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Bankruptcy Discharge: A Right or a Privilege

History of Discharges

The origins of the Bankruptcy Discharge can be found as early as 1705 in English law as a trial remedy; only applying to traders as Bankruptcy did at the time. It became permanent in English law through many consolidated statutes in 1732[1]. However, the discharge provisions at this time required the consent of creditors in order for a Bankrupt to obtain their discharge. The requirement of creditor assent was a lasting feature in the English Bankruptcy statutes until the nineteenth century. Creditor control required that creditors either vote in favour of the discharge, or the bankrupt remain in bankruptcy forever. This led to bribery, extortion, and other difficulties in the system[2].

Bankruptcy law continued to only apply to traders. Therefore, the rest of the insolvent debtors were subject to collection schemes, namely being sent to debtor's prison among other mechanisms. However, bankrupts could not be sent to jail. The distinction was abolished in 1861, and at that time both traders and non-traders could voluntarily put themselves into bankruptcy with the discharge being available a remedy[3].

The Bankruptcy Discharge in Canada first came into effect in Canada first bankruptcy statute *An Act respecting Insolvency*[4], which came into force as federal legislation shortly after confederation in 1869. Originally, farmers were not considered traders, and were therefore ineligible for a discharge. The court was able to provide a first class discharge, and a second class discharge; while both types of discharges permanently stayed the debts from being collected, a first class discharge was given for an honest but unfortunate debtor, while a second was given for a bankrupt who had committed some type of misconduct[5]. The act only applied to traders.

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[1] Thomas G. W. Telfer, "Ideas, Interests, Institutions and the History of Canadian Bankruptcy Law 1867-1880" (2009) UWO Faculty of Law
[2] Ibid.
[3] Ibid.
[4] 38 Vict., S.C. 1875, C. 16
[5] Ibid.

The discharge was a matter of quite debate in the early infancy of the Canadian economy. In the 1870's, the Canadian Federal government argued the merit of an all-encompassing discharge which would rid the average man of their debts. Canada's first Prime Minister, Sir John A. Macdonald, claimed that, "when a man made a clean breast of his affairs, and gave his estate honestly for the benefit of his creditors, he ought to have relief."[6] On the other hand, Alexander Mackenzie, the Leader of the Opposition, and future Prime Minister of Canada, argued that bankruptcy law "had been found eminently conducive to public immorality."[7] Bankruptcy law "was conceived in sin, and whose fruits had been iniquity from first to last."[8] A law that impaired the moral obligation to pay was "an unsound and impolitic law"[9] and should not be enacted by any Parliament.

In 1880, the Federal Government passed *An Act to Repeal the Acts Respecting Insolvency Now in Force in Canada*[10], which vacated the Bankruptcy legislation from the Federal Government to the Provincial Government.

Further debates were ongoing in Canada during an almost 40 year period in which the Provincial governments each set their own legislative bankruptcy framework, and it wasn't until *The Bankruptcy Act of 1919*[11], that the Canadian Federal Government reassumed control of the bankruptcy system and adopted many of the reforms that the English system had[12].

While there were many ongoing changes to the Canadian Legislative framework for Bankruptcy over the next half century, the foundation for the discharge already existed. The discharge would not change; only its applications.

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[6] Ibid, Page 2.
[7] Ibid.
[8] Ibid.
[9] Ibid.
[10] SC 43 Vic, c I
[11] 9 & 10 Geo. V, S.C. 1919, c.36
[12] Thomas G.W. Telfer, "The Canadian Bankruptcy Act of 1919: Public Legislation or Private Interest?" (1994-1995) 24 can. Bus. L.J. 257

Discharge mechanism to date

In 1992, the Federal government introduced automatic discharges from bankruptcy for first-time bankrupts, if they were unopposed by creditors or the Office of the Superintendent of Bankruptcy Canada. In 2009, parliament added automatic discharges for second time bankrupts after 24 months or 36 months depending on if there was surplus income to be contributed to the estate. Both of these changes were intended to push consumers through the insolvency system, without compromising the process.

Additionally, in both 1997 and 2009, the government expanded the portion of the *Bankruptcy and Insolvency Act*[13] which included debts which were non-dischargeable through bankruptcy. Section 178(1) contains various debts which are not able to be discharged, and which, 'survive' bankruptcy until such time as the debtor pays off the debt. These debts are considered outside of the bankruptcy, and will never be discharged.

It is interesting that Parliament found it within their grasp to expand the non-dischargeable debts. It's worth noting that they did this in the same time period that they saw fit to expand other mechanism to increase the efficiency of the system. As consumer debt continued to increase through the 1990's, Parliament wish to keep the bankruptcy system flowing and only stopping for debts which exceeded the use of the system and wouldn't have an applicable discharge at the end of the bankruptcy period. The only exception to this being the high income tax debtor.

Automatic & First Time Discharges

A person who has never been bankrupt before is entitled to an automatic discharge from bankruptcy. However, if there is an opposition, then the court considers factors in which they should grant a conditional discharge order. Those factor include the necessity for providing relief[14], the integrity of the bankruptcy process[15], and the amount that the creditors have received or may receive on their claims[16].

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[13] R.S.C., 1985, c. B-3 as amended
[14] *Re Shakell* (1988), 70 C.B.R. (N.S.) 270 (Ont. S.C.)
[15] *Re Raftis* (1984), 53 C.B.R. (N.S.) 19; affirmed 57 C.B.R. (N.S.) 318 (Ont. C.A.)
[16] Supra, Note 13.

Typically, the court looks at first time bankrupts with incredible leniency, and often grants absolute discharges or small conditional discharges for debtors who have not committed an act that is egregious or offends the court.

Second Time Discharges

The court looks at these types of situations with less leniency. However, they will often impose a small suspension or condition to ensure that the bankrupts actions are recognized.

Income Tax Debtor

According to Section 172.1 of the *Bankruptcy and Insolvency Act,* the court may not order that a high income tax debtor receives an absolute discharge. Canada Revenue Agency must object, and there are certain timelines that must be followed.

Disadvantages to being Undischarged

In the credit world today, almost every time a person applies for credit a credit check is conducted through the use of a credit bureau: Equifax or Transunion. These credit bureaus record every credit transaction that a person has, and they rate them. They then create a report which rates a person from R1 to R9 in terms of the credit that they should be given. This encompasses everything from a VISA card, to a mortgage, to a cell phone credit.

When a person files for bankruptcy, their credit rating drops to R9. They are unable to typically obtain credit unless they obtain high interest rates, or they are secured against an asset. The person also cannot be the director of a corporation, cannot be a practicing real estate agent, cannot sponsor an immigrant, cannot hold a trust account and cannot go on welfare. There are also social stigma’s which, although they are not as bad as they once were, attach themselves to bankrupts.

Charter of Rights and Freedoms

Discharge (General)

Bankruptcy proceedings enjoy an irregular status under the Canadian common-law. While part of the Bankruptcy and Insolvency Act is quasi-criminal in nature, most of it civil law in which debtors are seeking reprieve from an action that they have committed themselves to.

However, the Bankruptcy regime is designed to be rehabilitory[17] in nature. The discharge is this means of rehabilitation: it allows the Bankrupt to proceed out of bankruptcy, rehabilitated, and without debts which have latched onto them from their previous mistakes.

But what about debts which are dischargeable, but never get discharged. The Canada Revenue Agency is entitled under the current regime to keep a person in bankruptcy until they see fit. An individual who has gone bankrupt three times, who owes the CRA money from after his bankruptcy, may never be discharged. No matter how old they are, and the court would rather defer to the CRA to make an agreement, rather than force a discharge and allow a person dignity[18].

Section 7 of the *Canadian Charter of Rights and Freedoms*[19], state, that "Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice." And, Section 12 of the Canadian Charter of Rights and Freedoms, states, "Everyone has the right not to be subjected to any cruel and unusual treatment or punishment." This section has long been equated with prison sentences and physical acts of torture and executions.

The Supreme Court of Canada wrote in Suresh, that "torture is inherently repugnant that it could never be an appropriate punishment, however egregious the offence," and that

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[17] *Re Ross*, 2014 CarswellSask 730, 2014 SKQB 352 (Sask. Q.B.)
[18] *Pettle, Re* (April 20, 2015) Toronto, 31-286945 (ON ONSC: Bankruptcy Registrar)
[19] *Canada Act, 1982*

"the prospect of torture induces fear and its consequences may be devastating, irreversible, indeed, fatal."[20]

In tort law, the court has equated psychological and physical damages to be similar and both quantifiable and harmful.[21]

Yet the Court has not taken a procedural or substantive approach to the Bankruptcy and Insolvency system, and no person has challenged this to the writer's knowledge. The only position has simply been that the discharge is an economic issue, and this precludes it from Charter application.

The concept of being in Bankruptcy forever runs completely contrary to the Section 7, and 12. The court has the option of placing an onus on a Bankrupt which will in fact keep them in bankruptcy forever. A refusal, or a conditional discharge for such an amount of money which is unfathomable to a bankrupt has the same effect. And these aren't even related to actions which are required under the act; such as Section 172.1.

An individual owing Canada Revenue Agency a large amount of taxes, goes bankrupt, and they don't get discharged, then the creditors rights are renewed after the Trustee is discharged. Shortly after that, CRA can garnish the person's wages. If that same person does not apply for discharge for five-years later, and CRA has been garnishing them, and will not grant them their discharge because they have five years of taxes owing, the person will never be able to repay CRA[22]. This is a federal organization using its special status and powers to harm a citizen, and its conduct that shocks the conscience and should not be allowed under Section 7. Further, the "Principles of Fundamental Justice" require that *means* used to achieve a societal purpose or objective must be reasonably necessary. "Overbreadth analysis looks at the means chosen by the state in relation to its purpose. If the State, in pursuing a legitimate objective, uses means which are broader than is necessary to accomplish that objective, the principles of fundamental justice will be violated because the individual's rights will have been limited for no reason." [23]

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[20] *Suresh v. Canada (Minister of Citizenship and Immigration),* [2002] 1 S.C.R. 3
[21] *Hinz v. Berry* [1970] 2 Q.B. 40 & Toronto Railway Co. V. Toms (1911), 44 S.C.R. 268 at 274
[22] *Supra Note 11;*
[23] *R. v. Heywood [1994] 3 S.C.R. 761* at para 49

Procedural

In some bankruptcy jurisdictions bankrupts are not able to schedule a discharge for months or years based on backlog, and scheduling constraints. Section 11b of the Charter of Rights and Freedoms provides that all offences are to be tried within a reasonable time. Traffic courts have applied this section to mean that if an individual has a parking ticket or a speeding ticket not heard in a reasonable amount of time, it is to be stayed.[24] Yet Bankruptcy hearings which are not heard for months and sometimes years are not stayed on this basis.

Surplus Income Requirements and Conditional Discharges

The Canadian government sets net monthly income thresholds for a person (or family) to maintain a reasonable standard of living in Canada. These standards are set by the Office of the Superintendent in Bankruptcy Canada, and are derived from the Low Income Cut-offs released by Statistics Canada every year.

Bankrupts who earn over a certain amount of income are required to pay surplus income contributions to the Trustee in Bankruptcy, to compensate the estate. Additionally, if the bankrupt is a 2nd or 3rd (or more) time bankrupt, they are required to pay surplus for additional months and years.

Often, a bankrupt will not be able to pay their monthly payments for their surplus income, and they are then required to either make up the payment before being discharged, or receive a conditional discharge order which requires them to pay the amount for surplus. The only alternative, is that the bankrupt can choose to elect to attend mediation at the Office of the Superintendent in Bankruptcy Canada, and they can then ask for a longer period of time to pay off their surplus income.

Many bankrupts either do not know, or choose to forget that they owe additional funds to their trustee in bankruptcy. As a result, the trustee objects to their discharge, and the

[24] *R. v. Morin*, [1992] 1 SCR 771

bankrupt never gets discharged. While it is very common for this to occur from surplus income reasons, often this also occurs for various other reasons including not paying trustee's fees, not paying for assets which have become part of the bankrupt estate, or simply not attending counselling.

Section 7 of the Charter should serve to limit bankrupts who will live their life, and simply be undischarged bankrupts forever.

Fees and other unpaid items that are left to the bankrupt to pay often force them into situations where they cannot afford to live, and have to resort to homelessness and shelters. A bankrupt has nothing to live on, used every dollar he had to find food and shelter, and was given repayment terms of over $150,000.00.[25]

The Charter should apply to these type of proceedings. There is no reason that a person's life should effectively been restrained, and the bankruptcy process should be used as a pecuniary form of prison.

Right or Privilege.

A discharge should be a right under the Bankruptcy and Insolvency Act. A right is not unfettered, and can be tempered in specific circumstances. When certain procedural requirements are completed, such as counselling, a bankrupt should receive a discharge.

There is a line of case law which says that a discharge is not a right, but rather should be appraised on circumstance and should only be granted when that is the correct course of action[26]. However, it there are two points which charter rights seem to diverge from this line of case law. The first is that the case law is seeking a discharge which acts as a rehabilatory step; not as punitive. Second, it seems that the majority of the case law[27] is outside of Ontario and Quebec.

[25] *Mcdonald, Re* (25 June 2014), Toronto, 31-1152326 (ON ONSC: Bankruptcy Registrar)
[26] *Wensley (Trustee of), Re,* [1985] A.J. No. 516; 67 A.R. 184
[27] *Oxley, Re, 1999 ABQB 145*

While decisions along this line attack the fact that the discharge is an economic right, it seems to this writer that for someone stuck in a discharge it is a personal right.

A discharge should be a mechanism that can be achieved by a bankrupt, and it shouldn't be restrictive to the point that CRA or any other creditor can use its consent to put the individual through such hardship that it makes it impossible to obtain.

These rights which are attacked are no longer economic in nature, but they rise to the level of personal rights which protected under the Charter. [28]

At current, Bankruptcy discharges are treated more of a privilege then a right. It is only if there are no objections, and no problems with the bankrupt, that a person receives their discharge. But if there are any complications, then they are stuck in the system and if they choose to ignore it or not go along with the Trustee, then the protections do not apply to them and they become fodder for creditors to come after, and ultimately attack any asset that the individual has.

What's worse is that often a person's life is impacted negatively by being an undischarged bankrupt for so long. Certain professions will not allow a person to be an undischarged bankrupt and to work in that field. Therefore, a person's rights under Section 7 are effected as they are not able to work, and live freely, because they cannot obtain their discharge. Ultimately, discharges should not be a privilege, they should be a right. Not unfettered, but a right which can be reasonably controlled and not withheld.

[28] *Olympia Interiors Ltd. V. Canada*, 1999 CanLii 1992 (FC)

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