1

Overview of the Canadian Bankruptcy and Insolvency Regime

I. INTRODUCTION

The purpose of this book is to outline, at an introductory level, bankruptcy and insolvency law in Canada, the various avenues of relief for debtors, creditors and other stakeholders and participants, and to provide practical guidance on how to maximize outcomes for the parties involved in the context of an insolvency.

Bankruptcy and insolvency in Canada are complex areas of law composed of a number of complementary and sometimes competing and conflicting pieces of legislation, both federal and provincial, that have developed and evolved over the course of the last century. Through this primer, we will look to understand the basic composition and structure of the Canadian bankruptcy and insolvency regime, as well as the judicial, regulatory and legislative frameworks in which it operates. The chapters are broken down by the major bankruptcy and insolvency themes: bankruptcy, restructurings, receiverships and selected topics that cross all types of insolvency proceedings.

This primer is by no means intended to be a complete review of bankruptcy and insolvency law in Canada, an endeavor that, if undertaken, would span thousands of pages of scholarly work. Nor is this primer intended to be an

in-depth review of the case law. Instead, it is intended to be an introduction to the Canadian regime for non-Canadians who may have an interest in Canadian law. It may also be of interest to those who, as a result of the increasing globalization of the world economy, have, or expect to, come into contact with Canadian bankruptcy and insolvency law and wish to develop a basic understanding of the law and practice.

II. UNDERSTANDING CANADA AND THE CANADIAN INSOLVENCY FRAMEWORK

Before embarking on a review of any particular area of law in Canada, it is important to understand the general legal framework in Canada.

The area in North America that now comprises Canada at one time consisted of colonies of Great Britain and France. By 1867, all of what would become Canada was in the hands of Great Britain, and in that year, a small portion of what is now Canada (namely the current provinces of Ontario, Quebec, Nova Scotia and New Brunswick) were consolidated into the Dominion of Canada pursuant to the British North America Act of 1867 (the "BNA Act"), an Act of the British Parliament that made Canada a dominion within the British Empire with, among other things, the ability to pass its own laws.

The BNA Act did not involve a complete devolution of power to Canada; Great Britain retained a number of powers, including a certain amount of legislative control, full control over foreign policy, and the final say in judicial appeals in Canada.[1] Full control of all legislative powers and the establishment of the Supreme Court of Canada as the final court of appeal in Canada evolved over time and became complete with the Constitution Act of 1982, wherein Canada was finally granted full legal control over its own destiny.

Since confederation, six more provinces joined Canada, resulting in a total of 10 provinces and three territories—each with its own provincial or territorial laws, most being similar, some very different, and very few identical. Like British law,

1 Until 1949, the final court of appeal for Canadian cases was the Judicial Committee of the Privy Council, the highest appeals court in Great Britain for a number of Commonwealth states.

most of Canadian law developed under the common law system—a combination of statute law and case law that developed over time. The Federal government, the three territories and nine of the provinces operate under the common law system. The Province of Quebec, being a former French colony, has retained its civil law system at the provincial level and common law for Federal matters.

A. Division of Powers Between Federal and Provincial Governments

The BNA Act, among other things, created a federal dominion and outlined its federal structure, including the division of powers of state between the Federal government based in Ottawa and the various provincial governments.[2] The power to pass laws dealing with bankruptcy and insolvency was given to the Federal government, and the power to pass laws in relation to property rights (under which creditor and debtor rights would fall) was given to the provincial governments.

The main Federal statutes that flowed from the bankruptcy powers given to the Federal government are the Bankruptcy and Insolvency Act[3] (BIA), the Companies' Creditors Arrangement Act[4] (CCAA), the Winding Up and Restructuring Act[5] (WURA) and the Farm Debt Mediation Act[6] (FDMA). These four statutes, save a few very specific exceptions, collectively represent the bankruptcy and insolvency restructuring laws in Canada. In addition, the recent Wage Earner Protection Program Act[7] (WEPPA), which deals with employee wage areas in the context of a bankruptcy or receivership, completes the current list of the main Federal statutes that deal generally with bankruptcy and insolvency in Canada. Each is discussed in greater detail below and throughout this book.

At the provincial level, each province, having the power to pass laws in relation to property rights, has over time enacted laws in relation to (1) protecting creditors' rights and the appointment of receivers, (2) attacking preferences and

2 Ss. 91 and 92 of the BNA Act ostensibly divide almost all the powers of state between the Federal and provincial governments, respectively.

3 R.S.C. 1985, c. B-3, as amended.

4 R.S.C. 1985, c. C-36, as amended.

5 R.S.C. 1985, c. W-11, as amended.

6 S.C. 1997, c.21, as amended.

7 S.C. 2005, c.47, as amended.

conveyances intended to defeat creditors, (3) registering security interests in both land and personal (or movable) property, and (4) dealing with corporations and the individuals that manage them. Because each province has its own laws, it is beyond the scope of this book to look at the insolvency-related laws in each province. Instead, the laws of the province of Ontario will be reviewed as a guide to provincial law, unless otherwise noted.

B. The Judicial Framework Across Canada

Because of the Federal structure and the division of powers, in Canada there are both Federal courts[8] and courts established by the provinces.[9] The top and final court of appeal in Canada is the Supreme Court of Canada. Contrary to what might be expected, the Federal Court is not necessarily the court for all Federally regulated matters. Federal legislation will stipulate in which court matters falling under the particular statute's purview will be resolved: the Federal Court or the courts of the provinces. In the case of bankruptcy and restructuring matters, they fall to the courts of the provinces.

The courts of the provinces all have a similar overall structure in that in each province, there is a superior court of first instance and a court of appeal, which will represent the highest court in the province. But that is where the similarities end. Each province has its own legislation establishing the court system in the province, the structure and types of courts, and the matters they can hear. Each province establishes its own procedural rules, including the forms and court documents to be used in the respective provincial courts. In addition, each province also has control over the names of its own courts. So, for example, the superior court of first instance in Ontario is the Superior Court of Justice, in British Columbia it is the Supreme Court of British Columbia, and in Alberta it is the Court of Queen's Bench of Alberta.

The result is that even though the BIA is a Federal statute that has equal application across Canada, because court proceedings under the BIA fall to the courts in the provinces, the practical application of the BIA may vary procedurally from province to province. Readers are therefore cautioned that in addition

8 The Federal Court is the court of first instance for a number of Federally regulated matters, such as Federal taxation and admiralty, to name two, with appeals going to the Federal Court of Appeal.

9 Each province has the power to establish and regulate its own court system.

to an understanding of substantive insolvency law, an understanding of the procedural law in each relevant province is also required in order to effectively participate in an insolvency proceeding in Canada.

As noted, the Supreme Court of Canada is the final court of appeal in Canada[10] and hears appeals from all provincial courts of appeal and the Federal Court of Appeal. Parties seeking to appeal Courts of Appeal decisions involving bankruptcy, insolvencies and property rights to the Supreme Court of Canada must seek leave to do so; there is no automatic right of appeal to the Supreme Court with respect to these matters. Until very recently, the Supreme Court very rarely heard bankruptcy and insolvency-related appeals, generally only doing so when there were conflicting courts of appeal decisions. In recent years, however, the number of cases heard has gone up, albeit marginally.

C. The Insolvency Regulatory Framework

Insolvency law and matters are regulated by the Office of the Superintendent in Bankruptcy (OSB), an agency under the Federal Department of Industry Canada with the mandate to supervise the administration of all estates and matters under insolvency legislation. The stated objectives of the OSB are to: (1) maintain an efficient and effective regulatory framework; (2) promote awareness of the rights and responsibilities of the stakeholders in the insolvency system; (3) ensure trustee and debtor compliance with the legislative and regulatory framework; and (4) be an integral source of information on Canadian insolvency matters.

The main tasks of the OSB conducted to meet the stated objectives include:

(a) supervising the administration of estates in bankruptcy, commercial reorganizations, consumer proposals and receiverships under the BIA;

(b) maintaining a publicly accessible record of bankruptcy and insolvency proceedings under the BIA and of proceedings under the CCAA;

(c) licensing private-sector trustees;

10 In 1949, the Supreme Court of Canada was made the highest court in the land, ending the practice of final appeals going to Great Britain.

(d) recording and investigating complaints from creditors, debtors and members of the general public regarding possible wrongdoing by someone involved in the insolvency process under the BIA;

(e) recording and investigating complaints regarding the conduct of monitors under the CCAA;

(f) setting and enforcing professional standards for the administration of estates filed under the BIA; and

(g) promoting awareness of the rights and responsibilities of the stakeholders in the insolvency system.

Throughout this book, in particular in Chapter 2, there will be references to the Official Receiver. The Official Receiver is not a receiver in the ordinary sense; the Official Receiver is a Federal government employee in the OSB who accepts documents filed with the Federal government in connection with bankruptcies and insolvencies and performs other functions listed in the BIA, such as chairing first meetings of creditors and examining bankrupts under oath. There are a number of Official Receivers distributed across Canada.

III. BANKRUPTCY AND INSOLVENCY IN CANADA

In Canada, bankruptcy and insolvency law is focused on the end of a business and the redistribution of assets to creditors,[11] restructurings (which are focused on the compromise or arrangement of debt in accordance with a binding plan that will see a business or individual become solvent again), or creditor-driven proceedings such as receiverships or other debt collection remedies. This book is therefore divided into a chapter on bankruptcy, one on restructurings, one on receiverships, and one on issues that cross all three.

11 Or in the context of a bankrupt individual, bankruptcy is focused on both the redistribution of his or her assets to creditors and with a view toward a financial rehabilitation and fresh financial start.

IV. THE KEY BANKRUPTCY AND INSOLVENCY-RELATED STATUTES

As noted, in Canada there is no one piece of legislation or code that collects into one place all of the laws that affect or have an impact on an insolvent business or individual. Instead, there are a number of laws, both Federal and provincial, that may come into play in any particular case. Some deal with bankruptcy and restructuring, some deal with secured interests, and still others deal with the rights of debtors and creditors and avoidance transactions. The statutes that come into play most often are briefly discussed below and are quoted and noted throughout this primer.

A. Federal Legislation

As noted, the Federal government has the power under the BNA Act[12] to deal with bankruptcy and insolvency. There are five main statutes in Canada that deal with bankruptcy and insolvency.

1. The Bankruptcy and Insolvency Act (BIA)

The BIA deals with three main components: (1) bankruptcies; (2) statutory restructurings known as proposals; and (3) to some extent receivers and receiverships.

The BIA is the only statute in Canada that deals with bankruptcies and is a complete code on the subject. It sets out the procedures for the bankruptcy process, who may go or be put into bankruptcy, the administration of bankrupt estates, the distribution of the bankrupts assets to creditors, and how a person may exit bankruptcy. It sets out the various offenses for which a bankrupt may be prosecuted. Finally, the statute, and the rules and directives issued under it, regulates bankruptcy trustees and their conduct and activities. Bankruptcies are covered in Chapter 2 of this book.

12 The BNA Act, being the British North America Act of 1867, was subsequently renamed the Constitution Act of 1867.

The BIA also deals with statutory restructurings of insolvent persons. Restructurings under the BIA are called proposals and, if successful, can lead to a binding compromise of claims of creditors to whom a proposal is made. A proposal will be successful if it receives sufficient votes at a meeting of creditors and is approved by the court. If a proposal under the BIA fails, the debtor is deemed to have made an assignment into bankruptcy. The proposal process is only available to an insolvent person—either a business entity, such as a corporation or income trust, or an individual. An insolvent person may make a proposal either by filing a proposal at the outset of the proceeding or by filing a notice of intention to make a proposal (a "NOI"), which buys the debtor time to formulate a proposal to creditors. In either case, a statutory stay of proceedings by creditors is imposed and the debtor is given an opportunity to put a proposal to creditors. Proposals are discussed in Chapter 4.

The BIA also deals with receivers and receiverships on several fronts, and it sets out certain minimal reporting obligations, as well as duties and conduct standards for receivers. The BIA also provides for the appointment of an interim receiver (pending the appointment of a full-blown receiver, proposal or bankruptcy). As a result of a recent round of amendments in 2009, the BIA also provides for the appointment of a receiver over a debtor.[13] Each of these is discussed in detail in Chapter 4.

2. The Companies' Creditors Arrangement Act (CCAA)

The CCAA is a restructuring statute for larger insolvent corporations.[14] It was enacted in 1933 and was little used until the early 1980s. It is now a mainstay of restructuring proceedings in Canada. Until the recent amendments that came into force in 2009, the CCAA was very skeletal in nature, granting the court wide latitude on how to allow a debtor company to restructure. It was often referred to as "chapter 11 (referring to chapter 11 of the U.S. Bankruptcy Code) without rules." The CCAA today is significantly more substantial, but

13 Until these amendments, court-appointed receivers (other than interim receivers appointed under the BIA) could only be appointed under provincial legislation, meaning that they could only effectively operate, without further extra-provincial orders, in the appointing province. If the assets of the debtor were in more than one jurisdiction, creditors (or receivers) would have to incur additional cost and expense seeking court orders in other provinces so as to be able to operate effectively in other provinces.

14 More than $5 million in aggregate debt amongst all related filing entities.

still allows for more judicial latitude and discretion than is generally available under the BIA.

Restructurings under the CCAA are commenced by way of court application for what is commonly known as an "initial order." This operates in conjunction with the provisions of the CCAA to set out the ground rules for the debtor and its creditors on how the restructuring proceeding will operate and the basics of what the debtor can and cannot do, with or without prior court approval. An initial order will usually contain a stay of proceedings, establish priority charges, if any, and establish debtor-in-possession funding terms, if any. The initial order will also contain provisions appointing a "monitor" that acts as the eyes and ears of the court, is a source of information for creditors, and assists the debtor in formulating a plan of compromise or arrangement.

As with BIA proposals, once a plan is formulated, it is put to creditors for a vote and, if successful, to the court for approval. If successful, the plan binds all creditors to whom the plan is put. If unsuccessful, unlike in the context of a BIA proposal where there is an automatic bankruptcy, there is no automatic bankruptcy; rather, the stay is lifted and creditors are free to pursue their remedies. CCAA proceedings are discussed in Chapter 3.

3. The Wage Earners Protection Plan Act (WEPPA)

The WEPPA came into force in the summer of 2008 and was designed to deal with the all-too-common problem of employee wage arrears not being paid in the context of a bankruptcy or receivership of an employer. Employee claims in the normal course fall behind secured creditor claims, and where there are insufficient assets in a bankruptcy or insolvency to pay out secured creditors, employee claims would go unpaid.

The WEPPA now gives certain employee wage claims, such as for wages, vacation pay, and severance and termination pay, up to a certain amount, a higher priority than secured creditor claims. In this way, employees who, as a result of a bankruptcy or receivership, find a certain defined portion of their wages unpaid may receive some better recovery than they would otherwise have received in the past. The WEPPA is discussed throughout the book and in Chapters 2 and 4, in particular.

4. The Farm Debt Mediation Act (FDMA)

The FDMA is a low-cost, more informal restructuring statute for farmers. The FDMA is designed to assist farmers who wish to reach a mutually acceptable arrangement with creditors and for a stay of proceedings while the farmer tries to restructure his debts. The FDMA is discussed in Chapter 3.

5. The Winding Up and Restructuring Act (WURA)

The WURA is a specialized restructuring and liquidation statute that only deals with the restructuring and liquidations of certain defined entities, such as banks. Like the BIA and CCAA, it contains a code for procedures on either restructurings or liquidations. Like the CCAA, it provides wide latitude for courts to assist in a restructuring or liquidation. To the extent there is to be a restructuring, the WURA provides, as with the BIA and the CCAA, a procedure for creditor voting on the restructuring plan and for court approval. The WURA is discussed in Chapter 3.

B. Corporate Legislation and Legislation Affecting Corporations and Their Officers and Directors

Each province and the Federal government have their own legislation creating and regulating corporations. In addition to the laws establishing and governing corporations, these statutes impose restrictions on what corporations can do while insolvent or in connections with actions (such as issuing dividends) that would render the corporation insolvent.

Both Federal and provincial legislation will also impose liabilities on officers and directors of a corporation for their actions or inactions with respect to contraventions of the statutes or the failure of the corporation to make certain payments to government and to creditors. Director and officer liabilities are discussed throughout this book and in particular in Chapter 5.

C. Provincial Legislation

As noted above, property rights are within the purview of the provinces. And as a result, laws governing property rights and the interplay and relationships between creditors and debtors are governed for the most part by provincial legislation. Each province also has control over its courts and court systems. As a result, the rules and laws affecting creditors and debtors, both in and outside of bankruptcies and insolvencies, are governed and affected by the particular legislation in each province in which a debtor resides and operates.

In the context of insolvencies, each province will have a number of statutes that may have some impact on debtors, creditors and the officers and directors of the debtors. As it would be impossible to discuss the laws in each province, Ontario's laws will be used to illustrate the concepts discussed in the book unless otherwise noted. Relevant provincial legislation and its impact on debtors and creditors is discussed throughout this book, including Chapter 5, which deals with certain discrete topics that cut across all types of insolvency proceedings.

1. Legislation Establishing the Courts within the Provinces and Provincial Receivers

Each province has legislation establishing the courts within its boundaries and the procedures to be used in those courts. This affects how all insolvency proceedings, including those under Federal jurisdiction as BIA, CCAA and WURA proceedings, are commenced and continued. In addition, the provinces will have their own laws that provide for the appointment of a receiver.

As a result, it is very important for any debtor, creditor or advisor to know and understand the courts in each jurisdiction where the debtor resides or does business, as the particular provincial laws that affect debtor and creditor rights may have an impact on what debtors and/or creditors do when faced with debtor insolvency. Provincial laws and receiverships are generally discussed in Chapters 4 and 5.

2. Personal and Real Property Security Legislation

Each province will also have its own legislation dealing with the taking, registration, perfection and enforcement of security taken, whether it be in respect of land or personal or movable property. For example, in Ontario, the Personal Property Security Act[15] deals with security in relation to personal or movable property, and the Mortgages Act[16] deals with mortgages and charges over real property. The PPSA and its impact on creditors are noted throughout this book. The Mortgages Act is not discussed in this book.

At the Federal level, the Bank Act,[17] among other things, provides for the taking of security by banks. The Bank Act will also not be discussed in this primer.

3. Transaction Avoidance Legislation

Each province will also have one or more laws dealing with protecting creditors from the actions of debtors seeking to put assets out of the reach of creditors. For example, in Ontario, there are several pieces of legislation designed to overturn transactions that are intended to, or have, the result of defeating or hindering creditors. These include the Fraudulent Conveyances Act,[18] the Assignment and Preferences Act,[19] the Bulk Sales Act[20] and the Absconding Debtors Act.[21] Each of these statutes may be used either individually or two or more are collectively used to assist creditors seeking recovery from a debtor that has or is trying to prejudice the ability of creditors to properly recover on debts owing.

15 R.S.O. 1990, c. P-10, as amended.
16 R.S.O. 1990, c. M-40, as amended.
17 S.C. 1991, c.46.
18 R.S.O. 1990, c. F-29, as amended.
19 R.S.O. 1990, c. A-33, as amended.
20 R.S.O. 1990, c. B-14, as amended.
21 R.S.O. 1990, c. A-2, as amended.