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• VALUE FOR MONEY: A FAIR AND REASONABLE APPROACH TO ASSESSING PROFESSIONAL FEES IN A BANKRUPTCY AND INSOLVENCY CONTEXT •

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"In Canada, very little has been written on professional fees in insolvency proceedings".[1] This concern, most recently voiced by Madam Justice Pepall in a December 2014 decision by the Court of Appeal for Ontario ("Court of Appeal"), reflects upon the need for a greater discussion of professional fees in a bankruptcy and insolvency context, and this article will review the current approach that has been taken by the courts in assessing such professional fees. Bankruptcy and insolvency professionals should take note of three Ontario Superior Court decisions and one Court of Appeal decision that have placed professional fees directly in the spotlight. In *Bank of Nova Scotia v. Diemer,* [*Diemer*],[2] *TNG Acquisition Inc. (Re)*, [Commercial List] [*TNG Acquisition*],[3] and *HSBC Bank Canada v. Mahvash Lechcier-Kimel*, [Commercial List] [*Lechcier-Kimel*],[4] Justice Brown and Justice Goodman reduced the fees of court-appointed officers and their legal counsel that were

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submitted for approval on the basis that the amounts sought were unreasonable in consideration of the work performed. The Court of Appeal recently dismissed the appeal of Goodman J.'s decision in *Diemer*, finding that the motion judge had considered the correct factors in the decision respecting counsel to the receiver's fees, and that the appellant receiver had failed to establish any palpable and overriding error made by the motion judge. This exercise of judicial discretion signals that the courts are live to this issue and have been increasingly willing to scrutinize the fees of court officers and their counsel. This article identifies certain key takeaways from these decisions and offers practical advice for lawyers and court-appointed officers.

Passing Accounts

Generally in a bankruptcy and insolvency context, the remuneration of trustees is set out in s. 39 and rule 58 of the *Bankruptcy and Insolvency Act* (Canada) [*BIA*][5] and is established by an ordinary resolution at any meeting of creditors, but remains subject to court oversight. Monitors and receivers are required to pass accounts by way of a sworn fees affidavit submitted to the court for approval. In Ontario, which will be the primary jurisdiction considered within this article, the court's ability to review a receiver or its counsel's request for approval of its accounts stems from any of: (i) s. 243(6) of the *BIA*, (ii) the initial appointment order under s. 101 of the *Courts of Justice Act* (Ontario),[6] or (iii) the court's inherent jurisdiction, depending on the circumstances of the appointment.[7] Where a monitor or receiver's fees include an amount to be paid to its counsel, then counsel's accounts can also be assessed. The underlying goal of these requirements is to satisfy the court that fees and disbursements charged by court officers are fair and reasonable.

In *Re Bakemates International Inc.* (also referred to as *Confectionately Yours Inc., Re*) [*Bakemates*],[8] the Court of Appeal identified the general principles that a court ought to adopt when passing accounts. These principles require that the accounts disclose in detail:

- the name of each person who rendered services;
- the dates on which the services were rendered;
- time expended each day;
- the rates charged for the services; and
- the total charges for each of the categories of services rendered.[9]

In general, submitted accounts should be easily understandable.[10] Those affected by the work of the court-appointed officer should be able to determine the amount of time spent in respect of the various discrete services provided under the submitted accounts.

Principles for the Approval of Fees

TNG Acquisitions, *Lechcier-Kimel*, and *Diemer* demonstrate the exercise of judicial discretion when assessing the fees of court-appointed officers. This exercise of judicial discretion is guided by the principles of reasonableness and fairness. In *Bakemates*, the Court of Appeal held that the onus is on a receiver to demonstrate that the amount of its fees are fair and reasonable when the court's approval of its fees is sought.[11] Further, in *Federal Business Development Bank v. Belyea*, [*Belyea*],[12] the New Brunswick Court of Appeal held that a receiver's compensation must be a fair and reasonable measure of its services, and that those services should be administered as economically as possible.[13]

Belyea, which is cited approvingly in *Bakemates*, further lays out factors that a court ought to consider in assessing compensation. These factors constitute a useful guideline, but are not exhaustive, and include:

- the nature, extent, and value of the assets handled;
- whether any complications or difficulties were encountered;
- the degree of assistance provided by the company subject to the receivership, and the degree of assistance provided by the company's officers and its employees;
- the time expended by the receiver;
- the receiver's knowledge, experience, and skill;
- the diligence and thoroughness displayed;
- the responsibilities assumed;
- the results of the receiver's efforts; and
- the costs of comparable services when performed in a prudent and economical manner.[14]

TNG Acquisition

In *TNG Acquisition*, a May 2014 decision, a trustee in bankruptcy ("Trustee") sought an order authorizing the distribution of costs to the company's former monitor ("Monitor") appointed under the *Companies' Creditors Arrangement Act* (Canada) and the Monitor's legal counsel. The costs were incurred when complying with the Trustee's request for information about certain events which took place during the former Monitor's term. Justice Brown, of the Commercial List, referred to this task as an "archive-retrieval request".[15]

The Monitor recorded a total of 68.3 hours of time in order to comply with the Trustee's request. Of that time, 16.8 hours were billed by a partner at $750/hour, 49.8 hours were billed by a senior manager at $630/hour, and 1.7 hours

were billed by a para-professional at $200/hour. While Brown J. found that this time spent to obtain, review, and deliver the documentation in fulfillment of this archive-retrieval request was reasonable, the fees charged for such work were not. He referred to the court's discretion to review the reasonableness of the fees charged and reduced the amount to be distributed to $19,942.53 from the $54,581.55 originally invoiced.

Specifically, Brown J. took issue with the seniority and rates of professionals tasked to complete the work. He held that if a partner or senior manager elects to perform work of a clerical or administrative nature, then he or she should bill at clerical or administrative rates.[16] Thus, Brown J. charged the 68.3 hours of time required to comply with the Trustee's request at the para-professional's rate of $200/hour and added GST to reach the approved amount of $19,942.53.

On the contrary, with respect to the time charged for preparing a report, Brown J. accepted the professional rates charged by the Monitor as reasonable and approved in full the invoiced amount of $8,475.

Additionally, the Monitor's charge of 9 per cent of total costs, allocated to cover "administrative expenses", was found to be unreasonable. Justice Brown held that administrative costs are generally contemplated in the hourly rates of professionals and declined to approve the Monitor's administrative expenses charge.[17]

The Monitor's legal counsel recorded a total of 9.7 hours of work by two partners, both of whom charged over $800/hour. When this cost was "measured against the simplicity of the request", Brown J. found the amount to be unreasonable.[18] Instead of the invoiced amount of $9,306.46, Brown J. approved reduced fees in the amount of $3,000.

Lechcier-Kimel

In *Lechcier-Kimel*, a March 2014 decision, the Commercial List heard a dispute regarding the fees and disbursements submitted for approval by a court-appointed receiver (the "Lechcier-Kimel Receiver") and its counsel in the amount of $118,366, plus disbursements and HST. Justice Brown reduced the Lechcier-Kimel Receiver's and its counsel's fees to $68,197, plus disbursements and HST, finding that the fees were unreasonable, as a result of Lechcier-Kimel Receiver's decision to accept a sales transaction and "suddenly changing course" from the approved auction sales process.[19]

The Lechcier-Kimel Receiver initially sought an order to approve an auction sales process in respect of a residential property. At that time, the Lechcier-Kimel Receiver filed evidence to demonstrate that holding an auction would most likely result in the best realization for the estate. However, less than two weeks later, the Lechcier-Kimel Receiver and its counsel "began to expend significant amounts of time to pursue" an offer outside of the auction process, the realization of which Brown J. found would be unlikely to benefit any stakeholders other than the first mortgagee.[20] Upon receiving an offer from this potential purchaser, the Lechcier-Kimel Receiver then sought an order to abandon the approved auction process and accept the outside offer. This offer was 20 per cent higher than the court-approved reserve bid for the auction.

Justice Brown concluded that this offer was insufficient and that the Lechcier-Kimel Receiver and its counsel acted imprudently and unreasonably by obtaining approval for the sales auction process and then departing from that process to

pursue an outside offer. As Brown J. wrote in his decision:

> When a receiver recommends and secures court approval for a certain course of action, it must ride that horse to its commercially logical end…unless some material event intervenes which affords the prospect of significantly enhanced realization.[21]

Justice Brown wrote that a receiver has a responsibility to select, with professional care, the sales process most likely to be in the best interests of all stakeholders.[22] Justice Brown indicated that, had the outside offer provided the prospect of a materially enhanced return to stakeholders, namely 50 to 60 per cent higher than the reserve bid, then it would have been prudent for the Lechcier-Kimel Receiver to reconsider its approach and it would be appropriate to affirm the recommendation to abandon the auction process. However, the outside offer being 20 per cent higher than the reserve bid, which would only serve to benefit the first mortgagee, it was unreasonable for the Lechcier-Kimel Receiver to take action to secure the outside offer and move to abandon the approved sales auction process. Of note, the approved sales auction process did in fact result in a higher realization (notably from the same buyers who wished to avoid the auction) than the offer made outside of the approved process. The fees incurred in pursuing the offer outside of the approved sales auction process were in the amount of $28,750 by the Lechcier-Kimel Receiver and $21,419 by its counsel, all of which was disallowed by Brown J. as not being fair and reasonable given the prior approval of the sales auction process and the financial circumstances of the receivership.

Justice Brown's decision was subsequently upheld on appeal by the Court of Appeal in its October 2014 decision, *HSBC Bank Canada v Lechier-Kimel*, [*Lechier-Kimel* Appeal].[23]

The Lechcier-Kimel Receiver appealed the disallowance, arguing that: (1) a receiver's business decisions are entitled to be afforded deference; (2) a failure to consider the factual context in which the receiver was operating; and (3) an overemphasis of the integrity of the auction process and a failure to give sufficient consideration to a receiver's need for flexibility. The Court of Appeal noted that while a receiver's business decisions are to be afforded deference, the "procedure for reviewing a receiver's conduct of a receivership is not the same as that for reviewing the reasonableness of its fees".[24] The Court of Appeal identified that, while the burden of proof is upon the objecting party in a review of the receiver's conduct, the burden of proof shifts to the receiver in a consideration of its fees, wherein the receiver bears the burden of proving that its fees are fair and reasonable.[25] Thus, the "… deference to which the receiver's business decisions are owed does not insulate its accounts from review…"[26] The Court of Appeal further found that the factual context and integrity of the auction process were adequately canvassed and considered.

Diemer

In *Diemer*,[27] a January 2014 decision, the court-appointed receiver ("Receiver") sought an order approving the fees and disbursements of its legal counsel ("Counsel") in the amount of $255,955. In reducing this amount to $157,500, Goodman J. held that, notwithstanding the initial receivership order permitting Counsel to charge its standard rates, the fees charged were not appropriate given the simple nature of the receivership.

The facts of this particular receivership were that the debtor continued to operate its business. Accordingly, the Receiver expended little time in day-to-day management of the business or in

seeking a potential purchaser. Further, the Agreement of Purchase and Sale had already been completed and substantially finalized prior to the Receiver's appointment. Finally, all of the secured claimants had recovered and Goodman J. thus found that the scope of the receivership was modest. He went on to state that Counsel should have considered whether or not their usual hourly rates were suitable for the simple receivership.

Justice Goodman took several factors into consideration in reducing the fees.

First, the nature and extent of the value of the assets handled should have a linear relationship with the fees sought: in general, the lower the value of the assets, the lower the cost of administering the assets. In this case, Counsel's fees were $255,955 for an estate where there was only $8.3 million in assets and $500,000 in assets remaining to be distributed. In comparison to other receivership cases, Goodman J. found the relationship between fees and assets in *Diemer* to be unreasonable.

Second, Goodman J. considered whether there were complications or difficulties encountered during the receivership, as this would provide support for a claim for higher costs. Claims regarding complexities and difficulties faced by the Receiver and Counsel were rejected by Goodman J., reiterating his finding that this was a simple receivership.

Third, Goodman J. considered the cost of comparable services when performed in a prudent and economical manner. In this respect, Goodman J. noted that legal fees of Counsel were being billed at Toronto rates, which are higher than those of London area lawyers. As this receivership was administered in the London area, a London rate of $475 per hour for lawyers of similar experience and expertise was applied to the hours worked. This accordingly reduced the fees claim to $157,500.

Of interest, Goodman J. also commented that Counsel had not updated the court on its accrued costs generated supporting the receiver in administering the receivership. Justice Goodman noted that, while there is no obligation for the Receiver to routinely seek the court's approval for its Counsel's fees, it would be prudent for the Receiver to do so in matters where costs are running high relative to the value of the assets being administered.[28] Justice Goodman also took issue with the fact that Counsel's senior partners did not delegate sufficiently in what he regarded as a simple matter, where junior lawyers or staff could have competently performed the necessary work. Finally, Goodman J. commented that red flags are raised when too many lawyers are charging on one file, especially when it is a straightforward receivership. In this case, 11 different lawyers charged time to the file.

Justice Goodman's decision was subsequently upheld on appeal by the Court of Appeal in its December 2014 decision, *Diemer Appeal*.[29] The Receiver, as appellant, advanced three grounds of appeal and submitted that the motion judge erred by: (1) failing to apply the provisions of the appointment order, which entitled Counsel to charge fees at its standard rates; (2) reducing Counsel's fees in the absence of evidence that the fees were not fair and reasonable; and (3) making unfair and unsupported criticisms of Counsel.[30]

Madam Justice Pepall, writing for the Court of Appeal, dismissed the appeal, finding that Goodman J. did not err in his reduction of Counsel's fees. The Court of Appeal found that certain of the facts were open to interpretation,

but deferred to Goodman J.'s analysis, as it found that the motion judge had drawn conclusions based on evidence from the record in order to conclude that Counsel's fees were not fair and reasonable. The Court of Appeal found that the relevant *Bakemates* principles and *Belyea* factors had been identified and applied in the motion judge's analysis. Finally, while the Court of Appeal found there were some unfair criticisms made of Counsel, it held that the motion judge's analysis resulting in the reduction of fees was appropriate.

The Court of Appeal's analysis of what fees are fair and reasonable appeared to centre on the value provided for such fees: "the focus of the fair and reasonable assessment should be on what was accomplished, not on how much time it took".[31] Further, Pepall J. wrote, "value should pre-dominate over the mathematical calculation reflected in the hours times hourly rate equation".[32] Specifically, the Court of Appeal noted that it was inappropriate for Goodman J. to have adopted a mathematical approach and applied representative rates in place of those of Counsel. However, the Court of Appeal concluded that this approach was not fatal, as the motion judge's decision was informed by the correct factors and would have arrived at the same result in any event.

Practical Application of *TNG Acquisition*, *Lechcier-Kimel*, and *Diemer*

The courts have demonstrated an active willingness to exercise discretion in the approval of fees claimed in respect of bankruptcy and insolvency matters. Accordingly, professionals in this field should keep the following in mind.

First, professionals bear the burden of proving that fees submitted for approval are fair and reasonable. Be mindful that sufficient evidence will need to be provided to satisfy this burden of proof. Accordingly, be careful and precise when preparing and providing information contained in fee affidavits.

Second, an initial appointment order approving compensation for receiver and counsel to be paid at "standard rates" does not oust the court's need or ability to consider whether the fees claimed are fair and reasonable.[33]

Third, Ontario courts will look to *Bakemates* for the appropriate principles to be applied when passing accounts and *Belyea* identifies relevant factors to be considered, but this list of factors is not exhaustive. The Court of Appeal's focus on the value provided by the professional is instructive, as it focuses on whether the outcome, taking into account the difficulty and requirements in performing the task at hand, resulted in fair and reasonable fees.

Fourth, ensure that work is performed by individuals with the appropriate skill level and billing rates for a particular task. In short, delegate to the appropriate person for the task. Clerical and administrative tasks should not be performed by senior professionals, or in the event that timelines or other factors necessitate that this work be performed by a more senior professional, then appropriate rates that reflect the level of skill required for the work performed should be applied.

Fifth, the need to pass fees regularly as the file progresses, rather than waiting until the end of the matter to seek approval should be considered. The quantum of professional fees should not be a surprise when brought to be passed, and this should be carefully weighed against the need for a costly court appearance.

Sixth, the duty to monitor legal fees and services incurred by receiver's counsel is, in the

first instance, on the court-appointed officer.[34] While choice of counsel is entirely within the purview of the court-appointed officer, the court has a duty to ensure the fairness and reasonableness of the receiver's counsel's fees.[35]

Seventh, the practice of allocating administrative expenses as line items in invoices to account for general overhead expenses may need to be revised or eliminated. Justice Brown noted that 9 per cent of total costs is unreasonable and should instead be reflected in the hourly rates charged. Professional services providers may need to review the manner in which these costs are defrayed in order to ensure that they can be recaptured without the possibility that the courts will refuse to accept such costs.

Finally, professionals must carefully consider the preferred realization process prior to seeking court approval for its process. Once a process is approved, it should be pursued in good faith and, prior to pursuing an alternative approach to realization, professionals should seek to quantify the material benefits to all stakeholders resulting from the alternative approach. As indicated in *Lechcier-Kimel*, deviation from a court-approved process is the exception to the rule and should be carefully considered, primarily where material benefits from an alternative approach are substantially superior to the existing, court-approved process. If an alternative approach is unlikely to result in substantially superior realization, professionals should be mindful that any fees incurred in pursuing an alternative approach may be disallowed.

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1 *Bank of Nova Scotia v. Diemer*, [2014] O.J. No. 5731, 2014 ONCA 851 at para. 34 [*Diemer Appeal*].
2 [2014] O.J. No. 308, 2014 ONSC 365, aff'd [2014] O.J. No. 5731, 2014 ONCA 851 [*Diemer*].
3 [2014] O.J. No. 2149, 2014 ONSC 2754.
4 2014 ONSC 1690 (unreported), aff'd *HSBC Bank Canada v. Lechcier-Kimel*, [2014] O.J. No. 4948, 2014 ONCA 721, 246 A.C.W.S. (3d) 820.
5 R.S.C. 1985, c. B-3.
6 R.S.O. 1990, c. C.43.
7 *Diemer Appeal, supra* note 1 at para. 30.
8 [2002] O.J. No. 3569, 164 O.A.C. 84, leave to appeal refused [2002] S.C.C.A. No. 460
9 *Ibid.* at para. 37.
10 *Ibid*.
11 *Ibid.* at para. 31; see also *BT-PR Realty Holdings Inc. v Coopers & Lybrand*, [1997] O.J. No. 1097, 29 O.T.C. 354 at para. 22 [*BT-PR Realty Holdings*].
12 [1983] N.B.J. No. 41, 44 N.B.R. (2d) 248 (C.A.).
13 *Ibid.* at para. 3.
14 *Ibid.* at para. 9; see also *BT-PR Realty Holdings, supra* note 10 at para. 24.
15 *TNG Acquisition, supra* note 3 at para. 10.
16 *Ibid.* at para. 17.
17 *Ibid.* at para. 19.
18 *Ibid.* at para. 23.
19 *Lechcier-Kimel, supra* note 4 at para. 17.
20 *Ibid.* at para. 14.
21 *Ibid.* at para. 17.
22 *Ibid.* at para. 16.
23 [2014] O.J. No. 4948, 2014 ONCA 721.
24 *Lechier-Kimel Appeal* at para. 16.
25 *Ibid*.
26 *Ibid*.
27 *Supra* note 2.
28 *Diemer*, *supra* note 2 at para. 27.
29 *Supra* note 1.
30 *Ibid.* at para. 28.
31 *Ibid*. at para. 45.
32 *Ibid*.
33 *Ibid.* at para. 48.
34 *Ibid*. at para. 44.
35 *Ibid*.

• QUICK-FLIP RECEIVERSHIP SALES AND THE CASE OF ITRAVEL CANADA •

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The Ontario Superior Court of Justice recently approved a quick-flip credit-bid sale in the context of a receivership in the case of *Elleway Acquisitions Ltd. v. 4358376 Canada Inc. (c.o.b. itravel2000.com)* [*Elleway*].[1] Grant Thornton Ltd., as court-appointed receiver (in such capacity, the "Receiver") of the assets, property, and undertaking of three entities (collectively, "itravel Canada"), sought orders approving the entry into certain asset purchase agreements ("APAs"), which orders were granted by Justice Morawetz on November 4, 2013. In approving the quick flip, Morawetz J. expanded on his decision in the case of *Re Tool-Plas Systems Inc.* [*Tool-Plas*][2] and extended the principles enunciated in the case of *Royal Bank of Canada v. Soundair Corp.* [*Soundair*][3] to quick flips.

The itravel Canada entities were a collection of leading online travel retail companies that became insolvent. itravel Canada was indebted to Barclays Bank PLC, which debt was subsequently assigned to Elleway. Three separate purchasers each acquired a portion of the Elleway debt. Prior to its appointment, the would-be Receiver participated in negotiations of the APAs relating to each of the three itravel Canada entities, which provided for the going-concern purchase of substantially all of itravel Canada's assets. The purchase prices under the respective APAs were comprised of a reduction of a portion of the indebtedness owed to Elleway, as well as the reduction in full of an amount owed under a post-receivership working capital facility agreement and the assumption of certain liabilities. The purchase prices under the APAs amounted to less than the amount of the obligations owed by itravel Canada to Elleway.

After considering the factors for approving a sale process and transaction in a receivership context enunciated in the case of *Soundair*, Morawetz J. considered the application of such principles to a quick flip specifically and whether this feature has the effect of changing the legal test for approving the sought orders. He concluded that all of the *Soundair* principles continue to apply in this context and that two additional factors are to be considered in quick flips. He considered these two factors which have been taken into account when approving a sale immediately following the appointment of a receiver:

(a) an immediate sale is the only realistic way to provide maximum recovery for a creditor who stands in a clear priority of economic interest to all others; and

(b) delay of the transaction will erode the realization of the security of the creditor in sole economic interest.[4]

Justice Morawetz also considered his own decision in the case of *Tool-Plas*, in which he held that:

> A "quick flip" transaction is not the usual transaction. In certain circumstances, however, it may be the best, or the only, alternative. In considering whether to approve a "quick flip" transaction, the court should consider the impact on various parties and assess whether their respective positions and the proposed treatment that they will receive in the "quick flip" transaction would realistically be any different if an extended sales process were followed.[5]

After considering the above factors, Morawetz J. held:

> [T]he approval of the Orders and the consummation of the Sale Transactions to the Purchasers pursuant to the APAs is warranted as the best way to provide recovery for Elleway, the senior secured lender of itravel Canada and with the sole economic interest in the assets.[6]

What is most unique in the approval of the itravel Canada APAs is the credit-bid-like nature of the transactions. The case of *Tool-Plas* involved an assumption of liabilities; however, in the case of *Elleway*, the majority of the purchase price was satisfied by the reduction of a large portion of the debt owed to Elleway. In considering this feature of the transaction, Morawetz J. held that "[t]his mechanism is analogous to a credit bid by a secured lender, but with the Purchasers, instead of the secured lender, taking title to the purchased assets".[7]

In deciding that this transactional structure did not preclude the approval of the orders, Morawetz J. held that "[i]t is well-established in Canada insolvency law that a secured creditor is permitted to credit bid its debt in lieu of providing cash consideration".[8] He found that because no party was prejudiced by the reduction of debt owed to Elleway, the fact that a portion of the purchase price was to be paid through debt reduction did not preclude approval of the orders. In this case, it became clear that this holds true in the context of a quick-flip transaction.

The case of *Elleway* has built on the earlier cases of *Tool-Plas* and *Soundair.* In affirming that the same factors that apply generally to quick-flips also apply to quick-flips involving credit bids, *Elleway* affirmed the *Tool-Plas* factors that are to be considered in approving an immediate sale transaction, and extended their reach to transactions involving credit bids or credit-bid-like features.

[*Editor's note*: Torys LLP acted for Grant Thornton Ltd., the court-appointed receiver in this case.

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1 [2013] O.J. No. 5503, 2013 ONSC 7009.
2 [2008] O.J. No. 4218, 48 C.B.R. (5th) 91 (S.C.J.).
3 [1991] O.J. No. 1137, 7 C.B.R. (3d) 1 (C.A.).
4 *Elleway*, *supra* note 1 at para. 33.
5 *Tool-Plas*, *supra* note 2 at para. 15.
6 *Elleway*, *supra* note 1 at para. 37.
7 *Ibid.* at para. 38.
8 *Ibid.* at para. 38.

• A FAILURE TO COMMUNICATE: TRUSTEE'S CLAIM TO NON-EXEMPT EQUITY IN BANKRUPT'S PROPERTY SHOULD BE DECLARED AT TIME OF ASSIGNMENT IN BANKRUPTCY •

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The recent decision of the British Columbia Supreme Court in *Re Barter*[1] confirms that trustees should clearly communicate to the bankrupt their intent to make a claim against the non-exempt equity in the bankrupt's property at the time of the assignment into bankruptcy. A failure to communicate such an intent may result in the trustee being unable to realize the non-exempt equity or, as in *Re Barter*, the absolute discharge of the bankrupt, without requiring the bankrupt to pay to the estate the price agreed upon for the right to sell the property.

The property of the bankrupt, including the non-exempt equity in the bankrupt's home, vests in the trustee upon the assignment into bankruptcy pursuant to s. 71 of the *Bankruptcy and Insolvency Act* [*BIA*].[2] Section 74(1) of the *BIA* permits, but does not require, the trustee to register the bankruptcy order on title to the bankrupt's real property.

Background

In *Re Barter*, the bankrupt's property was subject to foreclosure proceedings and at the time of his assignment into bankruptcy, the bankrupt had listed the property for sale in the hopes of avoiding a shortfall on the mortgage which would save his wife from also assigning into bankruptcy. When he attended the trustee's office to sign the assignment documents, the bankrupt alleged he was not told that he was not allowed to sell the property. The trustee, in fact, did not register against title the trustee's interest in the property because the trustee estimated there was no realizable equity in the property.

The court held that it was not until six months later that the trustee advised the bankrupt that he did not have a right to sell the property. According to the court, the trustee only did so after learning that the bankrupt had received an offer for the property and was intending to make a counteroffer; at which time the trustee told the bankrupt he could only sell the property if he purchased the interest in the property from the estate. In light of the trustee's advice, the bankrupt agreed to pay $2,000 for the right to sell the property. The sale ultimately fell through and the property was sold with a shortfall on the mortgage. Upon his application for discharge, the bankrupt objected to paying the $2,000 to the estate as a condition of his discharge.

Minimum Requirements for Non-Exempt Equity in Bankrupt's Home

While acknowledging case law which suggests the trustee may declare an intention to claim the non-exempt equity in the bankrupt's property at any time up until the discharge of the bankrupt, the court held that the best time to declare such an intention is at the beginning of the bankruptcy when the value is estimated.[3] The court cited the Saskatchewan Court of Appeal in *Zemlak v. Deloitte Haskings & Sells Ltd.*,[4] for the minimum requirements to be met when dealing with non-exempt equity in the bankrupt's home, namely:

1. the trustee's report on the bankrupt's application for discharge should set out the value of any non-exempt equity if the trustee intends to attach it for future realization;
2. the notice to creditors of the discharge application should also indicate if the trustee intends to maintain a caveat against the property after the bankrupt's discharge; and
3. the trustee should advise the bankrupt to have independent legal advice for the discharge application.[5]

The minimum requirements were not applicable in *Re Barter* because the trustee was asserting the claim at the discharge hearing rather than after the bankrupt's discharge; however, the court concluded that the *Zemlak* decision established a minimum standard, which requires the trustee to clearly communicate to the bankrupt the trustee's intention to make a claim against the non-exempt equity.[6]

The court held the trustee failed to meet the minimum standard by advising the bankrupt of the trustee's intent to claim against the non-exempt equity only after the bankrupt indicated his intent to negotiate a sale of the property. Any discussion about the right to purchase an asset from the trustee should have occurred at the beginning of the bankruptcy.[7] Consequently, the bankrupt was granted an absolute discharge and was relieved from paying the $2,000 price for the right to sell the property.

The trustee, according to the court, should have at least explained to the bankrupt that he was of the view there was no non-exempt equity in the property and that the bankrupt would be paying $2,000 for nothing in return. The court went on to state:

> Instead, what happened was the bankrupt was pressured to make a decision in the middle of real estate negotiations and told that he had no right to continue the negotiations. Had it been fully explained to him that he was purchasing the right to negotiate a sale and that there was no guarantee that he would realize any money from the sale before he entered into this bill of sale, I likely would have upheld this condition of discharge.[8]

The clear communication by the trustee to show an intent to claim against the non-exempt equity in the bankrupt's property at the beginning of the bankruptcy will help avoid the outcome for the trustee in *Re Barter*.

Principles of Fairness and Neutrality

In addressing the trustee's conduct, the court cited the following passage from the Ontario Superior Court of Justice in *Engels v. Richard Killen & Associates Ltd.*:

> Bankruptcy is a court-supervised process governed by principles of fairness. The trustee in bankruptcy and its counsel are officers of the court. They must act with professional neutrality in the interests of the creditors and the bankrupt. The actions of trustees are accorded great deference by the Court. Coincidental with that deference is the responsibility of trustees and their counsel to be even-handed and dispassionate with all parties affected...[9]

The neutrality of the trustee is a central tenant of the bankruptcy process. As the decision in *Re Barter* confirms, trustees must meet the minimum standards of fairness when dealing with all parties. With regards to the bankrupt's property, the intent to make a claim against the non-exempt equity in the bankrupt's property should be clearly communicated by the trustee to the bankrupt at the beginning of the bankruptcy. Failure to do so could result in trustees being unable to realize against non-exempt equity in the bankrupt's property where the minimum requirements set out in *Zemlak* are not adhered to.

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1 [2014] B.C.J. No. 542, 2014 BCSC 528.
2 R.S.C. 1985, c. B-3.
3 *Re Barter*, *supra* note 1 at para. 23.
4 [1987] S.J. No. 881, 66 C.B.R. (N.S.) 1 ["*Zemlak*"].
5 *Re Barter*, *supra* note 1 at paras. 27–28, citing *Zemlak, supra*, note 4 at 11–12.
6 *Ibid.* at para. 29.
7 *Ibid.* at para. 37.
8 *Ibid.* at para. 38.
9 *Ibid.* at para. 36, citing *Engels v. Richard Killen & Associates Ltd.*, [2002] O.J. No. 2877 at para. 150 (S.C.J.).