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# Employers and Lenders Beware:

## Recent Amendments to the *Wage Earner Protection Program Act* and Related Legislation

by Simina Ionescu-Mocanu

### I. Introduction

Over the last six years, the federal government has made numerous attempts to revise the statutory scheme governing bankrupt corporations. The most recent series of amendments was introduced in the 2009 Federal Budget announcements, which were released on January 27, 2009. One of the more significant amendments was the creation of a new Wage Earner Protection Program (the "Program"). Through the Program, the federal government promises to take an active role in compensating wage earners for wages owed to them by employers who are bankrupt or under a receivership.

While these legislative additions are designed to provide added financial assistance to Canadian workers, the new scheme may bring added risks to corporate employers and their directors. To avoid potential liability, companies should work diligently to ensure that government remittances and employee wage payments are made on time. Employers should also be aware that this added level of liability might give rise to stricter lending practices.

This article provides an overview of the amendments to the *Bankruptcy and Insolvency Act*<sup>1</sup> (the "BIA"), the new *Wage Earner Protection Program Act*<sup>2</sup> (the "WEPPA"), the impact of the new legislation on the current insolvency regime and the potential consequences for lenders, employers and employees alike.



## II. General Overview of Priorities and Distribution

On bankruptcy, a debtor's property is typically divided on a *pari passu* basis among all of the creditors who have eligible claims. As a general rule, creditors are ranked based on the type (e.g. secured or unsecured) and amount of their claims. Under the BIA, creditors are classified in the following four groups: secured creditors, preferred creditors, ordinary creditors, and deferred creditors.

This classification system determines where the creditors rank in relation to their claim against the debtor's assets. For instance, creditors who hold security can realize on their secured collateral as if there were no bankruptcy because these parties have first priority on distribution. Once all of the secured creditors' claims (and, of course, any amounts owing to Canada Revenue Agency) are paid out, if the bankrupt company has any value in its remaining assets, the next group to receive a portion of the distribution is a special class of creditors commonly referred to as the "preferred" class. Unsecured creditors who are in this special "preferred" class are the first of the unsecured group to recover.

### A. Employee Claims: "Preferred Status"

Under the old regime, employees of bankrupt companies who were owed unpaid wages were placed in the "preferred" creditor class. As stated above, this meant that their claims had priority over those of other unsecured creditors. However, employees' chances of recovery were also highly dependant on the value of the bankrupt's assets, as payout could not occur until all of the secured creditors' claims were satisfied.

This classification system had negative implications for employees of insolvent corporations. Industry Canada estimated that 10,000 to 15,000 workers had unpaid wage claims resulting from bankruptcy each year.<sup>3</sup> Unpaid employee recovery was tallied at approximately thirteen cents on the dollar.

Some provinces attempted to use provincial employment legislation to rectify this problem. In one particular British Columbia case, the Director of Employment Standards relied on section 96 of the *Employment Standards Act*<sup>4</sup> and argued that the bankrupt employer's directors and officers ought to be held personally liable for up to two months' unpaid wages for each employee.<sup>5</sup> The Court of Appeal disagreed with the Director's position. It held that allowing such a claim to succeed would be "tantamount to a re-ordering of the priorities established under the BIA".<sup>6</sup> Since the federal legislation took precedence over the provincial enactments, the scheme of distribution outlined in the BIA applied.

As a result of these decisions, the federal government began to search for ways to increase employees' chances of recovery.

### B. The WEPPA: A Government-Funded Insurance Program

The Program was originally introduced along with a package of major amendments to bankruptcy legislation in Bill C-55, *An Act to Establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*. Although Bill C-55 received Royal Assent on November 25, 2006, it was never proclaimed into force, partly due to the fall of the minority Liberal government in early 2006.

Bill C-12 was introduced in early 2007 as *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 and subsequently became Chapter 36 of the Statutes of Canada, 2007 on December 14, 2007. On July 7, 2008, the WEPPA was finally proclaimed in force.

In turn, the WEPPA and its accompanying Regulations<sup>7</sup> created the Wage Earner Protection Program.

#### 1. Compensation

The Program compensates employees for unpaid wages earned in the six months immediately before an initial bankruptcy event, minus any applicable provincial or federal deductions, to a maximum amount of \$3,000 or four times the maximum weekly insurable earnings under the *Employment Insurance Act*<sup>8</sup>, whichever is greater<sup>9</sup>. The term "date of the initial bankruptcy event" is broadly defined to include proceedings commenced under the *Companies' Creditors Arrangements Act*<sup>10</sup> (the "CCAA"). This wide definition provides protection in instances where a debtor corporation has a failed reorganization attempt.<sup>11</sup>

Holiday pay, overtime pay, as well as all employee benefits and entitlements, are included in the WEPPA definition of wages.<sup>12</sup> Moreover, although severance and termination pay were specifically excluded from the wording of the WEPPA and BIA,<sup>13</sup> effective March 12, 2009, both of these payments are added to the group of compensated employee claims.

Payments to individuals under the Program are allocated in the following order:

- (a) wages other than those referred to in (b) through (e);
- (b) disbursements of travelling salespersons;
- (c) vacation pay;
- (d) termination pay; and
- (e) severance pay.<sup>14</sup>

Industry Canada anticipates that payments will occur within six to eight weeks of an employee's application<sup>15</sup> and that the Program will fully satisfy as much as 97% of unpaid wage claims arising out of bankruptcy.<sup>16</sup>

#### 2. Eligibility

To be eligible for payments under the Program, an employee must be terminated by a bankrupt employer or by a receiver and be owed wages earned during the last six months before the date of bankruptcy or receivership.<sup>17</sup>

Employees who earned wages while having a "controlling interest" or employees who occupied a managerial position in the bankrupt company cannot claim under the Program.<sup>18</sup> Individuals are thought to have had a "controlling interest" if they owned more than 40% of the voting shares in the corporation, a block of voting shares "large enough so that no one shareholder or coalition of shareholders can block a motion", or enough shares in the corporation to "control [its] policy."<sup>19</sup>

### C. The BIA: Limited "Super Priority"

The changes brought forward under the WEPPA are complemented by the newly-enacted sections in the BIA.

Sections 81.3 and 81.4 of the BIA give clerks, servants, travelling salespeople, labourers or workers a secured charge over wages earned for services rendered during the period commencing on the day that is six months before the date of the initial bankruptcy event and ending on the date of the bankruptcy. This means that employee claims are pushed ahead of **any other claim, charge or security** against a bankrupt's assets, regardless of when the other claim arose.<sup>20</sup>

These claims are, in effect, given a "super priority" over the claims of any other creditor. Secured creditors who rank below employee claims as a result of this "super priority" receive a preferred unsecured claim equal to the difference between the amounts *actually* recovered and the amounts that they *would have* recovered, but for the operation of these provisions.

As previously stated, the responsibility for making payments under the Program belongs to the federal government. However, the federal government is not the only entity that bears the financial burden of funding the Program.

In practice, once payments are made under the Program, the federal government, in effect, subrogates or steps into the wage earners' shoes to recuperate a portion of what it paid out to eligible claimants. The right to recover under these sections also belongs to employees who could not qualify for wage payments under the Program. Since most employee

Similar to the *WEPPA*, the new "super priority" charge granted under the *BIA* does not protect directors' and officers' unpaid wage claims. Additionally, it does not apply to a person who was not dealing at arm's length with the bankrupt, unless the trustee or the receiver finds it "reasonable to conclude that [the parties] would have entered into a substantially similar transaction if they had been dealing with each other at arm's length".<sup>22</sup>

Parties can claim these amounts either from the bankruptcy trustee or receiver, or through direct enforcement of the "super-priority".



claims are already covered under the Program's recovery fund, the federal government is the more likely party making a claim under these provisions. Government officials estimate that the federal government may recover as much as 50 cents on the dollar as a result of this new scheme.

It is highly important to note that the claims captured by the *BIA* amendments are "limited" in amount. The charge captures up to \$2,000 of unpaid wages, plus \$1,000 for disbursements of travelling sales people. Employees have comparable rights under a receivership.<sup>21</sup>

#### **D. Pension Fund Protection**

A similar charge protects employees' unremitted pension contributions, which include payments made under a defined contribution plan, a pension fund, or another benefit plan (i.e. amounts which are deducted from a worker's income, but not remitted to the worker).<sup>23</sup>

This protection is awarded in both bankruptcy and in a receivership. It is unlimited in amount and ranks subsequent to the "super-priority" discussed above.

The *WEPPA* and the *BIA* amendments are likely to have the greatest impact on small and medium-sized companies, as larger corporate firms are more likely to restructure when faced with the threat of insolvency.

### E. Restructuring Claims

The recent amendments, which came into force on September 18, 2009, provide further wage earner protection for corporations who are in the middle of restructuring proceedings. Under subsection 60(1.3) of the *BIA* and subsections 6(5) and 6(6) of the *CCAA*, a court cannot approve an employer's proposal unless the plan of arrangement provides for employee wage payments (in the amounts prescribed by legislation) or the court is satisfied that the employer "can and will" make the required payments.<sup>24</sup> Similar provisions also exist in relation to pension fund payments.

### III. Recent Amendments: the 2009 Budget Announcements

Termination and severance pay were previously not recoverable under the *WEPPA* because of the variance in pay between federal, provincial and territorial jurisdictions. Some argued that including these types of payments could lead to inter-provincial inequalities in payout levels.<sup>25</sup>

Nevertheless, as announced in the January 2009 Federal Budget, both of these payments are included in the *WEPPA*'s definition of "wages". The Federal Budget also advanced a government promise to allocate \$50 million over the next two years to extend the application of the *WEPPA* to severance and termination pay. This means that eligible workers will be able to include these amounts when advancing a claim under the Program.

It should be noted that the Federal Budget announcements did not address the priority of severance and termination claims as against the assets of the employer under the *BIA*. The *BIA* definition of "compensation" continues to exclude severance and termination pay. Thus, it is likely that such payments will not receive a "super priority" charge under the *BIA*.

The *WEPPA* amendments are effective as of March 12, 2009 and apply retroactively from January 27, 2009. Although employee recovery is still subject to the legislated cap, this funding is likely to provide some added assistance to former employees of bankrupt companies.

#### A. Defining Severance and Termination Pay

Employment standards legislation typically mandates that employers provide employees with a written notice of termination, termination pay, or with a combination of the two.

According to Service Canada, termination pay is a lump sum payment equal to the amount that an employee would normally have been entitled to be paid in regular weekly wages during the written notice period.<sup>26</sup> Severance pay is "compensation paid to qualified employees whose employment has been 'severed'". Unlike termination pay, which is intended to replace the required notice of termination, severance pay compensates an employee for the loss of seniority and recognizes an employee's long-term service.<sup>27</sup>

### B. Other Amendments

The new amendments, as introduced in the Federal Budget have, among others, the following additional aims:

- ensure consistency in the use and application of the term "eligible wages" throughout the *WEPPA* and its corresponding regulations;
- clarify the criteria for employee eligibility under the Program;
- ensure consistency between the French and English versions of the legislation;
- revise the *order* of payment allocations to include termination and severance pay; and
- grant trustees and receivers 10 additional days (an increase from the previous 35-day period) to provide the prescribed information to the Minister and to the individual, or even possible further extensions of time when circumstances beyond their control necessitate a longer period.<sup>28</sup>

### IV. Practical Implications – Who is at Risk?

#### A. Employers

The *WEPPA* and the *BIA* amendments are likely to have the greatest impact on small and medium-sized companies, as larger corporate firms are more likely to restructure when faced with the threat of insolvency. Potential liability arises if firms withhold government remittances and/or employee vacation pay. To remedy this threat, companies must work internally to improve their monitoring of wage payments.

The *WEPPA* also holds directors personally liable for unpaid employee wages.<sup>30</sup> Thus, it may be very useful for directors to conduct their own due diligence reviews to ensure that the company has enough assets to remain solvent and, more importantly, to guarantee that management is implementing the necessary procedures and not resorting to improper measures.<sup>31</sup>

#### B. Lenders

The new amendments, particularly the newly-enacted "super-priority" provisions in the *BIA*, create a drastic re-ordering of the typical claim-distribution system. Under the old system, secured creditors were guaranteed to recover the greatest portion of their claims, as they were the first players to have access to the debtor's assets upon bankruptcy.

Under the new regime, secured creditors' claims are subordinated to those of wage earners. Although wage earners' claims under sections 81.3 and 81.4 of the *BIA* are limited in amount, it is anticipated that these changes will impact secured lenders' willingness to advance credit. Some lenders may revise their lending margins to account for payroll expenditures, especially in instances where borrowers have high numbers of employees. Others may raise interest rates or even start to use insolvency professionals to monitor borrowers' current assets and the practices of management. Increased levels of due diligence may be required to determine borrowers' insolvency risks.

# meeting room

It should be noted, however, that the new provisions in paragraph 136(1) (d.01) of the *BIA* do offer secured creditors a small amount of protection. Under this section, lenders' claims are also preferred, ranking subsequent in priority to the claims of secured creditors and employee claims under sections 81.3 and 81.4. To be eligible for this additional priority, lenders must provide a proof of claim in which they must indicate the amount that they would have recovered as secured creditors, but for the operation of those sections. On a practical level, however, lenders will only benefit under this provision if the bankrupt company has sufficient assets to satisfy all of its secured creditors' claims. Thus, it may be extremely difficult for lenders to recover under this section.

## C. Trustees and Receivers

From the perspective of a trustee, administration may become significantly more complex once the new statutory provisions are in effect. First, trustees face increased personal responsibility for distributions made in contravention of the priorities scheme established under the new system. Trustees and receivers who commit an offence under the *WEPPA* may be personally liable if they realize on a bankrupt's current assets in error.<sup>32</sup>

Trustees and receivers will also have to identify potential eligible wage earners, identify the amounts owing, inform the earners of their rights under the *WEPPA*, and provide any information acquired to the Minister of Labour and Housing ("the **Minister**"). Trustees will need to manage details such as wage earners' names, addresses, SIN numbers, and amounts owed. These tasks may be quite arduous, especially if the task involves the distribution of a smaller firm's assets, where corporate records may not be as up to date.<sup>33</sup>

Once discharged, trustees will also have to inform the Minister of the discharge. Receivers have similar duties once their role is complete.

Moreover, as of March 12, 2009, trustees and receivers have added obligations as a result of the new Federal Budget announcements. With respect to bankruptcies taking place between January 27, 2009 and March 12, 2009, trustees and receivers must submit a new or amended Trustee/Receiver Information Form to trigger the retroactivity process.

## V. Conclusion

Bills C-55, C-12 and the recent Federal Budget announcements are an attempt to provide wage earners with the guaranteed protection which was unavailable under the traditional classification and asset re-distribution system. However, these changes may bring along added potential liability for corporate employers and their directors. Companies should work diligently to ensure that regular government remittances and employee wage payments are made on time.

## Footnotes

- <sup>1</sup> R.S.C. 1985, c. B-3.
- <sup>2</sup> S.C. 2005, C. 47.
- <sup>3</sup> Industry Canada, Regulations and Standards, Corporate and Insolvency Law Policy, online: <http://www.ic.gc.ca/eic/site/clip-pdci.nsf/eng/c100783.html> (date accessed 09, April, 2009).
- <sup>4</sup> R.S.B.C. 1996, c. 113.
- <sup>5</sup> James, Re (2002), (sub nom. British Columbia (Director of Employment Standards) v. Todd McMahon Inc.) 32 C.B.R. (4th) 250 (B.C. C.A.).
- <sup>6</sup> See also Continental Casualty Co. v. MacLeod Stedman Inc. (1996), 43 C.B.R. (3d) 211 (Man. C.A.), where employees relied on the statutory deemed trust created under subsection 28(3) of the Manitoba Pension Benefits Act, C.C.S.M., c. P32. The Manitoba Court of Appeal took the same route as its British Columbia counterpart and also found that imposing such a trust would, in effect, reorder the scheme of priorities established under the federal statute.
- <sup>7</sup> Wage Earner Protection Program Regulations, S.O.R. 2008-222.
- <sup>8</sup> S.C. 1996, c. 23, as amended.
- <sup>9</sup> Supra note 2, s. 7(1).
- <sup>10</sup> R.S.C. 1985, c. C-36; these subsections were introduced by Chapter 47 of Bill C-55 and subsequently amended by Bill C-12. At this time, these provisions have yet to be in force.
- <sup>11</sup> Supra note 1, s. 2.
- <sup>12</sup> Ted Leroy Trucking Ltd. (Re), 2009 B.C.S.C. 41, [2009] B.C.J. No. 80 (QL).
- <sup>13</sup> Supra note 2, ss. 2; See also BIA, supra note 1, ss. 81.3(9), 81.4(9).
- <sup>14</sup> Supra note 7, s. 8.
- <sup>15</sup> Supra note 3.
- <sup>16</sup> Supra note 3.
- <sup>17</sup> Supra note 2, s. 5.
- <sup>18</sup> Supra note 2, s. 6.
- <sup>19</sup> Supra note 7, s. 4.
- <sup>20</sup> One exception is the required payment of deemed trust claims under section 67 and claims of unpaid suppliers.
- <sup>21</sup> It should be noted, however, that these charges are not subordinate to the deemed trust for unpaid source deductions.
- <sup>22</sup> Supra note 1, ss. 81.3(7), 81.4(7).
- <sup>23</sup> Supra note 1, ss. 81.5, 81.6.
- <sup>24</sup> Supra note 1, s. 60(1.3); CCAA, supra note 10, s. 6(6), (currently not yet in force).
- <sup>25</sup> Supra, note 3.
- <sup>26</sup> Service Canada, Wage Earner Protection Program, Recent Legislative Changes to the WEPP, online: [http://www.servicecanada.gc.ca/eng/sc/wepp/changes\\_wepp.shtml](http://www.servicecanada.gc.ca/eng/sc/wepp/changes_wepp.shtml), (date accessed, 09 April, 2009).
- <sup>27</sup> Supra, note 26.
- <sup>28</sup> Supra, note 26.
- <sup>29</sup> Mark, Ken, "Act puts employees at front of the line", The Bottom Line, Vol. 24, No. 12 (October 2008), quoting Kevin Brennan, Calgary-based vice-chair of the Canadian Association of Insolvency and Restructuring Professionals.
- <sup>30</sup> Supra note 2, s. 36(1)(b).
- <sup>31</sup> Supra note 29.
- <sup>32</sup> Supra note 2, s. 38(2); see also BIA, supra note 1, ss. 81.3(5), 81.4(5), 81.5(3), 81.6(3).
- <sup>33</sup> Supra note 2, s. 21.



## Thank You Calgary!

BD&P wishes to thank its clients and the Calgary community for supporting the PUT THE BOOTS TO HUNGER campaign during Stampede week, 2009. PUT THE BOOTS TO HUNGER is a campaign partnership between BD&P and the Calgary Interfaith Food Bank whereby funds are raised to provide the basic necessity of food for numerous Calgarians facing economic challenges. In 2009, the Food Bank has experienced a 40 % increase in food requests from Calgary families.

Thanks to the generosity of numerous participating clients and other community partners during Stampede week 2009, BD&P was able to see its initial launch donation of \$150,000.00 grow to a total of \$350,000.

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