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Insolvency Law

June, 2007



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BANKRUPTCY OF A SECURITIES FIRM UNDER PART VII OF THE BANKRUPTCY AND INSOLVENCY ACT (CANADA). ONE OF THE MORE RECENT CASES TO CONSIDER THESE PROVISIONS, *ASHLEY V. MARLOW GROUP PRIVATE PORTFOLIO MANAGEMENT INC.*, REMINDS US THAT SECURITIES NOT REGISTERED IN THE NAME OF THE CUSTOMER VEST IN THE BANKRUPT ESTATE.

In *Ashley v. Marlow Group Private Portfolio Management Inc.* (2006) CarswellOnt. 3449 (Ont. S.C.), the Bankruptcy Court considered the insolvency of a group of companies which provided a number of investor services to its clients. There was a significant deficiency between the actual cash that the group of companies had in its accounts, and the amount which it was supposed to be holding in trust for its clients.

The companies also held a large number of securities for their customers, but very few of these were actually registered in the individuals' names. Their practice was to purchase large blocks of securities, and then allocate them to individual investors, without actually registering them in the client's names. Some securities were registered in the client's names, but these were held in separate personal accounts, unaffiliated with the group of companies.

The group of companies was placed into receivership, and the receiver applied to the Court to assign each of the corporate defendant's into bankruptcy. As part of that application the receiver suggested that one of the group of companies ("Management Inc.") was a "securities firm" as defined in section 253 of the Bankruptcy and Insolvency Act ("BIA"), and as a result the special provisions of Part XII of the BIA would be applicable. The receiver also sought a declaration that only those securities that were actually registered, or in the process of being registered, in the name of customers were to be considered as "customer named securities".

Part XII of the BIA is relatively new, having coming into force in 1997, in response to what were seen as undue complexities involving the bankruptcies of securities firms. This part of the BIA was enacted to simplify and streamline the administration of such estates. Part XII creates a particular class of securities that are to be returned to customers called "customer named securities". All other securities and cash held by a bankrupt securities firm are to be pooled in a "customer pool fund", and distributed among all of the customers of the securities firm on a pro-rata basis.

In this case the Court first concluded without hesitation that Management Inc. fit the definition of a "securities firm" as it carried on the business of buying and selling securities from, to or for its customers, as principal or agent, and entered into securities transactions with the public.

The next issue the Court considered was whether some of the securities held by Management Inc. were "customer named securities", in which case section 253 of the BIA mandated that those securities were to be returned to the individual customers in whose name they were registered.

The Court concluded that it was not sufficient that an observer was able to identify the beneficial owner of a security from the records of the security firm. Rather, there had to be actual registration of the securities in the name of the customer, and anything short of that would not suffice.

Finally, the Court considered the apparent conflict between Part XII of the BIA and section 67 of the BIA which allows for trust claims against a bankrupt estate. By contrast, section 261 of the BIA (which is contained within Part XII) vests in the trustee any securities held by the firm itself, as well as any securities or cash held by the securities firm for the account of a customer. The issue before the Court was whether section 261 precluded

those customers from making a trust claim to the securities or cash pursuant to section 67 of the BIA.

The Court concluded that in bankruptcies of securities firm section 261 took precedence over section 67, and that all cash and securities held by Management Inc. at the date of bankruptcy vested in the trustee, not just the cash or securities beneficially owned by the securities firm. The only exclusion from this pool of assets was those securities that fell into the definition of “customer name securities”.

The Court explicitly found that the plain reading of section 261 suggests that cash and securities “held... for a customer” must mean cash and securities held on trust for the benefit of a customer. Since section 261 mandates that these securities and this cash vest in the trustee of a securities firm upon its bankruptcy, section 261 clearly conflicts with section 67, but by virtue of other wording in Part XII, section 261 prevails over section 67 and trust claims are prohibited.

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