



Insolvency News

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The Wage Earner Protection Program and the Employee Remuneration Charge

*E. Patrick Shea**

The amendments to the *Bankruptcy and Insolvency Act* (the “**BIA**”) that create a charge in favour of employees for unpaid remuneration in the event of the bankruptcy, receivership or interim receivership of their employer – the Employee Remuneration Charge or the ERC – and the *Wage Earner Protection Program Act* (the “**WEPPA**”) came into force on July 7, 2008.

The Employee Remuneration Charge is a statutory charge over a debtor’s “current assets”¹ that arises automatically when: (a) the debtor becomes bankrupt; or (b) a receiver within the meaning of s. 243(2)² of the BIA or an interim receiver is appointed in respect of the debtor. In a bankruptcy, the ERC will rank in priority to every other claim, right, charge or security interest in or against the debtor’s current assets, except for: (a) an unpaid suppliers right to recover goods under s. 81.1 of the BIA; (b) the charge in favour of unpaid farmers, fishermen and aquaculturists that arises by operation of s. 81.2 of the BIA; and (c) statutory deemed trust claims that survive bankruptcy by virtue of s. 67(3) of the BIA. The priority afforded to the ERC in a receivership or interim receivership is slightly different than in a bankruptcy in that the ERC will also rank in priority statutory deemed trust claims when a receiver or interim receiver is appointed and there is no bankruptcy.

The ERC is applicable: (a) in bankruptcy proceedings where the debtor becomes bankrupt on or after July 7, 2008 or the bankruptcy results from proposal proceedings commenced on or after July 7, 2008; or (b) in receiverships or interim receiverships where the receiver or interim receiver is appointed on or after July 7, 2008.

The WEPPA establishes a government-administered program – the Wage Earner Protection Program or the WEPP – to provide compensation for remuneration owing to the employees in the case of the bankruptcy or receivership of their employer. Employees will be entitled to claim under the WEPP for compensation where their employment is terminated in the context of the bankruptcy or receivership.

The WEPP applies in respect of amounts owing by an employer: (a) who became bankrupt on or after July 7, 2007; or (b) whose property came under the possession or control of a



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receiver within the meaning of s. 243(2) of the BIA on or after July 7, 2008. The WEPP will not be triggered where an interim receiver is appointed, unless the interim receiver is determined to be a receiver within the meaning of s. 243(2) of the BIA.³

The ERC and the WEPP were brought into force at the same time and there has been a lot of discussion with respect to the linkages between the ERC and the WEPP in terms of the coverage provided to employees. There are, however, significant differences in the scope of the WEPP and the ERC and coverage provided by the ERC and the WEPP. This article will provide a brief comparative analysis of the key aspects of the coverage provided by the ERC and the WEPP.

A. Coverage Limit

The ERC secures up to \$2,000 wages, salaries, commissions or compensation for services rendered and vacation pay owing to most employees, and up to \$1,000 in disbursements owing to most travelling salespeople.

The WEPP, on the other hand, provides coverage for unpaid salaries, commissions, compensation for services rendered, vacation pay, gratuities, bonuses and shift premiums and disbursement for most employees and travelling salespeople. The maximum amount of the claim that can be paid out to an employee under the WEPP is the greater of \$3,000 or an amount equal to four times the employee's maximum insurable earning under the *Employment Insurance Act*.

The WEPP and the ERC do not provide coverage for termination or severance pay. Nor do they provide coverage for employee benefits.

B. Coverage Period

The WEPP provides coverage for remuneration earned during the six months prior to the date of bankruptcy or the first date that a receiver was appointed in respect of the employer. (See Fig. 1)

It appears that a bankruptcy after July 7, 2008 may give rise to claims under the WEPP in respect of remuneration owing by an employer in respect of whom a receiver was appointed more than six months prior to July 7, 2008.

The WEPP only applies where the bankruptcy occurs after July 7, 2008, but the WEPPA appears to provide coverage for remuneration owing by an employer that was placed into receivership prior to July 7, 2008 in respect of remuneration owing for services performed in the six month prior to the date the receiver was appointed. The WEPP provides coverage for remuneration owing in respect of services provided for the six month prior to the date of the bankruptcy **OR** the first day a receiver was appointed in respect of the employer. A bankruptcy on or after July 7, 2008 of a debtor in respect of whom a receiver was appointed years ago may give rise to claims under the WEPP for wages owing in respect of services provided during the six month prior to the date the receiver was appointed, notwithstanding that the receivership pre-dated the coming into force of the WEPPA. Where an employer is bankrupt and also subject to a receivership, the WEPPA provides that the amount covered by the WEPP is the greater of the amount determined in respect of the bankruptcy and the amount determined in respect of the receivership.

In the case of a bankruptcy, the ERC will secure remuneration owing in respect of the period beginning six months prior to the date of the initial bankruptcy event and ending on the date of bankruptcy. Where a receiver or interim receiver is appointed, the ERC will cover remuneration owing in respect of the six months prior to the appointment of the receiver or interim receiver.

A bankruptcy after July 7, 2008 will not result in the Employee Remuneration Charge being triggered in respect of wages owing more than six months prior to July 7, 2008.

The provisions of the BIA that create the ERC in the event of a bankruptcy are distinct from the provisions of the BIA that provide for the ERC in the event a receiver or interim receiver is appointed and there is no linkage between the provisions. The provisions of the BIA that create the ERC in a receivership provide that the ERC will secure remuneration owing for services performed in the six months prior to the appointment of the receiver. The BIA provisions that create the ERC in the case of a bankruptcy provide for the charge to apply in respect of remuneration owing for services performed in the period beginning six months prior to the date of the initial bankruptcy event and the appointment of a receiver is not an initial bankruptcy event. As a result, the ERC arises only where the bankruptcy or the date of the initial bankruptcy event is after July 7, 2008 and a bankruptcy after July 7, 2008 will give rise to security only for employee remuneration owing for the six months prior to the date of the bankruptcy.

C. Limitations on Coverage

The ERC will not secure claims by a debtor company's officers and directors. In addition, persons who did not deal with the debtor at arms'-length will only be entitled to benefit from the ERC if the trustee, receiver or interim receiver is of the opinion that the employment contract between the debtor and the non arms'-length party was on arms'-length terms.

The scope coverage provided by the WEPP may be somewhat narrower than the ERC. Aside from officers and directors s. 6 of the WEPPA excludes: (a) persons with a controlling interest in a corporate employer - persons who own 40% of the voting shares of a corporate employer or who control sufficient shares of a corporate employer to control the corporate employer; (b) managers - persons who make financial decisions or decisions with respect to payment of employee remuneration; and (c) persons who did not deal at arms'-length with any of the foregoing persons from making claims under the WEPP. The WEPPA provides the Minister with very little discretion in dealing with claims submitted by persons who are excluded by operation of s. 6 of the WEPPA. The only discretion is provided with respect to employees who are related, within the meaning of the BIA, to officers, directors, etc. and whether they dealt at arms'-length with the officer, director, etc.⁴

** E. Patrick Shea, C.S., Gowling Lafleur Henderson LLP.*

¹ The definition of "current assets" has not been brought into force. This definition is key to the application of the Employee Remuneration Charge because the ERC attaches only to the debtor's current assets, which is (intended to be) defined as "cash, cash equivalents – including negotiable instruments and demand deposits – inventory or accounts receivable, or the proceeds from any dealing with those assets".

² The amendment to the definition of "receiver" in s. 243(2) of the BIA has not been brought into force. The key difference between the current definition of "receiver" and the amended definition will be the specific inclusion of a receiver appointed under s. 243(1) of the BIA – a provision that is also not in force.

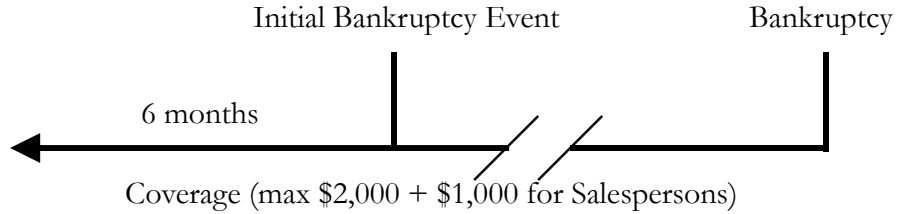
³ Subsection 243(2) defines a "receiver" as a person appointed to take or who takes possession or control of all or substantially all of the inventory, accounts receivable or other property of a debtor that was acquired for or used in relation to a business carried on by the debtor.

⁴ Note that s. 2(5) of the WEPPA appears to reference a provision of the BIA that is not yet in force.

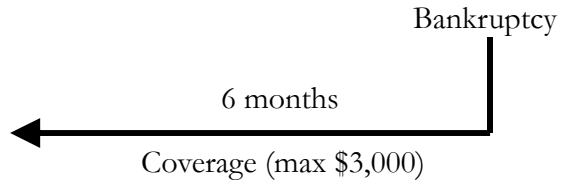
EMPLOYEE REMUNERATION COVERAGE

I. BANKRUPTCY

A. Employee Remuneration Charge



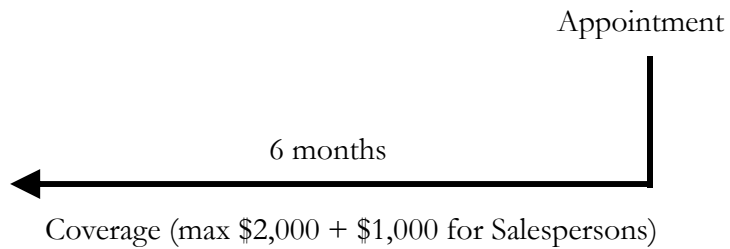
B. WEPP



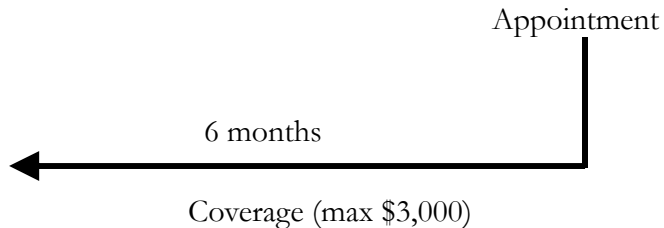
Note: Coverage under the WEPP is the greater of \$3,000 and an amount equal to four times the maximum weekly insurable earnings under the *Employment Insurance Act*.

II. RECEIVERSHIP

A. Employee Remuneration Charge



B. WEPP



Note: Coverage under the WEPP is the greater of \$3,000 and an amount equal to four times the maximum weekly insurable earnings under the *Employment Insurance Act*.

Message from the Chair

*Alex MacFarlane**



I would like to welcome all members of the OBA Insolvency Law Section and our colleagues at the Ontario Association of Insolvency and Restructuring Professionals (“OAIRP”) to the start of an extremely interesting and exciting year in the area of insolvency, bankruptcy and restructuring. Much has changed since this time last year when the United States and Canadian economies were at the initial stages of the now well-entrenched “credit crunch” and capital markets crisis, which have predominated the news in the United States and Canada for the past year. The economy in Ontario has also been subject to significant economic and structural realignment, which could have a more pronounced ripple effect on the larger economy in the months ahead. Moreover, the long-awaited *Wage Earner Protection Programme Act* (“WEPPA”) and the corresponding amendments to the *Bankruptcy and Insolvency Act* to create the Employee Remuneration Charge and the related Pension Charge came into force on July 7, 2008 and have already had a significant effect upon the insolvency landscape.

The OBA Insolvency Law Executive have responded to these economic and legislative developments by diligently working to formulate an interesting series of programs over the course of the Fall/Winter of 2008-2009 which will address (i) the challenges facing the auto sector (September 17, 2008); (ii) the impact of the legislative amendments (December 1, 2008) in conjunction with the Law Society of Upper Canada; and (iii) the OBA’s Annual Institute program (February, 2009).

The OBA’s Insolvency Law Section Newsletter, which is published on a quarterly basis, continues to provide timely and important updates on insolvency law from across Canada. The Newsletter Editors, Roger Jaipargas, Dominic Magisano and Sanj Mitra, continue to encourage all members of the OBA Insolvency Law Section and OAIRP members to regularly contribute articles to the newsletter.

This year, we have again been most fortunate to have the benefit of a well-rounded and active Executive, which is well-positioned to take on the challenges of the months ahead. I look forward to seeing each of our Section members and our colleagues from the OAIRP at the various educational and social events that we plan to host throughout the course of the upcoming year.

Best regards,

** Alex MacFarlane, Fraser Milner Casgrain LLP.*

Case Comment on Sally Creek Taxation

Trustee's Misconduct Results in Substantial Fee Reduction

*Bobby Sachdeva and Michael Nowina**

“A more bizarre set of circumstances is hard to imagine...” This comment by Registrar Nettie in *Re Sally Creek Environs Corporation* 2008 CarswellOnt 3702 (“*Sally Creek*”) was directed at the fact that the Trustee’s counsel had made legal arguments at an arbitration hearing to determine the validity of certain proofs of claim which directly contradicted the evidence of his own client, the Trustee, at the arbitration.

The term “bizarre” is equally applicable to the rancour between the Trustee and the major creditor (who happened to be former cottage buddies) and the manner in which the estate was managed by the Trustee. All of which 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 \$293,000.00 (out of total legal costs of \$333,000.00) as a disbursement to the estate and a reduction of the Trustee’s fees from over \$240,000.00 to \$1.00.

While *Sally Creek* is certainly an interesting read, the case also reaffirms the following important principles on the issues of trustee conduct, the management of an estate and the role of inspectors in the insolvency process.

1. Bankruptcy inspectors provide an important oversight function and a trustee should take all possible steps to enable the inspectors to fulfill their statutory duties. A trustee should take steps to educate inspectors on their roles and responsibilities and not ignore the inspectors or fail to follow their instructions, especially when dealing with complicated or contentious issues.
2. The right to seek directions from the court pursuant to section 119(2) of the *BIA* is a powerful protection afforded to trustees. The failure to exercise that right will be viewed unfavourably by the court, especially in situations where a trustee’s interests (for example, in retaining personal counsel to defend professional complaints) are in conflict with those of the creditors. A trustee should not simply override the wishes or instructions of inspectors.
3. The burden is on a trustee to persuade the court that the decisions or actions of the inspectors should be revoked or varied.
4. Obtaining the authorization of the inspectors to retain a solicitor is more than a mere formality. Failure to obtain proper authorization can be fatal to a trustee’s recovery of legal costs incurred as a disbursement on the trustee’s final statement of receipt and disbursements.
5. A trustee can obtain the oral authorization of the inspectors to retain a solicitor. However, this is fraught with evidentiary problems and it is wise to obtain written authorization at properly constituted meetings of inspectors.
6. The spirit and letter of the *BIA* mandates that it is the trustee who exercises his or her judgment over matters affecting the bankruptcy estate. A trustee will not be permitted to hide behind the actions of his counsel. A trustee must control and direct his or her legal counsel.

7. A trustee may take a position that is detrimental to the major creditor, such as disallowing the creditors' proof of claim, and may change that position if new evidence is received that warrants the change. What a trustee may not do is take such a position solely for tactical purposes.
8. A trustee must conduct himself or herself with fairness, even-handedness and impartiality at all times. A trustee is not an ordinary litigant engaging in the cut and thrust of litigation.
9. A trustee should take proper minutes of meetings and ensure that the inspectors pass proper resolutions. Certain formalities must be followed. The failure to have inspectors execute formal resolutions can be fatal to the argument that a trustee's actions were properly authorized.

Sally Creek also provides a good overview of previous case law on trustee misconduct and the factors that a court will consider when reducing a trustee's allowable fees because of misconduct. As stated by Justice Farley in *Confederation Treasury Services Ltd., Re* 1995 CarswellOnt 1169 when reviewing the grounds for the removal of a trustee:

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.** (emphasis added)

In noting Justice Farley's clear warning, Registrar Nettie found in *Sally Creek* that the Trustee's conduct was egregious and warranted a large reduction in the Trustee's fees. Registrar Nettie's decision was intended to uphold the integrity of the insolvency regime and to send a strong message to the Trustee and others that this type of misconduct will not be tolerated.

Lastly, the *Sally Creek* decision affirms the critical role of the trustee as an officer of the court in the insolvency process and the need for a trustee to maintain the highest level of integrity and impartiality. Trustees are afforded significant protections by the *BIA* and the Court. The courts also rely upon a trustee's business judgment. In return, the integrity and candour of trustees must be beyond reproach.

This decision is currently under appeal.

* *Bobby Sachdeva and Michael Nowina, Pallett Valo LLP.*

Bankruptcy Trustee's Personal Liability – Avoiding the Dangers Enumerated by *Greenstreet Management*

Harvey Garman and Laura Shiner*

While rarely done, section 197(3) of the *Bankruptcy and Insolvency Act* (the “BIA”) authorizes a court to hold a bankruptcy trustee personally liable for the costs of its conduct. The principles underlying section 197(3) were recently reviewed and discussed by one of the leading authorities of Canadian bankruptcy law, Morawetz J., in the Ontario Superior Court of Justice case of *Greenstreet Management*¹ where the Court used its statutory discretion to award costs personally against a trustee.

Greenstreet Management involved a case where the trustee originally brought a motion for directions as to the entitlement of the bankrupt estate to certain deposit proceeds which had been paid into Court. The trustee took the position that the funds were no longer to be held in trust and requested a declaration that they constituted property of the bankrupt estate rather than property of an aggrieved creditor. The Court sided with the creditor and the creditor subsequently requested that a costs award be made against the trustee personally under section 197(3) of the BIA.

The creditor made several arguments as to why the trustee should pay costs. Significantly, the creditor had previously provided the trustee with a detailed analysis of the law and supporting cases to show that the trustee's position was without merit and had warned the trustee that if it pursued the motion, the creditor would seek an award of costs personally against it. The creditor also submitted that in the circumstances, it was reasonable to assume that the trustee had obtained appropriate cost indemnities before bringing the motion.

The trustee argued that no costs should be awarded for three reasons. First, the issue at bar had not been settled by the prior case law. Second, the trustee needed to bring the motion because of the creditor's position that the deposit had been forfeited. Third, the creditor's materials included irrelevant documents and unwarranted attacks on the trustee and the bankrupt.

In his reasons for holding the trustee personally liable, Morawetz J. relied on the principle from *Vancouver Trade Mart*² that trustees in bankruptcy should not be allowed to pursue litigation with immunity against personal liability for costs in circumstances where there is no statutory duty to prosecute the litigation and the trustee knows or ought to know that there will likely be insufficient assets in the estate to satisfy a cost award in the event of unsuccessful litigation. The decision to award such costs personally against a bankruptcy trustee always remains one of judicial discretion.

In the case at bar, Morawetz J. found that there were several reasons why a cost award against the trustee was appropriate. First, the trustee knew that there were no other assets in the estate. Second, the trustee was not statutorily obligated to bring the motion. Third, the trustee did not remain neutral, but rather took an adversarial position. Fourth, the trustee accepted the inherent risk with litigation and in view of the lack of assets in the estate, it was up to the trustee to seek an appropriate source of indemnity. Morawetz J. also noted that caselaw principles are often uncertain in many potential actions and this does not mean that a bankruptcy trustee can proceed with immunity.

Greenstreet Management should be remembered whenever a bankruptcy trustee is determining whether to pursue litigation on behalf of the estate. While it is often the case that a bankruptcy trustee will not have

discretion, it is always important for the bankruptcy trustee to obtain appropriate protection which may include an indemnity either from the estate as sanctioned by the inspectors, or if no assets are available to backstop an estate indemnity, then some other source must be found. Additionally, it is critical for the bankruptcy trustee to act as a neutral arbiter and to obtain appropriate legal advice at all times before embarking on a course of action that may expose the bankruptcy trustee to undue monetary risk.

** Harvey Garman is an associate in the Financial Services Group and Business Reorganization Group at Cassels Brock & Blackwell LLP. Laura Shiner is a summer student-at-law at Cassels Brock & Blackwell LLP.*

¹ *Greenstreet Management Inc. (Re)*, 2007 CanLII 49869 (ON S.C.); 2008 WL 1709161 (Ont. S.C.J.); 2008 Carswell Ont 2043.

² *Vancouver Trade Mart Inc. (Trustee of) v. Creative Prosperity Capital Corp.* (1998), 7 C.B.R. (4th) 3, 1998 Carswell BC 2528 (B.C.S.C.).

Secured Claims in Proposal Proceedings

*Roger Jaipargas and Mary Arzoumanidis**

In the recent decision of *Re WorkGroup Designs Inc.*,¹ the Ontario Court of Appeal considered the provisions of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the “BIA”) which relate to valuing and determining the claims of secured creditors in proposal proceedings under the BIA.

Background

The Royal Bank of Canada (“RBC”) appealed the Order of Justice Wilton-Siegel which set aside an Order made by the Deputy Registrar in Bankruptcy which found that RBC was a secured creditor of *WorkGroup Designs Inc.* (“WorkGroup”). The Court of Appeal allowed the appeal and restored the Order of the Deputy Registrar in Bankruptcy.

RBC held a general security agreement over all of the assets, property and undertaking of WorkGroup. WorkGroup filed a proposal to its creditors pursuant to the provisions of the BIA. The proposal treated RBC as an Affected Secured Creditor and also required the trustee to determine the value of all “Proven Affected Secured Claims”, which was defined in the proposal to mean the value of any proven claim to the extent of the value of the secured property, as determined by the trustee in relation to that claim, subject to appeal rights. RBC filed a Proof of Claim as a secured creditor of WorkGroup in the amount of approximately \$125,000 and voted against the proposal.

Relying on section 135(3) of the BIA, the proposal trustee disallowed RBC’s secured claim. Section 135(3) of the BIA provides as follows:

Notice of determination of disallowance

135 (3) Where the trustee makes a determination under subsection (1.1) or, pursuant to subsection (2), disallows, in whole or in part, any claim, any right to a priority or any security, the trustee shall forthwith provide, in the prescribed manner, to the person whose claim was subject to a determination under subsection (1.1) or whose claim, right to a priority or security was disallowed under subsection (2), a notice in the prescribed form setting out the reasons for the determination or disallowance.

The disallowance of the RBC secured claim was based on the proposal trustee's view that there were no assets over which RBC held any security. All of WorkGroup's assets were encumbered by the Canada Revenue Agency ("CRA") in priority to RBC for employee withholdings that WorkGroup failed to remit. Applying a liquidation analysis, the proposal trustee determined that the CRA's prior claim exceeded the value of WorkGroup's assets. Since there would be insufficient assets to satisfy the CRA's claim, there could be no assets over which RBC could hold any security. Accordingly, the proposal trustee admitted the RBC claim as an unsecured claim.

The Decision of the Deputy Registrar in Bankruptcy

RBC appealed the proposal trustee's disallowance of its claim as a secured creditor to the Deputy Registrar in Bankruptcy.² Deputy Registrar Diamond allowed the appeal and restored RBC's secured creditor status. He found that while the proposal and section 50.1 (2) of the BIA specifically provided the proposal trustee with an opportunity to value the RBC claim, the proposal trustee did not do so. Rather, the approach taken by the proposal trustee was to disallow the claim pursuant to section 135(3) of the BIA on the basis that all the assets were encumbered by the super-priority claim of the CRA.

The Decision of Justice Wilton-Siegel

WorkGroup appealed the decision of Deputy Registrar Diamond to the Ontario Superior Court of Justice.³ Justice Wilton-Siegel allowed the appeal, finding the proposal had not complied with section 50.1 of the BIA. He went on to state that a proposal is intended to be a flexible proceeding under the BIA and, to permit this, sections 135(3) and 60(2) of the BIA collectively create a structure for a claims process administered by the proposal trustee that can be adapted to the specific circumstances of any particular proposal.

Justice Wilton-Siegel held that those provisions provided the proposal trustee with the authority to determine the quantum, if any, of RBC's secured claim under the proposal and subsequently disallow RBC's claim as a secured creditor. He also noted that there was no prejudice to RBC if the trustee's disallowance necessitated an appeal under section 135(3) rather than under section 50.1(4) of the BIA. In either case, the nature of the appeal would be the same.

The Decision of the Court of Appeal

The Court of Appeal found that the appeal by RBC should be allowed having regard to the proper interpretation of the provisions of the BIA. In particular, Justice Rouleau phrased the issue to be determined on appeal as follows: whether in a bankruptcy proposal, a proposal trustee can invoke the general statutory power set out in section 135 of the BIA to assess the value of a secured creditor's claim and disallow that claim, thereby eliminating the secured creditor's vote as a secured creditor on the proposal.

The Court of Appeal held that the statutory interpretation issue was dispositive of the appeal and the valuation issues did not need to be addressed. On a proper interpretation of the provisions of the BIA, Justice Rouleau stated that section 135 of the BIA cannot be used by a proposal trustee for the purpose of valuing and disallowing a secured claim. Rather, the proposal trustee should have adopted the procedure set out in section 50.1 of the BIA, which specifically addresses the proper approach to be applied where a proposal has been made.

Section 50.1 of the BIA provides as follows:

Secured creditor may file proof of secured claim

50.1 (1) Subject to subsections (2) to (4), a secured creditor to whom a proposal has been made in respect of a particular secured claim may respond to the proposal by filing with the trustee a proof of secured claim in the prescribed form, and may vote, on all questions relating to the proposal, in respect of that entire claim, and sections 124 to 126 apply, in so far as they are applicable, with such modifications as the circumstances require, to proofs of secured claim.

Proposed assessed value

(2) Where a proposal made to a secured creditor in respect of a claim includes a proposed assessed value of the security in respect of the claim, the secured creditor may file with the trustee a proof of secured claim in the prescribed form, and may vote as a secured creditor on all questions relating to the proposal in respect of an amount equal to the lesser of

- (a) the amount of the claim, and
- (b) the proposed assessed value of the security

...

(4) Where a secured creditor is dissatisfied with the proposed assessed value of his security, the secured creditor may apply to the court, within fifteen days after the proposal is sent to the creditors, to have the proposed assessed value revised, and the court may revise the proposed assessed value, in which case the revised value henceforth applies for the purposes of this Part.

RBC submitted that the proposal trustee is under an obligation to follow the procedure set out in section 50.1 of the BIA because the section *specifically* addresses the valuation of secured creditors' claims in the context of proposal proceedings. Accordingly, a general section such as section 135 of the BIA should not be relied upon in circumstances where the BIA specifically addresses a particular situation with a specific provision.

Conversely, WorkGroup argued that it was appropriate for the proposal trustee to rely upon section 135 of the BIA as section 50.1 need only be resorted to where, as set out in section 50.1(2), a proposal "includes a proposed assessed value of the security in respect of the claim." According to WorkGroup, since its proposal did not contain a proposed assessed value of RBC's secured claim, section 50.1 did not apply in the circumstances such that it was open to the proposal trustee to resort to section 135(2) to disallow RBC's secured claim. Interestingly enough, WorkGroup did concede that to the extent that a specific section in the proposal provisions of the BIA was applicable to the matter under consideration, then it would not be appropriate to resort to a section of more general application contained in another part of the BIA.

In allowing the appeal, Justice Rouleau made the following observations with respect to the procedure set out in section 50.1 of the BIA:

I agree with the appellant on this issue. Properly interpreted, s.50.1 of the BIA provides direction for the determination of the value of the secured creditor's claim that the secured creditor may vote in respect of a proposal. Section 50.1(1) sets out the general rule. It provides that, subject to subsections (2) to (4), the secured creditor has the right to vote the claim as a secured creditor for the entire amount once it has filed proof of security. Section 50.1(2) provides that, where the proposal ascribes an assessed value to the claim, the secured creditor is only allowed to vote for the lesser of the amount of the claim or the proposed assessed value...

The Court of Appeal noted that the WorkGroup proposal did not include a proposed assessed value for RBC's claim as provided for in section 50.1(2) of the BIA, therefore section 50.1(1) of the BIA applied to the WorkGroup proposal: "Therefore, when RBC responded to the proposal by filing a proof of \$125,000 secured claim in prescribed form, RBC became entitled to vote 'on all questions relating to the proposal in respect of that entire claim'."

In connection with the procedure set out in section 135 of the BIA, Justice Rouleau stated that section 135 is concerned with the allowance or disallowance of the security itself for the purposes of a distribution of dividends from a bankrupt's estate.

Justice Rouleau concluded that section 50.1, which "specifically applies in this fact situation", must prevail over the more general section 135.

In allowing the appeal and restoring the Order of the Deputy Registrar in Bankruptcy, Justice Rouleau made the following concluding remarks:

As a result, since no proposed assessed value was contained in the proposal, RBC, holding a general security agreement in WGD's assets, was entitled to vote the full amount of its \$125,000 claim as a secured creditor in accordance with s.50.1(1). Taking the vote of this \$125,000 secured claim into account results in the rejection of the proposal by the secured creditors' class.

The effect of this decision would be to restore the order of the Deputy Registrar in Bankruptcy. That was the order in effect when the parties sought and obtained court approval of the proposal. My understanding, therefore, is that the proposal as accepted by the court would remain in effect and RBC would regain the status it had when the proposal was approved.

This decision of the Court of Appeal serves to clarify the procedure to be applied by a proposal trustee for evaluating and determining secured creditors' claims in the context of Division I proposals under the BIA.

** Roger Jaipargas, Borden Ladner Gervais LLP.*

Mary Arzoumanidis, Borden Ladner Gervais LLP.

¹ *WorkGroup Designs Inc., Re*, (2008), 234 O.A.C. 166, 90 O.R. (3d) 26 (Ont. C.A.).

² *WorkGroup Designs Inc., Re*, (2007) 32 C.B.R. (5th) 125 (Ont. S.C.J.).

³ *WorkGroup Designs Inc., Re*, (2007) 35 C.B.R. (5th) 291 (Ont. S.C.J.).

The Chronicles of Property of the Bankrupt: Trustees, Interim Receivers and the Law of Trusts

Roger Jaipargas*

In *Re Norame Inc.*¹ the Ontario Court of Appeal was again called upon to consider various issues of importance to insolvency practitioners. In a decision released on April 28, 2008, Mr. Justice LaForme delivered the judgment for the Court of Appeal and in so doing dismissed the appeal of Paddon + Yorke Inc., in its capacity as trustee in bankruptcy of Norame Inc. (the “Trustee”). The issue that the Court of Appeal was required to consider was whether certain funds paid to a load brokers trustee in bankruptcy for the shipping services of an independent carrier are held in trust by the trustee in bankruptcy pursuant to the provisions of the Load Brokers Regulation, O. Reg. 556/92, made under the *Truck Transportation Act*, R.S.O. 1990, c. T.22, as amended (the “Regulation”).

Background

Norame Inc. (“Norame”), prior to its bankruptcy, carried on the business of a load broker, essentially arranging transportation services for the goods of its clients, including Dimplex North America Limited (“Dimplex”). In the course of its business operations, Norame engaged Vitran Corporation (“Vitran”) as the carrier to ship the goods of Dimplex.

Prior to its assignment into bankruptcy, Norame had co-mingled funds it received from its customers with its own funds rather than segregating those funds in a trust account as required by the Regulation. Upon the occurrence of the bankruptcy, the Trustee brought a motion for advice and directions and Mr. Justice Pitt ordered that all moneys owed by shippers in respect of carriage services were to be paid to the Trustee to be held in a separate account pending further Order of the Court. Vitran subsequently commenced an action against Norame and Dimplex seeking payment of its outstanding accounts. Madam Justice Mesbur issued a Consent Order which provided that Dimplex pay certain sums to the Trustee for Vitran’s shipping services and that the Trustee deposit these moneys into a separate trust account. Subsequently, the Trustee brought a motion seeking a determination of the priority and entitlement to the funds held by the Trustee. Vitran argued that it was entitled to the funds pursuant to section 67(1)(a) of the *Bankruptcy and Insolvency Act* (“BIA”), the Regulation and the Order of Justice Mesbur, while the Trustee argued that it was entitled to distribute the funds to Norame’s creditors in accordance with the provisions of the BIA.

The motions judge concluded that the funds which the Trustee had segregated satisfied the conditions for a trust such that the funds must be paid to the carrier, as opposed to for a distribution to the creditors of the bankrupt. The Court of Appeal affirmed the decision of the lower Court.

Court of Appeal Analysis

In considering the appeal of the Trustee from the decision of the Ontario Superior Court of Justice, the Court of Appeal framed the two issues for consideration as follows:

1. Whether the trust obligations imposed by s.15 of the Regulation apply to carrier fees paid to and held by a trustee in bankruptcy; and
2. Whether the carrier fees segregated by the Trustee were held in trust pursuant to s.67(1)(a) of the BIA.

Section 67(1)(a) of the BIA provides as follows:

67(1) **Property of Bankrupt** – The property of a bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person ...

Section 15 of the Load Brokers Regulation provides that every load broker “shall hold in trust, for the benefit of the carriers to whom the load broker is liable” all money that the load broker receives in respect to the carriage of goods. Accordingly, for the purposes of the Regulation, a load broker is required to hold such funds in a segregated trust account. In discussing the appeal of the Trustee, Justice LaForme considered the “only guiding authority” namely, the previous decision of the Court of Appeal in *GMAC Commercial Credit Corp. – Canada v. TCT Logistics Inc.* (2005), 74 O.R. (3d) 382 (“GMAC”). In so doing, Justice LaForme concluded as follows:

In my opinion, the motion judge correctly concluded that GMAC – which dealt with an interim receiver who collected carrier fees as required by the Regulation – also applies to the similarly situated trustee in bankruptcy. As a result, and for the reasons that follow, I would dismiss the appeal.

In the course of his reasons for decision, Justice LaForme placed great weight on the decision of Justice Feldman in GMAC, wherein Justice Feldman had concluded that any statutory deemed trust created by the provincial Regulation would not be a trust within the meaning of section 67(1)(a) of the BIA unless it otherwise conformed with the three common law trust principles of the certainties of intention, object and subject matter. In GMAC, Justice Feldman further concluded that a creditor’s security interest is “subject to the trust mandated by s.15, so long as the debtor carries out the trust obligation”. As Justice LaForme put it, “In other words, a creditor’s security interest does not take priority over carriers’ fees provided that the moneys received for those fees have been segregated in a trust account.”

In GMAC Justice Feldman had concluded that an interim receiver carrying on the business of the load broker is bound by the Regulation’s trust obligations such that the carrier fees that are collected after the receivership’s commencement are to be segregated and held in trust. Justice Feldman went on to conclude that the interim receiver “stands in the shoes of the [load broker], and is furthermore acting as an officer of the Court.”

In the Norame case, the Trustee argued that the principles established in GMAC by the Court of Appeal do not apply in the current situation on account of the fact that unlike an interim receiver, a trustee in bankruptcy does not “step into the shoes of the debtor or of the bankrupt.” The Trustee argued that a trustee in bankruptcy is merely “an assignee of the assets of the debtor”, and is “neither an agent, nor a substitute of the debtor”. Accordingly, as the Trustee argued, the provisions of the *Truck Transportation Act* do not apply and the provisions of the BIA take precedence. The Court of Appeal rejected this argument.

To begin with, Justice LaForme did not give credence to the Trustee’s argument that a trustee in bankruptcy does not step into the shoes of a bankrupt. Specifically, Justice LaForme noted that section 18(a) of the BIA empowers a trustee in bankruptcy to continue to run the business of the bankrupt and further a Trustee can do so on its own initiative in order to conserve the property of the bankrupt prior to the first meeting of creditors and then subsequently thereafter with the permission of the inspectors pursuant to section 30(1)(c) of the BIA.

In addressing the Trustee’s attempt to distinguish the role of an interim receiver versus that of a trustee in bankruptcy, Justice LaForme made the following observations:

Second, the difference between an interim receiver and a trustee in bankruptcy advanced by the Trustee to distinguish GMAC is not a principled distinction with respect to the issue at hand. While the Trustee relies on the difference between the formal status of a trustee in bankruptcy versus an interim receiver, it offers no plausible reason, and cites no authority, to explain why this difference should determine the applicability of the Regulation's trust obligations. Indeed, to the contrary, *GMAC Commercial Credit Corp. – Canada v. TCT Logistics Inc.*, [2006] 2 S.C.R. 123, [2006] S.C.J. No. 36 confirmed that, like an interim receiver, a trustee in bankruptcy is also an officer of the court.

Justice LaForme was of the view that the motion judge was correct in reaching the conclusion that the BIA does not entitle a load broker's creditors to moneys paid to its trustee in bankruptcy in respect of a carrier's shipping services, where those funds can be segregated in trust. To hold otherwise would be to confer an unexpected windfall to the other creditors to the detriment of the carrier. In essence, the Court of Appeal concluded that the principles enunciated previously by that Court in GMAC apply generally to trustees in bankruptcy. Justice LaForme summarized his conclusions as follows:

Given my conclusion that GMAC applies generally to trustees in bankruptcy as it does to interim receivers, it is clear that the Trustee cannot succeed in its argument that the carrier fees it received and placed in a separate trust account lacked the character of trust property in accordance with general trust principles. If the carrier fees the interim receiver in GMAC collected and held in trust bore the character of trust property, then so do the identically situated fees segregated by the trustee in bankruptcy in this case.

Clearly, this will be an important decision for trustees in bankruptcy to consider in the discharge of their duties in estates where a question arises as to what is or is not property of the bankrupt.

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¹ *Re Norame Inc.* (2008), 90 O.R. (3d) 303 (Ont. C.A.).

U.S. Bankruptcy Updates

U.S. Bankruptcy Court Recognizes Foreign Proceeding Despite Confirmation of Foreign Debtor's Reorganization Plan

*Garry M. Graber**

A recent decision by the U.S. Bankruptcy Court for the Southern District of New York (Hon. Stuart M. Bernstein) *In re Oversight and Control Commission of Avanzit, S.A.*, 2008 Bankr. LEXIS 1094 (Case No. 07-13765) addressed the question of the stage at which a foreign proceeding becomes ineligible for recognition under chapter 15 of the U.S. Bankruptcy Code.

Avanzit, S.A., a telecommunications business filed a petition in Spain in 2002 seeking a "suspension of payments" to creditors. Similar to reorganizations in Canada and the U.S., the suspension proceeding resulted in a stay and the Spanish Court appointed trustees to control the debtor's business while it developed an acceptable repayment plan with its creditors. Nearly two years later, the Spanish Court approved the repayment plan and replaced the trustees with an oversight committee. Avanzit resumed control of its operations.

During the reorganization proceeding, Avánzit disputed with Banque Nationale de Paris Paribas Andes, S.A., a Peruvian bank, over the inclusion of a \$25 million set off in Avánzit's reorganization proceeding. Avánzit's oversight committee concluded that a U.S. chapter 15 would be essential to the recovery of the monies in dispute.

To that end, some five years after the commencement of the Spanish proceeding and three years after the Spanish Court approved the repayment plan, Avánzit's representatives filed a chapter 15 petition. The Peruvian Bank quickly moved to dismiss, arguing that the Spanish proceeding was no longer a "pending" foreign proceeding - as of the date the trustees were discharged, restrictions were lifted and the debtor resumed control over its operations and was thus ineligible for recognition.

The Court rejected the bank's argument concluding that the bright line the bank asserted ran counter to chapter 15's goal of encouraging cooperation between domestic and foreign courts, increasing legal certainty, promoting fairness and efficiency, protecting and maximizing value and facilitating the restructuring of financially troubled businesses. The Court noted that the Spanish proceeding was similar to a U.S. proceeding as the presiding court continues to exercise control and supervision over a confirmed plan.

The Court also concluded that the word "pending" used by the statute in relation to foreign proceedings eligible for recognition referred only to the situs, and not the status of a case. The Court ruled that for purposes of chapter 15, a case would be considered "pending" until it was closed.

For all these reasons, the Court granted recognition of the chapter 15 proceeding.

** Garry M Graber is a member of the U.S. law firm Hodgson Russ, LLP where he heads its bankruptcy and restructuring group. He is the Regional Coordinator of the Executive Committee of the OBA Insolvency Law Section and will be contributing to this newsletter articles about U.S. bankruptcy practice of interest to Canadian insolvency professional.*

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