

**THE HEARING OF A TRUSTEE'S FINAL STATEMENT  
OF RECEIPTS AND DISBURSEMENTS –  
IT'S NOT BUSINESS AS USUAL**

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The days of the Court simply “rubber stamping” a trustee’s final statement of receipts and disbursements (the “SRD”) in commercial cases would appear to be long over. Recent decisions of the Court, and specifically that in the Bankruptcy of Sally Creek Environs Corporation (“Sally Creek”)<sup>1</sup> signal a new era of creditors and the Court exercising greater scrutiny over the SRD. Trustee’s must adjust to this new reality as their fair and just compensation will depend upon their ability to do so.

As the NHL playoffs are front and centre at the time that this paper was written, a hockey analogy would appear to be appropriate. Fans of the NHL are currently enjoying some of the best hockey seen in years as highly skilled players, such as Ovechkin, Crosby and Malkin, take centre stage. The NHL has once again become a sport which allows its talented players to shine. At the same time, the slower and larger players who dominated the sport from the mid-90s until the lockout of 2004/2005 with tactics of interference, hooking and holding, play a far lesser role in the sport and, in many instances, such players were unable to survive in the post-lockout era. The answer for this transformation lies primarily in the NHL rule book which the league dusted off and instructed the referees to apply with greater strictness in order to free up the game for its skilled players. For the most part, the rules which have given the NHL its renaissance always existed. It was just a matter of enforcing the rules and playing by them. Herein lies the answer for trustees.

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<sup>1</sup> Sally Creek Environs Corporation, Re, 2008 CarswellOnt 3702, (Registrar Nettie of the Ont. S.C.J.) overturned in part by the decision of the Hon. Madame Justice Mesbur of the Ont. S.C.J. dated February 19, 2009 (unreported). The Murphy Group has appealed the decision of the Hon. Madame Justice Mesbur to the Ontario Court of Appeal. No date for the appeal has been set at the time this paper was written.

The *Bankruptcy and Insolvency Act* (the “BIA”) and decisions of the Canadian Courts pursuant to the BIA provide a detailed set of rules, procedures and principles for all parties involved in the bankruptcy process, including trustees (the “BIA Rule Book”). Following the BIA Rule Book is the surest way for trustees to defend themselves against aggressive challenges from creditors and the watchful eyes of the Court. Those trustees who are able to adapt their practices to ensure maximum compliance with the BIA Rule Book will continue to thrive and will be able to ward off opposition to their fees and attacks on their reputations. Those who fail in this endeavour will face angry creditors and a Court that will increasingly hold their conduct up to strict compliance with the BIA Rule Book. The end result will be significant reductions on the SRD, greater legal fees to the trustee and perhaps serious damage to a trustee’s reputation. The stakes for trustees could not be greater.

The first part of this paper will highlight those elements of the BIA Rule Book which should guide a trustee’s role with respect to the various parties involved in the bankruptcy process. The second part of this paper will then set out steps that trustee’s can follow which will assist in maximizing recovery of their fees and disbursements and minimizing their exposure on the hearing of their SRD.

**PART I – GENERAL PRINCIPLES TO GOVERN THE CONDUCT OF TRUSTEES WITH RESPECT TO THE VARIOUS PLAYERS IN THE BANKRUPTCY PROCESS**

**The Factors Considered on the Hearing of the Trustee's SRD**

The factors to be considered by the Court in finding a trustee's fees and disbursements have been long established. Under section 39 of the BIA, the basic rule in calculating the trustee's compensation is that the trustee is to receive 7.5% of the amount remaining out of the realization of the property of the bankrupt after the claims of secured creditors have been paid. Subsection 39(5) permits the Court to make an order increasing or reducing this remuneration.

The factors the Court will consider are:

- i) to allow the trustee fair compensation for his services;
- ii) to prevent unjustifiable payments for fees to the detriment of the estate and the creditors; and
- iii) to encourage, rather than discourage, efficient, conscientious administration of the bankrupt estate for the benefit of the creditors.

The following should be disallowed:

- i) services not authorized by law;
- ii) irresponsible decisions producing no positive results;
- iii) conduct contrary to the instructions of the creditors, inspectors or the Court;
- iv) performing unproductive or unnecessary services not authorized by the inspectors;
- v) over-charging for routine services;
- vi) charging for services not clearly performed;
- vii) charging at an excessive rate for professional services;

- viii) errors in judgment, not based on the consent of the inspectors; and
- ix) any matter not required by law to be done that adversely affects the interests of the creditors and not approved by the creditors or the inspectors.<sup>2</sup>

In determining “fair compensation” *BT-PR Realty* sets out the items a Court should consider:

- a) the nature, extent and value of the case;
- b) the complications and difficulties encountered;
- c) the degree of assistance provided by the parties;
- d) time spent by the receiver or trustee;
- e) the receiver or trustee’s knowledge, experience or skills;
- f) diligence and thoroughness;
- g) responsibilities assumed;
- h) results obtained;
- i) the costs of comparable services; and
- j) other material consideration.<sup>3</sup>

### **The Trustee’s Role vis a vis the Court**

There are no new revelations here. The principles that should govern the conduct of a trustee have been long established by the Courts:

- ▶ a trustee is not an ordinary litigant before the court entitled to avail itself

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<sup>2</sup> *Hess, Re*, 1977 CarswellOnt 68 (Ont. S.C.J. In Bkcty) reversing 1976 CarswellOnt 103 (Ont. S.C.J. Reg in Bkcty) and *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended, s.39

<sup>3</sup> *BT-PR Realty Holdings Inc. v. Coopers & Lybrind* (1997), 29, O.T.C. 354

of the rules available to the ordinary litigant in an adversarial process.

- ▶ a trustee is an officer of the Court with a higher duty to the Court than any ordinary litigant. A trustee has an absolute duty to make full and frank disclosure.<sup>4</sup>
  
- ▶ As an officer of the Court, a trustee should act equitably and, as far as possible, hold an even hand between competing interests of various classes of creditors.<sup>5</sup>
  
- ▶ “The appointment of [a trustee] is not a franchise to make money although a trustee should be rewarded for its efforts on behalf of the estate nor to favour one party or one side. The trustee is an impartial officer of the Court; woe be to it if it does not act impartially towards the creditors of the estate.”<sup>6</sup>

A trustee should also ensure that its lawyers abide by the same principles. Should estate counsel conduct itself inappropriately with a trustee idly standing by and failing to intervene, the consequences will undoubtedly be visited upon the trustee.

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<sup>4</sup> Van Straten, Re, (1997) 46 C.B.R. (3d) 96 (Alta. Q.B.)

<sup>5</sup> Reed, Re, (1980) 111 D.L.R.(3d) 506 (Ont. C.A.)

<sup>6</sup> Confederation Treasury Services Ltd., (1995) CarswellOnt 1169 (Ont. S.C.J.)

When considering its options in a particular situation, it may be prudent for a trustee to consider whether a particular course of conduct can be defended under cross-examination by counsel for a creditor in open Court. Any conduct which impacts creditors negatively or which damages the integrity of the bankruptcy process will likely result in significant reductions to the trustee's fees and disbursements at the hearing of the SRD.

### **The Trustee's Role vis a vis Creditors**

There is, again, nothing earth shattering about the principles which govern the relationship between a trustee and the creditors of the estate. As stated by the Court of Appeal for Ontario in *Impact Tool & Mould Inc. (Trustee of) v. Impact Tool & Mould (Windsor) Inc. (Receiver of)*:

“Apart from its rehabilitative goals with respect to personal bankrupts, the purpose of a bankruptcy is to gather in and realize upon the assets of the bankrupt and to distribute those assets amongst the creditors on an equitable basis, subject to their priorities. In that sense, bankruptcy is a creditor driven process with the creditors pursuing their claims by collective action through the trustee.... The inspectors - appointed by the creditors under s.116 of the BIA – are the creditors' representatives.”<sup>7</sup>

### **The Trustee's Role vis a vis Inspectors**

Yet again, one would have thought that there would be no controversy as to the relationship between a trustee and the inspectors of an estate:

“the inspectors' role is integral to the operation of the bankruptcy regime... While the trustee in bankruptcy is vested with the assets of the bankrupt and is responsible for

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<sup>7</sup> *Impact Tool & Mould Inc. (2006) 208 O.A.C. 133*

the day-to-day administration, it is the inspectors who have the primary supervisory role in the administration of the bankrupt estate.”<sup>8</sup>

The Court of Appeal in *Impact Tool & Mould Inc.*, made it abundantly clear that the Trustee answers to the creditors’ representatives, in quoting with approval the following passage:

“The inspectors are the supervisors of the Trustee and it is their function to instruct the Trustee to take whatever steps they consider appropriate in order to protect the estate and the creditors.”<sup>9</sup>

This is not to ignore the practical reality that trustees face in their day to day dealings with the inspectors of an estate. In many situations, inspectors are simply lay persons with no legal or accounting background and no prior experience as inspectors of an estate. Inspectors can often also face situations of conflict of interest as they are often appointed by creditors who have a particular agenda in the bankruptcy process. Other inspectors may simply not be interested in performing their duties in the administration of the estate. All of these situations pose a significant problem for the trustee assigned the task of administering the estate.

The BIA, however, provides the trustees with more than sufficient recourse to address these types of situations with inspectors. Where an inspector may be conflicted on a particular issue, the inspector should not vote on any resolution in relation to that issue. This does not mean that the inspector should be excluded from discussion on the

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<sup>8</sup> *Impact Tool & Mould Inc.*, supra

<sup>9</sup> *Impact Tool & Mould Inc.*, supra, at paragraph 28

issue or should be excluded from being able to review the relevant documents on the particular issue. In fact, Cumming, J. held the exact opposite *In the Matter of the Bankruptcy of Cynar Dry Company Limited* wherein he stated:

“However, whether or not there was a conflict of interest is not the relevant issue in the case at hand. In my view, the Trustee had a duty to notify and inform *all* Inspectors about issues affecting the bankrupt estate and to afford *all* Inspectors the opportunity to make their views known about contemplated decisions by disinterested Inspectors<sup>10</sup>

In situations where the inspectors refuse or are unable to provide necessary instructions in a timely manner or if they provide instructions which the trustee strongly disagrees, it is almost never the appropriate response for the trustee to simply ignore the inspectors and do as it wishes. This will ultimately expose the trustee to serious second guessing for any adverse outcome for the estate and will expose the trustee to reductions of fees for having acted without the benefit and protection of the instructions of the inspectors.

Section 119(2) of the BIA provides:

**“Decisions of Inspectors subject to review by the Court** – the decisions and actions of the inspectors are subject to review by the Court at the instance of the Trustee or any interested person and the Court may revoke or vary any act or decision of the inspectors and it may give such directions, permission or authority as it deems proper in substitution thereof or may refer any matter back to the inspectors for reconsideration.”

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<sup>10</sup> In the Matter of the Bankruptcy of Cynar Dry Company Limited, (2005) 8 C.B.R. (5<sup>th</sup>) 46, paragraph 29

Nonetheless, any trustee seeking to have a decision of the inspectors overturned should keep in mind that the Court will not lightly interfere with the wishes of the inspectors of an estate.

“The general nature of the inspectors’ pivotal supervisory role is well-embedded in the jurisprudence.<sup>11</sup>

The Ontario Court of Appeal in both *Impact Tool & Mould Inc.*<sup>12</sup> and in *Re: Rizzo & Rizzo Shoes Ltd.*<sup>13</sup> quoted with approval the following passage of Master J.A. from *Re: Feldman*<sup>14</sup>:

“In other words, the whole scope and foundation of the Bankruptcy Act is that in the practical administration of the estate of the bankrupt, the governing authority shall be the inspectors and not the Court, the inspectors being practical men named by the creditors, and unless it is shown they are acting fraudulently or in some way not in good faith, for the benefit of the estate, the administration of the affairs of the estate is to be governed according to their directions.”

Accordingly, in situations where the trustee needs instructions which the inspectors are unable or unwilling to provide, the trustee should move before the Court for directions to obtain a Court order permitting the trustee to proceed in a manner other than that instructed by the inspectors. If the inspectors are consistently putting up roadblocks to the effective administration of the estate, the trustee would certainly be within its rights to seek the removal of the inspectors by the Court.

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<sup>11</sup> *Impact Tool & Mould Inc.*, supra, paragraph 30

<sup>12</sup> *Impact Tool & Mould Inc.*, supra, paragraph 30

<sup>13</sup> *Rizzo & Rizzo Shoes Ltd.*, Re, (1998), 38 O.R. (3d) 280, page 287

<sup>14</sup> *Feldman*, Re, (1932), 13 C.B.R. 313 (Ont. C.A.), page 314

Trustees should be mindful of Section 30(1) of the BIA which lists 12 powers that a trustee must exercise with the permission of the inspectors. To proceed without, or contrary to inspector approval, in any of these tasks would expose the trustee to possible liability for improvident expenditures or recoveries and sanction on its SRD by the Court. As made clear by Section 30(2), trustees cannot obtain general permission to do all of the things enumerated in Section 30(1). It is also imperative that trustees provide all relevant information and documents for the inspectors to exercise their discretion under Section 30(1).<sup>15</sup>

### **Trustee's Role vis a vis Estate Counsel**

With the approval of the inspectors, a trustee may retain estate counsel. Again, with the oversight of the inspectors, a trustee instructs estate counsel to carry out specific tasks. Estate counsel is not a “free agent” to do as he or she wills. Estate counsel’s role is to provide legal advice and recommendations to the estate as represented by the trustee and to then act upon the instructions of the trustee. It is the trustee that ultimately makes the decisions (as approved by the inspectors). Estate counsel does not dictate to the trustee. If estate counsel refuses to follow the instructions of the trustee, then the trustee should terminate the retainer of that particular lawyer. Similarly, the trustee must not abdicate its decision making role to estate counsel.

It is also the responsibility of a trustee to ensure that the conduct of estate counsel is appropriate and in keeping with the duties of the trustee as an officer of the Court. The

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<sup>15</sup> Impact Tool & Mould Inc., *supra*, paragraph 33

consequences of misconduct on the part of estate counsel are ultimately the responsibility of the trustee. Estate counsel cannot be permitted to wage vendettas against creditors or actively participate in battles between creditors.

“The duties and obligations of trustees in bankruptcy apply equally to their counsel. Counsel too are officers of the Court. They are not ordinary counsel representing one litigant entitled to wage war with the bankrupt, or to prefer one creditor over another utilizing all of the artillery of the adversary system. They are obliged to act neutrally and fairly throughout, to all creditors and to the bankrupt.”<sup>16</sup>

The trustee is also ultimately responsible for ensuring that the fees of estate counsel to the estate are reasonable and justifiable. A trustee must do more than simply “rubber stamp” bills of costs. The trustee should be aware of the hourly rates being charged by estate counsel and the amount of time spent on a particular task by estate counsel. Again, a trustee need only imagine being at the hearing of its SRD and being asked on cross-examination whether he was aware of how much time estate counsel spent on a particular task and why it took so long. If the trustee is unable to answer such questions in open Court, the trustee has quite simply not followed through on its obligation to the estate and the creditors.

The mandate of estate counsel should also be carefully addressed by the trustee. If estate counsel is solely retained to review and opine on security documents, then that should be made explicit to the lawyers. If the retainer is to be broader, then one would expect that, for the sake of efficiency, lawyers would not turn to the trustee for

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<sup>16</sup> Engles v. Richard Killen & Associates Ltd., (2002), 35 C.B.R. (4<sup>th</sup>) 77

instructions on all day to day matters. However, lawyers must seek instructions on matters of any significance or where their actions will result in any substantial legal fees or may expose the estate to an award of costs. It is strongly recommended that trustees consider the use of formal retainer agreements with estate counsel so that there is no confusion as to the scope of the lawyer's retainer or authority.

**PART II – BEST PRACTICES TO PROTECT A TRUSTEE ON THE HEARING OF ITS FINAL STATEMENT OF RECEIPTS AND DISBURSEMENTS.**

What can trustees do to protect themselves in this “brave new world” where their fees and disbursements are under close scrutiny and their conduct and decisions are subject to second guessing? The answer, yet again, lies within the BIA Rule Book. Here are some suggestions as to best practices which will help trustees fend off a creditor's challenge to their fees and disbursements and assist the Court in determining the legitimacy of those fees and disbursements at a hearing of the SRD.

**(1) Detailed Time Records**

The Court may approve the trustee's fees and disbursements where the trustee is able to provide detailed evidence as to the work done, supported by the appropriate documents; however, the task will be difficult for the Court without proper time records. Yet, the question one has to ask is why a trustee would want to place itself in such a vulnerable position? In the absence of time records, a trustee faces far greater exposure to challenges by creditors and may find it more difficult to convince the Court that its

fees and disbursements are appropriate. In the case of Sally Creek, the appellate Judge upheld the Registrar's decision to reject all of the trustee's fees which were not supported by time dockets given that the trustee had otherwise failed to lead any evidence as to what work was carried out in circumstances where there were no time records.<sup>17</sup>

**(2) Proper Minutes of Inspectors' Meetings**

- ▶ Have an assistant present to keep notes of inspectors meetings so that the trustee is freed up to handle the meeting and advise the inspectors while someone else is taking detailed and accurate notes.
  
- ▶ Prepare and circulate draft minutes of inspectors meetings to everyone present, as soon as possible, and ensure that inspectors sign off on the minutes as soon as possible. Inspectors should be encouraged in covering letters or emails to advise the trustee of any significant omissions or inaccuracies in the minutes.
  
- ▶ Prepare proper resolutions for the inspectors and have them vote on those resolutions with the results then being accurately recorded. It is not enough to record that the Trustee recommended that "Smith Barristers" be retained as estate counsel. There must in fact be a resolution of the inspectors actually approving the retainer of "Smith Barristers".

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<sup>17</sup> Sally Creek, *supra*

**(3) Ensure that Inspectors are made Aware of their Responsibilities**

- ▶ In order to properly carry out their duties, inspectors require more than the “Inspectors Handbook”. It is suggested that trustees have a standard form Memorandum which is provided to inspectors. The Memorandum would advise inspectors on the process of reviewing Bills of Costs, instructing legal counsel, instructing the trustee, approving the trustee’s actions, the process of allowing or disallowing claims of creditors and other relevant issues for inspectors to consider. It would be difficult, in the face of such a document having been provided to inspectors, for any creditor to argue that the trustee failed in its obligation to assist the inspectors in carrying out their duties.

**(4) Keep the Inspectors Informed of Key issues/disputes and Provide them with Copies of Key Communications and Documents for their Review**

- ▶ Transparency will blunt any arguments by creditors that the trustee failed to disclose key information to the inspectors which was required for the inspectors to carry out their duties.
  
- ▶ The Court of Appeal in *Impact Tool & Mould Inc.* made it clear that inspectors must have the documents and information necessary to carry out their duties.

**(5) Seek out Inspector Authorization for any Significant Expenditures**

- ▶ In Sally Creek, the appellate Judge agreed with the Registrar’s decision

that the trustee should not be compensated for all of the time spent responding to professional complaints because the trustee did not have inspector approval and also did not have prior approval of the Court. This resulted in a \$50,000.00 reduction. Again, one has to wonder why a trustee would take the risk of spending estate funds or carrying out any of the powers/tasks set out in section 30 of the BIA without inspector approval. The anticipated denial of inspector approval is simply not a good enough reason.

**(6) Provide Effective Oversight of Legal Fees and Disbursements**

- ▶ Insist upon written retainer agreements which set out the role of estate counsel, the names and hourly rates of the lawyers who will primarily be working on the file. The retainer agreement should provide that the hourly rates being charged to the estate should not be increased without the consent of the Trustee.
  
- ▶ All Bills of Costs must show the time spent on each entry/task. The Bills of Costs should also show the names of each lawyer or clerk who docketed time to the file and their hourly rates.
  
- ▶ Insist that the number of lawyers on the file be reasonable and that the estate not be billed for any turnover on the file which was entirely the result of matters beyond the control of the estate.

- ▶ Insist that work be carried out at appropriate rates. Ensure that legal research is carried out by more junior lawyers in most circumstances (there will always be exceptions dictated by the importance of the issues). This and the prior item can be addressed in the retainer agreement. Also ensure that only one lawyer attends on scheduling or unopposed motions or on consent motions except when legitimate interests of the estate dictate otherwise.
  
  - ▶ Ensure that there is some form of agreement with estate counsel that any interim amounts paid out by the estate shall be returned to the estate in the event that a Court subsequently rules that the fees paid were somehow improper and not a proper disbursement to the estate. This can also be addressed in the retainer agreement.
  
  - ▶ Ensure that the inspectors have sufficient information to review and sign off on Bills of Costs. Inspectors should be made aware of any legal services which were not authorized by the trustee and the fact that the estate should not pay for such services.
- (7) **Transparency in Communications with Inspectors, Creditors, Estate Counsel and the OSB.**
- ▶ Lawyers generally write all emails and letters to the opposing party and any third parties on the assumption that all such communications will

eventually be attached as an exhibit to an affidavit and will be read by the Court. Trustees should do the same.

- ▶ A trustee should be candid with creditors and their lawyers. As an officer of the Court, the trustee is expected to be up front about all problems within the estate and to propose resolutions. Problems cannot and should not be swept under the rug in the hopes that none of the creditors will uncover the problem at a later date.

As can be readily seen from the items discussed in this paper, the majority of the legal principles and the BIA provisions as applied in the case of Sally Creek have long been known to trustees and lawyers. The decisions (thus far) in Sally Creek did not create an entire set of new rules and procedures for trustee conduct. The decisions in Sally Creek were simply the application of long established BIA rules, procedures and principles. It is now simply a question of trustees playing by the “Rule Book” or facing the prospects of being severely penalized on the hearing of their SRDs. The choice should be simple.