

Administrative Monetary Penalties in the Afterlife

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Allegations of criminal or regulatory violations are often made in the civil and administrative law world. A securities broker may be alleged to have defrauded investors by making false statements regarding the use of their funds, and by using invested funds for improper purposes.[1] In the administrative regime, the securities broker may face restrictions on professional activities or an administrative monetary penalty ("AMP") of not more than a \$1 million for each failure to comply.

Following the imposition of a significant AMP in the millions of dollars, that securities broker may think that she got off lightly, if she was not prosecuted for fraud under the Criminal Code. She may take some solace in the thought that the AMP, unlike a criminal fine, will not survive a pending bankruptcy which will enable her to get on her feet again. She would be wrong in making that assumption. Recent cases have demonstrated that AMPs for fraudulent conduct may survive in the afterlife of bankruptcy.

The case of *Alberta Securities Commission v. Hennig*[2] offers a twist on the interpretation of the divide between administrative monetary penalties and offences. An application by the Alberta Securities Commission sought a declaration that an administrative penalty levied against Hennig survived his discharge as a bankrupt pursuant to s. 178(1)(a), (d) and (e) of the *Bankruptcy and Insolvency Act* (BIA) was granted.

Bankruptcy and Insolvency Act

As a basic principle, a bankrupt is released from all claims provable in bankruptcy by an order of discharge: section 178(2) of the BIA. However, section 178(1) of the BIA sets out eight classes of exceptions to that rule. Relevant to the application in *Hennig*, were subsections 178(1)(a)(d) and (e) of the BIA provide that an order of discharge does not release the bankrupt from:

- a) any fine, penalty, restitution order or other order similar in nature imposed by a court in respect of an offence, or any debt arising out of a recognizance or bail;
- d) any debt or liability arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity; or
- e) any debt or liability arising from obtaining property or services by false pretenses or fraudulent misrepresentation.[3]

The administrative penalty arose from the findings of a panel of the Securities Commission that Hennig was responsible for misrepresentations in the financial statements of a public company of which he was a director and officer, that he obtained financial benefits as a result of non-disclosure of material facts, that he participated in market manipulation which resulted in artificial prices for another company, and that he made ongoing misrepresentations to Commission staff, all contrary to the public interest. The decision of the Commission, upon filing with the Court, "has the same force and effect as if it were a judgment of the Court of Queen's Bench" pursuant to section 200 of the Securities Act.[4] The decisions of the Commission were certified by the Court of Queen's Bench and thus had the force and effect of a judgment of the Court.

Purposive interpretation

The Court held that the exceptions set out in s. 178(1) of the BIA exist to ensure that debtors who have been found to have engaged in fraudulent or dishonest conduct are not entitled to a discharge. They are to be interpreted purposively with that policy consideration in mind. The Court provided a ruling and guidance on

each of the exceptions in sections 178(1)(a)(d) and (e).

Under section 178(1)(a), the exception does not refer to the high bar of fraud but rather hinges on whether there is a fine, penalty, restitution order or other order similar in nature imposed by a court in respect of an offence, or any debt arising out of a recognizance or bail. On a strict reading of this section, an AMP is not an “offence” (per the reasoning of the Supreme Court of Canada in *Guindon*[5]) and would not qualify. The Alberta Court was not prepared to expand the interpretation of the subsection in such a way that would encompass any decision of a regulatory authority that involves the public interest, as suggested by the Commission, which would give the exception too broad a scope. The Alberta Court was prepared to read the section more broadly in the unique circumstances of the case:

In the circumstances, it is not necessary that I find that an administrative penalty levied in the circumstances of this case falls within the requirements that the penalty must be imposed by a court in respect of an offence, but, if I am incorrect in finding that subsection 178(1)(e) applies, I would find that subsection 178(1)(a) applies in this case in the specific circumstances of a penalty imposed for reprehensible conduct involving fraud, dishonesty and misrepresentation, filed in a timely manner with a court under provisions that give it the same effect as a judgment, scrutinized by the Court of Appeal, and under circumstances where the regulatory authority responded appropriately to the bankruptcy with an indication of its position on the issue.[6]

With respect to section 178(1)(d), the Court distinguished the situation of a third party private creditor attempting to apply section 178(1)(d) to exempt from discharge a debt founded on the breach of a fiduciary duty involving fraud from the administrative penalty at issue in this case, which was levied by a panel of the Alberta Securities Commission upon clear findings of fraudulent misrepresentation by Mr. Hennig as a director acting in a fiduciary capacity. Accordingly the Court found that subsection 178(1)(d) does not apply to the administrative penalty.[7]

Finally, with respect to subsection 178(1)(e) the Court adopted a purposive interpretation of the subsection in view of the intention of section 178 – to preclude dishonest debtors from benefitting from their dishonesty. A purposive approach “would surely extend to a decision of a securities commission, charged with enforcing securities laws in order to protect the interesting public and promoting the integrity of the capital markets, in circumstances that would otherwise fit within the subsection.”[8] Accordingly the Court found that the administrative penalty survives Mr. Hennig’s discharge after bankruptcy pursuant to the exception set out in section 178(1)(e).

The decision in *Hennig* was followed by the British Columbia Supreme Court in *Poonian (Re)*. [9] The magnitude of the losses in *Poonian* were significant. The clients lost \$7,102,902. The Commission ordered administrative penalties and issued disgorgement orders against the bankrupts, with the result that they owed it \$19,095,362. The trustee in bankruptcy reported that their proven liability was \$25,184,693. The Court engaged in statutory interpretation with the following purposive analysis:

Third, given the purpose of s 178(1) -- to avoid rewarding dishonest behaviour -- there is no principled basis to refuse to exempt debts imposed after a hearing before an administrative tribunal such as the Commission Panel. As discussed in the next section, a debt arising from a judgment may be exempted regardless of the strict cause of action in the original pleading: a court will consider whether the bankrupt seeking exemption was an honest but unfortunate debtor, or, rather, fell into liability through reprehensible behaviour. A debt, based in reprehensible behavior, imposed by an administrative body statutorily entrusted to make findings and impose penalties and to which courts grant deference, should be treated equally in our administrative state to a debt arising from a judgment.[10]

The same purposive approach was applied with respect to section 178(1)(e):

This returns us to the purpose and essence of s 178(1) generally, and s 178(1)(e) specifically. The Court is satisfied that the Poonians’ actions were morally unacceptable and harmful to society, such that they should not be rewarded with a release of those debts through the statutory discharge under the BIA. Their orchestrated market manipulation and knowing exploitation of vulnerable investors, with corrosion of public confidence in the securities markets, all evidence the deceit lying at the heart of s 178(1)(e).[11]

The Court in *Poonian* agreed with the Commission that market manipulation, particularly in the form of the multi-party elaborate scheme, involving disguise and aliases, orchestrated by the Poonians, is at its core a fraudulent misrepresentation and false pretense. An interesting note is that the observation that in order to establish “false pretenses” under this section, the behaviour need not satisfy the *Criminal Code* definition nor satisfy the test for the tort of deceit, which is consistent with the administrative nature of the proceedings.[12]



Of relevance to the status of the AMP proceedings, the Poonians argued that they were not afforded procedural fairness and denied natural justice before the Commission in the liability and sanctions hearings. Given that the parties in those administrative proceedings were the same parties before the Court in *Poonian*, the doctrines of issue estoppel and *res judicata* applied.

Comment

The extent to which the decisions in *Hennig* and *Poonian* will apply in other jurisdictions such as Ontario remains to be seen. And of course, each case must be evaluated on its own facts.

I am sympathetic to the notion that persons found to have committed fraud in administrative proceedings should not be able to escape AMPs in relation to that fraud by simply declaring bankruptcy. I do, however, have some concerns related to the burden of proof issue. Simply put, the balance of probabilities standard applies for fraud in an AMP proceeding, and there is not a higher “clear and convincing” standard that applies. The finding of fraud will be on a 50.1% basis.

Where the legislation in issue contains no statutory provision relating to the requisite standard, the default standard of proof will be based upon the classic balance of probabilities as articulated by the Supreme Court of Canada in *F.H. v. McDougall*.^[13] For example, the Ontario *Securities Act* s. 127, which provides for orders in the public interest, is silent about the standard of proof; accordingly the standard of proof applicable to Securities Commission proceedings is the balance of probabilities.^[14] That civil standard should remain uncluttered from any reference to the phrase “clear and convincing”. As a mathematical concept, the clear and convincing test of 75% obviously cannot be a subset of a balance of probabilities standard of 50.1%.^[15]

The survival of the AMP post-bankruptcy may have very significant repercussions for individuals. Unlike a finding in a criminal Court beyond a reasonable doubt, the finding of fraud in administrative proceedings will have been made on a balance of probabilities. Moreover, the finding is not by a Court but rather by an administrative tribunal with lower procedural protections than those in a court.

In another forum I have argued that for serious AMPs, the legislature should consider enacting a higher clear and compelling standard of proof.^[16] Such a recommendation would be consistent with the power of such AMPs to survive a bankruptcy. A PDF version is available to download [here](#).

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[1] *Meharchand (Re)*, 2019 ONSC 7, 42 O.S.C.B. 1135, 2019 CarswellOnt 1504 (Ont. Securities Comm.).

[2] *Alberta Securities Commission v. Hennig* [2020] A.J. No. 73

[3] *Alberta Securities Commission v. Hennig* [2020] A.J. No. 73 at paragraph 13.

[4] Securities Act, *RSA 2000*, c S-4, s. 1(gg), s. 1(ii), s. 38(6), s. 200

[5] *Guindon v. Canada* 2015 SCC 41

[6] *Alberta Securities Commission v. Hennig* [2020] A.J. No. 73 at paragraph 31.

[7] *Alberta Securities Commission v. Hennig* [2020] A.J. No. 73 at paragraph 60.

[8] *Alberta Securities Commission v. Hennig* [2020] A.J. No. 73 at paragraph 76.

[9] *Poonian (Re)*. [2021] B.C.J. No. 609 | 2021 BCSC 555

[10] *Poonian (Re)*. [2021] B.C.J. No. 609 | 2021 BCSC 555 at paragraph 92.

[11] *Poonian (Re)*. [2021] B.C.J. No. 609 | 2021 BCSC 555 at paragraph 112.

[12] *Poonian (Re)*. [2021] B.C.J. No. 609 | 2021 BCSC 555 at paragraphs 105–106.

[13] *F.H. v. McDougall*, 2008 SCC 53, [2008] 3 S.C.R. 41, 297 D.L.R. (4th) 193 (S.C.C.).



[14] *Hutchinson (Re)*, 2019 ONSEC 36, 42 O.S.C.B. 8543, 2019 CarswellOnt 17398 (Ont. Securities Comm.) at para. 56, additional reasons 2020 ONSEC 1, 43 O.S.C.B. 431, 2020 CarswellOnt 30, citing *F.H. v. McDougall*, 2008 SCC 53, [2008] 3 S.C.R. 41, 297 D.L.R. (4th) 193 (S.C.C.) at paras. 40, 46 and 49; *Azeff, Re*, 2015 ONSEC 11, 38 O.S.C.B. 2983, 2015 CarswellOnt 4300 (Ont. Securities Comm.) at paras. 41-42, reversed in part *Finkelstein v. Ontario (Securities Commission)*, 2016 ONSC 7508, 135 O.R. (3d) 590, 274 A.C.W.S. (3d) 656 (Ont. Div. Ct.), reversed in part 2018 ONCA 61, 421 D.L.R. (4th) 278, 139 O.R. (3d) 161 (Ont. C.A.), leave to appeal refused *Howard Jeffrey Miller v. Ontario Securities Commission*, 2018 CarswellOnt 21507, 2018 CarswellOnt 21508 (S.C.C.).

[15] Todd Archibald and Kenneth Jull "CLEAR AND CONVINCING"EVIDENCE CANNOT RESIDE IN THE HOUSE OF BALANCE OF PROBABILITIES: A SCIENTIFIC APPROACH" 51 *The Advocates' Quarterly* 315 (March 2021).

[16] Todd Archibald and Kenneth Jull "CLEAR AND CONVINCING"EVIDENCE CANNOT RESIDE IN THE HOUSE OF BALANCE OF PROBABILITIES: A SCIENTIFIC APPROACH" 51 *The Advocates' Quarterly* 315 (March 2021).

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