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Micro, Small and Medium Enterprise (MSME) Insolvency in Canada

Report for the Marketplace Policy Branch of Industry Canada

Dr. Janis P. Sarra

March 30, 2016

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Micro, Small and Medium Enterprise (MSME) Insolvency in Canada

March 30, 2016

Janis Sarra¹

INTRODUCTION

Insolvency law is broadly recognized as an essential tool in well-functioning economies.² A balance of mechanisms that allow for timely and effective liquidation, but also for a “fresh start” for individual entrepreneurs and the rehabilitation of viable businesses, tends to enhance creditor recoveries and lender confidence.³ Credible restructuring schemes can ensure that viable businesses with a going-forward business plan can survive, in turn preserving jobs, supply contracts, customer goodwill, and contributing more generally to economic stability.⁴ Globally, concern has been expressed that while insolvency systems are evolving, there continue to be barriers to effective restructuring for micro, small and medium enterprises (“MSME”). To that end, the World Bank will soon convene a task force to examine these issues.⁵ Insolvency law is broadly recognized as an essential tool in well-functioning economies.⁶ In Canada, it is generally acknowledged that the insolvency system works relatively well, particularly for

¹ Dr Janis P Sarra, Distinguished University Professor and Professor of Law, Allard School of Law, University of British Columbia. My sincerest thank you to the 53 trustees and ten loan officers that participated in the survey. My thanks to Mike Cremers, who created the relevant graphs with the data, and to Joanne Forbes and Caitlyn Gregg, who assisted in conducting the interviews with trustees. I deeply appreciate the advice of Jean-Daniel Breton of Ernst & Young Montréal on the draft of this report. Thank you also to the OSB, particularly Sarah Gaudet, who prepared the data to share for purposes of this study, and to the Canadian Association of Insolvency and Restructuring Professionals for its assistance in finding trustees to interview. The view expressed here are mine alone.

² The Financial Stability Board, which monitors the global financial system, recognizes “Insolvency and Creditor Rights” as one of fourteen policy domains “designated as key for sound financial systems”, in which internationally recognized best practice standards are considered as “deserving of priority implementation depending on country circumstances.” Financial Stability Board, *Key Standards for Sound Financial Systems*; www.fsb.org/what-we-do/about-the-compendium-of-standards/key_standards.

³ European Commission, “Declaring your enterprise to be an SME”, Commission communication — Model declaration on the information relating to the qualification of an enterprise as an SME, *Official Journal C 118*, 20/05/2003 P. 0005 – 0015, [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52003XC0520\(02\)](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52003XC0520(02)).

⁴ Ronald Davis, Stephan Madaus, Alberto Mazzoni, Irit Mevorach, Riz Mokal, Barbara Romaine, Janis Sarra, and Ignacio Tirado, *The Modular Approach to MSME Insolvency* (January 2016 partial draft, on file with author).

⁵ The author is a member of this Task Force, which will be convened in the autumn of 2016. The G20 has also identified MSME insolvency as an issue that needs to be addressed. See also Davis *et al*, *ibid* for a comprehensive analysis of the challenges globally.

⁶ The Financial Stability Board, which monitors the global financial system, recognizes “Insolvency and Creditor Rights” as one of fourteen policy domains “designated as key for sound financial systems”, in which internationally recognized best practice standards are considered as “deserving of priority implementation depending on country circumstances.” Financial Stability Board, *Key Standards for Sound Financial Systems*; www.fsb.org/what-we-do/about-the-compendium-of-standards/key_standards.

consumer debtors and large enterprises,⁷ but there is some question as to whether the system adequately serves MSME.

This study was undertaken for Industry Canada Marketplace Policy Branch as the Canadian Government looks to the next round of possible legislative reform.⁸ The study undertook a qualitative empirical examination of MSME filings under the *Bankruptcy and Insolvency Act (BIA)*,⁹ and undertook a survey of 53 licenced insolvency professionals and ten distressed loans officers, in order to understand the challenges that face Canadian MSME as they slide into financial distress. What is clear from the data that were obtained is that while the current system is fairly well-functioning on the “personal fresh start” aspects of MSME insolvency, it has significant barriers, both in terms of cost and administration, such that liquidations are occurring and value and employment is being lost where there is business potential going forward.

The study concluded that it is timely to undertake some amendments to the *BIA* to address MSME insolvency. In particular, I suggest that there is need for a streamlined approach to bankruptcy of micro and small businesses (“MSE”), so that MSE can access formal proceedings. Such a process would counter the current trend of secured creditors simply realizing on their assets without regard to other creditors’ interests. The streamlined approach should be administratively simpler and eliminate the need for repeated court appearances, unless creditors object. The MSE proposal process could include the following elements. The federal government should consider empowering the licensed insolvency trustee to extend the initial stay for a limited period, if notice has been given to creditors and there is no objection. Any objections would be dealt with by the court. I also suggest that the streamlined proposal process should be available to sole proprietors, whether or not incorporated, micro and small businesses. Consideration should be given to extending the streamlined process to medium enterprises, and if so, to the conditions under which such a streamlined process would be available.

Access to a MSE proposal process could be defined by a combination of numbers of employees and a cap of liabilities, the latter being much higher than the current limit under Division II of the *BIA*. Authority should be vested in the trustee to undertake specified tasks in order to facilitate agreement between the debtor and creditors of proposals, eliminating the requirement to seek supplemental orders from the court on appointment.

There should be an ability to make a proposal to creditors without the need to hold a meeting of creditors, unless a specified percentage of creditors, such as 25%, request it. Proposals in a streamlined process should provide for at least the liquidation value of creditors’ claims in the proposal. If, after a specified period, creditors have expressed support for the proposal in terms of a specified number of creditors holding a specified percentage of the debt, the proposal should be deemed approved, without having to

⁷ The recent trend of primarily liquidations for larger enterprises is, unfortunately, beyond the scope of this article, but merits study.

⁸ Specifically, the Marketplace Policy Branch of Industry Canada requested that the report: Examine access to and utilization by Canadian small and medium enterprises of the formal insolvency process, including trying to ascertain the reasons for the decline in filings; undertake a qualitative study of data from the Office of the Superintendent of Bankruptcy (“OSB”) on the reasons for SME insolvency and types of debt; survey a representative sample of trustees and five to ten loan officers, to identify the perceived barriers to accessing and utilizing *BIA* proceedings; generate policy questions and considerations on the issue of SME insolvency proceedings.

⁹ *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, as amended, *Loi sur la faillite et l’insolvabilité*, LRC 1985, c B-3, en sa version modifiée.

seek court approval. Any objections would still be dealt with by the court. The government could consider making the threshold for deemed approval of a MSE proposal a simple majority of creditors in both number and value of the claims. There should be time limits placed on Canada Revenue Agency's time to respond to the proposed proposal, after which it is deemed to have approved the proposal.

I suggest that the *BIA* proposal process should still be subject to a six-month limit in the normal case, but the court should be authorized to extend the six-month limit for all types of proposals under the *BIA* in circumstances that the court considers appropriate. There should be a streamlined process to cure a temporary default in the terms of a MSE proposal, including deeming it cured where creditors receive notice and do not object. For all filings, there is a need to modernize the notice provisions under the *BIA*, including allowing for electronic notice; and to modernize voting processes under the *BIA*, including the use of new technologies to allow for electronic voting by creditors. There is also need for the creation of a simplified standard form claims process that can be expedited where there is no dispute in the amounts owed to creditors.

Whether or not the government decides to create a streamlined process, it should consider raising the current cap on liabilities for access to Division II *BIA* proposals or exempting equipment used in trade or professional practice from the cap, so that individuals with a higher level of debt are not forced into the administratively costly Division I proposal process. The government should also consider expanding the current "tools of the trade" exemption to incorporated sole proprietorships and micro businesses. An innovative idea that was raised during the survey was that the government should consider raising the exemption amount to file GST/HST to 50,000 CAD or 60,000 CAD from the current 30,000 CAD that has been in place since the 1980s. Such a move would reduce both administrative and cost burdens on MSE.

Finally, there is an urgent need for funding and availability of education and skills building for individuals commencing new businesses. Modest amounts allocated to counselling for individual debtors after insolvency or bankruptcy fails to acknowledge that there is need for early intervention, perhaps at the time the business is being registered, to provide basic skills training on managing finances and understanding early financial risks to the new business.

In summary, as this study highlights, there needs to be a mechanism that allows for a more streamlined and accessible process to deal with the financial distress of micro and small businesses without the loss of safeguards for creditors, including employees. Moreover, it is important to note that this study did not canvass the views of any other stakeholder groups, such as trade unions, pensioner groups and trade suppliers, and the legislative reform process should engage with a much broader community regarding a range of possible options for legislative reform of the treatment of MSME insolvency.

A brief explanation of what the Marketplace Policy Branch of Industry Canada commissioned. It requested that the report:

- Examine access to and utilization by Canadian small and medium enterprises of the formal insolvency process, including trying to ascertain the reasons for the decline in filings.
- Undertake a qualitative study of data from the Office of the Superintendent of Bankruptcy ("OSB") on the reasons for SME insolvency and types of debt.
- Survey a representative sample of 30 to 50 bankruptcy trustees and five to ten loan officers, to identify the perceived barriers to accessing and utilizing *BIA* proceedings.
- Generate policy questions and considerations on the issue of SME insolvency proceedings.

The report has four parts. First, it introduces some of the challenges facing MSME within the existing legislative framework, briefly examining the Canadian system and the framework in the United States and United Kingdom. Part II then undertakes a qualitative examination of the filings of a sample of 200 corporate insolvencies in 2015, in order to try to understand the reasons for insolvency, types of debt, and outcomes of proposals. Part III examines the results of a survey of 53 licensed insolvency trustees and ten loan officers across Canada, in terms of their professional advice and experience with respect to the barriers to small and medium enterprise insolvency proceedings. Finally, Part IV makes some suggestions regarding possible amendments to the insolvency framework that are deserving of public policy discussion and consideration going forward.

I. MICRO, SMALL AND MEDIUM ENTERPRISE INSOLVENCY

1. Overview

Micro, small and medium businesses are very important to the Canadian economy, as a major source of jobs, development of new technologies and economic growth. As of 2012, small businesses employed 7.7 million employees in Canada, comprising 69.7% of the total private sector labour force.¹⁰ In the decade leading to 2012, small businesses created more than 100,000 jobs on average annually, accounting for almost 78% of all private jobs created in that period.¹¹ Industry Canada has also reported that 98% of the 1.08 million small businesses in Canada in 2013 had 1 to 99 employees.¹² At the same time, small businesses also frequently fail in the marketplace, particularly micro businesses;¹³ so timely access to the insolvency process is an essential part of the regulatory framework.

Small businesses usually need to secure loans with the personal assets or personal guarantees of the principals, blurring distinctions between personal and business liability. This convergence of personal and business debt means that debtors may have access to effective liquidation or rehabilitation schemes only if they fit within very specific criteria. In Canada, there is a highly streamlined mechanism for micro businesses to use Division II “consumer” proposal provisions of the *Bankruptcy and Insolvency Act (BIA)*, which are accessible to non-incorporated self-employed individuals and sole proprietors whose debts are less than 250,000 CAD, excluding a mortgage or hypothec on the individual’s principal residence.¹⁴ But this mechanism is not available where the individual has incorporated the business; and the existing process for rehabilitation under the *BIA* can be prohibitively expensive for micro and small businesses. Any legislative reform must balance facilitating rescue of viable enterprises with a timely and effective mechanism for the MSME to be liquidated, giving their principals a chance for a fresh start.

¹⁰ Industry Canada, *Key Small Business Statistics August 2013*, at 8; [www.ic.gc.ca/eic/site/061.nsf/vwapi/KSBS-PSRPE_August-Aout2013_eng.pdf/\\$FILE/KSBS-PSRPE_August-Aout2013_eng.pdf](http://www.ic.gc.ca/eic/site/061.nsf/vwapi/KSBS-PSRPE_August-Aout2013_eng.pdf/$FILE/KSBS-PSRPE_August-Aout2013_eng.pdf), most current available to December 2015.

¹¹ *Ibid* at 10.

¹² Industry Canada, *Key Small Business Statistics*, *supra* note 10.

¹³ For statistics in 2008-2009, see *ibid* at 14.

¹⁴ *Bankruptcy and Insolvency Act*, RSC 1985, c. B-3, as amended (*BIA*). Consumer debtor is defined in Division II, s. 66.11 of the *BIA* as: ““consumer debtor” means an individual who is bankrupt or insolvent and whose aggregate debts, excluding any debts secured by the individual’s principal residence, are not more than \$250,000 or any other prescribed amount”.

There are numerous ways to define small and medium enterprises (“SME”): annual gross or net revenue, value of assets and/or liabilities, value of sales, legal structure, or number of employees, to name a few.¹⁵ Industry Canada defines small business as employing 5 to 99 employees.¹⁶ It defines medium enterprises as employing over those numbers and up to 499 employees.¹⁷ I use those definitions for purposes of the discussion here. That would leave “micro” businesses to be defined as 1 to 4 employees. In contrast, the OSB, another federal government department, defines businesses differently for purposes of reporting statistics relating to Canada’s insolvency legislation. A business is “any commercial entity or organization other than an individual, or an individual who has incurred 50 percent or more of total liabilities as a result of operating a business.”¹⁸ Hence an individual consumer debtor is characterized as a business for purposes of the *BIA* where his or her business debts comprise 50% of total debts. These definitions do not align with the *BIA*, which does not expressly use the language of size of enterprise, but rather, defines persons, insolvent persons, debtors, consumer debtors, and corporations for purposes of the legislation.¹⁹ Access to particular mechanisms under the statute are based on personal identity and size of debt. It merits note that the lack of alignment of definitions between the OSB and Industry Canada has resulted in some problems with data analysis.

A definitional issue in respect of thinking about micro businesses is that of sole proprietorship. Many jurisdictions define “business” as having at least one employee on the payroll.²⁰ Many small businesses are sole proprietorships, and some are incorporated and some are not. Usually incorporation of the micro business occurs because someone has advised the individual business person that he or she will better protect his or her personal assets if the business is incorporated. While, generally, that is true in terms of protection from personal liability for tort claims against the incorporated entity, contract counter-party

¹⁵ For a discussion, see Ronald Davis, Stephan Madaus, Alberto Mazzoni, Irit Mevorach, Riz Mokhal, Barbara Romaine, Janis Sarra, and Ignacio Tirado, *The Modular Approach to MSME Insolvency* (January 2016 partial draft, on file with author).

¹⁶ Market Framework Policy Branch, Industry Canada, 2015. In the service industry, it defines small as employing 5 to 49 employees.

¹⁷ *Ibid.*

¹⁸ OSB, *Insolvency Statistics in Canada—August 2015*, www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br03457.html#tbl3. Consumer insolvency is defined as an individual for whom 50 percent or more of total liabilities relate to consumer goods and services.

¹⁹ The definitions, except for that of consumer debtor contained in footnote 9 above, are contained in s. 2 of the *BIA*. “Insolvent person” is defined as “a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and (a) who is for any reason unable to meet his obligations as they generally become due, (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due”; “person” is defined as: ““person” includes a partnership, an unincorporated association, a corporation, a cooperative society or a cooperative organization, the successors of a partnership, of an association, of a corporation, of a society or of an organization and the heirs, executors, liquidators of the succession, administrators or other legal representatives of a person”; “debtor” is defined as: ““debtor” includes an insolvent person and any person who, at the time an act of bankruptcy was committed by him, resided or carried on business in Canada and, where the context requires, includes a bankrupt”; “bankrupt” is defined as “a person who has made an assignment or against whom a bankruptcy order has been made or the legal status of that person”; and “corporation” “means a company or legal person that is incorporated by or under an Act of Parliament or of the legislature of a province, an incorporated company, wherever incorporated, that is authorized to carry on business in Canada or has an office or property in Canada or an income trust, but does not include banks, authorized foreign banks within the meaning of section 2 of the *Bank Act*, insurance companies, trust companies, loan companies or railway companies.”

²⁰ See for example, Industry Canada, *Key Small Business Statistics*, *supra* note 10 at 7.

claims, etc., the reality is that micro and small businesses (“MSE”) cannot get financing for their business unless they can guarantee the debt with their personal assets.²¹ Such guarantees effectively blur the distinction between personal and business debt. Industry Canada’s definition of “business” is one that has at least one employee on the payroll, submitting deductions to Canada Revenue Agency (“CRA”) for such employees.²² It does not count, as part of its small business statistics, sole proprietorships that do not employ anyone or that employ people as contractors or contract employees.²³

Bankruptcy liquidation is the most prevalent outcome of MSME insolvency in Canada, which in many cases is the most effective resolution to the financial distress. However, in other cases, liquidation can result in loss of value to creditors and debtors. Reasons for MSME financial distress can include a lack of management skills or corporate governance mechanisms to deal with business viability and downturns in the market, which, in turn, can result in untimely filing of insolvency proceedings, failure to prevent further downward spiralling of finances, failure to deal with operational and financial failures, and a lack of resources to hire effective expertise to deal with the insolvency.²⁴

There has been a continuing decline in business filings under the *BIA* for the past decade. In 2014, the insolvency rate of businesses commencing proceedings pursuant to the *BIA* were 1.4 per 1,000 businesses, down from 4.8 per 1,000 ten years prior.²⁵ As will be discussed in Part III, trustees and loan officers attribute this decline largely to the costly administrative burden for addressing MSME insolvency under the *BIA*.

Industry Canada reports that survival rates for small and medium-sized businesses in Canada decline over time.²⁶ For example, approximately 85% of businesses that enter the marketplace survive for one full year, only 70% survive for two years, and only 51% survive for five years. On average, from 2002 to 2008, about 99,000 new small businesses were created in Canada each year; the number of exits annually was approximately 86,000 from 2002 to 2004; and then rose to 95,000 in 2008.²⁷

2. Treatment of MSME Insolvency in Canada

The *BIA* provides a mechanism for bankruptcy of businesses. An insolvent debtor can make an assignment in bankruptcy or a creditor or group of creditors can make an application for a bankruptcy order in respect of a debtor, in order to have a licensed insolvency trustee appointed to liquidate the debtor’s assets for the benefit of the creditors. For individuals, bankruptcy offers an opportunity for a fresh start financially.

²¹ Davis *et al*, *supra* note 10.

²² Industry Canada, *supra* note 15.

²³ *Ibid* at 5.

²⁴ Davis *et al*, *supra* note 10.

²⁵ Industry Canada, “Annual Business Insolvency Rates by Province and Economic Region”, www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01821.html.

²⁶ Industry Canada, *Key Small Business Statistics*, *supra* note 10, defined as enterprises with less than 250 employees for purposes of this statistic.

²⁷ *Ibid* at 12.

For incorporated businesses, bankruptcy usually entails winding-up the company and liquidating all the assets, in order to pay out creditors based on the hierarchy of claims set out in the statute. In this respect, bankruptcy proceedings are an effective means of realizing on valuable assets, such as accounts receivable, for the benefit of the bankruptcy estate, and ensuring an expeditious and fair distribution of the proceeds. Sometimes the corporate shell is preserved if there is value to its continuation, although it appears not often for micro and small enterprises. Sometimes the bankruptcy involves a going-concern sale of all or part of the business, aimed at preserving value of the business, jobs and customer goodwill. Most often, however, the bankruptcy proceeding means the end of the incorporated business. The *BIA* also provides a series of interim mechanisms such as appointment of receivers or interim receivers to take conservatory and other measures for the protection of assets that creditors can lay claim to because of the firm's financial distress. The process is administrative, rather than largely court-based, as it is in some other jurisdictions.

For individuals, including business sole proprietors, automatic discharge is available for first-time bankrupts after they make an assignment or are ordered into bankruptcy, either in nine months or 21 months, depending on whether the bankrupt has surplus income, unless it is opposed by a creditor, the trustee, or the Superintendent of Bankruptcy.²⁸ Automatic discharge is available for second-time bankrupts, either in 24 months or in 36 months after the date of bankruptcy, depending on whether the bankrupt has surplus income, unless, in that period, an opposition to the discharge has been filed.²⁹ This “fresh start” is a positive aspect of the bankruptcy provisions, allowing, in some cases, the sole proprietor to salvage his or her business activity, retain customers and a quantity of tools used in performance of the business. The wind-up of an incorporated business, particularly small or micro business, can also result in a type of fresh start for the individuals that are principals of the entity, as they can move their employment activities elsewhere. However, because of personal guarantees and potential director liabilities, in many cases, the director may also have to file for personal bankruptcy, creating double the process and costs.³⁰

In addition to its liquidation and debt collection mechanism, the *BIA* provides a scheme for proposals, in order to allow an insolvent business an opportunity to restructure its affairs to become financially viable.³¹ A proposal can include a “proposal for a composition”, where creditors agree to accept less than full repayment or agree to an extension of time; and/or a scheme of arrangement in terms of alteration of

²⁸ Section 168.1, *BIA*. The provisions specify: 168.1 (1) Automatic discharge —Subject to subsections (2) and 157.1(3), the following provisions apply in respect of an individual bankrupt other than a bankrupt referred to in subsection 172.1(1): (a) in the case of a bankrupt who has never before been bankrupt under the laws of Canada or of any prescribed jurisdiction, the bankrupt is automatically discharged (i) on the expiry of 9 months after the date of bankruptcy unless, in that 9 month period, an opposition to the discharge has been filed or the bankrupt has been required to make payments under section 68 to the estate of the bankrupt, or (ii) on the expiry of 21 months after the date of bankruptcy unless an opposition to the discharge has been filed before the automatic discharge takes effect; and (b) in the case of a bankrupt who has been a bankrupt one time before under the laws of Canada or of any prescribed jurisdiction, the bankrupt is automatically discharged (i) on the expiry of 24 months after the date of bankruptcy unless, in that 24 month period, an opposition to the discharge has been filed or the bankrupt has been required to make payments under section 68 to the estate of the bankrupt, or (ii) on the expiry of 36 months after the date of bankruptcy unless an opposition to the discharge has been filed before the automatic discharge takes effect.

²⁹ *Ibid.*

³⁰ Davis *et al*, *supra* note 10.

³¹ Proposal provisions are found in Part III of the *BIA*. All insolvent debtors can access the proposal provisions in Division I of Part III, but only consumer debtors (insolvent natural persons whose debt load is within a specified threshold) have access to the proposal provisions in Division II of Part III.

debt and equity structure. The premise is that by reducing the amount of debt, renegotiating payment terms or terminating costly contracts, the business can turn around its financial affairs and become viable again.

Proposals can be made under the Division I proposal provisions of the *BIA*, or, in some circumstances, under the Division II consumer proposal provisions.³² Division I proposals are available for insolvent individuals and incorporated businesses. The mechanism is frequently used where the debts are more than 250,000 CAD, or the business is incorporated and thus Division II is not available. The Division I proposal provisions are highly codified, and there is supervision by a licensed insolvency trustee, creating some certainty and predictability for both debtors and creditors. The proposal process can, in many instances, offer a timely means of devising a workout plan for the financially troubled business. The process is generally timelier and less expensive than proceedings under the *Companies' Creditors Arrangement Act (CCAA)*.³³ The six month maximum period for such proceedings gives creditors some certainty that a proposal will be devised within that fixed period or the debtor will become automatically bankrupt.

Often the debtor needs time to prepare a proposal and the legislation allows the debtor, under the Division I proposal provisions, to file a "notice of intention to make a proposal", affording the debtor a period to devise a viable going-forward business strategy. On filing either a proposal or a notice of intention to make a proposal, there is an initial automatic stay of 30 days on creditors moving to enforce their claims. The stay lasts while the proceedings are continuing. During the notice of intention period, the court has the authority to extend the stay for periods up to 45 days to a maximum of six months in aggregate (including the initial 30 day period). The proposal trustee has a wide discretion to assist the debtor in developing a proposal, including assessing the debtor's ability to make a proposal, assisting the debtor with mandatory filing requirements and consulting creditors. Corporate officers or the sole proprietor debtor retain control of the business assets and operations during the proposal process; and the trustee that assists with development of the proposal acts in a monitoring and advisory capacity, as opposed to taking over control of the enterprise or assets. The *BIA* proposal proceedings are used for individuals and for all sizes of business, from sole proprietorships, to partnerships, to corporations of various sizes.³⁴ The mandatory stay affords the debtor "breathing space", in the sense that creditors cannot move to realize on their claims during this period; but the debtor must file a projected cash flow statement with prescribed representations with a trustee and the trustee must report on the reasonableness of the statement.

Under Division I of Part III of the *BIA*, when the debtor has a proposal to present to creditors, a meeting is called, which allows creditors to vote on the proposed plan. If creditors approve the proposal by two-

³² Sections 66.11-66.4, *BIA*. Essentially, a Division II proposal is available where the debtor is an individual and his or her debts, excluding the mortgage or hypothec on his or her personal residence, are less than 250,000 CAD. The relatively low threshold of 250,000 CAD makes it difficult to capture individuals whose business may have failed, and for which the process under Division I of Part III of the *BIA* may be too onerous. There could be some distinctions regarding joint consumer proposals, where the debt load, based on the OSB's interpretation, could end up being higher.

³³ *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, as amended (*CCAA*).

³⁴ A proposal is defined in s 2 of the *BIA* as: "'proposal" means (a) in any provision of Division I of Part III, a proposal made under that Division, and (b) in any other provision, a proposal made under Division I of Part III or a consumer proposal made under Division II of Part III and includes a proposal or consumer proposal, as the case may be, for a composition, for an extension of time or for a scheme or arrangement; ("*proposition concordataire*" ou "*proposition*")."

thirds in dollar value of voting claims and majority in number of creditors, the proposal is brought to the court for approval. The court assesses the fairness and reasonableness of the proposal and whether it meets the statutory requirements, and then decides to approve the proposal or not. Generally, if the proposal meets the statutory requirements, has garnered the requisite creditor support, and the trustee, creditors or the OSB are not opposing it, the court will approve it.

The *BIA* sets out specific requirements of the proposal, in terms of the priority of claims that must be observed in completing the proposal, the fees and expenses of the trustee, specified Crown claims, and specified amounts owing to employees and pension plans where the debtor is a business. Since Division I does not require mandatory counselling of the debtor, the proposal may or may not address the heart of the problems that caused the financial distress. An advantage of Division I proposals is that they can include disclaimer of leases and contracts;³⁵ and the statute makes express provision for interim financing for the business on a going-forward basis.³⁶

If the creditors do not support the proposal in the requisite numbers and value, it results in a deemed assignment in bankruptcy, creating a streamlined mechanism that does not require an order of the court. If the court refuses to approve the proposal, there is a deemed assignment in bankruptcy.³⁷

If there is a default in the performance of any provision of the proposal, the court has the authority to annul a proposal. It can also annul the proposal where it is subsequently discovered that the court's approval was obtained by fraud, or where it appears that the debtor cannot continue the proposal without injustice or undue delay.

The consumer proposal provisions of Division II of Part III of the *BIA*³⁸ allow a much more streamlined summary process. They are available to insolvent individuals whose debts are less than 250,000 CAD, excluding a mortgage or hypothec on the individual's principal residence. The provisions were enacted as a mechanism to deal with smaller estates on a more cost-effective and expedited basis. A Division II proposal must be made to creditors generally, but is not binding on secured creditors that have not filed a proof of claim. Division II proposals were designed as consumer proposals; however, they are available to self-employed individuals and sole proprietors that fall within the criteria mentioned above.

³⁵ Section 65.11 and 65.2, *BIA*.

³⁶ Section 50.6, *BIA*. The reality is that interim financing is not accessed very often because of the difficulty and cost in finding interim financing, the fact that the usual lenders do not want to prime each other, and the fact that the proposal would likely be doomed if the sole secured creditor is strongly against it.

³⁷ Section 61(2), *BIA* specifies: (2) Non-approval of proposal by court — Where the court refuses to approve a proposal in respect of an insolvent person a copy of which has been filed under section 62, (a) the insolvent person is deemed to have thereupon made an assignment; (b) the trustee shall, without delay, file with the official receiver, in the prescribed form, a report of the deemed assignment; (b.1) the official receiver shall issue a certificate of assignment, in the prescribed form, which has the same effect for the purposes of this Act as an assignment filed under section 49; and (c) the trustee shall, within five days after the day the certificate mentioned in paragraph (b) is issued, send notice of the meeting of creditors under section 102, at which meeting the creditors may by ordinary resolution, notwithstanding section 14, affirm the appointment of the trustee or appoint another licensed trustee in lieu of that trustee.

³⁸ See sections 66.11 to 66.4, *BIA*.

Division II proposal proceedings are commenced by the debtor obtaining the assistance of an administrator³⁹ in preparing the proposal and providing the administrator with the prescribed information on the debtor's current financial situation. The duties of the administrator are set out in the statute. The administrator investigates the debtor's property and financial affairs in order to assess with reasonable accuracy the debtor's financial situation and the cause of insolvency. The administrator provides counselling in accordance with directives issued by the OSB; prepares a proposal; and files a copy of the proposal, signed by the debtor, with the official receiver. Within ten days following, the administrator prepares and files with the official receiver a report on the results of the investigation; the administrator's opinion as to whether the proposal is reasonable and fair to the debtor and his or her creditors and whether the debtor will be able to perform the proposal; a condensed statement of the debtor's assets, liabilities, income and expenses; and a list of the creditors whose claims exceed 250 CAD.⁴⁰ A Division II proposal must provide for the payment of preferred claims; and for the payment of all prescribed fees and expenses of the administrator related to the proposal proceedings and of any person providing counselling. The proposal must also set out the manner of distributing dividends. A proposal typically takes three to five years to complete the payment schedule, but must be completed within five years.⁴¹

Division II proposals are streamlined because of some of their “deemed approved” features. The administrator sends a copy of the proposal and the report to creditors, along with a claims form and a statement explaining that a meeting of creditors will be called only if the official receiver directs the administrator to call a meeting of creditors within 45 days, or if creditors having an aggregate of at least 25% in value of the proven claims request a meeting.⁴² In most cases, no meeting of creditors to vote on the proposal is necessary. Creditors have up to 45 days to consider whether to accept or reject the proposal. If creditors do not respond, they are considered to have accepted the proposal.⁴³ If a sufficient number of creditors accept the proposal, it is binding on the debtor and creditors. Where, at the expiration of the 45 day period, no obligation has arisen to call a meeting of creditors, the proposal is deemed accepted by the creditors. No court hearing is required, unless the administrator receives a request from the official receiver or any other interested party within 15 days of the acceptance or deemed acceptance of the proposal; and failing such request, the proposal is deemed approved by the court. The debtor goes through two mandatory counselling sessions. The provisions are silent on CRA payroll deemed trust claims. Trustees’ fees are based on a tariff.

³⁹ See section 66.11 BIA. The administrator has to be a trustee or another person appointed or designated by the Superintendent of Bankruptcy to administer consumer proposals. Currently, only trustees act as administrators of consumer proposals.

⁴⁰ Section 66.14, *BIA* specifies: Duties of administrator —The administrator shall, within ten days after filing a consumer proposal with the official receiver, (a) prepare and file with the official receiver a report in the prescribed form setting out (i) the results of the investigation made under paragraph 66.13(2)(a), (ii) the administrator’s opinion as to whether the consumer proposal is reasonable and fair to the consumer debtor and the creditors, and whether the consumer debtor will be able to perform it, and..(iv) a list of the creditors whose claims exceed two hundred and fifty dollars; and (b) send to every known creditor, in the prescribed form and manner, (i) a copy of the consumer proposal and a copy of the statement of affairs referred to in paragraph 66.13(2)(d),

⁴¹ Section 66.12(5), *BIA*.

⁴² Section 66.15, *BIA*.

⁴³ Section 66.18 (1), *BIA* specifies: Where consumer proposal deemed accepted —Where, at the expiration of the forty-five day period following the filing of the consumer proposal, no obligation has arisen under subsection 66.15(2) to call a meeting of creditors, the consumer proposal is deemed to be accepted by the creditors.

Hence, the proceedings are highly streamlined and cost effective, saving time and resources in terms of creditors' meetings and court appearances where creditors and the official receiver do not object to the proposal. When the proposal is fully performed, the administrator submits a certificate of full performance to the debtor and the official receiver, and the debtor is thereupon discharged from all debts that can be discharged.⁴⁴

If the proposal is rejected by creditors, the stay under the *BIA* is no longer in effect and creditors can move to enforce their claims, but there is no deemed bankruptcy. If a proposal is accepted and the debtor later fails to comply with the terms of the proposal, the court, on application, can annul the proposal.⁴⁵ A Division II proposal is deemed annulled where payments under the proposal are to be made monthly or more frequently and the debtor is in default to the extent of an amount equal to three payments; or where payments under a proposal are to be made less frequently than monthly and the debtor is in default for more than three months on any payment.⁴⁶ The exception to the deemed annulment is where the court has previously ordered otherwise or where an amendment to the proposal is filed before the deemed annulment. The court also may annul a proposal where it appears to the court that the debtor was not eligible to make a consumer proposal when the proposal was filed; where the proposal cannot continue without injustice or undue delay; or where the approval of the court was obtained by fraud.

On annulment of a Division II proposal, creditors have a claim against the debtor for the amount owed to them before the proposal, minus any amount the debtor paid them during the proposal. If the debtor was bankrupt when the proposal was made and the court subsequently annuls the proposal, the debtor is reinstated as a bankrupt on the date of the annulment.

The provisions under the *BIA* thus set out different processes for the business debtor, depending on whether or not the particular debtor can fit within the criteria of the specific provisions.

3. Treatment of MSME Insolvency Elsewhere

The treatment of MSME insolvency appears to be a growing issue worldwide. The economic activities of MSME are significant to national and regional economies globally. For example, there are approximately 20 million MSME in the European Economic Area.⁴⁷ MSME are a major source of jobs and economic growth, in particular, their potential for utilizing new technologies.⁴⁸ In the United States, small and medium-sized enterprises⁴⁹ make up 99% of all firms, employ over 50% of private sector employees, and

⁴⁴ Sections 66.28, 66.38 and 178, *BIA*

⁴⁵ Section 66.3, *BIA*.

⁴⁶ Section 66.31, *BIA*.

⁴⁷ European Commission, "Declaring your enterprise to be an SME", Commission communication — Model declaration on the information relating to the qualification of an enterprise as an SME, *Official Journal C 118*, 20/05/2003 P. 0005 – 0015, [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52003XC0520\(02\)](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52003XC0520(02))

⁴⁸ *Ibid.*

⁴⁹ Defined in their study as firms with fewer than 500 employees, Shahin Firoozmand, Philip Haxel, Euijin Jung, and Kati Suominen, "State of SME Finance in the United States in 2015", Tradeup and Nexttrade Group, March 2015.

generate 65% of net new private sector jobs.⁵⁰ Kushnir *et al* report that there are 125 million formal MSME in 132 countries for which data are collected by the International Finance Corporation (“IFC”), including 89 million in emerging markets.⁵¹ The data collected in most jurisdictions cover only the “formal”⁵² registered sector,⁵³ and it is important to note that informal MSME, particularly in emerging countries, often outnumber formal MSME.⁵⁴ Formal MSME are more common in high-income economies, but in low-and middle-income economies, MSME density is rising at a faster pace.⁵⁵ The overwhelming majority of formal MSME globally, 83 percent, are micro enterprises.⁵⁶

Just as MSME are significant contributors to the global economy, they also fail in significant numbers. A US study found that in 1999, 80% of US firms that filed for bankruptcy reported assets under \$1 million, and 88% reported having fewer than 20 employees.⁵⁷ The OECD has observed that MSME are particularly vulnerable to macroeconomic and financial shocks, reporting that MSME insolvencies in Denmark, Italy, Spain, and Ireland exceeded 25% in 2007-2008.⁵⁸ Thus, insolvency resolution regimes that are responsive to the needs of MSME are particularly important.

Of significance for MSME globally are both the formal legal rules and informal societal rules and practice norms that affect entrepreneurs, including the design of bankruptcy laws, the structure of capital markets, and the perception of stigma related to personal responsibility.⁵⁹ Cost-effective insolvency proceedings can encourage inefficient firms to exit, encourage greater entrepreneurial activity and new firm creation, and can result in greater returns to creditors.⁶⁰ Yet one World Bank Research Paper suggests that a survey on debt enforcement in 88 countries indicates that bankruptcy procedures are time-consuming, costly and inefficient in being able to preserve the business as a going concern; that in only 36 percent of countries, the business is preserved as a going concern; and an estimated 48 percent, on average, of the business’ value is lost in debt enforcement.⁶¹ Timely resolution of financial distress can reduce uncertainty

⁵⁰ *Ibid* at 2.

⁵¹ Khrystyna Kushnir, Melina Laura Mirmulstein and Rita Ramalho, “Counting MSMEs Across the World”, IFC, www.ifc.org/msmecountryindicators. This database is current as of August 2010 and updates and expands on the January 2007 “Micro, Small, and Medium Enterprises: A Collection of Published Data”, www.ifc.org/msmecountryindicators.

⁵² By “formal” is meant recognized within the regulatory structures of a country, such as for taxation purposes, *ibid*.

⁵³ *Ibid*, except for 16 economies where data are available.

⁵⁴ For example, in India in 2007, there were fewer than 1.6 million registered MSME and 26 million unregistered MSME. *Ibid* at 2.

⁵⁵ *Ibid*.

⁵⁶ *Ibid*, the authors defining micro as 1 to 9 employees.

⁵⁷ E Warren, J L Westbrook, “Financial characteristics of business in bankruptcy.” (1999) *American Bankruptcy Law Journal*, 73: 499–589.

⁵⁸ Organization for Economic Co-operation and Development, “The Impact of the Global Crisis on SME and Entrepreneurship Financing and Policy Responses”, 2009 (“OECD”).

⁵⁹ S Lee, M W Peng, and JB Barney, “Bankruptcy Law and Entrepreneurship Development: a real options perspective”, (2007) *Academy of Management Review*, 32(1): 257–272; M W Peng, “Institutional transitions and strategic choices”, (2003) *Academy of Management Review*, 28(2): 275-296.

⁶⁰ Elena Cirmizi, Leora Klapper, and Mahesh Uttamchandani, “The Challenges of Bankruptcy Reform”, Policy Research Working Paper 5448, The World Bank Development Research Group Finance and Private Sector Development Team, 2010, at 4.

⁶¹ *Ibid* at 6.

for entrepreneurs, creditors and management, and improve assets value and transparency.⁶² Lee *et al* observe that a well-functioning MSME insolvency regime can make clear the downside risk of a venture, in turn increasing the number and variety of people pursuing entrepreneurial activities.⁶³ It can benefit lenders because of the certainty in recovery rules, in turn increasing confidence in lending. The World Bank has observed that effective insolvency systems enhance predictability and thus lender confidence in loan recovery on default, which encourages more lending and leads to financial inclusion for more businesses.⁶⁴ The World Bank Group *Doing Business* report for 2014 found that among 38 selected indicators/measures of the regulatory and institutional environment, the recovery rate in resolving insolvency was the single most valuable measure.⁶⁵

There is no globally accepted definition of MSME. As noted in the introduction, across jurisdictions there have been numerous ways in which states have defined MSME. The chart below illustrates several approaches:

⁶² *Ibid* at 5.

⁶³ Lee, *et al*, *supra* note 51.

⁶⁴ The World Bank Group, *Doing Business Series*, “*Doing Business 2014 – Understanding Regulations for Small and Medium-Size Enterprises*”, accessible at www.doingbusiness.org/reports/global-reports/doing-business-2014.

⁶⁵ *Ibid*, citing Kraay and Tawara (2014).

Chart 1: Definitions of Micro, Small and Medium Enterprises, 2016

Region	Micro/Small	Medium
European Union	Small is less than 50 employees and turnover ≤€ 10M or balance sheet total of ≤€ 10M. Micro is less than 10 employees and turnover ≤€ 2M or balance sheet total of ≤€ 2M	Medium is less than 250 employees and turnover ≤€ 50M or balance sheet total of ≤€ 43M.
United Kingdom	Small: meets two or more of the following requirements— Turnover not more than £5.6M. Balance sheet total not more than £2.8M. Number of employees 50 or less. Micro: not defined.	Meets two or more of the following requirements— Turnover not more than £22.8M. Balance sheet total not more than £11.4M. Number of employees 250 or less.
United States	Aggregate contingent liquidated secured and unsecured debts not more than \$2,490,425 (excluding debts owed to affiliates or insiders) and does not include any member of a group of affiliated debtors that has aggregate debts greater than \$2,490,425 (excluding debt owed to affiliates or insiders). The \$2M number in the <i>Bankruptcy Code</i> is adjusted tri-annually. Micro: not defined	Not defined
Canada	Small: employing 5 to 99 employees, or in the service industry, employing 5 to 49 employees. Micro: employing 1 to 4 employees	Medium: employing 50 to 499 employees
World Bank	Small: employing 5 to 30 employees Micro: employing 1 to 4 employees	Medium: employing 21 to 100 employees

Sources: European Commission, 2014; UK *Companies Act*, c. 46; US *Bankruptcy Code*; Canada, Market Framework Policy Branch, Industry Canada, 2015; World Bank, 2014, current to February 1, 2016

Ardic *et al* found that the most common definitions used by regulators are based on the number of employees, sales and/or loan size. The most common among the three is the number-of-employees criterion.⁶⁶ The OECD countries report that MSME with less than 250 employees employ two-thirds of the formal work force.⁶⁷ Of 68 countries for which Ardic *et al* had data, 50 countries use the number-of-employees criterion, and 29 out of these 50 also use the other two criteria.⁶⁸ A total of 41 regulators use maximum sales value criteria and 15 use maximum loan value criteria to define an SME.⁶⁹

⁶⁶ Oya Pinar Ardic, Nataliya Mylenko., Valentina Saltane, “Small and Medium Enterprises A Cross-Country Analysis with a New Data Set”, The World Bank Financial and Private Sector Development Consultative Group to Assist the Poor, Policy Research Working Paper 5538, January 2011 at 6-8.

⁶⁷ *Ibid*, citing Beck *et al*, 2008b; Dietrich, 2010.

⁶⁸ *Ibid*.

⁶⁹ *Ibid* at 8.

i. Small and Medium Enterprise Insolvency in the United States and United Kingdom

Industry Canada asked for any lessons that could be discerned from the treatment of SME insolvency in the United States (“US”) and United Kingdom (“UK”). While there is a special regime for small business reorganization in the US, there is not one specifically in the UK. Moreover, other than references to the fact that the processes in both countries are expensive and often end in liquidation, there is a paucity of accurate information or empirical data on their effectiveness, and neither appear to be held up in the literature as models for an effective procedure.

The US *Bankruptcy Code* specifies “small business debtors”, it does not refer to MSME or SME. The relevant definitions are in 11 U.S.C. § 101:

11 U.S.C. § 101(51C) The term “small business case” means a case filed under chapter 11 of this title in which the debtor is a small business debtor.

11 U.S.C. § 101(51D) The term “small business debtor”—

(A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning or operating real property or activities incidental thereto) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than \$2,000,000 (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor; and (B) does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than \$2,000,000 (excluding debt owed to 1 or more affiliates or insiders).

The amount of secured and unsecured debt to qualify as a small business under the US *Bankruptcy Code* adjusts every three years. The 2,000,000 USD limitation above in the *Bankruptcy Code* is now 2,490,425 USD, and this cap will adjust again on April 1, 2016. Bankruptcy Rule 1020 governs how to determine whether a debtor is a small business debtor and how a small business reorganization case is to be commenced.

Rule 1020. Small Business Chapter 11 Reorganization Case

(a) Small Business Debtor Designation. In a voluntary chapter 11 case, the debtor shall state in the petition whether the debtor is a small business debtor. In an involuntary chapter 11 case, the debtor shall file within 14 days after entry of the order for relief a statement as to whether the debtor is a small business debtor. Except as provided in subdivision (c), the status of the case as a small business case shall be in accordance with the debtor's statement under this subdivision, unless and until the court enters an order finding that the debtor's statement is incorrect.

(b) Objecting to Designation. Except as provided in subdivision (c), the United States trustee or a party in interest may file an objection to the debtor's statement under subdivision (a) no later than 30 days after the conclusion of the meeting of creditors held under §341(a) of the Code, or within 30 days after any amendment to the statement, whichever is later.

(c) Appointment of Committee of Unsecured Creditors. If a committee of unsecured creditors has been appointed under §1102(a)(1), the case shall proceed as a small business case only if, and from the time when, the court enters an order determining that the committee has not been sufficiently active and representative to provide effective oversight of the debtor and that the debtor satisfies all the other

requirements for being a small business. A request for a determination under this subdivision may be filed by the United States trustee or a party in interest only within a reasonable time after the failure of the committee to be sufficiently active and representative. The debtor may file a request for a determination at any time as to whether the committee has been sufficiently active and representative.

(d) Procedure for Objection or Determination. Any objection or request for a determination under this rule shall be governed by Rule 9014 and served on: the debtor; the debtor's attorney; the United States trustee; the trustee; any committee appointed under §1102 or its authorized agent, or, if no committee of unsecured creditors has been appointed under §1102, the creditors included on the list filed under Rule 1007(d); and any other entity as the court directs.

Section 1116 describes the basic duties of a small business debtor, with a series of statutory requirements for filing a Chapter 11 *Bankruptcy Code* proceeding:

11 U.S. Code § 1116 - Duties of trustee or debtor in possession in small business cases

In a small business case, a trustee or the debtor in possession, in addition to the duties provided in this title and as otherwise required by law, shall—

(1) append to the voluntary petition or, in an involuntary case, file not later than 7 days after the date of the order for relief—

(A) its most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return; or

(B) a statement made under penalty of perjury that no balance sheet, statement of operations, or cash-flow statement has been prepared and no Federal tax return has been filed;

(2) attend, through its senior management personnel and counsel, meetings scheduled by the court or the United States trustee, including initial debtor interviews, scheduling conferences, and meetings of creditors convened under section 341 unless the court, after notice and a hearing, waives that requirement upon a finding of extraordinary and compelling circumstances;

(3) timely file all schedules and statements of financial affairs, unless the court, after notice and a hearing, grants an extension, which shall not extend such time period to a date later than 30 days after the date of the order for relief, absent extraordinary and compelling circumstances;

(4) file all postpetition financial and other reports required by the Federal Rules of Bankruptcy Procedure or by local rule of the district court;

(5) subject to section 363(c)(2), maintain insurance customary and appropriate to the industry;

(6)

(A) timely file tax returns and other required government filings; and

(B) subject to section 363(c)(2), timely pay all taxes entitled to administrative expense priority except those being contested by appropriate proceedings being diligently prosecuted; and

(7) allow the United States trustee, or a designated representative of the United States trustee, to inspect the debtor's business premises, books, and records at reasonable times, after reasonable prior written notice, unless notice is waived by the debtor.

Hence while the provisions for small businesses under the US *Bankruptcy Code* are less onerous than for other debtors filing under Chapter 11, the US legislation is highly codified and places numerous obligations on the small business debtor. There are also costs associated with unsecured creditors' committees and court appearances.

In the United Kingdom, the vast majority of businesses are micro and small enterprises; and micro businesses, defined as having 1 to 9 employees, constitute 95% of the private sector, with small firms

employing 10–49 employees comprising a further 2%.⁷⁰ There have been few empirical studies on small business insolvency in the UK.

The UK legislation does not specifically use the term MSME. However, a company voluntary arrangement (“CVA”)⁷¹ is a vehicle for SME to restructure, rather than to liquidate through bankruptcy. The CVA can be undertaken with or without a moratorium, what we refer to as a stay in Canada, and can be coupled with administration or be a stand-alone CVA.⁷² Unlike informal arrangements where debtor companies and their creditors come to a mutually acceptable agreement, the CVA involves the assistance of an authorized insolvency practitioner and requires court approvals at various stages.⁷³ Cook *et al* found that SME experiencing temporary financial difficulties were likely to succeed in a CVA only if they had strong financial resources and good management.⁷⁴

Interviews with the UK Insolvency Service and several UK practitioners suggest that the CVA process can be beneficial for medium and large enterprises as much more responsibility devolves to the insolvency professional and there is reduced court time; but it is not well suited to micro and small businesses because of the significant administrative costs. CVA are largely used for liquidations, as often the debtor has waited too long before filing or seeking the advice of an insolvency professional. One advantage of the system is an early assessment by the insolvency professional of the possibility of a restructuring and an early liquidation decision if the business is not viable. In this respect, practitioners thought it was more accountable to creditors; the liquidation decision largely rests with the insolvency professional, thus saving legal expenses and court time. There was also some observation that in the UK, financial reports are generally better for all businesses, which can expedite the decision to liquidate or not on the commencing of a CVA.

One study found a significant failure rate for CVA in terms of meeting the policy objectives of preserving going-forward businesses.⁷⁵ Frisby and Walters, in a study commissioned by the UK Government, observe that the underlying rationale of the CVA is that it is aimed at offering creditors a better return than they

⁷⁰ BIS (Department for Business, Innovation and Skills) (2011), *SME business barometer: August 2011*: www.bis.gov.uk/assets/biscore/enterprise/docs/s/11-p75c-sme-business-barometer-august-2011. BIS (Department for Business Innovation and Skills) (2012), *Business population estimates for the UK and the regions*: www.bis.gov.uk. See also Eurofound, *Restructuring in SME: United Kingdom*, 2012.

⁷¹ UK *Insolvency Act*, 1986, chapter 48, Part I Company Involuntary Arrangements. The *Insolvency Act*, 1986 does not define small business, the definition is found in the UK *Companies Act*, 2006.

⁷² Sandra Frisby and Adrian Walters, “Preliminary Report to the Insolvency Service into Outcomes in Company Voluntary Arrangements”, 2012, report commissioned by UK Insolvency Services. They observe that the CVA with moratorium procedure was introduced for eligible companies in order to remedy a perceived weakness in the traditional CVA procedure, in that any creditor could take enforcement action against the company thus destroying the proposal’s chances, but three years after being put in place, the moratorium was not being widely used. *Ibid* at 10.

⁷³ The Insolvency Service, *Insolvencies in the Fourth Quarter 2012*, Statistics release, 4 February 2013: <http://webarchive.nationalarchives.gov.uk/20140311023846/http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201302/index.htm>. Insolvency Service (2013b), *Guide to bankruptcy: When-Where-How-What*, Department for Business Innovation and Skills, London: www.bis.gov.uk/insolvency/Publications/publications-by-theme/insolvency-publications; G Cook, N Pandit, and D Milman, “A resource-based analysis of bankruptcy law, SMEs and corporate recovery”, (2011) *International small business journal*, Vol. 30, No.3, Sage Publishing, at 275–293.

⁷⁴ Cook *et al*, *ibid*.

⁷⁵ Frisby and Walters, *supra* note 67. They examined over 500 CVA in 2006, documenting 13 types of outcomes.

would realize if some other form of insolvency procedure were commenced in relation to the debtor company.⁷⁶ There is also the possibility that trade creditors might retain a customer for the future. Frisby and Walters suggest that if creditors determine they will get at least what they would receive in liquidation, they have little to lose by agreeing to a CVA proposal: any payments into the CVA will be held exclusively for them, and if the CVA does not deliver the proposed return, they are entitled to prove for the balance and receive a dividend through the subsequent realization of the debtor's assets. Frisby and Walters note that the main danger to creditors in this respect is that the CVA is prematurely terminated and that the company has depleted assets that would have been available to creditors in a liquidation or administration. However, they found it impossible to quantify how often such losses occur from the government data available. Frisby and Walters found that in 49% of the cases, creditors received no return at all from the CVA, but in almost a quarter of the cases, unsecured creditors received half or more of their pre-CVA debt.⁷⁷ They found that the average cost of a CVA proceeding was £25,368,⁷⁸ which is approximately 48,000 CAD, primarily for the costs of the insolvency professional. Frisby and Walters found that only a small percentage of all CVA, about 14%, carried on business after the proceedings, of which 83% in the sample were small businesses.⁷⁹ They conclude that the CVA may represent a form of exit rather than rehabilitation.⁸⁰

One mechanism that is aimed at preventing delays in disclosing insolvency is the director liability provisions in the UK, which require that once a director is aware the company is insolvent, the director must stop the company from carrying on business or is liable for the debts incurred. The provision is aimed at preventing prejudice to creditors. Second, the UK has a directors' disqualification provision; the insolvency professionals report on the ability of each director and can recommend that they not be allowed to be a director. However, there are mixed views as to the effectiveness of these provisions.

Hence, neither the US nor the UK offer a model for a streamlined and expeditious process for MSME insolvency, although there are policy discussions in the UK regarding whether or not a special regime is required for small businesses. The next part undertakes a qualitative analysis of some Canadian data, in order to try to better understand what goes on in MSME insolvency in Canada.

II. THE OSB SAMPLE DATA ON BUSINESS INSOLVENCY PROCEEDINGS

1. Methodology

Industry Canada requested a qualitative analysis of SME insolvencies. The OSB generated a randomized sample drawn from regions across Canada of 200 corporate business files (100 bankruptcies, 100

⁷⁶ *Ibid* at 20.

⁷⁷ *Ibid* at 37.

⁷⁸ For the purposes of the database, costs comprise, for the most part, the fees of the nominee/supervisor of the arrangement, but where applicable included legal fees associated with the agreement, and any bonds, statutory advertising costs, stationary and postage costs, insurance costs and travel costs incurred and paid by the supervisor/nominee, and any irrecoverable value added tax ("VAT"). *Ibid* at 26-28.

⁷⁹ *Ibid* at 8.

⁸⁰ The authors acknowledged that their data revealed more questions and limitations than conclusions and that considerably more research is necessary. *Ibid*.

proposals) where the maximum number of employees during the 12 months prior was between 5 and 100 employees, thus falling within the “small” definition of business. The data contained the following information: type and quantum of liabilities; maximum number of employees during the past 12 months; preferred creditors for wages, rent, etc., as indicated on List C of Form 78 Statement of Affairs Business Bankruptcy / Proposal; and total return to creditors.⁸¹ This part examines the types of liabilities, compares debt to assets, and examines the declared reasons for insolvency.

The OSB also provided statistics on successful completion and failure of business proposals closed in the past two years, including reasons for failure and time to close.⁸² Time to close is calculated as the time between when the estate was filed and the closing date, presented below as average time to close and counts by bands. Also provided were a randomized sample of 100 individual business SME Division II proposals and a randomized sample of 25 individual business Division I proposals, with the following information: reasons for insolvency from Form 79;⁸³ type and quantum of liabilities; maximum number of employees during the past 12 months;⁸⁴ and total return to creditors, as indicated on the dividend sheet. The OSB also generated some information on court-appointed receiverships from 2009-2014.⁸⁵

The tables and graphs in this part were developed using the OSB data, as well as some information from Industry Canada where noted. Overall, while the data are interesting and offer insights as to the issues facing insolvent MSME, they are not sufficient to draw definite conclusions that could inform potential legislative reform. However, when coupled with the responses from the trustee and loan officers surveys discussed in Part III below, they are helpful in understanding some of the challenges for MSME insolvency.

2. Bankruptcies - Type of Debt

For small enterprise bankruptcies, unsecured debt is a significant portion of debt. Overall, the sample of 100 corporate bankruptcies indicates that unsecured debt comprised 73% of all liabilities at filing, as illustrated in Graph 1 below.

⁸¹ BKHQRA-2808 Corporate filings, Office of the Superintendent of Bankruptcy, 10 December 2015. Due to some large data points, we recalculated all data sets without outliers, on file with author. To determine the outliers, we set the z-score to 2.68 as per the standard used in statistics. The resulting data showed very little change to the median, but significant changes to the mean.

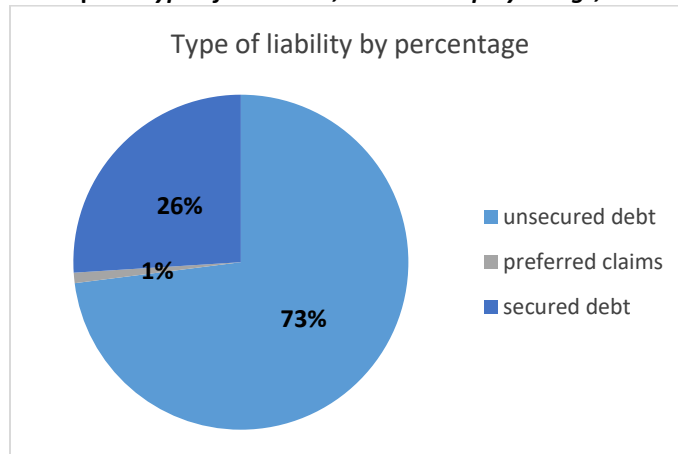
⁸² BKHQRA-2808 Proposal Outcomes, Office of the Superintendent of Bankruptcy, 10 December 2015.

⁸³ Reasons for financial difficulty are provided in text format as the response to Question 14 "Give reasons for your financial difficulties" on Form 79 Statement of Affairs. An individual business may choose to file either a Form 78 or a Form 79 Statement of Affairs.

⁸⁴ BKHQRA-2808 Division II and BKHQRA-2808 Division I, Office of the Superintendent of Bankruptcy, 10 December 2015.

⁸⁵ BKHQRA-2808 Receiverships DRAFT Statistics on Court appointed receiverships from 2009-2014, Office of the Superintendent of Bankruptcy, 10 December 2015.

Graph 1: Type of Liabilities, 100 Bankruptcy Filings, 2015



Source of data: Office of the Superintendent of Bankruptcy, December 2015

The mean amount of unsecured debt was 682,566 CAD and the median 180,529 CAD, as indicated in the summary data for the 100 bankruptcy cohort in Table 1 below. Unfortunately, the way in which data are reported does not allow for an analysis of the breakdown of unsecured debt, in terms of type of debt such as credit card debt or operating loans, and receiving the names of creditors did not assist in undertaking this analysis. Due to some large data points, we recalculated the unsecured debt data set without outliers, resulting in a mean secured debt of 395,357 CAD and a median of 179,938 CAD.⁸⁶ While there was almost no change to the median, it significantly changed the mean.

Secured debt for the 100 sample of corporate bankruptcies comprised 26% of the liabilities at filing. The mean secured debt was 242,260 CAD and the median 20,000 CAD. The low median indicates that there were a number of corporate insolvencies in which the amount of secured debt was quite low, considerably lower than unsecured debt. Here again, due to some large data points, we recalculated the secured debt data set without outliers, resulting in a mean secured debt of 168,544 CAD and a median of 17,566 CAD.⁸⁷ Thus there was little change to the median, but significant change to the mean. With or without the outliers, it reveals that there is a huge range of debt within this cohort of bankruptcies.

Also indicated in Table 1, total statutorily “preferred claims”, including employee wage claims, comprised less than 1% of total liabilities on filing. We were not able to accurately separate employee compensation claims from other claims such as rent in the preferred claim category from the way that OSB organizes its data, although we tried from the names of creditors listed. Nonetheless, if all preferred claims comprised such a small percentage of total liabilities, it is clear that wage claims did not comprise a significant portion of claims on filing. As the zero median illustrates, there were a large number of companies with no preferred liabilities. The mean amount of preferred claims was 10,621 CAD.

⁸⁶ To determine the outliers, the z-score was set to 2.68 as per the standard used in statistics.

⁸⁷ To determine the outliers, the z-score was set to 2.68 as per the standard used in statistics.

Table 1: Type of Liabilities in Corporate Bankruptcies - 100 Data Set, 2015

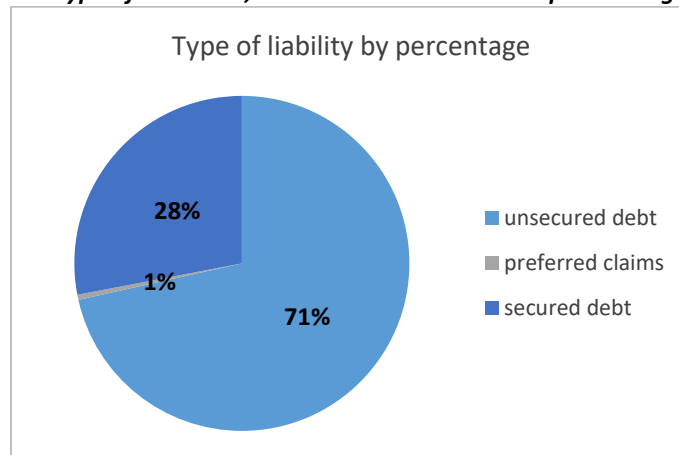
Bankruptcies					
	Maximum Number of Employees	Total Unsecured Liabilities	Total Secured Liabilities	Total Preferred Liabilities	Total Liabilities
Mean	15.71	\$682,565.67	\$242,260.18	\$10,620.96	\$311,815.60
Median	10.00	\$180,528.67	\$20,000.00	\$0.00	\$29,950.02
SD (S)	15.80	\$2,894,780.33	\$521,849.01	\$39,349.94	\$1,715,624.53
High	99.00	\$29,014,270.17	\$3,450,000.00	\$360,791.00	\$29,014,270.17
Low	5.00	\$2.00	\$0.00	\$0.00	\$0.00
Total	1,571	\$68,939,132.52	\$24,468,277.70	\$1,072,716.63	\$94,480,126.85
Percentage of Total Liabilities	-	72.97%	25.90%	1.14%	100%

Source of data: Office of the Superintendent of Bankruptcy, December 2015

3. Proposals - Type of Debt

In assessing the differences between proposals and bankruptcies, across the board, the liabilities of debtors undertaking proposal proceedings were larger. For the sample of 100 Division I business proposals, unsecured debt comprised 71.5% of all liabilities at filing, as illustrated in Graph 2 below, very similar to that in the cohort of corporate bankruptcies. Thus the ratio of unsecured debt to secured debt does not appear to be a factor in the decision as to what kind of proceeding to file in small business insolvency.

Graph 2: Type of Liabilities, 100 Business Division I Proposal Filings, 2015



Source of data: Office of the Superintendent of Bankruptcy, December 2015

However, the total amount of liabilities in the proposal cohort is much higher than for the bankruptcy files. The mean amount of unsecured debt was 1,399,801 CAD and the median 577,810 CAD, much more evenly distributed across the sample, as illustrated in Table 2 below. Secured debt for the 100 sample of Division I business proposals comprised 28% of the liabilities at filing, with the mean secured debt 545,238 CAD and the median 113,810 CAD. Unfortunately, the OSB does not collect any information on interim financing, so these data are not included in the proposal data. There was no obvious reason for the

significantly higher debt in the proposal cohort, and as will be illustrated below, the level of unencumbered assets is not an explanation of the difference. It could be that small enterprises that are on the larger size have greater capacity to retain advisers or have the in-house expertise to develop a sound business plan that may be acceptable to creditors, an observation made by several trustees. More likely, the explanation is pragmatic, in that a business needs to be of a certain size before the stakeholders are interested in investing the effort to restructure it, rather than simply liquidating and starting over.

In terms of employees, the average number for the Division I business proposal cohort was 21 employees, and while a higher number than the average number of employees for the bankruptcy cohort, the average amount of preferred claims was similar at 10,328 CAD. Preferred claims as a percentage of total liabilities was even smaller here, 0.53% of total liabilities. Here again the mean of preferred claims was zero, indicating many debtor companies with no preferred claims outstanding. Hence, at least for the randomized sample of 200 corporate insolvencies (bankruptcies and proposals), preferred liabilities are not significantly different, and are likely not a factor in the decision of what kind of proceeding to file.

Table 2: Division I Proposals - Corporate Filings 100 Data Set, 2015

	Proposals				
	Maximum Number of Employees	Total Unsecured Liabilities	Total Secured Liabilities	Total Preferred Liabilities	Total Liabilities
Mean	21.41	\$1,399,800.86	\$545,237.61	\$10,328.16	\$651,788.88
Median	10.5	\$577,810.22	\$113,810.00	\$0.00	\$83,613.25
SD (S)	24.2	\$2,152,321.12	\$1,548,949.98	\$32,685.20	\$1,629,255.83
High	100	\$14,019,577.82	\$12,834,570.00	\$204,000.00	\$14,019,577.82
Low	5	\$30,788.71	\$0.00	\$0.00	\$0.00
Total	2,141	\$139,980,086.40	\$54,523,761.02	\$1,032,816.41	\$195,536,663.83
Percent	-	71.59%	27.88%	0.53%	100%

Source of data: Office of the Superintendent of Bankruptcy, December 2015

4. Employees

As illustrated in Table 3 below, the majority of debtors in both the bankruptcy and proposal cohorts had fewer than 20 employees.⁸⁸ That may explain, in part, why the percentage of employee claims, in comparison to overall debt, was so low.

⁸⁸ Industry Canada asked about any insights on the service industry, its definition of small enterprise is employing 5 to 99 employees, or in the service industry, employing 5 to 49 employees. However, no insights could be drawn as the information provided by the OSB about the creditors or type of business is sparse to non-existent, so service industry could not be separated out.

Table 3: Number of Employees – Corporate Filings 200 Data Set, 2015

	Number of Employees	
	Bankruptcies – 100 files	Proposals – 100 files
Mean	15.71	21.41
Median	10	10.5
SD (S)	15.8	24.2
High	99	100
Low	5	5
Total	1,587	2,141

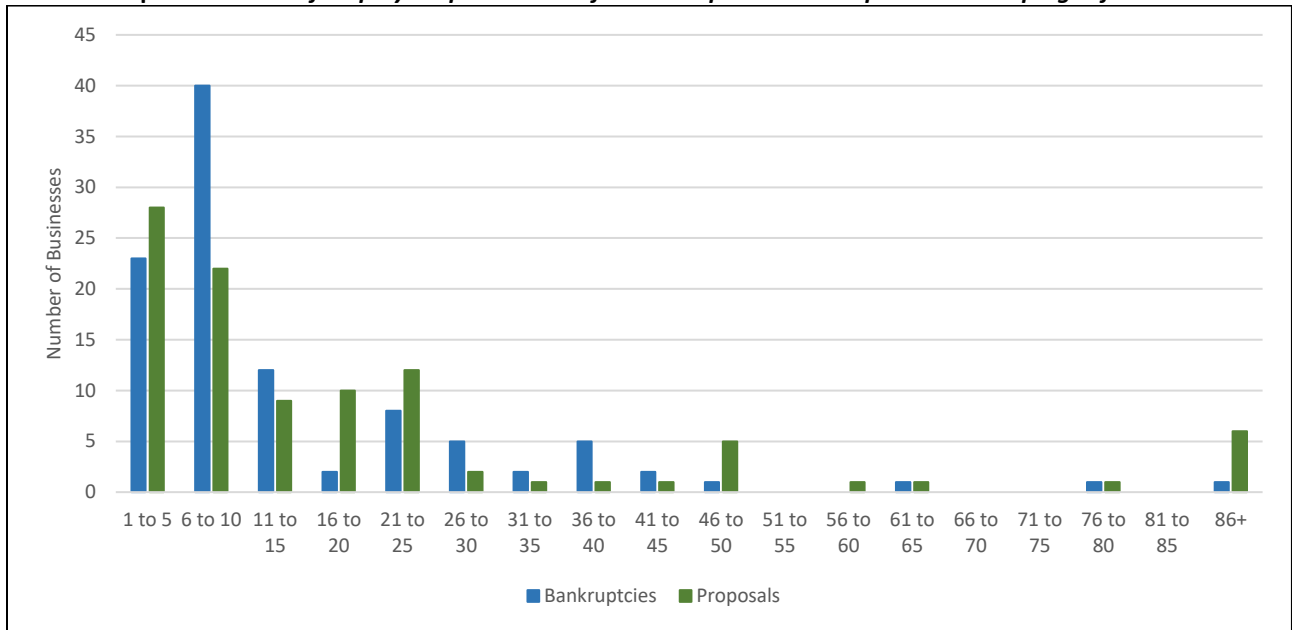
Source: Office of the Superintendent of Bankruptcy, December 2015

Categorizing a small business as having from 1 to 99 employees may miss the underlying patterns in the small business category. Looking at Industry Canada data more generally,⁸⁹ approximately 53% of small businesses in Canada have from 1-19 employees. The remaining 47% have 20-99 employees. These definitions are used to further breakdown the OSB sample data. 73% of the corporate bankruptcies in the cohort had fewer than 20 employees, compared with 63% of the corporate Division I proposal filings, as illustrated in Graphs 3 and 4 below. The data suggest that the smallest businesses fail in greater numbers compared with their presence in the micro and small sector in the Canadian economy as a whole, assuming that the random sample chosen by the OSB is representative of the population as a whole. The overrepresentation in the sample of businesses employing 1 to 19 employees and, conversely, the underrepresentation of businesses employing 20 to 99 employees, again assuming the sample is representative of the population, may indicate that once a business reaches a critical mass of employees and thus economic activity, it is less likely to fail and there may be greater possibility of making a proposal to carry on business.

It is important to note that the information on business failures maintained by the OSB is incomplete as it does not account for small businesses that simply close down without a formal insolvency process (“walk-aways”). In our inferences above, it is assumed that a business that is not reported on the OSB statistics on business failures continues to be successful, which may very well be incorrect. However, the incidence of walk-aways is more likely to occur in respect of very small businesses with very few employees, and if this is the case, it would further reinforce our inference that the smaller businesses (based on employee complement) fail at a higher rate than their representation in the population.

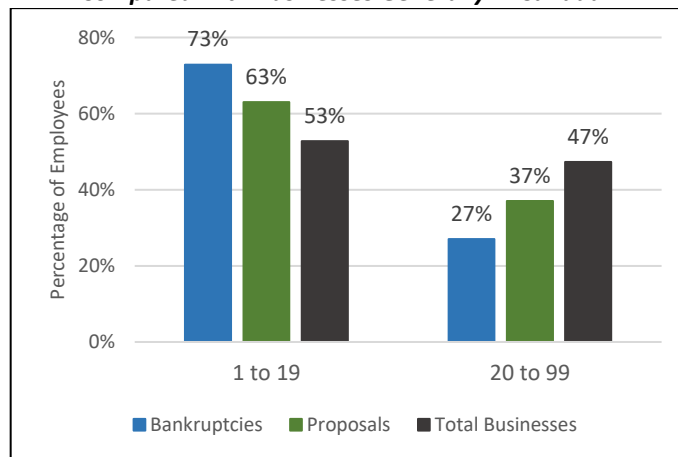
⁸⁹ Industry Canada, 2016, www.ic.gc.ca/eic/site/061.nsf/eng/02805.html.

Graph 3: Number of Employees per Business for Bankruptcies and Proposals in Groupings of Five



Source of data: Office of the Superintendent of Bankruptcy, December 2015

Graph 4: Percentage of Total Employees by Business Size for Bankruptcies, Proposals, Compared with Businesses Generally in Canada⁹⁰



Sources: Office of the Superintendent of Bankruptcy and Industry Canada

⁹⁰ The OSB data are effective December 2015, www.ic.gc.ca/eic/site/061.nsf/eng/02805.html, accessed March 2016, and the Industry Canada data relating to relative size of small businesses in terms of employee complement is from 2012.

5. Comparing Secured and Unsecured Debt Levels

Table 4 undertakes a direct comparison of unsecured liabilities between bankruptcies and proposals in the sample data. Debtors undertaking Division I proposals have on average twice the amount of unsecured debt. The median amounts of unsecured liabilities are also significantly different, the amount for proposals being three times that of bankruptcies. The lowest and highest figures vary greatly.

Table 4: Total Unsecured Liabilities for both Bankruptcies and Proposals, 2015

	Total Unsecured Liabilities	
	Bankruptcies – 100 files	Proposals – 100 files
Mean	\$682,565.67	\$1,399,800.86
Median	\$180,528.67	\$577,810.22
SD (\$)	\$2,894,780.33	\$2,152,321.12
High	\$29,014,270.17	\$14,019,577.82
Low	\$2.00	\$30,788.71
Total	\$68,939,132.52	\$139,980,086.40

Source of data: Office of the Superintendent of Bankruptcy, December 2015

Table 5 undertakes a direct comparison of secured liabilities between bankruptcies and proposals in the sample data. Debtors undertaking proposals have on average more than twice the amount of secured debt. The median amounts are also significantly different, the median amount of unsecured liabilities for proposals is almost six times that of bankruptcies, indicating that the distribution spread of secured liabilities is much broader in the bankruptcy cohort. The lowest and highest figures vary greatly.

Table 5: Total Secured Liabilities for both Bankruptcies and Proposals, 2015

	Total Secured Liabilities	
	Bankruptcies	Proposals
Mean	\$242,260.18	\$545,237.61
Median	\$20,000.00	\$117,311.52
SD (\$)	\$521,849.01	\$1,546,358.72
High	\$3,450,000.00	\$12,834,570.00
Low	\$0.00	\$0.00
Total	\$24,468,277.70	\$54,523,761.02

Source of data: Office of the Superintendent of Bankruptcy, December 2015

Table 6 illustrates that there are many debtor companies in both the corporate bankruptcy and proposal cohorts in which there are no preferred claims, as illustrated by the median of zero. As noted above, the average amount of liabilities do not vary as between bankruptcies and proposals, and given the size of the other liabilities, preferred claims do not appear to be a driver of filing under either process.

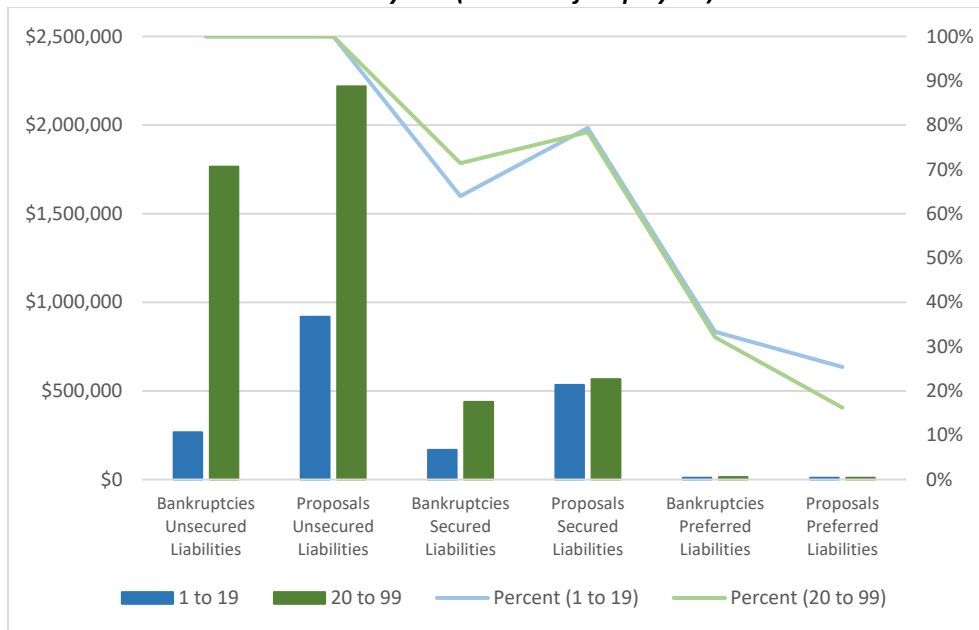
Table 6: Total Preferred Liabilities for both Bankruptcies and Proposals, 2015

	Total Preferred Liabilities	
	Bankruptcies	Proposals
Mean	\$10,620.96	\$10,328.16
Median	\$0.00	\$0.00
SD (S)	\$39,349.94	\$32,685.20
High	\$360,791.00	\$204,000.00
Low	\$0.00	\$0.00
Total	\$1,072,716.63	\$1,032,816.41

Source of data: Office of the Superintendent of Bankruptcy, December 2015

One can see in Graph 5 and Table 7 below that the average liabilities are higher for the companies that are in the larger range of small, specifically, companies with 20 to 99 employees. Here again, there is no difference in amount of preferred liabilities depending on firm size.

Graph 5: Amount of Liabilities and Percentage Businesses with Liabilities by Size (Number of Employees) 2015⁹¹



Source of data: Office of the Superintendent of Bankruptcy, December 2015

⁹¹ Average liabilities by type of liability and size of the business (1-19 or 20-99).

**Table 7: Average Amount of Liabilities and Percentage
Businesses with Liabilities by Size, 2015**

	All Liabilities for both Bankruptcies and Proposals					
	Unsecured Liabilities		Secured Liabilities		Preferred Liabilities	
	Bankruptcies	Proposals	Bankruptcies	Proposals	Bankruptcies	Proposals
1-19 Employees	\$265,387.24	\$918,740.35	\$162,802.83	\$533,296.94	\$9,528.78	\$10,454.53
% of Companies with such claims	100%	100%	64%	79%	33%	25%
20-99 Employees	\$1,765,594.22	\$2,218,903.91	\$438,692.80	\$565,569.02	\$13,713.16	\$10,112.99
% of Companies with such claims	100%	100%	71%	78%	32%	16%

Source: Office of the Superintendent of Bankruptcy, December 2015

The number of employees as indicator of size of business appears to be less determinative of the bankruptcy or proposal route as does the likelihood and amount of secured liabilities a business has. Regardless of the size of the business, the secured liabilities were higher for business proposals than for those businesses that entered into bankruptcy. Businesses with accepted proposals also had significantly higher unsecured liabilities as well. Information is not yet available as to the number of these proposals that will be successfully completed, but it may be helpful to track this information in the future.

6. Assets Compared with Liabilities

A comparison of assets and liabilities in Tables 8, 9 and 10 reveals that overall, MSME are highly leveraged, for both bankruptcies and proposals. For both the mean and median, assets are less than secured debt. This result is contrary to what one might have speculated - that all the assets would be encumbered in bankruptcy files, but that there would be unencumbered assets in proposal files, which is why the latter had a chance of devising a proposal. The data below indicate that was not generally the case. As Table 10 below illustrates, the 100 proposal files are more highly leveraged on average than the bankruptcy files, and the larger the firm, the more highly leveraged on average. Of course, it is important to remember that proposals often address only the unsecured debt; while secured creditors are stayed from enforcing their claims during the stay period, if they are not included in the proposal, they continue to receive payments and they retain their rights to enforce on their security.

Table 8: Bankruptcies – Assets Compared with Liabilities, 2015

	Bankruptcies				
	Total Assets	Total Liabilities	Total Unsecured Liabilities	Total Secured Liabilities	Total Preferred Liabilities
Mean	\$246,516.61	\$311,815.60	\$682,565.67	\$242,260.18	\$10,620.96
Median	\$15,150.50	\$29,950.02	\$180,528.67	\$20,000.00	\$0.00
SD (S)	\$529,442.42	\$1,715,624.53	\$2,894,780.33	\$521,849.01	\$39,349.94
High	\$3,116,936.44	\$29,014,270.17	\$29,014,270.17	\$3,450,000.00	\$360,791.00
Low	\$0.00	\$0.00	\$2.00	\$0.00	\$0.00
Total	\$24,898,177.78	\$94,480,126.85	\$68,939,132.52	\$24,468,277.70	\$1,072,716.63
Percent	-	-	72.97%	25.90%	1.14%

Source: Office of the Superintendent of Bankruptcy, December 2015

Table 9: Proposals – Assets Compared with Liabilities, 2015

	Proposals				
	Total Assets	Total Liabilities	Total Unsecured Liabilities	Total Secured Liabilities	Total Preferred Liabilities
Mean	\$443,924.72	\$651,788.88	\$1,399,800.86	\$545,237.61	\$10,328.16
Median	\$85,003.00	\$83,613.25	\$577,810.22	\$113,810.00	\$0.00
SD (S)	\$1,386,564.57	\$1,629,255.83	\$2,152,321.12	\$1,548,949.98	\$32,685.20
High	\$12,834,570.00	\$14,019,577.82	\$14,019,577.82	\$12,834,570.00	\$204,000.00
Low	\$0.00	\$0.00	\$30,788.71	\$0.00	\$0.00
Total	\$42,172,848.76	\$195,536,663.83	\$139,980,086.40	\$54,523,761.02	\$1,032,816.41
Percent	-	-	71.59%	27.88%	0.53%

Source: Office of the Superintendent of Bankruptcy, December 2015

Table 10: Debt to Asset Ratio, by Type of Proceeding and Size of Business, 2015

Number of Employees	Bankruptcies		Proposals	
	1 to 19	20 to 99	1 to 19	20 to 99
Total Assets	\$179,645.49	\$420,859.17	\$419,910.42	\$485,092.10
Total Liabilities	\$437,718.85	\$2,218,000.18	\$1,462,491.82	\$2,794,585.92
Debt to Asset Ratio	2.44	5.27	3.48	5.76

Source: Office of the Superintendent of Bankruptcy, December 2015

In analyzing the leverage of insolvent businesses, it is important to note that the calculated leverage may be skewed due to an improper valuation of the assets, as the asset values as reported in the statement of affairs may be distorted. The assets are usually reported at their estimated realizable value, as estimated by the person that completes the statement of affairs, and that assessment is by definition imperfect since the person completing the statement of affairs is not an expert in valuing assets. Furthermore, while the valuation of assets at their realizable value may be appropriate for a bankruptcy file, it may not be so in the context of a proposal, where the assets would likely have far more value based on a going concern than in a context of an outright liquidation. At the time of preparation of the statement of affairs, however, the person preparing it cannot assess whether the proper valuation context should be based on an outright liquidation or a going concern, because at that time the outcome of the proposal can be hoped for but cannot be known with certainty. Considering that, in order to assess their options, creditors use (at least in part) the information on the statement of affairs to estimate what would be the outcome of a bankruptcy, the debtor will tend to complete the statement of affairs with some degree of conservatism.

7. Division I & Division II Proposals

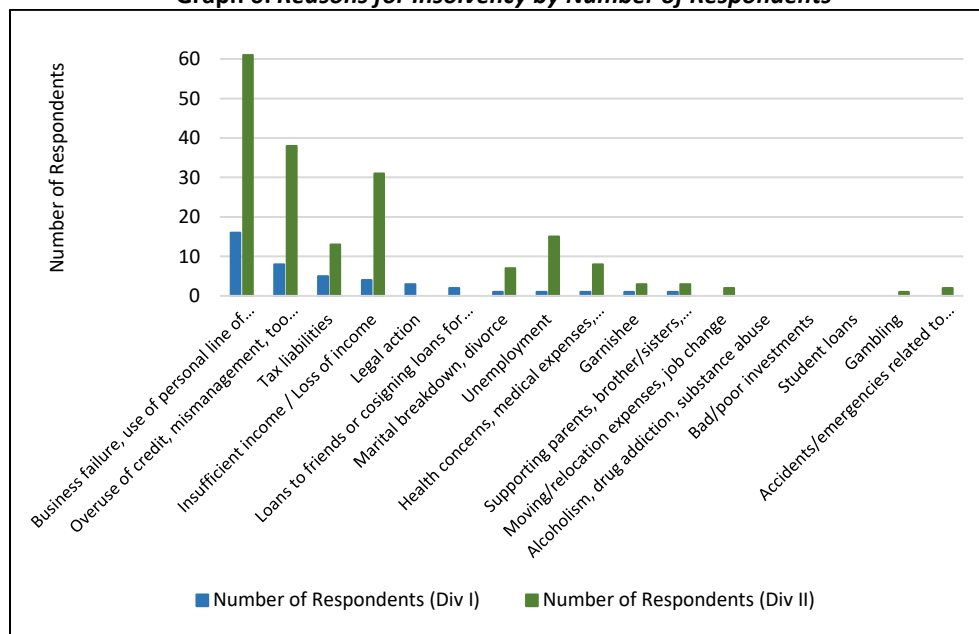
i. Reasons for Insolvency

In the next data set, also a randomized sample from across Canada, the reasons for insolvency were examined. There were 25 Division I individual business proposals and 100 Division II individual business proposals in the cohort. The Division I data set was significantly smaller, as are the number of filings under this part of the BIA. The text below reports both together to illustrate similarities. The OSB has chosen 17 standard reasons for bankruptcy, as listed below. Using a data cleansing and parsing program, the OSB

sorts the declared responses into causes of bankruptcy, and estates frequently have more than one reason for financial difficulty.⁹² As noted below in the discussion of the reasons, there is considerable overlap or blurring of the categories of reasons for insolvency. One recommendation going forward is that the OSB should consider redrafting its reasons section to more clearly capture the reasons for filing.

For both Division I and Division II filings in the cohort, more than 50% of debtors reported that the primary reasons for insolvency were “Business failure, use of personal line of credit for business” and “Overuse of credit, mismanagement, too much debt”, as illustrated in Graph 6 below. These categories are not sufficiently nuanced. For example, overuse of credit may be the result of a temporary downturn in the business that the debtor believed could be bridged through temporary credit, a decision that appears poor in hindsight, but may not be an indicator of mismanagement. There is considerable overlap in declared reasons, with many debtors responding that both “Business failure, use of personal line of credit for business” and “Overuse of credit, mismanagement, too much debt” were the primary reason. Clearly governance and management issues are important, but the data do not reveal the degree of mismanagement such that recommendations can be made. There is a similar lack of clarity in insufficient income and loss of income, with some overlap with unemployment, such that it is difficult to draw clear conclusions from the data. Comparatively, tax liabilities do not play a significant role in the insolvency of these files.

Graph 6: Reasons for Insolvency by Number of Respondents

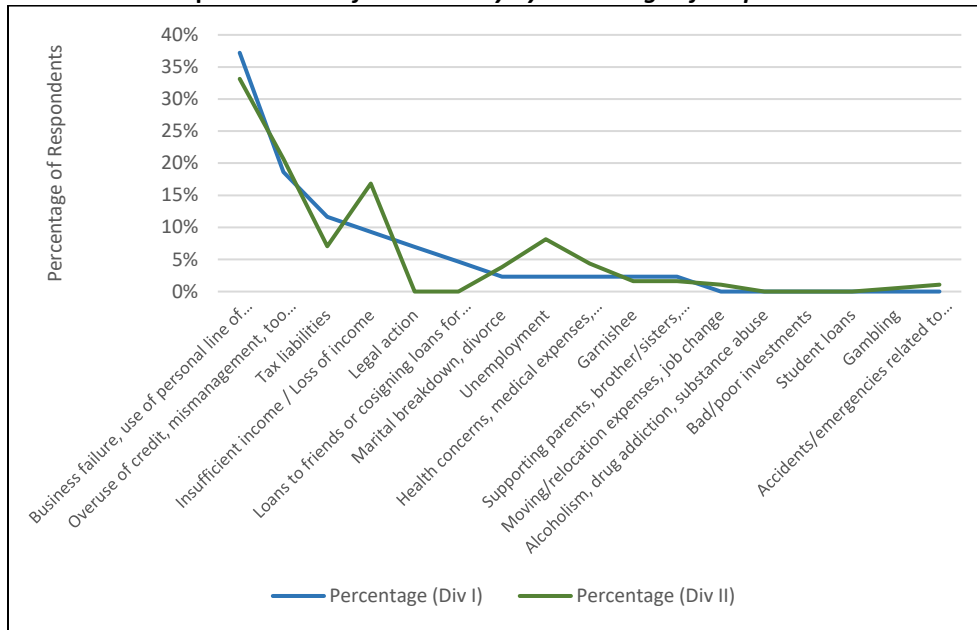


Source of data: Office of the Superintendent of Bankruptcy, December 2015

Representing the same data as a percentage of reasons for filing a proposal, as illustrated in Graph 7, one can observe similarities in the percentages, except for the larger percentage of Division II filings for reasons of insufficient income or loss of income.

⁹² OSB, description of data, December 2015.

Graph 7: Reasons for Insolvency by Percentage of Respondents



Source of data: Office of the Superintendent of Bankruptcy, December 2015

While some of the overlap is due to unclear wording of the data fields, it is also important to note that there are frequently multiple reasons for insolvency, and Table 11 and Graph 8 below illustrate that in the majority of cases, debtors identify multiple reasons. 57% of Division II business debtors declared multiple reasons for insolvency and for Division I, approximately 52% of businesses had multiple reasons for commencing insolvency proceedings, suggesting that the majority of business failures are caused by the interaction of more than one factor.

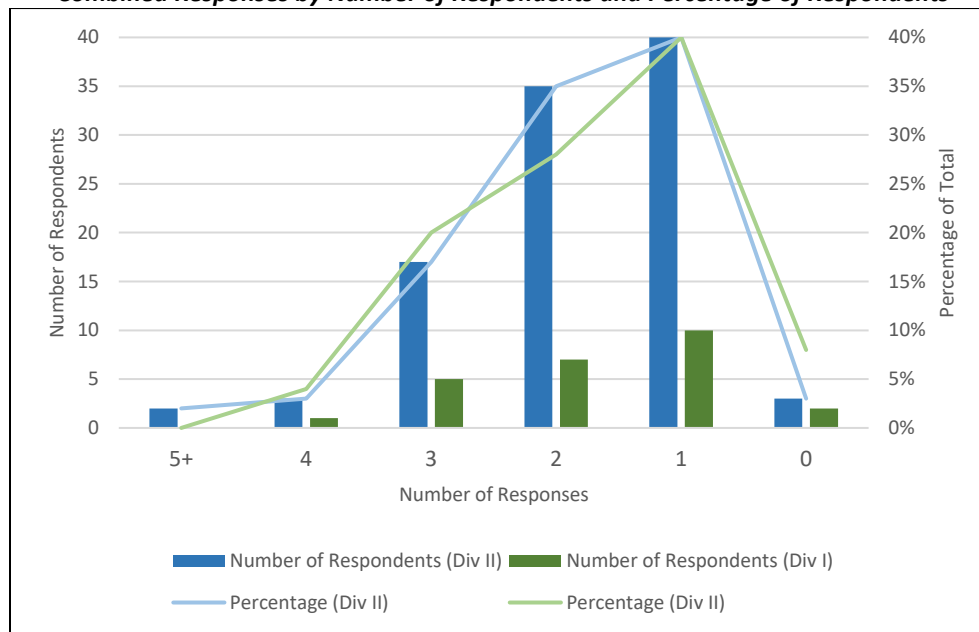
Table 11: Proposals - Reasons for Insolvency by Number of Responses and by Percentage

	Division I		Division II	
	Reason identified	% of Total	Reason identified	% of Total
Business failure, use of personal line of credit for business	16	37.21	61	33.15
Overuse of credit, mismanagement, too much debt	8	18.6	38	20.65
Tax liabilities	5	11.63	13	7.07
Insufficient income / Loss of income	4	9.3	31	16.85
Legal action	3	6.98	0	0
Loans to friends or cosigning loans for others		4.65	0	0
Marital breakdown, divorce	1	2.33	7	3.8
Unemployment	1	2.33	15	8.15
Health concerns, medical expenses, injuries, family deaths	1	2.33	8	4.35
Garnishee	1	2.33	3	1.63
Supporting parents, brother/sisters, relatives	1	2.33	3	1.63

	Division I		Division II	
	Reason identified	% of Total	Reason identified	% of Total
Moving/relocation expenses, job change	0	0	2	1.09
Alcoholism, drug addiction, substance abuse	0	0	0	0
Bad/poor investments	0	0	0	0
Student loans	0	0	0	0
Gambling	0	0	1	0.54
Accidents/emergencies related to property, i.e. fire, theft	0	0	2	1.09

Source: Office of the Superintendent of Bankruptcy, December 2015

Graph 8: Proposals – Multiple Reasons for Insolvency, Combined Responses by Number of Respondents and Percentage of Respondents



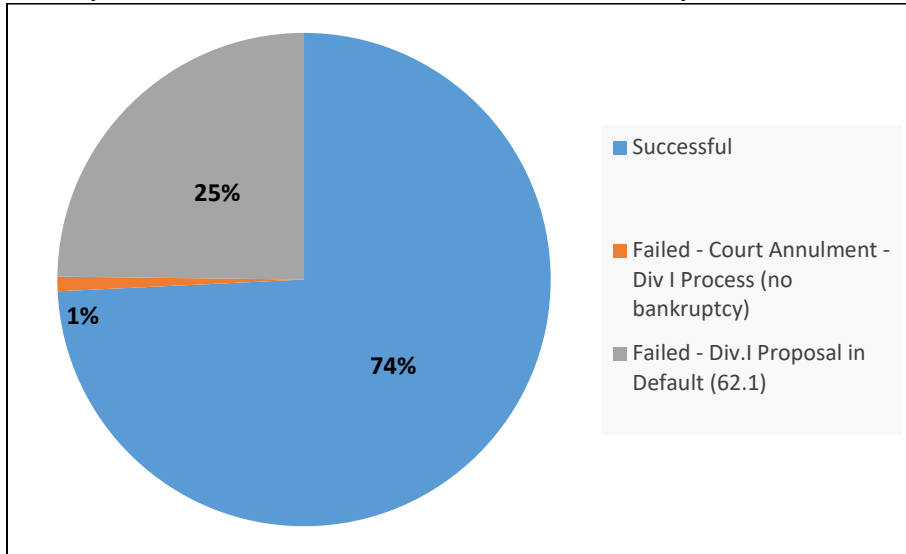
Source: Office of the Superintendent of Bankruptcy, December 2015

ii. Division I Proposal Success and Failure Rates

The OSB provided global statistics on successful completion and failure of business proposals under both Division I and Division II of the *BIA* that were closed in the past two years, including reasons for failure and time to close.⁹³ For Division I business proposals, 74% of closed files involved successful completion of the proposal, 25% failed by defaulting on the terms of the proposal and 1% were annulled by the court, as illustrated in Graph 9.

⁹³ BKHQRA-2808 Proposal Outcomes, Office of the Superintendent of Bankruptcy, 10 December 2015.

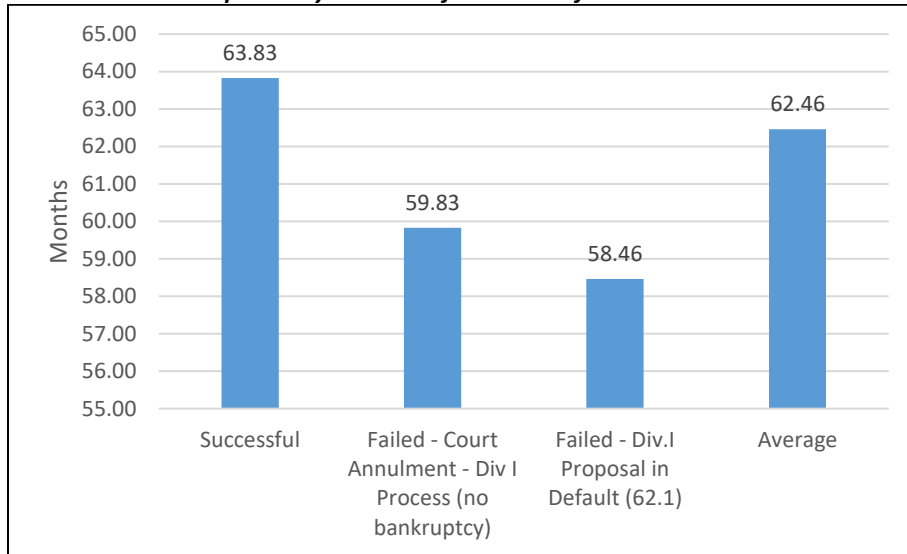
Graph 9: Success and Failure Rates Division I Business Proposal Files Closed



Source of data: Office of the Superintendent of Bankruptcy, December 2015

The OSB data also reveal at what point the Division I proposal succeeded or failed, in terms of months before files are closed. For example, the successful proposals on average were completed in just under 64 months. For proposals that failed by default, on average they failed at about 58 months, as illustrated in Graph 10 below.

Graph 10: Success and Failure Rates Division I Business Proposals by Number of Months before File Closed

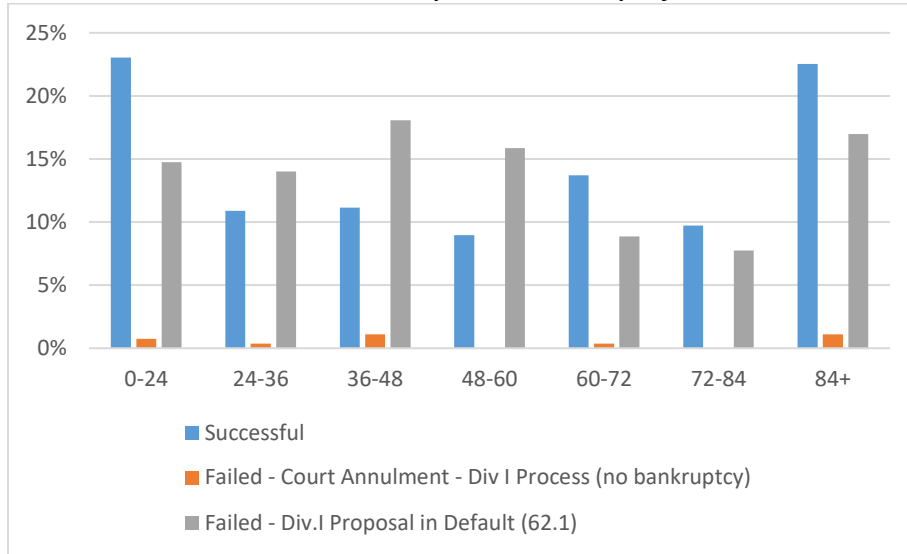


Source of data: Office of the Superintendent of Bankruptcy, December 2015

As illustrated in Graph 11 below, 23% of all successful proposals were completed in less than 24 months, but 23% took more than 84 months to complete. 11% of successful proposals took between 24 and 36 months, 11% took between 36 and 48 months to complete, 9% took between 48 and 60 months to complete, and 24% took 60 to 84 months to complete. 15% of Division I business proposals that failed

from default failed within the first 24 months, 14% failed between 24 and 36 months, 18% failed between 48 and 60 months, and 17 % failed after 84 months.

Graph 11: Success and Failure of Division I Business Proposals by Percentage that Closed or were Completed within a Specified Time

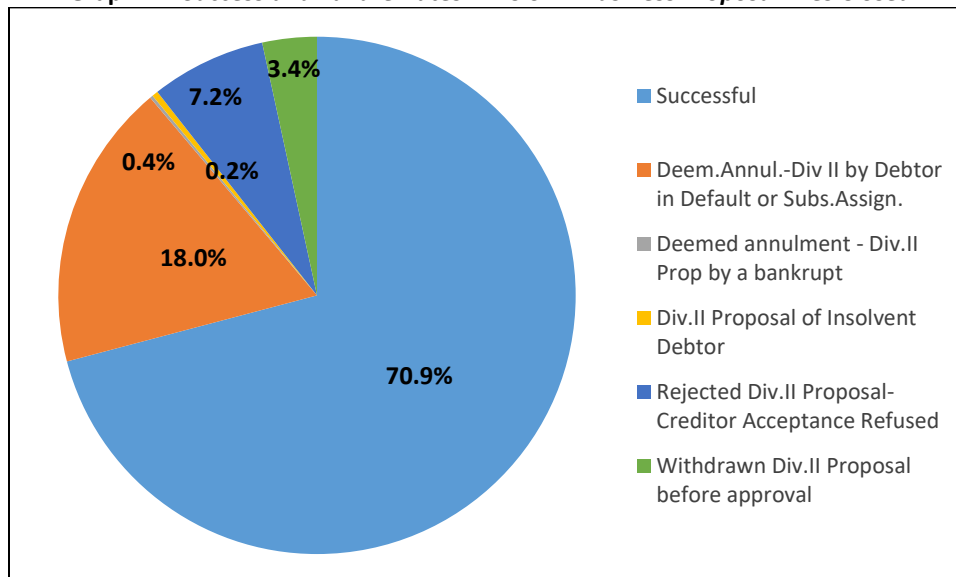


Horizontal axis is months. Source of data: Office of the Superintendent of Bankruptcy, December 2015

iii. *Division II Proposal Success and Failure Rates*

For Division II business proposals, almost 71% of closed files involved successful completion of the proposal, 18% failed by defaulting on the terms of the proposal or because of a subsequent assignment in bankruptcy; and 7.2% failed when creditors refused to accept the proposal (Graph 12). It is clear that creditors continue to be active under the streamlined provisions of Division II.

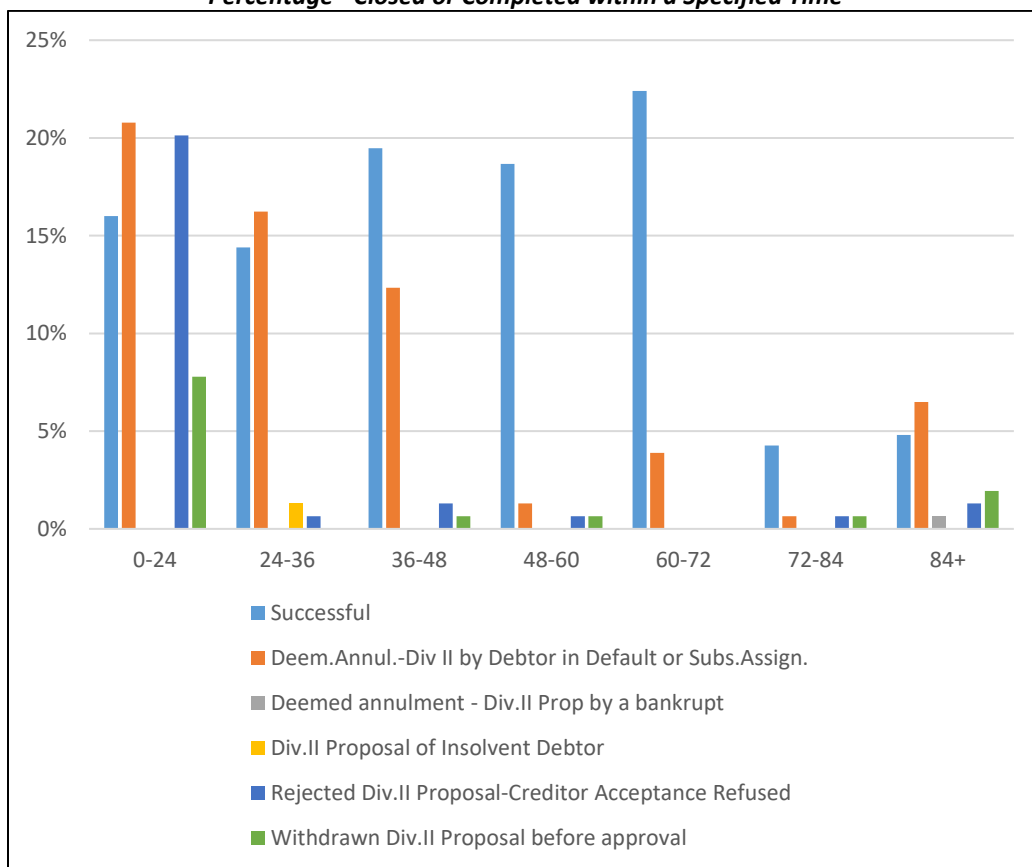
Graph 12: Success and Failure Rates Division II Business Proposal Files Closed



Source of data: Office of the Superintendent of Bankruptcy, December 2015

Graph 13 below illustrates the success and failure rates of Division II business proposals within specified periods and by reason for success or failure. The majority of successful proposals are completed within 60 months. There is less likelihood of default by the debtor as the period of the proposal continues. As expected, the Graph illustrates that rejection by creditors happens very early in the process.

Graph 13: Success and Failure of Division II Business Proposals by Percentage - Closed or Completed within a Specified Time



Horizontal axis is months. Source: Office of the Superintendent of Bankruptcy, December 2015

Thus, overall, a significant percentage of business debtors that had their proposals approved successfully completed the terms of the proposal, 74% for Division I business proposals and 71% for Division II business proposals. These success rates suggest that the proposal provisions are working to preserve both businesses and value for creditors. What is not available from these data is the number of proposals that resulted in the business being sold as a going concern versus continued in the original debtor’s possession. The success rate of approved and completed proposals may suggest that if barriers to MSME proposals can be removed, there could be an increase in the number of MSME proposals filed, and hopefully, successfully completed.

iv. Dividends to Creditors

For completeness of the record and requested information for the study, the dividends paid to creditors in Division I and II closed estates are included here in Table 12. However, without rates of return on bankruptcy files, the data are not particularly informative other than to illustrate that unsecured creditors

are receiving dividends under these proposals. What would be helpful to study in the future is the amount of return for unsecured creditors in terms of the percentage of their total claim paid in the proposal, compared with rate of return for unsecured creditors in the bankruptcy files. We do know from trustees surveyed that often the unsecured creditors receive nothing in a bankruptcy, because the secured lender has security over all the assets through a general security agreement. The zero figures for secured creditors in Division I below is not particularly surprising in that secured creditors can be outside the proposal and continuing to be paid.

Table 12: Dividends Paid to Creditors Business Proposals – Estates Closed

Division I	Total Unsecured Dividends	Total Secured Dividends	Total Preferred Dividends	Total
Total	\$513,244.25	\$0.00	\$0.00	\$513,244.25
Mean	\$38,617.38	\$0.00	\$0.00	\$29,349.21
Median	\$2,580.40	\$0.00	\$0.00	\$0.00
No. of Respondents	11	0	0	11
Percent of Respondents	44%	0%	0%	44%
Division II	Total Unsecured Dividends	Total Secured Dividends	Total Preferred Dividends	Total
Total	\$1,397,824.33	\$60,389.00	\$26,027.78	\$1,484,241.11
Mean	\$15,030.37	\$5,489.91	\$13,013.89	\$14,002.27
Median	\$10,385.73	\$0.00	\$13,013.89	\$10,084.37
No. of Respondents	79	3	2	81
Percent of Respondents	79%	3%	2%	81%

8. Receiverships

The OSB data on receiverships over the period since the last round of legislative amendments do not reveal why there has been a decline in receiverships. The numbers of receiverships in 2009-2010 are likely a reflection of the first effects of the global financial crisis and are significantly higher than for 2011 through 2014, as illustrated in Table 13 below. There were instances where a specific industry in a specific year experienced a very significant variation in receiverships, such as in the financial and insurance sector in 2009 and 2013. The reality is that there was simply not the time or resources in this study to examine the changes in receivership. With the data given, we tried comparing sector patterns to GDP, currency exchange rates and other indicators, but we concluded there were insufficient data to generate any specific insights.

However, the ten loan officers surveyed offered a glimpse into the pattern of receiverships. The loan officers were almost unanimous that they use private receivers rather than court-appointed receivers, because of the costs involved in the court-supervised process, specifically, the cost of filing reports and court appearances. In contrast, one trustee observed that after the initial court appointment, the court tends to leave receivers to do their work, and the need for further court appearances are only for approval of significant transactions, such as a sale of assets.

This trend toward private receiverships was confirmed by over 15 trustees, who also observed that the primary or secured lender is opting for private receivership to save the costs of court appearances and other administrative costs. This statement is somewhat surprising considering that the privately appointed receiver has the same administrative duties under the *BIA* and the *Wage Earner Protection Program Act*⁹⁴ as a court-appointed receiver. It suggests perhaps that some secured creditors are not appointing a receiver as that term is understood under the *BIA*, but rather, appoint some representative to liquidate the assets without following the statutory requirements regarding notifying employees and creditors, reporting to the OSB, dealing with recently received merchandise, fulfilling the requirements of the *WEPPA*, etc.

A number of trustees and loan officers surveyed observed that banks are often not appointing receivers at all, but rather, appointing an auctioneer or other person to liquidate the assets, without making use of the mechanisms under the *BIA*. While this strategy may be cost-effective for the secured lender, the issue that should be of concern to the government is that the bank may be realizing on the assets without advising other creditors, who, if given notice, might have exercised their 30-day goods remedies under the statute. Liquidation without a receivership or bankruptcy also means that terminated employees cannot access remedies under the Wage Earner Protection Program.

The OSB has expressed concern about this conduct of secured lenders, but currently does not have authority to require the banks to use the *BIA* unless the individual or firm appointed is conducting itself as a “receiver”.⁹⁵ In a 2010 report titled “Non-Trustee Receivers”, the OSB observed that:

The fact that a person is not called "receiver" but some other name such as "agent" or "monitor" is of no consequence. If the person takes or has taken possession or control of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or a bankrupt under a security agreement or court order, he or she is a receiver for the purpose of subsection 243(2) of the *BIA* (Bankruptcy and Insolvency Act) and therefore must be a licensed trustee.

Accordingly, it is the OSB (Office of the Superintendent of Bankruptcy)'s position that the appointment of a person who is not a licensed trustee in bankruptcy to act as a receiver within the meaning of subsection 243(2) is contrary to the provisions of the *BIA* (Bankruptcy and Insolvency Act). When such an appointment occurs, we will request that immediate steps be taken to have the non-licensed trustee receiver substituted with a licensed trustee in bankruptcy. Such steps may include obtaining a new or amended agreement or a court order that provides for the appropriate substitution. If the substitution is not effected immediately, the OSB (Office of the Superintendent of Bankruptcy) reserves its right to make an application to the court to effect the appropriate appointment and to seek costs in relation thereto and in enforcing the provisions of the *BIA* (Bankruptcy and Insolvency Act).⁹⁶

One issue is that of transparency. Unsecured creditors may not understand that this liquidation process is occurring at the time it is occurring. The OSB often will not be advised that an auctioneer is acting more like a receiver, so it cannot take action. It would seem that more research is needed into whether the

⁹⁴ *Wage Earner Protection Program Act*, S.C. 2005, c. 47, as amended.

⁹⁵ Office of the Superintendent of Bankruptcy Canada, “Non-Trustee Receivers”, 20 May 2010, <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02406.html>, modified 24 March 2015. Section 243(4) of the *BIA* specifies that only a licensed trustee in bankruptcy can be appointed as a receiver under s. 243(1) of the *BIA* or under an agreement or order referred to in s. 243(2)(b) of the *BIA*.

⁹⁶ *Ibid* at 2.

banks really are using the *BIA* receivership provisions appropriately, and how the legislation could be amended to ensure greater fairness and transparency for all creditors.

Three loan officers observed that they are more likely to do a forbearance or work with the debtor to undertake a self-liquidation, in order to save the expense of a formal proceeding. They suggest that there has been a shift in approach from ten years ago, in that they will work with debtors where the business may be viable. Two loan officers observed that there has been a lot of liquidity in the market in recent years, such that they are often able to get out of their positions without accessing the receivership provisions of the *BIA*.

Another loan officer observed that other than to create a process or service that is “free” for the debtor, it is unclear that there would be an incentive for companies with less than five million CAD in debt to access the *BIA* procedures; that their clients view the use of trustees and lawyers as expensive and coming directly out of their pockets. They distinguish this situation from medium and larger businesses where the funds being used to hire professionals are not the personal capital of the managers, so there is less resistance to accessing formal processes.

Four loan officers noted that there is an issue with respect to access to information, and a helpful process might be a mechanism for a licensed trustee to do a quick “look-see” on the finances, in order to determine whether or not it makes sense to commence a receivership or work with the debtor towards a proposal. They observe that access to accurate financial information at the front end of the process is one of their greatest challenges with MSME. One trustee suggested that it might be helpful to have funding available for just a quick assessment, rather than incurring the cost of appointment of a receiver or commencement of a proposal process just to get access to information for a preliminary assessment.

Table 13: Amount of Receiverships by Industry per Year

Industry	2009	2010	2011	2012	2013	2014	Total	Average
Agriculture, Forestry, Fishing and Hunting	18	11	10	26	13	14	92	15.33
Mining and Oil and Gas Extraction	28	10	15	10	16	17	96	16.00
Utilities	1	2	4	4	4	4	19	3.17
Construction	29	37	29	25	36	27	183	30.50
Manufacturing	54	72	46	47	42	43	304	50.67
Wholesale Trade	26	25	19	16	16	19	121	20.17
Retail Trade	22	50	21	23	15	20	151	25.17
Transportation and Warehousing	8	13	7	4	23	7	62	10.33
Information and Cultural Industries	4	2	6	4	15	1	32	5.33
Finance and Insurance	40	18	17	10	103	13	201	33.50
Real Estate and Rental and Leasing	53	65	45	36	31	32	262	43.67
Professional, Scientific and Technical Services	8	15	8	13	11	10	65	10.83
Management of Companies and Enterprises	22	14	9	17	14	26	102	17.00
Administrative and Support, Waste Management and Remediation Services	7	3	7	3	7	13	40	6.67
Health Care and Social Assistance	3	5	12	9	8	15	52	8.67

Arts, Entertainment and Recreation	5	6	9	9	2	13	44	7.33
Accommodation and Food Services	25	21	13	5	14	20	98	16.33
Other Services (except Public Administration)	3	2	2	4	1	2	14	2.33
Total	356	372	279	267	371	296	194	323.50
Average	19.78	20.61	15.50	14.72	20.61	16.4	107.	67

Source: Office of the Superintendent of Bankruptcy

III. SURVEY OF TRUSTEES

1. Methodology of the Trustee Survey

Industry Canada was interested in the views of licensed insolvency trustees in terms of the particular challenges facing SME, and it made sense to also collect views on sole proprietorships and micro enterprises. Three focus groups involving 15 trustees helped identify the issues that should be canvassed in the survey. The survey consisted of ten questions, as set out in Appendix 1. The participation of trustees was sought through a global email sent to all licensed insolvency trustees in Canada seeking their participation, with the helpful cooperation of the Canadian Association of Insolvency and Restructuring Professionals (“CAIRP”). An email request to participate was also sent to trustees that had attended the Annual Review of Insolvency Law conference in the past five years. Although trustees self-selected to respond, the response rate of 53 is significant. There are 217 licensed insolvency trustee firms with 1,046 individual licensed insolvency trustees in Canada⁹⁷ and a number of those trustees do not deal with MSME. Surveys were conducted in English and French and trustees had the opportunity to respond in writing or by telephone interview. 24 trustees of the 53 who were surveyed opted for a telephone interview, which lasted from 30 to 60 minutes. The surveys were conducted from November 2015 to February 2016. I wish to sincerely thank the trustees that participated, as their professional insights and experience were incredibly valuable.

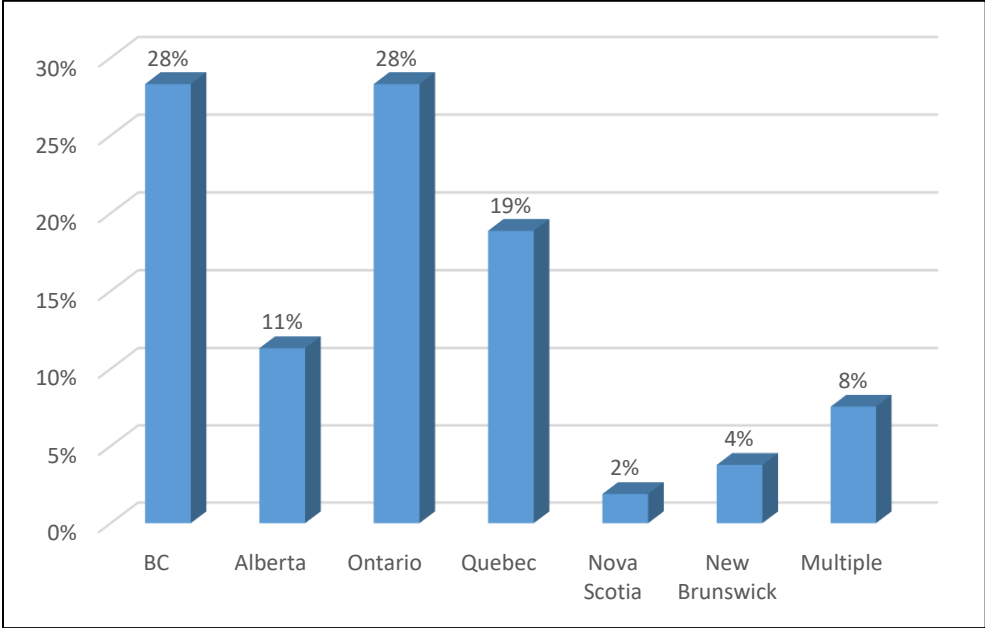
In terms of surveying lenders to MSME, the goal had been to speak to a small number of loan officers (five to ten), and here, it was much harder to get participation. Aside from general approaches to lenders in the MSME market, trustees surveyed were asked to recommend small loan officers and other lenders who might speak with us. We received 39 refusals to be interviewed before we found ten loan officers willing to participate, four by written survey, four by telephone interview and two by a combination of both. It is unfortunate that the lending community is not more forthcoming in its views or perhaps is overly concerned that responding to an interview or a survey might breach confidentiality. I am deeply grateful for the participating loan officers and their professionalism and willingness to be candid in their views. There are no graphs given the small numbers, but their views are interwoven in the qualitative analysis below.

Graph 14 offers a snapshot of participation by trustees from across the country. 50% of the respondents were from Ontario and British Columbia, and there was significant participation from Québec, with lower

⁹⁷ Office of the Superintendent of Bankruptcy, March 2016.

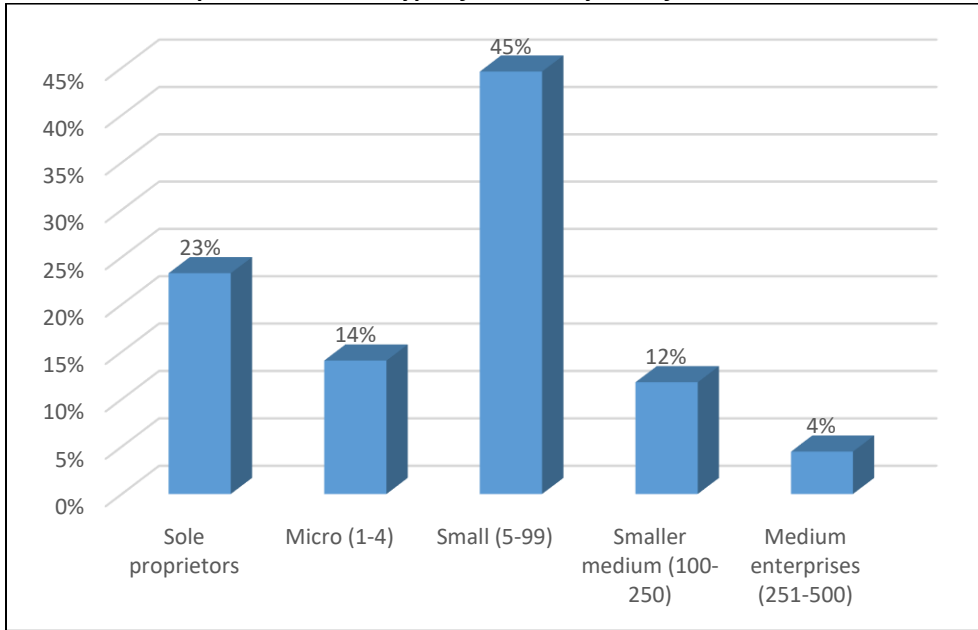
participation rates from the other provinces. In terms of loan officers participating in the survey, two were from Ontario, two from Québec, two from Alberta, and one each from British Columbia, Saskatchewan, Nova Scotia and New Brunswick.

Graph 14: Percentage of Trustee Responses by Province



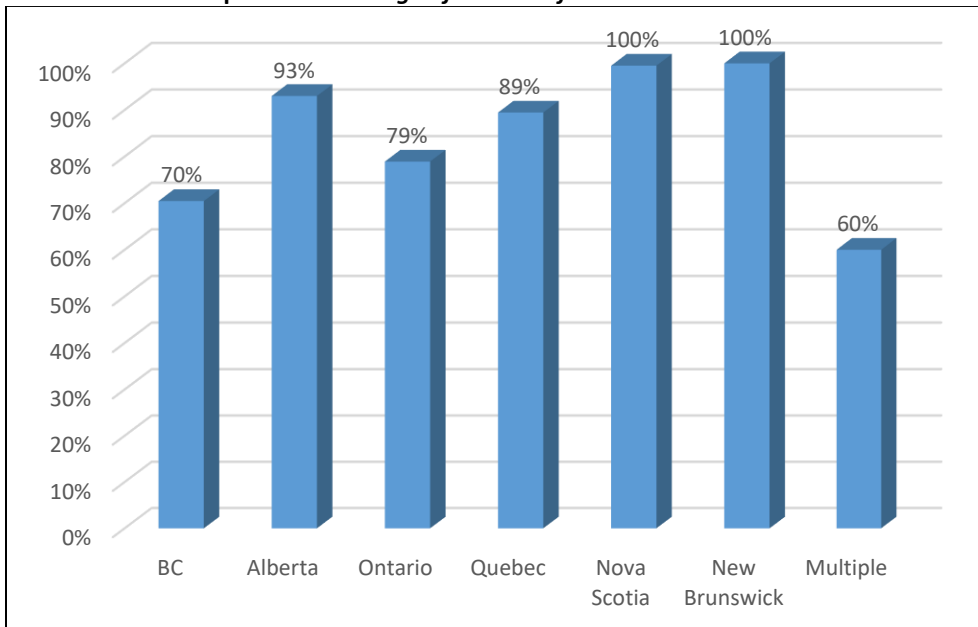
Graph 15 provides an illustration of the types of practice of trustees that responded to the survey. The survey used the parameters set out by Industry Canada for defining MSME, based on the number of employees, and for purposes of the survey, “medium” enterprises were further divided into small-medium and medium. By far, the surveyed trustees are dealing with small businesses, micro businesses and sole proprietorships. The loan officers interviewed deal with all MSME sizes, typically with loans ranging from 250,000 CAD to five million CAD.

Graph 15: Trustees – Type of Practice by Size of Business, 2015

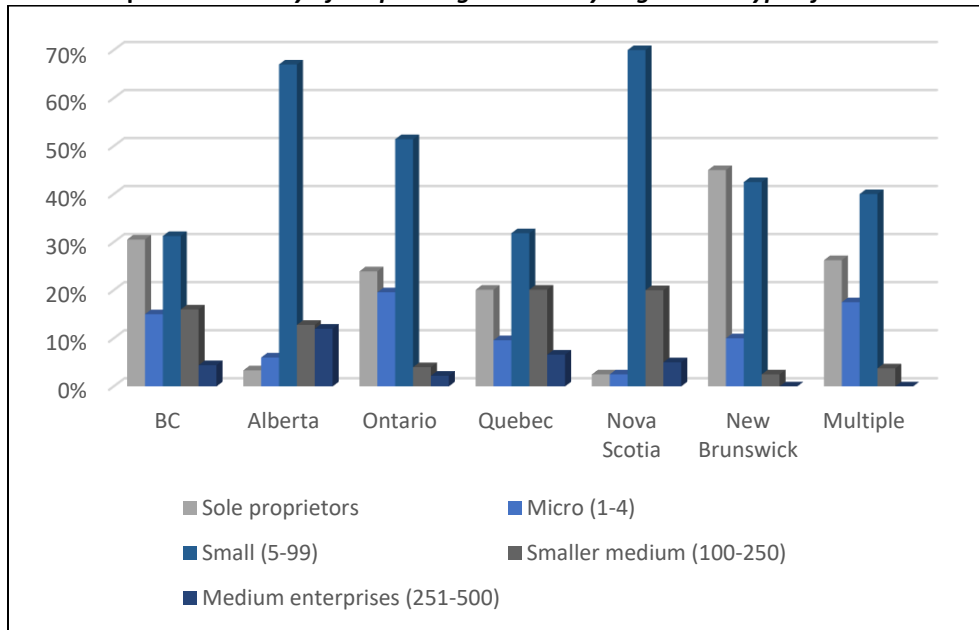


Graph 16 illustrates, for each province, the percentage of the responding trustees' practice is MSME, which is quite high across all jurisdictions. It means that their insights are particularly relevant as MSME comprise a very substantial portion of their practice. Graph 17 that follows breaks that number down further by the percentage of trustee practice by region and type of MSME.

Graph 16: Percentage of Business for MSME Practitioners



Graph 17: Summary of Responding Trustees by Region and Type of Practice



2. Survey Results

This section summarizes the results of the survey of 53 licensed insolvency trustees, recording all responses in graph form and then explanatory texts for many of the observations and insights. It also discusses the responses of the loan officers interviewed, although as noted above, the graphs represent only the trustee responses to the survey. Of note is that while the trustees have a direct personal economic interest in any legislative reform and loan officers have their principal's interests to consider, the survey responses indicated a sincere effort to assess the efficacy of the system from their professional expertise and experience.

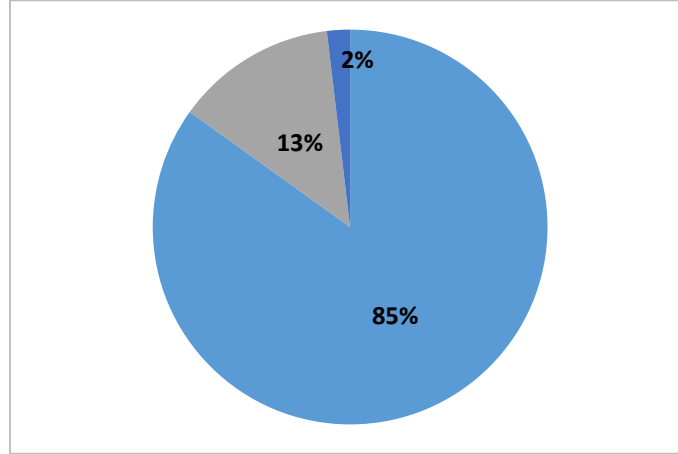
Generally, the vast majority of trustees expressed the view that there should be amendments to the *BIA* to ensure that the treatment of insolvent MSME gives viable businesses a chance for rehabilitation where possible, and at the same time, ensures timely bankruptcy where the business should be sold or liquidated. Several trustees discussed the problems of "midnight moves" by debtors of company assets to avoid landlords, and shuttered businesses or orphaned companies not being wound up through formal process because of the costs of bankruptcy proceedings. One trustee suggested considering a "deemed bankruptcy" right away, in that sometimes there is delay and value lost to creditors even though it is clear that a proposal is not possible. Another observed that on annulment of a Division II proposal, there should be a deemed bankruptcy, instead of placing these estates into limbo.

All ten loan officers surveyed agreed that some legislative reform to make the process more timely and cost effective would be helpful. Two loan officers noted, however, that there is still considerably stigma associated with the idea of "bankruptcy", and there is frequently a lack of understanding by debtors of the differences between proposals and other options under the *BIA*.

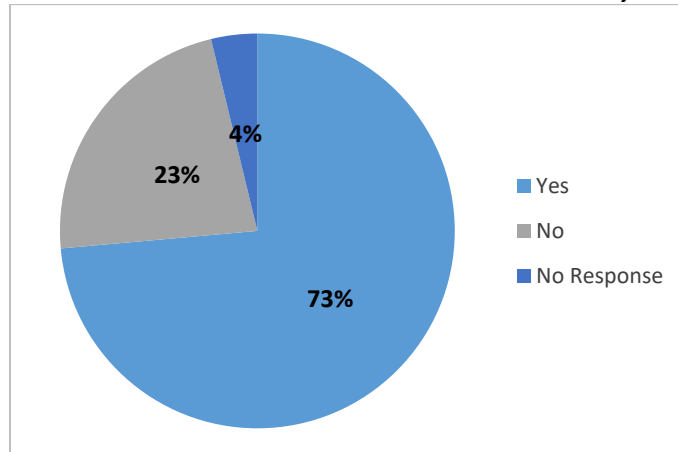
85% of surveyed trustees believe that the statutory provisions for proposals under the *BIA* could be enhanced to improve effectiveness and timeliness, as represented in Graph 18. The following Graph 19

illustrates that a smaller majority of trustees surveyed, 73%, believe that the statutory provisions for proposals could be enhanced to make the process less costly.

Graph 18: Statutory Provisions for Proposals under the BIA Could be Enhanced to Improve Effectiveness and Timeliness

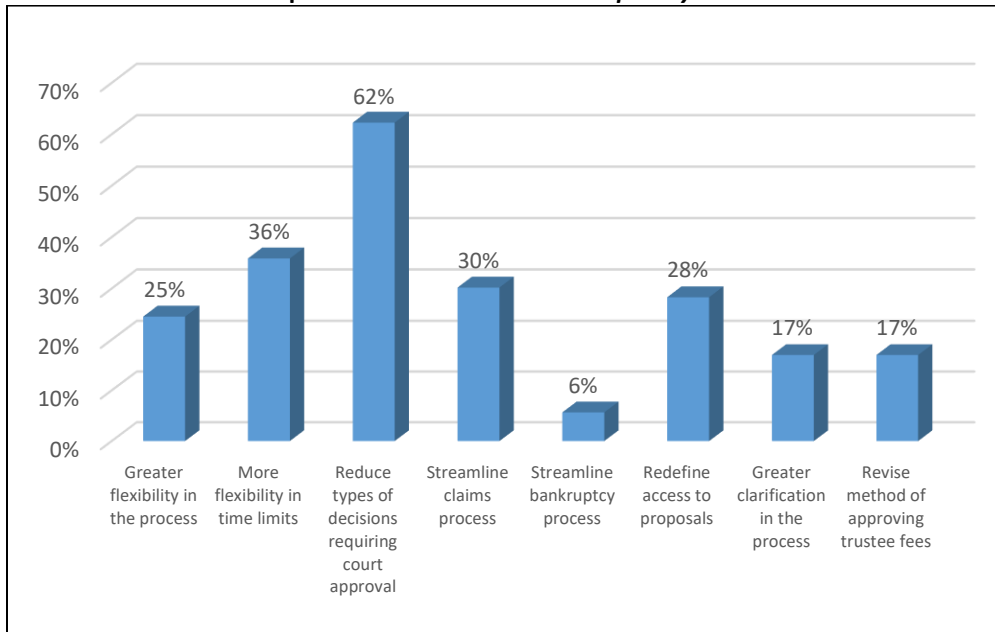


Graph 19: The Statutory Provisions for Proposals Could be Enhanced to Make the Process Less Costly



Survey participants were asked for specific ways in which the statutory scheme for MSME insolvency could be improved, and Graph 20 below represents the frequency of suggested ideas: the highest being the suggestion to reduce the number of decisions that require court approval and greater flexibility in time limits under the statute. Other suggestions included greater flexibility in the process, streamlining the claims process, redefining access to proposals, greater clarification in the process, and revising methods of trustee remuneration for MSME files.

Graph 20: Recommendations Frequently Made



Below is a summary of the types of recommendations and observations made. While there are subsections describing observations and recommendations for ease of reading, it is clear that there is overlap in some areas, and where necessary a bit of repetition. The suggestions should be read as a whole in terms of trustees' very helpful views on how to improve the system.

3. A Streamlined Process for Micro and Small Business

Many trustees pointed out that the objective of the provisions in the *BIA* is to encourage proposals for businesses that are viable, and to allow for a timely decision as to when bankruptcy is more appropriate. Many trustees recommended allowing for a process similar to a Division II proposal for micro and small businesses where the number of creditors is limited and level of debts are small and straightforward. Trustees observed that often in these cases, a stay is required to determine if a proposal can be made, but the process of presenting and voting on the proposal could be considerably condensed. Numerous trustees suggested that all sole proprietors should have access to the streamlined proposal restructuring provisions without restriction on debt levels. Several trustees observed that the 2009 amendments were effective in further enhancing rehabilitation as a priority over liquidation, but there are still barriers to micro enterprises having access to a streamlined Division II-type process. One trustee observed that, overall, the processes are good, and recognized as such by foreign investors and creditors, creating greater equity and certainty of outcome.

However, more than 2/3 of the trustees and all of the loan officers interviewed reported that the *BIA* provisions are far too costly for the majority of micro and small businesses, and they often cannot come within the definition of Division II consumer proposals. One trustee observed that of every ten micro businesses they work with, nine cannot access the insolvency process because the cost is prohibitive. With respect to bankruptcy, because of the high minimum cost, it is difficult to file a bankruptcy if there are no unencumbered assets. The fees for the service must be paid up front or are at risk of non-payment. The requirements on a small corporate bankruptcy are cost prohibitive, including a creditors' meeting

with no creditors in attendance, sales package/process for assets with minimal realizable value, taxation, etc. Thus the loan officer or the trustee will often forward secured asset files to an auctioneer to sell and pay out the bank or CRA. The difficulty is that these business owners have little protection from the general creditors in that instance.

The proposed solutions to the cost of micro and small bankruptcy were mixed. Loan officers suggested that there should be a service that does a quick “look-see” on viability, such that the bank can act quickly to realize where the business is not viable. Some suggested trustees could perform this preliminary assessment, while others proposed a trustee-type service, but supplied by the federal government. Trustees suggested that there needs to be a mechanism to pay the professional’s fees on liquidation, as bankruptcy is a public service, and where there are no assets to pay for the service and a secured creditor is unwilling to pay, the debtor often simply does not file. The majority of trustees surveyed found that the cost issue is likely the largest contributing factor to the decline in bankruptcy filings in recent years. Loan officers reported that they simply avoid the *BIA* bankruptcy process because of the expense, when they can realize directly on their security.

With respect to the proposal provisions under the *BIA*, the majority of both trustees and loan officers interviewed suggested that the proposal process could be streamlined for micro and small businesses. A streamlined proposal could redefine access to proposals, modernize notice, reduce numbers of creditor meetings, and create a deemed approval mechanism. Opinions varied as to whether there should be a new “Division III” for MSME, an expanded redefinition of Division II proposals to include micro and small businesses, or elimination of the Divisions entirely, setting in place a streamlined proposal process based on quantum and type of debt within one set of proposal provisions.

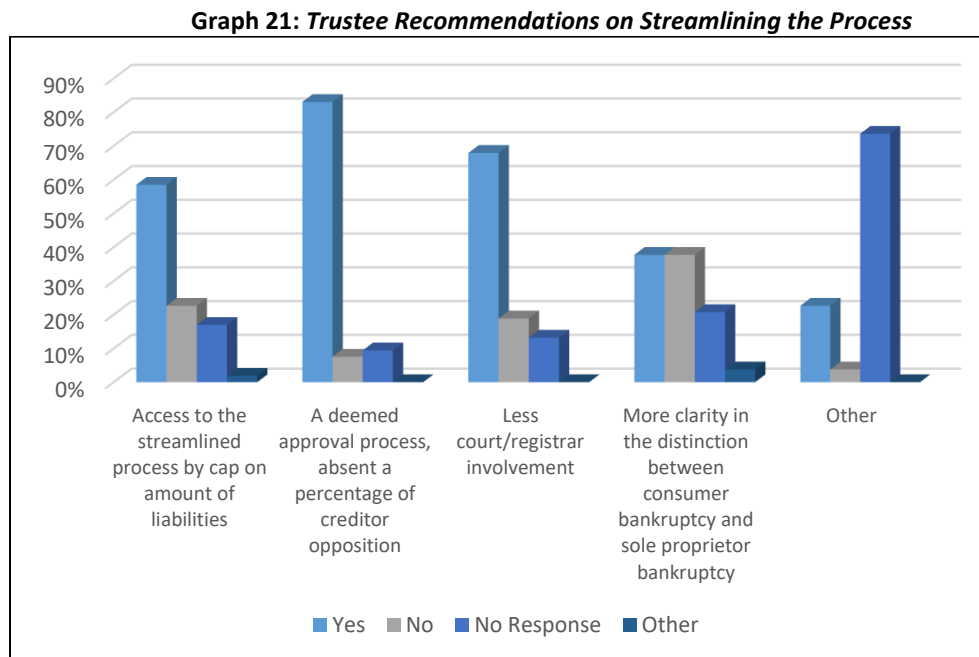
One trustee suggested that a helpful streamlining measure would be ability for the debtor to cure defaults such as delays in meeting payment terms under the proposal without the necessity of filing an amended proposal. The terms could allow inspectors or creditors at a creditors’ meeting to extend the payment terms if the trustee recommends it. Such an extension should not require court approval, payment of filing fees and additional cash flow reports. The trustee suggested that only if the quantum of dividends to be paid under the proposal is proposed to be reduced that the debtor would have to file an amended proposal and commence the process again. Pursuant to s. 62.1 of the *BIA*, defaults can be cured by the inspectors or creditors,⁹⁸ but the *BIA* should be made consistent across all proposals, and the use of inspectors and creditors in such situations helps maintain the integrity of the system.⁹⁹

The loan officers surveyed also supported the implementation of a streamlined process. They observed that MSME are typically “less sophisticated” in their finances; they may only have a bookkeeper in-house and often do not understand the benefits of engaging the services of a financial advisor or trustee. A streamlined process where the costs of the process are clear up front may assist in overcoming this barrier to filing.

⁹⁸ Section 62.1 specifies: Default in performance of proposal —Where (a) default is made in the performance of any provision in a proposal, (b) the default is not waived (i) by the inspectors, or (ii) if there are no inspectors, by the creditors, and (c) the default is not remedied by the insolvent person within the prescribed time, the trustee shall, within such time and in such form and manner as are prescribed, so inform all the creditors and the official receiver.

⁹⁹ It is important to acknowledge that trustees reported that the quality of inspectors really varies, but it is nonetheless an important integrity check.

Graph 21 summarizes some of the most frequent recommendations on how to streamline the process. Within these broad categories, there was a range of views, but 83% of surveyed trustees and 80% of the surveyed loan officers supported creating a deemed approval process for at least micro and small businesses.



i. *Redefine Access to Proposals*

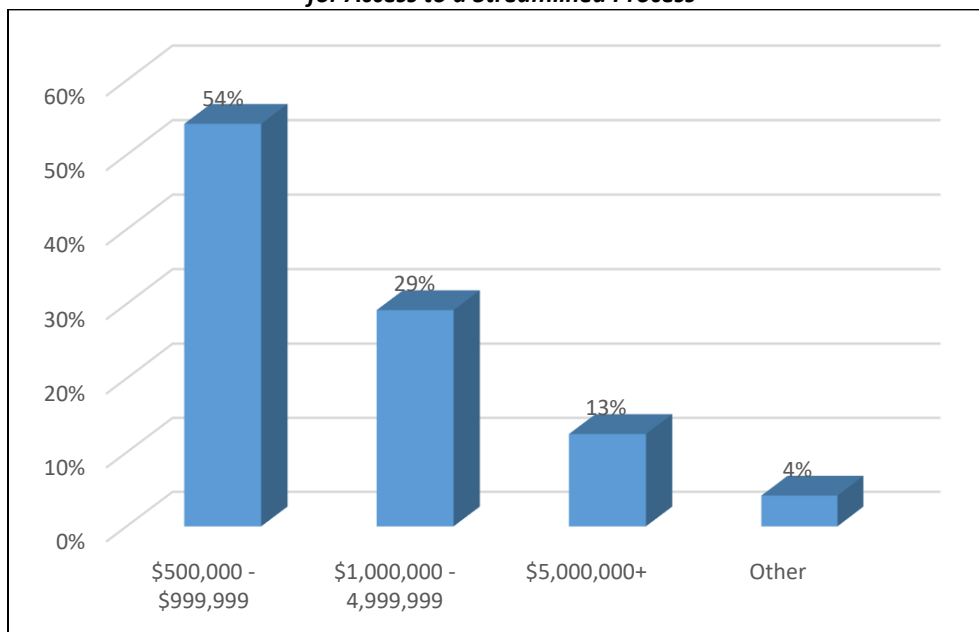
There were numerous suggestions as to how to improve access to proposals, with the objective that the small business person comes out of the process with a viable business, where possible. Some trustees recommended allowing incorporated sole proprietorships, micro and small businesses to file Division II consumer proposals. Two trustees were concerned that the word consumer misleads creditors and needs redefining. Three trustees suggested that purely consumer proposals should remain in the Division II provisions and all proposals relating to business activity should be dealt with in other provisions. Others suggested that the idea of “consumer debtor” should be eliminated, and access to the streamlined process should be dependent on amount of liabilities.

54% of the trustees’ surveyed believe that the cap for dealing with a micro or small business in a streamlined process should be between 500,000 CAD and 1 million CAD, and 29% recommended a cap between 1 and 5 million CAD. One trustee suggested a 10 million CAD cap for access to the streamlined process, as illustrated in Graph 22 below. If such a new streamlined process was to come within Division II proposals, the current cap of 250,000 CAD would have to be raised. One trustee observed that the current Division II limit includes secured loans for automobiles or other equipment, so it is not difficult for a small proprietorship to reach these limits. A common reason for sole proprietors, particularly professionals, having to avail themselves of the Division I procedures, which are more costly, is because they have secured indebtedness related to business assets like equipment and real estate that cause the 250,000 CAD threshold to be exceeded. Only one trustee thought that the current 250,000 CAD cap was set too high.

The decrease in business proposal filings in recent years may be partially explained by the change in the debt cap on consumer proposals increased from 75,000 to 250,000 CAD in 2009, making that process accessible to broader numbers of individual business debtors. Trustees reported that the increased cap of 250,000 CAD has driven a number of businesses into consumer proposal proceedings, as unincorporated individuals can use the less costly and more streamlined Division II process. The provisions thus appear to have been very helpful for the unincorporated self-employed and the individual business person in terms of benefiting from the simplified streamlined requirements of less reporting, fewer creditor meetings and less court involvement.

Thus whether a new process would fall under a redefined Division II or Division I, or a new Division III, there was broad support for greater access by changing the liability cap and by increasing access to the process for incorporated micro and small businesses, including sole proprietorships.

Graph 22: Trustee Recommendations for the Amount of Cap on Liabilities for Access to a Streamlined Process



The majority recommended allowing inclusion of personal debts of principals of the company in a proposal, inclusive of personal guarantees provided to third parties on MSME debts, corporate or otherwise. Others suggested that where there is a blending of corporate and personal debt, there is need to consider both at the same time, as business loans have to be secured with personal assets and personal credit cards are frequently used to support the business. One trustee observed that many businesspeople transfer assets into a limited company to protect themselves, but in the case of tools of the trade, they are no longer exempt. Access to rehabilitation requires protecting tools of the trade in all circumstances so the business person can earn income. Several trustees recommended creating an ability to compromise personal guarantees in a MSME corporate proposal, which would save using two separate filings.

Several trustees suggested that access to a streamlined process should not be pegged to liabilities, but rather, be available where debtors have a specified number of employees, such as 250 or fewer employees. Another trustee suggested a three-fold test for access: no more than 50 employees as

appropriate to access a new streamlined process, including lay-offs in the six months prior to filing, plus total unsecured debt of not more than 750,000 or one million CAD; and CRA deemed trusts such as unremitted payroll deductions not to exceed 100,000 CAD. Another trustee suggested access by number of creditors, such as 50, plus a dollar limit of 1-2 million CAD. Finally, one trustee recommended that access could be improved by allowing all individuals to use the Division II process, including sole proprietorships and without limitation by debt amount, but suggested amending the consumer provisions to include a notice of intention to make a proposal (“NOI”) and settlements with secured creditors.

ii. *Notice*

Almost all of the trustees and loan officers interviewed emphasized the importance of effective notice in both bankruptcies and proposals, an issue that becomes even more important for a streamlined process. One trustee suggested that bankruptcy is often the most effective way to transition a business, and that sometimes trustees pursue Division I proposals for sole proprietors where the likelihood of success is very low, simply to have a deemed bankruptcy in order to avoid a bankruptcy notice in the newspaper. Yet filing Division I proposals to avoid the notice requirements adds unnecessary cost for creditors in other parts of the process.

The majority of trustees responding to the survey believe that the notice provisions under the *BIA* are outdated and need to be improved. One trustee observed: “the public bankruptcy notice is archaic and adds unnecessary costs to the process”. Advertisements are often prohibitively expensive, one trustee reporting that in Toronto, for example, newspaper ads cost a minimum of \$800 to a \$1,000. Another trustee observed that sometimes trustees refuse to do small business proposals because of the cost of notices. Newspaper ads are viewed as ineffective, as many people no longer read the newspaper, unless they are in a small community. One trustee suggested that few creditors are missed in the initial filing, so the requirement of public notice to creditors is unnecessary. Others noted that if public notices are not required in consumer proposals and summary bankruptcies, it is difficult to understand the logic for requiring them in ordinary bankruptcies.

Numerous trustees recommended eliminating sending out notices by registered mail or ordinary mail, suggesting that most creditors just throw out all the information mailed to them, wasting time and paper. Trustees observed that registered mail is very costly where there are numerous creditors. However, another trustee observed that there are few creditors that need to be sent registered mail, and where it is required, such as for rescission of contracts, disallowing claims and lease disclaimers, it is very important that there is certainty the notice is received. Others suggested that it should be sufficient for the trustee to swear an affidavit of mailing to confirm that the notice was sent to the last known address, although there was disagreement among trustees in this respect, with the trustee observing that the cost of writing the affidavit, then finding a commissioner of oath and swearing the affidavit, is not any more cost-effective than registered mail or a delivery service.

Many trustees recommended that notice should be allowed to be sent by electronic means, such as email or fax, or through a link to a website, with new standards created for assessing sufficiency of notice. Several suggested that the first letter to creditors could be sent by mail, with an electronic link for information, which would serve as notice for the rest of the process. Another recommendation was to create a public notice board on the OSB website, which could replace newspaper public notice, where creditors could check at any time to see if the business is bankrupt or in receivership. Such a service would be highly accessible and cost effective. The question is how to ensure creditors receive effective notice of the proceedings and of any proposed treatment or compromise of their claims.

One trustee recommended making more summary the level of information required to be published and disseminated regarding the initial filing of the notice of intention to file a proposal. The trustee recommended providing stakeholders with *pro forma* information on what steps the debtor needs to take in order to resolve the causes of the insolvency.

In sum, almost all the trustees surveyed suggested that it is time to explore technologies to modernize notice under the *BIA*, in turn making the processes more transparent, timely and cost-effective.

iii. *Initial Stay Period, Extension of Stay Periods*

There were many and diverse views about the initial stay period and extensions of stay among the 53 trustees surveyed. In terms of the initial stay, the majority believe that the initial stay for a NOI or proposal should be automatic for all MSME, sole proprietor and consumer proposal filings. Many observed that there is insufficient information available to formulate a proposal at the time of filing and it is necessary to have preliminary discussions with significant creditors before formulating a proposal. The “breathing space” of the initial stay is critically important, several trustees observing that in the face of impending garnishments or asset seizures, trustees are forced to file a NOI and use the Division I process when a consumer proposal with an initial stay of proceedings would be far more efficient and cost effective. One trustee noted that the first 30 days after filing a NOI is often used to stabilize the company’s situation with its creditors, suppliers, etc.; and that companies often manage emergencies during this period and do not have the time to work out the terms of an eventual proposal.

Most trustees believe the initial stay period should be longer than 30 days, with recommendations ranging from 45 days to 90 days, with 60 days most frequently suggested. One trustee observed that a 60-day initial stay would give more opportunity to move directly to a proposal without spending time and resources on the extension application, thereby improving efficiency and reducing costs. Other trustees thought the initial 30 day period is sufficient, but that there is great need to streamline the extension of the stay process. One trustee observed that “it is extremely rare for a company to be able to make a proposal within 30 days, and the time taken to prepare a report and attend at court for an extension could be better used continuing to work on a proposal”. The majority of loan officers surveyed supported an initial stay period of 60 days.

The majority of trustees recommended that the trustee should be allowed to extend the initial stay unless creditors object. The recommended periods of extension ranged from 30 to 90 additional days. Trustees observed that the granting of the first extension is often a “rubber stamp” by the courts and the real work on the proposal occurs or is finalized during the following 45 day period. One trustee recommended that extensions of the stay could be given if there are positive cash flows as determined by the debtor and reviewed by the trustee; the time for the extension would be at the discretion of the trustee, after disclosure to creditors and an opportunity to object. Another suggestion was to give 30-60 days to prepare a cash flow statement rather than 10 days, perhaps requiring an update once a month to keep creditors informed. One suggestion was that the trustee should have an obligation to report accrued charges to the primed creditors on a bi-weekly basis and the primed creditors, if appropriate could proceed to court to set limits or other constraints on the priority charge. That safeguard could facilitate a more streamlined approval process.

One trustee suggested that if an independent assessment of an extension of the stay is required, official receivers could be given authority to authorize the first extension, saving the costs of a court hearing. One trustee recommended three 60-day stay periods, requiring just two extensions of the stay. The proposal trustee could send creditors a notice of extension of the stay, which would then be automatic if no one objects and the trustee certifies there was no objection. Another suggested that there should be a full six month stay from the outset, unless creditors object. Three trustees thought that the initial stay period of 30 days and 45-day extension periods as they are currently set out in the statute were appropriate and efficient.

Notwithstanding that the majority of trustees responding to the survey would like a more streamlined process within the six month period, the vast majority expressed the view that the six month limit worked well in the majority of cases, but that the court should be given authority to extend that period, as discussed below in part *vi*. The loan officers interviewed also preferred the six month cap on proposal proceedings as a general rule, but supported the idea of giving the court the authority to extend that period in some circumstances. They were generally supportive of giving the trustee the authority to extend the stay period at least once or twice, but noted that notice to creditors and the ability to object to the extension were very important protections against debtors that were using the process merely to delay inevitable liquidation.

iv. *Clarify the Distinction between Consumers and Sole Proprietor Debtors*

The surveyed trustees were equally divided as to whether there needs to be a better distinction made between consumer debtors and sole proprietors, 48% expressing the view “yes”, and 48% expressing the view “no”, and the remainder having no opinion. Many trustees expressed the view that it is not problematic, because the personal and business liabilities of the micro and small business person are so intermingled it is difficult to separate them. Others, however, believe that there should be a separate mechanism that offers businesses a streamlined process.

Many trustees suggested that there needs to be a clearer way to address the blending of corporate and personal debt of micro and small businesses, as business loans are usually required to be secured with personal assets, and debtors frequently use personal credit cards to support the business. The current system masks this confluence of personal and business debt. It was recommended that the proposal provisions should allow inclusion of personal debts of principals of companies, with no limitation, inclusive of personal guarantees provided to third parties on MSME debts, corporate or otherwise.

One trustee observed that treating sole proprietors in exactly the same way as consumer debtors who are not proprietors, as is the case now, does not take into account the significantly higher work load on trustees of sole proprietors; such as dealing with the sale of business assets, corporate landlord issues, accounts receivable,¹⁰⁰ professional regulatory bodies, employee issues, more and often complex lawsuits, reviewing business records, dealing with corporate tax returns, goods and sales tax (“GST”) and workers’ compensation returns, more complex income and expense statements and therefore surplus income calculations, sometimes the need for counsel, and, in the case of proprietors in the construction

¹⁰⁰ Which the trustee noted can involve privacy issues in the case of certain sole proprietor professionals such as lawyers.

industry, dealing with builders' liens. The trustee's time input is much higher for a Division II where there are business implications.

These observations suggest that the notion that one could simply eliminate the distinction between "consumer" and "business" debtor in Division II of the *BIA* will not address the problems identified. Another trustee observed that there should be clarity as to the distinction between personal debts and commercial debts, perhaps considering whether the system should provide for different treatment of liabilities based on the nature of those liabilities. Two trustees believe a sole proprietor should be treated like other businesses in both bankruptcy and in proposals. However, one trustee observed that if cash flow requirements for a sole proprietorship are made consistent with the Division I format, it will overly complicate things where record keeping for debtor is really only focused on requirements for annual tax filing. One trustee noted that it would help the sole proprietor files if there were an ability to compromise personal guarantees, or an ability to fashion a joint proposal for the MSME and the owner/director.

One trustee suggested that Division I proposals should only pertain to a "true business venture", not to a sole proprietor or micro business based on the amount of liabilities, defining a true business as business operations that employ at least five employees.

v. *Reduce Types of Decisions Requiring Court Approval*

Many trustees observed that proposals are essentially a new contract between the debtor and the creditors, and that if the creditors approve, there should be limited court involvement necessary. Many recommended a process similar to the Division II consumer proposals, where court involvement is minimal. The majority of responding trustees believe that courts add costs due to the administrative burden, and that reducing the amount of court time would have a meaningful impact. A deemed approval approach to MSME proposals should still allow for court hearings where a creditor requests it. One trustee observed that the biggest barrier is where a MSME knows it will need an extension, but cannot afford the cost of the court process to obtain it; for example, the success of a proposal or viability depends on a future event, expected to take place more than 30 days in the future, but requiring the protection of a stay of proceedings. If one were to eliminate the requirement for court approval for an extension, if unopposed, it would allow that business a chance to survive.

Numerous trustees recommended reducing the need for supplemental court orders. They observe that, currently, a great percentage of the Division I proposal provisions that are automatic, such as the stay, must be supplemented by a court order that clarifies the authority of the trustee or provides other relief such as interim financing. Such requirements negate the streamlined benefits of the Division I proposal provisions and increase the costs associated with the proceedings.

Two trustees suggested that if the value of assets is low and below a certain level, the trustee should be able to realize on the assets without having to go to court for approval if there are no inspectors. However, another trustee observed that this right already exists under ss. 30(1) and 30(3) of the *BIA*, which specify all the powers the trustee can exercise either with approval of the inspectors, or where there are no inspectors, on the trustee's own authority.¹⁰¹ However, the trustee cannot sell or otherwise dispose of

¹⁰¹ Section 30(1) specifies: 30.(1) Powers exercisable by trustee with permission of inspectors — The trustee may, with the permission of the inspectors, do all or any of the following things: (a) sell or otherwise dispose of for such price or other

any of the bankrupt's property to a person who is related to the bankrupt without the court's authorization, which serves as an accountability check on the integrity of the sale. To do otherwise might create incentives to inappropriately lower the value of the asset to be sold to a related person.

One trustee suggested keeping the requirement for court approval of Division I proposals. Another observed that the court and registrar involvement should be maintained as it assists with monitoring and serving as final arbiter of issues. Another trustee believes that registrars keep trustees honest, and they also give trustees peace of mind that they are acting appropriately and "getting it right".

Suggestions were made that the trustee should be given authority to take actions (fee draws, lawsuits, etc.) if no inspectors have been appointed, and that monitoring responsibilities should be clearly delineated to improve the efficiency of the trustee's monitoring activities for material adverse changes.

Small corporations are often highly dependent on a principal shareholder and the business is not easily saleable to a third party. The *BIA* currently requires court approval for the sale of assets to related parties, including the principal shareholder, and one trustee was of the view that the test for approval of such a sale is onerous. Several trustees observed that if the creditors approve a sale to a related party, it should be sufficient, assuming the proper disclosures have been made regarding relationships. It would save unnecessary costs and reduce burden on the court. Trustees also recommended that court ratification of a Division I proposal should only be required if a creditor opposes the ratification or if the trustee presents a report recommending the refusal of the proposal. What is important is to ensure that the court is available to preserve the integrity of the insolvency system, to protect the public interest and public trust.

Trustees noted that the cost of the multiple court applications for extensions are prohibitive and are a barrier to filing, trustees reporting that each court appearance to extend the time costs between 5,000 and 10,000 CAD. A suggestion was made to maintain the initial day stay period, but allow the first extension to be automatic unless creditors in a specified number object, saving both time and costs in seeking court approval for the extension. In such instances, the system would have to ensure proper notice and information to creditors, the OSB and other significant stakeholders, with an opportunity to object. There was concern expressed by two trustees that any streamlined process, including rethinking

consideration as the inspectors may approve all or any part of the property of the bankrupt, including the goodwill of the business, if any, and the book debts due or growing due to the bankrupt, by tender, public auction or private contract, with power to transfer the whole thereof to any person or company, or to sell the same in parcels; (b) lease any real property or immovable; (c) carry on the business of the bankrupt, in so far as may be necessary for the beneficial administration of the estate of the bankrupt; (d) bring, institute or defend any action or other legal proceeding relating to the property of the bankrupt; (e) employ a barrister or solicitor or, in the Province of Quebec, an advocate, or employ any other representative, to take any proceedings or do any business that may be sanctioned by the inspectors; (f) accept as the consideration for the sale of any property of the bankrupt a sum of money payable at a future time, subject to such stipulations as to security and otherwise as the inspectors think fit; (g) incur obligations, borrow money and give security on any property of the bankrupt by mortgage, hypothec, charge, lien, assignment, pledge or otherwise, such obligations and money borrowed to be discharged or repaid with interest out of the property of the bankrupt in priority to the claims of the creditors; (h) compromise and settle any debts owing to the bankrupt; (i) compromise any claim made by or against the estate; (j) divide in its existing form among the creditors, according to its estimated value, any property that from its peculiar nature or other special circumstances cannot be readily or advantageously sold; (k) elect to retain for the whole part of its unexpired term, or to assign, surrender, disclaim or resiliate any lease of, or other temporary interest or right in, any property of the bankrupt; and (l) appoint the bankrupt to aid in administering the estate of the bankrupt in such manner and on such terms as the inspectors may direct. Section 30(3) specifies: (3) If no inspectors — If no inspectors are appointed, the trustee may do all or any of the things referred to in subsection (1).

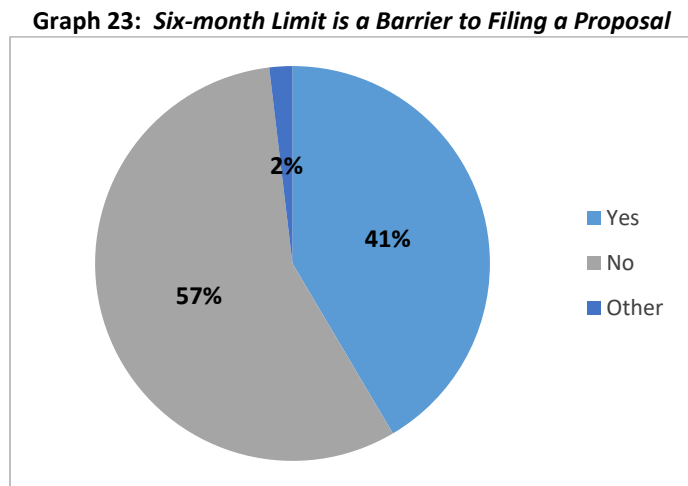
the court's role, should not add codification to the *BIA* unnecessarily. The *BIA* should facilitate arrangements, proposals and bankruptcies, but has become too expensive; streamlining would create greater access, being truer to the intent of the legislation.

One trustee recommended that there should be an ability for the trustee to assist the debtor to obtain a charge for minimal interim financing without court approval; because often, the cost of obtaining court approval and the time required to get court approval in place is prohibitive to companies that require a small amount of additional funding during the initial stay period.

vi. Is the Six-month Maximum Period to Devise a Proposal a Barrier to Filing?

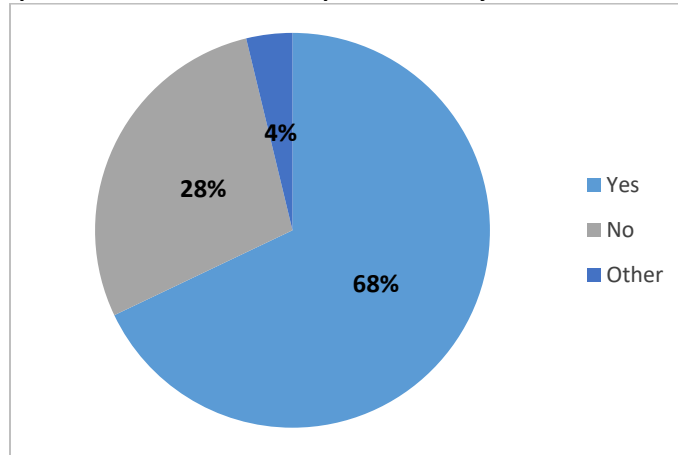
Related to the question of the role of the court is the issue of the statutory maximum period of six months afforded by the *BIA*. Currently the court does not have the authority to extend the statutory period. The loan officers surveyed generally observed that the majority of cases are resolved well under the six month limit, but that the court should be given authority to extend the time limit where circumstances warrant, such as where parties are very close to concluding agreement on a proposal.

When asked if the six month limit to devising a proposal is a barrier to filing, 57% of trustees surveyed disagreed, as illustrated in Graph 23 below. One trustee observed that normally a viable company should know where it is going after the first six-month period, and thus the period is not a barrier to filing since companies experiencing financial difficulties are experiencing them in the short term. The trustees that were opposed to the courts having the authority to extend the time limits took the view that the six months provides timeliness and certainty for the debtor and the creditors and should be maintained.

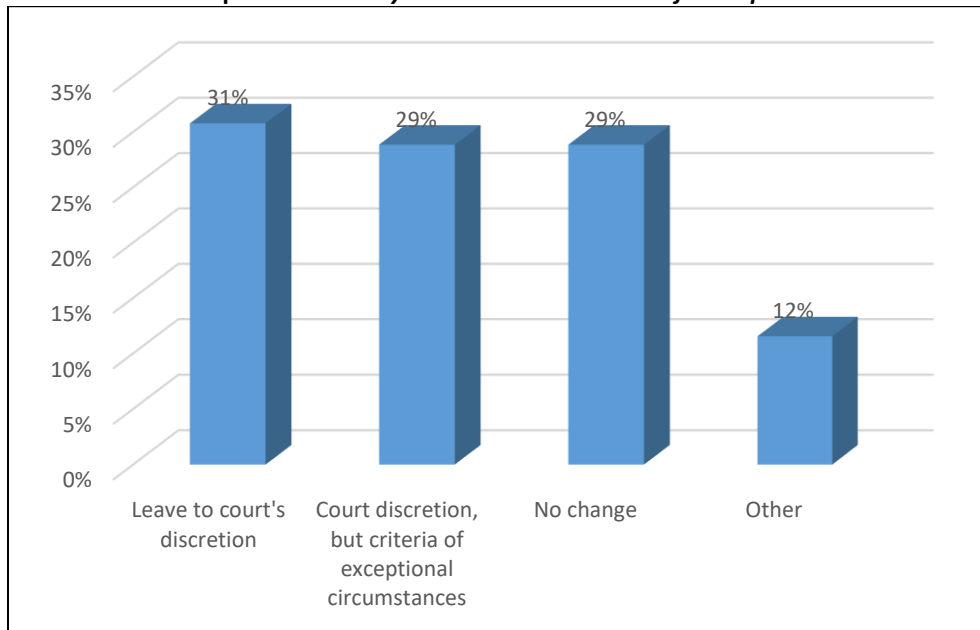


However, 68% of surveyed trustees expressed the view that the court should have express authority to extend the time limit in particular circumstances, as illustrated in Graph 24. More than half believe that it should be left to the court's discretion, but half of those trustees expressed the view that the circumstances should be limited to exceptional circumstances, as reflected in Graph 25 below.

Graph 24: Court should have Express Authority to Extend the Period



Graph 25: Flexibility in Six-month Time Limit for Proposals



Trustees reported that the vast majority of MSME cases can be finalized within six months, but that some flexibility would be helpful for medium enterprises. Six months is usually sufficient, but there are cases where additional time is warranted and a “hard” deadline of six months is overly restrictive. Trustees observed that more time may be required if there is a complex situation with many issues or where the viability of the company is dependent on the outcome of an event outside of the six-month time limit. Sometimes a sale of a major asset or business division or the finding of an investor can take longer, and the inflexibility may mean value is lost. Circumstances that could require an extension of time include an imminent sale of the company, imminent conclusion of a new financing contract, or where the debtor company has an important government debt for source deductions and requires time to negotiate with CRA or time to create a reserve fund that allows for the payment of the source deductions within six months of the court approval of the proposal. Trustees observed that for enterprises of any complexity, there is no certainty that six months can be sufficient to address the required operational changes and

then prove to skeptical creditors that as a result of those changes, things will be different going forward; to resolve claims to enable a proposal to be formulated; and then to hold the requisite creditor meetings and court approval process. The majority supported amending the legislation to allow such discretion, if the court is satisfied that the company continues to act in good faith and no creditors are materially prejudiced by the extension.

Some trustees suggested that extensions of the stay period are not really needed because the trustee can use a “holding proposal”. The holding proposal specifies how much additional time the debtor needs and creditors vote on that basis, allowing creditors, rather than the court, to make the decision to extend. However, there was serious disagreement among the responding trustees about the integrity, transparency and legality of this strategy, some trustees fully supporting it and others calling for a clearer and more accountable method of extending the time. Several trustees reported that they have tried filing a holding proposal to remove the need for extensions and also to extend the time for filing the definitive proposal, subject to creditor approval; but given the statutory restrictions, the court has rejected holding proposals that extend beyond six months. 20% of responding trustees noted that the only option now is to artificially convert the proceeding to a CCAA proceeding in order to extend the timing, which leads to unnecessary additional costs and is usually an inappropriate mechanism to use for the size of the business. The court’s ability to extend the time for the proposal would be a more appropriate way to address cases where particular circumstances warrant an extension.

With respect to when the court should exercise an authority to extend the six-month period, there were a number of suggestions. One trustee observed that the court’s discretion should take into account the size of the file, claim valuation, complexity of issues, and level of support from creditors. Several trustees observed that the debtor should be required to show that it is acting in good faith and that there is a compelling reason why more time is required. Most trustees thought that the courts should be left to determine the types of circumstances that warrant an extension. Such circumstances might include issues regarding refinancing, licencing and other issues associated with restructuring or due to the seasonal nature of the business or industry; real progress being made on coming to successful solutions; or a new fund provider, partner or buyer needing more time to perform or complete due diligence. Such decisions were thought best determined on a case by case basis with an experienced judge. One trustee recommended that in addition to the court being satisfied as to the diligence of the debtor in pursuing and advancing a viable proposal, some objective criteria could be developed to establish benchmarks to establish that progress.

There were four trustees who thought the maximum period to devise a proposal in the *BIA* should be extended to one year, with more flexible stay periods of two or three months. Another suggestion was to allow the trustee to extend up to the first six months and then the court thereafter for the next six months. There was strong support for reducing the number of court appearances for the extensions of the stay, as discussed above. One trustee suggested that the six-month time limit could be extended for bigger enterprises, such as where total debts exceeded a fixed amount, for example, one million CAD.

vi. *Improve the Claims Process*

The vast majority of survey responses in respect of improving the claims process were directed at issues related to CRA and to claims regarding the Wage Earner Protection Program (“WEPP”), both of which are discussed below in separate sections. The most frequent suggestion was finding a way to have greater flexibility *vis a vis* government claims. There were a few additional suggestions made, but trustees

generally expressed the view that the claims process is quite effective. One recommendation was that there should be an ability to compromise personal guarantees in a MSME proposal.

One trustee recommended that if an arm's-length creditor does not dispute the company's declared amount of debt, there should be a simplified claim form or no form at all, to expedite the process. Several trustees recommended a standardized form or electronic communication, by which the creditor could acknowledge that it agrees with the claim amount disclosed by the debtor. A number of trustees recommended allowing creditors to be paid electronically instead of by cheques as a way to expedite and streamline the claims process. Trustees also suggested that they need a period of time to bring everything up to date in terms of accounting. Trustees asked for more flexibility on the location requirement for the first meeting of creditors.

Three trustees suggested that there is a need for clarity in partnership, where one partner is filing a proposal, but claims can be made against the partnership. A lot of small businesses have not been structured properly, and there is no documented partnership agreement. In a formal partnership that comes to an end, there should be a mechanism for part of the business to carry forward. Other trustees suggested that there need to be clear rules for joint proposals of related companies in the treatment of claims.

In terms of assets that are available to satisfy claims, one trustee observed that if a sole proprietor incorporates, "tools of the trade" are no longer exempt; and that tools of the trade need to be protected in all circumstances so that the person can continue to have access to them to continue earn income. A "tools of the trade" type exemption is needed for micro and small businesses, leaving a baseline of equipment not subject to the claims of CRA or secured creditors.

vii. *A Mechanism for Deemed Approval of Proposals*

Trustees recommended that a streamlined proposal process for MSME in the *BIA* should require holding a meeting only if requested by the creditors, similar to a Division II *BIA* consumer proposal. Many recommended that for micro and small businesses, there should be no statutory requirement for a meeting of creditors where proper notice is given, unless a requisite number of creditors, such as 25%, request a meeting. Another suggestion was to eliminate the creditors' meeting and have electronic voting on a proposal. The majority of surveyed trustees and loan officers expressed the view that if the goal is speed and ease of restructuring micro and small businesses, then a deemed approval mechanism makes sense, because creditors would still be able to object and seek a court hearing.

Many suggested that trustees should be given authority to proceed to canvass creditors, and where a requisite number are in support, or not opposed to, a proposal, it should be deemed approved. Recommendations for the amount of opposition that would be required ranged from 25% to 50% of the proven dollar value of debt with a "headcount" of creditors opposing also recommended as between 25% and 50%. There were many recommendations to change the voting threshold for approval of proposals to a simple majority in value and head-count, trustees suggesting that 2/3 dollar value does not seem to be logical if the objective is to rehabilitate businesses where possible, since a lower dollar threshold should improve the approval rate of proposals. Several trustees suggested that the deemed approval of the proposal could be 15-30 days after the acceptance of the proposal by the creditors at the meeting of creditors, or by electronic voting. Another trustee recommended that if there are less than five creditors

in the estate, the statute should dispense with a meeting of creditors and allow the voting by letter or electronic vote only. Trustees would be required to monitor to ensure integrity of the system.

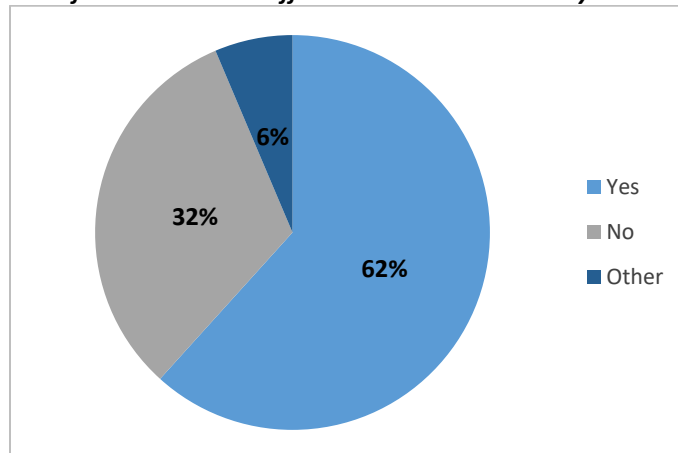
One trustee observed that in moving to a deemed process for creditors to vote on proposals filed by smaller enterprises, it may be more realistic to define micro and small business in terms of numbers of employees rather than assets/liabilities.

Not everyone surveyed recommended a deemed process for approval of MSME proposals. One trustee noted that “the present situation where the vote on the proposal is held at the meeting of creditors approximately 21 days after the filing of the proposal should be maintained. It allows all creditors to participate in the process and also avoids double notices to creditors”, a first notice sending out the proposal and a second one in the event the creditors would require a meeting of creditors. Others felt that creditors’ meetings should still be mandatory. One trustee observed that a “problem with proposals generally is that creditors must write off amounts for reasons that they may not be able to control. If a debtor is a strategically important supplier or vendor, then there may be good reason for creditors to support a restructuring”, but “that is generally difficult to establish in a smaller MSME debtor.” One trustee expressed the view that the current regulatory framework for proposals is adequate; however, in regard to micro and small employers where there are no trust claims and no secured debt or no restructuring of secured debt and a limited asset value, a deemed approval process would reduce some of the costs of restructuring.

4. Addressing the Reasons for Insolvency in the Proposal

Prior to the survey, trustees anecdotally observed that proposals can be problematic in that they usually do not specify how the reasons for the insolvency of the business are being addressed in the proposal, leaving creditors at a disadvantage in their consideration of whether or not to support the proposal. When asked in the survey whether there should be a requirement for the debtor or trustee to disclose how the reasons for insolvency are being addressed, the survey responses were mixed. As Graph 26 below illustrates, 62% reported that the proposal should specify how the reasons for the insolvency of the business are being addressed in the proposal, while 32% responded no. The 6% “other” was because the trustees were already undertaking this reporting to creditors.

Graph 26: Should the Trustee be Required to Disclose How the Reasons for the Financial Difficulties were Addressed by the Debtor?



Trustees observed that more details on the turnaround would be beneficial to the creditor group voting on the proposal, giving them more insight prior to having to decide how they will vote. It would allow creditors to more intelligently evaluate the likelihood that the debtor can carry out the proposal. It is the most frequently asked question at meetings and expressly requiring it to be addressed in the proposal sent to creditors may reduce the number of requests for meetings and increase the number of yes votes. Many survey respondents suggested that the trustee's report on the proposal should include how the reasons for the insolvency of the business are being addressed, together with the trustee's view on why the proposal is better than bankruptcy in terms of potential viable business going forward.¹⁰² Too often the causes of insolvency are not addressed adequately by the proposal process. The proposal process simply focuses on the level of debt relief that can be achieved and not on providing any assurance that the debtor has instituted operational changes that will enable the enterprise to both succeed in the short term and avoid its past mistakes in the longer term.

A few trustees believed that the reasons for insolvency should be expressly disclosed on the statement of affairs of the debtor. Trustees observed that it is important to understand/disclose how the MSME failed and what steps have been taken to correct the situation. It would ensure that the process is transparent and reduce the risk of debtors filing simply to delay liquidation, rather than addressing the underlying problems. A deemed annulment process, similar to a Division II proposal, ensures monitoring costs are kept to a minimum and creditors' rights are revived quickly in the event of default.

The "no" opinions referred to the fact that the reasons are not always relevant, or that creditors will raise the issue if they wish to know, and that it should be left to the parties who are interested and who will be involved in the post-restructuring business. Others suggested that it should be up to the discretion of the trustee, and thus not legislatively specified. A number of trustees suggested that the better route is to incorporate such reporting into CAIRP's best practices. One trustee observed that creditors are in a better position to assess the risks of the proposal being completed as they may have had a longer relationship with the debtor and had access to/or could have requested financial information. There was also concern expressed that while the reasons are important for personal insolvency, they are less important for corporate proposals. One trustee observed that the suggestion that the proposal provide specificity on how those causes are being addressed presumes a level of diligence in ferreting out all of the factors impacting the causes of insolvency in the first place. There is often not the scope of mandate or funding available for the trustee to undertake a sophisticated and independent review of the operations to determine the real causes of insolvency beyond a few summary observations. In smaller files, there is seldom an ability to really drive down into the operation to differentiate between general economic issues affecting the business and the structural inadequacies of the management team, and doing a critical evaluation of where the debtor company sits in relation to its key competitors.

There was concern expressed that specifying how the proposal would address the reasons for insolvency would unnecessarily raise the cost of proposals because the trustee would have a higher legal obligation to investigate and give an opinion. Such a requirement would likely increase the proposal trustee's obligation to monitor post filing; trustees reporting that detailed analysis of the reasons for insolvency

¹⁰² One trustee observed that where there are specific issues driving the insolvency, for example gambling, it is important to advise creditors and advise of the counselling or other action taken to address the reasons for the insolvency.

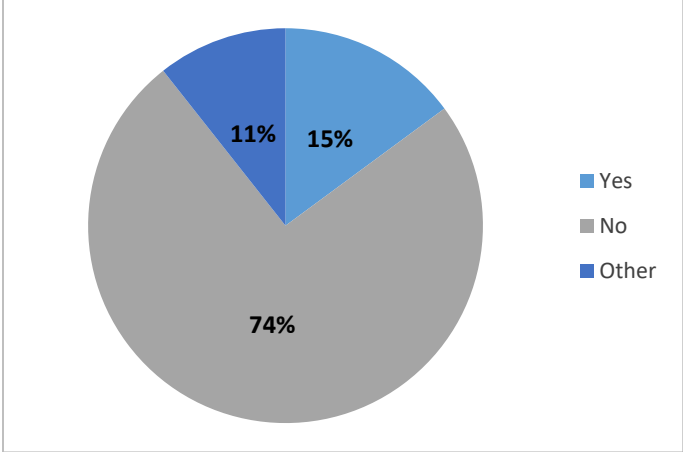
and how they are being addressed would add unnecessary professional costs to the process. Trustees observed that the reasons for the insolvency and viability of the MSME are addressed at the preliminary assessment and during the cash flow review, and from a practical perspective, major secured creditors, new lenders, significant unsecured creditors will have to have their issues regarding such matters addressed in order to achieve support for a proposal. Trustees suggested that outside of the financial terms of the proposal, the proposal should focus on why the proposal is better for creditors and the debtor than any realization in a bankruptcy scenario, with some explanation as it relates to a go-forward business plan. It would move the onus for highlighting the benefits of the proposal to creditors towards the debtor and away from the trustee. To gather sufficient knowledge would be time consuming and defeat the intent of modifications aimed at streamlining the process. There was also concern about creditor apathy, that creditors do not care about reasons, their interest is the money they get out of the proposal.

The loan officers surveyed had a different view, suggesting that it would be helpful to understand how a proposal is aimed at remedying the reasons for the financial distress. Two loan officers noted that they already try to discern this information from the debtor and the proposal trustee.

5. Is a New Source of Interim Financing Needed?

The trustees and loan officers were asked whether or not there should be a source of funding available, such as a program to provide temporary loans or loan guarantees to MSME that address their financial difficulties until the enterprise can again access other sources of capital. Here there was a very strong majority of 74% of trustees who were opposed to this idea. 15% of surveyed trustees supported the idea and 11% had other responses, illustrated in Graph 27 below.

Graph 27: Is a New Source of Interim Financing for MSME Needed?



A majority of trustees responded that there are capital market providers who are already available to fill this need in Canada, including the availability of further secured debt from primary lenders, credit unions, the Business Development Bank of Canada (“BDC”), high yield and high risk lenders, and companies that do factoring; so in their view, there is no need for a program to provide temporary loans or loan guarantees to MSME that address their financial difficulties until the enterprise can gain access to other sources of capital. B-lenders already exist and their interest rates reflect the additional risk they take in providing these loans. A number of trustees suggested that part of the problem that enterprises encounter in seeking solutions to their financial difficulties is that they wait too long to take corrective

action, so no amount of capital will assist. One trustee noted that a pool of funds would just provide further capital to delay the inevitable liquidation. The issue is frequently the lender's confidence that the debtors will manage their existing cash flows going forward. Lenders with expertise in MSME are the most qualified and adept at assessing the risk level of new credit compared with the potential for a turnaround of the businesses.

None of the loan officers interviewed thought that a new financing mechanism is needed. They believe that there continues to be sufficient liquidity in the market to finance viable businesses; and that the issue really is that the debtor waits too long before trying to access the financing; for example, coming to seek financing only the night before a payroll is due that they cannot meet. Loan officers reported that often, by the time the debtor discloses the financial distress, there is no longer a viable business to save.

Trustees strongly believed that the market has been consistently sufficiently liquid and competitive in recent years such that viable proposals get funded. Their view was that the debtor should obtain new financing through the market; if a company can't access funds, it is likely insolvent and the government would be throwing good money after bad. Ten trustees observed that if there was a government-sponsored program, it would likely be untimely and unwieldy, and would create the wrong incentive for businesses, a sentiment echoed by two loan officers. One trustee observed that creditors are already essentially providing interest-free financing going-forward, given the compromise or arrangement under the proposal, and that is sufficient to address the financing issues; it would be inappropriate to funnel public money into the debtor. Another trustee observed that there is adequate capital available in the private markets, and if a company is unable to access other sources of capital, then a governmental agency should not be risking its capital with temporary loans or guarantees. One trustee suggested that there is no way the government should give taxpayer money to companies facing bankruptcy unless it secures a prime position with regards to assets. There were a lot of responses about market forces being sufficient here, although some trustees thought that secured lenders' best practices could be better developed in terms of forbearance or extending financing for a limited period. One trustee observed that if a quasi-government fund existed, entrepreneurs would seek this funding rather than look to correct the problems of their business, skewing incentives for business rehabilitation

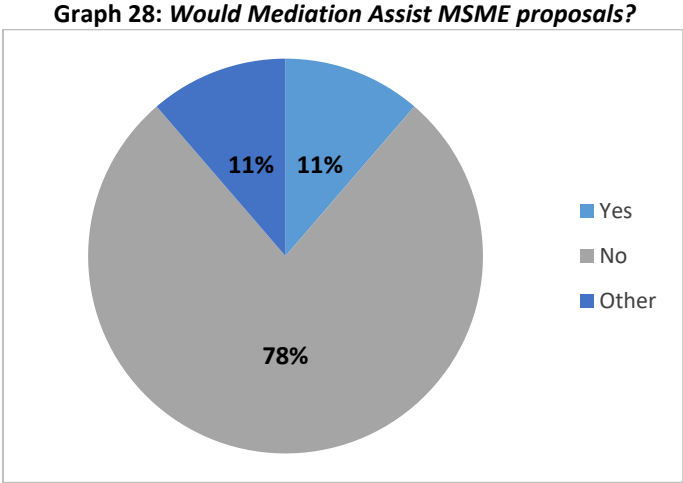
A number of trustees expressed approval for exploring the idea of such financing, but were concerned about the private/public divide of such sourcing, and the problems of monitoring and accountability. Trustees observed that it is easy for larger companies to get financing, but MSME often have to go to asset-based lenders and their rates and repayment schedules are prohibitive. Timeliness of access to such financing would also be key, because a number of businesses fail and value is left on the table because the financing cannot be arranged fast enough. Any financing should be for working capital going forward and not directed to paying pre-filing secured claims. Several trustees thought a mix of public/private "lights on" financing might work, such as a special part of BDC's SME financing program to provide some interim post-commencement financing while the proposal is being developed. Several trustees responded that such financing would have to weigh the risk of default against the potential jobs and other going-concern value being preserved, and questions were raised regarding the priority of such financing, in terms of whether it could have the current priority of interim financing set out in the *BIA*. Trustees that supported the idea of new bridge financing observed that there are already sufficient turnaround funds for large companies, but there isn't much available for the small companies because the banks don't want to get involved. If there was a source available for the small companies, it would need to be at low cost and low interest. One trustee observed that government guaranteed loans may be of use in case of a proposal that has passed the approval process in terms of creditor support.

A number of trustees said that a form of financing would be to allow deferral of deemed trust monies owing to CRA to be extended out to a year, so in essence, the government would be lending money without all the administration, but that the “loan” should not be extended further. CRA could extend the time for repayment; they suggested retaining the current six month deadline to repay, but develop a policy on principles or conditions under which to extend repayment if CRA determines the proposal is viable and there are good prospects for payment.

Numerous trustees noted that the last round of legislative amendments to the *BIA* provided for interim financing on a priority basis and that these provisions resolved any issues in respect of bridge financing pending a proposal and going-forward business strategy. While not frequently used, it has facilitated a deeper market for distress financing, with clear criteria. Several trustees cautioned that the court needs to be careful in its oversight as to the amount of fees and accessibility of rates, because there is potentially prejudice to other creditors. Trustees reported that the only issue should be how to streamline the decision process if the trustee supports the financing and the creditors do not object.

6. Would Mediation Assist the Proposal Process for MSME?

Trustees were asked if mediation would assist in better identifying whether or not and how a MSME business could be rehabilitated. 78% of the trustees surveyed responded “no”, as illustrated in Graph 28 below.



The surveyed trustees overwhelmingly expressed the view that mediation would not assist, and that creditors were unlikely to participate in a mediation to identify whether or not and how a MSME business could be rehabilitated. Trustees already play a mediation role in circumstances where there is potential rehabilitation of the business and parties have an interest in a going-forward relationship. Most often trustees are involved in conversations with the debtor and senior lenders prior to a filing. Trustees believe they already assess the situation and determine if the parties are willing to utilize mediation. There were strong views that making mediation a requirement would complicate the process and make it more expensive. One trustee observed that the problem encountered time and again is the recalcitrance of the owner/manager to accept that real change, including the loss of control, may be necessary to actually address the problems of the business. As a related point on rehabilitation, trustees observed that there

are instances where the trustee would have recommended basic business/financial counselling for directors of insolvent companies in a restructuring proceeding.

One trustee observed that formal mediation is not needed, but it could be stipulated that as part of trustee duties, they meet with the debtor and senior lenders to open lines of communication, evaluate their relationship and serve a mediating role; but this requirement could be difficult if there are many classes of creditors. There were numerous reported responses that the mediation provisions in consumer proposals were really unproductive, and five trustees had negative experiences with mediation under the *Farm Debt Mediation Act* in terms of cost involved versus any benefit. Mediation is only effective if there are a limited number of parties; it would not work with a large number of creditors or if the situation is very complex.

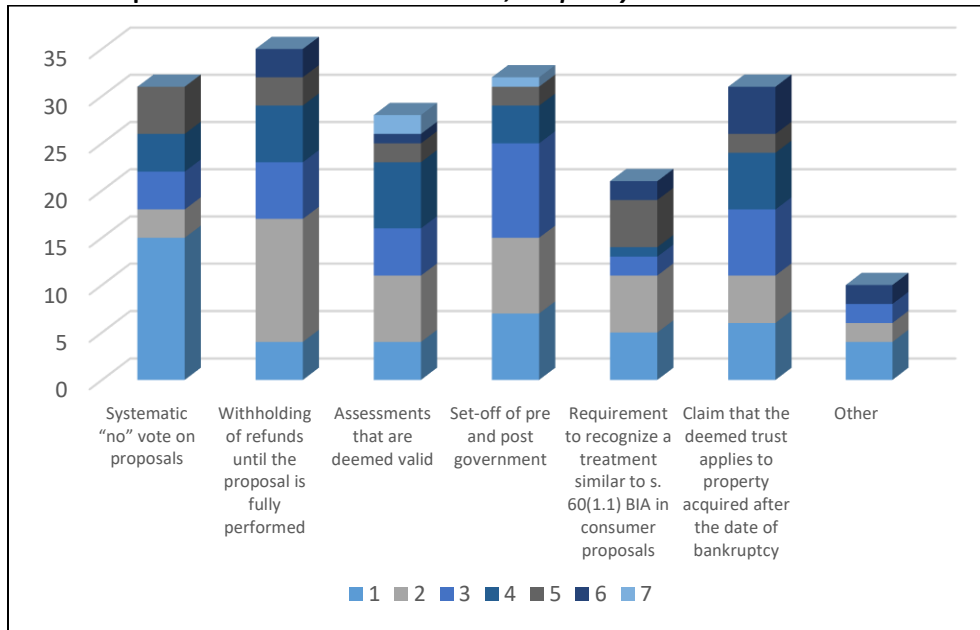
One trustee observed that more mediation between a debtor and its stakeholders will directly correlate to improved proposal outcomes. Another suggested that perhaps the only time there would be some utility in mediation is a situation where there has been a default in a proposal term, prior to an automatic bankruptcy.

7. Canada Revenue Agency as Creditor

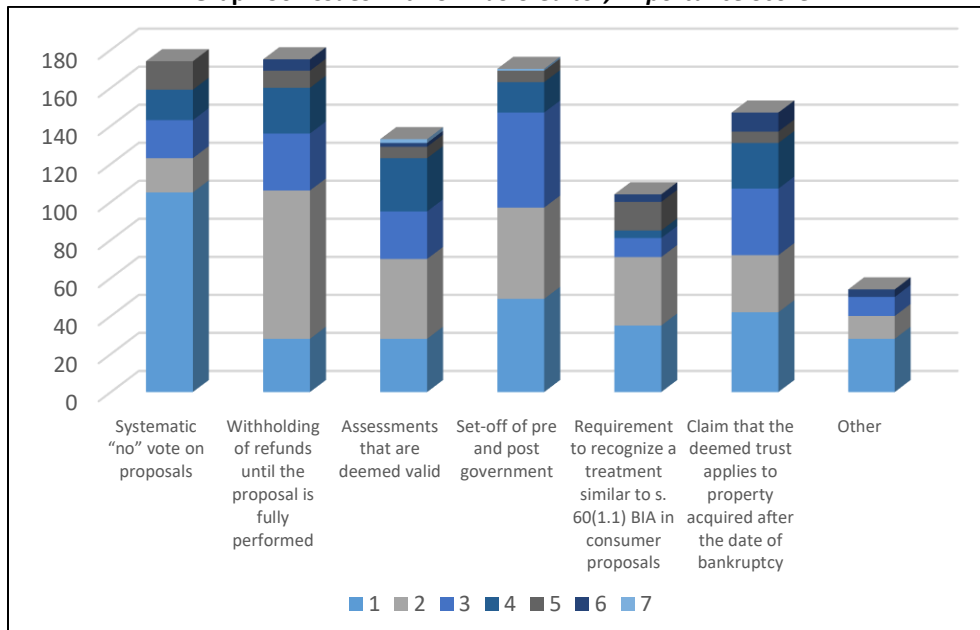
The survey asked whether there were any issues with Canada Revenue Agency (“CRA”) with respect to *BIA* proposals or bankruptcies of MSME, which may hinder the basic objectives of the legislation relating to rehabilitation, fresh start and promoting restructuring over liquidation. Trustees were asked to rank any issues they identified by order of importance. While some of the issues identified are not within the purview of Industry Canada’s direct policy mandate, the responses illustrate a significant problem with CRA as creditor, which may require some legislative change to address.

CRA is an involuntary creditor in *BIA* proceedings; it becomes a creditor because of the debtor’s inability or unwillingness to pay taxes and statutory remittances. Its role as creditor is to protect the public interest in its enforcement positions. The statute creates a deemed trust and places the Crown at the top of the hierarchy of claims, recognizing the importance of tax collection for the general public. Generally, the concerns expressed by trustees were not with respect to required remittances or the efforts by CRA to collect tax, but rather, concern about the failure by CRA to respond in a timely manner to important decision points during *BIA* proceedings. MSME are particularly prejudiced by this lack of timeliness, as the business often cannot survive the wait for CRA to make a decision. Premature liquidation also results in value lost to CRA. Graph 29 outlines the issues and concerns most frequently raised by trustees in the survey responses, and Graph 30 represents their ranking by order of importance.

Graph 29: Issues with CRA as Creditor, Frequency that Concern was Raised



Graph 30: Issues with CRA as Creditor, Importance Score



1 = 7 points; 2 = 6 points; 3 = 5 points; 4 = 4 points; 5 = 3 points; 6 = 2 points; 7 = 1 point.

i. Systematic "No" Vote on Proposals

An issue raised by the majority of trustees surveyed is that the CRA systematically votes no on proposals, resulting often in otherwise viable businesses being liquidated. Many trustees observed that CRA exhibits a lack of understanding and support for the notion of rehabilitation through a proposal, resulting in one arm of government working contrary to the policy goals of another federal government department that supports the notion of business rehabilitation. Trustees observed that this systematic voting against a

proposal is an important issue, but that experience with CRA appears to vary widely between CRA offices. Some offices automatically vote no, the staff arguing that debtors unable to pay their share of taxes are somehow dishonest, while other offices are more pragmatic, considering the proposal terms on a more business-like basis. One trustee observed that CRA votes no to every proposal and requests a meeting to ensure that its vote is registered.

Another prevalent concern was the excessive amount of time that it takes CRA to react to a proposed proposal, taking so long to make a decision that the business ends up being liquidated. Other trustees commented on CRA apathy, not voting on proposals at all. In some files, GST owed, which is a debt able to be compromised, is a significant portion of the debt, but CRA does not vote. Recommendations to address this issue included increased training for CRA staff, particularly in accounting and business decisions; and more consistent communication and direction to CRA staff to understand the federal government's public policy choice to try to rehabilitate viable businesses through *BIA* proposals. Ten trustees recommended imposing required timelines on CRA to respond to proposals, so that issues can be resolved in a timely fashion, with a deemed vote in support after a specified period of time if CRA has not responded, or conversion of the deemed trust to an ordinary claim if CRA fails to respond. One trustee suggested that CRA could consider more positive votes for proposals, but treat the vote as a form of further financing of the debtor, a form of interim financing that has priority over other claims.

ii. Withholding of Refunds until the Proposal is Fully Performed

The majority of trustees surveyed reported that the withholding of refunds until a proposal is fully performed is problematic, in that refunds help provide a source of capital to MSME to carry on the business, although a number of trustees expressed the view that it made good business sense for CRA to withhold and the practice did not affect other creditors. One trustee noted that while the courts had said that CRA cannot withhold refunds on this basis, CRA staff do it anyway, often unchallenged because of the legal costs that would be involved to fight the decision. Another trustee's experience was that if the pre-filing GST debt is fully paid, CRA will start to release its refunds prior to a proposal being fully performed.

iii. Government Set-off of Pre- and Post-Filing Claims

One trustee's experience is that until a GST debt has been compromised, *i.e.* that the proposal has been performed, CRA sets off post-filing refunds to a pre-filing debt, whereas all other pre-filing debt is stayed. The trustee observed that CRA enjoys those income tax credits instead of the debtor company, whereas no other creditor is afforded that opportunity. Moreover, CRA often issues an assessment to the debtor company in respect of the GST component of the accounts payable, thereby creating a pre-proposal debt that did not otherwise exist, which it uses to set off post-proposal refunds. The assessment of the GST component of the accounts payable becomes a duplicate claim, since the same amount is also claimed by the trade suppliers as part of their provable claims.

iv. Treatment under Section 60(1.1) of the BIA

Many trustees observed that the six-month period after court approval of the proposal to pay section 60(1.1) debts may be too short for micro and small enterprises, considering the funds generated from the

operating activities. While fewer trustees identified this issue as problematic, there were many suggestions as to how to remedy the problem. A good company may not be able to respect this condition, in turn precipitating bankruptcy. Many trustees observed that a significant barrier to proposal approval is the CRA's refusal to waive the six month requirement for payment of its super-priority claims in proposals, despite being permitted to do so under s. 60(1.1) of the *BIA*. Section 60(1.1) specifies that unless the Crown consents, no proposal is to be approved by the court that does not provide for the payment to the government within six months after court approval of the proposal, of all amounts that were outstanding at the time of the filing of the notice of intention or of the proposal, that are of a kind that could be subject to a demand under ss. 224(1.2) of the *Income Tax Act (ITA)*; any provision of the *Canada Pension Plan* or of the *Employment Insurance Act (EIA)* that refers to ss. 224(1.2) of the *ITA* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, an employee's premium or employer's premium, as defined in the *EIA*, and of any related interest, penalties or other amounts; or any provision of provincial legislation that has a similar purpose to or refers to ss. 224(1.2) of the *ITA*.¹⁰³ The provision is an important protection for the Crown, and ensures that debtors do not prefer other creditors and fail to pay taxes either in the period leading up to a proposal or based on the terms of the proposal itself. However, a number of trustees suggested that the provisions are too rigid, and that there are circumstances in which the debtor needs longer than six months to pay the amounts owing. In some instances, it may be sufficient to defeat a proposed proposal. Another trustee observed, however, that willingness to extend the period is dependent on the relationship between the CRA and the debtor; CRA is making its best efforts to recoup amounts owing, and if debtor maintains a payment schedule, the trustee's experience is that CRA may give extensions.

Several trustees recommended that the payment of the super-priority debt should be allowed over 12 months instead of six months, but that it would be reasonable to require monthly payments and current compliance. A period of 12 months could eliminate the financial hardship that MSME face in paying so quickly during the period the debtor is trying to turn around the business; and such a period would greatly enhance the prospects for the proposal to succeed. One recommendation was that CRA's payroll-related claims in a proposal should be limited to the actual deemed trust amount accrued in the 12 months preceding the initial bankruptcy event, without penalties and interest, suggesting that any claim beyond that is rewarding CRA negligence in collection activity. Another suggested that there needs to be equal treatment of deemed trust owed in proposals and bankruptcy. Three trustees recommended that the six months should be extended to 18 months, which could be paid in monthly installments to demonstrate good faith. Others observed that there is currently no distinction in the section between a natural person and a company and there should be, in that a natural person such as a tradesperson often has much less cash flow than a business/company.

Some trustees observed that under Division II of Part III of the *BIA* (consumer proposals), there is no equivalent to section 60(1.1) *BIA*, which means that a debtor can be allowed up to five years to pay; however, CRA often demands that the consumer debtor's proposal provide for a priority payment equivalent to that under section 60(1.1) *BIA* in its favour as a precondition to voting in favour of a consumer proposal. One trustee suggested that if there is a payroll remittance liability for a sole proprietor, that debtor should not be allowed to file a Division II proposal as CRA is requesting compliance clauses that do not comply with the *BIA* as it is written at this time; in the trustee's view, the *BIA* should contain provisions similar to s. 60(1.1) in Division II proposals.

¹⁰³ Section 60(1.1), *BIA*.

One trustee observed that a proposal may be on track for the business, but then the directors may have to put in a second proposal for themselves as they have to pay CRA; and that a more holistic approach is needed.

v. *Claim that the Deemed Trust Applies to Property Acquired After the Date of Bankruptcy*

Trustees reported that CRA has claimed that the deemed trust applies to property acquired after the date of bankruptcy, including income and inheritance, and while it is usually unsuccessful, it is costly and lengthy in time to resolve the dispute, disadvantaging both the debtor and all the other creditors.

vi. *Other - CRA Administrative Issues*

Trustees observed that CRA's refusal to use e-mail and sometimes fax results in long delays in the trustee's ability to make decisions while awaiting mailed documents. One trustee observed that CRA statements to proposal debtors still show the full amounts owing until the proposal has been completed. Others complained of poor record keeping by the CRA, often failing to distinguish between bankruptcy, proposal, receivership, agency appointments, and other insolvency appointments. That view was echoed by several of the loan officers interviewed. One trustee observed that CRA often refuses to accept or acknowledge a technical deemed year-end, which can create problems for administration of the estate. Another trustee suggested that CRA should be prepared to pay for the fair and reasonable out of pocket costs of financial institutions in retrieving and printing data that is required for CRA to audit GST and source deductions due by absconding taxpayers. CRA investigators should be more transparent in sharing information required by a receiver or trustee and ordered by the court.

The majority of trustees surveyed reported a general unwillingness by CRA to negotiate; an arrogance in CRA staff using their priority position to extract more from the debtor than it is capable of paying, creating conditions for failure of the proposal. Several trustees suggested that dealings with CRA need to be improved, in that trustees and the CRA seem engaged in a constant and unproductive set of differences. One trustee observed that the CRA staff treats both insolvency professionals and debtors with a lack of respect. One trustee observed that because of the deemed trust, CRA is the highest priority creditor, yet seems not to understand that the trustee is working also in its interests in terms of trying to craft a proposal that will give greater returns to creditors and allow the business to survive. Another observed that CRA could significantly increase recoveries by making trustees allies rather than enemies. One trustee noted that CRA seems incapable of making business decisions, and when staff just follow bureaucratic rules, assets are left to waste. Several trustees observed that there is poor understanding of the public policy underlying proposals or their practical value, and that intensive training should be undertaken with all CRA staff.

One trustee suggested that there are systemic problems with CRA that lead to premature bankruptcies, which could be easily fixed, observing that many sole proprietors and small companies are good at their business but terrible at bookkeeping and tax filings and get into trouble from a failure to file GST. The exemption from GST filing has been 30,000 CAD since the 1980s and is in need of an update in terms of the threshold required to file and pay GST. The trustee suggested that the amount for which a micro or small business should be required to charge GST should be raised from the current cap of 30,000 CAD to 60,000 CAD, allowing MSE a better chance at survival and avoiding many bankruptcies. Trustees also

observed that the T5018 reporting of contract payments has caused a lot of bankruptcies, and that if CRA demanded a 10% hold back on subcontractors, this issue would be mostly avoided.

Four trustees surveyed reported that they found CRA straight-forward, predictable to deal with, so the issues identified may be a regional governance problem. One trustee observed that the real problem is that there is a different set of rules for each CRA office; he deals with four different tax offices and each one is different.

8. Additional Recommendations

There were several additional observations and recommendations made as to how to improve the treatment of insolvent MSME under Canadian law, which did not fit neatly into one of the topics above. A number of trustees expressed the view that as MSME are a majority of businesses in Canada, there should be better information and education to help new businesses commence and be successful. Another expressed concern about ethics in business today, which may also speak to the need for greater education.

Trustees observed that MSME are increasingly being tied to the financial affairs of the company's principals. There is a general piercing of the corporate veil with little protection for company owners from creditors. This trend creates the need for two administrations: corporate plus personal, which adds to the overall insolvency administration cost and can lower creditor recovery.

Two trustees observed that the 30-day goods rule is ineffective and should be revisited or eliminated, although others did not identify this remedy as in need of reform. Several trustees recommended that a debtor advocacy agency is required, as exists in other jurisdictions.

Several trustees suggested having banks held more accountable for their decision making processes and involvement in the insolvency proceeding; one factor detrimental to the insolvency process is the inability of most major banks to move at the same speed in decision-making as the insolvency professional and the debtor companies. One trustee suggested a need to find a way to involve secured creditors more in the proposal process without giving them a complete veto power; their ability to refuse to negotiate with creditors often destroys any chance for recovery for other creditors.

One trustee suggested that there should be a better and clearer process for dealing with the principals/managers/employees of insolvent companies who fail to cooperate with the trustee or receiver or actively interfere with or sabotage the bankruptcy or receivership proceedings. The trustee noted that in a consumer bankruptcy, these matters are principally dealt with at the bankrupt's discharge hearing; but there is no similar process for the non-bankrupt principals of an insolvent company. OSB special investigations of fraudulent activity on the part of debtors can take years, with little benefit to the creditors. The trustee/receiver may end up having to hold the file open for years, and testify in court, with no benefit to the estate. The party funding the insolvency proceeding may have no interest in funding the trustee to testify in a fraud hearing, long after the business has been wound up and the assets sold. Sometimes the funding party may even be the same person who is the target of the investigation.

One trustee suggested that the cost of a statutory bankruptcy, in situations where there are employees subject to *WEPPA*, could be paid by a provincial agency such as the Ministry of Labour, addressing employee access to *WEPPA* and also orphaned companies. There is a high cost of CRA and other

government agencies following up on orphaned companies that are not under insolvency administration and have been abandoned. A federal agency could be created that would hold these orphaned companies; and the trustee suggested that trustees could then bid on tranches to complete the bankruptcy of these companies, and realizations on assets would offset the cost of the administration with any shortfall paid by the government.

Several trustees expressed concern about unqualified and unregulated debt counsellors, who charge a lot of money and give a lot of advice without adding value to the process, suggesting a qualification process should be put in place or they should be banned from giving advice.

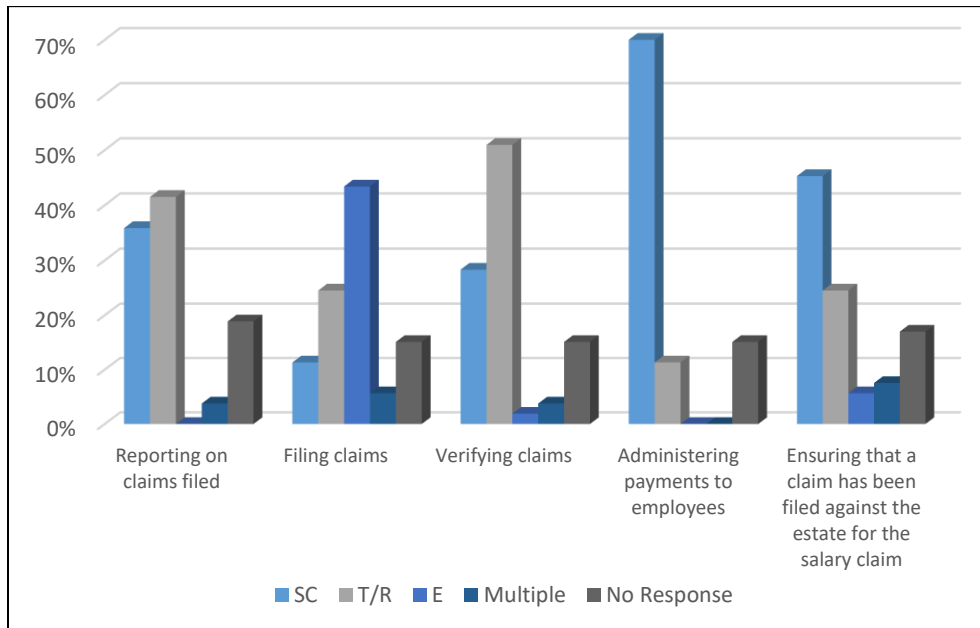
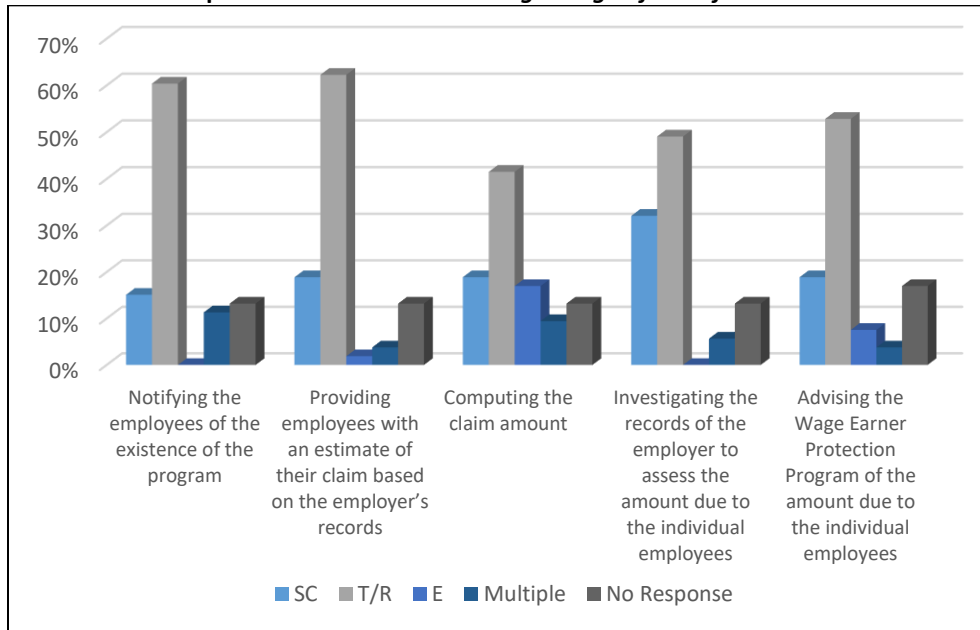
Finally, there were concerns expressed that the counselling fee of 85 CAD is too low to provide a real service to debtors, and the amount should be raised to at least 200 CAD so that appropriate time can be spent with the debtor. Some trustees are outsourcing the counselling and it is not helpful in assisting debtors because there are not resources to spend the time needed.

9. Trustee Responses on the Wage Earner Protection Program

Although not directly related to only MSME insolvency, the 53 trustees surveyed were asked their views on whether the effectiveness of the WEPP would be enhanced by modifying the involvement of insolvency professionals in the administration of the program. The majority of trustees supported the objectives of the WEPP and reported that returns to employees are higher with this program in place. One issue repeatedly raised was that where an insolvency filing is not made, employees are unable to access the WEPP to recover outstanding wages; thus creation of a low cost restructuring proposal would increase the recovery to employees. Trustees recommended that the WEPP be extended to all employees whose employment is terminated due to the employer's insolvency, not just those employees of employers that are bankrupt or in receivership. They cited numerous instances that have highlighted how inequitable the current program is. Trustees' concerns related to the administration of the problem.

Graph 31 below represents the responses to ten specific questions asked, in terms of which of the following tasks should be performed by the trustee/receiver ("T/R"), which should be performed by the employees ("E") and which should be performed by Service Canada ("SC") without involvement of the trustee/receiver. Trustees were given the opportunity to make additional observations and recommendations.

Graph 31: Recommendations Regarding Reform of the WEPP



Generally, surveyed trustees accepted that trustee/receiver involvement in the program was important, but the majority suggested that improvements are needed in the administration of the program. There were serious concerns expressed regarding the administrative duties currently imposed on trustees, which many of the surveyed trustees found unnecessarily burdensome and prejudicial to employees' interests.

i. Notifying Employees of the Wage Earner Protection Program

In terms of who should notify employees of the existence of the program, the majority of trustees, 60%, observed that this task should be the responsibility of the trustee or receiver, 15% reported it should be Service Canada, and another 10% reported that it should be a combination of the two. At the point of receivership, employees are experiencing heightened stress and need assistance in determining their access to compensation.

ii. Investigating and Estimating the Compensation Owning

62% of trustees observed that the trustee/receiver should be the person to provide employees with an estimate of their claim based on the employer's records, although 19% thought it should be Service Canada. In terms of investigating the records of the employer to assess the amount due to the individual employees, 49% of trustees surveyed believe that it should be the trustee/receiver, 32% believe it should be Service Canada, and 6% believe it should be a combination of these roles. In actually computing the amount of the claim, only 42% believe it should be the trustee/receiver, 19% believe it should be Service Canada and 17% believe it should be the employees themselves. Thus there was a mix of views on how precisely the amount owing is ascertained.

One trustee observed that there are situations where the amount of an employee's claim is unknown, the business books and financial records are incomplete, and a legal determination in addition to an arithmetical calculation is needed, but the provincial ministry of labour will only audit in limited situations. The trustee recommended that Service Canada or the provincial ministry should perform audits when requested, which would allow for certified data to use for employee claims.

One trustee observed that complications with the WEPP often arise due to the fact that there are often part-time employees, employees who work irregular week hours, some who have received vacation pay and others not, some who were on call but not working as of the date of the bankruptcy, and that there can be difficulties establishing the amounts covered in the six-month period prior to the filing of the proposal or notice of intention to make a proposal.

iii. Access to and Filings Claims with the Wage Earner Protection Program

Regarding who should advise the WEPP of the amount due to the individual employees, 53% of trustees observed that it should be the trustee/receiver, 19% thought it should be Service Canada, and 8% thought employees themselves should have this responsibility. Several trustees observed that many, if not the majority, of employees simply do not have the capacity to complete their proof of claim, either because of financial literacy issues or lack of sufficient comprehension of English to understand the process; they need the trustee/receiver's assistance. These barriers can cause delays in administering WEPP claims because it can be difficult to get employees to sign off on the proof of claim and then to file their claim with Service Canada. One trustee recommended there could be a single unified claim filed with Service Canada, which then becomes a proof of claim in the insolvency proceeding or then Service Canada files a single subrogated claim with the trustee setting out the individual employee particulars as an annexed schedule.

For the actual filings of claims, 25% of trustees observed that it should be the trustee/receiver, 11% thought it should be Service Canada, and 43% believe it should be the responsibility of the employees themselves. A number of trustees thought that the filing should be streamlined, allowing numerous claims to be filed with the WEPP simultaneously.

Another issue raised by numerous trustees was the rigidity of interpreting access for employees. Trustees observed that there are numerous cases in which the business closes and there are no assets, but employees are retained past the date of receivership, negating entitlement to termination and severance. There should be a streamlined process to ensure employees receive payment, regardless of how the business is finally wound up. For example, where a receiver can sell the business as a going concern and thus the employees are not terminated on appointment of the receiver, but within a couple of weeks the sale falls through, Service Canada will not recognize the claims, as the employees were not terminated on commencement of the receivership. When the WEPP denies all claims where employees work for the debtor company past the date of receivership, it creates inappropriate incentives to terminate employees prematurely, even where value might be preserved if a sale of the business as a going concern is possible. Other trustees reported that the electronic Trustee Information Form (“TIF”) should allow a trustee to indicate the specific circumstances that need consideration. One trustee observed, for example, that there is no answer field to indicate the date of the initial bankruptcy event, such as a CCAA filing; and if the company subsequently became bankrupt, the WEPP automatically (wrongly) rejects the WEPP application if the bankruptcy occurs six months after the CCAA filing.

One trustee reported that as trustee/receiver, they work with the debtor company records to ascertain the amount and make-up of employee claims; they disseminate that information to the employees *via* a pre-populated proof of claim (“POC”) and if the employee agrees with the calculation, he or she signs the POC and returns it; then the WEPP form is commenced if necessary. If the employee does not agree with the calculation, they are free to complete their own POC, a process that the trustee has found works well.

iv. *Verifying Claims*

In terms of responsibility for verifying claims, 51% of trustees observed that it should be the trustee/receiver and 28% thought it should be Service Canada. Yet 11% of trustees observed that it should be the trustee/receiver administering payments to employees and 74% thought it should be Service Canada. With respect to who should report on the claims filed, 42% of trustees observed that it should be the trustee/receiver and 36% thought it should be Service Canada.

Three trustees observed that on the federal government website, the words “gone through a restructuring” appear, and yet are not in the *WEPPA*, suggesting that it is confusing regarding which claims may be verifiable. Their concern highlights the above-noted problem that employees who are terminated in a proceeding that is not a bankruptcy or a receivership, such as in a liquidating CCAA process, do not have access to the WEPP, creating both inequity for employees and incentive effects for parties to avoid the administrative problems in dealing with the WEPP.

v. *Overall Responsibility for Administration of WEPP Claims*

There was division of opinion on whether the responsibility for the administration of the program should fall to the insolvency professionals or Service Canada. Many trustees believe that the government is highly

inefficient and needs to commit considerably more resources; and that it would disadvantage employees not to have the trustee/receiver participate in the process. Trustees reported that Service Canada does not have the resources to manage the program; that after the trustee/receiver advises Service Canada it is ready to pay the claims, Service Canada may take weeks or months to confirm amounts. The other view is that the WEPP is a government service, and should be administered entirely by the government. These trustees suggest that the trustee/receiver should only have to notify the government of the proceedings and the government should notify the employees, calculate their claims, collect employee claim forms and submit them to the trustee/receiver on behalf of the employees. The trustee/receiver should be responsible to give access to employee records to Service Canada, which should determine and administer employee claims and then file one claim on behalf of all employees with the trustee/receiver who can deal with that claim in accordance with the provisions of the *BIA*.

There were other administrative inefficiencies reported in the survey responses, such as the fact that the WEPP does not put the name of the debtor company on their statements, only an estate number appears, which generates work for the trustee to look for the debtor company name each month. Trustees also report that it is an incredibly time consuming manual process to provide Service Canada with the required information. One trustee noted, for example, that they have developed an excel spreadsheet based on the provincial ministry of labour's audit report that they use to track the pertinent WEPP details and that they use it as a mail merge template to populate correspondence to employees and to pre-fill proof of claim forms. But Service Canada requires that the trustees/receivers manually key in data. The trustee suggested that there could be an excel type form that could be simply uploaded to Service Canada, which could then be periodically updated if a number changes, or a new claim has been filed, a change that would save a tremendous amount of duplicated work and time.

One trustee raised concerns about the WEPP withholding 6.82% of the amount of payment when paying out on a claim, without explanation. The trustee used the following example: the employee has a secured claim for \$950, and the trustee has no money to pay it. A TIF is completed and filed; the WEPP accepts the \$950 claim, withholds paying \$65 (6.82%) and pays \$885 to the employee. WEPP is then subrogated to the estate for \$885 and the employee receives a T4A from the WEPP for \$885. Months later, the trustee pays out on secured claims, and must pay the WEPP \$885 and pay the employee \$65 as the balance of his or her claim. The trustee notes that this process is a huge "make work" project for the trustee, who must pay both the WEPP and the employee, and produce a T4A form for \$65. The trustee observed that Service Canada has not explained the purpose of withholding the amount, and has informed the trustee that it is not a fee and is not related to source deductions. The trustee recommends that if the WEPP accepts the entire \$950 claim as legitimate, it should pay the entire amount if it is within the cap. Another trustee observed that if someone is collecting unemployment insurance, they will get the unemployment insurance less the WEPP amount, creating unnecessary administrative costs for no benefit.

More than 30 trustees recommended a streamlined expedited process, suggesting some of the following elements: the trustee/receiver verifies the employee worked at the company and their payroll amount, and meets with employees to explain the process, ensure they have all their contact details to pass along to Service Canada; the WEPP then pays a lump sum equal to a specified number of weeks, such as eight weeks of their regular salary with tax withheld; the WEPP pays the employees within two weeks, electronically where possible; and the trustee/receiver and directors sign off on the amount. One trustee observed that employees need their money immediately to pay rent and other expenses and 99% know exactly how much is owed to them; therefore one way would be to have the employees electronically file their claim and be paid within two weeks by Service Canada; employees would need to know if they applied for too large an amount, the CRA would request the excess back; and the trustee would confirm

that they were an employee and verify the amount owed at the end of the process. Four trustees suggested that one possible streamlined measure would be that employees could all be eligible for exactly the same amount, a flat rate, and the trustee would confirm that they were an employee owed amounts and then the amount paid out. Another trustee suggested abolishing the six-month period and include in the program all wages, vacation pay and benefits owing as of the time of bankruptcy up to a maximum determined amount, which would administratively simplify the process.

vi. Filing Claims in the Insolvency Proceeding

25% of trustees observed that the trustee/receiver should ensure that a claim has been filed against the estate for the salary claim, 45% thought it should be Service Canada, 6% thought it should be the responsibility of the employees themselves, and 8% suggested it was a combination of the trustee/receiver and Service Canada. Many suggested streamlining the process, as suggested in the discussion above.

vii. Other Suggestions and Recommendations

Somewhat of concern, five of the 53 trustees reported that they generally avoid files that require working with the WEPP. Two trustees recommended eliminating the program and using unemployment insurance enhancements in place of it. One trustee observed that a WEPP files currently costs several thousands of dollars to administer and there is not fair compensation to trustees for doing it. Almost half of the trustees responding to the survey reported that the compensation to the trustee/receiver needs to be reformed to pay for the service being provided, that most are completing the WEPP process for no compensation. Trustees suggested there is need for a mechanism to compensate the trustees/receive for work with the WEPP, such as a % or flat fee for each employee, and if the estate doesn't have the funds, the trustee/receiver should be able to apply to Service Canada for a fee at a specified amount per employee. One trustee suggested that the *BIA* and *WEPPA* should be aligned regarding the time periods covered, because an employee's claim has to be re-calculated several times should a company move through different insolvency proceedings, leaving room for errors.

10. Revise Method of Approving Trustee Fees

Surveyed trustees were asked: "What problems, if any, are there with the administrative and payment structure under the *BIA* and should there be a different mechanism for assessing fees under the *BIA* rather than to wait until the end of the process?" In response to this question, there were so many and varied answers that it was difficult to sort and summarize them. They highlight the need to have a serious discussion with the professionals and the stakeholders involved. While fees are clearly in their economic self-interest, the structure of payment now may also serve as a barrier to effective functioning of the *BIA* in respect of MSME insolvency.

i. Payment of Fees

Trustees' suggestions included the following possible changes to payment of fees:

- Clarify the process for approval of pre-filing fees. Where a NOI is used, it was suggested that it be clarified that the debtor, up to the point of the creditors meeting, can pay the trustee. Post-approval fees can be paid as set out in the proposal without any need for comment letters or taxation, implementing a form of deemed approval, with creditors having the right to file an opposition to the discharge of the trustee.
- Eliminate the requirement for costly, time-consuming taxation for Division I proposals where the OSB has given a clean letter and no creditor objects.
- Repeal or amend section 39 of the *BIA* limiting the fees to 7.5% on small realization files.¹⁰⁴
- Institute a deemed approval process for fees where the OSB has provided a positive comment letter.
- Enhance the mechanisms for approving interim draws, including, allowing the debtor to approve these draws prior to the creditors meeting; and/or allowing fees to be paid on the presentation of invoices based on an hourly rate because the size of an insolvent company does not always govern the complexity of the file.
- Some trustees recommended implementing a tariff based on a flat fee per file or hours expended, without the need for taxation, unless the OSB requests it. Other trustees felt this fee structure might penalize small firms involved in complicated files, preferring instead a system of fees linked to both outcome and merit.
- Some trustees suggested that requiring approval of interim draws by both the inspectors and registrar/master was unnecessarily costly, suggesting approval of only inspectors appointed pursuant to the *BIA*, or a system of interim payments based on milestones reached, subject to objection by the creditors.
- Other trustees wanted to retain the present system in cases of some complexity or wanted to retain court approval subject to providing notice to the creditors.

¹⁰⁴ Section 39 specifies: 39. (1) To be voted by creditors —The remuneration of the trustee shall be such as is voted to the trustee by ordinary resolution at any meeting of creditors. (2) Not to exceed 7 ½ per cent —Where the remuneration of the trustee has not been fixed under subsection (1), the trustee may insert in his final statement and retain as his remuneration, subject to increase or reduction as hereinafter provided, a sum not exceeding seven and one-half per cent of the amount remaining out of the realization of the property of the debtor after the claims of the secured creditors have been paid or satisfied. (3) For carrying on debtor’s business or in case of a proposal —Where the business of the debtor has been carried on by the trustee or under his supervision, he may be allowed such special remuneration for such services as the creditors or the inspectors may by resolution authorize, and, in the case of a proposal, such special remuneration as may be agreed to by the debtor, or in the absence of agreement with the debtor such amount as may be approved by the court. (4) Successive trustees —In the case of two or more trustees acting in succession, the remuneration shall be apportioned between the trustees in accordance with the services rendered by each, and in the absence of agreement between the trustees the court shall determine the amount payable to each. (5) Court may increase or reduce —On application by the trustee, a creditor or the debtor and on notice to such parties as the court may direct, the court may make an order increasing or reducing the remuneration.

- Still others suggested interim draws should vary with the length of the discharge period and be allowed when court appearances are required.
- There was a suggestion that trustees should be allowed to charge \$25 per NSF transaction and \$85 for a missed counselling session over and above the tariff amounts, arguing that these events imposed costs for which the best recovery of the tariff in a summary bankruptcy is at the fifty percent level.¹⁰⁵
- Other suggestion made in connection with this issue included:
 - allowing trustees to keep any interest below \$250 on the trust account; and,
 - providing a deemed discharge of the trustee 30-60 days after filing of final statement of receipts and disbursements with the OSB and final payment of dividends to creditors.

Overall, it is clear that the payment system needs some revisiting, to clarify when proceedings are tariff-based; to streamline decisions about interim payments; and to avoid costs in those decisions.

ii. Priority of Administrative Fees

Trustees also recommended that a fixed amount should be designated for trustee fees and costs, in priority to CRA, so that the process can proceed rather than the company just closing its doors, without the need for a court order. Trustees are licensed and highly supervised by the OSB, which should prevent any misuse of such fees.

IV. CONSIDERATIONS FOR LEGISLATIVE REFORM

There were many and diverse types of recommendations made by trustees and loan officers, the professionals that work daily within the existing statutory framework. The suggestions contained above should all be considered by the government as it moves forward in its discussions regarding legislative reform. My suggestions here pull out some of the recommendations for which there was the greatest consensus, or where the idea is novel and warrants consideration, but the arbitrary selection in this part does not diminish the importance of Industry Canada considering all of the above insights and recommendations.

Moreover, this study did not canvass the views of any other stakeholder groups, such as trade unions and trade suppliers, and the legislative reform process should engage with a much broader community regarding a range of possible options for legislative reform of the treatment of MSME insolvency.

¹⁰⁵ NSF is “non-sufficient funds”.

For consideration:

1. There is need to consider a streamlined approach to bankruptcy of micro and small businesses, so that MSE can access formal proceedings; such a process would counter the current trend of secured creditors simply realizing on their assets without regard to other creditors' interests.
2. There should be a new streamlined framework for micro and small enterprise proposals that is administratively simpler and eliminates the need for repeated court appearances. The MSE proposal process could include the following elements:
 - An automatic stay of 45 or 60 days on commencing the proceeding; with the ability of the proposal trustee to extend the stay period for an additional period if notice has been given to creditors and there is no objection. Objections would be dealt with by the court.
 - The MSE proposal process should be available to sole proprietors, whether or not incorporated, micro and small businesses. Consideration should be given to extending the streamlined process to medium enterprises, and if so, to the conditions under which such a streamlined process would be available.
 - Access to a MSE proposal process could be defined by a combination of numbers of employees and a cap of liabilities, the latter being much higher than the current limit under Division II of the *BIA*.
 - Authority should be vested in the trustee to undertake specified tasks in order to facilitate agreement between the debtor and creditors of proposals, eliminating the requirement to seek supplemental orders from the court on appointment.
 - The ability to make a proposal to creditors without the need to hold a meeting of creditors, unless a specified percentage of creditors, such as 25%, request it.
 - Proposals in a streamlined process should provide for at least the liquidation value of creditors' claims in the proposal.
 - If, after a specified period, creditors have expressed support for the proposal in terms of a specified number of creditors holding a specified percentage of the debt, the proposal should be deemed approved, without having to seek court approval. Objections can be dealt with by the court.
 - Government could consider making the threshold for deemed approval of a MSE proposal a simple majority of creditors in both number and value of the claims.
 - There should be time limits placed on Canada Revenue Agency's time to respond to the proposed proposal, after which it is deemed to have approved the proposal.
 - The proposal process would be subject to a six-month limit in the normal case, but the court should be authorized to extend the six-month limit for MSE and for all types of proposals under the *BIA* in circumstances that the court considers appropriate.
 - There should be a streamlined process to cure a temporary default in the terms of a MSE proposal, including deeming it cured where creditors receive notice and do not object.
3. Modernize the notice provisions under the *BIA*, including allowing for electronic notice.

4. Create a simplified standard form claims process that can be expedited where there is no dispute in the amounts owed to creditors.
5. Modernize voting processes under the *BIA*, including use of new technologies to allow for electronic voting by creditors.
6. The current cap on liabilities for access to Division II proposals should be raised considerably if there is not a new proposal process for MSE insolvency. Even if there is a new MSE process, consider raising the cap or exempting equipment used in trade or professional practice from the cap, so that individuals with a higher level of debt are not forced into the administratively more costly Division I proposal process.
7. Expand the current “tools of the trade” exemption to incorporated sole proprietorships and micro businesses.
8. Consider raising the exemption amount to file GST/HST to 50,000 CAD or 60,000 CAD from the current 30,000 CAD that has been in place since the 1980s.
9. Consider amending the time period in which Crown claims must be paid under a proposal for MSE, allowing one year for payment, essentially a form of interim financing by the Crown, with the requirement of monthly payments of arrears owing and maintaining current payments.
10. There should be a review of how trustees are compensated for their professional services, including consideration of a fixed tariff for the MSE proposal process; a streamlining of the interim and final payment process for other insolvency proceedings; and consideration of a fixed amount of administration fees to be allowed a higher priority such that the *BIA* can be accessible.
11. Increase funding for and availability of education and skills building for individuals commencing new businesses.
12. Provide an expense within the new MSE proposal process for counselling on debt management, and increase the fees for counselling under Division II to allow for meaningful education.
13. Work with the trade union, employer and trustee community to revamp the claims process under the Wage Earner Protection Program to make it work in the best interests of the employees for whom it was designed.
14. Undertake research into whether the banks are using the *BIA* receivership provisions appropriately, and how the legislation could be amended to ensure greater fairness and transparency for all creditors. Such research might look at whether there could be a mechanism for a secured lender to have a licensed trustee do a quick “look-see” assessment of the finances, before commencing a receivership or proposal proceeding, to determine the most appropriate route.

15. The OSB should work with the stakeholder community and insolvency professionals to revise its forms and data collection to better capture the reasons for insolvency, the outcomes of proposals versus bankruptcy in terms of returns to creditors, and the support of viable businesses going forward.

In summary, while the provisions of the *BIA* may be largely effective for medium and larger enterprises, there needs to be a mechanism that allows for a more streamlined and accessible process to deal with the financial distress of micro and small businesses without the loss of safeguards for creditors, including employees.

Appendix 1

Survey of Trustees Regarding Treatment of Micro, Small and Medium Enterprises (“MSME”) in Insolvency

Name (no trustee will be individually quoted in the survey results) _____

Region (Province/Territory) _____

Percentage of your professional practice that is MSME insolvency, as per Industry Canada’s definition of less than 500 employees? _____

Of that number, what percentage are: Sole proprietors? _____ Micro (1-4 employees)? _____

Small (5-99 employees)? _____ Smaller medium (100 to 250 employees)? _____ and Medium Enterprises (251-500 employees)? _____

Questions for Survey

1. Do you believe the statutory provisions for proposals under the *Bankruptcy and Insolvency Act (BIA)* could be enhanced to improve effectiveness and timeliness?
 - a. If yes, please list three ways in which the process could be made more efficient.
 - b. Do you believe the statutory provisions for proposals could be enhanced to make the process less costly; and If yes, how?
2. If there was to be a more streamlined proposal process for MSME, what elements should it contain?
 - a. Access to the streamlined process by cap on amount of liabilities? If so, what amount?
 - b. A deemed approval process, absent a percentage of creditor opposition?
 - c. Less court/registrar involvement?
 - d. More clarity in the distinction between consumer bankruptcy and sole proprietor bankruptcy?
 - e. Other?
3. Should a proposal specify how the reasons for the insolvency of the business are being addressed in the proposal?
4. Should there be a source of funding available, such as a program to provide temporary loans or loan guarantees to MSME that address their financial difficulties until the enterprise can again access other sources of capital?
5. It has been suggested that the maximum six months afforded by the *BIA* to devise a proposal is a barrier to filing.
 - a. Do you agree?
 - b. Should there be a discretion by the court to extend the time limit, and if so, in what circumstances or on what conditions?
6. Would mediation assist in better identifying whether or not and how a MSME business could be rehabilitated?
7. What problems, if any, are there with the administrative and payment structure under the *BIA* and should there be a different mechanism for assessing fees under the *BIA* rather than to wait until the end of the process?
8. Do you have other views as to how to improve the treatment of insolvent MSME under Canadian law?
9. Do you believe that the effectiveness of the *Wage Earner Protection Program Act (WEPPA)* would be enhanced by modifying the involvement of the insolvency professionals in the administration of the program?

- a. If so, which of the following tasks do you believe should be performed by the trustee/receiver (“T/R”); and which should be performed by the employees (“E”) and by Service Canada (“SC”) without involvement of the trustee/receiver? (circle answers)
- i. Notifying the employees of the existence of the program T/R SC
 - ii. Providing employees with an estimate of their claim based on the employer’s records T/R SC
 - iii. Computing the claim amount T/R E SC
 - iv. Investigating the records of the employer to assess the amount due to the individual employees T/R E SC
 - v. Advising the Wage Earner Protection Program of the amount due to the individual employees T/R E SC
 - vi. Reporting on claims filed T/R E SC
 - vii. Filing claims T/R E SC
 - viii. Verifying claims T/R E SC
 - ix. Administering payments to employees T/R SC
 - x. Ensuring that a claim has been filed against the estate for the salary claim T/R E SC
10. There is colloquial evidence that issues arise with Canada Revenue Agency with respect to *BIA* proposals or bankruptcies of MSME, which hinder the basic objectives of the legislation relating to rehabilitation, fresh start and promoting restructuring over liquidation. Please rank the following issues by order of importance, or mark not applicable (“N/A”) if you consider it not a problem.
- a. Systematic “no” vote on proposals
 - b. Withholding of refunds until the proposal is fully performed
 - c. Assessments that are deemed valid
 - d. Set-off of pre and post government claims
 - e. Requirement to recognize a treatment similar to s. 60(1.1) *BIA* in consumer proposals
 - f. Claim that the deemed trust applies to property acquired after the date of bankruptcy
 - g. Other (please specify)

Thank you very much for assisting in this survey. We are also interested in speaking with some loans officers dealing with MSME insolvency. If you can assist with a name and contact information, it would be greatly appreciated.

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