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## Public Issues in a Private Law World: The Appointment of a Receiver as a Case Study

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## Public Issues in a Private Law World: The Appointment of a Receiver as a Case Study

### Abstract

This essay aims to bypass the doctrine/policy approach to contemporary legal analysis. Instead of resting content with an elaboration of legal doctrine, the authors incorporate social and economic evidence surrounding the call of a demand loan. This evidence creates an understanding of the practice of receivership law; a practice which legal doctrine inadequately describes. Secondly, instead of being content with an assertion of policy, the authors attempt to understand the practice by assessing the evidence in the light of the Greek forms of corrective justice and distributive justice.

### Keywords

Receivership; Canada

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# PUBLIC ISSUES IN A PRIVATE LAW WORLD: THE APPOINTMENT OF A RECEIVER AS A CASE STUDY\*

BY WILLIAM E. CONKLIN\*\* AND JODI J. MORRISON\*\*\*

This essay aims to bypass the doctrine/policy approach to contemporary legal analysis. Instead of resting content with an elaboration of legal doctrine, the authors incorporate social and economic evidence surrounding the call of a demand loan. This evidence creates an understanding of the practice of receivership law; a practice which legal doctrine inadequately describes. Secondly, instead of being content with an assertion of policy, the authors attempt to understand the practice by assessing the evidence in the light of the Greek forms of corrective justice and distributive justice.

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The views expressed in this paper are those of the authors and should not be taken as representing the views of the Ministry of the Attorney General, the Ontario Law Reform Commission, or any other branch of the Ontario government.

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## I. INTRODUCTION

Few Canadian businesses exist for any length of time without the need for bank financing.<sup>1</sup> Implicit in the decision to provide

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<sup>1</sup> W. Grover & D. Ross, *Materials on Corporate Finance* (Toronto: Richard DeBoo, 1975) at 119. Indeed, bank financing is so much a part of current corporate law practice that the organizational proceedings of virtually every newly incorporated company provide for appropriate borrowing by-laws and banking resolutions in a form provided by the bank. P. Papadopoulos, "Economic Role of our Banks" (1980) 87 Can. Banker & ICB Rev. 20 at 22. Without citing authority, Peter Newman suggests that the chartered banks have in excess of \$40 billion in loans at any time. See P. Newman, *The Canadian Establishment*, vol. 1 (revised and updated; Toronto: McClelland & Stewart, 1979) at 96.

financing is the expectation on the part of the financial institution that it will be repaid in the ordinary course of business. However, should the need arise, a financial institution is generally well prepared to coerce repayment through the exercise of its rights as a secured creditor, particularly through the appointment of a receiver/manager. The authority of the financial institution to appoint a receiver typically derives from the terms of a demand debenture, signed by the borrower, permitting such appointment in the event that the borrower does not repay the loan *upon demand*. While a receiver may be appointed and supervised by the court (which seems to be the normal practice in British Columbia), the normal practice in Ontario is for the receiver to be appointed privately by the secured creditor pursuant to the terms of the debenture. Once appointed, the receiver administers or manages the business for the purpose of selling the debtor's assets in order to repay the secured creditor.

Few lawyers would disagree that the appointment of a receiver and the overriding contract exemplify the lawyer's intuitive notion of private law. Why it is considered *private* law is not our immediate concern. But, upon labelling an area of law as private, as opposed to public, the lawyer intuitively considers the private law rules as immune from social or public scrutiny except via an excursus into the world of policy. Policy, in turn, is considered outside of the "real" law in an "ought" world of political values. Rules constitute reality. Policy goes to an "ought" world. When faced with the claim that public issues really do exist in the private law world, the lawyer naturally reacts that the parties have chosen to limit their general right to be free by signing the contract. That contract identifies conditions that, in turn, define harm. There is undoubtedly a public element to the private contract. When lawyers or courts construe its terms, for example, they sometimes appeal to "public policy." When a court appoints a receiver, the receiver takes on the role of a "public officer." But for some mysterious reason, no doubt lying deep within our legal consciousness, the lawyer retains his or her label of the area as "private law." By signing the contract, the parties agree to incorporate the "real" world of legal rules and to exclude "policy" or "ought" considerations. To consider public issues in the "private law" area would trigger the "ought" policy world. Or, so the lawyer has assumed to be the case.

This paper aims to demonstrate how one can identify the public issues in this private law world by by-passing the rule/policy distinction.<sup>2</sup> Instead of focusing upon a "rules-oriented" examination of the law, we use judicial decisions and the resultant legal rules as a supplement to a far wider context grounded in Aristotle's "forms of justice."<sup>3</sup> We shall identify the issues of justice without resolving them, leaving the latter for another day.

We consciously use the word "justice," not policy. The term "policy," again, ushers forth connotations of preference, prejudice, ideals, values, and unsubstantiated opinion in an "ought," subjective political world that law schools used to teach us to leave to the legislature. If we wish to criticize the rules, we are led, of necessity, into the legislature's world of preference — or, so the rules/policy orientation leads us to believe. We claim that this rule/policy conundrum falsely describes the alternatives actually available in legal analysis. Accordingly, we use the judicially created rules only to supplement more diversified resource material which can better inform us of the actual practice of the actors. More importantly, drawing from the eminent scholarship of Ernest Weinrib,<sup>4</sup> Christopher Arnold,<sup>5</sup> Kent Greenawalt,<sup>6</sup> and John Finnis,<sup>7</sup> we replace the rules/policy dichotomy with the far richer tradition of the forms of justice. We wish to demonstrate how the "forms of justice" can help us better identify the public issues in the private law world.

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<sup>2</sup> Why it is critical for lawyers to by-pass the rule/policy conception of law is explained in W.E. Conklin, "The Legal Theory of Horkheimer and Adorno" (1986) 5 Windsor Y.B. Access Just. 230.

<sup>3</sup> See generally, Aristotle, *Ethics*, book V and *Politics*, 1280-1284b.

<sup>4</sup> E. Weinrib, "Liberty, Community and Corrective Justice" (1988) 1 Can. L. & Juris. 3; "Legal Formalism" (1988) Yale L.J. 949; "The Insurance Justification and Private Law" (1985) 14 J. Leg. Stud. 681; "The Intelligibility of the Rule of Law" in A. Hutchinson & Patrick Monahan, eds, *The Rule of Law: Ideal or Ideology?* (Toronto: Carswell, 1987) 59 at 59-84; "Toward a Moral Theory of Negligence Law" (1983) 2 J. L. & Phil'y 37.

<sup>5</sup> C. Arnold, "Corrective Justice" (1980) 90 *Ethics* 180.

<sup>6</sup> K. Greenawalt, *Discrimination and Reverse Discrimination* (New York: Alfred A. Knopf, 1983) c. 8, 9.

<sup>7</sup> J. Finnis, *Natural Law and Natural Rights* (Oxford: Clarendon Press, 1982) c. 7.

## II. CURRENT DOCTRINE AND PRACTICE OF RECEIVERSHIP

### A. *General*

Traditional legal analysis in the common law jurisdictions of Canada begins with judicial decisions and statutes as the basic resource material and focal point of examination. Let us take this familiar route for the moment. As with any discussion of contractual rights, one should begin with the terms of the agreement. In particular, when considering the terms of a demand debenture, one should take into account primarily the promise to pay provision, the enumerated events of default, and the contractual rights of the secured creditor upon default.

In the typical promise-to-pay clause, the borrower promises to pay, "on demand," a stated sum of money together with interest at a specified rate. A common variation of the basic covenant provides that the borrower promises to pay, on demand, the principal sum plus interest "on presentation and surrender" of the debenture at a specified place (usually a particular branch of the bank). The debenture then sets out the events of default upon the happening of which the security becomes enforceable. Invariably a default in the payment of principal or interest under the terms of the debenture will trigger default. The debenture will often identify other conditions that will trigger default: bankruptcy; insolvency; winding-up or liquidation of the corporation; breach of a condition contained in the debenture; the levy of execution or similar process against the assets of the borrower; or the occurrence of a material and adverse change in the financial position of the borrower. The debenture will ordinarily provide that, in addition to certain other remedies, the secured creditor may appoint a receiver once the security becomes enforceable.

## B. Default and the "Reasonable Time" Requirement

It is the occurrence of an event of default that renders the security enforceable; and once the security becomes enforceable, it authorizes the appointment of a receiver. In the absence of an event of default, the security does not become enforceable. Accordingly, any appointment of a receiver is unlawful, thereby subjecting the receiver to liability for trespass and conversion. For the purposes of the present discussion it is convenient to deal with the existence of default under two headings: (a) default in payment after a valid demand therefor has been made; and (b) occurrence of one of the other events of default noted above.

### 1. Default in payment after demand

Assuming that a demand has been made that satisfies the express requirements contained in the debenture and that it is therefore technically effective,<sup>8</sup> it is now quite clear that the borrowing corporation must be afforded a reasonable time within which to meet that demand. The reasonable time doctrine seems to have taken its initial foothold with the following comment in the trial decision in *Ronald Elwyn Lister Ltd v. Dunlop Canada Ltd*:

[W]here money is payable on demand, the debtor is entitled to a reasonable time to meet the demand, the question of what is reasonable being a question of fact to be determined in the circumstances of the particular case.<sup>9</sup>

At the Court of Appeal the reasonable time doctrine received approval in the following terms:

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<sup>8</sup> For an example of a case in which a demand was rendered invalid as a result of a failure of the bank to present the debenture in accordance with its terms, see *Royal Bank of Canada v. Cal Glass Ltd* (1979), 18 B.C.L.R. 55, 9 B.L.R. 1 (S.C.), aff'd 22 B.C.L.R. 328 (C.A.). See also *Seawater Products (Nfld.) Limited v. Royal Bank of Canada* (1980), 36 C.B.R. (N.S.) 21, in which the debenture was presented for payment, as required by the debenture, but not at the location stipulated.

<sup>9</sup> (1978), 28 C.B.R. (N.S.) 128 [hereinafter *Lister*].



The law is clear that a debtor must be given a reasonable time to meet a demand for payment before a creditor may enforce his security. What is a reasonable time depends upon the terms of the security agreement and the circumstances of the case.<sup>10</sup>

Although the doctrine thus received appellate approval, it did so with one significant modification: a reasonable time was only to be afforded to those who had the good fortune, good sense, or good advice to request it:

Since the company could not meet Dunlop's demand for payment of 20th March, I think it was incumbent on Lister to say, "Hold on, I will find the money and lend it to the company." Instead, he emphasized that the Autopar stock did not belong to the company and should not be seized by the receiver. In these circumstances I think that Dunlop was not required to give time to the company to borrow money with which to pay up the indebtedness, unless time had been asked for, and it was not.<sup>11</sup>

Prior to both the Court of Appeal and the Supreme Court of Canada decisions in *Lister*, the issue again came before the Ontario High Court in *Mister Broadloom Corporation (1968) Ltd v. Bank of Montreal*.<sup>12</sup> It is important to quote from this case at some length. Mr. Justice Linden takes the opportunity to inject the calling of demand bank loans and the enforcement of security with an atmosphere of reasonableness:

When money is "payable on demand," what does this mean? Does it mean that the money must be paid immediately, or does it mean that it must be paid within a reasonable time thereafter? Clearly, the debtor does not have the right in every case to get as much time as he needs to see if he can raise the money ... If he did, a demand note would be useless. But neither can a creditor expect the debtor to have the money ready in his pocket to hand over instantly, especially if a large sum is involved. Even the strictest of the old cases permits the debtor enough time to go and get the money from his desk or from his bank... Between these two poles, it is not easy to determine how much time a debtor has to pay the money when it is demanded. It is clear that it need not be paid instantaneously. It is also clear the debtor cannot pay it at his leisure. A reasonable time always had to be given, and what is a reasonable time has always depended on the circumstances... More recently our courts appear to have extended the time allowed, in appropriate cases,

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<sup>10</sup> (1979), 32 C.B.R. (N.S.) 4 at 16.

<sup>11</sup> *Ibid.* at 19.

<sup>12</sup> (1979), 25 O.R. (2d) 198, 7 B.L.R. 222, 32 C.B.R. (N.S.) 241 (H.C.J.). [hereinafter *Mister Broadloom* cited to C.B.R.].

to "at least a few days in which to meet the demand".... The reason for this may be the increasing complexity of arranging for the payment of large sums of money today and the additional time now required to do so. This does not mean, of course, that a debtor is entitled as a matter of right in every demand situation to a few days to meet the demand. As is so often the case, the amount of time that will be allowed will depend on the individual circumstances of each situation.<sup>13</sup>

One should note that, at least in part because the debtor neither requested time nor made adequate proposals for payment, Linden J. ultimately came to the conclusion that the forty to fifty minutes afforded to the debtor to meet an unexpected demand for payment of \$1,500,000 was a reasonable time.

At the Supreme Court of Canada in *Lister*,<sup>14</sup> the doctrine of reasonable notice was reaffirmed, with some modification and some elaboration. Mr. Justice Estey made it quite clear that not only is the debtor entitled to a reasonable time to meet a demand for payment, but that such notice must not be illusory: the debtor is entitled to such notice as will afford it a reasonable opportunity to act, although precisely what constitutes such notice in any particular case will depend upon all the facts and circumstances.<sup>15</sup> Further, the appellants were entitled to such notice notwithstanding their failure to request time to pay: "[t]his technical or mechanical acquiescence in no way eliminated, by waiver, acquiescence or otherwise, the appellants' entitlement to reasonable notice."<sup>16</sup>

The hearing of the appeal in *Mister Broadloom*<sup>17</sup> was delayed, awaiting the Supreme Court of Canada's decision in *Lister*. The Ontario Court of Appeal then took the opportunity to restate the principles enunciated in *Lister* by the Supreme Court of Canada, thus recanting its earlier opinion that the debtor must ask for time to pay when the demand is made.

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<sup>13</sup> *Ibid.* at 251-52 of C.B.R.

<sup>14</sup> (1982), 135 D.L.R. (3d) 1, 41 C.B.R. (N.S.) 272.

<sup>15</sup> *Ibid.* at 288 of C.B.R.

<sup>16</sup> *Ibid.* at 289 of C.B.R.

<sup>17</sup> (1983), 49 C.B.R. (N.S.) 1 (Ont. C.A.).

While *Lister* and *Mister Broadloom* have been the two cases primarily associated with the reasonable time doctrine, other cases have begun to expand on the basic proposition. For example, in *Four-K Western Equipment Ltd v. Canadian Imperial Bank of Commerce*,<sup>18</sup> it was held that the right to a reasonable time could be waived, for "[t]o hold that reasonable notice could not be waived would be impractical to business."<sup>19</sup> In *Bank of Montreal v. Petronech*,<sup>20</sup> it was held that even though a failure to grant a reasonable time to pay after a demand from the principal debtor may relieve a guarantor of his or her obligations, the guarantor may contract out of such rights. Several other cases dealing with the notion of a reasonable time, referred to below, assist only to the extent they provide insight into the application of the doctrine within the particular factual context.

On the basis of the foregoing we may conclude that, notwithstanding the fact that a debenture, by its express terms, is payable "on demand," the debtor is entitled to a reasonable time after demand within which to pay. Although a reasonable time must be afforded to the debtor whether or not it is requested, the right is capable of being waived by the debtor. The time permitted to the debtor is such that it must be sufficient to afford him a reasonable opportunity to act and must not be merely illusory. Finally, precisely what constitutes reasonable time is a matter to be determined upon all the facts and circumstances of each individual case.

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<sup>18</sup> (1983), 46 C.B.R. (N.S.) 146 (B.C.S.C.) [hereinafter *Four-K*].

<sup>19</sup> *Ibid.* at 161. See also, *Continental Bank of Canada v. Maple Leaf Helicopters Ltd* (1983), 50 C.B.R. (N.S.) 265 (B.C.S.C.), in which the appointment of a receiver was held to be valid, at least in part, because the actions were taken with the consent of the debtor. However, see *Moose Produce Limited v. Royal Bank of Canada* (1986), 59 C.B.R. (N.S.) 300 (P.E.I. S.C.) where, at page 308, it was said that "the right to reasonable time to pay should not easily be taken as having been waived." An acknowledgement, signed by the debtor, was held not to constitute an effective waiver because the bank had prepared the document, it contained false and nonsensical statements, and the company received no consideration for signing it.

<sup>20</sup> (1984), 52 C.B.R. (N.S.) 17 (Alta. Q.B.) [hereinafter *Petronech*]. See also, *Nobes v. Royal Bank of Canada* (1982), 16 B.L.R. 289 (N.S.S.C. App. Div.). In this case Macdonald J.A. stated, at 301, that "even assuming lack of demand, improper notice and resulting wrongful entry the learned trial Judge has found, and I agree, that there was not, under the circumstances, any prejudice caused the sureties."

## 2. Other events of default

The typical debenture may include a long list of events of default in addition to the failure to pay principal or interest. As a consequence, the question arises whether the debtor is entitled to a reasonable time to pay, after a demand, if the secured creditor relies upon an event of default other than a failure to pay. For example, if a lender seeks to rely upon the insolvency of a corporate borrower or upon some other condition of the debenture (such as a failure to maintain the required financial ratios), must the lender then make a demand for payment and afford the debtor a reasonable time to pay or, alternatively, may the lender simply proceed to enforce its security without further formality? In order to answer this issue, it is suggested that the nature of the reasonable time requirement itself need be considered. More particularly, "is the requirement a condition precedent to enforcement or alternatively a substantive constituent element of default itself?" That is, "is it substantive, going to the question whether or not a default has occurred in the first instance?" Or, alternatively, "is the reasonable time requirement a procedural matter, going rather to the method that a secured creditor must adopt when seeking to enforce its security?" Phrased slightly differently: "What issue is determined by an application of the reasonable time doctrine? Does it resolve the question of whether or not default has occurred, such that there is no default until a reasonable time elapses after demand; or does it resolve the question of whether, after default, the secured creditor has proceeded in a procedurally fair manner in the enforcement of its security?"

If the former interpretation is correct and the requirement constitutes a substantive element of default (that is, that there is no default until the expiration of a reasonable time after demand), then one may legitimately conclude that the reasonable time requirement ought not to be extended to the other events of default. If there is no default until after both demand and lapse of a reasonable time, the creditor is then entitled to proceed to enforce its security immediately after default has occurred. By inference, there would appear to be no legitimate basis upon which the requirements of

demand and reasonable time could then be imposed on the other events of default. That is, if the reasonable time requirement is indeed a substantive element of default rather than a procedural condition of enforcement, the secured creditor could proceed to enforce its security immediately.

In contrast, an application of the alternative theory leads to a much different result. If the essential nature of the reasonable time requirement is procedural rather than substantive, then there is a default rendering the security enforceable upon demand and failure to pay. At that point, the reasonable time requirement ensures that the secured creditor proceeds to enforce its security in a fair manner. On this interpretation, it ought not to matter why the security becomes enforceable; it might become enforceable due to a failure to pay or some other event of default. The security having become enforceable, the secured creditor is simply constrained in the manner in which it may exercise its rights.

Although the courts may not have analyzed the issue in quite this way, some judicial support can be found for both interpretations. In *Seawater Products (Nfld.) Limited v. Royal Bank of Canada*, Goodridge J. indicated that he "would not consider that there was a default in respect of the demand for payment of the principal sum because, if for no other reason, no reasonable time was given within which to meet the demand."<sup>21</sup> In the trial decision in *Lister*, Rutherford J. had come to the same conclusion. In his opinion, although the demand for payment did render the amount under the debenture due and payable, it did not, of itself, render the security enforceable, unless the debtor had failed to pay in accordance with the demand and unless the debtor had a reasonable time within which to do so.<sup>22</sup> Rutherford J. concluded that the "plaintiff was entitled to a reasonable time to comply with Dunlop's demand under the debenture before the security became enforceable and, unless the security was enforceable, there was no authority to

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<sup>21</sup> (1980), 36 C.B.R. (N.S.) 21 at 34 [hereinafter *Seawater Products*].

<sup>22</sup> *Supra*, note 9 at 154.

appoint a receiver...."<sup>23</sup> Thus, without reasonable time to pay, there had been no default.<sup>24</sup>

On the other hand, while there is this support for the position that the reasonable time requirement is a substantive element of default, going to the question of whether an event of default has occurred, the weight of authority seems to be to the contrary. In the *Lister* case itself, both the Court of Appeal and the Supreme Court of Canada differed with Mr. Justice Rutherford on this issue. It is in the judgment of Weatherston J.A. that we begin to find a willingness to separate the contractual notions of default and enforceability from the actual ability of the secured creditor to proceed to enforce its security. Weatherston J.A. concluded that

[i]t may well be that the security became enforceable when default occurred, but that does not answer the question how soon Dunlop could move to enforce the security.... I think that the terms of s. 6.1 [the events of default contained in the debenture] should be construed as meaning that, although the security became enforceable, it would not be enforced until the debtor had been given a reasonable time to make payment of the amount due.<sup>25</sup>

Speaking for the Supreme Court of Canada, Estey J. was of the same opinion. In his judgment, there was no doubt that an event of default had occurred and that the security had become enforceable. The only issue respecting the enforcement of the debenture was that the holder "adopted a wrongful procedure in [the] enforcement proceedings in that no reasonable time was afforded the company to pay up the moneys secured by the debenture."<sup>26</sup> Clearly, Estey J. characterized the reasonable time requirement as purely one of procedure. Accordingly, the

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<sup>23</sup> *Ibid.* at 155.

<sup>24</sup> See also *Whonnock Industries Ltd v. National Bank of Canada* (1986), 61 C.B.R. 1 at 32. In this case it was held, at page 42, that since the notice was unreasonably short, "[i]t follows that CanAm was not in default of the debenture ... when the notice expired, and as there was no other default alleged under the debenture, the defendant had no right to appoint a receiver."

<sup>25</sup> *Supra*, note 10 at 18.

<sup>26</sup> *Supra*, note 14 at 6 of D.L.R., 278 of C.B.R.

requirement may operate irrespective of the nature of the default relied upon by the secured creditor.

In *Skyrotors v. Bank of Montreal*,<sup>27</sup> Osborne J. adopted the distinction noted by Weatherston J.A. in *Lister*. The right to appoint a receiver, one of the first steps in the enforcement of security, only arises when the security becomes enforceable. That right, in turn, is triggered by the occurrence of an event of default. However, Osborne J. made it clear that "[t]he creditor's right to regard the security as enforceable is not be equated to a right to actually enforce the security."<sup>28</sup>

And again, Fawcus J. emphasized the importance of procedural justice in all cases in *Royal Bank of Canada v. Cal Glass Ltd*<sup>29</sup> In that case Fawcus J. said:

Mr. Molson submitted that where a breach of condition 5(c) occurs [the Company becomes insolvent], then no demand for payment need be made by the plaintiff and therefore that no time, reasonable or otherwise, need be given. However, I agree with the submission of Mr. Hungerford that regardless of the nature of the breach, a demand for payment must always be made. That being so, in my view a reasonable time must then be given to the borrower to meet the demand.<sup>30</sup>

Notwithstanding the trial court judgments in *Seawater* and *Lister*, the only logical conclusion is that the reasonable time requirement goes to the procedure of enforcement, and is not a constituent element of default. The courts generated the requirement out of a judicial desire to ensure procedural justice in the enforcement of security interests. This becomes clear when one

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<sup>27</sup> (1980), 34 C.B.R. (N.S.) 238 (Ont. S.C.) [hereinafter *Skyrotors*].

<sup>28</sup> *Ibid.* at 242.

<sup>29</sup> (1979), 18 B.C.L.R. 55 at 68, 9 B.L.R. 1 at 18 (S.C.), aff'd 22 B.C.L.R. 328 (C.A.) [hereinafter *Cal Glass* cited to B.L.R.].

<sup>30</sup> *Ibid.* See, also, *Moase Produce Ltd v. Royal Bank of Canada*, *supra*, note 19, in which it was held that the creditor must grant the debtor a reasonable time within which to pay, after a demand for payment has been made, even when the default consists of the insolvency of the debtor. In *Canadian Imperial Bank of Commerce v. Quesnel Machinery Ltd* (1985) 39 A.C.W.S. (2d) 28 (B.C.S.C.), default consisted of the breach of three terms of the debenture: (1) permitting operating loans to exceed 100% of assigned accounts receivable; (2) permitting operating loans to exceed 50% of assigned accounts receivable in inventory; and (3) failure to maintain the required net worth. Default having been established, the court continued to consider whether the bank had given sufficient notice of the appointment of the receiver.

looks to the rationale for the requirement as enunciated in the cases. Its basis, according to Osborne J. is "to enable the debtor to redeem its security, and to avoid the stigma and consequences of the imposition of a precipitous receivership."<sup>31</sup> Similarly, in the view of Davies J., the reasonable notice requirement is "to protect a debtor from unannounced, precipitous action of a creditor."<sup>32</sup> If this is indeed the purpose of the reasonable time requirement, as it most certainly must be, then surely the debtor ought to be entitled to the protection provided by the principle irrespective of the nature of the default upon which the creditor relies. Accordingly, the creditor is not prevented from enforcing its security because there has been no default, or because there has been no valid demand for payment (reasonable time not having transpired). Rather, the creditor is prevented from enforcing its security simply because it ought not to be permitted to do so until the debtor has had a reasonable opportunity to avoid the catastrophic consequences of default.

The necessity of making a demand for payment and the necessity of extending a reasonable time within which to make payment are obviously related issues, though separate. One commentator has argued in favour of the necessity of making a demand for payment (and presumably, therefore, the necessity of extending a reasonable time within which to make payment) on the basis that it "makes eminently good sense" and that it "[c]ertainly is not in the best interest of borrowers to allow lenders to move without warning."<sup>33</sup> Of course, as pointed out by Osborne J. in *Skyrotors*, "[i]t is not the demand to pay as such that is significant. What is significant is the time extended to the debtor before action is taken to enforce the security."<sup>34</sup> The requirement of "notice" is an essential part of the entire notion of procedural justice. The reasonable time requirement, the very purpose of which is to permit

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<sup>31</sup> *Supra*, note 27 at 242.

<sup>32</sup> *Supra*, note 18 at 161.

<sup>33</sup> D.R. Johnson, "The Enforcement of Demand Debentures" (1981-82) 6 C.B.L.J. 153 at 167-68.

<sup>34</sup> *Supra*, note 27 at 242.



the debtor to avoid the consequences of default, would be rendered useless and absurd if the creditor did not have to make the debtor aware of default and, more importantly, of the creditor's intention to exercise its rights. If a secured creditor, by a concealed and purely intellectual exercise, were permitted to wait a reasonable time and then proceed, unannounced, to enforce its security, the very rationale for the requirement would be defeated. To realize the procedural justice intended by the reasonable time requirement, the debtor must be put on notice. While the notice may very well consist of a demand under the terms of the debenture, as pointed out by Osborne J., the demand is not particularly significant in and of itself.<sup>35</sup> Rather, it is significant only to the extent that it renders the reasonable time requirement meaningful.

It has been suggested that "[t]his area of the law is in a state of unsatisfactory uncertainty."<sup>36</sup> We suggest that the uncertainty will vanish once it is realized that the reasonable time doctrine is a purely justice-generated requirement, designed to ensure that the debtor is treated in a procedurally fair fashion. The creditor's actions are circumscribed simply because it is just that they be so; the creditor simply ought not to be permitted to enforce its security without first affording the debtor a reasonable opportunity to avoid the consequences of his or her default. The requirement thus being procedural rather than substantive in nature, it becomes clear that the debtor ought to be equally entitled to the protection of the doctrine whether the default consists of a failure to pay or some other event of default enumerated in the debenture. In either case, procedural justice demands that the debtor be put upon notice (by demand or otherwise) that the creditor intends to proceed to enforce its security if payment is not forthcoming within a reasonable time.

### 3. Calculation of reasonable time

Before we can proceed to consider what constitutes a reasonable time we must first answer a more basic question: a

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<sup>35</sup> *Ibid.*

<sup>36</sup> Johnson, *supra*, note 33 at 167.

reasonable time for what? The obvious response one might expect to that question is "a reasonable time to pay." But surely if that is all that is meant, then a reasonable time may very well consist only of the time it takes to write a cheque or other some such illusory protection. A reasonable time must consist of something more if the intent of the requirement is to be effectuated. It must mean a reasonable time within which to make the necessary arrangements to obtain the required funds; that is, a reasonable time in which to refinance the debt. This purpose was recognized by Rutherford J. in the trial decision in *Lister*<sup>37</sup> and has been noted elsewhere.<sup>38</sup> It is also inferred from Linden J.'s assertion that "lenders are more reluctant to lend money to businesses in receivership than they are to other businesses."<sup>39</sup> Even if somewhat understated, it is nevertheless implicit in this comment that the very purpose of the reasonable time doctrine is to permit the debtor to make alternative financing arrangement while it still is able to do so. Only with this purpose in mind can the reasonable time doctrine accomplish its underlying policy.

It has been repeatedly emphasized that what constitutes a reasonable time will depend upon all the facts and circumstances in each particular case, as they existed at the time of enforcement.<sup>40</sup> The factors to be assessed in each individual situation have been set

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<sup>37</sup> *Lister*, *supra*, note 9 at 154.

<sup>38</sup> See, for example, J.I. McLean, "Reasonable Demand" in *Enforcing Debenture Security* (Vancouver: The Continuing Legal Education Society of British Columbia, 1984) 1.3 at 1.3.02 and 1.3.09. See also F. Bennet, "Rights and Remedies of a Debtor in a Receivership" in F. Bennet & J. Berman, eds, *Handbook on Receivership* (Toronto: Insight Educational Services Limited, 1983) at 63.

<sup>39</sup> *Supra*, note 12 at 251 of C.B.R. See also, *Proud and Parkway Volkswagon Ltd v. National Bank of Canada* (1985), 57 Nfld. & P.E.I.R. 14 (P.E.I. C.A.). In this case the bank argued that reasonable notice had been given, if measured from the date of seizure to date of sale. In rejecting the argument, Macdonald J. asked, at 19, "[w]ho would make a loan to a business that had just had all its assets seized and removed from the province?"

<sup>40</sup> See, for example, *Ronald Elwyn Lister Ltd v. Dunlop Canada Ltd* (1982), 41 C.B.R. (N.S.) 272 at 288 (S.C.C.); and (1979), 32 C.B.R. (N.S.) 4 at 16 (C.A.); *Mister Broadloom Corp. (1968) Ltd. v. Bank of Montreal*, *supra*, note 12 at 252, note 17 at 3-4; *Skyrotors*, *supra*, note 27 at 242.

out in the oft-quoted passage from the decision of Linden J. in *Mister Broadloom*:

[I]n assessing what length of time is reasonable in a particular fact situation various factors must be analyzed: (1) the amount of the loan; (2) the risk to the creditor of losing his money or the security; (3) the length of the relationship between the debtor and the creditor; (4) the character and reputation of the debtor; (5) the potential ability to raise the money required in a short period; (6) the circumstances surrounding the demand for payment; and (7) any other relevant factors.<sup>41</sup>

Each factor is to be applied in its turn to the facts of the particular case. In *Mister Broadloom*, the amount demanded was \$600,000. Added to this was the fact that a demand was also being made from a related company, bringing the total amount to be raised by the principals to \$1,500,000. Such a large sum was said to "indicate that a period of time would be needed to arrange for payment."<sup>42</sup> As to the second factor, there appeared to be some real risk to the bank if it did not act quickly. The business was insolvent and the security was declining in value. This element of potential risk was said to be "weighed heavily" in the assessment, and the creditor need not wait until the security vanishes before it takes action.<sup>43</sup> The long (thirteen years) and satisfactory relationship between the principals of the debtor and the bank is also to be taken into account, presumably here extending what would otherwise be a reasonable time. Also to receive "considerable weight" in this case was the fourth factor: the fact that the officers at the head office of the bank had lost confidence in the ability and integrity of the principals of Mr. Broadloom. As to the fifth factor, there was a good likelihood that the debtor would be able to raise the necessary funds to satisfy the demand within a relatively short period of time. Finally, there was the "inexplicable behaviour of the debtor at the time of the demand in failing to make a specific proposal."<sup>44</sup>

After having taken all of the factors into account and after

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<sup>41</sup> *Mister Broadloom*, *supra*, note 12 at 253.

<sup>42</sup> *Ibid.* at 254.

<sup>43</sup> *Ibid.* at 254.

<sup>44</sup> *Ibid.* at 257.

having given each its appropriate weighting, Linden J. concluded that the forty to fifty minutes afforded to the debtor to meet the unexpected demand for payment of \$1,500,000 was a reasonable time, notwithstanding his specific finding that "[t]he chances of the debtor being able to raise the money owed in a short period of time were pretty good."<sup>45</sup> After all the appeals to reasonableness contained in Linden J.'s judgment, the learned judge seemed to have been primarily motivated by the fact that the debtor neither requested time nor made adequate proposals for payment; and the learned judge was motivated by this circumstance, notwithstanding his express recognition of the fact that the debtor "was inexperienced and was in a state of shock at what was happening."<sup>46</sup> So much for the atmosphere of reasonableness!

The irony inherent in the decision was recognized by the Court of Appeal in the following terms:

In essence, Linden J. was faced with the question of whether the period of 40 to 50 minutes was a reasonable time to meet an unexpected demand for immediate payment of the large sum of \$1,500,000. Merely to ask the question is to invite the obvious response that it could not be a reasonable time unless there plainly were no resources available to meet the debt or unless it were certain that the debtors would abscond with their assets.... It was unrealistic, if not illusory, to suggest that the brief 40 to 50-minute period ... constituted a reasonable time for payment of the large debt demanded by the bank.<sup>47</sup>

Of course, at the time Linden J. heard *Mister Broadloom*, he did not have the benefit of the Supreme Court of Canada's decision in *Lister* which held, as noted above, that the debtor was entitled to reasonable notice notwithstanding a failure to request time to pay. While the trial decision in *Mister Broadloom* has thus been overruled in this respect, the seven factors outlined by Linden J. have been adopted and applied elsewhere.<sup>48</sup>

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<sup>45</sup> *Ibid.* at 255.

<sup>46</sup> *Ibid.* at 256.

<sup>47</sup> *Supra*, note 17 at 9.

<sup>48</sup> See, for example, *Brake's Construction Company Limited v. Bank of Montreal* (1982), 46 C.B.R. (N.S.) 81 at 96-98 (Nfld. S.C. [T.D.]); *Cal Glass*, *supra*, note 29 at 18-19; *Four-K*, *supra*, note 18 at 160-61; *Federal Business Development Bank v. Dunn* (1984), [1984] 6 W.W.R. 46 (Sask. Q.B.) at 52-53; *Bank of Montreal v. Western Shore Supplies Ltd* (1983), 57 N.S.R.

In *Lister*, demand for payment of the sum of \$127,160.84 was made on the morning of 20 March 1972. Before Mr. Lister had even finished reading the demand letter, he was handed a formal notice, addressed to the company and its directors, that a receiver had been appointed. Although he originally objected to the possession of the premises by the receiver, his objection was withdrawn a few hours later (after he had been assured that his personal guarantee would not be enforced.) The few hours effectively granted to the debtor was held, by the Supreme Court of Canada, not to constitute a reasonable time to satisfy the demand; and this was so notwithstanding Mr. Lister's statement, before seizure, that he did not intend to advance further monies to the company. This was said to be "something quite different from a waiver of a right to reasonable notice."<sup>49</sup>

Similarly, in *Seawater Products*, the bank demanded payment under a debenture of \$500,000.<sup>50</sup> As part of the "comedy of errors on the part of the bank,"<sup>51</sup> the appointment of the receiver "followed within moments or 1 1/2 days depending on whether one takes the view that a receiver is appointed when he is nominated or when he accepts his nomination."<sup>52</sup> It was held that no reasonable time for payment had been given.

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(2d) 118 (N.S.S.C., T.D.) at 121-22; *Proud and Parkway Volkswagon Ltd v. National Bank of Canada*, *supra*, note 39; *Royal Bank of Canada v. Estabrooks Pontiac Buick Ltd* (1985), 28 B.L.R. 1 (N.B.C.A.) at 13; *Whonnock Industries Ltd v. National Bank of Canada*, *supra*, note 24; and *Canadian Imperial Bank of Commerce v. Quesnel Machinery Ltd*, *supra*, note 30.

<sup>49</sup> *Supra*, note 14 at 289 of C.B.R.

<sup>50</sup> *Supra*, note 21.

<sup>51</sup> *Ibid.* at 30.

<sup>52</sup> *Ibid.* at 32.

While these, as well as a number of other cases,<sup>53</sup> may be cited as examples of situations in which the creditor failed to provide the debtor with a reasonable time, one ought not to be left with the impression that the debtor will always have at least several days within which to arrange alternate financing. In *Cal Glass*, demand was made, after banking hours, for repayment of a debt of \$425,000. Approximately thirty minutes was given to the debtor before the receiver arrived. After an application of the seven factors set out by Linden J. in *Mister Broadloom*, and after considering all of the circumstances of the case, it was held that "the plaintiff acted reasonably and that ... under the circumstances, it was reasonable for the plaintiff to give Cal Glass only a nominal amount of time to meet the demand."<sup>54</sup> Fawcus J. seemed persuaded by the following factors: (1) the debtor was invoicing its inventory to another company in order to avoid third party demands; (2) preparations were being made to remove certain assets from the debtor's premises; and (3) the ability or potential ability of the debtor to refinance the debt was improbable ... the debtor had no source of funds.

A nominal period, this time one of several hours, was also held to be sufficient in *Brake's Construction Company Limited v. Bank of Montreal*.<sup>55</sup> In this case, the debt was slightly in excess of \$280,000. A written demand was delivered at 9:30 a.m. for repayment in full by 12:00 noon. On request of the debtor, the time for payment was extended to 3:00 p.m. The receiver took possession of the debtor's property at approximately 4:00 p.m. that day. Again the seven factors set out in *Mister Broadloom* were applied; and again it was held that the time allowed for repayment

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<sup>53</sup> See, for example, *Proud and Parkway Volkswagon Ltd v. National Bank of Canada*, *supra*, note 39; *Re Sooke Forest Products Ltd* (1984), 55 C.B.R. (N.S.) 268 (B.C.S.C.); *Moose Produce Ltd v. Royal Bank of Canada*, *supra*, note 19; *Royal Bank of Canada v. Estabrooks Pontiac Buick Ltd*, *supra*, note 48; *Northern Meat Packers Ltd v. Roynat Ltd* (1985), 164 A.P.R. 41 (N.B.Q.B. T.D.); *Whonnock Industries Ltd v. National Bank of Canada*, *supra*, note 24; and *Bank of Montreal v. Wilder* (1986), 2 S.C.R. 551, aff'g (1983), 149 D.L.R. (3d) 193 (B.C.C.A.), aff'g, in part, (1980), 19 B.C.L.R. 77 (B.C.S.C.).

<sup>54</sup> *Supra*, note 29 at 19.

<sup>55</sup> (1982), 46 C.B.R. (N.S.) 81.

was reasonable. Among the factors relied upon by the court were the following: (1) the amount of the loan was large, but, unlike *Mister Broadloom* where payment was demanded immediately, here originally two and one-half hours were given for repayment and even this was extended for a further three hours; (2) the value of the security was declining and the ability of the bank to recover its loan was being reduced by the actions of other creditors; (3) the debtor was continually in excess of its line of credit; (4) a contract that was expected to produce large profits for the company actually resulted in losses; and (5) the company had a large working capital deficiency. After considering each of the factors in turn, it was held that "in light of legal authority and the facts and circumstances of this case the time allowed the plaintiff for repayment was reasonable."<sup>56</sup>

In the *Skyrotors* case the debenture secured a line of credit of \$150,000. On 6 March 1975, the bank both demanded its loan and appointed a receiver. Osborne J. considered all of the circumstances of the case including the security document, the relations between the debtor and the creditor, and the absence of any apparent solution to the corporation's financial problems, and concluded that the bank acted reasonably.

The above authorities, in addition to numerous others,<sup>57</sup> may be referred to as examples of situations in which the creditor was held to have fulfilled its obligation to provide the debtor with a reasonable time within which to meet a demand for payment;

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<sup>56</sup> *Ibid.* at 99.

<sup>57</sup> See, for example, *Canadian Imperial Bank of Commerce v. Quesnel Machinery Ltd.*, *supra*, note 30; *Canadian Imperial Bank of Commerce v. Prosser* (1981), 41 N.B.R. (2d) 671 (Q.B., T.D.); *Bank of Montreal v. Western Shore Supplies Ltd.*, *supra*, note 48; *Federal Business Development Bank v. Dunn*, *supra*, note 48; *Burik Enterprises Inc. v. Bank of Montreal* (1985), 30 A.C.W.S. (2d) 98 (Ont. H.C.J.); *Re S.P.M. Plastics Ltd* (1983), 48 C.B.R. (N.S.) 255 (Ont. S.C.); *Nobes v. Royal Bank of Canada*, *supra*, note 20; *263121 Ontario Ltd., carrying on business as Alpha Engineering v. Toronto Dominion Bank* (1984), 27 A.C.W.S. (2d) 381 (Ont. S.C.); and *Continental Bank of Canada of Canada v. Maple Leaf Helicopters Ltd.*, *supra*, note 19.

See also *Whonnock Industries Ltd v. National Bank of Canada*, *supra*, note 24 at 32, where it was said that "[t]o the defendant's knowledge there was no realistic expectation that CanAm could pay its debt in anything less than 30 days. Not only was 7 days' notice far too short, anything less than 30 days' notice would also have been too short. The notice given was artificial, since the defendant knew that payment could not be made any sooner than the 30 days' extension which CanAm requested."

however, a number of these cases suggest that a reasonable time is sometimes relatively short. The courts have sometimes narrowly interpreted the "reasonable time" requirement in this way, notwithstanding the fact that the underlying purpose of the requirement is to permit the debtor to refinance its debt, and, notwithstanding the fact that the "notice given must not be illusory and must give the debtor a reasonable time to act."<sup>58</sup> It is important to keep in mind that the facts and circumstances of the case are not assessed in order to determine whether the debtor ought to be afforded a reasonable time to satisfy a demand for payment, for the debtor is entitled to reasonable notice in every case. Rather, the factors are applied and the circumstances are assessed in order to determine, in each case, what constitutes such reasonable notice. It is not the purpose of this paper to provide the reader with a set of rules by which the appropriate number of hours or days may be calculated; they have been attempted elsewhere.<sup>59</sup>

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<sup>58</sup> *Supra*, note 17 at 4.

See also, Canada, Advisory Committee on Bankruptcy and Insolvency, *Report: Proposed Bankruptcy Act Amendments* (Ottawa: Ministry of Supply and Services, 1986).

It is interesting to note that the *Report* recommended, at 38, that the *Bankruptcy Act*, R.S.C. 1970, c. B-3, be amended to include provisions controlling the appointment and conduct of receivers where the debtor is insolvent, irrespective of whether the debtor is adjudged bankrupt. Specifically, it recommended, at 43, that the secured creditor should be required to obtain leave of the bankruptcy court to appoint a receiver. The advantages of such a requirement were explained, at 43-44, as follows:

The debtor is given an opportunity to have a court hearing before any property is seized. The creditor obtains an immediate decision confirming its right to appoint a receiver and avoiding a subsequent lawsuit over the issue. The current problem of what constitutes reasonable notice of the creditor's intention to enforce this security is resolved before the receiver enters into possession.

The *Report* continued, at 44, to recommend an automatic 21-day stay, subject to variation by the court, on sales out of the ordinary course of business and removal of the debtor's property.

<sup>59</sup> See, for example, W.S. Robertson, "Enforcement: Demands" in *Workouts and Enforcing Creditors' Security* (Toronto: Insight Educational Services, 1984) Tab 1 at 42-43 where the author suggests that ordinarily, more than 20 days may be safely ruled out as unreasonably long, unless there are exceptional circumstances. Between 10 and 20 days is said to be reasonable only if the debtor is able to make sound proposals indicating some ability to raise the required funds during the period, along with adequate measures to ensure that the security does not decline in value during the period. Between 0 and 10 days is said to be a reasonable time if there is a slight possibility that the funds can be raised. This period, it is suggested, would be a reasonable time in most cases. See also C.H. Morawetz, *Annotation* (1984) 49 C.B.R. (N.S.) 2, where it is suggested that if a creditor could not be



Nor do we think that a new set of rules will resolve the justice issues as our discussion in section III below shows. Rather, we are concerned here to enquire into the nature and scope of reasonableness itself. Its application is relevant for present purposes only to the extent that it demonstrates the relative degree of success (or lack thereof) of the reasonable time requirement in achieving its underlying policy. How does one rationalize the statement of the rule (that after a demand for payment the debtor is entitled to a reasonable time within which to satisfy the demand, presumably by refinancing the debt) with its application (particularly those cases in which no time, or a purely nominal time, was held to be reasonable)?<sup>60</sup>

We suggest that the difference between the way in which the rule is stated and the way in which it is applied stems from a basic

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sure that there were plainly no resources available to meet the debt or that it was certain that the debtor would abscond with its assets, then it would be necessary to give between 48 hours and 10 days notice. The precise amount of time within that range is said to depend upon a number of factors: (1) the size of the debt; (2) the business of the debtor; (3) the location of the debtor; (4) the proximity of the bank; and (5) any other relevant factors.

Another commentator has suggested that the rule of thumb should be 3 full business days, although the court might accept a shorter period in special circumstances. To decide if there are any "special circumstances," the court will balance the interests of the debtor and the creditor and consider the following factors: (1) the size of the loan; (2) the risk of rapid asset value deterioration; (3) the character and reputation of the debtor; (4) any fraudulent preferences or misrepresentations by the debtor; (5) the pre-demand history of discussions and negotiations that would indicate to the debtor that the bank had serious concerns; (6) whether there was a plain deficiency of assets; (7) whether time to pay was offered; (8) whether the debtor could have raised the funds if time had been extended; (9) whether it was certain the debtor would have absconded with the assets; and (10) whether the debtor had given a clear indication that it no longer wished to carry on business. See Varley, "Receivership: The Contest Between Secured and General Creditors" in M.A. Springman & E. Gertner, eds, *Debtor-Creditor Law: Practice and Doctrine* (Toronto: Butterworths, 1985) at 456.

See also, Johnson, *supra*, note 33.

<sup>60</sup> One answer has been suggested as follows:

[W]hile the condition precedent to the secured party being able to enforce his security by taking possession is expressed as being that he grant a reasonable time to pay following demand, the question actually considered by the court always seems to be whether or not the secured party acted reasonably in the particular circumstances of the case, regardless of how nominal or even non-existent the time given may have been ... One is inclined to wonder if the true rationale might be better expressed as a limitation on the exercise of self-help.

R. Robertson, "Remedies Under Security Documents" (1981) *Law Society of Upper Canada Special Lectures: New Developments in the Law of Remedies* 35 at 56.

misunderstanding of the underlying purpose of the reasonable time requirement. As we have argued above, the rule goes to procedural fairness rather than to the constituent elements of default. It does not appear to be particularly helpful, in light of its underlying purpose, to construe the terms of a demand or debenture or, for that matter, any other loan agreement, as including an implied term to extend reasonable notice. To do so obscures the true nature of the requirement. As suggested above, the creditor is not just prevented from enforcing its security as a result of any contractual constraint such as the absence of default, the absence of a valid demand for payment, or indeed the non-compliance with any other contractual term. Rather, the creditor is prevented from enforcing its security simply because the creditor ought not to be permitted to do so until the debtor has had one last reasonable opportunity to avoid the catastrophic consequences of default. Thus, the creditor's behaviour is circumscribed simply because the courts presuppose procedural fairness to be important. Once this is accepted, it will no longer be necessary for courts to create a "rule" about "reasonable time." The question will then become, "has the creditor proceeded in a procedurally just fashion?"

### III. JUSTICE ISSUES

The traditional response to an academic's suggestion that lawyers consider "justice issues" is that such an enquiry takes the lawyer and judge beyond his or her proper role into the realm of policy. Policy concerns politics, preference, unsubstantiated wishful thinking, it is believed; and one person's preference is as good as the next person's. Accordingly, the lawyer should leave policy to the public at large. He or she should retreat to his or her more familiar, seemingly more certain, world of legal rules.

An attempt has been made elsewhere, however, to argue that rules of law are metaphysical constructs which intercede between the lawyer and the world he or she wishes to comprehend.<sup>61</sup> Rules of law act as abstract prisms which pre-censor the perceptible world

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<sup>61</sup> Conklin, *supra*, note 2, and W.E. Conklin, *Images of a Constitution* (Toronto: University of Toronto Press, 1990) c. 1 and 13.

"out there." The more abstract the rules and the more scientific our analytic tools as lawyers, the more distant is the perceptible world from the rules with which the lawyer works. Accordingly, judicial decisions can sometimes offer a primitive resource material with which to attempt to understand the world of practice.<sup>62</sup>

Because of the shallow "subjective" character of policy and because of the risk that legal rules might misdescribe the practice of receivership, it is advantageous to transcend the traditional policy/rules approach to Anglo-American-Canadian legal analysis. This essay attempts to show how that is possible. In place of a "policy analysis," this essay appeals to the forms of justice. The legal rules elaborated in section II above are intended merely to supplement a more diversified and realistic resource material with which to apprehend the actual practice of receivership.

No doubt an expensive economic/social survey would provide one with the most reliable, more precise, and objective resource material with which to perceive the practice of receivership. The approach of this essay has been less systematic and admittedly eclectic. One source of resource material for this enquiry has been the testimony before various parliamentary committees during the early 1980s. While a parliamentary committee does not offer a forum to test the credibility of a witness as one finds in a court of law, the media attentiveness and social stress surrounding the particular sittings under discussion do warrant that one give some weight to the credibility of the witnesses. The large number of similar cases discussed in the hearings lends additional support to the credibility of the witnesses. This resource material has been supplemented by the use of a series of empirically oriented studies of the commercial finance industry by respected scholars,<sup>63</sup> one

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<sup>62</sup> This misdescription and misdirection may prevent the lawyer from identifying, let alone appreciating, the victims of laws.

<sup>63</sup> J.L. McMullan, "Social Resistance and the Exploited Poor in the Low-Income Marketplace: The Case of Debt Collection in Two Montreal Communities" (1982) 19 *Can. Rev. Soc. & Anth.* 326; W. Carroll, J. Fox, & M.D. Ornstein, "The Network of Directorate Links among the Largest Canadian Firms" (1982) 19 *Can. Rev. Sociol. & Anthr.* 44; W. Carroll, "The Individual, Class & Corporate Power in Canada" (1984) 9 *Can. J. Sociol.* 245; W. Carroll, "The Canadian Corporate Elite: Financiers or Finance Capitalists?" 8 *Stud. Pol. Econ.* 89; P.F. Haas, "Social Responsibility: An Indicator of Market Power" (1977) 35 *Rev. Soc. Econ.* 185; and G. Lerner, "The Performance of Canadian Banking" (1980) 13 *Can. J.*

empirical study of debt collection in two Montreal communities in 1982,<sup>64</sup> interviews and statistical studies collected by two of Canada's most respected journalists,<sup>65</sup> various studies published in banking and business journals,<sup>66</sup> and by discussions held in the early 1980s with lawyers, merchants, real estate agents, farmers, and others from Southern Essex County.

This resource material is of little use unless one knows what one is looking for. Obviously, one could rest content with judicial decisions if one were only searching for rules of law. And, if one were limited by the rules/policy dichotomy, one would focus upon that resource material which would support one's own preferences, prejudices, *et cetera*. In an effort to escape from such a stricture as the rule/policy dichotomy offers, this study has gone to the forms of justice. The forms of justice, not legal rules nor political preferences, provide the focal point of this inquiry. The following sections will demonstrate how the forms of justice can provide a constructive frame of reference with which to identify the relevant issues surrounding the rules and practice of receivership.

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Econ. 578.

<sup>64</sup> McMullan, *supra*, note 63.

<sup>65</sup> See Newman, *supra*, note 1 and W. Stewart, *Towers of Gold: Feet of Clay* (Toronto: Collins, 1982).

<sup>66</sup> See G.F. Boreham, "Academic Looks at Banking" (1976) 83 Can. Banker & I.C.B. Rev. 4; G.F. Boreham, "The Changing Nature of Canadian Banking" (1983) 90 Can. Banker & I.C.B. Rev. 6; Papadopoulos, *supra*, note 1; and J.H. Perry, "Government and the Banks: Laws, Laws, and More Laws" (1981) 88 Can. Banker & I.C.B. Rev. 4.

See also, J. Bumister, "The Challenge of Change in Banking" (1983) 48 Bus. Q. 82; D. Cox, "Above the Law: banks have been allowed to play by their own rules and this has nearly had disastrous consequences" (1984) 57 Can. Bus. 170; D. Jenish, "Rebellion Against the Banks: Seven Alberta Firms Sue Over Receiverships and Tough Tactics" (1984) 11 Alta. Rep. 26; J.M. Messiner, "What Do Bankers Expect of Receivers?" (1982) 115 Ca. Mag. 102; B. McDougall, "On the Ropes: Its a Struggle to Pull Yourself out of Receivership when your Bank's not in your Corner" (1984) 3 Small Bus. 30; M. Tefft, "Handling of Receiverships Scrutinized as Business Failures Continue to Grow" (1983) 77 Fin. Post 23 (26 November); C. Berstein, "Banks have Limits on their right to self-Protection" *The [Toronto] Globe and Mail* (11 February 1985) B8.

It has been argued elsewhere that justice has two general forms: procedural justice and substantive justice.<sup>67</sup> The more familiar form of justice in the Canadian legal system is the former. Procedural justice assumes or claims that if an institution, decision-maker, or electorate can reach a decision according to a fair procedure, the procedure itself will ensure that the outcome will be just. This presupposition underlies much of administrative law, evidence, criminal, securities, and *Charter* law. Lawyers, judges, reformers, and politicians have concentrated their efforts so as to identify the conditions essential to a fair process in varying contexts. Once society has reached a consensus as to the constitutive elements of a fair procedure, lawyers and judges have scrupulously insisted that the procedure be properly followed. The appointment of a receiver has been no exception to this traditional concern for procedural fairness. As explained and documented in section II B above, the common law courts have superimposed a "reasonable time" requirement upon "demand" debentures out of deference to procedural justice. By creating the "reasonable time" requirement, the Canadian courts presupposed that any eventual distribution of property pursuant to a receivership would be just. That is, the justice embedded in the procedure by which a creditor enforced his security would translate itself into a just outcome.

Substantive justice recognizes that a fair procedure will not guarantee a just outcome. Rather, one must examine the content of the outcome itself in order to ascertain the justice (or injustice) of a decision. Further, one must question whether the content of the outcome is consistent with a criterion (or criteria) of justice independent of and prior to both the procedure and the outcome. That is why this second form of justice has been called substantive, rather than procedural justice. We intend to show that although Canadian courts appealed to procedural justice in their creation of the "reasonable time" requirement, the rule did not accomplish procedural justice during the early 1980s, and the requirement cannot possibly provide procedural justice more generally. As a

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<sup>67</sup> The distinction between the two forms is identified and developed in W.E. Conklin, "Clear Cases" (1981) 31 U. Toronto L.J. 231. The implications of the distinction for the study of law are discussed in W.E. Conklin, "A Practical Legal Education" (1982) 7 Dal. L.J. 122.

consequence of these two conclusions, the court's focus upon procedural justice is misdirected. One can fully comprehend the doctrine and practice of appointing a receiver only if one looks to the forms of substantive justice, and only one form of substantive justice at that.

### A. *Procedural Justice Issues*

Procedural justice assumes, again, that the fairness of a procedure will translate itself into a just outcome. The task of a lawyer, judge, or reformer is to identify those conditions necessary to ensure a procedurally fair call of a loan. Section II B above showed that that was the very purpose for which Canadian Courts re-emphasized, if not created, the "reasonable time" requirement. Judges in such cases as *Mister Broadloom* and *Lister* sought to scrutinize whether reasonable time had been allowed in particular circumstances. Two questions come to the forefront. Has the requirement assured procedural justice? Secondly, can the requirement ever guarantee procedural justice?

#### 1. Has the requirement assured procedural justice?

Procedural justice goes to the procedural conditions preceding a decision. One such condition is that "ought implies can": that is, that the debtor can be reasonably expected to perform his or her contractual duties upon signing a demand debenture. A second condition is that the decision-maker reach his or her decision equitably: that is, that he or she treat similar cases similarly. Third, parties affected by the decision were fully informed of the alternatives prior to embarking upon one alternative over another. The resource material in this study suggests that the three conditions have not been met, particularly during the early 1980s.

## 2. Procedural conditions precedent to reaching a decision

### a) *That ought implies can*<sup>68</sup>

First, as the economic circumstances during the early 1980s dramatically illustrate, procedural justice cannot always be fulfilled. This is important because procedural justice assumes that if the individual is given a fair opportunity to fulfill his or her duties, he or she will be able to do so. It presupposes that if he or she cannot, his or her failure to do so stems from matters within his or her own competence. Enforcement of security in the circumstances is deemed just. However, this necessarily assumes that a debtor can be reasonably expected to perform his or her contractual duties. The corollary of this assumption is that inability to perform a legal duty due to circumstances beyond one's control marks the failure of a constituent element of procedural justice.

The public record suggests that the factors triggering most loan calls during the early 1980s were entirely external to the debtor's management competence, foreseeability, blameworthiness, and control. The most important factor during that period was the extraordinarily rapid rise in interest rates beginning in late 1979. The prime interest rate charged by the Bank of Canada to chartered banks gradually climbed from 12% on 28 February 1979, to 22.75% in August 1981, where it remained until 11 September 1981. By 1984, however, the Bank of Canada had gradually lowered this rate to its former level. It is not within the scope of this essay to allocate economic blame for this extraordinary phenomenon. Whether the cause be the pressure for interest payments on government deficits, the outstanding interest payments due from Poland, Mexico, Brazil, and other countries, the outstanding interest payments due to Government and banks from companies which the government and banks had bailed out (such as Massey-Ferguson, Dome Petroleum, and the like), or the invisible hand of the market: in no way can the source of the interest rate climb be attributed to the general incompetence of the small businessperson. Nor can it

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<sup>68</sup> This condition is best described in J. Rawls, *A Theory of Justice* (Cambridge: Harvard University Press, 1971) at 236-237; and L. Fuller, *The Morality of Law*, rev'd ed. (New Haven & London: Yale University Press, 1964) at 70-78.

be attributed to his or her control, notwithstanding the fact that default of most debentures hung upon a floating interest rate. Further, against this international and domestic background, there were regional economic factors external to the small businessperson's control. So, for example, the declining markets for American-made cars had a serious impact upon the Southern Ontario region. Again, whatever the economic causes of the declining markets, the small businessperson's debenture was subject to them.

Not infrequently, businesspersons found themselves entrapped in the reverberating circumstances brought on by the call of a loan in the same region, industry, or trade. Much of the business community hangs upon a psychological confidence in the present and future. This is reflected in some debentures which directly or indirectly incorporate market value land and property prices as a built-in factor in ascertaining a condition of default. But the call of one or two loans in important businesses in a community can rapidly undermine the community's confidence in the future. Since a privately appointed receiver wishes to obtain the best price as soon as possible and to meet the secured creditors' debt — but not necessarily that of other secured creditors, unsecured creditors, or shareholders — the receiver invariably sells his or her property at less than fair market value. Once the public realizes that a business is in receivership, interested prospective purchasers of the assets expect a lower or "firesale" price. But that event of receivership triggers lower market values throughout the community. This is especially so when the first call of a loan is to a chain of businesses located throughout a region. The lower land prices, in turn, collapse the equity of other businesspersons and increase the risk of a default in their own loan agreements.

Again, the bank's initial decision to call the loan of a small business may trigger a multiplying effect resulting in a decline in the overall market value of the assets of many other businesses. But the latter's default is entirely outside its control in that the decisions underlying the default are made by the lender, even though the business may have been warranted in acting as it did in any particular case. The receivership phenomenon, therefore, takes on an air of irrationality from the viewpoint of the debtor, the



community at large, and, indeed, the lender. The lender digs his or her own grave by initiating this process.<sup>69</sup>

### b) *Equal treatment*

Procedural justice also requires that the process leading to the enforcement of security be equitably administered.<sup>70</sup> The public record does not inform one as to the equitable enforcement of security amongst farmers and small businesspersons according to region and industry. The record does demonstrate, however, how the enforcement procedures applied to small businesspersons and farmers were noticeably absent for those national and multi-national corporations which defaulted in their loan agreements during the same time period. During a 1981 board meeting of one chartered bank, for example, the Board decided to buy \$150,000,000 in convertible preferred shares from a large debtor company, the bank helped to put together a \$715,000,000 distribution of new capital, and the bank forgave its loan interest due from the debtor company, according to Walter Stewart.<sup>71</sup> The debtor company had been losing extraordinarily large sums of money over the preceding months. Two of the debtor's officers served on the boards of each of the three banks to whom the debtor company was indebted, and the vice-president of one of the creditor banks later joined the debtor's Board. With the help of various provincial and federal governments, the commercial banks allowed major Canadian corporations (such as Dome Petroleum, Chrysler Canada, and others) to renegotiate their

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<sup>69</sup> See generally cases described by Mr. Ralph Barrie (President, Ontario Federation of Agriculture) in *Minutes of Proceedings & Evidence of Standing Committee on Finance, Trade & Economic Affairs*, 1st sess. 32nd. Parl. 1080-83, 89:6-8 (2015-2020); Barrie at 89:20-23 (2055-2110); and Mrs. Alix Granger (Confederation of National Trade Unions) at 102:37-39 (1815-1825). See also, A. Fisher, "Farming's Mortgaged Future" (1986) Vol. 2 No. 10 *Report on Business Magazine* (The Globe & Mail) 24.

<sup>70</sup> This requirement is a critical element of the Canadian legal culture. See generally, W.E. Conklin, "The Utilitarian Theory of Equality Before the Law" (1976) 8 *Ottawa L. Rev.* 485.

<sup>71</sup> See Stewart, *supra*, note 65 at 114.

loan agreements in circumstances that were quite similar to the circumstances justifying the call of loans to small businesspersons, farmers, and consumers throughout Canada. The point of noting this apparent inequity is not to suggest that governments and banks should have placed such companies into receivership as they had the 25,000 "small" and "medium-sized" Quebec businesses alone during 1981 and 1982 (that is, approximately 17 percent of the total number of small and medium-sized businesses in Quebec at the time).<sup>72</sup> Rather, the special treatment granted to Canada's major corporations violated an important constituent element of fairness: namely, that all parties be treated equally before the law. The distinct unequal treatment of small businesspersons/farmers *vis-à-vis* Canada's powerful and interconnected businesses assured that a rigorous adherence to the "reasonable time" requirement in the case of the small businesspersons could not guarantee procedural justice during the circumstances of the early 1980s.

c) *Appraisal of the alternatives*

A third constituent element of procedural justice is that, in order for a process to be fair, the parties must be informed of the alternatives. Without being informed, choice is illusory.<sup>73</sup> This third element is very important when one examines the fairness of a procedure not at an isolated point in a process (such as during or immediately after the call of a loan) but over an extended period of time. The latter context ushers forth the issue whether small businesspersons and farmers were fully informed of the negative consequences when they signed their demand loan agreements during the 1970s. Prior to the 1980s, Canada's financial institutions

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<sup>72</sup> However, the small Business Secretariat of the Federal Department of Consumer and Corporate Affairs estimated that from 2 to 5 times that number of businesses simply closed their doors, sold their inventory and assets, or had their assets seized by banks without publicly declaring "bankruptcy." This meant that an additional 15,000 to 38,000 businesses quietly collapsed in Quebec during those two years, according to the Canadian Press on 16 May 1983.

<sup>73</sup> This requirement of informed choice is best explained in H.L.A. Hart, "Are There any Natural Rights?" in A.L. Melden & J. Waldron, eds, *Theories of Rights* (Oxford: Clarendon Press, 1985).

had expanded loans to small businesspersons and farmers.<sup>74</sup> This, in turn, raised the latter's expectation of profits; an expectation which only a lender's confidence in a businessperson can bring.<sup>75</sup> Financial institutions were not alone in expanding credit and thereby projecting an optimistic future. Government and government agencies encouraged small businesspersons and farmers to think that this was the only realistic alternative. The Central Mortgage and Housing Corporation, for example, influenced expectations through loans at below-market interest rates; capital contributions for low and moderate-income housing, rural and native housing, and rental accommodation; loans and grants to assist municipal land assembly, sewage, water projects, and low-income housing and low-rental housing; and subsidies for home insulation. Similarly, the Federal Business Development Bank financed businesses that had been unable to obtain credit under reasonable terms from traditional financial institutions.<sup>76</sup> The Farm Credit Corporation had, by 31 March 1979, made 71,722 outstanding loans totalling 2.7 billion dollars for farm purchases, the purchase of livestock, machinery, equipment or buildings, and the sale of farms. And the Export Development Corporation insured commercial credit for the financing of exports and granted loans to foreign buyers of large capital projects in Canada. By the end of the 1970s, these four government agencies had extended 8.7 billion dollars to businesses in Canada — mostly small businesspersons and farmers. In addition, numerous provincial banks and development corporations held out an optimistic forecast of the future. One witness before one parliamentary committee insisted, for example, that the Ontario Industrial Milk Incentive Programme had placed no limit to the

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<sup>74</sup> As reported by Canadian Press (Montreal). Evidence before *Farm Credit Arrangements Sub-Committee of the Standing Committee on Agriculture*, 1st sess. 32nd Parl., 1980-83 (issue 4) at 0950. For other examples, see M. Tefft, *Handling of Receiverships Scrutinized as Business Failures Continue to Grow* (1983) 77 *Fin. Post* 23 (26 November 1983).

<sup>75</sup> See, for example, the testimony of Mr. Ralph Barrie, President, Ontario Federation of Labour in *Minutes of Proceedings and Evidence of Standing Committee on Finance, Trade and Economic Affairs*, 1st sess. 32nd Parl. 1980-83, issue 86. See also, C. Bernstein, "Banks Must Toe the Line In Giving Financial Advice" *The [Toronto] Globe & Mail* (25 February 1985) B13.

<sup>76</sup> See testimony, *supra*, notes 74 and 75.

amount of milk expansion assisted by the Programme during the early 70s until the Ontario Milk Marketing Board cut back quotas and thereby undermined a farmer's ability to service the debt which he or she had incurred to expand his or her milk production.<sup>77</sup>

The point of identifying the role of financial institutions and government agencies during the 1970s is not to suggest that they should not have expanded credit, that they were imprudent, or intentionally deceptive. Rather, their role provided an important background to the farmer and small businessperson's financial arrangements during the 1970s. Procedural justice requires that a party be fully informed of the options before him or her. If not informed, the procedure is unfair and the "choice" of restricting one's general right to be free by signing the contract is illusory. The expansive role of financial institutions and government raised the expectation of only one alternative: unlimited optimism. This optimism extended to the day-to-day financial arrangements of farmers and small businesspersons. Testimony before parliamentary committees again and again complained that during 1978 and 1979, banks advised agricultural producers to agree to floating interest rates on loans in the expectation that interest rates would fall.<sup>78</sup> The usual trait of a farmer — caution — was swept to the side when he or she agreed to commit collateral security far in excess of the amount of funds borrowed; to authorize the lenders, without notice, to forcibly enter, lease, or sell his or her assets upon demand; and to call loans at any time during the year (including the period prior to harvest or prior to readying animals for the market when the farmer would be unable to repay his or her loans). Again, loans officers of Canada's financial institutions did not consciously mislead farmers and small businesspersons prior to the signing of demand debentures. Indeed, it is inconceivable that each of the 7,500 bank branches in Canada should have been staffed by competent, thoughtful, intelligent, well-trained loans officers, who were fully apprised of the long-term and short-term negative alternatives for a

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<sup>77</sup> Evidence before Farm Credit Arrangements Sub-Committee of the Standing Committee on Agriculture, 1st sess. 32nd Parl. 1980-83 (issue 4) at 0950.

<sup>78</sup> See, for example, *ibid.* and Minutes of Proceedings and Evidence of Standing Committee on Finance, Trade & Economic Affairs, 1st sess. 32nd Parl. 1980-83, 89: 6-8.

small businessperson. It is inconceivable that any loans officer, let alone farmer/small businessperson, could predict that interest rates would more than double within months in dire contrast to relative stability and extraordinary optimism of the prior decade. Accordingly, an important condition of procedural justice was absent: the parties were not fully apprised of the negative alternatives before them. A rigorous adherence to the "reasonable time" requirement, had it occurred, would not have assured procedural justice.

### 3. Can the "reasonable time" requirement ever guarantee procedural justice?

It was explained in section II above, that, notwithstanding the specific wording of demand debentures, Canadian courts have superimposed a requirement that the creditor must give a debtor reasonable time to repay a loan before the creditor can legally enforce its security. But that is a legal rule and a legal rule is an abstraction. It is a creation of the judge's/lawyer's mind. For that reason alone, a legal rule does not, by itself, guarantee procedural justice. The rule may well be divorced from the day-to-day decisions and social/economic context within which the rule is administered. We submit that although our Courts created the rule in order to ensure procedural justice, the social/economic context within which it is applied renders procedural justice illusory.

First, what is a *reasonable* time? Section II above showed that our Courts have held that reasonableness depends upon the circumstances of each case. But the inevitably open-ended vague character of reasonableness requires that, to protect his or her common law right to reasonable time, the borrower must be prepared to litigate the (un)reasonable time allowed for re-payment. As a judicial decision in favour of a borrower can have serious financial repercussions for commercial lenders *vis-à-vis* other borrowers, the borrower must be prepared to pay for legal costs to the appellate level of the court system — indeed, to the Supreme Court of Canada, if leave to appeal should be granted. Of course, should the borrower eventually succeed in his or her claim, the Court will assess costs against the secured creditor on a party/party

basis (that is, a main part of the borrower's legal and reasonable expert witness fees). But that eventual reimbursement may be several years away and, in the meantime, the litigant must advance funds to his or her lawyers to pay for their fees and disbursements. Because secured lenders usually require a small businessperson to sign a personal guarantee as a condition for his or her business loan, a lawsuit against the lender takes on an exceedingly academic air once the creditor has retained a private receiver to seize the private assets, as well as the business assets, of the borrower. Even if his or her personal assets have not been seized, the borrower does not find himself or herself to be in the most creditworthy situation to borrow funds, let alone to borrow funds to sue a *confrère* of the prospective lender. Furthermore, our discussion of the judicial decisions in section II showed that some courts have held that a short time may be sufficient to meet the common law requirement of "reasonable time in some circumstances." This fact requires, in turn, that the borrower have time to gain access to expert legal and accounting advice in the circumstances of a call.

Our submission is that this factor and the factors discussed below make the common law requirement of "reasonable time" extraordinarily academic. The practice belies the abstract theory. Indeed, the common law requirement itself offends procedural justice more than it helps in that it makes the public and the financial institutions believe that procedural justice is being followed when, in fact, the economic and legal circumstances make the effective operation of the common law rule negligible.

Second, whether fifty minutes or six months is a "reasonable time" for repayment of a demand loan, the "reasonable time" requirement itself does not take into account the fact that since the early nineteenth century, the function of the commercial lender has evolved to the point where he is no longer simply a supplier of funds. Rather, it serves as a "*de facto*" partner in any business enterprise. The rule assumes that the lender remains primarily a lender alone. But the practice of banking suggests that the lender is a financial adviser who, in some cases, oversees the monthly or even weekly operation of businesses or to whom businesspersons must periodically report and justify their management decisions.

Third, the "reasonable time" requirement presupposes that the small businessperson *does* have an effective option of obtaining

alternative financing from his existing lender. We suggest that the close cohesiveness of the community, described elsewhere, pervades the local financial community as much as it does at the head office level. This cohesiveness renders "the opportunity to seek alternative financing" somewhat redundant. The redundancy magnifies itself in that a borrower is unlikely to possess instant expert information concerning alternate sources of financing even within his or her own geographic community. Even if the latter were known, the credit reputation of the small businessperson is invariably harmed once the community learns (and a small community invariably learns within hours) that the local bank has called one's loan. The call is sometimes accompanied by the freezing of the borrower's accounts and the dishonouring of outstanding cheques; a practice which can destroy the credit reputation of the business *vis-à-vis* the outside trading world within minutes or hours.

Fourth, the above assumes, of course, that commercial lenders do attempt to give debtors "reasonable time" to repay their loans. That is, our above criticisms go to the content of the common law rule itself and its ineffective role in the practice of receivership. But the public record indicates otherwise as the bank's officer explained in *Mister Broadloom*: "it was not customary to give notice in such circumstances, because it is felt vital to protect the prime security, which might possibly be removed if the debtors were aware of the proposed plans [to enforce the debenture]."<sup>79</sup> We have found little evidence in the public record to show that loans officers who did call loans were aware of the legal requirement of "reasonable time" during the early 1980s or, if they were aware, that they endeavoured to offer adequate notice prior to the enforcement of security. An abstract rule is one thing. It is quite another for the principal parties to be *informed* of that rule. And the latter is just as important as the rule itself for procedural justice to be more than illusory.

Fifth, the purpose of the rule is to ensure that the debtor has an effective opportunity to repay his or her loan. His or her most realistic alternative is to seek out alternative financing from

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<sup>79</sup> *Supra*, note 12 at 246 of O.R. See also, Jenish, *supra*, note 66 and Bernstein, *supra*, note 66.

another financial institution. But this prospect is somewhat academic in that if one commercial lender calls a loan, the odds are that another dominant competitor will be uninterested. Accordingly, the borrower must be informed or have quick access to information about non-traditional lenders. If the borrower should decide to remain with the present lender, he or she must propose an alternative financial package. He or she must do this within hours, depending upon the creditor's interpretation of what constitutes a "reasonable time." But this, in turn, requires that the small businessperson have immediate access to accountants, lawyers, or other advisers who are already sufficiently familiar with the business's finances, markets, and supplies to be able to ready such an alternative financial package within hours (or even minutes). Ironically, whereas loans officers may need days or weeks to study a loan application before sending it through the institution's hierarchy for approval, the actual circumstances surrounding the call of a loan require that, if he or she does have access to expert legal and financial advice, the businessperson can produce an alternative financial package within hours. But the call of a loan undermines the economic and social context presupposed by that package. The demand loan prevents the debtor from being afforded the time to make his or her one phone call. Indeed, even if the debtor has the good fortune of having immediate access to a lawyer, the accompaniment of a lawyer raises the stakes for the lender. The lender will naturally see the debtor as an adversary once the debtor brings in his or her lawyer. And that perception of an adversarial relationship may well persist with the receiver and the bank months later.

Sixth, procedural justice requires more than the elements of reasonable notice, access to a lawyer, access to financial advisors, and access to effective alternate sources of funding. Procedural justice requires that decisions that affect the liberty, life, and security of the person, and the conditions necessary to make the latter effective, must be justifiable. Our courts have consistently held that legality involves an appeal to reason and that where rules are administered without an opportunity for a justificatory process, we



have fiat — not law.<sup>80</sup> The major lobbyist for the Bankers' Association, Robert McIntosh, appealed to reason rather than fiat when he once suggested the following:

The criticism you read in the media about calling the loans on some of these guys — that's not the problem. The problem is that most of these guys shouldn't have been lent that money in the first place and that criticism I accept. Having gotten into that position, the banks are trying to work their way out of it. Most of the stories that hit the media, and are causing such a furor politically are about people who would not measure up to the judgment of the farmers, of their own peers. If you put them in front of a jury of their own equals in the business, they wouldn't look so good.<sup>81</sup>

The point is, though, that the borrower does not have an opportunity to test whether his or her competence, management skills, and financial position "measure up to the judgment of the farmers, of their own peers." McIntosh's opinion is simply that, an opinion. The holder of a demand debenture needs no justification, nor argument, nor evidence for his or her decision to enforce his or her security unless the decision is litigated. In contradistinction with legality as reason, the onus to justify oneself seems absent in the "law" of receivership. Sometimes, the secured creditor fails to provide the evidence, or the reasons why it considers a debtor in default of a debenture agreement.<sup>82</sup> Indeed, as the terms of the debenture in the *Lister* case indicated, a debenture may theoretically allow a demand call for any reason unless, of course, the borrower

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<sup>80</sup> This has been a concern of recent *Charter* cases which have focused upon the meaning of "by law" in section 1 of the *Charter*. See, for example, *Que. Assn. of Protestant School Bds. v. A.-G. Que. (No. 2)* (1982), 140 D.L.R. (3d) 33 (Que. S.C.), 1 D.L.R. (4th) 573 (Que. C.A.); aff'd (*sub nom. A.-G. Que. v. Que. Assn. of Protestant Sch. Bds.*) (1984), 10 D.L.R. (4th) 321, 54 N.R. 196 (S.C.C.); *Ont. Film and Video Appreciation Society v. Ont. Bd. of Censors* (1983), 41 O.R. (2d) 583, 147 D.L.R. (3d) 58 (Div. Ct.); aff'd (1984) 45 O.R. (2d) 80, 5 D.L.R. (4th) 766 (Ont. C.A.); and *Re Southam Inc. and The Queen (No. 1)* (1983), 41 O.R. (2d) 113, 3 C.C.C. (3d) 515, (*sub nom. R. v. Southam Inc.*) 34 C.R. (3d) 27, 146 D.L.R. (3d) 408 (Ont. C.A.). See also Fuller, *supra*, note 68 at 91-94; and Rawls, *supra*, note 68 at 239-40.

<sup>81</sup> J. Lindhorst, "The Banks and their Critics — A Panel Discussion" (1983) 11 Bus. Life 18 at 21.

<sup>82</sup> See Canadian Press items dated 9 June 1982, and the testimony of Mrs. Alix Granger (Confederation of National Trade Unions before the Standing Committee on Finance, Trade and Economic Affairs, 1st sess. 32nd Parl. 1980-83, 102:22-26).

See also: M. Tefft, "Handling of Receiverships Scrutinized as Business Failures Continue to Grow" *Fin. Post* (26 November 1983) 23; and Jenish, *supra*, note 66.

litigates. Only if the debtor has not signed a personal guarantee and only if he or she retains sufficient liquid personal funds to litigate in the courts: only then can the lender be brought to an accounting. The borrower's lack of funds to pay for a trial and appeal, his or her lack of effective access to expert counsel and financial advisor at the time of the call, his or her lack of adequate notice to seek out alternate sources of financing, the lack of such alternate financing: these and other factors militate against the very possibility that the lender will ever be required to provide the evidence or the reasons for his or her acquisition of the assets of a borrower. And yet, the "law" of receivership violates the very principle of legality in practice unless there is such an accounting.

### B. *Substantive Justice Issues*

Procedural justice is only one form of justice. We have demonstrated above that procedural justice does not accurately describe the procedures underlying the relationship between a lender and the borrower when a loan is called, notwithstanding the intent of the "reasonable time" requirement. Once again, the lawyer is tempted to appeal to his or her emotive preferences as an exit. But we wish to suggest that the second important form of justice, substantive justice, is a more accurate descriptive category with which to understand the doctrine and practice of the appointment of a receiver.

Substantive justice suggests that one must go beyond the procedure itself to a criterion (or criteria) of justice, independent of and prior to the procedure by which a lender calls a loan. The first task of the legislator/lawyer is to identify the criterion of justice presupposed in the content of the existing rules (and practice). If the criterion is based upon fallacious social or cultural premises, or if it remains a holdover from the past era, his or her duty is to offer an alternative criterion and to translate it into reformed rules that will modify the practice of receivership in fact as well as in form. In the remainder of this section, we intend to clarify the issues that the reformer must identify before he or she can resolve the difficult complexities, competing rights, and the social good involved. Aristotle tells us that substantive justice can take several forms:

corrective (rectificatory), distributive, justice in exchange, and political.<sup>83</sup> Receivership law concerns only the first two forms.

## 1. Forms of substantive justice and receivership law

### a) *Corrective justice*

Corrective justice applies to a private transaction. It must involve three elements: two parties, a transaction, and a remedy that places the party harmed back into his or her position prior to the harm (that is, the "*status quo ante*").<sup>84</sup> Corrective justice assumes that, prior to the harm, the two parties hold an equal position. Corrective justice intends to correct the inequality caused by the harm by transferring resources from the injurer to the injured party such that the former's gain compensates the latter's loss.

In the event of a demand pursuant to the terms of a demand debenture, the injured party is assumed to be the lender and the injurer is assumed to be the debtor. The transaction, of course, is the loan agreement secured by the demand debenture. Having borrowed funds from the lender and having failed to pay principal and interest, the form of corrective justice allows the lender to call back the loan and to appoint a receiver who will, in turn, sell the assets so that the parties can be returned to the *status quo ante*. That is, the receiver will compensate the lender by transferring resources from the borrower to the lender such that the debtor's gain will compensate the lender's loss. That is the theory.

There are several factors in the receivership procedure, however, that undermine the applicability of the form of corrective

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<sup>83</sup> Aristotle, *Ethics*, *supra*, note 3.

<sup>84</sup> The form of corrective justice is discussed and applied to tort law in Weinrib, *supra*, note 4; to remedies law in Arnold, *supra*, note 5; and to human rights law in Greenawalt, *supra*, note 6 at 47-62. See also, Weinrib, *The Intelligibility of the Rule of Law*, *supra*, note 4 at 59.

After writing this essay, we found a discussion of the application of the forms of justice to British bankruptcy rules in J. Finnis, *supra*, note 7 at 7.

justice to the law of receivership. We can best appreciate these factors by returning to the three elements of corrective justice. First, are there two parties? Yes, on paper, there are two parties to the agreement. Second, is there a transaction? Yes, the agreement constitutes the transaction. But at this point the form of corrective justice loses its descriptive force.

First, the form of corrective justice claims that the *wrongdoer* should pay for the compensation. But it would seem that the burden of compensating the secured creditor falls upon innocent creditors who were ignorant of the terms of the debenture agreement and ignorant of the intent of the lender to call the loan (recall that the usual agreement allows for the lender to call the loan *on demand*). These creditors include employees who may well have put a quarter of a century of labour into the business. Furthermore, we have seen that during the early 80s, the wrongdoer was *not* the debtor in many cases. It was not through his or her incompetent management that the debtor defaulted. Rather, circumstances external to his or her control and foreseeability triggered his or her default. We have already identified those external factors: the doubling of the interest rates, the rapid decline in the market value of buildings and real estate, the decline in consumer demand for regional industries, extraordinarily large defaults of national and multi-national corporations, the large defaults in foreign governments, and the like. If there was *one* wrongdoer, it certainly was not the debtor. Further, if there was a wrongdoer during the early 80s, the wrongdoer was the Federal Government which over a period of years allowed the deficit to climb, guaranteed expensive mega-loans to defaulting corporations, authorized the chartered banks to grant large scale loans to mega-companies and foreign governments, and meekly allowed the central bank to double the interest rates. The receivership rules identify the wrong "wrongdoer" for the harm while the real wrongdoers escaped from paying the compensation. For these reasons alone, the form of corrective justice collapses as the appropriate justificatory and descriptive grounding for existing receivership laws.

Second, aside from the issue as to *who* should pay for the harm, corrective justice insists that the compensation should reach the injured person. But we have shown that under receivership practice, the receiver's first duty is to the secured lender. This

practice of reducing the market value of assets to compensate the secured creditor of them often leaves little balance, if any, for other creditors or shareholders. Thus, the compensation reaches only a portion of those persons who actually suffered injury. Further, the present rules compensate those *least* harmed in that, relative to their total assets, the impact of default upon the financial lender's losses are minuscule relative to the impact upon the employees, unsecured creditors, suppliers, and shareholders.

Third, what is *the source* of the harm? Corrective justice states that the harm caused to the lender must result from the transaction. That is, *the transaction* must be the source of the harm in that, contrary to its terms, the borrower has been unable to repay the lender upon demand. But we suggested above that the source of the harm to the lender during the 80s was *not* the transaction but the economic factors *external* to that transaction. The existence of those externalities undermines a key element in the corrective justice form.

Fourth, does the *status quo ante* place the lender and borrower on an equal plane? We have suggested that a demand loan is the main source of funds for a small business in Canada. We have also suggested that due to the social cohesiveness of the small financial community, the call of a loan from one financial institution makes it difficult, if not impossible, to gain alternate funds from one of the remaining traditional lenders. Given the unrealistic options in the background, the extraordinary asset base and investment power at a commercial lender's disposal render any suggestion of equality between the lender and the small businessperson a fiction. It might render the application of the corrective justice form coherent, but it does so at the cost of connecting the form to a semblance of the perceived world. The remedy of *status quo ante* begs deeper questions as to why the community's rules ought to preserve a position of gross inequality of bargaining power prior to the signing of any debenture agreement.

Fifth, what is *the harm*? The corrective justice form orients our focus upon the particular economic loss caused to the lender by the failure of the businessperson to repay his or her loan upon demand. But if our claim above has any merit that receivership practice counters any semblance of procedural justice, then such a constricted focus is misdirected. The failure of the borrower to

repay his or her loan upon demand causes economic harm to his or her employees, suppliers, other creditors, and family.<sup>85</sup> More importantly, the stress incurred in the perceived arbitrariness of the lender's decision to call the loan causes unverifiable economic costs in terms of hospitalization, medical attention, drugs, unemployment insurance, and the loss of productivity resulting in the destroyed self-esteem of borrowers, employees, and families. Finally, the receivership rules and process cause harm to our community's values of fair play (procedural justice) and corrective justice itself.<sup>86</sup> The arbitrariness of the call and the lack of a justificatory process prior to the call offend the former. The receivership rules violate corrective justice in that the borrower often is not the wrongdoer; the real wrongdoers do not pay for the compensation; innocent persons bear the burden of compensation; the compensation does not reach all injured parties; and the alleged violation of the transaction is not the source of the harm. Both procedural and corrective justice constitute important community values in our liberal society. And, to the extent that they do, contemporary receivership rules and practices oppose those values and thereby cause harm to all.

No doubt it is easier to measure the harm caused to the lender in contrast to the economic and psychological harm caused to others. But that facility should not justify a focus upon the former to the exclusion of the other. The question "does the wrongdoer cause harm to another" depends upon what counts as harm. That evaluative question must first be addressed before we examine the evidence surrounding the harm caused. And that prescriptive question requires us to ask ourselves, "toward what ends does our community aspire?" For reasons expressed elsewhere, procedural justice serves as one such critical end in a liberal society.<sup>87</sup> Threats to such an end constitute harm. The more significant the end, the

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<sup>85</sup> J.L. McMullan, *supra*, note 63.

<sup>86</sup> For an interesting study showing the importance of understanding "harm" in terms of the community's values, see the early study of the Canada Law Reform Commission, *Limits of Criminal Law* (Working Paper #10) (Ottawa: Information Canada, 1975).

<sup>87</sup> W.E. Conklin, *Clear Cases*, *supra*, note 67.

more seriously inadequate is our use of the form of corrective justice in describing receivership practice. Accordingly, we must look to Aristotle's second form of substantive justice (distributive justice) in order to appreciate better the justice issues presupposed in the receivership rules and practice.

b) *Distributive justice*

Distributive justice is a form whereby a given resource is distributed among competing claimants in accordance with some criterion of proportionate equality.<sup>88</sup> Distributive justice does not emanate from some particular transaction, as in the case of corrective justice. Nor does it involve only two claimants. Rather, there is no transaction and there can be several or many claimants to distributive justice. What mediates the relationship among competing claimants is the criterion of proportionate equality of the resource to be distributed. The resource need not be wealth or income. The resource may be honour, social status, or safety. Our present receivership rules assume wealth (assets) and income to be the sole resources which the community must distribute.

Liberal societies have elaborated complex criteria by which the community should distribute given resources amongst competing claimants. Three such criteria are merit, need, and human worth.<sup>89</sup> Liberal societies have rewarded persons according to one or a combination of differing criteria in differing social contexts. So, for example, some rules define merit in terms of aptitude (rewarding employees with proportionate secondary school or university education), strength (for example, construction workers or athletes), skill (athletes), memory, personality (salespersons), effort (scholars), productivity (profits), blameworthiness (criminal law), originality (scientists), duration of effort (seniority), income (tax law), and

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<sup>88</sup> See generally the sources, *supra*, note 84, especially Greenawalt at 52-62.

<sup>89</sup> These criteria of distributive justices are best explained, exemplified, and analyzed in Gregory Vlastos, *Justice and Equality* reprinted in J. Waldron, ed., *Theories of Rights* (Oxford: Oxford University Press, 1984) 41 and in A.I. Meldon, ed., *Human Rights* (Belmont, Calif.: Wadsworth, 1970). It was originally published in R.B. Brandt, ed., *Social Justice* (Englewood Cliffs, N.J.: Prentice-Hall, 1962) 31.

capital (capital gains tax and secured creditors). Merit serves as a criteria of distributive justice whenever we value a human characteristic that a possessor has himself or herself *acquired* (rather than being gifted or born with the characteristic). Other examples of meritorious characteristics are wit, grace of manner, technical skill, sincerity, generosity, or courage. We have allocated different criteria relative to differing enterprises or we have assessed varying weights to the criteria from enterprise to enterprise. Sometimes, our conceptions of merit have clashed, and, on such occasions, social strife has resulted.

Our content to the form of distributive justice has become more complicated since the Second World War in that need and human worth have increasingly challenged merit as the criterion for distributive justice in a liberal society. The criterion of need goes to equality of benefits, not equality in the allocation of resources. So, for example, the allocation of several policemen to guard the Prime Minister ensures him equality in "security of his life and person," notwithstanding the fact that more resources are allocated to his protection in contrast to the rest of us. His need, not necessarily his merit (he may not satisfy many of the criteria of merit noted above), justifies the extra resources for his protection. In contrast, human worth proportions resources because human beings are "ends in themselves," not because they merit or need the resources. Although we may not merit police protection (as in the case of the organized crime leader who does not meet the criterion of, say, originality or productivity), nor need the equal benefit of police protection (where, for example, the organized crime leader possesses his own "police" force), our equal human worth may justify such protection (as well as other constitutional rights). Sometimes, we can appeal to each of the three criteria of distributive justice when we deliberate about the allocation of scarce resources. So, for example, we can arguably ground the welfare system, universal access to universities, and access to the courts in terms of merit ("without equality of opportunity, we do not have distribution according to merit"), or need ("minimum shelter, food, income, intellectual challenge, or effective legal rights are human *needs* without which a human being cannot function as a Canadian citizen"), or human worth ("minimum shelter, food, income, intellectual development, or effective legal rights without



discrimination on grounds of sex, *et cetera* recognize the equal worth of "humans as humans").

These competing conceptions of proportionate equality present themselves in the receivership circumstances. We cannot resolve the clash of criteria without serious thoughtful political consideration of the competing theories of freedom, democracy, and the nature of a person himself or herself, and, indeed, the relationship between culture and nature. We do suggest, however, that the present receivership rules and practices presuppose that capital is the grounding of distribution of resources and that the receivership rules define capital in vulgar, eighteenth-century terms of capital accumulation. The rules give priority to the capital of the lender over the productivity, seniority, effort, and income of employees. The greater the lender's capital input into the enterprise, the greater the preference to that lender over other lenders. The blameworthiness, effort, skill, personality, originality, length of labour, income, and capital input of the borrower are deemed irrelevant. Similarly, the preference rules grant preference to the lender's raw capital contribution over the economic, social, and psychological needs of employees, the borrower's family, and the immediate community.

The post-War appeal to the notion of equal human worth, as evidenced in the plethora of human rights statutes, constitutional bills of rights, and international covenants has yet to make its entry into receivership practice — if not the private world generally. Arbitrary self-preference in terms of raw capital, rather than some notion of the equal worth of human beings, provides the content to the form of distributive justice prior, during, and after the call of a loan. But the very open-endedness of the content of that form calls into question the lender's arbitrary self-preference. And, precisely because distributive justice better *describes* existing contemporary receivership rules and practice (in contrast to both procedural justice and corrective justice), the lawyer and scholar alike must assess the competing political theories in support of the existing criterion of distributive justice (capital accumulation) embedded within the receivership rules and practice. The lawyer/scholar in the private law world must identify competing criteria of distributive justice such as need, equal human worth, and alternate criteria of merit (such as productivity, blameworthiness, effort, management skill, or the like).

And the lawyer/scholar must question whether the political theories of distributive justice underlying the latter criteria are more in tune with the ends of a good society.

#### IV. CONCLUSIONS

This essay has been about the appointment of a receiver. But it has been more than that. We have used that admittedly narrow area of commercial law practice as a case study of the private law world more generally. We have attempted to demonstrate that very serious public issues emanate from the private law world. And we have done so by approaching the subject matter using a methodology which is admittedly unorthodox to legal practitioners.

Since the Second World War, Canadian judges, reformers, scholars, and practitioners have criticized legal rules on the basis of policy. And the notion "policy" has been understood variously as the community's values, the goals of society, or the preferences of the individual critic. Lawyers have understood rules and doctrine as "objective"; policy as "subjective." We have tried to show, in contrast, how the forms of justice offer a conceptual frame of reference with which to describe the actual practice (in this case, the appointment of a receiver) and, second, to analyze the social/moral shortcomings of that practice.

More particularly, the use of the forms of justice led us to conclude that we could accurately describe the current doctrine and practice of receivership neither in terms of procedural justice nor in terms of corrective justice. Rather, one could describe the practice only in terms of distributive justice. Having used the forms to describe the doctrine and practice, we found ourselves in a better position to identify what questions to ask. If we should wish to reform or to critique existing practice in the private law world, we must be capable of identifying competing criteria of distributive justice. This would provide alternatives to the contemporary, vulgar criterion of distributive justice encompassing the law and practice of receivership: namely, capital accumulation. We must also be capable of identifying the respective theories of the state, the community, and the person underlying those alternatives. Further,

we must be capable of translating those alternative criteria and theories so as to pose the relevant issues and arguments in the resolution of concrete problems. The forms of justice analysis, we have argued, trigger a new set of questions which the rules/policy continuum of legal analysis does not offer. The forms of justice offer to the lawyer a richer frame of reference with which to understand and critique the public issues in a private law world.

