DEBTOR & CREDITOR LAW

CHAPTER 5

Discharge of Bankrupt

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DISCHARGE OF BANKRUPT

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I received an innocuous call from the Director of the Continuing Legal Education Society several months ago inquiring if I would speak on the subject of the discharge of bankrupts. I agreed. A few weeks later, I received a letter from him advising me that he would like to have my "Paper" by November 9. However, being an obedient servant of the public, I have prepared a "Paper" as requested and, as I am a judge, I assume the Society would like me to focus on the topic from the perspective of a judge. I therefore decided that I should mention to you certain matters that you may wish to consider if appearing on a hearing before the Court on a discharge application. I will touch on matters that would be of interest to you if you were acting for the bankrupt and applying for the discharge or appearing for an opposing creditor or simply appearing for the trustee.

I shall set out some general comments on the law relating to applications for discharge before dealing with the hearing itself. I will conclude my remarks by

commenting on the question "Will the Court grant the application for discharge?" In the course of my remarks, I will touch on the four topics referred to in the Programme under the heading Dicharge of Bankrupt.

LAW RELATING TO DISCHARGE OF BANKRUPTS

As I am sure you are aware, the law with respect to discharge of bankrupts is set out in Sections 139 to 152 of the Bankruptcy Act and in Rules 106 to 109. I am sure you are all equally aware that probably the most useful text dealing with bankruptcy matters is Bankruptcy Law of Canada by Houlden & Morawetz. The issue of the discharge of a bankrupt is dealt with in Volume 2. There is little point in my setting out a number of the sections of the Act; they are easily looked up. But I will comment briefly on some of the more significant sections in the Act. You will note from Section 139 that, oddly enough, except in the case of corporations, it is the Trustee who actually makes the application for the discharge of the bankrupt. Generally speaking, applications for discharge are made by individuals rather than ccrporations. Under Section 139 the making of a receiving order or an assignment in bankruptcy operates as an application for discharge. Of course, there are requirements in that Section that the creditors be given notice of the appointed time for the hearing (Section 139(6)).

Pursuant to Section 140(1), the Trustee is required to prepare a Report and I think it is worth setting out this Subsection so you will have in this Paper a statement of what is to be in the Report. Section 140(1) provides:

> "Sec. 140. **Trustee to prepare report.**-(1) The trustee shall prepare a report in the prescribed form as to affairs of the bankrupt, the causes of his bankruptcy, the manner in which the bankrupt has performed the duties imposed on him under this Act or obeyed the orders of the court, and as to his conduct both before and after the bankruptcy, as to whether he has been convicted of any offence under this Act, and as to any other fact, matter or circumstance that would justify the court in refusing an unconditional order of discharge, and the report shall be accompanied by a resolution of the inspectors declaring whether or not they approve or disapprove of the report, and in the latter case the reasons of such disapproval shall be given."

The Trustee or any creditor may attend the hearing and be heard in person or by counsel and the Trustee's Report for the purpose of the application is evidence of the statements therein contained.

Section 140(7) provides that a creditor who intends to oppose the discharge of a bankrupt on grounds other than those mentioned in the Trustee's Report shall give notice of the intended opposition and state the grounds thereof to the Trustee and to the bankrupt before the time appointed for the hearing; this has been overlooked on occasion. Section 141(c) requires that the Trustee's

Report contain a statement of opinion by the Trustee with respect to the probable causes of the bankruptcy and that his opinion shall be expressed that the bankruptcy resulted from one or more of the probable causes set forth in that section, namely "misfortune, inexperience, incompetence, carelessness, over-expansion, unwarranted speculation, gross negligence, fraud and other probable causes to be specified." It is also significant to note that Section 141(d) requires that the Trustee's Report contain a statement of the facts and information on which the Trustee relied in arriving at his opinion on the aforesaid matters. This is important so the judge can make an assessment as to the validity of the opinion.

Generally speaking, the bankrupt's financial situation is such that the assets of the bankrupt are not of a value equal to fifty cents on the dollar of his unsecured liabilities. Pursuant to Sections 142 and 143 of the Act, if that has been proven, then the Court cannot grant an absolute discharge unless the bankrupt satisfies the Court that the fact that the assets are not equal to fifty cents on the dollar has arisen from "circumstances for which he cannot justly be held responsible." If the Trustee has given the bankrupt a "favourable" Report, and I must say I am not sure what that means but would infer it means that the Trustee feels it was "misfortune"

or some other blameless cause that resulted in the assets being of a value less than fifty cents on the dollar, then the bankrupt has for the moment, by reason of the Trustee having given this opinion, satisfied the Court that the fact that his assets did not equal fifty cents on the dollar of the unsecured liabilities arose from circumstances for which he could not justly be held responsible. Therefore, under those circumstances, the Court should probably grant an absolute discharge unless the opposing creditor provides evidence to the Court that would persuade the Court that the Trustee's opinion is not valid. That is why it becomes important for the Trustee in his Report to state the facts and information on which he arrived at what might be categorized as a favourable opinion. It is quite obvious that if the cause of the bankruptcy was gross negligence or unwarranted speculation or fraud, being matters enumerated in Section 141(d), then that would be an unfavourable Report.

Under the Act, the Court, pursuant to Section 142, may grant an absolute discharge, suspend the discharge or grant the discharge subject to terms and conditions that may require the bankrupt to pay money to the Trustee from his future earnings or income or with respect to his after-acquired property. If the Court concludes, after hearing all the evidence, that the bankrupt has

not satisfied the Court that the fact that his assets are not of a value equal to fifty cents on the dollar arose from circumstances for which he could not justly be held responsible, then the Court must refuse the absolute discharge pursuant to Section 142(2)(a) and then will consider whether to simply suspend the discharge or require the bankrupt as a condition of his discharge to perform such acts, pay such money or consent to such judgments as the Court may direct.

In considering any application for discharge, then it becomes mandatory for the Court to consider whether there are any facts as set forth in Section 143 that would require the Court to refuse the discharge outrightly. The facts which require this are set out in Section 143 which I have attached hereto as Schedule "A" for your easy reference.

If an order is made requiring the bankrupt to make payments out of his future income or after-acquired property, then the bankrupt has the duties imposed on him by Section 146 of the Bankruptcy Act. Under that Section, he must provide the Trustee with information with respect to his future earnings and after-acquired property and that all payments that are required of him by the Court order to be made shall be made to the Trustee for distribution to the creditors.

The foregoing is a general outline of the Sections of the Act that are under consideration on an application for discharge. I shall now move to a consideration of the hearing before the Court.

THE HEARING OF AN APPLICATION FOR DISCHARGE

Although generally the Trustee makes the application for a date for the hearing of the application for the discharge of the bankrupt, the Trustee does not carry the ball for him. The bankrupt must persuade the Court that he is entitled to an absolute discharge if that is what he seeks. Where there is no opposition to the application for a discharge, the Registrar hears the application and, assuming there is a favourable Report, would generally grant an absolute discharge.

Where there is opposition, if both parties consent, the application can be heard by the Registrar. Otherwise, the hearing comes before a Justice of the Trial Division of the Supreme Court of Nova Scotia. Prior to the hearing, the judge will have read with care the Trustee's Report and, as well, will have read the material filed by the objecting creditor. I would remind you of the requirement of Section 140(7) that a creditor who intends to oppose the discharge on grounds other than those mentioned in the Trustee's Report shall give notice of his intended opposition, stating the grounds thereof.

As a rule, the bankrupt and his counsel, if he has one, will be at the hearing. Representations will be made by the bankrupt or his counsel as to why he should have an absolute discharge if that is what he seeks. Generally speaking, counsel for the Trustee advises the Court that the Trustee is available to be questioned on any statements in his Report. If the Trustee has made a favourable Report, then the bankrupt has met the initial onus on him of showing that the fact that the assets have a value of less than fifty cents on the dollar of the unsecured liabilities arose from circumstances for which he could not justly be held responsible. The task then falls to the objecting creditor to contradict that evidence provided, of course, that was the only "Section 143 fact" that had been set out in the Trustee's Report or raised by the opposing creditor. The role of the objecting creditor, which is one of the subheadings on which I was asked to speak, is clear. He wishes to convince the Court that an order of discharge should only be made on the condition that there be some payment from the debtor over a period of time, either by way of his consenting to judgment or otherwise, as the cost the bankrupt should have to pay to obtain his discharge.

To achieve his objective, the opposing creditor, of course, must present some evidence. He may do this

through his own witnesses and he may request that the bankrupt be cross-examined and the bankrupt should be available for cross-examination (Re Hood (1975), 21 C.B.R.(N.S.) 128). As noted before, if the Trustee's Report is favourable, it must be accepted provided the Report complies with the provisions of Section 141 which requires that there be a statement of the facts and information on which the Trustee relied in arriving at his opinion as to the probable cause of bankruptcy being something that did not reflect unfavourably on the bankrupt. I have observed that such statement of facts is not always in the Trustee's Report; simply a statement that the probable cause of the bankruptcy was either "misfortune" or "inexperience" without any statement as to how this opinion was arrived at by the Trustee. Therefore, the Trustee should generally be available for cross-examination on this important subject matter because his opinion is very relevant on the hearing as the basis of his opinion should be made known to the Court so the validity of the opinion can be assessed by the Court. I am not sure that Section 140(5) which provides that for the purposes of the application the Report of the Trustee is evidence of the "statements" therein contained includes not only the statements of fact in the Report but also the "opinions" of the Trustee. There is case law to the effect that

the Court must accept the statements. Those cases are Re Alden; Bank of British Columbia v. Alden (1982), 41 C.B.R.(N.S.) 145 (B.C.S.C.) and Re Barrick (1980), 36 C.B.R.(N.S.) 286 (B.C.C.A.). If the word "statements" as used in Section 140(5) is interpreted literally, it would include the Trustee's opinion.

It is very clear that if there is a favourable Report, then the bankrupt has met the initial burden required of him to negate any Section 143 facts that are raised and, therefore, if the opposing creditor cannot bring before the Court evidence upon which the Court could come to a conclusion that one of the fact situations referred to in Section 143 had been proven, then the bankrupt would be entitled to an absolute discharge. In the face of evidence that would lead the Court to a conclusion contrary to the Trustee's favourable opinion, the Court's hands cannot be tied by the requirement to accept the statements in the Report. So it becomes important for the opposing creditor to be prepared to bring forth evidence on this subject matter, be it through independent witnesses or through cross-examination of the bankrupt or an examination of the Trustee on his opinion if it is a favourable one.

If the Trustee has not made a favourable report; in other words, if there were Section 143 facts that he

found existed that would disentitle the bankrupt to an absolute discharge; then the Trustee should be prepared to present to the Court evidence of the bankrupt's present income and expenses and evidence as to any after-acquired property of the bankrupt so that the Court can assess what, if any, requirement should be imposed on the bankrupt such as periodic payments of money over a term of months as a condition of his discharge.

Of course, whether or not there is evidence adduced at the hearing, counsel will be given an opportunity to present their arguments as to what is the appropriate disposition of the application. Which leads me to the next subject heading.

WILL THE COURT GRANT THE APPLICATION FOR DISCHARGE?

There are certain principles to bear in mind that arise from the relevant Sections of the Bankruptcy Act. I am referring particularly to Sections 142 and 143 which do impose certain limitations on what the Court can do, depending on the facts of a particular case. In Re Crowley (A Bankrupt (1985), 54 C.B.R.(N.S.) 303; (1985), 66 N.S.R. (2d) 390 I had occasion to give some thought to what principles should guide the Court on these applications. In that case, I stated at 66 N.S.R. (2d) 399, paragraph 40, as follows:

"What are the principles that the court should apply in considering an application for discharge by a bankrupt? There are very few Supreme Court of Canada decisions on the subject and the sections of the Bankruptcy Act provide little guidance as to how the judge who hears an application for a discharge is to exercise his discretion. The only clear guideline is that if one of the facts mentioned in section 143 is proven, then the court cannot grant an absolute discharge. Where the difficulty comes in is under what circumstances should a bankrupt who does not qualify for an absolute discharge be ordered to pay money to the Trustee or consent to a judgment as a condition of his discharge or merely have the inconvenience of having his discharge suspended for a period of months. There seem to be two basic and conflicting themes that run through the decisions of the courts on this subject. On the one hand, the courts emphasize the purpose of the Bankruptcy Act is not only to provide for an orderly scheme of distribution of the assets of a bankrupt amongst his creditors but to allow a bankrupt to get on with his life unfettered by burden of debt which he had incurred. Typical of such statements is that contained in Industrial Acceptance Corp. et al. v. Lalonde et al., [1952] 3 D.L.R. 348 (S.C.C.) where Estey, J., in an unanimous decision of the court, stated at p. 356:

> 'The purpose and object of the Bankruptcy Act is to equitably distribute the assets of the debtor and to permit of his rehabilitation as a citizen, unfettered by past debts. The discharge, however, is not a matter of right and the provisions of ss. 142 and 143 plainly indicate that in certain cases the debtor should suffer a period of probation. The penalty involved in the absolute refusal of discharge ought to be imposed only in cases where the conduct of the debtor has been particularly reprehensible, or in what have been described as extreme cases. The conduct of the debtor in this case, while not sufficient, with great respect, to justify the absolute refusal, does justify his discharge only subject to the imposition of terms.'

It is to be noted that in the Lalonde case the Supreme Court of Canada allowed an appeal and imposed a condition on the bankrupt that he consent to judgment in the amount of $5,000.00 as the cost of obtaining his discharge.

While one of the principal purposes and objects of the Bankruptcy Act is to permit the rehabilitation of a debtor as a citizen, unfettered by his past debts, there are many cases in which a bankrupt in modest circumstances and with dependents is ordered to consent to a judgment in a percentage of his indebtedness. Typical of this class of cases is Kozack v. Richter (1975), 20 C.B.R.(N.S.) 223 (S.C.C.). The headnote adequately summarizes the facts of that case as follows:

> 'The appellant suffered injuries in a motor vehicle accident which was caused by the wilful and wanton misconduct of the bankrupt. After the appellant recovered judgment for $12,909.03 plus costs of $1,194, the respondent filed an assignment in bankruptcy. The bankrupt was a wage-earner with a large family in modest circumstances. The Judge of the Court of Queen's Bench hearing the application for discharge of the bankrupt suspended the discharge for three months. The Court of Appeal for Saskatchewan varied the order and required the bankrupt to consent to judgment for $1,800 without interest payable at the rate of $50 per month.
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> Held (Abbott J., dissenting), the bankrupt was required to consent to judgment in the amount of $7,200 plus the costs of the hearing in the Supreme Court of Canada as a condition of his discharge. This amount was payable at the rate of $50 per month. The application of the provisions of the Bankruptcy Act should result in a plaintiff receiving recovery for personal injuries caused by the gross negligence of the bankrupt. The Bankruptcy Act was not intended to enable a judgment debtor to rid of a judgment for damages. Abbott, J., would have dismissed the appeal on the ground that the judicial discretion exercised by the court below was reasonable and should not be interefered with by a second

appellate court. He also found that no distinction exists under the Bankruptcy Act between a bankruptcy arising out of trade debts and one arising out of the commission of a tort.'

Pigeon, J., writing for the majority of the court (there was one dissent), stated at p. 225:

'In the present case, respondent's bankruptcy was precipitated by his condemnation to pay damages to the appellant. This being due to a finding of "wilful and wanton misconduct" on his part, certainly his financial predicament cannot be said to have arisen "from circumstances for which he cannot justly be held responsible." The courts below did not ignore this provision. However, the sanction meted out in the first instance was purely nominal. In the Court of Appeal, respondent was in effect ordered to make payments that would hardly cover more than appellant's costs in the trial court and in the Court of Appeal. Although respondent is a wage-earner with a large family in very modest circumstances, I cannot agree that the proper application of the provisions above quoted should result in a plaintiff making no recovery for personal injuries caused by gross negligence. It would mean that motorists in respondent's situation would be able to tell such a claimant: "There is no use suing me, if you lose you will have to pay the costs, if you win I will make an assignment in bankruptcy and you will get nothing."

The dilemma facing a judge in considering an application for discharge is reflected in the following two quotations from Bankruptcy Law of Canada by Houlden and Morawetz at pp. H-18 and H-19:

'It is incumbent upon the court to guard against laxity in granting discharges so as not to offend against commercial morality. It is nevertheless the duty of the court to administer the Bankruptcy Act in such a way as to assist honest debtors who have been unfortunate: Re Beerman and Sands (1925), 5 C.B.R. 781 (Ont.S.C.).

> The purpose of the Bankruptcy Act is to enable someone who has had financial misfortune or a series of misfortunes to be purged or relieved of the consequences and to obtain a new start financially. It is not to be considered as a process which can be resorted to on a regular basis with a view to washing out one's debts: Re Label (1979), 31 C.B.R.(N.S.) 320 (Ont.S.C.).'
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> Despite the inherent difficulty created by these two conflicting themes, the case law does provide some firm footing to assist a judge in the exercise of his discretion when determining how to apply the provisions of section 142 of the Bankruptcy Act in any particular case."

The Court must, of course, be guided by the provisions of the Act. However, a reading of Section 142 of the Act, which I quote as follows:

> "Sec. 142. **Court may grant or refuse discharge.**-(1) On the hearing of the application, the court may either grant or refuse an absolute order of discharge or suspend the operation of the order for a specified time, or grant an order of discharge subject to any terms or conditions with respect to any earnings or income that may afterwards become due to the bankrupt or with respect to his after-acquired property.
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> (2) **Powers of court to refuse or suspend discharge or grant conditional discharge.**-The court shall on proof of any of the facts mentioned in section 143
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> (a) refuse the discharge,
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> (b) suspend the discharge for such period as the court thinks proper, or
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> (c) require the bankrupt, as a condition of his discharge, to perform such acts, pay such moneys, consent to such judgments, or comply with such other terms, as the court may direct.

> (3) **Court may modify after year.**-Where at any time after the expiration of one year from the date of any order made under this section the bankrupt satisfies the court that there is no reasonable probability of his being in a position to comply with the terms of the order, the court may modify the terms of the order or of any substituted order, in such manner and upon such conditions as it may think fit.
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> (4) **Power to suspend.**-The powers of suspending and of attaching conditions to the discharge of a bankrupt may be exercised concurrently."

provides no guidance for the exercise of the judge's discretion except that he must refuse an absolute discharge if a Section 143 fact is proven against the bankrupt.

It is obviously important that the judge consider carefully the causes of the bankruptcy and consider the Trustee's Report in this respect and other evidence on that subject matter. In Industrial Acceptance Corp. et al. v. Lalonde et al., [1952] 3 D.L.R. 348, the Supreme Court of Canada held that a discharge should only be outrightly refused if the debtor's conduct has been particularly reprehensible or is an extreme case. What was meant by that statement is that only rarely will there be an outright refusal of a discharge. Generally speaking, the conduct of the bankrupt is not particularly reprehensible and, therefore, under the circumstances, the alternatives the Court will consider are a suspension of the discharge or attaching conditions, usually a

requirement for payment, as the cost of the discharge. The practice of our Court has generally been not to merely suspend the granting of an absolute discharge but to grant a discharge conditional on payment. Which leads to the next point.

If conditions for payment are imposed, the Court does bear in mind that the bankrupt must be able to retain sufficient money to maintain himself and his family and that is why it is necessary for the Court to have before it evidence of the bankrupt's income and living expenses so the Court's discretion can be exercised rationally. With this information, the Court can make an assessment of what a reasonable payment would be considering the extent of the debts the bankrupt leaves behind, the nature of the opposition, the causes of the bankruptcy, the nature of the Section 143 fact that has been proven, the statements in the Trustee's Report, including his opinion, and all the evidence given at the hearing.

Our Court is very mindful of the primary purposes of the bankruptcy legislation but there is the necessity of balancing the requirement to let the bankrupt get back on his feet financially, so to speak, against the public interest in seeing that there is commercial morality in dealing with bankrupts in a manner that is fair to the creditors and will retain the confidence of the public

in the processes under the Bankruptcy Act. In Re Crowley I stated in paragraph 57:

> "In recent years there has been a trend by this court to impose conditions of payment on the bankrupt as the price for his discharge. This reflects the feeling of the public as stated through the decisions of this court that abuses of the bankruptcy process are perceived. While the vast majority of the public are wrestling with their finances to make ends meet, there is a small percentage, albeit a large number of persons, who are availing themselves of the provisions of the Bankruptcy Act and, in particular, the discharge provisions, to walk away from the debts which they have accumulated. Imposing a condition that a bankrupt consent to judgment in a reasonable percentage of his unsecured liabilities under certain circumstances is not to frustrate the object of the Bankruptcy Act. In fact, not to do so in many cases may offend the integrity of the discharge procedure. Where a debtor owes a substantial number of creditors, it is reasonable that he be freed from their harassment and get on with earning a living under peaceful conditions but subject to a reasonable judgment in favour of the Trustee who, based on his knowledge of the debtor's circumstances, can exercise a sensible discretion in collection procedures; it being understood that under no circumstances should a judgment be entered against a bankrupt which he would be unable to pay over a reasonable period of time. Each case must be judged on its own facts as to the causes of the bankruptcy and a decision made as to whether it is appropriate under the circumstances to impose conditions of payment on the bankrupt as a price for his discharge."

The Programme distributed to the registrants at this Seminar indicated that there would be "Advice from Bench" re the topic of discharges. I guess you could consider what I have already stated as advice but the short advice I would give you is not to assume if your

client is the bankrupt, that he will be given an absolute discharge if it is opposed. To paraphrase that distinguished, but boring, old actor who advertises on television for one of the financial houses, the name of which escapes me for the moment, an absolute discharge will only be obtained "the old-fashioned way"; the bankrupt will have to "earn it."