

FOCUS ON BANKRUPTCY & INSOLVENCY

BANKRUPTCY INSPECTORS:

effective overseers or rubber stampers?

By Michael Nowina

The participation of inspectors in the bankruptcy system as elected representatives of creditors of a bankrupt is intended to protect the interests of the general body of creditors by requiring the trustee in bankruptcy to consult with and obtain inspector authorization for certain actions. Inspectors act as a watchdog on the trustee, thereby ensuring that the general body of creditors (to whom the inspectors owe a fiduciary duty) will be protected from unnecessary costs incurred by an overzealous trustee.

Ironically, the ability of the inspectors to fulfill this important role is mostly dependent upon the conduct of the trustee, who is entrusted with the duty to act fairly and properly towards all inspectors.

The entire foundation of the bankruptcy system in Canada is premised on the idea that inspectors will have the necessary knowledge and experience to discharge their duties. The reality is that inspectors are usually laypersons, sometimes the credit managers of large creditors, unfamiliar with the bankruptcy system and what is supposed to happen in the average individual or corporate bankruptcy.

On the other hand, the trustee is an insolvency professional who earns his or her livelihood by the fees generated through the bankruptcy.

After their election by the

creditors, inspectors should be given a handbook prepared by the Office of the Superintendent of Bankruptcy (OSB) with a basic overview of the inspector's role. Armed with this, it is then up to the inspectors to provide effective oversight of the trustee.

Thankfully, the vast majority of trustees conduct themselves professionally and take seriously their dual responsibility to provide inspectors with proper information and advice as well as to take direction from the inspectors.

This is supplemented with a general code of ethics which forms part of the general rules to the *Bankruptcy and Insolvency Act*. This code prescribes a number of standards for trustee conduct, including that trustees shall provide full and accurate information to, amongst others, the inspectors.

But to work properly, the process relies in large part on the trustees themselves as officers of the court. Neither the court nor the OSB have the resources to micromanage the number of bankruptcies that flow through the system each year.

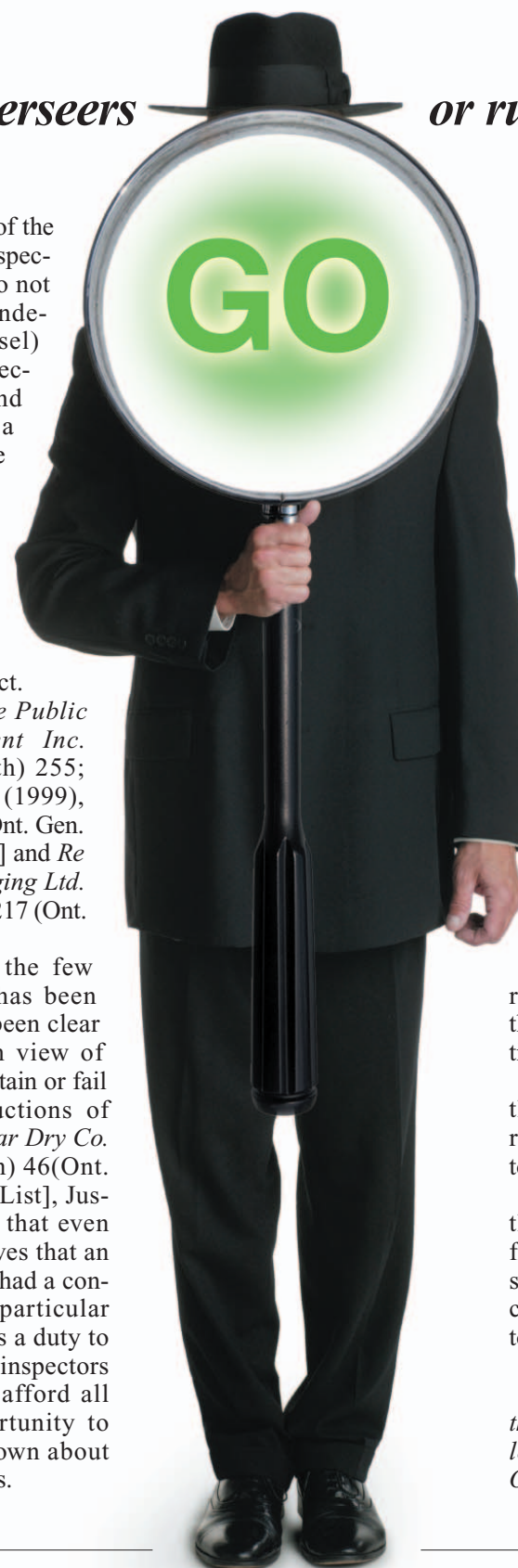
The system is open to problems when a trustee becomes lax in calling inspector meetings and recording inspectors' instructions. And even more problematic, is the susceptibility of the system to abuse when trustees deliberately fail to seek instructions from inspectors, perhaps thinking that they know better.

These types of issues rarely

come to the attention of the courts, because the inspectors (who normally do not have the benefit of independent legal counsel) themselves may not recognize the issues and frequently there is not a lot of money in the bankruptcy to fight over them.

Without a doubt, the vast majority of reported decisions deal with cases involving inspector, not trustee, misconduct. (See for example, *Re Public Eyecare Management Inc.* (1998), 7 C.B.R. (4th) 255; additional reasons at (1999), 14 C.B.R. (4th) 264 (Ont. Gen. Div. [Commercial List] and *Re Global Plastic Packaging Ltd.* (2004) 2 C.B.R. (5th) 217 (Ont. S.C.J.))

Nevertheless, on the few occasions where it has been proven, judges have been clear that they take a dim view of trustees who fail to obtain or fail to follow the instructions of inspectors. In *Re Cynar Dry Co.* (2005), 8 C.B.R. (5th) 46 (Ont. S.C.J.) [Commercial List], Justice Cummings held that even where a trustee believes that an inspector would have had a conflict of interest on a particular matter, the trustee has a duty to notify and inform all inspectors about issues and to afford all inspectors the opportunity to make their views known about contemplated decisions.



Cynar Dry involved a trustee signing a release which significantly prejudiced the major creditor, without properly consulting the inspectors and ignoring the inspector appointed by the major creditor. Justice Cummings held that by choosing to simply ignore the existence of one of the inspectors whom the trustee believed was in conflict and by failing to call a proper meeting of inspectors, the trustee had acted irresponsibly in respect of his duties to the inspectors. The court found the trustee personally responsible for the unnecessary costs incurred.

The decision is noteworthy as one of the few reported decisions dealing with trustee malfeasance in relation to inspectors. Certainly, there is significant room for further development of the law in relation to the obligations of trustees to inspectors.

Unless they wish to become the test case, trustees should remember that there is no need to “go it alone.”

The Act provides recourse for the trustee to seek directions from the court if the trustee considers that the inspectors are in conflict or to override inspectors' decisions.

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