

**THE PERSONAL LIABILITIES OF INSOLVENCY PRACTITIONERS**

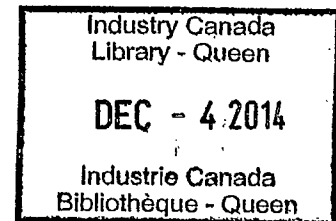
**UNDER INSOLVENCY LEGISLATION:**

**A COMPARATIVE ANALYSIS OF THE CANADIAN, ENGLISH AND**

**AMERICAN POSITIONS**

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**Important.** This is work in progress. Comments will be very welcome and should be sent to: [j.ziegel@utoronto.ca](mailto:j.ziegel@utoronto.ca). I am deeply indebted to Ryan Ashmead, JD 2005 (Univ of Toronto), for excellent research assistance during the late spring and summer of 2005, and to Carlin McGoogan, JD 2005 (Univ of Toronto) for indispensable help in formatting the paper at short notice and often at great personal inconvenience, and to the Office of the Superintendent of Bankruptcy, Ottawa, for financial assistance to defray the costs of the research. Because of time constraints, this version of the paper incorporates only a small part of the massive volume of material collected for my use by Mr. Ashmead.

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## I INTRODUCTION: NATURE OF PROBLEM

Canadian insolvency legislation recognizes a variety of persons<sup>1</sup> who play a role in the administration of the estates of insolvent persons. These persons include a trustee in bankruptcy for liquidation purposes, a trustee in relation to a commercial proposal under Part III.1 of the Bankruptcy and Insolvency Act (BIA), an interim receiver under ss 46, 47 and 47.1 of the BIA, and a receiver under s 243(1) of the recently enacted but not yet proclaimed Bill C-55<sup>2</sup>. In respect of the Companies' Creditors Arrangement Act (CCAA),<sup>3</sup> there is the monitor, a receiver if appointed by the court at the request of a secured party, and arguably<sup>4</sup> the directors of the debtor company while the company is under CCAA protection.

The purpose of this study is to determine the personal liabilities of an insolvency practitioner (IP) in the discharge of his mandate under this legislation and to compare the Canadian position with the rules obtaining under English and US insolvency law. By

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<sup>1</sup> The term 'persons', and not individuals, is used advisedly because both Canadian and US insolvency law permit corporations to act as trustees in bankruptcy and, in Canada's case, of other types of insolvency administrators as well. See, for Canada, the Bankruptcy and Insolvency Act, RSC 1985, c.B-3, as am., s.14.08 (BIA), and, for the United States, US Bankruptcy Code 1978 as am., s 321(a)(2). This paper is concerned with the liabilities of private insolvency practitioners involved in the administration of insolvent estates and does not address the liabilities of government officials who may also play a role, notably the Superintendent of Bankruptcy and the official receivers in Canada at the regional offices of the OSB, US Trustees in the US, and the Official Receiver in England. With respect to Canada and the US, the reason for the exclusion is that the indicated officials, while discharging very important public functions, are not directly implicated in the administration of individual estates but only play a supervisory and regulatory role. The position is different in England since there the Official Receiver and his staff are heavily involved in the administration of estates where an insolvency practitioner is not willing to act. Nevertheless, economically, the English official receiver is in a different position from private insolvency practitioners and it seems best not to complicate an already complex scenario by adding yet another dimension to it.

<sup>2</sup> 53-54 Elizabeth II, S.C. 2005, c. 47, assented to 25<sup>th</sup> November, 2005. For the legislative history of Bill C-55, see J. Ziegel, "The Travails of Bill C-55" (2005) 42 CBLJ 440.

<sup>3</sup> R.S.C. 1985, c.C-36 as am..

<sup>4</sup> 'Arguably' because the CCAA assigns no formal administrative roles to directors in relation to the company's restructuring. However, except as otherwise provided in the CCAA or in a court order the directors retain their powers under the statute governing the incorporation of their companies; on principle, it would seem that the directors must also approve any plan of reorganization to be put before the company's creditors that is prepared by the company's officers.

'insolvency practitioner', we mean an individual or corporation in the private sector duly qualified or licensed to administer insolvency estates whether for liquidational or reorganizational purposes. The emphasis in this paper is on commercial, not consumer estates, but encompassing personal as well as corporate debtors. 'Personal liability' is used in this study to mean liability imposed under general principles of the common law in Canada, England and the US, or by statutory law in these countries, including the Quebec civil code, and whether or not the IP is also entitled to be indemnified by the estate in respect of his liability assuming there are enough assets in the estate to accomplish this purpose.<sup>5</sup>

In considering the personal liabilities of IPs, it is important to distinguish between two very different types of liability. The first involves liabilities incurred by the IP while discharging his functions as administrator of the estate, including the operation or liquidation of any business associated with the estate. Typical examples are contractual debts for goods and services incurred by the IP during the winding up of the estate, payment of occupation rent to landlords, wages, vacation, termination pay and pension benefits owed to employees, and taxes owing to various levels of government arising out of the IPs administration during his term of office.

The second type of liability attaches to the IP because he has *breached* an obligation imposed on him by law. Examples are: negligent or fraudulent conduct in the administration of the estate, breach of the IP's fiduciary obligations,<sup>6</sup> and various forms of strict liability

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<sup>5</sup> Almost invariably the assets are insufficient, which is why the issue of the IP's personal liability arises to begin with. However, as explained below, there are many types of personal liabilities for which an IP may not be entitled to be indemnified, e.g., where the IP has guilty of negligence in the discharge of his functions or where he has breached his fiduciary obligations.

<sup>6</sup> E.g., by making secret profits from the administration of the estate or occupying conflicting positions not permitted at law e.g., acting for the estate as well as for an individual creditor. (Exceptionally, and not without some difficulty, the BIA permits a trustee to act for the estate and as private receiver for a secured creditor subject to some minimal safeguards. See BIA s 13.4 and the perceptive comments in *Bennett on Bankruptcy*, 7<sup>th</sup> ed. (2002), pp 29-30. The reason for the exception is a practical one. The secured creditor's claim frequently covers the total value of the estate. Because of this, unsecured creditors are usually not willing to underwrite the IP's fees and expenses if he agrees to serve; the secured creditor has a strong incentive to do so.

arising out of the IP's activities.<sup>7</sup> IPs' environmental liabilities can also be subsumed under this heading though they are really *sui generis* in character and belong to a category of their own.

The distinction between the two types of liability is of fundamental importance in Canadian insolvency law. If the IP is treated as the legal owner or (which amounts to the same thing) as trustee of the property of the estate, or occupies an equivalent position, basic common law doctrine dictates that the IP/trustee will be held personally liable for the debts of the estate or any breaches of contract committed during the trustee's watch whether by the trustee personally or by employees retained by the trustee. Absent statutory exculpatory provisions, the trustee can only escape personal liability by clearly excluding it in the contract. A different legal result ensues if the IP is only treated at law or by statute as an agent of the estate – the classical example is the status of a liquidator under the federal Winding Up and Restructuring Act (WURA)<sup>8</sup> – or as a watchdog or monitor of the business and affairs of the debtor company. An interim receiver under s.46 of the BIA or a monitor appointed under the CCAA would seem to meet this test since neither acts as principal or owner of the assets of the estate although paradoxically the law still treats them as personally liable.<sup>9</sup>

Apart from this basic distinction (which is relevant in all three jurisdictions), the status and liabilities of IPs differs widely in Canada, England and the US. So do the statutory defences and exemptions from liability to which the IPs may be entitled. The purpose of this paper is to describe non-exhaustively these similarities and differences. An equally important goal is to consider what changes are desirable in the Canadian law:

<sup>7</sup> At common law, a person is guilty of the tort of conversion if he wrongfully converts the goods of another person even if the converter was not aware of the competing claim and acted in perfect good faith. IPs are particularly susceptible to committing this tort because they have no sure means of knowing whether personal property in the insolvent's estate is subject to a competing claim except where the competing claim is a security interest which requires to be perfected. The British Insolvency Act has some protective provisions in the IP's favour to cover such exigencies (see Insolvency Act 1986 as am., s.304(3)) as does the BIA, s.80(1).

<sup>8</sup> RSC 1985, c. 11, as am.

<sup>9</sup> For the reasons, see *infra*, Part II.B.2(a).

- To provide consistent treatment of the liabilities of IPs regardless of the particular status of an IP;
- Where appropriate, to confer explicit rights of indemnity on the IP;
- To clarify procedural requirements for actions against IPs, particularly those arising under section 215 of the BIA and section 11 of the CCAA.

## II IPS' PERSONAL LIABILITIES UNDER CANADIAN LAW

### A. STRUCTURE OF CANADIAN INSOLVENCY LEGISLATION AND ROLES OF IPS IN THE ADMINISTRATION OF ESTATES

#### 1. Structure

Canada's first insolvency act was adopted in 1869. It ran into much opposition from various interest groups and was repealed in 1880. Between then and 1919 Canada had no general insolvency legislation at all. However, in relation to companies, the gap was partially filled by the Winding Up Act of 1882,<sup>10</sup> which was based on British precedents. The Act is still in force in a revised form<sup>11</sup> but is rarely used by insolvent corporate entities other than those (mainly financial institutions) that are not free to proceed under the BIA or the CCAA.

The Bankruptcy Act adopted by Parliament in 1919<sup>12</sup> was largely based on the British Bankruptcy Act of 1914. One key difference between the two acts was that the British Act only applied to individuals and partnerships; the winding up of insolvent

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<sup>10</sup> Now replaced by WURA.

<sup>11</sup> See *infra*, Part II.

<sup>12</sup> 9 & 10 Geo. V, S.C. 1919, c.36.

companies continued to be governed by the British companies legislation.<sup>13</sup> The 1919 Canadian Act did not adopt this distinction and applied to companies as well as individuals, partnerships and other persons. Another important conceptual difference between the Canadian and English approaches involved (and continues to involve) the types of insolvency administrators used in insolvency proceedings. Under the Canadian legislation, the trustee serves as IP for all bankrupts, companies as well as individuals and whether or not the individuals are engaged in trade. The British legislation, on the other hand, continues to distinguish between the administration of unincorporated estates and the administration of incorporated estates and uses trustees for the first type and liquidators for the second. These basic distinctions survive in the current British and Canadian legislation.

*(a) Post-1919 Canadian Developments*

The 1919 Bankruptcy Act was revised in 1949<sup>14</sup> and substantial amendments were adopted in 1966,<sup>15</sup> 1992, and 1997. Major changes affecting almost every part of the BIA were also adopted in Bill C-55, which received royal assent on November 29, 2005 but has not been proclaimed.<sup>16</sup> Despite the many statutory changes adopted since 1919, the essential roles and attributes of the various types of IPs remain the same under the current bankruptcy legislation as they were under the earlier legislation. This is particularly true with respect to the status and role of the trustee as the pivotal figure in the administration of bankrupt estates in Canada.

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<sup>13</sup> See e.g., Companies (Consolidation) Act 1908, 8 Edw VII, c. 69, ss. 182 et seq.

<sup>14</sup> S.C. 1949 (2ndSess.) c.7.

<sup>15</sup> S.C. 1966-67, c. 32.

<sup>16</sup> The Minister of Industry and the Minister of Labour gave a written undertaking to the Senate that Bill C-55 would not be proclaimed before June 30, 2006 and that before then, following the January 2006 elections, the incoming government would refer the bill to the Canadian Senate for detailed study and recommendations. See further J Ziegel (2005) 42 CBLJ 440, 447.



(b) CCAA

The Companies' Creditors Arrangement Act was first adopted in 1933 in response to the Depression crisis and was designed to allow large companies with outstanding bonds and debentures to restructure their debts without first having to suffer the indignity and possibly fatal consequences of having to declare bankruptcy under the BIA. Significantly, the original CCAA contained no provisions for the administration of the company's assets pending the creditors' vote on the company's proposal for the reorganization of the company's debts.<sup>17</sup> The Act was little used during the first fifty years of its life.<sup>18</sup> The position changed significantly in the early 1980s when Canada was faced with the worst recession since the end of World War II. Debtors' counsel prevailed on the courts to relax or 'reinterpret' the strict eligibility requirements in the Act so as to permit its use by a much wider range of insolvent companies.<sup>19</sup> In addition, as part of the Initial Order bringing the debtor company under the court's protection, the courts imposed a comprehensive stay of proceedings against the company under s 11 of the Act and also appointed a monitor to act as watchdog of the creditors' interests pending the crafting of a plan of reorganization for the creditors' approval. The monitor's role was formally recognized in the 1997 amendments to the CCAA<sup>20</sup> and was further refined as part of the much more comprehensive amendments to the CCAA included in Bill C-55 in 2005.<sup>21</sup>

B. ROLE, POWERS, DUTIES AND LIABILITIES OF IPs UNDER THE BIA

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<sup>17</sup> This was because the court was expected to call a meeting promptly to consider the company's proposal to its creditors so that there was no need for a protracted stay of proceedings against the company pending the outcome of a vote on the proposal. The current practice of seeking an *ex parte* stay of proceedings against the company coupled with an initial order providing the company with the means to continue to carry on business while it was negotiating with its creditors and developing a plan of reorganization only emerged in the 1980s and 1990s.

<sup>18</sup> See Stanley E. Edwards, "Reorganization under the Companies' Creditors Arrangement Act" (1947) 25 Can. Bar Rev. 587. The author was only able to find seven reported decisions on the Act between 1933 and 1947.

<sup>19</sup> See *Elan Corp. v. Comiskey* (1990) 1 C.B.R. (3d) 101 (O.C.A.).

<sup>20</sup> See now CCAA s. 11(7).

<sup>21</sup> See *infra* Part II.C.(a).

## 1. Trustee in Bankruptcy

As previously mentioned, Canadian trustees play a pivotal role in the liquidation of bankrupt estates under the BIA. The trustees are required to be licensed by the Superintendent of Bankruptcy<sup>22</sup> and are subject to the Superintendent's ongoing supervision and control. Importantly, trustee licences may also be issued to corporations<sup>23</sup>; as of November 1, 2005, there were 1057 individual licences and 228 corporate licences. Of the 1057 individual licencees, 829 also practised in corporate form.<sup>24</sup> Judging by the reported cases, corporate trustees are now predominantly appointed to act as trustees of bankrupt estates. As a condition of their licence, trustees are required to furnish the Superintendent with a general bond to secure the faithful and honest performance of their duties and of the funds entrusted for their administration<sup>25</sup>; trustees must also provide an additional bond for each estate administered by them.<sup>26</sup>

The trustees' rights, powers and duties are all embracing under the BIA but are subject to the supervision of the bankruptcy court and of the inspectors elected by the creditors. Trustees are charged, inter alia, with the collection and realization of the assets of the estate<sup>27</sup> (including investigation of suspect prebankruptcy transactions), determination and verification of liabilities of the estate and proofs of claim submitted by creditors<sup>28</sup>, the ranking of creditors' claims<sup>29</sup>, and the distribution of the net proceeds of the estate among creditors in accordance with entitlements.

Of key conceptual importance is the fact that, to enable them to discharge their functions, the BIA automatically vests in the trustee, once the trustee has been appointed to administer the estate, all the bankrupt's property, real and personal, present and future and

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<sup>22</sup> BIA s 13.

<sup>23</sup> BIA s 14.08.

<sup>24</sup> Email information, December 5, 2005, provided by Claude Le Duc, Assistant Superintendent of Licences, OSB, to Norman Kondo, Executive Director, CAIRP.

<sup>25</sup> BIA s 16 and Directive 13.

<sup>26</sup> *Ibid.*

<sup>27</sup> BIA ss. 16(3), 71(2).

<sup>28</sup> BIA s 135.

<sup>29</sup> BIA s. 136.

wherever situated.<sup>30</sup> The vesting of title assists the trustee to take control of the assets, and to convey title to a buyer when selling the assets. Just as importantly (particularly in the case of individual bankrupts), the vesting of title prevents the bankrupt from disposing of the assets and transferring title to a third party who may not know of the bankruptcy.<sup>31</sup>

Obviously, to enable him to discharge his functions, the trustee must enter into many different types of contract. These include contracts of employment with respect to those of the bankrupt's employees whose services the trustee elects to retain<sup>32</sup>, the services of independent contractors, the provision of utility services, the renting of temporary premises where the trustee elects to disclaim an existing lease, and contracts for the sale of the estate's assets either piecemeal or in their entirety.

*(a) Trustee's Personal Liability for Contractual Debts of the Estate*

Given the range of activities engaged in by the trustee, a threshold question is whether the trustee is personally responsible for the debts properly incurred by him in the discharge of his functions or whether the debts are solely those of the estate.<sup>33</sup> In principle, the answer is that the trustee is personally responsible because in contemplation of law he is a principal and not an agent for the estate. At common law, the estate has no legal personality of its own and only exists in the eyes of equity.<sup>34</sup> Basically, absent contrary statutory provisions, a trustee is in no different position with respect to his contractual

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<sup>30</sup> BIA ss 71(2), 67(1).

<sup>31</sup> Note however that BIA s 75 confers protection on a purchaser or mortgagee of the debtor's real property in accordance with applicable provincial law if the purchase or mortgage occurred before notice of the debtor's bankruptcy had been filed in the relevant provincial land registry office.

<sup>32</sup> Employment issues raise special problems and are further considered, *infra*, Part II.3(b).

<sup>33</sup> At the outset it is important to draw a clear distinction between prebankruptcy and postbankruptcy debts of the estate. Prebankruptcy debts are provable claims against the estate and will be paid (if at all) out of bankruptcy dollars. BIA s 151. Postbankruptcy debts are debts for which the trustee may be personally liable as described above and for which he will seek reimbursement under the heading of disbursements and costs of administration if there are enough funds in the estate to cover them. See BIA s 136(1)(b).

<sup>34</sup> See further, *infra*, Part II-D.

liabilities than is any other type of trustee.<sup>35</sup> The following extracts from two leading Canadian and US treatises describe the general position:

*Scott on Trusts, 4<sup>th</sup> ed.:*

Where a trustee in the administration of the trust makes a contract with a third person, the trustee is personally liable on the contract in the absence of a stipulation in the contract relieving him of personal liability. This is true not only where the trustee exceeded his powers in making the contract, but also where he was acting in accordance with the terms of the trust or even under the direction of the court. It is true not only where the third person had no notice of the existence of the trust and believed that the trustee in making the contract was acting for his own benefit, but also where the third person knew that the contract was made by the trustee in the administration of the trust and not for his own benefit. As we shall see, the trustee is not personally liable if the contract provides that he shall not be personally liable; but the mere fact that he signs the contract in his representative capacity is ordinarily held not of itself sufficient to relieve him of personal liability.<sup>36</sup>

D.W.M. Waters, M. Gillen, L. Smith, *Waters' Law of Trusts in Canada, 3<sup>rd</sup> ed.*, Thomson Canada Limited (2005):

**[Liability for contracts concluded for the benefit of the estate]**

[The trustee] is not only invested with title in the trust property, [but] he contracts with third parties as if he also had the beneficial enjoyment of that title, being personally liable on those contracts. His right of recovery from the trust property for the outgoings from his own pocket is of no concern or interest to the third party, nor whether the trust property is sufficient to meet any action for damages the third party might have.

FN 62 If the trustee wishes to limit his liability in any breach of contract action, thus ensuring that he will be liable only to the extent of the trust property, he must have a term to that effect in his contract with the third party.

Despite the clear conceptual position, a substantial number of Canadian courts have equivocated when faced with contractual claims against a trustee. In an

<sup>35</sup> The Québec civil law position should be even clearer since the Civil Code does not recognize the distinction between legal and equitable interests in property and the dual status of a trustee as owner and trustee. As a result, in interpreting the BIA provisions Quebec jurists have difficulties understanding how a trustee can be treated as owner of the estate's property given the many BIA restrictions on his powers of disposition and his duty to account for his dealing with the property. See A. Bohémier, *Faillite et Insolvabilité*, vol. 1, pp 714 et seq. (1992).

<sup>36</sup> Note however that some American states go further and exempt the trustee altogether from personal liability for debts properly incurred for the estate's benefit.

excellent discussion of the issues, Prof Bohémier divides the cases into two groups.<sup>37</sup> The first group<sup>38</sup> holds that if the other party knows he is dealing with a trustee the presumption is that the trustee is not to be held personally liable unless the parties have agreed otherwise. The second group of cases<sup>39</sup> adopts the reverse position. Here the presumption is that the trustee is personally liable by virtue of trustee's status unless the creditor has agreed to limit his claim to the assets in the estate. Prof Bohémier claims there is no practical difference between the two positions but this is surely mistaken, at least from a common law perspective. Determining who has the burden of proof in a litigated claim is always important, particularly where there are disputed facts about the terms of the contract and about what was said by the parties at the time of the formation of the contract.<sup>40</sup>

It is easy to understand why some Canadian courts would feel sympathetic towards a trustee who acted properly for the benefit of the estate and then found, through no fault of the trustee, that the estate lacked sufficient funds to satisfy the creditor's claim. However, the sympathy may be misplaced. The trustee is a professional and should know what the law says about his contractual liability. If the trustee thinks the burden is misplaced, it is easy enough for him to make it plain that he is not assuming personal liability.

<sup>37</sup> Albert Bohémier, *Faillite et Insolvabilité*, Tome 1, pp 781-87.

<sup>38</sup> See *Edwards v. Duclos* (1940-41) 22 C.B.R. 215 (Que. C.A.); *In re Steven & Gross Lbr Co. Ltd.* (1924-25) 5 C.B.R. 522 (Ont.).

<sup>39</sup> *In re Smith & Son* (1929) 10 C.B.R. 393 (Ont.); *In re Walker* (1929-30) 11 C.B.R. 288 (Ont.); *Transalta Utilities Corp. v. Hudson* (1983) 44 C.B.R. (N.S.) 97 (Alta.) See also F. Bennett, "The Personal Liability of a Trustee in Bankruptcy" (1973) 17 C.B.R. (N.S.) 122, and I. Duncan & J.D. Honsberger, *Bankruptcy in Canada*, 3<sup>rd</sup> ed. (1961), 123, 141-42.

<sup>40</sup> If the presumption is that the trustee is not personally liable unless he has agreed to assume liability, the burden rests with the other party to show that the trustee assumed personal responsibility for the debt and if the evidence is inconclusive the claim will fail. If the rule is that the trustee is prima facie liable he will have to prove that the other party had agreed not to hold the trustee personally liable. Apart from the question of the burden of proof, it is clear that Prof. Bohémier's sympathies are with the first line of cases holding the trustee prima facie liable. *Op. cit.*, 794-95, also citing with approval the following English Court of Appeal's reasoning in *Burt, Boulton & Hayward v. Bull* [1895] 1 Q.B. 276 to justify the personal liability of a receiver-manager for debts incurred while the receiver-manager was in charge of the debtor's business: "[F]or the result would be that no tradesman could safely deal with such a manager without inquiring as to the existence of a fund to which he might look, whether, if such a fund existed it was not subject to other liabilities ...".

Some clarification is also needed about the meaning of a judgment that finds that the parties agreed that the creditor's claim would be against "the estate" and not against the trustee personally. Does this mean the creditor can only sue the estate where there is default in payment even though the estate has no legal personality at common law and the estate's bank accounts are all in the trustee's name? Will the courts allow a writ to be issued against an estate where the writ does not also name the trustee as a co-defendant, and will the sheriff be willing to levy execution against the trust estate without the trustee also being named in the writ of execution?

*(b) Trustee's Liability for Occupation Rent*

A surprising amount of litigation has arisen over the trustee's personal liability to pay for occupation rent where the trustee has elected not to reaffirm an existing lease relating to the premises. In addition to the subsisting ambiguity with respect to the trustee's personal liability for the estate's postbankruptcy debts, further confusion may have been induced by the fact that the trustee's and landlord's positions are partly regulated under provincial landlord and tenant legislation<sup>41</sup> and partly by the priority of ranking provisions in s. 136(1)(f) of the BIA.<sup>42</sup> Additional uncertainty arises from the fact that it is not entirely clear whether occupation rent is intended to be treated as a postbankruptcy claim against the estate, and therefore outside s.136 altogether, or whether it is meant to be included as part of the recognized landlord's claims against the estate for prebankruptcy liability.<sup>43</sup>

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<sup>41</sup> See BIA s 146 and, for Ontario, the Commercial Tenancies Act, RSO 1990, c. L.7 as am., ss. 38-39.

<sup>42</sup> BIA s 136 is extensively revised in s 88 of Bill C-55 (2005) but the changes do not affect the treatment of landlords' claims for rent.

<sup>43</sup> Mr. Rowe adopted the latter position in an elaborate argument. See William A.C. Rowe, "The Trustee in Bankruptcy's Liability for Occupation Rent" (1985) 51 C.B.R. (N.S.) 206. Mr. Rowe also relies heavily on the impact of s. 31(4) of the BIA, discussed *infra*, on the trustee's personal liability. Mr. Rowe's thesis was rejected by Isaac J in his careful judgment in *Sasso v. D. & A. MacLeod Co.* (1991), 5 C.B.R. (3d) 239 (Ont. Gen. Div.). Isaac J also found that the trustee could not rely on BIA s. 31(4) because he was not purporting to carry on the debtor's business while occupying the premises. For other cases that have found the trustee personally liable for occupation rent see *1133 Yonge Street Holdings Ltd. v. Clarke Henning & Hahn Ltd.* (1991), 2 C.B.R. (3d) 11 (Ont. Gen. Div.);

(c) *The Impact of Section 31(4) of the BIA on the Trustee's Contractual Liability*<sup>44</sup>

Section 31(4) of the BIA was adopted in 1949 as part of the revision of the 1919 Bankruptcy Act. Unfortunately the Parliamentary record does not indicate what inspired the introduction of the subsection and what exactly it was designed to accomplish. We may fairly infer however that its objective was to insulate the trustee from personal liability for the estate's debts. It seems equally clear that, as drafted, the subsection falls far short of the drafters' presumed intention. Section 31(4) reads:

(4) All debts incurred and credit received in carrying on the business of a bankrupt are deemed to be debts incurred and credit received by the estate of the bankrupt.

Subsection 4 gives rise to the following interpretive problems and raises the following policy issues:

1. It only applies to "debts incurred" by the trustee. Whatever "debts incurred" may mean linguistically, the meaning cannot reasonably be extended to cover claims for breach of contract, breach of fiduciary obligations, claims in negligence, or to conversion or other types of tort alleged to have been committed by the trustee in his official capacity.

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and *Re Yonemitsu Investments Ltd.* (1992), 14 C.B.R. (3d) 279 (Ont. Gen. Div.). For examples of contrary decisions, see *Ottawa Eglin Investment Ltd. v. McKechnie* (1983), 42 O.R. (2d) 366; and *Re Listowel Feed Mill Ltd.* (1990) 1 O.R. (3d) 628 (Ont. Gen. Div.) It is suggested that the answer turns on the proper interpretation of the provincial legislation. Typically, the legislation gives the trustee the option of affirming the lease, assigning the lease or disclaiming the lease, and allows the trustee a substantial period of time for making the election. The better view is that if the trustee is in active occupation of the premises before he has made his election he is under an implied obligation to pay a reasonable occupation rent. This reasoning to the conclusion that if the trustee has not assumed possession of the premises he is not personally liable and the landlord's claim will be against the estate for the stipulated rent under the prebankruptcy lease but subject to the limits of recovery for preferred claims under BIA s.136(1)(f). If the trustee affirms the lease as authorized under the provincial legislation he should on principle be held personally liable unless the landlord has agreed only to look against the estate for payment.

<sup>44</sup> Other defenses and mechanisms, procedural and substantive, available to a trustee to avoid or mitigate the risks of personal liability are discussed *infra* Part II.B1(d).

2. It is not clear from the English version of s 31(4) whether “debts incurred” is meant to be confined to contractual debts incurred by the trustee or whether the words include non-contractual obligations imposed on an enterprise such as the various forms of municipal, provincial and federal taxes. Read in context, the words can be read either way though the French version of “debts incurred”<sup>45</sup> indicates that only consensual debts were meant to be covered. Assuming the propriety of using the French version to resolve the ambiguity, it still raises the policy question why the trustee’s immunity from personal liability should be limited to contractual debts. The distinction also leads to numerous anomalies. For example, if the trustee has purchased supplies for the benefit of the business of the estate he will not be held personally liable but he can be held personally liable if he has failed to pay the provincial and federal sales taxes.
3. The debts must be incurred by the trustee in the course of “carrying on the business of the estate.” Even if the quoted words are construed broadly, many of the debts incurred by trustees in administering the debtor’s estate will fall outside this sphere. It is not obvious why the drafters only wished to insulate trustees from the estate’s business debts.
4. It has also been held that s 31(4) does not apply to actions against the trustee brought in the regular provincial courts, or required to be brought there, because the disputes were not regarded as intrinsic bankruptcy disputes.<sup>46</sup> The reasoning used in these cases is suspect and seems to contradict the drafter’s intention to

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<sup>45</sup> ‘*Toute dette contractée*’. In *St Mary’s Paper Inc.* (1993) 19 O.R. (3d) 163 (OCA) the trustees invoked BIA s.31(4) as one of the grounds to show that they should not be held liable personally for pension contributions payable under the Pension Benefits Act. The Ontario Court of Appeal rejected the argument on the ground that the statutory liability arose under the PBA because of the agreement the trustees had made with the employees and not because of the provisions of BIA s 31(4). The Court’s attention was not drawn to the French version of s.31(4) and, if it had been, would have provided a simpler answer to the trustees’ contention, viz. that the debt under the PBA was a statutory and not a contractual debt and therefore unaffected by s.31(4) altogether.

<sup>46</sup> See e.g., *Re Walker* (1930), 11 C.B.R. 288, 37 O.W.N. 473 (S.C.); *Re Smith & Son* (1929), 10 C.B.R. 393, 35 O.W.N. 323 (S.C.).



protect trustees from liability for estate debts. The cases suggest that some judges resort to these technical distinctions because they have ambivalent feelings about the merits of the underlying policy of s 31(4) and the imputed justification for insulating trustees from personal liability.

5. It is not clear to what extent section 31(4) enures for the benefit of interim receivers appointed under ss. 46, 47 and 47.1 of the BIA since they are not mentioned in the subsection. It is well settled that a receiver appointed under these provisions is personally liable for debts incurred in the course of the receivership<sup>47</sup> unless the order appointing the receiver provides otherwise, and that the receiver is not an agent of the bankrupt. This suggests that an interim receiver should be entitled to the protection of s 31(4) if he was acting within the scope of his authority and to promote the estate's interests since the underlying policy of subs (4) is the same in both cases.

However, several arguments militate against this view. One is that an interim receiver under s 46 only serves a watch dog or monitoring role and is not ordinarily authorized to carry on the debtor's business. So far as receivers appointed under ss 47 and 47.1 are concerned, their claims for protection encounter the following objections. The receiver is almost invariably appointed to protect and advance the interests of secured creditors who have secured their appointment. This being the case, it would be difficult to argue that the receiver is carrying on the business of the debtor if these words mean that the business must be carried on for the benefit of the debtor's estate. Conceivably the interim receiver may be promoting the business interests of both the debtor and the secured party. It seems reasonably clear however that what the drafter of s 31(4) had in contemplation were IPS acting for the estate's benefit or for the benefit of the general

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<sup>47</sup> See *infra*, Part II.B.2.

body of creditors, and not IPS appointed primarily for the protection and advancement of secured creditor interests.

*(d) Other Protective Devices available to Trustee*

The trustee is not limited to s.31(4) in his search for defences to a contractual claim or, for that matter, against other types of claim. In contractual matter, the best strategy would be to exclude the trustee's personal liability on the contract but this may be a counsel of perfection. Many contracts are concluded orally and it would be unrealistic to expect to be reduced to writing. However, in this electronic age it would be easy enough for the trustee to follow up a telephone conversation with an electronic confirmation excluding his personal liability.<sup>48</sup> Another very common device, not a defence, is for the trustee to insist on a full indemnity where he has agreed to serve as trustee on a creditor's request.<sup>49</sup> Finally, there is the procedural device offered by s 215, which requires the Court's consent before prospective plaintiff can sue the trustee.<sup>50</sup> Section 215 is only a screening device and does not of course eliminate the plaintiff's claim. Apart from this feature, Section 215 has its own interpretive problems<sup>51</sup> and the propriety of its purpose is coming under increasing scrutiny.<sup>52</sup> Two difficulties are of particular relevance. First, it seems to be well settled that s 215 does not apply where the plaintiff can bring his action in another court because it is not regarded as an intrinsic

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<sup>48</sup> Of course, there is nothing to preclude the trustee from making it clear orally that he is not to be held personally liable on the contract but proving that the parties actually agreed on such a term may prove difficult.

<sup>49</sup> Very often the creditor is a bank and the trustee is also serving as the bank's agent for enforcing the security interest. On the propriety of the trustee also acting as receiver for the secured party see BIA s 13.4. On the frequent use of indemnity agreements where the trustee is acting at the request of a creditor, see *infra*, Appendix and Replies to Questionnaire.

<sup>50</sup> Section 215 reads: "Except by leave of the court, no action lies against the Superintendent, an official receiver, an interim receiver or a trustee with respect to any report made under, or any action taken pursuant to, this Act".

<sup>51</sup> See Bennett, *op cit.*, pp 36 et seq; Bohémier, *op cit.*, pp 802-04.

<sup>52</sup> Neither English insolvency law nor the US Bankruptcy Code requires a litigant to secure the court's permission to initiate proceedings against a trustee or other insolvency administrator.

bankruptcy matter.<sup>53</sup> The second difficulty arises out of the fact that, in a less than persuasive judgment, the Supreme Court of Canada held in *Mercure v. A Marquette et Fils Inc.*<sup>54</sup>

that s 215 does not apply where the prospective plaintiff is complaining of an act of omission and not of commission.

A more powerful device available to individual trustees to protect themselves against personal liability is to incorporate themselves and to use the corporation as the contracting vehicle. As we have seen, BIA s. 14.08 allows a licence to be issued to a corporate trustee. It is true that s. 14.09 also provides that a licensed corporation can only act through a director or officer of the corporation who are themselves licensed trustees but, on general principles of corporate law, this does not mean that the officers or directors can held personally liable on the contracts even though they are the ones who authorized the engagements.<sup>55</sup> The corporate veil will be especially valuable where trustees are exposed to environmental liabilities or to liabilities as successor employers.<sup>56</sup>

*(e) Trustees' Public Law Liabilities*

In addition to their private law and statutory liabilities to a broad range of persons, trustees are also exposed to potentially very burdensome public law liabilities especially in the environmental, employment, pensions and taxation fields, which quantitatively and qualitatively, may exceed in importance the private law liabilities. This alone would warrant the public law liabilities being treated separately as they are in this study.<sup>57</sup>

There is however an added reason and this that their impact is often felt more heavily by

<sup>53</sup> *In re J.H. Smith & Son* (1929) 10 C.B.R. 393 (Ont.).

<sup>54</sup> [1977] 1 S.C.R. 547.

<sup>55</sup> Nevertheless, incorporation will not protect the officers or directors from personal liability where they would be held personally liable under general principles of the common law for tortious conduct or where a statutory provision expressly so provides. Cf. C.C. Nicholls, "Liability of Corporate Officers and Directors to Third Parties" (2001) 35 CBLJ 1.

<sup>56</sup> See *infra*, Part II.B.3.

<sup>57</sup> *Ibid.*

receivers and interim receivers than by trustees. This makes it convenient to address this topic after I have dealt with the status and personal liabilities of Interim Receivers.

## **2. Status and Personal Liabilities of Interim Receivers**

Receivers and receiver-managers are positions of equitable origin and serve a great variety of functions in many different contexts. A receiver is a person, usually a professional, who is entrusted by agreement of the parties or pursuant to a court order or legislation with custody of property pending the outcome of contested proceedings, but not with management of the property. A receiver-manager is a person who combines both custodial and managerial functions. A receiver or receiver-manager may be privately appointed and such powers of appointment are routinely conferred on a secured party pursuant to the terms of a security agreement or on a trustee acting for debenture or bond holders where the debtor is in default with the terms of the agreement. Such agreements also commonly provide that the receiver or receiver manager, when appointed, is deemed to be agent of the debtor and not of the creditor or other person making the appointment.<sup>58</sup>

The appointment of private receivers to enforce security agreements gave rise to many complaints by debtors during the 1980s on the grounds of alleged abuses by receivers and lack of accountability and transparency in the receiver's management and disposition of the collateral. The complaints led to the adoption of regulatory provisions governing the conduct of receivers and receiver-managers in Part XI of the 1992 amendments to the BIA, and subjecting privately appointed receivers to the supervision of the bankruptcy court. The Part XI provisions are triggered whether or not insolvency proceedings have been initiated by or against the debtor.

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<sup>58</sup> This device was first adopted by Chancery counsel in the 19<sup>th</sup> century to insulate the secured party from liability for the acts of the receiver-manager in the operation and disposition of the debtor's business.

So far as the role of receivers in insolvency proceedings is concerned, the BIA has long provided for the appointment of an interim receiver at the petitioner's request pending the determination of an involuntary bankruptcy petition against the debtor.<sup>59</sup> Section 46 of the BIA makes it clear that such interim receivers serve a conservatory or custodial function and are not authorized to manage the debtor's business.

The 1992 BIA amendments also introduced two new types of interim receiverships, which have radically transformed insolvency administrations over the past thirteen years because of their great popularity with secured creditors.<sup>60</sup> Section 47 authorizes the appointment of an interim receiver where the court is satisfied that notice is about to be sent or has been sent by a secured party under s 244(1) of the Act notifying the debtor of the secured party's intention to enforce a general security interest. If the appointment is made, the order may invest with the interim receiver with much broader powers than is possible with respect to a receiver appointed under s 46. Thus an order made pursuant to s 47(2) may authorize the interim receiver to do any or all of the following:

- (a) take possession of all or part of the debtor's property mentioned in the appointment;
- (b) exercise such control over that property, and over the debtor's business, as the court considers advisable; and

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<sup>59</sup> See BIA s 46. The section reads: (1) The court may, if it is shown to be necessary for the protection of the estate of a debtor, at any time after the filing of an application for a bankruptcy order and before a bankruptcy order is made, appoint a licensed trustee as interim receiver of the property or any part of the property of the debtor and direct the interim receiver to take immediate possession of the property or any part of it on an undertaking being given by the applicant that the court may impose with respect to interference with the debtor's legal rights and with respect to damages in the event of the application being dismissed. (2) The interim receiver appointed under subsection (1) may, under the direction of the court, take conservatory measures and summarily dispose of property that is perishable or likely to depreciate rapidly in value and exercise such control over the business of the debtor as the court deems advisable, but the interim receiver shall not unduly interfere with the debtor in the carrying on of his business except as may be necessary for conservatory purposes or to comply with the order of the court.

<sup>60</sup> In many cases the applicants have also secured an order under s 101 of the Ontario Courts of Justice Act, R.S.O. 1990, c.C43, to supplement the powers conferred under the BIA provisions. A s 101 appointment is sought because it triggers s 142 providing important protection for the interim receiver. Section 142 reads: "A person is not liable for any act done in good faith in accordance with an order or process of a court in Ontario."

(c) take such other action as the court considers advisable.

Clause (c) in particular has been relied on by secured creditors as an important source of power to promote the secured creditor's goals in the appointment of the receiver and, just as importantly, to confer broad immunity on the interim receiver from otherwise applicable laws and grounds of liability.<sup>61</sup>

Section 47.1 of the BIA authorizes the court to appoint an interim receiver where the debtor has filed a notice of intention under s 50.4 of the BIA to make a proposal or where a proposal has actually been filed by the debtor under s 62(1). When appointed the s 47.1 interim receiver enjoys almost the same broad powers as are conferred on interim receivers under s 47.

To round out this picture, it must be noted that s 47.2 authorizes the court to create a first ranking charge on the debtor's assets to cover the interim receivers' fees and disbursements under ss. 47 and 47.1.<sup>62</sup>

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<sup>61</sup> E.g., *Re Royal Oak Mines* 2001 O.J. No 562 (OCA); *Canada (Minister of Indian Affairs and Northern Development) v. Curragh Inc.* (1994) 27 C.B.R. (3d) 148; *Re Big Sky Living* (202) 37 C.B.R. (4<sup>th</sup>) 42 (Alta QB) and *ibid.*, Comment by David E. Baird, Q.C. These developments are discussed in detail in an impressive list of predominantly practitioner based articles and conference papers. See inter alia Allan Rutman, John Varley and Jeff Carhart, "Interim Receivers Under the Bankruptcy and Insolvency Act", 9 C.B.R. (4th) 69; Paul Macdonald and Brett Harrison, "Receivership Orders -- Where Do We go from Here?" (2004), 21 Nat. Insolv. Rev 65; Justin Fogarty, "The Rise of the Interim Receiver: The right approach for the times" vol. 21, National Insolvency Review, Feb. 2004; David F.W. Cohen and David S. Kolesar, "Interim Receivership: Decline of the Private Receiver in Ontario?", National Insolvency Review (August 2002); Justin Fogarty, "Bankruptcy and Insolvency Update: 1998-1999 The year in Review" 16 Nat'l Insolv. Rev. 77, 1999; Fay Sulley, Torkin, Manes (Cohen & Arbus Toronto) "Directors' and officers' roles and responsibilities in times of insolvency" 10 Comm. Insolv. R. 25; Feb. 1998, Vol. 10, No. 3; The Canadian Institute, Advanced Insolvency Law & Practice Conference, *Interim Receivership: The Creditors' Tool for Reorganizing the Debtor*: David F.W. Cohen, Partner, Gowling LaFleur Henderson, LLP and Maxine M. Kerr, Partner, Gowling LaFleur Henderson, LLP

<sup>62</sup> "Disbursement" is defined in s.47.2 as excluding the expenses of operating the debtor's business.

The bloom has now gone off the ss 47 and 47.1 interim receiverships, and this for two reasons. The first is that the courts have criticized the extravagant powers and immunities provided by receivership orders.<sup>63</sup> In particular, the Ontario Court of Appeal held in *GMAC Commercial Credit Corp. v. TCT Logistics*<sup>64</sup> that the bankruptcy judge had exceeded his powers in endorsing an interim receivership order under s 47 declaring that the receiver was not a successor employer under the Ontario Labour Relations Act in relation to a collective agreement signed before the defendant's bankruptcy between the debtor and its employees.

The second set back suffered by ss 47 and 47.1 receiverships derives from Bill C-55 and has two components. First, temporally, the maximum term of office of the interim receiver is sharply reduced and is now limited, in the case of a s. 47 appointment, to one of a series of events or the expiry of 60 days, whichever is the earliest, or to the earliest of a number of events in the case of a s. 47.1 order.<sup>65</sup> Second, the omnibus power clauses in ss. 47(1)(c) and 47(2)(d) have been deleted, thereby confining the receiver to the specific and statutorily authorized powers.

Nevertheless, although their wings have been clipped, it is safe to assume that interim receivers will continue to be appointed because secured creditors value them so highly. It is therefore relevant to ascertain how the personal liabilities of interim receivers compare with the personal liabilities of trustees previously discussed in this paper and what devices are available to interim receivers to exclude or limit their liabilities although the reasoning is not the same.

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<sup>63</sup> The practice may also have been encouraged by a model template order developed in Toronto by insolvency lawyers and insolvency practitioners. See Fred Myers, "The New Standard Form Template Receivership Order --- Explanatory Notes for Version No. 1 Sept. 14, 2004", 17 *Comm. Insol. R.* 1. See further David E. Baird, "The Section 47 Interim Receiver: A Modern Trojan Horse Designed by Secured Creditors or the Right Approach for Our Times?" *Annual Review of Insolvency Law 2005*, p. 37.

<sup>64</sup> (2004) 71 O.R. (3d) 54.

<sup>65</sup> See Bill C-55, ss. 30 and 31.

(a) *Personal Liabilities of Interim Receivers and Protective Devices*

Subject to one important caveat, it appears that the potential liabilities of an interim receiver are as extensive as the liabilities of a trustee and may include liability for contractual obligations and liability for breach of contractual, tortious, fiduciary and statutory obligations. This proposition is conditioned on determination of the threshold question whether an interim receiver is the agent of the person at whose request he is appointed or whether he acts as principal when exercising his powers – in short, the same question that permeates the discussion of trustee liabilities.

The authorities<sup>66</sup> addressing this question are not as clear as might be wished and the reasons given for holding the receiver personally liable even less so. Nevertheless, the consensus appears to be that the interim receiver is personally liable for his contractual engagements. This may seem puzzling since interim receivers are also regularly referred to as officers of the court because they are appointed by the court. This suggests that interim receivers should be treated as a special species of agent. However, this suggestion has not found favour because it would lead to the unacceptable result that no one could be held responsible for the receiver's engagements – not the receiver because he is only claiming to act for the benefit of the person responsible for his appointment, not the latter person

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<sup>66</sup> E.g., *Re Smith & Son* (1929) 10 C.B.R. 393 (Logie J., Ont.) (liability in contract; following *Strapp v. Bull & Sons & Co.* [1895] 2 Ch. 1 and other cases approved in *Moss Steamship Co. v. Whinney* [1912] A.C. 254, at 259, 270, and 271; *Glick v. Jordan* (1967) 11 C.B.R. (N.S.) 70 (Ont.) (liability in contract and in negligence); cf. *Clifford Van & Storage Co. v. Clifford Van & Storage Co. (Trustee of)* (1989) 73 C.B.R. (N.S.) 129 (Ont.) (trustee's liability for negligent removal of fixtures and stored goods from landlord's premises). These cases should be contrasted with decisions under s .46 holding the interim receiver not liable to the landlord of the debtor's premises on the ground that the interim receiver was only in the position of a custodian or caretaker. See *In re Soren Bros. (No.2)* (1926) 7 C.B.R. 545 (Ont.) relying also on Tobier T.C.J.'s judgment in *Plaskett & Associates Ltd. v. MNR* (1991) 2 C.B.R. (3d) 13. As noted in the text, BIA s 47.2 empowers the court to make an order giving the interim receiver under ss. 47 and 47.1 a charge on the debtor's assets, including a charge ranking ahead of any secured creditors. There is much discussion among the commentators, supra n 61, about the scope of this provision and the discussion may become moot if the amendments to ss 47 and 47.1. and 47.2 in Bill C-55 are proclaimed.



because he sought a court appointment precisely because he wanted to avoid personal liability, and not the court because constitutionally it serves an independent role and derives no economic benefits from making the appointment.

In the non-contractual sphere, the principal-agent dichotomy may be less troubling or even irrelevant, just as is true in the trustee context. This will be true for example where the receiver's conduct is responsible for damage to or loss of the insolvent's property while in the receiver's custody or where the receiver's conduct causes damage to the landlord's premises.<sup>67</sup>

So far as protective devices that are available to an interim receiver are concerned, they embrace the same range of possibilities as apply to trustees, and are subject to the same limitations. In practice, interim receivers will be well advised not to accept an appointment without a full promise of indemnity from the creditor seeking their appointment. It is true that s 47.2 of the BIA<sup>68</sup> authorizes the court to grant a first charge on the debtor's property to cover the receiver's fees and disbursements. However, the charge will only be as good as the value of the assets under the receiver's control. The value may not be sufficient to cover all the potential risks to which the receiver may be exposed.

### 3. IPS Public Law Environmental and Employer Liabilities

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<sup>67</sup> See *supra* cases cited in n 65.

<sup>68</sup> S. 47.2 reads: (1) Where an appointment of an interim receiver is made under section 47 or 47.1, the court may make such order respecting the payment of fees and disbursements of the interim receiver as it considers proper, including an order giving the interim receiver a charge, ranking ahead of any or all secured creditors, over any or all of the assets of the debtor in respect of his claim for fees or disbursements, but the court shall not make such an order unless it is satisfied that all secured creditors who would be materially affected by the order were given reasonable advance notification and an opportunity to make representations to the court. (2) In subsection (1), "disbursements" do not include payments made in operating a business of the debtor. (3) With respect to interim receivers appointed under section 46, 47 or 47.1, (a) the form and content of their accounts, (b) the procedure for the preparation and taxation of those accounts, and (c) the procedure for the discharge of the interim receiver shall be as prescribed.

In the 1980s and early 1990s, two types of liability imposed by public law on insolvency practitioners and secured parties, regardless of fault, caused these parties much concern. The first involved liability for contaminated or polluted premises forming part of the debtor's estate. The second type of liability arose out of provincial employment and labor relations legislation. In the environmental area – for the moment at least – the competing parties appear to have reached a satisfactory accommodation. Such a satisfactory *dénouement* has so far eluded the parties with respect to the liabilities of trustees, receivers, secured parties and purchasers of the property of insolvent enterprises as successor employers. This second group of problems therefore deserves much closer attention than the first.

(a) *Environmental Liabilities*<sup>69</sup>

In the 1980s, the federal and provincial governments adopted much environmental legislation imposing personal and *in rem* liability on a wide range of persons having, or having had, relationship to a property or undertaking causing environmental problems. The legislation provided for the issuance of administrative directives by environmental regulatory authorities

- Directed to persons whether or not they were responsible for causing the environmental hazards;
- Without limitation as to the time following the cessation of ownership or occupation of the property;
- without regard to any causal connection between the respondents and the environmental conditions;

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<sup>69</sup> The following discussion relies heavily on the article by Joseph Marin and Alex Ilchenko, "Priority of Remediation Costs and Limitation of Environmental Liabilities --- Bankruptcy and Insolvency Act and CCAA (Part 1)" (1997) 14 Nat'l Insolv. Rev. 19. Any shortcomings in summarizing their fine article are mine and should not be attributed to the authors. See also the much cited article by Dianne Saxe, "Trustees' and receivers' Environmental Liability Update" (1997) 49 C.B.R. (3d) 138, which focuses heavily on the evolution of the legal interaction between bankruptcy and environmental remediation law between 1989 and 1997.

- and without apportionment of liability among the persons to whom the order was directed.

The affected persons included owners and occupiers of the land, IPS administering or otherwise involved in the administration of an insolvent estate, and secured parties with a security interest in all or part of the debtor's assets. All these persons could be held responsible under the administrative directive for the cost of cleaning up the contaminated property and the land itself and any other property owned by the debtor was subject to a first and overriding lien in favour of the regulatory authority to cover the costs of remediation. These liabilities were imposed on IPs and secured parties even if the harm to the land had been caused without the knowledge or acquiescence of the secured party.

These provisions caused IPS and secured parties much anxiety. The representations and discussions with the regulatory authorities resulted in the adoption of the 1992 amendments of the BIA of s.14.06(2) and (3) exempting trustees from personal liability under federal or provincial law for any environmental liabilities arising before their appointment or that occurred after the trustee's appointment except where the condition or damage arose because of the trustee's failure to exercise due diligence.

Although welcomed as a first and constructive step in reconciling the divergent interests of the several parties, IPS and secured creditors also found that the 1992 amendments did not go far enough. This was first because the protection only extended to trustees acting for a bankrupt person and not to trustees acting in a commercial proposal and, second, because there was too much uncertainty about what would constitute negligence by trustees who had assumed control of premises subject to an environmental remediation order.

In the course of preparing for the second phase of amendments to the BIA in 1997, renewed negotiations were held between federal and provincial officials and the BIAC

Environmental Task Force. These resulted in further amendments to the BIA in the 1997 legislation and were to the following effect<sup>70</sup>:

- the protection conferred on trustees under the 1992 amendments was extended to interim receivers and receivers and trustees acting under proposals; and
- under the 1997 amendments trustees will only be personally liable for environmental conditions arising after their appointment except where the conditions were caused or occurred as a result of the trustees' 'gross negligence or willful misconduct'. Further,
- Trustees will not be personally liable for failure to comply with an environmental administrative order if, within the prescribed period, trustees comply with the order, abandon the property or are divested of the property subject to such an order. Trustees may also apply to the court for a stay of enforcement of the order or a stay of proceedings with respect to such order.
- A federal or provincial government claim for environmental or remediation costs will be secured by a superpriority charge against the affected real property and any real property contiguous to the affected real property causing the environmental condition or damage. If the remediation costs exceed the value of the property subject to the charge the difference may be claimed as an ordinary unsecured claim of the estate but cannot be treated as costs of administration of the estate where the trustee has abandoned the property.

*(b) Interface of Employment Law and Insolvency Law*

Employment law and bankruptcy law basically pursue conflicting policy goals. For the most part, they also fall under the jurisdiction of different levels of government.

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<sup>70</sup> BIA s. 14.06(1.1) to (8) as am. Stat. Can 1997, c.12, s.15.

Bankruptcy law belongs to the exclusive domain of the federal government;<sup>71</sup> employment law is primarily a provincial responsibility although the federal government also has important powers with respect to employees of federally regulated undertakings. Employment law is concerned with the protection and advancement of the interests of employees and the recognition and enforcement of collective bargaining agreements between employers and employees. Bankruptcy law, on the other hand, is concerned with the efficient liquidation of insolvent enterprises or, if this is feasible, restructuring the assets and liabilities to enable the debtor to continue operating or selling the undertaking to another corporation which will then merge the acquired assets with its own assets. However, neither objective will be feasible unless the debtor is also able to restructure its work force and to negotiate a revised collective agreement with its employees. This also means that IPS administering an insolvent business with employees at the time of their appointment may need to ask themselves following questions :

1. What is the status of the employees at the time of the insolvency order? Do the employees retain their status until discharged and is the IP free to discharge them?
2. If the employees are discharged or resign of their own volition, what rights do the employees have with respect to wage arrears, vacation and termination pay, and other employee benefits?
3. If the employees are covered by a collective employment agreement between the employer and a union, does the agreement continue to apply postbankruptcy and to protect the employees from unilateral dismissal?

Until the adoption by Parliament of Bill C-55 on November 25, 2005, the BIA and CCAA had little to say about these questions. Section 136 of the current BIA<sup>72</sup> defines the preferential claims of the bankrupt's employees in respect of outstanding wage claims and claims for vacation pay but does not address other employment issues. Presumably these

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<sup>71</sup> Constitution Act, s. 91(21).

<sup>72</sup> Now radically revised in Bill C-55.

must be determined by applicable federal or provincial law invoked under BIA s 72(1). More questionably, the inherent jurisdiction of bankruptcy courts to fill gaps in the insolvency legislation may also be invoked. Of key importance, however, is the Ontario Court of Appeal's decision in *GMAC Commercial Credit Corporation of Can. v. TCT Logistics Inc.*<sup>73</sup> ("TCT" or "TCT Logistics"), holding that the court's discretionary powers may be used under BIA s 215 to deny or permit the employees or their union representatives to sue the employer for breach of the collective agreement or to file a grievance petition with the relevant labour relations board.

As previously noted, conflict between federal insolvency law and provincial and federal employment law is unavoidable because these two branches of the law have different goals. Employment law's objectives are to protect workers' rights after, as well as before, an employer's insolvency. Insolvency law's objectives are to restore an ailing business back to health if this is feasible and, if it is not, to sell the business as a going concern or, as a last resort, to liquidate the assets and sell them piecemeal. From the debtor's point of view and that of its creditors (particularly secured creditors who often have a major stake in the enterprise), the restructuring goal cannot be achieved if the IP administering the business and any buyer of the insolvent business are treated as successor employers under the applicable labour code and are therefore bound by any subsisting collective agreement. This is because most buyers would find the collective agreement too onerous and incompatible with their goals in absorbing the new assets.

It seems insolvency practitioners were slow to appreciate these challenges and it took the decision of the Ontario Court of Appeal in *Re St Mary's Paper Inc.*<sup>74</sup> to drive home to them the potency of the conflict and the serious risks it posed to IPs and secured creditors. In *St Mary's* case, a majority of the court found that KPMG, the trustee and

<sup>73</sup> (2004) 71 O.R. (3d) 54 (C.A.) Leave to appeal was granted by the Supreme Court of Canada and the appeal was heard but as of December 28, 2005, the Court had not released its judgment. For a comprehensive analysis of the issues raised in *TCT Logistics*, see Ronald B. Davis, "From *St. Mary's Paper* to *TCT Logistics*: Receiver-Managers of Insolvent Companies in a Constitutional Battlefield" (2005) 42 CBLJ 1.

<sup>74</sup> (1994) 19 O.R. (3d) 163 (C.A.).

receiver of the bankrupt company, was personally liable to make good the shortfall in the company's pension plan under the provisions of Ontario's Pension Benefits Act<sup>75</sup>, even though the shortfall had arisen before St Mary's bankruptcy and was not KPMG's fault. KPMG was found liable because it had retained the services of many of St Mary's employees after the bankruptcy (although on a voluntary basis) and had agreed to continue to make payments into St Mary's pension plan and to top them up with 'current' payments. A divided Court of Appeal found that these steps were sufficient to bring KPMG within the definition of employer under the PBA.

Many observers felt at the time that the court's decision had saddled KPMG with a totally unexpected and unfair liability.<sup>76</sup> Parliament obviously agreed because a new subsection (s 14.06(1.2)) was added shortly afterwards in the 1997 amendments to the BIA.<sup>77</sup> This makes it clear that where a trustee carries on the business of the bankrupt or retains the services of the bankrupt's employees, the trustee is not personally liable in respect of any claim against the bankrupt to pay an amount where the claim arose before or upon the trustee's appointment.

In *St Mary's* case, the Court of Appeal was not called upon to decide whether KPMG was a successor employer for the purposes of s 69 of the Ontario Labour Relations Act. That sharply contested issue was decided by the Court in 2004 in the *TCT Logistics* case (supra). TCT carried on a warehousing and trucking business and had signed a collective agreement with the Industrial, Wood and Allied Workers Union of Canada. GMAC held a general security interest in TCT's assets to secure a line of credit extended by GMAC.

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<sup>75</sup> R.S.O. 1990, c.P8 as am.

<sup>76</sup> Presumably KPMG had an indemnity agreement with the major secured lenders who had appointed KPMG as receivers, so that the ultimate burden of the judgment would have fallen on their shoulders.

<sup>77</sup> Section 14.06(1.2) reads: "Notwithstanding anything in any federal or provincial law, where a trustee carries on in that position the business of the debtor or continues the employment of the debtor's employees, the trustee is not by reason of that fact personally liable in respect of any claim against the debtor or related to a requirement imposed on the debtor to pay an amount where the claim arose before or upon the trustee's appointment."

TCT became seriously insolvent and GMAC obtained a court order under BIA s 47 appointing KPMG interim receiver of TCT. The order appointing KPMG was cast in very broad terms. It authorized KPMG to dispose of all or part of TCT's business and assets and, as subsequently amended, also declared that KPMG was not a successor employer of TCT and was not bound by the collective agreement concluded between TCT and the union. KPMG made full use of these powers. It terminated all the existing contracts with TCT's employees and hired back some of the employees but on substantially different terms from the old terms.

The union took the position that what KPMG had done was in serious violation of its collective agreement with TCT. It sought leave from Ground J. under s 215 of the BIA to bring action against KPMG , GMAC and the other parties implicated in these events. Ground J. refused leave. A divided Court of Appeal upheld his decision but on very different grounds from those relied on by Ground J.

All three members of the Court of Appeal (Feldman, Cronk and McPherson JJ.A.) agreed on the following propositions. First, the obligation of successor employers under the Ontario Labour Relations to honour collective agreements signed by a previous employer was valid Ontario legislation and did not conflict with the statutory powers conferred on trustees and interim receivers in the BIA. Second, the bankruptcy judge had exceeded his powers under section 47 in approving the order exempting KPMG from the successor employers provisions in the OLRA.

However, the members of the court were sharply divided over the question whether the union should be granted leave under s 215 to pursue its grievances before the Ontario Labour Relations Board. The majority of the court (Feldman and Cronk JJ.A.) thought the application involved the delicate balancing of bankruptcy and labour law goals against the background of the facts of this particular case and the prospect of TCT's successor being willing to hire back a substantial number of TCT's employees. They therefore believed the application should be remitted to the bankruptcy court for further consideration in light of



the majority's judgment. Feldman and Cronk JJ.A. also agreed that s 215 did not preclude the court from engaging in this balancing exercise and that the court's role in considering the application was not restricted to determining whether the claim was meritorious or vexatious and without substance in law.

Justice McPherson strongly disagreed. He thought the earlier s 215 jurisprudence<sup>78</sup> imposed a low threshold for an applicant to receive the court's leave and he strongly opposed s 215 being converted into a mediational device for resolving competing insolvency and labour law goals.

*(c) Impact of Bill C-55 on TCT Logistics*

The majority judgment in TCT was appealed to the Supreme Court of Canada but, as of this writing, the Supreme Court has not rendered its decision. It seems unlikely that the Court's judgment, whichever way it goes, will uphold the power of insolvency practitioners to disclaim collective agreements or relieve the buyer of a bankrupt business from being treated as a successor employer.

My reasons for reaching this conclusion are as follows. All the appellate judges in TCT agreed that the bankruptcy court had exceeded its powers in authorizing the sale of TCT's business unencumbered with the obligations of a successor employer. They also agreed that the provincial labour legislation was valid law and therefore binding on the bankrupt persons and insolvency administrators. On this ground alone, it is unlikely that future interim receivers will be tempted to follow KPMG's footsteps and to pin their hopes on being able to persuade a bankruptcy judge to refuse leave under s 215 to prevent a union from enforcing the collective agreement. The risks of losing are too great. It also seems unlikely that even a deep pocket secured party will be willing to fund such a hugely expensive exercise.

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<sup>78</sup> In particular, the Court's decision in *Mancini (Trustee of) v. Falconi* (1989) 76 C.B.R. (N.S.) 90 (Ont.).

The second reason for querying the enduring impact of the majority's decision in TCT derives from the provisions in Bill C-55. Directly and indirectly these provisions make it very clear that that collective agreements are meant to remain in force after the initiation of insolvency proceedings<sup>79</sup> and cannot be assigned or disclaimed by a bankrupt employer without the union's consent.<sup>80</sup> All that the bankrupt employer can do, with a view to persuading the union to agree to changes in the collective agreement, is to ask the court's permission to serve notice to bargain on the union's bargaining agent.<sup>81</sup> Many observers question the value of this provision.

The Bill C-55 amendments were adopted by the Martin administration in the face of very strong union pressure for Canada not to follow the American route,<sup>82</sup> and not to allow Canadian bankruptcy courts to authorize disclaimer of union agreements where the parties have been unable to reach agreement and the court is of the view that the business cannot be saved without a revised collective agreement. Of course, this does not mean that CCAA debtor companies will not be able to continue to negotiate with unions on changes to collective agreements on a consensual basis or that energetic judges like Justice Farley will not continue to use strong moral suasion behind the scenes to persuade the parties to make compromises to save important enterprises.<sup>83</sup> What it does mean is that the courts will no longer play a formal role in resolving the conflict and that the parties will have to resort to arbitration, mediation and other extra-curial means to try and reach an accommodation to save an ailing enterprise.<sup>84</sup>

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<sup>79</sup> Bill C-55, CCAA amendments s 33(1). There does not seem to be a parallel provision in the BIA amendments of the bill.

<sup>80</sup> Bill C-55, BIA amendments, ss. 11.3(2), 65.11(2); CCAA amendments s 33(2).

<sup>81</sup> Ibid., BIA amendments, s 65.12; CCAA amendments, s 33(2).

<sup>82</sup> See US Bankruptcy Code, s.1113.

<sup>83</sup> As the insolvency reorganization of corporations such as Algoma Steel, Air Canada and, more recently, Stelco show, the parties' own interests may ultimately persuade them to make sufficient concessions to enable the business to survive.

<sup>84</sup> Cf. Stephen Wahl, "Bankruptcy and Insolvency: High Stakes Poker at the Collective Bargaining Table" in *Annual Review of Insolvency Law 2004*, p.203. Mr. Wahl does not tell us, nor did the majority judges in *TCT Logistics*, what is to happen if the union and the other parties cannot reach agreement. Presumably liquidation of the business will be the only option although it may not be in the interests of the workers or the community. In the

### C. STATUS AND PERSONAL LIABILITIES OF MONITORS UNDER THE CCAA<sup>85</sup>

We have previously noted that monitors were introduced by Canadian courts in the late 1980s and early 1990s as part of the effort to revive the CCAA in response to the economic crisis. The appointment of monitors was perceived by the courts and the credit community as a compromise between transferring management of the ailing enterprise into entirely new hands on the one hand and putting their faith in existing management not to run the business further into the ground on the other. The monitor was installed to serve as a watch dog of the creditors' interests, to investigate the debtor's financial affairs, and to keep the creditors and the court informed about important changes in the debtor's affairs.

Section 11.7 of the CCAA, introduced in 1997, made the appointment of a monitor mandatory and also defines the monitor's status and powers. These are:

- To monitor the company's business and financial affairs
- To file reports with the court on the state of the company's business and financial affairs

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past, judges invoking their inherent powers doctrine under the CCAA have often said or implied that the sum is more important than the parts and that creditors may be required to make sacrifices to enable the debtor company to survive. However, this proposition has never been applied consistently and it is not consistent with the voting rights and implicit veto powers conferred on classes of creditors under the CCAA. Resolving this dilemma is probably the single most important question facing contemporary Canadian bankruptcy law as of that of many other insolvency systems.

<sup>85</sup> "Chief Restructuring Officers" (CRO) have also made their appearance on the CCAA scene over the past ten years or so. However, they are not appointed by the court but by the directors of the debtor company (often at the urging of senior creditors) and have no official standing under the CCAA. In any event, they are not ordinarily involved in the operation of the debtor's business. (I am indebted to David E. Baird, Q.c. for this information.) For all these reasons, the liabilities of CROs is not considered in this report.

- To advise the creditors when reports have been filed with the court and to advise them of materially adverse changes in the company's financial circumstances
- To carry out such other functions as the court may require (subs. (d)).

The last obligation, framed in subsection (d), is obviously of great conceptual importance. It reflects the fact that in the past court orders have sometimes conferred important managerial functions on monitors.<sup>86</sup> Where this is the case the monitor will wear several hats and this may give rise to concerns about conflicts of interest between his monitoring and managerial functions.

*(a) Characterization Of Monitor's Status And Exposure To Personal Liabilities*

Assuming the monitor's role is confined to that of watch dog, how should his status be defined for liability purposes? Obviously he is an officer of the court since he owes his appointment to the court and is obliged to make his reports to the court. However, this does not take us very far. As noted earlier, interim receivers are also officers of the court but are not treated as agents of the court. Equally obviously, the monitor is not an officer or agent of the debtor company since the company has not appointed him and has no control over his activities. This leads us to the conclusion that the monitor is an independent functionary who will be held responsible for his own contracts and other obligations and may incur liabilities if he fails to meet them.

This conclusion ought not to give monitors cause for alarm. The reasons are as follows. The monitor's liabilities are likely to be very modest. Second, unless the monitor plays a managerial role, there is no reason for him to be concerned about exposure to

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<sup>86</sup> In the *Jeffrey Mines* CCAA case, for example, [2003] R.J. Q. No. 420, the monitor effectively ran the mine presumably because the previous management had resigned and no one else was available or suitable to take their place. The directors of the company may also have lost confidence in the prior management. Both phenomena are quite common when companies run into serious financial difficulties. Monitors are often appointed precisely because they have developed an acknowledged expertise as restructuring specialists.

employee wage and pension claims. Moreover, s.11.8 of the CCAA contains mirror image provisions to those in BIA ss.14.06 (1.2), (1.3) excluding the monitor's liability for claims against the estate arising before the date of the monitor's appointment. Similarly, ss. 11.8(3) to 11.8(9) of the CCAA confer the same protection against environmental claims as are available to trustees and interim receivers under BIA s 14.06(3) to (9). Fourth, so far as the monitor's fees and disbursements are concerned, although not explicitly regulated in the CCAA, court orders under the CCAA have long authorized their payment and have given them the status of a first ranking charge against the company's assets.<sup>87</sup>

It seems therefore that the only significant liability to which a monitor may be exposed is liability to the debtor company and the company's creditors for negligently prepared financial statements and reports. Section 11.7(4) of the CCAA provides that the monitor is not liable for loss or damage suffered by a person who has relied on the monitor's report "if the monitor has acted in good faith and has exercised reasonable care in the preparation of his report." The quoted words imply that the monitor will be held liable if his report has been negligently prepared. It is suggested however that the inference is not justified and that all that s 11.7(4) means to say is that the monitor *may* be exposed to liability under the *Hedley Byrne* doctrine.<sup>88</sup> It does not follow that liability will follow as a matter of course even if the monitor's report contains material errors or omissions. Over the past decade, the Supreme Court of Canada has substantially narrowed the scope of the *Hedley Byrne* doctrine.<sup>89</sup> It is reasonable to assume that this jurisprudence will also be invoked if claims are made against a monitor for allegedly negligently prepared reports.

#### D. WINDING UP AND RESTRUCTURING ACT : STATUS AND PERSONAL LIABILITIES OF LIQUIDATORS

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<sup>87</sup> See *Re United Used Auto* (1999) 12 C.B.R. (4<sup>th</sup>) 144 (B.C.), a leading authority on the point.

<sup>88</sup> *Hedley Byrne & Co v. Heller Partners Ltd.* [1964] A.C. 465.

<sup>89</sup> See Earl Cherniak and Elissa How, "Policy and Predictability: Pure Economic Loss in the Supreme Court of Canada" (1999) 31 Can. Bus LJ 209.

It is not necessary to say much about the status and personal liabilities of liquidators under WURA. As previously explained, the Act is now almost exclusively used by financial institutions and other enumerated insolvent corporations that cannot make use of the BIA or the CCAA. WURA is therefore of limited interest for the purposes of this study except in one respect: the use of a liquidator instead of a trustee to administer and wind up the affairs of the insolvent corporation and what it tells us about the comparative merits of these two devices.

Under WURA, the court appoints the liquidator (s 23) and the liquidator may be a corporation (s 29). The court can also appoint a provisional liquidator (s 28). Appointment of the liquidator results in the corporation's directors being immediately relieved of their rights, duties and powers. A comparison of the WURA and BIA provisions shows that there are strong similarities between the functions, duties and powers of a trustee and a liquidator.<sup>90</sup> This should come as no surprise. Both officials serve the same function – to ensure the orderly liquidation or disposition of the company's assets under the court's supervision and the direction of a committee of inspectors (if there is one) and to distribute the net proceeds of the estate among the company's creditors according to their ranking.

The key conceptual difference between a liquidator and a trustee is that a court appointed liquidator is regarded as a statutory agent of the company<sup>91</sup> without title to the company's assets. Under the BIA, on the other hand, a trustee is automatically invested on his appointment with the debtor company's property while in a liquidation the property remains with the company. The distinction was treated as being of great importance by Gonthier J. in writing the Supreme Court's judgment in *Coopérants Mutual Life Ins Socy*

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<sup>90</sup> Cf. Kevin McGuinness, *The Law and Practice of Canadian Business Corporations* (1999) § 1132, and *Re Home Colonial Ins Co.* [1930] 102, 124-5.

<sup>91</sup> Roy Goode, *Principles of Corporate Insolvency Law*, 3<sup>rd</sup> ed. (2005), pp 120-21; *Knowles v. Scott* [1891] 1 Ch 717.

*v. Dubois Richard*.<sup>92</sup> The plaintiff and the insolvent defendant company owned two real estate properties in common (*par indivision*) in the City of Laval. The agreement conferred an option on the non-insolvent party to purchase the other's interests if one of them became insolvent. The agreement had not been registered in the land registry office. Coopérant became insolvent and the plaintiff sued to enforce the agreement. The liquidator defended the action on the ground *inter alia* that the agreement had not been registered and because the liquidator was in the position of a third party. The Supreme Court rejected both arguments. Gonthier J emphasized<sup>93</sup> the agency role of the liquidator and the fact that Coopérants had retained its legal personality and title to its property. He contrasted this with the status of a trustee under Canada's bankruptcy legislation. Apparently therefore he regarded the distinction in status between a liquidator and a trustee as more than formal.

Be that as it may, it follows from the liquidator's status as agent of the company that, unlike a trustee, he is not personally liable for the company's postliquidation debts unless he pledges his personal credit. Like a trustee, however, a liquidator will be liable for breach of his fiduciary duties as liquidator and failure to exercise reasonable skill and care in the winding up of the company's affairs. For obvious reasons WURA does not have, and does not need, a provision comparable to BIA s 31(4). Less clear is the question whether the court's permission is necessary for a third party to bring action against the liquidator for breach of the liquidator's duties. The answer appears to be that no such permission is required because WURA contains no counterpart to BIA s 215. WURA does however impose a stay of all proceedings against the company after a winding up order has been made (s 21). This restriction only appears to apply to claims that arose before the winding up order, not to postliquidation claims.<sup>94</sup> In any event, a claim against the liquidator for

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<sup>92</sup> [1996] 1 S.C.R. 900.

<sup>93</sup> *Ibid.*, at paras. 30-34.

<sup>94</sup> Check for authorities if any.

breach of his duties will be brought against him personally and not against the company, thereby bypassing s 21 altogether.



### III IPS' PERSONAL LIABILITIES UNDER ENGLISH LAW

#### A. INTRODUCTION

Earlier in this paper we noted the basic divergence between the Canadian and English approaches to insolvency administrations that occurred with Canada's adoption of the Bankruptcy Act of 1919. This happened when it was decided that the Act should apply to corporations as well as individuals, thereby causing Canada to depart from the well established English precedent that the winding up of insolvent (as well as solvent) companies should be governed by separate legislation. We also noted the separate nomenclature adopted in the English legislation to describe the insolvency administrators for companies and the different status accorded to them from that of trustees in personal bankruptcies.

Since then important new legislation has been adopted in England, notably the Insolvency Act of 1986<sup>95</sup> and subsequent amendments to the Act, in particular the amendments appearing in the Enterprise Act 2002.<sup>96</sup> These developments have both narrowed the differences between the insolvency systems of Canada and England and expanded it in other areas. The important English changes are the following:

- The provisions for the winding up of companies and bankruptcy procedures for individuals has been brought under one roof in the Insolvency Act 1986, but the distinction between the two procedures is maintained. However, for some purposes, a common set of rules has been adopted for companies and individuals.<sup>97</sup>

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<sup>95</sup> UK Statutes 1986, c.45.

<sup>96</sup> UK Statutes 2002, c. 40.

<sup>97</sup> 1986 Act as am., Part III

- The 1986 Act contains a separate chapter dealing with private receiverships, now described as “administrative receiverships”.<sup>98</sup> However, the Enterprise Act 2002 has sharply curtailed the availability of private receiverships and henceforth, in most cases, holders of floating charges will now have to resort to the new Administration provisions to find a solution to the company’s debt problems.<sup>99</sup>
- The Administration concept introduced in the 1986 legislation<sup>100</sup>, and further refined in the 2002 amendments, is a unique type of “stand still” procedure for companies in financial difficulties. Its purpose is to enable a new functionary, the Administrator, to take charge of the company and to explore the best alternatives for rescuing the company from its financial difficulties. However, unlike the CCAA, an administration does not actually result in a restructuring of the company but only sets the stage for that event if the administrator decides a rescue is feasible.
- The 1986 Act also introduced two new procedures (“voluntary arrangements”) for reorganizing the debts of insolvent persons, one for companies (CVAs)<sup>101</sup> and another for individuals (IVAs).<sup>102</sup> Both have become increasingly popular. CVAs and IVAs have their Canadian counterparts in commercial proposals and consumer proposals in Part III Divisions 1 and 2 of the Canadian BIA.
- The 1986 and 2002 legislation also creates an enhanced role for the Official Receiver<sup>103</sup> in acting as trustee or liquidator in those cases where private IPs cannot be persuaded to act (usually because the estates are too small to make it attractive to them), and similarly in promoting the use of IVAs and CVAs by offering the OR’s services at a lower cost than would be charged by IPs.

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<sup>98</sup> Insolvency Act, s 29(2) (IA).

<sup>99</sup> R.M. Goode, *Principles of Corporate Insolvency Law*, 3<sup>rd</sup> ed. (2005), 1.23.

<sup>100</sup> *Ibid.*, 1.21.

<sup>101</sup> IA, Part I.

<sup>102</sup> IA, Part X.

<sup>103</sup> IA, Part XIV as am.

B. STATUS, DUTIES AND PERSONAL LIABILITIES OF ENGLISH IPS IN  
INSOLVENCY PROCEEDINGS

**1. Bankruptcies**

Trustees are licensed by the Insolvency Service and must either be members of a recognized professional organization or make direct application for recognition to the IS.<sup>104</sup> Trustees are also required to provide security for the faithful performance of their duties. Companies are not eligible to service as trustees.<sup>105</sup> The duties and functions of trustees are basically the same as they are under the BIA.<sup>106</sup> Similarly, trustees are invested on their appointment with title to the bankrupt's non-exempt property.

Consequently, it has been well established since the 19<sup>th</sup> century that trustees are personally responsible for contracts expressly or impliedly entered into for the benefit of the estate, and this remains true today.<sup>107</sup> There has been no movement to change the position and, curiously, there is very little discussion of it in leading English bankruptcy and insolvency texts.<sup>108</sup> The Insolvency Act contains no provision comparable to s 31(4) of the BIA and no provision comparable to s 215 of the BIA requiring the court's permission before suit can be brought against a trustee. Instead, s 303 (which appears to be the English counterpart to s 37 in the BIA) allows misfeasance application to be brought against the trustee though seemingly without prejudice to any liability arising apart from the section.<sup>109</sup>

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<sup>104</sup> Ian F. Fletcher, *The Law of Insolvency*, 3<sup>rd</sup> ed.(2002), 2-010/2.

<sup>105</sup> IA s. 390.

<sup>106</sup> For the details see Fletcher, *op cit.*, 7-053.

<sup>107</sup> See e.g., *Re Lister* [1926] Ch. 149.

<sup>108</sup> E.g., *Williams' Law and Practice in Bankruptcy*, 18<sup>th</sup> ed., London: Stevens, 1968; Fletcher, *supra* n.104, 8-089.

<sup>109</sup> IA, s. 304; Fletcher, *op cit.*, 7-058.

My own explanation for English acquiescence in the status quo are the following. 1. IPS will not accept an appointment where they have doubts about the sufficiency of assets to at least cover their prospective fees and expenses. 2. The Official Receiver's obligation to act as trustee where the creditors have not appointed a trustee (which appears now to account for the great majority of all personal insolvencies)<sup>110</sup> basically leaves private sector IPs with the more remunerative and less risk prone estates. 3. The more important commercial insolvencies involve companies whose liquidators, as we have seen, attract no personal liability for post-liquidation contracts. 4. An English court is empowered to grant trustees relief from personal liability under s 61 of the English Trustee Act 1925.<sup>111</sup> However, it seems unlikely a court would exercise its discretion in the trustee's favour in a contractual setting since the trustee would have difficulty satisfying the s 61 criteria. 5. Another possible explanation for the apparent lack of concern about trustees' personal liability is that the Insolvency Act confers broad powers on a trustee to disclaim onerous contracts.<sup>112</sup> However, it is difficult to see why this would make a difference to an IP's decision whether or not to serve as trustee of an estate. There is no obligation at common law for a trustee to perform burdensome contracts and the statutory provisions have only made explicit what was always implicit in the law. Another possible explanation for the lack of controversy over an English trustee's continuing personal liability for performance of contractual obligations is that the trustee's fees and expenses rank ahead of floating charges and preferential claims against the estate. This rationale also lacks persuasiveness. If the estate has too few assets to begin with, being first in line provides little incentive to the trustee to assume the risk of being held personally liable for the estate's postbankruptcy debts.

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<sup>110</sup> According to an English author, many insolvency practitioners consider that the [2002] Act is "the end of the road for them." See Stephen Davies, Q.C. (ed.), *Insolvency and the Enterprise Act 2002* (2003), p. 189.

<sup>111</sup> Trustee Act 1925, s. 61. However, I have not been able to locate cases involving applications for relief by an English IP.

<sup>112</sup> IA s 315(1). Company liquidators enjoy the same power.

*(a) Proceedings against trustees*

As already mentioned, the IA contains no provision comparable to s 215 of the BIA. The relevant IA provisions appear to be the following. Under s 303(1) the English court has broad powers to give directions and make any other order affecting the administration of the estate. This power is similar, to but seemingly not identical with, the powers conferred on Canadian courts under s 37 of the BIA. Section 304 of the IA deals with misfeasance applications and enables the court to make a remedial order where the trustee has been guilty of conversion of estate property,<sup>113</sup> has committed a breach of fiduciary duty, or has committed some other breach of his obligations. It seems that s 304 does not preclude an aggrieved party from starting a regular action against the trustee.

## **2. Liquidator's Status and Liabilities**

It has long been well established in England that the liquidator is an agent of the company being wound up<sup>114</sup> and therefore is not personally liable for contracts entered into by him on behalf of the company. The company will be liable even though the company has not appointed the liquidator. Similarly, the liquidator will not be personally liable for contracts of employment which he chooses to continue even if there are insufficient assets in the estate. The employee claims will rank as preferential claims and will take precedence over floating charges but not over fixed charges.<sup>115</sup>

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<sup>113</sup> Note however, by way of contrast, that s 304(3) relieves a trustee from liability for loss or damage where he has inadvertently seized or disposed of property not belonging to the estate.

<sup>114</sup> *Re Silver Valley Mines (1882)* 21 Ch D 381, 392. (The case actually involved the liquidator's obligations and duty of impartiality in dealing with creditor interests.) For a more nuanced description of the liquidator's position, see *Ayerst v. C & K (Construction) Ltd.* [1976] A.C. 176.

<sup>115</sup> IA ss. 175, 386; Fletcher, *op. cit.*, 17-004.

### 3. Administrative Receivers<sup>116</sup>

We have previously noted the history of private receiverships in England and the important role they play in the enforcement of floating charges given by a company over its assets. We also observed that under the terms of a typical debenture, if a receiver is appointed by the secured party, he is deemed to be the debtor company's agent, not the secured party's agent. This practice is now given statutory recognition in s 44(1)(a) of the IA. However, s 44(1)(b) carves out two important exceptions. First, the receiver is personally liable on contracts entered into by him in carrying out his functions. Second, he is personally liable for contracts of employment "adopted" by him but the liability is qualified as the result of a 1994 amendment.<sup>117</sup> English authors describing the 1986 provisions do not provide a rationale for imposing these personal liabilities on the

<sup>116</sup> "Administrative receiver" is defined in the IA, Part III, s 29(2).

<sup>117</sup> S 44 as amended reads as follows: (1) The administrative receiver of a company; (a) is deemed to be the company's agent, unless and until the company goes into liquidation; (b) is personally liable on any contract entered into by him in the carrying out of his functions (except in so far as the contract otherwise provides) and on any contract of employment adopted by him in the carrying out of those functions; and (c) is entitled in respect of that liability to an indemnity out of those assets of the company. (2) For the purposes of subsection (1)(b) the administrative receiver is not to be taken to have adopted a contract of employment by reason of anything done or omitted to be done within 14 days after his appointment. (2A) For the purposes of subsection (1)(b) a liability under a contract of employment is a qualifying liability if- (a) it is a liability to pay a sum by way of wages or salary or contribution to an occupational pension scheme, (b) it is incurred while the administrative receiver is in office, and (c) it is in respect of services rendered wholly or partly after the adoption of the contract. (2B) Where a sum payable in respect of a liability which is a qualifying liability for the purposes of subsection (1)(b) is payable in respect of services rendered partly before and partly after the adoption of the contract, liability under subsection (1)(b) shall only extend to so much of the sum as is payable in respect of services rendered after adoption of the contract. (2C) For the purposes of subsections (2A) and (2B) - (a) wages or salary payable in respect of a period of holiday or absence from work through sickness or other good cause are deemed to be wages or (as the case may be) salary in respect of services rendered in that period, and (b) a sum payable in lieu of holiday is deemed to be wages or (as the case may be) salary in respect of services rendered in the period by reference to which the holiday entitlement arose. (2D) In subsection (2C)(a), the reference to wages or salary payable in respect to a period of holiday includes any sums which, if they had been paid, would have been treated for the purposes of the enactments relating to social security as earnings in respect of that period. (3) This section does not limit any right to indemnity which the administrative receiver would have apart from it, nor limit his liability on contracts entered into or adopted without authority, nor confer any right to indemnity in respect of that liability. The second exception has generated a lot of litigation. For the details, see Goode, *op cit.*, 9-53 et seq.

administrative receiver. Presumably, the explanation is that since the receiver is only acting for the benefit of the secured party, not creditors generally, it is reasonable to expect him to assume responsibility for this particularly vulnerable class of creditors and to seek an indemnity from the secured party in case the debtor's assets prove insufficient to cover the employees' claims.

#### 4. Company Administrators<sup>118</sup>

As in the case of the administrative receiver, the IA treats the administrator as an agent of the company<sup>119</sup> but, unlike an administrative receiver, he is a true agent since his obligation is to promote the interests of all the company's creditors. Presumably this is the reason why the Insolvency Act does not hold the administrator personally liable even for the salaries of new employees engaged by him and for pre-appointment employee contracts that he is deemed to have adopted. Whether this is an entirely satisfactory explanation for the administrator's non-liability is debatable, and is a question that is further pursued in the concluding part of this paper.

Like a liquidator, a company administrator is accountable for his actions and may be subject to misfeasance proceedings if he has abused his powers or breached other obligations. Importantly, the administrator is also able to seek relief from liability under s 727 of the Companies Act 1985. This section applies where an officer of the company or its auditor is being sued in negligence, breach of duty or breach of trust and empowers the court to grant relief where the court concludes that that the officer had acted honestly and

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<sup>118</sup> For detailed treatment of this topic, see Goode, *op. cit.*, ch 10. In 2004, there were 12,192 compulsory and creditors' voluntary company liquidations in England and Wales, 1,601 company administrations, and 864 administrative receivers. *Ibid.*, p 313.

<sup>119</sup> IA 1986, Sch B1, para 69.

reasonably and that in all the circumstances the officer ought reasonably to be excused from personal liability.<sup>120</sup>

## 5. Public Law Issues and IP Liabilities

1. *Environmental Issues.* The English Insolvency Act contains no provision comparable to s.14.06 of the BIA and provides no guidance to English courts how to balance the competing interests of creditors of an insolvent company, and the power of an insolvent company to disclaim onerous property, with the statutory responsibility of the Department of the Environment (DOE) to order the clean up of contaminated sites. In *Re Mineral Resources Ltd*<sup>121</sup> Mr. Justice Kennedy held that the Environmental Protection Act 1990 should be given priority over the disclaimer provisions in the Insolvency Act. However, this part of his judgment was disapproved of by the Court of Appeal in *Re Celtic Extraction Ltd*.<sup>122</sup> on the ground that the disclaimer powers in the Insolvency Act embody an important public policy.<sup>123</sup> It is safe to assume that this is not the end of the story and that the conflict may have to be resolved by Parliament if it is not addressed first by the House of Lords.

2. *Employment Issues and Successor Employer Liability.* It is impossible to do justice here to this complex topic and I can only sketch what appear to me to be some of the salient

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<sup>120</sup> There is a substantial body of case law on the section and courts have generally shown themselves reluctant to grant relief except where the breach was technical and unintentional and has not caused the company actual harm. See *The Commissioners of Inland Revenue v. Richmond, Jones* (2001) Ch. D. 5157, *The Equitable Life Assurance Society v. Bowley et al.* (2002) QBD (Comm Ct) 406, *First Global Media Group Limited v. Larkin* 2003 WL 22656466, *Inn Spirit Limited v. Burns & Another* 2002 WL 1654974, *The Liquidator of Marini Limited v. Dickenson* (2003) Ch. D. 2894, *Murray v. Leisureplay Plc* 2004 WL 1640214, and *Whalley v. Doney* (2000) Ch. D. 8011. English commentators have remarked on the anomaly of the court being empowered to grant relief to an officer who has been found to have acted negligently (which implies that the officer has failed to exercise the appropriate degree of care) on the ground that the officer has acted reasonably! The courts have reconciled the apparent conflict by concluding that the test of reasonableness under s 727 is a subjective test unlike the usual objective test applied in negligence cases.

<sup>121</sup> [1999] 1 All E.R. 766.

<sup>122</sup> [2001] Ch 475.

<sup>123</sup> For further discussion of the issues, see Goode, *op cit.*, pp 54-55.



differences between the British and Canadian approaches where the administrator of an insolvent English enterprise seeks to hive off part of it to a new company or to sell the whole undertaking to another company. The general common law rule is that the sale of the business to another company terminates contracts of employment, thereby relieving the new owners of the undertaking from liability to the old employees.<sup>124</sup> The position changed in 1981 when the British government adopted the *Transfer of Undertakings (Protection of Employment) Regulations 1981* (S.I. 1981 No. 1794) (“Transfer Regulations”, or TURP). The regulations were designed to implement EC Directive 77/187: [1977] O.J L61/26 (“Acquired Rights Directive”) and were meant to preserve the contractual rights of employees on a transfer of their employer’s business. Both the Directive and the Regulation have give rise to much interpretive litigation, the first before the European Court of Justice and the second before the English courts.<sup>125</sup> At a broader level, commentators have debated the issue, in terms equally familiar to North American lawyers, whether stringent successor employer rules will throttle the prospects of finding a buyer for an insolvent enterprise and how the competing interests of insolvency law and employee protection can best be reconciled.<sup>126</sup> The important difference between the Canadian and the English approach is that in England the answer was supplied by statutory regulation whereas in Canada, at least prior to Bill C-55, the courts have used s 215 of the BIA to mediate the conflict.<sup>127</sup>

#### IV IPS’ STATUS AND PERSONAL LIABILITIES UNDER AMERICAN LAW

<sup>124</sup> *Brace v. Calder* [1895] 2 Q. B. 253; *Re Foster Clark Ltd’s Indenture Trusts* [1966] 1 WLR 125; [1966]1 ALL ER 43.

<sup>125</sup> See in particular *Litster v. Forth Dry Dock & Engineering Co. Ltd.* [1989] 2 W.L.R. 634 (H.L.), discussed in Hugh Collins, “Transfer of Undertakings and Insolvency Law” (1989) 18 Ind. L.J. 144.

<sup>126</sup> See, inter alia, Hugh Collins, *supra* n. 124; and J. Armour & S. Deakin, “Insolvency, Employment Protection and Corporate Restructuring: the Effects of Tupe”, Centre for Business Research, Univ of Cambridge, CBR Working Paper No 204 (2002); and Goode, *op cit.*, 2-11,

<sup>127</sup> See *supra*, Part II.B.3(b).

### A. PRELIMINARY OBSERVATIONS

Some preliminary observations are in order about significant differences and similarities between American bankruptcy law and their British and Canadian counterparts. To begin with, unlike Canadian law, all the substantive American rules are found in one statute, the Bankruptcy Code, which was adopted in 1978 but has been frequently amended since then.<sup>128</sup> However, Canadian and US law share a common feature in that the Canadian and US legislation applies equally to individual and corporate bankruptcy and other insolvency proceedings.<sup>129</sup> Chapter 11 in the US Bankruptcy Code is *sui generis* because the appointment of a trustee or monitor is not a prerequisite to the debtor being allowed to remain in possession and to continue to operate its business. However, a DIP is entrusted with all the rights and powers of a trustee, and the bankruptcy court may also appoint an independent trustee to manage the debtor's affairs and to prepare a plan for the creditors' consideration, but such an appointment is very unusual.

So far as the trustees themselves are concerned, they are all drawn from the private sector. Corporate trustees are permitted. There is no formal licensing system for trustees but all the appointments are made by the US Trustee in Bankruptcy, a Washington based government official who plays a role similar to the Superintendent of Bankruptcy in Canada.<sup>130</sup> Overwhelmingly, most of the US bankruptcies, commercial and consumer, are voluntary bankruptcies. The debtor's creditors have the first right to appoint the trustee but choose not to exercise it most of the time. If they do not exercise the right,

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<sup>128</sup> The most recent (and most substantial) set of amendments were adopted in 2005. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), S. 256, Pub. L. No. 109-8, 119 Stat. 23 (April 20, 2005)

<sup>129</sup> In the Code, the term 'bankruptcy' is applied to reorganizational bankruptcies under chapters 11 and 13 as well as to liquidational bankruptcies under chapter 5 of the Code. This terminological feature is often overlooked by statisticians and scholars seeking to compare US insolvencies with insolvencies in other jurisdictions that apply a different terminology.

<sup>130</sup> The Office of the US Trustee is a branch of the Department of Justice and has its chief office in Washington, DC. There are also regional US Trustees who supervise the administrative work of the US courts and private trustees in their areas.

the US Trustee will appoint a trustee from his list of Chapter 7 'panel' trustees.<sup>131</sup> The US Trustee can appoint an interim trustee if there is likely to be a delay in the appointment of a full fledged trustee following the commencement of a case, but such appointments appear to be uncommon. The US Code makes no provision for the appointment of interim receivers and the need to do so was expressly rejected by the Code's drafters as unnecessary.<sup>132</sup>

#### B. TRUSTEE NOT SUCCESSOR IN TITLE

A key difference between the Code trustee and his Canadian and British counterparts is that despite his title the Code trustee does not acquire title to the debtor's estate. Instead, section 541 of the Code creates a legal entity, the debtor's 'estate', comprising all of the debtor non-exempt personal and real property. Code trustees are representatives of the estate and may sue and be sued in their representative capacities.<sup>133</sup> The legal personification of the estate was introduced in 1978 as part of the new Bankruptcy Code. The change appears to have generated little discussion (and apparently no opposition) at the time and there is very little discussion of the conceptual significance of the change in the otherwise superabundant US bankruptcy literature.<sup>134</sup>

#### C. TRUSTEE REMAINS LIABLE FOR PERSONAL WRONGS

<sup>131</sup> Bankruptcy Code, §See further CJ Tabb, *The Law of Bankruptcy* (Foundation Press, Westbury, New York, 1997), §1.18.

<sup>132</sup> The Legislative Notes accompanying adoption of the Code provide no reasoning. Presumably the reason was that a secured creditor who is concerned about the safety and maintenance of its security in the debtor's hands is free to apply to the court for protection pursuant to ss 361 and 362(d) of the Code.

<sup>133</sup> Code, s. 323.

<sup>134</sup> Two exceptions are Stephen McJohn, "Person or Property? On the Legal Nature of the Bankruptcy Estate" 10 *Bankr. Dev. J.* 465 (1994) and Thomas E. Planck, "The Bankruptcy Trust as a Legal Person" (2000) 35 *Wake Forest L. Rev.* 251. Mr. McJohn's article focuses on the question whether the effect of s 541 is to create a new *persona* that is invested with the assets of the debtor or whether it is the estate itself that is personified. Prof. Planck favours the second view and his article is primarily concerned to determine the effect of personification of the estate. He concludes that it is beneficial and avoids the friction that had previously existed over the question whether federal courts had jurisdiction over bankruptcy estate matters.

A key consequence of the personification of the debtor's estate is that Code trustees are no longer personally liable on contracts concluded by them for the benefit of the estate. However, this conceptual change grants them no immunity from personal liability for lack of diligence, dereliction of their statutory duties, and breach of their fiduciary duties. The topic has attracted a large volume of litigation<sup>135</sup> and has prompted one prominent author to observe that:

Few aspects of the bankruptcy law are as rife with confusion, misunderstanding and irreconcilable statements as the subject of liabilities of the trustee for his or her acts or omissions. There is no clear or well-settled body of law. ....<sup>136</sup>

The author then proceeds to examine a trustee's potential liability under the following heads: 1. Was the trustee's conduct negligent or intentional? 2. Did it involve the exercise of business judgment? 3. Is the asserted liability for acts of the trustee personally or for acts of servants, agents and employees? 4. Is the liability of the trustee a personal one or may he or she be reimbursed from the estate? 5. Is the trustee insulated from liability by such procedures as obtaining a court order or filing an account? 6. Is the liability different under Chapter 11 or 13 than it is in a Chapter 7 liquidation?

So far as the procedural aspects of suing the trustee are concerned, the U.S. bankruptcy court's consent is not necessary to commence action in the court seized of the bankruptcy proceedings. The trustee may also be sued in a non-bankruptcy court without leave if the claim relates to the trustee's carrying on the debtor's business.<sup>137</sup> In other cases, it seems, leave will be necessary to bring suit in a non-bankruptcy court.

#### D. PUBLIC LAW ISSUES: ENVIRONMENTAL AND SUCCESSOR EMPLOYER PROBLEMS

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<sup>135</sup> Daniel R Cowans, *Bankruptcy Law and Practice*, 6<sup>th</sup> ed., vol 1, §2.7, pp 161-69.

<sup>136</sup> *Ibid.*, p 161.

<sup>137</sup> US Code, title 28, §959(a).

## 1. Environmental Problems

It is difficult to do justice to the complex American rules in this area and the often unresolved conflict between the Bankruptcy Code provisions and state and federal environmental prescriptions. However, it is believed the following statements capture at least part of the picture.<sup>138</sup>

The trustee must comply with environmental regulations.<sup>139</sup> This obligation rests in part on s 959(b) of Title 28 of the US Code<sup>140</sup> requiring a trustee carrying on the debtor's business to comply with state law. Read literally, the subsection does not apply to liquidating trustees; nevertheless, trustees have been reluctant to serve even in this capacity where the property suffered from environmental problems. Further, if a trustee has unwittingly assumed possession of contaminated property he faces the US Supreme Court's decision in *Midlantic National Bank v. New Jersey Department of Environmental Protection*<sup>141</sup> holding that a chapter 7 trustee may not abandon contaminated property in breach of state law designed to protect public health or safety from "imminent and identifiable harm". According to Collier, this confronts the trustee with a dilemma. He may try to escape it by seeking to have the case dismissed under ss 305 or 707(a) of the Code<sup>142</sup>,

<sup>138</sup> The description that follows is based on *Collier on Bankruptcy*, electronic edition, ch 323.

<sup>139</sup> *Ibid.*, citing *In re N.P. Mining, Inc.*, 963 F.2d 1449, 27 C.B.C.2d 24 (11th Cir. 1992) *In re Wall Tube & Metal Prods. Co.*, 831 F.2d 118, 17 C.B.C.2d 736 (6th Cir. 1987); *In re Quanta Resources Corp.*, 739 F.2d 912, 919, 10 C.B.C.2d 1375 (3d Cir. 1984) (chapter 7 trustee); and *In re Guterl Special Steel Corp.*, 198 B.R. 128 (Bankr. W.D. Pa. 1996) both holding that a chapter 7 trustee cannot abandon hazardous waste without complying with state law); *Wilner Wood Prods. v. State of Maine, Dep't of Envtl. Protection*, 128 B.R. 1 (Bankr. D. Me. 1991) (chapter 11 debtor); and *In re Kaiser Steel Corp.*, 87 B.R. 662 (Bankr. D. Colo. 1988) (chapter 11 debtor); *In re Stevens*, 16 C.B.C.2d 253, 68 B.R. 774 (Bankr. D. Me. 1987).

<sup>140</sup> Section 959(b) provides that "Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof".

<sup>141</sup> (1986) 474 U.S. 494, 106 S. Ct. 755.

<sup>142</sup> S. 305 provides "(a) The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if— (1) the interests of creditors and the debtor would be better served by such dismissal or

to resign as trustee, to try to transfer the property to a federal or state agency charged with protection of the environment, or, finally, to seek an order from the bankruptcy court relieving the trustee from personal liability. However, there is no guarantee that any of these options will work.

A Canadian IP reading this description of the American complexities must surely be grateful for the much simpler Canadian provisions and the dispensation from personal liability granted Canadian trustees in s. 14.06 of the BIA.

## 2. Successor Employer Problems

This too is an area where US law is apparently different from, and substantially more complex than, Canadian law. The first difference is that federal and state courts have developed a common law doctrine of successor liability for the purchaser of a business where *any* of the following elements are present: (i) the purchaser expressly or impliedly agreed to assume the seller's obligations; (ii) the transaction was fraudulent; (iii) the transaction was a *de facto* merger; and (iv) the purchaser is a continuation of the seller.<sup>143</sup> It seems however that even if a purchaser of the debtor's assets is a successor in interest the bankruptcy court may extinguish the buyer's liability pursuant to s 363(f)(5) of the Bankruptcy Code.<sup>144</sup> However, the conditions attached to the operation of the subsection

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suspension; or (2) (A) there is pending a foreign proceeding; and (B) the factors specified in section 304 (c) of this title warrant such dismissal or suspension". S. 707 provides "(a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including— (1) unreasonable delay by the debtor that is prejudicial to creditors; (2) nonpayment of any fees or charges required under chapter 123 of title 28; and (3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee."

<sup>143</sup> *Norton on Bankruptcy*, §37:22, fn 51.

<sup>144</sup> *Ibid.*, n 51, citing *In re Leckie Smokeless Coal Co.*, 99 F.3d 573 (CCA 4), a decision on the Coal Act. S 363(f)(5) is a complex provision entitling a trustee to sell property free of any interest in the property of an entity other than the estate if one of five conditions is satisfied. The conditions are: "(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest; (2) such entity consents; (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property; (4) such interest is in bona fide dispute; or (5) such entity could be

may not be easy to satisfy and it is not clear how much relief it actually offers the successor buyer.

The other basic difference between Canadian and American bankruptcy law in this area arises out of the provisions of s. 1113 of the US Code. This entitles the US bankruptcy court to authorize the debtor to reject a collective bargaining agreement if the following conditions are satisfied: 1. the trustee has made the employee representatives a proposal meeting the requirements of subs (b)(1); 2. the authorized representative of the employees has refused to accept the proposal without good cause; and 3. if in the court's opinion, the equities clearly favour rejection of the collective agreement. As we saw earlier,<sup>145</sup> a Canadian court is not invested with similar powers in the BIA or the CCAA; on the contrary, Bill C-55 now makes it very clear that collective agreements remain in effect in bankruptcy, even if the employer seeks to reorganize itself, and must not be tampered with by Canadian courts.

## V HOW DO CANADIAN IPS VIEW THEIR PERSONAL LIABILITIES IN PRACTICE?

In June 2005, with the much appreciated assistance of Brian Casey, chair of the CAIRP restructuring committee, the author and his assistant Ryan Ashmead distributed a questionnaire among the 24 members of Mr. Casey's committee. The questionnaire is appended to this paper and asked the respondent a series of questions about their roles as insolvency administrators; whether, from their perspective, the personal liabilities imposed on trustees and other administrators under the BIA created significant hurdles and, if it did, how they coped with the problems. Unfortunately, only four of the respondents answered

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compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."

<sup>145</sup> *Supra* Part II.B.3(c).

the questionnaire<sup>146</sup> and obviously the completed questionnaires have no statistical validity.<sup>147</sup> Nevertheless, I believe the exercise still served a useful purpose. First, the poor response rate suggests that Canadian IPs are not greatly exercised as a group about their personal liability as insolvency administrators except in selected areas involving the debtor's business. Second, the comments offered by two of the respondents cast useful light on the protective measures adopted by Canadian IPS to shield themselves from personal liability.

## VI CONCLUSIONS

Having now completed my overview of the current Canadian, English, and American positions with respect to the personal liabilities of IPs, it is now appropriate for me to state my main conclusions. These are:

1. From a functional point of view, the distinction drawn in Canadian insolvency law between the non-personal liability of a liquidator for contracts concluded by him in his official capacity and the personal liability of a trustee when acting in a similar capacity seems quite arbitrary.<sup>148</sup> Since both administrators serve essentially the same economic function, the law should treat them alike for liability purposes. There is therefore much to be said for the US Code approach of treating the debtor's estate as a legal entity and the trustee as the representative of the estate for contractual and other purposes. This solution

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<sup>146</sup> The replies have been integrated with the Questionnaire in Appendix 1. One of the questionnaires was returned uncompleted; despite our best efforts, Mr. Ashmead and I were not successful in trying to persuade the respondent to forward us a completed questionnaire.

<sup>147</sup> This would have been true even if all 24 respondents had completed the questionnaire given the fact that CAIRP has some 1100 members.

<sup>148</sup> However, the argument could be turned on its head and it could be reasoned that since in Canada most corporate bankruptcies proceed under the BIA and not under WURA, there is no need to contrast the liability positions of trustees and liquidators. Even if there is substance to this argument (which seems doubtful) it still leaves at large the question why, from a functional perspective, a trustee should have greater liabilities than the officer or director of an incorporated company. I address the question in paragraph 5 below of the Conclusions.



overcomes the legal title fixation which lies at the root of the common law's treatment of a trustee's personal liability.<sup>149</sup> However, it does not answer the question whether the insolvency administrator should be held liable for the estate's debts on grounds other than that the administrator ("trustee") is the legal owner of the estate's assets.

2. The BIA's attempt to ameliorate trustees' concerns by adopting BIA s 31(4) has largely proven a failure. It has engendered as many problems as it has solved. The subsection should either be repealed or be completely revised; the first solution is probably the better one. If the US solution is adopted and the trustee is only regarded as an agent of the estate, then of course there would be no need for a provision like s. 31(4).
3. In my view, there is not much to be said either in favour of a provision like s 727 of the English Companies Act 1985 allowing the court to grant an officer of the company and other designated persons relief from liability. It creates too much uncertainty and arguably only serves a useful purpose where the defendant has been guilty of a purely technical breach that has caused no harm.
4. Similarly, section 215 of the BIA is a dubious means for discouraging vexatious claims against insolvency administrators. The section was never designed for this purpose and its role has been distorted even more as a result of the Ontario Court of Appeal's majority decision in the *TCT Logistics* case. However laudatory the court's intentions in that case, s 215 is a very cumbersome vehicle for mediating successor employer liability issues under the BIA. The job is better left to Parliament. Another objection to s 215 is that it complicates the

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<sup>149</sup> If this approach were to be adopted in the BIA, it should apply both to corporate and personal insolvencies, just as it does in s 521 of the US Bankruptcy Code. Though not necessary from a practical point of view (because a liquidator is not invested with title to the company's property and he has always been treated as just an agent of the company), for reasons of consistency the change should also be made in WURA so that the insolvent company's assets would be deemed to be held by a new entity. The liquidator's role itself would not change nor would the liquidator's become liable for contracts entered into by him on behalf of the company because he is not now personally liable on such contracts.

court's task in determining when a complainant can use the s 37 route (which requires no prior judicial consent) to seek redress for a grievance and when the complainant is obliged to use the s 215 route to achieve the same goal. So far as we are aware, no logical reason has been advanced why prior permission is not required for an application under s. 37 and why the court's consent is necessary for claims and grievances falling outside the nebulous parameters of s 37.

5. Acceptance of the proposition that IPS should basically be treated alike for liability purposes does not answer the critical question how the risk of non-payment or other loss should be allocated between the IP and the other party in a contractual setting. Between them who is in a better position to assess the risks and to bear the loss if there are not sufficient funds in the estate to cover the claim? Analysis of the economic factors suggests that in many cases the IP is the better risk bearer because he knows the financial condition of the debtor. It seems right therefore that he should have the burden of disclaiming liability as, for example, in the case of liability for occupation rent or liability for the common expenses incurred in the course of liquidating the assets of an insolvent estate. This approach should be all the more palatable because the BIA allows trustees to operate in corporate form so that, even if found liable on the contract, the liability would be a limited liability. Another option would be to hold the insolvency administrator personally liable if he had no reasonable grounds for believing that the estate will have sufficient funds to cover the debts incurred on behalf of the estate. This qualified form of liability would be similar to the liability for wrongful trading imposed on directors of a company under the English Insolvency Act of 1986.<sup>150</sup> Admittedly the uncertainty engendered in

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<sup>150</sup> For details of the English provisions and the relevant case law see Goode, *op cit.*, ch 12. There is no wrongful trading provision in the BIA or the CBCA and none of the provincial business corporations acts has adopted such a provision. However, the CBCA and many of the provincial acts contain an "oppression" remedy for unfair and harsh conduct by a corporation or its directors and these provisions have been successfully invoked in wrongful

these types of approaches will make them unpopular with IPS, some of whom may prefer a clear cut rule of liability or non-liability rather than a rule that distinguishes between different types of contract or that turns on an *ex post* allocation of risk between the parties. However, an experienced IP should have no difficulties assessing the risks *ex ante* and, if he finds them too great, working his way around them.

6. In any event, in the case of wage claims for services rendered to the estate after the debtor's bankruptcy, or in the case of a commercial proposal under the BIA or reorganization under the CCAA rendered at that time, a strong case can be made for holding the IP liable up to a prescribed amount on the grounds of the vulnerability of the wage earners and the superior ability of the administrator to evaluate the risks of there being insufficient funds in the estate to pay the wage claims. The analogy here is with the provisions in the Canada Business Corporations Act,<sup>151</sup> the Ontario Business Corporations Act<sup>152</sup> and other provincial business corporations acts holding directors personally liable for unpaid wages up to a prescribed amount.
7. The treatment of the liability of administrative receivers in the English Insolvency Act for new contracts concluded by the administrative receiver and for existing employee contracts adopted by the Administrative Receiver raises another line of enquiry. It suggests, first, that interim receivers appointed under BIA s 47 and 47.1 to protect the interests of a secured party should similarly be liable for new contacts entered into by the receiver and for existing employment contracts adopted by him and, second, that the secured party should be obliged to indemnify the interim receivers as a matter of course. A case can even be

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trading type situations. See further J.S. Ziegel, "Creditors as Corporate stakeholders: The Quiet Resolution – An Anglo-Canadian Perspective" (1993) 43 UTLJ 511.

<sup>151</sup> R.S.C. 1985, c. C-44.

<sup>152</sup> R.S.O. 1990 c. B. 16.

made for holding the secured party directly liable to third parties for debts properly incurred by an interim receiver for the secured party's benefit.

8. The replies to the Questionnaire distributed in connection with this project and the case law suggest that what insolvency administrators and their creditor clients fear most are hidden liabilities accumulated by a debtor - whether in the form of unremitted tax deductions, pension contribution shortfalls, or environmentally contaminated premises - about which they know nothing until it is too late to reverse course. As demonstrated by the provisions in s 14.06 of the BIA, Canadian lawmakers in this area have shown themselves both progressive and accommodating. The best recommendation one can offer here is that governments and creditors should continue to work closely together to identify new areas of friction and to seek to resolve them together to the parties' mutual satisfaction.
9. The resolution of the competing goals of labour law and insolvency law raises a separate set of problems and has two parts. The first part involves the question of the extent to which the IP should be governed by the terms of the collective agreement in seeking to liquidate the assets of the insolvent estate and trying to operate the business on a reduced scale in the meantime. Much of course will turn on the terms of the collective agreement and the relevant labour law regime applying to the collective agreement. Though Bill C-55 seems to offer no compromises on this score, there will surely be widespread agreement that insolvency law, not labour law, should be the dominant voice in determining the most efficient means for liquidating the assets of the insolvent estate if that is the most appropriate solution. The second part of the problem comes into play if there are good prospects for reorganizing the insolvent debtor or selling the business to a purchaser as a going concern. Here too the question of priorities between insolvency law and labour law needs to be addressed but the issues are

not so clear cut as in the first scenario. There are equities on both sides. Collective agreement should not simply be sacrificed on the creditors' alter but neither should a union have an absolute veto right on a reorganization or going concern sale that strives to balance both interests in the best possible way. The critical question is who is to decide whether a fair balance has been struck: should it be the court or some other independent agency or should it be left up to the parties to sweat it out? Regrettably Bill C-55 provides no answer to this challenge (other than to reaffirm the integrity of the collective bargaining agreement) but it will surely have to be met sooner or later if the CCAA and the BIA wish to retain their commitment to an effective rescue culture.

## APPENDIX – QUESTIONNAIRE AND REPLIES TO QUESTIONNAIRE

### QUESTIONNAIRE TO TRUSTEES, RECEIVERS, & INTERIM RECEIVERS IN RESPECT OF THEIR PERSONAL LIABILITY IN THE EXECUTION OF THEIR OFFICES

*Your assistance would be greatly appreciated in completing the following Questionnaire. The replies are intended to be incorporated in a research project on the comparative liability of insolvency administrators under Canadian, American, and English law sponsored by the Office of the Superintendent of Bankruptcy.*

*Jacob Ziegel*

*The names of individual respondents will not be disclosed to third parties without the respondent's consent.*

**Instructions:**

- (1) Please enter your name, position, and contact information.
- (2) Fill in the form.
- (3) Save a copy of the Form on your computer.
- (4) Reply to this e-mail from [j.ziegel@utoronto.ca](mailto:j.ziegel@utoronto.ca) with the copy saved in (3) as an attachment. Please cc my Research Assistant [ryan.ashmead@utoronto.ca](mailto:ryan.ashmead@utoronto.ca).

Name:	
Position:	
Mailing address:	

Telephone no.:	Fax no.:	E-mail address:
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<b>1. How often have you encountered liability as trustee, receiver, or interim receiver:</b>		<b>Responses Received</b>
<b>(a)</b> When carrying on the debtor's business or liquidating the debtor's assets?	Often	2
	Sometimes	1
	Never	0
<b>(b)</b> For contracts entered into by you during your administration (excluding employment contracts)?	Often	2
	Sometimes	1
	Never	0
<b>(c)</b> As occupier of the debtor's premises?	Often	2
	Sometimes	1
	Never	0



<b>(d)</b> For engaging the services of former <i>non-unionized</i> employees of the debtor?	Often Sometimes Never	1 1 1
<b>(e)</b> For engaging the services of former <i>unionized</i> employees of the debtor?	Often Sometimes Never	0 2 1
<b>(f)</b> For utility bills?	Often Sometimes Never	2 1 0
<p><b>(g)</b> Other?</p> <p><i>please specify:</i></p> <ul style="list-style-type: none"> <li>- Environmental--agreement preset with the Ministry of the Environment</li> <li>- Unremitted Employee Source Deductions</li> <li>- PST arrears</li> <li>- ...As Trustee or receiver, I always incur liability for post-filing obligations if I run the business. Hopefully my risk is confined to the value of the assets under administration, but this is a gray area and in many cases I could incur personal liability. Accordingly, at the onset of an engagement I must very carefully review my risks. Often, we find ways to avoid being in control of the business. The practice has evolved of having the debtor operate under an NOI under BIA, or under a CCAA stay, while we have a limited appointment as Interim receiver, simply to conduct a sales process. Otherwise, it may be necessary to close the operations down while seeking a buyer on a package-deal basis, rather than a bare-bones liquidation. Then a buyer would resurrect the business.</li> <li>- Do not fully understand question "encountering liability". Do you mean personal liability. If we contract for goods or services in an appointment then obviously we pay them. Is that what you mean. We have never not paid anything we contracted for</li> </ul>		

<b>2. How do you protect yourself against personal liability as trustee, receiver, or interim receiver?</b>		<b>Responses Received</b>
<b>(a)</b> Prior to accepting an appointment, I assess whether the estate will have sufficient assets to cover my expenses and fees.	Yes No N/A	4 0 0
<b>(b)</b> I refuse the appointment.	Yes No N/A	2 2 0

<p><b>(c)</b> I require an indemnity from a creditor or other solvent person.</p>	<p>Yes No N/A</p>	<p>4 0 0</p>
<p><i>if "other solvent person", please specify the type of relationship (e.g. guarantor, shareholder, secured creditor):</i></p> <ul style="list-style-type: none"> <li>- If I'm not satisfied entirely with the indemnity I'll request a court appointment and seek further protection through the court order</li> <li>- It would be rare to refuse an appointment. But it is very common to insist on changes to the appointment as originally contemplated, so as to minimize the liability issues and trap them in the debtor's hands, where they belong, rather than expose the trustee/receiver to them</li> <li>- Usually secured creditor (s)</li> <li>- Sometimes shareholder</li> <li>- Any of the above</li> </ul>		
<p><b>(d)</b> I will seek waivers from the other contracting parties.</p>	<p>Yes No N/A</p>	<p>1 1 1</p>
<p><b>(e)</b> I will rely on errors and omissions insurance or other forms of liability insurance.</p> <p><i>please specify the type of insurance:</i></p> <ul style="list-style-type: none"> <li>- See d above--this is answered with a yes only when I've been involved in a construction lien dispute case--I'll seek waivers in such a case if appropriate. For other administrations the answer would be no. With respect to insurance I have relied on product liability insurance on one occasion</li> <li>- The purpose of negligence insurance is to provide a last-ditch safeguard in case we get caught, unexpectedly, in something we didn't foresee. You can't build a practice on defending negligence lawsuits; your reputation will collapse, and after a couple of cases you won't get coverage.</li> <li>- I have not found this to be available.</li> <li>- Insurance is a fall back if all else fails. We do not "rely" on it. It probably wouldn't apply to the situation you are considering anyhow.</li> </ul>	<p>Yes No N/A</p>	<p>0 4 0</p>



3. In insolvency proceedings, what percentage of your corporate files over the last three years were:	<i>Responses Received</i>	
(a) Private Receiverships?	2 x 0-10%, 1 x 41-50%, 1x 51-60%	
(b) BIA Trustee Administration?	2 x 0-10%, 2 x 11-20%	
(c) Court-appointed Receiverships?	2 x 0-10%, 1 x 11-20%, 1 x 21-30%	
(d) Receiver / Trustee dual appointments?	2 x 0-10%, 1 x 11-20%, 1 x 21-30%	
(e) BIA Proposals?	1 x 0-10%, 1 x 11-20%, 1 x 21-30%	
(f) CCAA Monitors?	4 x 0-10%,	
(g) WURA Liquidations?	4 x 0-10%,	
(h) Other?  <i>please specify:</i> <ul style="list-style-type: none"> <li>- I'm in a very unique position in that I've been overseeing an ongoing large interim receivership which take up substantially all of my time.</li> <li>- There has been a noticeable decline in private receiverships, a slight increase in court-appointed receiverships (often with limited possession or control rights by the practitioner , so as to avoid liability), and a pronounced increase in all sorts of restructurings, both under BIA and under CCAA (often being disguised liquidations so as to maximize value by avoiding the negativity of bankruptcy proceedings)</li> </ul>		
4.	<i>Responses Received</i>	
Approximately what percentage of your files over the past 3 years involved collective bargaining agreements?	3 x 0-10%, 1 x 31-40%	
5.	<i>Responses Received</i>	
Does your decision whether to carry on an insolvent business and engage former employees of the debtor as receiver, interim receiver, trustee, or liquidator depend on whether or not there is a collective bargaining agreement in place?	Yes No N/A	2 2 0



<b>6.</b>		<b>Responses Received</b>
<b>Have you declined an appointment because you were concerned about the risk of personal liability for successor employer obligations?</b>	Yes No N/A	0 3 0
<b>7.</b>		<b>Responses Received</b>
<b>Have you recommended liquidation rather than carrying on the business for purposes of sale as a going concern due to the risk of successor employer obligations?</b>	Yes No N/A	1 2 0
<b>8.</b>	<b>Responses Received</b>	
<b>In what percentage of your files over the last three years did employees receive payments for arrears of wages, vacation pay, and pension plan contributions on a consensual basis to permit continuation of the business during an insolvency proceeding?</b>	3 x 0-10%, 1 x 81-90%	
<b>9.</b>		<b>Responses Received</b>
<b>In your practice, how material is the risk of successor employer obligations in determining which course of proceedings to use in a given situation?</b>	Often material Usually material Sometimes material Never material	0 2 1 0

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