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Bankruptcy Reform

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Well publicized amendments to the Federal *Bankruptcy Act* became effective on November 30, 1992. The statute is now known as the *Bankruptcy and Insolvency Act* ("*New Act*"). This article will summarize changes relevant to the practising bar.

1. Receivers and Secured Creditors

Inclusion of the word "Insolvency" in the name of the statute suggests the scope of the statute has been broadened. This is particularly true by the inclusion of *Part XI* governing secured creditors and receivers. Now a secured creditor must give 10 days notice before realizing on security over substantially all the inventory, accounts receivable or other property of an insolvent person used in a business. The notice must be in prescribed form and the notice period cannot be waived in advance. It is interesting to note a secured creditor's realization is not limited to appointment of a receiver, but may also include a foreclosure where the real estate comprises substantially all the assets of the debtor, or appointment of an agent to collect accounts receivable.

Giving the prescribed 10 day notice may reduce the risk of a secured creditor not giving reasonable notice required by the common law before enforcing its security. The 10 day notice period is not required where there is already a receiver appointed for the debtor or where the debtor has made a commercial proposal that does not include the secured creditor.

The *New Act* provides a means for all creditors to receive substantially more information about a debtor who has been placed in receivership. A receiver must within 10 days of his appointment send a notice in prescribed form to all creditors including a list of the amounts owing to each creditor. Creditors are also entitled to a receiver's statement if they request it from the receiver anytime up to six months after the end of the receivership. The statement will include a list of assets with book values and intended plan of action for the receivership. Creditors may also request copies of interim reports and a final report on the results of the receivership.

2. Business Restructurings

One of the most significant changes to the legislation is the strengthening of the provisions related to proposals in bankruptcy in *Part III* of the *Act*. Use of this *Part* has often been referred to in the press as "seeking bankruptcy protection". In recent years insolvent persons seeking to restructure their business rather than see it liquidated through receivership or bankruptcy resorted to the *Companies Creditors Arrangement Act* ("CCAA") which provided a means

Continued on Page 25

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Bankruptcy Reform

Continued from Page 1

to stay actions by secured creditors while the debtor devised a plan of arrangement or restructuring. *Part III* of the old *Act* did not provide a stay against secured creditors but the *New Act* now permits it. Most future restructurings will likely take place under the *New Act* rather than under the CCAA because the *New Act* which sets out clearer but more rigid requirements, will likely prove less expensive. The *New Act* also has a lower threshold for approval (majority of 2/3 of each class of creditors in value rather than 3/4 in value of each class under the CCAA).

Initiating a proposal is straightforward. It requires a consent of a trustee, a list of creditors and a notice of intention to make a proposal in prescribed form to be filed with the official receiver.

The trustee named in the proposal must send a copy of the notice to every creditor and assist the debtor prepare a projected cash flow statement to be filed within 10 days after the notice of intention. The proposal must be filed within 30 days of the notice of intention, but this period may be extended for periods of up to 45 days, although not to exceed in aggregate five months. The trustee must file a report to the court on the proposal. Creditors may apply to court to prematurely end the stay of proceedings prior to filing a proposal, by application proving that the debtor is not acting in good faith and with due diligence, that he will not likely be able to file a viable proposal, that no proposal will likely be accepted by the creditors or the creditors as a whole would be materially prejudiced. Creditors may request an interim receiver be appointed while the insolvent company is preparing a proposal.

Creditors each have one vote per dollar of their claim and are divided into classes for voting. Secured creditors must be divided into classes based on a commonality of interest including nature of their debts, nature and priority of their security, remedies available and the extent to which claims will be paid under their proposal.

If the proposal is accepted by all classes of unsecured creditors by majority in number and 2/3 in value of the claims, the trustee must apply for court approval. The court considers whether the proposal is reasonable, whether it is calculated to benefit the general body of creditors and whether the debtor has committed any bankruptcy offences.

If the proposal is refused by the unsecured creditors or by the court, the insolvent business is deemed to be placed in bankruptcy. The proposal must provide for payment of preferred creditors before unsecured creditors, for payment of arrears of employees wages up to $2,000 and expenses of $1,000 and for payment of all employee source deductions within six months of court approval.

Commercial leases can be significantly affected by proposals, as a landlord may not terminate a lease or accelerate rent following notice of intention or proposal filed by a tenant, unless a court order is obtained. An insolvent business may on the other hand repudiate a lease between the time of filing the notice of intention and filing the proposal, upon 30 days notice to the landlord. The landlord in turn, may apply within 15 days of receiving such notice to set aside the repudiation if the landlord can satisfy the court the insolvent business cannot make a viable proposal or that a viable proposal could be made without repudiation of leases. If the lease is repudiated, the landlord must be paid, within six months of approval of the proposal, compensation equal six months rent or rent for the remainder of the term, whichever amount is lower.

There are also protective provisions restricting third parties from terminating licensing agreements or discontinuing public utilities as a result of the proposal, unless a court order is obtained on the basis that significant financial hardship would be caused to such suppliers.

3. Thirty-Day Goods

A right for unpaid suppliers to repossess goods supplied to an insolvent purchaser, similar to the right which has existed in Quebec for hundreds of years, has been included in the *New Act*. The right is limited to very specific circumstances. The purchaser must be in bankruptcy or receivership and the supplier must give a written demand for repossession in the prescribed form not later than 30 days after delivery of the goods. The goods must be in the possession of the purchaser, trustee or receiver, be identifiable, be in the same state as they were on delivery, not have been resold at arm's

length and not be subject to any agreement for sale at arm's length. The priority of the right of repossession, as against the debtor's right to deal with goods if he has filed a proposal or a receiver to deal with goods which might be subject to the notice, will likely be considered by the courts. There is a summary procedure to apply to a court for directions on such issues.

The requirements that goods be identifiable and in the same state as when delivered are relaxed where the goods supplied are agricultural products, products of the sea, lakes and rivers, or products of aquaculture. In these cases the goods must have been delivered within 15 days of the bankruptcy or receivership. Where established, a claim of farmers, fisherman and aquaculturists creates a prior charge on all inventory of the purchaser.

4. Debts Owing to the Crown

The *New Act* abolishes the preferred claim status of all liabilities owing to the Crown for bankruptcies occurring after November 30, 1992. Instead, the Crown will rank as an unsecured creditor, except where the claims are for source deductions of income tax, CPP or UIC. These will continue to be recognized as deemed trusts. However the *New Act* will recognize the validity of prior secured Crown interests if they are registered under an established registry system where priorities based on the order of registration prior to bankruptcy.

5. Consumer Bankruptcies

Individual bankrupts will receive an automatic absolute discharge from bankruptcy after nine months unless a creditor or the Superintendent of Bankruptcy opposes the discharge. Streamlined procedures apply to bankruptcy estates under $5,000. A trustee in bankruptcy is entitled to garnish a wider range of income earned by a debtor during his bankruptcy for the benefit of creditors. Counselling of bankrupts is now mandatory.

6. Consumer Proposals

A simpler procedure has been introduced for consumer debtors to make a proposal under the *New Act*. A consumer debtor is defined as an individual with debts of $75,000 or less (excluding his principal residence mortgage). Consumer proposals are not binding on secured creditors but create a stay of proceeding against other creditors. A meeting of creditors is held only when requested by 25 per cent or more of the creditors with proven claims. A court hearing is only necessary if requested by interested parties within 30 days of the meeting or deemed meeting of creditors. Rejection by the creditors or the court of a proposal or subsequent default under a consumer proposal does not automatically place the consumer in bankruptcy, although the consumer may have no alternative but to file an assignment in bankruptcy. As well, agreements cannot be cancelled or payments accelerated by reason only that the consumer proposal is filed. This includes leases and supplies by public utilities.

7. Environmental Liabilities

The *New Act* states trustees are not responsible under environmental legislation for damage not caused by their acts or omissions. This should rectify most situations where a trustee would not agree to act where potential environmental claims existed for which the trustee could have been personally liable.

8. General Comments

The foregoing is a summary of the significant changes introduced in the *New Act*. There are numerous limitation periods within which notices, actions, objections, and applications must occur. Solicitors should take care to ensure any action that ought to be taken is taken within the appropriate limitation period, although the court has a discretion to extend such periods. There will likely be numerous judicial interpretations of novel provisions in the *New Act*, including when a creditor is likely to be "materially prejudiced", when a commercial proposal should be declared terminated on application by a creditor, when a lease repudiation will be satisfied on application by a landlord, and the extent of suppliers' repossession rights when the bankrupt makes a proposal, when a receiver is appointed or when third party purchasers of the goods are involved. These issues should create an interesting and innovative period for trustees and lawyers dealing with insolvent individuals and businesses.