



**CANADIAN FINANCE & LEASING ASSOCIATION  
ASSOCIATION CANADIENNE DE FINANCEMENT ET DE LOCATION**

April 20, 2004

**By e-mail: [Minister.Industry@ic.gc.ca](mailto:Minister.Industry@ic.gc.ca)  
Original by courier**

The Honourable Lucienne Robillard  
Minister of Industry  
Industry Canada  
11<sup>th</sup> Floor, East Tower  
C.D. Howe Building  
235 Queen Street  
Ottawa, ON K1A 0H5

**Bankruptcy and Insolvency Law Reform and the  
Asset-based Financing, Vehicle and Equipment Leasing Industry in Canada**

Dear Minister,

The Canadian Finance and Leasing Association (“**CFLA**”) represents the interests of the industry that provides specific asset-based priority financing, vehicle and equipment leasing in Canada (the “**Industry**”). For your review, a list of our 230 plus members is attached to this letter.

We are aware that the administration and operation of the *Bankruptcy and Insolvency Act* (“**BIA**”) and *Companies’ Creditors Arrangement Act* (“**CCAA**”) are currently under review by the federal government. We are also aware of the report released by the Standing Senate Committee on Banking, Trade and Commerce on November 4, 2003, “Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies’ Creditors Arrangement Act*”, and the legislative amendments to the BIA and CCAA proposed therein (the “**Senate Committee’s Report**”). We understand that, as Minister of Industry, you will be reviewing these proposed amendments, among others.

In anticipation of your review, CFLA would like to take this opportunity to outline various issues under the current BIA and CCAA that unfairly prejudice the interests of the Industry, and propose certain recommendations that the government should consider in developing amendments or clarifying existing provisions under the two statutes.

To begin, a description of specific asset-based priority financing and leasing in Canada is provided below, followed by an overview of the key issues and recommendations proposed by CFLA.

**Specific Asset-based Priority Financing and Leasing in Canada**

As identified by the Task Force on the Future of the Canadian Financial Services Sector (the “**Task Force**”), the Industry plays a key role in the government’s long-standing strategy to ensure a diversity of providers of financial services in this country. After the traditional lenders (banks and credit unions), the Industry is the most important supplier of debt financing to Canadians. We estimate the Industry to have over \$100 billion in financing in place with Canadian small, medium and large businesses, as well as, consumers.

Specific asset-based priority financing is the financing of equipment, vehicles and related assets by way of a lease, conditional sales contract or other financing agreement where

title and ownership remains with the financier until they are paid in full. Throughout this submission, the term "financing agreement" will include the financing of specific assets where title and ownership remains with the financier until it is paid in full. These assets are usually the only assets against which the lessor/financier has recourse in the event the lessee/borrower fails to make payments over the term of the agreement or otherwise defaults under the agreement.

These types of financing agreements are significant and unique as they enable lessors/borrowers to use the value of the specific asset as security to finance its acquisition. They rely on cash-flow based credit analysis, and because the lessor/financier retains title and legal ownership of the asset until the financing agreement ends, it allows a person to qualify based on his or her generated cash flow rather than on a personal worth lending formula basis as typically offered by traditional lenders.

According to Statistics Canada, machinery and equipment investment intentions for 2004 are estimated to be \$84.5 billion<sup>1</sup>. We estimate that between 20 to 25 percent of that business investment is financed by the Industry, which is a significant advance from 5% or less, just 15 years ago. The services of the Industry are complementary to traditional banking and other financial lending in providing incremental capital to increase the pool of available credit in Canada and provide a vital competitive alternative in the financial services sector.

On the vehicle leasing side, over the last 5 years (1999-2003) nearly 8 million new passenger and light trucks were sold in Canada.<sup>2</sup> By our estimate over 40% were leased, and of that number approximately 80% were retail leases (mostly consumer customers but some business customers likely as well) and around 20% were fleet leases (largely commercial customers vehicles for sales forces, customer delivery, service and maintenance).

The substantial and unique financing provided by the Industry plays a key role in improving Canada's productivity. By facilitating the acquisition of productive assets by Canadian businesses and consumers, the Industry is enabling Canadians to work smarter. The Industry provides a flexible and timely means for businesses to respond to the productivity and competitive challenges of technological obsolescence and product innovation.

### **Key Issues and Recommendations**

The Industry is confronted by many challenges under Canada's insolvency laws and the issues addressed in this letter are not exhaustive, but are those which CFLA members have currently identified as being most important. These issues concern the following:

- (a) the stay provision under section 11.3 of the CCAA;
- (b) liquidations under the CCAA; and
- (c) reaffirmation agreements.

The purpose in defining these issues and recommendations is not only to advocate the interests of the Industry but to enhance the fairness provided by Canada's insolvency laws and ensure that credit is available at a reasonable cost to businesses and consumers alike.

#### **(a) Section 11.3 of the CCAA**

The CCAA is the primary means through which large and medium-sized Canadian corporations, under a court supervised process, restructure their financial affairs with their creditors. The CCAA provides that the Court may issue an order staying the rights of creditors and other contractual counterparties during the term of the restructuring (in practice and

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<sup>1</sup> *Private and Public Investment in Canada, Intentions 2004* Statistics Canada (61-205-XIB), February 25, 2004

<sup>2</sup> *Desrosiers Automotive Reports Market Snapshot*, Desrosiers Automotive Consultants Inc., Richmond Hill, Ontario

on average in excess of one year). Accordingly, even though an event of default might have occurred under a loan agreement, operating lenders are stayed from enforcing on their security without leave of the Court.<sup>3</sup> Equipment and vehicle lessors and financiers though have posited that they should be entitled to the protection provided under s. 11.3 of the CCAA which in substance provides that nothing in the stay order can restrict a lessor's ability to require immediate payment for the use of leased assets during the restructuring period.<sup>4</sup> The dominant view advocated by operating lenders and supported by the courts though is that only lessors that have "true leases" with the debtor can enjoy the benefit of this section. Conditional sales contracts, meaning, specific asset financing agreements in which title and ownership is retained by the financier, are not at all considered under this provision of the CCAA. Operating lenders consider those that have financed the acquisition of specific assets as simply lenders, and the obligations owed to them as a debt – like any other type of debt that is not being repaid during the restructuring.

Neither the BIA nor CCAA define a "true lease". Consequently, the courts have adopted the test set out in cases that consider the true lease/ financing lease distinction under the *Personal Property Security Act* (Ontario). Where the court articulated test indicates the agreement is a financing lease, the lessor's rights and remedies are stayed (e.g. the lessor is unable to seize the leased asset), even though continuing payment is not received during the restructuring process.

The judicial trend has unfolded in a way that is unfair to equipment and vehicle lessors and financiers. **By denying them the benefit of the protection provided for in s. 11.3, equipment and vehicle lessors and financiers are unfairly prejudiced because their security, unlike operating lenders, is restricted to a depreciable asset that is consumed during the restructuring period. (According to your Department, the average time to complete a CCAA restructuring is 14 months).** Other lenders who finance inventory or receivables are not, on the other hand, prejudiced so long as the debtor company continues in business during the restructuring process, as inventory and receivables continue to be generated.

There are two primary concerns here.

First, the theory is that where a restructuring occurs, the *status quo* should be maintained and no one's rights should be prejudiced going forward. But, if a party's asset is consumed or depreciates as a result of the continued use of that property, the party should be properly compensated for the loss in the value of the asset (through regular payments) or else they should not be required to participate in the restructuring process. It should not matter whether the lease is a "true lease" or "financing lease".

Second, currently, the debtor company can use the specifically financed assets during the restructuring process without payment and without any obligation to maintain them. At a minimum, the debtor company should be required to properly maintain the specifically financed assets during the restructuring process or, alternatively, the lessor/financier should be able to

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<sup>3</sup> Currently under the CCAA, stays applicable to creditors are imposed by court order almost as a matter of course in CCAA proceedings. Frequently, the court order is issued based on an application made to the court by the debtor without notice to the affected parties. On an initial application for a stay order, the court need only be satisfied that the order is appropriate in the circumstances. Where an applicant seeks the extension of a stay, a finding that the applicant is acting in good faith and is proceeding with due diligence under the CCAA is sufficient. Furthermore, the CCAA contains no guidelines for the courts on lifting stays, and the courts, to date, have been generally reluctant to undermine reorganizations and will rarely lift stays. Where the debtor company seeks to reorganize, its creditors can generally expect to have their rights significantly curtailed for a period of time.

<sup>4</sup> Section 11.3 of the CCAA:

"No order made under section 11 shall have the effect of: (a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made; or (b) requiring the further advance of money or credit."

maintain its assets and the cost of doing so should be a post-filing obligation of the debtor company. CFLA's main concern here is that the value and integrity of the assets must be maintained to the maximum extent possible throughout the restructuring process.

The prejudicial treatment experienced by equipment and vehicle lessors and financiers under section 11.3 of the CCAA will undermine the valuable financing alternative provided by the Industry. Unlike other lenders, Industry members typically finance 100% of the purchase price of the value of the asset. The value of the asset leased is the core of the transaction; generally, it is the only security for the transaction. The inability of Industry members to be properly compensated for the loss in value of specifically financed assets during a restructuring process puts an impossible burden on Industry members, with a negative impact on businesses and consumers generally in Canada: (a) the bar will be raised on minimum creditworthiness; (b) the cost of financing will become more expensive; and (c) the current willingness of Industry members to work with financially-challenged customers will be inhibited. The implications are significant and far-reaching.

We submit that the cost of using a specifically financed asset is no different from the cost of inventory which must be paid during the restructuring process. Perhaps in a restructuring, the statute should provide the debtor with a certain period (say 30 days) in which to disclaim the financing agreement and return the asset. If the financing agreement is not disclaimed, the debtor would be required to make the regular payments called for under the original agreement during the restructuring.

***We therefore recommend that the government consider the following principles in developing amendments or clarifying applicable provisions of existing legislation:***

- 1. Equipment and vehicle lessors and financiers should be properly compensated for the loss in the value of the specifically financed assets (through regular payments) as these assets depreciate during the restructuring process or else they should not be required to participate in the restructuring process;***
- 2. In a restructuring, the statute should provide the debtor with a certain period (say, 30 days) in which to disclaim the financing agreement and return the asset. If the agreement is not disclaimed, the debtor should be required to make the regular payments during the restructuring; and***
- 3. The debtor company should be required to maintain the specifically financed asset(s) in accordance with the terms of the financing agreement during the restructuring process or, alternatively, the lessor or financier should be able to maintain its asset(s) and the cost of doing so should be a post-filing obligation of the debtor company.***

**(b) CCAA Liquidations**

Although the general purpose behind the CCAA is to provide an insolvent debtor company the time to reorganize and develop a plan of arrangement or compromise to restructure its affairs, there is a growing concern that, in some cases, creditors employ the CCAA to their direct benefit as a means of effecting an orderly process of liquidation, that may last years. This allows the operating lender to preserve the value of the company by staying the remedies of various parties, including certain equipment and vehicle financiers despite the fact the debtor is not making its payments. In such case, the "restructuring" under the CCAA is in effect a disguised receivership for the benefit of the operating lender. This returns us to the fundamental point noted above: equipment and vehicle financiers are not compensated for the loss in the value of the asset as it depreciates during the stay period and are not able to participate in the enterprise value of the business.

A secured party with a general security agreement, on the other hand, is usually adequately compensated for the resources used during the continuing operation of the debtor

during the stay period because the value of the receivables or inventory covered under a general security agreement should increase or be maintained with the continuation of the business. If the security position is deteriorating then this would be a strong argument in support of a motion to lift the stay of proceedings in the restructuring and appoint a receiver.

It could be argued that there is a greater value to a business by maintaining it as a going concern so that it can be restructured or sold in a manner that maintains jobs and continues to generate value to the economy as a whole and allowing lessors/financiers with financing agreements to exercise their right of repossession would undermine that goal. While the goals of the CCAA may be laudable, it is also fair in such circumstances that lessors whose leases might be characterized as “financing leases” or financiers with conditional sales contracts should receive the market value of these assets when sold based on the “going concern” value or selling value of the business associated with having the specifically financed assets in the business, as opposed to the liquidation value that could be obtained at an auction of those assets.

The following example illustrates the point. Assume a transportation company files for CCAA protection with the blessing of its senior secured lender. Leased trucks form an integral part of the transportation company’s business. All parties, including the lessor, are stayed from exercising remedies (e.g. seizing the leased assets for non-payment). As the “restructuring” continues the receivables are increased or maintained while the value of the trucks depreciates and the lessor is unpaid. When the transportation business is eventually sold, the senior secured creditor claims first priority to the lion’s share of the proceeds pursuant to its general security agreement as little value is attributed to the trucks (just the liquidation/auction value as of the date of the sale), although it was the use of those trucks which was vital to maintaining the business as a going concern and generating value for the operating lender.

***We therefore recommend that the government consider the following principles in developing amendments or clarifying applicable provisions of existing legislation:***

- 1. Equipment and vehicle lessors and financiers should be properly compensated for the loss in the value of the specifically financed assets (through regular payments) as these assets depreciate during the restructuring process; and***
- 2. As these assets are often vital to maintaining the business as a going concern and generating value for the operating lender, when a debtor company business is sold as a going concern, equipment and vehicle lessors and financiers should receive the market value of these assets based on the “going concern” value or selling value of the business.***

**(c) Reaffirmation Agreements**

As described in the Senate Committee’s Report, a reaffirmation agreement is an implied or expressed agreement between a bankrupt and his or her creditor(s) to reaffirm responsibility for pre-bankruptcy debts that have been discharged as a result of the bankruptcy of the debtor. Implied reaffirmation occurs through conduct when the bankrupt continues to make payments to creditors following the date of bankruptcy. Reaffirmation through expressed agreement occurs when bankrupts expressly enter into written agreements with creditors to maintain use of assets which were subject to a loan or lease agreement.

Although Courts have permitted such agreements in certain circumstances (e.g. where sufficient or new consideration is offered, such as the granting of new credit), the BIA is silent on the issue of reaffirmation agreements.

The treatment of reaffirmation agreements was considered by the Senate Committee during its review of the BIA and CCAA. In summary, the Senate Committee recommended that the BIA be amended to prohibit reaffirmation by conduct or express

agreement in all cases. This recommendation followed the strong recommendation by the Personal Insolvency Task Force (“PITF”) on this matter. In essence, the PITF recommended that subject to certain conditions, reaffirmation agreements should be prohibited, as they are inconsistent with the “fresh start” principle believed to be the hallmark of insolvency law in Canada.

If adopted, this recommendation will have a severe impact on the retail finance industry and, in particular, the auto finance industry wherein a common practice of reaffirmation has developed, as bankrupts often desire to keep their vehicles and maintain their regular payments upon their bankruptcy and following their discharge. Under PITF’s recommendation, however, such reaffirmation will only be permitted for the then current value of the vehicle, which will result in lower monthly payments, rather than the regular payments agreed to at the commencement of the financing agreement. The effect of the proposed change is alarming. As one of our members, the financing affiliate of a vehicle manufacturer, stated, they alone process in excess of 200 reaffirmations per year and the requirement to reaffirm at fair market value will have a significant impact on their business, resulting in estimated losses well in excess of \$2 million per year. This is the estimated loss of only one of our many members. Projected across the auto finance industry, no doubt the loss to all members will be significant and far reaching.

In respect of the above, we wish to point out that at the present time, upon the debtor’s bankruptcy, the debtor is not precluded from attempting to negotiate a change in the monthly payments taking into account existing circumstances.

We do not agree that the PITF recommendation is consistent with the “fresh start” principle. It is our belief the PITF recommendation would instead have negative consequences on bankrupts wishing to redeem their standing with particular creditors. To explain, if an agreement can only be reaffirmed based on the then current market value of the vehicle, the lessor will not have any “upside” in continuing to work with the debtor. If the lessor takes the position that its first loss is its best loss, it may choose to take possession of and sell the vehicle upon the bankruptcy, rather than continue to have, as a lessee, a debtor who may be a significantly higher credit risk. In that case, the debtor may find that it is not able to secure alternative financing that will enable the debtor to obtain a vehicle, which will impede the debtor’s ability to rehabilitate and in some cases continue employment that requires the use of a vehicle.

The government must understand the negative consequences to the rehabilitation process that this proposed amendment may have, as CFLA members reconsider their respective positions should the government proceed with this initiative.

***We therefore recommend that the government consider the following principles in developing amendments or clarifying applicable provisions of existing legislation:***

- 1. The PITF’s recommendation should not be adopted;***
- 2. Reaffirmation of debt should not be prohibited; and***
- 3. The debtor should be able to choose whether it wishes to continue to make payments to the lessor/financier to maintain use of the specifically financed assets. If the parties choose, they should be able to negotiate a change in the regular payments.***

## **Conclusion**

As provided in the Senate Committee Report, “Canada’s insolvency system must be – and must be perceived to be – fair” and that “from a financial perspective alone, the fairness and predictability provided by insolvency laws increase the amount of credit that is available and help to ensure that it is available at a reasonable cost.” Under current legislation and the recommendation proposed by the PITF, the treatment of equipment and vehicle lessors and


financiers is unfair, as they experience a prejudice and inappropriate burden not experienced by other lenders.

We ask that you seriously consider these issues and the possible recommendations for change set out herein. It is essential to eliminate or minimize the concerns over these issues so as to allow the Industry to continue to grow as an effective alternative provider of capital and credit to Canadians. This is particularly important as leasing has traditionally been a significant source of alternative funding in times when the economy flourishes or when other types of lenders' credit is tightened.

We would be pleased to assist you in respect of the matters addressed in this submission, including providing suggestions for amendments to applicable legislation. In that regard, we would very much welcome the opportunity to meet with you to discuss these issues and recommendations further.

Thank you for your time and consideration.

Yours very truly,

A handwritten signature in black ink, appearing to read "David Powell", written over a light grey rectangular background.

David Powell  
President & Chief Executive Officer

Copies:

Jean-Claude Villiard, Deputy Minister of Industry Canada  
The Hon. Ralph Goodale, P.C.M.P., Minister of Finance  
CFLA members

Attachments:

CFLA members list