From Pro Rata to Piecemeal: An Analysis of the Pension Protection Act

Connor Axel Jonsson

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Introduction

The consensus among bankruptcy and insolvency scholars is that Canadian bankruptcy laws are outdated and require significant modernization.\(^1\) Previous attempts at comprehensive reform have repeatedly failed due to resistance from influential interest groups and a lack of political will.\(^2\) Instead, lawmakers have introduced piecemeal amendments based on immediate needs rather than long-term goals. This incremental approach is evident in the recently passed *Pension Protection Act*\(^3\) (PPA), a private members bill which expands super-priority protection for pensioners in case of bankruptcy. Although nobly aimed at addressing a specific social issue, the PPA represents another fragmentary change to an outdated legislative framework and exacerbates long-standing problems with Canadian bankruptcy law. While the public interest concern upon which the PPA is based is commendable, the problem with the singular focus of the Act, aimed at elevating the claims of one group above others, is that it will likely lead to others seeking to elevate their own status in bankruptcy. This never-ending race to the front of the line is antithetical to the principles of bankruptcy law, which seeks to spread losses equitably in the name of “efficiency, fairness, and predictability.”\(^4\) This paper briefly explores the history of bankruptcy law in Canada, assesses criticisms of the PPA, and examines the debate surrounding secured credit and bankruptcy priorities to shed light on how the new Act deviates from foundational bankruptcy principles.

A Brief History

Canada’s first bankruptcy law, the *Insolvent Act of 1869* and its successor the *Insolvent Act of 1875*, marked a dramatic shift from Canada’s common law, eliminating the customary

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\(^3\) Bill C-228, *An Act to amend the Bankruptcy and Insolvency Act, the Companies’ Creditors Arrangement Act and the Pension Benefits Standards Act, 1985*, 1st Sess, 44th Parl, 2023 (assented to 27 April 2023), c 6.

\(^4\) Jacob Ziegel, “Canada’s Dysfunctional Insolvency Reform Process and the Search for Solutions” (2010), 26 BFLR 63 at 64 [Ziegel, “Canada’s Dysfunctional Reform”].
race for the debtor's assets by instituting pro rata distribution to all unsecured creditors.\(^5\)
Described as “bankruptcy’s first policy”,\(^6\) the statutory obligation to equitably distribute assets prevented the most diligent creditor from racing to seize all of the debtors assets for themselves, leaving other creditors with nothing. This “fundamentally changed the common law”\(^7\) and to this day, pro rata distribution is one of the bedrock principles upon which Canadian bankruptcy law is built.

Since 1949, there have been multiple attempts to reform Canadian bankruptcy law. The Tasse Committee, established in 1966, called for a new bankruptcy statute to completely overhaul what was considered an old and rickety system, but bills introduced in response to the Committee's recommendations\(^8\) failed to become law.\(^9\) As a result, an incremental approach to reform was adopted, leading to several amendments in discrete areas of bankruptcy law.\(^10\) These reforms lacked coherence, were not transparent, and failed to address the outdated structure and principles of the original 1949 Act.\(^11\) Consequently, today the legal framework has become increasingly inadequate for addressing modern bankruptcy issues, forcing groups to pursue stakeholder-led, narrow reforms to protect their interests, with the PPA being a recent and significant example of this phenomenon.

A look at the history of the Companies Creditors Arrangement Act\(^12\) (CCAA) provides an instructive example of how the failure of legislative reform can lead to inefficiencies in the system. The CCAA, long considered a dead-letter law after restrictive amendments in 1953, experienced a revival in the late 1980s and early 1990s as Courts began to resort to creative

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\(^6\) Telfer, *supra note 5* at 7.

\(^7\) Ibid.

\(^8\) Information Canada, *Report of the Study Committee on Bankruptcy and Insolvency Legislation*, (Ottawa: June 1970) [Tasse Report].


\(^10\) Ibid.

\(^11\) Jacob Ziegel, “Canada’s Phased-In Bankruptcy Law Reform” (1996), 70 Am Bankr LJ 383 at 416. See also Ziegel, “Canada’s Dysfunctional Reform” *supra note 4*.

\(^12\) *Companies’ Creditors Arrangement Act*, RSC 1985, c C-36.
interpretations of its provisions to facilitate large-scale corporate reorganizations.\textsuperscript{13} The \textit{CCAA} was seen as a more flexible alternative to the \textit{Bankruptcy and Insolvency Act’s}\textsuperscript{14} (\textit{BIA}) proposal provisions, which were deemed too rigid for the needs of more complex businesses.\textsuperscript{15}

Both the phenomena of narrow stakeholder-led reforms and creative judicial interpretation of the \textit{CCAA} are symptoms of a legislative framework that is well past its expiry date. The recent passage of the \textit{PPA} is only the most recent example of a systemic issue. Aimed at resolving a specific social concern, the new Act embraces the piecemeal approach and indicates a larger problem within the bankruptcy framework. The issue, as noted by Jacob Ziegel, is that despite many amendments to the law, “the 1919 Canadian Bankruptcy Act still provides the conceptual framework for the current Bankruptcy and Insolvency Act.”\textsuperscript{16} The law has failed to keep pace with changing economic and social conditions and private member reforms like the \textit{PPA} are characteristic of a system which has been largely ignored by the Canadian government.

Of course, a complete overhaul may not politically realistic and it has been suggested that piecemeal reforms (like the \textit{PPA}) have, “a higher chance of being adopted by Parliament than a massive overhaul project.”\textsuperscript{17} Indeed, obtaining consensus is difficult when there are genuine opposing interests. The history of Canada's bankruptcy legislation reflects competing financial, social, and political interests and Thomas Telfer, in his monumental book, \textit{Ruin and Redemption}, emphasizes the importance of lobbying efforts by specific commercial coalitions to explain the success or failure of Canadian bankruptcy laws at any given time.\textsuperscript{18} Creditor’s and debtor’s interests, influenced by broader social and economic factors, shape bankruptcy law,

\begin{itemize}
\item \textsuperscript{14} \textit{Bankruptcy and Insolvency Act}, RSC 1985, c B-3.
\item \textsuperscript{15} Prior to the Sears bankruptcy and the passage of the \textit{PPA} there was no super-priority in liquidating \textit{CCAAs}. Sears’ liquidating through the \textit{CCAA} led to pressure to extend the super-priority to the \textit{CCAA} as well, when it is used to liquidate a company. Liquidation through the \textit{CCAA} in fact is contrary to the narrative used to justify the resurrection of the statute: namely, it is to facilitate going concern restructurings. Thus, the attachment of super-priorities to the \textit{CCAA} through the \textit{PPA} highlights the lack of principled objectives built into the Act itself.
\item \textsuperscript{16} Ziegel, “Canada’s Dysfunctional Reform”, \textit{supra} note 4 at 386.
\item \textsuperscript{17} Richard Stankowski, \textit{The Reform of Canada’s Bankruptcy Act - A Legislative Process Case Study} (2020) at 36.
\item \textsuperscript{18} Telfer, \textit{supra} note 5 at 3.
\end{itemize}
and major commercial lenders, notably banks, may oppose significant reform, making meaningful headway difficult. As a result, lawmakers may prioritize political support over public benefit and rely on concentrated interest groups when making decisions.\textsuperscript{19} In the case of the PPA, the high-profile Sears bankruptcy brought together a coalition that secured support from all political parties.\textsuperscript{20} Ultimately, the problem with such an approach is that the resulting framework is sub-optimal for responding to the needs of all stakeholders. History indicates that what is needed is a dedicated entity to monitor and improve the overall utility and effectiveness of the commercial bankruptcy system, something the federal government has demonstrated little interest in to date. Without this, piecemeal reforms such as the PPA may continue and contribute to the loss of coherence of the overall framework.

\textbf{The Pension Protection Act}

The PPA amends the BIA, the CCAA and the \textit{Pensions Benefits Standards Act}\textsuperscript{21} (PBSA). The PPA, which originated as a private members bill, received broad support from members of all political parties. The new Act, which received Royal Assent on April 27\textsuperscript{th} after passing unanimously in the House of Commons and moving through the Senate without amendment, will provide a much more expansive super-priority to defined benefit pension plan members in the event of employer insolvency.

Prior to the PPA, legislation conferred super-priority protection to a portion of pension funds in bankruptcy proceedings but not the full amount, extending only to deductions from an employee’s pay for the pension fund, the employer's required contribution to the pension fund, and payments under a defined contribution provision.\textsuperscript{22} The PPA modifies certain provisions to expand super-priority protection to special payments for unfunded liabilities or solvency

\begin{itemize}
\item \textsuperscript{19} \textit{Ibid.}
\item \textsuperscript{20} The Sears bankruptcy resulted in pensioners losing roughly 30 percent of their retirement savings due to a large pension deficit at the time of bankruptcy. MP Marilyn Gladu, who sponsored the private members bill, had a neighbour who was directly affected and cited this as the motivation to bring the bill forward. See Ian Campbell, “MP Gladu ‘Cherry Picked’ Items ‘People Could Absolutely Agree On’ to Craft Private Member’s Bill on Pensions” (28 October 2022), online: \textit{The Hill Times} <https://www.hilltimes.com/story/2022/10/28/mp-gladu-cherry-picked-items-people-could-absolutely-agree-on-to-craft-private-members-bill-on-pensions/354178/>.
\item \textsuperscript{21} \textit{Pension Benefits Standards Act}, RSC 1985, c 3.
\item \textsuperscript{22} BIA, supra note 13 at s. 81(5)(1). See also Pension Benefits Standards Regulations, 1985, S.O.R./87-19, s. 2(1) “normal cost” and “special payment,” s. 9.
\end{itemize}
deficiencies, as well as amounts needed to address other unfunded liabilities or solvency deficiencies of the pension fund. In doing so, the PPA expands the super-priority claim to cover the entirety of a pension fund, ensuring that pensioners will be completely protected ahead of secured creditors. These amounts were previously near the end of the line when allocating liquid assets to creditors, resulting, at times, in a lack of available funds to meet obligations to pensioners.

Criticism

Critics have argued that the new Act could make it more difficult for companies with defined benefit pension plans to access credit. By giving pension claims full priority, secured lenders such as banks may face a larger and uncertain liability, potentially leading to higher interest rates and credit-related challenges. Commercial lobby groups, including banks and investment associations, strongly opposed the bill, raising concerns about its impact on the lending environment and stability.23 This is not an uncommon concern, with similar arguments about the effect of super-priorities on credit being brought forth since the middle of the 20th century. It is worth revisiting some Canadian history in order to get a better sense of whether such claims hold any weight.

Looking back, it is clear that objections from banks and secured creditors have been consistent. When bankruptcy legislation was being drafted after the Tasse Report in 1970, discussions arose regarding whether unpaid employee wages should receive super-priority protection.24 Secured creditors strongly opposed such priorities25 and it wasn’t until amendments in 2005 (later amended in 2007) when wages and pensions received some super-priority protection. Some have argued that because the 2005/2007 Act did not have catastrophic effects on the credit system and the economy, similar concerns about the PPA may be exaggerated. However, this claim is challenged by the unique features of the PPA, which

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24 Standing Senate Committee on Banking, Trade, and Commerce, A Review of the Bankruptcy and Insolvency Act and the Companies Creditors Arrangement Act (Ottawa: November 2003) at 88 [Senate Committee Review].
25 Ibid.
differ from previous super-priority amendments. Specifically, the unpredictability and complexity of special pension payments which are covered by this Act creates a potentially large unforeseeable liability that is much more likely to have a significant impact on lending practices.26

The passage of the PPA may in fact lead companies to eliminate defined benefit pension plans altogether due to the increased risk profile associated with these plans. While the decline of defined benefit plans predates the Act, the fact that the effectiveness of the PPA is tied to a pension plan which is unlikely to be around much longer reflects the short-sighted, emotionally driven concern that motivated it’s conception. This fragmented approach, led by members of Parliament instead of the government, further complicates an already outdated and complex bankruptcy system. The lack of coherence and unified philosophy in the Act was also evident in its drafting process, where older iterations were cherry-picked to find common ground, taking provisions from bills as far back as 2005.27 Despite the positive outcome of fully protecting pensioners, the new Act only highlights the need for comprehensive and forward-thinking bankruptcy reform rather than piecemeal changes that undermine the very thing they aim to protect.

What this new Act means is that pensioners with defined benefit plans won’t have to take a haircut on their pensions again. It also means that other creditors may receive little or no distribution from an insolvent estate as they will now rank behind a much larger super-priority amount. This amendment provides more robust pension protection in employer insolvencies than any other country in the world,28 and surpasses the protection originally provided for in the 2005/2007 amendments, which explicitly rejected the idea of extending protection to unfunded pension liabilities due to concerns about fairness to other

26 Special payments are inherently difficult to predict. Often it is not clear what the deficit is until the plan is terminated and calculating the deficit is incredibly complex and involves “estimates about future demographic trends, economic trends, assumed rates of return, discount rates and inflation.” See Craig J Hill & James Farley, “Pension Reform” (2011) 27:1 BFLR 1 at 4.
27 Campbell, supra note 20.
stakeholders. This new approach raises questions about the overuse of super-priorities, which were originally designed to distribute the proceeds of an insolvent estate more broadly, not protect vulnerable or politically appealing classes.

**Where are our Priorities?**

The use of super-priorities and the importance of secured credit has been a source of contention in academic circles. Opinions on how the losses of an insolvent corporation should be distributed in bankruptcy and who should bear the losses vary considerably. Some think that without super-priorities “non-financial creditors bear the externalized cost of the poor lending practices of certain of the debtor’s financial creditors.” This reasoning surely animated some of the thought process behind the PPA. Many MPs framed the purpose of the new bill as taking money away from banks and putting it back in the pockets of pensioners. Several times during the debates of the bill MPs expressed the belief that banks could afford to bear the externalized costs more easily than retirees, who have been prejudiced by the practice of secured lending which prioritizes payouts to big banks and commercial lenders over the individual with little resources. This is a compelling policy argument and there are “good reasons for giving special protection to members of pension plans in insolvency proceedings.” However, it is not obvious that such protections need to be provided for through amendments to the BIA and CCAA or that there are no other, more useful ways to protect pensions in cases of insolvency. By taking the path that the PPA does, the burden of any new amount that will be received by pensioners in insolvency may not be borne by banks. As discussed above, the costs may be borne by companies in the form of decreased access to credit, which in turn will directly affect current employees of companies with defined benefit plans and employees who are entering the workforce.

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29 Senate Committee Review, supra note 24 at 98.
It is worth assessing the normative value of secured credit as the PPA represents an encroachment into its sphere of operation. Alan Schwartz describes the issue in this way: “The principal justification for a distribution scheme that seemingly advantages the sophisticated and relatively affluent, who often take security, at the expense of the relatively poor and unsophisticated, who often do not, is that the institution of secured debt is efficient.”33 This normative claim underpins many of the beliefs of the more conservative stakeholders in bankruptcy proceedings such as banks, who believe that, with reforms like the PPA, lawmakers are eroding the foundations of secured credit at their peril and market efficiency is likely to suffer. This claim, while intuitively satisfying, has its detractors. In particular, Lucian Arye Bebchuk and Jesse Fried have argued that granting security to one creditor actually transfers uncompensated risk to unsecured creditors who cannot adjust their own terms in response, which leads to significant market inefficiencies.34 Others have claimed that security “tends to misallocate resources by imposing on unsecured creditors a bargain to which many, if not most, of them have given no meaningful consent”35 leading to further inefficiencies.

However, given that the widespread use of secured credit persists, these debates continue to be mostly theoretical and the preferential treatment of secured credit in bankruptcy continues to be the norm. While there are legitimate concerns that “unsecured creditors could be prejudiced by a debtor’s subsequent bankruptcy” due to the priority afforded secured credit, it is generally agreed that the “availability of secured credit provides liquidity, which reduces the expected value of unsecured claims”36 and the granting of security lowers overall screening costs.37 There is ample evidence to suggest that legal regimes should still “facilitate rather than restrict secured lending.”38 There is a proven wisdom in the use of secured credit in commercial lending and the practice has a strong historical foundation. Of

38 Buckley, supra note 37 at 1469.
course, just because something is rooted in tradition does not mean there isn’t room for valid criticism. However, any experiments which are likely to erode this well established practice should be done on the basis of clear evidence, comprehensive review and thorough deliberation, not political expediency and pressure from interest groups, as is apparent in the PPA.

The use of super-priorities to protect pensioners is likely to have adverse effects beyond just encroaching on secured credit and reducing access to credit. Historically, the bankruptcy system has failed to safeguard assets for ordinary unsecured creditors, with multiple factors contributing to this issue, notably the prioritization of certain classes of creditors over others.39 By adding a larger super-priority position, the PPA further diminishes the funds available to unsecured creditors. The Tasse Report strongly recommended that bankruptcy’s economic impact should be diffused by fairly spreading losses across a broad group, without unjustified distribution priorities.40 To date, there is little evidence that justifies the creation of such a substantial and unpredictable super-priority solely for the protection of a specific stakeholder group. Such an approach should attract much more scrutiny and review than was observed in the House and Senate proceedings.

Altering Canada’s bankruptcy legislation without considering its interconnected provisions may lead to unintended negative consequences, despite the compelling moral argument behind the proposed change. The PPA’s rapid passage reinforces the notion that statutory preference improvement is the only way to advance one’s interests41 (in this case pensioners) and the growing trend of granting super-priorities for various vulnerable groups risks undermining the integrity of insolvency reform and proceedings. Offering priority in insolvency is an incomplete solution, as more priority categories invites additional claims,

39 Tasse Report, supra note 8 at 120.
40 Tasse Report, supra note 8 at 86.
41 In 2014 Industry Canada undertook a public consultation seeking input on key aspects of Canada’s insolvency regime and noted that “there were calls from employee groups, pensioners, fresh produce sellers, small businesses and tax authorities seeking priority payment on the basis that they experience different vulnerabilities and, therefore, are in need of special protection”. See “Fresh Start: A Review of Canada’s Insolvency Law” (2014) online (pdf): Industry Canada <https://ised-isde.canada.ca/site/corporate-insolvency-competition-law-policy/sites/default/files/attachments/review_canada_insolvency_laws-eng.pdf> at 14.
diluting the value of such treatment. Exploring alternative options outside of insolvency is necessary, and these discussions should extend beyond protecting one interest group at the expense of others.

Alternative Methods of Pension Protection

The PPA has faced criticism for its narrow focus and potential to lead to further incremental reforms. While it provides some protection for pensioners, alternative options like establishing a "pension champion" to work with stakeholders or adopting something similar to the Pension Benefit Guaranty Fund (PBGF) in Ontario could address the larger issues in the Canadian pension system. Alternatively, something similar to the Wage Earner Protection Program (WEPP), which offers a hybrid solution by providing insurance for wage claims in bankruptcies, could have been considered for pension protection. These approaches would have better balanced the rights of employees and the integrity of the bankruptcy system. The impact of such variable law-making on the bankruptcy system remains uncertain. Overall, a comprehensive approach to pension reform is necessary, considering the interests of all stakeholders and ensuring the security of pensions in Canada. Seeking to elevate claims to super-priority in bankruptcy is a poorly thought out solution to a difficult problem.

Conclusion

Progress on reform has been slow, with the outdated provisions of the country’s bankruptcy system leading to piecemeal reforms like the PPA. Despite calls for comprehensive reforms and various attempts to modernize the legislation, there has been little political motivation to overhaul the existing framework. Banks and other commercial lenders continue to remain obstacles to comprehensive reform, making it uncertain when or if significant changes will occur. The history of bankruptcy law in Canada indicates that achieving meaningful progress may rely on incremental changes, as competing economic interests and social forces

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43 In Ontario, the success of the second Algoma restructuring in 2001 was attributed by Janis Sarra to the involvement of the Ontario government, who stepped in reluctantly in part due to the fact that they would have been on the hook for approximately $650 million in pension shortfalls through the PBGF. See Janis Sarra, Creditor Rights and the Public Interest (Toronto: University of Toronto Press, 2003) at 178-179.
often lead to legislative stalemates. Although that may be true, the resulting legislation from such an approach is far from optimal and there has been a loss of "coherence, consistency and responsiveness of the total Act."\textsuperscript{44}

The PPA holds great significance for the limited number of pensioners it aims to help. However, it is crucial to consider alternative options beyond super-priorities in improving the position of these groups. While politicians' attention to protecting the interests of ordinary individuals over the interests of banks is commendable, comprehensive bankruptcy law reform remains urgently needed. Genuine change must come from a review of the scheme as a whole, prioritizing the overall system's best interests over partisan concerns or narrow social policy objectives.

We have reached a situation where stakeholders are in a race with each other to have their interests prioritized by lawmakers in the form of narrow amendments, which is ironic considering that one of the foundational policies of bankruptcy law was to prevent such races among creditors. Today, the race has shifted to Parliament, where the priority of claims is being contested, rather than a race to collect debts from individual debtors.\textsuperscript{45} This illustrates how far we have strayed from the principle of pro rata sharing among creditors, as bankruptcy law is now perceived by stakeholders as merely a system of creditor priorities. This can be attributed, at least partially, to the existence of super-priorities, which are created by bankruptcy law itself. This situation is a regrettable waste of Parliamentary time. It would be more sensible to address the competing stakeholder requests as part of comprehensive bankruptcy reform, rather than dealing with them separately.

\textsuperscript{44} Jacob S Ziegel, "New and Old Challenges in Approaching Phase Three Amendments to Canada's Commercial Insolvency Laws" (2002) 37 Can Bus LJ 75 at 76.
\textsuperscript{45} There are currently two bills before Parliament which are piecemeal in nature and seek to elevate the interests of certain groups, including one launched in direct response to the PPA, with suppliers of 30 day goods seeking to re-assert their priority. See Bill C-280, An Act to amend the Bankruptcy and Insolvency Act and the Companies’ Creditors Arrangement Act (deemed trust – perishable fruits and vegetables), 1\textsuperscript{st} Sess, 44\textsuperscript{th} Parl, 2023 (Completed Second Reading 17 May 2023) <https://www.parl.ca/legisinfo/en/bill/44-1/c-280>. See also Bill S-215, An Act respecting measures in relation to the financial stability of post-secondary institutions, 1\textsuperscript{st} Sess, 44\textsuperscript{th} Parl, 2023 (In Consideration Stage at Senate Committee) <https://www.parl.ca/DocumentViewer/en/44-1/bill/S-215/first-reading>.