

Insolvency and Corporate Restructuring

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Insolvency Legislation Amendments - Priorities for Secured Creditors Re-Ordered

The *Wage Earner Protection Program Act* (“*WEPPA*”) and amendments to the *Bankruptcy & Insolvency Act* (“*BIA*”), proclaimed in force on July 7, 2008, provide new super priority rights to employees in the event of the bankruptcy or receivership of their employer for: (i) unpaid wages; and (ii) unpaid pension plan contributions. These claims will now rank ahead of all secured creditors in bankruptcies or receiverships occurring on or after July 7, 2008.

Prior to these legislative changes, employees frequently received nothing or only a portion of their claims when their employer became insolvent. Moreover, workers could recover their claims only at the conclusion of the bankruptcy proceedings. The rationale for the re-balancing of creditor priorities is that vulnerable employees, unlike secured creditors, are unable to protect themselves against employer insolvencies.

Wage and Pension Super Priorities

A new limited super priority charge has been created for unpaid employee wages, salaries, commissions and “compensation” up to a maximum of \$2,000.00 and up to \$1,000.00 in respect of disbursements owing to travelling sales people incurred during the six months prior to bankruptcy or the appointment of a receiver. “Compensation” includes vacation pay, but not termination or severance pay.

This amount will now be a statutorily-secured claim on all the “current assets” (cash and cash equivalents) of the bankrupt or employer in receivership which will rank in priority to other claims. Unpaid employee wage claims that exceed this threshold amount would be recoverable as preferred claims, ranking after the claims of secured creditors but ahead of unsecured creditors. The amendments have altered bankruptcy law in a very significant way by subordinating secured creditors to unpaid employee wage claims. Previously, all wage claims constituted only preferred claims in a bankruptcy.

Previously, insolvency legislation did not contain provisions that gave priority to pension contributions deducted but not remitted to the pension plan (even those deducted from the employees themselves). The *BIA* now grants a

super priority charge for outstanding pension plan contributions that ranks immediately behind the employee remuneration super priority charge. The super priority afforded to pension plan contributions is unlimited in amount and extends to all assets of a bankrupt in respect of:

- a) any amount that was deducted from the employees’ remuneration for payment to the pension plan;
- b) any unremitted employer pension contributions towards a defined contribution pension plan; and
- c) any unpaid “normal costs” (ongoing payments made in defined benefit pension plans to meet the plan obligations to members) as required by applicable pension legislation.

It is particularly important for mortgage lenders to note that the pension plan super priority charge will extend to real and personal property.

The only exceptions to these newly-created super priority charges in a bankruptcy are the special rights which currently exist for suppliers, farmers and fishers, and the pre-existing governmental deemed trusts for employment source deductions. In a receivership, the super priorities are treated similarly but are not subordinate to existing governmental deemed trusts for source deductions.

Wage Earner Protection Program

In addition, the *WEPPA* establishes a new government funded and administered program designed to provide timely payment of a maximum of \$3000 of unpaid wages and vacation pay owed to each employee and earned in the six months immediately preceding the bankruptcy or receivership. Some employees including directors, officers

or non- arms length parties will be excluded from the program. The key feature of this program permits unpaid eligible employees to recover unpaid wages and vacation pay from the Government of Canada, which then assumes the employee's position as creditor in the bankruptcy or receivership. Workers who do not qualify for payment from this government program can pursue their wage claims in a bankruptcy or receivership by asserting the limited super priority or a preferred claim for unpaid wages.

Other Key Amendments

Other legislative amendments to the *BIA* now in force include provisions dealing with **RRSPs** and **RRIFs**. Such funds are now exempt from seizure by a trustee-in-bankruptcy except for contributions made in the twelve-month period prior to bankruptcy (Judgment creditors can seize such funds prior to bankruptcy). In Ontario, existing blanket protection for **RRSPs** or **RRIFs** with insurance companies continues to apply.

Impact of the new Amendments

The new super priorities will clearly have an impact on secured lenders. Some financial institutions may already factor potential employee wage claims into the borrowing facility. Lenders not currently taking such steps are well advised to implement measures to protect against the potential risk of super priorities for wage claims. Lenders may wish to revise their credit agreements to include specific covenants requiring employers to use third-party payroll services and to regularly report on their payroll and pension contribution activity. The decision to consider additional protective measures will depend upon the value of the realizable security and the size of the employee group. Creditors may now require additional security or decide to change their current reserve practices to deduct the amount of the potential prior-ranking claims from the available loan amounts.

Bobby Sachdeva practices in the area of commercial litigation with a specific focus on bankruptcy and insolvency.



Pallett Valo LLP Insolvency & Corporate Restructuring Law Group

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