2021

Equitable subordination redux? Section 183 of the Bankruptcy and Insolvency Act and respecting the 'legislative will' of Parliament

Thomas G. W. Telfer
Western University, ttelfer@uwo.ca

This is a pre-copy edited, post-peer reviewed version of the contribution accepted for publication in *Canadian Business Law Journal*. Reproduced by permission of Canada Business Law Journal Inc. and Thomson Reuters Canada Limited.

(2021) 64:3 Canadian Business Law Journal 316-341

EQUITABLE SUBORDINATION REDUX?

SECTION 183 OF THE *BANKRUPTCY AND INSOLVENCY* ACT AND RESPECTING THE 'LEGISLATIVE WILL'[1] OF PARLIAMENT

Thomas G.W. Telfer*

The Supreme Court of Canada has yet to rule on whether the American doctrine of equitable subordination is part of Canadian law. In Re US Steel, the Ontario Court of Appeal suggested in obiter that section 183 of the Bankruptcy and Insolvency Act (BIA) conferred upon courts the power to equitably subordinate a claim. This article focuses on the specific point of whether section 183 of the BIA provides the court jurisdiction in equity to subordinate a claim and alter the statutory priority scheme. Equitable jurisdiction found in section 183 of the BIA does not represent a broad power to reorder statutory priorities based on notions of fairness and good conscience. The section 183 jurisprudence simply does not support the obiter statement in US Steel. In interpreting section 183, Canadian courts have relied upon traditional doctrines of equity. To allow equitable subordination under section 183 would be an attempt to ignore the legislative will of Parliament and the BIA priority regime. There may be no need to import equitable subordination as there are existing provisions in the BIA which subordinate claims of the type often considered under the American doctrine of equitable subordination. Canadian law also effectively deals with creditor and insider misconduct through the oppression remedy and the new statutory duty of good faith.

"[C]ourts should not use equity to do what they wish Parliament had done through legislation."

Re Indalex Ltd, 2013 SCC 6 (S.C.C.), at para. 82 (Deschamps J.)

"Equality is the great object and virtue of the Bankruptcy Acts."

Farmers' Mart Ltd v Milne [1915] A.C. 106 (H.L.), at p.115 (Lord Atkinson)

[1] *Re Residential Warranty Co of Canada Inc,* 2006 ABCA 293 (Alta. C.A.), at para. 20.

* Professor and Teaching Fellow, Faculty of Law, Western University. Research Assistance provided by Stephanie Zuk, David Fanjoy, Chirine Ali and Saima Ahmad.

I. INTRODUCTION

The Supreme Court of Canada has "twice side-stepped making a ruling on the doctrine"[2] of equitable subordination leaving the matter "open for another day".[3] The American doctrine refers to "a form of equitable relief to subordinate the claim of a creditor who has engaged in inequitable conduct."[4] In effect, equitable subordination "permits a court to alter the statutory distribution scheme by moving a creditor down in the priority chain."[5] In 2016, the Ontario Court of Appeal[6] held that equitable subordination had no application to the *Companies' Creditors Arrangement Act*[7] (CCAA). Strathy C.J.O. concluded that in the CCAA "there is no 'gap' in the legislative scheme to be filled by equitable subordination through the exercise of discretion, the common law, the court's inherent jurisdiction or by equitable principles."[8]

This article has no quarrel with the Ontario Court of Appeal's conclusion on equitable subordination and the CCAA. However, in *obiter dictum* the Court reasoned that equitable

---

[2] Janis Sarra, "Brueghel's Brush: A Portrait of the CCAA" (2020), 64 Can. Bus. L.J. 72, at p. 89.

[3] *Canada Deposit Insurance Corp v. Canadian Commercial Bank* [1992] 3 S.C.R. 558 (S.C.C.), at para. 97; *Sun Indalex Finance, LLC v United Steelworkers*, 2013 SCC 6 (S.C.C.), at para. 77. Several articles have traced the case law developments on whether equitable subordination is part of Canadian law. Lawrence J. Crozier, "Equitable Subordination of Claims in Canadian Bankruptcy Law" (1992), 7 C.B.R. (3d) 40; Thomas G.W. Telfer, "Transplanting Equitable Subordination: The New Free-Wheeling Equitable Discretion in Canadian Insolvency Law" (2002), 36 Can. Bus. L.J. 36, at p. 54; Michael J. MacNaughton and Sam P. Rappos, "Equitable Subordination in Canadian Insolvency Law" (2008), Ann. Rev. Insol. L. 4; Jeremy Opolsky, "Intercorporate Debt and Equitable Subordination: One Case Forward and One Case Back" (2015), Ann. Rev. Insol. L. 2; H. Lance Williams, Alan Hutchens and Jared Enns, "Re-ordering Priorities: A Review of Recent Jurisprudence Regarding the Categorization of Debt vs. Equity and Equitable Subordination" (2018), 7:2 J.I.I.C. 27.

[4] *Re US Steel Canada Inc* 2016 ONCA 662 (Ont. C.A.), at para. 91. *Re US Steel Canada Inc* 2016 ONCA 662 (Ont. C.A.), leave to appeal to S.C.C. granted 2017 CarswellOnt 3573; *Re US Steel Canada Inc* 2016 ONCA 662 (Ont. C.A.), leave to appeal to S.C.C. discontinued [2016] SCCA No. 480.

[5] Natasha MacParland, "How Close is Too Close? The Treatment of Related Party Claims in Canadian Restructurings" (2004), Ann. Rev. Insol. L. 13. On examples of misconduct in U.S. law see Bruce A. Markell, "Courting Equity in Bankruptcy" (2020), 94:2 Am. Bank. L.J. 227, at p. 249.

[6] *Re US Steel* , *supra*, footnote 4.

[7] R.S.C. 1985 c. C-36.

[8] *Re US Steel*, *supra*, footnote, 4 at para. 103.

subordination applied to the *Bankruptcy and Insolvency Act*[9] (BIA). Strathy C.J.O. relied upon section 183 of the BIA which provides:

> 183 (1) The following courts are invested with such **jurisdiction at law and in equity** as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings....[10]

Strathy C.J.O. concluded:

> [I]f equitable subordination is to become a part of Canadian law, it would appear that the *BIA* gives the bankruptcy court explicit jurisdiction as a court of equity to ground such a remedy and a legislative purpose that is more relevant to the potential reordering of priorities.[11]

No court has relied upon this *dictum* to equitably subordinate a claim. This article calls into question the *dictum* of the Ontario Court of Appeal.

The focus of the article is on the specific point of whether section 183 of the BIA allows a court to equitably subordinate a claim and alter the statutory priority scheme. The origins of the American doctrine can be traced to the United States Supreme Court decision in *Pepper v Litton* in which Justice Douglas relied upon the equitable jurisdiction of the bankruptcy court and held that subordination may simply be available as a result of the "violation of rules of fair play and good conscience by the claimant."[12] The article argues that section 183 of the BIA does not allow for the subordination of claims on some broader grounds of fairness and good conscience. The origins of section 183 suggest that it was never intended to be the source of a wide ranging discretion to alter priorities. Courts have relied upon section 183 of the BIA to invoke *traditional*

---

[9] R.S.C. 1985, c. B-3. It is beyond the scope of the paper to deal with the Ontario Court of Appeal's reasoning on equitable subordination and the CCAA. For an analysis of the reasoning on the CCAA see works cited in footnote 11.
[10] *Ibid*., at section 183(1) [emphasis added].
[11] *Re US Steel*, *supra*, footnote 4, at para. 104. The *US Steel* case has been considered in a number of articles, yet none explore the implications of the section 183 *obiter* statement. See e.g., Kelly J. Bourassa and James W. Reid, "Swift Justice? Use of Summary Trials in Restructuring Proceedings" (2017), Ann. Rev. Insol. L. 14; Andrew Kent and Caitlin Fell, "2009 Revisited" (2017), Ann. Rev. Insol. L. 17; Edward A. Sellers, "Developments and Trends in the Governance of Distressed Enterprises in Canadian Insolvency Proceedings: Who is Making Critical Decisions" (2018), Ann. Rev. Insol. L. 17. However, cf Williams, Hutchens and Enns, *supra*, footnote 3.
[12] *Pepper v. Litton*, 308 US 295 (1939), at p. 310. On a moral reading of the law in equity and how it is distinct from equity as developed by English Courts of Chancery see Markell, *supra*, footnote 5, at p. 246.

doctrines of equity such as specific performance and rectification. Jurisprudence from Quebec confirms that equity in section 183 is confined to conventional equitable principles as developed by the English Courts of Chancery, rather than broad principles of fairness.[13]

Canadian courts have not relied upon their inherent jurisdiction under section 183 to subordinate claims. The courts have emphasized that inherent jurisdiction "cannot be used to negate the unambiguous expression of legislative will and moreover, because it is a special and extraordinary power, should be exercised only sparingly and in a clear case."[14] The alteration of statutory priorities through the doctrine of equitable subordination would not respect Parliament's will as expressed in the BIA distribution scheme. The equitable maxim of "equity follows the law" means that "equity may not depart from statute law."[15] To allow equitable subordination under section 183 would be an attempt to reorder the statutory priority scheme under the BIA. Further, *US Steel* did not consider the 1923 decision of the Ontario Court of Appeal *Re Orzy*[16] in which the court rejected the conclusion of the trial judge that principles of fairness and good conscience could alter bankruptcy priorities.[17] Finally, there is no need to read in a power to equitably subordinate claims under section 183 of the BIA. There are existing provisions in the BIA which subordinate claims of the type often considered in the American doctrine of equitable

[13] Laura Coordes argues a "cabined notion of equity also indicates that bankruptcy equity does not exist for the purpose of doing 'justice,' broadly defined." Laura N. Coordes, "Narrowing Equity in Bankruptcy" (2020), 94 Am. Bank. L.J. 303, at p. 324.
[14] *Re Residential Warranty, supra* footnote 1, at para. 20.
[15] Jill Martin, *Hanbury & Martin: Modern Equity* (London: Thomson Reuters, 2008), at pp. 30; J.D. Heydon et al, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (Chatswood NSW: LexisNexis, 2015), at p. 71. See e.g., *Strata Plan No VIS3305 v. Best* 2000 BCSC 935 (B.C.S.C.), at para. 18; *JM Voith GmbH v. Beloit Corp* [1997] 3 F.C. 497 (C.A.), at para. 116.
[16] [1924] 1 D.L.R. 250 (Ont. C.A.).
[17] *US Steel* did not mention the 2003 decision in *CC Petroleum Ltd v. Allen* (2003), 46 C.B.R. (4th) 221 (Ont. C.A.), at para. 18, in which the Ontario Court of Appeal rejected the trial judge's application of equitable subordination on the basis of "the uncertain state of the law on this point," (overturning the trial judge's order that a secured claim be subordinated to an unsecured claim). See *CC Petroleum v. Allen* (2002), 35 C.B.R. (4th) 22 (Ont. S.C.J.), at para. 68.

subordination. Canadian law also effectively deals with creditor and insider misconduct through the oppression remedy and the new statutory duty of good faith.

Part II of this article examines the origins of equitable subordination in US law. Part III considers why Parliament included jurisdiction in "law and equity" in the forerunner of section 183 of the BIA. Part IV examines Quebec equity jurisprudence arising under section 183 which focuses on the traditional concepts of equity rather than broad principles of fairness. In Part V, the article examines the jurisprudence under section 183 of the BIA. In Part VI, the article deals with the maxim that equity follows the law. Part VII considers the functional equivalence of equitable subordination found in Canadian law. Part VIII concludes.

II. THE AMERICAN ORIGINS OF EQUITABLE SUBORDINATION

In 1978, the United States Congress added section 510(c) to the US *Bankruptcy Code.* The provision inserted an express power to apply the principles of equitable subordination to "subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim."[18] But equitable subordination has a much older heritage. Most trace the emergence of the doctrine to two US Supreme Court cases: *Taylor v Standard Gas and Electric Co*[19] and *Pepper v Litton.*[20]

Since the interpretation of "law and in equity" in section 183 is in issue for Canadian courts, it is instructive to examine the judgment of Justice Douglas in *Pepper v Litton* to determine the source of his authority to apply equitable subordination. Justice Douglas began his judgment in

[18] 11 U.S.C. § 510(c). Congress did not define equitable subordination allowing for case law to define the doctrine. Samantha Kidd, "A Distressing Dilemma: How the Bankruptcy Doctrines of Equitable Subordination and Vote Designation Affect Distressed Debt Investors in a Post Great Recession Economy" (2012), 10 Dartmouth L.J. 25, at p. 31.

[19] 306 U.S. 307 (1939) as discussed in Telfer, *supra* footnote 3, at p. 40. In *Taylor* the court subordinated the claim of a parent against a subsidiary.

[20] *Pepper*, *supra*, footnote 12. In *Pepper* the court subordinated the claim of a dominant shareholder who had used his inside position to prejudice a creditor.

Pepper by quoting from section 2 of the US *Bankruptcy Code* which provided that Courts of Bankruptcy are "invested 'with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings.'"[21] Justice Douglas held that "[b]y virtue of s 2 a bankruptcy court is a court of equity at least in the sense that in the exercise of the jurisdiction conferred upon it by the act, it applies the principles and rules of equity jurisprudence."[22] What were the "principles and rules of equity jurisprudence" for Justice Douglas? Equitable principles "have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done."[23] This meant that "disallowance or subordination may be necessitated by certain cardinal principles of equity jurisprudence."[24] Justice Douglas concluded that "in the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate."[25] If "injustice" and "unfairness" were not broad enough, Justice Douglas claimed that "a sufficient consideration may be simply the violation of rules of fair play and good conscience by the claimant."[26]

It is important to recognize how the introduction of the doctrine of equitable subordination was a marked change in the law in 1939. In 1940, one author wrote that the decision in *Pepper* "came as a surprise to the Bar generally in the length that it went in holding that claims of officers, directors, and the like, of public corporations for back salaries were subject to equitable considerations."[27] Similarly in 1941 an author stated: "I do not know of any case that has extended

[21] *Pepper*, *supra*, footnote 12, at p. 304.
[22] *Ibid*., at p. 304.
[23] *Ibid*., at p. 305.
[24] *Ibid*., at p. 306.
[25] *Ibid*., at pp. 307–08.
[26] *Ibid*., at p. 310.
[27] "Report of Committee on Commercial Law and Bankruptcy" (1940), 11 Mo. B.J. 101, at p. 107.

the jurisdiction of the bankruptcy court further than that has."[28] It would appear that "the violation of moral obligations" would lead the court to invoke equity to subordinate a claim and alter priorities.[29]

The current accepted framework[30] to analyze equitable subordination in US law comes from a three-part test from the Fifth Circuit in *Re Mobile Steel*:[31]

> (i) The claimant must have engaged in some type of inequitable conduct;
>
> (ii) The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant;
>
> (iii) Equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy Act.

The United States Supreme Court has placed limits on the doctrine through the third limb of the test. In *United States v Noland,*[32] the Supreme Court characterized the last element of the three part test: "This last requirement has been read as a 'reminder to the bankruptcy court that although it is a court of equity, it is not free to adjust the legally valid claim of an innocent party who asserts the claim in good faith merely because the court perceives that the result is inequitable.'"[33]

But since Justice Douglas grounded his analysis in the law and equity jurisdiction in the US *Bankruptcy Act* a question for Canadian courts is whether section 183 of the BIA extends to broad principles of "injustice", "unfairness" or "the violation of rules of fair play and good conscience"

---

[28] Alton W. Teale, "Recent Decisions of the U.S. Supreme Court as They Affect Bankruptcy" (1941), 15 J. Nat'l Ass'n Ref. Bankr. 80, at p. 80. See also Fred H. Kruse, "Tax Claims, Wage Claims and Inheritances" (1941), 15 J Nat'l Ass'n Ref. Bankr. 64, at p. 71 (power to subordinate was "absolute").
[29] Asa S. Herzog and Joel B. Zweibel, "The Equitable Subordination of Claims in Bankruptcy" (1961), 15 Vand. L. Rev. 83, at p. 107.
[30] Janis Sarra, "Brueghel's Brush: A Portrait of the CCAA" (2020), 64 Can. Bus. L.J. 72, at p. 89; David M. Holliday, "Cause of Action Under 11 U.S.C.A. § 510(c)(1) for Equitable Subordination of Claim in Bankruptcy" (2020), 78 Causes of Action 2d 779 [Retrieved from WestlawNext Canada], at p. 12. The Supreme Court of Canada cited the three-part *Mobile Steel* test in its 1992 decision in *Canada Deposit Insurance Corp v. Canadian Commercial Bank* [1992] 3 S.C.R. 558 (S.C.C.).
[31] 563 F.2d 692 (5th Cir. 1977), at p. 700.
[32] 517 U.S. 535 (1996).
[33] *Ibid*., at 539. On how the third element imposes restrictions see Holliday, *supra*, footnote 30, at p. 21.

as found in *Pepper v Litton.* Canadian courts have long recognized that matters of justice and conscience are relevant to equitable relief.[34] However, as discussed below, in the interpretation of "equity" in section 183 Canadian courts have not invoked fairness and good conscience as a source of discretion to alter the BIA priority scheme. Canadian courts have instead relied upon traditional doctrines of equity such as rectification and specific performance when interpreting section 183. Before considering section 183 jurisprudence it is instructive to examine the origins of the law and equity jurisdiction of Canadian courts found in the original *Bankruptcy Act.* [35]

III. THE ORIGINS OF S.183: "AT LAW AND IN EQUITY"

In 1919, Canada enacted a new *Bankruptcy Act.*[36] The drafter of the new legislation, HP Grundy, sought to follow the UK *Bankruptcy Act* of 1914.[37] The original version of section 183 could be found in section 63 of the *Bankruptcy Act*:

> The following named courts are constituted Courts of Bankruptcy and invested within their territorial limits as now established, or as these may be hereafter changed, with such jurisdiction *at law and in equity* as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy.…[38]

In drafting section 63, Grundy relied in part upon section 122 of the UK *Bankruptcy Act* of 1914 which granted the High Court jurisdiction in bankruptcy and every officer of the court was to "act in aid of and be auxiliary to each other in all matters of bankruptcy."[39] But in the English *Bankruptcy Act* there is no specific reference to the UK High Court having jurisdiction in law and

---

[34] See e.g., *Moore v. Sweet* 2018 SCC 52 (S.C.C.), at para. 32. *Canson Enterprises Ltd v. Boughton & Co,* [1991] 3 S.C.R. 534 (S.C.C.), at para. 54. For a review of conscience in equity see Graham Virgo, "Conscience in Equity: A New Utopia" (2017), 15 Otago. L. Rev. 1; Irit Samet, *Equity: Conscience Goes to Market* (Oxford: Oxford University Press, 2018), chapter 1.

[35] S.C. 1919, c. 36.

[36] See Thomas G.W. Telfer, *Ruin and Redemption: The Struggle for a Canadian Bankruptcy Law, 1867-1919* (Toronto: University of Toronto Press, 2014) [Telfer, *Ruin and Redemption*].

[37] H.P. Grundy, "Synopsis of the Canadian Bankruptcy Act" (1919), 1 C.B.R. 325, at p. 327; Telfer, *Ruin and Redemption*, *ibid*., at p. 161.

[38] *Bankruptcy Act*, *supra*, footnote 35, section 63 [emphasis added]. There is no equivalent provision found in the *Insolvent Act of 1869,* S.C. 1869, c. 16 or in the *Insolvent Act of 1875,* S.C. 1875, c. 16.

[39] *Bankruptcy Act 1914* (U.K.), 4 & 5 Geo. Vic., c. 59, section 122.

in equity. The Canadian Parliamentary Debates of 1919 reveal that MPs did not discuss the law and equity provisions.[40]

A key to understanding why Parliament inserted jurisdiction "at law and in equity" into the *Bankruptcy Act* is that in 1919 the government created new federal independent "Courts of Bankruptcy". Parliament abolished the "Courts of Bankruptcy" 1922[41] but their short life explains the existence of the current wording of section 183. The 1919 legislation conferred upon Provincial superior courts jurisdiction in bankruptcy and "constituted them 'Courts of Bankruptcy.'"[42] During the life of the federal Courts of Bankruptcy, each provincial judge "wore two hats—a general jurisdiction hat and a bankruptcy hat."[43] As Honsberger and DaRe note the new Bankruptcy Court "was made out of whole cloth. It was an orphan with no antecedents, inheritance, accumulation of jurisdiction or history."[44] The authors argue that Parliament added section 63 in an attempt to make up for the newness of the court.

In 1922, Chief Justice Meredith of the Ontario Court of Appeal ruled that Parliament's attempt to create new Courts of Bankruptcy was *ultra vires*.[45] In that year Parliament abolished the Courts of Bankruptcy.[46] Sir Lomer Gouin, the Minister of Justice, explained the changes to section 63:

> [A] doubt…exists in section 63 of the statute, which invests the provincial courts with jurisdiction. Under this section as it stands the view has been taken that federal courts are thereby established each of which has original jurisdiction in bankruptcy throughout Canada.…By striking out the words which purport to constitute the provincial courts into federal courts the doubt which exists will be cleared away.[47]

---

[40] *House of Commons Debates*, 9 May 1919, at 2268-2269 (debate over clause 63, "Court's Jurisdiction").
[41] *An Act to Amend the Bankruptcy Act*, S.C. 1922, c. 8, section 8.
[42] Lewis Duncan and William John Reilley, *Bankruptcy in Canada*, 2nd ed. (Toronto: Canadian Legal Authors), at p. 795.
[43] John D. Honsberger and Vern W. DaRe, *Honsberger's Bankruptcy in Canada,* 5th ed, (Toronto: Thomson Reuters, 2017) at p. 106.
[44] *Ibid*., at p. 102.
[45] *Re Canadian Western Steel Corp* (1922), 2 C.B.R. 494 (Ont. C.A.), at para. 27. See also *Re Messervey's Limited* (1922), 3 C.B.R. 480 (Ont. S.C.), at para. 1.
[46] *An Act to Amend the Bankruptcy Act,* S.C. 1922, c. 8.
[47] *House of Commons Debates,* 22 May 1922, at p. 2036 (Sir Lomer Gouin, Minister of Justice).

Parliament agreed to strike out the reference to "Courts of Bankruptcy" and thus vesting jurisdiction in bankruptcy clearly within the existing provincial superior courts and "not on any Bankruptcy Court."[48] Senator Beique explained that the revised Act permitted "the administration of the Bankruptcy Act by the judges of the ordinary courts in each province....[T]here ceases to be any bankruptcy judge; the court ceases to be the Bankruptcy Court—it is the existing [provincial superior] court."[49] In 1925, the Supreme Court of Canada confirmed that there is no Court of Bankruptcy: "The so-called Court of Bankruptcy is merely the Superior Court of the Province... exercising jurisdiction under a statute which applies throughout Canada."[50]

When Parliament abolished the Courts of Bankruptcy in 1922, the original grant of jurisdiction found in section 63 remained leaving the wording to read "[t]he following courts are invested with such *jurisdiction at law and in equity* as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy".[51] That is the current wording of section 183 of the BIA. Thus, the words "at law and in equity" stem from an attempt to bolster the jurisdiction of a Court which has long been abolished. In 1922, there was no debate about the impact of leaving the courts with jurisdiction in "law and in equity." Parliament must have assumed the jurisdictional

[48] Duncan and Reilley, *supra*, footnote 42, at p. 796. See *Castor Holdings Ltd, Re* (1999), CarswellQue 3486 (Que. S.C.), at para. 6; *Smith Doll Toy Co, Re* (1923), 4 C.B.R. 183 (Ont. S.C.), at para. 1. See *Eagle River International Ltd, Re* 2001 SCC 92 (S.C.C.), at para. 20. "Parliament decided to use the superior courts of the provinces and territories to exercise bankruptcy jurisdiction (section 183). The courts mentioned in section 183 retain their character as superior courts of inherent jurisdiction, but will be referred to here, perhaps with some imprecision of language, as the bankruptcy courts.

[49] *Senate Debates*, 24 June 1922, at p. 605 (Beique). See also *House of Commons Debates*, 22 May 1922, at p. 2036. Subsequent jurisprudence confirmed that there was no longer a separate "Bankruptcy Court". See Bernard Boucher, "La juridiction de la Cour de faillite" (1994), 24 C.B.R. (3d) 61; *Re Smith Doll Toy Co* (1923), 4 C.B.R. 183 (Ont. S.C.), at para. 1; *Turcotte v. Side* (1936), 18 C.B.R. 47 (Que. K.B. on Appeal), at paras. 38-39; *Re Arctic Gardens Inc* (1989), 78 C.B.R. (N.S.) 1 (Que. C.A.), at para. 12; *Mancini (Trustee of) v. Falconi* (1987), 61 O.R. (2d) 554 (Ont. S.C.), at para. 5, aff'd. [1992] O.J. No. 3504 (C.A.). As a matter of convenience sometimes writers continue refer to a "bankruptcy court" even though there is no such separate court: *Re Eagle River supra*, footnote 48, at para. 20. See also *PricewaterhouseCoopers Inc v. Perpetual Energy Inc* 2021 ABCA 16 (Alta. C.A.), at para. 184.

[50] *Re Gilbert* [1925] S.C.R. 275 (S.C.C.), at para. 11.

[51] BIA, *supra*, footnote 9, section 183(1) [emphasis added].

grant "must mean something and that if deleted there could be a problem."[52] That something has never contemplated the re-ordering of priorities under the rubric of equity. An examination of the equity jurisprudence under section 183 and its predecessors confirms this point.

IV. QUEBEC: TRADITIONS OF EQUITY VS FAIRNESS AND GOOD CONSCIENCE

When Parliament sought to clarify that bankruptcy jurisdiction was vested in the provincial superior courts, the *Bankruptcy Act* listed Quebec as a province that had jurisdiction over bankruptcy "at law and in equity." This created confusion because Quebec is a civil law jurisdiction.[53] "[E]quity, derived as it is from English law, forms part of a tradition and a terminology that are foreign to Quebec civil law."[54] According to one author the Superior Court of Quebec and the Quebec Court of Appeal "has never had jurisdiction in equity in private law matters."[55]

Quebec courts grappled with how to interpret the law and equity jurisdiction and largely concluded that equity in section 183 of the BIA meant traditional forms of equity developed in England rather than principles of fairness and justice.[56] In *125258 Canada Inc (Trustee) c Royal Bank*,[57] the Quebec Superior Court concluded:

> The term "equity" used in section 153 (1) [now section 183] of the Bankruptcy Act does not correspond to the words "justice, fairness or good conscience" as alleged by the trustee.

---

[52] Honsberger and DaRe, *supra*, footnote 43, at pp. 102-103.
[53] *Ibid*., at pp. 95, 99.
[54] Alain Vauclair and Martin-François Parent, "Harmonization of Federal Legislation with Quebec Civil Law: Some Examples from the Bankruptcy and Insolvency Act" (Department of Justice Canada) at p. 10, online: <https://www.justice.gc.ca/eng/rp-pr/csj-sjc/harmonization/hfl-hlf/b8-f8/bf8a.pdf>.
[55] See Alain Vauclair and Annie Drzymala, "Some Legislative Policy Issues: Bijuralism and Drafting Support Services Group Legislative Services Branch Department of Justice Canada and Corporate and Insolvency Law Policy Directorate Industry Canada" (2003), 37 R.J.T. 145, at p. 153, note 16.
[56] *Ibid*., at note 14.
[57] [1986] R.J.Q. 1666 (Que. S.C.), at paras. 81-82 [*125258 Canada Inc*], aff'd [1990] R.J.Q. 1547 (Que. C.A.) [translated by author].

> The Court is therefore not justified in resorting to the principles of "fairness and good conscience" pursuant to section 153 (1) of the Bankruptcy Act, that section only referred to English "equity".[58]

In 1992, the Quebec Court of Appeal confirmed this view in *Meublerie André Viger Inc c Wener*:[59]

> Although some judgments have already been based on this provision to decide according to the standards of "fairness and good conscience.... I am of the opinion that the term "equity"...employed in art. 183 refers to the concept of "equity" in English law, as opposed to "fairness and good conscience".[60]

One Quebec judgment concluded that equity in section 183 must necessarily be "the set of legal rules and procedures developed in England, beginning in the fifteenth century, in response to the formalism of the 'common law'".[61] Professor Bohémier in his text *Faillite et Insolvabilité* wrote:

> The word "equity" of article 183... does not have to be understood as the simple desire to make justice, fair treatment and good conscience prevail. Rather, it refers to a true system of law developed in English law outside the common law....
>
> Therefore, when a court acquires an equitable jurisdiction, that does not mean that it has complete freedom to seek any solution that appears to it equitable. On the contrary, it must refer to the fundamental principles of the equity system or to the solutions that have developed within this system.[62]

In 2001, section 183(1.1) was added to specify that Quebec had the same powers as other jurisdictions, excepting the language "at law and in equity."[63] The Quebec Court of Appeal in *Re Montreal Fast Print Ltd,*[64] considered the impact of the 2001 amendment:

---

[58] *125258 Canada Inc*, *supra*, footnote 57, at paras. 81-82. See also *Trustee of 9270-4378 Quebec Inc*. 2020 QCCS 400 (Que. S.C.), at para. 104.
[59] [1992] R.J.Q. 1461 (Que. C.A.), at para. 37 followed *Re Perrette Inc.* [1998] R.J.Q. 1015 (Que. C.A.), at para. 54; *Re St-Jacques* 1996 CarswellQue 1212 (Que. S.C.); *Re Bedard* [2005] R.J.Q. 1732 (Que. S.C.). However, cf *Re Societé Petrochemique Kemtec Inc.* [1994] R.J.Q. 1345 (Que. S.C.), at para. 61.
[60] *Wener*, *supra*, footnote 59, at para. 37. It is important to note that the Quebec Court of Appeal in *Wener* rejected earlier jurisprudence which had adopted a broader notion of equity to embrace matters of fairness and good conscience. *Re Fredericton Co-operative Ltd* (1921), 2 C.B.R. 154 (N.B.S.C.); *Re Stanley and Bunting* (1924), 5 C.B.R. 18 (Ont. S.C.); *Re Duranceau* (1954), 34 CBR 198 (Que. S.C.), rev'd on other grounds [1956] Que. Q.B. 80 (Que. Q.B.).
[61] *Re Pogany*, [1997] R.J.Q. 1693 (Que. S.C.), at para. 31 [translated by author]. See also *Gagnon v. Montreal Trust Co* (1971), 17 C.B.R. (N.S.) 136 (Que. S.C.), at para. 60 (referring to two systems of equity and common law); *Syndic de Groupe Opex inc.*, 2020 CarswellQue 8362 (Que. S.C.), at para. 48; *Syndic de 9270-4378 Québec inc.*, 2020 CarswellQue 743 (Que. S.C.), at para. 104.
[62] Albert Bohémier, *Faillite et Insolvabilité,* Tome 1 (Montréal: Thémis, 1992), at p. 576 [translated by author]. Cited with approval in *3042073 Canada inc, Re* [2000] R.J.Q. 1314 (Que. S.C.), at para. 74.
[63] *Federal Law-Civil Law Harmonization Act, No 1,* S.C. 2001, c. 4, section 33. See Lloyd W. Houlden, Geoffrey B. Morawetz and Janis P. Sarra, *The 2017 Annotated Bankruptcy Act* (Toronto: Thomson Reuters, 2017), at p. 953.
[64] [2003], J.Q. No. 7151 (C.A.).

> The deletion of the words "*in equity*" does not have the effect of restricting the jurisdiction of the Superior Court. This is a common law court, not a Court of Chancery....and it is not necessary...to import the concept of *in equity* jurisdiction... The change was expected, however, because for a civil law "*equity*" cannot replace the rule of law.[65]

It is clear from the Quebec jurisprudence that equity is confined to traditional equitable doctrines developed in England[66] and does not extend to larger concepts of fairness and good conscience that would allow for the re-ordering of priorities. In 1998, the judge at first instance in *Re People's Department Stores Ltd (1992) Inc*[67] held that the principles of equity provided for in section 183 "include the notions of fair play, justice, fairness, etc."[68] Such a broad principle was not accepted by the Supreme Court of Canada in that case.[69] Outside of Quebec, Canadian courts have relied upon traditional doctrines of equity when making an order under section 183.

V. EQUITY JURISPRUDENCE UNDER SECTION 183

From the outset Canadian courts have recognized that in bankruptcy proceedings the court is a Court of Equity.[70] In 1925, the Ontario Supreme Court acknowledged in *Re Bryant Isard & Co*[71] that "[t]he Court in its bankruptcy jurisdiction is a Court of Equity just as much as is the Court in its ordinary jurisdiction, and it is just as much bound to give effect to equitable rights as is the Court in its ordinary jurisdiction."[72] Canadian courts have continued to recognize that in bankruptcy the court is a court of equity.[73]

---

[65] *Re Montreal Fast Print Ltd* [2003] J.Q. No. 7151 (Que. C.A.), at para. 70.
[66] See *Re CA Macdonald & Co* (1961), 2 C.B.R. (N.S.) 258 (Alta. C.A.), at para. 5, referring to "doctrines firmly grounded in English equitable jurisprudence."
[67] (1998), 23 C.B.R. (4th) 200 (Que. S.C.).
[68] *Re People's Department Stores Ltd. (1992) Inc.* (1998), 23 C.B.R. (4th) 200 (Que. S.C.), at para. 461.
[69] *Re People's Department Stores Ltd. (1992) Inc.* 2004 SCC 68 (S.C.C.).
[70] On the debate in the United States on this point see Markell, *supra*, footnote 5, at p. 309.
[71] (1925), 5 C.B.R. 793 (Ont S.C.).
[72] *Re Bryant Isard & Co* (1925), 5 C.B.R. 793 (Ont. S.C.), at para. 7; See also *Re Gold Medal Manufacturing Company Limited* (1926), 8 C.B.R. 39 (Ont. S.C.), rev'd on other grounds (1927), 8 C,B,R, 169 (Ont. S.C.).
[73] *Re Heron & Co* (1933) O.R. 693, at para. 28 (Ont. S.C.); *Interclaim Holdings Ltd v. Down*, 1999 ABCA 329 (Alta. C.A.), at para. 37; *Re Olympia & York Developments Ltd* (1997), 143 D.L.R. (4th) 536 (Ont. Ct. Gen. Div.), at para. 10 (Ont. Ct. Gen. Div).

Conferring jurisdiction "in equity" enables courts to exercise their powers over traditional doctrines of equity. The general grant of equitable jurisdiction avoids the need to list specific equitable powers in the BIA.[74] Canadian courts have "consistently applied principles of equity to the solution of problems in bankruptcy matters."[75] Thus, courts have exercised their equitable jurisdiction in section 183[76] to (1) rectify a contract,[77] (2) grant an injunction,[78] (3) order specific performance,[79] (4) make declaratory judgments,[80] (5) consolidate bankrupt estates[81] and (6) grant relief from forfeiture.[82] For example, the New Brunswick Court of Appeal recognized that an injunction "is an equitable remedy, which, in bankruptcy matters, may be granted by a Bankruptcy Court pursuant to section 183 of the *BIA*."[83] By invoking traditional doctrines of equity to fashion an order under section 183, there is no sense that courts have been drawing upon a broader power of the "rules of fair play" that would allow for the re-ordering of priorities through the doctrine of equitable subordination.[84]

---

[74] Herzog and Zweibel, *supra* footnote 29 at p. 84. See *Re Kemtec Petroleum Corporation Inc,* [1994] R.J.Q. 1345 (Que. S.C.), at p. 1352 (no need for specific listing of equitable powers).
[75] *Re Alliance Credit Corp* (1971), 17 C.B.R. (N.S.) 136, at para. 37.
[76] Houlden, Morawetz and Sarra, *supra*, footnote 63, at p. 953.
[77] *Truestar Investments Ltd v. Baer* 2018 ONSC 7372 (Ont. S.C.J.), at para. 17.
[78] See e.g., *Re Walker Ranch Ltd* (1996), 39 C.B.R. (3d) 70 (Sask. Q.B.), at para. 17; *Re Leby Fixtures & Interiors Ltd* 2006 NBCA 93 (N.B.C.A.), at para. 20.
[79] See e.g., *Re Triangle Lumber & Supply Co* (1978), 27 C.B.R. (N.S.) 317 (Ont. S.C.); *Re Western Canada Pulpwood & Lumber Co* (1929), 38 Man. R. 378 (Man. C.A.); *Canadian Credit Men's Trust Assn v. Edmonton Lumber Co* (1930), 11 C.B.R. 376 (Alta. S.C.).
[80] See e.g., *Fiorito v. Wiggins*, 2016 ONSC 5822 (Ont. S.C.J.), at para. 30, aff'd 2017 ONCA 765 (Ont. C.A.); *Re Reynolds* (1928), 10 C.B.R. 127 (Ont. S.C.), aff'd (1928), 10 C.B.R. 127 (Ont. C.A.), at p. 131; *Holley v. Gifford Smith Ltd* (1986), 54 O.R. (2d) 225 (Ont. C.A.).
[81] See e.g., *Re A & F Baillargeon Express Inc* (1993), 27 C.B.R. (3d) 36 (Que. S.C.); A*shley v. Marlow Group Private Portfolio Management Inc* (2006), 22 C.B.R. (5th) 126 (Ont. S.C.J. [Commercial List]; *Re Associated Freezers of Canada Inc* (1995), 36 C.B.R. (3d) 227 (Ont. Ct. Gen. Div); *Re Gray Aqua Group of Companies*, 2015 NBQB 107 (N.B.Q.B.); *Bacic v. Millennium Educational & Research Charitable Foundation* 2014 ONSC 5875 (Ont. S.C.J.); *Re Kitchener Frame Ltd* 2012 ONSC 234 (Ont. S.C.J.); *Re Redstone Investment Corp (Receiver of)* 2016 ONSC 4453(Ont. S.C.J.); *Re Walker* (1998), 5 C.B.R. (4th) 123 (Ont. Ct. Gen. Div).
[82] *Re Stanley & Bunting* [1924] 3 D.L.R. 599 (Ont. S.C.); *Re Goldray Inc* 2005 ABCA 341 (Alta. C.A.), at para. 22.
[83] *Re Leby Fixtures & Interiors Ltd*, 2006 NBCA 93 (N.B.C.A.), at para. 20.
[84] However, cf *Lloyd's Non-Marine Underwriters v. JJ Lacey Insurance Ltd* 2009 NLTD 148 (N.L.T.D.), discussed below. In *Re Sellathamby* 2020 BCSC 1567 (B.C.S.C.), at para. 73, the court stated that "I have jurisdiction under s. 183 of the *BIA* to do "what is right and equitable in the circumstances of a case". The case did not involve the re-ordering of priorities.

Few cases have commented on the scope of section 183. Early cases confirmed that the jurisdiction under the equivalent provision in section 183 was broad.[85] In *Re Eagle River International Ltd*, the Supreme Court of Canada considered the breadth of section 183.[86] Justice Binnie linked section 183 to Parliament's broad powers over bankruptcy and insolvency law in section 91 (21) of the *Constitution Act* and concluded that there was "broad jurisdiction" under section 183:

> It seems to me that the decided cases recognize that the word "Bankruptcy" in s. 91(21) of the *Constitution Act, 1867* must be given a broad scope if it is to accomplish its purpose. Anything less would unnecessarily complicate and undermine the economical and expeditious winding up of the bankrupt's affairs. Creation of a national jurisdiction in bankruptcy would be of little utility if its exercise were continually frustrated by a pinched and narrow construction of the constitutional head of power. *The broad scope of authority conferred on Parliament has been passed along to the bankruptcy court in s. 183(1) of the Act, which confers a correspondingly broad jurisdiction.*[87]

While it might be suggested that "broad jurisdiction" offers scope for equitable subordination, there is no discussion of equity in the case. The case concerned the other branch of section 183 dealing with "original, auxiliary and ancillary jurisdiction."[88] It remains for the Supreme Court to clarify whether the broad jurisdiction in section 183 also includes broad equitable powers such as equitable subordination.

Some courts have confirmed that section 183 "preserves the inherent jurisdiction of the Superior Court sitting in *BIA* matters".[89] As pointed out by the Alberta Court of Appeal in *Re Residential Warranty Co of Canada Inc*: "Inherent jurisdiction is not without limits, however. It cannot be used to negate the unambiguous expression of legislative will and moreover, because it

---

[85] *Re Tremblay* (1922), 3 C.B.R. 488 (Que. S.C.), at para. 45 ("Undoubtedly, sec. 63 [now section 183] of *The Bankruptcy Act* gives to this Court the widest jurisdiction."); *Re Maritime Mining Co* [1940] 2 D.L.R. 792 (N.B.S.C.), at para. 3 ("comprehensive jurisdiction).
[86] *Re Eagle River*, *supra*, footnote 48.
[87] *Re Eagle River*, *supra*, footnote 48, at para. 38 [emphasis added].
[88] *Re Eagle River*, *supra*, footnote 48, at para. 17. The case is better known for establishing the single control principle in bankruptcy. See para. 76. See *GMAC Commercial Credit Corp - Canada v. TCT Logistics Inc.* 2006 SCC 35 (S.C.C.), at para. 63; *Re Dugas* 2004 NBCA 15 (N.B.C.A.), at para. 23.
[89] *Business Development Bank of Canada v. Astoria Organic Matters Ltd,* 2019 ONCA 269 (Ont. C.A.), at para. 64.

is a special and extraordinary power, should be exercised only sparingly and in a clear case."[90] A superior court may exercise its inherent jurisdiction in matters that are regulated by statute "if it can do so without contravening any such statutory provision."[91] Equitable subordination is inconsistent with the BIA priority scheme. No court has relied upon its inherent jurisdiction to equitably subordinate a claim.

Other courts have addressed head on whether section 183 gives courts the jurisdiction to alter statutory priorities. In *Unisource Canada Inc v Hongkong Bank of Canada*,[92] Reilly J. referred to equitable subordination and concluded that "[a] Court presiding in bankruptcy clearly has an equitable jurisdiction (see section 183, *Bankruptcy and Insolvency Act)*….However, barring evidence of fraud or misrepresentation, in my view the Court should exercise great caution in departing from the statutory scheme for distribution and relief."[93] In *Re Burroughs*,[94] the court concluded that it did not "have jurisdiction to alter the distribution scheme in the *BIA*.[95]

One court purported to rely upon section 183 to equitably subordinate a claim.[96] In 2009, the Newfoundland and Labrador Trial Division in *Lloyd's Non-Marine Underwriters v JJ Lacey Insurance Ltd*[97] recognized the doctrine of equitable subordination and applied the three-part

---

[90] *Re Residential Warranty*, *supra*, footnote 1, at para. 20 citing *Baxter Student Housing Ltd v. College Housing Co-operative Ltd,* [1976] 2 S.C.R. 475 (S.C.C.), at para. 6. See also *Petrowest Corporation v. Peace River Hydro Partners* 2020 BCCA 339 (B.C.C.A.), at para. 18 (leave to appeal filed, 2021WL762371, S.C.C.). For a detailed discussion of inherent jurisdiction, see Madam Justice Georgina R Jackson and Dr. Janis Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters" (2007), Ann. Rev. Insol. L. 3; Sam Babe, "Recent Use of Statutory Discretion and Inherent Jurisdiction in Insolvency and Restructuring" (2020), Ann. Rev. Insol. L. 365, 2020 CanLIIDocs 3608, online: <https://canlii.ca/t/t1wz>.

[91] Babe, *ibid*., citing *R v. Caron* 2011 SCC 5 (S.C.C.), at para. 32.

[92] (1998), 43 B.L.R. (2d) 226 (Ont. Ct. Gen. Div.).

[93] *Unisource Canada Inc. v. Hongkong Bank of Canada* (1998), 43 B.L.R. (2d) 226 (Ont. Ct. Gen. Div.) at para. 134. See also *Re Burroughs* 2013 SKQB 262 (Sask. Q.B.), at para. 25.

[94] *Re Burroughs*, *supra*, footnote 93.

[95] *Re Burroughs, supra*, footnote 93, at para. 26.

[96] *Lloyd's Non-Marine Underwriters*, *supra*, footnote 84. The court purported to rely upon the author's earlier article as support for equitable subordination under section 183. My earlier article had asked the question of whether equitable subordination could be invoked under section 183. See Telfer, *supra*, footnote 3, at p. 54. The general conclusion of that article was that there was no need to import equitable subordination into Canadian law.

[97] *Lloyd's Non-Marine Underwriters*, *supra*, footnote 84.

Mobile Steel test. The court began its analysis by raising the question of "whether the codified scheme of distribution of the assets of a bankrupt, under the BIA, can be modified by a court on the basis of equitable principles, in particular the proposed notion of equitable subordination."[98] The court answered that question with a resounding yes. The court was "satisfied that the three-part test for equitable subordination…is appropriate to be applied in the circumstances of this matter and conclude that the claim of Hiland in the bankruptcy of Lacey is to be subordinated until all other unsecured claims have been satisfied."[99] The decision in *Lloyd's Non-Marine Underwriters* has not been followed and must be regarded as an anomaly. Ten years after the *Lloyd's* decision the Ontario Superior Court of Justice concluded in *Doyle Salewski Inc v Scott*[100] that "[t]he doctrine of equitable subordination has not however been clearly recognized in Canadian law."[101] The review of section 183 jurisprudence confirms that jurisdiction "in equity" does not mean principles of fairness to alter the statutory priority scheme of the BIA.

VI. EQUITY FOLLOWS THE LAW

An important maxim of equity is that "equity follows the law."[102] This principle is relevant to the relationship between the principles of equity, the common law and statutes. As noted by the authors of *Snell's Equity* "rules produced by courts of equity must not be flatly inconsistent with

---

[98] *Lloyd's Non-Marine Underwriters*, *supra*, footnote 84, at para. 32.
[99] *Ibid.*, at para. 54. There are very few cases that support equitable subordination. For another application of equitable subordination see *S-Marque Inc v. Homburg Industries Ltd* [1998] N.S.J. No. 550 (N.S.S.C.). The British Columbia Court of Appeal in *Laronge Realty Ltd v. Golconda Investments Ltd et al* (1986), 7 B.C.L.R. (2d) 90 (B.C.C.A.), at para. 29 concluded that it was unnecessary to reach a conclusion on whether equitable subordination was part of Canadian law but in a *dictum* the court stated "I prefer to say no more than that it should not be inferred that there is no such jurisdiction available. I would not wish to say anything which would encourage the view that the court does not have a long arm to prevent the kind of grossly unjust results which I think would have been achieved had the appellants succeeded in the position they took."
[100] 2019 ONSC 5108 (Ont. S.C.J.).
[101] *Doyle Salewski Inc*., *supra*, footnote 100, at para. 559.
[102] See Robert L. McWilliams, "Equity Follows the Law" (1908), 66 Cent. L.J. 177; "Equity follows the Law" (1906), 40 Am. L. Rev. 108; John Ordronaux, "Institutes of Equity as Revealed through its Leading Maxims" (1878), 18 Alb. L.J. 326, at p. 328. The principle has been cited by the Supreme Court of Canada. See e.g., *Canson*, *supra*, footnote 34, at para. 54; *Pro Swing Inc v. ELTA Golf Inc,* 2006 SCC 52 (S.C.C.), at para 22. See MacNaughton and Rappos, *supra*, footnote 3.

those established at common law."[103] It is also clear that this maxim applies to statutes: "Equity follows the law: Clearly equity may not depart from statute law."[104] The Manitoba Court of Appeal in *Horch v Horch,*[105] in referring to the maxim "equity follows the law", recognized that "the relationship between equity and other legal principles has been based on the premise that equitable doctrines cannot operate in plain inconsistency with other sources of law, such as statute or the common law."[106] In the recent decision of *House v Baird,*[107] the Ontario Superior Court of Justice noted that the maxim "equity follows the law" "most clearly applies to principles of law derived from statutes."[108] Therefore, "in the face of clear statutory provisions, equitable remedies cannot apply."[109] The court declined to make an order for marshalling in light of the conflict between the equitable principle and the "unambiguous wording of the *Insurance Act*."[110] This has implications for equity and the BIA. As noted by Houlden, Morawetz and Sarra: "Equity follows the law, and if a provision of the *Bankruptcy and Insolvency Act* is clear on a particular point, a court of equity is bound to apply it, even though the court believes that the result is unfair or unjust."[111]

The most relevant statutory provision in the BIA to the equitable subordination question is the distribution scheme found in section 136 and in section 141 which provides "[s]ubject to this Act, all claims proved in a bankruptcy shall be paid rateably." It is a fundamental principle of

---

[103] John McGhee, *Snell's Equity*, 33rd ed., (London: Sweet & Maxwell, 2015), at p. 90. See e.g., *N-Krypt International Corp v. LeVasseur* 2018 BCCA 20 (B.C.C.A.), at para. 27.
[104] Jill Martin, *Hanbury & Martin: Modern Equity* (London: Thomson Reuters, 2008), at p. 30; Heydon et al, *supra*, footnote 15, at p. 71. See e.g., *Strata Plan No VIS3305 v. Best* 2000 BCSC 935 (B.C.S.C.), at para. 18; *JM Voith*, *supra*, footnote 15, at para. 116.
[105] 2017 MBCA 97 (Man. C.A.).
[106] *Horch*, *supra*, footnote 105, at para. 63.
[107] 2019 ONSC 1712 (Ont. S.C.J.).
[108] *House*, *supra*, footnote 107, at para. 44.
[109] *Ibid.,* at para. 45.
[110] *Ibid.,* at paras. 42, 45.
[111] The Honourable Mr. Justice Lloyd W. Houlden, Mr. Justice Geoffrey B. Morawetz and Dr. Janis P. Sarra, *Bankruptcy and Insolvency Law of Canada*, 4th ed (W.L. Can.), at para. I§4. See also *3042073 Canada inc, Re* [2000] R.J.Q. 1314 (Que. S.C.), at para. 77 ("rules of equity…must give way in the presence of provisions that apply to a particular issue, either in the BIA or in provincial law.") [translated by author].

bankruptcy law that once preferred claims have been paid (and subject to the rights of secured creditors) unsecured creditors share on a *pro rata* basis.[112] This was the very basis of the first English bankruptcy statute enacted in 1542[113] and the pro-rata sharing principle "is viewed as one of the foundational principles of bankruptcy law."[114] The Supreme Court of Canada described this principle as a "rule of absolute equality".[115] Is it possible to invoke fairness and good conscience to disturb this equality of distribution? The case law suggests otherwise.

In 1923, the Ontario Court of Appeal in *Re Orzy*[116] reversed the decision of the judge of first instance who had postponed the claim of a creditor until all other claims of creditors had been paid in full. A father had extended credit to a son to support the son's business. The father had taken a chattel mortgage over the son's stock in trade to secure the father's advancement of credit. The son found he could no longer obtain credit from his suppliers because of the existence of the chattel mortgage. To facilitate the son's access to credit with suppliers, the father discharged the chattel mortgage and had the son sign promissory notes for the debt. The continued existence of the son's debt to the father was not made known to other creditors. One creditor subsequently extended credit on the basis that there was no longer a chattel mortgage. When the son later made an assignment in bankruptcy, Fisher J. at first instance found the father's claim as a creditor to be suspicious.[117] Fisher J. relied upon "equity and good conscience" and ruled that the father was not entitled to a dividend until all other creditors had been paid:

> It would, therefore, be contrary to equity and good conscience for the claimant appellant, after having entered into a scheme or conspiracy, as I find he did, with his son, enabling his son to defraud his creditors by obtaining credit, to allow him now to compete with

[112] *Re Gingras automobile Ltée* [1962] S.C.R. 676 (S.C.C.), at para. 7. Roderick Wood, *Bankruptcy and Insolvency Law* (Toronto: Irwin Law, 2015), at p. 281.
[113] Emily Kadens, "The Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law" (2010), 59 Duke L.J. 1229.
[114] Roderick J. Wood, "Subordination Agreements, Bankruptcy and the PPSA" (2010), 49 Can. Bus. L.J. 66, at p. 76.
[115] *Re Gingras automobile Ltée* [1962] S.C.R. 676 (S.C.C.), at para. 7.
[116] *Re Orzy* [1924] 1 D.L.R. 250 (Ont. C.A.) [*Orzy* 1924].
[117] *Re Orzy* (1922), 3 C.B.R. 44 (Ont. S.C.), at para. 1 [*Orzy* 1922].

the creditors who gave credit to the son, as the claimant intended they should.[118]

The Ontario Court of Appeal reversed Fisher J.'s decision. Hodgins J.A. began by citing the *Bankruptcy Act* to the effect that all debts proved in the bankruptcy or under an assignment "shall be paid *pari passu*".[119] For Hodgins J.A., "in bankruptcy the rule of equality is absolute."[120] Ferguson J.A. agreed holding that "bankruptcy does not permit…the adjustment of the rights and privileges of creditors *inter se.*"[121] Thus, once a claim was a provable debt the creditor was entitled to a dividend. The Court of Appeal rejected Fisher J.'s conclusion that principles of equity and good conscience could alter bankruptcy priorities. Under the *Re Orzy* principle a court "will not apply equitable principles in the distribution of the property of the debtor. The rule of equality is absolute in bankruptcy except where the Act itself gives priority to some debts over others."[122] The Ontario Court of Appeal in *US Steel* did not consider *Re Orzy.*

Re Orzy continues to be cited.[123] In 2019, the Ontario Superior Court of Justice in *Doyle Salewski Inc v Scott*[124] considered a case in which the trustee sought judgments against 17 defendants. The case involved an illegal Ponzi scheme. For four of the actions the trustee sought an order that "the defendants [as creditors] shall not be entitled to claim a dividend in the bankruptcy proceedings until all claims of the other creditors have been satisfied."[125] The cited *Re Orzy* and stated that "the rateability principle trumps equity considerations and is only displaced

[118] *Ibid.,* at para. 9.
[119] *Orzy* 1924, *supra*, footnote 116, at para. 4.
[120] *Ibid.,* at para. 5.
[121] *Ibid.*, at para. 19.
[122] Houlden, Morawetz and Sarra, *supra*, footnote 111, at para. G§161. See also Crozier, *supra*, footnote 3, at para. 8.
[123] *Re Lipson* (1923), 3 C.B.R. 640 (Ont. S.C.), at para. 23; *Re Canadian Tabulating Card Co* [1972] 3 O.R. 648 (Ont. S.C.J.), at para. 11; *Re Keele-Wilson Supermarkets Ltd* (1990), 72 O.R. (2d) 771 (Ont. S.C.J.), at para. 12; *Re Rico Enterprises Ltd* (1994), 24 C.B.R. (3d) 309 (B.C.S.C.), at para. 26; *Canada (Attorney General) v. Confederation Life Insurance Co* (2002), 39 C.B.R. (4th) 182 (Ont. S.C.J.), at para. 15.
[124] *Doyle Salewski Inc*, *supra*, footnote 100.
[125] *Ibid.,* at para. 555.

by explicit statutory provisions". Gomery J. cited *Bankruptcy Law in Canada*, 4th ed for the following principle:

> Though invested with jurisdiction, both in law and equity (s. 183(1)), the court will not apply equitable principles in the distribution of the property of the debtor. The rule of equality is absolute in bankruptcy except where the Act itself gives priority to some debts over others. Once a provable debt is established the creditor is entitled to rank for dividend rateably: *Orzy, Re*.[126]

Other courts have commented on the relationship between the exercise of equitable powers and the existing statutory regime. In *Wasserman, Arsenault Ltd v Sone*, Farley J. concluded that:

> While the Superior Court of Justice in Bankruptcy is vested by s. 183 (1) of the BIA with jurisdiction in law and equity, that does not confer on this Court the ability, capacity, or jurisdiction to do something not allowed by the BIA in the sense that that statute provides otherwise.[127]

In 2005, the New Brunswick Court of Appeal in *Sunny Corner Enterprises Inc v St Anne-Nackawic Pulp Co (Receiver of)* noted that section 183 gave the court jurisdiction in law and in equity but importantly stated that "[i]t is well known that section 183 may be invoked so long as its application does not conflict with another provision of the BIA."[128] Roderick Wood argues that the statutory scheme of distribution in the BIA would appear to rule out the application of equitable subordination "completely":

> Under Canadian bankruptcy legislation, ordinary creditors are given a statutory right to share rateably in the bankrupt estate unless the statute postpones their claims. A judicial subordination of a claim on grounds other than those permitted by statute would appear to interfere with the bankruptcy scheme of distribution.[129]

---

[126] *Ibid.*, at para. 557, citing Houlden, Morawetz and Sarra, *supra*, footnote 111, at G§161. Gomery J. stated at para 560: "Since the Trustee did not make any submissions on this part of its claim, I decline to grant this relief or make any comment on the court's power to grant [equitable subordination] under Canadian law."

[127] (2000), 22 C.B.R. (4th) 153 (Ont. S.C.J.), at para. 7, aff'd *Wasserman, Arsenault Ltd v Sone* (2002), 33 C.B.R. (4th) 145 (Ont. C.A.).

[128] 2005 NBCA 54 (N.B.C.A.), at para. 13. See also *Bulut v. City of Brampton* (2000), 48 O.R. (3d) 108 (Ont. C.A.), at para. 88. ("There is, as the courts recognized, a serious issue as to whether courts should modify explicit priorities created by statute, even if the modification arose through the application of equitable principles."); *Re Alary* 2016 BCSC 2108 (B.C.S.C.), at para. 27 ("The Court's exercise of discretion must be reasonable. It must not erode confidence in, or frustrate the purposes of, the insolvency legislation.")

[129] Wood, *supra*, footnote 112, at p. 285. See also Honsberger and DaRe, *supra*, footnote 43, at p. 103.

VII. FUNCTIONAL EQUIVALENCE OF EQUITABLE SUBORDINATION IN CANADIAN LAW

In *Re I Waxman & Sons Ltd,*[130] Pepall J., as she then was, wrote "[i]t seems to me that the importation or application of a doctrine such as equitable subordination should respond to a lacuna in our law."[131] There are existing provisions in the BIA which subordinate claims of the type often considered in the American doctrine of equitable subordination making the importation of the doctrine unnecessary.[132] Reilly J. in *Unisource Canada Inc v Hongkong Bank of Canada* stated:

> It might be noted in passing that the *Bankruptcy and Insolvency Act*, together with provincial legislation such as the *Fraudulent Conveyances Act*, the *Personal Property Security Act* and the *Assignments and Preferences Act* provide for a statutory scheme of distribution of the estate of a bankrupt that enshrines most of the "equitable principles" that form the basis for many "equitable subordination" decisions in American cases (see, for example, secs. 3, 4, 91, 95, 96, 100, 101 and 136-147 of the *Bankruptcy and Insolvency Act*). Principles such as settlement of property, fraudulent preferences, reviewable transactions and the rules for priority and postponement of claims involving non-arm's length transactions or related parties are all recognized within the legislation.[133]

The BIA seeks to postpone the claims of insiders in a number of provisions. For example, section 137 of the BIA postpones claims of creditors who enter into non-arm's length transactions with the debtor.[134] Section 139 also postpones disguised equity claims.[135] Insiders are also caught by section 140 which provides that no director or officer of that corporation is entitled to have his or her claim preferred by section 136 for wages. As one author writes, "[t]hese provisions are

---

[130] (2008), 89 O.R. (3d) 427 (Ont. S.C.J.).
[131] *Re Waxman*, *supra*, footnote 130, at para. 34.
[132] See MacNaughton and Rappos, *supra*, footnote 3; Opolsky, *supra*, footnote 2; Telfer, *supra*, footnote 3, at pp. 81-82; Crozier, *supra*, footnote 3, at para. 12.
[133] *Unisource Canada, supra,* footnote 93, at para. 134.
[134] In *Alberta Energy Regulator v. Lexin Resources Ltd* the Alberta Court of Queen's Bench refused to consider the doctrine of equitable subordination because section 137 was "sufficient to determine the issue," 2018 ABQB 590 (Alta. Q.B.), at para. 90. In *Stone Mountain Resources Holdings Ltd v. Stone Mountain Resources Ltd* 2012 ABQB 534 (Alta. Q.B.), the Alberta Court of Queen's Bench held that because the transaction was for a proper purpose section 137 and the doctrine of equitable subordination did not apply.
[135] BIA, *supra*, footnote 2, section 139. The British Columbia Court of Appeal held in *674921 BC Ltd v. Advanced Wing Technologies Corp,* 2006 BCCA 49 (B.C.C.A.), at para. 42 that section 139 and the doctrine of equitable subordination ("were it applicable in Canada") did not apply to the facts in this case.

sufficiently broad that they may cover some of the ground occupied by equitable subordination in the US."[136]

Existing Canadian law also responds to the issue of inappropriate behavior on the part of creditors and insiders. As Jacob Ziegel writes, "the federal and provincial business corporations Acts contain powerful 'oppression remedy' provisions which, so far as insiders are concerned, may lead to the same results as equitable subordination."[137] If there is any provision in the BIA that squarely deals with creditor misconduct or abuse by an insider it is the new good faith obligation in insolvency proceedings.[138] On November 1, 2019, Parliament added the new duty of good faith to the BIA:[139]

> 4.2 (1) Any interested person in any proceedings under this Act shall act in good faith with respect to those proceedings.

Concerns about creditor misconduct could be dealt with by the new duty of good faith. The good faith obligation is arguably broader than the concept of equitable subordination. The remedy for breach of this good faith obligation is expressed in very broad terms:

---

[136] Opolsky, *supra*, footnote 2, at p. 6. Now section 101 of the BIA enables the court to grant judgment to the trustee against directors for termination pay, severance pay or incentive benefits where the transaction occurred at a time when the corporation was insolvent or the transaction rendered the corporation insolvent.

[137] Jacob Ziegel, "Corporate Groups and Crossborder Insolvencies: A Canada- United States Perspective" (2002), 7 Fordham J. Corp. & Fin. L. 367, at p. 374. In 2005, Anthony Duggan asked "How is the oppression remedy different from the doctrine of equitable subordination?" Anthony Duggan, "Canadian Bankruptcy Law Reform: A Selective Research Agenda" (2005), 13 lnsolv. L.J. 67, at p. 82. See *BCE Inc v. 1976 Debentureholders*, 2008 SCC 69 (S.C.C.); *Wilson v.* Alharayeri, 2017 SCC 39 (S.C.C.).

[138] BIA, *supra*, footnote 2, section 4.2. Added, S.C. 2019, c. 29, section 133. See the parallel provision in section 18.6 of the CCAA. See *9354-9186 Québec inc v. Callidus Capital Corp*, 2020 SCC 10 (S.C.C.), at para. 50; *Sequestre de Media5 Corporation* 2020 QCCA 943 (Que. C.A.), at para. 9 (application for leave to appeal to Supreme Court of Canada [2020] S.C.C.A. No. 458)); *CWB Maxium Financial Inc v. 2026998 Alberta Ltd* 2021 ABQB 137 (Alta. Q.B.), at para. 38. On the uncertainty that the new provision creates see Jassmine Girgis, "A Generalized Duty of Good Faith in Insolvency Proceedings: Effective or Meaningless?" (2020), 64 Can. Bus. L.J. 98.

[139] See Jules A. Monteyne, "The New Duty of Good Faith and How it Applies in Insolvency Proceedings" (2019) Ann. Rev. Insol. L. 16; Ari Y. Sorek. and Charlotte Dion, "Good Faith in Insolvency and Restructuring: At The Intersection of Civilian and Common Law Paradigms, at a Fork in the Road or in a Merging Lane?" (2020), Ann. Rev. Insol. L. 34, 2020 CanLIIDocs 3598, online: <https://canlii.ca/t/t1wm>; Julien Morissette, Ilia Kravtsov and Cristina Cosneanu, "Being a Good Sport: A Comparative Analysis of Good Faith as a Statutory Obligation in Insolvency Proceedings" (2020), Ann. Rev. Insol. L. 254, 2020 CanLIIDocs 3604, online: <https://canlii.ca/t/t1wt>.

> 4.2(2) If the court is satisfied that an interested person fails to act in good faith, on application by any interested person, the court may make any order that it considers appropriate in the circumstances.

One author suggests that given the "broad powers granted to courts under these amendments, we may see the emergence of the doctrine of equitable subordination under the good faith rubric."[140] It would be an unfortunate development if Canadian courts were to simply introduce equitable subordination when there is a breach of the good faith obligation. The oppression remedy in Canadian corporate law statutes similarly grants the courts very broad powers to fashion remedial orders but no Canadian court in granting an oppression remedy has sought to import equitable subordination as an appropriate response to oppressive behaviour. Under the oppression remedy, Canadian courts have fashioned their own remedies, such as director liability, when there is a breach of a corporation statute.[141] In interpreting the new good faith obligation, Canadian courts should develop their own remedy regime rather than relying upon equitable subordination.[142]

VIII. CONCLUSION

This article has raised the issue of the meaning of "equity" in section 183.[143] As Jay Westbrook writes, "[f]or a lawyer, 'equity' is an enormous word. Far beyond a technical reference to a group of courts in England, it evokes broad notions of fair consideration of all the values and circumstances that should be weighed in rendering a judicial decision."[144] Justice Douglas adopted that broader conception of equity in *Pepper v Litton* relying upon the court's equitable jurisdiction

[140]Girgis, *supra*, footnote 138.
[141] See *Alharayeri*, *supra*, footnote 137.
[142] On the need for "meaningful remedies" for breach of a good faith obligation in insolvency proceedings see Janis Sarra, "La bonne foi est une considération de base — Requiring Nothing Less than Good Faith in Insolvency Law Proceedings" (2014), Ann. Rev. Insol. L. 6.
[143] "Scholars of modern theories of equity have long recognized that the term 'equity' is notoriously ambiguous". Maggie Blackhawk, "Equity outside the Courts" (2020), 120 Colum. L. Rev. 2037, at p. 2048.
[144] Jay Lawrence Westbrook, "Equity in Bankruptcy Courts: Public Priorities" (2020), 94 Am. Bank. L.J 203. For a discussion of the confusion in the scholarship on the meaning of equity see Laura N. Coordes, "Narrowing Equity in Bankruptcy" (2020), 94 Am. Bank. L.J. 303; Michelle M. Harner and Emily A. Bryant-Alvarez, "The Equitable Powers of the Bankruptcy Court" (2020), 94 Am. Bank. L.J. 189.

to subordinate a claim as a result of the "violation of rules of fair play and good conscience by the claimant."[145]

Equitable jurisdiction found in section 183 of the BIA does not represent a broad power to reorder statutory priorities based on notions of fairness and good conscience. The section 183 jurisprudence simply does not support the *obiter* statement in *US Steel* that the provision invests the court with jurisdiction to equitably subordinate a claim and alter statutory priorities. Canadian courts have not adopted a "moral reading"[146] of section 183. Instead, the jurisprudence demonstrates that courts in Canada have relied upon section 183 to support traditional equitable powers such as rectification and specific performance. The jurisprudence also shows that Canadian courts have not relied upon inherent jurisdiction to subordinate claims under section 183. Further, the important maxim "equity follows the law" means that "equity may not depart from statute law."[147] In *US Steel,* Strathy C.J.O. did not cite any cases in support of his *dictum* ignoring the 1923 decision of *Re Orzy*[148] in which the Ontario Court of Appeal rejected the conclusion of the judge of first instance that principles of equity and good conscience could alter bankruptcy priorities. To allow equitable subordination under section 183 would be an attempt to ignore the "legislative will" of Parliament.[149]

There may be no need to import equitable subordination as there are existing provisions in the BIA which subordinate claims of the type often considered under the American doctrine of equitable subordination. Canadian law also effectively deals with creditor and insider misconduct through the oppression remedy and the new statutory duty of good faith. One is reminded of the

---

[145] *Pepper*, *supra*, footnote 12, at p. 310.
[146] Markell, *supra*, footnote 5, at p. 246.
[147] Jill Martin, *Hanbury & Martin: Modern Equity* (London: Thomson Reuters, 2008), at p. 30; Heydon et al, *supra*, footnote 15, at p. 71. See e.g., *Strata Plan No VIS3305 v. Best* 2000 BCSC 935 (B.C.S.C.), at para. 18; *JM Voith*, *supra*, footnote 15, at para. 116.
[148] *Orzy* 1924, *supra*, footnote 116.
[149] *Re Residential Warranty*, *supra*, footnote 1, at para. 20.

words of Pepall J., as she then was, in *Re I Waxman & Sons Ltd,*[150] in which she referred to equitable subordination and stated: "There is of course a danger associated with taking a doctrine divorced from its legal home and applying it to Canada's statutory bankruptcy regime unencumbered with deep knowledge of the origin, development and legal system from which it originated."[151]

[150] *Re Waxman*, *supra*, footnote 130.
[151] *Ibid.*, at para. 33.