Proceedings of the Standing Senate Committee on Banking, Trade and Commerce

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The Standing Senate Committee on Banking, Trade and Commerce, to which was referred Bill C-5, to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act and the Income Tax Act, met this day at 5:05 p.m. to give consideration to the bill.

Senator Michael Kirby (*Chairman*) in the Chair.

[*English*]

The Chairman: This is the beginning of our set of hearings on Bill C-5, the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act and the Income Tax Act.

Our purpose this evening is to have officials and their outside legal counsel take us through the proposed amendments. I have suggested to officials that we would try to go through this fairly slowly and systematically, rather than in the form of a long presentation followed by questions.

If you are to go through one section of the bill at a time, Mr. Tobin, it would be helpful if you did a section and then we talked about that. We could then cover the next section. I think that would work well.

I understand that you have an overview presentation, which will take approximately 20 minutes. We would then like to get into the details of the bill.

With us today is, David Tobin, whom you met before during our corporate governance hearings. He is the Director General of the Corporate Governance Branch of the Department of Industry.

Mr. Tobin, Please introduce your colleagues and then proceed with your presentation. We will then have a discussion and, at the end, I should like to make some comments about our process from here through to the end. Thank you for coming here tonight.

Mr. David Tobin, Director General, Corporate Governance Branch, Department of Industry: With me today is Marc Mayrand, Acting Superintendent of Bankruptcy.

The Chairman: That is part of the Department of Industry; is that correct?

Mr. Tobin: That is right; it was formerly part of Consumer and Corporate Affairs and was part of that reorganization in June of 1993.

The Chairman: Is that a quasi-regulatory position?

Mr. Marc Mayrand, Superintendent of Bankruptcy, Department of Industry: It is a GIC appointment, yes.

Mr. Tobin: Mr. Mayrand can certainly walk through the duties of his office, particularly as they relate to some of the amendments put in place in 1992 and further pursued in 1995.

Also with me tonight are Jacques Hains, a director of the Corporate Law Review Branch within Industry Canada, who has been involved with not only these amendments but the ones in 1992; Max Mendelsohn, a bankruptcy and solvency expert from Montreal; and Gordon Marantz, Legal Advisor, who is with Osler, Hoskin in Toronto and was involved in the 1992 amendments and in the BIAC process leading up to the amendments that you have before you in Bill C-5.

There are several other officials with us from the Department of Justice, as well as our own department, who are also available to answer questions.

The Chairman: Please proceed with your presentation, which is largely an overview. When we get to the act itself, given its very technical nature, it is important that we cover the broad sections of the act piece by piece.

[…]

Mr. Hains: Another area under commercial reorganization is the area of environmental liability. Again, Bill C-5 is proposing to alter the 1992 provisions approved by Parliament. What Parliament tried to do in 1992 was to provide a relief to insolvency practitioners -- essentially these are receivers and trustees, although it was only trustees in 1992 -- because they were at risk when they accepted a mandate to liquidate an insolvent business. That was so because, technically and legally speaking, they are vested with the assets of the bankrupt individual; they become more or less the owner of those assets and are in control of them. Under environmental laws, therefore, they could have been subject to personal liability to clean up the environment. I am speaking of personal liability here, meaning "out of their own pockets." Of course, they were quite concerned about that provision.

In 1992, they approached the government and said, "Look, we are professionals working on a for-fee basis. We are trying to do creditors, debtors and society at large a service, but we are exposing ourselves. We are not going to approach any insolvent estate that has any risk of environmental liability. It is too risky for our pockets." The result was that we saw a lot of so-called "orphan sites" in the country, where the business was insolvent, the debtor was out of it, and the site was unattended. It might or might not have had an environmental problem, such as the spilling of pollutants, for example, but the environmental regulators would never find out or would find out only by accident.

That was the big problem which the 1992 amendment tried to address, and it did so in this way: The 1992 provision said that, if you are a trustee and you accept a mandate such as that, you shall not be personally liable, out of your own pocket, for any environmental damage that occurred prior to your accepting the mandate, and you shall also not be personally liable if you exercise due diligence after you accept the mandate. We thought that that would help.

Three years later, almost all trustees have come to us and said that that approach does not work. They ask: "What does `due diligence' mean? We are potentially facing millions of dollars in personal liability. Thank you very much for the `due diligence', but it is not enough."

The Chairman: As a matter of curiosity, why is that not sufficient? To a lay person, it sounds like it ought to be sufficient.

Mr. Hains: It is just that the standard is too vague. No one knows what it does and it may vary from one case to another. With the vagueness of the standard and what may be required to satisfy it, and with the risk of personal liability, the trustees were not even interested in investigating how they might exercise due diligence.

The Chairman: This takes us back to another issue that we looked at for you people a few months ago. I am going to the broad issue of corporate governance, not the Bankruptcy Act, and my colleagues may want to comment on this. It was clearly argued before us, by both lawyers and senior executives across the country at the time, that the due diligence defence would be adequate to ensure that directors would not be personally liable for some of the things for which they are now liable, if, in fact, they had clearly exercised due diligence. Many of us who are directors were at peace with that recommendation. Are you telling me now that the due diligence defence is not worth the paper it is written on?

Mr. Hains: I have two comments. First, environmental laws across the country provide for due diligence, as they should from a public policy point of view, because those laws deal with the owners or managers of the business. They should be diligent when they run their business and manage their business to ensure that they satisfy environmental regulations. Here we are talking about for-fee professionals whose job it is to try to salvage the business, if not liquidate it. They are different from the owners or managers of the business.

Secondly, due diligence is reasonably safe to exercise in instances such as discharging due diligence for redemption of shares and things like that, because people have the feel for what they need to do to show due diligence. In the area of environmental liability, and the Bata case comes to mind, it is pretty risky business. Again, it is risk versus the exposure element, but perhaps my learned colleagues may wish to add something.

Mr. Marantz: The main point with due diligence is that in a financial area, such as directors' responsibilities, the guidelines are fairly clearly defined and understood. When you come to an environmental issue, due diligence is industry specific. If you have an apartment building with a trash compactor, due diligence is different from the way it is if you are the receiver of a paper mill. Because the standards are so industry specific, the professional trustees tried to write a due diligence standard, but it was meaningless and unhelpful.

In response to that, the amendments to the bill were reached in consultation with the CCME, the Canadian Council of Ministers of the Environment, and there is now agreement across a broad sector as to how we set the standard.

Mr. Hains: There are three elements, therefore, to the proposal in Bill C-5. The first element deals with standards of personal liability for insolvency practitioners. We are replacing "due diligence" with "gross negligence or wilful misconduct".

The second element of the proposal in Bill C-5 is that, when trustees are on the premises and they are issued a cleanup order by a regulator, they will have four options, two of which exist now in provincial and federal environmental law. First, they can comply with the order, in which case it becomes a cost of administration and ranks high up in the preferred claim. Second, they can contest the order. They can say, "We do not agree." Then it will go to the relevant court to be debated.

Bill C-5 then adds two more options. The first is the possibility for trustees or receivers -- insolvency practitioners -- to seek time from courts to say, "I need to assess the economic viability of the proposal." Regulators would be there to say, "There is a health hazard; therefore, you have 24 hours," or "You can take two to three weeks." The court will give that time. Moreover, knowing that the bill will be too expensive and will not be economically viable, the trustees are then out of it and can abandon that piece of property subject to the order.

That is when the third element of the proposal kicks in. For the first time, the Canadian Bankruptcy and Insolvency Act will give environmental claims an absolute first-rank priority over banks, over all secured creditors, over the real property that is the object of the order, plus any contiguous property related to the activity that caused the contamination. They will have an absolute super-priority, recognized in law, over the banks. A super-lien.

The Chairman: It also ranks ahead of wages, I presume.

Mr. Hains: That is right. It is on this real property. Those assets would go.

You have to compare that to the current situation. What happens now when a site is abandoned like that? A trustee would never go in. A trustee would say, "I am out of here," and the site is abandoned.

What is happening now has to do with legal chaos and a vacuum. No one knows who holds the title or who is responsible for cleaning that up. If the regulator cleans it up and restores the land to a marketable value, technically, the owner of the land still has the title, not the regulator. Well, this proposal will clear that up. It will stipulate that whoever owns that property has an absolute super-priority. The proceeds from selling this clean asset will first go to reimburse society for the cleanup.

The Chairman: I want to be sure I understand your underlying philosophy. I totally agree with your issue of protecting the trustee. What is your rationale for giving environmental claims a super-priority? Is that because the environment is now the "flavour of the year" or the "flavour of the decade"?

Mr. Hains: It has that benefit as well. This is a recognized benefit. However, the prime objective is to encourage insolvency practitioners to get on the premises and salvage a business which might have environmental problems. If they cannot salvage the business, they will liquidate it.

The Chairman: I do not understand how it works as an incentive. A suspicious part of me says that, because the Crown would pay to clean up the environmental damage, the Crown, as usual, is taking care of itself by giving itself super-priority. Is that just my inherently suspicious mind, or am I misunderstanding something?

Mr. Mendelsohn: Perhaps we can shed some light on that, Mr. Chairman.

If the site is environmentally damaged to begin with, it is damaged goods already. From an economic point of view, that super-priority is there, not because the law says so, but because that property cannot be dealt with by anyone without first addressing the situation of contamination. All this provision does is to recognize that reality and create an orderly context in which the situation can be played out. If there is net economic value to the property after the contaminated situation is dealt with, this super-priority will be irrelevant, because the owner of the property, or the bank, if it forecloses, will have to attempt to clean it up anyway. This creates a situation such that when there is no net economic value to the property, the Crown or the authorities have a legal instrument through which to take possession of the property and deal with it. We think it is really economically neutral.

Senator Angus: Let us assume that a small business owns a service station and there is a fire. There is contamination due to seepage through cracks in the concrete tanks, and the company has gone belly-up. The people have disappeared and the bankruptcy is being resolved. Would this be a case where people would be able to move in and clean up the mess?

Mr. Mendelsohn: Yes, indeed.

Senator Angus: That would rank first over all claims, over income tax and any other claim. Someone has made a value judgment there.

Mr. Mendelsohn: Remember that when we talk about ranking first before income tax and so forth, we are talking about real rights. It is only over the real estate. It would be ahead of the mortgage.

Senator Angus: I think that is a key point.

The Chairman: That helps a lot.

Mr. Marantz: The issue is: How do you convert the real estate to cash? It has to be sold, but anyone who buys it has to deal with the problem.

Mr. Hains: Mr. Chairman, I said there were three elements. I have just looked at my notes and I find that there is a fourth element and a fifth element. They are also very important, Mr. Chairman.

Senator Angus: There were the commercial leases, the environment, and what was the third element?

Mr. Hains: Within the environment, I mentioned three: lowering the standards to wilful misconduct, the four options to deal with a cleanup once a cleanup order is issued, and the super-lien.

If the super-lien is not enough to reimburse the Crown totally, the unsatisfied claim would now be recognized as an ordinary unsecured claim on the remainder of the estate of the bankrupt enterprise. That is the fourth one, which is important. It is a net gain for environmental regulators.

Senator Meighen: Is that just for the capital amount, or does interest run on that as well?

Mr. Hains: It is the cleanup cost, and I think that is to be defined. I do not think we define it here.

Mr. Marantz: Interest under the Bankruptcy Act does not run after the date of bankruptcy.

Mr. Hains: The last and fifth element, which is not specific in Bill C-5 but which is obvious, -- and, again, the environmental regulators wanted some assurance in this respect -- is that once practitioners are on the premises, they fall under environmental laws. If they see something, they must report it to the environmental regulators right away. Nothing here will diminish that obligation.

[Translation]

Mr. Hains: The third element, Mr. Chairman, with respect to the commercial reorganization of businesses, concerns directors' liability. I know that you are very interested in this subject. The objective is to ensure that when a business becomes insolvent, the directors are the ones who must, first and foremost, make the difficult decisions and suggest that the creditor, for example the Crown, receive less than he is owed in order to salvage the business.

Senator Meighen: Instead of stepping down immediately.

Mr. Hains: That is my point. Directors often leave themselves open to further legal action as a result of the creditors' losses. Instead of fighting to salvage the business, directors often do not want to assume too big a risk. They abandon ship as it is set to go down.

In addition, the proposal in Bill C-5 does three things. Pursuant to section 101 of the Bankruptcy and Insolvency Act, directors must be satisfied that the business is solvent before buying back shares. This is known as absolute liability. We are amending this provision to read with "due diligence". We are doing this for directors in case of insolvency.

[English]

Senator Angus: This is in the declaring of dividends that would impair the working capital.

Mr. Hains: That is right. In clause 101 of the BIA, it is an absolute liability. You have no defence whatsoever. We will now say, "The directors had reasonable grounds to believe that when they made that decision it was solvent."

Senator Angus: Because management told them it was.

Mr. Hains: That is right.

The Chairman: The thrust of that change is absolutely consistent with the thrust that we gave you on corporate governance?

Mr. Hains: Yes.

Senator Angus: With regard to giving a disincentive to resign or an encouragement to stay on and help salvage the failing enterprise, has there been an attempt, in coming up with this proposal, to harmonize the 150 laws which impose responsibility on directors for things related to environment and/or insolvency? Those laws are quite controversial and not well catalogued.

Mr. Hains: There is a developing standard in the CBCA, for example, and in federal financial legislation, that defines "due diligence" in some ways. It says that you must have been as reasonable and prudent as a reasonable person with your expertise would have been in the same circumstances. This is the standard that not only federal statutes but also provincial statutes are now trying to adopt. They are trying to use the very same phrases in order that the courts have something harmonized to deal with.

Senator Angus: The most onerous and identifiable statutory liability imposed on a corporate director under present legislation is the liability for unpaid wages. The irony is that these provisions were not in the Bankruptcy Act but were in the Companies Act and other acts. That is what my question is directed at.

Mr. Mendelsohn: Perhaps this is anticipating Mr. Hains' next topic, but there is a first step in this revision, according to which, up until now, the only party in favour of whom debts could be compromised was the debtor himself. It is now suggested that the proposal contain a provision to include a compromise of the debt, not only for the benefit of the debtor corporation, but also for the benefit of the directors, who are statutorily liable. If you take the example of a wage claim, it would be possible, not only to compromise the unpaid wages in favour of the corporation, but also to get the directors off the hook by having the corporation pay whatever is proposed.

That will form part of the proposal. It is part of what is voted on. Presumably the employees can vote for or against, but the directors can obtain relief through that mechanism.

Senator Angus: That is in the case of a proposal, but what if it is voted down?

Mr. Mendelsohn: If it is voted down, the company is bankrupt and that is it. This addresses itself solely to statutory liability; not to contractual liability. You cannot blow off a director's or a guarantor's guarantee through this mechanism.

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