

DEBT AND FEDERALISM

Landmark Cases in Canadian
Bankruptcy and Insolvency Law,
1894–1937

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INTRODUCTION

An Untested Federal Power

The long history of bankruptcy has been one of an expanding concept.

– Tassé Report, 1970

The apparent clarity of the wording of “bankruptcy and insolvency” in the *British North America Act* (now known as the *Constitution Act, 1867*)¹ belies the controversy that surrounded Parliament’s early exercises of this federal legislative power. Bankruptcy law is a statutory exception to the common law and interferes with ordinary debtor-creditor relations, such as contract, otherwise regulated by provinces.² Bankruptcy law at its core seeks to achieve two important objectives: “[T]he equitable distribution of the bankrupt’s assets among his or her creditors and the bankrupt’s financial rehabilitation.”³ These two objectives have long been recognized. In 1924, Justice Fisher of the Ontario Supreme Court wrote:

I may observe at the outset that in all commercial countries ... it is of vital moment to the trading part of the community that there shall be some legal provision for dealing with debtors who have ceased to be able to meet their liabilities, so that the rights of creditors may reasonably be protected, and so that debtors who have acted honestly may be enabled to get a discharge from their liabilities and be thereby enabled

to make a fresh start without a millstone of debts forever crippling their efforts.⁴

Bankruptcy law’s “fresh-start principle” is well known as it permits individual debtors to obtain a release of debts through a statutory discharge.⁵ The equitable distribution of assets in an “orderly manner is at the heart of insolvency legislation”⁶ and is enforced through “a single proceeding model”⁷ whereby unsecured creditors seeking to enforce a claim must participate in a collective proceeding.⁸ Generally speaking, all assets are distributed equally to unsecured creditors in a bankruptcy proceeding. Without a bankruptcy regime or something similar, chaos would result.⁹

The meaning of “bankruptcy and insolvency law” in the *British North America Act* has often proved to be elusive as the federal power must be measured against provincial jurisdiction over property and civil rights and other heads of provincial power.¹⁰ Furthermore, there is a mistaken impression that there was an established definition of “bankruptcy and insolvency”¹¹ at Confederation and that this definition remains the same today.¹² As Justice Laskin noted in *Robinson v Countrywide Factors Ltd*, the ambit of the federal bankruptcy power “does not lie frozen under conceptions held of bankruptcy and insolvency in 1867.”¹³ The 1970 Study Committee on Bankruptcy and Insolvency Legislation described the history of bankruptcy and insolvency law as an “expanding concept.”¹⁴ Federal bankruptcy law-making was tentative in the nineteenth century but more comprehensive in 1919 and during the Great Depression. The judgments in the four landmark cases discussed in this book forged the bankruptcy power at times when federal and provincial views seemed irreconcilable.

On 18 December 1922, Premier Louis Taschereau rose in the Quebec National Assembly and proclaimed that the federal *Bankruptcy Act*¹⁵ was *ultra vires*.¹⁶ Parliament had enacted the Act only three years earlier. This legislation established Canada’s first permanent bankruptcy regime, yet its viability as a federal law was in doubt. Taschereau argued that the new federal law intruded on provincial jurisdiction over the *Civil Code of Québec*, and he threatened to challenge the *Bankruptcy Act* in the highest

courts. Taschereau's challenge is but one example demonstrating that the words "bankruptcy and insolvency" law, as they appear in the *British North America Act*, have been anything but clear. The debate about the scope of the federal bankruptcy power began in the nineteenth century and continues to this day. Federalism has had a significant impact on the development of Canadian bankruptcy and insolvency law.¹⁷

At its core, this book is about the evolution of the federal bankruptcy and insolvency power in the *British North America Act*, and its important relationship with provincial property and civil rights jurisdiction. This study offers an in-depth historical examination of the four landmark cases that provided the constitutional foundation for the development of contemporary bankruptcy and insolvency law: the *Voluntary Assignments Case* (1894);¹⁸ *Royal Bank of Canada v Larue* (1928);¹⁹ the *Companies' Creditors Arrangement Act Reference* (1934);²⁰ and the *Farmers' Creditors Arrangement Act Reference* (1936, 1937).²¹ Each case took place at a "critical juncture" in the history of Canadian bankruptcy law.²² By situating these four cases on a continuum, we show how the incremental changes brought about by each decision laid the groundwork for the constitutional challenge that followed. These four cases also demonstrate that the jurisdictional gains were all in favour of Parliament, with the courts adopting a broad interpretation of the bankruptcy and insolvency power.

Section 91 of the *British North America Act* gives the Parliament of Canada significant powers over matters that affect the national economy. Section 91(21) grants Parliament exclusive jurisdiction over "bankruptcy and insolvency." The framers of the Act gave no express reason for the inclusion of bankruptcy and insolvency law in this section,²³ but it fit naturally with other national powers such as "trade and commerce" and "banking."²⁴ Although it was important to establish a national²⁵ uniform bankruptcy law rather than allow the provinces to establish diverse regimes, the path to a stable national regime was anything but certain. Bankruptcy law provisions have varied over time in response to social and economic changes.²⁶

According to the Supreme Court of Canada, the "very design of insolvency legislation raises difficult policy issues for Parliament."²⁷ The

difficulty arises as bankruptcy and insolvency law “expresses fundamental conflicts at the heart of the capitalist political economy between labour and capital, owners and managers, debtors and creditors, and the state and the market.”²⁸ In a federal state, conflict also arises between federal and provincial levels of government over the scope of the bankruptcy power in the *British North America Act*. Indeed, “[t]he way that a country chooses to deal with [debtors] ... tells a deep and complex story about the underlying values in that society.”²⁹ In particular, the equitable distribution of assets involves a choice. As Philip Wood states: “There is not enough money to go around and so the law must choose whom to pay. The choice cannot be avoided or compromised or fudged. The law must always decide who is to bear the risk so that there is always a winner and a loser.”³⁰ Supreme Court of Canada Justice Cromwell recognized in *Sun Indalex Finance, LLC v United Steelworkers* that “creditors find themselves in a zero-sum game with not enough money to go around.”³¹ Therefore, “[c]reditors may not be able to recover their debts, investors may lose their investments and employees may lose their jobs.”³² A bankruptcy may involve “catastrophic consequences,”³³ with few appreciating “the *haircuts* or even outright losses that bankruptcies trigger.”³⁴

A nineteenth-century writer recognized the difficulty for legislators: “In all commercial countries one of the most difficult problems to be solved by legislation has been the settlement of the relations between a creditor and his bankrupt debtor.”³⁵ In 2013, Jérôme Sgard wrote: “Bankruptcy is the ultimate market sanction ... Since medieval times, lawmakers have endlessly redesigned and reformed this intricate mechanism.”³⁶ Canada provides a perfect illustration of Sgard’s point. The historical path that led to the modern system of bankruptcy and insolvency law has been incremental and at times unpredictable.³⁷ In Canada, there was no consensus on the need for a national bankruptcy law until 1919. After Confederation, Parliament enacted two statutes, in 1869 and 1875, which proved to be short-lived.³⁸ The overall commitment to a strong bankruptcy law was weak. These statutes were limited in scope and applied to traders only, thus excluding wage earners.

In the late 1870s, MPs could simply not agree on whether a bankruptcy law should include a discharge. As a result of this sharp division in Parliament, the Dominion repealed the bankruptcy statute in 1880.³⁹ The absence of a federal law led to an expansion of provincial powers over debtor-creditor law, with provinces relying on their property and civil rights jurisdiction. Canada was without a national bankruptcy law for nearly forty years before the *Bankruptcy Act* of 1919 established a permanent bankruptcy regime.⁴⁰ By 1923, this statute had been amended such that there was no meaningful provision to restructure debts in order to keep businesses in operation, and there was no clear answer to the question of whether the provinces or Parliament could restructure secured debt.⁴¹ Parliament therefore acted boldly during the Great Depression to rectify this problem.

Economic challenges in the 1930s exposed the deficiencies of the *Bankruptcy Act* and led Parliament to enact specific legislation to deal with insolvent companies (*Companies' Creditors Arrangement Act* [CCAA] in 1933)⁴² and insolvent farmers (*Farmers' Creditors Arrangement Act* [FCAA] in 1934).⁴³ These statutes adopted a different approach from the *Bankruptcy Act*. Their objective “was the negotiation of an arrangement under which the creditors compromised their claims and the debtor was permitted to carry on the business or farming operations.”⁴⁴ By necessity, both Depression-era statutes imposed a stay on secured creditors, raising the question of whether the bankruptcy power extended to interfering with provincial jurisdiction over secured debt, and leading to constitutional challenges to the federal statutes. Federal law, therefore, is only part of the story when the debtor is insolvent, as there is an important interaction with provincial law.

If powers of national importance lay with Parliament to ensure unity, the *British North America Act* granted “[b]road powers ... to the provincial legislatures with respect to local matters, in recognition of regional diversity.”⁴⁵ Ordinary debtor-creditor relationships, e.g., matters of contract, are regulated by the provinces under their jurisdiction over “property and civil rights” under section 92(13) of the *British North America Act*. Thus, for example, provincial law relating to mortgages and secured debt will establish the validity of the underlying debt.

Uncertainty over the extent of the federal bankruptcy and insolvency power can be explained by the presence of the provincial power over “property and civil rights.” This uncertainty left it to the courts to assess the inexact scope of the federal and provincial fields due to the anticipated overlap of federal and provincial powers.⁴⁶ As Justice Binnie notes in *Sam Lévy & Associés Inc v Azco Mining Inc*: “Most bankruptcy issues, of course, present a property and civil rights aspect.”⁴⁷ Justice Laskin stated in *Robinson v Countrywide Factors Ltd*: “[T]he starting point is in [the] relevant words of the *British North America Act*, namely s. 91(21), ‘bankruptcy and insolvency,’ as they relate to s. 92(13), ‘property and civil rights in the Province.’”⁴⁸

The procedural nature of the federal bankruptcy regime “relies heavily on the continued existence of provincial substantive rights, and thus the continued operation of provincial laws.”⁴⁹ But insolvency may lie at the core of provincially regulated debtor-creditor relations. Creditors always face the risk that a debtor will become insolvent.⁵⁰ When a loan is not repaid, “the debtor breaks a contract that is considered fundamental in every economy.”⁵¹

Bankruptcy law, therefore, interferes with the ordinary relations between debtors and creditors.⁵² Where there is a conflict between

provincial laws concerning property and civil rights and federal bankruptcy legislation, the *BIA* [*Bankruptcy and Insolvency Act*] prevails ... In other words, bankruptcy is carved out from property and civil rights but remains conceptually part of it. Valid provincial legislation of general application continues to apply in bankruptcy until Parliament legislates pursuant to its exclusive jurisdiction in relation to bankruptcy and insolvency. At that point, the provincial law becomes inoperative to the extent of the conflict.⁵³

From a modern perspective, this proposition seems relatively straightforward. But when federalism is viewed in a historical perspective, a great deal of doubt existed about the scope of the federal bankruptcy power. Provisions of the *Bankruptcy Act*, the *Companies’ Creditors Arrangement Act*, and the *Farmers’ Creditors Arrangement Act* all came

under constitutional scrutiny. Provincial Attorneys General led the charge, arguing that the newly enacted federal provisions interfered with property and civil rights jurisdiction, among other provincial fields, with the Attorney General of Quebec claiming that the federal law intruded on the Civil Code. Constitutional questions that we now take for granted were very much in play from Confederation to the Great Depression. In creating a federal distribution scheme or a reorganization regime, how far may Parliament go in its interference with provincial law? Conversely, if a provincial regime purports to regulate insolvency matters, would that constitute a valid exercise of property and civil rights jurisdiction? In other words, what is the scope of the federal bankruptcy power? Bankruptcy law therefore constitutes much more than the distribution of losses among creditors, as federalism cases can also involve picking the winner in a dispute between Parliament and provincial legislatures over the breadth of the federal bankruptcy power. As the four cases in this book demonstrate, this power was highly contested.

The exact meaning of the wording in section 91(21) is not always easy to discern, but appellate cases provide a starting point. As Justice Laskin notes in *Robinson v Countrywide Factors Ltd.*:

The elucidation of the meaning and scope of s. 91(21), as of the meaning and scope of any other heads of legislative power, can hardly ever be a purely abstract exercise, even where an attempt is made at neutral definition; but I see no reason why judicial pronouncements, especially at the appellate level where they are those of the court, should not be considered as throwing light upon the integrity of the head of power in the scheme of the B.N.A. Act as a whole.⁵⁴

However, there has been a significant amount of litigation over the scope of the bankruptcy power, “and the cases are not always easy to reconcile.”⁵⁵ Indeed, the constitutional jurisprudence regarding the meaning of section 91(21) “contains inconsistencies and contradictions.”⁵⁶ Despite being a very technical area of commercial law, the term “bankruptcy and insolvency law,” as defined by the decisions of

judicial generalists in the Privy Council and the Supreme Court of Canada, has undergone distinct changes in its generally accepted meaning over time. The role of the highest court and the institution of federalism are therefore essential to the understanding of the modern interpretation on which the Canadian bankruptcy and insolvency system rests.

Such an understanding of the evolution of bankruptcy law and its relationship to federalism cannot be arrived at by analyzing just one leading case. Four landmark cases are crucial to a historical understanding of this field, as they illuminate changing conceptions of the federal “bankruptcy and insolvency” power under the *British North America Act*. These cases are important to developments in the field of bankruptcy and insolvency law in terms of both legislation and case law developments, but their influence has wider political ramifications. Our analysis begins in the late nineteenth century, when bankruptcy law-making was tentative. In 1880, Parliament repealed federal bankruptcy legislation and left the issue of overindebtedness to the provinces. An 1894 decision of the Privy Council influenced whether there would be a national bankruptcy law at all. When Parliament finally reasserted its jurisdiction over bankruptcy in 1919, there was significant doubt about its ability to interfere with provincial jurisdiction. The hiatus of almost forty years helped to solidify provincial approaches to insolvent debtors, particularly in Quebec. In 1928, the Privy Council sought to resolve the doubt about the scope of the federal bankruptcy power.

This book concludes with an examination of the late 1930s, a decade that was defined by the Great Depression and the Dust Bowl. The “Dust Bowl” refers to a severe drought in the prairie regions of Canada and the United States during the 1930s.⁵⁷ The topsoil was blown away by strong winds, making farming impossible in certain places.⁵⁸ The Dust Bowl devastated the economies of the prairie provinces, particularly Saskatchewan. This decade stands out as the boldest and most comprehensive period of federal bankruptcy and insolvency law-making in Canadian history.⁵⁹ Canadian bankruptcy law has often responded to economic recessions and depressions.⁶⁰ The Depression-era reforms occurred at a time when several provinces were sliding into insolvency,⁶¹

and Prime Minister R.B. Bennett sought greater centralization of Parliament's powers to deal with the political and economic challenges of the 1930s. While much of Bennett's Canadian New Deal legislation was eventually struck down, his efforts to create the Bank of Canada, the Canadian Wheat Board, and the Canadian Broadcasting Corporation succeeded in consolidating more power centrally.⁶² The courts ultimately decided whether a corporate rescue statute and farm debt relief legislation would remain in force or be struck down as *ultra vires*. We highlight how the final attributes of the contemporary federal bankruptcy and insolvency power were hammered out in the strained Canadian federalism of the 1930s. The final case in this book marks the last time that a federal bankruptcy and insolvency law was subjected to constitutional challenge.

Our subject-matter expertise enables us to critically assess the division of powers analysis from a substantive perspective. In our concluding chapter, we highlight the lasting significance of these cases for the broader field. Since constitutional disputes over bankruptcy and insolvency law are a live issue today, this book highlights the significance of the four cases for present-day judicial interpretations of Parliament's legislative jurisdiction in this field. Since 2015, six bankruptcy and insolvency cases have come before the Supreme Court of Canada, and four of them have considered the "contest between sections 91(21) and 92(13)."⁶³ Constitutional litigation over the scope of the federal power remains "among the hottest topics in the bankruptcy and insolvency field."⁶⁴

We bring a doctrinal perspective to the analysis of the four cases, but we also adopt a historical approach. While it is important to recognize how each of these landmark cases influenced subsequent case law,⁶⁵ this book has a much wider goal. We examine the cases in their social, economic, and political contexts due to the "inherent value in considering the[ir] ... historical impact."⁶⁶ In doing so, we seek to "open up the black box of the Court's decision making"⁶⁷ process and consider sources well beyond the four corners of the decisions. Limiting one's attention "to the text of the statute and the appellate cases ... misses much of the dynamics of the ... bankruptcy system."⁶⁸ As

Professor Brian Simpson notes, “[y]ou cannot understand litigation simply by reading law reports.” It would be “misguided ... to rely upon law reports alone to tell us what happened in the case, how the dispute arose, what the persons involved conceived the dispute to be about, how it came to be litigated, [and] how it came to be decided the way it was.”⁶⁹ The analysis in this book, therefore, draws from full appeal records, including appellant and respondent factums, transcripts of counsel arguments, coverage in newspapers and the commercial press, historical law reviews, judicial and lawyer biographies, materials published by trade organizations, Hansard, archival records from the Department of Justice and Department of Finance, provincial archival materials, and the personal papers of civil servants and politicians. Ultimately, we show how the four decisions were “[b]oth cheered and jeered,” set legal precedents, and provoked social and political change.⁷⁰

This book contains five chapters following this one. **Chapter 1** examines the *Voluntary Assignments Case* (Judicial Committee of the Privy Council [JCPC], 1894). With the repeal of the federal bankruptcy legislation in 1880, questions arose about the constitutionality of the provincial assignments and preferences legislation. In 1894, the Privy Council upheld a provision of an Ontario law that had been enacted in the absence of federal bankruptcy law. This decision had two immediate impacts. First, it enabled the provincial era of debtor-creditor regulation to continue unscathed. Second, the decision effectively stalled federal bankruptcy reform efforts for decades. Over the longer term, however, this case also had significant constitutional consequences for the interpretation of the federal bankruptcy power.

Chapter 2 considers an important sequel to the *Voluntary Assignments Case*. In 1919, Parliament reasserted its constitutional jurisdiction over bankruptcy and insolvency by enacting the *Bankruptcy Act*. The absence of federal bankruptcy law for nearly forty years had a significant impact on the debate over the division of powers in the 1920s. A provincial rights perspective surfaced in constitutional cases where litigants sought to protect the property and civil rights jurisdiction of the provinces from the intrusion of the *Bankruptcy Act*. In 1928, the Privy Council in *Royal Bank of Canada v Larue* sought to end this debate by reaffirming

a broad federal bankruptcy and insolvency power. However, as this chapter illustrates, the outcome was anything but inevitable and was not accepted in certain quarters of Quebec.

[Chapter 3](#) provides an assessment of the *Companies' Creditors Arrangement Act Reference* (Supreme Court of Canada [SCC], 1934). Prior to the 1930s, large creditors relied on the private remedy of receivership to restructure insolvent firms.⁷¹ However, in the 1920s the terms that facilitated this remedy were removed from financing instruments by the private parties themselves, and this left no means to restructure insolvent companies.⁷² This failure of private ordering over corporate reorganization during the Great Depression prompted Parliament to enact a federal corporate reorganization statute – the *Companies' Creditors Arrangement Act* – ostensibly under its bankruptcy and insolvency power. This Act provoked controversy because it could compulsorily bind secured claims, which fell under provincial jurisdiction. [Chapter 3](#) goes on to describe the competing constitutional arguments as well as the contingency and controversy that surrounded the court's decision. It describes the significance of the court's upholding of the constitutional validity of the federal CCAA as a component part of a system of bankruptcy and insolvency, as opposed to its being a matter of property and civil rights or a branch of corporate law. It explains how the anomalous nature of this decision made a subsequent challenge to the highest court inevitable.

[Chapter 4](#) studies another Depression-era decision: the *Farmers' Creditors Arrangement Act Reference* (SCC, 1936; JCPC, 1937). In the early 1930s, in response to political pressure from farmers affected by the Dust Bowl, the Saskatchewan legislature was on the brink of enacting radical debt moratorium legislation. Spurred by plaintive telegrams from Saskatchewan MLAs, Prime Minister Bennett's Conservative government drafted a federal farm insolvency bill in an effort to address the farm-debt crisis. This statute formed part of the Canadian New Deal legislation, which was sent in 1935 for constitutional reference by the incoming Liberal government headed by W.L.M. King. This chapter offers a critical assessment of the constitutional reference case that upheld the validity of the federal farm insolvency act under

Parliament's bankruptcy and insolvency power. It describes how this decision affirmed and entrenched the constitutional analysis in the *CCAA Reference*, making the *FCAA Reference* an outlier among the other New Deal decisions rendered by the Privy Council. This chapter highlights how this decision led to subsequent constitutional challenges,⁷³ which were also decided in favour of Parliament, and ultimately led to the addition of provincial debt-adjustment regimes to federal bankruptcy and insolvency law.⁷⁴

The Conclusion provides a synthesis of the four cases. It shows the linkages between the cases and their combined significance for the development of the wider field. It argues that these four cases deserve landmark status because they established the contours of the federal bankruptcy and insolvency power under the *British North America Act*. In tracing Canada's unique path to a modern bankruptcy regime, this chapter also highlights the contingency that surrounded individual case outcomes, the role of prominent figures in the historical narrative, and the importance of path dependence for understanding the trajectory toward a robust federal power over bankruptcy. It concludes by connecting the historical insights from this study to contemporary constitutional issues and the modern bankruptcy and insolvency system.

Our story begins in the nineteenth century.

insolvency power came under attack from Quebec, and it would take the 1928 decision in *Royal Bank of Canada v Larue* to resolve the constitutional impasse. Lord Herschell's *dicta* became the very basis of the Privy Council's decision in *Larue* in 1928. This case is explored in [Chapter 2](#).

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