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Supreme Court of Canada Holds that Bankruptcy May Erase Some Penalties Imposed by Regulators

In *Poonian v British Columbia (Securities Commission),* a majority of the Supreme Court of Canada clarified provisions in the *Bankruptcy and Insolvency Act* (the "***BIA***") that govern when a bankrupt is not released from a claim upon an order of discharge. The Supreme Court concluded that while bankruptcy may release bankrupts from administrative penalties, it will not release them from orders to pay amounts obtained by fraud.

Facts

In 2014, the British Columbia Securities Commission (the "**Commission**") found that the Appellants, the Poonians, violated the *Securities Act* (the "***Act***") by engaging in market manipulation that caused investors to lose millions of dollars. The Commission imposed financial sanctions on the Poonians, including over $13 million in administrative penalties and over $5 million in disgorgement orders. The Commission then registered these sanctions with the British Columbia Supreme Court under the *Act.*

In 2018, the Poonians declared bankruptcy. The Commission, relying on subsections 178(1)(a) and 178(1)(e) of the *BIA,* applied for a declaration that the amounts owed to it by the Poonians would not be released by an order of discharge. Section 178(1) provides that an order of discharge does not release a bankrupt from:

> (a) any fine, penalty, restitution order or other order similar in nature to a fine, penalty or restitution order, imposed by a court in respect of an offence; or
>
> …
>
> (e) any debt or liability resulting from obtaining property or services by false pretences or fraudulent misrepresentation…

The British Columbia Supreme Court found that both section 178(1)(a) and section 178(1)(e) applied to the administrative penalties and disgorgement order imposed by the Commission because: (1) the Commission registered the order with the

court, so the sanction had been imposed by a court; and (2) the Poonians' market manipulation involved fraudulent misrepresentation or false pretence and represented the deceitful conduct which was the essence of what section 178(e) was intended to target. Both sanctions were therefore exempted from discharge.

On appeal, the B.C. Court of Appeal found that the section 178(1)(a) exception did not capture the sanctions imposed by the Commission, but that the section 178(1)(e) exception captured both the disgorgement order and the administrative penalties; both sanctions therefore survived the Poonians' bankruptcy under subsection 178(1)(e). The Poonians appealed to the Supreme Court of Canada.

The Supreme Court confirmed that the "principle that every claim is swept into the bankruptcy and that the bankrupt is released from all of them upon being discharged unless the law sets out a clear exclusion or exemption" guides the proper interpretation of the *BIA*. However, section 178(1) limits this principle by listing specific debts that survive bankruptcy. As the Supreme Court explained, those exceptions to the general rule must be interpreted narrowly and applied only in clear cases because: (1) courts have no discretion respecting their application; and (2) "the more claims that survive bankruptcy, the more difficult it becomes for a debtor to rehabilitate".

The Supreme Court then clarified the interpretation of subsections 178(1)(a) and 178(1)(e) of the *BIA.* The Court confirmed that:

- Subsection 178(1)(a) does not apply to decisions of regulators or administrative tribunals that are subsequently registered in court; and
- Subsection 178(1)(e) captures disgorgement orders because there is a link between disgorgement orders and fraudulent conduct. Administrative penalties may not fall within the exception because they do not directly result from the offence. Rather, administrative penalties arise indirectly from the administrative tribunal's decision to impose a sanction.

Section 178(1)(a) of the *BIA*

For a debt to survive bankruptcy under section 178(1)(a), the creditor must establish that the debt is:

> (i) a fine, penalty, restitution order or other order similar in nature;

(ii) imposed by a court; and

(iii) in respect of an offence.

The Supreme Court ruled that to find a debt to be imposed by a court, a court must have been "actively involved in making the decision". The definition of "court" cannot be broadened to allow section 178(1)(a) to capture orders of administrative tribunals or regulatory bodies; even when these decisions are later registered in court, the court's involvement is passive. As registration of a decision does not change the fact that it was made and imposed by an administrative decision maker, it is insufficient to shelter an order under section 178(1)(a).

Because both the administrative penalties and disgorgement orders were imposed by the Commission, neither could survive the order of discharge based on the section 178(1)(a) exception.

Section 178(1)(e) of the *BIA*

For a debt or liability to survive bankruptcy under section 178(1)(e), the creditor must establish three elements:

(i) false pretences or fraudulent misrepresentation;

(ii) a passing of property or provision of services; and

(iii) a link between the debt or liability and the fraud.

The Supreme Court held that the first element puts the onus on the creditor to prove through "clear and cogent" evidence that the debts or liabilities were obtained through false pretences or fraudulent misrepresentation. The court cannot take judicial notice of fraud or rely on findings from an administrative tribunal. Rather, the court must rigorously review the record, even where the administrative findings of fraud are expressed, and assess the evidence presented to them.

The Supreme Court rejected the proposition that to fall under the section 178(1)(e) exemption, the bankrupt/debtor must be the direct recipient of the property of which a person was deprived. Rather, the Supreme Court found that section 178(1)(e) may apply even when the bankrupt had not obtained the property giving rise to the debt or liability, and it had gone to a third party instead. All that is required is that the fraudulent misrepresentation induced a person to give the property to the bankrupt or someone associated with the bankrupt.

With respect to the third element, the Supreme Court found that the use of the phrase "resulting from" in section 178(1)(e) requires a direct link between the bankrupt's deceit and the creation of the debt or liability.

The administrative penalties imposed by the Commission did

not fall within the section 178(1)(e) exception because they did not result directly from the fraudulent scheme. The administrative penalties arose from the Commission's decision to impose a sanction, and could not survive the bankruptcy. The disgorgement orders were captured under the exception as there was a direct link between the orders and the Poonians' fraudulent conduct. The disgorgement orders were therefore not released by any possible future order of discharge.

Key Takeaways

- The courts may treat administrative penalties and disgorgement orders differently under the *BIA;*
- Bankrupts may be able to discharge administrative penalties through bankruptcy;
- Bankrupts are not able to discharge disgorgement orders through bankruptcy;
- The Supreme Court has brought uniformity to the interpretation of section 178(1) of the *BIA*, resolving disagreement between the British Columbia Court of Appeal and Alberta Court of Appeal; and
- The British Columbia Securities Commission scheme provides for mandatory disgorgement. Other provincial securities acts are permissive.