

on

Insolvency Law

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SUPERINTENDENT'S LEVY DEDUCTED FROM REPAYMENT OF BANK'S MORTGAGE

In *Seeley (Trustee of) v. Canadian Imperial Bank of Commerce* (2008), the Bankruptcy Court determined that the Superintendent's Levy was payable on the amount paid to a secured creditor by a Trustee in bankruptcy.

The bankrupt made an assignment into bankruptcy. He owned a cabin which was mortgaged to the Bank. The Trustee sent the Bank three notices requiring it to file proof of its security. The Bank did not respond.

The cabin was sold and subsequently the Bank filed a Proof of Claim in the bankruptcy. The Trustee wrote to the Bank and released to it the Trustee's interest in the cabin, to the extent of the amount owing as set out in the Proof of Claim.

Initially the Trustee repaid the Bank in full without deducting the Superintendent's Levy. When the Trustee realized this potential error, it applied to the Court for an Order requiring the Bank to return the levy amount to the Trustee for payment to the Superintendent.

The Trustee argued that the mortgage repayment fell squarely within section 147(1) of the *Bankruptcy and Insolvency Act*, and therefore the levy should have been deducted from the dividend it paid to the Bank. That provision states:

For the purpose of defraying the expenses of the supervision by the Superintendent, there shall be payable to the Superintendent for deposit with the Receiver General a levy on all payments, except costs referred to in subsection 70(2), made by the Trustee by way of dividend or otherwise on the claims of creditors, whether unsecured, preferred or secured creditors, including Her Majesty in Right of Canada or a Province claiming in respect of taxes or otherwise.

The Court observed previous cases which held (1) the levy is a form of tax payable by creditors who benefit from payments in the course of an administration of a bankruptcy, and (2) the levy is to be shared by all creditors who benefit from the proceedings.

The Bank took the position that the repayment by the Trustee constituted a redemption of the security, which is excluded from the obligation to pay the levy. The Court referred to Superintendent's Directive No. 10, which establishes the circumstances in which Trustee's are considered to be making a redemption of security and sets out as policy that the levy is payable on all payments by a Trustee to a secured creditor, except in cases of certain exceptions, one of which is where the Trustee proceeded with a redemption of the security within the meaning of section 128(3) of the BIA.

Section 128 states:

128.(1) Where the trustee has knowledge of property that may be subject to a security, the trustee may, by serving notice in the prescribed form and manner, require any person to file, in the prescribed form and manner, a proof of the security that gives full particulars of the security, including the date on which the security was given and the value at which that person assesses it.

(1.1) Where the trustee serves a notice pursuant to subsection (1), and the person on whom the notice is served does not file a proof of security within thirty days after the day of service of the notice, the trustee may thereupon, with leave of the court, sell or dispose of any property that was subject to the security, free of that security.

(2) A creditor is entitled to receive a dividend in respect only of the balance due to him after deducting the assessed value of his security.

(3) The trustee may redeem a security on payment to the secured creditor of the debt or the value of the security as assessed, in the proof of security, by the secured creditor.

The Court stated the issue and resolved it as follows, commencing at paragraph 16:

The main issue in this case is whether the Trustee paying out the Bank's mortgage on sale of the cabin amounts to a redemption within s. 128(3). In [citation omitted], Topolniski J. said that there had been no clear and consistent interpretation of the redemption provisions in the BIA and that the result is a legal muddle. She concluded that the levy is not payable on a redemption by payment of the debt, whether a proof of security has been filed or not under s. 128, as payment is not made on the claim of the creditor. Rather, it is payment to acquire the secured creditor's right or interest in the security [paragraph 163].

... the decision whether a particular situation is held to be a redemption and the s. 147 levy not payable is very much dependent on the facts. In some cases, the decision seems to turn less on whether the situation can be said to be a redemption and more on whether the secured creditor can be said to have participated in the bankruptcy process or whether the secured creditor gains a benefit where the trustee is acting as the trustee in bankruptcy and not in any sense as agent for the secured creditor...

... In my opinion, Cutting Edge does not go so far as to say that whenever a trustee pays out the claim of a secured creditor, that amounts to a redemption that is excepted by Directive 10 from payment of the levy. One must look at the facts to determine whether a redemption has taken place, remembering that Directive 10 specifies that the exception is where redemption has taken place within the meaning of s. 128(3) of the BIA.

In this case the Bank did not file a proof of security within s. 128 (1.1), which requires that full particulars of the security and the value at which the holder assesses it be provided.

By the time the Bank filed its proof of claim in July 2006, its mortgage had matured. Its proof of claim set out the amount owing and that in respect of the debt, the Bank held as security assets of the debtor valued at an "unknown" amount. By filing its proof of claim, the Bank asserted its claim within the context of the bankruptcy proceedings.

Counsel for the Bank submits that when the Trustee acknowledged receipt of the proof of claim and released its interest in the cabin to the extent of the claim, the Trustee was acknowledging that the Bank had the right to the property. The Bank's position is that at that point, the situation became a redemption.

However, the Bank did nothing after the release was given by the Trustee. Had it started foreclosure proceedings, payment of the secured amount thereafter might be considered a redemption. But in my view, where, as here, the Bank did nothing with the release it was given and instead stood by while the Trustee continued with the agreement for sale in the context of the bankruptcy, what occurred is not a redemption. There is no evidence that the Bank did anything to assess the value of its security. There is no evidence as to whether it expected its claim to be fully satisfied by the value or sale price of the cabin or whether it expected to have to claim a shortfall as an unsecured creditor in the bankruptcy. The fact that it filed a proof of claim suggests that it may have been concerned about a shortfall. The main point however, is that the Bank simply deferred to the bankruptcy process, awaiting payment of its claim. [emphasis added]

And in conclusion, the Court stated the following, which will be of particular interest to secured creditors, at paragraph 25:

To the extent that Cutting Edge may be taken to hold that in any circumstances, payment of the debt of a secured creditor amounts to a redemption, I respectfully disagree. Section 128(3) should be read in the context of s. 128 as a whole in setting out the method by which a redemption may take place. The Bank chose not to follow the procedure set out in s. 128 but instead to file a proof of claim in the bankruptcy. Having chosen the latter procedure, and benefited from the bankruptcy process, it should be in the same position as any other creditor who benefits from that process.

In a decision pre-dating Cutting Edge, Topolniski J. Found that redemption did not occur where secured creditors participated in a bankruptcy and accepted a proposal made by the bankrupt in the course of a voluntary liquidation; the secured creditors were found to have elected to rely on the BIA process rather than enforcement of their security: Canada (Superintendent of Bankruptcy) v. Aberant Arnold and Chow Inc. [2004] A.J. No. 1601 (Q.B.). In that case, there was no redemption as the trustee was simply paying an agreed upon sum in satisfaction of the secured creditors' claims.

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