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[Home](#) > [Bankruptcy](#) > [Office of the Superintendent of Bankruptcy Canada](#) > [For Trustees](#) > [OSB Position Papers](#)

Office of the Superintendent of Bankruptcy Canada

Recovering a Section 178 Debt

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Issue

Some creditors are unaware of how to proceed when a debt appears to fall under section 178 of the *Bankruptcy and Insolvency Act* (BIA), while others, student loan creditors specifically, have indicated that they want the bankrupt's discharge order to specify that the student loan debt is included in the discharge, failing which they indicate they will pursue the debt as if not discharged.

Analysis

Subsection 178(1) of the BIA lists eight classes of debts that are not released by an order of discharge. These exceptions are based on an overriding social policy.

Subject to these eight exceptions, an order of discharge releases the bankrupt from all claims provable in bankruptcy. The claims listed in subsection 178(1) of the BIA are properly provable in bankruptcy. Proofs of claim may be filed for them and creditors can receive a dividend on them.

For student loan debt, if the bankruptcy is filed seven or more years after the date on which the bankrupt ceased to be a full- or part-time student, the bankrupt's student loan debt does not fall within paragraph 178(1)(g) of the BIA as an undischargeable debt and is, therefore, eligible for discharge along with the other dischargeable debts of the bankrupt. However, if it had been less than seven years since the bankrupt ceased to be a full- or part-time student at the time the bankruptcy was filed, then the student loan debt falls within paragraph 178(1)(g) of the BIA and is, therefore, an undischargeable debt that will not be released by an order of discharge. No further court order is needed with regard to these debts. Similarly, orders obtained prior to bankruptcy that conclusively bring a debt within section 178 do not require a further court order after the trustee's discharge.

For all other debts that are alleged to fall under section 178 of the BIA, a court ruling is the only conclusive way to confirm that this is the case and the onus is on the creditor to prove that its claim falls within subsection 178(1) of the BIA. There is case law to the effect that, on an application for discharge, the court will not make a declaration that the claim of a creditor is not released by the order of discharge, nor will it make a declaration that a debt is released by an order of discharge. For example, in *Re Kierdorf* (1990), 80 C.B.R. (N.S.) 6, 1990, the court concluded that the issue of whether a claim survives the bankruptcy cannot be determined at a discharge hearing. The court specifically held that "the hearing is summary in nature and is to determine whether the bankrupt ought to be discharged and, if so, what conditions, if any, should be imposed. The court has said on many occasions that it will not examine or determine other matters which can be dealt with at another time and in other proceedings."

By virtue of subsections 69.3(1) and 69.3(1.1) of the BIA, upon the bankruptcy of a debtor, a creditor is stayed from pursuing a claim provable in bankruptcy until the trustee is discharged. If a creditor has a provable claim that is not released by the bankrupt's discharge and if the trustee has not been discharged, in order to take proceedings against the bankrupt, leave must be obtained from the bankruptcy court (section 69.4 of the BIA). It is important to note, however, that sections 69 to 69.31 of the BIA do not apply in respect of a debt or liability referred to in subsection 121(4) of the BIA (family support claims).

From a practical perspective, it may be in the best interests of a bankrupt to voluntarily make payments during the course of his/her bankruptcy toward a debt that may not be discharged in the bankruptcy. In such circumstances, the creditor should contact the trustee and the trustee should ensure the debtor is fully aware of his/her rights and responsibilities. The Office of the Superintendent of Bankruptcy (OSB) recommends that the letter for a Section 178 Claim be reviewed and signed by the debtor with the trustee and retained on file, after which time the debtor can contact the creditor to discuss a possible resolution.

Conclusion

Creditors should not initiate or continue collection actions while a stay remains in place and should not, at any time, unilaterally declare that a claim is released by an order of discharge. It is the position of the OSB that sending a demand letter for recovery of a section 178 debt constitutes a collection action that is contrary to the provisions of the BIA.

It is also the OSB's view that the debtor should be made aware that the onus is on a creditor that alleges that its claim falls within subsection 178(1) of the BIA to prove that such is the case, and this is done by bringing an action in the ordinary civil courts, subject to the stay restrictions under the BIA. However, if upon receipt of proper advice from his/her trustee a debtor whose debt may not be released by an order of discharge wishes to make payments to a creditor, he/she may make arrangements to do so.