

Limitations Act, 2002: Issues of Concern to Trustees in Bankruptcy

by Doug Palmateer and John Swan

Aird & Berlis LLP

June 2005

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A. Introduction

The *Limitations Act, 2002*, S.O. 2002, chap. 24 (the "New Act") came into force on January 1, 2004 and replaced the *Limitations Act*, R.S.O. 1990, chap. L.15 (the "Old Act").

However, the Old Act continues to apply to certain claims that were based on acts or omissions that took place before January 1, 2004.

B. Limitations Act, 2002

The principal features of the New Act that are of interest to trustees in bankruptcy are the following:

(a) Basic Limitation Period

Section 4 of the New Act establishes the basic limitation period of two years following the day on which the claim was discovered. Section 4 provides as follows:

"Unless this Act provides otherwise, a proceeding shall not be commenced in respect of a claim after the second anniversary of the day on which the claim was discovered."

"Claim" is defined as "a claim to remedy an injury, loss or damage that occurred as a result of an act or omission" (section 1).

By contrast, the Old Act listed specific types of actions and fixed limitation periods for them, ranging from two to twenty years "after the cause of action arose". If an action was not listed, there was no limitation period applicable to it. The limitation period most familiar to trustees in bankruptcy was that set by section 45(1)(g) of the Old Act, which established a limitation period, for actions based on contract or simple debt, of six years "after the cause of action arose".

(b) Discovery

Section 4 of the New Act starts the limitation period running for a claim when it is "discovered". Section 5(1) of the New Act defines discovery:

"A claim is discovered on the earlier of,

- (a) the day on which the person with the claim first knew,
 - (i) that the injury, loss or damage had occurred,
 - (ii) that the injury, loss or damage was caused by or contributed to by an act or omission,
 - (iii) that the act or omission was that of the person against whom the claim is made, and
 - (iv) that, having regard to the nature of the injury, loss or damage, a proceeding would be an appropriate means to seek to remedy it; and
- (b) the day on which a reasonable person with the abilities and in the circumstances of the person with the claim first ought to have known of the matters referred to in clause (a).

(A “proceeding” in paragraph (a)(iv) above means a court proceeding.)

(c) Acknowledgments

Under the New Act, a person liable to another in respect of a claim for payment of a liquidated sum may acknowledge liability, in which event the act or omission on which the claim is based will be deemed to have taken place on the day on which the acknowledgment was made (section 13(1) of the New Act).

To have the foregoing effect, an acknowledgment must

- (1) be in writing (section 13(10)),
- (2) be signed by the person making it or the person’s agent (section 13(10)),
- (3) be made before the expiry of the limitation period (section 13(9)), and
- (4) be made to the person with the claim, the person’s agent or an official receiver or trustee under the *Bankruptcy and Insolvency Act* (the “BIA”) (section 13(9)).

By contrast, the Old Act did not expressly provide for acknowledgments with regard to actions based on contract or simple debt (although it did so provide with regard to other actions, e.g. actions for specialty debts). However, the courts did recognize that an acknowledgment or part payment would, whether made before or after the expiry of a limitation period, provide a new limitation period from the time of the acknowledgment or part payment.

The New Act does not mention part payment, although it does recognize that “an acknowledgment of liability in respect of a claim for interest” is an acknowledgment of liability for the principal and for interest falling due after the acknowledgment is made.

(d) Successors

Where there is a successor in right, title or interest to a person with a claim, the limitation period commences on the earlier of (1) the day that the person with the claim knew or ought to have known of the matters set out in section 5(1)(a) (part (b) above) and (2) the day that the successor first knew or ought to have known of those matters (section 12(1)).

(e) Ultimate Limitation Period

A proceeding may not in any event be commenced in respect of any claim after the fifteenth anniversary of the day on which the act or omission on which the claim is based took place, even if the limitation period established by section 4 (part (a) above) has not expired (section 15(1) and (3)).

(f) No Limitation Period

There is no limitation period in respect of the proceedings enumerated in section 16. Those proceedings include proceedings to enforce court orders, proceedings for support or maintenance, proceedings arising from sexual assault and proceedings to recover money owing in respect of student loans, awards and grants.

(g) Other Acts

Limitation periods that are set out in the other Acts that are listed in Schedule A to the New Act remain in effect notwithstanding the coming into force of the New Act (section 19). Some of the statutory limitation periods that have been preserved are those applicable to court proceedings to set aside sales in bulk (discussed in Part D below), preserving and perfecting liens under the *Construction Lien Act* and pursuing directors of a corporation for unpaid employee source deductions under the *Income Tax Act* (Ontario).

C. Effect on Claims Against Bankrupt Estate

(a) Where Limitation Period Has Not Expired at Date of Bankruptcy

Under the Old Act, a statutory limitation period stopped running in respect of a claim against a debtor when the debtor became bankrupt. Under the New Act, the law appears to be the same. First, there is nothing in the New Act that changed the law in this regard.

In addition, the BIA permits a proof of claim to be filed at any time up to the expiry of the thirty-day notice of final dividend (section 149). Federal paramountcy in the field of bankruptcy and insolvency dictates that a provincial limitation statute will be inoperative to the extent that it is inconsistent with the BIA.

Finally, the New Act applies only to “claims pursued in court proceedings” (section 2(1)). The process of filing claims with a trustee in bankruptcy is not a court proceeding.

Consequently, a creditor will have a valid claim even though it would have become statute-barred, had bankruptcy not occurred, by the time that the creditor files a proof of claim with the trustee, or even though a proof of claim is not filed until more than two years after the date of bankruptcy.

(b) Where Limitation Period Has Expired at Date of Bankruptcy

Under the Old Act, where a limitation period had expired before the date of bankruptcy of the debtor, the creditor did not have a claim that was provable against the estate. Again, the New Act has not changed the law in this regard.

What has changed, of course, is the length of the period of time within which a claim becomes statute-barred. Previously, with a six-year limitation period from the date that the claim came into existence, there were relatively few bankruptcies in which the issue of the running of a limitation period even arose.

However, under the New Act, trustees in bankruptcy in Ontario will encounter many more cases in which the limitation period has run, and will need to be alert to this issue in examining proofs of claim.

Trustees do not need to be concerned that preparing and distributing a bankrupt’s statement of affairs will revive a statute-barred debt. Prior to the enactment of the New Act, courts held that the act of a bankrupt in listing a debt in a statement of affairs was simply a statement of fact, but not an

acknowledgment as contemplated by a statute of limitations. As noted above, under section 13(9) of the New Act, an acknowledgment can revive a debt only if it is made “before expiry of the limitation period applicable to the claim”. In addition, no act on the part of a trustee in bankruptcy can amount to an acknowledgment because the trustee is not the debtor or the debtor’s agent (section 13(10)).

D. Effect on Claims by Bankrupt Estate

(a) Claims that Bankrupt Owned at Date of Bankruptcy

If a claim by the bankrupt against a third party has become statute-barred at the date of bankruptcy, the trustee in bankruptcy is unable to pursue the claim. That was the law prior to the enactment of the New Act, and nothing in the New Act has changed the law. However, trustees may find that claims have become statute-barred in many more cases because of the shorter limitation period under the New Act.

Where a limitation period has partially run against the bankrupt prior to the date of bankruptcy, it will continue to run against the trustee after bankruptcy. The trustee is a “successor” to the bankrupt for the purpose of section 12 of the New Act. Trustees will be faced with determining when the bankrupt knew or ought to have known of the existence of a claim, in order to calculate the amount of time remaining to the trustee to commence a court action. An acknowledgment of liability made by the bankrupt’s debtor to the trustee before the expiry of the limitation period will be effective to re-start the limitation period (section 13(9)).

(b) Claims by Trustee Pursuant to *Bankruptcy and Insolvency Act*

The BIA provides a trustee in bankruptcy with a number of remedies to attack transactions entered into by the bankrupt before the date of bankruptcy:

- (1) settlements of property – section 91;
- (2) conveyances, transfers, etc. that confer a preference on any creditor – sections 95 and 96;
- (3) reviewable transactions – section 100; and
- (4) payments of dividends or redemptions of shares by a corporation when it was insolvent – section 101.

The law prior to January 1, 2004 was unclear as to the limitation period applicable to these remedies. The BIA itself does not establish any limitation periods for commencing proceedings for relief under these sections, and therefore, if any limitation periods apply, it is provincial law that supplies them.

The Old Act, which set out limitation periods for a defined list of actions, but had no “catch-all” provision, did not include any actions in which such relief was sought. Consequently, prior to January 1, 2004, the better view is that there were no limitation periods for the BIA remedies enumerated above.

The law on this issue has changed dramatically with the enactment of the New Act. Claims for relief in connection with settlements, preferences, reviewable transactions and improper payments of dividends or redemptions of shares are undoubtedly encompassed in the broad definition of “claims” in section 1 of the New Act. It therefore appears that trustees in bankruptcy in Ontario will be subject to the two-year limitation period in the New Act. The difficult question is when the limitation period starts to run.

The earliest possible date is the date of bankruptcy or, where the debtor makes a proposal under Division I of Part III and the proposal does not exclude the application of sections 91 to 101, the date of filing of a notice of intention or a proposal, whichever filing was done first. That date would be appropriate if the trustee learned the relevant facts before its official appointment. Otherwise, it may be a later time, such as the first meeting of creditors, when the trustee acquired or ought to have acquired the requisite knowledge. The commencement date will be a question of fact in each case.

(c) Claims by Trustee Pursuant to Provincial Statutes

Various Ontario statutes establish remedies that are available to trustees in bankruptcy:

- (1) *Assignments and Preferences Act* – fraudulent conveyances and fraudulent preferences;
- (2) *Fraudulent Conveyances Act* – fraudulent conveyances;
- (3) *Business Corporations Act* – oppression remedy; and
- (4) *Bulk Sales Act* – sales of assets out of the usual course of business or trade of the seller.

No limitation periods are enumerated in the first three statutes listed above. The Ontario Court of Appeal had held that, under the Old Act, there was no limitation period for claims under the *Fraudulent Conveyances Act*. The same was likely true of claims under the other two statutes.

Such claims are undoubtedly caught by the definition of “claim” in the New Act, and will be subject to a limitation period of two years following discovery of the impugned transaction or oppressive conduct. Trustees and inspectors will need to consider the availability of such remedies at an early stage of the estate administration.

The *Bulk Sales Act* establishes a specific limitation period for challenging sales in bulk. Under section 19, an action to set aside a sale in bulk for failure to comply with the Act must be brought before the buyer complies with section 11 or within six months thereafter. That limitation period is preserved under the New Act.

E. Statement of Affairs and Proofs of Claim

(a) Statement of Affairs

Under the BIA it is the bankrupt’s duty to prepare a statement of affairs, including particulars of assets and liabilities, and the trustee’s duty to verify the statement.

While the Old Act was in force, “... the Statute of Limitations only barred the plaintiff’s remedy, not the debt”. Consequently, it was appropriate to list all liabilities, even those that were statute-barred, in the statement of affairs.

The status of statute-barred debts under the New Act is unclear. One (unstated) consequence of the fact that acknowledgments are ineffective if they are made after the expiry of a limitation period may be that statute-barred debts cease to exist. That result is far from certain, however. Until the law is clear on this issue, trustees should continue to do what they have always done: ensure that all liabilities of which they are made aware by the bankrupt are listed in the statement of affairs. (As a practical matter, when the trustee is verifying the statement of affairs during the first five days after the bankruptcy, the trustee is unlikely to have sufficient information to make a conclusive determination that a debt is statute-barred.)

(b) Proofs of Claim

Trustees are required to examine every proof of claim, and may disallow, in whole or in part, any proof of claim. One ground for disallowing a claim is, of course, that it is statute-barred.

Under the New Act, trustees will need to be particularly careful in examining claims that are more than two years old. Trustees should not simply disallow such claims out of hand, but they should determine when the limitation period under the New Act started running, and whether or not an acknowledgment was made with the effect of extending the limitation period past the date of bankruptcy.

F. Some Problems with the New Act.

The New Act creates some awkward problems that are going to have to be dealt with by the courts before there will be any certainty under the new law. Among the more difficult problems are the following:

- The definition of claim and indeed the structure of the New Act are principally focused on potential tort claims: the definition of “claim” fits far more easily into a tort context than a contract one.
- A claim will not be “discovered” until, under section 5(1)(a)(iv), “having regard to the nature of the injury, loss or damage, a proceeding would be an appropriate means to seek to remedy it”. A representative of the Attorney General’s office has explained this provision by saying that it was intended to deal with the case where, to use his example, a small crack in a basement turns into a large crack. Outside that rather limited situation, the question will be whether, for example, negotiations to reach a settlement will be a circumstance which would justify not starting a proceeding to enforce the claim. The result of provisions like this will probably mean that there will be a great deal of uncertainty on just when the limitation period starts to run.
- The old law was that the limitation period on a demand loan ran from the date of execution of, say, the promissory note recording the loan. This rule has not been formally changed by the New Act and, if applied, would catch many creditors by very unpleasant surprise because many claims will now have the limitation period applicable to them suddenly shortened. One view of the effect of the New Act is that, relying on the definition of “claim”, the limitation period for a demand loan will only begin to run when a demand has been made. (Many lawyers are re-drafting demand loans to require a demand before the loan is due.) Some weak and uncertain support for the requirement that a demand must be made for a claim to arise is found in section 15(6)(c) which states that, with regard to the ultimate limitation period, that period only begins to run from “the day on which the default occurs”.
- It is not clear why an acknowledgment has to have occurred *before* the expiry of the limitation period applicable to the claim (section 13(9)). If the debtor chooses to acknowledge a debt by, for example, paying interest (section 13(2)) on an overdue (and already statute-barred) debt, is the acknowledgment ineffective? Can the interest or any other payment on the debt now be recovered as money paid by mistake? Without section 13(9), the creditor would have an absolute defence to such a claim because it would be owed the money.
- While claims for conversion may not often arise in an insolvency, the New Act’s treatment of such claims is very odd. Section 15(3) provides that “no proceeding against a purchaser of personal property for value acting in good faith shall be commenced in respect of conversion of the property after the second anniversary of the day on which the property was converted.” The problem with this section is that every subsequent purchaser of personal property that was, for example, stolen or wrongfully taken from its true owner, is liable in conversion if (i) he or she sells the property or (ii) fails to return it to the true owner on demand. If a demand is made on the purchaser from the person protected by section 15(3), that person will not be protected by the section and will be liable to the owner.
- Perhaps the most baffling aspect of the New Act is section 22. That section prohibits agreements which would either extend or shorten the limitation period in the New Act. No one knows the origin of this provision—none of the many reports prepared over the last twenty or thirty years on the amendment of the Old Act recommended such a provision and many expressly recommended against it. If it was enacted to deal, for example, with some consumer contracts, there are far better ways to do that. Why should two commercial parties (often acting of course with legal advice) be unable to fix the time within which one may sue the other? No one yet knows what the courts will do with the section and many attempts have been made in

commercial agreements to deal with the problems created by the section. It appears to prevent tolling agreements, *i.e.*, agreements between parties who are trying to settle a dispute not to raise a limitation defence. The only way now open to parties in this situation is by a formal agreement to arbitrate while they continue their negotiations. (Section 11 provides that the limitation period established by section 4 does not run from the date of the agreement to arbitrate.) From the other end, solicitors trying to limit warranty coverage in, say, an agreement of purchase and sale have to be imaginative in finding ways to impose a limit while not running afoul of the New Act. Again, the effects of section 22 will only be known when there have been some cases. The Attorney General has been repeatedly requested to repeal the section for, apart from its pointlessness, it is driving important deals away from Ontario.

In short, as an attempt to simplify and rationalize the law governing the survival of actions, the New Act will, at least until there is a considerable body of case law built up, turn out to be largely a failure. Litigants can look forward to greatly increased uncertainty and the costs associated with that state of affairs.