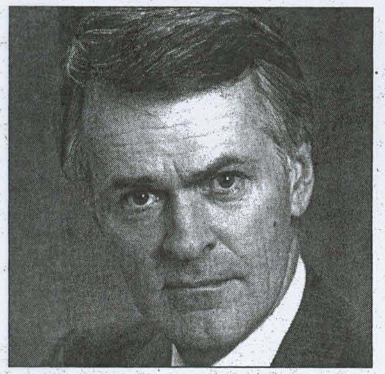
Practitioners continue to debate the merits of Bill C-55 before it comes into force ...

... but will the reforms do any good?

By Bruce Leonard



In case you missed it, Canada passed new bankruptcy legislation on the eve of Parliament's being dissolved in November. The legislation was rushed through Parliament and the Senate in haste despite dozens of amendments that had been offered, including many that were suggested by the drafters of the legislation. In a political compromise to get the legislation passed, it was agreed that the new legislation would not become effective until at least June 30. The delay was an acknowledgment on the part of both the Liberals and the Conservatives that the legislation was premature and should be considered further by Parliament to fix the problems it was expected to create.

It is still too early to tell whether the necessary changes to the new legislation will actually be made. In the tradition of hastily passed legislation, we should probably expect the worst, i.e. that the badly needed changes will not be made and that the worst new insolvency legislation in a generation will be inflicted on the Canadian public and the Canadian economy. This article highlights some of the more obvious problems with the legislation so that everyone affected will have the opportunity to begin to prepare for it, if they can.

The most obvious financial dislocation will be provided by a super-priority for arrears of wages which gives wage claims priority over secured creditors holding security on current assets (*viz,* banks). A similar super-priority has been created for arrears of pension contributions which will have priority over secured creditors on *all* assets of the debtor (*viz*, everyone). Wage arrears as a practical matter have not been a problem in Canadian practice but, no matter, the situation is going to be fixed whether it is a problem or not.

As if that isn't bad enough, a new bureaucratic organization will be created called the Wage Earner Protection Program (the "WEPP"). The WEPP will "promptly" pay employee arrears and then will become subrogated to the employees' super-priority clams over secured creditors. This, of course, creates a government agency with super-priority liens on the most important assets of the beleaguered debtor. Where a secured creditor's collateral is devoured in the course of placating the WEPP, the secured creditor's vaporized collateral is replaced by a simple preferred claim in the debtor's insolvency which, of course, will rank behind the claims of all other secured creditors. There seems to be no intention of providing the secured creditor whose collateral has been expropriated by the WEPP with any kind of compensatory treatment and the WEPP will apparently be able to wreak its havoc on any secured creditor it chooses.

The economic fallout from the creation of major super-priority claims over existing security has not yet been assessed. There is no sign that any empirical research has been done to determine the extent of the harm to the credit system that these new credit changes will present. In terms of proportionality, very few businesses actually go bankrupt but every operating loan to every active business will now be reduced by the amount necessary to margin for these new super-priority claims. This inevitably will lead to significant contractions of credit for small and medium-sized businesses which, after all, employ most of the workforce. All of this social engineering in the bankruptcy process will benefit the only relative handful of employees who suffer wage arrears on the bankruptcy of their employer.

As to unionized employees, any thoughts that Canada would allow for the modification of union contracts when the union won't agree to changes and the existing contract is imperilling a reorganization have been firmly squelched. Reorganizing companies will not be able to alter collective agreements no matter what harm will result to other stakeholders of the business. There was a thought that the CCAA might have permitted this sort of thing but the legislation provides certitude by indicating that it won't happen – ever.

Corporately, the courts will have the power to remove directors who are "impairing" the prospects of a successful reorganization and to replace them with those who won't. The courts have also been given the rather weird jurisdiction to replace a director who is "acting inappropriately as a director", whatever that means. Directors, consequently, will need to avoid "inappropriateness" at all costs, whatever it is. There will be a debate about the jurisdiction of the federal government to control the corporate governance of provincially incorporated companies on the grounds of "inappropriateness". Again, the evils that these changes are intended to banish are not readily apparent to the naked eye.

After several years of *Sarbanes-Oxley* in the United States and enormous lawsuits and settlements based on allegations of conflict of interest and disregard of corporate obligations and duties, the government inserted a tiny bit of transparency into Canada's bankruptcy system. The current system does not prohibit multiple, or, even, conflicting, roles. Most systems do not stand for these kinds of multiple representations but the Canadian government is apparently satisfied with most of them and the only significant change made to increase transparency in the bankruptcy process in Canada was to remove the ability of a company's auditors to act for its credi-

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tors as a monitor in the company's CCAA proceedings, a practice which, mercifully, was already in decline before the legislation was introduced. Canada's bankruptcy legislation will still lack even an "independence" requirement that insolvency representatives should be free of conflicts of interest. In transparency, Canada has a long way to go, but, evidently, no legislative desire to go there.

Internationally, it is claimed that Canada has adopted the UNCITRAL *Model Law on Cross-Border Insolvency*, which provides an international set of procedures for recognition of foreign insolvency proceedings and foreign insolvency representatives. To date, nine countries have adopted the *Model Law* including, most recently, the United States, and the U.K. is poised to do so. The folks in Ottawa, for inexplicable reasons, took it upon themselves to devise their own form of Model Law which doesn't resemble any other adaptation of the Model Law anywhere in the world. In dealing with cross-border cases abroad, Canadian insolvency representatives will be hard-pressed to persuade foreign courts that Canada has adopted the Model Law.

Those who hope that Canada can have the proper insolvency legislation it deserves have had their hopes dashed on previous occasions and again this time. There is only a slim hope that a Parliamentary Committee review of the shortcomings of the new legislation will produce modest improvements in it. *The Lawyers Weekly* will keep readers up-to-date on developments.

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