

Creeping Statutory Obsolescence in Bankruptcy Law

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A. Introduction

The Canadian approach to the reform of insolvency law has been described as “piecemeal”¹ and “haphazard”.² It came about because of the inability, over three decades ago, to get a comprehensive insolvency bill through Parliament. Canada had undertaken a major study of its insolvency law³, and the report formed the blueprint for a senate bill that was introduced in 1978.⁴ It foundered and four other bills that were subsequently introduced over the next four years suffered a similar fate.⁵ A major stumbling block was the controversial issue concerning the treatment of unpaid wage claims.⁶ Instead of attempting to float yet another bill, the government decided not to attempt an overhaul of insolvency law. Instead it chose to focus on a number of discrete issues that were thought to be the most pressing.⁷ At least this way some needed reforms might see the light of day even if other matters could not be resolved because of a failure to reach a consensus. Amending bills were passed in 1992⁸ and 1997.⁹ Two more were passed in 2005¹⁰ and 2007,¹¹ but most of the provisions did not come into force until 2009. Anyone who remembers the unrelenting uncertainty of this period can be forgiven if they fail to display a keen enthusiasm for the current process of reform.¹²

Although piecemeal insolvency reform undoubtedly led to the introduction of many desirable reforms, it also has had its dark side. The policy of piecemeal amendment of the *Bankruptcy*

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¹ Jacob S. Ziegel, “New and Old Challenges in Approaching Phase Three Amendments to Canada’s Commercial Insolvency Laws” (2002), *Can. Bus. L.J.* 75 at 76.

² Jacob S. Ziegel, “Canada’s Phased-In Bankruptcy Law Reform” (1996), 70 *Am. Bankr. L.J.* 383 at 416.

³ House of Commons, Study Committee on Bankruptcy and Insolvency Legislation, *Report of the Study Committee on Bankruptcy and Insolvency Legislation* (June 1970) [Tassé Committee Report].

⁴ Bill S-11, 3rd Sess., 30th Parl. (1978). The Senate bill modified an earlier bill that was introduced in the House of Commons: Bill C-60, 1st Sess., 30th Parl. (1975).

⁵ Ziegel, *supra* note 2 at 2.

⁶ Jacob S. Ziegel, “The Travails of Bill C-12” (1984) 8 *Can. Bus. L.J.* 374 at 375

⁷ See House of Commons, Advisory Committee on Bankruptcy and Insolvency, *Report of the Advisory Committee on Bankruptcy and Insolvency* (January 1986).

⁸ S.C. 1992, 1992, c. 27.

⁹ S.C. 1997, c. 12.

¹⁰ S.C. 2005, c. 47.

¹¹ S.C. 2005, c. 36.

¹² Thomas Telfer, “Canadian Insolvency Law Reform and ‘Our Bankrupt Legislative Process’” *Annual Review of Insolvency Law 2010* (Toronto, Carswell, 2009) 583.

*and Insolvency Act*¹³ has meant that some portions of the *BIA* are modern and are directed towards contemporary issues that were thought to be sufficiently important to justify the amendment of the legislation, while other parts of the Act adhere to the same concepts and terminology of the original 1919 *Bankruptcy Act*.¹⁴ Jacob Ziegel commented that the heavy price of the Canadian process of piecemeal insolvency reform is the consequential loss of "coherence, consistency and responsiveness of the total Act."¹⁵ The problem is one of statutory obsolescence. Our task in this paper is to illustrate some of the more serious problems of creeping statutory obsolescence in its many manifestations. It is not our objective to undertake a comprehensive review of all the bankruptcy provisions or to attempt to redraft legislative provisions. The problem of creeping statutory obsolescence is simply too pervasive. There are many other issues that might also have been included in our discussion. For example, we are of the view that the current provisions respecting patents and copyrights are clearly in need of modernization. Similarly, the incorporation of provincial exemptions seems inconsistent in a bankruptcy statute that is designed to take a national approach to the economic rehabilitation of insolvent individuals.¹⁶ However, we chose not to discuss these topics as they are not capable of easy resolution as the real challenge here is in designing new substantive provisions that adequately deal with the contemporary problems that arise in connection with these matters.

In examining the phenomenon of statutory obsolescence in the bankruptcy provisions, we identify three different aspects of this problem. In the first class, the difficulty is that the statute continues to adhere to outmoded concepts or terminology. We refer to this as the problem of archaic approaches. In the second class, the difficulty is that the original meaning or purpose of the provisions has been forgotten with the passage of time, or that changes in other areas of law have undercut the legislative provisions. We refer to this as the problem of deciphering forgotten meanings. In the third class, the problem is that the provision may have lost its function and remains as a dead letter. We refer to this as the problem of vestigial provisions. This ultimately leads into a dilemma. Is it desirable in the next round of piecemeal amendments to consider additional amendments that would address the particular issues that have been identified? This would produce a net improvement to the legislation, but it is not capable of producing a thorough modernization of the statute. Only a comprehensive review of the bankruptcy provision can produce this result. Or is it better to leave these problems to a later

¹³ R.S.C. 1985, c. B-3 [*BIA*].

¹⁴ In many instances these provisions are themselves derived the earlier Canadian insolvency statutes of 1869 and 1875. [For example, the definition of "insolvent person" was first formulated]

¹⁵ "New and Old Challenges in Approaching Phase Three Amendments to Canada's Commercial Insolvency Laws" (2002) 37 *Can. Bus. L.J.* 75 at 76.

¹⁶ See Thomas Telfer, "The Evolution of Bankruptcy Exemption Law in Canada 1867-1919: The Triumph of the Provincial Model" in *Annual Review of Insolvency Law*, 2007 (Carswell, 2008) 577.

day in the hopes that a more thorough review will be undertaken? The danger with this approach is that there that there is a strong possibility that this day might never arrive.

B. Archaic Approaches

1. Acts of Bankruptcy

The concept of an act of bankruptcy goes back a very long ways. The concept was utilized in in the very first Canadian insolvency statutes of 1865¹⁷ and 1875¹⁸. These were in turn derived from the early English bankruptcy statutes and can be traced back to the original bankruptcy statute passed in the reign of Henry VIII.¹⁹ Proof of an act of bankruptcy on the part of a debtor was a necessary condition for the initiation of the process. An act of bankruptcy was regarded as an intentional and legally culpable act committed by the bankrupt. It conceived of the bankrupt as a kind of fugitive who was seeking to evade or defeat the creditors.²⁰ This concept was later supplemented by the addition of other acts of bankruptcy that focused upon the financial condition of the bankrupt rather than the wrongful conduct of the bankrupt.

This division between culpable conduct and insolvent financial condition is clearly exhibited in Canada. The acts of bankruptcy that involve culpable conduct include making fraudulent gifts or transfers, making a fraudulent preference in the form of a transfer of property or the granting of a charge, departing or remaining out of Canada or absenting or departing from the debtor's dwelling house with the intent of defeating creditors, and assigning, removing, secreting or disposing of property with intent to defraud, defeat or delay creditors.²¹ The acts of bankruptcy that relate to the debtor's financial condition include the making of an assignment outside of Canada, permitting judgment enforcement measures to proceed beyond a specified stage, exhibiting a statement of assets and liabilities that shows that the debtor is insolvent or a written admission of an inability to pay at a meeting of creditors, giving notice of the

¹⁷ *Insolvent Act of 1869*, 32-33 Vic. 1869, s 13.

¹⁸ *Insolvent Act of 1875*, 39 Vic. 1875, s 3.

¹⁹ 34-35 Hen. VIII, c. 4 (1542). The Act identified flight to parts unknown and keeping house as acts of bankruptcy. The second bankruptcy statute passed in the reign of Elizabeth I added, as further acts of bankruptcy, a betaking oneself to sanctuary, an alienation in fraud of creditors, and the voluntary procurement of one's arrest to avoid execution against property. See 13 Eliz c 7 (1570).

²⁰ Israel Treiman, "Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law" (1938), 52 Harv. L. Rev. 189 at 195 identified the problem over 65 years ago: English bankruptcy law thus was from in inception grounded in the notion that the status of bankruptcy commenced with some positive and intentional act of the part of the debtor, and that, such an act having been committed, the solvency of the debtor was unimportant."

²¹ *BIA*, *supra* note 13, s. 42(1)(b), (c), (d) and (g).

suspension of creditors, defaulting on a proposal, or ceasing to meet his liabilities generally as they become due.²²

Canadian bankruptcy law therefore contemplates that a solvent debtor may be forced into bankruptcy by the creditors. This seems out of step with the objectives of modern bankruptcy law which is primarily concerned with insolvent debtors. The Supreme Court of Canada in *Century Services Inc. v. Canada (Attorney General)*²³ has identified the single proceeding justification as a foundational objective of insolvency law:

The single proceeding model avoids the inefficiency and chaos that would attend insolvency if each creditor initiated proceedings to recover its debt. Grouping all possible actions against the debtor into a single proceeding controlled in a single forum facilitates negotiation with creditors because it places them all on an equal footing, rather than exposing them to the risk that a more aggressive creditor will realize its claims against the debtor's limited assets...

A debtor who attempts to defraud a creditor acts wrongfully. But the wrongfulness of this conduct is not something that requires the invocation of the single proceeding apparatus of bankruptcy law. A creditor may seek to have the transaction set aside under provincial fraudulent conveyance law. It is only when the debtor is unable to pay several creditors that the single proceeding rationale of insolvency law is engaged. There is, additionally, a highly practical reason why it might make sense to undertake a similar reform in Canada. The reality is that the acts of bankruptcy that relate to some form of misconduct on the part of the debtor are notoriously difficult to prove as they depend upon proof of an intent to defraud, defeat or delay the creditors. They are seldom invoked because the acts of bankruptcy that look to inability of the debtor to pay are much easier to prove.

Even if it were thought desirable to permit involuntary bankruptcy proceedings against the debtor as a response to debtor misconduct, the present acts of bankruptcy are badly out of step with other changes that have been made to the bankruptcy provisions. For example, paragraph 42(1)(c) refers to a transfer of the debtor's property that would be void under the *BIA* as a fraudulent preference. It was drafted at a time when the bankruptcy provisions for the avoidance of transfers to creditors required proof of an intention to prefer on the part of the debtor. This has since been altered. The *BIA* now permits the avoidance of non-arm's length transactions if they have the effect of giving the creditor a preference.²⁴ Should the reference to a *fraudulent* preference be taken to mean that a transaction that involves a non-arm's length dealing should not be covered in the absence of any intent to prefer? This would not be the

²² *Ibid.*, s. 42(1)(a), (e), (f), (h), (i) and (j).

²³ 2010 SCC 60 at para 22.

²⁴ *BIA*, *supra* note 13, s. 95(1)(b).

first time that the provision has been interpreted narrowly. Its scope has been severely limited by cases that restricted its application to a grant of security or a transfer of property, but not a payment of money.²⁵ In any event, it is necessary for the creditors to prove that the debtor was insolvent at the time of the transaction in order to prove that a transaction was a voidable preference under the Act. It will therefore usually be easier for the creditors to assert the failure to meet obligations generally as the act of bankruptcy.

The United Kingdom²⁶ and the United States²⁷ have abandoned the concept of an act of bankruptcy in involuntary bankruptcy proceedings.²⁸ The 1982 Report of the Cork Commission that proposed extensive reforms to United Kingdom proposed “the complete abolition of the whole concept of the act of bankruptcy”.²⁹ It was of the view that most of the grounds were “obsolete or obsolescent” and that their abolition would “greatly simplify and modernize the law of bankruptcy.”³⁰ Nor is the idea of eliminating the requirement of an act of bankruptcy a novel or radical idea in Canada. It was first proposed in the Tassé Committee Report in 1970, which recommended that “[t]he traditional concept of “acts of bankruptcy should be abolished” and replaced with a provisions that looked to the inability of the debtor to pay.³¹ The move away from authorizing bankruptcy proceedings on proof of wrongful conduct of the debtor is consonant with the foundational principles of modern bankruptcy law and is also in line with bankruptcy reform initiatives elsewhere.

This is not to say that the matter can be simply be resolved by eliminating the requirement of proof of an act of bankruptcy. Once a decision is made to identify a general inability to pay obligations as the focal point, it becomes necessary to determine how difficult or easy it should be for creditors to convince a court that this is indeed the current state of affairs. In both the United States and the United Kingdom, the acts of bankruptcy have been replaced with criteria that look solely to the financial condition of the debtor. The United States Bankruptcy Code specifies two situations where involuntary bankruptcy proceedings may be brought against a debtor.³² The first is if a debtor “is generally not paying such debtor’s debts as such debts become due unless such debts are the subject of a bona fide dispute as to liability or amount.” The second is the debtor’s property is within the past 120 days by a creditor to enforce a debt. This is roughly equivalent to the acts of bankruptcy set out in paragraphs 42(1)(e) and (j) and

²⁵ *Re Tysak Ltd.* (1981), 38 C.B.R. (N.S.) 142 (Ont. S.C.); *Re King Petroleum Ltd.* (1973), 19 C.B.R. (N.S.) 16 (Ont. S.C.).

²⁶ *Insolvency Act*, 1986, c. 45, ss. 267-68.

²⁷ *United States Bankruptcy Code*, 11 U.S.C. §303(h).

²⁸ For a description of the early evolution of the provisions in the United States, see note, “‘Acts of Bankruptcy’ in Perspective” (1954), 67 Harv. L. Rev. 500.

²⁹ *Insolvency Law and Practice – Report of the Review Committee*, Cmnd. 8558 (June 1982) at 125-6.

³⁰ *Ibid.*

³¹ Tassé Committee Report, *supra* note 3 at 105.

³² *United States Bankruptcy Code*, *supra* note 27, §303(h)

would seem to be a reasonable approach. The current wording of paragraph (e) displays a density that renders it all but incomprehensible:

(e) if the debtor permits any execution or other process issued against the debtor under which any of the debtor's property is seized, levied on or taken in execution to remain unsatisfied until within five days after the time fixed by the executing officer for the sale of the property or for fifteen days after the seizure, levy or taking in execution, or if any of the debtor's property has been sold by the executing officer, or if the execution or other process has been held by the executing officer for a period of fifteen days after written demand for payment without seizure, levy or taking in execution or satisfaction by payment, or if it is returned endorsed to the effect that the executing officer can find no property on which to levy or to seize or take, but if interpleader or opposition proceedings have been instituted with respect to the property seized, the time elapsing between the date at which the proceedings were instituted and the date at which the proceedings are finally disposed of, settled or abandoned shall not be taken into account in calculating the period of fifteen days;

The idea that a seizure of property by creditors to enforce a debt is generally a good signal that the debtor is unable to pay seems reasonable, but the current drafting of this provision simply cannot be allowed to stand.³³

The continued adherence to the medieval concept of an act of bankruptcy in Canada is a product of our piecemeal bankruptcy reform process. The persistence of the concept is not attributable to any belief as to its intrinsic merit. A thorough reform of the provisions respecting involuntary bankruptcy proceedings is clearly overdue. Rather, the concept hangs on simply because it has never attained the "A" list of hot button issues that are of current concern to insolvency lawyers and professionals.

2. The Definition of "Secured Creditor"

In some instances the reason for the obsolescence is that other areas of the law have changed since the original bankruptcy provisions were put into place. There has been a fundamental revolution in personal property security law in Canada.³⁴ The adoption of a unitary concept of a security interest has displaced the former system of different security devices or quasi-security devices, some of which operate by way of transfer of title or grant of interest and some of

³³ For a discussion of some of the other interpretive difficulties associated with this provision, see Roderick J Wood, *Bankruptcy and Insolvency Law* (Irwin Law, 2009) at 61-4.

³⁴ See R.C.C. Cuming, C. Walsh & R.J. Wood, *Personal Property Security Law*, 2nd ed. (Irwin Law, 2012) at 5-6.

which operate by title-retention.³⁵ The provisions of the *BIA* have remained oblivious to these momentous developments, and this has produced a mismatch between the outdated concepts reflected in the *BIA* and the current state of the substantive law in the provinces and territories.

The problem centers upon the definition of “secured creditor” in the *BIA*. The relevant portion of the current definition provides:³⁶

“secured creditor” means a person holding a mortgage, hypothec, pledge, charge or lien on or against the property of the debtor or any part of that property as security for a debt due or accruing due to the person from the debtor...

The core of the current definition is substantially similar to that of the 1919 *Bankruptcy Act*.³⁷ The definition was eminently suitable in respect of the unreformed secured transactions law that then prevailed. The difficulty with this definition is that it has been completely overtaken by the modernization of secured transactions law. These older concepts have been swept away in the personal property security law statutes, and yet they live on in the *BIA*. This divergence between the older concept of a secured creditor in the *BIA* and the modern concept in the personal property security statutes creates a problem in connection with conditional sales agreements and finance leases. These transactions are regarded as genuine security interests under modernized provincial secured transactions law.³⁸ But is a conditional seller or financing lessor considered to be a secured creditor for the purposes of federal insolvency law?

The idea that the definition of secured creditor used in federal statutes might not be wide enough to cover conditional sales agreements and finance leases emerged out of a line of cases decided in British Columbia³⁹, Saskatchewan⁴⁰ and Ontario.⁴¹ The courts held that the definition of “secured creditor” and “security interest” in the *Income Tax Act* ⁴²(“*ITA*”) – the provisions associated with the creation and priority of the statutory deemed trust for source deductions – does not cover transactions in which title to the goods was retained by the conditional seller or lessor. The definition only covers transactions in which the debtor grants an interest in the debtor’s assets; it does not cover transactions in which title to the asset has never vested in the

³⁵ *Ibid* at 116-17.

³⁶ *Supra* note 13, s. 2(1) “secured creditor”.

³⁷ Except for the deletion of the term “privilege” that appeared in the original, this portion of the definition is identical to the definition of “secured creditor” in s 2(gg) of the original 1919 *Bankruptcy Act*, S.C. 1919, c. 36.

³⁸ See, e.g., *Personal Property Security Act*, R.S.A. 2000, c P-7, s. 3(1)(b).

³⁹ *DaimlerChrysler Financial Services (debis) Canada Inc. v. Mega Pets Ltd.*, 2002 BCCA 2428.

⁴⁰ *Canada (Deputy Attorney General) v. Schwab Construction Ltd.*, 2002 SKCA 6

⁴¹ *Bank of Nova Scotia v. Turyders Trucking Ltd.* (2001), 32 C.B.R. (4th) 14 (Ont. S.C.J.)

⁴² R.S.C. 1985, c. 1 (5th Supp.), s. 224(1.3).

debtor. The definition of “secured creditor” in the *BIA*⁴³ and the *Companies’ Creditors Arrangement Act*⁴⁴ (“*CCAA*”) is similar in structure to the definition in the *ITA*.

Courts may be hesitant to take this step because of the undesirable consequences that would flow from doing so.⁴⁵ For one thing, it would mean that conditional sellers and lessors would be elevated in priority. The unpaid employee charge and the pension contribution charge created by the recent bankruptcy law amendments provide that these charges rank in priority over secured creditors. But if conditional sellers and lessors are not brought within this definition, they would be unaffected by these charges. Another consequence is that a seller who intends to seize inventory that it supplied under a wholesale conditional sales agreement would not be required to give the debtor a notice of intention to enforce its security interest pursuant to section 244 of the *BIA*. The notice requirement only applies to a secured creditor. If a conditional seller is not considered to be a secured creditor, the notice requirement will not apply to it.

Courts might decide to restrict the *ITA* line of cases. They might conclude that the definition in the federal insolvency statutes does, in fact, cover conditional sellers and financing lessors, even though a similar definition in the *ITA* does not. Unfortunately, this creates an even worse set of difficulties in the form of inconsistent and unstable priority rankings.⁴⁶ The *BIA* provides the following ranking of priorities of secured claims: (1) thirty day goods under section 81.1; (2) the agricultural producer’s charge under section 81.2; (3) the deemed statutory trust under section 227(4.1) of the *ITA*; (4) the unpaid employee’s charge under s. 81.3; (5) the pension contribution charge under section 81.5; and (6) ordinary secured creditors.

Suppose that the courts hold that the *BIA* definition of “secured creditor” covers conditional sales agreements and finance leases. Consider the priority ranking in a case involving a deemed statutory trust for source deductions, a pension contribution charge and a conditional sales agreement. The statutory deemed trust (DT) for unremitted source deductions has priority over the pension contribution (PC) charge. The conditional sales (CS) beats out the deemed trust because of the restricted definition of secured creditor in the *ITA*. But if the *BIA* uses a wider definition of secured creditor that includes conditional sales agreements, this means that the pension contribution charge prevails over the conditional sales agreement. The result is that DT has priority over PC; PC has priority over CS; but CS has priority over DT. This produces a circular

⁴³ *Supra* note 13, s. 2 “secured creditor”.

⁴⁴ R.S.C. 1986, c. C-36, 2(1) “secured creditor”.

⁴⁵ See Roderick J. Wood, “The Definition of Secured Creditor in Insolvency Law” (2010), 25 *Banking & Finance L. Rev.* 341 at 353-55.

⁴⁶ Roderick J. Wood, “The Structure of Secured Priorities in Insolvency Law” (2011), 27 *Banking & Finance L. Rev.* 25 at 32-4.

priority system. It does not provide an outcome as it produces a futile and never-ending journey around the circle.

Now suppose that the conditional seller comes into competition with a bank that has taken and perfected a general security agreement (GSA) on all of the debtor's assets. The conditional seller has registered its security interest, but not within the time period needed to give it priority over the GSA. The Crown claims a deemed statutory trust on the assets. This gives rise to a further circular priority system. CS has priority over DT; DT has priority over GSA; and GSA has priority over CS.

The federal priority provisions were designed to create an integrated scheme of priorities. They were designed to provide a ranking as among the various types of interests that arise in insolvency proceedings. They will only properly work together if they use the same definition of a secured creditor. The simplest solution to this problem is for Parliament to amend the definition of secured creditor in the ITA and in the federal insolvency statutes to ensure that they cover title retention devices by using a formulation similar to that found in provincial secured transactions law. This would eliminate the circular priority systems since everyone would be reading off the same page when deciding who is a secured creditor.

Every common law province and territory has adopted modernized personal property security legislation. Indeed, Newfoundland and Labrador was the last jurisdiction to do so in 1998. The fact that the federal statutes still seemingly operate on the misapprehension that pre-reform concepts continue to prevail is somewhat of a national embarrassment. The matter becomes even more bewildering when one reads the remainder of the definition of secured creditor and it becomes apparent that the definition has been modified so as to encompass conditional sales agreements and security trusts under the civil code of Quebec.⁴⁷ The federal definition therefore takes into account the reform of secured transactions law that has occurred under the civil code, but it fails to do so in respect of the reform in the common law jurisdictions. This truly is a mess that needs to be cleaned up.

3. The Outdated Model of Governance

Since its origin in 1919, the Canadian bankruptcy statute has adopted a hybrid approach to the administrative governance of the bankrupt estate. The statute endorses the idea of official control of bankruptcy administration by giving the trustee the general power to administer the

⁴⁷ These amendments to the definition of secured creditor were introduced in 1991 as a result of a pilot harmonization program that sought to ensure each language version of federal statutes properly reflected civil law as well as common law concepts. See Wood, "The Definition of Secured Creditor in Insolvency Law", *supra* note 45 at 355.

bankrupt estate. However, the statute sanctions the idea of creditor control by conferring upon the creditors the ultimate power of decision-making on a wide variety of matters.⁴⁸ It does so through the appointment by the creditors of a board of inspectors.⁴⁹ The *Inspectors' Handbook*, issued by the Office of the Superintendent of Bankruptcy Canada, sets out the Inspectors' responsibilities as follows:

Inspectors give direction and advice to the trustee regarding specific actions to be taken in the administration of the estate. They also supervise the trustee's administration and ensure the trustee acts in accordance with their directions.⁵⁰

The *BIA* provides that a number of highly significant decisions must be authorized by the board of inspectors, including:

- the sale, lease or other disposition of the assets of the bankrupt estate, the carrying on of the business of the bankrupt, and an election to retain, disclaim, or assign a lease;⁵¹
- the institution or continuation of legal proceedings and a compromise or settlement of claims by or against the bankrupt estate;⁵²
- the return of unrealizable property to the bankrupt;⁵³
- the timing of the declaration and distribution of dividends;⁵⁴
- the examination of the bankrupt or other persons.⁵⁵

The heavier reliance on creditor control went some ways in addressing one of the long-standing controversies in Canada. The lack of any supervisory oversight in respect of trustees in bankruptcy resulted in "scandals involving inefficient and collusive liquidations by incompetent and untrustworthy trustees."⁵⁶ Giving the representatives of creditors the ultimate authority over key decisions therefore provided a check against such conduct on the part of trustees. The

⁴⁸ For a discussion of official control, creditor control and court control over insolvency administration, see Wood, *Bankruptcy and Insolvency Law*, *supra* note 33 at 219-21.

⁴⁹ See *ibid* at 223-26 for a more detailed discussion of the powers and duties of the inspectors.

⁵⁰ <https://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01479.html>.

⁵¹ *BIA*, s. 30(1)(a), (b), (c), (f) & (k).

⁵² *Ibid*, s. 30(1)(d), (e), (h) & (i).

⁵³ *Ibid*, s. 40.

⁵⁴ *Ibid*, s. 148(1).

⁵⁵ *Ibid*, s. 163(1).

⁵⁶ Tassé Committee Report, *supra* note 3 at 17.

Office of the Superintendent in Bankruptcy (OSB) was created in 1932 to address these concerns.⁵⁷ The OSB now provides an independent and impartial supervision of trustees in bankruptcy. This has led to the emergence of a highly qualified and competent cadre of insolvency professionals who are vastly different in their knowledge and training from those who were originally permitted to act as trustee in bankruptcy under the original statute.

Although it is likely that the board of inspectors may have exercised a useful role in the administration of estates in the early years of Canadian bankruptcy law, it is less clear whether they continue to do so. Although, the *BIA* gives the inspectors power to make decisions on a variety of matters, this governance structure is seldom used and the responsibility to make most estate administration decisions tends to fall to (or remain with) the trustee. This appears to be driven by an increasing lack of interest by creditors to act as Inspectors except in circumstances where they have a broader interest (for example, when a secured creditor is expecting a shortfall on their security and wants to remain connected and involved as an unsecured creditor).

In situations where there are inspectors, one does not have to look far to find examples of frustration over estate matters as between the trustee and the inspectors particularly in situations where the inspectors wish to direct the trustee to perform certain acts but the trustee is unable to do so due to insufficient funds in the estate. Also, inspectors have been known to become uninterested in the administration of an estate once it is apparent that there will be little or no funds available to make any meaningful distribution to unsecured creditors. These inspectors tend to view their ongoing participation as throwing “good money after bad”. When an inspector becomes unwilling to participate it may slow down the administration of the estate and actually increase costs.

Arguably the participation of inspectors in the decision-making will add costs to the overall administration with no offsetting value being realized. Specifically, there is obviously a cost associated with holding inspectors meetings, preparing motions and minutes to obtain guidance or direction from the inspectors only to have the inspectors generally agree with the trustees proposed course of action or to reach the same conclusions as those of the trustee. While the goal of bringing on inspectors is to assist the trustee and provide efficiencies in the administration of the estate, in these instances this is not always achieved.

The idea of the board of inspectors was originally derived from the 1914 English bankruptcy statute.⁵⁸ The Cork Committee considered the role of the committee of inspectors. It recommended that the committee should be called a committee of creditors rather than a

⁵⁷ *Ibid.*

⁵⁸ 4 & 5 Geo. 5 c. 59, s. 20.

committee of inspectors in order to better describe their new role.⁵⁹ It concluded that the committee of creditors should no longer have the responsibility for approving specific actions by the trustee, but should rather one of receiving information and consultation:⁶⁰

We recommend that, apart from fixing the practitioner's remuneration, the rights and duties of the committee should be limited to receiving information from the liquidator, trustee, etc, and to consultation.... By removing the present requirement to sanction actions by the liquidator or trustee and enacting that the committee be entitled to receive information, we think that the task of serving on a committee will be more attractive to creditors, that they will be consulted more readily and that, in the result they will play a more active and useful role in the administration of insolvent estates.

This approach seems to be an eminently sensible approach. It is also the approach adopted in the U.S. *Bankruptcy Code*, which provides that a committee of creditors may consult with the trustee in connection with the administration of the estate, make recommendations to the trustee respecting the trustee's duties, and submit to the court any questions affecting the administration of the estate.⁶¹

The typical trustee in bankruptcy in Canada has significant business experience and is knowledgeable about the applicable insolvency legislation and procedures. The trustee should be recognized as the primary decision maker in estate administration, particularly given that the trustee is an officer of the court and has a fiduciary duty to act in the best interest of all creditors. The creditors will always continue to retain their right to take a matter to court if they do not support a decision made by the trustee in the administration of a bankrupt estate. The provisions concerning the board of inspectors should therefore be retired and replaced with new provisions governing committees of creditors which should define this important thought more limited role.

C. Deciphering Obscure Meanings

Another consequence of working with a very old statute is that one cannot confidently rely upon the words of the statute to convey its meaning. The statutory provisions become encrusted with judicial decisions that introduce an added layer of meaning on the provisions. In other cases, the original purpose of a statutory provision designed to alter a particular

⁵⁹ *Supra* note 29 at 218.

⁶⁰ *Ibid* at 222.

⁶¹ *Supra* note 27, § 705(b).

judicial decision is forgotten. Grant Gilmore observed that the true function of a codifying statute “is to reduce the past to order and certainty – and thus to abolish it”.⁶²

1. The Concept of a Provable Claim

In some instances, it is difficult to understand what the statute is getting at. Sometimes the original purpose for a provision has become obscured with the passage of time. Without this context, courts may arrive at erroneous conclusions. A good illustration of this can be seen in relation to the provision that sets out the conditions that must be satisfied in order for a claim to be provable in bankruptcy. Section 121(1) provides as follows:

121(1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt *or to which the bankrupt may become subject before the bankrupt’s discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt* shall be deemed to be claims provable in proceedings under this Act (emphasis added).

The first portion of the provision is unproblematic. Debts and liabilities that are in existence at the date of the bankruptcy are provable even if the amount does not become payable until a later date. The difficulty concerns the words of the provision that go on to include a debt or liability “to which the bankrupt may become subject before the bankrupt’s discharge” arising out of a pre-bankruptcy obligation.

In *Ontario New Home Warranty Program v Jordan Homes Ltd.*⁶³, the court held that a guarantee that had been granted before the commencement of the bankruptcy of the guarantor was provable only if the default of the principal debtor occurred before the discharge of the bankrupt. Clearly, the court was attempting to give some meaning to the additional words. Unfortunately, the consequence was that a bankrupt is potentially subject to a variety of contingent obligations that were unresolved at the date of the discharge. This outcome has been criticized as undermining the fresh start policy of debtor rehabilitation that is fundamental to bankruptcy law as it relates to individual debtors.⁶⁴ The case law in Canada has been divided. The decision has been followed in Quebec⁶⁵ and PEI⁶⁶, but not in Alberta.⁶⁷

⁶² “On Statutory Obsolescence” (1967), 39 U. of Col. L. Rev. 361 at 376.

⁶³ 43 O.R. (3d) 756 (Gen. Div.).

⁶⁴ Scott Bomhof, “Case Comment: *Ontario New Home Warranty Program v Jordan Homes Ltd.*” (1999), 10 C.B.R. (4th) 5.

⁶⁵ *Axa Assurances inc. c. Immeuble Saratoga inc.*, 2007 QCCA 1807.

⁶⁶ *E.R.I. Engine v. MacEachern*, 2011 PECA 2.

⁶⁷ *Re: SemCanada Crude Company (Orleans Energy Ltd.)*, 2012 ABQB 495, application for leave to appeal dismissed *RMP Energy Inc. v. SemCAMS ULC*, 2012 ABCA 312.

The mystery behind the wording of this provision is dispelled once one examines the textbook written by Lewis Duncan⁶⁸ shortly after the enactment of the 1919 Act. Duncan indicated that the purpose was to cover executory contracts that are disclaimed by the trustee after the occurrence of the bankruptcy. He stated:⁶⁹

The class of claims covered by the words “or to which the bankrupt may become subject before his discharge by reason of any obligation incurred before the date of the receiving order or the making of the authorized assignment,” include cases of contract where the trustee either disclaims or ceases to perform the contract. In such case the creditor may prove against the estate for the damages occasioned by the breach of the contract, and this is his only remedy.

Bankruptcy does not by itself constitute a repudiation of an executory contract. The trustee has the option of affirming the contract, in which case the counterparty will not have a provable claim. It is only when the trustee disclaims that contract that the counterparty obtains the right to prove a claim, and this will typically arise after the date of bankruptcy.

The operation of section 121(1) is illustrated in the following example. At the date of bankruptcy, there is an executory contract between the bankrupt and a person who has agreed to sell goods to the bankrupt. The seller has not delivered the goods, and the bankrupt has not paid for them. At the date of the bankruptcy, it cannot be determined if the seller has a provable claim since this will depend upon the actions of the trustee in bankruptcy. If the trustee affirms the contract, the seller will deliver the goods and will receive payment of the price. In this event, the seller will not have a provable claim. If the trustee disclaims the contract, the seller will have a claim for breach of contract that qualifies as a provable claim. The liability is therefore one that does not exist at the date of bankruptcy, but which arises before the bankrupt’s discharge (upon disclaimer of the contract by the trustee) and which relates to an “obligation incurred before the day on which the bankrupt becomes bankrupt” (since the contract was concluded before the date of the bankruptcy).

Unfortunately, by failing to directly deal with the matter of disclaimer and leaving the matter to implication, the bankruptcy legislation did not make clear this legislative objective and opened the road for the misinterpretation of the provision. The provision was never intended to exclude contingent liabilities from the definition of a provable claim. It was merely included to ensure that claims that arose following the bankruptcy as a result of a disclaimer of the contract by the trustee were to be included.

⁶⁸ *The Law and Practice of Bankruptcy in Canada* (Carswell, 1922).

⁶⁹ *Ibid* at 428-29.

Section 121(1) should be redrafted to make it clear that guarantees and other contingent obligations are provable and therefore also dischargeable claims even if the contingency has not been resolved by the date of bankruptcy discharge. This is particularly important in light of the divided case law on this point and the fact that the *Jordan* line of cases undermines a fundamental policy of bankruptcy law. But this raises a larger question. One of problems with the current drafting of the *BIA* is that the legislation is almost wholly silent concerning the important issue of executory contracts. A strong case can be made for an amendment that would set out in detail the rules concerning the trustee's ability to affirm or disclaim contracts.⁷⁰ We believe that this would be a desirable step as the rules that have been developed by the courts to fill this gap are not self-evident and this area is often fraught with difficulties.

2. The Vesting of Non-Divisible Property

Another type of interpretive problem arises when a court interprets the statutory framework in such a way as to give effect to some underlying objective of a particular provision. The provision is later repealed, but the interpretation of the associated provisions continues to apply. In this sense it may be likened to the flotsam of a sunken vessel. The Supreme Court of Canada decision in *Royal Bank of Canada v. North American Life Assurance Co.*⁷¹ provides a classic example of this phenomenon.

Upon bankruptcy, the property of the debtor vests in the trustee.⁷² The Act has long provided that property held by the debtor in trust for another and exempt property is not divisible among the creditors.⁷³ It was originally thought that this meant that trust property and exempt property did not vest in the trustee in bankruptcy.⁷⁴ The Supreme Court of Canada departed from this view in its attempt to construe the exemption provisions and the settlement provisions of the bankruptcy legislation so as to avoid unjust and absurd results. The concern was that the settlement provisions might have the effect of invalidating insurance-based RRSP contributions despite the fact that the debtor was not insolvent at the time the contribution was made and had no intention to defraud creditors.

⁷⁰ See Anthony Duggan, "Partly Performed Contracts" in S. Ben-Ishai & A. Duggan, eds., *Canadian Bankruptcy and Insolvency Law: Bill C-55, Statute c. 47 and Beyond* (LexisNexis, 2007) c. 3.

⁷¹ [1996] 1 S.C.R. 325.

⁷² *BIA*, *supra* note 13, s. 71.

⁷³ *Ibid*, s. 67(1)(a) & (b).

⁷⁴ The Alberta Court of Appeal in *Direct Rental Centre (West) Ltd. v. A.C. Waring & Associates Inc.*, [1997] 6 W.W.R. 476 at para. 12 commented that "[f]or a long time the conventional legal wisdom was that exempt property did not pass to the trustee."

The Court avoided this result through a novel two step conceptualization of the bankruptcy process.⁷⁵ In the property vesting stage, the trustee in bankruptcy gathers in the assets. This stage includes the clawing back of assets through the avoidance powers of the trustee in bankruptcy.⁷⁶ This was followed by the estate-administration stage.⁷⁷ This encompasses the application of the exemption provisions.⁷⁸ The Court held that exempt property and trust property vest in the trustee in bankruptcy upon the occurrence of the bankruptcy. These assets are not available to satisfy the claims of the creditors. The trustee in bankruptcy is therefore required to convey this property back to the bankrupt.⁷⁹ The Court held that the designation of a beneficiary in respect of the RRSP (which clothed the RRSP with the status of exempt property) could be avoided by the trustee in bankruptcy as a settlement, but that this did not affect its status as exempt property.

The settlement provisions were eliminated and replaced with the current provisions respecting transfers at undervalue in 2009⁸⁰, but the tortuous construction of the vesting provisions have not disappeared. The practical reality is that trustees in bankruptcy do not convey trust property and exempt property back to the bankrupt. They treat the property as not ever having vested in the bankrupt's estate. The difficulty, of course, is that the bankrupt has no power to dispose or otherwise deal with the property until the property has been transferred back to the bankrupt.⁸¹ If exempt goods are sold by a bankrupt to a third party, the bankrupt is unable to transfer good title and the buyer has an action in the buyer has the right to sue the bankrupt for breach of the implied condition that the seller had the right to sell the goods.⁸²

The bankruptcy legislation in the United Kingdom expressly states that trust property and exempt property do not vest in the trustee in bankruptcy.⁸³ This was originally the position in the United States, but it was altered in 1987 so that exempt property vests in the trustee in bankruptcy but is later withdrawn from the bankrupt estate.⁸⁴ The crucial difference is that U.S. bankruptcy law provides a procedure by which this withdrawal occurs at a relatively early stage in the proceedings.⁸⁵ Exempt property in the first instance vests in the trustee in bankruptcy and then the debtor must file a claim or exemption to remove the property from the estate.

⁷⁵ *Supra* note 71 at para 44.

⁷⁶ *Ibid*, at para 46.

⁷⁷ *Ibid*, at para 45.

⁷⁸ *Ibid*, at para 48.

⁷⁹ *Ibid*, at para 52.

⁸⁰ *BIA*, *supra* note 13, s. 96.

⁸¹ *Ibid*, s. 71.

⁸² See, e.g., *Sale of Goods Act*, R.S.A. 2000, c. S-2, s. 14(a).

⁸³ *Insolvency Act*, 1986, *supra* note 29, ss. 306 and 283(1). Section 283(1) provides that the bankrupt's estate does not include exempt property or property held in trust. Section 306 provides that only the bankrupt's estate vests in the trustee in bankruptcy.

⁸⁴ See Charles Tabb, *The Law of Bankruptcy* (Foundation Press, 1997) at 305.

⁸⁵ See 11 U.S.C., §522(l) and *Federal Rules of Bankruptcy Procedure*, Rule 4003(a).

The debtor must do so within 15 days of the petition. The trustee or any creditor then has 30 days to object to the debtor's claim of an exemption. Canadian bankruptcy law should either provide that non-divisible assets do not vest in the trustee in bankruptcy, or else set out a specific procedure as has been done in the United States. Sitting on the fence is not an adequate response.

D. Vestigial Provisions

Some provisions performed some useful function in the past, but no longer do so. They remain as vestigial structures, akin to the appendix and wisdom teeth in humans. The reasons for the loss of function vary. In some cases, the reason is that the original statute imposed a monetary limitation that has not been updated. Over time, the significance of the limitation becomes progressively eroded until it reaches a state of complete irrelevancy. Although its function is lost, the structure remains. The *BIA* provides that a debtor must owe a debt of \$1000 or more before bankruptcy proceedings can be commenced.⁸⁶ This monetary limit has not been changed since 1949.⁸⁷ Although the monetary limit might have served a useful gatekeeper function in the past, it no longer does so. By way of comparison, the amount that must be owed to creditors in respect of involuntary bankruptcy proceedings under the *United States Bankruptcy Code* was originally set at an aggregate of at least \$10,000 in 1994 and is revised every three years. As of April 1, 2013, it stands at \$15,325.⁸⁸ Another example of a monetary limit is found in the section 48 of the *BIA*. It provides that involuntary bankruptcy proceedings are unavailable against "any individual who works for wages, salary, commission or hire at a rate of compensation not exceeding twenty-five hundred dollars per year." The provision has been unchanged since 1949, and now is absolutely irrelevant. With these provisions, a choice needs to be made. They can be pruned from the statute as deadwood, or their function can be revived by replacement of a more meaningful monetary amount.

Another example of vestigial provisions is found in the list of preferred creditors in section 136(1). This provision sets out the hierarchy of preferred claims in bankruptcy. Paragraphs (h) and (j) read as follows:

(h) in the case of a bankrupt who became bankrupt before the prescribed date, all indebtedness of the bankrupt under any Act respecting workers' compensation, under any Act respecting unemployment insurance or under any provision of the Income Tax

⁸⁶ *Supra* note 13, s. 42(1)(a).

⁸⁷ S.C. 1949 (2nd Sess.), c.7, s. 21(a). The 1949 Act doubled the previous amount of \$500 established in the original 1919 Act. See S.C. 1919, c. 36, s. 4.

⁸⁸ See 11 U.S.C. §§303(b) and 104.

Act creating an obligation to pay to Her Majesty amounts that have been deducted or withheld, rateably;

...

(j) in the case of a bankrupt who became bankrupt before the prescribed date, 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.

These provisions are a dead letter and should be repealed. Prior to 1992, claims owed to the Crown or to a worker's compensation body were afforded the status of a preferred claim. In 1992, this was changed. These claims were relegated to the status of an ordinary claim unless a statute created them created a non-consensual security interest in their favour and if registration of this interest was effected before the date of the initial bankruptcy event.⁸⁹ However, paragraphs (i) and (j) were not repealed. Instead, their operation was restricted to that they only operated "in the case of a bankrupt who became bankrupt before the prescribed date" – a date specified by the regulations as November 30, 1992.⁹⁰ The provisions may still ensnare the unwary and cause them to misunderstand the law, but their force is spent.

Section 98.1 of the *BIA* is another prime candidate for the scrap heap. It provides that an assignment of book debts is void against a trustee in bankruptcy unless it is registered under provincial law.⁹¹ The provision was included in the original 1919 statute.⁹² In the absence of this avoidance provision, an unregistered assignment was fully effective against the trustee in bankruptcy.⁹³ At the time, many of the provinces had not enacted provincial assignment of book debts statutes that required registration of assignments of book debts.⁹⁴ Within a matter of years, most provinces had enacted assignment of book debts legislation that created the requisite registry system. Although this was an interesting phase in the historical development of secured transactions law in Canada, there is no reason for its perpetual memorialization in the *BIA*. The legislation has had its intended effect in that it spurred the provinces to enact assignment of books debts statutes.⁹⁵ Decades later these were repealed and replaced by modernized secured transactions legislation that requires registration of assignments of accounts.⁹⁶ Provincial secured transactions law now provides that an unperfected or

⁸⁹ *BIA*, *supra* note 13, ss. 86-87.

⁹⁰ *Bankruptcy and Insolvency General Rules*, C.R.C., c. 368, s. 137.

⁹¹ See *Re Inverness Railway & Collieries* (1922), 3 C.B.R. 724 (S.C.C.).

⁹² *Bankruptcy Act*, S.C. 1919, c. 36, s. 30.

⁹³ *Tailby v. Official Receiver* (1888), 13 App. Cas. 523.

⁹⁴ See L. Duncan, *supra* note 68 at 337-38.

⁹⁵ See, e.g., *Assignment of Book Debts Act*, R.S.A. 1980, c. A-47 [repealed].

⁹⁶ See, e.g., *Personal Property Security Act*, R.S.A. 2000, c. P-7, s. 3.

unpublicized security interest is ineffective against a trustee in bankruptcy.⁹⁷ There is no longer any need for a special federal provision to create an avoidance provision for one particular class of asset. Prior to the 2009 amendments, the avoidance provision appeared as s. 94. It was repealed and re-enacted as s. 98.1. It seems strange that the provision was merely shunted about and not abolished outright. This reveals yet another dimension of creeping statutory obsolescence. Some the provisions are so little understood that there is a nagging worry that they just might be doing something important despite the fact that no one can actually state what that might happen to be. So the provision is retained – just in case.

D. Conclusion

It is clear that many of the bankruptcy provisions of the *BIA* are old and rickety. We have identified some of the most egregious instances of statutory obsolescence. But how should these problems be resolved? Are the matters that we have identified ones that should be added to the list of fixes in the next round of insolvency law amendments? Although we think that tackling these issues in a discrete set of amendments would produce a net improvement to insolvency law and to the practice of insolvency professionals, we also recognize that this involves the stitching-on of several more patches to the threadbare fabric of a worn out statute. Our Canadian process of piecemeal insolvency law reform is simply incapable of achieving a thorough modernization of the bankruptcy provisions. Only a comprehensive review of the entire statute can do so. Our current reform process came about because of the failure several decades ago to pass a comprehensive and modernized bankruptcy statute, and it was always recognized to be a second-best solution. Unfortunately, the piecemeal reform process appears to have become institutionalized, and the prospect of a comprehensive modernization of the bankruptcy provisions now seems very slim indeed. Until that day arrives, if it ever does, many curiosities such as the subtle distinction between someone engaged in the occupation is farming and another engaged in the tillage of the soil will be lovingly preserved in our bankruptcy statute.⁹⁸

⁹⁷ *Re Giffin*, [1998] 1 S.C.R. 91.

⁹⁸ Section 48 of the *BIA* provides that involuntary bankruptcy proceedings are not available against an “individuals whose principal occupation and means of livelihood is fishing, farming or the tillage of the soil.” The wording was introduced in 1910 into the first Canadian bankruptcy statute, and was taken from the United States *Bankruptcy Act* of 1898, §4(b). The United States Bankruptcy Code continues to use the terminology, but does so in a modernized definition of “farming operation” that encompasses “farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.” See *Bankruptcy Code*, 11 US Code §101(21).