**CAIRP 2010 ANNUAL CONFERENCE**

**AUGUST 18 – 20, 2010 KELOWNA**

**DRAFTING PROPOSALS**

Prepared by

**Murray Jamieson**

Katherine Wellburn

*Prepared for the*

*Canadian Association of Insolvency and Restructuring Professionals*

*August 2010*

**DRAFTING PROPOSALS**

**Plain Language**

Since a proposal is submitted for approval to creditors and some of the unsecured creditors may not have lawyers and may be unsophisticated and unfamiliar with legal language, the court will give the words of the proposal their plain and ordinary meaning: *Re Dav-Jor Contracting Ltd.,* 2006 BCCA 330.

Clear language should be used to avoid problems with interpretation of the proposal in the future.

Court Approval of Division I Proposals

A debtor bears the onus of establishing that a proposal should be approved by the court: *Re Aquatex Corp.* (1998) 8 C.B.R. 4th 177 (Alta Q.B.).

For a proposal to be approved, it must be more advantageous to the creditors than a bankruptcy: *Re Allen Theatres Limited*, (1922), [3 C.B.R. 147](http://www.lexisnexis.com:80/ca/legal/search/runRemoteLink.do?langcountry=CA&linkInfo=F%23CA%23CBR%23sel2%253%25page%25147%25vol%253%25&risb=21_T9898151264&bct=A&service=citation&A=0.5749978715518189) (Ont. S.C.)*; Re Mayer* [1994] [25 C.B.R. (3d) 113](http://www.lexisnexis.com:80/ca/legal/search/runRemoteLink.do?langcountry=CA&linkInfo=F%23CA%23CBR3%23sel2%2525%25page%25113%25vol%2525%25&risb=21_T9898151264&bct=A&service=citation&A=0.9984055418148771) (Ontario S.C.)

The court will consider three interests on an application to approve a proposal

(a) the interests of the debtor;

(b) the interests of the creditors generally by ensuring that the proposal is reasonable; and

(c) the interests of the public in the integrity of bankruptcy legislation.

*Re Mernick*, (1994) 24 C.B.R. (3d) 8 (Ont. S.C.)

**Reasonableness of Terms**

The debtor must satisfy the court that the proposal is reasonable. This includes a consideration of whether the proposal has a reasonable possibility of success, based on financial analysis and projections. A proposal with little detail of the debtor’s current situation and plans for the future may be rejected: *Re: McNamara & McNamara* (1984) 53 C.B.R. (N.S.) 240 (Ont. S.C.) *Re*: *Farkvam (*1996) 39 C.B.R. 3rd 293 (B.C.S.C.)

Where a proposal calls for payment over an extended time the debtor must show a reasonable prospect of being able to generate the money to make the payments: *Re Gareau* (1922) 2 C.B.R. 265 (Que. S.C.)

Performance Security

If any of the facts mentioned in s.173 are proved, the court must refuse to approve a Division I proposal unless it provides reasonable security for payment of not less than 50 cents on the dollar on all the unsecured claims provable against the debtor’s estate or such percentage thereof as the court may direct: *BIA* 59(3).

The court has a discretion to reduce the amount of security from the statutory minimum but it may consider the debtor’s inability to provide the security up to the statutory requirement as a factor in assessing the reasonableness of the proposal under s.59 (2) of the *BIA*: *Re Wandler* (2007) 32 C.B.R. 5th 292 (Alta Q.B.)

A guarantee of performance provided as security may not be acceptable to the court if there is no evidence to show that the individual providing the guarantee has assets to support it: *Re National Fruit Exchange Inc.* (1948) 29 C.B.R. 125 (Que. S.C.)

**Duties of Trustee**

Once a trustee has accepted an appointment as trustee under a notice of intention to make a proposal the trustee must act as the trustee until discharged or another trustee is appointed. The trustee may be sued for damages for resigning without authority.

*Canadian Glacier Beverage Corp. v. Barnes & Kissack Inc.*  (1999) 6 C.B.R. (4th) 212 (B.C.S.C.)

Before agreeing to act, the trustee should investigate whether there are sufficient unsecured assets of the debtor to fund the proposal and to pay the trustee’s fees. While the trustee is entitled to fees payable by the debtor if the proposal fails, the trustees’ fees do not have any priority over the claims of the secured creditors.

The trustee on a Division I proposal is required to investigate the affairs and property of the debtor and prepare a report for the court and creditors. The trustee should perform searches to see if the assets are secured: *Re Young* (2004) 4 C.B.R. (5th) 303 (Man. Q.B.)

At the meeting of creditors, the creditors and the debtor can agree to insert terms concerning the supervision of the debtor’s affairs: *BIA* section 55.

The terms of the proposal should be clear so that it is possible to tell whether the debtor is in compliance and when the proposal has been completed. A proposal for a debtor running a business or with complex financial affairs should include clear time limits for completion of actions by the debtor and requirements for monitoring by the trustee particularly if the debtor is to remain in control of a business the creditors: *Re Skalbania* (1990) 2 C.B.R. (3rd) 205 (B.C.S.C.)

**Trustee’s Fees**

The *BIA* provides that the trustee’s fees must be given priority in both Division I and consumer proposals. For a Division I proposal, the court may grant security over the debtor’s assets in order to give the trustee priority for fees and expenses: section 64.2(1)

If a Division I proposal fails, the costs of the trustee are paid from the bankrupt estate: section 61(4).

If it is likely that the proposal will take some time to complete, the trustee may insist that it contain terms providing for reasonable interim draws on fees. Otherwise, the trustee may be without fees until the proposal is completed or will have to apply to the court for interim remuneration without compensation for the application: *Re Cheng* 2008 BCSC 145.

A Division I proposal may contain terms setting out how the trustee’s fees will be calculated.

**Statutory Terms for Crown Claims**

Section 60(1.1) contains certain mandatory terms that must be included or a Division I proposal cannot be approved by the court. The priority under the *Income Tax Act* includes penalties and interest: *Re Dav-Jor Contracting Ltd.,* 2006 BCCA 330

Additional terms are mandatory if the debtor is an employer: section 60(1.3-1.5)

Illegal Terms

The court must consider the legal effect of any term of a proposal at the time of the approval hearing. A clause in a proposal that is illegal will lead the court to find that the proposal is not reasonable so the proposal will not be approved by the court. A clause providing that the debtor is exempt from s.80 of the Income Tax Act is illegal: *R. v. Beach* 2001 B.C.C.A. 7

Clauses Dealing with Particular Creditors

*CRA Compliance Clause*

A clause providing that the debtor agrees to keep all filings, remittances and installments to CRA current for the period of the proposal and that the debtor will be in default if the installments are in arrears is permissible and does not lead to the conclusion that the terms of the proposal are unreasonable: *Re Silbernagel* 2006 20 C.B.R. (5th) 155 (Ont. S.C.)

***Section 178 Creditors***

Amendments to the *BIA* have made it clear that a proposal does not release the debtor from debts or liabilities set out in section 178(1*)* unless the proposal explicitly provides for the compromise of that debt and the creditor voted for the acceptance of the proposal (Division I - section 62(2.1); consumer proposal - 66.28(2.1)).

If it is unknown whether the section 178 creditor will accept a Division I proposal, it may be prudent to put the section 178 creditor in a separate class with a separate payout rather than sharing with the other creditors. That way, if the section 178 creditor votes against the proposal and the proposal is accepted by the other unsecured creditors, the proposal can still go forward but without the debtor using funds that were earmarked for the section 178 creditor.

***Equity Claims***

The *BIA* now provides that equity claims are not to be paid unless a Division I proposal provides that all claims that are not equity claims are first paid in full: section 60(1.7). In some cases, if the books and records of the debtor are poor, it may be difficult to tell whether or not a claim is an equity claim or is a claim in debt. Equity creditors are not allowed to vote on the proposal unless the court allows orders, so the trustee must be extremely cautious on reviewing the claims to determine whether the claims are claims in debt, or are really equity claims, particularly if the doubtful claims may affect the vote.

***Transfers at Under Value and Preferences***

A Division I proposal may provide that sections 95-101 of the *BIA*, concerning transfers at under value and preferences shall not apply to the proposal. This clause may be appropriate where there is a questionable transaction and there is an issue about whether there may be a further claim outside the proposal.

If this clause is included, the trustee’s report must give an opinion on the reasonableness of the term at least 10 days before the meeting of creditors: *BIA* section 50(10(b)).

If such a term is not provided in a Division I proposal, then sections 95-101 of the *BIA* apply pursuant to section 101.1. This provision does not apply to consumer proposals.

***Secured Claims***

A proposal can be made to secured classes of creditors. Generally, a term of a proposal interfering with the priority of a secured creditor will not be approved or binding on the secured creditor, unless the secured creditor votes in favour of the proposal.

However, in *Re Cox*, the proposal contained a condition that CRA would take no action to enforce its security interest registered against property of the debtor and would discharge its charge upon issuance of a certificate of full performance. CRA filed a proof of claim as an unsecured creditor and voted against the proposal. The proposal was approved by the creditors and subsequently received court approval. CRA did not appeal the approval but instead filed an amended proof of claim as a secured creditor after the certificate of full performance was issued and took the position that the proposal did not apply to it. The court found that CRA was bound by the proposal including the term requiring it to discharge its security: *Re Cox* 2007 BCSC 1665

**Interim Financing**

Section 50.6 of the *BIA* permits the court to grant a charge against property of the debtor in favour of a lender who has agreed to provide new interim financing. This remedy is limited to corporate debtors or individuals carrying on business. The charge is limited to property used for the business. The financing may encourage lenders to provide a source of funding to enable a debtor operating a business to make a viable proposal.

The court must consider the debtor’s cash flow statement and may order that the security rank in priority over the claim of any secured creditor of the debtor.

In making such an order the court will consider:

(a) the period during which the debtor is expected to be subject to proceedings under the *BIA*;

(b) how the debtor’s business and financial affairs are to be managed;

(c) whether the debtor’s management has the confidence of its major creditors;

(d) whether the loan would enhance the prospects of a viable proposal being made in respect of the debtor;

(e) the nature and value of the debtor’s property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the trustee’s report.

The application must be made to the court on notice to the secured creditors who are likely to be affected by the order.

Power of Administrator to Amend a Consumer Proposal

A clause permitting the administrator of a consumer proposal to extend the time for making any payment to be made under the proposal provided that no such extension would extend beyond 5 years following the approval of the proposal by the court is permissible: *Re Dondale* 2009 B.C.C.A. 10

This type of clause can be used in addition to the statutory right of the debtor to seek to amend a consumer proposal prior to default pursuant to section 66.31(1) or, for consumer proposals not made by bankrupts, for the debtor to seek revival of the proposal after default pursuant to section 66.31(6-11). Inclusion of the clause considered by the court in *Re Dondale* may avoid the necessity of a court application.

Amending a Division I Proposal after Default

As a result of the decision of Registrar Nettie in *Re Northmore* 2010 CanLII 10144 (Ont. S.C.) and the Position Paper of the OSB issued on June 10, 2010, it is not possible for the debtor, after default of a Division I proposal to file an amended proposal. Rather, the debtor must make an application to the court on notice to all proven creditors.

Contact Information:

Katherine Wellburn, Murray Jamieson

[kwellburn@murrayjamieson.com](mailto:kwellburn@murrayjamieson.com)

604-688-0775