

**THOUGHTS ON SECTION 13.4 OF THE  
*BANKRUPTCY AND INSOLVENCY ACT*  
(CANADA)**

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## THOUGHTS ON SECTION 13.4 OF THE BANKRUPTCY AND INSOLVENCY ACT (CANADA)

By David Mann<sup>1</sup>

### *Introduction*

Section 13.4 of the *Bankruptcy and Insolvency Act (Canada)*<sup>2</sup> (the “**BIA**”) prohibits a trustee in bankruptcy from acting for, or assisting, a secured creditor of the estate unless the trustee has obtained a written opinion of a solicitor who does not act for the secured creditor that the security is valid and enforceable as against the estate.

Some observers have interpreted s. 13.4 to require the trustee to obtain an opinion on the validity and enforceability of security against the estate where the other role occupied by the trustee is that of court-appointed receiver. Such a broad reading of s.13.4 is troubling for a variety of reasons, including:

- a) it suggests that a court appointed receiver and a bankruptcy trustee have a conflict and, *a priori*, a different duty owed to different stakeholders;
- b) it overlooks the premise that a court appointed receiver is not a mechanism of enforcement for a party’s position – it is a mechanism by which a court officer is made the custodian of the defendant’s property for the benefit of all stakeholders, becoming a multi-faceted interpleader of sorts whereby all stakeholders can provide input to the conduct of the business (or its liquidation), establish their respective claims and, perhaps, achieve some recovery of their rights – indeed, it is entirely possible that a court appointed receiver is sought by a party who is unsure of the validity or priority of its security, or may not even have security at all;
- c) it adds a level of uncertainty to an insolvency situation at a time when the situation least needs more uncertainty – raising questions like - Can the same party serve in both roles or is another layer of professionals required? Will a delay occur as new professional, or their opinions, are sought? Who’s security needs to be reviewed – everyone’s? the first charge holder? The initiating creditor? etc; and
- d) if the broad interpretation of s.13.4 is ultimately found to be incorrect, could it be said that the trustee has divulged communications from its solicitor without compulsion and therefore waived its right to rely on solicitor-client privilege?

This paper concludes that an interpretation of s. 13.4 which requires an independent legal opinion in circumstances where a court appointed receiver is involved is overly broad, inconsistent with the wording, history, and purpose of the section, and therefore incorrect. A more appropriate interpretation, it is submitted, is that a trustee is only required to get such an opinion where its other role has been specific to the rights of a particular secured creditor.

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<sup>2</sup> *Bankruptcy and Insolvency Act*, c. 27, S.C. 1992.



Generally, although not always, this role is that of private receiver acting under that creditor's security.

### *The Legislation*

Section 13.4 of the BIA provides:

13.4 (1) No trustee shall, while acting as the trustee of an estate, act for or assist a secured creditor of the estate to assert any claim against the estate or to realize or otherwise deal with the security that the secured creditor holds, unless the trustee has obtained a written opinion of a legal counsel who does not act for the secured creditor that the security is valid and enforceable as against the estate.

(1.1) Forthwith on commencing to act for or assist a secured creditor of the estate in the manner set out in subsection (1), a trustee shall notify the Superintendent and the creditors or the inspectors

- (a) that the trustee is acting for the secured creditor;
- (b) of the basis of any remuneration from the secured creditor; and
- (c) of the opinion referred to in subsection (1).

(2) Within two days after receiving a request therefor, a trustee shall provide the Superintendent with a copy of the opinion referred to in subsection (1) and shall also provide a copy to each creditor who has made a request therefor.

1992, c. 27, s. 9; 1997, c. 12, s. 10.

Significantly, the section does not use the term “receiver” that is elsewhere defined in the BIA<sup>3</sup> (and includes both court and instrument appointed receivers) but, instead, limits the requirement to situations where the trustee acts “for or assist[s] a secured creditor of the estate to assert any

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<sup>3</sup> Section 243(2) defines “receiver” as follows:

Subject to subsection (3), in this Part, “receiver” means a person who has been appointed to take, or has taken, possession or control, pursuant to

- a) an agreement under which property becomes subject to a security (in this Part referred to as a “security agreement”), or
- b) an order of court made under any law that provides for or authorizes the appointment of a receiver or receiver-manager,

of all or substantially all of

- c) the inventory,
- d) the accounts receivable, or
- e) the other property

of an insolvent person or a bankrupt that was acquired for, or is used in relation to, a business carried on by the insolvent person or bankrupt.



claim against the estate or to realize or otherwise deal with the security that the secured creditor hold”.

The plain wording of the section does not seem to contemplate obtaining an independent legal opinion where the trustee also occupies the role of court appointed receiver.

## ***Legislative History***

### Introduction

Section 13.4 was introduced to the legislation with the 1992 amendments to the BIA. The 1992 amendments marked Parliament’s first attempt at bringing substantive issues surrounding secured creditors and receivers under the BIA. A review of the history of these amendments demonstrates, however, that by and large the concern surrounded secured creditors and *their* remedies; primarily, the privately appointed receiver.

### Parliamentary Debate

Not surprisingly, the more technical amendments with respect to secured creditors and receivers were only referred to in passing in the debates in the House of Commons during the period of time leading up to the 1992 amendments.

Some of the quotes from the House of Commons Debates include:

[October 29, 1991 at p.4177 - Mr. Blais]

As we all know, because we have constituents who are in business, all too often secured creditors walk in quickly, seize the assets, cut of credit lines, and put receivers in place. Many times healthy companies that, for whatever reason - they may be having some temporary difficulty - find themselves in a position where they cannot go on with their business and bankruptcy ensues.

...

It is also why we are adding a new Part XI to the act, to impose duties of disclosure and good faith on secured creditors and receivers ...

[October 29, 1991 at p.4186 - Mr. MacDonald]

Currently under the Bankruptcy Act there really is no provision for a debtor or a company that is in debt to stop a creditor from basically jumping the queue and immediately appointing a receiver with 10 or 15 days’ notice in effect putting the company out of business.

[October 30, 1991 at p.4233-34]

On the other hand, secured creditors such as banks, financial institutions, governments, equipment lessors, landlords, etc. remain free to claim the reimbursement of the debts or to exercise other remedies such as having a receiver appointed to realize their security interest.



For businesses trying to rationalize their operations or to restructure their debt, this type of unilateral action on the part of some creditors can make rationalization very difficult, if not impossible.

...

There are five basic issues in a bankruptcy. First of all, there is the issue of receivers. Right now, if a receiver is appointed, there is no law. He walks in. He takes over under the terms of the security agreement. If the security agreement is breached, somebody else can start a lawsuit, but essentially the receiver takes over under the terms of the security agreement ...

It is difficult to take anything seriously from the last paragraph of the quotation, although a persuasive argument could be made that the references to “no law” and taking over “under the terms of the security agreement”, suggest that parliament is concerned about secured creditors and the realization of their security pursuant to private receivership appointments.

### Other Legislative Background

Greater discussion about the amendments as they affect secured creditors and receivers can be gleaned from some of the subcommittee reports, specifically the *Report of the Advisory Committee on Bankruptcy and Insolvency* (the “*Colter Report*”). It seems clear that the *Colter Report* is concerned about secured creditors and their enforcement of security through their private appointment of a receiver. In this regard the report notes:

No provisions existed in the *Bankruptcy Act* to govern the conduct of secured creditors and receivers, and the only protection for debtors has been afforded by the Courts. ... A private receiver is only required to account to the secured creditor who made the appointment. There are no provisions requiring consultation with the unsecured creditors or the debtor as to the method of realizing the maximum amount from the assets of the debtor. After the assets have been realized, the receiver is not obliged to supply any information to the unsecured creditors or the debtor, although many receivers voluntarily provide this information.<sup>4</sup>

The report then goes on to cite five specific problems:

#### No Restraint on Enforcement of Security

Since there is no effective restraint on the enforcement of security, the secured creditor and *its* receiver are the parties who determine the method and timing of the liquidation of the property of an insolvent debtor. ...

#### Improper Conduct of Receivers

A common but generally erroneous perception is that the secured creditor *and the private receiver* are only interested in realizing an amount sufficient to

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<sup>4</sup> *Colter Report*, at 36-38.



satisfy the outstanding debt; they do not attempt to realize a surplus for distribution to the unsecured creditors and the debtor. *This perception arises from the fact that there are conflicting interests.* A forced sale by a secured creditor will almost inevitably fail to bring the best possible price, for this may only be obtained at a private sale under the debtor's control. Nevertheless, the creditor is required to act honestly and in good faith and to deal with the property in a timely and appropriate manner having regard to the nature of the property and the interest of the debtor. It must be recognized, however, that the creditor should control the sale, not the debtor who would not have wished the sale in the first place. ...

#### Lack of Information

A common complaint by both the unsecured creditors and the debtor is that they are not consulted prior to the liquidation of the assets. In some cases the unsecured creditors and the debtor are given no information concerning the receivership. In fact, some receivers do not even notify the creditors of their appointments.

#### No Summary Method for Review of Accounts

The commencement of a court action against a secured creditor or a receiver for an accounting involves considerable expense and does not permit these issues to be resolved promptly.

#### Conflict of Interest

In 1970 the report of the Study Committee on Bankruptcy and Insolvency Legislation stated that:

"Conflict of Interest: Some of the most serious and pervasive weaknesses of the system relate to the numerous situations of conflicts of interest that proliferate the bankruptcy administration and that, generally speaking, the law fails to recognize. Even the best system would suffer from the distortions brought about by the various unregulated conflicts of interest in which those who have key roles to play find themselves."

The accountant or auditor of the debtor is not precluded by the Act from being a trustee in bankruptcy or a receiver of the debtor. *A trustee responsible for the liquidation of an estate for the benefit of the unsecured creditors often acts in the same matter as a receiver or agent for a secured creditor. In such a case, a trustee who is required to attack the security agreement has been placed in a potential conflict-of-interest situation.*<sup>5</sup> [emphasis added]

The *Colter Report* considered three alternatives for regulating instrument appointed receivers. These were:

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<sup>5</sup> *Ibid*



Option A - requiring the secured creditor to obtain leave of the bankruptcy court to appoint a receiver;

Option B - requiring all receivers to be appointed by the court;

Option C - requiring the secured creditor to give 15 days' notice of intention to appoint a receiver.

It is interesting to note that under Options A and C, the report suggests that receivers appointed by the court pursuant to provincial legislation would not be changed. This, when coupled with the fact that Option B was to make all receivers court appointed, strongly suggest that the *Colter Report* did not see court appointed receivers as a concern - indeed, such appointments were seen as a solution to overcome these problems, including potential conflicts of interests with secured parties.

Reports issued by the department of Consumer and Corporate Affairs Canada in 1988 and 1991 don't shed any further light on the issue, although a paper issued by the Research Branch of the Library of Canada<sup>6</sup> does indicate that an opinion would only be required when the trustee acted for a secured creditor - no reference to a "receiver" is made.

### ***Judicial and Academic Commentary***

Since its enactment in 1992, there has been limited judicial consideration of s.13.4 of the *BIA*. Of these, only a handful analyze the purpose of s.13.4 and the section's applicability to different types of receivers. In *Pratchler Agro Services Inc. (Trustee of) v. Cargill Ltd.*<sup>7</sup>, Justice Maher briefly considered the purpose of s.13.4:

The purpose of s.13.4 is obviously to protect the unsecured creditors from the secured creditor accessing its close relationship with the trustee, causing the trustee to not act in the best interests of the unsecured creditors, but rather in the best interests of the secured creditor.

Interestingly, in this case the court found that the trustee had activated the operation of s. 13.4 simply by its conduct, the court finding:

The request by the trustee for an order that the security registered by the Bank of Nova Scotia has priority to the security interest registered by the respondent is in my view the trustee commencing to "act for, or assist a secured creditor of the estate" within the meaning of s. 13(4)(1.1) of the *Act*.

I find that the trustee in this application has commenced to act for, or assist a secured creditor of the estate as defined in s. 13.4(1.1) of the *Act* and has failed to comply with the provisions of that section.<sup>8</sup>

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<sup>6</sup> Bill C-22: *The Bankruptcy and Insolvency Act*, M. Smith, Law and Government Division, dated August 22, 1991, revised June 25, 1992, page 17.

<sup>7</sup> Docket: Saskatoon Q.B. 3830/97, Estate No. 025618.

<sup>8</sup> *Ibid.* paras. 10 and 11.



The case of *Dynatek Automation Systems Inc., Re*<sup>9</sup>, does not add much to this issue. There, Registrar Ferron noted that s.13.4 is a provision to enable the Superintendent of Bankruptcy to regulate the activities of trustees and the court cannot negative that authority at the instance of a trustee which is in default of the provision of the section.<sup>10</sup> This case involved a private receiver being appointed as the trustee of the bankrupt.

In *Sunny Corner Enterprises Inc. v. St. Anne-Nackawic Pulp Co. (Trustee & Receiver)*,<sup>11</sup> the Court reviewed circumstances wherein the private receiver was also appointed to act as the trustee in bankruptcy. There, Justice Glennie provided a useful review on the incompatibility of the role of privately appointed receiver-manager and a trustee in bankruptcy, pointing out that a privately appointed receiver-manager is expected to preserve and realize on the assets of the bankrupt for the benefit of the secured creditor, whereas the trustee is actually an officer of the court expected to represent all creditors.<sup>12</sup>

*2325074 Nova Scotia Ltd. (Re)*<sup>13</sup>, was similar to the *Pratchler* decision, above, in that it found that s.13.4 was applicable to the trustee, not because he had any other formal role, but because the trustee did little to differentiate between duties related to the estate and duties undertaken on behalf of the secured creditor. In that case the Trustee was required to meet the requirements under that section.

The most helpful academic commentary on this issue is found in the article, *Conflicts of Interest and the Insolvency Practitioner: Keeping Up Appearances*.<sup>14</sup> There, the author had this to say about dual appointments:

#### *Private Receivers*

Unlike Monitorships, the incorporation of provisions relating to private receiverships are a standard term of most security agreements. The private receiver is the secured creditor's agent. The receiver takes possession of the security to manage the business in the hope of selling it as a going concern or else liquidate the business assets. In jurisdictions with personal property security legislation, the private receiver has a duty to realize on the security in a commercially reasonable manner. The duty is owed to the secured creditor who appointed the receiver as well as to the other secured creditors, the debtor and any guarantors. This duty is a change from the common law position which only gave the debtor the right to an accounting from the secured creditor and acknowledged a duty on the receiver not to sell recklessly.

Under Part XI of the BIA introduced by Parliament in 1992, private and court-appointed receivers are accountable to other creditors and the trustee in bankruptcy of the debtor in cases where:

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<sup>9</sup> Docket: Ontario 97-BK-000350.

<sup>10</sup> *Ibid.* at para 5.

<sup>11</sup> Docket: 10985, Estate No. 51-117738 (N.B.Q.B.)

<sup>12</sup> *Ibid.* at paras 29-31.

<sup>13</sup> Court No: 19991 Estate No: 51-063587 (N.S.S.C.)

<sup>14</sup> E.O. Peterson (1996), 40 C.B.R. (3d) 56



- (a) the debtor is insolvent;
- (b) the debtor uses the secured property in the business; and
- (c) the secured creditor can enforce its rights against all or substantially all of the debtor's property.

If these criteria are met, the private receiver has a duty of care to its principal, the other creditors and the trustee. This duty is to act honestly and in good faith and to deal with the property in a commercially reasonable manner.

Before the 1992 amendments, Canadian bankruptcy law was silent on whether a private receiver could also act as a trustee in bankruptcy. *The Prince Edward Island v. Bank of Nova Scotia* case appears to express the prevailing view of the courts prior to 1992, namely, that the two functions are mutually exclusive. The courts did permit an apparent conflict where compelling business realities demanded the dual engagement.

In *Royal Bank v. Sefel Geophysical Ltd.* the Alberta Court of Queen's Bench allowed a trustee to act concurrently as private receiver for a secured creditor. The court noted that although there was an obvious conflict and a potential for conflict, there was no real conflict. On the facts, the court found that the trustee's retainer of independent counsel would help to reduce the potential conflict. MacPherson J. preferred to maintain the status quo as the file was "practically concluded" and there was no detriment to "creditors or others" in allowing the dual engagement to continue. He observed that "[t]he creditors would obviously like to see costs kept to a minimum and saw the situation as a practical cost-saving measure". The decision follows the reasoning in *United Fuels* given that there was significant delay in bringing the court application. Ethical propriety must be balanced economic practicalities [*sic*], particularly, the amount of work completed by the practitioner and the amount remaining to be finished.

Under the 1992 amendments, Parliament set up a disclosure system for a proposed trustee who already acts as the private receiver of a secured creditor. [emphasis added] Section 13.4 of the BIA provides: [intentionally omitted].

The insolvency practitioner may wear both hats if he or she complies with these conditions and there is no objection from the creditors or inspectors. The creditors must ask for a copy of the opinion if they wish to review it. The trustee is not otherwise obliged to produce it. If the creditors are of the view that the opinion is unclear or wrong, they may request the trustee to obtain a second opinion. ...

### *Court Appointed Receivers*

A court-appointed receiver is appointed by a superior court at the request of an interested person, usually a creditor. The appointing order establishes the receiver's power and duties. The order is a standard precedent tailored to suit the case. Unlike a private receiver, a court-appointed receiver owes a duty of care to



*all* creditors and persons interested in the assets and business affairs of the debtor.  
[all footnotes removed].

Mr. Peterson's premise is the same as the conclusion of this paper; namely, that a court appointed receiver has a duty to all creditors, just as a trustee does, and therefore does not trigger s. 13.4.

Indeed, a court-appointed receiver has more potential to conflict with the creditor who appointed it than with the trustee. As the author pointed out in *Conflicts, Conflicts, Conflicts - All Day Long! Or Is it a Real Conflict or Does it Just Look Like a Conflict - and Does it Matter Which?*<sup>15</sup>, the decision of Justice MacDonald in *Bank of Montreal v. Big White Ski Development Ltd.* (1988), 25 B.C.L.R. (2d) 86, made these very observations in expressing the following principles:

The Court-appointed receiver is an officer of the Court

There is a clear potential for conflict between the interests of a secured creditor who obtains the Court appointment of the receiver and the obligations of that receiver as an officer of the Court to the other creditors, to the debtor itself and to the Court.

Independent legal advice is usually an effective safeguard in that situation.<sup>16</sup>

### **Conclusion**

In the writer's view, the provisions of section 13.4 of the BIA do not apply to situations where the trustee also serves as court appointed receiver over some or all of the debtor's assets. In such circumstances, the duties of the receiver and the trustee dovetail – they both owe duties to all creditors. Not only is this conclusion born out by the precise wording of the section and the judicial and academic commentary surrounding it, it is entirely consistent with the concern that parliament was attempting to address: a concern that, prior to 1992, secured creditors were not governed by the BIA and their methods of realization, primarily through privately appointed receivers, were potentially in conflict with the balance of constituents of the borrower.

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<sup>15</sup> Clive S. Bird, "Conflicts, Conflicts, Conflicts - All Day Long! Or Is it a Real Conflict or Does it Just Look Like a Conflict - and Does it Matter Which" (1992) The Insolvency Institute of Canada Third Annual General Meeting and Conference (Harrison Hot Springs, B.C.)

<sup>16</sup> *Ibid.* at 335.

