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Exemptions to the *BIA* "Fresh Start" Policy

By: Jassmine Girgis

Case Commented On: *Alberta Securities Commission v Hennig*, 2021 ABCA 411 (CanLII)

In this decision, the Alberta Court of Appeal (CA) considered whether a debt fell within the exceptions contained in s 178(1) of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (*BIA*), and therefore survived the discharge of the bankrupt.

The CA allowed the appeal. The majority reasons were written by Justice Ritu Khullar and concurred in by Justice Jack Watson. Justice Dawn Pentelechuk wrote reasons concurring in the result.

Facts

Mr. Hennig, the CFO of various corporations, and another individual who was president, were alleged to have misrepresented the corporations' financial statements and disclosure for the years of 1998-2000, failed to disclose secret commissions, engaged in market manipulation, failed to file reports of insider trading, and misrepresented to the Alberta Securities Commission (ASC) in the course of their investigations. After 38 days of hearings, the ASC Panel concluded that Mr. Hennig and the other individual had contravened Alberta securities laws or acted contrary to the public interest or both (paras 4-5).

As a sanction, the ASC Panel permanently banned Mr. Hennig from serving as a director and/or officer of any issuer, issued a 20-year cease trade and denial of exemptions order, and required him to pay an administrative penalty of $400,000 and hearing costs of $175,000 (para 6). The ASC filed copies of its decision at the Court of Queen's Bench, upon which, the decision had "the same force and effect as if it were a judgment of the Court of Queen's Bench" (*Securities Act*, RSA 2000, c S-4 at s 200(1)). Upon registration, the administrative penalty became enforceable as a judgment debt. The ASC issued a writ against Mr. Hennig at the Court and the Personal Property Registry (paras 7-8).

On July 4, 2011, Mr. Hennig made an assignment into bankruptcy. On Sept 6, 2011, the ASC filed a proof of claim for $601,932.43, and asserted that its claim would survive bankruptcy pursuant to ss 178(1)(a) or (e) of the *BIA*. The relevant provisions state:

> **178 (1)** An order of discharge does not release the bankrupt from

(a) any fine, penalty, restitution order or other order similar in nature to a fine, penalty or restitution order, imposed by a court in respect of an offence, or any debt arising out of a recognizance or bail;

…

(e) any debt or liability resulting from obtaining property or services by false pretences or fraudulent misrepresentation, other than a debt or liability that arises from an equity claim;

(2) Subject to subsection (1), an order of discharge releases the bankrupt from all claims provable in bankruptcy.

On August 19, 2015, Mr. Hennig was discharged from bankruptcy. Three years later, when it was time to renew its judgment, the ASC sought a declaration from the Court that its debt arising from an administrative penalty and associated costs survived the bankruptcy discharge. The Chambers judge granted the ASC's application (paras 10-12). The Court of Appeal overturned the chambers judge's decision.

Issue

At issue in this appeal was whether the ASC's penalty was exempted from discharge under s 178 of the *BIA*.

Decision

The judge started by noting that exceptions to the bankruptcy discharge should be construed narrowly and applied only in clear cases, maintaining that "the more debts that survive discharge by falling within s 178(1) the more difficult it becomes for a bankrupt debtor to be rehabilitated" (para 25). For that reason, the focus must remain on the rehabilitation of the debtor, which is the purpose for the section, and not on the reprehensible conduct, as s 178(1) "does *not* specifically exempt *all* debts arising from reprehensible or dishonest conduct, only those identified in that section" (para 26, emphasis in original). The Court then proceeded to identify the limitations of s 178(1).

First, it concluded that Parliament had not intended to have exemptions for payments ordered by regulatory bodies under s 178 since the provision does not mention regulatory bodies, though they are addressed in other sections in the *BIA* (paras 39-40).

Second, it determined that ASC's debts, which comprised of an administrative penalty and the costs order, do not survive the bankruptcy because s 178(1)(a) does not exempt debts arising from a regulator's imposition of a monetary penalty in the public interest. It noted that the words "fine" and "penalty" in s 178(1)(a) refer to money penalties imposed as punishment in criminal or quasi-criminal proceedings, but not because the conduct underlying criminal fines and penalties is more reprehensible; rather, it is because criminal courts should not be controlled by civil courts. Specifically, "it reflects a policy choice that those subjected to criminal sanction should not be allowed to escape the burden of that sanction through bankruptcy proceedings" (para 49). The Court provided two additional reasons for interpreting "fine" and "penalty" in this way, namely

that administrative penalties are neither remedial nor punitive, and that the ASC's debt is neither a penalty nor a fine, nor is it similar in nature (para 50). Rather, ASC imposed the administrative penalty and costs order to prevent future misconduct (para 52).

Third, it determined that there are three elements required under s 178(1)(e): a fraudulent misrepresentation or false pretence, a link between the debt and the fraud, and a passing of property as a result of the fraud (para 57). With regard to the first element, it noted that although there is a significant difference between a fraudulent misrepresentation and a false pretense, there is no practical difference between the two in s 178(1)(e). A fraudulent misrepresentation requires an individual to knowingly make a false representation and for the creditor to rely on the representation to its detriment whereas a false pretense does not require detrimental reliance. However, the language of s 178(1)(e) requires a transfer of property as a result of the fraudulent misrepresentation and the false pretense, resulting in no practical difference between the two (para 58).

Hennig owed the ASC a debt (and not one that arises from an equity claim), making the ASC a creditor. However, the ASC did not meet the requirements under s 178(1)(e). First, the fraudulent statements made by Hennig did not amount to the making of fraudulent statements for the purposes of s 178(1)(e) (which is the point of contention between the majority and concurring judgments) (para 107). Second, Hennig did not make the fraudulent statements directly to the ASC, meaning he did not satisfy the required link between the fraudulent statements and the debt, nor was the link satisfied by his statements to ASC's staff (para 96). Specifically, s 178(1)(e) requires the fraudulent statements to have been directed to the creditor whose judgment survives the bankruptcy (para 81). The Court found that s 178(1)(e) protects creditors who are vulnerable in that they were the target of the debtor's fraudulent statements (para 86), and "a regulatory body imposing an administrative penalty for conduct contrary to the public interest will rarely be able to establish such a link, as typically it only becomes involved after the impugned conduct has already occurred" (para 93).

The final element, that the property must be transferred as a result of the fraudulent statement, was not addressed by the Court, as it does not apply to ASC's debt (para 99).

Comments on Bankruptcy Policy

The *BIA*'s goals are two-fold; it exists to allow for an equitable distribution of the bankrupt's assets to creditors and to facilitate a bankrupt's financial rehabilitation, otherwise known as a "fresh start." This appeal involves the latter goal. The discharge recognizes that bankrupts will never be able to repay their creditors in full, and that individuals cannot live under the weight of their old debt for the rest of their lives. The fresh start doctrine appears to have begun to take shape in 1904 in the United States, with *Wetmore v Markoe*, 196 U.S. 68 (1904), where the Court noted, "[s]ystems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has become oppressive and to permit him to have a fresh start in business and commercial life, freed from the obligation and responsibilities which may have resulted from business misfortunes."

There are exceptions to the fresh start doctrine, listed in s 178(1) of the *BIA*. This list covers a broad range of debts, including alimony, maintenance, student loan debt, debts arising from fraud or embezzlement while acting in a fiduciary capacity, awards of civil damages with respect to intentional bodily harm or sexual assault, or wrongful death resulting from either, and a fine or penalty imposed by a court in respect of an offence. While attempts have been made to explain these exceptions as relating to the fraudulent or morally reprehensible conduct of the debtor, that classification does not apply to every exception, and specifically, as the Court said in this case, these exceptions more so seem to "reflect… a number of disparate policy choices by Parliament reflecting different considerations" (para 19), and, "a bankrupt's 'wrongdoing or improper conduct is not itself sufficient to bring a debt within the ambit' of s 128(1)" (para 20, quoting *Korea Data Systems (USA), Inc v Amazing Technologies Inc*, 2015 ONCA 465 (CanLII) at paras 63-64).

The absence of a singular policy reason underlying all the exceptions can make it challenging for courts to balance the limits of these exceptions with the fresh start goal, especially if courts are not in agreement about how to interpret the exceptions. This Court applied the modern rule of statutory interpretation, which requires reading legislative words "in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament" (EA Driedger, Construction of Statutes, 2nd ed (Toronto: Butterworths, 1983) at 87 as cited in *Rizzo & Rizzo Shoes Ltd (Re)*, [1998] 1 SCR 27, 1998 CanLII 837 at para 21). It went on to find that these exceptions must be construed narrowly and applied only in clear cases, justifying this approach on the grounds that it allows for the focus to remain on the goal of rehabilitating the bankrupt. As the Court said, "the more debts that survive discharge by falling within s 178(1) the more difficult it becomes for a bankrupt debtor to be rehabilitated" (para 25). See also *Attorney General of Canada v Collins*, 2013 NLCA 17 (CanLII) at para 15. There has been some disagreement with this approach. See for example *Mallory (Re)*, 2015 BCSC 5 (CanLII), where Justice Geoffrey Gaul found, in the context of considering whether a student loan survived the discharge, that narrowly construing the exceptions and focusing on the purpose of the *BIA* instead of the purpose and intent of the specific exception, was erroneous (para 82).

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