Discharged bankrupts may be exempt from administrative penalties: Poonian v. British Columbia (Securities Commission)

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Recently, in *Poonian v. British Columbia (Securities Commission)*, the Supreme Court of Canada clarified that while a bankrupt can be discharged from the obligation to pay administrative penalties ordered by administrative tribunals, including provincial securities regulators, a bankrupt cannot be discharged from the obligation to pay disgorgement orders resulting from fraudulent conduct.

Generally, the *Bankruptcy and Insolvency Act* (BIA) grants broad discretion to the court to grant or refuse an absolute or conditional discharge from bankruptcy. However, section 178(1) of the BIA enumerates specific debts that cannot be discharged by a court, due to overriding public policy objectives. The creditor bears the onus of demonstrating that the debt is captured by one of these exemptions.

Justice Côté, writing for a 5-2 majority, emphasized that these exceptions set out categories of specific wrongful conduct that must be interpreted narrowly, in order to achieve the BIA's purpose of financial rehabilitation and economic reintegration of debtors.

What you need to know

- A discharged bankrupt may be exempt from administrative penalties
- A bankrupt cannot be discharged from paying disgorgement orders resulting from fraudulent conduct

Factual background

Between 2007 and 2009, Thalbinder Singh Poonian and Shailu Poonian (the Poonians) operated a market manipulation scheme that caused vulnerable investors to lose millions of dollars. In enforcement proceedings, the British Columbia Securities Commission (the Commission) found that the Poonians' conduct violated s. 57(1)(a) of

the British Columbia *Securities Act*. The Poonians were ordered to pay administrative penalties of $13.5 million in total, and they were ordered to disgorge $4.47 million, as well as $1.13 jointly and severally with another respondent, representing the amounts obtained as a result of the market manipulation scheme. The Commission registered the administrative penalties and the disgorgement orders with the Supreme Court of British Columbia pursuant to the *Securities Act*.

In April 2018, the Poonians made a voluntary assignment into bankruptcy. In February 2020, they applied for a discharge from bankruptcy, which the Court refused to grant.

Subsequently, the Commission sought a declaration that the administrative penalties and disgorgement orders owed by the Poonians could not be released by any order of discharge, due to the exceptions at sections 178(1)(a) and 178(1)(e).

Section 178(1)(a) – Exception for fines, penalties, restitution orders imposed by a Court

Section 178(1)(a) provides that a bankrupt cannot be discharged from "any fine, penalty, restitution order or other order similar in nature to a fine, penalty or restitution order, imposed by a court in respect of an offence, or any debt arising out of a recognizance or bail".

The majority and dissenting justices agreed that the administrative penalties and disgorgement orders imposed by the Commission were not captured by s. 178(1)(a), for two principal reasons. First, the Supreme Court found that the word "court" cannot be interpreted to include administrative tribunals or regulatory bodies such as the Commission, since the word "court" refers to the judiciary and implies that a dispute will be adjudicated by a judge or judges. The majority noted that, had Parliament wished to render fines, penalties, restitution orders or other orders similar in nature exempt from discharge, it could have done so expressly.

Second, the Supreme Court found that the orders were not "imposed" by a court, as required by s. 178(1)(a) – they were made and imposed by an administrative decision-maker, and subsequently registered with the court. The Supreme Court specified that the court takes a passive role in registering an administrative decision, whereas the act of "imposing" a fine, penalty or restitution order requires that the court be actively involved in making the decision.

Section 178(1)(e) – Exception for any debt or liability resulting from obtaining property or services by false pretences or fraudulent misrepresentation

Section 178(1)(e) provides that a bankrupt cannot be discharged from "any debt or liability resulting from obtaining property or services by false pretences or fraudulent misrepresentation". For a debt or liability to survive bankruptcy under s. 178(1)(e), the creditor must establish three elements: (1) false pretences or fraudulent misrepresentation; (2) a passing of property or provision of services; and (3) a link between the debt or liability and the fraud.

The majority found that, for both the administrative penalties and the disgorgement orders, the first two elements of the above test were satisfied – the Poonians knowingly made false statements to investors and obtained property in the form of millions of dollars.

However, the majority found that only the disgorgement orders met the third element of the test, which requires a direct link between the debt or liability and the fraudulent conduct. In doing so, the majority referred to the legislative purpose of s. 178(1)(e), which is to make fraud victims whole, rather than to preserve penalties imposed for deterrence purposes.

Consequently, since the administrative penalties arose indirectly as a result of the regulator's choice to sanction the Poonians and not as a direct result of their fraudulent misrepresentation, the administrative penalties were not captured by s. 178(1)(e).

In a short dissent, Justice Karakatsanis, joined by Justice Martin, disagreed with the majority, finding that s. 178(1)(e) is a "moral sanction" that should be interpreted purposively, rather than narrowly. Justice Karakatsanis found that both the administrative penalties and the disgorgement orders are debts that originated from the Poonians having obtained property by false pretences or fraudulent misrepresentation.

Takeaways

The Supreme Court's decision provides clarity to the treatment of debts for administrative penalties and disgorgement orders resulting from fraudulent conduct. However, it remains an open question as to whether a discharged bankrupt can be exempted from satisfying disgorgement orders that are unrelated to fraudulent conduct. It will be interesting to follow the application of the *Poonian* decision in future cases, especially because securities regulators seem to be seeking disgorgement orders more and more frequently. Regulators such as the Canadian Investment Regulatory Organization (CIRO) have also recently made clear that they will seek disgorgement orders as separate penalty items.

Further, the relief to debtors provided by the *Poonian* decision may be short-lived. In the wake of the decision, the British Columbia Securities Commission has called for amendment of the *Bankruptcy and Insolvency Act.* In early August, the Commission published a press release, noting that the *Poonian* decision highlights "a significant flaw in federal bankruptcy law that needs to be fixed".

If you have any questions about anything related to this decision, please don't hesitate to reach out to any of the authors or key contacts below.

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