

# focus

on

## Insolvency Law

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FRASER MILNER CASGRAIN LLP

### B.C. COURT REFUSES TO GRANT POTENTIAL DEFENDANT STANDING TO RESIST SECTION 38 APPLICATION

In *Re: IC Creative Homes Inc.* (2005) Carswell BC 3157 (Master) the Bankruptcy Court had previously granted an order under section 38 of the BIA allowing a creditor of the bankrupt to commence proceedings against the bankrupt's accounting and business advisor for alleged misconduct and negligence relating to the operations of the bankrupt prior to its bankruptcy.

Section 38 of the BIA provides:

38(1) Proceeding by creditor when trustee refuses to act - Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.

2) Transfer to creditor - On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.

(3) Benefits belong to creditor - Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.

4) Trustee may institute proceeding - Where, before an order is made under subsection (1), the trustee, with the permission of the inspectors, signifies to the court his

readiness to institute the proceeding for the benefit of the creditors, the order shall fix the time within which he shall do so, and in that case the benefit derived from the proceeding, if instituted within the time so fixed, belongs to the estate.

The proposed defendant applied to the Court *ex parte* and obtained an order staying the section 38 Order pending a full hearing as to whether or not the Court should set aside, vary or review the section 38 Order.

Referring to a previous decision of the British Columbia Court of Appeal (*Coroband Plastics Ltd.* (citation omitted)), the Bankruptcy Court concluded that a proposed defendant has no right to notice of the application under section 38, has no standing to oppose such an application, and has no standing to appeal any order made under section 38.

The Bankruptcy Court also held that section 187(5) of the BIA (which permits a Court to review, vary or rescind its previous orders) cannot be utilized by a potential defendant to give that defendant standing, or be used by a potential defendant to otherwise challenge the existing section 38 Order.

Finally, the Court commented on the test under section 38, noting that the applicant creditor need only demonstrate a *prima face case*, which means that the section 38 application will not be granted where the claim is obviously spurious.

The Order of Master Keighley was appealed to the British Columbia Supreme Court. Master Keighley's Order was affirmed by Justice Rice. Leave to Appeal the Order of Rice J. was denied.

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