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Insolvency Law Section

RE INDALEX LIMITED 2011 ONCA 265 CASE COMMENT*

Robin Schwill

Indalex Limited's assets were sold in a liquidating proceeding under the federal *Companies' Creditors Arrangement Act* (the "CCAA"). Indalex administered defined benefit pension plans which had substantial deficiencies at the time of the filing, although the company was up to date in making all statutorily mandated payments. Former employees and the union asserted priority claims over the sale proceeds in respect of Indalex's pension plan deficits giving rise to the question: Does the statutory deemed trust under Ontario's *Pension Benefits Act* trump the Court ordered super-priority charge typically granted to a debtor-in-possession (DIP) lender inside CCAA proceedings? Shockingly, the Ontario Court of Appeal's answer was: "Yes".

That answer, however, was still not the most concerning aspect of its decision. The Court of Appeal also held that where a debtor has breached its fiduciary duties¹ to the pension plan beneficiaries, then the Court may find that a "constructive trust" applies to the debtor's property (such as the proceeds resulting from the sale of its business) and, therefore, such property (or sale proceeds) must be used to fund the full amount of any pension plan deficiencies first ahead of anyone else – whether or not the statutory deemed trust applies to such pension obligations. In addition, the Court of Appeal stated that a voluntary assignment into bankruptcy should not be used to defeat a secured claim under valid provincial legislation and, in particular, that: "it is inappropriate for a CCAA applicant with a fiduciary duty to pension plan beneficiaries to seek to avoid those obligations to the benefit of a related party by invoking bankruptcy proceedings when no other creditor seeks to do so."

The decision suggests that the priority question can be addressed by clearer and more explicit priority language being drafted into CCAA orders pertaining to DIP financing than currently exists under the model orders prescribed by the Ontario court. However, to grant such an order, the CCAA court must find that the recognition of the pension deemed trust would frustrate the purpose of the CCAA proceeding and therefore explicitly invoke the federal paramountcy of the CCAA to grant a super-priority charge. This will necessitate providing evidence in DIP financing motions that the financing will

* The author wishes to thank his partners, Jay Swartz and Natasha vandenHoven for their comments and revisions to earlier renditions of the content used to put this case comment together.

¹ Because Indalex acted as administrator of its pension plans it had fiduciary duties to the beneficiaries of the plans.

not be made available (or otherwise materially more onerous) without the ability to trump the pension deemed trust. This may be tricky to do under recent CCAA amendments dealing with DIP financing and the definition of "secured creditor" under the CCAA. Further, any motion to approve the DIP priority must be on notice to the affected pension beneficiaries. Giving such notice may be problematic particularly if funding is needed on the first day. However, if successful, the end result would be to put DIP lenders back to the spot where they believed they were prior to *Indalex* and, therefore, resolve at least part of the problem.

The larger issue – avoiding a breach of fiduciary duty finding that leads to a constructive trust proprietary remedy of paying out all pension plan deficiencies first – will be considerably more difficult (if not impossible) to address. Furthermore, this issue affects all creditors with claims against a debtor's assets, not just DIP lenders and, therefore, will impact credit markets generally. And, while an argument exists to distinguish *Indalex* on its facts,² relying on the ability to successfully distinguish *Indalex* will likely be cold comfort to any lender until there are a number of cases clearly recognizing the distinction.

Where an employer is also the pension plan administrator (as is almost always the case with single employer plans in Ontario), it is very difficult to see how such an employer can implement a CCAA restructuring without being held to then have breached its fiduciary duties to pension plan beneficiaries as plan administrator. While the Court of Appeal did hold that the decision to commence a CCAA proceeding was not part of the administration of the pension plan nor does it necessarily engage the right of the beneficiaries of the pension plan, it did allude to the following factors in considering whether or not a breach of fiduciary duty occurs: doing nothing in the CCAA proceedings to fund the deficit in underfunded plans; taking no steps to protect the vested rights of the plan beneficiaries to continue to receive their full pension entitlements; applying for CCAA protection and obtaining the CCAA order that provided the super-priority charge in favour of its DIP lender without notice to the plan beneficiaries; selling assets without making any provision for the plans; doing nothing to protect the best interests of the plan beneficiaries; and, basically, ignoring its role as pension plan administrator.³

Of course, if a debtor attempts to fund a plan deficiency (in cases where the deficiency is not subject to the statutory deemed trust) in preference to its other creditors, that action will likely be attacked as not only being a fraudulent preference but possibly also oppressive conduct. The Monitor, the CCAA Court's officer, would likely not sanction such payments. Insolvency law requires that the debtor preserve the status quo standing of all creditors at the date of filing so that no one creditor can obtain a "leg up" on other creditors of the same class. As of the CCAA filing date, any deficit in an ongoing pension plan would be an unsecured claim which should share *pro rata* with all other unsecured creditors as of the filing date. Accordingly, a CCAA debtor essentially cannot engage in actions that prefer one pre-filing unsecured creditor over another – yet, this decision suggests that if the CCAA debtor does not attempt to engage in such conduct it

² By arguing that such a result really only applies where the beneficiary of the security that is to be enforced is a related party that effectively controlled the decisions of the CCAA debtor and, thereby, was the party in effect breaching the fiduciary duties (as it was effectively *Indalex's* U.S. parent invoking the DIP charge in this case having paid out on a guarantee to the DIP lender). There may be a trend to creditor imposed filings in order to avoid this issue.

³ It is noted that *Indalex's* filing always contemplated a liquidation of the business and there was never any prospect that the company would be restructured and that the pension plans would continue.

will be seen as being in breach of its fiduciary duties as plan administrator. Furthermore, even if a debtor wished to have someone independent appointed as the plan administrator just prior to or shortly after a CCAA filing, it would be very difficult to do so. As such, debtors (and their creditors) have now been placed in an impossible position with no apparent way out.

The Court's holding that attempting to deal with the priority issues by bankrupting a CCAA debtor once the assets have been sold is essentially impermissible creates further uncertainty. Secured lenders to Canadian debtors have long relied on plan deficits being unsecured claims in a bankruptcy when determining the amount of borrowing availability to provide a debtor. Prior court decisions had approved of debtors converting CCAA proceedings into bankruptcies to alter priorities. This reliance is now in question if the bankruptcy is preceded by a CCAA filing as is often the case.

It is expected that Canadian credit markets will be reacting with caution to the *Indalex* decision until it is clarified by future case law or legislative amendments, and debtors inside or contemplating CCAA proceedings will need find ways of ensuring that the "breach of fiduciary duty as plan administrator issue" is not visited upon them.

Furthermore, in corporate group insolvencies, there is no obvious reason that the Court of Appeal's approach in this case could not be used by any creditor of one of the companies in the corporate group as against other members of the corporate group for any proven breach of fiduciary duty. This issue can be highlighted best in cross-border insolvencies. For example, assume the relatively common circumstance where there is a U.S. parent company with U.S. affiliates that files for Chapter 11 protection while its Canadian subsidiary and its respective affiliates file a parallel CCAA proceeding. A sale of the entire business transpires with proceeds being initially allocated to the U.S. estate and the Canadian estate based on some reasonable assessment of relative asset values. Let us also assume that the Canadian subsidiary owes a considerable sum of money to the U.S. parent for inter-company loans or some other reason. If creditors of the Canadian estate can successfully prove that the U.S. parent controlled the decisions of the Canadian subsidiary⁴ and, in so doing, breached fiduciary duties that the Canadian subsidiary owed to one or more particular groups of creditors,⁵ then *Indalex* would provide strong precedent for a trial court to hold that the creditors of the Canadian estate should be paid out prior to any money being paid to the U.S. parent on the inter-company indebtedness. If the sale proceeds are held in escrow in Canada for some reason, then the situation could be even worse (for U.S. creditors) with the court holding that the entire proceeds (or some portion) are held in "constructive trust" for the benefit of the Canadian estate. All good for Canada.

However, turn the situation around – a Canadian parent company in CCAA with a U.S. subsidiary in Chapter 11. The U.S. estate can successfully prove that the Canadian parent breached fiduciary duties it owed to U.S. stakeholders through exercising complete control over the U.S. subsidiary. For example, by having the U.S. subsidiary fund the

⁴ Which would not be difficult if there was a unanimous shareholder declaration in place which is often the case.

⁵ Admittedly, it is difficult to suggest a general example applicable to typical creditors as Canadian law to date has held that a company does not owe any fiduciary duties to its creditors generally. However, there may always be creditors like pension plan beneficiaries. Employees for termination and severance payments or lost health and welfare benefits also come to mind. Various government taxation authorities are also a likely candidate as they are wholly reliant on the debtor to collect and remit the various taxes in question not all of which have been granted "extra protection" by statute.

Canadian parent through inter-company loans that it knew would never be repaid or through a transfer pricing scheme that it knew stripped value from the U.S. Now the U.S. estate can argue in the Canadian CCAA proceeding that certain proceeds of sale ought to be held in "constructive trust" for its creditors first, with only the remainder being made available for creditors of the Canadian estate.

Of course, inter-company lending and trading structures are generally never as simple and easy to sort out. However, it should be expected that *Indalex* will certainly be used by various creditor groups of certain companies in corporate groups – and especially cross-border cases -- to attempt to "ring fence" value in the relevant company or estate in an attempt to secure a better recovery for them at the expense of others. How this will all play out and be handled by future trial courts remains to be seen.

One may also expect that various stakeholders in a CCAA proceeding will try to elevate their claims to claims for breach of fiduciary duty in order to give them priority over other creditors. The nature of these claims will be limited only by the scope of lawyers' imaginations. While we expect courts to resist finding new fiduciary obligations, equity is a broad tool that is always available to judges.

Leave to appeal this decision to the Supreme Court of Canada has been sought.

Robin Schwill



ON WHAT LEGAL BASIS IS A REPORT ADMISSABLE AS EVIDENCE?

Farber & Partners Inc. v. Morris Goldfinger et al

E. Patrick Shea C.S.

On 31 March 2011, Madam Justice Mesbur released her decision in *A. Farber & Partners Inc. v. Morris Goldfinger et al*¹. The case involved a motion to expunge a report prepared by A. Farber & Partners Inc. (“**Farber**”) in its capacity as trustee of various bankruptcy estates on the basis that the report was not admissible as evidence. The report in issue was prepared by Farber in response to a motion brought by Dr. Morris Goldfinger to remove Farber as trustee of various estates on the basis of assertions that Farber had a conflict in administering the estates.

The decision in *Farber v. Goldfinger* is not groundbreaking in that it confirms what most insolvency practitioners would have agreed is the law – that a report prepared by an officer of the Court is admissible as evidence. The decision does, however, explain the basis for the admissibility of a report as an exception to the rule against hearsay² and, on that basis, ought to be of interest to insolvency practitioners.

Farber, in its capacity as trustee of a number of bankruptcy estates had brought an application (the “**Farber Application**”) against the principles of a number of the bankrupt companies and their former business partner, Dr. Goldfinger, to, *inter alia*, recover certain payments that Farber asserts were improperly paid to Dr. Goldfinger.

In the Farber Application, Dr. Goldfinger brought a motion (the “**Removal Motion**”) to have Farber removed as trustee of various bankruptcy estates pursuant to s. 14.04 of the *Bankruptcy and Insolvency Act*³, which permits a person with an interest in a bankruptcy estate to bring an application to have the bankruptcy trustee removed for cause.

In support of the Removal Motion, Dr. Goldfinger delivered an affidavit containing various assertions that Farber was in conflict *vis-a-vis* the administration of the

¹ 2011 CarswellOnt 2214 (S.C.J.) (“*Farber v. Goldfinger*”).

² A report prepared by an officer of the Court is, to the extent that it is relied upon as proof of the truth of the statements made in that report, hearsay.

³ R.S.C. 1985, c. B-3 (the “*BIA*”). Rather than bring separate motions in the bankruptcy proceedings, Dr. Goldfinger brought a single motion in the Farber Application to remove Farber as trustee of the Applicant bankruptcy estates and one additional bankruptcy estate.

bankruptcy estates and making allegations with respect to Farber's conduct in administering the bankruptcy estates.

In response to the Removal Motion and to address the matters raised in the affidavit delivered in support of the Removal Motion including Dr. Goldfinger's status *vis-à-vis* the various estates and Farber's administration of the estates, Farber delivered a report (the "**Farber Report**").

The Court-ordered schedule for the hearing of the Removal Motion included a provision for the cross-examination of a representative of Farber, but that cross-examination was limited by the Court to the matters in issue on the Removal Motion.

A dispute arose with respect to whether Dr. Goldfinger was entitled to cross-examine a specific employee of Farber and the scope of the cross-examination that could be undertaken. Rather than conduct the limited cross-examination ordered or move to vary the scheduling order to permit a broader cross-examination of a specific Farber employee, Dr. Goldfinger delivered a motion (the "**Expunge Motion**") seeking to have the Farber Report expunged.

While a number of collateral issues were raised by Dr. Goldfinger, the key issue on the Expunge Motion was whether the Farber Report was admissible as evidence.

Dr. Goldfinger argued that the *Rules of Civil Procedure*⁴, the BIA and the *Bankruptcy and Insolvency Act General Rules*⁵ did not specifically permit a report to be filed in response to a motion, and in the absence of a specific authority to deliver a report, Farber was required to provide its evidence by way of an affidavit in the form required by the *Rules of Civil Procedure* and submit to cross-examination. Dr. Goldfinger also argued that the *Rules of Civil Procedure* contemplated that only affidavits could be relied upon as evidence on a motion.

Farber argued, in response, that the *Rules of Civil Procedure* did not require an affidavit and, in the absence a specific requirement that evidence be provided in the form of an affidavit, an officer of the Court could provide evidence by way of a written report. Farber took the position that, while an unsworn written statement was hearsay and not generally admissible, a report prepared by an officer of the Court was admissible based on the common law "public documents" exception to the rule against hearsay or based on the application of what is generally referred to as the "principled approach" to hearsay.

With respect to the admissibility of the Farber Report, Madame Justice Mesbur accepted Farber's position and found that: (a) the *Rules of Civil Procedure* did not require that evidence on a motion be provided by affidavit; and (b) the Farber Report was admissible as evidence on the basis of the public document exception to the rule against hearsay⁶.

⁴ R.R.O. 1990, Reg. 194 (the "*Rules of Civil Procedure*").

⁵ C.R.C. 1978, c. 368 (the "*General Rules*").

⁶ Having found the Farber Report admissible based on the public document exception, Madame Justice Mesbur did not consider the application of the principled approach to hearsay.

Prior to *Farber v. Goldfinger* it was generally accepted that a report prepared by an officer of the Court was admissible as evidence⁷. However, the closest that the Courts had come to explaining the basis for the admissibility of a report was in *Bell Canada International Inc. (Re)*⁸ where Mr. Justice Farley, in dismissing an argument that a report by a monitor was not “evidence”, referenced the portion of *Wigmore on Evidence*⁹ with respect to the public document exception to the rule against hearsay¹⁰.

The common law public document exception was not developed to deal specifically with reports prepared by officers of the Court. It is a broad exception to the rule against hearsay that was developed to deal with written documents where the information in the document is considered to be sufficiently reliable that cross-examination is not required to test its reliability¹¹. The exception is founded upon the belief that “public officials” will perform their tasks properly, carefully, and honestly - public documents are admissible because of the inherent reliability or trustworthiness of the information in the document¹².

There are four criteria for the application of the “public document” exception:

- (a) the document must have been made by a person on whom a duty has been imposed to carry out an official function or duty such that the person would be expected to be truthful in making a statement;
- (b) the person must have made the document in the discharge of a “public duty or function”;
- (c) the document must have been made with the intention that it serve as a permanent record; and
- (d) the document must be available for public inspection.¹³

⁷ There are, literally, dozens of reported cases where reports prepared by officers of the Court have been accepted as evidence.

⁸ 2003 CarswellOnt 4537 (S.C.J.).

⁹ J H Wigmore, *Evidence in Trials at Common Law* (1974, Little Brown & Co.) (“*Wigmore on Evidence*”).

¹⁰ See also *Mortgage Insurance Co. of Canada v. Innisfil Landfill Corp.*, 1995 CarswellOnt 43 (Gen. Div.) and *SemCanada Crude Co. (Re)*, 2010 CarswellAlta 1702 (Q.B.) leave to appeal ref’d, 2010 CarswellAlta 2459 (C.A.).

¹¹ It is important to note that the intention underlying Rule 39.01(4) of the *Rules of Civil Procedure* is to create an exception to the rule against hearsay applicable to affidavits for use on a motion. Rule 4.06 requires, inter alia, that an affidavit be based only on personal knowledge of the deponent, but Rule 39.01(4) permits information in an affidavit for use on a motion to contain statements of the deponent’s information and belief – hearsay – where the source of the information and the fact of the belief are specified in the affidavit. The requirement that the deponent state the sources of information, and the ability to conduct examinations and cross-examinations, are the means by which the reliability of hearsay evidence in an affidavit is assured.

¹² See, *Wigmore on Evidence* at §1632 and §1633(5) and *R. v. Khelawon*, 2006 CarswellOnt 7825 (S.C.C.).

¹³ See, A.W. Bryant et al, *The Law of Evidence in Canada* (3rd ed.) (LexisNexis, 2009) at §6.295. It should be noted that the exceptions to the rule against hearsay are “generalized” by what is often referred to as the principled approach to hearsay evidence and reports by an officer of the Court would also be admissible by application of the principled approach: see *R. v. B. (K.G.)*, 1993 CarswellOnt 76 (S.C.C.).

With respect to criteria (a), the concern with hearsay is that the evidence will be admitted for its truth without other parties being able to cross-examine the witness to test the reliability of the evidence. To address this concern, the law requires that there must be some circumstantial probability that the evidence is reliable for hearsay to be admissible. This requirement for a circumstantial guarantee of the reliability is satisfied where:

- (a) there is no real concern about whether the evidence is true or not because of the circumstances in which it came about; or
- (b) no real concern arises from the fact that the evidence is presented in hearsay form because its truth and accuracy can be sufficiently tested by some other means.

A “public official” includes any person who is required, by statute to otherwise, to carry out an official function or duty such that the person would be expected to be truthful in making a statement¹⁴. An officer of the Court carries out an official duty or function¹⁵, and there are a number of statutory obligations imposed on licensed trustees with respect to how they perform their duties and functions¹⁶. In the case of reports by officers of the Court, the procedure developed by the Court that required the officer of the Court to answer questions on the information in the report and, where there are reasons to doubt the reliability of the information in the report, permit the cross-examination of a representative of the officer of the Court¹⁷, adds to the circumstantial guarantee of reliability.

With respect to the applicability of (b), it will depend on the facts of the particular case whether the report was prepared in the discharge of the officer of the Court’s function or duties. Generally speaking, to be admissible under the public document exception, a report must relate to matters that are within the officer’s mandate and authority and must have been prepared by the officer to address the matter for which it is submitted as evidence¹⁸. In *Principal Group Ltd. (Trustee of) v. Principal Savings & Trust Co.*¹⁹, for example, a creditor sought to rely on a report prepared by an inspector appointed under the *Business Corporations Act* (Alberta) as evidence in a disputed claims proceeding under the *Winding-up Act*. The Court found that the report was not admissible. *Principal Group Ltd.* can be contrasted with *Canada (Attorney General) v. Continental Trust Co.*²⁰, where a report prepared pursuant to the *Trust Companies Act* with respect to “the condition of the company and its ability or otherwise to meet its obligations and guarantees” was found to be admissible as evidence on a winding up application in respect of a trust company.

¹⁴ *Wigmore on Evidence* at §1630.

¹⁵ See, *Page (Re)*, 2002 CarswellOnt 3892 (S.C.J.) and *Braich (Re)*, 2007 CarswellBC 2660 (S.C.).

¹⁶ See, *BIA*, s 13.5 and *General Rules*, Rules 34 – 52.

¹⁷ See, *Ravelston Corp. (Re)*, [2007] O.J. No. 414 (S.C.J.) aff’d, 2007 CarswellOnt 1115 (C.A.), *Big Sky Living Inc. (Re)*, 2007 CarswellAlta 489 (Q.B.) and *Big Sky Living Inc. (Re)*, 2007 CarswellAlta 638 (Q.B.).

¹⁸ It is important to note, however, that reports are not admissible because of the information in the report, but because of the role played by the trustee and obligation imposed on the trustee to be truthful and provide reliable information.

¹⁹ 1994 CarswellAlta 357 (C.A.) leave to appeal ref’d, 36 C.B.R. (3d) 107 (note) (S.C.C.) (“*Principal Group*”).

²⁰ 1985 CarswellOnt 983 (S.C.).

The fact that the *BIA* and the *General Rules* do not specifically contemplate that a trustee will provide evidence by report is not determinative as to whether a report prepared by a trustee is admissible as evidence. No express statute or regulation is needed creating the authority or duty to make a statement for the exception to the rule against hearsay to be available. Where the nature of an office fairly renders the making and recording of a statement appropriate, that statement is admissible as evidence under the public document exception²¹.

With respect to the applicability of criteria (c) and (d), the fact that a report is submitted to the Court and becomes part of the Court record is sufficient to satisfy these criteria²².

In conclusion, *Farber v. Goldfinger* explains the legal basis for the admissibility of reports prepared by officers of the Court as evidence, but it is not the whole story. *Farber v. Goldfinger* did not deal with the circumstances in which the cross-examination of an officer of the Court on a report is appropriate. As a result, the case should not be read in isolation and a complete understanding of the use of reports by officers of the Court requires an understanding of the law that has developed with respect to the ability to cross-examine a representative of an officer of the Court on a report. A number of the cases with respect to challenging the information in a report and cross-examination of a representative on a report are referenced above.

Finally, it should be noted that a motion to the Divisional Court seeking leave to appeal Madam Justice Mesbur's decision is scheduled to be heard on 28 June 2011.

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²¹ In some circumstances, the *BIA* mandates a report be prepared by the trustee in various circumstances, but only s. 170(5) of the *BIA* deals specifically with admissibility of reports as evidence. As Madame Justice Mesbur noted in *Farber v. Goldfinger*, it is the generally accepted practice for officers of the Court to provide evidence by way of reports rather than sworn affidavits. See also *Impact Tool & Mould Inc. (Re)*, 2007 CarswellOnt 9136 (S.C.J.) aff'd, 2008 CarswellOnt 1360 (C.A.) leave to appeal ref'd, 256 O.A.C. 395 (note) (S.C.C.).

²² *R. v. P.(A.)*, 1996 CarswellOnt 3150 (C.A.).



**INTERPLAY BETWEEN THE *LIMITATIONS ACT* AND SECTION 38 OF THE BIA:
A REVIEW OF *INCONDO BUILDING CORP. v. SLOAN***

Kate H. Stigler

Introduction

The recent decision of the Ontario Court of Appeal (the “OCA”) in *Indcondo Building Corp. v. Sloan* provides guidance as to the interplay between the *Limitations Act, 2002* (Ontario) (the “**Limitations Act**”) and section 38 of the *Bankruptcy and Insolvency Act* (Canada) (the “**BIA**”) by making it clear that the commencement of bankruptcy proceedings will not restart or toll the limitations clock for creditors who wish to bring actions pursuant to section 38 of the BIA. This impacts creditor actions in bankruptcies in two important ways: Firstly, creditors who would otherwise be barred from bringing an action due to the Limitations Act will not be given a second opportunity to do so by virtue of the debtor becoming bankrupt and commencing a proceeding under section 38 of the BIA; second, the decision of the OCA indicates that the limitations clock for actions capable of being assigned under section 38 of the BIA is not tolled upon the debtor becoming a bankrupt; accordingly, creditors will need to act expeditiously post-bankruptcy should they intend to pursue such an action.

Background to Litigation

Indcondo Building Corp. (“**Indcondo**”) and Mr. Sloan (“**Sloan**”) had been engaged in litigation since May of 1992 when Indcondo started an action against Sloan for the recovery of 8.7 million dollars Indcondo alleged to be owing by Sloan. Indcondo was successful in this action and obtained judgment against Sloan in December of 2001. When Indcondo proceeded to enforce the judgement it found that Sloan had transferred certain of his assets to his wife for no consideration. Pursuant to such discovery, Indcondo initiated a fraudulent conveyance action against Sloan in August of 2002. Sloan made an assignment into bankruptcy on January 13, 2004 and Indcondo’s fraudulent conveyance action was stayed pursuant to the stay provisions of the BIA. Sloan was discharged from bankruptcy on August 15, 2005 and Indcondo’s fraudulent conveyance action was dismissed by Justice Belobaba in April of 2006 on the basis that it was a claim provable in bankruptcy and released pursuant to subsection 178(2) of the BIA. Indcondo was unsuccessful in appealing this decision.

Not to be dissuaded, in April of 2006 Indcondo sought and obtained from the Bankruptcy Court an order under section 38 of the BIA allowing it to initiate a new fraudulent conveyance action against Sloan (the “**Section 38 Order**”). On June 20, 2008, over two years after obtaining the Section 38 Order and four years after Sloan had become a bankrupt, Indcondo initiated its second fraudulent conveyance action against Sloan (the “**Action**”). In response to the Action, Sloan brought a motion before the Ontario Superior Court of Justice (Commercial List) (the “**Superior Court**”) seeking, amongst other things, the dismissal of the Action on the basis that it was barred pursuant to the Limitations Act.

Decision of the Superior Court

The Superior Court held that the Action, having been initiated pursuant to the Section 38 Order, at first instance ‘belonged’ to the trustee in bankruptcy of Sloan (the “**Trustee**”) and that since Indcondo obtained the Action by assignment from the Trustee it did not have any higher rights in the Action than the Trustee.

The Superior Court concluded that in order to determine when the Action was discoverable in accordance with section 5 of the Limitations Act, the applicable point in time would be when the Trustee learned of the facts underlying the Action.

The Superior Court ruled that since the Trustee learned of claim sometime between January 13, 2004 (date of its appointment) and April 2006 (the granting of the Section 38 Order) and more than two years prior to Indcondo bringing the Action, the Action was statute barred.

Decision of the OCA

Indcondo appealed the decision on the basis that section 12 of the Limitations Act should have been considered by the Superior Court when determining the issue of discoverability and that had that section been considered by the court, Indcondo would have been successful on the motion.

On appeal, although the OCA agreed with the Superior Court that Indcondo had obtained its rights to the Action through the Trustee by way of assignment, it went on to find that the relationship between the Trustee and Indcondo was one of assignor/assignee and that for the purpose of determining the discoverability of the Action, section 12 of the Limitations Act governed. The OCA noted that Section 12 of the Limitations Act had not been brought to the attention of the Superior Court on the original motion.

Section 12 of the Limitations Act states that in order to determine discoverability under section 5 of the Act, where a proceeding is commenced by a person claiming through a predecessor in right, title or interest, that person shall be deemed to have knowledge of the matters referred to in section 5 on the earlier of the following: (i) the day the predecessor first knew or ought to have known of those matters; and (ii) the day the person claiming first knew or ought to have known of them.

Accordingly, since Indcondo knew of the basis for the Action prior to the appointment of the Trustee, that date governed as the “discoverability” date. Due to the fact that (i)

Indcondo discovered the cause of action prior to the Limitations Act coming into force (i.e. 2004), (ii) the old Limitations Act provided that there was no applicable limitation period for a fraudulent conveyance action, and (iii) the transition provisions of the Limitations Act stipulated that for such situations the old Limitations Act governed, the OCA allowed the appeal and found that the Action was not statute barred.

Going Forward

The OCA's decision in this case resulted in a favourable decision for the creditor. However, creditors who have not commenced an action within the applicable limitation period will not be afforded a second opportunity to pursue a claim upon the bankruptcy of the debtor. The ruling also makes it clear that the Limitations Act "clock" continues to run notwithstanding that the debtor has become bankrupt and is not tolled by reason of the bankruptcy. Accordingly, creditors who prior to the debtor's bankruptcy are aware of causes of actions which are for the benefit of the debtor's estate, will need to act expeditiously upon the bankruptcy of the debtor in order to obtain a section 38 order and initiate the action should they wish to pursue such action. Should a creditor fail to do so, it would be barred from commencing the action if by reason of its earlier discoverability of the claim, the subsequent commencement of the action is outside of the applicable limitation period. If this occurs, their only remaining option may be to request that the Trustee pursue the claim by agreeing to fund the Trustee's action. This would be a less favourable course of action on account of the requirement under the BIA that the proceeds of any recovery are to be shared pro rata amongst all unsecured creditors of the bankrupt. Lastly, should a Trustee become aware of a cause of action and fail to take steps to preserve the claim within the prescribed limitation period, the ability for any creditors to proceed with the cause of action pursuant an application under section 38 of the BIA would be lost.

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