

THE CONFLICT BETWEEN CANADIAN PROVINCIAL PERSONAL PROPERTY SECURITY ACTS AND THE FEDERAL BANKRUPTCY ACT: THE WAR IS OVER

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In this article the authors analyse a quartet of Supreme Court of Canada judgments which consider the constitutional relationships between bankruptcy and a number of branches of law governing property, such as trusts and personal property security legislation. The authors argue that the controversy about the appropriate relationship between bankruptcy and law governing property has been resolved as section 91(21) of the Constitution Act, 1867, gives exclusive legislative authority over bankruptcy and insolvency to the Federal Parliament. The authors maintain that the provinces cannot legislate priorities in bankruptcy situations, nor change the scheme of distribution established by Parliament under section 136(1) of the Bankruptcy Act. Once bankruptcy has occurred federal legislation prevails. Otherwise, it is contended by the authors that the provinces could create up to ten different schemes of distribution, leading to complex and costly commercial law regimes. They therefore urge the courts to recognize that certain provisions of provincial Personal Property Security Acts are attempts to do what the Supreme Court of Canada says cannot be done: to legislate, for bankruptcy purposes, a different distribution or priority scheme and a different provincial definition of a term already defined in the Bankruptcy Act.

Dans cet article les auteurs analysent quatre décisions de la Cour suprême du Canada qui ont trait aux relations qui existent sur le plan constitutionnel entre la faillite et un certain nombre de branches du droit traitant de la propriété, à savoir par exemple la législation sur les trusts et sur les sûretés mobilières. Selon les auteurs, la controverse sur ce sujet est résolue puisque l'article 91(21) de la Loi constitutionnelle de 1867 donne au Parlement fédéral le pouvoir législatif exclusif sur la faillite et l'insolvabilité. Les auteurs affirment que les provinces ne peuvent ni passer des lois sur l'ordre de priorité dans les mises en faillite, ni changer le système de distribution qui a été décidé par le parlement fédéral en vertu de l'article 136(1) de la Loi sur la faillite. Une fois que la faillite a été déclarée, la législation fédérale prévaut. S'il en était autrement, les provinces, selon les auteurs, pourraient créer dix systèmes de distribution différents, ce qui entraînerait des régimes de droit commercial à la fois complexes et coûteux. Ils incitent donc les tribunaux à reconnaître que certaines dispositions des lois sur les sûretés mobilières promulguées par les provinces tentent de faire ce qui, selon la Cour suprême du Canada, ne peut se faire: promulguer des lois sur la faillite qui instituent des systèmes de distribution et des ordres de priorité différents et donnent une définition provinciale différente d'un terme déjà défini dans la Loi sur la faillite.

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Introduction

The armistice which ended World War II was widely celebrated throughout the world. Nevertheless, there were a few people who did not find out about it until many years later. For decades after the armistice was signed, there were occasional stories in the newspapers that a soldier who had been hiding in the jungle or on a deserted island had been discovered or had come out to surrender and had only then learned that the war was over.

A quartet of important constitutional cases decided by the Supreme Court of Canada has resolved the controversy about the appropriate constitutional relationship between bankruptcy and a number of branches of law governing property, such as trusts and personal property security legislation. Surprisingly, however, a few lower and even appeal court judgments and certain legislative actions give the impression that the bench, the bar and the legislature seem unaware that the war is over, at least when bankruptcy has occurred.

The quartet of cases involved the fact situation of deemed trusts, designed to ensure that provincial governments or their agencies are able to collect their taxes from businesses which are supposed to make deductions for that purpose. However, the reasoning in these cases is not limited to trusts, nor to situations of colourable legislation attempting to give an artificial preference to government. Rather, these rulings are broad enough to encompass any potential area of conflict between provincial power to legislate in the area of property and civil rights, and exclusive federal jurisdiction over bankruptcy and insolvency.

The central thesis of this article is that the quartet of judgments leads to the following principles of law now being settled:

- (1) provinces cannot create priorities between creditors or change the scheme of distribution on bankruptcy under s. 136(1) of the Bankruptcy Act;¹

¹ R.S.C. 1985, c. B-3, s. 136(1), formerly R.S.C. 1970, c. B-3, s. 107(1). Section 136(1) reads, in part:

136(1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payments as follows: . . .

(h) all indebtedness of the bankrupt under any *Workmen's Compensation Act*, under any *Unemployment Insurance Act*, under any provision of the *Income Tax Act* creating an obligation to pay to her Majesty amounts that have been deducted or withheld, rateably;

(i) claims resulting from injuries to employees of the bankrupt to which the provisions of any *Workmen's Compensation Act* do not apply, but only to the extent of moneys received from persons or companies guaranteeing the bankrupt against damages resulting from those injuries; and

(j) claims of the Crown not mentioned in paragraphs (a) to (i), in right of Canada or any province, rateably notwithstanding any statutory preference to the contrary.

- (2) while provincial legislation may validly affect priorities in a non-bankruptcy situation, once bankruptcy has occurred section 136(1) of the Bankruptcy Act determines the status and priority of the claims specifically dealt with in the section;
- (3) if provinces could create their own priorities or affect priorities under the Bankruptcy Act this would invite a different scheme of distribution on bankruptcy from province to province, an unacceptable situation; and
- (4) the definition of terms such as "secured creditor", if defined under the Bankruptcy Act, must be interpreted in bankruptcy cases as defined by the federal Parliament, not the provincial legislatures. Provinces cannot affect how such terms are defined for purposes of the Bankruptcy Act.

During our discussion of the quartet, we will consider the relationship between bankruptcy and trusts. However, as there has been only limited and, we believe, incorrect jurisprudence regarding conflicts between personal property security and bankruptcy legislation, that conflict will be the focus of this article.

The central provision of personal property security acts (hereinafter, PPSA)² of relevance to bankruptcy is the part which affects priorities in the event of bankruptcy. The purpose of these provisions is to force a creditor to use the PPSA by perfecting personal property security interests, under penalty of subordination to others with perfected PPSA interests. Included in that list of persons to whom the unperfected creditor is subordinate is the trustee in bankruptcy.

One would think that it is a relatively easy matter for a creditor to perfect a security interest under a PPSA statute. However, that is not always the case. Since PPSA searches are done by computer which only finds names precisely as entered in the computerized searching data base, relatively minor clerical errors can make a large difference. Thus, the omission of a middle initial, the reversal of the order of initials, or errors in vehicle identification numbers, can result in costly litigation over whether the registration was correct and, therefore, the interest perfected. Moreover, judges have interpreted their statutory power to correct clerical errors strictly and narrowly rather than broadly and liberally, resulting in considerable fear and uncertainty on the part of those registering both small and large

² The following jurisdictions have enacted personal property security legislation: Alberta, Personal Property Security Act, S.A. 1988, c. P-4.05; British Columbia, Personal Property Security Act, S.B.C. 1989, c. 36; Manitoba, Personal Property Security Act, R.S.M. 1987, c. P.35; Ontario, Personal Property Security Act, S.O. 1989, c. 16; Saskatchewan, Personal Property Security Act, S.S. 1979-1980, c. P-61; Yukon, Personal Property Security Act, R.S.Y. 1986, c. 130.

debt instruments as to whether they have done it correctly. In many cases, the problem may come from the debtor inadvertently providing information which, while not incorrect, is incomplete or careless (for example, omission of an initial), with potentially disastrous consequences for a lender³ in the event of the borrower's bankruptcy. For these reasons, it can safely be predicted that until the Supreme Court of Canada authoritatively determines the question, creditors who thought they had perfected their security interest under PPSA legislation, and whose perfection is challenged, will continue to attack the constitutional validity of those provisions in bankruptcy situations.

In public policy terms, there is a dilemma. If the PPSA legislation is stripped of its sanction in the event of bankruptcy, that may have the effect of diminishing its force; on the other hand, if this legislation is permitted to affect priorities in bankruptcy, Canada will have a balkanized bankruptcy regime which will diminish the significance of the exclusivity of federal jurisdiction over bankruptcy and insolvency. As one commentator has observed:

The Bankruptcy Act recognizes and preserves the rights of secured creditors to realize and deal with their security as if bankruptcy had not occurred. Secured creditors have priority over creditors represented by the trustee subject to a few exemptions set out in the Bankruptcy Act. Section 22(1)(a)(iii) of the [Ontario] PPSA⁴ conflicts with the Bankruptcy Act in that it provides that trustees shall have priority over a certain kind of secured creditor; namely, one who has not perfected his security interest prior to the bankruptcy.⁵

This statement by Arthur Peltomaa, published in 1982, is still valid today. Although it preceded two of the quartet of Supreme Court of Canada decisions, the view it represents has continued to be rejected in the PPSA context by the courts in Ontario and Saskatchewan. Despite this, we believe that as a result of the reasoning of the Supreme Court of Canada in the quartet, section 22(1)(a)(iii) of the Ontario PPSA, and its replacement,

³ This is a real problem for financial institutions with numerous retail branches, as training must be detailed and uniform; likewise for automobile finance companies, dependent entirely for their information on borrowers or the dealer's sales personnel.

⁴ R.S.O. 1980, c. 375:

22.(1) Except as provided in subsection (3), an unperfected security interest is subordinate to,

(a) the interest of a person . . .

(iii) who represents the creditors of the debtor as assignee for the benefit of creditors, trustee in bankruptcy, or receiver; (Emphasis added).

Manitoba followed this lead and enacted a similar provision: *supra*, footnote 2, s. 22(1)(iii).

⁵ A. Peltomaa, Constitutional Validity of Provincial Legislation Subordinating Unperfected Security Interests to Trustees in Bankruptcy (1982), 42 C.B.R. (N.S.) 104, at p. 104. The footnote inserted in the above quotation is our own.

section 20(1)(b),⁶ and similar provisions in other jurisdictions⁷ are now clearly *ultra vires*: the war is over.

The Supreme Court of Canada's quartet of decisions,⁸ although dealing with provincial statutory trusts which affected priorities in bankruptcy, has progressively and finally provided a definite ruling on the relationship between priorities under the Bankruptcy Act and *any* other provincial statute which directly or indirectly affects priorities. The PPSA problem continues because lawyers and some judges and perhaps even the Ontario Legislature,⁹ either do not realize or are resisting the idea that the issue is settled; hence the purpose of this article, to raise awareness that the war is over. As mentioned, notwithstanding a few Ontario and Saskatchewan decisions to the contrary,¹⁰ as a result of the quartet of judgments of the Supreme

⁶ R.S.O. 1990, c. P.10, s. 20(1)(b):

20.(1) Except as provided in subsection (3), until perfected, a security interest, ...

(b) *in collateral is not effective* against a person who represents the creditors of the debtor, including an assignee for the benefit of creditors and a *trustee in bankruptcy*; (Emphasis added).

⁷ Two versions of the section exist. One is s. 22(1) of the Ontario PPSA and s. 22(1)(iii) of the Manitoba PPSA, *supra*, footnote 4. The second version has been enacted in Alberta, s. 20(1); British Columbia, s. 20(1); Saskatchewan, s. 20(1); and the Yukon, s. 19(1); *supra*, footnote 2. The operative sections in Alberta and British Columbia read, in part:

20.(1) A security interest

(b) *in collateral is not effective against*

(i) *a trustee in bankruptcy* if the security interest is unperfected at the date of bankruptcy, (Emphasis added)

The Saskatchewan and Yukon provisions read, in part:

20.(1) An unperfected security interest *is subordinate to* the interest of

(b) a person who causes the collateral to be seized under legal process to enforce a judgment, including execution, attachment or garnishment, or who obtains a charging order or equitable execution affecting to the collateral;

(d) a representative of creditors, but only for the purposes of enforcing the rights of persons mentioned in clause (b), and a *trustee in bankruptcy*; (Emphasis added).

⁸ *Deputy Minister of Revenue v. Rainville*, [1980] 1 S.C.R. 35, (1979), 105 D.L.R. (3d) 270 (*sub nom. Re Bourgault*) ("*Rainville*"); *Deloitte Haskins and Sells Limited v. Workers' Compensation Board*, [1985] 1 S.C.R. 785, (1985), 19 D.L.R. (4th) 577 ("*Deloitte Haskins*"); *Federal Business Development Bank v. Commission de la Santé et de la Sécurité du Travail*, [1988] 1 S.C.R. 1061, (1988), 50 D.L.R. (4th) 577 ("*FDBD*"); *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24, (1989), 59 D.L.R. (4th) 726 ("*Henfrey*").

⁹ See *supra*, footnote 6. The attempt is to make the 1989 version cosmetically better, or less overtly *ultra vires*, by changing the blatant "is subordinate to" to the more neutral-sounding "is not effective against".

¹⁰ *Touche Ross Ltd. v. Paccar Financial Services Ltd.* (1989), 57 D.L.R. (4th) 438, 73 C.B.R. (N.S.) 28 (Sask. C.A.); *Re Hannah* (1988), 8 P.P.S.A.C. 181 (S.C.O. in Bankruptcy); *Re Phoenix Paper Products Ltd.* (1983), 3 D.L.R. (4th) 617, 48 C.B.R. (N.S.) 113 (Ont. C.A.).

Court of Canada, it is now settled that provinces cannot directly or indirectly affect priorities under the Bankruptcy Act. In the quartet the fact situations have involved provincial efforts to change priorities indirectly, when taxes or workers' compensation deductions have been collected but not remitted to the province. With the PPSA provisions, the attempt to change priorities on bankruptcy does not even have the argument of indirectness, as the trustee in bankruptcy is mentioned in all the PPSAs.

The consequences of the quartet are not always happy ones. Some creditors might force a bankruptcy situation just to improve their position. As Jacob S. Ziegel, writing about *Henfrey*,¹¹ the final case in the quartet, recognized:¹²

Until the Bankruptcy Act is amended we face the prospect of at least two unpleasing consequences flowing from the majority decision in the present case. The first is that it accentuates the disparity between the Crown's position before and after the debtor's bankruptcy—the one governed by provincial law and the other by federal law. Such anomalies ought surely to be avoided and call for a much higher degree of policy coordination between the federal and provincial governments than what we have seen so far.

The other consequence is that secured parties are given much incentive to put the debtor into bankruptcy even though the debtor's other creditors will derive no benefit from the event.

There are three possible legal outcomes in case of conflict between the federal and provincial legislation. Each has its costs and benefits.

The first is for a court to strike down the provincial provisions that conflict on the basis that they are unconstitutional. This outcome is both harsh and costly. If the provisions are declared unconstitutional, then that part of any provincial Act loses its effectiveness, not only in a bankruptcy but altogether. This possibility is not a likely result since it goes further than may be necessary to cure the conflict.

The second possibility, which tends to be reflected in the dissenting opinions¹³ in the Supreme Court of Canada, is to uphold the provincial legislation either by holding that no conflict exists or by characterizing the problem as the result of the creditor's failure of perfection, not of the law.¹⁴ The costs associated with this possibility are two-fold. First, it

¹¹ *Supra*, footnote 8.

¹² J.S. Ziegel, *The Supreme Court of Canada Scuttles The Deemed Trust in Bankruptcy* (1989), 15 C.B.L.J. 498, at p. 505.

¹³ These dissenting judicial opinions are of Estey J. in *Rainville*, *supra*, footnote 8, and *Deloitte Haskins*, *supra*, footnote 8; and Cory J. in *Henfrey*, *supra*, footnote 8.

¹⁴ Austin J. in *Re Hannah*, *supra*, footnote 10, both denied the conflict and attributed the secured creditor's problem to lack of perfection under the PPSA, that is, it was the creditor's own fault and, had it perfected, its problem would not have arisen. This case was decided after *Rainville* and *Deloitte Haskins*, but before *FBDB* and *Henfrey*: see *supra*, footnote 8. Nevertheless, it was, we believe, wrongly decided even then and unquestionably so today.

undermines exclusive federal power over bankruptcy. This head of jurisdiction becomes, in effect, a concurrent power, which is contrary to subsection 91(21) of the Constitution Act, 1867.¹⁵ Second, Canada would soon have a different bankruptcy regime in each province. This consequence is also contrary to the spirit of exclusive federal jurisdiction and frustrates the policy objective of developing a national standard.

The third possibility is to declare the provincial legislation valid except in bankruptcy situations. The costs of this possibility are a weakening of personal property security legislation in the event of bankruptcy as well as the creation, in some circumstances, of the perverse incentive for a secured creditor to petition a party into bankruptcy in order to improve the creditor's priority.

In this world of imperfect solutions, which of the three is the most tolerable? None is ideal. The ideal solution would be for all provincial governments to devise uniform legislation which dovetailed properly with the federal law. Such uniformity is unlikely in the foreseeable future.

The Supreme Court of Canada has selected¹⁶ possibility three: to declare the provincial legislation valid except in bankruptcy situations. It has decided to maintain a coherent, homogeneous national bankruptcy scheme and to preserve federal exclusivity over bankruptcy on the ground that this exhibits greater fidelity to the Constitution Act, 1867, than the alternatives. This solution—as any solution—has its inconveniences and costs.

I. *The Jurisprudence*

Until the quartet of Supreme Court of Canada decisions, two diverging lines of cases had developed: one emanating from Ontario and the other from British Columbia. This part of the article, after summarizing the quartet, reviews these two lines of decisions and argues that the Ontario line of reasoning is now dead and should be given a decent burial.

As has been noted earlier,¹⁷ the quartet of decisions did not deal directly with personal property security legislation. Rather, the decisions concerned statutory provisions in which the province had given itself some authority which indirectly encroached upon federal bankruptcy jurisdiction. For reasons which will become clear, whether the legislation in issue creates

¹⁵ Constitution Act, 1982, enacted by the Canada Act 1982 (U.K.), 1982, c. 11, Sch. B.

¹⁶ For example, McLachlin J. in *Henfrey*, *supra*, footnote 8, at pp. 33 (S.C.R.), 740 (D.L.R.), stated:

To interpret s. 47(a) [now s. 67(a)] as applying not only to trusts as defined by the general law, but to statutory trusts created by the provinces ... would be to permit the provinces to create their own priorities under the *Bankruptcy Act* and to invite a differential scheme of distribution from province to province.

¹⁷ *Supra*, at p. 78.

a deemed trust or anything else makes no difference because, in our opinion, the Supreme Court's reasoning is equally applicable.

A. *The Quartet*

The first decision is *Rainville*.¹⁸ The debtor owed some money to the Deputy Minister of Revenue of Quebec under the provincial Retail Sales Act.¹⁹ The debtor made an assignment in bankruptcy authorizing the trustee in bankruptcy to sell, by private sale, the land on which a privilege was registered with respect to the amount owed under the Act. The trustee made a motion to the Quebec Superior Court seeking cancellation of the privilege. The Deputy Minister of Revenue attacked the authorization and opposed the trustee's motion. The Deputy Minister argued that he was a "secured creditor" within the definition of that expression in section 2 of the Bankruptcy Act.

The Superior Court agreed with the Deputy Minister's submission and dismissed the trustee's motion. The Court of Appeal (with one dissent) reversed the decision, and ruled in favour of the trustee.²⁰ The Deputy Minister appealed to the Supreme Court of Canada.

Pigeon J. for the majority wrote that the priorities in section 136(1)(j)²¹ of the Bankruptcy Act are intended to put on equal footing all claims by Her Majesty in right of Canada, or a province, except in cases where it is provided otherwise:²²

The purpose of this part of the provision is obvious. Parliament intended to put all debts to a government on an equal footing; it therefore cannot have intended to allow provincial statutes to confer any higher priority. In my opinion, this is precisely what is being contended for when it is argued that, because the Quebec statute creates a privilege on immovable property effective from the date of registration, the Crown thereby becomes a "secured creditor" and thus escapes the effect of the provision which gives it only a lower priority.

As the provision in question is federal law intended to override provincial laws throughout Canada, this is not a case for interpretation on the basis of technical meaning. However, even on a literal construction, I see no unsurmountable difficulty. There is of course a contradiction between the reservation at the outset of the rights of secured creditors which include privileges and "notwithstanding any statutory preference. . . ." However, it is certainly clear that the reservation is a general rule

¹⁸ *Supra*, footnote 8.

¹⁹ R.S.Q. 1964, c. 71, s. 30.

²⁰ [1978] R.D.F.Q. 153. The majority of the Court of Appeal refused to follow its own earlier judgment in *Supertest Petroleum v. Jacques-Cartier Automobile Inc. and Shink*, [1963] B.R. 336, where it was held that the Crown was a secured creditor.

²¹ With the revised Statutes of Canada in 1985 the sections in the Bankruptcy Act were renumbered. This article cites the present section numbers. Where appropriate, the old section numbers are referenced. Section 136(1)(j) was formally section 107(1)(j) and the text of this provision is found *supra*, footnote 1.

²² *Supra*, footnote 8, at pp. 44-45 (S.C.R.), 277 (D.L.R.).

and the "notwithstanding" an exception which takes precedence wherever applicable. Furthermore, subs. 3 shows that s. 107 does derogate from the rights of some secured creditors by providing that a secured creditor whose "rights are restricted" ranks as an "unsecured creditor".

In the majority's view, if the Deputy Minister's contention was upheld it would mean that the Quebec tax collector, provided his privilege was registered before the bankruptcy, would obtain a special preference on the proceeds of the sale of the property in question, instead of having only the priority contemplated in the Bankruptcy Act. Such a result would be contrary to the intent of the federal legislation and no imperfection in drafting could justify it. Just as Parliament intended in section 136(1)(e) and (f) to define the priority of municipal corporations and lessors, it is clear that it also intended by section 136(1)(j), by the word "notwithstanding", to deal with the preferential rights of the federal and provincial tax collectors. Furthermore, section 136(3)²³ showed that, despite the reservation of the rights of "secured creditors",²⁴ the impugned legislation derogated from the rights of some secured creditors because it provided that a secured creditor whose "rights are restricted" ranks as an "unsecured creditor".

In dissent, Estey J. held that from the construction of section 136(1)(j) and the Act's definition of "secured creditor", in particular the word "charged" contained in that definition, it was clear that the claim of the Province was a secured claim. By registering that claim, the Crown had charged the property of the debtor. This charge was embraced by the federal statute in the definition of "secured creditor". Section 136 operated only for the purposes of providing for realization ahead of the ten preferred claims mentioned in the scheme of distribution. Estey J. stated:²⁵

It may be said that para. (j) has the effect of overriding any other provision and thereby ranks a claim by the Crown of the kind now before the Court after the previous nine classes of claims. However, in my view, it is unnecessary to consider the meaning of para. (j) because such a subclause, inserted only to rank or create priorities of claims after the payment of secured claims, cannot be construed as somehow reducing the definition of a secured creditor under the Act. If the Crown is indeed within the definition of a secured creditor, as I have concluded above, then as such the Crown will recover the assets of the estate to the satisfaction of its claim or the exhaustion of those assets, whichever first occurs. The succeeding paragraphs operate only after the secured claim is paid off, and then only if assets remain in the hands of the Trustee.

The Supreme Court of Canada confirmed and extended its position in *Rainville* in *Deloitte Haskins*,²⁶ the second decision of the quartet, an

²³ This provision reads:

A creditor whose rights are restricted by this section is entitled to rank as an unsecured creditor for any balance of claim due to him.

²⁴ Which were to rank in priority before unsecured creditors.

²⁵ *Supra*, footnote 8, at pp. 48 (S.C.R.), 280 (D.L.R.).

²⁶ *Supra*, footnote 8.

appeal under Alberta's Workers' Compensation Act.²⁷ The Supreme Court of Canada held, in two concurring judgments, that the Alberta Workers' Compensation Board was not a secured creditor for bankruptcy purposes under section 136(1)(h).

Wilson J. (on behalf of herself and McIntyre and Lamer JJ.), in allowing the appeal, relied upon the decision of the Privy Council in *Royal Bank of Canada v. Leroux*,²⁸ which held that the exclusive legislative jurisdiction conferred on the federal Parliament in relation to bankruptcy and insolvency²⁹ enabled it to legislate the relative priorities of creditors on a bankruptcy. Although legislation under the provincial property and civil rights power³⁰ could secure certain debts on property of the debtor, as soon as the provincial legislation came into conflict with federal bankruptcy legislation the latter prevailed.³¹ Therefore, Wilson J. held that section 136(1)(h) of the Bankruptcy Act applied to determine priorities on a bankruptcy and section 78(4) of the Workers' Compensation Act of Alberta had no application in such situations.

The other majority opinion, of Chouinard J. (on behalf of himself and Dickson C.J.C. and Beetz J.), agreed with Wilson J. that the Workers' Compensation Act and the Bankruptcy Act had their respective legitimate spheres of operations.

In dissent, Estey J. found it unnecessary to answer the constitutional question because, in his view, the issue was whether Parliament in effect regulated the Workers' Compensation Act for the purposes of bankruptcy proceedings. Estey J. believed that the provincial Act clearly and validly established a charge against the property of a delinquent employer. Furthermore, the federal Act did not make any exceptions for charges or other security established by provincial statute generally or specifically with reference to those statutes of the provinces which are named in section 136 of the Bankruptcy Act. Therefore, the scheme of distribution in bankruptcy is entirely predicated upon the prior rights of secured creditors. As he stated:³²

There is nothing in the use of the term "secured creditors" in the opening of this plan of distribution of a bankrupt's assets to indicate that Parliament did not intend to incorporate into s. 107 [now s. 136] the statutory definition of that term. . . .

The natural sequence, in my view, is that the provincial statute is examined to determine the character of the status of the claim in provincial law. The federal Act is then examined to determine whether the provincial claim so established will be recognized as a secured creditor or otherwise in the bankruptcy scheme adopted by Parliament.

²⁷ S.A. 1973, c. 87.

²⁸ [1928] A.C. 187 (P.C.).

²⁹ Constitution Act, 1867, s. 91(21).

³⁰ *Ibid.*, s. 92(13).

³¹ *Supra*, footnote 8, at pp. 800 (S.C.R.), 588 (D.L.R.).

³² *Ibid.*, at pp. 790-791 (S.C.R.), 580-581 (D.L.R.).

There is considerable logical force behind Estey J.'s position. Intuitively, it seems to make sense that because Parliament should not be legislating in the area of property and civil rights, it should not attempt to define in detail what a secured creditor is and what rights flow from secured creditor status. It would then follow that although Parliament can rank secured creditors wherever it wants in a hierarchy of creditors, the provincial legislatures should be permitted to define "secured creditor" under provincial law for both bankruptcy and non-bankruptcy purposes. Nevertheless, this opinion was in dissent and has not prevailed.

Against Estey J.'s view it may be argued that had the two heads of jurisdiction, bankruptcy and property and civil rights, been concurrent, this would have been the correct view. However, as Parliament has been granted exclusive jurisdiction in relation to bankruptcy, this exclusivity would naturally limit the power of any laws enacted under provincial property and civil rights jurisdiction to affect priorities in bankruptcy. Furthermore, it seems not at all unreasonable or overextensive for Parliament, when legislating by employing terms such as "secured creditor", to define those terms to make it clear what it means. Had Parliament wished to do so, it could always have defined "secured creditor" to mean whatever it meant under the law of the province in which the bankruptcy occurred. Alternatively, it could have declined to define "secured creditor", to the same effect.

Estey J. would have had a response to that criticism. In his view, there was no conflict. Rather, he viewed the federal scheme as recognizing the provincial scheme:³³

If the provincial legislation creates a charge which falls within the definition of s. 2, and if the appropriate subparagraph under s. 107 [now s. 136] does not reduce the status of the secured creditor to that of a preferred creditor, then the claimant is excepted from the distribution of s. 107(1) by the opening words of subs. (1). It is not because the provincial legislature has defeated or subverted the federal statutory scheme. It is because the federal scheme recognizes the provincially legislated charge which gives the claimant the status of a secured creditor. It is, in my view, quite contrary to law to translate this interrelationship between the provincial and the federal statutes as elevating the provinces to the position where they may determine priorities in the event of a bankruptcy.

Estey J.'s position, however, ignores the definition of "secured creditor" in section 2 of the Bankruptcy Act.³⁴ As is clear from this definition, Parliament has provided a fairly detailed description, so that it is quite possible that in many circumstances any provincial legislation applicable

³³ *Ibid.*, at pp. 795 (S.C.R.), 583-584 (D.L.R.).

³⁴ The definition of "secured creditor" is:

a person holding a mortgage, hypothec, pledge, charge, lien or privilege on or against the property of a debtor or any part thereof as security for a debt due or accruing to him from the debtor, or a person whose claim is based on, or secured by, a negotiable instrument held as collateral security and on which the debtor is only indirectly or secondarily liable.

in bankruptcy circumstances will conflict. Even if the federal scheme "recognizes the provincially legislated charge", as Estey J. asserted, given the federal definition of "secured creditor", that is no reason to uphold the provincial legislation if it purports to affect priorities.

In the third decision of the quartet, *FBDB*,³⁵ Royal Trust as trustee took possession of the debtor's immovable property because the debtor did not meet its obligations. Three months later, the debtor made an assignment of all its property in accordance with the provisions of the Bankruptcy Act. Royal Trust brought an action in the civil division of the Quebec Superior Court to have the property sold by the court. The trustee in bankruptcy did not appear. Before the sale, the FBDB registered a privilege against the property under section 110 of the Workmen's Compensation Act.³⁶ Once the property had been sold, an order of distribution was prepared in accordance with the provincial law. This order resulted in the FBDB being placed fourth and the trustee in bankruptcy seventh. The latter then challenged the order, arguing that it should have been prepared in accordance with the provisions of the Bankruptcy Act.

The Quebec Court of Appeal restored the initial scheme of distribution. By taking possession and bringing a civil action the creditor, Royal Trust, was acting as a secured creditor unrelated to the bankruptcy. Since this action belonged to Royal Trust as a right of being a secured creditor, this right was outside section 136 of the Bankruptcy Act. Thus, only the rules of provincial law were applicable.

The issue involved two legislative enactments whose application led to opposing solutions. If the provincial law prevailed then the FBDB was a secured creditor and its debt ranked before that of the trustee in bankruptcy. If, on the other hand, the Bankruptcy Act had priority, then the FBDB would lose the benefit of its privilege and become a preferred creditor.³⁷

In the Supreme Court of Canada, Lamer J. held that the law governing the liquidation of property of the bankrupt and the distribution of the proceeds of the sale of that property is contained in the Bankruptcy Act. When a secured creditor proceeds to liquidate his security outside the bankruptcy proceeding, it is because section 69(2)³⁸ of the Bankruptcy Act has authorized the secured creditor to do so.

³⁵ *Supra*, footnote 8.

³⁶ R.S.Q. (1977), c. A-3.

³⁷ *Supra*, footnote 8, at pp. 1066 (S.C.R.), 580 (D.L.R.).

³⁸ Formerly R.S.C. 1970, c. B-3, s. 49(2). Section 69(2) is as follows:

69.(2) Subject to section 79 and sections 127 to 134, a secured creditor may realize or otherwise deal with his security in the same manner as he would have been entitled to realize or deal with it if this section had not been passed, unless the court otherwise orders, but in so ordering the court shall not postpone the right of the secured creditor to realize or otherwise deal with his security, except as follows:

Lamer J. disagreed with the Court of Appeal's view that the rights of Royal Trust as trustee in possession of a debtor's assets were not affected by the occurrence of a bankruptcy. He held that the immoveable property seized by Royal Trust was part of the "property of a bankrupt" mentioned in section 136. Therefore, even if Royal Trust took the property of the debtor before the bankruptcy, the bankrupt remained the owner of the property. Royal Trust, having seized immoveable property, could not claim to have a right of ownership over that property, it had only the right of a creditor under a pledge.

Under section 67³⁹ of the Bankruptcy Act the fact that property was owned by the bankrupt at the time of the bankruptcy was sufficient to make it part of the bankrupt's estate and for it to pass to the trustee in bankruptcy automatically. Thus, the immoveable and "property of the bankrupt" was within the meaning of section 67 of the Bankruptcy Act regardless of the rights conferred on Royal Trust by its security. Lamer J. rejected the argument that section 136 of the Bankruptcy Act did not apply. In his view, although this property was held by the trustee at the time of the bankruptcy, it was property of the bankrupt within the meaning of section 67 and thus of section 136 of the Bankruptcy Act to the extent that these provisions were applicable.

The issue, again, was what legislation, provincial or federal, applied? Following *Rainville* and *Deloitte Haskins*, the court held that in the event of bankruptcy, priorities are exclusively a matter of federal jurisdiction. Those cases stood for the following proposition:⁴⁰

... in a bankruptcy matter it is the *Bankruptcy Act* which must be applied. If a bankruptcy occurs, the order of priority is determined by the ranking of s. 107 [now s. 136] of the Act, and any debt mentioned in that provision must therefore be given the specified priority.... As [the] respondent's claim was covered by s. 107(1)(h) of the Act [the] respondent is a preferred creditor whose claim must

(a) in the case of a security for a debt that is due at the date of the bankruptcy or of the approval of the proposal or that becomes due not later than six months thereafter, that right shall not be postponed for more than six months from that date; and

(b) in the case of a security for a debt that does not become due until more than six months after the date of bankruptcy or of the approval of the proposal, that right shall not be postponed for more than six months from that date, unless all instalments of interest that are more than six months in arrears are paid and all other defaults of more than six months standing are cured, and then only so long as no instalment of interest remains in arrears or defaults beyond the date at which the debt secured by the security becomes payable under the instrument or law creating the security.

³⁹ Section 67(a) (formerly R.S.C. 1970, c. B-3, s. 47(a)) is as follows:

67. The property of the bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person, ...

⁴⁰ *Supra*, footnote 8, at pp. 1071-1072 (S.C.R.), 585 (D.L.R.).

be ranked after that of [the] appellant, whether or not the trustee realized on his security outside the bankruptcy proceeding. Once a bankruptcy has occurred the federal statute applies to all creditors of the debtor.

Lamer J. acknowledged the concern that such a solution may encourage secured creditors to bring about the bankruptcy of the debtor in order to improve their title. Nevertheless, he held that the court's policy choice had obvious advantages. If provincial statutes are not permitted to affect priorities once bankruptcy has occurred, consistency in the order of priority in bankruptcy, from one province to another, would ensue.⁴¹

In the fourth decision of the quartet, *Henfrey*,⁴² the Supreme Court of Canada finally had an opportunity to decide the question of whether the statutory trusts created by provincial legislation were either valid trusts within the meaning of section 67(a) of the Bankruptcy Act or were Crown preferred claims under section 136(1)(j). In *Henfrey*, an appeal from the British Columbia Court of Appeal, the Supreme Court of Canada concluded that section 67(a) did not apply on the facts in the case; therefore, the claim of the Province of British Columbia was not a trust claim as provided by the provincial statute but, rather, was a preferred claim governed by section 136(1)(j) of the Bankruptcy Act.

The debtor company was placed in receivership by a secured creditor. Provincial sales tax had been collected under the Social Service Tax Act.⁴³ The receiver reduced the secured creditor's indebtedness by applying the company's assets. The statutory trust created by section 18 of the SSTA was held ineffective to give the Province priority over other creditors under the Bankruptcy Act. McLachlin J., for the majority in the Supreme Court of Canada, wrote:⁴⁴

The intention of Parliament in enacting s. 47(a),⁴⁵ then, was to permit the removal of property which can be specifically identified as not belonging to the bankrupt under general principles of trust law from the distribution scheme established by the Bankruptcy Act.

Section 107(1)(j) [now s. 136(1)(i)], on the other hand, has been held to deal not with rights conferred by general law, but with the statutorily created claims of federal and provincial tax collectors.

And she later added:⁴⁶

[T]o interpret s. 47(a) as applying not only to trusts as defined by the general law but the statutory trusts created by the provinces . . . would be to permit the provinces to create their own priorities under the Bankruptcy Act and to invite a differential scheme of distribution from province to province.

⁴¹ *Ibid.*, at pp. 1072 (S.C.R.), 585-586 (D.L.R.).

⁴² *Supra*, footnote 8.

⁴³ R.S.B.C. 1979, c. 388, s. 18 ("SSTA").

⁴⁴ *Supra*, footnote 8, at pp. 31 (S.C.R.), 739 (D.L.R.).

⁴⁵ Now R.S.C. 1985, c. B-3, s. 67(a). See *supra*, footnote 39.

⁴⁶ *Supra*, footnote 8, at pp. 33 (S.C.R.), 740 (D.L.R.).

Thus, the Supreme Court of Canada held that section 67(a) trusts should be confined to trusts arising under general principles of the law of trusts while section 136(1)(j) should be applied to claims not established under such general law but secured by provincial preference through legislation. The effect was to invalidate the Province's statutorily created trust.

McLachlin J. upheld the British Columbia Court of Appeal, and agreed with it that the Supreme Court of Canada decision in *Deloitte Haskins* had implicitly overruled the Ontario Court of Appeal decision in *Re Phoenix Paper Products Ltd.*,⁴⁷ which had applied section 67(a) to deemed trusts created under provincial law.

In lone dissent, Cory J., perhaps influenced by the Ontario school of thought on this issue, was of the view that there was nothing wrong with allowing a provincial government to create, in good faith, a lien or a charge on the assets for the amount of the statutory trust.⁴⁸ In his view, section 18 of the SSTA should prevail unless it was in conflict with the provisions of the Bankruptcy Act. In this case he saw no conflict:⁴⁹

... as the property which was subject to s. 18 of the *Social Service Tax Act* never at any time became the property of the bankrupt and is, therefore, not subject to distribution as the property of the bankrupt pursuant to s. 107 [now s. 136] of the *Bankruptcy Act*. On a plain reading of the *Bankruptcy Act* there is no conflict created by the two statutes.

Therefore, he held, the trust was valid and the subject matter thereof properly fell outside the property of the bankrupt.

Cory J. seemed to place a great deal of emphasis on the argument that what the province did was done in good faith. There was no attempt to give itself any special priority in the bankruptcy situation, as evidenced by the fact that the legislation applied not only in the event of bankruptcy but also in other situations. It also seemed important that, as a matter of public policy, provinces be allowed to ensure that taxes for such things as social security, which employers had a statutory duty to collect and set aside, would not be lost to the Crown merely because of the apparently arbitrary fact that the employer failed to set aside the taxes collected in a separate bank account and had then gone bankrupt. It was this difference between the statutory trust and the common law principles of trust which determined the outcome in the case and which, in Cory J.'s opinion, was insufficient to justify the outcome. Nevertheless, again on policy grounds, the majority held that the need for a nationally homogeneous scheme of priority upon bankruptcy must prevail.

⁴⁷ *Supra*, footnote 10. See further, *infra*, at p. 92.

⁴⁸ *Supra*, footnote 8, at pp. 39-40 (S.C.R.), 730 (D.L.R.).

⁴⁹ *Ibid.*, at pp. 43 (S.C.R.), 733 (D.L.R.).

Perhaps it is just an interesting coincidence, but both dissents in the Supreme Court of Canada (Estey J. in *Deloitte Haskins* and in *Rainville*, Cory J. in *Henfrey*) were from Ontario, while McLachlin J., from British Columbia, wrote the majority judgment in the latter case. Perhaps the two judges from Ontario were influenced by their Ontario background to believe that commercial law considerations should be given greater weight, even in a bankruptcy, than the majority judges had been willing to support. As well, perhaps, as a Crown agency was involved in *Rainville*, *Deloitte Haskins*, and *Henfrey*, it may have been felt by the two dissenting judges that the interests of the taxpayer, as represented by the Crown or its agencies, should be given greater weight than the need for uniformity in bankruptcy laws.

A parallel exists between Estey J.'s dissent in *Deloitte Haskins* and that of Cory J.'s in *Henfrey*. Their arguments "duck" the applicability of section 2 of the Bankruptcy Act in order to give effect to provincial legislation. They argue that the Bankruptcy Act gives trusts, for example, a certain priority, but the question of what is a trust is to be left to be defined by provincial law, even in a bankruptcy situation.

It is clear by now that this argument, whatever its merits, has failed to obtain majority support in the Supreme Court of Canada. The need for a homogeneous national scheme of priority upon bankruptcy has prevailed. The war is truly over.

B. The "Ontario" Line of Cases

The "Ontario" line of cases has been supported by courts in Ontario and Saskatchewan. In *Re Phoenix Paper Products Ltd.* ("*Phoenix*")⁵⁰ the Ontario Court of Appeal considered whether section 15 of the Employment Standards Act⁵¹ created a valid trust claim within section 67(a)⁵² of the Bankruptcy Act. The trial court declared that by virtue of section 67(a) of the Bankruptcy Act the vacation pay claims of the bankrupt employer's employees were excluded from the priorities and limitations provided for in section 136(1)(d). Therefore, these claims did not form part of the "property of the bankrupt divisible among his creditors". The trustee in bankruptcy appealed.

⁵⁰ *Supra*, footnote 10. This was not the first opportunity for a court to consider this issue. Previous decisions and ones which *Phoenix* relied upon are: *Re Black Forest Restaurants Ltd.* (1981), 121 D.L.R. (3d) 435, 37 C.B.R. (N.S.) 176 (N.S.S.C.), aff'd (1981), 126 D.L.R. (3d) 417, 38 C.B.R. (N.S.) 253 (*sub nom. Director of Labour Standards of Nova Scotia v. Trustee in Bankruptcy*) (N.S. App. Div.); *Re Dairy Maid Chocolates Ltd.*, [1973] 1 O.R. 603, (1972), 17 C.B.R. (N.S.) 270 (Ont. S.C.); *Dauphin Plains Credit Union Ltd. v. Xylloid Indust. Ltd.*, [1980] 1 S.C.R. 1182, (1980), 108 D.L.R. (3d) 257; *Re Alduco Mechanical Contr. Ltd.* (1982), 134 D.L.R. (3d) 104, 40 C.B.R. (N.S.) 239 (Ont. S.C.).

⁵¹ R.S.O. 1980, c. 137.

⁵² For text, see *supra*, footnote 39.

The Court of Appeal, after considering both the Ontario and British Columbia lines of cases,⁵³ dismissed the appeal because in its view the decisions in *Rainville* and *Dauphin Plains Credit Union Ltd. v. Xyloid Industries Ltd.*⁵⁴ were preferable. The court held that the employees' claims were impressed with the valid trust pursuant to the Employment Standards Act and these amounts therefore were not property of the bankrupt by virtue of section 67(a) of the Bankruptcy Act. These claims were not governed by section 136(1). The court stated that it was important, if possible, that there be uniformity in the bankruptcy decisions handed down in the various provinces of Canada and certainly in the common law provinces, but did not make this policy concern an absolute requirement.

Although the judgment in *Phoenix* is no longer good law, having been implicitly overruled by *Deloitte Haskins*, as noted by McLachlin J. in *FBDB*, at the time it was rightly decided. It was still possible to hold at the time that, despite *Rainville*, the Supreme Court of Canada's reasoning had not yet progressed to the point where *Phoenix* was clearly wrong. Nevertheless, it does show the tendency of the Ontario judges to uphold the provincial legislation, even in the face of what might by then have been recognized as a dark cloud over that viewpoint from the Supreme Court of Canada. As with the dissenting judgments of Estey J. and Cory J. examined earlier, the reasons of Tarnopolsky J.A. in *Phoenix* have an intuitive appeal. The fact that these views are now "wrong" in law is in no way to criticize them or to denigrate their value. However, other policy choices have been made in subsequent judgments by the Supreme Court of Canada.

Another decision, *Re Hannah*,⁵⁵ examined section 22(1)(a)(iii) of the Ontario PPSA.⁵⁶ It was argued by the trustee in bankruptcy that section 22(1)(a)(iii) was *ultra vires* the province or, in the alternative, was in conflict with federal bankruptcy legislation. The trustee's position was that in the event of bankruptcy, section 69(2) of the Bankruptcy Act⁵⁷ allowed

⁵³ The cases in the first line that the Court of Appeal considered are: *Rainville*, *supra*, footnote 8; *Re Black Forest Restaurants Ltd.* *supra*, footnote 50; *Re Kinross Mortgage Corp. and Bushell* (1981), 127 D.L.R. (3d) 740, 41 C.B.R. (N.S.) 1 (*sub. nom. Workers' Compensation Board v. Kinross Mortgage Corp.*) (B.C.C.A.); *Re Racknagel* (1982), 42 C.B.R. (N.S.) 135 (B.C.S.C.). The other line of cases is: *Re Dairy Maid Chocolate Ltd.*, *supra*, footnote 50; *Re Alduco Mechanical Contractors Ltd.*, *supra*, footnote 50; *John M.M. Troup Ltd. v. Royal Bank of Canada*, [1962] S.C.R. 487, (1962), 34 D.L.R. (2d) 556; *Re KRA Restaurants Ltd. and Toronto-Dominion Bank* (1977), 74 D.L.R. (3d) 272, 36 A.P.R. 605, 25 N.S.R. (2d) 605 (N.S.S.C.); *Re Deslauriers Construction Products Ltd.* (1970), 13 D.L.R. (3d) 551, 14 C.B.R. (N.S.) 197 (Ont. C.A.); *Dauphin Plains Credit Union Ltd. v. Xyloid Indust. Ltd.*, *supra*, footnote 50; *Re Kraemer* (1982), 42 C.B.R. (N.S.) 259 (Ont. Mast.), *aff'd* (1982), 43 C.B.R. (N.S.) 232 (Ont. S.C.).

⁵⁴ *Supra*, footnote 50.

⁵⁵ *Supra*, footnote 10

⁵⁶ See *supra*, footnote 4, for the text of the provision.

⁵⁷ See *supra*, footnote 38, for the text of this provision.

secured creditors to realize or otherwise deal with their securities as if bankruptcy had not occurred. Section 22(1)(a)(iii), however, precluded secured creditors from so doing, thus changing their rights upon bankruptcy.

In rejecting this argument, Austin J. stressed that the relevant section of the PPSA was not restricted to cases of bankruptcy and was valid provincial legislation. Echoing the language of Estey J., Cory J. and Tarnopolsky J.A. in the cases discussed earlier, he wrote:⁵⁸

Section 22 sets out the provincial law respecting priorities in the event a secured creditor fails to register in accordance with the requirements of the Act. That is an exercise of the province's jurisdiction respecting property and civil rights. The trustee is not the only person involved; he is but one of a class. An unperfected security interest holder who attempted to enforce a claim on his security by way of a seizure or receivership would be equally subject to the priority scheme set out in Section 22(1) of the Act.

I conclude therefore that Section 22(1)(a)(iii) is not in essence bankruptcy legislation but rather that the inclusion of the trustee was incidental to the legitimate attempt of the province to spell out the consequences, in relation to a range of persons or interests, of failure to perfect registration of a security interest.

The learned judge then went on to hold⁵⁹ that section 69(2) of the Bankruptcy Act does not spell out the rights of a secured creditor. Rather, those rules are set out in section 72(1)⁶⁰ of the Bankruptcy Act, which provides that the provisions of the Act "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 . . ." Section 136(1) of the Bankruptcy Act contains a list of persons who rank in priority according to their places on the list. If there is a conflict between one of those classes and provincial legislation, the federal legislation must prevail. Absent such a conflict, however, the rights of secured creditors are left to be regulated by the provincial legislation. Austin J. found no conflict between section 22(1)(a)(iii) of the Act and sections 69(2) or 136(1) of the Bankruptcy Act. The PPSA was valid legislation and was not in operational conflict with the bankruptcy legislation.

For reasons which are clear from the foregoing discussion *Re Hannah* was probably wrongly decided and is certainly no longer good law. First, it ignored the definition of "secured creditor" set out in section 2 of the Bankruptcy Act, and, second, it used section 72(1) of the Act in an argument that is circular. Finally, the position that there is no conflict between the

⁵⁸ *Supra*, footnote 10, at pp. 190-191.

⁵⁹ *Ibid.*, at p. 191.

⁶⁰ Section 72(1) (formerly R.S.C. 1970, c. B-3, s. 50(6)) is as follows:

72.(1) The provisions of the Act 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, and the trustee is entitled to avail himself of all rights and remedies provided by such law or statute as supplementary to and in addition to the rights and remedies provided by this Act.

PPSA and the Bankruptcy Act is plainly incorrect because a secured creditor who meets the definition of secured creditor in the Bankruptcy Act, but who has not perfected security under the PPSA, would no longer rank ahead of the trustee in bankruptcy. Indeed, given such a conflict, the fact situation in *Re Hannah* would appear to be determined by the reasoning of the Supreme Court of Canada in *FBDB* and even more clearly so by the post-*Re Hannah* judgment of that court in *Henfrey*.

In the Saskatchewan decision of *Touche Ross Ltd. v. Paccar Financial Services Limited*,⁶¹ the claimant, a large financial institution who regularly engaged in financing the purchase of trucks, leased four trucks for a term of more than one year. The lease, a pure lease under which the lessee obtained no interest in the trucks, was not registered under Saskatchewan's PPSA.⁶² The lessee subsequently leased two of the trucks to the respondents, C. and G., and then entered into bills of sale which purported to sell them the trucks. The lessee subsequently made an assignment into bankruptcy and the claimant submitted a proof of claim to the trustee, claiming ownership of the trucks. The trustee disputed the claim on the basis that Paccar had not perfected its interest as lessor and, therefore, because of section 20(1) of the SPPSA,⁶³ its interest was subordinate to that of the trustee.

Paccar applied under section 81(2)⁶⁴ of the Bankruptcy Act for a declaration that it was the owner of the trucks and entitled to possession. The chambers Judge held that to the extent that section 20(1)(d) of the SPPSA purported to give a trustee in bankruptcy priority over the claim of the lessor of goods for a term of more than one year, it was in actual conflict with the Bankruptcy Act and was therefore inoperative. The court also found that in the event it had misinterpreted section 20(1)(d), C. had established, on a balance of probabilities, that he was a purchaser without notice of Paccar's security interest. C. appealed. The appeal was allowed.

The Court of Appeal held that section 20(1)(d) of the SPPSA, which subordinates the interest of an unperfected lessor under a lease for a term

⁶¹ *Supra*, footnote 10.

⁶² S.S. 1979-80, c. P-61, as amended ("SSPSA").

⁶³ See *supra*, footnote 7, for the relevant provision.

⁶⁴ S. 81.(2) [formerly R.S.C. 1970, c. B-3, s. 59(2)] is as follows:

The trustee with whom a proof of claim is filed under subsection (1) shall within fifteen days thereafter or within fifteen days after the first meeting of creditors, whichever is the later, either admit the claim and deliver possession of the property to the claimant or give notice in writing to the claimant that the claim is disputed with his reasons therefor, and, unless the claimant appeals therefrom to the court within fifteen days after the mailing of the notice of dispute, he shall be deemed to have abandoned or relinquished all his right to or interest in the property to the trustee who thereupon may sell or dispose of the property free of any lien, right, title or interest of the claimant.

of more than one year to the interests of a trustee in bankruptcy, was valid provincial legislation. The SPPSA was in truth and substance legislation in relation to property and civil rights in the province within section 93(13) of the Constitution Act, 1867 and was not legislation in relation to bankruptcy under section 91(21).

The court stated that the purpose of the SPPSA was to regulate the property interest and debts of creditors in the province by the establishment of a system of priorities based upon the perfection of security interests. The purpose and function of the registration scheme was to protect third parties who acquired an interest in the goods from a person in possession, by subordinating the security interests of a person who parts with possession but fails to perfect his security interest by registration of the interest described in section 20(1). The fact that one of the persons⁶⁵ in favour of whom the security interest was subordinated was a trustee in bankruptcy did not alter the fundamental nature of the transaction. Since a trustee in bankruptcy could make use of the valid provincial legislation when administering an estate of a bankrupt, this did not taint otherwise valid provincial legislation.

The court held that the SPPSA was not rendered inoperative by reason of an operational conflict within the Bankruptcy Act. The doctrine of paramountcy only applied when valid federal and provincial legislation are in actual conflict. As a lessor did not fall within the definition of a "secured creditor" under section 2 of the Bankruptcy Act, and as the SPPSA was silent as to the rights of a lessor, there was no statutory conflict between the two Acts.

Rather than conflicting with the Bankruptcy Act, the court concluded that section 20(1)(d) of the SPPSA was an important part of the integrated scheme of federal and provincial legislation dealing with priorities and entitlement to property. A legal integration of the Bankruptcy Act and provincial laws relating to property and civil rights was not only permissible but desirable and essential. The exemption provisions of the SPPSA⁶⁶ were designed to exempt lessors who occasionally leased goods but could not be described as having made it their business. As Paccar was a large financial institution regularly engaged in financing the purchase of trucks, it was not entitled to the exemption. Finally, as C. did not have notice of the claimant's leasehold interest, the court held that Paccar's interest was

⁶⁵ This "one of the persons" argument is similar to the reasoning in *Re Hannah*, *supra*, footnote 10. It assumes that it is acceptable for provincial legislation to affect the essence of an exclusively federal area of jurisdiction as long as it does not do it in isolation, but mixes it with several other provisions which do not encroach upon federal jurisdiction. It is a fallacious argument, analogous to that of an accused polluter raising as a defence that the emissions of toxic chemicals into the river, although in excess of legal limits, should be excused because it was diluted with lots of non-toxic fresh water.

⁶⁶ Namely, s. 2(y)(iv).

subordinate to that of C. Again, this case would appear to have been wrongly decided, as detailed examination below will show.

A recent Saskatchewan case, *Re Passmore*,⁶⁷ relies upon *Paccar* to declare that section 20(1)(d) of the SPPSA is neither *ultra vires* nor in operational conflict with federal bankruptcy legislation. In this case the trustee in bankruptcy sought an order that its interest took priority over the creditor's unperfected personal property interest. The creditor's interest was acquired prior to, but registered subsequent to, the assignment in bankruptcy. The court, following the Saskatchewan Court of Appeal's decision in *Paccar*, rejected the argument that section 20(1)(d) was inoperative because it allegedly dismissed the rights given to secured creditors under the Bankruptcy Act. The court noted:⁶⁸

It was determined in *Paccar* ... that there was no operational conflict between s. 20(1)(d) and the distribution scheme of the Bankruptcy Act. The court noted the Bankruptcy Act preserves the rights of secured creditors but does not define the rights of the creditors in collateral. This was left to provincial legislation such as the Personal Property Security Act.

In view of the comments in ... [*Paccar*], I cannot accede to the ... argument that a constitutional conflict exists. The comments cannot be disregarded merely because the creditor in that case was found not to be a secured creditor under the Bankruptcy Act.

The significance of *Passmore* is its failure to refer to the Supreme Court of Canada decisions in *FBDB* and *Henfrey*, two judgments which disagree with the earlier jurisprudence. It shows, as does *Re Hannah*, that a problem exists. The absolute reliance upon *Paccar* ignores the fact that after *FBDB* and *Henfrey*, *Paccar* is probably no longer good law.

C. The "British Columbia" Line of Cases

In contrast with the Ontario line of decisions, British Columbia courts adopted the opposite and, now, clearly the correct view. This line of cases begins with *Re Kinross Mortgage Corporation and Bushell* ("*Kinross*")⁶⁹ and culminates in the Supreme Court of Canada decision in *Henfrey*.

The mortgagor in *Kinross*, who was an employer under the Workers' Compensation Act,⁷⁰ became bankrupt. It was the Workers' Compensation Board's ("WCB") position that by virtue of its lien it was a "secured creditor" under section 136 of the Bankruptcy Act. *Kinross* argued that the WCB was not a secured creditor and that section 136 determined the priority scheme. The trial court found that the WCB's lien ranked in priority to the *Kinross*' mortgage. *Kinross* appealed.

⁶⁷ (1990), 79 C.B.R. (N.S.) 306 (Sask. Q.B.).

⁶⁸ *Ibid.*, at pp. 307-308.

⁶⁹ *Supra*, footnote 53.

⁷⁰ R.S.B.C. 1979, c. 437.

The Court of Appeal allowed the appeal, holding that the WCB was not entitled to rank in priority because the WCB's lien was of no effect, since a statutory lien created by provincial legislation ceased to be valid upon bankruptcy.

In concluding that the WCB was not a secured creditor the Court of Appeal relied upon the then recent Supreme Court of Canada decision in *Rainville* as well as the Nova Scotia trial decision in *Re Black Forest Restaurants Ltd.*⁷¹ From this latter decision the court quoted with approval the following passages:⁷²

Any lien or charge created by provincial legislation in the case of such claims is valid and effective so long as the debtor is not a bankrupt, but ceases to be valid and effective when bankruptcy occurs with the result that the claimant ceases to be a secured creditor, except to the extent permitted by the provisions of any of paragraphs. (a) to (i) of s. 107(1) [now s. 136(1)] . . .

The result, in my opinion, is that, so long as there is no bankruptcy, full effect must be given to statutory provisions such as those contained in the *Labour Standards Code* of this province and in the *Workers' Compensation Act* of this province. . . . However, when bankruptcy occurs, the provisions of s. 107 of the *Bankruptcy Act* take effect and the scheme of distribution of the property of the bankrupt coming into the hands of the trustee must be followed. The statutory liens and charges, to the extent to which they are affected by the provisions of s. 107, cease to be of any force and effect.

The Supreme Court of Canada confirmed this position in *Deloitte Haskins*.

In the second British Columbia case, *Coopers & Lybrand v. R. in Right of Canada*,⁷³ the trustee in bankruptcy applied for directions for distribution of moneys collected or withheld under taxation, pension and unemployment insurance statutes.

The British Columbia Supreme Court held that section 136 of the Bankruptcy Act prevailed whenever there was a conflict between the policies behind the rankings and the provisions which purported to give the Crown claims a higher priority by creating deemed trust obligations. Hence, deemed trust obligations were to be ignored in distribution of assets, unless the statute creating the obligation was enacted after, and contained a specific reference to section 136.

The third decision, *Re Rachnagel*,⁷⁴ concerned the ranking of the British Columbia Board of Industrial Relations for wages owing under the Payment of Wages Act, 1962.⁷⁵ The British Columbia Supreme Court, relying upon *Rainville* and *Director of Labour Standards*, held:⁷⁶

⁷¹ *Supra*, footnote 50.

⁷² *Supra*, footnote 53, at pp. 743 (D.L.R.), 4-5 (C.B.R.), quoting *Re Black Forest Restaurants Ltd.*, *supra*, footnote 50, at pp. 446, 448 (D.L.R.), 190, 192 (C.B.R.) (N.S.S.C.).

⁷³ (1982), 41 C.B.R. (N.S.) 188 (B.C.S.C.).

⁷⁴ *Supra*, footnote 53.

⁷⁵ S.B.C. 1962, c. 45. Now the Employment Standards Act, B.C. 1980, c. 101.

⁷⁶ *Supra*, footnote 53, at p. 139.

It is my view that this appeal must fail on the ground that the province of British Columbia cannot competently legislate to convert the claims of unsecured creditors into a claim of a creditor having a priority under s. 107(1)(j). As authority for my view I refer to ... [Rainville] ... and to the following passage from the judgment of Jones J.A. in [*Re Black Forest Restaurants Ltd.*]:⁷⁷

... Mr. Justice Pigeon made it abundantly clear that priorities of provincial claims must be determined in accordance with s. 107(1) [now s. 136] of the Bankruptcy Act notwithstanding any statutory preference to the contrary. ... With deference, it is not open to the province to provide any higher or more extensive priority for wages in view of the express provisions contained in that clause. It is clear from *Rainville* that the provincial Crown cannot claim as a secured creditor under the Bankruptcy Act, notwithstanding the form of the provincial legislation, where the claim is governed by s. 107(1) of the Bankruptcy Act.

Thus, unlike the Ontario courts and those in Saskatchewan, which have resisted this approach, the British Columbia courts readily accepted at an early date the result which the Supreme Court of Canada has decreed as the choice.

D. *The Bank Act Analogy*

The need for a national policy on bankruptcy can be seen from the analogous situation in banking. Under sections 91(15) and 91(16) of the Constitution Act, 1867, the federal Parliament has exclusive jurisdiction over "Banking, Incorporation of Banks, and the Issuing of Paper Money", and "Saving Banks", respectively.

A recent judgment of the Supreme Court of Canada, *Bank of Montreal v. Hall*,⁷⁸ involved a conflict between provincial legislation designed to assist farmers having difficulty making payments to their lenders⁷⁹ and section 178 of the Bank Act.⁸⁰ The provincial legislation required judicial approval prior to seizure of security, while no such condition was required under section 178. The issue was whether the bank was required to comply with the provisions of the provincial act when enforcing its security interest created under federal law. The Supreme Court of Canada held, first, that neither the provincial nor the federal legislation was *ultra vires*, both being valid legislation within their constitutional spheres; and, second, that the provincial legislation is inapplicable to a security taken pursuant to the federal Act. The reasoning of the court in the *Hall* case is interesting because of its parallel to the bankruptcy context.

The court held that the federal banking power authorizes Parliament to create a particular form of security and, thus, to design, in a comprehensive and exclusive manner, the rights and obligations of the borrower and the

⁷⁷ *Supra*, footnote 50, at pp. 422 (D.L.R.), 260 (C.B.R.) (N.S. App. Div.).

⁷⁸ [1990] 1 S.C.R. 121, (1990), 65 D.L.R. (4th) 361 ("*Hall*").

⁷⁹ Limitation of Civil Rights Act, R.S.S. 1978, c. 1-16, ss. 19-236.

⁸⁰ Now see Bank Act R.S.C. 1985, c. B-1.

lender. Accordingly, the rights, duties and obligations of both the creditor and the debtor are to be determined solely by reference to the Bank Act.

The court expressly recognized that there can be no hermetic division between banking as a generic activity and the scope of the power covered by the phrase "property and civil rights". An overlap is inevitable. The fact that a particular aspect of banking legislation inevitably will have an impact on property and civil rights in the provinces does not lead to the conclusion that the federal legislation is *ultra vires*. As a result of the actual conflict in operation between the provincial and federal legislation, the provincial legislation becomes "inoperative" in the case of security taken under the federal Act. In describing the conflict, La Forest J. wrote:⁸¹

The focus of the inquiry, rather, must be on the broader question whether operation of the provincial act is compatible with the federal legislative purpose. Absent this compatibility, dual compliance is impossible. Such is the case here. The two statutes differ to such a degree in the approach taken to the problem of realization that the provincial cannot substitute for the federal . . .

At the end of the day, I agree with counsel for the Attorney General of Canada that this is simply a case where Parliament, under its power to regulate banking, has enacted a complete code that at once defines and provides for the realization of a security interest. There is no room left for the operation of the provincial legislation and that legislation should, accordingly, be construed as inapplicable to the extent that it trenches on valid federal banking legislation.

E. *The Bell Canada Case*

Another non-bankruptcy decision of the Supreme Court of Canada should be noted because it reaffirms that provincial law must not affect an exclusively federal jurisdiction. Only a small part of Beetz J.'s long judgment in *Bell Canada v. Québec (Commission de la santé et de la sécurité du travail)*⁸² is relevant to this article. Neither the facts nor the lengthy reasoning is directly on point. However, one of the most important reasons for the court's arriving at the conclusion it did is in setting a threshold for holding provincial legislation inoperative in the event of inconsistency with the valid provisions of a federal statute. Where Parliament has exclusive (as opposed to concurrent) power, provincial legislation cannot even *affect* federal legislation. In other words, merely to affect it is to conflict with it.⁸³

II. *The Constitutional Position of PPSA Legislation*

A. *The Present Position*

The Constitution Act, 1867, gave exclusive legislative authority to Parliament to legislate in relation to "Bankruptcy and Insolvency".⁸⁴

⁸¹ *Supra*, footnote 78, at pp. 155 (S.C.R.), 386 (D.L.R.).

⁸² [1988] 1 S.C.R. 749, (1988), 51 D.L.R. (4th) 161 ("*Bell Canada*").

⁸³ *Ibid.*, at pp. 859-860 (S.C.R.), 244-245 (D.L.R.).

⁸⁴ Section 91(21).

Notwithstanding some decisions to the contrary,⁸⁵ as a result of the Supreme Court of Canada quartet,⁸⁶ the principles of law on this point are settled.⁸⁷

Section 20(1)(b) of the Ontario PPSA⁸⁸ creates a series of sanctions for failure to perfect a security interest in accordance with the Act. One of these sanctions is to subordinate the interest of secured creditors who have not perfected their security under the PPSA to that of the trustee in bankruptcy under section 136(1) of the Bankruptcy Act. The priority granted under the federal Act is, therefore, purportedly reversed. Thus, although a party may fall within the definition of "secured creditor" in section 2 of the Bankruptcy Act, the party is purportedly relegated to a position subordinate rather than prior to the trustee in bankruptcy by virtue of section 20(1)(b) of the Ontario PPSA.

Provincial law cannot validly affect an integral part of a federal subject matter,⁸⁹ and the priority of creditors is the very essence of bankruptcy law. Bankruptcy is to be governed by a set of uniform, national rules which apply to all creditors, regardless of variations in the laws of the provinces in which the debts were incurred. Any provincial alteration in the priorities established by the Bankruptcy Act is an obvious conflict and, therefore, cannot stand. The consequences of the conflict are discussed below.

B. The Previous Position

This position, as expressed by the "Ontario" line of cases, argues that the purpose and scheme of the PPSA is to define, set up and regulate debtor/creditor relationships within the province, particularly to enable any person to check with the central registry as to the status of encumbrances and liens.⁹⁰ Within the context of this scheme, section 20 of the Ontario PPSA attempts to establish priorities: between a creditor's unperfected security interest and those who are entitled to priority under the PPSA; between persons who, without knowledge of the security interest, have

⁸⁵ *Touche Ross Ltd. v. Paccar Financial Services Ltd.*, *supra*, footnote 10; *Re Hannah*, *supra*, footnote 10; *Re Phoenix Paper Products Ltd.*, *supra*, footnote 10.

⁸⁶ *Rainville*, *supra*, footnote 8; *Deloitte Haskins*, *supra*, footnote 8; *FBDB*, *supra*, footnote 8; *Henfrey*, *supra*, footnote 8.

⁸⁷ See, *supra*, pp. 78-79 for a summary of these principles.

⁸⁸ *Supra*, footnote 6.

⁸⁹ *Bell Canada v. Québec (Commission de la santé et de la sécurité du travail)*, *supra*, footnote 82.

⁹⁰ *Bank of Nova Scotia v. International Harvester Credit Corporation* (1987), 7 P.P.S.A.C. 1, at p. 9 (Ont. H.C.), cited with approval in *Re Hannah*, *supra*, footnote 10. See also *Touche Ross Ltd. v. Paccar Financial Services Ltd.*, *supra*, footnote 10, at pp. 446 (D.L.R.), 37 (C.B.R.).

assumed control of the collateral through the legal process and those who represent the debtor's creditors as receiver, assignee or trustee in bankruptcy.

The PPSA operates regardless of bankruptcy against a whole range of creditors. It effectively indicates that the secured creditor who does not perfect his security interest ranks behind or ranks after a list of other creditors. In short, it sets out the provincial law respecting the rights of secured and unsecured creditors.

Furthermore, provincial legislation dealing with assignments and preferences by insolvent persons and dealing with priority amongst creditors had been determined to be within the competence of the provincial legislature⁹¹ where it does not directly conflict with any existing bankruptcy legislation of the federal Parliament. Such legislation is within the constitutional powers of the province as granted in section 92(13) of the Constitution Act, 1867, dealing with "property and civil rights in the province".

We have no real difficulty with respect to the goal and purpose of the PPSA. However, arguments that rely upon the general scheme of personal property security legislation are irrelevant or unresponsive to the issue because they deal with the entire PPSA, or at least all of section 20. As noted above, it is only the one small sub-clause, in Ontario, section 20(1)(b), that is in issue. Although section 20 does set out the provincial law respecting the rights of unperfected secured creditors, it also purports to govern secured creditors in a bankruptcy situation. This, the Supreme Court of Canada has held in its two most recent judgments,⁹² is not constitutionally valid.

A second argument is that section 20 on its face does not diminish the rights of a secured creditor when bankruptcy occurs. Rather, secured creditor rights are diminished because the secured creditor failed to perfect its security interest under the PPSA. The provisions of the PPSA are not "triggered" or made applicable because of the bankruptcy. They apply to a whole range of creditors, whether bankruptcy occurs or not. Indeed, the unperfected security holder who attempts to enforce his security, for example, by way of receivership or seizure, would equally be subject to the priority scheme in section 20(1) of the PPSA.⁹³

The argument that the provisions of the PPSA are not "triggered" or made applicable because of bankruptcy is irrelevant. It fails to acknowledge that if the Bankruptcy Act empowers a secured creditor to realize upon its security ahead of the creditors ranked in section 136(1) then

⁹¹ *Attorney-General of Ontario v. Attorney General for Canada*, [1894] A.C. 189, at p. 201 (P.C.); *Robinson v. Country Wide Factors Ltd.*, [1978] 1 S.C.R. 753, at pp. 794, 804-805, (1977), 72 D.L.R. (3d) 500, at pp. 528, 535-536; *Bank of Nova Scotia v. International Harvester Credit Corporation*, *supra*, footnote 90, at pp. 10-11.

⁹² *FBDB and Henfrey*, *supra*, footnote 8.

⁹³ This argument comes from *Re Hannah*, *supra*, footnote 10, at pp. 190-191.

it may do so regardless of whether it has registered and perfected under the PPSA. Hence, the argument that secured creditors' rights under the Bankruptcy Act are diminished by having failed to perfect under the PPSA is tantamount to an admission that the impugned provision is in conflict with section 136 of the Bankruptcy Act.

A third argument attempts to rely on section 72(1)⁹⁴ of the Bankruptcy Act to clarify any doubt as to the constitutionality of section 20(1) as provincial legislation in relation to property and civil rights in the province. Parliament has chosen not to prescribe a comprehensive code of secured creditor's rights but has instead delegated to the provinces the task of defining "the rights of secured creditors" by adopting by reference the laws of the province. Section 72(1) "did in fact aim at the highest possible degree of legal integration of federal and provincial laws".⁹⁵ Accordingly, as the argument goes, the creation of relative and competing "rights" of secured creditors was acknowledged by the federal Parliament in the Bankruptcy Act itself as properly falling within the provincial power over property and civil rights in the province.

This was the position taken in *Robinson v. Country Wide Factors Ltd.*,⁹⁶ a decision which continues to be relied upon by trustees in bankruptcy. In that case, the bankrupt sold its stock-in-trade to a creditor, giving a debenture for the remaining indebtedness. The debenture was registered. The trustee in bankruptcy initiated proceedings to set aside the transaction under the Fraudulent Preferences Act,⁹⁷ a provincial statute. The Supreme Court of Canada faced two issues on appeal from the Saskatchewan Court of Appeal: first, did the transaction constitute a preference, and, second, whether the provisions of the provincial statute were *ultra vires*.

In dealing with the constitutional issue, Laskin C.J.C., in dissent, reiterated that an exclusive federal power such as "Bankruptcy and Insolvency" remains a power confined to Parliament.⁹⁸

If it is for Parliament alone to deal with insolvency, indeed to define it where it chooses to do so and to leave it otherwise to judicial definition, there can be no argument about unlawful invasion of provincial power in relation to property and civil rights. A limitation upon such power necessarily inheres to the federal catalogue of powers in s. 91....

In fact, the Bankruptcy Act defines secured creditors leaving no doubt as to Parliament's intention. However laudable a legislature's motives, it may not satisfy them by encroaching upon a field not available to it.

⁹⁴ The text of this provision is found *supra*, footnote 60.

⁹⁵ *Robinson v. Country Wide Factors Ltd.*, *supra*, footnote 91, at pp. 809 (S.C.R.), 539 (D.L.R.) (per Beetz J.).

⁹⁶ *Ibid.*

⁹⁷ R.S.S. 1965, c. 397.

⁹⁸ *Supra*, footnote 91, at pp. 761 (S.C.R.), 504 (D.L.R.).

The majority decision, written by Spence J., determined that the provisions of the Bankruptcy Act⁹⁹ did not supersede provincial legislation unless the latter directly conflicted with federal legislation. In fact, Spence J. held that Parliament left the criteria for setting aside fraudulent transactions to provincial competence, independently of the Bankruptcy Act. It is noteworthy that *Robinson* was a 5:4 decision. Today, it is clear that the view of the minority has prevailed.

An argument that relies upon section 72(1) of the Bankruptcy Act is circular. The trustee under that subsection is entitled to avail himself only of such rights and remedies as are supplementary to the rights and remedies provided by the Bankruptcy Act, and "are not in conflict with this Act". Hence, section 72(1) neither adds nor subtracts anything from the constitutional validity of the impugned portion of the PPSA.

It is also an exaggeration to state that Parliament has delegated to the provinces the task of defining the "rights of secured creditors". The Supreme Court of Canada has held in *FBDB* and *Henfrey*¹⁰⁰ that the provinces' power to define the rights of secured creditors is valid only up to the point of bankruptcy, after which the provisions of the Bankruptcy Act provide a complete code. Otherwise there could be a different scheme in every jurisdiction; ten different bankruptcy regimes would make ordinary commercial affairs extremely complex, unwieldy and costly, not only for Canadians but also for our international trading partners.

Finally, an argument that a provincial legislative provision which, on its face, reduces the interest of a trustee in bankruptcy or a receiver is not legislation in relation to bankruptcy and insolvency is incomprehensible.

Austin J. in *Re Hannah*¹⁰¹ correctly concluded that section 22(1)(a)(iii) (now section 20(a)(b)) of the Ontario PPSA was not in essence bankruptcy legislation. Rather, he found the inclusion of the trustee in bankruptcy to be incidental to legitimate attempts by the provinces to spell out the consequences, in relation to a range of persons or interests, of a failure to perfect a security interest. This provision was not, in his view, "in pith and substance" legislation in relation to bankruptcy and insolvency. That view¹⁰² was possible up until *Re Phoenix Paper Products Ltd.*¹⁰³ but not thereafter because of *Deloitte Haskins*, as shown in *Henfrey*.¹⁰⁴

⁹⁹ R.S.C. 1985, c. B-3, ss. 72 and 95 (formerly R.S.C. 1970, c. B-3, ss. 50 and 73, respectively).

¹⁰⁰ *Supra*, footnote 8.

¹⁰¹ *Supra*, footnote 10.

¹⁰² See also *Touche Ross Ltd. v. Paccar Financial Services Ltd.*, *supra*, footnote 10.

¹⁰³ *Supra*, footnote 10.

¹⁰⁴ *Supra*, footnote 8.

The law, in our opinion, is settled by these four judgments of the Supreme Court of Canada. In all four cases the issues were not whether the provinces could directly and blatantly attempt to alter the scheme of interests of secured and other creditors under what is now section 136(1) of the Bankruptcy Act. Rather, the issue was whether a province could indirectly influence priorities under the Bankruptcy Act. Even in this weaker version of influence, the Supreme Court of Canada has held that the provinces could not. The impugned subclause of the PPSA is, if anything, an even stronger situation in that it overtly mentions the trustee in bankruptcy. To reverse the usual cliché, provinces certainly cannot do directly what they cannot do indirectly.

Conclusion

This article discussed the reasons why section 20(1)(b) of the Ontario PPSA and its counterparts are *ultra vires*. It is a simple argument: the Bankruptcy Act, as federal legislation under section 91(21) of the Constitution Act, 1867, gives exclusive legislative authority over bankruptcy and insolvency to Parliament. The provinces cannot determine priorities in bankruptcy situations, nor change the scheme of distribution established by Parliament under section 136(1). Therefore, once bankruptcy has occurred the federal legislation prevails. Otherwise, the provinces could create up to ten different schemes of distribution, leading to complex and costly commercial law regimes.

The justifications in the quartet of the Supreme Court of Canada cases are broader than merely invalidating provincially created trusts or security interests which conflict with the Bankruptcy Act. Rather, these cases establish important principles of constitutional and bankruptcy law which are generally applicable to the intersection of the Bankruptcy Act and provincial security law, namely: (1) that provinces cannot change the scheme of distribution under section 136(1); (2) once bankruptcy has occurred it is section 136(1) which determines the status and priority of claims dealt with in the subsection and not provincial law; (3) the possibility of a differential scheme of distribution of bankruptcy from province to province is unacceptable; and (4) the provinces cannot dictate to Parliament how general terms (such as "trust" or "secured creditor") should be defined for purposes of the Bankruptcy Act.

It is noteworthy that the word "trust", in issue in *Henfrey*,¹⁰⁵ is not defined in section 2 of the Bankruptcy Act, whereas the term "secured creditor" is. Therefore, rather than distinguishing the trust cases, courts should recognize that section 20(1)(d) of the Ontario PPSA and its counterparts in other provinces to be even stronger instances of provincial

¹⁰⁵ *Ibid.*

attempts to do what the Supreme Court of Canada says cannot be done: to legislate, for bankruptcy purposes, a provincial definition of a term already defined differently in the Bankruptcy Act.

It is also incorrect to state that in all four cases the provinces attempted to redistribute or change priorities by explicitly elevating one of the lower ranked claims to a higher rank. As seen from an examination of the dissenting judgments in *Deloitte Haskins* and *Henfrey*,¹⁰⁶ the provinces were not attempting specifically to target the bankruptcy situation but, rather, to create a general priority. Although it is true that the result in those cases was of benefit to the provincial Crown, no principled distinction can be made between the quartet and the PPSA on that ground. The provinces cannot alter or affect federal priorities in a bankruptcy situation because to do so would create different regimes across Canada. It makes no difference whether the provincial purpose is to enrich the Crown itself, or any other purpose. It is time to acknowledge that the battle was lost: the war is over.

¹⁰⁶ *Ibid.*