

New Labor Priorities in Canadian Insolvency Law Give Super Priority Status for Hockey Moms, Dads and the Rest of the Canadian Workforce

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Recent amendments to Canadian insolvency laws regarding employment issues may have a significant cross-border impact.

What do a U.S.-based lender advancing funds to a Canadian company, an investor in a business with a division in Canada, and the manager of a multinational company with operations north of the border have in common? In any of these scenarios, recent amendments to Canadian insolvency laws regarding employment issues may have a significant impact upon them. Priority liens have been created to protect wages and certain pension plan contributions of Canadian workers. Additional amendments, passed by Canada's Parliament but not yet in force, will entrench collective agreements. There are significant practical implications of these changes.

One of the most vulnerable constituencies in any insolvency is the workforce. Particularly in smaller business failures, employees are at risk

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of not being paid pre-filing arrears of wages, expense reimbursement and, in particular, vacation pay. Canadian lawmakers have spent the past 30 years debating how this constituency can be protected. Recent amendments to Canadian insolvency legislation reflect the solution they have forged that will impact any company with a labor constituency in Canada.

MONETARY CAPS FOR WAGES AND VACATION PAY

Prior to these amendments workers had scant protection for their arrears of wages and vacation pay. They have traditionally been granted a limited preferred status over ordinary creditors; however, this preferred status is usually illusory as it is subject to prior secured claims and priority statutory claims. They have a statutory claim against directors of their employer, but this is an expensive and difficult remedy to enforce.

The new amendments radically change this landscape by granting employee claims a super priority with respect to certain wage arrears, statutory vacation pay and expense reimbursement obligations. These protections are subject to certain limitations, the main one being a monetary cap of \$2,000 for wages and vacation pay.

The wage priority lien arises only upon a bankruptcy (the equivalent of Chapter 7 liquidation in the U.S.) or receivership. The lien is against "current assets" which are defined as, essentially, cash, cash equivalents, inventory or accounts receivable. The lien ranks ahead of all other claims, rights, charges, or securities, with very limited exceptions. The lien does not extend to statutory or common law amounts payable to employees for severance or termination.

As a result of the amendments, in a Canadian bankruptcy or receivership the pecking order has been altered such that these employee claims now rank at the top. In an employee-intensive business, such as a manufacturing, retail or technology service business, the quantum of this potential liability may be very significant. In a restructuring scenario, the amendments provide that a plan cannot be approved by the court unless the amounts secured by the wage lien are provided for. Likewise, the amendments prohibit the Court from approving a sale of assets by an insolvent company unless it is satisfied that the debtor can and will pay

the amounts secured by the wage lien.

In addition to the wage priority lien, the federal government has established a fund under the Wage Earner Protection Program Act to protect employees. Qualifying employees can seek immediate reimbursement from the federal government of arrears of wages and vacation pay, subject to a monetary limit of \$3,000, where a business goes into bankruptcy or receivership. The government is then subrogated into the employees wage priority lien to the limit of \$2,000.

PENSION ARREARS

Another area of historical vulnerability for workers concerned the failure of an employer to make required pension contributions in the time leading up to its insolvency. Little protection was granted to employees with respect to such arrears.

The new amendments grant employees a super priority lien subject only to the wage priority lien (with a few exceptions) to protect arrears of certain pension contributions in a bankruptcy or receivership scenario.

Unlike the wage priority lien, the pension lien is over *all* of the assets of the employer, not just current assets. Thus, for example, the holder of a first ranking land mortgage, with funds advanced many years previous, may find itself primed by this new pension lien. The lien secures:

- (i) the employee portion of a pension contribution deducted by the employer but not remitted to the pension plan;
- (ii) in a defined benefit pension plan, the amount of the arrears of the employers “normal” monthly payments. Normal payments do not include special solvency catch up payments or wind up deficiencies;
- (iii) in a defined contribution plan, the amount of the employers’ arrears of contributions.

There is no cap on the amount secured by this pension lien.

In a restructuring scenario no plan or arrangement can be approved by a court unless provision is made — or an agreement with all stakeholders

is reached — with respect to the pension liability secured by the pension lien and an asset sale cannot be approved unless the Court is satisfied that those amounts can and will be paid.

Obviously, this unlimited super-priority lien must be factored into the mix in making lending decisions with respect to Canadian companies. Similarly, restructuring strategies will now need to take into account this new factor.

The bottom line is that lenders to Canadian companies or investors in Canadian companies in financial difficulty must be mindful of these newly created priority liens and factor the change into lending or investments strategies.

COLLECTIVE AGREEMENTS

As was the case in the United States, there has been a great deal of debate in Canada, — but little decided case law — with respect to the status of collective agreements. Are they executory contracts, like any other, that can be repudiated by a debtor in a restructuring? Or are they something different, a right to be protected as a matter of public policy?

In the recent Air Canada restructuring that issue was central to the case and was put squarely before the court. However, before the matter was argued, a settlement was achieved. It is fair to say that a driving force for the settlement was the uncertainty of the answer to this question.

Canada often looks to the U.S. Bankruptcy Code for solutions in dealing with these difficult issues. That has not been the case with collective agreements. The new amendments now make it clear that a collective agreement cannot be repudiated in a restructuring nor can it be varied without the consent of labor. The amendments provide a mechanism by which a debtor, restructuring under the provisions of the Companies' Creditors Arrangement Act, can require the union to bargain. However, if a satisfactory compromise cannot be achieved, there is no power in the debtor to repudiate the collective agreement or to force its amendment.

Depending upon your point of view this could be a good thing or a bad thing. In our opinion the elimination of uncertainty with respect to the status of collective agreements will embolden labor and cause them to

become more intransigent in negotiations with an insolvent debtor. They will have a much stronger position in extracting value from other stakeholders, which will make the task of restructuring a unionized debtor that much more challenging.

CHANGED INSOLVENCY LANDSCAPE EXPECTED ON EMPLOYMENT ISSUES

The amendments with respect to the Wage Earner Protection Program Act, the wage priority lien and the pension lien are now in force. The amendments with respect to collective agreements have been passed by Parliament but not yet proclaimed, as the regulations dealing with the statute have not yet been completed. It is anticipated that this aspect of the amendments will become law before the end of the year.

After many years of debate the Canadian Parliament has put in place structures to protect the interests of the country's workforce in the event of corporate failures. Those doing business in Canada need to understand this altered landscape as they navigate a challenging cross-border economy in the year ahead.