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Bankruptcy & Insolvency

Appealing a trustee's proof of claim disallowance

In considering whether an appeal from a trustee's disallowance of a proof of claim is a true appeal or a hearing *de novo*, the Ontario Superior Court of Justice in Bankruptcy and Insolvency decided that the appeal may proceed as a hearing *de novo* in circumstances where an injustice would result if restricted to the record—but that otherwise the appeal should proceed based on the record before the trustee.

In *Charlestown Residential School (Re)*, [2010] O.J. No. 3140 (Ont. Reg.), Wayne Dunster retired on June 30, 2004, after serving for 31 years as executive director of the Charlestown Residential School. The school agreed to pay Dunster an annual gratuitous allowance while he was alive which was secured by a promissory note.

The school made the gratuitous payments until April 3, 2009, when it made an assignment in bankruptcy.

The school listed Dunster in its statement of affairs with a contingent claim of \$210,000. Dunster filed a proof of claim for \$397,130.24 supported by a Canada Life life expectancy chart, his agreement with the school and the promissory note.

The trustee in bankruptcy disallowed Dunster's claim because the obligation to pay the allowance was gratuitous and there was no termination date. The trustee also relied on the Ontario *Employment Standards Act, 2000* and common law to assess Dunster's entitlement to reasonable notice for the termination of



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his employment. Dunster appealed the disallowance.

The decision

As a preliminary matter, Deputy Registrar Janet Mills considered whether the appeal was a true appeal or a hearing *de novo*. To resolve this issue, Deputy Registrar Mills reviewed three lines of decisions:

- those following *Eskasoni Fisheries Ltd. (Re)*, [2000] N.S.J. No. 122, holding that the appeal was a hearing *de novo*;
- those following *Galaxy Sports Inc. (Re)*, [2004] B.C.J. No. 1008, holding that the appeal is a true appeal; and
- *San Juan Resources Inc. (Re)*, [2009] A.J. No. 79, which tried to reconcile the two lines.

Deputy Registrar Mills found the third approach compelling. She held that the appeal should be a hearing *de novo* in circumstances where an injustice would result if restricted to the record, but otherwise ought to proceed based on the record before the trustee.

What this means for trustees and creditors

Deputy Registrar Mills' decision affects how both trustees and creditors should approach a proof of claim. Creditors must treat the proof of claim as the only chance to prove the bankrupt's liability. Trustees must

assess proofs of claim judiciously.

Before filing a claim, the creditor should compile all relevant documentation and prepare affidavits from all necessary witnesses. The documents and affidavits that are filed may be the only evidence that the creditor will be able to rely on in a subsequent appeal.

Lawyers should treat the proof of claim like a motion for summary judgment. Even if such a motion would never be brought, it is necessary to "lead trump or risk losing." This means ensuring that all the evidence needed to prove liability and damages is put forth.

Trustees have three matters to consider: ensuring that the creditor has a chance to respond to the defences raised by the trustee; ensuring that the trustee has the expertise needed to make the decision; and preparing reasons for the decision.

Trustees can expect creditors to produce all documents necessary to prove the claim. If the trustee plans to advance an affirmative defence, the creditor should be allowed to respond and to file further documents to deal with the defence. If the trustee does not give the creditor this opportunity the case will likely fall into the category where an injustice will result if restricted to the record.

Depending on the nature of the claim, the trustee may not have sufficient expertise to properly assess the situation. The trustee may have to deal with liabilities such as amounts due to departing employees, assessments of damages arising out of motor vehicle accidents or assess-

ing liability and damages for libel and slander. Trustees must recognize when they lack expertise and consult with experts.

Once the trustee has all the relevant information and has consulted with all necessary experts, the trustee should prepare reasons for its decision. For the appeal to be a true appeal, the court has to consider the trustee's reasons for disallowing a claim.

In the past, if the trustee was uncertain or there were insufficient assets in an estate to justify a lengthy analysis, the trustee could disallow the claim and wait for the creditor to appeal. This is no longer an option. The trustee now has to consider the situation and make a decision.

Charlestown Residential School places responsibility on both trustees and creditors to ensure that claims are assessed properly. To overcome the concern that justice will be sacrificed to expediency, both creditors and trustees must be diligent in fulfilling their roles. ■

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Creditors need to watch limitation periods

Limitation

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bankruptcy trustee is a predecessor in interest, then is the bankrupt himself not the ultimate predecessor? Judging a limitation period from when the bankrupt committed an impugned act would clearly be an absurd result, but unfortunately this issue was not addressed by the Court of Appeal.

In *Indcondo*, the appeal court relied on the assignment stipulated by s. 38 of the BIA as the basis for applying s. 12 of the LA. This articulation of s. 38 as just an assignment of the bankruptcy trustee's interest marks a departure from *Traders Finance Corp. v. Levesque*, [1961] S.C.R. 83, in which the Supreme Court of Canada held that the creditor's right to a proceeding under what is now s. 38 of the BIA is conferred by

law and the assignment of interest referred to in s. 38 is not the foundation or a precondition to the commencement of an action by a creditor.

The facts in *Traders Finance* were the reverse of those in *Indcondo*. The defendant argued that prior knowledge by the bankruptcy trustee should preclude a creditor from taking proceedings under what is now s. 38. The Supreme Court of Canada rejected this argument holding that the rights accorded by s. 38 were personal to the creditor. Applying the reasoning in *Traders Finance* to the facts in *Indcondo* would have led to a similar, but not identical, result: the limitations period for a s. 38 proceeding would have run from the day the creditor bringing the s. 38 proceeding discovered the claim.

In *Indcondo*, the creditor's claim was preserved due to the

unusual circumstances of the old limitations regime coming into play. In the future, *Indcondo* will mean that creditors need to be vigilant where they are considering a s. 38 proceeding to ensure that they do not run afoul of a limitations period.

An interesting question left unanswered by the Court of Appeal is whether earlier knowledge by one creditor of the claim will preclude another creditor from bringing a s. 38 proceeding, or if that earlier knowledge will simply preclude participation in the s. 38 proceeding by the creditor with that earlier knowledge. ■

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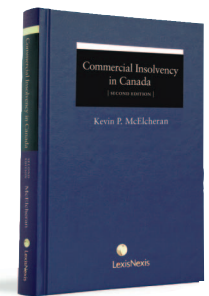
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