C.A. No. 116299

NOVA SCOTIA COURT OF APPEAL
Cite as: Dartmouth (City) v. Barclays Bank of Canada, 1996 NSCA 119

Hallett, Matthews and Chipman, JJ.A.

BETWEEN:

CITY OF DARTMOUTH Appellant - and - BARCLAYS BANK OF CANADA and DELOITTE & TOUCHE, a body corporate Respondent	Peter D. Darling for the Appellant Roy F. Redgrave and Lloyd MacNeil for the Respondent Appeal Heard: April 10, 1996 Judgment Delivered: May 21, 1996

THE COURT: Appeal dismissed per reasons for judgment of Hallett, J.A.; Matthews and Chipman, JJ.A. concurring.

HALLETT, J.A.:

This is an appeal from a decision of Saunders J. in which he dismissed the City of Dartmouth's application under **Civil Procedure Rule** 25 for an order for judgment against Barclays Bank for outstanding taxes owing to the City of Dartmouth by CNC Machining Limited (CNC) in the amount of $25,498.89. Barclays Bank held mortgage security on the machinery and equipment of CNC. On default the Bank went into possession of CNC's assets. Shortly after Barclays Bank went into possession CNC made an assignment in bankruptcy pursuant to the provisions of the **Bankruptcy Act**, R.S.C. 1985, c. B-3, as amended. The City of Dartmouth sued Barclays Bank for payment of CNC's outstanding taxes which had been levied on the machinery and equipment. The action was based on the provisions of s. 118 of the **Assessment Act**, R.S.N.S. 1989, c. 23 as amended, which provides:

> "118 (1) No personal property shall be taken possession of by the holder of any bill of sale, chattel mortgage, instalment payment contract, hire purchase agreement, transfer or mortgage thereof, or any lien thereon, nor except as provided in this Act, shall the same be seized or levied upon, under or by virtue of any warrant, execution or attachment, or other process, nor shall the same be distrained for rent, nor shall the same be sold under any order of any court, until the holder or the person, at whose instance or suit the warrant, execution, attachment or other process issued or order of sale was granted, pays all rates and taxes rated and levied against the owner or person in possession thereof.
>
> (2) Any sheriff, constable, bailiff or other officer having process to levy upon such property shall, before selling the same, pay to the treasurer such rates and taxes and the amount paid to any municipality for rates or taxes may be added to the amount claimed under such process.
>
> (3) The assignee, mortgagee or person holding a lien on such property, or the sheriff, constable, bailiff or officer who takes possession thereof, shall be personally liable to the municipality for the amount of the rates and taxes rated and levied against the owner or person in possession thereof for the then current taxation year, and may be sued therefor by the municipality as for an ordinary

debt.

> (4) Such property shall be liable to be levied upon, seized, taken and sold under warrant to pay such rates and taxes, together with costs, charges and expenses."

Saunders J. found that s. 118 of the **Assessment Act** was rendered inoperative upon the bankruptcy of CNC by reason of the provisions of the **Bankruptcy Act** which, in his opinion, altered the scheme of distribution provided for in s. 136(1) of the **Bankruptcy Act**. He concluded that once the voluntary assignment in bankruptcy had been made, the **Bankruptcy Act** exclusively determined the status, priority and ranking of creditors. Pursuant to s. 136(1)(h) of the **Bankruptcy Act** the municipal taxes would rank fifth in priority among preferred creditors and after payment of the secured creditors. Therefore, he found that the City could not claim against Barclays Bank (as mortgagee in possession of CNC's assets) pursuant to s. 118 of the **Assessment Act**. He was of the opinion that these provisions of the **Assessment Act** were not within the sphere of legislative competency of a province.

As required by **Rule** 25, the matter went before Justice Saunders upon an agreed statement of facts. I will summarize the relevant facts in a chronological order:

(i) CNC carried on business in Dartmouth from and prior to January 1st, 1991 until February 11th, 1992;

(ii) Barclays Bank held a fixed and floating charge debenture charging the machinery and equipment of CNC;

(iii) on February 11th, 1992, CNC was in default. Pursuant to the terms of the debenture, Barclays Bank appointed Deloitte & Touche Inc. receiver and manager of the property and assets of CNC;

(iv) on the instructions of Barclays Bank, Deloitte & Touche took

possession of the assets and undertaking of CNC;

(v) at the time Deloitte & Touche took possession of the assets, CNC owed rates and taxes to the City of Dartmouth for the current year in the amount of $25,498.89. This tax was with respect to the ownership of the machinery and equipment mortgaged to Barclays Bank and which Deloitte & Touche took possession of on February 11th, 1992;

(vi) on February 12th, 1992, Deloitte & Touche wrote the City of Dartmouth seeking particulars as to the amount of taxes outstanding. These particulars were provided to Deloitte & Touche;

(vii) Deloitte & Touche, as receiver and manager, advertised the assets of CNC for sale by tender. Five tenders were submitted by the closing date but none were acceptable to Barclays Bank;

(viii) on April 28th, 1992, CNC made a voluntary assignment in bankruptcy pursuant to the provisions of the **Bankruptcy Act**. Deloitte & Touche was named the trustee in bankruptcy. Its appointment was subsequently confirmed at the first meeting of creditors of the estate of CNC in bankruptcy;

(ix) between the months of April and July, 1992, discussions were held between M&M Manufacturing Limited, a business enterprise in Dartmouth, Deloitte & Touche and Barclays Bank, concerning the sale of the assets of CNC. M&M Manufacturing was willing to purchase the assets but required financing in the form of a long term lease option. Barclays Bank, on the other hand, wanted to sell the machinery and equipment outright. In order to conclude the transaction Barclays contacted Kes Pacific Leasing Inc., an equipment financing company.

Kes Pacific agreed with Barclays Bank to purchase the assets of CNC, including those in respect of which CNC was rated for machinery and equipment tax. The agreed purchase price was $400,000. It had been arranged that Kes Pacific would lease the equipment to M&M;

(x) on the 26th of May, 1992, the City of Dartmouth commenced an action against Barclays Bank and Deloitte & Touche claiming that Deloitte & Touche as agent, and at the instigation of Barclays Bank took possession of the assets and undertaking of CNC and sold the assets. The City of Dartmouth claimed that Deloitte & Touche and/or Barclays thereby became personally responsible to the City of Dartmouth for CNC taxes pursuant to the provisions of s. 118 of the **Assessment Act**;

(xi) on the 9th day of June, 1992, the defendants filed a defence stating that Barclays Bank was a secured creditor of CNC, as defined in s. 2 of the **Bankruptcy Act**, and pleaded the provisions of the **Bankruptcy Act** as a full defence to the City of Dartmouth's claim;

(xii) on August 4th, 1992, Deloitte & Touche as trustee in bankruptcy of CNC executed a bill of sale transferring the assets of CNC, including those in respect of which CNC was rated for machinery and equipment tax transferring said assets to Kes Pacific for the nominal consideration of $1.00;

(xiii) on the same date Barclays Bank gave a letter to Kes Pacific acknowledging the receipt of $399,500 from Kes Pacific representing the amount required to release its security interest in CNC's machinery and equipment. Barclays Bank also confirmed that $500 was paid by Kes Pacific to Deloitte & Touche, trustee in bankruptcy for the estate

of CNC;

(xiv) on the 13th day of January, 1995, the City of Dartmouth applied to the Supreme Court for an order pursuant to **Civil Procedure Rule** 25 for an order for judgment in favour of the City of Dartmouth against both Barclays Bank and Deloitte & Touche for the amount claimed in the statement of claim;

(xv) the application was heard by Justice Saunders in special Chambers on March 7th, 1995, and by a decision released on March 27th, 1995, Justice Saunders dismissed the application of the City of Dartmouth and awarded costs to the defendants;

(xvi) by notice of appeal filed on the 25th of April, 1995, the City of Dartmouth asserts that the learned Chambers judge erred in law in finding that s. 118 of the **Assessment Act** was rendered inoperative by the **Bankruptcy Act** and the assignment in bankruptcy of CNC made pursuant to the said **Act**. The City of Dartmouth asked this Court to award judgment in favour of the City of Dartmouth against Barclays Bank and Deloitte & Touche or one of them in the amount of $25,670.30 plus pre-judgment interest and costs;

(xvii) on the hearing of the appeal counsel agreed: (a) that the amount owing to the City of Dartmouth for the current year was $25,498.89 and this was the amount being claimed by the City of Dartmouth; (b) that should judgment be awarded to the City of Dartmouth that the pre-judgment interest would be at the rate of 7% and run from February 11th, 1992; and, (c) that the machinery and equipment that was mortgaged to Barclays Bank and subsequently sold to Kes Pacific were all the assets

of CNC.

Section 136 of the **Bankruptcy Act** is relevant; it provides:

> "136. (1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payments as follows:
>
> . . . . .
>
> (e) municipal taxes assessed or levied against the bankrupt, within the two years immediately preceding his bankruptcy, that do not constitute a preferential lien or charge against the real property of the bankrupt, but not exceeding the value of the interest of the bankrupt in the property in respect of which the taxes were imposed as declared by the trustee;
>
> . . . . .
>
> (j) in the case of a bankrupt who became bankrupt before the prescribed date, claims of the Crown not mentioned in paragraphs (a) to (i), in right of Canada or any province, rateably notwithstanding any statutory preference to the contrary."

The appellant's counsel characterizes the issue raised on this appeal as follows:

> "Is the personal liability of Barclays, as imposed upon it by s. 118 of the *Assessment Act*, R.S.N.S. 1989, c. 23, rendered inapplicable by the *Bankruptcy Act*, R.S.C. 1985, c. B-3 (now the *Bankruptcy and Insolvency Act*), and the assignment into bankruptcy of CNC Machining Limited made thereunder?"

Before deciding whether s. 118 is rendered inapplicable, it is necessary to determine what it means. The Section has been recognized in several decisions of the courts of this Province as being difficult to interpret (**FBDB v. Halifax (City of)** (1982), 56 N.S.R. (2d) 139 at p. 144; **Matheson v. Calkin, et al.** (1931), 3 M.P.R. 9).

Mellish J., writing for the Supreme Court en banc, in **Matheson v. Calkin**, decided that it was not necessary for the bailiff who sold personal property distrained on

by the landlord for arrears of rent to have paid the taxes owing to the town prior to selling the personal property distrained upon. Mellish J. directed his attention to the object of the legislation. He stated at p. 14:

> "The object of the legislation is primarily to secure the payment of taxes and with that end in view to empower the town, if so advised, to sell any goods for taxes in the hands of any person exercising by possession any claim thereto, to make such person liable for the current year's taxes, and in the event of such person selling the same to make taxes a first charge on the proceeds. The provisions of the Act are not very clearly expressed, but they do not in my opinion make such a sale as has taken place here, void or illegal as between the landlord and tenant."

Paton, J. concurred in the disposition of the appeal in that case and stated at p. 14:

> ""The proper interpretation of the sections of the statute quoted in the judgment of my brother Mellish is very difficult. This is due in some cases to the indefiniteness of the words and expressions used, and in other cases to the use of the same words and expressions with apparently different and inconsistent meanings. A logical analysis of the meaning of the Act in its application to this action is impossible. On the whole, I think we should give the Act an interpretation which brings about the result arrived at by Mellish, J."

Mellish, J. concluded that the section should not receive a technical interpretation.

In my opinion s. 118(1) of the **Assessment Act** clearly describes four events that give rise to a requirement that a person, other than the owner of the personal property, pay the rates and taxes rated and levied against the owner or person in possession of the personal property in question. The first of these events is when a mortgagee takes possession of personal property of the taxpayer. When this happens the mortgagee is required, pursuant to s. 118(1), to pay the taxes on the said personal property that is taken possession of pursuant to the terms of the mortgage.

By reason of the provisions of s. 118(3), the mortgagee, who takes possession, is personally liable to the municipality for the taxes owing for the current year and may be sued therefore by the municipality as for an ordinary debt.

It was on the basis of the provisions in s. 118(1) and (3) that the City of Dartmouth sued Barclays Bank. Barclays Bank had taken possession of the machinery and equipment of CNC by the appointment of Deloitte & Touche as receiver and the requirement to pay was, therefore, triggered on February 11, 1992, when Deloitte & Touche, on behalf of Barclays Bank, went into possession.

I see the issue in the case as being whether or not those provisions of the **Assessment Act** are rendered inapplicable or inoperative by reason of the subsequent assignment in bankruptcy of CNC. The answer to this question turns on the objects of the federal/provincial legislation and, in particular, the interpretation of s. 136(1) of the **Bankruptcy Act** which provides for a scheme of distribution of the proceeds realized from the sale of the bankrupt's property and what effect applying s. 118 of the **Assessment Act** has on the scheme of distribution.

The Trial Judge's Decision

After reviewing the facts the learned Chambers judge stated the issue before him as follows:

> "Is Barclays and/or Deloitte required to pay the taxes owed by CNC to Dartmouth for the 1991/1992 taxation year? The analysis of that issue necessitates an inquiry whether s. 118 of the **Assessment Act** directly or indirectly overrides the scheme of distribution set out in the **Bankruptcy Act**."

Justice Saunders accepted the argument of counsel for Barclays Bank which he reproduced in his judgment as follows:

"Under the **Bankruptcy Act**, the secured creditor is entitled to sell

> all assets over which it has security and there are two alternative positions with respect to the proceeds of the sale:
>
> > first, the proceeds can be less than the amount owed to the secured creditor, in which case the secured creditor retains all proceeds of sale and files as an unsecured creditor with the trustee in bankruptcy for the deficiency;
> >
> > secondly, the proceeds of distribution totally retire the secured creditors debt and costs of realization, in which case the surplus is remitted to the trustee in bankruptcy for *the general benefit of all creditors and to be distributed in accordance with the terms and provisions of the Bankruptcy Act, notably Section 136(1).*
>
> If, however, the position advanced by the City of Dartmouth is adopted the following results: the proceeds of realization by Barclays Bank of Canada would, in effect, be used first to retire the debt of the bankrupt to the City of Dartmouth for machinery and equipment and business occupancy taxes and second to be applied to reduce the debt of the bankrupt to Barclays Bank. In the situation where there is a surplus, the City of Dartmouth would not have to file a proof of claim with the Trustee, since their debt was the first to be retrieved.
>
> If, as the Plaintiff claims, Section 118 of the *Assessment Act* applies in the event of a bankruptcy, then the province will be viewed as a secured creditor and its position will be elevated from the rank of tenth (j) or fifth (e) to the rank of first in the scheme of distribution. The Defendant submits that such an interpretation is ultra vires the province since it attempts to usurp the Federal scheme."

The learned Chambers judge considered four decisions of the Supreme Court of Canada on the subject of provincial legislation that appears to be in conflict with the Federal bankruptcy legislation which have become known as the "quartet". He concluded his decision as follows:

> "I can come to no other conclusion but that the application of s. 118 of the Nova Scotia **Assessment Act** in these circumstances is to alter the scheme of distribution under the **Bankruptcy Act**. Although the **Assessment Act** may determine priorities prior to bankruptcy, once CNC made a voluntary assignment into bankruptcy, the **Bankruptcy Act** exclusively determined the status,

> priority and ranking of creditors. To permit the plaintiff's application would be to subvert the scheme of distribution under the **Bankruptcy Act**. That is not within the sphere of legislative competence of a province.
>
> In the result, s. 118 of the **Assessment Act** was rendered inoperative, upon the bankruptcy of CNC, by the provisions of the **Bankruptcy Act**.
>
> The plaintiff's application is dismissed with costs to the defendants."

Review of the Relevant Law

Subsequent to the trial judge's decision which was rendered on March 27th, 1995, the Supreme Court of Canada on October 19th, 1995, filed its decision in **Workers' Compensation Board v. Husky Oil Operations Limited** indexed as **Husky Oil Operations Limited v. M.N.R.**, [1995] 3 S.C.R. 453; 128 D.L.R. (4th) 1 (S.C.C.). The issue before the Supreme Court of Canada involved consideration of the applicability of provincial workers' compensation legislation to s. 136(1)(h) of the **Bankruptcy Act**. In that case Husky Oil contracted with Metal Fabricating and Construction Limited respecting the construction of a heavy oil upgrader owned by Husky Oil in Saskatchewan. The contractor had not paid the required contributions to the Workers' Compensation Fund. On March 2nd, 1992, the Workers' Compensation Board advised the contractor that $208,850.50 was due and payable. Soon thereafter the Bank of Montreal obtained an assignment of book debts from the contractor. On March 16th the Board was advised that the contractor had ceased operations. The Board then sought payment from Husky Oil, the principal of the defaulting contractor, pursuant to s. 133(1) of the of the **Workers' Compensation Act** which, in such circumstances, allows the Board to obtain the required contributions from the principal. Pursuant to s. 133(3) of the **Act** the principal could set off the amount paid to the Board from what it owed to the contractor. At that time Husky

Oil owed the contractor approximately $800,000. On March 19, 1992, subsequent to the Board having sought payment from Husky Oil, the contractor made an assignment in bankruptcy (Iacobucci J., paragraph 95).

Under s. 136(1)(h) of the **Bankruptcy Act**, a claim by the Workers' Compensation Board would rank 8th in priority to payment from the proceeds of realization by the trustee on the sale of the bankrupt's assets after the claims of secured creditors were paid.

Husky Oil applied to the trial judge to determine whether it should make the payments required by s. 133(1) to the Compensation Board. The trial judge held that the Provincial legislation was inapplicable as, if applied, it would alter the scheme of distribution in the federal bankruptcy legislation. The Saskatchewan Court of Appeal dismissed the appeal on the basis that s. 133(1) and (3) of the Workers' Compensation Act were *ultra vires* as they applied to bankruptcy. On appeal to the Supreme Court of Canada, the Court split five to four. The majority dismissed the appeal.

Gonthier, J., writing for the majority, found that the debt deemed against Husky Oil by s. 133(1) of the Workers' Compensation Act working in tandem with the set-off allowed the principal against the bankrupt contractor under s. 133(3) of the Act, diminished the bankrupt's estate. The net effect of this is that the contractor's liability is discharged out of its own property and not from the property of the principal. The effect of this was also to secure the claim of the Board against the assets of the bankrupt contractor and allow recovery by the Board ahead of the priority assigned to such an entity by Parliament under s. 136(1)(h) of the **Bankruptcy Act**. The majority was of the opinion that there was a clear conflict between the provincial and federal legislation because the provisions of the Workers' Compensation Act re-ordered federal priorities for claims by third parties such as the Compensation Board against the bankrupt even though the federal

bankruptcy legislation allows for the operation of the law of set-off as between Husky Oil and the contractor. The majority concluded that s. 133 should be read down as inapplicable to the exclusive federal sphere of bankruptcy even though it was legislation of general application that had not been enacted with the intention to interfere with the **Bankruptcy Act**.

Iacobucci J., writing for the minority, held that s. 133(1) of the Workers' Compensation Act did not affect the property of the bankrupt; it simply allows the Compensation Board to recover from Husky Oil, a non-bankrupt third party. The minority held that the provisions were not enacted for the purpose of improving the ranking of the Compensation Board in bankruptcy proceedings and that the section was not in operational conflict with federal bankruptcy law. The minority were of the opinion that s. 133(1) could stand independent from s. 133(3). Although s. 133(3) allowed Husky Oil to take from the bankrupt's property by asserting a set-off, the operation of the law of set-off has been preserved by s. 97(3) of the **Bankruptcy Act**. The minority held that any interference with the bankruptcy scheme does not result in the clear conflict required to trigger the paramountcy doctrine; a mere effect on a federal sphere of legislative power is not sufficient to invalidate legislation.

Gonthier J., writing for the majority, did a thorough review of the purposes of the federal bankruptcy legislation and a review of the decisions of the Supreme Court in **Re Bourgault** (1979), 105 D.L.R. (3d) 270, [1980] 1 S.C.R. 35 *sub nom. Deputy Minister of Revenue v. Rainville*; **Deloitte Haskins & Sells Ltd. v. Alberta (Workers' Compensation Board)** (1985), 19 D.L.R. (4th) 577, [1985] 1 S.C.R. 785**; Federal Business Development Bank v. Québec (Commission de la Santé et de la Sécurité du Travail** (1988), 50 D.L.R. (4th) 577, [1988] 1 S.C.R. 1061; and **British Columbia v. Henfrey Samson Belair Limited** (1989), 59 D.L.R. (4th) 726, [1989] 2 S.C.R. 24 (the so-

called "quartet").

At 120 D.L.R. p. 18 Gonthier J. then summarized his review of the quartet as follows:

> ".....my overview of the quartet hopefully indicated, the goal of maintaining a nationally homogeneous system of bankruptcy priorities has properly been a constant concern of this court. Were the situation otherwise, "Canada [would] have a balkanized bankruptcy regime which [would] diminish the significance of the exclusivity of federal jurisdiction over bankruptcy and insolvency. ... Otherwise there could be a different scheme in every jurisdiction; ten different bankruptcy regimes would make ordinary commercial affairs extremely complex, unwieldy and costly, not only for Canadians but also for our international trading partners" (Roman and Sweatman, *supra*, at pp. 80, 104). This is a prospect which this court has been acutely mindful of in the past, and its vigilance has ensured the continuing vitality of our nation's bankruptcy legislation. In my view, its past vigilance commends itself to the present and, barring an amendment to s. 91(21) of the *Constitution Act, 1867*, also to the future.
>
> In this regard, I agree with Iacobucci J., at para. 147, that a bankruptcy priority is a category, and also that provincial law may result in the content of such categories being different from province to province. However, provincial law does not and cannot define the content of bankruptcy priorities or categories without limitation. Indeed, crucial limitation is imposed by the order of priorities in the *Bankruptcy Act* itself. Thus, while individual provinces can define and rank categories such as "secured creditor" and "trust" as they each have their own purposes, those provincial laws which enter into conflict with the provisions of the *Bankruptcy Act* are simply without application in bankruptcy. Such, indeed, was this court's unequivocal holding in *Re Bourgault, Deloitte Haskins, and F.B.D.B.* with respect to "secured creditors" and in *Henfrey Samson* with respect to "trusts"."

The essence of the majority's decision in **Husky Oil** is contained in paragraph 49 where Justice Gonthier stated:

> "Furthermore, when s. 133(1) and (3) operate in tandem as intended by this legislation, the principal's right to withhold and be indemnified from moneys owing to the contractor in the event that the principal is deemed responsible *for the contractor's liability* means that the principal will ultimately *not* be responsible for that liability. Instead, the debt to the Board is effectively discharged

> with property of the contractor when the principal exercises its right of set-off. Differently put, when s. 133(1) and (3) operate together, the principal is no worse off after having acted as the contractor's surety. The principal's estate or, to use civil law terminology, its patrimony remains entirely unaffected even after discharging its "personal" liability to the Board. As a result of the principal's right of set-off against moneys owing to the contractor, it is the contractor's estate or patrimony which is diminished to the extent of the assessments owing to the Board. The reality of this scheme, then, is that the contractor discharges its own liability to the Board, mediated through the legally compelled agency of the principal."

Justice Gonthier concluded that the combined effect of ss. 133(1) and (3) was to secure the claim of the Compensation Board against the assets of the contractor. In short, the bankrupt's estate, available for distribution to preferred creditors pursuant to s. 136(1) of the **Bankruptcy Act**, (after the claims of secured creditors are satisfied) is diminished by the application of ss. 133(1) and 133(3) of the Saskatchewan Workers' Compensation Act. The effect of the provincial legislation is to secure the Board's claim against the bankrupt estate ahead of its priority ranking under s. 136 of the **Bankruptcy Act**. In paragraph 68 Gonthier J. stated:

> "We have consistently held that the deference to provincial law in the *Bankruptcy Act* does not extend to the reordering of claims against the estate. At that point, provincial law simply ceases to apply for intruding into an exclusive federal sphere. Such, then, must also be the fate of the impugned legislation in this appeal."

Of significance to the issue before us are the comments of Justice Gonthier at paragraph 77 of his opinion where he stated:

> "At this point, I should perhaps stress that nothing I have said detracts from a province's authority to impose liability on a third party for a bankrupt's debt. What a province cannot do, however, is create a statutory security device which has the effect of reordering the priorities of distribution of the assets in the bankrupt's estate. In such a case, what is otherwise valid provincial legislation is simply without application upon the occurrence of bankruptcy."

He went on in paragraph 79 to again emphasize that his decision rested on the operation in tandem of the provisions of s. 133(1) and 133(3) of the Workers' Compensation Act. He stated:

> "In the foregoing, I have proceeded on the basis that s. 133(1) operates in tandem with s. 133(3), that is, that the principal has moneys owing to the contractor which it can use as a basis for set-off when the Board deems it liable for the contractor's assessment. Where a principal has such moneys owing, it was clearly the legislature's intention that such a right to set-off be exercised in order that the contractor ultimately be responsible for its own assessment. In this sense, where both s. 133(1) and (3) potentially apply on the facts of a given case, it was clearly the legislature's intention that the right to set-off be exercised. As a result, in such a case s. 133 is inapplicable *in toto* against the bankruptcy."

Counsel for the City of Dartmouth puts considerable reliance on the statement made by Justice Gonthier in paragraph 80 to support his argument that s. 118 of the **Assessment Act** should be allowed to operate in the case we have under appeal. Justice Gonthier stated:

> "(80) However, there may be instances where the principal does not hold or retain any moneys owing to the contractor. While the court did not have the benefit of extensive submissions on this point, I believe it is quite plausible to conclude that the principal can then claim from the estate as a preferred creditor under s. 136(1)(h), since its claim is comprehended with "indebtedness of the bankrupt under any Workmen's Compensation Act". This would appear to be permissible because on its plain wording s. 136(1)(h) specifies only the nature of the claim and not the identity of the claimant. As a result, if only s. 133(1) applies, the Board has not secured its claim against the estate but recovers only from the principal. <u>The scheme of distribution of assets in the estate is thereby unaffected. In such a case, there is no constitutional reason why full effect should not be given to provincial law within its legitimate sphere of operation.</u> I would therefore only read down s. 133 to the extent that in application it enters into conflict with the scheme of distribution in the *Bankruptcy Act*. Where s. 133(1) alone is engaged in a given case, the Board's claim against the principal continues to be fully applicable." (Emphasis added)

I will return to the considerations raised by the foregoing statement.

In paragraph 87 Gonthier J. felt it appropriate to summarize his view on the proper constitutional analysis where federal and provincial legislation potentially conflict. He stated:

> "In view of Iacobucci J.'s statement that "[provincial] [l]egislation that is *intra vires* is permitted to have an incidental and ancillary effect on a federal sphere" [at para. 162], I think it appropriate in concluding to summarize my view as to the proper constitutional analysis where federal and provincial legislation potentially conflict. One must first determine whether the laws are respectively valid federal or provincial legislation. If so, the actual operation of the laws must be examined to determine whether they are in operational conflict, that is, inconsistent or incapable of being fully complied with in a given situation. If they are in operational conflict, the federal legislation prevails and the provincial legislation is without effect to the extent of this conflict. If the operational conflict is in a field of exclusive federal jurisdiction, the provincial legislation will be inapplicable as being *ultra vires* to that extent. If the conflict is in an area of concurrent or overlapping jurisdictions, the provincial legislation will remain *intra vires* but be inoperative. To the extent that there is operational conflict, there is no room for an incidental or ancillary effect of provincial legislation. If, on the other hand, there is no operational conflict, then both laws continue to operate and both continue to have effect to the extent that operational conflict does not arise. Short of operational conflict, provincial law may validly have an effect on bankruptcy, as I have indeed acknowledged in observing that there is no bankruptcy "bottom line" without provincial law (at para. 30). In the present case, I have found clear operational conflict in that s. 133(1) and (3) in their operation together entail a reordering or subverting of the federal order of priorities under the *Bankruptcy Act*. Such an intrusion into an exclusive federal sphere necessarily goes far beyond an incidental and ancillary effect. I believe this proposition runs thorough my reasons."

What emerges from Gonthier J.'s analysis of the quartet is the recognition by the Supreme Court of Canada of six propositions or principles to be considered by a court when dealing with potential conflicts between provincial and federal legislation where s. 136(1) of the **Bankruptcy Act** is engaged (**Husky Oil**, paras. 39 and 40).

Those principles are as follows:

"(1) provinces cannot create priorities between creditors or

change the scheme of distribution on bankruptcy under s. 136(1) of the Bankruptcy Act;

(2) while provincial legislation may validly affect priorities in a non-bankruptcy situation, once bankruptcy has occurred section 136(1) of the Bankruptcy Act determines the status and priority of the claims specifically dealt with in that section;

(3) if the provinces could create their own priorities or affect priorities under the Bankruptcy Act this would invite a different scheme of distribution on bankruptcy from province to province, an unacceptable situation; and

(4) the definition of terms such as "secured creditor", if defined under the Bankruptcy Act, must be interpreted in bankruptcy cases as defined by the federal Parliament, not the provincial legislatures. Provinces cannot affect how such terms are defined for purposes of the Bankruptcy Act.

(5) in determining the relationship between provincial legislation and the *Bankruptcy Act*, the form of the provincial interest created must not be allowed to triumph over its substance. The provinces are not entitled to do indirectly what they are prohibited from doing directly;

(6) there need not be any provincial intention to intrude into the exclusive federal sphere of bankruptcy and to conflict with the order of priorities of the *Bankruptcy Act* in order to render the provincial law inapplicable. It is sufficient that the effect of provincial legislation is to do so."

Appellant's Submission

The appellant submits that the *ratio decidendi* of the majority decision of the Supreme Court of Canada in **Husky Oil** is the rejection of what was labelled the "bottom line approach" in that case (See paragraphs 29 and 30). I disagree. I would refer to Gonthier J.'s statement in paragraph 31:

> "However, even rejecting the simplistic "bottom line" approach, I do not agree that the quartet stands for the sole proposition that the provinces cannot "jump the queue". In my opinion, the quartet embodies a consistent and general philosophy as to the purposes of the federal system of bankruptcy and its relation to provincial property arrangements. That philosophy cannot be captured in the pithy but limited proposition that the provinces cannot "jump the queue".

Counsel for the City of Dartmouth argues that the learned trial judge applied

the "bottom line approach" which was described by Gonthier J. in paragraph 29 as being an approach which posits that "any time provincial law affects the final result of a bankruptcy, the province is improperly attempting to alter the priorities of distribution".

The essence of the appellant's submission is that one must look to the facts of the particular case and if the effect of applying s. 118 of the **Assessment Act** on the facts of the case does not diminish the estate of the bankrupt then s. 118 does no more than impose a liability on a secured creditor as a cost of realization of its security. He argues s. 118 makes no attempt to affect the property of the bankrupt nor does it attempt to give a secured creditor, Barclays Bank, recovery rights with respect to the bankrupt property whether through setoff or otherwise.

I will deal with these submissions in setting out the reasons why I am of the opinion that this appeal ought to be dismissed.

Analysis of Issues raised on this Appeal

The provincial legislation in issue in three of the so-called quartet cases was different in a fundamental aspect from the facts of the case we have before us. In these cases the issue of s. 136(1) priorities affected by the conflicting provincial legislation related to provincial legislation securing a claim (of the nature identified in s. 136(1)) against the bankrupt's property thus giving that claimant security and, thus, priority against the property that otherwise would be available for distribution pursuant to the order of priority established in s. 136(1) of the **Bankruptcy Act**. In **British Columbia v. Henfrey Samson Belair Ltd.** (1989), 59 D.L.R. (4th) 726, [1989] 2 S.C.R. 24, 75 C.B.R. (N.S.) 1, the provincial legislature created a deemed statutory trust with respect to monies held by the bankrupt that had been collected as provincial sales tax. The majority of the Court held that it was not a valid trust. McLachlin J., writing for the majority, concluded that the

reality of the property interest created by the provincial legislation ought to govern over the form, and as a result the province's claim failed.

In **Husky Oil** the provincial legislation did not directly create a charge on the bankrupt's property; it made a third party personally liable. That is the situation that exists in the case before us. Furthermore, in **Husky Oil** and in the case we have under consideration the personal liability of the third parties had been triggered before the assignment in bankruptcy. There is no clear indication in **Husky Oil** if there were surplus funds from realization of the bankrupt property after payment of the secured claims. However, in paragraph 96 there is an indication that there would not have been any funds available to the Board as a preferred creditor if s. 133 of the **Workers' Compensation Act** was inapplicable. Therefore, on the facts of **Husky Oil**, as in the case we have under consideration, there would not have been any money for the preferred creditor in question unless effect were given to the provincial legislation in issue.

In **Husky Oil**, if effect were given to s. 131(1) and (3) of the **Workers' Compensation Act** the property of the bankrupt available for distribution to the other preferred creditors would have been diminished and, therefore, the order of priorities under s. 136(1) altered.

In each of the cases on which the Supreme Court of Canada ruled, it was held that if the provincial legislation were given effect it would diminish the amounts realized from the bankrupt's property and, thus, diminish the amounts available for payment of preferred and unsecured creditors. However, the provincial legislation under which the City of Dartmouth claims Barclays Bank is liable for CNC's taxes does not expressly involve a priority claim to the bankrupt's property that but for the priority would have been available for the preferred or unsecured creditors but a <u>personal</u> claim against a mortgagee who went into possession.

The question arises as to whether or not the provincial legislation we have under consideration can be given effect without affecting the scheme of distribution under s. 136(1) of the **Bankruptcy Act**. If the City's claim against Barclays Bank is enforceable there would not appear to be a diminishment of the bankrupt's property available for distribution to the preferred creditors pursuant to s. 136(1) of the **Act** as on the facts of this case there is nothing to distribute after payment of the secured creditor Barclays Bank.

"The quartet" and **Husky Oil** decisions all involved situations where the application of the provincial legislation would clearly have had the effect of diminishing the proceeds from the realization of the bankrupt's property and thus effect the distribution envisaged under. 136(1) of the **Bankruptcy Act**. The majority decision in **Husky Oil** in paragraph 80 concedes that provincial legislation designed to secure payment of money owing to a provincial entity may be allowed to operate if the application of the provincial legislation does not effect the scheme of distribution provided for in s. 136(1) of the **Bankruptcy Act**.

The minority in **Husky Oil** would have allowed s. 133(1) and (3) of the Workers' Compensation Act to operate despite the bankruptcy of the contractor. The minority concluded at p. 71:

> "In terms of constitutional analysis, the simple fact that a provincial undertaking may have an effect upon a bankruptcy does not necessarily mean that such an undertaking is to be nullified under paramountcy analysis. Further, the fact that the Board might be able to recover more money as a result of s. 133 does not mean that this provision is in operational conflict with the *Bankruptcy Act.* Operational conflict means that compliance with the provincial statute means offending the federal one. But the two pieces of legislation involved here are complementary."

With respect to the proper approach to questions of paramountcy between

federal and provincial legislation, Iacobucci J. stated at paragraph 122:

> "In the case at bar, the courts below did not demonstrate the appropriate level of judicial restraint in their application of paramountcy doctrine. In my view, courts should carefully look for co-existence, not strive to find conflict."

After reviewing the so-called quartet decisions Justice Iacobucci directed his attention to the consequences of these decisions and made further comments on the proper approach when dealing with potential conflicting general provincial legislation and federal legislation respecting bankruptcy; he stated at paragraph 141:

> "....The quartet stands for the position that only those provincial laws which directly improve the priority of a claim upon the actual property of the bankrupt over that accorded by the *Bankruptcy Act* are inoperative. This accords with the facts of the cases in the quartet. In each case, the provincial governments endeavoured to change the priorities of preferred creditors in s. 136(1) by elevating a lower ranked claim to a higher rank. In *Re Bourgault* and *Belair*, the province attempted to "queue jump" claims of the Crown ranked last by s. 136(1)(j) by declaring such debts to be "privileges" (*Re Bourgault*) or deeming them to be "trust money" and hence outside the distribution scheme (*Belair*). In *Deloitte*, the province attempted to elevate its claim through a proposed security interest and, finally, in *F.B.D.B.*, the province once again endeavoured to use the mechanism of a privilege/lien." {Emphasis added}

And further at paragraph 149:

> "I conclude that within the context of the bankruptcy process judicial authority and common sense militate in favour of a guarded approach to invalidation under the paramountcy doctrine. When this analysis is applied to the case at bar, it obliges the respondents, in order to prevail, to demonstrate that s. 133 of the impugned provincial Act actually reorders the federally established priority scheme with regard to the property of the bankrupt Metal Fab by directly creating interests therein. I now turn to this issue." {Emphasis added}

Most significantly for the matters we have under consideration, he stated at paragraph 161:

> "In sum, s. 136(1)(h) encompasses a claim against the property of

> the bankrupt. The Board's claim under s. 133(1) targets a solvent principal. The two provisions are co-extensive, not mutually exclusive. Use of s. 133(1) does not displace s. 136(1)(h); it complements it."

If one were to apply the persuasive reasoning of the minority decision, the City of Dartmouth's claim would prevail on the facts of this case as s. 118 of the **Assessment Act** is valid provincial legislation enacted pursuant to s. 92(13) of the **Constitution Act, 1867** and does not directly create an interest in the bankrupt's property in favour of the City of Dartmouth. As such, it should be given effect if it is not in operational conflict with federal bankruptcy legislation which would be paramount pursuant to the provisions of s. 91(21) of the **Constitution Act, 1867**. By applying s. 118(1) and (3) of the **Assessment Act** so as to require Barclays Bank to pay the City of Dartmouth $25,498.89, does not diminish the proceeds from the realization on the bankrupt's property by the trustee that would be available for distribution to the preferred creditors pursuant to s. 136(1) of the **Bankruptcy Act** as there was nothing left to be diminished; the assets having sold for an amount that is only sufficient, if that, to pay the secured claim of Barclays Bank and something towards the trustee's fees.

On such an analysis the liability of the mortgagee, Barclays Bank, in relation to obligations created by the provincial legislation ought not to be extinguished by the mere fact that subsequent to the liability being created (when the mortgagee went into possession on February 11th, 1992) the mortgagor made an assignment in bankruptcy. The mortgagee is still subject to the laws of the province that may affect the mortgagee's remedies when realizing on the security for the loan. So long as the operational effect of this provincial law does not diminish the bankrupt's property available for distribution pursuant to s. 136(1) of the **Act**, the provincial legislation ought to be allowed to operate. Whether s. 118 of the **Assessment Act** can be invoked by a municipality in any given

bankruptcy would on this analysis turn on the facts of the particular case.

Such a conclusion would be consistent with the views expressed by Gonthier J. in paragraph 80 of the **Husky Oil** decision and would certainly accord with the views of the minority.

However, I should state that in a different factual situation than that before us, s. 118(1) and (3) of the **Assessment Act** could not be given operational effect as this would offend the principles enunciated in **Husky Oil**. For example, in a bankruptcy in which there was a secured debt of $400,000 and the assets of the bankrupt realized $450,000, giving effect to s. 118(1) and (3) of the **Assessment Act** would require the mortgagee, who had gone into possession as Barclays Bank had, in this case, to pay a current year's taxes owing by the bankrupt to the municipality in which it did business. Pursuant to the standard form of debenture (as was provided for in Barclays debenture form) the mortgagee could add this sum (say $25,000) to its secured claim. The trustee in bankruptcy would have paid out $425,000 leaving only $25,000 available for the other creditors pursuant to s. 136(1) of the **Bankruptcy Act** rather than $50,000 had s. 118(1) of the **Assessment Act** not been applied. Under such circumstances the pool of money available to s. 136 creditors would be reduced from $50,000 to $25,000. Such a situation would clearly fall within the principles developed by the majority decision in **Husky Oil** in that the proceeds of realization of the bankrupt property would be diminished by the application of s. 118 of the **Assessment Act** and would have the effect of reordering the priorities provided for in s. 136(1) of the **Bankruptcy Act** as the municipal taxes would be paid out of the bankrupt's property prior to payments to the preferred creditors with a superior ranking under s. 136(1) of the **Bankruptcy Act**. Under such circumstances s. 118 could not be applied as it would be in operational conflict with s. 136 of the **Bankruptcy Act**. Therefore, under such circumstances a municipality could not rank as a creditor of

the bankrupt other than as provided for in s. 136(1) of the **Bankruptcy Act**.

Conclusion

I will briefly review the relevant facts:

(i) Barclays Bank went into possession of CNC's property as mortgagee following a default in payment of a mortgage on CNC's personal property;

(ii) there was a subsequent bankruptcy of CNC;

(iii) Section 136(1) of the **Bankruptcy Act** provides for a scheme of distribution from the proceeds of realization of the bankrupt's property subject to the rights of secured creditors;

(iv) the City of Dartmouth does not claim a security interest in any of the bankrupt's property and is not a secured creditor within the meaning of that term in the **Bankruptcy Act**;

(v) there was no evidence in the agreed statement of facts as to the exact amount that was owing to Barclays Bank by CNC on the date the receiver went into possession - February 11th, 1992. However, the trustee, who has a duty to all the creditors, was apparently satisfied that at least $399,500 was owing to Barclays Bank under the Debenture as that amount was paid for the release of its security;

(vi) we know that the trustee was paid $500.00 and that it is reasonable to infer that his fees would be more that this amount. We also know that the trustee's fees are the second priority for payment under s. 136(1) of the **Bankruptcy Act**;

(vii) if Barclays Bank is held personally liable to pay to the City CNC's outstanding taxes on personal property by the application of s. 118(1) and (3) of the **Assessment Act**, it can pursuant to Clause 3.5(b) of the Debenture add the

amount paid to the debt secured by the Debenture and thus bring the indebtedness back up to $399,500;

(viii) there are no funds available for preferred creditors from the sale of the bankrupt's property other than the $500 generated from the sale of the assets of CNC to Kes Pacific.

The fundamental difference between the majority and minority decisions in **Husky Oil** is that Gonthier J.'s decision is rooted in what he correctly perceives as a constant theme of the Supreme Court of Canada to have a consistent application of bankruptcy law from province to province and that any provincial legislation that creates a "statutory security device" which has the effect of re-ordering the priorities of creditors specifically mentioned in s. 136(1) of the **Bankruptcy Act** has no application once a debtor has gone into bankruptcy. And in assessing whether the legislation has the effect of creating a "statutory security device", substance must govern over form. The court must look to the effect of the provincial legislation on the scheme of distribution of a bankrupt property as provided in the **Bankruptcy Act**.

The minority's opinion is founded on an approach that requires the courts, when dealing with these problems, to attempt to reach a resolution that would allow the provincial legislation to operate rather than to strive to find conflict. Inherent in the minority view is that if the provincial legislation does not directly create an interest in the bankrupt's property because the legislation creates a claim against a third party, the provincial legislation does not diminish the bankrupt's property and can therefore co-exist with the **Bankruptcy Act**. In such circumstances the legislation should be given operational effect as it will not interfere with the order of priorities for distribution of the proceeds of the realization on the property of the bankrupt as provided for in s. 136(1) of the **Bankruptcy Act**.

In concluding that the appeal ought to be dismissed I have obviously been guided by the six propositions or principles adopted by the majority in **Husky Oil**. But I would note that in paragraph 80 Gonthier J. seems to concur with the minority that if the preferred creditors' claim is not secured against the bankrupt's property but recoverable from a third party the scheme of distribution of assets of the bankrupt is unaffected and full effect should be given to the provincial legislation. It is this aspect of the majority decision that forms the foundation of the appellant's argument before us and creates the dilemma in resolving this appeal.

In **Husky Oil**, the Bank of Montreal, as the principal secured creditor, was in a similar, although not identical position, to that of Barclays Bank. Both would lose their secured position to the extent of the preferred creditors' claims if the provincial legislation were given operative effect.

One of the prime purposes of the **Bankruptcy Act** is to provided a regime whereby the creditors of the bankrupt will pursue their claims by collective action through the trustee so that the assets of the bankrupt can be realized and distributed on an equitable basis subject to the priorities of preferred creditors and the rights of secured creditors. The **Bankruptcy Act** allows secured creditors to realize on their security as if there was not a bankruptcy (**Husky Oil**, paragraph 9).

Creditors holding security, such as a mortgage on real or personal property, are subject to a variety of provincial laws that have the effect of diminishing the amount realized on a sale of the secured property. One such device is s. 118 of the **Assessment Act** which provides that if a taxpayer has outstanding taxes owing to the Municipality on personal property and the mortgagee goes into possession, the mortgagee is liable to pay those taxes. Should the mere fact that the debtor has gone into bankruptcy make that provincial law inapplicable? The majority decision in **Husky Oil** seems to answer yes to

that question.

Although there seems to be a mixed message created by paragraph 80 of the majority decision, I would note that the comments of Gonthier J. in that paragraph were clearly *obiter dicta* and seem to run contrary to the general theme of the judgment.

Iacobucci J. stated that he found the concepts developed in the majority judgment with respect to tests to be applied in resolving conflicts between provincial legislation that infringe upon the federal bankruptcy field to be "somewhat confusing".

The situations in **Husky Oil** and in this appeal are significantly similar in three respects: (i) the provincial legislation in issue does not in its form create a charge against property of the bankrupt; (ii) the personal liability of the third parties arose before the bankruptcy; and (iii) giving operational effect to the provincial legislation on the facts would not have diminished the funds available for the preferred creditors under s. 136(1) of the **Bankruptcy Act** as there would not have been a surplus after payment of the secured creditors.

In addition to the similarity of the facts, what is persuasive in resolving the issues in the appeal we have under consideration is that the majority decision in **Husky Oil** reaffirms the principles upon which the decisions in the quartet were founded. We must be guided by the majority decision in **Husky Oil** and, in particular, the six propositions spelled out in that decision as representing the current law relating to the issue before us.

With these propositions in mind one is driven to the conclusion that s. 118 of the **Assessment Act** has the combined effect of diminishing the security of the mortgagee and re-ordering the priorities of preferred creditors to payment as established by s. 136(1) of the **Bankruptcy Act**. This is so because Barclays Bank as mortgagee holds the first fixed charge against the machinery and equipment of the bankrupt. Under s. 136(1) of the **Bankruptcy Act** the right of a municipality to have outstanding taxes on personal property

of the bankrupt paid by the trustee in bankruptcy is subject to both the rights of the secured creditors and to those preferred creditors ranking ahead of the municipality under s. 136(1). The majority decision in **Husky Oil** makes it clear that in considering such statutory security devices substance must govern over form. Although the liability of Barclays Bank under s. 118(1) is personal the substantive effect of applying s. 118(1) is to give the City of Dartmouth what amounts to a secured claim against the machinery and equipment ranking ahead of, not only other higher ranked preferred creditors under s. 136(1), but also ahead of Barclays Bank, a secured creditor. This is so because, in effect, the City of Dartmouth's claim will be paid out of the realization of the sale of the bankrupt's property that secured the claim of Barclays Bank. Gonthier J.'s use of the term "statutory security device" must be considered in combination with his statement that the substance of the legislation in question governs over its form. Therefore the term includes, not only statutory provisions which create a lien against property of the bankrupt, but also provisions that have such an effect. Section 118(1) is such a statutory security device as the personal liability of the mortgagee who goes into possession will, in effect, be covered by the proceeds of the realization of the bankrupt property by the mortgagee. Furthermore, the effect of applying s. 118 of the **Assessment Act** is to re-order the priorities of preferred creditors to realize from the sale of the bankrupt property as provided for in s. 136(1) of the **Bankruptcy Act**. Based on the majority decision in **Husky Oil**, the fact that there would not be any funds available for the preferred creditors in any event does not appear to be a relevant consideration in determining the applicability of the provincial legislation following a bankruptcy. Therefore, applying the majority decision in **Husky Oil** and the propositions therein recognized, s. 118 of the **Assessment Act** is inapplicable following the assignment in bankruptcy by CNC as it is in conflict with the federal bankruptcy legislation. If s. 118 of the **Assessment Act** were to be applied by this court in these

circumstances the decision would be contrary to each of the six propositions recognized by the majority decision in **Husky Oil**.

The fact that a secured creditor can improve his position by causing a debtor to be put into bankruptcy is a price that was acceptable to the Supreme Court of Canada in **FBDB v. Quebec** to accomplish the end of having uniform bankruptcy laws from coast to coast in Canada. In that case Lamer J. stated:

> " Once the bankruptcy has occurred, the federal statute applies to all creditors of the debtor.
>
> It is true that such a solution may encourage secured creditors to bring about the bankruptcy of their debtor in order to improve their title. On the other hand, this solution has obvious advantages. As soon as a the bankruptcy occurs the **Bankruptcy Act** will be applied: the mere fact that a creditor is mentioned in s. 107 of the **Bankruptcy Act** suffices for such creditor to be ranked as a preferred creditor and in the position indicated in that provision. As provincial statutes cannot affect the priorities created by the federal statute, consistency in the order of priority in bankruptcy situations is ensured from one province to another."

Accordingly, I would dismiss the appeal and order the City of Dartmouth to pay to Barclays Bank the costs with respect to the hearing before Justice Saunders and the appeal to this Court in the total amount of $4,000 plus disbursements to be taxed.

Hallett, J.A.

Concurred in:

Matthews, J.A.

Chipman, J.A.

C.A. No. 116299

NOVA SCOTIA COURT OF APPEAL

BETWEEN:

CITY OF DARTMOUTH

Appellant

- and -

BARCLAYS BANK OF CANADA and DELOITTE & TOUCHE INC.

Respondent

REASONS FOR JUDGMENT BY:

HALLETT, J.A.