



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

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**SUBMISSION TO THE STANDING SENATE COMMITTEE
ON BANKING, TRADE AND COMMERCE**

Introduction

The Insolvency Institute of Canada strongly supports the reforms to Canadian insolvency legislation that are included in Bill C-12.

The Bill is a great improvement on the amendments that were passed in late 2005. The IIC is grateful to the Standing Senate Committee on Banking, Trade and Commerce, whose action in identifying concerns with the 2005 amendments was instrumental in making sure the legislation obtained a more thorough review. We would like to thank the Minister of Industry and the Minister of Labour for their action in correcting many of the deficiencies in the 2005 amendments. We would also like to thank the officials at Industry Canada for their cooperation in consulting with us over the past year to review and clear up many of the technical and drafting problems with the previous amendments.

In 2005, the Senate Committee expressed concerns with the 2005 amendments as they related to a number of areas, including debtor in possession financing, transfers at undervalue and preferences, executory contracts, governance, and insolvency of other vehicles, including income trusts. Bill C-12 represents a significant step forward in many of these areas.

While great progress has been made, there are still some aspects of the issues with the previous amendments that the Bill does not fully resolve. As professionals who deal with the insolvency system on a daily basis, we understand how it works in practice, particularly with respect to business insolvencies. We have provided below a list of comments on the provisions related to business insolvencies that we recommend should be addressed if that is possible without unduly delaying the amendment process. If that is not possible, the issues noted in these comments should be monitored on an ongoing basis and should be considered as part of the next review of Canada's insolvency legislation.

Discussion Points

Interim Financing

1. In the process of expressly empowering the Courts to authorize interim financing (“DIP Loans”) to reorganizing businesses, some important balancing considerations have not been codified which increases the risk of misuse of the new provisions. The IIC recommends the two following additions to the DIP Loan provisions:

- (a) a requirement (i.e., not just a factor to consider) that before granting a DIP Loan in priority to existing secured creditors, the Courts should use the existing balance of prejudice/limited prejudice test to creditors; and
- (b) that an additional factor be added to the list of factors to be considered by the Court as follows: “Whether the interim financing will enhance the prospect for a going concern solution or rehabilitation through a reorganization or sale that would create more value than a liquidation.”

With these two additions, it should be clear to the Courts that the legislation is intended to validate and codify existing DIP Loan practices in CCAA cases (rather than materially alter them) and to extend these practices to BIA proposal proceedings.

Governance

2. The increased powers given to troubled debtors by the new legislation can facilitate the rescue of troubled businesses, but the existence of those powers also increases the importance of good governance of troubled businesses. The IIC recommends consideration of the following additions to the legislation:

- (a) providing a general due diligence defence for officers and directors with respect to personal statutory liabilities in and during the course of a reorganization proceeding including specific protection for pre-filing obligations not paid by the debtor that are not more than seven days overdue at the time of filing; and
- (b) directing the Court to assess during a reorganization proceeding whether the debtor has established appropriate governance mechanisms (such as establishing an independent board committee and retaining an independent chief restructuring officer), with the Court having the power to appoint an interim manager to replace management or to replace directors if the governance of the debtor is impairing or could impair the process of developing and implementing a going concern solution.

The purpose of the first provision is to make it easier to attract and retain good directors for businesses in distress. The purpose of the second amendment is to direct the Court to oversee management and to give the Court a way to deal with management issues without ending the reorganization process.

Insolvency Administrators

3. The proposed amendments in Bill C-12 to s.14.06 of the BIA that protects receivers and trustees in bankruptcy (“insolvency administrators”) from personal liability for employment and pension commitments made by the debtor were a significant step forward. However, the wording as drafted does not clearly protect insolvency administrators from personal liability in respect of a pension plan if a deficiency in the pension plan arises or increases after the insolvency administrator’s appointment, for example as a result of a decline in value of the assets in a plan because of a decline in the stock market. We recommend that the wording be clarified so that if an insolvency administrator has responsibility for a pension plan its liability is limited to making “normal cost” contributions to the plan with respect to work done for the insolvency administrator.

Executory Contracts

General Provisions

4. The provisions providing for a scheme to deal with executory contracts would be improved by the following amendments:

- (a) providing that the disclaimer of an agreement does not affect any property rights already acquired by the counter-party, such as the right to use personal property leased from the debtor during the term of the lease or to retain the ownership of property when title has passed before the disclaimer;
- (b) expressly providing that when an agreement is assigned, the assignee must agree to assume the obligations to be performed under the agreement in respect of the period after the assignment, and empower the Court when approving an assignment to impose such terms as it sees fit; and,
- (c) confirming that the statutory power to disclaim agreements does not restrict any existing termination rights.

Disclaimer of Agreements

5. While generally the IIC has no objection to the special statutory protections afforded to derivative agreements (“EFCs”), the current scheme when combined with the new section 19 of the CCAA has an important gap. There is no mechanism for the debtor to compromise its exposure under outstanding EFCs if the counter-party does not elect to exercise its power to terminate the EFCs. That omission could make it impossible for some debtors to reorganize. A debtor should be entitled to be able to have its exposure fixed if the counter-party does not elect to terminate within a reasonable time following a reorganization filing.

Collective Bargaining Agreements

6. The IIC continues to have reservations about whether the proposed new scheme for dealing with collective bargaining agreements is workable.

WEPP/Employment Related Statutory Charges

7. It is inappropriate to impose criminal liability on insolvency administrators in respect of compliance with the WEPP, since insolvency administrators are already licensed and regulated. Compliance issues should be dealt with by the OSB exercising its existing regulatory authority.

8. The IIC understands the need to have statutory charges on the assets of a debtor to prevent government funding of the WEPP system from being used excessively. However, in order not to unnecessarily increase the cost of borrowing or to impair access to funding the definition of “working capital” should be amended to refer to inventory and accounts receivable (excluding bank deposits) in the same manner as defined under provincial personal property security legislation. For similar reasons the IIC submits that the new statutory charge for pension plan contributions should similarly apply only to inventory and accounts receivable. Otherwise, multiple lenders to the debtor will have to price and manage the same risks. If each lender reduces the amount it will lend in order to protect itself against the potential statutory charge, that would be less economically efficient than imposing the risk on operating lenders who are in the best position to manage the risk.

Technical Amendments

9. In reviewing the various proposed amendments, the IIC is concerned that some amendments may unintentionally impair the ability of debtors to re-organize or otherwise cause difficulties with the insolvency process. The IIC submits that it would be beneficial if the following amendments were made:

- (a) provide that in a reorganization context, creditors cannot generally set off pre-filing claims against post-filing obligations so the debtors can continue to operate their businesses while attempting to reorganize. By way of example, under current rules a bank that provides banking services may be entitled to seize deposits made after the filing and apply them to pre-filing loans;
- (b) provide that trusts generally can be liquidated under the BIA, in addition to the power to reorganize income trusts;
- (c) in the provisions providing for classification of creditors, provide that in connection with reorganization proceedings the terms of the plan of arrangement or proposal are one of the factors to be considered;
- (d) amend the new CCAA section 6(5) and BIA section 60(1.3) so that any arrears of wages must be paid on plan implementation, not on Court approval. The new financing that a debtor needs to implement a restructuring is normally not available until plan implementation, so the payment should not be required until then. This timing would be consistent with when pension plan arrears are required to be paid;
- (e) amend the proposed CCAA section 6(8) to expressly permit the Court to sanction a CCAA plan that provides for no distributions to a class or to all classes of equity claims even if the plan has not been voted upon or approved by such equity

claimants. This amendment would indirectly permit a Court to approve a plan that provided for distributions to equity claimants if approved by the creditors;

- (f) amend the new s.19 of the CCAA to make it clear that all contingent liabilities can be reorganized under the CCAA and delete the proposed s. 19(2);
- (g) amend the language of CCAA s.48(4) to conform with s.49(3);
- (h) expressly empower the Court to grant vesting orders with respect to sales by national receivers;
- (i) specify in the provisions governing monitors and proposal trustees, that in order to approve a CCAA reorganization plan or a Division I proposal, the Court must receive a report from the monitor or the proposal trustee opining that it is reasonable to expect that any dissenting creditor will not receive less under the plan or proposal than it would receive in a liquidation;
- (j) amend BIA s.95(2) to add a reference to provision of services in order to conform to the amendments made to s.95(1);
- (k) amend BIA s.101.1(1) to add s.38 to the other sections referred to; and
- (l) provide the same treatment for GST claims under CCAA as in a BIA proposal.

3-Year Review

The IIC also recommends that the legislation be reviewed every three years instead of the proposed five year review period. The purpose of the review would be not only to assess how the reforms contained in the current amending legislature are working in practice but also to review the issues that have not been addressed in the Bill at all. It is seven years since the current round of reform began and ten years since the last significant reforms came into effect. Many issues that have emerged or become more important during the intervening years are not dealt with in the current legislation. In order to keep up with the changes in legislation in other jurisdictions, and with the pace of change in the business world, it is important that further amendments be made within the next few years.

Conclusion

We would be pleased to have the opportunity to discuss our recommendations in more detail.