

***UNREVISED / NON-RÉVISÉ******THE STANDING SENATE COMMITTEE ON  
BANKING, TRADE AND COMMERCE / COMITÉ PERMANENT DES  
BANQUES ET DU COMMERCE******EVIDENCE / TÉMOIGNAGES***

OTTAWA, Thursday, May 29, 2003

The Standing Senate Committee on Banking, Trade and Commerce met this day at 11:00 a.m. to examine on the administration and operation of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act.

**Senator E. Leo Kolber** (*Chairman*) in the Chair.

**The Chairman:** We are meeting today for the examination on the administration and operation of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act, sometimes known as CCAA. We have two witnesses: Professor Jacob Ziegel, University of Toronto; and Professor Thomas Telfer, University of Western Ontario.

Welcome, gentlemen. I believe you each have an opening statement and we would look forward to hearing it, and Professor Ziegel will go first, I understand.

**Professor Jacob Ziegel, University of Toronto:** Mr. Chairman, honourable senators, my colleague, Professor Tom Telfer, of the University of Western Ontario, and I greatly appreciate the opportunity to appear before you today to speak to the written submissions made by us and five other of our legal academic colleagues.

Collectively, we are located at law schools across Canada from coast to coast. Our intervention is prompted by the hope that the committee's deliberations may be assisted by hearing the views of a wholly disinterested group of legal observers who are not beholden to any clients and who will neither gain nor lose any material advantage by advancing a particular position.

Our written submissions are divided into three major sections: Part 1 involves some general considerations affecting insolvency reform agenda in Canada; part 2 addresses commercial insolvency issues; and part 3 focuses on consumer insolvency questions.

Given the time constraints, I will focus selectively on important themes under each of these headings. Professor Telfer will address issues not covered in my oral remarks and add some further prospectives on topics also referred to by me.

Our first and overriding concern is that the federal government has not presented the Senate committee with specific proposals, much less a specific set of draft amendments for the third round of amendments to the BIA and the CCAA. It is now 33 years since the Tassé committee published its recommendations for a complete overhaul of Canada's insolvency legislation, yet despite the time elapsed since then the job is still far from complete.

Even if the federal government presented its phase 3 proposals tomorrow, this will leave untouched dozens of ambiguities, gaps and obsolete provisions in both acts, but particularly in

the BIA, that require attention. We have included examples of the latter type provisions in appendix A to our submissions.

Many of Canada's major trading partners have managed to do better than we have in updating their insolvency legislation. We urge the federal government to assume its political responsibilities and not delay any further. To expedite the drafting process we also recommend the establishment of a small and balanced committee of outside insolvency experts, supported by proper technical resources to prepare new draft legislation for the federal government's consideration.

With respect to commercial insolvency issues, of the many that are canvassed in the written submissions there are three that warrant particular emphasis. The first is the need to integrate the BIA and CCAA. I dealt with this issue at length in my submissions to this committee in August 1996 on Bill C-5. The basic issues have not changed. The integration is needed to promote greater efficiency, predictability and fairness in commercial reorganizations. Supporters of the status quo often argue that the CCAA needs to be open textured to give the courts great flexibility in addressing large reorganizations. This is a red herring. Judges should not have to conjure up solutions from thin air. They need to be provided with principles, standards and, where necessary, specific rules. Interest groups were quick to advance specific provisions to add to the CCAA in 1997. The Insolvency Institute of Canada is now recommending some 70 more provisions, some of them of considerable complexity. Obviously the attractions of flexibility lie in the eyes of the beholder.

Second, we warmly recommend Canada adopting the UNCITRAL Model Law on Cross-Border Insolvency. We do this not because it will resolve all the problems in this area, it will not, but to show Canada's goodwill in the search for greater international harmonization among states, and because we believe the model law rules are superior to the skeletal rules in part 13 of the BIA and section 18.6 of the CCAA.

Our third concern in the commercial insolvency area involves the need for a Crown priorities act. The current position is chaotic. There are dozens of federal, provincial and municipal provisions, each purporting to give priority or super-priority to particular Crown or public authority claim, and frequently purporting to override existing security interests. The case law is enormous and continues to grow. There are several dozen Supreme Court of Canada decisions alone. We believe an important start can be made with what has come to be labelled as the "Crown priorities act." However, nothing can be done without the support of the CCAA and the federal government. Regrettably, the authorities have so far sheltered behind the excuse that the federal government must protect its revenue sources, particularly so far as they involve unremitted deductions and collections. We do not question these important goals. What we do say is that they can be accomplished within the framework of a Crown priorities act.

I turn now to the third main area of our submissions, which is the area of consumer insolvency issues. Here, somewhat ironically, the Senate committee has the advantage of a specific set of recommendations from the Personal Insolvency Task Force established by the superintendent of bankruptcy in 2000. Two of the subscribers to our submissions, Professor Iain Ramsay of the Osgoode Hall Law School, and I, were members of the task force. Importantly, we also dissented from some of the recommendations the traffic force and from the task force's failure to address other significant issues.

The submissions by the academic group adopt the same bifurcated approach. On the plus side we warmly support, for example, the recommendations for an optional federal exemption scheme for individual bankrupts, and for a more liberal approach to the discharge of student debts. On the minor side, we oppose allowing trustees to sue consumer bankrupts for outstanding fees and disbursements where the debtor has no surplus income and is at or below the official poverty level as determined by the superintendent's directive under section 68 of the BIA. We do so because we believe it is contrary to Parliament's intention and contrary to public policy that poverty level debtors who have been discharged from bankruptcy should still be required to make payments in respect of trustee fees even though the debtors have no surplus income, as determined under section 68.

We also are concerned about trustees continuing to wear several incompatible hats and being required to blow the whistle on their clients, the consumers, under various provisions of the BIA.

As far as the fee problem is concerned, we believe the appropriate solution is for the federal government to reintroduce a federally sponsored FITA program for poverty level consumers, which operated between 1972 and 1978, and was by all accounts very successful. As we note in our written submissions, Australia has an even simpler and cheaper system for making bankruptcy accessible to low-income consumers, which Canada could study to great advantage.

Let me turn finally to the issues of credit counselling for insolvent consumers and creditors' contribution to the high level of over-indebtedness among Canadian consumers. In our submissions we express our skepticism about the value of the mandatory credit counselling that every consumer insolvent is required to receive under the BIA as a precondition to discharge from bankruptcy or completion of a consumer proposal. Nevertheless we do not recommend repeal of these provisions. We do, however, argue that there needs to be offsetting investigation of credit-granting abuses by credit granters, and sanctions for those who are reckless or clearly negligent in advancing credit to impecunious debtors or debtors who are already over-committed.

The evidence of these practices is overwhelming. Just ask yourselves, honourable senators, how many offers of unsolicited credit cards and consumer loans you have received in the mail over the last year; how often your credit card limits have been increased without your asking for them; and how often we see advertisements offering to supply goods and services on credit without a down payment and with no need to make payments for a year or more.

We are not alone in expressing our concerns about these excesses, which contribute in a major way to the high incidence of over-indebtedness among Canadians. The problem is also receiving close attention in the United Kingdom at the present time, and was targeted in recent proposals of the European Union on consumer credit.

Regrettably, the task force report does not address this issue, although it was raised at several meetings of the task force. We earnestly hope that the Senate's own report will not be guilty of the same omission.

I thank honourable senators for your courteous attention to this introductory statement, and I look forward to answering your questions.

**Professor Thomas Telfer, University of Western Ontario:** Thank you for the opportunity to appear before you today. In my opening remarks I will offer some brief comments on

bankruptcy reform process and further highlight three substantive areas in our joint submission. Those three areas are voidable preferences, director liability and unpaid suppliers.

Some of my comments offer a comparative perspective in that I was a member of the Faculty of Law of the University of Auckland in New Zealand for eight years before joining the University of Western Ontario's Law Faculty.

My initial comments about bankruptcy reform highlight the point that although we have had major amendments in 1992 and 1997, reform has been piecemeal. Reform has addressed some specific issues but it has been some time since the legislation has been looked at as a whole. The current act can be traced back to the Bankruptcy Act of 1919, which in turn was based upon English legislation of 1883. In numerous places in the current act, the impact of that 19<sup>th</sup> century legislation is still with us. Appendix A in our submission draws attention to some of these issues.

My second general point is to highlight the fact that the Industry Canada report does not make specific policy recommendations. The reform process leading up to today's hearings includes the publication of a number of discussion papers, some going back to 1998.

If I may refer to my New Zealand experience for a moment, New Zealand it currently undergoing a similar review of its insolvency regime. That review was launched in 1999, and after a series of consultation papers the associate minister has already announced a series of policy decisions and it is expected that new legislation will be introduced in that country this year.

My first substantive topic is the issue of voidable transactions, or pre-bankruptcy transactions dealt with at page 21 of our submission. Pre-bankruptcy transactions are one of the most highly contestable issues in a bankruptcy. As there is never enough money to satisfy the claims of all creditors, the ability of the trustee in bankruptcy to enlarge the estate by setting aside pre-bankruptcy transactions is one of the most fundamental provisions found in any bankruptcy regime. Our submissions call for reform of a number of different provisions in the BIA dealing with pre-bankruptcy transactions, including the modernization of settlements, a term that has been narrowly defined by the courts. Our submission also addresses the issue of overlapping federal and provincial law.

However, I would like to alert the committee to a significant policy choice in the area of pre-bankruptcy payments: The choices between the status quo, which is the traditional culpability test, and a more modern effects-based test, which would be a reform option. On the eve of bankruptcy, debtors often make payments to a preferred creditor. If these payments cannot be challenged or set aside there may be nothing left for the trustee to distribute. The traditional concept of a preference is that the trustee is given the power to set aside this transaction where the transaction is made with the intention to prefer. This culpability test is found in the current version, section 95. This traditional test has been criticized as uncertain, difficult to apply and antiquated.

A more modern approach or reform option would be to adopt an effects-based regime. Allowing the trustee to set aside the transaction has the effect of preferring one creditor over another without looking at intention. The United States and New Zealand, for example, have abandoned the culpability test and has adopted an affects-based regime. However, as experience shows in other jurisdictions, the exceptions or defences to any effects-based regime become the

new source of litigation. Our submission asks specifically, "Can a culpability test be replaced with an effects-based test without causing more problems than it solves?"

Again referring to my New Zealand experience, New Zealand, in 1993, abandoned the culpability test, which is being suggested for this country, in favour of the more modern effects-based regime. However, the 1993 amendments failed. Over 10 years of extensive litigation and uncertainty have followed the amendments. So controversial were the amendments that in 2001 the New Zealand government announced decision that it would recast the preference regime in the coming round of insolvency reform. I highlight this issue as a significant policy choice, and if there is to be reform in this area and Parliament decides to abandon the culpability test careful consideration should be given to the design of a new effects-based regime.

My second point deals with director liability for unpaid wages. Our submission recommends that once a company is insolvent a uniform bankruptcy insolvency act rule should govern directors' liability for wages. Currently director liable for unpaid wages varies across the country both in terms of extent of liability and whether there is any defence. A provision in the BIA would ensure uniform treatment across the country.

There is also a second issue arising under director liability not specifically addressed in our report, and that is the issue of whether there are appropriate sanctions for directors' conduct prejudicial to creditors. I would be happy to answer any questions on that issue and refer to the New Zealand experience again with that issue and the specific legislation adopted in that country.

A recent decision of the Quebec Court of Appeal calls into question whether there is a need for specific legislation in the Bankruptcy and Insolvency Act to deal with the issue of wrongful or reckless trading by directors.

My final point is with respect to the issue of unpaid suppliers. Currently, section 81.1 enables a person who has supplied goods to a commercial buyer to repossess those goods within 30 days of delivery. If the buyer is a bankrupt, the goods are identifiable in the same state and have not been resold.

These provisions, which were adopted in 1992, have not been effective and have been described as illusory. The provisions do not apply in a re-organization, seriously weakening the effect of this remedy. The seller's right to repossess is largely dependent on what the buyer does with the goods.

Third, the time frame for exercising the right to repossess is quite short in that by the time the seller discovers the buyer is bankrupt the time in which to exercise the remedy may be near expiring. This issue is controversial in that unpaid suppliers point to these weaknesses, while secured creditors object to any reforms or object to the remedy at all because the right to repossess weakens the secured party's position. After all, suppliers have the option to extending credit on a secured basis. However, we know as a matter of practice that not all suppliers sell goods on secured terms. Where there is a sale of goods on unsecured terms, the question arises as to whether Parliament should intervene by providing an effective right to repossess when the buyer goes bankrupt?

I would submit that Parliament has already made that policy choice by adopting the provision in 1992; however, there are numerous deficiencies in the law that could be addressed through

reform. Specifically, the integration of the remedy into the context of a re-organization, and second, addressing the time lines to allow for a more effective right of repossession.

Thank you very much, and I look forward to answering any specific questions you may have.

**Senator Kelleher:** I will first address the remarks of Professor Ziegel in the first paragraph, where he mentions concern about the absence of specific proposal in Industry Canada's report. I want you to know if you were disappointed you were not any more disappointed than we as members of this committee. I believe they gave us a list of 82 or 84 areas and said, "Here are the concerns," and divided them up into sections, and we have sort of hoped there might have been some draft proposals forwarded to us but such is not the case. We feel a little abandoned in that regard, just like you.

Turning now to specific questions, a couple of weeks ago we had representatives here from various student organizations, and one of them put the argument, "We do not know why we are being treated differently from any other consumer group. "You should abolish the area of the act dealing with us and treat us the same as everyone else." What have you to say about that?

**Mr. Ziegel:** The short answer, senator, is that we support the recommendation in the task force report which recommended allowing discharge from student loans after five years from the completion of the student's studies.

We also support an additional recommendation from the task force report that would give the court the power to shorten the period even more where there was proven hardship with respect to the student.

We do not go the whole way, by any means, in terms of the request by the students. We appreciate that we are talking about government funds, government-supported student loans. They are not in the same category as loans made for private profit-making purposes.

We see the justification for government being concerned, but not making discharge too easily. I speak now also a member of the task force. We sought an accommodation between two competing interests. We thought our recommendation in favour of a five-year period seemed reasonable in all the circumstances.

Canada is not alone in this problem. It would be fair to say the majority of English-speaking, if not French-speaking, countries have been wrestling with this problem. They impose restrictions on the discharge of student loans. Canada has nothing to be embarrassed or ashamed about. We are all grappling with the same problem, trying to reach some accommodation.

**Senator Kelleher:** As you know, we have two acts, the BIA and the CCAA. You are recommending that they should be combined. I know a little bit about this area. I know what goes on in Ontario. We have one judge who deals with all of these. He is a bit dictatorial at times. How is that for an understatement? In fairness to him, it is partly because the CCAA is so loose that it does not say anything. It does not even provide guidelines. It sort of leaves it up to the judge. I am wondering how you think we can resolve this matter of these two acts.

**Mr. Ziegel:** Senator, when I appeared before this committee in 1996, I made some detailed observations on this issue. I have been interested in it for a substantial number of years.

I argued strongly on that occasion that the two acts should be combined. The submissions of my colleagues and I have presented today make the same point.

I should make it clear that when we talk about integration, we are not arguing that the same rules should apply to large reorganizations as those which apply to small reorganizations. What we say is that these differences can be accommodated under the umbrella of the Bankruptcy and Insolvency Act which, historically, was intended to be the primary, if not the exclusive, source of Canada's insolvency legislation.

I would also remind you, senator, that the House of Commons committee recommended at the time of the adoption of the 1992 amendment that the CCAA should be repealed at the end of a three-year period. That was never done. There was never any official explanation as to why it was not done. It was probably because, in the meantime, practitioners had probably got used to courts adapting the CCAA to their purposes. In my view, this was a serious distortion of legal history.

We have now come to the point at which we need to do two things. First, the CCAA provisions should be integrated as part of the BIA.

Second, if we decide to retain, as I think we probably should, a separate part of the BIA for large reorganizations, then we must ensure that it has a comprehensive set of principles, guidelines and rules.

As you rightly pointed out, senator, it is unsatisfactory, that we throw the problem at a judge, and there are immense problems, and say, "Now you sort it out." If the judge were to consult the act, much of the time there is nothing to guide him. Because of the absence of specific principles and rules, the courts conjured up something called the "inherent jurisdiction of the courts" which basically means, go to it; you fashion some sort of solution to grapple with the problems before you.

This is a unique approach to legal problems in Canada. In my view, it is not compatible with our conception of the rule of law. It makes it very unpredictable for petitioners. Its good for the debtors who are urging the court to create these new solutions to accommodate their needs. It is bad for the range of creditors and others who may be adversely affected by the judge's ruling.

For all these reasons, my colleagues and I strongly argue, first, for the integration of the BIA and the CCAA; and, second, for filling in the many gaps that presently exist in the CCAA provisions.

**Senator Kroft:** Following on that, we have heard presentations both for and against flexibility. I understand that by putting the two together you are not saying that we should put all sizes into the same box.

To give us a little insight, could you suggest two or three specific areas where there is now an absence of direction, where the judge in the case is left free to draw conclusions, where you think it may be helpful to bring some specificity to it?

**Mr. Ziegel:** I would be happy to do so. Let me give you several current examples that have arisen both in the Air Canada case and one in Quebec in connection with the restructuring of a mine.

The issue to which I wish to refer is whether the court has the power to authorize the debtor company to break collective bargaining agreements. There is not a word in the act at the moment that deals with a debtor's right to repudiate existing contracts. This is something the courts have, I am tempted to say, invented, although that is a somewhat pejorative term, but

which they have adopted because they felt it was necessary to make the CCAA workable. It gives an enormous discretion to the courts.

The American Bankruptcy Code has detailed provisions about the power of debtors to repudiate contracts in bankruptcy, including reorganizations. In its submission to Industry Canada, the Insolvency Institute of Canada has strongly argued in favour of spelling out this area in some detail.

The question of whether a court should authorize the debtor to repudiate collective bargaining agreements is a very important subset of this problem. It seems to me markedly inappropriate for a judge to be asked to answer this question of immense importance to the parties without any guidelines from Parliament.

Understandably, the unions are very upset. In the recent Quebec Court of Appeal decision to which I referred, the court concluded that on the facts of that particular case no authority had been given to the monitor to repudiate union contracts. The court also raised the question whether Parliament could even authorize the monitor to repudiate the union contracts.

We now have two conflicting approaches, one in Ontario, which assumes that the judge does have the power, if he or she sees fit, and we have serious doubts cast upon the whole area in the province of Quebec.

It seems to me the obvious solution is for Parliament to give some specific guidelines. You will find such guidelines in the U.S. Bankruptcy Code.

The problem we have here, senators, is that Parliament does not seem to want to grapple with these technical problems, presumably because ministers do not see any political advantage in doing so. In the views of my colleague and myself that is not the correct approach to insolvency problems. They are not doing it to massage anyone's ego but because these are active legal, social and economic issues. They need to be addressed and it is the role of governments to do that. We elect governments to address them and not to throw everything back into the laps of the courts.

There are two other examples. One concerns a question that arose in the case of Air Canada as to whether an order of the court restraining actions against the debtor company was also binding on government instrumentalities. For example, the Competition Bureau was conducting hearings as to whether Air Canada had violated provisions of the Competition Act dealing with some of its pre- bankruptcy activities.

Again, section 11 of the act does not address this issue, which is an important one. Quite often in the case of large reorganizations, there may be other proceedings that may be outstanding.

An issue was also raised by the Winnipeg Airport Authority. They said Air Canada had collected large amounts of money by way of airport fees and had not paid them over to the airport authority. These are funds that belong to the airport authority and not to Air Canada.

Again, there is absolutely no guidance in the current act as to the disposition of funds that are being held by the debtor on trust for a government agency.

Here are three examples of what I regard as very important gaps in the CCAA.

Another one that comes up all the time is what lawyers refer to as debtor and possession financing. The debtor needs a line of credit to continue in business. However, to get a line of credit, it has to be able to give security to its bankers. The current act does not deal with this issue. Not only do the bankers want security for any post-bankruptcy loans being made to the restructuring company, they want super priority. That is to say they want to be able to trump existing security interests. The courts are divided in their reaction to these requests. Some courts will grant it, while others will not. Some will try to mediate a solution at either end of these extremes.

Again, the courts should not have to speculate about the appropriate solution. The act should be giving guidelines to the courts, just as happens in the U.S. Bankruptcy Code.

I hope that answers your question, senator.

**Senator Meighen:** Thank you, professors, for being here.

I want to talk to you briefly about the issue of unpaid wage earners and directors' liability. I ask about that because the memory is still fresh in my mind of when I was a relatively young lawyer and had been given the opportunity to sit on the board of a well-known Montreal company in the clothing business. At one point, a bailiff walked into my office and slapped me with a writ for \$865,000, which I did not have in my bank account at that time; nor do I now. I was only able to extricate myself from the situation with the help of our adviser, Yoine Goldstein. What Mr. Goldstein says, I listen to carefully even today.

That is by the by. I note that we have had 12 years of talk in terms of wage earner protection, and we still have not got an agreement as to how to do it.

You talk about an enlarged Employment Insurance fund and a preference to go that way as opposed to a lien on insolvent employers' inventory and accounts receivable.

Do you have any statistics or objective data to demonstrate the extent of the problem of unpaid wages and what the projected costs might be of an enhanced Employment Insurance fund?

**Mr. Ziegel:** I am not remotely an expert in the area, senator. However, I think you will find some statistics in the Industry Canada report. They offer one set of projections in using the Employment Insurance fund. Another one is to use the route of giving unpaid wages priority lien.

In the case of the Employment Insurance fund, they calculated the costs might be -- I may be hopelessly wrong; if so, I hope my Industry Canada friends will correct me -- a figure of around \$20 million a year. In the case of first liens, they had a substantially lower figure. I think it was in the order of \$12 million. As I recall, neither figure was overwhelming.

When the parliamentary hearings were held in 1991 for what became the 1992 amendments, the figures at that time suggested that 10 cents a week per employee would be sufficient to enable the Employment Insurance fund to cover unpaid wages. I recall I wrote a Globe and Mail op-ed piece at the time using that figure.

We are not talking about huge problems. In my view, it is essentially a matter of political will. As I said earlier, for reasons that escape me, politicians seem to wait for consensus. They are not willing to move unless they see overwhelming support for a particular solution. You might as well wait for Godot to come home. I think the time has come for the federal

government to assume its proper responsibilities. The issue of unpaid wages has been debated ad nauseam. We have had umpteen reports. We have spent hundreds of thousands dollars on reports and committees travelling around, in some cases around Western Europe, to see what is being done there. We have an enormous body of precedents and information. Now it is time to act.

**Senator Meighen:** I could not have said it better myself.

What about unpaid pension benefit contributions; would you lump that in with unpaid wages?

**Mr. Ziegel:** I am not sufficiently knowledgeable in the area. I can see that is a more complex area because it may involve significantly larger funds. Pension funds are also being administered in many of the provinces which have various pension supervisory agencies.

If you will permit, I will beg off trying to give you a specific answer.

**Senator Meighen:** We will try to provoke the leadership on the basic problem of unpaid wages, first, and then perhaps at another time and place we could turn to the unpaid pension contributions.

In your paper you indicated you support the concept of a uniform bankruptcy and insolvency act with respect to the liability of directors and insolvent corporations. First, may I ask: Do your comments apply also to the CCAA?

**Mr. Ziegel:** Do you mean in terms of unpaid wages?

**Senator Meighen:** Yes.

**Mr. Ziegel:** Yes.

**Senator Meighen:** In terms of concept of liability for unpaid wages?

**Mr. Ziegel:** That would be logical.

**Senator Meighen:** As I see it, the problem then lies with the BIA which, as you note in your paper, has varying degrees of liability for directors and varying ability to raise defences.

Did you not also say that it is a constitutional conundrum in that here, now, we are dealing with provincial jurisdiction? If that is so, other than a pious good wish, do you have any magic bullet for us to ensure that we get all the provinces to agree?

**Mr. Ziegel:** We said there was a constitutional doubt. We did not indicate one way or the other whether we shared that doubt. We did not have time to investigate the issue. Personally, I think a persuasive case can be made. The issue of directors' liability and unpaid wages is sufficiently close to insolvency that federal action can be justified in terms of the federal insolvency power.

As I say, I am not purporting to give professional advice. I think Justice has lots of highly competent experts of its own.

There is a precedent, however, for federal government intervention. That is to say, in the CCAA there is a provision, which was added in 1997, that allows an arrangement to be made with the company's directors, as well as with the debtor company. It also provides that the court can make an order staying any action or proceedings against the company's directors.

If that is intra vires the federal Parliament, I think we are already hot on the way to an answer to the question whether Parliament could also adopt a uniform provision for directors' liability of unpaid wages.

**Senator Meighen:** I gather the bottom line is damn the torpedoes, full steam ahead?

**Mr. Ziegel:** Not necessarily.

**Senator Meighen:** We can fend off any challenges.

**Mr. Ziegel:** I am not even saying that. All I am saying is that to the extent reflective colleagues have raised the constitutional issue, certainly, it should be addressed. We are not recommending because someone raised a constitutional issue we immediately abandon the issue and become scared.

**Senator Meighen:** Do you favour the due diligence defence on the part of directors? Would you allow that if you had the power to decide?

**Mr. Ziegel:** Personally, I would be sympathetic. I cannot necessarily speak for my colleagues.

In terms of my personal philosophy, I find it difficult to justify imposing strict liability on directors for unpaid wages, in particular, if they are outside directors and have nothing to do with the day-to-day operations of the company, except to ask the right questions at directors' meetings to ensure that the funds are available to meet the claims of employees.

**Senator Meighen:** Do you agree, Professor Telfer?

**Mr. Telfer:** With respect to due diligence, there is an issue as to whether you are targeting due diligence with respect to unpaid wages or you are having a broader concept.

**Senator Meighen:** I am talking about unpaid wages for now.

**Mr. Telfer:** I would agree that if you are going to the broader due diligence to cover any liability, then it raises more serious issues.

**Senator Kroft:** I wanted to follow up on the issue of the American comparison with the Canadian situation. You said there is specific guidance in their legislation. I think we are talking in particular about the area of breaking of contracts, for instance.

Of course, it is difficult not to recite the law. In these areas, do you not end up about basically empowering the court, given that there are appropriate circumstances? Can the law effectively envisage all the combinations of circumstances to make those kinds of provisions meaningful? Is that not why there has been an inclination to maintain flexibility in Canada, that is, because the circumstances vary so much? Or is there another line of argument altogether?

**Mr. Ziegel:** On the whole, I cannot agree. The Americans have had much more experience in this area than have we. Chapter 11 of the American Bankruptcy Code addresses in considerable detail all the types of issues that have arisen in Canada. They provide, on the whole, clear guidelines to the U.S. courts.

I believe I am correct in saying that we cannot anticipate the vast range of issues that can arise in large reorganizations. We have now accumulated a large body of experience. The proof is in the pudding.

The submissions made by the Insolvency Institute of Canada include some 70-odd recommendations for changes to the CCAA. Many of those changes involve issues that you and I have discussed this morning, senator.

Many of their members are actively involved in insolvency reorganizations. Thus, they are speaking from experience. They are reflecting their concern about the lack of specific provisions in the act.

The people who are on the front line who are actively litigating these issues are reflecting the same concerns that my colleagues and I reflect in our submission. As I said earlier, I think that is a complete red herring. It is one thing to say you want to have a separate provisions for large reorganizations. I can see that. The argument then is: Should they be outside the BIA or inside? It seems to me it is an entirely different proposition to argue that you should have a basically open-ended act where the courts are free to make up the rules as they go along. As a lawyer, I find that unacceptable. It offends my sense of the principle of the predictability of law and our concepts of the rule of law.

**Senator Angus:** Good morning, professors. I would like to carry on with this issue of the CCAA and what you seem to be categorizing as large restructurings. As I understand it, the rationale for having legislation of this type is to enable a big company that gets into big trouble to somehow survive rather than being liquidated and to have not only its liabilities disappear but also the assets it has gathered over many years. As I understand it, in the U.S., that was the rationale for chapter 11 of the U.S. bankruptcy laws. This is just one chapter.

If I am hearing you correctly this morning, I am getting the sense that you feel that Chapter 11 has a lot of merit to it and, if we had similar legislation here, it would be a good thing. Am I right in that regard?

**Mr. Ziegel:** Basically, yes.

**Senator Angus:** Again, if I understood some of the earlier testimony we have heard in these particular hearings, it would have tended at least in my view to have been a trend in the evidence against importing chapter 11 into Canada, and I happen to be more on your side, clearly, if only because of the demographics. It is a huge country and it has had many examples of restructurings of big corporations that have been successful and have avoided liquidations.

One of the things Senator Kroft raised in his first questioning had to do with the labour, but maybe not in a larger sense. As I understand chapter 11, the judge has the ability to open up collective agreements and go a lot further than we can here. Obviously one of the problem with this current high profile restructuring that is going on in Canada, the labour unions are the huge elements of the debts -- some \$3 billion or more. The judge, of course, is admirably trying mediation and bringing in fellow judges, but the reality is that the unions are able to say sorry.

What is your view on that? There has been talk and it has been in the media, I believe, that one of the issues that Mr. Collenette and his colleagues have been looking at is the possibility of perhaps amending certain statutes here with a specific industry in mind as opposed to a general thing. Again, I believe it makes some sense that in industries that are cross-border it is desirable to have uniform laws. Therefore in transportation, railways, airlines, those kinds of industry, it seems to make a lot of sense that our law would be the same as the American because most of the creditors per force happen to be in the U.S.A. When you file here under CCAA I believe you have to also file in the U.S. and it becomes sort of a conflict-of-law situation.

I wanted to get your view on that issue, namely amending our laws just for specific industry as opposed perhaps to having an across-the-board thing, which seems to have been found offensive by some of our witnesses.

**Mr. Ziegel:** First, I will say that you put the case extremely well, senator. You asked two separate questions. First, should Canada adopt chapter 11-type provisions? In principle, I would say yes but I want to make it clear my colleagues and I are not arguing for a verbatim copying of chapter 11 provisions. What I said earlier, in response to questions, was that chapter 11 deals with almost every one of the issues that have risen in Canada much more coherently and systematically, they thought through the problems, they provide solutions, and we can learn from it. Their experience shows that you can have specific provisions and still have successful restructuring. This notion that you need an open-ended act and leave it all up to the judge is, in my view, mystical, it is not founded in fact.

The second question you asked me is what shall we do about collective bargaining agreements, should we confer general power on the court to authorize the breaking of agreements that will be restricted to a particular industry? I believe we are dealing there with fundamental value judgments, and this is one of the things that concerns me at the moment, that we simply say to the judge, "Now you decide for society which is more important, to attempt to bring about a restructuring of an industry or to respect the status quo." It is not so much a matter of respect for collective bargaining as it is hoping to be able to persuade the unions that it is in their own interests to agree to a modification of existing collective bargaining agreements. Do we use the compulsion of the state through the courts or do we rely on the good sense of the parties?

These are basic value judgments and the point I would make is it is not the sort of fundamental judgment that we should ask the courts to make. It is a role for Parliament. When the railway workers go on strike we do not throw the problem in the hands of the court, Parliament must decide whether or not it wants to order the workers back to work while the issues are being considered by a mediator. In similar fashion, I think our judges are entitled to specific guidance.

If you say to me, "If you are going to allow union contracts to be forcibly rewritten we should restrict it to particular industries," that is something that I could live with and it seems to be a reasonable compromise. However, this illustrates the point I have been hammering away, senator. These are issues that should be considered by a Parliament. That is why we have Parliaments. These are not issues that should be thrown into the laps of the courts because the judges have not asked for it, and if there are negative fallouts they will be blamed for trying to do an almost insuperable job.

**Senator Angus:** As you know, this committee is part of Parliament and so we are in the right ballpark at least.

**Mr. Ziegel:** I just hope that some of the ministers are listening and are not turning their backs on these issues and saying that there is no political mileage to be made here and therefore we are happy to leave it with the judges.

**The Chairman:** You made that point many times. We are quite impressed with it.

**Senator Angus:** I believe we are ad idem on the issue. The fundamental resistance or distaste that we might share for being able to abrogate what was a collective bargaining process,

which is fundamental to our society, on the other hand, what I see as a salutary element of chapter 11 in the U.S. The very fact that the threat is there and that the judge can, if the parties do not get together, it is an inducement for the parties to get together, whereas here the unions know that the court cannot do it so the unions can just give you the little smile and not play. That is, I think, the problem, and I believe you agree with that.

**Mr. Ziegel:** Except, senator, I would question your assumption that our courts do not have the power. As I indicated earlier in response to a question from Senator Kroft, at the moment we have what appear to be conflicting decisions in Canada. We have one from the Quebec Court of Appeal arising out a specific set of facts, and we have an implied assumption of the Air Canada case that the court could, if necessary, authorize the management to break a union contract. I want to be absolutely fair to the court in the Air Canada case; the judge has not actually sell held. There was an initial order made, but it was an ex parte order. It was being challenged on the basis of whether Justice Farley would have to address the issue because the parties are still busy negotiating. Unlike you, I do not feel we have a firm answer at the present time.

**Senator Angus:** That is true, and it will be a higher tribunal that will likely have to decide and I suspect there will be some new jurisprudence before we all go away for the weekend in terms of that particular case. We will have to see. It would be much nicer if we had something clear so we would know.

Senator Meighen raised the issues of directors' liability, which I think basically were well-canvassed and your views are spelled out, but I have two specific questions. First, on your comment that CCAA does provide for the judge to order a suspension of suits against directors, I believe that is only for wages and things during the CCAA process, not pre nor post filing, correct?

Do you agree with that?

**Mr. Ziegel:** Basically, yes.

**Senator Angus:** The other thing I wanted to know, because this business of directors' liability, as Judge Farley himself has commented, quite unusually I suggest in the press recently, about directors being preoccupied with their liability in these big restructurings. Can you blame them? I wonder if you believe in the concept. I believe you said you do not agree with absolute or strict liability. I hope I heard you correctly because my ears perked up. This goes right to the wages and the government holdbacks and all of that. Would you view a due diligence defence across the board as being at least a step forward?

**Mr. Ziegel:** Yes, I indicated earlier that philosophically I support a due diligence defence. We already have it in much legislation, we have it in the tax legislation, and I think there is a due diligence defence in the recent CBCA amendments, so there are precedents for it.

**Senator Angus:** My last question is again on hearing and liking what I heard about your belief in uniformity of law, especially when you are dealing in multi-jurisdictional affairs. I understand in the CBCA itself -- Canada Business Corporations Act -- as amended recently, there are provisions for plans of arrangement and effectively restructurings without going into the purview and the stigmatic results of insolvency legislation. Do you have any comments on that, and do those provisions in the CBCA make any sense?

**Mr. Ziegel:** I have not reflected on the CBCA amendments dealing with arrangements. I do know that in the early 1990s there were one or two cases where companies in financial

difficulties resorted to the arrangement provisions in the CBCA because they were concerned about the fallout from using the CCAA. They had to avoid at all costs a formal finding of insolvency. Those were very special cases.

I am not aware that any of the recent restructuring cases have invoked the arrangements provisions in the CBCA. I would think it might be difficult to apply them to companies that are clearly insolvent and where you require extensive orders from the court to enable the contracts to be cancelled, suspended, rewritten, a whole range of issues that are currently being addressed by the courts under the CCAA but not in the context of the CBCA.

**Senator Moore:** I am interested in page 29, the section in your brief with respect to trustees' conflicts of interest. You say that the trustee owes duties to the debtor's creditors and to the court, let alone the indebted consumer with whom he has entered into a contract to look after his affairs, and you say that this gives rise to a conflict of interests between the trustee's duty to the consumer and his duties to the creditors and the court. You go on to say thereby in effect forcing the trustee to blow the whistle on his client. You say that the PITF study recommendations would add to this conflict of interest, "We have no easy solution for the current impasse, however, we believe it important for Parliament to take note of the conflict of interest."

We had one witness before us, Mr. Owen, of Omega-One, a couple of weeks ago, and in his testimony he stated that there was not a conflict of interest but a convergence of interests. That was his take on the situation. To me it looks like a conflict, so I wonder, would your concerns be resolved if trustees were obliged to divulge, in writing to prospective bankrupts, the consumers, that their primary interest is the protection of the estate and of the creditors' rights?

You mention that you do not have any solution for the impasse but you think it is that important for Parliament to address the issue. Do you have thoughts on that or suggestion of some written declaration or piece that would give some guidance so that a consumer would know what to expect from his or her trustee? It is a very important area of the whole business and process, and you have obviously struggled with it so you must have some ideas on each side of the issue.

**Mr. Ziegel:** I am grateful to you for you raising that issue. You are quite right, my colleagues and I believe it to be an important issue, particularly since those of us who were on the Personal Insolvency Task Force did not succeed in persuading our colleagues to take it seriously.

The ideal solution obviously would be for the trustee to only become involved in the case after the consumer has sought advice from an independent party as to whether or not he or she should go into bankruptcy and pursuant to what kind of bankruptcy. It is not the system we have in Canada at the moment. We have trustees who advertise extensively, encouraging and inviting indebted consumers to come and consult them about their debt problems and then advising them on the procedure to follow in order to resolve their debt problems, but then the moment the debtor accepts the advice, goes into bankruptcy, suddenly the trustee changes his or her hat and suddenly is expected to pursue the interests of the creditors. It is not clear how the interests of creditors and debtors can be reconciled, whether as a consult between the two as there often may be, and this is what troubles us. You have put forward one suggestion -- a suggestion I also put forward on before another forum -- that is that at a minimum the trustee should be required to prepare a document, perhaps a document prepared by the superintendent of bankruptcy, handed to the debtor at the time of bankruptcy so that the debtor will be absolutely clear in his or her

mind as to what happens once bankruptcy has ensued and where he stands with the respect to his relations with the trustee.

Even so, I do not think that will go far enough. I am uncomfortable with the trustee knowing as much as he does about the debtor, then being required to make a report to the court at the end of the month period about the debtor's conduct, and sometimes that conduct may have been in breach of the act. Not only is the trustee under the existing provisions required to make this report, but also is required to make recommendations to the court. That seems to me to fly in the face of the consumer's natural assumption that the trustee is on the consumer's side.

We say in our submissions that at a minimum when it comes to recommendations trustee should be neutral. He should simply give the facts to the court and let someone else make recommendations. We have the superintendent of bankruptcy, we have the creditors, we have lots of other people, people other than the trustee who can draw their own conclusions from the established facts and tell the court what should happen.

Speaking for my colleagues and me, we do not feel it is compatible with our established principles of loyalty to a client that the agent should be expected to breach faith with his own client, which I would argue the consumer still is at the time of these proceedings.

**Senator Moore:** You mentioned that such a document would be put to the consumer upon bankruptcy. Did you mean at the first interview? Did you mean with the first office interview with the trustee? Yes. Therefore they will know right from the outset what the parameters are and who is looking after whose interests and when.

**Mr. Ziegel:** Yes.

**The Chairman:** The meeting is adjourned. Thank you, gentlemen.

The committee adjourned.