

The Role of the Trustee in Personal Insolvency Matters



David S. Wood, CIRP
(Chartered Insolvency and Restructuring Professional)
Partner - Boale, Wood & Company Ltd.

I. Introduction

The purpose of this paper is to describe some of the many roles of the consumer Trustee in the current system and the ways in which the Trustee adds value to the Canadian insolvency process and contributes to the achievement of the central goals and objectives that process.

There has been considerable debate among stakeholders as to whom the Trustee acts for, or, if the Trustee acts for any one stakeholder at all. There have been comments that the Trustee is in an untenable position in that the Trustee is constantly dealing with competing interests and is therefore in a revolving conflict of interest. However, as one creditor representative, and member of the Personal Insolvency Task Force said, the Trustee, rather than being in a conflict of interest is, in his view, a convergence of interests¹.

¹ John Owen – Omega One Ltd.

The role of the Trustee is an ever-evolving one as changes are made to the practice of Consumer Insolvency either through legislative changes, the issuance of Directives or through jurisprudence. Trustees are also obliged to keep themselves current regarding ongoing reforms and amendments to statutes other than the *Bankruptcy and Insolvency Act* (“*BIA*”) that affect the administration of estates.

It has been often said that the Trustee is an “Officer of the Court” and is required to balance the interests of all parties; ensure that the integrity of the insolvency system is maintained, and ensure the requirements of the *BIA* are being complied with. The appearance of not being unbiased and impartial will only erode public confidence in the system.

Most Trustees are members of the Canadian Association of Insolvency and Restructuring Professionals. The Canadian Association of Insolvency and Restructuring Professionals is a national professional organization whose members comprise the majority of Canadian insolvency professionals acting as Trustees in bankruptcy, receivers, agents, monitors and consultants in insolvency matters. Admission to general membership is open to anyone who meets the Association's standards of admission, completes the Prescribed Course of Study and passes the required examinations. General members are entitled to use the certification mark “CIRP” (Chartered Insolvency and Restructuring Professional).

Part II highlights the many roles that the Trustee has in the administration of a consumer bankruptcy. Each of these roles is undertaken with consideration of maintaining the integrity of the bankruptcy system.

II. Advisor to the Debtor – The Initial Interview

The initial interview is where the debtor lays out his or her financial position, identifies his or her assets and liabilities, income and expenses. The debtor is also to describe, in his or her own words, what the debtor believes to be the cause of financial difficulty. During this interview, the Trustee is acting in an advisory capacity in discussing the options and alternatives available to the debtor.

In the majority of cases, the debtor have will little or no idea as to what options exist for financial relief. Most will never have filled out a budget, don't really know where their money goes and are not really certain as to what their cause of financial difficulty is other than, "I don't have enough money". In reality, this means they have run out of credit and have come to the Trustee at a point of financial crisis.

As a Trustee, we already know that this is why the debtor is seeking the Trustee's advice at this point in time. Running out of money or credit is the symptom of their problem; it is not the cause of their problem. Yet frequently, it is difficult for debtors to appreciate the distinction between the symptom and the causes of financial distress.

As well, at the point of the initial interview, the debtor can be overcome with emotion. The debtor is under intense pressure from not being able to meet financial responsibilities and obligations and has a personal sense of failure. Often the debtor has been subject to harassing phone calls from collectors and or has been served with writs of seizure and sale and is being sued by many creditors.

The Trustee's role at this point in the process involves a number of responsibilities. First, the Trustee is an information provider. The Trustee will assess the information the debtor has provided and determine what the debtor's options are, outlining the advantages and disadvantages of each of the options available. In most cases, the Trustee will also make a recommendation as to the debtor's best course of action based on the Trustee's considerable professional experience. Payment arrangements are also usually agreed to at this meeting.

Second, the Trustee must recognize that if the debtor has been involved in transactions such as preferential payments, reviewable transactions or settlements that may require further scrutiny, the Trustee is obligated to advise the debtor of the disclosure requirements set out on the statement of affairs and of the Trustee's ability to investigate those transactions and to advise the creditors of such. In these instances, the Trustee may wish to advise the debtor to seek independent legal advice prior to making an assignment or filing a proposal.

Third, on the emotional level, the Trustee sometimes has to be the hand holder, the friendly face who is not demanding immediate payment of an account, a sympathizer without compromising their duties and responsibilities under the *BIA*.

1. The Sign up

After the initial interview, the debtor will leave the Trustee's office with information as to what their options are and what their preferred course of action should be. If the debtor chooses to make an assignment or file a consumer proposal or a Division I proposal, the role of the Trustee will change.

The Trustee's role here is to provide the debtor with an assessment. The assessment the Trustee is to perform is set out in *Directive 6R – Assessment of an Individual Debtor*.² The Trustee is to assess the debtor and to ensure that the debtor is choosing the appropriate option. The Directive specifically states that the Trustee shall discuss with the debtor:

- (a) the debtors views of the situation;
- (b) the merits and consequences of the various pertinent options;
- (c) the rights and responsibilities of the debtor in a bankruptcy or a proposal;

² Issued by the Office of the Superintendent of Bankruptcy – April 30, 1998

- (d) the specific effect of relevant credit and insolvency matters, as they relate to the debtors circumstances;
- (e) the possible outcome of the discharge process as it may relate to the debtor's circumstances including the Trustees statutory responsibility to report any fact, matter or circumstances which may, if an opposition is filed, justify the court's refusal to grant an absolute order of discharge;
- (f) the responsibility of the bankrupt to contribute surplus income to the estate, where appropriate; and
- (g) the type and nature of counselling adapted to the debtors needs that will be offered to assist in the rehabilitation.

During the sign up and subsequent assessment, the Trustee's role then becomes one of impartiality. He or she then becomes an unbiased and impartial party within the process. Specifically, the Trustee should ensure that the debtor understands the process. In a bankruptcy, the Trustee should ensure that the debtor acknowledges that he or she understands the scope and meaning of the stay of proceedings and debtor's rights in this respect. The Trustee also confirms that the debtor understands his or her responsibilities and duties in the process, such as mandatory counselling and the requirement in respect of disclosure and surplus income payment requirements. The Trustee must be confident that the debtor understands the discharge process, including the availability of first-time automatic discharge; what occurs when there is an opposition to discharge; the availability of mediation and other parts of the process. The Trustee ensures that the debtor understands the ramifications of non-compliance with statutory duties, including creditor opposition to discharge and possible offences. The debtor must acknowledge that he or she understands the options available to them. This explanation and verification of the debtor's exercise of choice forms part of the assessment certificate.

In a consumer proposal or a Division I proposal, the Trustee should ensure that the debtor knows and understands the voting process, including threshold requirements; and that the debtor appreciates the significance of the results of a non acceptance vote, including the

option of automatic bankruptcy to deal with the debt if proposal is turned down. The Trustee also acts as information sources on relaying other key responsibilities, such as ensuring the debtor understands the result of a default in the proposal, in terms of annulment, deemed annulment or an application to the court to annul.

Finally it is imperative that the debtor understands the Trustee's role. In my own professional consumer insolvency practice I stress that even though the debtor comes to us and pays us, we do not act for them. Simply put, they are not our clients. I explain that the Trustee's role is to act in an unbiased and impartial manner and to ensure that the *BIA* is complied with.

There are also a range of exceptional issues that the Trustee encounters with the initial assessment, many of which may continue to surface at different times throughout the administration. They generally derive from:

- Engaging each debtor in a discussion of his/her problems and, where necessary, continuing to do so as the administration unfolds. Where there is an improvement, creditors may be entitled to an increased share of surplus income.
- Ensuring that the debtor understands the significance and gravity of insolvency proceedings.
- Looking into mismanagement, misconduct, or credit manipulation or abuse and the degree of the debtor's culpability, if any; for example, checking into credit cards "kiting" (drawing on one card to simply pay another "maxed out" card) or borrowing under altered names (using middle names or initials).
- Looking into and considering the implications of health problems or matrimonial breakdowns and any other extenuating issues.
- Deciding on the need for legal advice, for the Trustee or the debtor.
- Examining potentially fraudulent conduct as an issue contributing factor; and
- Deciding upon whether in fact a legal proceeding; i.e., use of the *BIA* is actually called for and which one is suitable to the circumstances (assignment or Division II proposal) and making a suitable recommendation. Ultimately, the decision of how to proceed rests entirely with the debtor.

2. Counsellor

Another role of the Trustee is in respect of counselling. The *BIA* specifies that the Trustee is to make counselling available to the debtor in both a bankruptcy and proposal process. Counselling requirements are set out in *Directive IR2 – Counselling in Insolvency Matters*.³ The debtor is to attend two counselling sessions within specified time periods. Failure to do so will result in the debtor not being eligible for the automatic discharge provisions of the *BIA*.

The first counselling session is to provide the debtor with information on aspects of personal financial management such as money management, spending and shopping habits, warning signs of financial difficulties and obtaining and using credit.

The second counselling session is to follow up on the items discussed in first counselling session and to ensure that the debtor also recognizes non-financial causes of bankruptcy. The Trustee is to make the debtor aware of what outside counselling services may be available to the debtor to assist them in dealing with issues that are outside the Trustee's expertise.

The Trustee can be alerted to non-financial causes of bankruptcy by reviewing the bankrupt's income and expense reports, through discussions with the debtor or from information received from creditors. The Trustee should be alert to these items in order to advise the debtor concerning what assistance may be available for them. The Trustee's role during the counselling session is again, that of an advisor.

3. Investigator

The Trustee has many investigative tools available to him or her. Creditors and others sometimes criticize Trustees for their apparent indifference to alleged misconduct on the part of the bankrupt. While this criticism is seldom justified, there often is much more

³ Issued by the Office of the Superintendent of Bankruptcy – December 21, 1994

that Trustees could, and should, do in reviewing and, where appropriate, investigating the affairs and conduct of their bankrupts. Experience shows that, when this situation occurs, it usually results from one or more of the following: the Trustee has concluded that pursuing misconduct is too costly, or that it is too difficult procedurally. The Trustee knows that the estate has inadequate resources to undertake the investigation warranted, or there is a lack of hard, preliminary information. Occasionally there is misunderstanding regarding the Trustee's duty to investigate. Finally, there may be a lack of familiarity with the procedures available to the Trustee for investigation.

The Trustee has a duty to investigate the affairs and conduct of the debtor⁴. However, this duty is discharged by undertaking reasonable steps taking into account all the circumstances and the resources available to the estate. A Trustee cannot be expected to be a police officer or a private investigator, or incur significant costs without being compensated for his or her efforts, but can be expected to make a reasonable effort to investigate the debtor and his or her dealings if it appears warranted. This need not be unduly costly or even very difficult. Indeed, the *BIA* provisions that imposes the duty to investigate also provides some very effective and inexpensive tools of investigation.

The tools of investigation that the Trustee can utilize are as follows:

- Statement of affairs
- Information from creditors
- First meeting of creditors
- Personal property registry searches
- Counselling Sessions
- Section 164 – Demand for Documents
- Section 163 – Examinations under oath
- Redirection of Mail
- Bankrupts Income and Expense Statements

⁴ Section 16(3) of the *BIA*.

- Search Warrants
- Tax returns

The Trustee's role is of an information gatherer. The information obtained will determine the Trustee's next decision and role. It may very well be that the information obtained by, and interpreted by, the Trustee could very well exonerate the debtor. Alternatively, it could lead to the Trustee advising the creditors of transactions that potentially require additional scrutiny, or advising of the need to bring a court application to take the matter further for recovery.

4. Creditor and/or Debtor Advocate

The Trustee, while being impartial, can become an advocate of the creditors when the bankrupt has not complied with his or her duties, or where the Trustee is pursuing preferential payments and so forth. However, the Trustee performs this role while enforcing the provisions of the *BIA* and not in pursuance of the creditors' interests except where the *BIA* requires that pursuit.

At the other extreme, the Trustee can become an advocate for the debtor. This situation occurs where creditors are taking action against the bankrupt without obtaining leave of the Court, where there is continued harassment of the bankrupt by collection agencies or where creditors object to the bankrupt's discharge out of spite or malice and not sound reasoning. Again, Trustee performs this role while enforcing the provisions of the *BIA*.

5. Asset Valuator

This area of the process can be one of the most challenging and difficult areas for the Trustee. The challenge for the Trustee is to determine what equity may be available for the creditors after taking into account the provincial personal exemptions.

The value of vehicles can easily be determined by using an average of the Black Book or by having the debtor obtain an appraisal of the vehicle. The challenge for the Trustee arises when there is no published valuation guide or where there is a volatile market in the price of particular assets. This can apply to any type of property including jewelry, sporting goods and real property. While jewelry and sporting goods can be valued relatively easily and inexpensively, an appraisal of real property can become costly. In a summary administration, the Trustee may not have sufficient funds to obtain an appraisal and it would be unlikely that the creditors would fund the Trustee to obtain one. As well, the Trustee must consider whether or not there would be any equity available if the Trustee actually had to market and sell the real property.

When determining whether there is equity in real property, the Trustee must go through a process that is subjective and requires his or her professional expertise. Firstly, if possible, a review of the title is helpful. The Trustee can then use the assessed value of the property as a starting point to determine value and calculate what, if any, equity exists. This is only a preliminary indication of value and has risks associated with it, particularly in a rising market.

After deducting the mortgages and the provincial exemptions, the Trustee then must consider what allowances should be made for selling costs (commissions and legal fees). This is where the Trustee must use his or her expertise and balance that with the practicalities of realizing on real property while continuing to balance the interest of all parties. This can be particularly difficult in a rising market, where the equity is marginal, where title is not in the debtors name only and so forth.

As well, there have been a number of cases that comment on real property issues regarding deductions from the value and the timing of the valuation. Of particular note is the *Rassell*⁵ case, in which the court held that the Trustee's obligation in dealing with

⁵ Canada (A.G.) v Russell – ABCA 232, 98-17752

equity is to obtain the best price possible. As well, the Court held that the deduction of selling costs should not be an automatic deduction. In British Columbia, the most recent case dealing with this issue is in *Re: Bankruptcy of Prior*,⁶ where the Court held that selling costs were an appropriate deduction. The Court further held that the time to determine the equity was at the date of the bankruptcy assignment, not some later date before the Trustees discharge. The Alberta court held an opposing view in the *ICI Paints v. Gazelle*⁷ case. The Court in that case found that the Trustee was entitled to the increased equity of the property subsequent to the date of the assignment. Therefore, the Trustee has an obligation to take into account all of these factors when determining a course he or she must take to realize upon that equity.

6. Claims Adjudicator

The Trustee has a duty to examine every proof of claim⁸. During this examination, the Trustee must determine whether the claim is valid and the creditor can be allowed to participate in the insolvency process and receive any dividends. The Trustee also has the power to disallow any claim⁹, in full, or in part if he or she feels that the claim does not meet the requirements as a provable claim. However, any disallowance must be well thought out and have sound reasoning behind it.

7. Tax Preparer

The Trustee is required to file with Canada Customs and Revenue Agency (“CCRA”) the prior year tax return and the pre-bankruptcy tax return. The Trustee should have a basic knowledge of personal tax matters and should be able to recognize if there are tax issues relating to the debtor. The Trustee need not have an in depth knowledge of tax issues, but should have at least sufficient knowledge to be able to recognize issues that may lead

⁶ Bankruptcy of Prior – 2003 BCSC 1475

⁷ *ICI Paints v. Gazelle* (2001) 24CBR (4th) 54

⁸ Section 135(1) of the *BIA*

⁹ Section 135(3) of the *BIA*.

to larger tax refunds or situations where a particular action or non action could increase the debtor's liability.

While most of these returns are very basic, comprised of nothing more than T4 slips and RRSP contributions, there can be issues that arise that relate to tax such as loss carrybacks, shareholder loans, depreciation, professional corporations and so forth. In most instances where there are tax issues, the debtor previously had a tax advisor that the Trustee may be able to rely on to prepare the returns or provide information.

8. Judge and Jury – the Section 170 Report

At the eighth month of a consumer bankruptcy, the Trustee is required to prepare a report, called the section 170 Report,¹⁰ with respect to the affairs of the Bankrupt. The report includes the causes of bankruptcy; whether or not the bankrupt has performed the duties required under the statute; the conduct of the bankrupt both before and after bankruptcy; and disclose whether the bankrupt has been convicted of an offence under the *BIA*. The Trustee must also report on any other fact or matter that would justify the Court in refusing an unconditional order of discharge.

When preparing this report, the Trustee must consider all of the factors that have occurred throughout the bankruptcy and to make a recommendation as to whether the bankrupt should be discharged subject to conditions.

When making this recommendation, the Trustee must call upon his or her professional judgment and experience and weigh all of the factors to reach a decision. Some of those factors can include whether or not the bankrupt should somehow be held responsible, depending on the causes of bankruptcy, as well as an assessment of the conduct of the debtor and compliance with his or her duties. The Trustee will also consider amounts owed to CCRA and the reason for the debt; the availability of surplus income and the debtor's ability to pay. The Trustee will assess any claims review for three months prior

to the bankruptcy, such as abnormal purchases; ongoing investigations into the debtor's financial situation and the economics of the administration in terms of whether or not there are funds available. After considering these factors and any others that might be relevant, the Trustee then decides if the first time bankrupt will receive an automatic discharge or some other type of discharge. If there are limited funds in the estate, or no surplus income, it is unlikely that the bankrupt would receive anything but an automatic discharge. This is particularly true where creditors take no interest in the bankruptcy.

In addition, *Directive 12 – Terms of Discharge* allows a Trustee to extend a bankruptcy up to an additional twelve months where there is surplus income.¹¹ When the Trustee is faced with this situation, the Trustee again must use his or her experience and judgment when considering the above factors as to how long the extension might be, if extended at all.

9. Officer of the Court

Finally, and critically important, the Trustee is also an officer of the court. Hence the Trustee must never perform in a manner that would compel the court to repudiate the Trustee's conduct or behaviour. Accountability to the court ensures that the Trustee is mindful of the gravity of the proceedings, referred to at times as quasi-criminal in nature.¹² The role of the Trustee is to administer estates fairly, in fact and in appearance, balancing the disparate interests of debtors and creditors, but having regard for the shared *paramount* interest of all parties in the need to maintain public confidence in the fairness and the integrity of the system. As an Officer of the Court, the Trustee must act in keeping with the oft-stated rule in *Ex parte James* to do the "fullest equity".¹³

¹⁰ Section 170(1) of the *BIA*.

¹¹ Issued by the OSB – April 30, 1998

¹² *Re Elkind: Samuel Hart & Co. v. Elkind* (1966), 9 C.B.R. (N.S.) 274 (Ont. S.C.). The case commentary notes that, "Bankruptcy proceedings savour of criminal law".

¹³ 8 Ves. 337, [1803-13] all E.R. Rep. 78, 32 E.R. 385.

III. Conclusion

The many varied roles of the Trustee described above are common to personal insolvency practices, all of them carried out in the ordinary course. Each aspect of the consumer insolvency contributes in different ways to the achievement of some of the stated goals of the Canadian insolvency process (debtor rehabilitation, deterrent to fraud, balancing competing interests, and providing a fair and effective system). It is this type of ongoing process that governs all insolvency practices. In practice, timely recognition and treatment of issues of these types are continual. Complexities often surface in administrations that appear straightforward at the time when the file is initiated.

Trustees face many challenges throughout their day-to-day activities and throughout their career. Ensuring the integrity of the insolvency process is maintained is paramount in their administration of estates. However, there is much more to being a Trustee than that. Dealing with many stakeholders who often have different agendas can be emotionally draining and sometimes Trustees have a sense of loss of compassion. Trustees are human and at times it can be difficult to maintain their impartiality based on their own personal beliefs and biases. Balancing the interests of all stakeholders without appearing biased and being labeled a debtors Trustee or a creditors Trustee is a challenge we all face. And finally, keeping knowledgeable of the ever-changing jurisprudence and other changes that affect the practice of consumer insolvency is a must.

Contact Information

David Wood, CIRP

Telephone: (604) 605-3335

Facsimile: (604) 605-3359

Email: dwood@boalewood.ca

Website: www.boalewood.ca