PROFESSIONALISM & ETHICS

Reference Materials

CQP Insolvency Tutorial

Fall 2017

Jane Dietrich

Cassels Brock & Blackwell LLP

INDEX

PROFESSIONALISM & ETHICS

Reference Materials

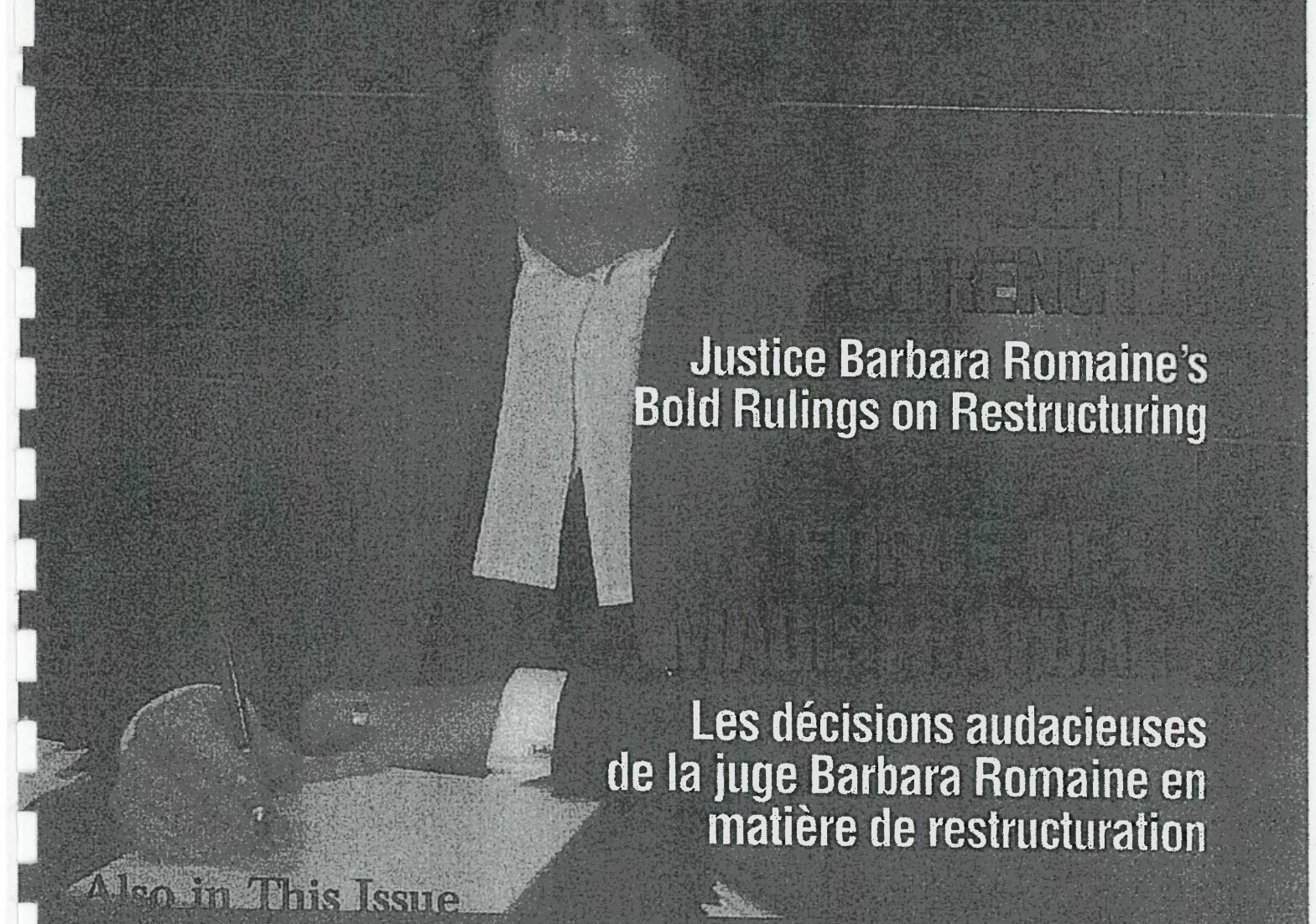
Jane Dietrich, Cassels Brock & Blackwell LLP

TAB 1

Spring 2011 Volume 10 Issue 1

Rebuilding Success

The official magazine of the Canadian Association of Insolvency and Restructuring Professionals
La publication officielle de l'Association canadienne des professionnels de l'insolvabilité et de la réorganisation



Justice Barbara Romaine's Bold Rulings on Restructuring

Les décisions audacieuses de la juge Barbara Romaine en matière de restructuration

Also in This Issue

Chair's Reflections

Réflexions du Président du Conseil

By Kevin Brennan, CA•CIRP, CIRP
Chair

Par Kevin Brennan, CA•CIRP, CIRP
Président du Conseil d'administration

What exactly is professionalism? The dictionary doesn't take us very far, referring only to "the methods, character, and status of a professional." That definition simply begs the question, what is a professional? I would argue that professionalism is the conduct of one's practice with due regard for the public interest. Further, professionalism requires a degree of passion as to the manner in which the service is provided to meet the objectives of the ultimate stakeholder.

It is crucial that CIRPs conduct their practices not only with the expertise required in the insolvency and restructuring field — and not only with attention to the bottom line — but with the public interest clearly in view. Such service must be delivered with passion and a quality that is above reproach. It is all about professionalism.

Much of the work that CAIRP does is devoted to maintaining, and indeed raising, the professionalism of our members. We have our Standards of Professional Practice, our Rules of Professional Conduct and our Mandatory Professional Development. We educate candidates in the CIRP Qualification Program about adherence to these standards and to the *Code of Ethics for Trustees* enshrined in the *Bankruptcy and Insolvency Act*. We demand of our members continued education and development to maintain professional aptitude.

But professionalism is not just about adherence to a static body of rules; it is a work in progress and a continuum that evolves — from day-to-day and circumstance-to-circumstance. As the business climate evolves, so must professionalism. For example, CAIRP promotes observance of its Standards and Rules through its Continuing Education programs; however, even these Standards and Rules must

Qu'entend-on exactement par professionnalisme? La définition du *Petit Robert* ne nous avance pas beaucoup : « Qualité d'une personne qui exerce une activité, un métier en tant que professionnel expérimenté ». En fait, cette définition renvoie simplement à la question de savoir ce qu'est un professionnel. Pour ma part, le professionnalisme m'apparaît comme étant la conduite d'une personne qui, dans l'exercice de ses fonctions, se préoccupe comme il se doit de l'intérêt public. En outre, le professionnalisme requiert une certaine dose de passion quant à la façon de fournir le service pour être conforme aux objectifs de l'intervenant ultime.

Il est capital que les CIRP/PAIR exercent leur profession non seulement avec l'expertise requise dans le domaine de l'insolvabilité et de la restructuration – et en ne se préoccupant pas uniquement du résultat (financier) – mais aussi avec le souci de l'intérêt public. Cette charge doit être exercée avec passion et avec une qualité irréprochable. Le professionnalisme, c'est tout ça.

L'ACPIR consacre le gros de ses efforts à assurer, voire à rehausser le professionnalisme de ses membres. Nous avons nos normes de pratique professionnelle, nos règles de conduite professionnelle et le Perfectionnement professionnel obligatoire. Nous formons les candidats au Programme de qualification des CIRP/PAIR concernant l'adhésion à ces normes et au *Code de déontologie des syndics* qui fait partie de la *Loi sur la faillite et l'insolvabilité*. Nous exigeons de nos membres une formation et un perfectionnement continus pour assurer le maintien de leur aptitude professionnelle.

Mais le professionnalisme ne se limite pas à respecter un ensemble de règles statiques. C'est un travail continu et une échelle de valeurs qui évolue avec le temps et en fonction des circonstances. Le climat d'affaires change et il en va de même du professionnalisme. Par exemple, l'ACPIR fait la promotion du respect de ses normes et règles par l'intermédiaire de

evolve to reflect new developments in the insolvency field and changing business practices. Furthermore, the Association does not hesitate to enact new Standards when and where appropriate. The three new Consumer Standards are the most recent example, with seven Standards of Professional Practice respecting commercial and corporate matters having been proclaimed in 2009.

CAIRP recently departed from its governance protocol and extended the timeline for discussion and debate of the Consumer Standards to ensure we got them right. We wished to strike the proper balance between the economics of a CIRP's practice and the needs of the consumer debtor — recognizing that where conflict exists between these two realities, we must always default to the needs of the consumer debtor.

Over the past number of weeks Guylaine Houle, Vice-Chair, and I have engaged several members in debate about the impact of the Consumer Standards on member practices and concerns expressed that these Consumer Standards will put trustees that are members of CAIRP at a competitive disadvantage with those trustees outside the Association. Some suggested that we defer proclamation of the Consumer Standards until the Superintendent has made a decision concerning third parties acting as Administrators of Consumer Proposals (ACP) — the thought being, I guess, that if less qualified individuals assume the role of ACP, then our members should not be held to a higher professional standard than those third parties; that the overall quality of service to the consumer debtor be lowered to the lowest common quality denominator, that of the third party, so as to create economic equality and thereby competitiveness.

Let's turn the tables on this thinking once and for all — the Consumer Standards, and, for that matter, all Standards proclaimed by the Association, provide our members a distinct

ses programmes de formation continue. Toutefois, même ces normes et règles doivent parfois être modifiées pour intégrer les nouveaux développements dans le domaine de l'insolvabilité et suivre l'évolution des pratiques. En outre, l'Association n'hésite pas à promulguer au besoin de nouvelles normes. Les trois nouveaux projets de normes de pratique professionnelle portant sur l'insolvabilité de consommateurs sont l'exemple le plus récent avec les sept nouvelles normes de pratique professionnelle en matière commerciale qui ont été adoptées en 2009.

L'ACPIR s'est récemment écartée de son protocole de gouvernance et a prolongé la durée de la discussion et du débat concernant les normes de pratique professionnelle portant sur l'insolvabilité de consommateurs pour s'assurer de leur bien-fondé. Nous souhaitons trouver le juste équilibre entre les aspects économiques de la pratique d'un CIRP/PAIR et les besoins du débiteur consommateur – en reconnaissant que lorsqu'il y a conflit entre ces deux réalités, nous devons toujours privilégier les besoins du débiteur consommateur.

Au cours des dernières semaines, la vice-présidente Guylaine Houle et moi-même avons engagé plusieurs membres dans un débat sur l'incidence des normes de pratique professionnelle portant sur l'insolvabilité de consommateurs sur la pratique des membres et les craintes que ces normes n'aient pour effet de défavoriser les syndics qui sont membres de l'ACPIR, par rapport à leurs concurrents qui n'adhèrent pas à l'Association. D'aucuns ont suggéré que l'on retarde la proclamation des normes jusqu'à ce que le surintendant ait pris une décision concernant les tiers agissant en tant qu'administrateurs de propositions de consommateur – l'idée étant, je suppose, que si des personnes moins qualifiées sont nommées en tant qu'administrateurs de proposition de consommateur, nos membres ne devraient pas être tenus de respecter une norme professionnelle plus élevée que ces tiers; que la qualité globale du service rendu aux débiteurs consommateurs devrait être ramenée au dénominateur commun le plus bas, celui du tiers, de façon à créer une égalité sur le plan économique et à restaurer la concurrence.

Permettez-moi de revenir sur cette idée une fois pour toutes. Les normes de pratique professionnelle portant sur l'insolvabilité de consommateurs, comme toutes les normes adoptées par l'Association, procurent à ses membres un avantage concurrentiel par rapport aux non-membres. En effet, les normes, entre autres avantages, renforcent la reconnaissance du professionnalisme, elles atténuent le profil de risque professionnel du syndic selon l'évaluation de l'organisme de réglementation et elles donnent les moyens d'expulser de l'Association les membres qui n'adhèrent pas à la norme attendue d'un professionnel. Pourquoi certains syndics en exercice (à l'exclusion des membres du personnel du BSF qui ne sont pas autorisés à adhérer à l'ACPIR) ne sont-ils pas membres de l'Association?

advantage over those trustees outside the Association. The Standards, amongst other advantages, enhance the recognition of professionalism, they mitigate the operating risk profile of a trustee when assessed by the regulator, and they provide a means to dismiss from the Association those members who do not adhere to the standard expected of a professional. Ask yourself why there are practising trustees (excluding the staff members of the OSB who are precluded from joining CAIRP) who are not members of the Association; the answer may be more evident than you think — the Association often does not want them as members.

As the OSB conducts its review of the Trustee Licensing Regulatory Framework, we have to send a strong signal to the regulator about the commitment of the Association and its members to professionalism. It is therefore vital that CIRPs raise the bar on performance well above that of other service providers to the consumer debtor marketplace; part of this entails proclaiming the Consumer Standards. Thankfully, those who wish to defer proclaiming the Consumer Standards are few in number and not representative of the vast majority of the membership. Based on comments received from the Provincial Presidents and individual members, the overwhelming majority of members support the Association enacting the Consumer Standards at the earliest possible date; it is these members who hold true to a belief in professionalism.

On September 15, 2010, CAIRP verbally presented its written submission (of August 31, 2010) to Superintendent James Callon and his senior staff, invoking the written words of preserving public trust in the system and maintaining the highest standards for those delivering services to the public. Our presentation promoted the qualities of trustees, providing an opportunity to showcase the confidence Parliament has demonstrated in the profession through legislation, including as the lead professionals acting under the *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act*, and the *Wage Earner Protection Program Act*. We as practitioners must never violate this trust.

Ultimately, what's good for the public will be good for the profession. Our focus should be on the consumer and less on the bottom line. What will it profit us to concentrate on minimizing costs (at the expense of quality or professional standards) and, in the process, lose our exclusivity, as the service provider to the insolvent consumer debtor, to less qualified and unregulated service providers? Self-interest, if pursued too narrowly, will eventually damage our profession's credibility as well as its profits.

La réponse est peut-être plus évidente que vous ne le pensez – souvent, c'est l'Association qui n'en veut pas.

Alors que le BSF procède à l'examen du cadre de réglementation des licences de syndic, il nous faut envoyer un signal fort à l'organisme de réglementation quant au souci de professionnalisme qui anime l'Association et ses membres. Il est par conséquent essentiel que les PAIR rehaussent encore la barre de l'excellence pour se démarquer des autres fournisseurs de services aux débiteurs consommateurs, ce qui implique la nécessité de proclamer les normes de pratique professionnelle portant sur l'insolvabilité de consommateurs. Heureusement, ceux qui veulent repousser la proclamation des normes sont peu nombreux et non représentatifs de la grande majorité de nos membres. En effet, d'après les commentaires reçus des présidents provinciaux et des membres eux-mêmes, une majorité écrasante de membres estiment que l'Association devrait promulguer le plus tôt possible les normes de pratique professionnelle portant sur l'insolvabilité de consommateurs. Ce sont ces membres qui ont vraiment foi dans le professionnalisme.

Le 15 septembre 2010, l'ACPIR a présenté oralement son mémoire écrit (datant du 31 août 2010) au surintendant des faillites, James Callon, et à ses cadres supérieurs, en faisant valoir que le mot d'ordre était de préserver la confiance du public dans le système et de maintenir les normes les plus élevées pour ceux qui assurent la prestation de services au public. Cette présentation nous a permis de mettre en évidence les qualités des syndics ainsi que de souligner la confiance que le Parlement a mise dans la profession en promulguant les lois, notamment le statut de professionnels de premier plan que nous accordent la *Loi sur la faillite et l'insolvabilité*, la *Loi sur les arrangements avec les créanciers des compagnies* et la *Loi sur le Programme de protection des salariés*. En tant que praticiens, nous ne devons jamais trahir cette confiance.

En définitive, ce qui est bon pour le public est bon pour la profession. Nous devons mettre l'accent sur le consommateur et moins sur les résultats financiers. À quoi servirait de chercher à tout prix à réduire les coûts (au détriment de la qualité ou des normes professionnelles) si cela doit nous faire perdre notre exclusivité en tant que fournisseurs de services aux débiteurs consommateurs insolvables, au profit de fournisseurs de services moins qualifiés et non réglementés? À poursuivre de trop près notre intérêt personnel, nous risquons de porter atteinte à la crédibilité de notre profession de même qu'à sa rentabilité.

Lorsque nous nous sommes engagés dans la voie menant à l'obtention de notre titre professionnel CIRP/PAIR (ou des titres qui l'ont précédée) ainsi que de la licence de syndic de faillite, c'était, pour la grande majorité d'entre nous, avec la conviction que nous pourrions avoir un impact réel dans la vie des gens, que nous répondions à un appel plus noble que le simple désir de nous assurer un bon niveau de vie. J'estime qu'il

When we started down the path of obtaining our CIRP (or the predecessor certifications) and licence as a trustee in bankruptcy, the vast majority of us did so with a belief that we could make a difference in someone's life, that we were assuming a more noble calling than simply achieving a good standard of living. For some of our members, a reminder of this noble calling is in order, as to be overly pre-occupied with the bottom line, at the expense of quality, is to threaten the existence of the profession.

When I and the rest of the CAIRP Executive meet with Jim Callon and his senior team, we discuss the many issues facing the profession, including the challenges posed by the regulator. What is apparent from all of these discussions is that the solution for these challenges is often very simple: raise the bar of professionalism. The concerns of the OSB are real (although limited to the few) and must be addressed. The OSB openly states its concern about trustees who treat the consumer debtor as if he or she is being run through a car wash (washing the outside clean of debt, but doing little to nothing to make a difference to the interior). This is not a flattering image for a certification and a licence that require so much education and perseverance to achieve.

The OSB's Trustee Licensing Framework Review is but one opportunity for the Association to set out and differentiate the credentials, experience and professionalism of its members from all others who service, or seek to service, stakeholders within the insolvency and restructuring field. While it's *necessary* for individual CIRPs to keep their own practices above reproach, it is not *sufficient*. We have a duty to maintain the integrity of the profession that extends beyond our own practices; professional rights carry professional responsibility. We also have a responsibility to re-direct those who have lost focus on the true calling of the profession.

It is time to use the strength of the membership, with the support of the Association, to rid the profession of those who threaten its very existence. We as practitioners need to stop talking about those who take inappropriate procedural shortcuts and lack the professionalism expected of a CIRP, and *take responsibility* to end these practices. Article 73.01 of CAIRP's Bylaws imposes an obligation on every member who becomes aware of any apparent breach of the bylaws, the Rules of Professional Conduct or Standards, or any instance involving or appearing to involve doubt as to the competence, reputation or integrity of a member, to forthwith bring the matter to the attention of the Association.

In addition to filing a complaint with the Association or volunteering to investigate a complaint filed by a fellow member or other third party, it is also appropriate for members to report

importe de rappeler ce noble idéal à certains de nos membres, car à trop nous préoccuper des résultats financiers, au détriment de la qualité, c'est l'existence même de la profession que nous mettons en péril.

Lorsque les membres de la direction de l'ACPIR et moi-même rencontrons Jim Callon et son équipe de cadres supérieurs, nous discutons des nombreux enjeux pour la profession, et notamment des problèmes soulevés par l'organisme de réglementation. Ce qui ressort de toutes ces discussions, c'est que la solution à ces problèmes est souvent très simple : rehausser la barre du professionnalisme. Les préoccupations du BSF sont réelles (même si elles ne concernent qu'une poignée d'entre nous) et il convient d'en tenir compte. Le BSF se préoccupe ouvertement du fait que certains syndics traitent les débiteurs consommateurs comme les clients d'un lave-auto (le lavage de la voiture étant assimilé à l'épuration des dettes sans que rien ne soit fait, ou très peu, pour nettoyer l'intérieur ou corriger le problème de fond). Ce n'est pas une image très flatteuse, étant donné que l'obtention du titre et la licence exigent tant d'années d'études et de persévérance.

L'examen du cadre de licence des syndics n'est rien de moins qu'une occasion pour l'Association de se faire valoir et de se démarquer, grâce aux titres de compétence, à l'expérience et au professionnalisme de ses membres par rapport à tous ceux qui assurent un service ou cherchent à assurer un service aux intervenants du domaine de l'insolvabilité et de la restructuration. Bien que les CIRP/PAIR soient *tenus*, à titre individuel, de maintenir une pratique irréprochable, ce n'est pas *suffisant*. Nous avons l'obligation de maintenir l'intégrité de la profession, ce qui va au-delà de l'exercice de notre profession à titre individuel; qui dit « droits professionnels » dit aussi « responsabilité professionnelle ». Nous avons également la responsabilité de remettre sur la bonne voie ceux qui ont perdu leur idéal professionnel.

C'est le moment ou jamais d'utiliser la force de nos adhérents, avec l'appui de l'Association, pour évincer de la profession ceux qui menacent son existence même. En tant que professionnels, nous devons *cesser de médire* de ceux qui prennent des libertés avec la procédure et manquent du professionnalisme qu'on attend d'un CIRP/PAIR et *prendre nos responsabilités* afin de mettre fin à ces pratiques. L'article 73.01 des règlements de l'ACPIR impose à tout membre qui prend connaissance d'une violation apparente des règlements, des règles de conduite professionnelle ou des normes de pratique professionnelle ou encore d'un cas qui soulève ou semble soulever un doute sur la compétence, la réputation ou l'intégrité d'un membre, l'obligation de porter la question à l'attention de l'Association.

En plus de porter plainte à l'Association ou de se porter volontaire pour faire enquête sur une plainte déposée par un confrère ou une autre partie, il est également pertinent que les membres signalent au BSF les violations au *Code de déontologie des syndics*. Ceux qui

breaches of the Code of Ethics to the OSB. Those who threaten the profession deserve no sympathy or respect. If we neglect to deal with them, we can be sure the regulators will act aggressively to fill the vacuum — and in a manner that may not be welcomed by our members.

We as a profession are lucky that the vast majority of our members hold true to the concept of professionalism and that these same members remember why they entered the profession. Serving the public, whether as a consumer or corporate practitioner, during a period of financial crisis is a noble calling. Being a financial healer is why we do what we do — let's never forget that. RS

nuisent à la profession ne méritent ni notre sympathie ni notre respect. Si nous ne prenons pas la peine de nous occuper de leur cas, il ne fait aucun doute que les organismes de réglementation prendront les moyens de combler le vide – et d'une manière qui pourrait bien ne pas plaire à nos membres.

En tant que corps professionnel, estimons-nous heureux que la grande majorité de nos membres adhèrent au concept de professionnalisme et qu'ils se rappellent pourquoi ils ont embrassé notre profession. Servir le public, que ce soit en qualité de professionnel exerçant auprès des consommateurs ou des entreprises, au cours d'une période de crise financière, est une noble entreprise. Aider les gens à se sortir des difficultés financières est notre raison d'être – ne l'oublions jamais. RS

TAB 2

Ethics and Conflicts, The Role of Insolvency Professionals in the Integrity of the Canadian Bankruptcy and Insolvency System

Prepared by

Dr. Janis Sarra, Assistant Dean and Associate Professor
University of British Columbia – Faculty of Law

Prepared for the Insolvency and Restructuring Forum of
Canadian Association of Insolvency and Restructuring Professionals
May 2004

May 2004

Ethics and Conflicts, The Role of Insolvency Professionals

In the Integrity of the Canadian Bankruptcy and Insolvency System

April 2004

Janis Sarra[1]

Introduction

For almost a century, Canadian insolvency professionals have enjoyed relatively high confidence of creditors and legislators in their multiple and diverse roles in the insolvency and bankruptcy system. They draw their authority from the *Bankruptcy and Insolvency Act (BIA)* and the *Companies' Creditors Arrangement Act (CCAA)*.[2] Insolvency practice involves a balance between adherence to rules of ethical conduct and the avoidance of conflicts of interest, and the need to find cost effective methods of debt collection or restructuring under the statutory regime.

In the past two years, in both commercial insolvency and personal insolvency, trustees, monitors, receivers, accountants and other insolvency professionals have witnessed a decline in the public's confidence in their professionalism. Sparked primarily by the corporate failures in the United States and consequent regulatory action, Canada has not experienced the same type of scandal or accounting failures, yet it faces the same challenges regarding the public's concern about independence. Some publicly profiled events have also contributed to an overall perception of the accounting profession, including:

- A bankruptcy trustee in Québec was charged with fraud, alleged to have taken $1.25 million from trust accounts over the past 11 years;[3]

- A monitor files its own factum taking adverse legal positions in *CCAA* proceedings, appearing more as a party to the *CCAA* proceeding than a neutral, court-appointed officer;[4]

---

[1] Dr. Sarra is Assistant Dean and Associate Professor, Faculty of Law, University of British Columbia, Canada.

My sincere thanks to Jean-Daniel Breton and to another friend who is my "best critic" for their detailed and thoughtful comments and to Roger Burgon for reviewing the draft of this paper. Thanks also to Sarah Jones (UBC Law II) for assisting with footnote citation checking and to Dave Stewart of the Office of the Superintendent of Bankruptcy for helpful historical and statistical information. Any errors are my own.

[2] *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (hereinafter *BIA*) and the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (hereinafter *CCAA*).

[3] "Bankruptcy Trustee Charged with Fraud", Montreal Gazette (9 December 2003).

- Arthur Andersen LLP was fined $500,000 for obstruction of justice in the Enron case when it shredded documents relevant to the SEC investigation of Enron; it settled the first shareholder suit for $40 million; and its global accounting empire of 85,000 employees (including its Canadian operation) dissolved in the wake of the scandal;[5]

- Public commentary by bankers, trade suppliers and other creditors that the auditor should not be the monitor in a *CCAA* workout because of conflicts of interest;

- Full-page yellow page ads and television ads represent the bankruptcy trustee as an advocate for the debtor, instead of making clear that the trustee's obligation as an officer of the court is to ensure that the objectives of the *BIA* are met, including balancing the interests of creditors in maximizing recovery and protecting the rights of the debtor in the rehabilitation process.[6]

- Critiques by two leading academics have labelled trustees as self-serving in the bankruptcy reform process.[7]

These represent substantive issues facing insolvency professionals in terms of ethics and perceived or actual conflicts of interest. They are also illustrative of issues of public perception of the role of insolvency professionals. Two types of conflicts can arise, the first is where the insolvency professional has a direct conflict of interest, in that accounting fees may be owed or there may have been a professional or personal relationship with the debtor that gives rise to a conflict.[8] The second type of conflict arises where the professional is performing multiple roles in one insolvency proceeding, such as privately-appointed receiver and court-appointed trustee.

---

[4] See for example, Factum of the Monitor, *In the Matter of the Companies' Creditors Arrangement Act and in the Matter of the Plan of Compromise or Arrangement of Ivaco Inc.* (27 February 2004).

[5] "Andersen Fined $500,00 for Obstruction of Justice in Enron case", NewsMax.com Wires, (17 October 2002); Mary Flood, "Andersen Branches to Settle for $40 Million", Houston Chronicle (24 July 2003). While not all trustees are accountants, the public frequently views them as the same professionals and hence any problems or misconduct can add to the overall public perception.

[6] While the traditional view is that trustees are acting in the interests of creditors, there is indication in the *BIA* that the trustee must also consider the interests of the debtor; see for example, section 68 requiring the trustee to take into consideration the family situation of the bankrupt in determining earnings contributions; section 170 and 170.1 where the trustee prepares its report and recommendation on the discharge process and the Part III proposal provisions, in which the trustee is to assist the debtor in devising a proposal.

[7] Iain Ramsay, "Interest Groups and the Politics of Consumer Bankruptcy Reform in Canada", (2003) 53 University of Toronto Law Journal 379. See also the critique of Professor Jacob Ziegel, *infra*, note 115.

[8] Rule 4 of the Rules of Professional Conduct of the Canadian Association of Insolvency and Restructuring Professionals (CAIRP) specifies that a member, when engaged in an assignment, shall be free of any influence,

Recently, the Standing Senate Committee on Banking, Trade and Commerce recommended that the *BIA* and *CCAA* be reviewed in order to identify and eliminate opportunities for insolvency practitioners to have real or perceived conflicts of interest, including calling for federal guidelines on professional conduct, conflicts of interest and disclosure of business and legal relationships with the debtor. It also recommended that the auditor of the debtor should not be permitted to be monitor and that in the event of a failed restructuring, the monitor should not be permitted to become the trustee or a receiver for a secured creditor. The Senate Committee recommendations raise the question of whether there is a problem with professional ethics and conflicts of interest such that the government needs to legislate further in personal and commercial insolvency. Do the multiple roles of bankruptcy trustees create insurmountable conflicts in consumer bankruptcy? Would a prohibition on the auditor serving as monitor adequately address current ethical issues in *CCAA* workouts?

New rules under the *Sarbanes-Oxley Act* have also created fresh challenges and liability risks for accounting firms. These risks are both in terms of perceptions of independence and the risk of violating new independence rules within the meaning of recent U.S. statutory requirements. For example, PricewaterhouseCoopers LLP (PWC) resigned as one of the auditors of Royal Bank of Canada (RBC) because it may have contravened new U.S. rules by taking on a RBC unit as a client for non-audit services.[9] It had to forgo millions in audit work from $200,000 in non-audit services performed.[10]

Ethics has been defined as a set of moral principles or values, a guiding philosophy or the principles of conduct governing an individual or a professional group.[11] For Canadian insolvency professionals, the guiding philosophy is in part governed by a statutory and professional standard of care. The standard of care for trustees and receivers is to act with integrity and within the law at all times, to act honestly and in good faith in dealings with all parties, and to deal with the estate assets in a commercially reasonable manner.[12] A framework for a code of ethics for trustees was enacted as part of the *Bankruptcy and Insolvency General Rules*, which applies to all licensed trustees whenever an estate is administered by a trustee, pursuant to provisions of

---

interest or relationship that impairs professional judgment or objectivity or which, in the view of a reasonable and informed observer, has that effect. http://www.cip.ca/english/aboutcipa/pcrules.html.

[9] "PWC resigns as RBC Auditor" The Globe and Mail (23 September 2003).

[10] *Ibid.*

[11] Merriam-Webster Online Dictionary. http://www.m-w.com/cgi-bin/dictionary?book=Dictionary&va=ethics.

[12] Section 13.5, *BIA*; Canadian Association of Insolvency and Restructuring Professionals Standards of Professional Practice and Rules of Professional Conduct, http://www.cairp.ca.

the *BIA*.[13] The regulations specify that every trustee shall maintain the high standards of ethics that are central to the maintenance of public trust and confidence in the administration of the *BIA*.[14] Trustees are to perform their duties in a timely manner, with competence, honesty, integrity and due care; are to act in an honest and impartial manner, providing full and accurate disclosure of information as required by the *BIA*; and are to avoid any influence, interest or relationship that impairs, or appears in the opinion of an informed person to impair, their professional judgment.[15] The Canadian Association of Insolvency and Restructuring Professionals (CAIRP) Rules of Professional Conduct for insolvency professionals specify that members are to perform services with integrity and care, free of influence and interest.[16] Canadian insolvency professionals are also governed by professional codes of ethics, through their accounting and insolvency professional associations. However, ethics is arguably broader than a statutory standard of care, it speaks to the principles or values that drive the professional's conduct, particularly in situations where there is a potential conflict of interest. There is also some indication that professionals are guided by their own behavioural and cultural norms both in perceiving conflicts and in responding to them.

How the insolvency community deals with these conflicts may influence daily practice and long-term planning for the profession. This paper canvasses some of the issues facing insolvency practitioners, both in perceived and actual conflicts of interest. It touches on aspects of both commercial and personal (consumer) insolvency and bankruptcy. At the heart of real or perceived conflict issues is often the need for the debtor to resolve his, her or its financial distress. Given that resources are limited, frequently a single insolvency practitioner appears the most economically efficient strategy for dealing with a single or multiple creditors.[17] The costs of insolvency professionals are significant because of the financial distress of the debtor, whether the insolvency or bankruptcy is personal or commercial. In the personal insolvency context, the trustee in bankruptcy or proposal trustee is to consider the interests of the creditors generally and this may not always be clear to the debtor. In the commercial insolvency context, a single trustee, monitor or receiver can prove an optimal strategy, particularly where there is a successful going

---

[13] Sections 34 to 53. *Bankruptcy and Insolvency General Rules*, C.R.C. 1978, c. 368; DORS/SOR/98-240. Previously, this was covered by Rules 54.3 - 54.49, DORS/SOR/95-463, enacted by P.C. 1995-1607, *Canada Gazette*, Part II, October 18, 1995 at 2761-2766, amending the *Bankruptcy and Insolvency Rules*, C.R.C. 1978, c. 368, which was subsequently replaced by sections 34 to 53.

[14] Section 34, *ibid.*

[15] Sections 36, 39 and 44, *ibid.*

[16] Rules 2 and 4, *supra*, note 8.

[17] As discussed below, there is a live issue as to whether two or more insolvency professionals would be more effective than one, particularly in commercial insolvency.

forward strategy devised. However, numerous conflicts can arise at multiple stages of the process, and this paper begins to explore whether or not these serve as barriers to the effective administration of the insolvency and bankruptcy system.

Part I briefly examines the recommendations of the Standing Senate Committee on Banking Trade and Commerce that touch on the role of insolvency professionals in Canada. Part II examines the role of professionals in commercial insolvencies, including the ongoing debate regarding whether the auditor can or should be the monitor in a *Companies' Creditors Arrangement Act* proceeding. Drawing on the example of the treatment of trustees under the *Bankruptcy and Insolvency Act*, the paper suggests that not enough attention has been focused on the harm sought to be remedied in thinking about this question. Part III then turns to issues arising in personal bankruptcy, exploring a host of conflicts concerns that range from advertising norms to fundamental questions for the profession. Part IV examines some of the recent regulatory changes in the United States in terms of the accounting profession and discusses the potential impact on the accounting profession in Canada. The paper is intended to spark discussion, as opposed to generating answers to these challenges.

I. The Recommendations of the Senate Committee

The Canadian Standing Senate Committee on Banking, Trade and Commerce issued its report on reform of the *Bankruptcy and Insolvency Act (BIA)* and the *Companies' Creditors Arrangement Act (CCAA)* in November 2003 after months of public hearings and deliberations. The Senate Committee made a series of recommendations regarding the role of monitors, trustees and other insolvency professionals.[18] It is helpful to start with these recommendations as they are likely to frame the debate regarding professional ethics in the next round of legislative reform expected in late 2004 or early 2005. In particular, the Senate Committee focused on the conflicts issue that may arise because of the multiple roles of insolvency professionals. It reported that:

> The Committee is firmly of the opinion that roles and responsibilities that would create conflicts of interest- whether real or perceived – for trustees, monitors or other insolvency practitioners must be avoided. If other stakeholders perceive these individuals to be in a position of conflict, then their faith in the integrity of our insolvency system and their sense of fairness in the process are reduced.

---

[18] *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and Companies' Creditors Arrangement Act*, Report of the Standing Senate Committee on Banking, Trade and Commerce (November 2003).

> While this occurrence has negative implications for Canadian stakeholders, the effects extend to foreign investors and thereby to the Canadian economy. The insolvency system in Canada must be – and must be seen to be- fair and transparent.[19]

In respect of the role of insolvency professionals, the Senate Committee recommended that:

> 48. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be reviewed in order to identify and eliminate any opportunities for the roles and responsibilities of insolvency practitioners to place them in a real or perceived conflict of interest. Moreover, in order to ensure that all practitioners fulfil their duties with a high level of integrity, the federal government should adopt guidelines for insolvency practitioners regarding professional conduct and conflicts of interest, expanding upon Rules 34 to 53 of the *Bankruptcy and Insolvency Act* where appropriate.[20]

In respect of governance, the Senate Committee recommended the following:

> 35. The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit the Court to replace some or all of the debtor's directors during proposals or reorganizations if the governance structure is impairing the process of developing and implementing a going concern solution. Moreover, prior to appointment, a trustee/monitor should disclose, to the Court, any business and legal relationships it has or has had with the debtor. The auditor or recent former auditor of the debtor should not be permitted to be monitor. Furthermore, the monitor should not be permitted, in the event of a failed restructuring, to become the trustee or a receiver for a secured creditor.[21]

The Senate Committee's reasoning was that all officers of the court involved in proceedings under the *BIA* or the *CCAA* should act in a manner characterized by good faith, competent

---

[19] *Ibid.* at 186.

[20] *Ibid.* at 185. Rule 34 of the Code of Ethics specifies that every trustee shall maintain the high standards of ethics that are central to the maintenance of public trust and confidence in the administration of the Act. Rule 35 specifies that for the purposes of sections 39 to 52, "professional engagement" means any bankruptcy or insolvency matter in respect of which a trustee is appointed or designated to act in that capacity pursuant to the Act.

[21] *Ibid.* at 150.

execution of their duties and freedom from real or perceived conflicts of interest.[22] It called for disclosure of any circumstances that could be construed as a conflict of interest. The Senate Committee also suggested that behaviour consistent with these standards would generate fairness, predictability and transparency, and would increase the confidence of both domestic and international stakeholders in the integrity of the bankruptcy system.[23]

Finally, in respect of insolvency professionals, the Senate Committee recommended that the *BIA* be amended to clarify the role of interim receiver and the duration and meaning of the word "interim". It further recommended that the definition of receiver be amended to include interim receivers when they operate in a manner similar to court-appointed receivers.[24]

II. Commercial Insolvency and bankruptcy and the Role of Insolvency Professionals

In 2003, there were 111,415 reported bankruptcies and proposals in Canada, including both commercial and consumer insolvency. 8,844 of these were commercial bankruptcies.[25] There were 2,920 commercial proposals out of a total of 18,320 proposals under the *BIA*, where debtors successfully secured the support of creditors in a workout plan.[26] In 2003, there were 785 privately appointed receivers and 82 court-appointed receivers reported.[27] Hence, 900 licensed trustees in Canada deal with more than 100,000 financially distressed debtors each year and many more creditors whose claims are at risk in the insolvency or bankruptcy. The volume of cases, the interaction with stakeholders and the public policy objective of maintaining public trust in the integrity of the system all indicate why conflicts and ethics issues are so important.

In respect of commercial insolvency or bankruptcy, there are similar conflict issues for trustees, receivers and monitors, although there are also significant differences given the highly codified *BIA* and the considerably less codified *CCAA*. The role of the trustee under the *BIA* is to assess the debtor's financial affairs and property; evaluate the cause of financial distress and the nature and extent of the problems facing the debtor; review the options for dealing with the distress,

---

[22] *Ibid.* at 150-151.

[23] *Ibid.* at 151.

[24] *Ibid.* at 145.

[25] Office of the Superintendent of Bankruptcy Canada, *Annual Statistical Report, 2003*, http://osb-bsf.gc.ca at Tables 1 and 3.

[26] *Ibid.* at Table 4.

[27] *Ibid.* at Table 6.

including bankruptcy and proposals; and assist the debtor in choosing an appropriate option.[28] However, the trustee is also to act in the interests of creditors, creating the potential for conflict at the outset in the relationship with the debtor. Thus while the trustee is a fiduciary, its fiduciary obligations are to multiple parties with conflicting interests, timelines and goals. The creditors' ability to confirm the appointment of the trustee at the first creditors' meeting does act as an initial check on the trustee's impartiality,[29] however, this assumes no information asymmetries and the sophistication of the parties. It also does not address the perception problem in terms of the debtor's impression of the trustee's obligations.

One of the potential areas of conflict occurs because of multiple hats or shifting hats worn by insolvency professionals. A professional serving in more than one capacity can be more efficient in increasing timeliness and reducing costs of professional services. Timeliness is absolutely key to the commercial insolvency process because value may be rapidly eroding and action must be taken expeditiously to preserve any value in the company. The professional may be advising a debtor corporation prior to entering insolvency proceedings about the best course of action, as well as answering directors' questions regarding ongoing liability for a host of statutory liabilities. While the professional should not be answering questions regarding the directors' personal liability and instead should be advising them to consult their own counsel, the financial reality of the smaller, financially distressed company in which directors are also the major stakeholders is that there may not be resources for such independent advice. In such a case, the directors may not fully understand that the client is the debtor corporation and that their interests at the point of financial distress may not completely align. Best practice would suggest that the directors be advised to seek independent legal advice or retain their own legal counsel, and in some instances their own accounting professional. Transparency would suggest that any advice given to directors and officers be in writing and that they signal informed consent in return. However, there may not be resources to retain separate insolvency professionals, leaving the professional with some pressure to provide advice to corporate officers as well as to the entity itself. This occurs in small commercial insolvencies. Moreover, the professional may then be named by the debtor as monitor or proposal trustee. While its fees in preparation of the filing have been sanctioned by the courts, the issue is whether undertaking the preparation has resulted in the monitor becoming too closely aligned with the debtor, posing a potential conflict of interest in the workout process. The CAIRP Rules of Practice specify that at the time of appointment, disclosure of any prior

---

[28] Directive 6R, Superintendent of Bankruptcy Canada. http://osb-bsf.gc.ca; section 66.13 of the *BIA* with respect to individual debtors; and sections 50(5) and 50.5 of the *BIA* with respect to commercial insolvencies.

[29] Section 102(5). *BIA*.

relationship to the debtor is necessary and best practice.[30] Where the insolvency professional is acting for multiple parties, this needs to be made very transparent, including signalling the limits of this multiple role in terms of lack of confidentiality, the course of action in the event of conflict of interest, and advising parties to seek independent legal advice.

In both personal and commercial insolvency or bankruptcy, the insolvency professional will always face the potential for conflicts of interest or the perception of conflict. This is because the interests of debtors and creditors frequently diverge. Moreover, the interests of different creditors can diverge more than converge. One example is the recent entry of distressed debt lenders in insolvency proceedings, whose interest in a viable workout or liquidation can be very different from that of trade suppliers who may have a strong interest in the long-term viability of the debtor corporation. The role of the insolvency professional is to be aware of these converging and diverging interests, and to manage any conflicts by balancing the various interests, as opposed to acting as advocate for one party. It may be that the insolvency professional should be required to expressly communicate to the debtor and to creditors in its original communication that the officer has an obligation to all interested stakeholders and to the court.

A. The Role of the Monitor in *CCAA* Proceedings

The *Companies' Creditors Arrangement Act* has emerged as the principal restructuring statute for large corporations. Under the *CCAA*, the monitor, as a court-appointed officer, is to represent all stakeholders in monitoring the debtor's affairs during the proceeding and providing opinions to the court. The monitor's fees are paid for out of the assets of the debtor corporation on a priority basis, and the courts have justified the exercise of their discretion to order this security of payment because the monitor is an officer of the court.[31] The introduction of the monitor in *CCAA* proceedings was in part a Canadian response to the U.S. practice of having creditors' committees in Chapter 11 workouts, with the company paying for counsel and financial advisors of the creditors, a practice that was viewed as often highly confrontational and expensive. The monitor, as an officer of the court, could provide independent observation and oversight of the debtor's activities during the *CCAA* proceeding, providing an accountability check for creditors without the

---

[30] Rules of Professional Conduct and Interpretation, Canadian Association of Insolvency and Restructuring Professionals, online: Http://www.cairp.ca.

[31] *Starcom International Optics Corp., Re* (1998), 3 C.B.R. (4th) 177, [1998] B.C.J. No. 506; *Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 43, 109 N.S.R. (2d) 12; *Canadian Asbestos Services Ltd. v. Bank of Montreal* (1992), 16 C.B.R. (3d) 114, [1992] G.S.T.C. 15, 11 O.R. (3d) 353.

time and expense of a creditors' committee. Given the independent role envisioned, in some instances the company's outside auditor acted as monitor.

Yet a key issue is whether the auditor of a debtor corporation can serve as monitor. While in both theory and in law, the financial statements of the company are the work product of the company and its officers, with the auditor providing only an opinion on the financial statements, the reality is frequently different. A company's auditor, while formally having an arm's length role in auditing the financial records of the company, in reality, frequently works closely with corporate officers. The auditor's views can heavily influence the work of the company in financial reporting. In other cases, a controlling or managing shareholder may push the auditor to see the statements its way, resulting in "auditor capture". Close relationships can develop between external auditors and corporate officers, particularly where the audit partner is not rotated every few years.

In the past five years, roughly 25% of *CCAA* proceedings involved a monitor that had been the auditor of the debtor corporation, primarily occurring in smaller and mid-market workouts.[32] Are there inherent conflicts in performing both of these roles? Unlike the *Bankruptcy and Insolvency Act*, which generally excludes the auditor or accountant of a debtor from acting as its trustee in bankruptcy in a liquidation proceeding, there is no similar statutory provision under the *CCAA*. In fact, it is quite the opposite. Section 11.7 of the *CCAA* specifies that the monitor is appointed to monitor the business and affairs of the debtor, and expressly notes that the auditor may be appointed as monitor:

> 11.7 (1) Court to appoint monitor- When an order is made in respect of a company by the court under section 11, the court shall at the same time appoint a person, in this section and in section 11.8 referred to as "the monitor", to monitor the business and financial affairs of the company while the order remains in effect.
>
> (2) Auditor may be monitor- Except as may be otherwise directed by the court, the auditor of the company may be appointed as the monitor.

The role of monitor was codified in 1997, reflecting the growing practice of appointing monitors in *CCAA* proceedings and based on recommendations of the Task Force studying the *CCAA*. The Task Force suggested that mandatory appointment of a monitor would give creditors in *CCAA* applications the protection of a professional and impartial "watchdog", similar to the protection

---

[32] Industry Canada Statistics. More recent statistics suggest that this number is closer to 1/3.

provided by the proposal trustee under a Part III *BIA* proposal proceeding.[33] Prior to codification, the practice of appointing monitors or interim receivers as they were sometimes referred to, was aimed at monitoring the supervision and affairs of the corporation during the workout process.[34] The appointment of a monitor was initially driven by creditors seeking enhanced disclosure from debtor corporations during *CCAA* proceedings, as a means of reducing transaction costs associated with court appearances in disputes regarding the scope and timing of financial disclosure.

Although initially creditors sought the appointment of a monitor to protect their interests, the practice evolved that the debtor corporation proposed a monitor on its initial application. While this was likely an attempt to assert some control over the choice of monitor, it opened the door to criticism that the monitor is not as independent as required for a successful *CCAA* workout.

The duties of the monitor are also set out in section 11.7 of the *CCAA:*

> 11.7(3) Functions of the monitor – The monitor shall
>
> (a) for the purposes of monitoring the company's business and financial affairs, have access to and examine the company's property, including the premises, books, records, data, including data in electronic form, and other financial documents of the company to the extent necessary to adequately assess the company's business and financial affairs;
>
> (b) file a report with the court on the state of the company's business and financial affairs, containing the prescribed information,
>
> (i) forthwith after ascertaining any material adverse change in the company's projected cash-flow or financial circumstances,
>
> (ii) at least seven days before any meeting of creditors under section 4 or 5, or
>
> (iii) at such other times as the court may order;
>
> (c) advise the creditors of the filing of the report referred to in paragraph (b) in any notice of a meeting of creditors referred to in section 4 or 5; and
>
> (d) carry out such other functions in relation to the company as the court may direct.

---

[33] *Report of the Task Force on the CCAA to the Bankruptcy and Insolvency Advisory Committee Working Group on Commercial Reorganizations, Bankruptcies and Receiverships*, 1994 at 3.

[34] *Re Northland Properties Ltd* (1988), 73 C.B.R. (N.S.) 175; *Re United Co-Operatives of Ontario* (August 1984), unreported.

As originally conceived, the monitor had a relatively narrow monitoring and reporting function to the court and creditors, in its monitoring of the business and financial affairs of the debtor corporation. When the role of monitor was codified in 1997, the language of the statute reflected this role. The monitor is a court-appointed officer, and thus is to act in the best interests of all of the stakeholders in the process. The monitor is precisely as its name suggests, it is appointed to monitor the debtor during the proceeding, to ensure that the debtor does not engage in any conduct that will prejudice the interests of the creditors and other stakeholders. The monitor can serve as a stabilising force in the sense of reassuring creditors because it is monitoring the debtor's business and affairs, projected cash flow and appropriate use of assets and is monitoring managerial conduct in the operation of the business during the stay period. Given the limited size of the Canadian market of insolvency professionals and the less litigious legal culture in Canada than in the United States, there has also developed a level of trust among professionals that serve as monitors and the creditors that are repeat players in insolvency proceedings. This can facilitate proceedings and enhance the effectiveness of the monitor. Equally, however, the monitor must be cognisant of the fact that for stakeholders that are new to the process, the trust and co-operation among repeat players can create a perception of bias. The monitor must be scrupulous in fulfilling its obligation to consider and balance the interests of all stakeholders.

The role of monitor has been continually evolving. Monitors increasingly navigate the debtor through the complexity of the *CCAA* process, providing business judgment, negotiation skills and financial advice. The monitor can act as mediator or facilitator, bringing the parties together in an effort to build consensus on a viable going forward business plan. In some cases, the monitor has developed the plan of arrangement. The monitor makes judgment calls on levels of disclosure to creditors and timing of that disclosure and increasingly takes positions on disputes before the court during the *CCAA* proceeding. These multiple roles may be needed, yet the issue is whether they create a real or perceived conflict with the obligation of the monitor to monitor the debtor on behalf of all stakeholders.

B. What Lessons Can Be Drawn from the Limitation on the Auditor as Trustee in Bankruptcy?

Although the rhetoric used by insolvency practitioners is frequently that there is a prohibition on the auditor or accountant acting as trustee in bankruptcy, the precise language of the *BIA* is not

an absolute prohibition.[35] Rather it is a presumption that the auditor cannot act without express permission of the court.

Section 13.3(1) of the *BIA* specifies:

> 13.3(1) Where trustee is not qualified to act – Except with the permission of the court and on such conditions as the court may impose, no trustee shall act as trustee in relation to the estate of a debtor
>
> (a) where the trustee is, or at any time during the preceding two years was,
>
> .....
>
> (iv) the auditor, accountant or solicitor, or a partner or employee of the auditor, accountant or solicitor, of the debtor;....

Section 13.3(1) was aimed at preventing conflicts of interest, responding to a series of judgments in which the court held that it is improper for affiliated parties to become the trustee.[36] In 1986, the *Report of the Advisory Committee on Bankruptcy and Insolvency* recommended that the debtor corporation's auditors and accountants should be expressly prohibited from acting as a trustee, interim receiver or receiver of the debtor because of the inherent conflicts of interest.[37] The conflicts arose due to tension between the need for confidentiality in the audit or accounting relationship and the need for disclosure in the trustee and receiver roles.[38] Yet instead of

---

[35] Note however that the Interpretations to Rule 4 of the Rules of Professional Conduct of the CAIRP make it an absolute prohibition to act in any appointment under the *BIA*, except as an inspector, where the member was the auditor or accountant of the debtor in the preceding 2 years; see www.cairp.ca/english/aboutcipa/pcrules.html. As well, certain of the Code of Ethics of Chartered Accountants create a similar prohibition. For example, see section 31 of the Code of Ethics of Chartered Accountants of Québec (www.ocaq.qc.ca/pdf/ang/2_protection/code_of_ethics.pdf), although a new draft regulation amending the Code of Ethics of Chartered Accountants in Québec, published for consultation in the *Gazette officielle du Québec* on March 31, 2004 proposes repealing section 31.

It should be noted that the codes of ethics of chartered accountants are incorporated by reference in the Rules of Professional Conduct of the CAIRP, such that a CAIRP member, whether or not he or she is a chartered accountant, must abide by the Code of Ethics of the Order or Institute of Chartered Accountants applicable in the province of residence of the CAIRP member, and in the province in which an insolvency assignment is carried out (see in this respect, Rule 13 of the CAIRP Rules of Professional Conduct at http://www.cip.ca/english/aboutcipa/pcrules.html). My thanks to Jean-Daniel Breton for pointing this out.

[36] *Re Walter W. Shaw Co.* (1922), 16 Sask. L.R. 275, 68 D.L.R. 616, 3 C.B.R 198, [1922] 3 W.W.R. 119 (K.B.); *Re Erie Gas Co.* (1938) 20 C.B.R. 14, [1938] O.J. No. 227 (Ont. S.C.); and *Tannis Trading Inc. v. Camco Food Services Ltd.* (Trustee of) (1988), 67 C.B.R (N.S.) 1, 63 O.R. (2d) 775, 49 D.L.R. (4th) 128 (S.C.).

[37] Canada, *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency*, (Ottawa: Minister of Supply and Services Canada, 1986) at 5, 47.

[38] For historical reasons, the auditors' codes of ethics provide for an obligation to maintain the confidentiality of the client's affairs and specify that this obligation is absolute (see for example section 48 of the Code of Ethics of Chartered Accountants of Québec, at www.ocaq.qc.ca/pdf/ang/2_protection/code_of_ethics.pdf). Jean Daniel Breton observes that it is always possible for a client to waive this obligation of confidentiality, however, given the

enacting an absolute prohibition, Parliament chose to enact a provision that limits the auditor's ability to act. The auditor cannot do so absent the court's permission and the court's imposition of any conditions it deems appropriate.[39] This limitation addressed the concern that auditors as trustees as a general practice could undermine the public's confidence in the bankruptcy system and the pivotal role of the trustee in that process.[40]

In terms of auditors serving as trustees, Canadian courts have held that where there is no evidence of real prejudice and where the removal of the trustee that was auditor would delay administration of the estate and cause additional expense, the court would permit the trustee to continue in its administration of the estate.[41] The court has refused to remove the trustee where there was no actual conflict of interest or infringement of independence established.[42] In the context of an accountant of a debtor that was acting as a trustee under the proposal provisions of the *BIA*, the court held:

> the purpose of section 13.3 is to prevent a conflict of interest, to protect the debtor from an accountant who may have information that could be used to the prejudice of the debtor and to insure that the trustee who may have a close relationship with the debtor does not work to the prejudice of the creditors. There is not evidence that the trustee has or will act in a way that would prejudice the creditors. The debtor and the majority of the creditors support the continuation ...as... trustee.[43]

In *Re United Fuel Investment Ltd.*, the court refused to disqualify a corporate trustee from continuing to act as a liquidator where the corporate trustee was owned by the accounting firm that had acted as the corporation's auditor.[44] The court held that it was not satisfied that the audit partners who had acted as a "watch-dog" of the company would attempt to influence the

---

special relationship between the parties (the auditor is engaged and paid by the corporation, further to a resolution of the shareholders, to provide a report to the shareholders), it may be difficult or impossible to obtain such a waiver.

[39] Section 13.3(1), *BIA*.

[40] Canada. Parliament. "Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations" Issue No. 5, September 3, 1991.

[41] *Re Planta Dei Pharma Inc.* (Trustee of) v. *Planta Dei Pharma Inc.* (1999), 14 C.B.R. (4th) 256; *Re Hover* (2000), 21 C.B.R. (4th) 263.

[42] *Koskie, (Re)* (1997), 152 Sask. R. 209.

[43] *Re Hover, supra*, note 41 at para. 26.

[44] *Re United Fuel Investment Ltd.* (No. 1) [1964] 2 O.R. 411, 45 D.L.R. (2d) 624 (H.C.), affirmed [1966] 1 O.R. 165, 53 D.L.R. (2d) 12 (C.A.).

corporate trustee so as to deprive it of the required independence and impartiality.[45] The result in *United Fuel* appears driven by the particular facts, in that the court was not persuaded that there was a risk to independence and impartiality of the officer. Notwithstanding these judgments, best practice suggests that in most cases, the auditor will not act as trustee. Moreover, the view of independence of the auditor as trustee has evolved over time and with experience under the *BIA*.

The role of the trustee is in contrast to the role of monitor as originally conceived in that the monitor was viewed as more akin to an independent auditor. One of the rationales for the distinction between auditors serving as monitors and not trustees is that trustees are frequently required to examine pre-filing transactions, in order to assess whether there has been a preference, fraudulent conveyance, settlement or other reviewable transaction. To date, monitors have only infrequently been asked to undertake this role, although in such circumstances it does create risk of a conflict of interest.

C. Officer of the Court or Accountable to Creditors?

An under-explored aspect of the conflicts issue is precisely to whom the fiduciary obligation of monitors is owed. Canadian courts have held that the monitor is an officer of the court and has an obligation to act independently and to consider the interest of the debtor and its creditors.[46] The courts have also held that the duty of the monitor is to act in the interests of all stakeholders with an interest in the proceeding.[47] This broader notion of the monitor's duties recognizes that multiple stakeholders may be interested in the proceedings. This can include shareholders, although frequently, shareholders' interests are so far under water that in weighing the interests and the prejudice, the shareholders receive less priority than other stakeholders. The stakeholder accountability approach also recognizes that workers, local trade suppliers and others may have an interest in the *CCAA* workout that is greater than their fixed capital claims, because of the importance of the debtor to the local community or the economy, or because of the public's interest in the service being delivered by the debtor corporation.[48] In this respect, the

---

[45] *Re United Fuel Investment Ltd.* [1966] 1 O.R. 165 (C.A.) at para. 28.

[46] *Fairview, supra* note 31, at para. 75; *Siscoe & Savoie v. Royal Bank* (1994), 29 C.B.R. (3d) 1 at para. 28; *United Used Auto & Truck Parts Ltd., Re* (1999), 12 C.B.R. (4th) 144 at para. 20; *Hickman Equipment (1985) Ltd., Re* (2002), 34 C.B.R. (4th) 203 at para. 33, 214 Nfld. & P.E.I.R. 126.

[47] *Royal Oak Mines Inc. Re* (1999), 11 C.B.R. (4th) 122 at para. 6.

[48] For a full discussion of this, see Janis P. Sarra, *Creditor Rights and the Public Interest, Restructuring Insolvent Corporations* (Toronto, University of Toronto Press, 2003), particularly the chapters on Anvil Range Mining Corporation and Canadian Red Cross.

monitor should not be in a conflict of interest, given the court's reliance on the monitor as an officer. The Ontario Superior Court of Justice in *Royal Oak Mines* held that the monitor's role is to be neutral and to act in the best interests of all concerned.[49] In *PSINet*, Mr. Justice Farley held that there was no jurisprudence to support an argument that a monitor represents the interests of creditors in the same way as a trustee in bankruptcy, receiver or liquidator, given that the monitor does not act as an asset collector for purposes of distribution to creditors.[50] The court has held that the monitor is to provide an independent assessment of the debtor's financial status and actions during the proceeding.[51] The court's recognition of impartiality and consideration of the interests of all stakeholders in the monitor's role has resulted in a very high level of deference by the court to the monitor's opinion. Where the opinion is contested by multiple stakeholders, the court may exercise slightly less deference, although it is still difficult for stakeholders to succeed where their objections do not align with the monitor's opinion. Even where the court has very serious reservations regarding the opinion of the monitor, it will recognize the monitor's experience, expertise and objectivity.[52] It should be noted, however, that the deference to the monitor will depend on how independent and objective the monitor is; and the court's assessment of that independence and objectivity may be influenced by past experience with the particular monitor, by the particular subject matter, and by how controversial the opinion offered is. Hence the need for the monitor to be accountable to the court and to all stakeholders and to be objective in performance of its obligations is key to the court's continued recognition of and deference to the monitor's opinion.

As an officer of the court, the monitor has been found not to be compellable to give evidence in a proceeding, although in Nova Scotia monitors have been cross-examined on their opinions while still enjoying a high level of deference. The monitor's report has been found to be "not evidence" and hence not generally subject to cross-examination; rather, as an officer of the court, the monitor is to act "lawfully, fairly and honourably".[53] In Ontario, the court has held that insolvency officers such as receivers, trustees and monitors will not generally be subject to cross-examination of their reports, while acknowledging that these court-appointed officers do

---

[49] *Ibid.*

[50] *PSINet Ltd., Re* (2002), 30 C.B.R. (4th) 226 at para. 12, discussed in the context of being a representative of creditors for purposes of the *PPSA*.

[51] *Canadian Imperial Bank of Commerce and Bank of Montreal v. Quintette Coal Limited* (1991), 1 C.B.R. (3d) 253, 53 B.C.L.R. (2d) 34.

[52] See for example, the discussion regarding the CIBC Aerogold Agreement in *Re Air Canada* [2003] O.J. No. 2267 (Ont. S.C.J.).

[53] *Re In the Matter of Bell Canada International Inc., Endorsement* (29 October 2003) (Ont. S.C.J.), Court File 02-CL-4553 at para. 6.

occasionally make themselves available for examination in the spirit of co-operation and common sense.[54] The report of a court-appointed officer is distinguishable from the officer seeking approval for its fees and disbursements. In *Re Bakemates International Inc.*, the Ontario Court of Appeal held that in refusing to allow cross-examination of a receiver but allowing the appellant, as a "proxy" of the court, to extensively question a receiver, the motion judge had provided a fair opportunity for the appellant to question the receiver's compensation request.[55] However, the Court of Appeal held that, generally, while the receiver could include a statement of fees and disbursements in its report, it should file a affidavit in support of the compensation request, which would be subject to cross-examination by any party questioning the amount claimed.[56] The Court distinguished the rule that precludes cross-examination of a receiver in the context of its report, from the situation where the receiver is seeking court approval of its compensation.

Mr. Justice Farley of the Ontario Superior Court of Justice recently held that although the situation did not warrant it in the instant case, an officer of the court may be cross-examined on a report in exceptional or unusual circumstances.[57] Such circumstances could include situations where the monitor refused to co-operate in clarifying a part of its report or in not expanding on any element in the report as may be reasonably requested. The Court held that the reasonability of a request must take into account the objectivity and neutrality of the officer of the court, specifying that: "woe betide any officer of the court who did not observe his duty to be neutral and objective".[58] This judgment creates a benchmark against which the monitor can measure its obligations, indicating that one of its duties is to clarify information to stakeholders based on a reasonableness test. Failing this, the court may in exceptional circumstances compel the monitor to be examined. It also indicates that the court's deference will depend on the monitor complying with its duty to be impartial, objective and fulsome in its reporting.

The general lack of compellability of the monitor may give rise to incentive effects on the part of the debtor to shirk its reporting obligations. There may be circumstances in which the debtor corporation is reporting most of its financial disclosure through the monitor to the court. In such circumstances, creditors may not be able to cross-examine the debtor on the accuracy of the

---

[54] *Mortgage Insurance Co. of Canada* v. *Innisfill Landfill Corp.* (1995), 30 C.B.R. (3d) 100 (Ont. Gen. Div.) at 101-102; see also *Re Anvil Range Mining Corp.* (2001), 21 C.B.R. (4th) 194 (Ont. S.C.J.); *Re Canadian Airlines Corp.* (2000), 20 C.B.R. (4th) 1 (Alb. Q.B.).

[55] *Re Bakemates International Inc.* [2002] O.J. No. 3569 (Ont. C.A.), application for leave to appeal dismissed [2002] S.C.C.A. No. 460.

[56] *Ibid.* at paras. 31-35, 38, 65.

[57] *Re In the Matter of Bell Canada International Inc., supra*, note 53 at para 8.

[58] *Ibid.*; *Re Confederation Treasury Services Ltd.* (1995), 37 C.B.R. (3d) 237 (Ont. Gen. Div.).

disclosures. The monitor's report offers an opinion to the court as to the accuracy of the information or the wisdom of particular proposed actions. This is not problematic if the monitor is not acting as an advocate for the debtor corporation. However, where it is, it is unclear that the courts have yet generally recognized that this may be problematic for creditors and other stakeholders seeking to challenge the monitor's conclusions. This has implications for interim decisions during the course of *CCAA* proceedings, such as a sale of assets during the proceeding and the court's reliance on the monitor for its business judgment.[59] Rarely has the court preferred the evidence of creditors or disregarded the opinion of the monitor.

The use of the monitor's report to insulate the debtor from cross-examination may also have implications for the dispute resolution process under the *CCAA* as the debtor may have a tactical advantage in the bargaining process where the monitor acts as advocate. Alternatively, information asymmetries could work to completely hinder or discourage negotiations for a viable workout strategy. There is a substantial difference between the monitor as facilitator in the dispute resolution process and acting as a financial advisor and strategist for the debtor. The risk of prejudice to stakeholders is far greater with the latter role, a factor that has not yet been explicitly addressed by the courts. This concern must be counter-balanced by any benefits accruing to the parties through the practice of monitors using their role behind closed doors to pressure the debtor to move on particular issues.

The Ontario Superior Court of Justice recently commented on this risk of the debtor shirking its disclosure obligations through the use of the monitor's report.[60] It observed that there have been problems with motions supported by nothing other that the monitor's report. The Court held that if a matter is reasonably expected to be contentious or turns contentious, it is important to have an affidavit from the moving party and time to allow cross-examination.[61] This represents an important recognition by the court that the monitor may risk its impartiality or the perception of impartiality if its reporting role is used inappropriately to insulate parties from cross-examination. Clear recognition of the scope and limits of the monitor's reporting role will reduce conflicts or perceived conflicts of interest.

There is an expression that justice must not only be done, but must be seen to be done. This relates to more than just optics about the process, it goes to the perception of parties, particularly those that are not repeat players in the system, that the integrity of the insolvency and bankruptcy

---

[59] *Consumers Packaging Inc., Re* (2001), 27 C.B.R. (4th) 194; affirmed (2001), 27 C.B.R. (4th) 197.

[60] *Re In the Matter of Bell Canada International Inc., supra*, note 53 at para 9.

[61] *Ibid.*

system is maintained. Those who are to bring an element of neutrality or lack of bias to the process must in fact do so. Recently, there was a case in which the monitor filed a 36-page factum opposing a motion by a stakeholder, a union, to vary the initial stay order.[62] While one paragraph of the 36 pages notes that the monitor is to be independent, the rest of the factum descends into the arena in opposing the motion on legal grounds, prior to the parties being able to make their submissions to the court. As an officer of the court, the monitor's obligation is to review the parties' positions and then give an opinion based on its expertise. The expertise that the monitor brings to the proceeding is financial expertise, not legal expertise. This kind of legal advocacy can lead to failed confidence in the integrity of the system. Rather, the opposition to the motion should have come from the debtor, whose interests are being advocated in this matter. This kind of action on the part of the monitor may have done considerable damage to its image as the neutral officer of the court and provided the best ammunition for defining the role of monitor to exclude the more activist role that recent files have adopted.

D. The Auditor as Monitor, Does this Exacerbate the Challenge?

In mid-market workouts under the *CCAA*, the auditor is more likely to act as monitor because there are not sufficient assets remaining to pay for the costs of both. Hence the practical realities of the debtor's financial situation drive the decision about the dual use of the professional, as less time and expense is incurred in coming up to speed on the debtor's financial situation. In this, the interest of the debtor corporation may converge with that of creditors, since payment of the professional comes out of the debtor's assets as a first charge and creditors will weigh the double costs against concerns about conflicts of interest or impartiality of the monitor. Yet the auditor as monitor can create a problem of perception of conflict of interest and in some instances, an actual conflict in the insolvency proceedings. One issue is whether the efficiencies generated by the dual role, in terms of more timely proceedings, reduction of information asymmetries and confidence of officers, are sufficient to overcome any perception of bias. In Canada, there have been very few cases where creditors have objected to the auditor serving as monitor and hence there is little caselaw as guidance. In the rare case where senior creditors have objected, the monitor/auditor has resigned.

Given that the nature of the audit function is monitoring and rendering an opinion based on financial data and best practices in accounting, it is here that the potential for conflict of interest

---

[62] Factum of the Monitor, *In the Matter of the Companies' Creditors Arrangement Act and in the Matter of the Plan of Compromise or Arrangement of Ivaco Inc.* (27 February 2004).

appears the greatest. Recently, monitors have taken on the role of negotiator, sometimes appearing more as the agent of the debtor than impartial officer of the court. While the debtor has an experienced professional bargaining on its behalf, it may be problematic for both perception and conflict. The previous and ongoing business relationship with the debtor corporation may impair the ability of the auditor to fully embrace the role of independent monitor. One can track the evolving role of the monitor through the initial orders, which have continually expanded the scope of duties of the monitor and continually buttressed their protection against liability. While these questions are separate, they are related.

It is important to step back and think about the role of the external auditor, which is ostensibly to monitor and report on the financial affairs of the corporation to shareholders. If this is the relationship of the auditor to the debtor, then the traditional role of monitor as monitoring the business and affairs of the debtor may be a natural continuation. It is usually the insolvency professional in the same accounting firm, as opposed to the individual accounting practitioner, that takes over the monitor duties. While the potential conflict exists, there is the advantage of having all the relevant financial information in-house, allowing for timely performance of the monitor's duties. However, auditors often take on the role of business advisors, advising the company on the scope and limits of particular transactions. In some cases, as was evident in the corporate scandals in the United States, their role in non-audit services was more in the form of advocacy, pushing the limits of acceptable accounting practices. This is one of many factors leading to "corporate capture" of auditors by corporate officers. In the U.S. context, there appears also to have been issues regarding the timing of disclosures and move into Chapter 11, arguably accounting professionals did not want close examination of pre-filing audits.[63] The challenges do not exist in the same way in Canada, due to a host of differences including principles-based versus rules-based accounting norms. Hence the risks posed by auditor capture are less apparent but can nevertheless exist.

There may be a conflict of interest where the auditor is potentially a claimant because of outstanding audit fees owing, shareholder actions regarding the accounting practices of the debtor or other disputes regarding financial reporting. Although there is no codification of how to respond to this, it seems that there are clear conflicts such that the auditor should not act as monitor. Where the conflict is not clear, the monitor should seek direction of the court.

---

[63] See discussion in Part IV below.