Intelligence MEMOS

From: Edward Waitzer

To: Bankruptcy law watchers

Date: August 8, 2024

Re: **Change Needed: Crooks Shouldn't Get Out of Fines Through Bankruptcy**

Insolvency laws in Canada (as in the United States, Britain and Australia) have long enshrined the principle that bankruptcy should not assist dishonest debtors. But the Supreme Court of Canada recently determined that fraudsters are able to avoid regulatory penalties from provincial securities commissions by declaring themselves bankrupt.

It is disappointing to have a Supreme Court **decision** that allows swindlers to insulate themselves from key sanctions – ones that serve to deter wrongful conduct. This cries out for legislative reform.

First, though, how did this happen?

In 2014 the BC Securities Commission found Thalbinder Singh Poonian and Shailu Poonian guilty of fraudulent market manipulation that defrauded public investors of more than $7 million between 2007 and 2009. The commission subsequently imposed administrative penalties and disgorgement orders.

The couple declared bankruptcy and then cited that as the reason they could avoid paying the penalties. Two courts rejected that argument.

In 2022 the BC Court of Appeal upheld a decision of the BC Supreme Court and determined that these debts were not extinguished by the Poonians declaring bankruptcy. This is because the *Bankruptcy and Insolvency Act* provides that an order of discharge does not release the bankrupt from any debt resulting from obtaining property by fraudulent misrepresentation.

Meanwhile, in 2021 an unrelated but similar issue was decided by the Alberta Court of Appeal, which reached the opposite conclusion – favouring the "fresh start" function of bankruptcy over the public policy objectives of securities laws.

But it was the Poonian case, which was appealed to the Supreme Court of Canada, that ultimately set the precedent for future cases.

Last month, the Supreme Court majority interpreted "resulting from" to require that a creditor relied on the fraudulent misrepresentation to their detriment. In other words, a scammer's debt can survive a bankruptcy only if it's owed to someone they'd scammed.

Accordingly, while the Supreme Court did not discharge the Poonians' debt under the disgorgement orders, they relieved them of their obligation to pay the administrative penalties imposed by the BC Securities Commission (because the commission itself did not detrimentally rely on the Poonians' fraudulent conduct).

The two dissenting justices, Andromache Karakatsanis and Sheilah Martin, would not have so relieved the Poonians. The minority looked to the purpose of bankruptcy laws. They determined that the monetary penalties imposed on the Poonians resulted from the fact that property was obtained by fraudulent misrepresentation – the two were directly related. The dissenters pointed out that the "fresh start" principle of bankruptcy was never intended to relieve a bankrupt of liabilities resulting directly from their fraudulent conduct.

The Superintendent of Bankruptcy (the federal official who administers the *Bankruptcy and Insolvency Act*) intervened in the case, arguing in favour of the Poonians. The superintendent said that the provision in the Act was intended to make victims of fraud whole, rather than to preserve administrative penalties imposed for deterrence purposes.

That logic, if correct, means the bankruptcy act needs to be reformed – something Canadian securities (and other) regulators have been urging for years. Regrettably, such reform initiatives enjoy little political currency, so tend to drift to the bottom of the list of public policy priorities.

It should be noted that there's a salient, secondary argument to this case that never reached the Supreme Court.

The *Bankruptcy and Insolvency Act* specifically preserves debt arising from fines, penalties and restitution orders that are imposed by courts. Indeed, the BC Supreme Court took the view that orders imposed by a securities commission (and registered in court) should be treated the same. The BC Court of Appeal, to which the Poonians appealed, disagreed, and that issue was closed.

Whether it's a penalty imposed by a court or a securities commission, the underlying logic is identical. So why protect criminals who want to escape the consequences of their wrongdoing by filing for bankruptcy?

That said and as the majority decision noted, it is certainly preferable to solve this regulatory gap through focused amendments to the *Bankruptcy and Insolvency Act*, rather than rely on sporadic judicial decisions in response to whatever situations should arise.

The federal government has been aware of this concern for many years. One hopes the Supreme Court's decision will call attention to the need for and motivate legislative reform.

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A version of this Memo first **appeared** in *The Globe and Mail.*