

# HOW SHOULD A CREDITOR RESPOND TO A CONSUMER PROPOSAL?

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Division II - Consumer Proposals are governed by sections 66.11 – 66.4 of the *Bankruptcy and Insolvency Act* (the “BIA”). This paper is a non-technical reworking of these sections. Reference to the actual provisions of the BIA is always recommended.

Division II of the BIA establishes a system for insolvent debtors to make consumer proposals, rather than file for bankruptcy protection. Consumer proposals are:

- an alternative to personal bankruptcy
- only available to individuals who are insolvent and who have unsecured debt between \$5,000 and \$250,000 in the aggregate (not including debts secured by the individual’s principal residence)
- in essence, an offer by a debtor to his or her unsecured creditors, or to all of his or her creditors generally, to only repay a portion of the outstanding debt; either in a lump sum or over a period of time (which cannot exceed 5 years)
- usually made to the unsecured creditors only and therefore, usually include a provision that all of the secured creditors’ claims will be fully paid as and when due. As such, I will assume in this paper that the consumer proposals mentioned are directed to the unsecured creditors only
- available to bankrupt individuals, as a way of avoiding (or ‘getting out of’) bankruptcy

**NOTE 1:** Once the consumer proposal is fully satisfied, none of the creditors have any claim against the debtor for the unpaid balance of their debt (subject to section 178 of the BIA)

## HOW DOES A CONSUMER PROPOSAL GET STARTED

- a consumer proposal starts with a debtor’s visit to a trustee in bankruptcy

- the trustee, acting as a 'Proposal Administrator', will review the debtor's financial situation and once satisfied with the debtor's eligibility, work out a proposal with the debtor; being a legally binding offer to repay to all of the debtor's unsecured creditors, pro-rata to each other, a portion of their debt over a period of time
- the Proposal Administrator will prepare the requisite Consumer Proposal forms under the BIA and send them to each of the unsecured creditors and to the Superintendent of Bankruptcy

## **WHAT THE DEBTOR DOES**

The Debtor shall:

- include all unsecured debts in the consumer proposal (no cherry picking allowed)
- immediately stop making regular payments to the unsecured creditors
- attend any meeting of creditors
- attend two counseling sessions
- continue to own all of his and her assets and continue to keep all of his or her income
- fulfill the terms and conditions of the consumer proposal

## **WHAT THE CREDITORS DO**

Each creditor shall:

- stop all collection activities (note that secured creditors may enforce their security upon default in payment)
- file a proof of claim with the Proposal Administrator
- have 45 days within which to request a meeting of creditors (if considered necessary or desirable by the creditor)
- attend at any creditors meeting and vote to approve or to reject the proposal

## WHAT ARE THE MECHANICS OF APPROVING OR REJECTING A PROPOSAL

- each creditor has 45 days from the date of the proposal within which it can file a Proof of Claim and request a meeting of creditors
- the Office of the Superintendent of Bankruptcy may also request a meeting of creditors, but rarely does so
- if creditors holding in the aggregate 25% of the total unsecured debt request a meeting of creditors (within the 45 day period) then the Proposal Administrator shall hold a meeting of creditors within the next 21 days
- at the creditors' meeting, creditors may ask questions of the debtor and, most importantly, may vote to either accept or to reject the proposal
- the proposal shall be accepted if:
  - there is no quorum at the creditors' meeting,OR
  - if creditors present at the meeting (either represented in person or by proxy) holding more than half of the dollar value of the debt owing to all creditors at the meeting, vote to accept the proposal
- if creditors holding more than half of the dollar value of the debt owing to all creditors at the meeting vote to reject the proposal, then the proposal is rejected

**NOTE:** Often, no creditors request a meeting of creditors to be held or, if one or more creditors request a meeting, but their aggregate debt does not exceed 25% of all unsecured debt, then there shall be no creditors' meeting. In either case, if there is no creditors' meeting, then the proposal is deemed to have been accepted on the 45th day after the making of a proposal

**IF THE CONSUMER PROPOSAL IS ACCEPTED OR DEEMED ACCEPTED**

- any creditor or other interested party may, within 15 days, request the Proposal Administrator to apply to the Bankruptcy Court in order to review the proposal
- if no such request is made within such 15 day period, then the proposal is deemed to have been approved by the Court
- the stay of proceedings on all unsecured creditors continues
- the debtor must fulfill all terms and conditions of the proposal

**IF THE CONSUMER PROPOSAL IS REJECTED**

- the proposal is terminated
- the stay imposed on all unsecured creditors is automatically lifted
- the debtor is free to file another proposal or to assign him or herself into bankruptcy (or to do neither)

**WHAT HAPPENS UPON DEFAULT**

- a consumer proposal is annulled:
  - if the consumer proposal provides for monthly (or more frequent) payments, and three payments are in default
- OR
- if the consumer proposal provides for payments less frequently than monthly, and there has been a default for three months or more
- if the annulled consumer proposal was filed by a debtor who was not a bankrupt, the creditors may continue to collect their debts less, of course, any dividend amounts received during the proposal

- if the annulled consumer proposal was filed by a bankrupt, then the consumer debtor is deemed to be bankrupt

## **ADVANTAGES OF A CONSUMER PROPOSAL**

### **TO THE DEBTOR:**

A consumer proposal can be advantageous to a consumer debtor as it may allow the consumer debtor to avoid bankruptcy. Remember, the consumer proposal:

- stays all debt collection action and proceedings (including execution and garnishment) – see s. 69.2(1) of the BIA
- allows the debtor to keep any equity in his or her home (unlike bankruptcy)
- allows the debtor to keep all assets (unlike bankruptcy)
- allows the debtor to keep all of his or her personal and family surplus income (unlike bankruptcy)
- allows the debtor to continue to make home mortgage and secured debt payments outside of the proposal
- completely wipes the slate clean - cancels all unsecured debt after completing all proposal payments; which usually amount to 20% (but sometimes more) of the aggregate unsecured debt (subject to section 178 of the BIA)

### **TO THE UNSECURED CREDITORS:**

A consumer proposal can be advantageous to the unsecured creditors of a consumer debtor, as the consumer proposal:

- greatly increases net receipts from the debtor (which is often only 1% - 2% payout on a typical bankruptcy)

- can minimize collection costs (for example, no need to sue to judgment and then enforce the judgment by, say, garnishment - which may then be shared by all judgment creditors, in any event)

## **CREDITORS BEWARE**

- creditors' packages from trustees can be very confusing; and often lead one to believe that objecting to a proposal is the same as voting to reject a proposal. **IT IS NOT!!**
- if a creditor intends to reject the proposal:
  - the creditors must specifically, in writing, request a meeting of creditors (and ensure that creditors with at least 25% of the proven debt do likewise)
  - then the creditor must attend at the creditors' meeting (either in person or by proxy)
  - finally, the creditor must vote "no" at the creditors' meeting

## **HOW TO DEAL WITH A CONSUMER PROPOSAL**

- a creditor should review the proposal package in detail, paying particular attention to the stated equity in the debtor's home and to the debtor's stated family income. There are some quite wealthy individuals who try to sneak through a proposal!!
- file a proof of claim with the Proposal Administrator immediately
- if the creditor has 25% (or more) of the debt, call a meeting of creditors
- talk to the trustee and find out the total dollar value of claims with respect to which a proof of claim has been filed, and if the creditor has less than 25% of the proven debt, contact other creditors (ask the Proposal Administrator for contact information) and solicit support for the calling of a creditors meeting. There is no downside to calling a meeting, so there is rarely any objection among creditors to the calling of a meeting

- if you think that the debtor is 'pulling a fast one' or can afford to pay more than offered in the proposal, advise the Proposal Administrator that you intend to vote “no” at the creditors meeting
- remember, that the Proposal Administrator does not get paid if the proposal fails, so the Proposal Administrator is usually an asset in negotiating larger payments (when appropriate)
- Courts throughout Canada have identified non-government insured loans to students (advanced or made available in order to assist those students in obtaining a professional degree – such as Doctors and Chiropractors and Dentists) as having a special status because:
  - the loan was made to the student while the student was in school with little or no ability to repay
  - the loan was only intended to be repaid after graduation - when professional income permits payment
  - if a professional files for bankrupt protection, he or she keeps his or her professional degree... and thus it would be unfair to allow a bankrupt to completely walk away from the student loan that allowed him or her to obtain the degree

THEREFORE, as a parting thought, if a professional – whether a student or new graduate - files a consumer proposal, any creditor who paid for all or a part of that student’s or that graduate’s professional degree ought to review all of the facts very carefully, as bankruptcy may not be a viable option and as such, the student or new graduate debtor may very well be more willing than most to increase the proposal - rather than see it rejected.