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starting OVER Personal Financial Difficulties

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Division 1 Proposals - Let's Make a Deal Part 2

Our previous article ("Proposals to Creditors - Let's Make a Deal") presented an overview of the proposal process where a debtor's liabilities do not exceed $250,000 (this threshold excludes mortgage debt on a residential home). In summary, the process in such circumstances is as follows:

- The proposal is filed with the Office of the Superintendent of Bankruptcy ("OSB"). Upon filing, a stay of proceedings is immedi ately in effect whereby the debtor becomes creditor-proof.
- The proposal is sent to creditors for review. The creditors are deemed to have accepted the proposal if no objections are received from them within 45 days after the filing date.
- There is an additional 15-day waiting period to allow the trustee, the OSB, or a creditor to request the bankruptcy court to review the proposal.
- After the completion of the 60-day waiting period, the proposal is deemed to have been accepted by the creditors and the court.
- The debtor performs the proposal and gets dis charged from debts.

This type of proposal is called a **Division II Proposal**, also known as a **Consumer Proposal**. It is a streamlined process oriented towards "consumer debtors" – i.e., individuals who get into financial difficulty usually through the overextension of credit.

The obvious question then arises – what if a person's debts exceed the $250,000 threshold? In that situation, we turn to a process called a Division I Proposal.

Overview

A Division I Proposal, like a Consumer Proposal, is a legal process available under the Bankruptcy and Insolvency Act that allows a debtor to settle with his creditors and avoid bankruptcy. It is used when the debtor's liabilities exceed $250,000.

Upon the completion of the proposal, the debtor's liabilities are discharged and his credit rating is registered at R7 for a three-year period thereafter

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The Division I process is also available to business corporations to settle debt.

Features & Benefits

To the debtor, the most important benefit of the proposal process (be it a Division I or Consumer Proposal) is the avoidance of bankruptcy and the attendant effect it has of pegging a debtor's credit rating with the credit bureau at R9 for 7 years.

To the creditors, a proposal is most attractive in that they get a higher return than in a bankruptcy scenario.

Most Frequent Users

The typical debtor filing a Division I proposal falls into one of two categories:

1. Professionals

Most doctors and lawyers are self-employed. Due to a variety of challenges, some either fail to pay their personal income taxes (which, with the penalties and interest, can be substantial) or invest in disallowed tax shelters leading to an income tax reassessment by Canada Revenue Agency ("CRA"). Whatever the reason, Proposals filed by these professionals are often driven by their obligations to CRA.

The filing of a Division I proposal under the Bankruptcy and Insolvency Act is the only method of abating the principal portion of the income tax obligation, along with the penalties and interest. An income tax debtor may be eligible for relief of the penalties and interest under a CRA Fairness Package, but the stipulations that must be met in order to qualify are onerous, and it is rare that such relief under the Fairness Package will be granted.

2. Business Owners

An owner of a failed or failing business, be it a corporation, sole proprietorship or a partnership, will be statutorily liable for certain business obligations such as Goods & Services Tax, Provincial Sales Tax, wages in arrears, and unremitted payroll source deductions. As well, the owner is often liable for guaranteed business obligations.

Such debtors typically have some personal assets and wish to avoid bankruptcy. A proposal would facilitate them to settle these business-related debts.

The Process

The Division I process is fairly straightforward to understand. However, unlike the Consumer Proposal process, the Division I process requires a substantial investment of the trustee's time:

- The trustee meets with the debtor to assess the financial circumstances and determine what type of proposal can be made and what type of proposal will be acceptable to the creditors.
- The proposal is drafted and signed by the debtor along with other statutory documents. The proposal

is filed with the Office of the Superintendent of Bankruptcy. The trustee is required to schedule with the OSB a meeting of creditors to review and discuss the proposal no later than 21 days after the Proposal is filed.

- The proposal and a report on the proposal drafted by the trustee, is sent to the creditors by mail in anticipation of the meeting.
- At the meeting, the creditors which have had their proofs of claim admitted discuss the debtor's affairs and the proposal terms and vote either for or against the proposal. The approval of the proposal by the creditors requires the vote of: (1) a majority in the number of creditors present at the meeting either in person, by proxy or by voting letter; and (2) two-thirds in the value of the claims of those creditors in (1). If these voting criteria are not met, then the debtor is automatically bankrupt.

In actual practice, the meeting of creditors is often the time for negotiating a proposal palatable to the creditors. It is in effect a bargaining forum. If the creditors and the debtor mutually agree to amendments to the proposal, then the creditors vote for the amended version of the proposal.

- Once the proposal is approved by the creditors, the trustee arranges for a court hearing date for the proposal to be reviewed and approved by the Bankruptcy Court. The Court reviews the proposal for fairness (to the creditors and the debtor) and ensures that it complies with certain statutory requirements.
- Upon the approval of the proposal by the Bankruptcy Court, the debtor proceeds to fulfil the terms of the proposal (which will be discussed below under "Most Common Proposals"). Upon fulfilling the obligations under the proposal, the debtor is issued a Certificate of Full Performance of Proposal by the trustee.
- The Certificate of Full Performance is filed with OSB. This information is sent by the OSB to the credit bureaus to update the debtor's credit file. The debtor is at an R9 rating from the date the Proposal is filed until its completion. Upon receiving the Certificate of Full Performance, the credit bureaus register the debtor's credit file at an R7 rating for 3 years. After the 3-year period expires, the R7 will be deleted from the debtor's credit file.

For example, the debtor submits a proposal to pay his creditors $100,000 in 6 months. The debtor subsequently completes his proposal and is issued a Certificate. During the 6-month period the debtor is completing the proposal, he is at an R9 rating. His credit rating then moves up to R7 after he completes it. Therefore, he is at an R9 for 6 months and is then at R7 for three years.

Most Common Proposals

There are generally no restrictions on what proposal can be offered to creditors. The only restriction is the creativity of the drafter. However, in the writer's experience, the most common proposal terms are as follows:

- The debtor can make monthly payments over several years to pay off the settlement amount.
- The debtor can make a lump sum settlement by borrowing from friends and family. If there is sufficient equity in his home, the debtor may be able to take out a second mortgage, with the assistance of a mortgage broker to use as a settlement fund.
- The debtor may voluntarily liquidate assets over a period of time to finance the proposal. This type of proposal is similar to a bankruptcy scenario where the debtor's assets are liquidated by the trustee. The key difference is that the proposal method has less of a detrimental effect on the debtor's lifestyle and credit rating.

Conclusion

The proposal offers a viable and attractive alternative to bankruptcy and has been steadily gaining popularity over the past several years.

For the debtor, a proposal offers flexibility: A repayment plan can be tailored to the debtor's ability to pay. A proposal also minimizes the impact on the credit rating. The process enables the debtor to repay creditors and encourages personal responsibility for the repayment of debts. For the creditor, a proposal is advantageous: The creditor will receive more money from a proposal than from a bankruptcy.

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