# SUPREME COURT OF CANADA

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## Case in Brief: *Chandos Construction Ltd. v. Deloitte Restructuring Inc.*

**Judgment of October 2, 2020 | On appeal from the Court of Appeal of Alberta**
**Neutral citation: 2020 SCC 25**

***A company couldn't make a bankrupt company it had a contract with pay a penalty just because of the bankruptcy, the Supreme Court has ruled.***

When a company can't pay all of its bills, it can file for bankruptcy. When this happens, everything it owns is given to a "trustee." The trustee decides how to divide everything among the people the company owes money to. The rules for doing this are set out in the *Bankruptcy and Insolvency Act*, a federal law.

Chandos Construction signed a contract with Capital Steel. It was worth almost $1.4 million. Part of the contract said Chandos would get money if Capital Steel went bankrupt. The contract would be frozen and Capital Steel would have to pay Chandos for anything it lost, plus extra for overhead and profit. The contract also said Capital Steel would have to pay Chandos 10% of the contract price (that is, about $140,000) for the inconvenience.

Capital Steel went bankrupt. At the time, Chandos owed Capital Steel about $150,000 on the contract. But it said Capital Steel actually *owed it* over $10,000. This was because of the costs and the 10% inconvenience fee that the contract said Capital Steel had to pay if it went bankrupt. This added up to more than was left on the contract.

The trustee asked the court if this was allowed. The application judge said yes. The majority of the Court of Appeal said no. This was because it broke the "anti-deprivation rule." The anti-deprivation rule says any part of a contract that takes away (that is, *deprives* the trustee of) some of what the bankrupt company owns isn't allowed.

The majority of judges at the Supreme Court agreed with the Court of Appeal. They said there are two reasons why part of a contract might be found invalid during a bankruptcy. The first is where the contract gives some people who are owed money more than their fair share, so they get bigger slices of the pie than they deserve. This is called the "*pari passu* rule." The second is when part of the pie is taken away so the whole pie is shrunk before it can even be sliced. This is the situation covered by the anti-deprivation rule.

The majority said that the anti-deprivation rule had been part of Canadian law since the 1870s. It was part of "common law," not legislation. Common law is law made by courts when there is no legislation (laws passed by Parliament or legislatures). It can also help interpret and apply legislation. Common law can't go against legislation. It is just there to fill in the gaps, keeping with the spirit of what Parliament or the legislature wanted. Legislation can change common law, though. But in this case, the majority said the common law was never changed, even by the *Bankruptcy and Insolvency Act*.

The majority said the Act's purpose was to make sure the trustee had as much as possible to give to people who were owed money. The anti-deprivation rule helps make sure this happens. It stops people from writing contracts to get around the rules in the Act.

When deciding if something broke the anti-deprivation rule, the majority said that courts should look at its effect. They shouldn't look at what the parties wanted, or said they wanted, at the time they came to an agreement. First, it would be hard to know or prove what people wanted if a contract was signed a long time ago. Second, a contract could still have the effect of hurting others who were owed money, even if no one meant for that to happen. This would still be wrong.

However, the majority said the anti-deprivation rule might not be broken where someone agreed to give up physical property (not money). Agreeing to get insurance, or a putting up money (security) as a guarantee for the contract, might also be allowed.

The majority said that Chandos wasn't allowed to reduce what it owed to Capital Steel by deducting the inconvenience fee amounts. Capital Steel didn't actually owe Chandos any money, so there was nothing to deduct.

Bankruptcy is a complicated process, and often involves many companies, people, and issues. The Court previously dealt with bankruptcy's effect on companies' environmental obligations in *Orphan Well Association v. Grant Thornton Ltd.* and *Resolute FP Canada Inc. v. Ontario (Attorney General)*. It dealt with bankruptcy's effect on shareholders in *Brunette v. Legault Joly Thiffault*.

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**Breakdown of the decision:** ***Majority:*** Justice Malcolm Rowe dismissed the appeal (Chief Justice Wagner and Justices Abella, Moldaver, Karakatsanis, Brown, Martin, and Kasirer agreed) | ***Dissenting:*** Justice Suzanne Côté would have allowed the appeal, saying the anti-deprivation rule shouldn't apply where there is a real commercial purpose for the agreement

**More information (case # 38571):** Decision | Case information | Webcast of hearing

**Lower court rulings**: application for advice and direction (Court of Queen's Bench of Alberta, not available online) | appeal (Court of Appeal of Alberta)

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