

## THE SUPREME COURT, COMMERCE AND THE CONSUMER: MAKING THE MOST OF LIMITED OPPORTUNITIES

Ronald C.C. Cuming\*  
Saskatoon

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*In this essay, Professor Cuming examines three related areas of commercial law that have been influenced by decisions of the Supreme Court of Canada: secured financing law, Crown priorities and bankruptcy law. Major public policy choices made by the Court when interpreting provincial and federal legislation are noted. He concludes that the Court has had a very positive effect on the development of secured financing law. In his opinion, the Court's practice of "reading down" statutory provisions designed to subordinate prior in rem third party interests to claims of the Crown should cause legislators to approach tax collection in less detrimental ways. According to the author the Court's record in dealing with important bankruptcy issues is mixed. He applauds the Court's approach to the protection of non-corporate bankrupts through rejection of the concept of self-settlement. However, when it comes to the Court's application of section 136 of the Bankruptcy and Insolvency Act, Professor Cuming is less supportive. He questions why the very constructive approach employed by the Court when addressing the interface between the federal legislation and provincial personal property security laws was not applied where secured creditors of bankrupt debtors employ section 136 to circumvent provincial legislation designed to protect unpaid former employees of bankrupt organizations or crucial provincial revenue sources.*

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*Le professeur Cuming examine trois domaines du droit commercial qui sont reliés entre eux et qui ont été influencés par des décisions de la Cour suprême du Canada: le financement au moyen de sûretés réelles, les créances prioritaires de la Couronne, et le droit de la faillite. L'auteur relève que la Cour a effectué des choix politiques importants dans l'interprétation des législations provinciales et fédérales. Il conclut que la Cour a eu un effet très positif sur le développement du droit des sûretés réelles en matière de financement. D'après lui, la pratique de la Cour de réduire la portée de dispositions législatives visant à subordonner les intérêts prioritaires in rem des tiers aux créances de la Couronne devrait avoir pour conséquence que les législateurs auront à l'avenir une approche moins préjudiciable de la perception des impôts. Selon le professeur Cuming, le bilan des décisions de la Cour concernant d'importantes questions de faillite est mixte. Il applaudit à l'approche qu'a prise la Cour de la protection des faillis non corporatifs en rejetant le concept d'«auto-règlement». Toutefois, quand il s'agit de l'application de l'article 136 de la Loi sur la faillite et l'insolvabilité, le professeur Cuming est moins élogieux. Il s'interroge sur les raisons pour lesquelles la méthode d'interprétation élaborée que la Cour a employée en examinant l'interface entre la Loi sur la faillite et l'insolvabilité et la législation provinciale sur les sûretés réelles mobilières n'a pas été aussi employée par la Cour lorsque*

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\* Ronald C.C. Cumming, of the Faculty of Law, University of Saskatchewan, Saskatoon, Saskatchewan.

*des créanciers garantis utilisent l'article 136 pour contourner les lois provinciales destinées à protéger les anciens employés impayés du failli ou des sources provinciales de revenus qui sont cruciales.*

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### *I. Introduction - Scope of the Presentation*

The term “commerce” or more specifically, “commercial law” is very broad. It encompasses a wide spectrum of matters from A (agency) to W (winding-up). Within this spectrum are large and important areas such as contract law, corporation law, consumer protection law, secured financing law, bankruptcy law, insurance law and property law. Constraints of time and competence, not to mention the desire to do more than to make some superficial observations on a large number of areas, dictated that only a few decisions of the Court affecting a small number of areas of commercial and consumer law can be addressed. The need to find an approach that was not too broad and not too narrow has resulted in a presentation that, in some respects, is eclectic but not completely random with respect to the areas examined. It is eclectic in that it addresses a few areas of law that are only tangentially related so far as subject-matter is concerned. However, the areas do have features in common. In the first place, they all deal with aspects of commercial activity that fall within the theme, The Supreme Court and The Regulatory State, in that they are directly affected by elaborate statutory schemes. Secondly, constitutional issues are endemic to most of the areas chosen for examination. Finally, these areas all involve important policy considerations with the result that, through them, the Court has been given the opportunity to go well beyond narrow interpretation of statutory provisions and influence the course of commercial law development in Canada.

Commercial and consumer law have not provided the same opportunity as other areas, such as administrative law, criminal law, human rights and aboriginal law, for the Court to enunciate or refine fundamental policy choices.

By comparison, only a small number of cases involving commercial and consumer law have come before the Court.<sup>1</sup> While the role of the Court in the development of these areas of law has been much more limited and subtle than in the development of others, it has been significant.<sup>2</sup>

This presentation addresses on three areas of commercial law: secured financing law, taxation law and bankruptcy law. All three areas have been the focus of considerable legislative and judicial attention in recent years and are ones which have been significantly affected by decisions of the Court. The essay is an exploration of the extent to which, in the areas examined, the Court has influenced, through a single judgment or a series of judgments, the development of aspects of commercial law and consumer law by purposeful interpretation of statutory provisions, by setting new or modified legal norms, by providing or seeking to provide a functional interface between federal and provincial law or by implicitly pointing to the need for legislative measures to address deficiencies in existing law.

The bulk of this work contains comments on decisions of the Court handed down after the elimination of dollar amounts as the principal basis for the Court's appellate jurisdiction. This is not to say that prior to this change the Court viewed its role narrowly. There are instances referred to in the essay in which the Court took the opportunity to go beyond *ad hoc* application of statutory provisions or established principles of common law. However, they are few. The change in jurisdiction signalled a new era in which the Court is able to select for hearing those cases in which important issues of broad significance are involved.

## II. *The Role of the Court in the Development of Canadian Secured Financing Law*

### A. *The Early Years*

Canadian provincial and territorial secured financing law is as highly developed as any in the world. There is nothing equivalent to it in the United Kingdom or any Commonwealth country except in New Zealand.<sup>3</sup> Few civil

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<sup>1</sup> The small volume of commercial law cases coming before the Court is reflected in the paucity of analysis of commercial law decisions in the Supreme Court Law Review. A survey of all 23 volumes of the Review (1980-2000) reveals only one year (1995 - Volume 6, 2nd series) in which there was an item in the table of contents: Developments in Commercial and Corporate Law. Admittedly, some commercial law cases are addressed under the heading: Developments in Contract Law, which appears in nearly all of the volumes.

<sup>2</sup> For a very brief criticism of what the authors assert is the Court's reluctance to take cases in commercial law, and the consequences of the Court's decision to "essentially vacate" a role in the development of this area of the law, see R. Corley & M. Disney, "Developments in Corporate and Commercial Law: The 1993-94 Term" (1995), 6 Sup.Ct.L.R. (2d) 127 at 205.

<sup>3</sup> The New Zealand *Personal Property Securities Act 1999* No. 126 was substantially copied from the Saskatchewan *Personal Property Security Act, 1993*, R.S.S. 1978, c. P-6.1.

law jurisdictions have anything equivalent to the hypothec on movable property contained in Book Six of the *Québec Civil Code*.<sup>4</sup> This is not just an accident of history. It is the product of several factors including progressively-minded legislators and the early and consistent recognition by the Supreme Court of the importance of secured financing law to the economic development of Canada. There are three central features of this law that underpin its efficacy: its conceptual unity, the extent to which it facilitates secured financing involving transient commercial assets such as inventory and accounts, and the central role of public disclosure of charges against property principally through registration. In its judgments, the Supreme Court has consistently recognized the importance of these features.

Colonial and provincial legislators in common law jurisdictions in Canada displayed early on not only a readiness to modify the common law in order to accommodate local needs, but, as well, a reluctance to adopt unquestioningly English legislation dealing with transactions providing for security interests in personal property.<sup>5</sup> In 1849 the Legislative Assembly of the Province of Canada enacted legislation requiring the filing of chattel mortgages. Equivalent legislation was not passed by the English Parliament until 1854.<sup>6</sup> The 1849 statute demonstrates that the use of chattel mortgages was sufficiently common at that time to cause problems for unsecured creditors and persons buying or taking mortgages on goods in the hands of mortgagors.<sup>7</sup> During the last half of the 19th century, chattel mortgage legislation was frequently amended so as to encompass the increasing variety of situations in which chattel mortgages were being used as security devices.

The first opportunity for the Supreme Court of Canada to address specifically the use of chattel mortgages in the context of inventory financing<sup>8</sup> was in the 1888 decision of *Dedrick v. Ashdown*.<sup>9</sup> One of the issues before the Court

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<sup>4</sup> *An Act respecting the Implementation of the Reform of the Civil Code*, S.Q. 1992, c. 57, ss. 134, 520, 642-655.

<sup>5</sup> The restrictions on the use of chattel mortgages contained in the 1882 English *Bills of Sale Amendment Act*, 1882 (U.K.), 45 & 46 Vict., c.36, were not copied in Canada.

<sup>6</sup> *Bills of Sale Act*, 1854 (U.K.), 17 & 18 Vict., c. 36.

<sup>7</sup> See R. Risk, "The Golden Age: The Law About the Market in Nineteenth-Century Ontario" (1976) 26 U.T.L.J. 307 at 331. The case law demonstrates that as early as the 1850's chattel mortgages were commonly taken on household furnishings, farm livestock and crops to secure what now would be categorized as personal or farm loans. See e.g. *Beaty v. Fowler* (1853), 10 U.C.Q.B. 382. Even before the use of equitable mortgages on after-acquired property had been sanctioned by the courts, chattel mortgages played a role in business financial arrangements to secure credit obtained by primary producers, small manufacturers and retailers. The collateral involved included both fixed business assets and stock-in-trade. *Squair v. Fortune*, (1859), 18 U.C.Q.B. 547; *Railway Co. The Grand Trunk v. Lees* (1860), 9 U.C.C.P. 249; *Closter v. Headley* (1855), 12 U.C.Q.B. 364; *Ross v. Conger* (1857), 14 U.C.Q.B. 525.

<sup>8</sup> Three years earlier the Court gave a broad and flexible interpretation of the collateral description requirements of chattel mortgage legislation. See *McCall v. Wolff* (1885), 13 S.C.R. 130. See also *Hovey v. Whiting* (1887), 14 S.C.R. 515; *Thomson v. Quirk* (1889), 18 S.C.R. 695 (appendix) and *Royal Bank of Canada v. MacKenzie*, [1932] S.C.R. 524.

<sup>9</sup> (1888), 15 S.C.R. 227 at 244.

was whether a lender holding a chattel mortgage on inventory could treat the mortgage agreement as being in default when the mortgagor sold some of the inventory in the ordinary course of business. The mortgage contained a clause providing that the inventory could not be sold without the written consent of the mortgagee. Some of it was sold without this consent and the mortgagee caused the mortgage property to be seized. In giving the majority judgment of the Court, Gwynne J. displayed an understanding of the growing importance of the secured inventory financing to the economy of his time. In his judgment he took special note of the need to recognize that mortgages should not be interpreted so as to paralyse the business of mortgagors. The law should recognize the object and intent of the parties to a mortgage on stock-in-trade to allow the mortgagor to sell the inventory in the ordinary course of business without this resulting in a default.<sup>10</sup>

The same policy-oriented approach was taken by the Court in the 1895 decision in *Clarkson v. McMaster*.<sup>11</sup> In this case, the Court determined the scope of section 2 of the 1887 Ontario *Chattel Mortgage Act*<sup>12</sup> which provided that an unregistered mortgage was "void as against creditors." The issue was whether these words referred to simple contract creditors or to execution creditors. The Court concluded that, as a matter of public policy, a liberal interpretation should be given to the statute and that an unregistered mortgage should be "void" against ordinary creditors. Strong C.J. concluded that registration was intended for the protection of both prior and subsequent creditors not just those who happen to have a judgment at the date of registrations.<sup>13</sup>

By the beginning of the Twentieth Century, floating charges had come into common use as a method of securing corporate obligations. What made this form of security unusual was that it purported to be a non-specific charge frequently covering all of the "undertaking" of the corporate debtor and not a fixed mortgage on specific chattels or types of chattels owned by it. There appears to have been a great deal of uncertainty in the minds of Canadian legislators during this period as to how to deal with the registration of floating charges. Some provinces were prepared to accept the conclusion that floating charges were not within the scope of chattel mortgage registration provisions. They required that copies of corporation mortgages and charges securing bonds

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<sup>10</sup> *ibid.*, especially at 244-246. An interesting feature of the case was the willingness of the Court to recognize the possibility of having a fixed equitable mortgage on stock-in-trade. This is not possible under English law. The floating charge is the only mechanism available in England and several other Commonwealth jurisdictions for taking a security interest in inventory the debtor is free to sell in the ordinary course of business. Whether or not this feature of English law had been adopted in Canada was debated by the British Columbia Court of Appeal in *The Queen in the Right of British Columbia v. Federal Business Development Bank* (1987), 43 D.L.R. (4th) 188. The majority of the Court concluded that it had. No reference was made in the decision to *Dedrick v. Ashdown*. A contrary view was taken by the Alberta Court of Appeal in *Toronto-Dominion Bank v. Hayworth Equipment Sales Ltd. and Commerce-UD Inc.* (1987), 35 D.L.R. (4th) 413.

<sup>11</sup> (1896), 25 S.C.R. 96.

<sup>12</sup> 55 Vict, c. 26 (Ont).

<sup>13</sup> *Supra*, note 11 at 101-02.

and debentures or other securities be filed in the office of the provincial secretary or registrar of companies. This was not an effective measure since failure to comply with the registration requirements did not affect the validity or enforceability of the mortgages or charges.

In 1909, the Ontario Court of Appeal in *Johnston v. Wade*<sup>14</sup> ruled that floating charges were not within the scope of the Ontario *Bills of Sale Act*. The effect of the decision was to exempt floating charges from any effective registration requirements in Ontario. However, in 1927, this conclusion was reversed by the Supreme Court of Canada in *Gordon Mackay & Co. Ltd. v. J.A. Larocque Limited*.<sup>15</sup> The short term implications of the judgment were viewed by some with alarm. In his dissenting judgment, Chief Justice Anglin concluded that the effect of the decision was that "debentures running into many millions of dollars are probably secured today throughout Ontario by covering conveyances in the nature of floating charges which are invalid for want of registration . . ." <sup>16</sup> However, the majority of the Court took a broader view of the matter concluding that there was no good policy reason why floating charges should not be subject to effective public disclosure like other security interests. The law of Canadian common law jurisdictions was well on its way to providing full accommodation for very flexible security devices while at the same time protecting third parties from the dangers of undisclosed interests held by secured creditors. If it was difficult to accommodate floating charges to the requirements of chattel mortgage registration requirements, the solution was to be legislative not judicial. In the same year, the Ontario *Bills of Sale Act* was amended to make specific provision for registration of all types of mortgages or charges securing bonds and debentures.<sup>17</sup>

## B. A Uniquely Canadian Pre-Seizure Notice Rule

Perhaps the most controversial contribution of the Supreme Court of Canada to the development of a uniquely Canadian secured financing law came many years later in the 1982 decision in *Lister (R.E.) Ltd. v. Dunlop Canada Ltd.*<sup>18</sup> In this case, Estey J., speaking for the unanimous Court, enunciated what to the Court was a simple proposition: a debtor must be given reasonable notice of a secured creditor's intention to enforce a security interest on which he or she might reasonably be expected to be able to act.<sup>19</sup> The policy basis of the proposition is the importance

<sup>14</sup> (1908), 17 O.L.R. 372 (C.A.).

<sup>15</sup> [1927] S.C.R. 374.

<sup>16</sup> *Ibid.* at 383.

<sup>17</sup> S.O. 1927, c. 41. The pattern for further legislative developments in this area was provided by the Saskatchewan *Corporation Securities Registration Act*, enacted in 1930. See S.S. 1930, c. 76. In 1931, the Conference of Commissioners on Uniformity of Legislation recommended a Uniform Corporation Securities Registration Act containing provisions very similar to those of the 1930 Saskatchewan Act. The Uniform Act was ultimately adopted in six jurisdictions, including Ontario.

<sup>18</sup> [1982] 1 S.C.R. 726.

<sup>19</sup> *Ibid.* at 746.

of protecting defaulting debtors from loss resulting from unexpected or commercially unwarranted seizure of assets. The problem of peremptory seizure is particularly acute where business assets are involved since seizure generally results in termination of the business and the loss of its going-concern value. Seven years later in *Houle v. Canadian National Bank*<sup>20</sup> the Court recognized a very similar principle in Québec law based on the civil law concept of abuse of contractual rights.

There can be little doubt that the *Lister* principle is much more than an application of the English cases that Estey J. cited<sup>21</sup> as support for it.<sup>22</sup> It established a new "reasonable notice" principle for enforcing security interests which significantly limits the ability of secured lenders to take full advantage of the often more powerful position they occupy in lender-borrower relationships.<sup>23</sup> However, the decision simply planted the seed. The full flowering of the principle came through the large number of subsequent cases in lower courts<sup>24</sup> where it has been applied. Of particular significance in this respect are the decision of the Ontario Court of Appeal in *Kavcar Investments v. Aetna Financial Services Ltd.*<sup>25</sup>

<sup>20</sup> [1990] 3 S.C.R. 122.

<sup>21</sup> *Massey v. Staden* (1868), L.R. 4 Ex. 13; *Toms v. Wilson* (1863), 4 B. & S. 442; and *Moore v. Shelly* (1883), 8 App. Cas. 285 (P.C.).

<sup>22</sup> In *Bank of Baroda v. Panessar*, [1986] 3 All E.R. 751 (Ch.D.), the Court implicitly criticized the decision in *Lister* as failing to follow the "mechanics of payment" rule set out in *Cripps (Pharmaceuticals) Ltd. v. Wickenden*, [1973] 2 All E.R. 606 (Ch.D.), under which the debtor need not be given more than a reasonable period of time to access his or her sources of money to pay the debt.

<sup>23</sup> The decision elicited a large body of academic and practitioner commentary and analysis. See e.g. K. Doerksen & M. Rudoff, "Business Issues: Reconsidering *Lister v. Dunlop*" (1989) 53 Sask. L. Rev. 263; L. Lalonde, "Reasonable Notice and Abuse of Contractual Rights" (1992) 8 B.F.L.R. 105; R.G. Marantz, "Reasonable Notice: The Elusive Shrinking Concept" (1990) 6 B.F.L.R. 106; P. Alinec, "Notice Requirements under Debentures" (1989) 4 Nat. Creditor/Debtor Rev. 73; M. Fera, "The New Interloper in Mortgage Remedies: Notice of Intention to Enforce Security" (1993) 21 C.B.R. (3d) 75; and A.B. Laidlaw, "Enforcement of Security: The Battle of the Notices" (1996) 37 C.B.R. (3d) 281.

<sup>24</sup> The Supreme Court pointedly eschewed the opportunity to provide further amplification of the principle in *Lister* when it refused leave to appeal the decision of the Ontario Court of Appeal in *Mister Broadloom Corporation (1968) Ltd. v. Bank of Montreal* (1983), 4 D.L.R. (4th) 74. However, in 1990, the Court extended the principle to Québec law in *Houle v. Canadian National Bank*, *supra* note 20. See also *Pax Management Ltd. v. Canadian Imperial Bank of Commerce*, [1992] 2 S.C.R. 998 and *Royal Bank of Canada v. W. Got & Associates Electric Ltd.*, [1999] 3 S.C.R. 408, in which the Court approved of amplification of the principle by lower courts.

<sup>25</sup> (1989), 62 D.L.R. (4th) 277 (Ont. C.A.). See also the following appeal court decisions: *Degelder Construction Co. v. Dancorp Developments Ltd.* (1996), 21 B.C.L.R. (3d) 112 (B.C. C.A.); *Marchands Unis Inc. c. Price Waterhouse Lee.*, [1996] R.R.A. 71 (C.A. Qué.); *British Columbia (Deputy Sheriff, Victoria) v. Canada* (1992), 66 B.C.L.R. (2d) 371 (B.C. C.A.); *Bank of Nova Scotia v. Dunphy Leasing Enterprises Ltd.* (1991), 83 Alta. L.R. (2d) 289 (Alta. C.A.); *Stott v. Merit Investment Corp.* (1988), 19 C.C.E.L. 68 (Ont. C.A.); *Bank of Nova Scotia v. Ham*, [1986] 5 W.W.R. 249 (Sask. C.A.); *Northern Meat Packers Ltd. v. RoyNat Ltd.* (1986), 60 C.B.R. (N.S.) 1 (N.B. C.A.); *Proud v. National Bank of Canada* (1985), 57 Nfld. & P.E.I.R. 14 (P.E.I. C.A.); *Portage Credit Union Ltd. v. D.E.R. Auctions* (1994), 18 Alta. L.R. (3d) 185 (Alta. C.A.); *Jeanette BBQ v. Caisse Populaire de Tracadie* (1991), 82 D.L.R. (4th) 548 (N.B. C.A.), leave to appeal denied.

and the decision of the British Columbia Court of Appeal in *Waldron v. Royal Bank*.<sup>26</sup> In *Kavcar* McKinley J.A., speaking for the Court, concluded that there is a notice requirement regardless of the wording of the security agreement. In *Waldron*, Lambert J.A. adopted Justice McKinlay's approach and noted that the principle applies to the "realization of all security interests where a person's property is being taken away by the security holder."<sup>27</sup> He concluded that it is an "independent rule of law about seizures"<sup>28</sup> that rests on one or both of two grounds: public policy or unconscionability. The companion principle in *Québec Civil Law* is based on the Civil Law concept of abuse of contractual rights.<sup>29</sup>

The principle of law established by the Court in *Lister* is an important adjunct to the Personal Property Security Acts of the common law provinces and territories and the security provisions of the *Bank Act*.<sup>30</sup> These systems provide protection to debtors' property interests in collateral but only after the collateral has been seized. Generally, there are no requirements for pre-seizure notices to debtors.<sup>31</sup> Section 244 of the *Bankruptcy and Insolvency Act*,<sup>31a</sup> requires a 10 day pre-enforcement notice in cases where the security interest being enforced is on all or substantially all of the inventory, accounts receivable or other property of an insolvent debtor that was acquired for or used in that person's business. However, this provision is not a codification of the *Lister-Houle* principle. The purpose of the notice and the delay in enforcing the security interest is to give time to the debtor to file a notice of intention to make a proposal as provided in section 50.4 of the *Act*. The *Lister* principle embodies the recognition that protection against the damaging effect of unjustified hasty seizure of the collateral is fundamental to Canadian secured financing law.

### C. *The Court's Approach to the Enigmatic Bank Act System for Secured Financing*

Unfortunately, not every aspect of the role of the Supreme Court in the development of Canadian secured financing law is deserving of unmitigated praise. What might be described as a blemish on the Court's record in giving enhanced efficacy to secured financing law is the 1964 decision in *Flintoft v. Royal Bank*.<sup>32</sup> Fortunately, the Court very recently addressed the most serious

<sup>26</sup> (1991), 78 D.L.R. (4th) 1.

<sup>27</sup> *Ibid.* at 4.

<sup>28</sup> *Ibid.* at 8.

<sup>29</sup> *Supra* note 20 at 142.

<sup>30</sup> R.S.C. 1985, c. B-1.01, ss. 426-429.

<sup>31</sup> The principle is less important in the context of hypothecs governed by the *Québec Civil Code*. Article 2757 of the *Code* requires a pre-seizure notice of 20 days (which can be shortened by court order) after a notice of exercise of hypothecary rights is registered in the Registry of Personal and Movable Real Rights. Further, as a result of Article 2964, forced surrender is not permitted without court order.

<sup>31a</sup> R.S.C. 1985, c. B-3.

<sup>32</sup> [1964] S.C.R. 631.

inadequacies of this decision. In *Flintoft*, the Court avoided a perfect opportunity to provide a sound conceptual basis for *Bank Act*<sup>33</sup> security interests with the result that important aspects of secured financing under the *Bank Act* until recently remained unclear and potentially disruptive to secured lending practices of both banks and other participants in secured financing markets in Canada. Many years later the Court in *Bank of Montreal v. Hall*<sup>34</sup> and *Royal Bank v. Sparrow Electric Corp.*<sup>35</sup> removed some of the conceptual uncertainty associated with this ill-defined, uniquely Canadian form of secured financing.<sup>36</sup> However, the circumstances of these cases did not present the same opportunity offered in *Flintoft* to provide guidance as to the nature and extent of a secured lender's interest in proceeds of disposition of collateral subject to a *Bank Act* security. This issue became very important with the later development of sophisticated provincial and territorial statutory systems for recognizing and regulating security interests in personal property.

In *Flintoft*, the Court concluded that accounts generated from the sale of inventory in which the bank held a *Bank Act* security did not become property of its customer's estate in bankruptcy when the security agreement provided for an assignment of the accounts to the bank and a recognition that the proceeds were to be held in trust for the bank.<sup>37</sup> What is not clear from the judgment is whether this conclusion was based on the existence of the trust clause in the agreement or on the inherent nature of this "unique form of security"<sup>38</sup> provided by the *Bank Act*.<sup>39</sup>

The distinction is very important. If a bank's interest in proceeds is viewed as an extension of its interest in the tangible collateral in which the bank holds its *Bank Act* security, the result would be that a bank would have a security interest in all proceeds of whatever kind generated from the sale of the original collateral even though the proceeds are in a form, such as intangibles, that

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<sup>33</sup> *Supra* note 30, ss. 427 *et seq.*

<sup>34</sup> [1990] 1 S.C.R. 121.

<sup>35</sup> [1997] 1 S.C.R. 411. The ratio of this decision was applied in *Credit Suisse Canada v. 1133 Yonge Street Holdings*, (1998), 114 O.A.C. 296 and *Abraham v. Canadian Admiral Corp. (Receiver and Manager of)* (1998), 109 O.A.C. 36.

<sup>36</sup> In *Sparrow Electric*, Gonthier J., speaking for the majority, concluded that a section 427 *Bank Act* security is a fixed charge over a dynamic collective of present and future assets. It is "a form of security interest" which to this extent "challenges our traditional conception of a fixed charge; to the same extent, in my opinion, our conception of this form or charge must change to meet the modern realities of commercial law, and in particular the legislative provisions which have been brought to bear in this appeal." *Ibid.* at 461. The result of this conclusion is that, in some important respects, section 427 *Bank Act* security parallels the Personal Property Security Acts.

<sup>37</sup> The Court gave no significance to the Manitoba *Assignment of Book Debts Act*, S.M. 1957, c. 4, s. 4, which provided that unregistered assignments of book debts were void against assignees' trustees in bankruptcy.

<sup>38</sup> *Supra* note 32 at 634.

<sup>39</sup> For a more expansive examination of the issues involved in *Flintoft*, see R. Cuming and R. Wood, "Compatibility of Federal and Provincial Personal Property Security Law" (1986) 65 Can. Bar Rev. 267 at 292-301.

otherwise cannot be taken as collateral under the *Bank Act*. To accept this would be to place a very significant gloss on the relevant provisions of the *Bank Act*. However, if the bank's interest in the proceeds of collateral taken under *Bank Act* security is viewed as property subject to the express trust created through the agreement with the debtor, that interest would not be one falling within the *Bank Act* but would be one governed by provincial law. In contemporary terms, it would be collateral subject to a security interest under a Personal Property Security Act. As such, the relevant registration requirements and priority rules of provincial or territorial law would apply to it.

Much of the uncertainty arising out of the *Flintoft* decision appears to have been removed through comments in the recent judgment of the Court in *Re Giffen*.<sup>40</sup> When giving the judgment of the Court, Iacobucci J. noted that the bank's interest in *Flintoft* was protected by an express trust.<sup>41</sup> It was for this reason that the debtor's trustee in bankruptcy had no right to the property in the accounts. This conclusion as to the basis of the decision in *Flintoft* carries with it some very important implications for further rational development of secured financing law in Canada. It avoids the very significant potential for a dramatic increase in conflict with provincial security interests that is endemic to the conclusion that a bank's interest in proceeds is an inherent aspect of its statutory interest. An implication of the Court's interpretation of this aspect of its decision in *Flintoft* is that a bank's interest in proceeds of *Bank Act* collateral is a security interest subject to provincial or territorial law that treats trusts as creating security interests when the purpose of the trust is to secure payment or performance of an obligation.<sup>42</sup> If banks wish to protect that interest from subordination or defeat by buyers, other secured parties, unsecured creditors or the trustee in bankruptcy,<sup>43</sup> the issue that remains outstanding is whether there is a direct conflict between section 67(1)(a) of the *Bankruptcy and Insolvency Act* and provincial law which gives to the trustee the power to subordinate a security interest in the form of trust thereby, in effect, taking for distribution among the creditors of the bankrupt property held in trust for another person.

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<sup>40</sup> [1998] 1 S.C.R. 91.

<sup>41</sup> *Ibid.* at 112-13.

<sup>42</sup> See e.g. *The Personal Property Security Act*, R.S.S. 1978, c. P-6.1, s. 3(1)(b).

<sup>43</sup> There remains the question as to whether a trust proceeds clause which, under provincial law, creates not only a security interest but also a trust, protects the bank (or any other secured creditor in a similar position) from the exercise of the powers of the debtor's trustee under provincial law to take priority over an unperfected security interest in the proceeds. While section 67(1)(a) of the *Bankruptcy and Insolvency Act* provides that the property divisible among the bankrupt's creditors does not include property held by the bankrupt in trust for any other person, this principle is no longer as important as it apparently was at the time *Flintoft* was decided. In *Re Giffen*, *supra* note 40, the Court concluded that the power given by provincial law to the trustee in bankruptcy to attack unperfected security interest was not dependent upon the extent of the interest in the bankrupt's property vesting in the trustee under section 71(2) of the *Bankruptcy and Insolvency Act*. Any interest that falls within the very broad definition of the term "property" in section 2 of the *Act* is sufficient to give the trustee standing to employ provincial powers. Presumably a trustee's ownership is sufficient for this purpose.

The resolution of this issue will depend, for the most part, on whether, by defining a trust established to secure payment or performance of an obligation as a security interest subject to a Personal Property Security Act, provincial legislatures will be seen as intending to displace trust law in this context. While the decision in *Re Giffen* might suggest that a different approach would be applied where the bankrupt is a trustee-debtor and not a lessee, the spirit of the judgment would suggest otherwise. They will have to comply with the *Bank Act* with respect to the original collateral and with the appropriate provincial regime with respect to the proceeds.<sup>44</sup> This constitutional accommodation of aspects of both federal and provincial secured financing law is very important to the further development of this area of the law. The conceptual soundness of the approach implicit in the statement of Iacobucci J. is clear, and its benefits for the commercial community are significant. The predictability and economic rationality that is provided by modern provincial and territorial secured financing law is applied to competing security interests in proceeds of original collateral subject to *Bank Act* security interests.

#### D. *A Functional Interface Between Provincial Secured Financing Law and Bankruptcy Law*

The decision of the Court in *Re Giffen*<sup>45</sup> is very important in another context. It is evidence of the Court's appreciation of the importance of recognizing a functional interface between bankruptcy law and provincial secured financing law and the importance of finding ways to ensure that, whenever possible, federal and provincial law be treated as being complementary. The issue before the Court was the effect of a provision of the British Columbia *Personal Property Security Act*<sup>46</sup> which renders "ineffective" an unregistered lease of goods against the lessee's trustee in bankruptcy. The British Columbia Court of Appeal<sup>47</sup> concluded that, since a lessee has no property interest in the leased goods,<sup>48</sup> the lessee's trustee, who gets only the property of the bankrupt under section 71(2) of the *Bankruptcy and Insolvency Act*, has no status to attack the lessor's ownership of the goods. This decision was in direct conflict with those of the Saskatchewan and Alberta Courts of Appeal<sup>49</sup> and rejected an

<sup>44</sup> See T. Buckwold, "Re *Giffen*: The *Personal Property Security Act* and the *Bankruptcy and Insolvency Act* – Peace at Last" (1999), 14 B.F.L.R. 173 at 176.

<sup>45</sup> *Supra* note 40.

<sup>46</sup> S.B.C. 1989, c. 36, s.20(b)(i), as amended 1990, c. 11, c. 25 & c. 53, s. 12; 1991, c. 13; 1992, c. 48; 1993, c. 28, s. 16. Very similar provisions are contained in the Personal Property Security Acts of all other common law jurisdictions.

<sup>47</sup> (1996), 131 D.L.R. (4th) 453.

<sup>48</sup> The Court of Appeal was not prepared to give any significance in this context to section 12 of the *Personal Property Security Act* which deems the lessee to have rights in leased goods in the possession of the lessee.

<sup>49</sup> *International Harvester Credit Corp. of Canada v. Bell's Dairy Ltd.*, [1986] 6 W.W.R. 161 (Sask. C.A.) and *David Morris Fine Cars Ltd. v. North Sky Trading Inc.* [1996] 7 W.W.R. 332 (Alta. C.A.). See also *Paccar Financial Services Ltd v. Sinco Trucking Ltd (Trustee Of)* (1989), 57 D.L.R. (4th) 438 (Sask. C.A.).

assumption that had been part of Canadian statutory secured financing law for many years.<sup>50</sup>

Confirmation of the British Columbia Court's conclusion would have produced a great deal of disruption to and anomalies in provincial and territorial secured financing law that could only be addressed through changes to federal bankruptcy law. While the case involved a lease that is deemed by the British Columbia legislation to be a security agreement, the logic of the Court of Appeal's reasoning necessarily led to the conclusion that a trustee in bankruptcy could not successfully attack an unperfected generic security interest. A security interest is an *in rem* interest and a trustee of the bankrupt debtor succeeds only to the interest of the debtor that is subject to that right. Had the approach of the British Columbia Court of Appeal prevailed, a secured party who failed to perfect his or her security interest could avoid being subordinated to an executing creditor by petitioning an insolvent debtor into bankruptcy. This would be an anomalous although, unfortunately, not unique outcome.<sup>51</sup> It would destroy the integrity that legislators have sought to incorporate in personal property security legislation from the early stages of development of secured financing law.<sup>52</sup>

The decision of the British Columbia Court of Appeal was reversed by the Supreme Court.<sup>53</sup> In giving the unanimous judgment of the Court, Iacobucci J. focussed heavily on the policy considerations involved. He concluded that the *Personal Property Security Act* must be given its "intended effect", which was to give to the trustee the power to assert unsecured creditors' status once that status is barred by invocation of bankruptcy proceedings. The power given by the *Act* to an unsecured creditor to defeat an unperfected security interest merges in the debtor's trustee in bankruptcy as a result of section 70(1) of the *Bankruptcy and Insolvency Act*. It is for this reason that the trustee is specifically identified in the *Personal Property Security Act* as having power to defeat an unperfected security interest.<sup>54</sup> The Court removed any doubt as to the power of provincial legislators to give to the trustee in bankruptcy greater rights than those held by the bankrupt at the date of bankruptcy. To do so is not to intrude into the field of federal law of bankruptcy.

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<sup>50</sup> See generally T. Buckwold and R. Cuming, "The *Personal Property Security Act* and the *Bankruptcy and Insolvency Act*: Two Solitudes or Complementary Systems?" (1997), 12 B.F.L.R. 467.

<sup>51</sup> "Priority flips" resulting from the invocation of bankruptcy proceedings are examined later in this presentation. See text accompanying note 83.

<sup>52</sup> For example, section 6 the *Bills of Sale Act*, Consol. Statutes of British Columbia, 1888, declared an unfiled bill of sale void against all assignees of the estate of a person whose goods are comprised in the bill of sale under the laws relating to bankruptcy or insolvency. Similar provisions were for many years a feature of conditional sales, bills of sale, assignment of book debt and corporation securities legislation of most common law provinces.

<sup>53</sup> *Supra* note 40.

<sup>54</sup> *Supra* note 40 at 110-11.

### III. Secured Financing Law and Crown Priorities

The effect of statutory charges and trusts on prior property interests of persons who are not obligated to the Crown is an issue that has been heavily influenced by a series of decisions of the Supreme Court. At the heart of these decisions is the balancing of competing interests: those of the Crown in its need to enforce tax and other obligations in order to protect revenues and implement public policies, and those of persons, usually secured creditors, whose property interests are affected by the enforcement of obligations owing to the Crown. While the Court has not overlooked the importance of the Crown having effective measures to enforce monetary obligations, there can be no doubt that, on balance, it has heavily favoured the recognition of third party property rights.

Two related factors have been the focus of the Court's conceptual approach to statutory provisions giving *in rem* priority rights to the Crown: the property to which the security interest attaches and the time when the security interest arises. The *locus classicus* on the interpretation of statutory provisions creating Crown charges is the Supreme Court of Canada decision in *Board of Industrial Relations v. Avco Financial Services Realty Limited*.<sup>55</sup> Martland J., giving the judgment of the Court, concluded that, in the absence of clear indication in the wording of the relevant statutory provision to the contrary, a statutory charge "should not be construed in a manner that could deprive third parties of their pre-existing property rights."<sup>56</sup> The doctrinal soundness of the approach employed by the Supreme Court in this case is inescapable. When a statutory security interest attaches to the property of the debtor, what is affected is the residual interest of the debtor remaining after all prior *in rem* interests, including security interests, are accounted for. In order to preclude this conclusion it is necessary that the legislation creating the statutory security interest expressly or by clear necessary implication provides that the security interest charges not only the property of the debtor, but as well, prior *in rem* interests of other creditors of the debtor or other classes of persons specified in the statute.

The doctrinal property law on which the anti-confiscation presumption enunciated in *Board of Industrial Relations* is based has been applied in tandem with a policy-based consideration. This is the importance of protecting the system of secured financing that has been so significant in the development of the Canadian economy. This influence was clearly enunciated by Iacobucci J. (giving judgment for the majority of the Supreme Court) in *Royal Bank of Canada v. Sparrow Electric Corp.*<sup>57</sup> The issue in the case was the efficacy of section 227(4) of the *Income Tax Act*.<sup>58</sup> He noted that broadly-based inventory security agreements are "a very common and important financing device. To a considerable extent, commerce in our country depends on the vitality of such

<sup>55</sup> [1979] 2 S.C.R. 699.

<sup>56</sup> *Ibid.* at 706.

<sup>57</sup> *Supra* note 35.

<sup>58</sup> The section was amended before the decision of the Court was released: R.S.C. 1985 (5th Supp.), c. 1, as am. by S.C. 1998, c.19, s. 226(1).

agreements... Accordingly, tinkering with security interests is a dangerous business. The risks of judicial innovation in this neighbourhood of law are considerable."<sup>59</sup> The majority decision placed significant limitations on the "licence theory" that both the majority and the minority concluded was a basis for the Crown having priority over holders of security interests arising before the obligation of the debtor to the Crown arose.<sup>60</sup> The majority view was presented by Iacobucci J., Sopinka, McLachlin and Major JJ. concurred. The majority concluded that the licence to sell inventory in the ordinary course of business was not broad enough to encompass the satisfaction of tax obligations. What the majority required for the operation of a licence under the licence theory is evidence of an expressed or implied intention on the part of the secured party to modify its security interest so as to allow the debtor to deal with the collateral in a specific way. Clearly, an influential factor in the decision was the potential effect an expansive view of the licence theory would have.<sup>61</sup> Iacobucci J. concluded that the minority position would "obliterate" charges against inventory with the result that financing would become more expensive. He noted that "if Parliament mandated this outcome, the courts must perforce accept it. However, judges should not rush to embrace such a weighty consequence unless the statutory language requiring them to do so is unequivocal."<sup>62</sup>

The decision of the Court in *Alberta (Treasury Branches) v. M.N.R.*<sup>63</sup> might induce the conclusion that the Court has not been particularly consistent in its approach to the conflicts between the interests of the Crown and those of secured creditors. The issue before the Court in this case was the scope to be given to sections 224(1.2)-(1.3) of the *Income Tax Act*<sup>64</sup> which was obviously designed to give to the Crown the power to override the property interests of secured parties holding security interests in debts owing to persons who have collected taxes (source deductions) on behalf of the Crown but have not remitted the amounts collected to the Crown. Cory J., in giving the majority judgment of the Court,<sup>65</sup> noted that the differences of opinion in lower courts as to the scope and meaning of the section demonstrated its lack of clarity. In order to arrive at

<sup>59</sup> *Supra* note 35 at 483.

<sup>60</sup> Gonthier J., with whose minority opinion La Forest and Cory JJ. concurred, concluded that, on the facts of the case, the bank had given an implied licence to the debtor to sell the inventory collateral in the ordinary course of business and to use the proceeds to pay the wages of its employees, including deductions from wages for payment of income tax. By so doing, the bank in effect consented to the statutory scheme of the *Income Tax Act* to cover unpaid wage deductions with respect to wages that had been paid to the employees.

<sup>61</sup> Gonthier J. denied that his view of the licence theory would have this effect. See *supra* note 35 at 471-73.

<sup>62</sup> *Ibid.* at 484 (S.C.R.) and 432 (D.L.R.).

<sup>63</sup> [1996] 1 S.C.R. 963.

<sup>64</sup> S.C. 1970-71-72, c. 63. Section 224 of the *Income Tax Act* was added in 1987 and supplemented in 1990 in order to respond to judicial rulings that the garnishment provisions of the Act were ineffective to give priority to the Crown over prior assignees of accounts. Very similar provisions are found in the *Excise Tax Act*, R.S.C. 1985, c. E-15, s. 317.

<sup>65</sup> La Forest and McLachlin JJ. concurred. Major and Iacobucci JJ. dissented.

the true meaning of the section, he took into account the purpose of the legislation: to give to the Minister of National Revenue an overriding right to collect by garnishment the taxes collected which ought to have been remitted by the debtor to the Minister. He concluded that “[i]n a sense the funds collected and not remitted might be considered to be held in the form of a trust since the entities that have collected these funds are not in any circumstances entitled to retain them.” In these circumstances the priority granted the Crown “to recover such funds cannot possibly be said to be expropriation without compensation.”<sup>66</sup> The remedy is given to the Minister in order to ensure that source deductions are remitted. He noted that the system of collecting taxes through source deduction is “exceedingly important.”<sup>67</sup>

Mr. Justice Cory’s heavy reliance on public policy in context of a statutory provision that he concluded was ambiguous represents a departure from the orthodoxy established in *Board of Industrial Relations v. Avco Financial Services Realty Limited*.<sup>68</sup> The secured parties in competition with the Crown held assignments of accounts. The Crown was asserting a right to collect these accounts. The money owing by the account debtors was totally unconnected with the source deductions not remitted to the Crown. Consequently, the statutory provision being applied by the Court did not affect Crown property held in trust; it affected the property rights of third parties.

While the apparently more sympathetic view of the Crown’s position enunciated by Cory J. represents a departure from the traditional approach of the courts to the interpretation of legislation providing for Crown priorities that negatively affect prior interests of third parties, there was unanimity in the Court as to the efficacy of section 224(1.3) in overriding prior *in rem* interest in the property of the debtor.<sup>69</sup> The wording of the section is apparently clear enough to leave no doubt as to the intentions of Parliament.

<sup>66</sup> *Supra*, note 63 at 989.

<sup>67</sup> *Ibid.* at 970 (S.C.R.) and 612 (D.L.R.).

<sup>68</sup> *Supra*, note 55.

<sup>69</sup> Major and Iacobucci JJ. dissented, however, on basic features of choses in actions law. The disagreement between the majority and the minority resulted from a difference in characterization of a general assignment of accounts given to secure a debt obligation. Cory J., speaking for the majority, concluded that it was a “security interest” as the term is defined in section 224(1.3) of the *Income Tax Act*. Major and Iacobucci JJ. concluded that an absolute transfer of ownership was involved with the result that the assignee could not be seen as having a “security interest in the property of another” as required by the definition in section 224(1.3). What is, perhaps, a bit surprising is that, notwithstanding the similarity between the definition of “security interest” in the *Income Tax Act* and the definition of the term in the *Alberta Personal Property Security Act*, S.A. 1988, c. P-4.05, the law applicable to the assignments, neither the majority or minority judgments refer to the doctrinal changes in personal property security law produced by the *Personal Property Security Acts*. Cory J. makes passing reference to the right of redemption given by section 63 of the *Alberta Act*. However, overwhelming support for the majority decision can be found in section 3 of the *Act* which declares that an agreement that provides for an interest in personal property to secured payment or performance of an obligation creates a security interest. This is so without regard to the form of the agreement and without regard to the person who has title to the collateral.

The decision in *Alberta (Treasury Branches) v. M.N.R.* precludes any suggestion that the Court has adopted a policy of frustrating the will of Parliament or legislatures through the explicit or covert adoption of a constitutional convention under which property rights are protected against the encroachment of the state. Indeed, in *Royal Bank of Canada v. Sparrow Electric Corp.* Iacobucci J. states in reference to section 224(1.3) that "Parliament has shown that it knows how to assert priority over rival security interests.<sup>70</sup> All that is needed to overtake a fixed and specific charge is clear language to that effect."<sup>71</sup>

It is the view of the author that there is an unstated public policy issue associated with these cases that goes beyond the expressed conclusions of the Court. There will always be circumstances in which it will be necessary in the public interest to override third party property rights. However, the temptation to define these circumstances very broadly is hard for legislators to resist. The effect of the approach taken by the Court has been to force legislators to define in clear, unequivocal terms the circumstances in which legislation has this effect. This should result in greater public awareness of what is being done. This awareness should have the effect of forcing legislators to justify, if not reduce, the incidence and scope of statutory measures that have retroactive effect on property rights and disruptive consequences for private economic activity. It may well cause legislators to pursue less detrimental ways of ensuring that monetary obligations to the Crown are fully discharged.

#### IV. Bankruptcy

##### A. The Quintet - A Missed Opportunity?

Bankruptcy is another area of commercial law in which the Court has recently played a significant role in the formulation of public policy. In a series of decisions, which can be referred to as the Quintet,<sup>72</sup> the Court has clearly

<sup>70</sup> *Supra*, note 63 at 975 (S.C.R.) and 615 (D.L.R.).

<sup>71</sup> *Supra*, note 35 at 483.

<sup>72</sup> The following four decisions were referred to in *Re Giffen*, *supra* note 40 at 117 (S.C.R.) and 353 (D.L.R.) and in the fifth as the "Quartet." The fifth, therefore, creates a quintet. See, *Re Bourgault* (also *Deputy Minister of Revenue v. Rainville*), [1980] 1 S.C.R. 35, (1979), 105 D.L.R. (3d) 270 (S.C.C.); *Deloitte Haskins & Sells v. Alberta (Workers' Compensation Board)*, [1985] 1 S.C.R. 785, (1985), 19 D.L.R. (4th) 577; *Federal Business Development Bank v. Québec (Commission de la Santé et de la sécurité du travail)*, [1988] 1 S.C.R. 1061, (1988), 50 D.L.R. (4th) 577; *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24, (1989), 59 D.L.R. (4th) 726; *Workers' Compensation Board of Saskatchewan v. Husky Oil Operators Ltd.*, [1995] 3 S.C.R. 453, (1996), 128 D.L.R. (4th) 1.

The practical relevance of the approach adopted or applied in the cases of the Quintet is demonstrated in the number of cases in provincial courts of appeal in which the issues involved in the Quintet have been addressed. *Bourgault* was applied in *British Columbia (Board of Ind. Relations) v. CIBC* (1981), 125 D.L.R. (3d) 487, (B.C. C.A.); *Deloitte* was applied in *Re Metro Const (1978) Ltd. supra Ford Motor Co. of Canada v.*

delimited the scope of provincial legislative jurisdiction to affect the priority regime of section 136 of the *Bankruptcy and Insolvency Act*. The approach taken by the Court has a significant effect not only on aspects of provincial public policy implementation but as well on the operation of the bankruptcy system itself.

Central to all of the decisions in the Quintet was the extent, if any, to which the priority regime of section 136 of the *Bankruptcy and Insolvency Act* could be affected by provincial statutes that give to the provincial Crown, an agency of the provincial Crown or a workers' compensation body, the status of secured creditor or beneficiary under a deemed trust. Under section 136, as it was until amended in 1992,<sup>73</sup> claims against the estate of a bankrupt made by the Crown or a worker's compensation body were classified as "preferred." Under the scheme of the *Act*, however, a preferred claim is subordinate to a secured claim. Clearly, therefore, to the extent provincial law can deem claims within section 136 to be secured or protected by deemed trusts, section 136 would be circumvented.

The Court maintained throughout the five decisions the principle that provincial law cannot negate or distort the effect of section 136 whether through deemed security interests,<sup>74</sup> deemed trusts<sup>75</sup> or by creating a relationship under

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*Manning Mercury Sales Ltd. (trustee of)*, (1996) 140 D.L.R. (4th) 344, 148 Sask.R. 161 (Sask. C.A.); *Robinson Little & Co (Trustee Of) v. Saskatchewan (Min of Labour)*, (1989), 63 D.L.R. (4th) 392 (Sask. C.A.). *Federal Business Development Bank* was applied in *Ford Motor Co., supra*. *Henfry Samson Belair* was applied in *Bassano Growers Ltd. v. Diamond S. Produce Ltd.* (1998), 6 C.B.R. (4th) 199 (Alta. C.A.); *British Columbia v. National Bank of Canada*, (1994), 119 D.L.R. (4th) 669 (B.C. C.A.); *Re Points of Call Holidays Ltd.*, (1991), 5 C.B.R. (3d) 307 (B.C.C.A.); *NB (Min of Finance) v. Coopers & Lybrand Ltd.*, (1993) 136 N.B.R. (2d) 136 (C.A.); *Bank of Montreal v. Lundrigans Ltd.*, (1996), 142 D.L.R. (4th) 100, (Nfld. C.A.); *Ford Motor Co. v. Manning Mercury, supra*; *Robinson Little, supra*. *Husky Oil* was applied in *Dartmouth (City) v. Barclay's Bank of Canada*, (1996), 40 C.B.R. (3d) 1 (N.S.C.A.); *Everingham Brothers Ltd. (Re)*, (1999), 171 D.L.R. (4th) 426 (Ont. C.A.); *728835 Ontario Ltd. (c.o.b. Cellular World) (Re)*, (1998), 111 O.A.C. 155.

<sup>73</sup> R.S.C. 1985, c. B-3, s. 136, as am. by S.C. 1992, c. 1, s. 143, c. 27, ss. 39(1), 54; S.C. 1997, c. 12, ss. 73-74. The amendments resulted in the deletion of references to Crown claims and claims of workers' compensation boards from section 136 and the enactment of sections 86-87 which establish a special regime for these claims under which, with very stringent limitations, they can be treated as secured claims. The amendments did not affect the priority position of wage claims. At the same time sections 67(2)-(3) were added with the effect that deemed trusts (i.e., a statutory trust that would not qualify as a trust in equity due to the lack of a specific res) were nullified in bankruptcy. See S.C. 1992, c. 27, s. 33; 1996, c. 23, s. 168; 1997, c. 12, s. 59 and 1998, c. 19, s. 250. However, specified Crown claims created by federal statutes, along with provincial equivalents, were excluded from the effect of sections 86-87 and 67(2)-(3).

<sup>74</sup> *Re Bourgault* (also *Deputy Minister of Revenue v. Rainville*), *supra*, note 72; *Deloitte Haskins & Sells v. Alberta (Workers' Compensation Board)*, *supra*, note 72; *Federal Business Development Bank v. Québec (Commission de la Santé et de la sécurité du travail)*, *supra*, note 72.

<sup>75</sup> *British Columbia v. Henfry Samson Belair Ltd.*, *supra*, note 72; *Workers' Compensation Board of Saskatchewan v. Husky Oil Operators Ltd.*, *supra*, note 72.

which a workers' compensation body can indirectly gain priority through set-off.<sup>76</sup> However, the basis for this conclusion has not always been the same. In the first decision of the Quintet, the rationale offered by the Court was that Parliament intended to put all debts to a government on an equal footing.<sup>77</sup> While this may have been the original intention of Parliament, it is no longer.<sup>78</sup> Later, the basis for concluding that the priority regime of the *Bankruptcy and Insolvency Act* is unaffected by provincial law was the importance of having "consistency in the order of priority in bankruptcy situations... from one province to another"<sup>79</sup> and the avoidance of a differential scheme of distribution on bankruptcy from province to province.<sup>80</sup> Most recently, the need to give Parliament exclusive jurisdiction to defined priorities in bankruptcy distribution has been grounded in the importance of having a national body of law to ensure that all creditors are fairly treated, and to avoid complexity and cost in ordinary commercial affairs not only for Canadians but also for international trading partners.<sup>81</sup>

While the more recent policy basis for the approach taken by the Court in the Quintet has much merit, its implementation has not produced universally positive results or, at least, not the results that the members of the Court may have had in mind when reaching the conclusion they did in the cases. The approach of the Court could be seen as appropriate to conditions in Canada during the first half of the last century, but inappropriate in the context of current commercial practices and social conditions.

The factor which appears not to have been given much significance by the Court is the effectiveness and ubiquitousness of secured financing practices in the current Canadian economy. Over the last 25 years a revolution in provincial

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<sup>76</sup> *Workers' Compensation Board of Saskatchewan v. Husky Oil Operators Ltd.*, *supra*, note 72.

<sup>77</sup> *Re Bourgault* (also *Deputy Minister of Revenue v. Rainville*), *supra* note 72, per Pigeon J. at 44 (S.C.R.) and at 277 (D.L.R.).

<sup>78</sup> See e.g. *Bankruptcy and Insolvency Act*, *supra* note 31, ss. 67(3), 86(3). Section 67(2) of the *Bankruptcy and Insolvency Act* does not apply to a trust arising under section 227(4) of the *Income Tax Act*, sections 23(3) or (4) of the *Canada Pension Plan* or sections 86(2) or (2.1) of the *Employment Insurance Act* or trusts arising under equivalent provincial tax and pension legislation. The priority given to the federal Crown under section 224(1.2) of the *Income Tax Act* is expressly not affected by bankruptcy proceedings.

<sup>79</sup> *Federal Business Development Bank v. Québec (Commission de la Santé et de la sécurité du travail)*, *supra* note 72, per Lamer J. at 1072.

<sup>80</sup> *British Columbia v. Henfrey Samson Belair Ltd.*, *supra*, note 72, per McLachlin J. at 33.

<sup>81</sup> *Workers' Compensation Board of Saskatchewan v. Husky Oil Operators Ltd.*, *supra* note 72. Indeed, it is not clear that this is or has ever been a goal of bankruptcy law. From the very beginning to the present, section 67 of the *Act* and its predecessors have specifically excluded from a bankruptcy estate property which, under provincial law, is exempt from execution or seizure under provincial law. Since the exemptions laws vary widely among the provinces, creditors get very different treatment depending upon the province in which the debtor resides at the date of bankruptcy.

secured financing law has occurred which has resulted in regimes that greatly facilitate the use of security interests in all types of movable property. Accompanying this has been a dramatic increase in the use of secured financing transactions, particularly in business financing. The result is that, in a large number of cases involving business bankruptcies, three types of claims predominate: secured claims, claims of the Crown (generally unpaid or unremitted taxes) and claims of unpaid former employees. In this context, the effect of the Quintet is to place secured creditors in the position of being able to defeat provincial law (that otherwise regulates all aspects of their rights as secured parties unless they hold *Bank Act* security interests) designed to give priority to Crown claims or claims for unpaid wages of former employees. In other words, the Court has developed an approach to a central feature of bankruptcy law that, in its application, has little to do with the historic *raison d'être* of bankruptcy law: fair treatment of the claims of unsecured creditors.<sup>82</sup> *The Bankruptcy and Insolvency Act* has become a source of federally superimposed priority rules, which heavily favour secured creditors, applicable to two areas which are socially and commercially very important to provincial legislators: priority for provincial Crown claims and priority for unpaid wages of employees or former employees of bankrupt business organizations. Short of dramatically limiting the circumstances in which security interests can be taken under provincial law, provincial legislators are powerless to introduce balance into the system of secured financing law so as to protect other interests from over-reaching, if not abusive conduct.<sup>83</sup> I observe that... the result would seem to be the anomalous one that this small and largely futile preference [given to wage-earners under section 136(1)(d) of the *Bankruptcy Act*] leaves wage-earners in a worse position than if they were not mentioned in the *Bankruptcy Act*. This is so even when this balance is needed

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<sup>82</sup> The potential for this was recognized, but approved by Lamer J. in *Federal Business Development Bank v. Québec (Commission de la Santé et de la sécurité du travail)*, *supra*, note 72, at 1072 (S.C.R.) and 585-586 (D.L.R.). Not surprisingly, others, including lower courts and academic observers were not so ready to view this as an acceptable use of bankruptcy law. See the discussion of the matter in *Re Bank of Montreal and Scott Road Enterprises Ltd.* (1989), 57 D.L.R. (4th) 623 (B.C. C.A.).

<sup>83</sup> In *Re Bank of Montreal and Scott Road Enterprises Ltd.*, *supra*, note 82, Esson J. observed at 629-32:

The circumstances of this case illustrate starkly the inequitable consequences which can flow from permitting the debenture-holder to employ the *Bankruptcy Act* to destroy the priority which would otherwise have been enjoyed by the Crown and the wage-earners....

The difficulty thus created for wage-earners may be very serious because the extent to which the legislative scheme can be set at naught by the device employed here may be almost complete... Most businesses large enough to have employees carry on at the sufferance of their bankers in the sense that their loans may be called on demand... It follows that, in most cases, the bank will be in a position to do what was done here, *i.e.*, to employ its security to make the debtor effectively bankrupt, and then to petition it into bankruptcy. Because of the inherent flexibility of its security, the bank in all such cases will be in a position to time the appointment of the receiver, as was done here, to arrange matters so that the undertaking will have the benefit of the employees' efforts for a maximum period. In those businesses which are labour intensive, that may be an important consideration...

to protect public revenue sources or unpaid wage-earners who have little or no bargaining power in the market.<sup>84</sup> The effect of the Quintet is to put into the hands of Parliament the exclusive power to control matters which, in most other contexts, are properly within the provincial legislative competence. A very respectable argument can be made that this power has not been exercised in a manner that recognizes the important public policy issues that are of crucial importance to the provinces and which, in other contexts, fall within provincial jurisdiction. It is a matter of speculation as to whether the dismal record of Parliament in this area will change in the foreseeable future.<sup>85</sup>

The effect of the Quintet stands in stark contrast to the effect of the decision of the Court in *Giffen*. As a consequence of the *Giffen* decision, a functional integration of provincial secured financing law and federal bankruptcy law has been confirmed. Priority flips resulting from the invocation bankruptcy proceedings are not possible. The position of the holder of an unperfected security interest or deemed security interest is very similar whether the competing interest is that of an execution creditor of the debtor or the debtor's trustee in

<sup>84</sup> It is somewhat ironic that Parliament has provided this balance where federally created and regulated security interests are involved. See *Bank Act*, S.C. 1991, c.46, s. 427(7). The irony is compounded by the practice of banks taking both section 427 *Bank Act* security and provincial security and relying on their provincial security interests to circumvent section 427(7) and gain priority over wage claimants under section 136 of the *Bankruptcy and Insolvency Act*. See e.g. *Kassian v. National Bank*, [1998] 10 W.W.R. 63, (1998), 61 Alta.L.R. (3d) 92, 4 C.B.R. (4th) 295, (Alta. Q.B.), aff'd. [1999] 11 W.W.R. 500, (1999), 73 Alta. L.R. (3d) 56, 10 C.B.R. (4th) 20 (Alta. C.A.). This is not possible under Saskatchewan law. See *The Personal Property Security Act*, R.S.S. 1978, c. P-6.1, ss. 9(2)-(3). There is one context within which section 427 of the *Bank Act* can result in the recognition of a wage claim priority protected by provincial law that gives priority through a deemed lien, charge, security interest or trust even though the employer is a bankrupt. Upon bankruptcy of the employer, the collateral taken under section 427 of the *Bank Act* does not become property that vests in the trustee. The result is that the *Bankruptcy and Insolvency Act* does not apply to it, and, consequently, there is no conflict between section 136(1)(d) of that Act and provincial law creating a deemed lien, charge, security or trust. If under provincial law the deemed lien, charge, security interest or trust has priority over the section 427 interest, the wage claim it protects has priority over the interest of the bank. See *Abraham v. Canadian Admiral Corp.* (1993), 20 C.B.R. (3d) 257, 13 O.R. (3d) 649, 48 C.C.E.L. 58 (Ont. S.C.).

<sup>85</sup> To date, Parliament has been conspicuously incapable of addressing the position of unpaid employees or former employees of bankrupt businesses. There is, perhaps, no aspect of recent bankruptcy law reform that has received more attention than this issue. Many proposals to increase the likelihood of recovery of at least some unpaid wages when the assets of an employer are being involuntarily liquidated have been put forward. The common theme to all of these proposals is the need to redress the inadequacy of the protection that wage-earners get under existing law. The following are the most significant of these proposals: Bill C-60, 1st Sess. 13th Parl., 1974-75; *Report of the Committee on Wage Protection in Matters of Bankruptcy and Insolvency*, 1981, issued by the Canada Department of Consumer and Corporate Affairs; Amendments to Bill C-17, 2d Sess., 32d Parl., 1983-84; The Report of the Advisory Committee on Bankruptcy and Insolvency, 1986; a policy paper published in 1988 the Department of Consumer and Corporate Affairs; The Report of The Advisory Council on Adjustment, 1989; and Bill C-22, 3d Sess. 34th Parl., 1991.

bankruptcy. However, as a result of the Quintet, the position of a secured creditor may well be very different depending upon whether or not the debtor is subject to bankruptcy proceedings.

While, as a result of the Quintet and statutory modifications that substantially codify this result as it applies to provincial statutory revenue claims,<sup>86</sup> the “dye is cast” with respect to this issue, the circumstances surrounding the application of section 136 of the *Bankruptcy and Insolvency Act* raise the constitutional issue as to whether it is appropriate for the Supreme Court to take into account practical considerations, for example the adequacy of federal measures affecting matters of fundamental social and economic concern such as the protection of provincial revenues and unpaid wage-earners, when it is interpreting a federal statute such as the *Bankruptcy and Insolvency Act*. It might be observed that the Court has answered this question in the context of the cases noted earlier in this presentation involving the interpretation of federal tax statutes that have the effect of disrupting private secured financing practices by overriding pre-existing property interests of persons other than tax debtors. At least one member of the Court, Mr. Justice La Forest, identified a “constitutional principle in the British sense” that, in the absence of clear indication in the statute to the contrary, legislatures should not be seen as intending to take or destroy persons’ property without compensation.<sup>87</sup> Is there not room for a similar “constitutional principle” when it comes to frustration of provincial social and economic policies such as those expressed in the form of statutory security interests given to provincial Crown tax claims and unpaid employees or former employees of bankrupt business enterprise? Should the Court have been so willing to give bankruptcy law such a sweeping scope as to leave little room for the recognition of these policies?<sup>88</sup> Of course, if section 136, and now sections 86-87, of the *Bankruptcy and Insolvency Act* are so unambiguous as to remove any doubt in the matter,<sup>89</sup> the Court would have to go beyond a

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<sup>86</sup> See *supra*, note 73.

<sup>87</sup> This was stated by Mr. Justice La Forest, as a member of the New Brunswick Court of Appeal in *The Queen in the Right of New Brunswick v. Estabrook Pontiac Buick Ltd.* (1982), 144 D.L.R. (3d) 21 at 28-37, 44 N.B.R. (2d) 201 (N.B.C.A.).

<sup>88</sup> In the first of the Quintet, *Re Bourgault*, *supra* note 72, Pigeon J., when giving the judgment of the Court, stated with respect to the effect of section 107(f) of the *Bankruptcy Act* (repealed and replaced by sections 86-87 of the *Bankruptcy and Insolvency Act*): “It is abundantly clear that this was intended to put on an equal footing all claims by Her Majesty in right of Canada or of a Province.... The purpose of this part 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 right” at 44 (S.C.R.), 277 (D.L.R.). The four other decisions of the Quintet restated the presumed policy basis of section 136 and extended it to other than statutorily-created Crown security interests. Little emphasis was placed on the wording of the section.

<sup>89</sup> Section 86(1) does not appear to leave any scope for recognition of provincial statutory secured claims. It declares that, subject to the exceptions set out in subsection (2), in relation to a bankruptcy and a proposal, all provable claims, including secured claims, of Her Majesty in the right of Canada or of a province or of any body under an Act respecting worker’s compensation rank as unsecured creditors.

constitutional principle that affects only the approach to the interpretation of a federal statute. It would have to find a basis for limiting the jurisdiction of Parliament in the area of bankruptcy. This is extremely unlikely.

It is interesting to speculate whether the outcome would have been different had the Court been more sensitive to the potentially negative consequences of what might be viewed as a first impression interpretation of section 136 of the *Bankruptcy and Insolvency Act*. Even if it is accepted, as it apparently must be that Parliament has the legislative jurisdiction to include the *Bankruptcy and Insolvency Act* provisions, such as sections 86-87, clearly directed to provincial statutory security interests, would Parliament have been so willing to do so if the Court had given a more accommodating interpretation to section 136 of the *Act*? If provincial deemed security interests protecting wage claims had been recognized as effective in bankruptcy, would a socially acceptable approach to this problem have been implemented years ago thereby removing the need for Parliamentarians to overcome their demonstrated inability to address it?

#### V. Exemptions in Bankruptcy

The recent decision of the Court in *Ramgotra v. North American Life Assurance Co.*<sup>90</sup> appears on the surface to be a technical interpretation of a very old provision<sup>91</sup> of the *Bankruptcy and Insolvency Act*, section 91. However, it is much more. The decision brought an end to wide-spread confusion and judicial free lancing that was occurring in lower courts. In addition, it dramatically enhanced the protection afforded individual bankrupts under bankruptcy law and, at the same time, reduced the amount of property that comprises bankruptcy estates. In the context of all of this it enunciated an entirely new principle of bankruptcy law.

A policy issue that troubled lower courts prior to the *Ramgotra* decision was whether a debtor should be permitted to convert non-exempt property into exempt property prior to bankruptcy with the result that the bankruptcy estate is proportionately diminished and the debtor retains the exempt property after discharge. A few courts decided that this practice was objectionable and agreed with trustees in bankruptcy that it constituted a "settlement" which could be set aside under section 91 of the *Bankruptcy and Insolvency Act*.<sup>92</sup>

<sup>90</sup> [1996] 1 S.C.R. 325. This decision was followed in *Amex Bank of Canada v. Toronto Dominion Bank*, [1997] 6 W.W.R. 530 (Alta. C.A.); *Sun Life Assurance Co. of Canada v. Canada (Revenue)*, [1997] 5 W.W.R. 159 (Alta. C.A.); *Sykes (Re)*, [1998] 8 W.W.R. 120 (B.C. C.A.).

<sup>91</sup> Section 91. This section can be traced back to the English *Bankruptcy Act* of 1869 (U.K.), 32 & 33 Vict., c. 71. In form it is substantially similar to the original legislation.

<sup>92</sup> See e.g. *Wilson v. Doane Raymond* (1988), 69 C.B.R. (N.S.) 156, [1988] 5 W.W.R. 572 (Alta. C.A.); *Camgoz v. Sun Life Assurance Co.* (1988), 70 C.B.R. (N.S.) 131, 70 Sask. R. 70, 35 C.C.L.I. 256 (Sask. Q.B.), aff'd (1988), 72 C.B.R. (N.S.) 319 (Sask. C.A.); *Re Molloy* (1983), 48 C.B.R. (N.S.) 308 (Ont. S.C.).

The Supreme Court was able to decide the issue through a technical application of the established definition of the term "settlement." Self-settlement is conceptually impossible.<sup>93</sup> While it may be treated as *dicta*, the statements of Gonthier J., who gave the unanimous decision of the Court, demonstrate that the Court clearly supported a policy choice favouring bankrupt non-corporate debtors. The Court concluded that to allow section 91 to be used to attach self-settlement, in the words of Gonthier J., would be a failure to "strike an appropriate balance between the Act's dual, and sometimes conflicting purposes of protecting creditors and rehabilitating bankrupts...To interpret s. 91 of the BIA in a manner which automatically allows creditors to attach exempt property of such an essential character is... going too far."<sup>94</sup>

The new principle established by the Court in this decision is that, when a debtor takes non-exempt property and uses it to purchase property which is then transferred to another person, the exempt status of the property resulting from the transfer is not affected as a result of it being void against the trustee under section 91. In *Ramgotra*, the transfer involved the purchase of an annuity by the debtor under which his wife acquired a residual interest. The annuity was exempt under sections 2(kk)(vii) and 158(2) of *The Saskatchewan Insurance Act* because of the wife's interest. The Court concluded that, notwithstanding that the settlement was void under section 91, it remained valid under provincial law. As such the transferred property, while vested in the trustee, was not available for distribution among the creditors of the settlor. In a more general context, the Court decided that a transfer of property void against the trustee under the *Bankruptcy and Insolvency Act* is not, by that fact alone, also void under provincial law. To date, this principle has practical effect only in the context of void settlements which give rise to exemptions under provincial law.

The full implications of the principle in *Ramgotra* have yet to be explored in litigation. It would defeat the *raison d'être* of section 91 to give full scope to the principle and conclude that, whether or not an exemption issue is involved, section 91 of the *Bankruptcy and Insolvency Act* has no effect on a transfer under provincial law. The principle must, therefore, be confined to the interplay between sections 67(1)(b) and 91. However, even in this context, difficult issues remain to be settled.<sup>95</sup>

The *Ramgotra* decision reflects a major policy choice on the part of the Court. Clearly, the "fresh-start" feature of bankruptcy law was emphasized at the expense of the "fairness to creditors" feature.<sup>96</sup> It sanctions the use of a

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<sup>93</sup> The Court applied the approach set out in *Re Bozanich*, [1942] S.C.R. 130, which confined the concept of settlement to a transfer of property to be held for the enjoyment of another person. See *supra*, note 90, per Gonthier J. at 341-42.

<sup>94</sup> *Supra*, note 90, per Gonthier J. at 344.

<sup>95</sup> See *Goertz v. Goretz* (1996), 37 C.B.R. (3d) 1 (Sask. C.A.). Compare (although not directly on point), *Holthuysen v. Holthuysen*, [1987] 2 W.W.R. 304 (Alta. C.A.).

<sup>96</sup> This is in line with the unstated policy of the Court arising out of its decision in *Marzetti v. Marzetti*, [1994] 2 S.C.R. 765, to view broadly what constitutes property of the debtor that can be retained by the bankrupt as a result of section 67.

method through which a debtor can shield very substantial assets from the reach of his or her trustee in bankruptcy. However, the decision is completely consistent with the basic approach to exemptions contained in the *Bankruptcy and Insolvency Act*. Parliament has left the matter of exemptions to provincial law. It would be anomalous if section 91 were to be sanctioned as a method of frustrating the implementation of this policy.

## VI. Summary

The reference to “making the most of limited opportunities” in the title to this presentation was designed to highlight the impact of a relatively few Supreme Court judgments on the development of the areas of commercial and consumer law selected for examination. This impact has been felt most dramatically in the last three decades.

It is clear that the decisions of the Court affecting secured financing and bankruptcy law have gone well beyond narrow application of statutory provisions. They have involved important public policy choices. In some decisions, these choices have been explicitly stated. In others they have been obscured by what on the surface appears to be nothing more than an application of the words of the statute or the diving of Parliamentary intention.<sup>97</sup>

The policy choices made by the Court in the area of secured financing law have been very much in line with both legislative and market developments in Canada. The central role that secured financing plays in the development of the Canadian economy has been consistently recognized and supported by the Court. It is not possible to divorce the Court’s interpretation of legislation creating Crown priorities in tax and other debt collection from its general approach to this area of the law. While it is important that modern governments be able to enforce debt obligations owing to them, it is equally important that this not be done through systems that function in an arbitrary way and which, as a result, dramatically reduce effective risk assessment by credit grantors. While it is open to legislators to design and implement systems for debt collection that have the effect of reducing the availability of credit to business organizations, the effect of the Supreme Court decisions in this area is to raise public awareness of the need for better approaches.

The author has concluded that, in the context of aspects of bankruptcy law, the Court’s decisions have proved to be too much of a good thing. The principal beneficiaries of the outcome of the Quintet have been secured creditors. They have been given the facility to use bankruptcy proceedings for purposes for which they were not designed. It is now a matter of academic speculation as to whether or not, given the wording of section 136 of the *Bankruptcy and Insolvency Act*, the Court could have avoided this result.

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<sup>97</sup> See generally R. Sullivan, “Statutory Interpretation in the Supreme Court of Canada” (1998-99), 30 *Ott. L.Rev.* 175.

Factors endemic to the litigation process guarantee that very few cases involving consumers come before the Supreme Court. On the one occasion examined in this presentation when such a case did get before the Court, very important principles affecting the economic interests of consumer bankrupts were established. Credit now plays such a central role in the life of Canadian consumers that failure to give full scope to the protection afforded by provincial law to over-committed debtors who seek bankruptcy protection or who are forced into bankruptcy is to ignore this reality.