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A Creditor's Approach to the Bankruptcy & Insolvency Act

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1. What is bankruptcy?

To oversimplify somewhat, a person who has more than $1,000.00 in debt and is unable to pay his debts as they come due may make a voluntary assignment in bankruptcy. Bankruptcy may also occur as a result of a creditor commencing proceedings, known as Petition for Bankruptcy, to have a debtor declared bankrupt; but this is relatively rare. The great majority of personal (as distinct from corporate) bankruptcies, occur by voluntary assignment.

A debtor contemplating bankruptcy will consult a licenced Trustee in Bankruptcy, who will assess the person's financial circumstances and make a recommendation as to an appropriate course of action; including credit counselling, a Proposal to Creditors under the Bankruptcy & Insolvency Act ("BIA") or an Assignment in Bankruptcy. It is the policy of the BIA to encourage proposals (discussed below) over bankruptcies, but bankruptcy remains by far the more popular remedy.

Upon making a voluntary assignment in bankruptcy, the debtor assigns to the Trustee all of his property, subject to certain exceptions, including household goods to a value of $11,300, "tools of the trade" to a value of $11,300, an automobile to a value of $5650, farm equipment to a value of $28,300, pension benefits, damages for personal injury and the right to receive wages (which is dealt with separately, as discussed below).

2. What is the function of the Trustee?

Under the *Bankruptcy & Insolvency Act,* the Trustee is the impartial representative of the creditors. However, as the Trustee is, in cases of voluntary bankruptcies, effectively hired by the Bankrupt, and as the Trustee's business, like all businesses, depends to a considerable degree on pleasing his customers, some Trustees have been known to adopt, inappropriately, the role of advocate for the Bankrupt. Creditors may properly take exception to such conduct. Nevertheless, it should also be observed that it is not the function of the Trustee to act as a kind of prosecutor of the Bankrupt. The Trustee fulfills his role by administering the Bankrupt's Estate within the law in the best interests of the Creditors. He is bound to act in a way which respects the integrity of the bankruptcy system and the rights of the Creditors and of the Bankrupt and assists in the rehabilitation of the Bankrupt.

It is the duty of the Trustee to realize on (i.e., gather in and sell) the property of the Bankrupt and, after deducting his own fees (usually determined on a percentage basis) and disbursements and the 5% levy imposed by the Superintendent in Bankruptcy, distribute the balance remaining by way of pro rata dividends to the creditors. In practice, only a minority of personal bankruptcies result in any distribution to unsecured creditors, as usually by the time a debtor resorts to bankruptcy, the realizable value of his or her remaining property (in excess of the claims of secured creditors, such as mortgagees) is less than the amount of the Trustee's fees and disbursements (minimally, about $1,500).

Upon receiving an assignment in bankruptcy, the Trustee will send written notice thereof to all creditors, including a Statement of Affairs setting out the assets, liabilities and personal circumstances of the Bankrupt, and enclosing a blank Proof of Claim form to be completed by the creditor and submitted to the Trustee, confirming particulars of the debt claimed by the creditor from the Bankrupt.

3. What is the effect of bankruptcy on a creditor's rights?

Once a debtor has made an assignment in bankruptcy, the legal remedies otherwise available to unsecured creditors are "stayed"; with the result that an unpaid creditor may not (without the consent of the bankruptcy court) commence or continue legal or other collection proceedings against the debtor.

A creditor is prohibited from making separate arrangements—even at the bankrupt's wish—to receive payment from the bankrupt in respect of unsecured debts existing at the date of bankruptcy; as such payment would offend the fundamental principle that all unsecured creditors of a bankrupt are to be treated equally, and their debts paid ratably to the extent that the Trustee can realize on the property owned by the bankrupt at the date of bankruptcy.

Bankruptcy also terminates the effectiveness of an Assignment of Wages in respect of any wages earned after the date of bankruptcy.

Bankruptcy does not affect the rights of secured creditors (such as mortgagees or holders of a security interest in a chattel, such as automobile) from seizing and selling their security in accordance with the law and the security agreement between the parties. Secured creditors may also negotiate directly with the bankrupt to make arrangements for continued retention of the collateral by the bankrupt in exchange for continued periodic, or lump sum, payment.

Bankruptcy does not affect the rights of a creditor as against a co-signor or guarantor of the bankrupt's debt, nor to accept voluntary payment from a third party (such as a concerned family member, as occasionally occurs) in respect of a bankrupt's debt.

Bankruptcy does not affect the right of a creditor to enforce payment of debt if that debt was incurred after the date of bankruptcy. It is an offence for a bankrupt to incur debt in excess of $1000 from any person after bankruptcy without disclosing his bankrupt status.

4. How should a Creditor respond to a Notice of Bankruptcy?

a. Complete and file the Proof of Claim. Although, in many cases, the whole of the debt will ultimately have to be written off, this should not be assumed at the outset. Circumstances can change or unknown facts might be discovered. There is no cost to filing a Proof of Claim and the form is relatively simple. If no Proof of Claim is filed, the Creditor might not receive notice of any further developments in the bankruptcy.

b. Review information in the Bankrupt's "Statement of Affairs", which will accompany the Notice of Bankruptcy in light of any other information available; including, in particular, any information provided in recent loan applications. Consider:

Are there significant inconsistencies?

Is there an unexplained failure to disclose to the Trustee assets recently held, or the proceeds of sale thereof (or, alternatively, does it appear that the Bankrupt included misleading information or omissions in the loan application)?

Does it appear that the Bankrupt could reasonably have made arrangements to meet his obligations, and is therefore making inappropriate resort to the bankruptcy process?

Are the causes of bankruptcy ones for which the bankrupt ought to be held

responsible (e.g., gambling or extravagance, as distinct from illness, unemployment, business failure etc.)?

If the answer to any of the foregoing questions is "yes", the Creditor might have remedies worth exercising within, or possibly outside, the bankruptcy process. If so, it may be worth consulting your lawyer; bearing in mind that there remains truth in the old adage that one cannot get blood from a stone and that, in the absence of any prospect of an asset of significant value becoming available or of significant future income earning capacity in the bankrupt, recovery will be improbable.

5. What remedies are available to the unsecured creditor?

a. Creditors' Meetings and Inspectors: Included with the Proof of Claim form there should be a blank form of Proxy. If a Creditor intends to involve itself in the bankruptcy process, it is appropriate to complete the Proxy form appointing a representative of the Creditor as the Creditor's Proxy to vote at Meetings of Creditors, if any. If the circumstances of the bankruptcy are not such that a Creditors' meeting is automatically required under the BIA, a Creditor or Creditors holding 25% of the unsecured debt may, within 30 days of bankruptcy, require such a meeting to be held. At such a meeting, the Bankrupt will be required to attend and answer questions concerning his or her financial affairs and one or more Creditors may be elected as Inspectors of the Bankrupt Estate, giving them some power to direct the administration of the bankruptcy by the Trustee.

b. Opposing Discharge: A Creditor may also file an Opposition to the Bankrupt's Application for Discharge from bankruptcy, based on certain grounds set out in the BIA. Upon the hearing of the Application for Discharge, the Court may, depending on the circumstances, grant the discharge unconditionally, grant the discharge on conditions or dismiss the Application. Although the Court may

exercise considerable discretion in fashioning conditions to suit particular circumstances, the most common form of condition requires the Bankrupt to make additional monthly payments to his Trustee (for pro rata distribution to creditors) over a period of months or years. Whether such a condition is appropriate will depend on the Court's assessment of Bankrupt's conduct and means to pay. Such a conditional discharge order may be worth pursuing in cases where the Opposing Creditor holds a significant percentage of the Bankrupt's unsecured debt and it appears that the Bankrupt will have the ability to pay a significant amount.

c. Fraud: If a Creditor's debt was obtained by fraud, the debt will not be discharged by the Bankrupt's discharge from bankruptcy and may, with the Court's permission, be pursued outside the bankruptcy process. In each such case, one must assess whether the amount in issue and chances of success in proving fraud will justify the costs of pursuing the debt. However, such cases will sometimes settle without the necessity of protracted proceedings.

d. Trustee's Claims & BIA s. 38: In some cases the Trustee may be aware of claims or causes of action which the Trustee could assert on behalf of the Bankrupt Estate, but be unwilling to pursue because the Trustee is not sufficiently confident of success or, more commonly, because he has insufficient funds in the Estate to fund litigation. A common example is a case where it appears the Bankrupt may have given property to a family member or friend to avoid having it pass to the Trustee on bankruptcy and with the intent that it be given back to the Bankrupt once he has obtained his discharge. If the Trustee declines to pursue a claim, a Creditor may apply to the Court pursuant to BIA s. 38 for an order permitting the Creditor to effectively acquire the Trustee's rights in that regard, which the Creditor may then pursue for at his own expense and for his own benefit (subject to any other Creditor electing to participate--which is rare).

6. Who is a “Secured Creditor”?

The fact that an unsecured Creditor may have obtained Judgment, issued and filed a Writ of Seizure and Sale or Notice of Garnishment attaching the Debtor's assets or income will not convert an unsecured debt into a secured one. Assets or income of the bankrupt in the hands of the Sheriff or Enforcement Office do not belong to the creditor who directed seizure thereof, and will pass to the Trustee, subject only to an execution creditor's claim for costs.

Note as well that security interests not registered under Land Titles Act or the Personal Property Security Act (as the case may be) will usually be subordinate to the interest of the Trustee.

7. What happens to the salary or wages of a bankrupt?

A bankrupt’s right to receive salary or wages does not pass to his trustee. However, the Act prescribes a formula for the calculation of monthly payments which the bankrupt is required to make to the trustee, having regard to the bankrupt’s income and family expenses. Unless the creditor is aware of sources of income which the bankrupt has failed to disclose to his trustee (in which case the creditor should provide that information to the trustee), there is not much scope for creditor involvement in this aspect of the bankruptcy. If a bankrupt fails to make the required payments, that information must be reported to the court and be taken into account on the bankrupt’s application for discharge.

8. What happens on a Proposal?

Under the BIA, an insolvent person may make a Proposal. If the person has debts of not more than $250,000 (excluding mortgages on a principal residence), the Proposal will be a “Consumer Proposal” (discussed below), which

is most commonly encountered by retail lenders and has rules somewhat different from the “Division I Proposal”, which will apply in other circumstances.

Under a Consumer Proposal the debtor retains his property and makes a proposal to his creditors generally to deal with his outstanding debts; usually by making monthly payments in a prescribed amount to the Proposal Administrator (a trustee in bankruptcy wearing a different hat) over a defined period of time (usually several years, not exceeding five), out of which the Administrator will pay his own fees and disbursements and pay dividends to the creditors on a pro rata basis. A Proposal will seldom, if ever, result in payment in full to creditors.

As with bankruptcy, the debt-enforcement rights of unsecured creditors (and credit unions pursuant to wage assignments) against the debtor are stayed, but the rights of secured creditors and creditors’ rights against third parties, such as co-signors and guarantors, will not be affected.

The Administrator will forward to each creditor a copy of the Consumer Proposal, together with a Statement of Affairs and a Proof of Claim form and invite the creditor to assent to or dissent from the Proposal in the prescribed form within 45 days of the filing of the Proposal.

The Act sets out certain procedures for Creditors’ Meetings in certain circumstances and for consideration and approval of the Proposal by the court. However, the net practical effect is that, unless a majority of creditors by value dissent from the Proposal within the prescribed times, the Proposal will be deemed to be accepted and will bind all unsecured creditors.

Sometimes, in the face of creditor dissent, the Proposal will be modified in attempt to make it more acceptable.

If the Proposal is refused, the debtor's status remains as it was prior to the Proposal being made, and creditors' rights are unaffected. However, it is not uncommon for debtors to make an Assignment in Bankruptcy following a refusal of a Proposal.

If the Proposal is accepted or deemed to be accepted and the debtor defaults in compliance for three months, the Proposal will be annulled.

In deciding how to respond to a Proposal, a creditor should take into account the means of the debtor to pay his debts, the amount of this creditor's debt (relative to costs of collection and relative to the debtor's total unsecured debt) and the amount which the creditor is likely to recover if the Proposal is or is not accepted (including the likelihood of bankruptcy in the event that the Proposal is refused, which might result in a greater or lesser recovery). As noted above, negotiation with the Administrator and the debtor for a better Proposal is permitted. Consultation with a lawyer will be prudent in some cases.

If the creditors, by majority vote, refuse the Proposal, the debtor returns to his pre-proposal status and rights of the creditors are restored. However, it is not uncommon for a debtor in such circumstances to then make an assignment in bankruptcy. In the case of a Division 1 Proposal (which you will encounter less frequently), bankruptcy will be automatic upon the refusal of the Proposal by creditors.

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