September 23, 2022

How does Bankruptcy Impact the Priority of a Writ of Enforcement's 'Binding Interest'?

By: Jassmine Girgis

Case Commented On: *MNP Ltd v Canada Revenue Agency*, 2022 ABQB 320 (CanLII)

This case is about the priority of a writ of enforcement's "binding interest" upon bankruptcy. As the court found here, where a writ is not fully executed as of the date of bankruptcy, the writ's binding interest ceases to have effect, rendering the writ holder an unsecured creditor and putting it last in priority, after secured and preferred creditors.

Facts & Arguments

The debtor, Skyrider Holdings Ltd. (Skyrider), went bankrupt. Prior to Skyrider's bankruptcy, various writs of enforcement had been registered against its lands, some of which were in favour of the Canada Revenue Agency (CRA), for unpaid taxes and associated amounts. The CRA registered its writs after most or all of the other creditors' writs, meaning that pre-bankruptcy, the other creditors' writs had priority over the CRA's. Another creditor, the Royal Bank of Canada, held a general security agreement against all the debtor's present and after-acquired personal property (an "All PAAP"). Once Skyrider's bankruptcy occurred, proceeds were harvested from its lands.

Upon bankruptcy, the combined effect of s 223(11.1) of the *Income Tax Act*, RSC 1985, c 1 (*ITA*) and ss 86 and 87 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (*BIA*) deemed the CRA to be a secured creditor in the bankruptcy.

Although the trustee, MNP Ltd (MNP), acknowledged the conversion of the CRA's writs to security interests, the issue was whether this conversion "leapfrogged" the CRA over prior registered writs and their "binding interest" priority, putting them ahead of the writs that had priority pre-bankruptcy, or whether the pre-bankruptcy priority remained the same in bankruptcy, leaving the CRA behind the other writs (at para 9). MNP had similar concerns regarding RBC's security interest.

A writ's binding interest outside of bankruptcy is understood as:

> (1) anchoring the judgment creditor's right to seek a sale of the property; (2) protecting that creditor's position against sales or other dispositions… of the property by the judgment debtor; and (3) enabling that creditor to share in the proceeds of lawful dispositions… (at para 12, quoting C. R. B. Dunlop, *Creditor-Debtor Law in Canada*, Second Edition (Toronto: Carswell, 1995) at 507-22).

MNP argued that although a writ holder's ability to enforce its own interest vests in the trustee upon the debtor's bankruptcy, that vesting does not affect the status of the writ's binding interest against the land. As a result, secured creditors cannot enforce their interests until the writ holders have been paid. In the trustee's words:

> [b]ankruptcy does not disturb or obliterate the status of registered writs of enforcement against land, but simply removes the right of the writ holders to enforce upon same, thus leaving that duty to the Trustee… consequently the secured claim of CRA cannot be paid out until the full value of all Writs of Enforcement which bound the lands have been retired in full (at para 20).

In other words, MNP's argument effectively "asks for secured-creditor treatment for such writ-holders" (at para 21). The court ultimately rejected MNP's argument that writ holders should be paid ahead of secured creditors.

Legal Issue

What is the effect of bankruptcy on the priority of a writ's binding interest in relation to security interests?

Decision

Mr. Justice Michael J. Lema found that the priorities changed once Skyrider became bankrupt. He determined that upon bankruptcy, secured creditors came before unsecured creditors, regardless of their pre-bankruptcy priority. Consequently, the CRA and RBC, as secured creditors in the bankruptcy, took priority over the other writ holders who became unsecured creditors upon the debtor's bankruptcy (at paras 70-75).

My Analysis

This is an area of law that tends to be confusing due to the different provisions at work and the changing status of creditors upon the debtor's bankruptcy.

The trustee's premise here is correct: a creditor can no longer enforce a writ after bankruptcy and must rely on the trustee in bankruptcy to sell or dispose of the debtor's property and distribute the proceeds. However, the conclusion MNP draws from this premise, that the priority of a writ-holder's binding interest is unaffected, is incorrect. In fact, the reason writ holders must rely on the trustee in bankruptcy is because they become unsecured creditors in bankruptcy, and the trustee enforces interests as the representative of unsecured creditors. Under s 136 of the *BIA*, unsecured creditors are last in priority and share equally among themselves. For that reason, and contrary to the rest of the trustee's argument, a writ's binding interest does not continue to operate after bankruptcy. If it did, it would conflict with the *BIA*, which recognizes only three types of creditors, and none of them give effect to a writ's binding interest. As Justice Lema notes, "[t]he trustee effectively seeks the recognition of a fourth category: unsecured but anchored by a binding-interest writ. Nothing in the *BIA* reflects any such category" (at para 40).

What follows is a comment on priorities outside bankruptcy, then a list of steps and principles that impact pre-bankruptcy priorities upon a debtor's bankruptcy.

Outside Bankruptcy

Prior to bankruptcy, the *Civil Enforcement Act*, RSA 2000, c C-15 (*CEA*) governs writs of enforcement in Alberta. In Alberta, an order (a writ) issued by a judge must be registered in order to be binding (*CEA*, s 33(1)), meaning to affect an enforcement debtor's interest. Writs binding interests in personal property must be registered in the Personal Property Registry, and those binding the enforcement debtor's exigible land must be registered under the *Land Titles Act*, RSA 2000, c L-4.

The priority of the writ is determined by both the registration system in which the writ is registered and by the *CEA*. Once a writ is registered, s 34 of the *CEA* says, unless provided otherwise in ss 35-40 of the *CEA* or any other enactment, an interest in property that is acquired after the property is bound by a writ is subordinate to the writ.

It is important to remember that a writ is not a security interest, and though its registration (depending on the timing) might allow the creditor holding the writ to take priority over security interests outside of bankruptcy, that registration does not transform the writ into a security interest inside bankruptcy. The judgment notes this, when Justice Lema says, "[a]ll also agree that a writ-holder's binding interest does not make it a 'secured creditor' per the BIA" (at para 15). This becomes relevant upon bankruptcy because bankruptcy changes pre-bankruptcy priority, and affords special priority to perfected security interests, priority it does not afford to any other type of interest.

Bankruptcy

The following principles show how bankruptcy changes pre-bankruptcy priorities.

1. It is well established that when federal and provincial legislation conflict, federal legislation prevails. The *BIA* governs bankruptcy; as federal legislation, any priorities set by the *BIA* (and sometimes, as here, in combination with the *ITA*) take precedence over conflicting priorities that are legislated by the provinces, unless those enactments have been accounted for in the *BIA*. As s 70(1) of the *BIA* states, every bankruptcy order will take precedence over "all judicial or other attachments, garnishments, certificates having the effects of judgments, judgments, certificates of judgments… except the rights of a secured creditor" unless the execution procedure has been completed (*Canadian Credit Men's Trust Association v Beaver Trucking Ltd*, [1959] SCR 311, 1959 CanLII 58 (SCC); see also *Pioneer Grain Company Ltd v Sullivan & Associates Inc*, 2007 SKCA 73 (CanLII) at para 21).

   At s 72(1), the *BIA* also says that its provisions, "shall not be deemed to abrogate or supersede the substantive provisions of any other law or statute relating to property and civil rights that are not in conflict with this Act" (emphasis added). Case law has also maintained this principle for decades. Recently, the Supreme Court reiterated, "provincial law will be rendered inoperative in the context of bankruptcy where the effect of the law is to conflict with, reorder

or alter the priorities established by the BIA" (*Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 (CanLII) at para 116).

2. This leads to the second point, which is that under the *BIA*, security interests typically have first priority. Section 136, the provision governing the rankings of claims, opens with "subject to the rights of secured creditors…" then lists how the proceeds realized from the property of the bankrupt shall be applied.

3. A secured creditor is defined in the *BIA* as "a person holding a mortgage, hypothec, pledge, charge or lien on or against the property of the debtor or any part of that property as security for a debt due or accruing due to the person from the debtor…" (s 2). This does not include writ holders. Writ holders are creditors holding judgments (judgment creditors), whereas a secured creditor holds a security interest in the debtor's property.

4. A creditor can become secured either through the usual steps or through deeming legislation. Upon Skyrider's bankruptcy, the CRA was deemed to be a secured creditor through the combined operation of s 223(11.1) of the *ITA* and ss 86 and 87 of the *BIA*. Nothing in the judgment questions the CRA's position.

5. Following from the previous point, writ holders are a type of unsecured creditor, as they have not taken the steps required for security, nor does legislation deem them to be secured. For that reason, they do not acquire the status of secured creditors in a bankruptcy. Although writs do have "binding interest" prior to bankruptcy (at paras 11-15), that interest is not the same as a security interest.

   There are several types of creditors that exist pre-bankruptcy, including judgment creditors, but bankruptcy allocates all of these creditors into one of three categories: secured, preferred, and unsecured. (There are also deferred creditors, whose claims are postponed by virtue of their relationship to the debtor – see *BIA*, ss 137-140.1). Any creditor that is not a perfected secured creditor as at the date of bankruptcy (and the creditor must be perfected – explained further below) becomes an unsecured creditor upon bankruptcy. Some of those unsecured creditors will be classified as preferred creditors for public policy reasons, which means they are higher in priority to other unsecured creditors, but they remain second in priority to secured creditors.

   Secured creditors can be perfected or unperfected, and only interests perfected at the date of bankruptcy can benefit from the priority afforded in s 136. Although s 136 does not specifically refer to *perfected* secured creditors, the Supreme Court of Canada in *Re Giffen*, [1998] 1 SCR 91, 1998 CanLII 844 (SCC), clarified that only perfected secured creditors get that priority and that secured creditors who are unperfected at the date of bankruptcy are relegated to the position of unsecured creditors (see *Personal Property Security Act*, RSA 2000, c P-7 at s 20(1)(i)). In this case, MNP argued that *Re Giffen* determined that writ-holders were secured creditors but, as Justice Lema maintains, *Re Giffin* did not do that, nor is *Re Giffen* relevant to this decision because the CRA was deemed to be a secured creditor and there was therefore never any issue with the status of its perfection (at paras 21-26).

6. Section 69 of the *BIA* says, "on a bankruptcy order being made… a bankrupt ceases to have any capacity to dispose of or otherwise deal with their property, which shall, subject to this act and to the rights of secured creditors, immediately pass to and vest in the trustee…" The combination of this provision and s 71, which determines that any property of the debtor shall, subject to the rights of secured creditors, immediately pass to and vest in the trustee upon a bankruptcy order and assignment, means that the trustee in bankruptcy becomes the representative of unsecured creditors.

   In other words, unsecured creditors cannot pursue claims against the debtor and must instead rely on the trustee in bankruptcy to distribute the property. In that way, one of the two purposes of bankruptcy – the equitable distribution of assets – can be accomplished. Through this "single proceeding model", "creditors of the bankrupt wishing to enforce a claim provable in bankruptcy must participate in one collective proceeding" (*Alberta (Attorney General) v Moloney*, 2015 SCC 51 (CanLII) at para 33. Section 141 of the *BIA* provides that all proven claims, which are unsecured claims, shall be paid rateably.

7. One may take issue with Parliament's decision to confer a deemed security interest on the CRA, or to reverse priorities upon bankruptcy. The inherent reality of bankruptcy is that the money available in the debtor's estate is not enough to pay the different stakeholders, making the priority of payments an incredibly important and fraught policy issue. However, it is exactly that – a policy issue – and changing those priorities or elevating certain priorities is a decision left to the Parliament (*Re Ivaco Inc.* (2006) 275 DLR (4th) 132, 2006 CanLII 34551 (ONCA) at para 75).

This post may be cited as: Jassmine Girgis, "How does Bankruptcy Impact the Priority of a Writ of Enforcement's 'Binding Interest'?" (September 23, 2022), online: ABlawg, http://ablawg.ca/wp-content/uploads/2022/09/Blog_JG_Bankruptcy_Priority.pdf

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