CROWN PRIORITY IN INSOLVENCY

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Crown Priority: An Overview

1. INTRODUCTION

As mentioned in the preface, the state is entitled at common law to a priority in respect of certain debts owed to it. In this chapter, the nature and extent of the common-law priority is examined. The manner in which it has been diminished or augmented in Canada by provincial and federal statutes is also outlined. Finally, the federal bankruptcy provisions that are relevant to the following discussion are set out, and a few straightforward points respecting the effect of bankruptcy on various common-law and statutory rights of priority are dealt with.

2. CROWN PRIORITY AT COMMON LAW

(a) Definition of "the Crown"

In Canadian legal literature, "the Crown" is a term of art meaning Her Majesty Queen Elizabeth II in her public capacity as "Sovereign of the United Kingdom, Canada, and Her Other Realms and Territories and Head of the Commonwealth."[1] References to "the Crown" in right of Canada or a province can signify either the Queen or her representative[2] exercising her own discretion or acting on the advice of her federal

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1 Interpretation Act, R.S.C. 1970, c. I-23, s. 28 ; Interpretation Act, R.S.O. 1980, c. 219, s. 30.

2 That is, the Governor General of Canada or the Lieutenant Governor of a province.

or provincial Ministers, or Ministers acting on behalf of Her Majesty. In effect, then, the expression "the Crown" is synonymous with "the government" of Canada or a province, and describes:

> the corporate legal entity to which the law ascribes the legal rights and obligations of the various semi-sovereign units of government created by the British North America Act.[3]

(b) Nature and Extent of Common-Law Priority

Historically, the English common law recognized the entitlement of the Crown to a number of rights, powers, privileges and immunities not shared by other persons and described collectively as "the royal prerogative". Blackstone referred to the prerogative as "the special pre-eminence which the King hath, over and above all other persons, and out of the ordinary course of the common law, in right of his regal dignity."[4] More recently, V.A. Dicey defined it as "both historically and as a matter of actual fact nothing else than the residue of discretionary or arbitrary authority which at any given time is legally left in the hands of the Crown."[5] To the extent that the prerogative has not been limited or abolished by statute, it continues to be recognized by the courts in the common-law provinces of Canada and in England.[6]

Included as part of the royal prerogative is the proposition that "[w]here the Crown's right and that of a subject meet at one and the same time, that of the Crown is in general preferred, the rule being "*detur digniori*" "[7] or "let it be given to the worthier." It is apparently from this general right that the rule has arisen that, in a competition between debts of equal degree owed to the government and to a subject, the claim of the Crown is entitled to preference.[8] The Crown has traditionally been permitted to enforce this right by use of a prerogative remedy, the writ of extent.[9]

The extent of the prerogative right of priority has been considered

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3 Dale Gibson, "Interjurisdictional Immunity in Canadian Federalism" (1969), 47 *Can. Bar. Rev.* 40 at 41.

4 Blackstone, *Commentaries*, vol. I, at p. 239.

5 A.V. Dicey, *Law of the Constitution*, 10th ed. at 424.

6 E.g., *Maritime Bank of Can. (Liquidators)* v. *New Brunswick (Receiver General)*, [1892] A.C. 437 at 441 (P.C.). As to the position in Quebec, see *Exchange Bank of Can.* v. *The Queen* (1885), 11 A.C. 157 (P.C.).

7 *Halsbury*, 4th ed., vol. 8, (1974) at p. 666.

8 *R.* v. *Bank of N.S.* (1885), 11 S.C.R. 1 at 10.

9 *Food Controller* v. *Cork*, [1923] A.C. 647 (H.L.).

in numerous cases. Determining when the claims of the Crown and a subject are "of equal degree" has caused particular problems. In *Re Henley & Co.*,[10] counsel suggested that the phrase referred to the now obsolete distinction between debts due by specialty (that is, under seal) or on record and simple contract debts, but the point was not really decided. It now appears to be accepted that the words "of equal degree" refer to the equal status of debts as unsecured. The prerogative right of priority relates only to claims *in personam* and not *in rem*;[11] in order for the government to be successful in asserting priority under the prerogative rule, both its debt and the debt of its subject must be unsecured. The Crown prerogative has been upheld in cases involving the competition of unsecured claims of the state with private judgments.[12] However, attempts to establish a prerogative priority for ordinary Crown debts or judgments over previous security interests have generally failed. In *Household Realty Corp. Ltd.* v. *Attorney General of Canada; MacCulloch and Co.* v. *Attorney General of Canada*,[13] for example, the Supreme Court of Canada held that the claim of a second mortgagee of land was of higher degree than a Crown claim pursuant to a subsequently-recorded judgment.[14]

Some recent Anglo-Canadian cases have shown an inclination to deny the Crown a priority respecting debts arising out of an ordinary business transaction between the government and a private person, as opposed to debts arising from the imposition of a tax or the exercise of some other truly governmental function. The leading case dealing with this question is *Food Controller* v. *Cork*,[15] a House of Lords decision. The facts giving rise to the case were that the Food Controller, an official of the Ministry of Food in World War I England, had appointed a private company as his agent to sell frozen rabbits imported into England from Australia by the Board of Trade. In the liquidation of the company, the Food Controller claimed to be entitled to recover the amount of purchase moneys collected by the company and not yet remitted to him in priority to debts due to other creditors of the company. The members of the House of Lords found that the prerogative right of priority had been

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10 (1878), 9 Ch. D. 469 at 472 (C.A.).

11 E.g., *Montreal Trust* v. *The King*, [1924] 1 D.L.R. 1030 at 1031 (C.A.).

12 E.g., *supra*, note 8; *Crowther* v. *A.G. Can.* (1959), 42 M.P.R. 269 (N.S.C.A.); *Prince Edward Island* v. *J.A. Hughes Construction Ltd.* (1977), 12 Nfld. & P.E.I.R. 425 (P.E.I.C.A.); *Re Marten; Royal Bank of Can.* v. *The Queen* (1981), 40 C.B.R. (N.S.) 46 (Ont. S.C.).

13 [1980] 1 S.C.R. 423.

14 See also *Uniacke* v. *Dickson*, (1848), 2 N.S.R. 287 (C.A.); *Bartlet* v. *Osterhout* (1931), 12 C.B.R. 340 (Ont. S.C.). *Re Downe* (1972), 3 Nfld. & P.E.I.R. 496 (P.E.I.T.D.).

15 *Supra*, note 9.

abolished in liquidations by the applicable winding-up legislation, but expressed grave doubts that the royal prerogative would have extended to the debt anyway. Lord Shaw of Dunfermline stated:

> My Lords, I venture to interpose much doubt as to the application or extension of the expression used by Macdonald C.B., "that where the King's and the subject's title concur the King's shall be preferred," and the modernization of it given by Lord Macnaghten [in *Commissioners of Taxes for New South Wales* v. *Palmer,* [1907] A.C. 179], to cases of ordinary commercial or industrial contracts entered into by a Government department in the course of the business or enterprise which it carries on.[16]

Lord Shaw noted that the *Palmer* case had dealt with an amount of taxes owing to the Crown, this being clearly a "Crown debt", but remarked with respect to the nature of the debt in the case before him:

> How is this a Crown debt? It springs out of no power vested in the Crown by way of the imposition of a duty or a tax. It is not in the ordinary enumeration of debts incurred for the service of the country. It is an instance simply of a debt arising under ordinary transactions of principal and agent. . . .
>
> It is unnecessary in this case to commit oneself to the proposition that when Departments of Government enter into the commercial or industrial sphere they do so with such an enormous leverage against all competitors or subjects of the Crown.[17]

In *Re K.L. Tractors Ltd.*,[18] dealing with a Crown claim arising from the supply of tractor parts by the Australian government to a private company, an Australian court rejected the *dicta* in the *Food Controller* case. It held that the right to assert the prerogative did not depend on the nature of the obligation owed to the government, but on the fact that the competing creditors were the Crown and its subject. In the Canadian decision of *R.* v. *Workmen's Compensation Board and the City of Edmonton*,[19] however, Buchanan C.J.D.C. adopted the views set forth in the *Food Controller* case and stated that a Crown claim asserted for a loan made "in the course of the financial or banking business carried on by the Treasurer [of the Treasury Branch of Alberta] is not of the kind or nature held from earliest times to be included in or covered by the royal preroga-

16 *Ibid.* at 666.
17 *Ibid.* at 667–68.
18 (1961), 106 C.L.R. 318 (Aust. H.C.).
19 (1962), 36 D.L.R. (2d) 166 (Alta. Dist. Ct.); affirmed on this point (1963), 40 D.L.R. (2d) 243 (Alta. C.A.).