



BDO Dunwoody Limited  
Financial Recovery Services

# BDO News Bulletin

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December 6,  
2005

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## **New Insolvency Legislation Receives Royal Assent**

### **BACKGROUND**

On November 25, 2005 Bill C-55, "*An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*", received Royal Assent and became Chapter 47, Statutes of Canada, 2005. The coming into force date will be set by the Governor in Council, however not before June 30, 2006.

Royal Assent completes a lengthy process mandated in the 1997 amendments to the *Bankruptcy and Insolvency Act* ("BIA") and the *Companies' Creditors Arrangement Act* ("CCAA"). The political will for amendments to insolvency legislation was non-existent until a private member's bill, Bill C-281, dealing with employee wage and pension issues, was introduced in the fall of 2004. While there was some political support, the Bill was not comprehensive, and many believed that it was not a balanced approach. Accordingly C-55 was drafted quickly in the spring of 2005 and introduced in Parliament on June 3, 2005.

The Senate gave its approval after receiving an undertaking that there be an Order of Reference back to the Senate that would permit for a comprehensive review, and the opportunity to fix some of the obvious errors in the Bill. Many provisions of Chapter 47 are to be set by regulations which have not yet been drafted. Therefore the full impact of the amendments is not determinable.

We have provided you with a summary of the amendments, and brief comments on the implications as they are now determinable. We have not editorialized widely on these amendments, nor have we attempted to predict what changes will be made as the result of the review by the Senate. This Bulletin is not designed to provide legal advice or to replace the advice of a lawyer or BDO Financial Recovery Services professional.

## **WAGE EARNER PROTECTION PROGRAM**

The amendments introduce the *Wage Earner Protection Program Act* (“WEPP”). The WEPP provides for the payment of unpaid wages and vacation pay accrued in the past six months, up to \$3,000 per employee, from the government’s Consolidated Revenue Fund. The plan is restricted to unrelated non-management employees with over three months seniority, who are terminated as a result of bankruptcy or receivership.

The trustee or receiver is required to report to Human Resources and Skills Development Canada (“HRSDC”) the amounts of unpaid wages and vacation pay. HRSDC will coordinate payment directly to the former employees and will then be subrogated to the employees’ claims up to \$2,000 per employee. This claim will have a super-priority against current assets (e.g. cash, accounts receivable and inventory) of the employer, after deemed trust source deductions and 30 day goods claims.

The administration of the WEPP has yet to be established and regulations have yet to be drafted. It should be noted that HRSDC has substantial review and examination powers. Management employees will be able to make a secured claim directly against the bankruptcy or receivership at the same priority level as claims by HRSDC to recover funds for WEPP. In addition to wage claims, there is a further priority claim provided for expenses of travelling salespersons to the extent of \$1,000.

## **PENSIONS**

The amendments provide that unpaid pension contributions that exist as at the date of receivership or a bankruptcy will be secured by a charge on all the assets of a debtor. Unpaid pension contributions include “normal” pre-filing pension contributions but do not include claims for actuarial deficiencies in defined benefit plans. The charge in respect of unpaid pension contributions will rank above every other claim against the debtor’s assets except for thirty day goods claims, claims of farmers, fishermen, and aquaculturalists, statutory deemed trust claims and unpaid wages.

The amendments also require that where a debtor is reorganizing its financial affairs, the proposal or plan of arrangement must provide for the payment of unpaid pension contributions.

The super-priority being granted in respect of wages and unpaid pension contributions will likely impact the decisions of financial institutions in the future when determining loan amounts and margin requirements.

## UNPAID SUPPLIERS

The existing law allows unpaid suppliers to obtain access to and repossess goods that meet specific criteria, within a given timeframe. Historically, many suppliers did not benefit from these provisions as they did not fully understand the timeframes and other criteria related to the claims process.

The amendments simplify the timeframes in which the claims can be made. Now, an unpaid supplier may make a claim for goods delivered within 30 days before the date of bankruptcy or receivership but must make such a claim in writing to the trustee or receiver within 15 days of the appointment. The existing requirements regarding identification, condition and status of the inventory remain.

## ALIGNMENT OF CCAA AND BIA

Numerous changes to the CCAA and BIA harmonize the two pieces of federal legislation to provide more consistency regardless of the legislation under which a debtor may attempt to reorganize. The more significant changes include the following:

### Executory Contracts

In a proposal or a CCAA plan of arrangement, on notice to the other party and subject to appeal, contracts can be disclaimed if it is necessary for the success of the proposal or plan of arrangement. The other party then has an unsecured claim for its losses. This is an expansion and codification of current practice.

Certain types of contracts are excluded. These include:

- Collective agreements
- Eligible financial contracts (e.g. derivative and futures contracts)
- Financing agreements if the debtor is the borrower
- Leases if the debtor is the lessor
- Intellectual property licenses where the debtor is the licensor (subject to conditions)

The court may also make an order assigning a contract without the consent of the other party to the contract. The court must be satisfied that, among other things, assignment of the contract is necessary to success of the proposal and that the debtor is not in default of the agreement.

These assignment rights do not apply to:

- Collective agreements
- Eligible financial contracts
- Leases for land and premises (in these cases landlord consent is required)
- Rights and obligations that are not assignable “by reason of their nature”.

Amendments also codify current CCAA practice that in a proposal or plan of arrangement, contracts cannot be terminated or amended by reason of commencement of an insolvency proceeding. These clauses are known as “ipso facto” clauses.

### Collective Agreements

The amendments specifically provide that collective agreements will remain in force unless agreed otherwise. If, in a proposal or plan of arrangement, the debtor company has made good faith efforts to renegotiate, without success, it can apply to the court for authorization to serve a notice to bargain on the union. If the collective agreement is revised, the union can make an unsecured claim in the proceeding for the value of any concessions granted.

The notice to bargain is a court direction to management and the bargaining unit that they must attempt to renegotiate the contract. While a notice to bargain opens up the collective agreement for negotiation, there is no certainty of changes since both sides must agree. It would appear unlikely therefore that this amendment will substantially change the current environment surrounding reorganizations and collective agreements.

This is a significant difference from the provisions of Chapter 11 of the *United States Bankruptcy Code* which does allow modification to collective agreements by the court in the course of a restructuring if a negotiated settlement cannot be reached.

### Interim financing

The amendments provide that the debtor company may be able to obtain interim financing during either a CCAA proceeding or a BIA proposal. In such cases, the court may issue an order providing a charge to the interim lender which ranks in priority to the claims of existing secured creditors or any previous court-ordered charge.

Rules are set out that provide guidance to the court in granting interim financing, essentially codifying the practice that the courts followed prior to the amendments in CCAA proceedings, and now providing for financing in BIA filings. In addition, there are provisions for an administrative charge that will secure the costs of the proceedings and ensure that debtors have access to qualified professional help.

### Equity Claims

Claims of shareholders for damages arising from the purchase or sale of shares of the bankrupt are subordinated to the claims of creditors.

### Governance of the Process

The amendments have introduced substantial changes to the processes by which insolvency and restructuring files are administered.

In a complex restructuring, the involvement of a competent and committed board of directors is essential to the success of the proceeding. The BIA and the CCAA have now been amended to codify practice for the creation of priority charges to indemnify directors and officers from statutory liabilities that may arise post filing. This is designed to ensure that directors do not “abandon ship” once a company in difficulty initiates plans to restructure the company.

At the same time that directors are recognized as essential to a restructuring, it is also recognized that they can be a barrier to a successful restructuring. There are provisions that allow for the removal of directors if they appear to impair the process, or appear likely to impair the process or act inappropriately.

The amendments clarify issues relating to the appointment of professionals in insolvency and restructuring files. In a CCAA filing, the monitor appointed to oversee the process must be a licensed trustee in bankruptcy. As well, the auditor of a debtor company can no longer be appointed monitor under the CCAA.

As well, for private appointment receiverships and the new BIA provisions for court appointed receiverships, a receiver must be a licensed trustee. No qualifications are set out for the appointment of a receiver under a provincial *Courts of Justice Act* (or equivalent) appointment. We cannot determine if this is deliberate, or because it anticipates that provincial appointments will become a thing of the past.

Up until now, the interim receivership provisions of the BIA have answered the need for a “national” receiver. The new provisions eliminate the need to stretch the definition of interim, and add provisions that ensure that an interim appointment is of fixed length.

## **UNCITRAL**

The amendments to the BIA and CCAA, which are based upon the United Nations Commission on International Trade Law Model Law, are intended to promote co-operation in international insolvency proceedings. The revisions authorize courts to co-ordinate and co-operate with each other, restrict the scope of Canadian insolvency proceedings when foreign proceedings were previously commenced, and grant relief to representatives of foreign proceedings. The United States has also adopted similar revisions to their insolvency legislation.

## **TECHNICAL**

### Transfers at Undervalue

The amendments eliminate the current provisions dealing with settlements and reviewable transactions and introduce provisions that deal with “transfers at undervalue”. Where such a transaction is identified, the trustee is able to apply to court and obtain judgement for the difference between the consideration paid and fair market value. These changes are designed to cast a much wider net than the previous provisions, and contain provisions to deal with related parties as well.

## Asset Sales

Rules have been introduced that require that a sale of assets during a proposal or restructuring, out of the ordinary course of business, must be approved by the court. The court is given guidance on matters to consider prior to approving any such sale. In a bankruptcy, the court must also approve sales of assets to related persons.

## **CONSUMER ISSUES**

### Exemption of RRSPs

RRSPs will be exempt from seizure, subject to a claw back for contributions made in the one year period prior to bankruptcy. This exemption will be subject to prescribed conditions and limitations setting a cap on amounts in the RRSP and lock-in provisions to ensure that debtors do not withdraw the funds post-discharge. These provisions are significant for self-employed persons, and bring protection for RRSPs in line with the rules for pension plans.

### Income Tax Debt

A bankrupt who has \$200,000 or more of personal income tax debt representing 75% or more of the bankrupt's total unsecured proven claims will not be eligible for an automatic discharge. A court hearing regarding the discharge application would be held after 9 months (if the bankrupt has no surplus income) or 21 months (if the bankrupt has surplus income) from the date of bankruptcy.

### Consumer Proposals

Several changes have been made to encourage debtors to make proposals to their creditors as opposed to filing an assignment in bankruptcy. Some of the more significant changes are:

- The definition of a consumer debtor has been changed to increase the maximum filing threshold from \$75,000 to \$250,000, excluding any debts secured by the individual's principal residence.
- Defaulted consumer proposals can now be revived. Administrators may send notices to the creditors informing them that the proposal will be automatically revived after 45 days unless one of them files a notice of objection. If a notice of objection is filed, the proposal will not be revived. Alternatively, the administrator may at any time apply to court to make an order reviving the proposal on any terms the court considers appropriate.
- No meeting of creditors will be required when an amended consumer proposal has been filed by a debtor.
- Unless the proposal explicitly provides for the compromise of non-dischargeable debts, and the creditor votes in favour of the proposal, debts listed in Section 178 of the BIA will not be discharged.

## Student Loans

An order of discharge does not release the bankrupt from any student loan debts if the bankruptcy occurred within seven years after the date on which the individual ceased to be a full or part-time student. The individual may make application to court, at any time after five years after ceasing to be a full or part-time student, to request discharge of the student loan based on financial hardship. Prior to this, student loans were non-dischargeable, and no application to court was possible, within ten years of ceasing to be a student.

## Technical Amendments

- The definition of income has been amended to include any amounts for wrongful dismissal, pay equity settlements or workers' compensation, but not to include amounts received as a gift, inheritance or other windfall. Inheritances or other windfalls are considered to be property and are realizable by the trustee.
- A first-time bankrupt who has surplus income will be required to pay surplus income to the estate for 21 months and a second-time bankrupt will be required to pay for 36 months.
- A second-time bankrupt with no surplus income will be eligible for an automatic discharge after 24 months.
- If a bankrupt remains undischarged, a creditor may realize against the property of the bankrupt without leave of the court.
- The court may grant a conditional discharge order and direct that the payments be made to the trustee, to any one or more creditors or any class of creditors.
- Income tax refunds for both the pre- and post-bankruptcy period will form part of the estate of the bankrupt.
- If the bankrupt is not required to make any surplus income payments, the trustee can enter into and enforce an agreement with the bankrupt for the payment of the trustee's fees and disbursements provided the amount does not exceed a prescribed amount and the payments do not extend beyond 12 months following discharge.