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BUSINESS INSOLVENCY: AN OVERVIEW OF LEGISLATION AND RECENT TRENDS IN CANADA

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Business Insolvency: An Overview of Legislation and Recent Trends in Canada
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EXECUTIVE SUMMARY

The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* provide the legal framework for the resolution of insolvency of individuals and most businesses, through either a bankruptcy or proposal process, or a restructuring process.

While the COVID-19 pandemic and related containment measures caused a severe recession in 2020, the number of businesses undertaking insolvency proceedings declined significantly in 2020 and 2021, contrary to what could have reasonably been expected. This decline was due in part to the various support measures and business loan and liquidity programs put in place by governments. However, while the number of business insolvencies remained below pre-pandemic levels through most of 2021 and 2022, it has been on a rising trend since then. Higher input and borrowing costs and an expected decline in economic growth at a time when many businesses are more indebted due to the pandemic have led to renewed concerns of a rising number of business insolvencies.

This paper provides an overview of Canada's business insolvency framework, as well as recent amendments and proposed changes to legislation. It also examines long-term and short-term trends in the number of business insolvency filings, with a focus on developments since the onset of the COVID-19 pandemic.

BUSINESS INSOLVENCY: AN OVERVIEW OF LEGISLATION AND RECENT TRENDS IN CANADA

1 INTRODUCTION

This paper provides an overview of insolvency legislation in Canada and discusses recent areas of reform, with a particular focus on amendments to the *Bankruptcy and Insolvency Act* (BIA)[1] and the *Companies' Creditors Arrangement Act* (CCAA).[2] The paper also examines long-term trends in business insolvency filings and recent developments since the COVID-19 pandemic.

2 INSOLVENCY LEGISLATION IN CANADA

Under the *Constitution Act, 1867*,[3] bankruptcy and insolvency fall within federal jurisdiction.[4]

While often used interchangeably, bankruptcy and insolvency have different meanings under Canadian law.[5] Generally, insolvency occurs when a debtor is unable to pay debts as they become due. More specifically, under section 2 of the BIA, an "insolvent person" is a person who resides, carries on business or has property in Canada and:

- whose liabilities to creditors amount to at least $1,000;
- who is unable to pay obligations as they become due;
- who has ceased paying obligations as they become due; and
- whose assets do not have sufficient value to cover all of the person's liabilities.

In contrast, bankruptcy refers to the legal process by which an insolvent person's assets are transferred to a licensed insolvency trustee who then makes distributions to creditors to settle the person's debts according to the priority set out in law. When a bankruptcy is filed, creditors are no longer allowed to pursue legal action against the debtor for their unpaid debts.

The two main federal statutes that govern bankruptcy and insolvency are the BIA and the CCAA. The Office of the Superintendent of Bankruptcy (OSB) is the federal regulator responsible for supervising BIA and CCAA proceedings and ensuring compliance with those Acts. It also regulates licensed insolvency trustees and maintains a public registry of BIA and CCAA filings.[6]

First enacted in 1919, the BIA applies to personal and corporate bankruptcies. In addition to setting out the administrative process required to file for bankruptcy, the BIA governs the licensing of insolvency trustees and the types of assets that are eligible to be sold or redistributed for the purpose of paying debts. It also regulates how the bankrupt company's estate is to be distributed among different classes of creditors; this is often referred to as the order of priority. Table 1 sets out the order of priority for creditors' claims under the BIA.

Table 1 – Priority of Creditor Claims in a Bankruptcy Under the *Bankruptcy and Insolvency Act*

Type of Claim	Description
I. Deemed trusts (section 67(3))	Amount of unremitted source deductions in relation to: ▪ the Canada and Quebec pension plans; ▪ federal and provincial/territorial income taxes payable; and ▪ the Employment Insurance program. These amounts are deemed to be held in trust for the benefit of the Crown and are not part of the bankrupt company's assets.
II. Unpaid suppliers (section 81.1)	Rights of suppliers to repossess unpaid goods delivered 30 days prior to the bankruptcy.
III. Super-priorities ▪ Agricultural products (section 81.2) ▪ Salaries (sections 81.3 and 81.4) ▪ Pension fund contributions (sections 81.5 and 81.6) ▪ Restoration of contaminated land (section 14.06(7))	▪ Value of unpaid agricultural and aquaculture products delivered 15 days prior to the bankruptcy. ▪ Value of unpaid salaries and allowances, up to a maximum of $2,000 per employee. ▪ Value of deducted salary contributions and employer contributions to a registered pension plan and the sum of all special payments and any other amount required to liquidate the unfunded liability or solvency deficiency of a pension plan fund. ▪ Costs incurred by a government to decontaminate land included in the bankrupt's assets.
IV. Secured claims	Claims guaranteed by the bankrupt's assets that cover the value of this asset.
V. Preferred claims (section 136(1))	Unsecured claims, which must be paid before regular unsecured claims in the order specified in section 136(1).
VI. Unsecured claims	All other claims, which are paid by prorating their value according to the total value of all other unsecured claims.

Note: Regarding deemed trusts, it should be noted that property held in trust is not part of the bankrupt's assets and cannot be distributed among creditors. This feature of trusts has allowed the enactment of legislation ensuring that insolvent individuals and companies pay governments before any other creditors, because a portion of an insolvent individual's or company's assets is deemed to be held in trust for governments' benefit. Under the *Bankruptcy and Insolvency Act*, only deemed trusts created for employers' unremitted income tax deductions and contributions to the Employment Insurance program and to the Canada and Quebec pension plans are recognized. Of note, under the *Companies' Creditors Arrangements Act*, the court has the discretion to rank deemed trusts lower in priority. See *Canada v. Canada North Group Inc.*, 2021 SCC 30.

Source: Table prepared by the Library of Parliament using data obtained from *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.

The BIA also allows individuals and corporations to make a proposal to their creditors, rather than file for bankruptcy. A proposal is an offer put forth by a debtor to their creditors to pay them a percentage of the debt owed or to extend the time to pay the debt. A proposal must be approved by the court.

The CCAA was enacted in 1933, and unlike the BIA, it applies only to insolvent corporations or affiliated corporations with liabilities of more than $5 million. Furthermore, the CCAA does not apply to all types of corporations; the main exclusion is financial institutions. The purpose of the CCAA is to allow corporations to restructure their business with the approval of the various classes of creditors and under supervision by the court. The terms "compromise" or "arrangement" are often used to describe the plan put forth by the company to pay creditors and reorganize the affairs of the business, and they are similar to a proposal under the BIA. CCAA proceedings include the appointment of a licensed insolvency trustee as the monitor. The monitor's role is to assist in preparing the plan of arrangement, draft regular reports for the court on the status of the proceedings and provide relevant information to creditors and the public.

Given some overlap in the types of insolvency proceedings offered to businesses through the BIA and the CCAA, choosing whether a BIA or CCAA proceeding is more appropriate often depends on the corporate structure of the insolvent business, the amount of debt owing and the potential cost of the insolvency proceeding. Some insolvent corporations that closed their Canadian operations filed for creditor protection under the CCAA rather than the BIA. One example is Target Canada in 2015. According to insolvency experts, the court allowed Target Canada's CCAA filing because of the complexity of the insolvency and because the CCAA has a more flexible framework than does the more rigid, rules-based BIA scheme.[7]

While the BIA and the CCAA are the primary insolvency statutes, other federal statutes address insolvency in specific sectors. The *Winding-up and Restructuring Act*[8] governs the insolvency, dissolution and restructuring of all federally regulated and some provincially regulated financial institutions, such as banks, trust companies, loan companies and insurance companies. The *Farm Debt Mediation Act*[9] assists insolvent farmers by mediating agreements with their creditors. As well, Part XV of the *Canada Business Corporations Act* (CBCA)[10] allows a federally incorporated corporation to propose an arrangement with its creditors in certain circumstances.

Lastly, some rights of employees with respect to unpaid wages are addressed in the *Wage Earner Protection Program Act*.[11] This Act establishes a program that makes payments to individuals of up to $8,278.83 for 2023 for unpaid wages and vacation pay owed to them by employers who are bankrupt or subject to receivership under the BIA.[12] The program requires employees to sign over their claims against the employer to the federal government so that it can then recover some or all of its costs as a creditor of the employer.

3 RECENT AMENDMENTS TO BUSINESS INSOLVENCY LEGISLATION

According to the World Bank, one of the ways governments strengthened their lending environments after the 2008 global financial crisis was by improving their business insolvency regimes.[13] It notes that efficient and predictable insolvency and debt resolution frameworks are necessary in order to improve financial inclusion, make access to credit easier and lower borrowing costs.

Recent amendments to Canada’s business insolvency framework have focused on restructuring insolvent businesses while protecting employees’ claims for unpaid wages. For example, some of the legislative changes introduced in 2008–2009 to the BIA and CCAA included:

- codifying certain best practices in the CCAA to provide certainty of restructuring procedures;
- introducing super-priority status for claims related to unremitted pension plan contributions and unpaid wages and vacation pay up to $2,000 per employee; and
- enacting the *Wage Earner Protection Program Act*.[14]

Legislative changes made in 2019 to the BIA, CCAA, CBCA and the *Pension Benefits Standards Act, 1985* (PBSA)[15] focused on the fairness of insolvency proceedings. The amendments included:

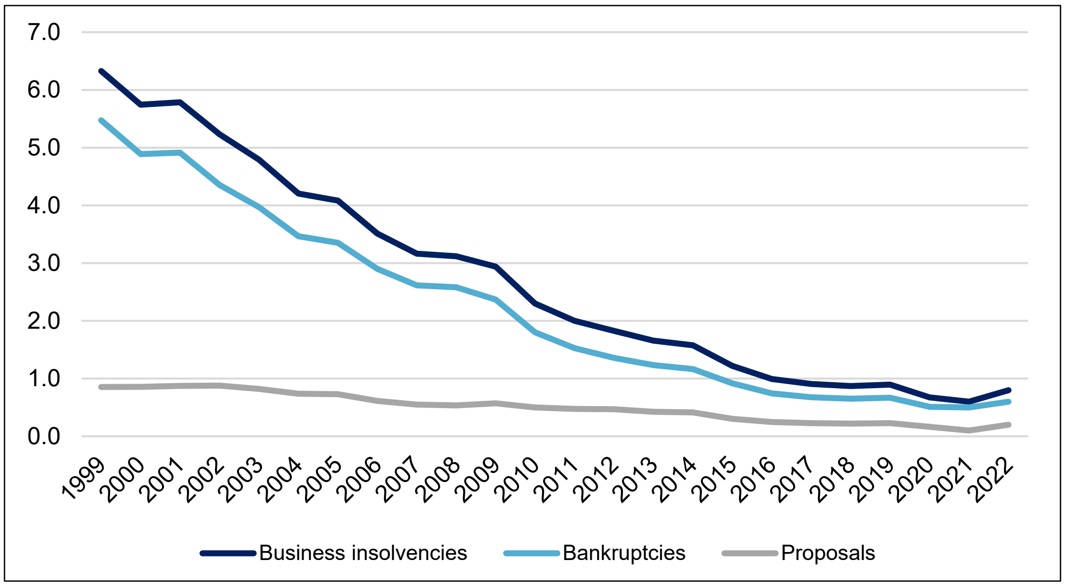
- introducing a duty to act in good faith applicable to any party to an insolvency proceeding under the BIA or CCAA, and giving the court the power to make any order it finds appropriate, if it finds that a party did not act in good faith; and
- giving powers to the court to examine payments made to executives prior to the bankruptcy, and if appropriate, recover these amounts for the benefit of creditors.[16]

In April 2023, the claims of defined-benefit pension plan members were further strengthened when Bill C-228, An Act to amend the Bankruptcy and Insolvency Act, the Companies’ Creditors Arrangement Act and the Pension Benefits Standards Act, 1985,[17] received Royal Assent. This bill amended the BIA and the CCAA to ensure that creditor claims in relation to shortfalls in defined-benefit pension plans are super-priority claims in the event that an employer becomes insolvent. It also amended the PBSA to provide for the tabling of an annual report regarding the solvency of pension plans regulated under that statute. Bill C-228 was the culmination of many bills introduced in Parliament over the past decade that attempted to improve the priority of claims related to unfunded pension liabilities in bankruptcy.

4 LONG-TERM TRENDS IN THE NUMBER OF INSOLVENCY FILINGS

Since 1999, the incidence of business insolvency in Canada has been decreasing. The business insolvency rate, or the number of business insolvency filings under the BIA per 1,000 businesses, fell from 5.7 in that year (11,601 cases) to 0.6 in 2021 (2,480 cases), but increased to 0.8 (3,402 cases) in 2022 as shown in Figure 1. The incidence of both types of business insolvencies – bankruptcy and proposal – has declined over that period.

Figure 1 – Number of Business Insolvency, Bankruptcy and Proposal Filings Under the *Bankruptcy and Insolvency Act*, 1999 to 2022 (number of filings per 1,000 businesses)

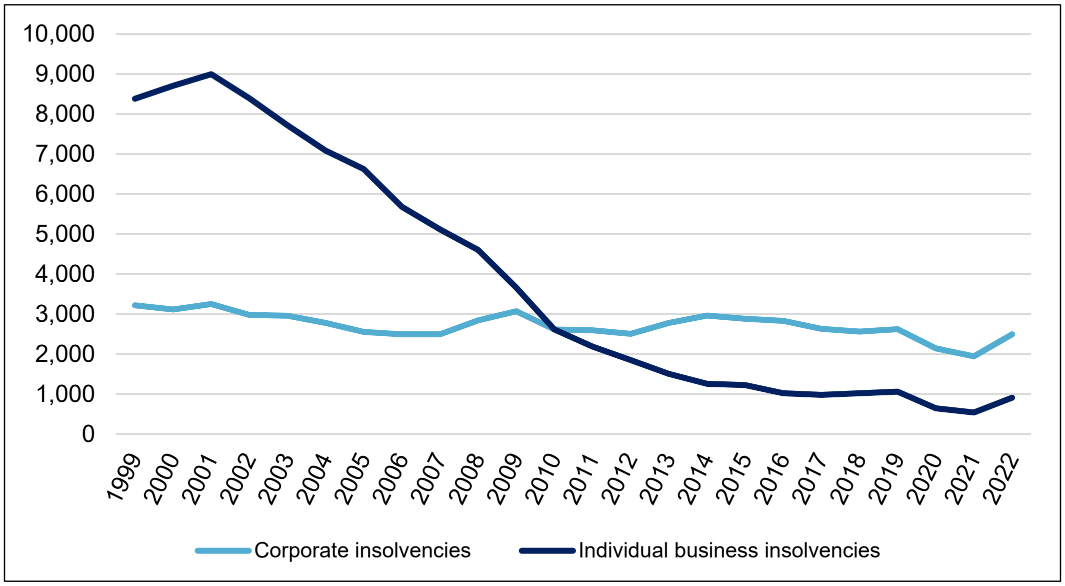


Note: This figure does not include filings made under the *Companies' Creditors Arrangement Act* (CCAA). The collection of data on the number of CCAA filings began in the fourth quarter of 2009.

Source: Figure prepared by the Library of Parliament using data obtained from Government of Canada, "Annual Insolvency Rates," Database, accessed 28 September 2023.

Business insolvencies can also be divided by type of entity, individual business or corporation. As shown in Figure 2, the decrease in the business insolvency rate is largely due to the decline in the number of individual business insolvencies, which are cases where 50% or more of an insolvent individual's total liabilities result from their business operations. In 2001, there were almost 9,000 individual business insolvencies, and by 2016, that number had dropped by nearly 90% to about 1,000 annually. During the same period, the number of corporate insolvencies decreased by about 18%. The number of individual business and corporate insolvencies decreased further in 2020 and 2021, but increased in 2022.

Figure 2 – Number of Corporate and Individual Business Insolvency Filings Under the *Bankruptcy and Insolvency Act*, 1999 to 2022



Note: Individual business insolvency refers to an individual for whom 50% or more of their total liabilities are the result of operating a business.

Source: Figure prepared by the Library of Parliament using data obtained from Government of Canada, "Historic Insolvency Statistics – Annual (from 1987)," Database, accessed on 28 September 2023.

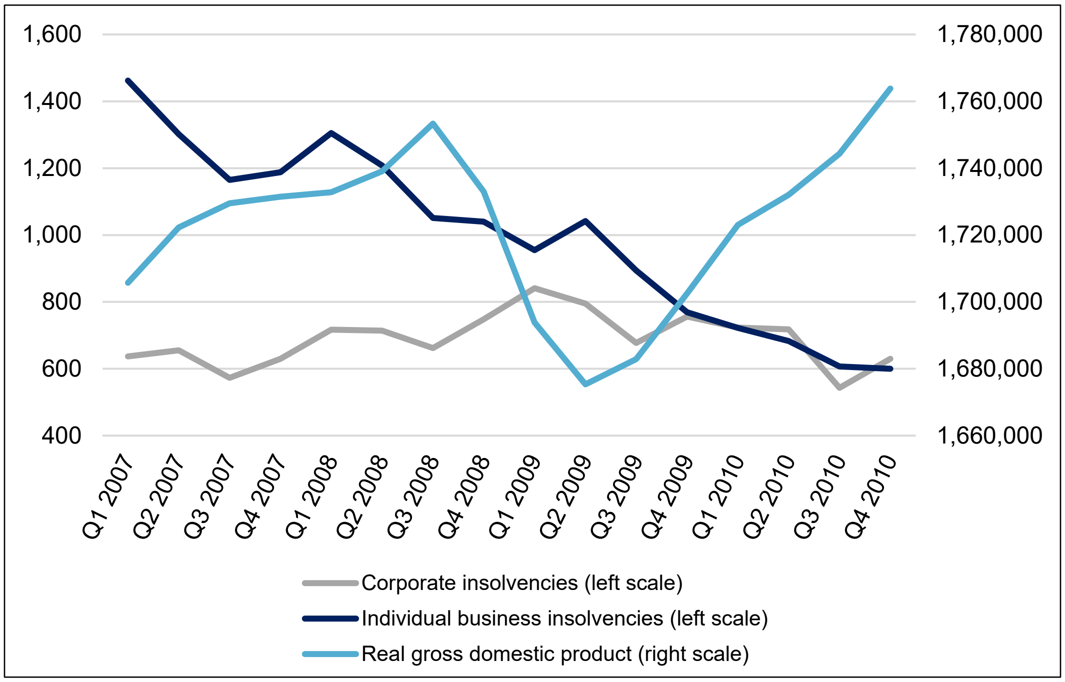
This decreasing trend in the number of business insolvencies could be explained in part by the relatively high incidence of business insolvency in Canada during the 1980s and 1990s. This period was characterized by two recessions and the implementation of first the *Canada–United States Free Trade Agreement* in 1989, then the *North American Free Trade Agreement* in 1994. This exposed many Canadian businesses to increased levels of foreign competition and led to a restructuring of economic activity in North America.[18]

As well, most respondents in a 2016 survey of licensed insolvency trustees indicated that the largest contributing factor to the declining number of business insolvency filings in recent years is the cost associated with the bankruptcy or proposal processes, which can be prohibitive for small businesses. In the case of corporate bankruptcies, for example, these costs may be due to the requirement for a creditors' meeting or for a sales process for assets with low value.[19]

5 INSOLVENCY FILINGS DURING THE COVID-19 PANDEMIC

During recessions, many businesses experience a reduction in their revenues or their access to credit, which causes some to begin insolvency proceedings. For example, during the recession of 2008–2009, the number of corporate insolvencies increased by 27% between the third quarter of 2008 and the first quarter of 2009, as shown in Figure 3. The number of individual business insolvencies decreased over the period of 2008 to 2009, although a 9% increase was recorded between the first and second quarters of 2009.

Figure 3 – Number of Corporate and Individual Business Insolvency Filings Under the *Bankruptcy and Insolvency Act* and Real Gross Domestic Product, First Quarter of 2007 to Fourth Quarter of 2010 (number of filings and $)

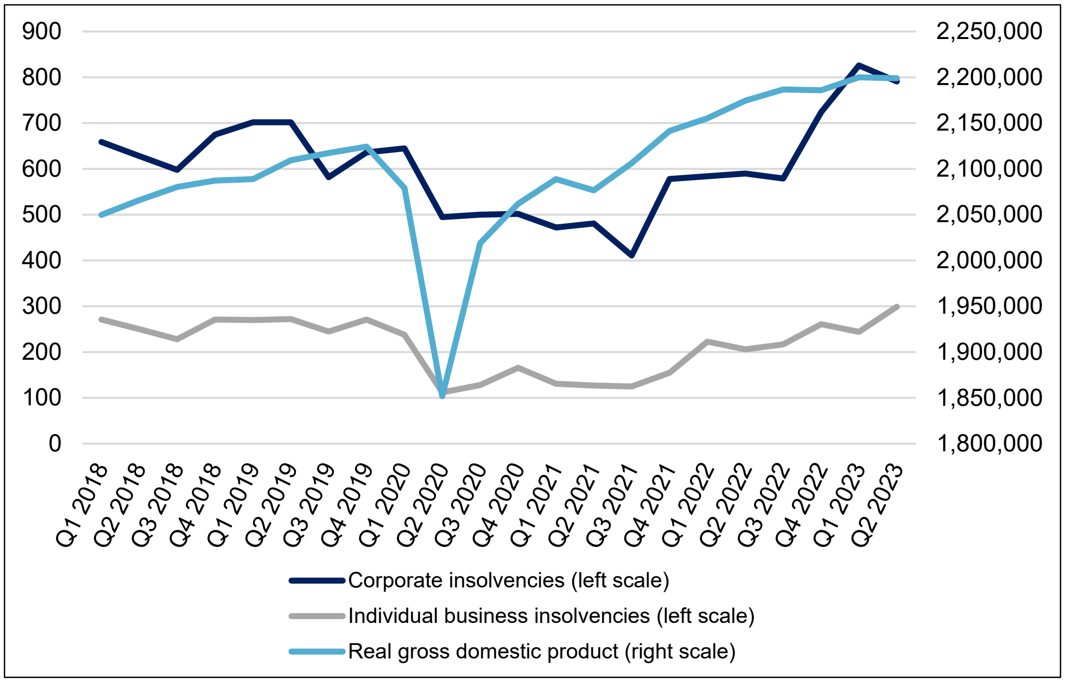


Note: The real gross domestic product series is presented in millions of chained 2012 dollars.

Source: Figure prepared by the Library of Parliament using data obtained from Government of Canada, "Historic Insolvency Statistics – Monthly (from 1987)," Database, accessed 20 December 2022; and Statistics Canada, "Table 36-10-0104-01: Gross domestic product, expenditure-based, Canada, quarterly (x 1,000,000)," Database, accessed 27 June 2023.

Since the COVID-19 pandemic and associated containment measures caused a significant economic downturn, it seems reasonable to expect that the number of business insolvencies would have increased as a result. However, as shown in Figure 4, the number of corporate and individual business insolvencies fell by 55% and 117%, respectively, between the fourth quarter of 2019 and the third quarter of 2021. These figures rose in subsequent quarters, especially for corporate insolvencies, which is now higher than it was pre-pandemic.

Figure 4 – Number of Corporate and Individual Business Insolvency Filings Under the *Bankruptcy and Insolvency Act* and Real Gross Domestic Product, First Quarter of 2018 to Second Quarter of 2023 (number of filings and $)

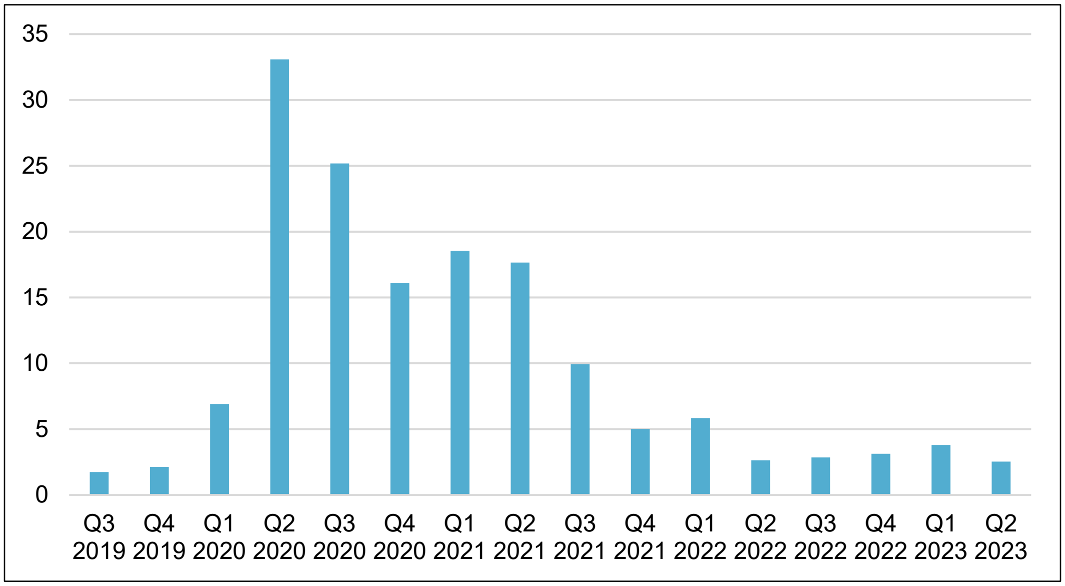


Note: The real gross domestic product series is expressed in millions of chained 2012 dollars.

Source: Figure prepared by the Library of Parliament using data obtained from Government of Canada, "Historic Insolvency Statistics – Monthly (from 1987)," Database, accessed 28 September 2023; and Statistics Canada, "Table 36-10-0104-01: Gross domestic product, expenditure-based, quarterly, Canada (x 1,000,000)," Database, accessed 28 September 2023.

The decrease in the number of business insolvencies during the COVID-19 pandemic is likely due – at least in part – to the various support measures and business loan and liquidity programs put in place by the federal government, such as the Canada Emergency Wage Subsidy (CEWS) and the Canada Emergency Business Account (CEBA). The level of government support provided is shown in Figure 5; it reports the amounts of subsidies on production given to businesses by all levels of government. Subsidies on production grew from $2.1 billion in the fourth quarter of 2019 to a maximum of $33.1 billion in the second quarter of 2020, primarily due to CEWS payments to businesses. With the end of these temporary support programs, these subsidies have since decreased to less than $5.0 billion per quarter.

Figure 5 – Subsidies on Production to Businesses by All Levels of Government, Canada, Third Quarter of 2019 to Second Quarter of 2023 ($ billions)



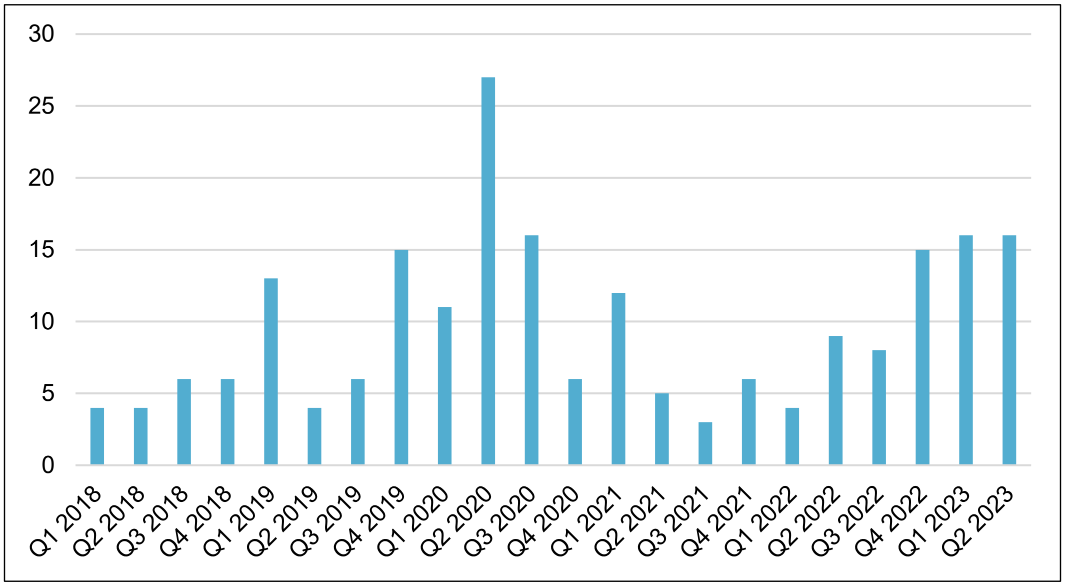
Note: As indicated by Statistics Canada, a number of federal programs are included in subsidies on production, such as the Canada Emergency Wage Subsidy, the Canada Emergency Rent Subsidy and Lockdown Support for businesses. See Statistics Canada, *Federal government expenditures on COVID-19 response measures*.

Source: Figure prepared by the Library of Parliament using unadjusted data obtained from Statistics Canada, "Table 36-10-0477-01: Revenue, expenditure and budgetary balance – General governments (x 1,000,000)," Database, accessed 28 September 2023.

Furthermore, the Bank of Canada's response to the COVID-19 pandemic may have contributed to the decrease in the number of business insolvencies. In March 2020, it helped keep interest rates low by reducing the target for the overnight rate from 1.75% to 0.25%, its effective lower bound. It also established asset purchase programs to support the functioning of financial markets. These measures led to lower borrowing costs for businesses and helped them manage their cash flow. Reduced enforcement and collection activity by creditors during the beginning of the pandemic may also have helped businesses avoid or delay the commencement of insolvency proceedings.[20]

While the number of business insolvencies dropped following the onset of the COVID-19 pandemic, the number of filings under the CCAA rose to 27 in the second quarter of 2020 (see Figure 6), the highest quarterly value since the fourth quarter of 2009, which is the earliest quarter for which that data was collected. In the 12-month period ending on 31 March 2021, 58 filings were recorded, for an increase of 61% over the preceding 12-month period. The three sectors with the most filings in that period were retail trade (12), manufacturing (10) and mining, quarrying and oil and gas extraction (9).[21] The number of quarterly filings returned to pre-pandemic levels in subsequent quarters, but began to rise in the fourth quarter of 2022, like corporate insolvency filings.

Figure 6 – Number of Filings Under the *Companies' Creditors Arrangement Act*, First Quarter of 2018 to Second Quarter of 2023



Source: Figure prepared by the Library of Parliament using data obtained from Office of the Superintendent of Bankruptcy, *Insolvency and CCAA Statistics in Canada*, various quarters.

6 GOING FORWARD

In 2021, there were concerns that for many businesses, the inevitable had only been delayed and that business insolvencies would rise following the end of many temporary support measures related to the COVID-19 pandemic. Although the number of business insolvencies remained below pre-pandemic levels through most of 2021 and 2022, it has been rising since the fourth quarter of 2022.

In 2022, inflation rose to levels not seen since the 1980s. In response, the Bank of Canada raised its target for the overnight rate on several occasions, bringing it to 5% in July 2023. Higher input and borrowing costs, and an expected decline in economic growth at a time when many businesses are more indebted because of the pandemic, have led to renewed concerns of a rising number of business insolvencies. According to the Canadian Federation of Independent Business (CFIB), the percentage of small businesses considering bankruptcy or permanent closure has increased from 14% to 17% between January and June 2022.[22] As well, many businesses have indicated that they may have difficulties repaying temporary support loans, such as those provided through CEBA. Of the 62% of businesses who took on such loans, about 30% reported that repayment will be a challenge.[23]

Ultimately, business bankruptcies represent only a small portion of total business exits. For instance, businesses with limited amounts of debt may simply pay back creditors before ceasing operations, rather than file for bankruptcy. In fact, among the small businesses considering bankruptcy or permanent closure in 2022, the CFIB found that only 10% would do so through the bankruptcy process.[24] Given this, it is possible that an economic downturn in 2023 or later would not be accompanied by a significant increase in business insolvencies, as most businesses would simply cease operations before resorting to the insolvency process.

NOTES

1. *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.
2. *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.
3. *Constitution Act, 1867*, 30 & 31 Victoria, c. 3 (U.K.), s. 91(21).
4. It is important to note that, as the provinces have power over property and civil rights in their jurisdiction pursuant to section 92(13) of the *Constitution Act, 1867*, they have enacted legislation that allows individuals to keep certain assets upon filing for bankruptcy. While these exemptions vary by province, most exempt assets include items such as food, tools of a trade, clothing and other personal property valued below a certain prescribed amount.
5. Peter W. Hogg, "Chapter 25 – Bankruptcy and Insolvency," *Constitutional Law of Canada, 5th Edition Supplemented*, 2021.
6. Government of Canada, *Office of the Superintendent of Bankruptcy*.
7. Shannon Kari, "CCAA v. BIA," *Canadian Lawyer,* 1 June 2015.
8. *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11.
9. *Farm Debt Mediation Act*, S.C. 1997, c. 21.
10. *Canada Business Corporations Act*, R.S.C. 1985, c. C-44.
11. *Wage Earner Protection Program Act*, S.C. 2005, c. 47, s. 1.
12. In general, receivership is a legal process available to secured creditors if a business starts to default on payments with respect to a secured loan.
13. Antonia Menezes et al., "Insolvency and Debt Resolution," *Understanding Poverty*, World Bank, 1 February 2021.
14. See *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47; and *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, S.C. 2007, c. 36.
15. *Pension Benefits Standards Act, 1985*, R.S.C. 1985, c. 32 (2nd Supp.).
16. *Budget Implementation Act, 2019, No. 1*, S.C. 2019, c. 29, ss. 133–142.
17. *Pension Protection Act*, S.C. 2023, c. 6.
18. Cindy Lecavalier, "National and Regional Trends in Business Bankruptcies, 1980 to 2005," *Insights on the Canadian Economy*, Statistics Canada, October 2006.
19. Janis P. Sarra, *Micro, Small and Medium Enterprise (MSME) Insolvency in Canada*, *Allard Faculty Publications*, The Peter A. Allard School of Law, Allard Research Commons, 30 March 2016, pp. 43–44.
20. Canadian Association of Insolvency and Restructuring Professionals (CAIRP), *CAIRP: 2020 Canadian Insolvency Statistics*, News release, 8 February 2021.

21. Office of the Superintendent of Bankruptcy, "Table 3: CCAA Proceedings Filed by NAICS Economic Sector, Canada," *CCAA Statistics – First Quarter of 2021*.

22. Canadian Federation of Independent Businesses (CFIB), *Small Business Insolvency: The Tip of the Iceberg?*, 17 August 2022.

23. Stephanie Tam, Robert Fair and Chris Johnston, "The state of business financing and debt in Canada, fourth quarter of 2022," *Analysis in Brief*, Statistics Canada, 8 December 2022.

24. CFIB, *Small Business Insolvency: The Tip of the Iceberg?*, 17 August 2022.