CITATION: Galty B.V. (Re), 2021 ONSC 7250
COURT FILE NO.: 31-248304
DATE: 2021-11-03

SUPERIOR COURT OF JUSTICE – ONTARIO (COMMERCIAL LIST)

RE: GALTY B.V., HAVING ITS HEAD OFFICE IN THE CITY OF AMSTERDAM IN THE NETHERLANDS

BEFORE: Penny J.

COUNSEL: *Brendan Bissell* for MNP Ltd. in its capacity as the trustee in bankruptcy of Galty B.V.
Mark Wiffen for The Avenue Road Trust

HEARD: October 26, 2021

ENDORSEMENT

[1] This is a motion by MNP Ltd., the trustee in bankruptcy of Galty B.V., for advice and directions regarding a vote by inspectors on a proposed settlement of a potential claim by the Bankrupt against its parent corporation, Galty N.V.

[2] The key issue on the motion is whether a lawyer acting for one of the creditors in litigation with the bankrupt and related companies, who was also made that creditor's appointee as an inspector, had a disqualifying conflict of interest when he voted against accepting the proposed settlement of the potential claim by the estate.

[3] For the reasons that follow, I conclude that the lawyer/inspector did have an operative and disqualifying conflict at the time of the vote and that the Trustee is entitled to disallow or disregard that inspector's vote on the proposed settlement.

Background

[4] As of the date of bankruptcy (which was March 11, 2019):

- the Bankrupt's only tangible asset was $591,503 held by its solicitors on account of the sale of property in Toronto. After payment of the solicitor's fees, the amount on hand is now $499,654.03, before fees for the administration of the estate; and

- the Bankrupt was involved in litigation with The Avenue Road Trust and with La Houge Financial Management Services Corp. and Pantrust International. That litigation concerned respective claims by ART and LaHogue against the Bankrupt. After the bankruptcy, the plaintiffs amended their claim to assert claims against Galty N.V. and individuals and entities affiliated with them (in particular, the Brazilian Trust, which owns Galty N.V.) for multi-million dollar amounts claimed

to be owing to each of ART and LaHogue. This includes a fraudulent preference claim for monies received by the defendants from Galty B.V. pre-bankruptcy.

[5] The creditors of the Bankrupt have filed claims totalling $25,079,500. Of the total claims, the largest claim is by Galty N.V., which has filed a claim for $20,679,439. This is based on a term loan made by Galty N.V. to its subsidiary, Galty B.V. The Trustee reviewed that claim, including various grounds raised by the inspectors about the bona fides of the loan and its quantum. The Trustee concluded that the loan and the amount claimed were consistent with the Bankrupt's records and advised the inspectors of the estate that the Trustee had accepted Galty N.V.'s claim. The Trustee's acceptance of that proof of claim was not appealed or otherwise challenged and is, therefore, not under further review by the court on the application of any creditor.

[6] The second largest claim made in the bankruptcy was a claim by ART for an amount that the Trustee calculated as being about CAD $3,197,000. ART had originally made a trust claim against the Bankrupt for that amount, but that claim was disallowed by the Trustee. ART's appeal of that disallowance was abandoned. ART's claim then proceeded as unsecured, but it too was disallowed by the Trustee. ART's appeal from that decision is pending.

The Potential Preference Claim

[7] On July 13, 2017, Galty B.V.'s directors authorized the transfer of $1.1 million to the Brazilian Trust to be applied against Galty N.V.'s loan to Galty B.V. The funds for this transfer came from a corporate tax rebate arising out of the sale of 88 Elm Street in Toronto, which was the Bankrupt's only material asset in Canada. The payment was made to Galty N.V. on July 14, 2017.

[8] Upon analysis, the Trustee determined that the $1.1 million payment, in light of Galty B.V.'s subsequent assignment in bankruptcy in March 2019, might constitute a preferential payment in Galty N.V.'s favour. The Trustee entered into negotiations with Galty N.V. about this potential claim by the estate. Because the claim may have become statute -barred on September 8, 2020, the Trustee entered into a tolling agreement with Galty N.V., originally set to expire in August 2021. The deadline was extended twice, with the expiry to take place on October 15, 2021. Galty N.V. was not prepared to grant any further extensions. Because of certain delays in the hearing of this motion, however, Galty N.V. did ultimately agree to an extension of the tolling agreement until 10:00 PM of the day on which the decision of the court on this motion is released.

[9] A settlement between the Trustee and Galty N.V. was reached. The proposed settlement was put to the inspectors for approval at a meeting on August 30, 2021. It is the consequences of that meeting of inspectors that give rise to this motion.

[10] The terms of the settlement are that Galty N.V. shall return to the estate that portion of the payment that would not otherwise be distributed to it as the principal creditor in the bankruptcy. Depending on the outcome of the ART appeal of the disallowance of its claim, the settlement is worth something in the order of $100,000 to $150,000 to the estate.

The Meeting of Inspectors

[11] The proposed settlement was considered at the August 30, 2021 meeting of inspectors called for that purpose. The Trustee recommended to the inspectors that they approve the settlement for the following reasons:

(1) the settlement avoids the necessity of extending the tolling agreement (which, as noted above, Galty N.V. is no longer willing to do);

(2) the settlement avoids the cost of litigation with Galty N.V. over the alleged preference claim which:

(a) even if successful, might not succeed; and

(b) might not be enforceable (because Galty N.V. is a foreign corporation with no assets in Canada); and

(3) given the extent of Galty N.V.'s accepted claim in the bankruptcy (which acceptance has not been challenged in any way), the settlement is a pragmatic, cost-effective way to resolve the dispute which will contribute materially to the funds available for distribution and to the timely completion of the estate's administration.

[12] There are five inspectors:

Ron Chapman – counsel to ART in the litigation
Anne Marie Heinrich – a discretionary beneficiary of the Brazilian Trust (the Brazilian Trust being a potential defendant in the preference claim)
Masiel Matus – counsel to La Houge
Oliver Egerton-Vernon – Galty N.V. (creditor with accepted claim but potential defendant in preference claim by the estate)
Maureen Ward – Bennett Jones (creditor with accepted claim)

[13] Egerton-Vernon did not attend the meeting to vote on the proposed settlement on the basis that he had a disqualifying conflict as the representative of Galty N.V. Chapman did not attend, apparently thinking, incorrectly, that because ART's claim had been disallowed, he was no longer an inspector. Heinrich and Ward voting in favour of the settlement; Matus voted against.

[14] After the vote, however, the Trustee was concerned that, as a discretionary beneficiary of the Brazilian Trust, Heinrich might also have a disqualifying conflict. The Trustee reasoned that, while all of the inspectors were in some way associated with parties having an adverse claim against the bankrupt, the Brazilian Trust, like Galty N.V., was a potential defendant in the preference claim, which was a different kind of conflict and one more likely to be disqualifying on a vote to approve the settlement of that claim. No one, during the argument of this motion, took the position that the Trustee was wrong in his assessment of this issue or that Heinrich's vote should be restored. For that reason, I will not comment on this issue further, as it is not before me.

[15] The disallowance of Heinrich's vote left a 1:1 tie in votes of the inspectors.

[16] Under s. 117(2) of the BIA, in the event of an equal division of opinion among inspectors, the opinion of any absent inspector shall be ought. If that does not resolve the difference, "it shall be resolved by the trustee".

[17] Accordingly, the Trustee sought Chapman's views to break the tie. Upon being advised of the situation, Chapman asked for "the terms of the settlement" and indicated he would "seek instructions". Chapman's reference to seeking instructions raised a red flag for the Trustee. Counsel for the Trustee responded to Chapman, indicating to him that "your appointment as inspector is in a personal capacity with fiduciary obligations to the entire group of creditors" not on the basis of "representing your client". This was especially so, in the Trustee's view, because Chapman's client was precluded from being an inspector by s. 116(2) because ART and Mr. Seabrook, its principal, were parties in the litigation with the bankrupt.

[18] A few days later, Chapman provided his opinion that the proposed settlement "should not be accepted".[1]

[19] The Trustee is concerned that the dynamics of the litigation between ART and Galty N.V. and the Brazilian Trust, which is of course ongoing, is motivating and being played out in the vote of the inspectors on the proposed settlement. Four of the five inspectors (all but Ward) are connected to that litigation. The Trustee takes the view, in short, that Chapman, as counsel of record for ART and Seabrook in the litigation, is conflicted and, in voting against the settlement, has not conducted himself in accordance with his obligations to the entire group of creditors of the bankrupt as a whole. The Trustee takes the position, therefore, that Chapman's vote, like Heinrich's (and Egerton-Vernon's), should not be counted. In this circumstance, the Trustee proposes to exercise the deciding vote, under s. 117(2), in favour of the settlement.

[20] This is what has brought to parties to court on the present motion by the Trustee.

Analysis

[21] The law is well settled that inspectors stand in a fiduciary relation to the general body of creditors in a bankruptcy: *Re Bryant Isard & Co*. (1923), 4 C.B.R. 41 at 48 (ON SC). An inspector must not permit their duty as inspector to conflict with some other interest and, if they do, they may be disqualified from acting on that matter: *Re Fentiman* (1926), 7 C.B.R. 355 (ON SC).

[22] In *Re Preston* (1979), 30 C.B.R. 222 at 223, Registrar Ferron concisely outlined the law applicable to the type of situation we have here. He said, in that case, that the decision of the trustee to disqualify an inspector on account of a conflict:

> was based on the best evidence available to the trustee and on the documents which he had, and in my opinion he acted prudently in

[1] Seabrook's October 18, 2021 affidavit filed on this motion confirmed that Chapman has since resigned as an inspector. ART has not appointed any successor.

> proceeding with the action without the consent of the inspector. It is not necessary for the trustee to prove that a conflict existed, as one would prove that conflict in court, as long as he acts reasonably on the evidence available.

[23] Mr. Wiffen, counsel for Chapman on this motion, argues, however, that in order for the Trustee to disallow Chapman's vote, it must be shown that Chapman acted in bad faith. Because there is no evidence of conduct on Chapman's part that could meet the threshold of bad faith, the Trustee would be wrong to disregard Chapman's vote. In making this argument, he relies on *Lamb Ford Sales Ltd. (Re)*, [2006] N.B.J. No. 329 (Registrar).

[24] In *Lamb Ford Sales Ltd.,* the registrar of bankruptcy in New Brunswick dealt with the question of whether a counsel of record for a party engaged in litigation with the bankrupt could act as an inspector. Registrar Bray held that being in the role as counsel of record did not, of itself, constitute a disqualifying conflict. Rather, he reasoned, the question was whether there is a sufficient commonality of interest between the lawyer who has been acting as inspector and his client who is suing the bankrupt that there exists either a true conflict of interest that would be detrimental to other creditors or a perceived conflict of interest that would undermine the confidence of a reasonable person that the BIA was being properly administered.

[25] At para. 4 he wrote:

> Another way of phrasing the question is to ask whether Mr. Gillis as inspector was participating in making any arrangement that would advance the litigation interests of the creditor that he represents. An inspector acts in a fiduciary capacity to the Estate and must cooperate with the Trustee to ensure that the Estate is effectively administered for the general benefit of the creditors. One must ask if there is proof of an element of bad faith in Mr. Gillis' activities.

[26] I agree with Registrar Bray's conclusion that the mere fact of being counsel of record for a party in litigation with the bankrupt is not, of itself, offside s. 116(2) nor, standing alone, does it constitute a disqualifying conflict of interest for an inspector's ability to act or to vote. This conclusion seems consistent with The Inspectors' Handbook prepared by the Office of the Superintendent of Bankruptcy which provides the general guidance that "a lawyer representing a client may be appointed an inspector".

[27] I also agree with the Registrar's conclusion that the real issue, where counsel of record for a creditor in pre-bankruptcy litigation is an inspector, is whether there is a sufficient commonality of interest between the lawyer and his client who is suing the bankrupt that there exists either a true conflict that would be detrimental to other creditors or a perceived conflict of interest that would undermine confidence in the administration of the scheme of the BIA. Put slightly differently, while the appointment, as an inspector, of counsel to a creditor in litigation with the Bankrupt may not be prohibited, the counsel runs the risk that they may, on

issues that come before the inspectors, come into conflict between their duty to creditors at large as inspector and their duty to their client as litigation counsel.

[28] Where I part company with Registrar Bray is over his implication of a requirement of bad faith to establish the necessary disqualifying conflict. Registrar Bray's decision is, of course, not binding on me in any event. But, in my view, his decision is inconsistent with the decisions in *Re Bryant Isard, Re Fentiman* and *Re Preston* as well as *Intercoast Lumber (Re)(Trustee of)*, 1995 CanLII 1240 (BCSC), which all stand for the proposition that it is sufficient, to disqualify an inspector from voting on an issue, if there is an operative conflict of interest with respect to that issue. A material conflict of interest is a question of fact, the existence of which does not require any finding of bad faith. Registrar Bray's imputation of this requirement into the conflict of interest analysis is wrong, in my view. Further, it conflates the issue of whether the trustee may disqualify an inspector's vote on the basis of a conflict with the quite different question of whether a decision of the inspectors can be overturned by a court under s. 119(2) of the BIA. Under s. 119(2), the case law suggests a court ought not to interfere with a decision of the inspectors "unless it is shown they are acting fraudulently or in some way not in good faith for the benefit of the estate". *Rizzo & Rizzo Shoes Ltd. (Bankruptcy of)* (1998), 38 O.R. (3d) 280, 1998 CanLII 2673 (ON CA).

[29] While the Trustee's alternative argument does rely on s. 119(2), in light of my disposition of the conflict issue, it is not necessary to address s. 119(2).[2]

[30] The question here, therefore, is whether Chapman, in voting against the proposed settlement, was participating in making any arrangement that would advance the litigation interests of the creditor, ART, that he represents in litigation against the Bankrupt, Galty N.V. and the Brazilian Trust, to the possible detriment of the creditors as a whole. In my view, he was. The conflict was of a nature as to constitute a "true conflict" or one that would undermine confidence in the administration of the scheme of the BIA.

[31] It is manifestly true that, if Galty N.V.'s claim was finally disallowed or if a preference claim against Galty N.V. and the Brazilian Trust was successfully pursued, the other creditors would be better off. If those choices were the real basis for Chapman's vote, it might not involve a disqualifying conflict for him to have voted as he did. On the evidence, however, those are not the binary choices available and that is not the basis upon which ART and Chapman now argue the disputed vote was taken.

[32] In this case, Mr. Wiffen argues that Chapman's (and ART's) opposition to the settlement was on the basis that the settlement assumes the validity of Galty N.V.'s $20 million claim in the bankruptcy. Chapman, and more importantly ART, does not accept the validity of the Galty N.V. claim. Mr. Wiffen submits that a finding by the Trustee that the Bankrupt's debt owed to

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[2] I agree with Mr. Wiffen that there is no evidence Chapman acted in bad faith. Accordingly, to the extent bad faith were a requirement in order for the court to revoke or vary any decision of the inspectors under s. 119(2), I would not have been prepared to do that in this case.

Galty N.V. is bona fide could be prejudicial to ART in its outstanding litigation with Galty N.V. and the Brazilian Trust.

[33] The nature of Chapman's conflict is made plain, it seems to me, by this submission and, more generally, by the manner in which Mr. Wiffen has, on Chapman's behalf, responded to this motion. On one hand, Chapman has filed affidavit evidence that he was not "acting on [his] client's instructions" when he voted against the settlement. On the other, Mr. Seabrook has also filed affidavits, supported by evidence from Chapman as his counsel in the litigation, vociferously attacking the Trustee's allowance of the Galty N.V. claim in the bankruptcy. Among other things, Mr. Seabrook says, the quantum of Galty N.V.'s claim has not been explained or justified, enforcement of Galty N.V.'s claim would be barred by the *Limitations Act*, *2002*, and no demand for payment was ever delivered by Galty N.V. to the Bankrupt.

[34] The Trustee's reasons for accepting Galty N.V.'s claim are, on their face, entirely reasonable. Each of Mr. Seabrook's concerns was considered and rejected by the Trustee. The Trustee concluded that the expanded quantum of the claim is fully explained by the provision for compound interest in the loan documents; the debt became due in December 2017, so the two year limitation had not yet run when Galty B.V.'s assignment into bankruptcy took place; and, the loan is a term loan, not a demand loan such that whether there was ever a demand for payment is irrelevant.

[35] More importantly, it was open to ART to apply to the court to expunge or reduce Galty N.V.'s claim under s. 135(5) of the BIA. ART appealed the disallowance of its own claim under s. 135(4) but has not taken any similar action with respect to the Trustee's allowance of the Galty N.V. claim.

[36] It was also open to ART, in the face of the Trustee's proposed settlement of the preference claim with Galty N.V., to apply under s. 38 of the BIA for an order authorizing ART to take that proceeding in its own name and at its own expense and risk. ART has not done that either. Indeed, it seems clear that ART wants the Trustee to take carriage of that claim, and the associated risks of the litigation, utilizing the funds available to the estate for that purpose. This, the evidence is clear, the Trustee is not prepared, and cannot be compelled, to do. That is precisely why s. 38 exists; it is the creditor's fall back if the trustee will not pursue a potential claim. Here, the Trustee has weighed the merit of the preference claim, together with the risks, costs and delay in the administration of the estate associated with pursuing that claim, and come to the conclusion that to pursue the claim is not consistent with the interests of the creditors as a whole. That assessment was the very foundation for the settlement reached with Galty N.V.

[37] All of this leads me to the following conclusion: it was reasonable for the trustee to conclude, from the circumstances of this case, that Chapman, in voting against the proposed settlement, was "participating in making an arrangement that would advance the litigation interests of" his client, ART (which he represents in ongoing litigation against the Bankrupt, Galty N.V. and the Brazilian Trust), to the detriment of the other creditors. It was therefore reasonable for the Trustee to conclude that Chapman was, therefore, either acting in his client's interests (as he was, frankly, obliged to do), and not in the interests of creditors as a whole, or was at least engaging in conduct which would undermine confidence in the administration of

the scheme of the BIA, when he voted to refuse the settlement. The Trustee is entitled to disregard Chapman's vote as having been disqualified by that conflict: *Intercoast Lumber; Re Preston*.

[38] In light of this conclusion, there remains a 1:1 tie in the inspectors' vote on the proposed settlement. The Trustee may exercise his prerogative under s. 117(2), therefore, to cast the deciding vote.

[39] Finally, the Trustee raised a technical issue about whether there was a quorum of inspectors if Chapman is not able to vote. This was not pursued by any other party. I take the view that inspectors disqualified by conflict are not considered in determining quorum, or, if they are, the workings of s. 117(2) and the proper administration of the scheme of the BIA require that where the trustee must cast the deciding vote, the trustee be counted in determining quorum. In any event, I do not regard quorum as a barrier to the Trustee's exercise of the power to cast the deciding vote under s. 117(2) of the BIA in this case.

[40] I make no order as to costs.

Penny J.

Date: November 3, 2021