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ON BANKRUPTCY & INSOLVENCY

Trustee misconduct

Trustees-in-bankruptcy must act fairly or risk fee cuts

“Trustees cannot obfuscate, prevaricate, mislead, hide behind counsel, expend estate funds without proper authorizations, and generally comport themselves as if an estate were their personal fiefdom, and then expect to be rewarded by the creditors or this Court for so doing.”

The above statement is a harsh condemnation by Registrar Nettie in *Re Sally Creek Environs Corporation*, [2008] O.J. No. 2491 (Ont. S.C.J. Reg in Bkcty) of the conduct of the trustee. It serves as a warning to all trustee and insolvency practitioners that the manner in which an estate is administered is as important as the outcome.

In *Sally Creek*, the rancour between the trustee and the major creditor (who happened to be former cottage buddies) over the administration of the estate culminated in a 14-day taxation of the trustee's final statement of receipts and disbursements. This taxation resulted in the disallowance of legal costs of approximately \$293,000 (out of total legal costs of \$333,000) as a disbursement to the estate and a reduction of the trustee's fees from over \$240,000 to \$1. *Sally Creek* reads like the Ten Commandments of what not to do when administering a bankruptcy estate.

Registrar Nettie confirmed that a trustee may be duty bound to take a position that is detrimental to the major creditor, but a trustee may not take such a position solely for tactical purposes. The decision in *Sally Creek* follows the principles set out in *Engels v. Richard Killen & Associates Ltd.*, [2002] O.J. No. 2877 (Ont. S.C.J.) (affirmed by Ont. C.A.) that a trustee is not an ordinary litigant engaging in the cut and thrust of litigation and must conduct himself with fairness, even-handedness and impartiality at all times.

Sally Creek provides a good overview of previous case law on trustee misconduct



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and the factors that a court will consider when reducing a trustee's allowable fees because of misconduct.

Sally Creek is also noteworthy as one of the few reported decisions dealing with trustee malfeasance in relation to inspectors. The purpose of having elected inspectors in the bankruptcy system as representatives of creditors of the bankrupt is to act as watchdogs of the trustee, which insures that creditors (to whom the inspectors owe a fiduciary duty) will be protected from unnecessary costs incurred by an overzealous or out-of-control trustee.

Inspectors cannot dictate to the trustee, and where inspectors are in a position of conflict of interest with respect to a particular matter, the trustee may proceed without their approval.

In *Re Cynar Dry Co.*, [2005] O.J. No. 47 (Ont. S.C.J. - Commercial List), Justice Cummings held that, even where a trustee believes that inspectors 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. This case involved a situation where a trustee signed a release that significantly



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prejudiced the major creditor without properly consulting the inspectors and ignoring the inspector appointed by the major creditor. In *Sally Creek*, the trustee was severely criticized by the court, in part, for the casual indifference shown by the trustee to the three inspectors of the estate. The failure to seek inspector approval or to go to court to seek court direction for certain legal steps taken by the trustee resulted in the disallowance of the vast majority of the trustee's legal fees.

In fixing costs of the opposing creditor, Registrar Nettie's decision made it clear that the court will consider the policy objectives of encouraging creditor participation in the insolvency system when making an award of costs. As well, since a trustee who successfully defends against allegations of misconduct is usually granted substantial indemnity costs, it is within the reasonable expectation of the parties that where an opposing creditor successfully establishes such misconduct then he or she will be entitled to substantial indemnity costs against the trustee. Although technically under the *Bankruptcy and Insolvency Act*, it is “party and party” or “solicitor and client” costs which are awarded by the court.

While the trustee is presumptively entitled to be indemnified by the estate for a costs award, the court may exercise its discretion to order that costs be paid personally when the conduct of the trustee during the bankruptcy or at the hearing itself unnecessarily lengthened or exacerbated the hearing.

The appeal of *Sally Creek* will be heard in December 2008. ■

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Purchasers in bankruptcy may owe back pay



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The federal government recently introduced reforms that will provide limited protection to workers when their employer declares bankruptcy or becomes subject to receivership. However, these reforms leave unanswered the question of whether a purchaser in bankruptcy who is deemed a successor employer pursuant to provincial legislation should be liable for the unmet pecuniary obligations of the debtor toward its unionized employees.

One of the government's key reforms is the Wage Earner Protection Program (WEPP), which provides for the payment of outstanding wages (up to a maximum of \$3,000) to workers whose employment is terminated as a result of a bankruptcy or receivership. The term “wages” is defined to include salary and vacation pay, but does not include severance or termination pay and other benefits.

The claims of workers under the WEPP are secured against current assets of the debtor to the extent of \$2,000. Division 1 proposals under the *Canada Bankruptcy and Insolvency Act* (BIA) and plans of compromise or arrangement under the *Canada Companies' Creditors Arrangement Act* must provide for payment of those claims immediately after court approval of the proposal or plan.

By creating the reforms noted above, the government has recognized the vulnerability of workers in the event of a bankruptcy and, to the extent that employee wages will be given