would be sufficient to prove that the transaction amounted to a preference in fact. However, if the transaction is an arm’s length one, it would be necessary to prove that the debtor intended to prefer the counterparty. Proposed s.96 was apparently drafted with a view to implementing these aspects of the IIC Model. However, as presently drafted, the provision does not achieve its objective. It does no more than expand the s.95 review period if the transaction has the effect of preferring a non-arm’s length creditor. The s.95 subjective test continues to apply.
2.5 The IIC Model envisages continuation of the English subjective test for preferences, at least for arm’s length transactions. The subjective test is open to criticism on the ground that it is out of touch with modern bankruptcy policy. For example, Cuming says of the test that it is:

“not only difficult to apply, but, to a great extent, it misses the point. The point is that the transfer, if left intact, frustrates implementation of the policy of bankruptcy legislation, equitable treatment of all creditors. The fact that the debtor intended or did not intend this result should not be relevant. The actual or presumed intentions of the debtor when making a preferential transfer are not important. What is important is the effect that such a transfer has on the position of creditors with claims in bankruptcy. What matters to them is that a central policy of bankruptcy law is not frustrated by a preferential payment or transfer which, by definition, results in material loss to them” (2002) 37 Canadian Business Law Journal 5 at 23).

The policy Cuming describes is reflected in s.547 of the United States Bankruptcy Code, which adopts an effects-based or preference in fact test of what constitutes a preference. Broadly speaking, a transfer constitutes a preference if it enables the counterparty creditor to recover more than it would have received in a formal bankruptcy distribution if the transfer had not been made. The debtor’s state of mind is immaterial. The IIC’s concern was that “transactions in good faith are not necessarily protected from an effects-based standard, as all preferences in the review period would be caught”. The IIC’s objective was to “strike a balance between the ability of the debtor to conduct its affairs in the period prior to the commencement of insolvency proceedings and the ability of trustees, receivers and creditors to recover value where a transaction has given a preference contrary to the statute”. Section 547 addresses this concern by enacting a detailed set of safe harbour provisions which exempt specific transactions from the reach of the provision. The downside of this approach is that it increases the law’s complexity. Furthermore, it runs the risk of overlooking particular exemptions. Piecemeal reforms may be necessary to fill the gaps and this makes the law more complex still.

2.6 The preference provisions in ss 588FA and following of the Australian Corporations Act 2001 take a different tack. In common with the United States, the Australian
provisions use an effects-based test. However, in place of detailed safe harbour provisions to protect legitimate commercial dealings, the Australian model relies on a shortly stated good faith defence. It is a defence if: (a) the counterparty creditor acted in good faith; (b) the creditor had no grounds for suspecting that the debtor was insolvent or close to insolvency on the transaction date and a reasonable person in the creditor’s circumstances would have no reasonable grounds for so suspecting; and (c) the creditor provided valuable consideration or changed its position in reliance on the transaction. In summary, U.S. Code, s.547, in carving out a detailed set of specific exceptions, adopts a rules-based approach. The Australian model, with its reliance on the shortly stated good faith defence, adopts a standards-based approach. The advantage of the rules-based approach is greater certainty. The disadvantages are more complex drafting and the risk of both over- and under-inclusiveness. The advantages of the standards-based approach are drafting simplicity and flexibility of application. The main disadvantage is reduced certainty.

3. Summary of submissions

3.1 There seems to be widespread agreement on the need for reform of the preference provisions. The sticking point lies in the details. The government should establish some kind of consultative mechanism to resolve the differences outlined above. This should be a short-term objective. It should not be left until the next proposed 5 yearly review of the bankruptcy laws.
INTRODUCTION

Section 122 of Bill C-55 introduces a new Part XIII in the BIA provisions to replace the existing Part XIII provisions. Similarly, s.131 of Bill C-55 introduces a new Part IV in the CCAA provisions to replace s.18.6 dealing with recognition of foreign insolvency proceedings. New CCAA Part IV appears to be identical to new Part XIII of the Bill C-55 provisions and will therefore not be considered any further in this memorandum.

The focus of the existing cross border provisions in the BIA and CCAA is to encourage, if not to require, foreign representatives, to initiate proceedings in Canada for the administration of Canadian based assets. This strategy was consciously adopted by the drafting committee in the early 1990s (of which I was a member) because of the strong concern of the banking community and their lawyers that Canadian courts might be persuaded to allow foreign representatives to remove or liquidate Canadian based assets subject to security interests governed by Canadian law without the consent of the secured parties.

These fears were probably exaggerated. In any event, in practice, prompted by Farley J’s creative decision in Re Babcock & Wilcox Canada Ltd. (2000) 18 C.B.R. (4th) 157, Canadian courts were largely able to by-pass ss.268(1) to (4) of the BIA and CCAA ss.18.6(1) to (3) by invoking s.268(5) and CCAA s.18.6(4). These subsections provide that Canadian courts retain their common law jurisdiction with respect to the recognition and enforcement of foreign insolvency orders. At common law, foreign insolvency orders were often recognized without requiring the foreign representatives to initiate proceedings under the Canadian insolvency legislation. There were also other important North American developments affecting the treatment of cross-border insolvencies, viz. the ALI Principles of Cooperation in Transnational Insolvency Cases Among the Members of the North American Free Trade Agreement (May 2000) and the accompanying Protocol for Court to Court Communications to facilitate efficient administration of cross border cases.

19 This Memorandum was initially prepared for use at the Roundtable Conference on Bill C-55 held at the offices of Fasken Campbell Martineau on October 7, 2005, and should be read in conjunction with Angela Chu’s Table of Concordance of Model Law and Part XIII Provisions [now superseded by Carlin McCoogan’s revised table reproduced below] and Carlin McCoogan’s Table of Sources of Bill C-55 Provisions, which is not reproduced in this Appendix.
The thrust of the UNCITRAL Model Law provisions is to promote recognition of foreign insolvency proceedings without requiring the foreign representative to initiate proceedings under the recognizing state’s domestic insolvency law. However, the consequences of recognizing the foreign insolvency order are very limited under the Model Law. In the case of foreign main proceedings (FMP), the forum court is required to recognize the status of the foreign representative and to issue a stay of proceedings by creditors against the locally based assets of the foreign estate; in the case of non-foreign main proceedings (NFMP), the forum court is only obliged to extend recognition to the foreign representatives; all other orders are in the discretion of the court.

Overwhelmingly, Canada’s cross border insolvency links are with the US. Given the fact that Canadian and US courts seem to have evolved a good working relationship over the past 15 years, it could be argued that there is no real need for Canada to adopt the Model Law. Nevertheless, because Canada participated in the drafting of the Model Law and is generally sympathetic to the strengthening of legal ties among trading nations, a substantial number of us felt that it would be appropriate to include the Model Law provisions in the stage three BIA and CCAA amendments.

The Senate Banking, Trade and Commerce Committee was confronted with divided views. Some witnesses were opposed to the adoption of the ML and others argued that if the ML was to be adopted recognition of foreign insolvency orders should be limited to states according reciprocity to Canadian insolvency proceedings. The Senate Committee adopted the latter recommendation. Obviously the drafters of Bill C-55 disagreed and there is no reciprocity requirement in the Bill. Though we are not told what the drafters’ reasons were, I believe their decision was the right one and that it is consistent with Canada’s traditional approach to the recognition of foreign insolvency proceedings.

Analysis of Part XIII Provisions

The Part XIII provisions fall under three headings, viz. (A). Provisions that substantially replicate the ML provisions; (B). ML provisions that have no counterpart in Part XIII, and (C) Part XIII provisions that depart substantially from the ML provisions.

(A) REPLICATED PROVISIONS

The replicated provisions are the following and generally appear to be uncontroversial:

- S 269 Application for recognition of FMP and FNMP
- S 270 Order recognizing FMP and NFMP
- S 278 Coordination of Domestic and Foreign Proceedings and of Concurrent Foreign Proceeding
• S 279 Appointment of Person by Canadian court to represent Canadian proceedings outside Canada for recognitional purposes

• S 283 Adoption of Hotchpot rule in cross border proceedings

(B) ML PROVISIONS NOT REPLICATED IN PART XIII

• Article 3: Conflicting treaty obligations

• Article 4: Court or other authority competent to deal with recognition of foreign proceedings

• Article 6: Public policy exceptions

The reasons for the exclusion of arts 3 and 4 are fairly obvious; those for the exclusion of art 6 are not.

• Art 22: Protection of Interests of Creditors and Other Interested Parties. This exclusion is also not obvious. It is very common for creditors to seek court assistance in domestic insolvency proceedings. One would have thought therefore that foreign creditors whose claims arise under foreign insolvency proceedings should be given the same opportunity though it is unlikely that foreign creditors would often avail themselves of this access in practice.

• Art 23: Avoidance of acts detrimental to estate. This is an important issue that frequently arises in domestic insolvency proceedings. Again, therefore, there appears to be a strong case for allowing a foreign representative to seek the Canadian court’s assistance to enjoin or set aside a voidable transaction without the need to initiate separate BIA proceedings. (The issue of which law governs such transactions is a separate question that is not addressed in the ML).

• Art 24: Intervention by foreign representative in domestic proceedings in forum state. Again, I don’t know why this useful provision was omitted.

(C) PART III PROVISIONS THAT DEVIATE FROM OR HAVE NO ML COUNTERPART

• Section 268(1) – the definition of FNMP differs substantially from the definition in the ML. The ML, article 2©, requires the debtor to have an ‘establishment’ in the place of the foreign proceedings. ‘Establishment’ is defined in art 2(f) as any place of operations where the debtor carries out a non-transitory economic activity with
human means and involving goods or services. S 268(1) doesn’t use the term ‘establishment’. Instead, it defines FNMP as ‘a foreign proceeding other than a foreign main proceeding’ (italics added). This suggests that a Canadian court will or may be obliged to cooperate with a foreign proceeding even if the debtor has no place of business in the jurisdiction where the proceedings have been brought. This open ended provision is at odds with the standard Morguard test adopted by Canadian courts in many recent cross border proceedings that there must be a substantial connection between the debtor and the foreign jurisdiction before the Canadian court will extend its assistance.

- Section 268(2). There are two issues here. The first arises out of the fact that subs 2 clearly envisages Part XIII being applied to individuals even though the debtor may not be engaged in trade or business. In my view, the ML is meant to be restricted to business enterprises. S 268(2) therefore needs to be clarified on this important point. The second difficulty stems from the fact that the subsection adopts the presumption that the debtor’s registered office and, in the case of an individual, the debtor’s ordinary place of residence, is the centre of the debtor’s main interests. I see no reason for either presumption and believe that the ML provisions are quite sufficient on their own.

- Section 270 (ML art 17) (Order recognizing foreign proceeding). Section 270 is more concise than art 17 but appears to impose the same essential requirements.

- Section 271 (ML art 20)(Effect of Recognition of FMP). Subs. (2) has no counterpart to art 20. It excludes subs (1) entirely if BIA proceedings are in progress in Canada at the time of the foreign representative’s application. Subs (3) also has no ML counterpart, i.e., recognition of FMP subject to exceptions that would apply if foreign proceedings had taken place in Canada under the BIA. What types of situation did the Bill C-55 drafters have in mind?

  Subs. (4) also has no ML counterpart and may in fact conflict with art 28. Subs (4) retains right of parties to commence or continue proceedings under the BIA, CCAA or WURA. Art 28 provides that local proceedings in the recognizing state should be confined to proceedings involving locally situated assets. Subs (4) may need to be amended to reflect the same policy.

- Section 272 (ML 21) (Orders that Canadian court can make on recognition of foreign proceedings). Sect 272 has no counterpart to ML 21(2) allowing forum court to approve distribution (release?) of all or part of local assets to foreign representative if the court is satisfied that the assets (sic) of local creditors are adequately protected. Presumably the Canadian drafters were concerned that the ML power might be abused, but this could be said of all discretionary powers under the ML or the BIA. I see no reason to exclude ML 21(2).

- Section 274. (No ML counterpart). If recognitional order is made, foreign representative may commence or continue proceedings under BIA ss. 43, 46-47.1,
50(1) and 50.4(1) as if the FR were a creditor or the debtor. These provisions seem unobjectionable and reflect the partiality shown in existing Part XIII for Canadian initiated proceedings over recognition of foreign proceedings and foreign insolvency orders. Sec 274 would be objectionable if the courts used its provisions as an excuse for not recognizing the foreign proceedings or for refusing the court’s assistance to the FR.

- Section 275 (ML arts 25-27). (Forms of cooperation between Canadian and foreign courts). Sec 275 is not as explicit as the ML in spelling out the forms of cooperation between the Canadian and foreign courts. It is not obvious what objections the Canadian drafters found to the more detailed ML provisions.

- Section 280. (No ML counterpart?) (FR’s application to Canadian court for order under Part XIII not to be treated as submission to Canadian court’s jurisdiction except with respect to costs and compliance by FR with any order made by the court.) This seems to be a standard Canadian provision in proceedings involving a FR. However, I don’t feel competent to judge whether granting the FR this degree of immunity is always appropriate, particularly where the FR is seeking to recover assets located in Canada or is seeking to set aside a voidable transaction.

- Section 281. (No ML counterpart). (FR may make application to Canadian court even though an appeal is pending in a foreign court (s. 281 doesn’t state what type of appeal but presumably it must implicate the FR’s standing in the Canadian proceedings.)

**Two Unaddressed Issues**

Neither the Model Law nor new Part XIII address the following related questions: (1) whether the provisions apply to insolvency proceedings involving corporate groups, and (2) whether insolvency of the member of the group in respect of whom the foreign representative seeks recognition and a consequential order in Canada is a prerequisite of the Canadian court’s jurisdiction. The issues are discussed in some detail in my article ‘Corporate Groups and Canada-US Crossborder Insolvencies: Contrasting Judicial Visions’ (2001) 25 C.B.R. (4th) 161 critiquing Farley J’s decision in Re Babcock & Wilcox Canada Ltd. (supra). The second question also has an important constitutional dimension and it is a matter for keen regret that Bill C-55 has side stepped the issue.
### B. Comparative Tables of Bill C-55 and Other Provisions

#### Table 1

**Table of Concordance - UNCITRAL Model**

**Cross-border Insolvency Law and Bill C-55, BIA Part XIII and CCAA, Part IV**

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<td>(minor verbal changes)</td>
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<td><strong>CH. I. GENERAL PROVISIONS</strong></td>
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<td>Article 4 – Competent court or authority</td>
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<td>Article 5 – Authorization of [insert the title...] to act in a foreign state</td>
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<td>Article 13 – Access of foreign creditors to a proceeding under [identify laws of the enacting State relating to insolvency]</td>
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recognition of a foreign proceeding

Article 20 – Effects of recognition of a foreign main proceeding

Article 21 – Relief that may be granted upon recognition of a foreign proceeding

Article 17 – Decision to Recognize a foreign proceeding

Article 22 – Protection of creditors and other Interested persons

Article 23 – Actions to avoid acts detrimental to creditors

Article 24 – Intervention by a foreign representative in actions in this State

CH. IV. COOPERATION WITH FOREIGN COURTS AND FOREIGN REPRESENTATIVES

Article 25 – Authorization of cooperation

CH. V. CONCURRENT PROCEEDINGS

Article 28 – Concurrent proceedings

Article 32 – Rate of payment of creditors

s. 271 – Effects of recognition of a foreign main proceeding

s. 272 – Orders

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s. 275 – Cooperation – court

s. 277 – Concurrent proceedings

s. 275 – Cooperation – court and direct communication with foreign courts

s. 277 – Concurrent proceedings

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