Alberta court allows Securities Commission penalty to survive bankruptcy

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By: Adrienne Wong | Gillian Broadbent (Articling Student)

On January 17, 2020, Justice Romaine of the Alberta Court of Queen's Bench found that the Alberta Securities Commission's (the "ASC") administrative penalties against Theodor Hennig ("Hennig") survived Hennig's discharge in bankruptcy. This decision marks the first time a Canadian court has considered securities regulatory penalties within the context of subsection 178(1) of the *Bankruptcy and Insolvency Act* (the "*BIA*"). Justice Romaine's reasoning sheds light on important interpretive aspects of subsection 178(1) of the *BIA* and emphasizes the legislative purpose of the statutory exceptions.

Background

The ASC's penalties against Hennig were issued in June 2008 after the ASC found that Hennig contravened Alberta securities laws and acted contrary to public interest. Hennig's improprieties included the following: i) misrepresenting financial statements; ii) participating in market manipulation; iii) contravening insider trading reporting requirements; iv) obtaining financial benefits from investor funds; and v) making misrepresentations to the ASC "so numerous as to constitute a pattern of conduct." The administrative penalties levied against Henning totalled $400,000, with an additional $175,000 in costs. On appeal, the Alberta Court of Appeal upheld the ASC's decision.

Hennig did not pay the fines levied against him, and in 2011 he filed for bankruptcy. In July 2015, Hennig was discharged from bankruptcy, raising the question of whether or not his obligation to pay the regulatory fines survived his discharge.

The Alberta Court's decision

The *BIA* sets out that a bankrupt individual is released from all claims provable in bankruptcy unless the claim falls under the exceptions provided in subsection 178(1). These exceptions include: i) fines or penalties imposed by a court; ii) debt or liability arising out of fraud, embezzlement, misappropriation, or misappropriation while acting in a fiduciary capacity; and iii) debt or liability arising from obtaining property or services by false pretenses or fraudulent misrepresentation.

Regarding the interpretation and scope of the *BIA*, Justice Romaine clarified that the exceptions set out in subsection 178(1) "exists to ensure that debtors who have been found to have engaged in fraudulent or dishonest conduct are not entitled to a discharge." In her decision, Justice Romaine referenced the decision of *Martin v Martin*, wherein the Court stated, "Parliament has clearly made a policy decision that a bankrupt should not be allowed to raise the shield of his or her general discharge against judgment creditors who hold judgments grounded in such reprehensible conduct." Justice Romaine emphasized that the exceptions in subsection 178(1) of the *BIA* should be interpreted purposively with the policy considerations in mind. Policy considerations include that, "a debtor that has engaged in fraudulent or dishonest conduct is not entitled to the fresh start offered by a general discharge of bankruptcy."

While Justice Romaine clarified that not all regulatory penalties will constitute exceptions from discharge, she ultimately determined that Henning's conduct and the overall context of his penalties fell within the scope of the *BIA*'s statutory exceptions. In concluding, Justice Romaine stated, "there are no valid policy reasons based on the principles of bankruptcy that would prevent subsection 178(1)(e) from being interpreted so as to include this debt. As such, Justice Romaine found that the penalties the ASC imposed on Hennig survived his discharge in bankruptcy.

In her decision, Justice Romaine also granted the ASC's application to renew its judgment against Hennig for an additional 10 years pursuant to Rule 9.21 of the *Alberta Rules of Court*. This order effectively renews the ASC's judgment against Hennig until January 2030.

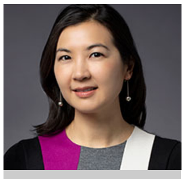
Takeaways

Justice Romaine's decision in *Hennig* is significant because it highlights the potential for uncertainty and tension when the securities and insolvency regimes intersect. Justice Romaine's decision underscores an underlying purpose of the *BIA*, as well as the understanding that these statutory exceptions attempt to "strike a balance between rehabilitation and the legitimate interests of creditors." The purposive interpretation of subsection 178(1) emphasized by Justice Romaine is the intention to "preclude dishonest debtors from benefitting from their dishonesty." Justice Romaine further indicated that the purposive intention of subsection 178(1), "would surely extend to a decision of a securities commission, charged with enforcing securities laws in order to protect the investing public and promoting the integrity of capital markets, in circumstances that would otherwise fit within the subsection."

While this decision may be seen by Canadian securities regulators as encouraging, some provincial regulators have stated that it is still no substitute for more sweeping amendments to the *BIA.* It has been posited that amendments to the *BIA* are required to provide greater clarity in this area and prevent regulators from litigating issues of whether securities penalties survive bankruptcy on a case-by-case basis. For example, the British Columbia Securities Commission (the "BCSC") recently announced that the British Columbia government has sought amendments to the *BIA* from the federal government to ensure that financial fraud penalties such as those levied by securities regulators automatically survive bankruptcy. The BCSC has stated that the proposed amendment to the *BIA* would be another step to improving collection rates by securities regulators across the country so that those sanctioned by regulators cannot use bankruptcy to evade paying penalties.

AUTHORS

Adrienne Wong



Associate
Calgary | T: +1 403 296 4470
adrienne.wong@dlapiper.com