C.A. No. 02977

NOVA SCOTIA COURT OF APPEAL

Cite as: Coopers & Lybrand Ltd. v. Bruncor Leasing Inc., 1994 NSCA 122
Hallett, Matthews & Chipman, JJ.A.

BETWEEN:

COOPERS & LYBRAND LIMITED, Trustee under the proposal filed by Zutphen Bros. Construction Limited		Robert W. Carmichael for the Appellant
	Appellant	
- and -		George W. MacDonald, Q.C. and Bernard F. Miller for the Respondent
BRUNCOR LEASING INC.		
	Respondent	Appeal Heard: June 6, 1994
		Judgment Delivered: July 12, 1994

THE COURT: Appeal dismissed per reasons for judgment of Hallett, J.A.; Matthews and Chipman, JJ.A. concurring.

HALLETT, J.A.

The main issue in this appeal is whether the appellant, the trustee named in a Proposal made by Zutphen Bros. Construction Limited under the **Bankruptcy and Insolvency Act**, R.S.C. 1985, c. B-3, as amended, erred in disallowing the respondent's claim that it had security against an asset of Zutphen. The respondent was the assignee of a conditional sales contract entered into between a seller of motor vehicles and Zutphen with respect to a sale to Zutphen of a Volvo dump truck. The trustee disallowed the claim to security on the ground that there was a failure to register the conditional sales contract in the registration district for the City of Halifax as required by the **Conditional Sales Act**, R.S.N.S. 1989, c. 84.

To determine if the trustee erred it is essential to review the terms of Zutphen's proposal. Clause 4 in the Proposal states"

> "Whereas the Company is of the view that to provide for the orderly realization of its principal assets through a Trustee under the Proposal will recover significantly more for the benefit of its creditors generally than would be recovered through a Receivership or other forced liquidation initiated by a single creditor, to the point that the Company is of the view that its assets will likely exceed its liabilities, thus ensuring that all creditors will ultimately be paid in full."

Clause 5 of the Proposal sets out the background of the Company; it states in part:

> "...The Company is of the view that its insolvency is a result of the drain upon cash flow made by certain investments in subsidiary companies and projects in the United States of America, which have failed to yield any return. This, and the reluctance of the Company's banker to advance further credit, has caused the Company to be unable to make payments to its creditors on the due dates which has, in turn, lead to delay in resolving matters on the two major contracts. The Company is of the view it is best able to resolve the outstanding matters in respect to these contracts and that these contracts alone will ultimately yield sufficient funds to pay substantially all, if not all, of the claims of all preferred and ordinary creditors."

Clause 6 describes the "purpose" of the Proposal as including the objectives set out in the latter part of Clause 5 and further to enable the company to continue with the available cash after meeting the claims of its creditors to settle deficiencies and to provide ongoing warranty where required on existing contracts and to bid and finance new work.

Clauses 7, 8, 9, and 10 of the Proposal provide as follows:

> "7. There shall be one class of Secured Creditors, being all the creditors with a charge or security over assets of the company.
>
> 8. Creditors with a priority under Section 136.1 of the Bankruptcy and Insolvency Act shall be a class of "Preferred" creditors.
>
> 9. All other creditors, being the ordinary creditors of the Company without any security, shall be one class of creditor.
>
> **VESTING OF CERTAIN ASSETS AND CONTINUED OPERATIONS**
>
> 10. Upon acceptance of this Proposal, the Company shall vest in the Trustee under the Proposal its interest in its equipment and the Trustee shall enter into an Auction Contract with Ritchie Bros. Auctioneers which will provide for a net guarantee of $2.759 million, which guarantee shall be secured by a Letter of Credit, pursuant to an offer from Ritchie Bros. Auctioneers dated March 11, 1993, attached as Schedule A to this Proposal.

Clause 11 provides for the vesting of Zutphen's interest in certain real property in the trustee for the purpose of sale. Clause 12 vests in the trustee Zutphen's interest in the net proceeds of certain contracts. Clause 13 provides that the assets aforementioned are being vested in the trustee so that the current value would not become co-mingled with new work generated and undertaken by the Company. Clause 14 provides that the company would continue to operate in the ordinary course of business and to use cash flow generated by assets other than those vested in the trustee to maintain its corporate presence and meet its overhead and operating expenses with two exceptions.

Clause 15 provides for a scheme of distribution. I will not set it out in its entirety; the part that is relevant to this decision is Clause 15(1)(i):

SCHEME OF DISTRIBUTION

15. The proceeds of realization shall be distributed in the following manner:

Secured Creditors

(1) To the extent secured creditors hold a specific charge (which shall include a crystallized floating charge) over a single asset or group of assets, they shall be paid from the net proceeds of realization, an amount sufficient to discharge their claim, limited to the actual net realization, which is defined as follows:

i) In the case of a charge over equipment, the net proceeds of sale as guaranteed by Ritchie Brothers on the attached schedule, plus their pro-rata share of the net proceeds in excess of the total guarantee of Ritchie Brothers, to the limit of their indebtedness.

Clauses 7 and 15(1)(i) are particularly relevant to the issues before the Court. Other clauses show the intention of Zutphen to carry on its business despite the fact that significant assets are vested in the trustee for disposition. This type of proposal is often referred to as a "vesting proposal" in contrast to the more usual proposal in which assets remain in the hands of the debtor.

The Proposal was accepted by the creditors and approved by the court pursuant to the provisions of the **Bankruptcy and Insolvency Act**. The Volvo dump truck and other equipment was sold by Ritchie Bros. Auctioneers. The appellant then disallowed the respondent's claim that it held security against the Volvo.

The respondent appealed the disallowance to the Registrar in Bankruptcy who dismissed the appeal. (*Bruncor Leasing Inc. v. Zutphen Bros. Construction Ltd. (Trustee of)* (1993) 21 C.B.R. (3d) 1) The respondent then appealed the Registrar's decision to the Supreme Court of Nova Scotia. Anderson J. allowed the appeal; that decision is reported in (1993) 23 C.B.R. (3d) 70 and has given rise to this appeal by the trustee.

The appellant's counsel states the issue as being whether the respondent is a

secured creditor for the purpose of the distribution of the proceeds realized under the proposal. As set out in paragraph 12 of its factum:

> "The Appellant's position can be simply stated. The Respondent is not a secured creditor. The Conditional Sales Contract held by the Respondent was not properly registered. The title retention provisions are, in the circumstances of this case, void and of no effect as against the Appellant by virtue of s. 3(1) of the *Conditional Sales Act*."

Section 3(1) of the **Conditional Sales Act** reads as follows:

> "3(1) After possession of goods has been delivered to a buyer under a conditional sale, every provision contained therein whereby the property in the goods remains in the seller shall be void as against
>
> (a) subsequent purchasers or mortgagees claiming from or under the buyer in good faith, for valuable consideration and without notice; and
>
> (b) creditors of the buyer who at the time of becoming creditors have no notice of the provision,
>
> and, for the purpose of enforcing the rights of such creditors but not otherwise, shall be void as against
>
> (c) a creditor suing on behalf of himself and other creditors;
>
> (d) an assignee for the general benefit of creditors;
>
> (e) a trustee under the *Bankruptcy Act*, (Canada);
>
> (f) a receiver of the estate and effects of the buyer;
>
> (g) a liquidator of a corporation under the *Winding-Up Act* (Canada) or under a Provincial Act in a compulsory winding-up proceeding,
>
> without regard to whether or not the creditor so suing had at the time of becoming a creditor notice of the provision or whether or not the assignee, trustee, receiver or liquidator at the time of his appointment had notice of the provision, and the buyer shall, notwithstanding such provision, be deemed the owner of the goods, unless the requirements of this Act are complied with." (Underlining by appellant's counsel)

The appellant's counsel argues that the trustee is either or both an assignee for the general benefit of the creditors and/or a trustee under the **Bankruptcy Act**; that the trustee in disallowing the claim was enforcing the rights of unsecured creditors who did not have notice of the retention, in the respondent, of title to the Volvo because of the failure to register the conditional sales contract in Halifax and, therefore, pursuant to **s. 3(1)** of the **Act** the conditional sales contract is void as against the trustee. Counsel considers it of great significance that the Proposal vests substantially all of Zutphen's assets in the trustee for disposition. There is evidence that certain of Zutphen's creditors, at the time they extended credit to Zutphen, did not have notice that title to the Volvo was in the respondent. Counsel for the appellant takes the position:

> "that the purpose (or at least one of the primary purposes) of the Proposal is to enforce the rights of creditors of Zutphen Bros. (including those who had no notice of the Respondent's Conditional Sales Contract at the time of becoming creditors) by vesting the property of Zutphen Bros. in the Trustee for the purpose of liquidating the property in order to satisfy the claims of those creditors. The Proposal is a mechanism for enforcing the respective rights of creditors to payment of their claims."

The appellant's counsel states that the crucial issue on appeal "...is not whether a trustee, as matter of procedure, has the right to disallow a claim for security asserted by a particular creditor by making a preliminary determination as to the validity of the claim. Rather, the crucial issue is whether in fact the creditor has a valid security as claimed." He argues that the respondent could not become a secured creditor "merely because it claims to be one and has filed a proof of security under the Proposal."

He further argues that a trustee under a proposal has the authority to disallow claims to security by the combined effects of **s. 135(2)** of the **Bankruptcy and Insolvency Act**, as amended in 1992, and **s. 66.1**. These sections provide:

"**Section 135.** (2) **Disallowance by trustee.** ---The trustee may

disallow, in whole or in part,

(a) any claim;

(b) any right to a priority under the applicable order of priority set out in this Act; or

(c) any security.

"**Section 66. Act to apply** -- (1) All the provisions of this Act except Division II of this Part, in so far as they are applicable, apply with such modifications as the circumstances require, to proposals made under this Division."

Counsel for the appellant concluded his argument in paragraphs 81 and 82 of his factum as follows:

"It is important to bear in mind, however, that section 135 of the Act and the other sections of the Act cited above are primarily procedurally in nature as regards the rights in respect of security held by secured creditors. These sections do not give the trustee (whether it is a trustee in bankruptcy or a trustee under a proposal) substantive rights which would allow the trustee to defeat claims for security which would otherwise be valid and effective as against the trustee under the relevant provincial (or, for certain types of security-federal) legislation. Section 135, for instance, simply establishes a procedure whereby the trustee can make a preliminary determination and disallow any secured or other claim which the trustee determines to be invalid. The purpose of this is to permit the proper and efficient administration of the affairs of the bankrupt or insolvent debtor. (See Houlden and Morawetz, Bankruptcy Law of Canada, 3rd ed at p. 1-3 and *Re Arnco Business Service Ltd.* (1983) 49 C.B.R. (N.S.) 188 (Ont. S.C.)). The trustee's decision can be appealed and ultimately the rights of the parties must be determined by application of the substantive law applicable to the claim asserted.

In this particular case, it is submitted that the Respondent's claim for security is, as a matter of substantive law, not supportable."

With respect, I do not see the issue quite the same way as counsel for the appellant. I am of the opinion the appeal ought to be dismissed on the ground that the Trustee's decision to disallow the respondent's claim to security was founded on his

misinterpretation of the terms of the Proposal.

A proposal to creditors, once accepted and approved by the court, becomes a binding contract between the parties with respect to the payment of the creditors' claims (**Employers Liability Insurance Corp. Ltd. v. Ideal Petroleum (1959) Ltd.** (1976), 75 D.L.R. (3d) 63 (S.C.C.)). The Proposal in this case provided that there would be one class of secured creditors "being all creditors with a charge or security over assets of the company." The critical point is that the respondent vis-a-vis Zutphen had security over the Volvo pursuant to the conditional sales contract as it had retained title and had the right to take possession of the Volvo if Zutphen defaulted. **Section 3(1)** of the **Conditional Sales Act** does not make the security void as between Zutphen and the respondent. The respondent, like other creditors with security, gave up their rights in exchange for Zutphen's undertaking in Clause 15 of the Proposal that those creditors with a specific charge on equipment would be paid from the net proceeds of realization from the sale by Ritchie Bros. In my opinion the respondent, as holder of the conditional sales contract on the Volvo, was a secured creditor within the meaning of that term as defined in Clause 7 of the Proposal.

A proposal is very different from an assignment in bankruptcy, even in a case such as this, where the debtor proposes that most of its assets will be sold by the trustee. The essence of a proposal is that it is an offer of terms by an insolvent person to its creditors to settle its debts and, if accepted by the required statutory majority of the various classes of creditors and approved by the court, becomes a binding contract between the parties. In this case that contract should have been interpreted by the Trustee in a manner that would give effect to its terms and purpose. The clear intention of the parties was that creditors with security against equipment would be paid from the proceeds of the Ritchie Bros sale. In disallowing the respondent's claim to security the trustee failed to give effect to this intention and therefore misinterpreted the Proposal.

Apart from the contractual intention of Zutphen in making the offer as set out in the Proposal and the creditors in accepting it, there are a number of factors, when taken together with the terms of the Proposal, have led me to the foregoing conclusion.

There is no express authority in the **Bankruptcy and Insolvency Act** to authorize a trustee named in a proposal to disallow a claim to security. While the trustee has this right when acting as a trustee in bankruptcy (**s. 135**), a trustee could only invoke the power when acting in a proposal by application of **s. 66.(1)** of the **Act**.

As so often stated, the proposal, once accepted and approved, is a contract between the insolvent person and his creditors. Had Zutphen and the creditors wished the trustee to be empowered to challenge securities held by various creditors they would likely have provided in the Proposal a mechanism for doing so similar to that found in the proposal that was reviewed by this Court in **Neiff Joseph Land Surveyors Limited v. Bruce** (1976), 23 C.B.R. (N.S.) 172 affirmed, 23 C.B.R. (N.S.) 258. That proposal contained a term that the trustee could attack any preference to the same extent as if there had been an assignment in bankruptcy. This Court was of the opinion that the trustee could exercise this authority conferred on him by the terms of the proposal.

In an annotation to the report of the decision of Anderson J. in **Re Mercantile Steel Products Limited** (1978), 27 C.B.R. (N.S.) 161 (Ont. S.C.) C.H. Morawetz, Q.C. contrasted the **Mercantile** decision, which held that a trustee named in a proposal could not challenge the validity of a creditor's security, with that of this Court in the **Neiff Joseph** case. Morawetz expressed a view that he doubted if the parties to a proposal could confer such authority on a trustee. He was of the view that the wording of the **Act** reserves this power to a trustee when acting in a bankruptcy. In the **Neiff Joseph** case there was a vesting of assets in the trustee as in this case. I would infer that Mr. Morawetz was of the opinion at the time he penned the annotation that if there is a vesting of assets in the trustee this might

be sufficient to enable the creditors to clothe the trustee with the power to review and disallow claims to security but he had "doubts." These two decisions were rendered prior to the 1992 amendments to the **Act** which , for the first time, provided statutory authority to allow an insolvent person to make a proposal to classes of secured creditors and, if accepted, would be binding on all within the class.

In **Re Henfrey Samson Belair Ltd. and Wedgewood Village Estates Ltd. et al** (1984), 7 D.L.R. (4th) 79 the British Columbia Court of Appeal held that Section 46(1) of the *Bankruptcy Act*, R.S.C. 1970, c. B-3, which provided that "all the provisions of the Act, insofar as they are applicable, apply *mutatis mutandis* to proposals", has the effect of making ss. 69, 73, 74 and 78 (dealing with fraudulent settlements and preferences) applicable to a proposal in which the debtor's property vests in the trustee. In that case the proposal had been made by a Mr. Scalbania and his company.

In that proposal the trustee was expressly authorized to use the fraudulent preference sections of the **Act** to set aside any transaction to the same extent as if *Scalbania* had made an assignment in bankruptcy. Nemetz C.J., writing for the court, made reference to the decision of this court in the **Neiff Joseph** case but made a point of stating that the trustee's power to invoke the fraudulent preference provisions of the **Act** depended not so much on the spirit and intent of the proposal but on the provisions of **s. 46(1)** of the **Act**, the predecessor section to **s. 66.1** of the present **Act**. Applying this reasoning then a trustee named in a proposal would appear to have the power to disallow a claim for security by the application of **s. 66(1)** of the **Act**.

The 1992 amendments to the **Bankruptcy Act** included the addition of **s. 101.1** which empowers a trustee named in a proposal to challenge preferences and settlements. **Section 101.1** states:

"(1) Where a proposal was made under Division I of Part III,

> sections 91 to 101 apply to the proposal, with such modifications as the circumstances require, except where the proposal otherwise provides.
>
> (2) For the purposes of subsection (1), any reference in sections 91 to 101 'becomes bankrupt' shall be construed as a reference to 'files a notice of intention' or 'files a proposal', whichever filing was done first, and any reference in those sections to a bankrupt shall be construed as a reference to the debtor in respect of whom the proposal is filed."

Sections 91 to **101** authorize a trustee in bankruptcy to challenge certain settlements and preferences. Therefore, pursuant to **s. 101.1**, unless the proposal otherwise provided, a trustee can challenge settlements and preferences. There is nothing in the **Act** that expressly authorizes a trustee named in a proposal to disallow a claim to security. **Section 135** is in Part V of the **Act** which parts deals with the administration of the estates of bankrupt.

The case law with respect to the right of a trustee named in the proposal to challenge security for non perfection is in conflict. In the **Mercantile** case Anderson J. stated that a trustee under a proposal could not challenge a creditor's security. While the decision turned on other issues Anderson J. stated at p. 164:

> "My conclusions have been arrived at on the wording of the Act [the **Ontario Personal Property Security Act**] and on the relevant provisions of the Bankruptcy Act. I am fortified in my conclusions, however, by consideration of the ultimate purpose and effect of a proposal, and the bearing which that has on the attack made on the position of a secured creditor. The purpose sought by a proposal is continuation of the business carried on by the debtor. While the proposal must present benefits for creditors, it is fundamentally a mechanism for the advantage of the debtor making it. That being the case, it would be anomalous if the debtor could improve its position through objections put forward by the trustee concerning security, of a nature such that they could not have been successfully asserted by the debtor directly. If the proposal succeeds, the ordinary creditors will have received what they contracted to accept and there is no reason why it should be augmented by an amount realized at the expense of a secured creditor. If this proposal does not succeed, bankruptcy will ensue and the trustee in bankruptcy can assert all the rights created by the Act."

This statement was made with reference to a proposal which did not contain a provision for vesting assets in a trustee for disposition and was decided before the 1992 amendments to **s. 135** that gave trustees in bankruptcy a new power to disallow claims to security. Prior to this a trustee in bankruptcy could challenge security that was void under provincial legislation but he could not disallow a security claim. The effect of the amendment is to give the trustee this power and then the onus is on the creditor claiming security to appeal the trustee's disallowance to the courts. There is nothing in **s. 135** that would indicate an intention of Parliament that trustees named in proposals had a duty to disallow claims to security.

In **Re Toronto Permanent Furniture Showrooms Co. Ltd.** (1960) 1 C.B.R. (N.S.) 16 (Ont. S.C.) it was held that a trustee on a proposal has the same powers to disallow claims as a trustee in bankruptcy. That case did not deal with setting aside a security. But as argued by counsel for the appellant it is relevant since the 1992 amendments which allow proposals to be made to secured creditors and in particular the amendment to **s. 135** which authorizes a trustee in bankruptcy to disallow claims to security. It would be a logical extension of this decision that the trustee under a proposal could disallow security claims.

In **Bankruptcy Law of Canada**, 3rd edition, Houlden and Morawetz seemed to come down on each side of the issue. At p. 3-75 the authors state:

> "A trustee under a proposal cannot challenge a security interest for failure to comply with the P.P.S.A., even though the proposal purports to confer such powers on the trustee. A trustee under a proposal does not represent the creditors of the debtor; he represents the creditors only to the extent necessary to assure performance of the proposal: *Re Mercantile Steel Products Ltd.* (1978), 20 O.R. (2d) 237, 27 C.B.R. (N.S.) 161 (S.C.)."

At p. 5-89/90, in reviewing **s. 135** of the **Act**, the authors state:

> "In the case of a proposal the trustee is also under a responsibility to see that only provable claims are paid in accordance with their

> priorities. The appropriate provisions of s. 135 are, by virtue of s. 66, applicable to proposals. Therefore, it would appear that the trustee is entitled to disallow the claim of a creditor for priority also in the case of a proposal and not only in the case of a bankruptcy and this would even be so if the proposal provides for payment in full of all claims: *Re Toronto Permanent Furniture Showrooms Co. (Ont.)* (1960), 1 C.B.R. (N.S.) 16 (Ont. S.C.). Apparently the right of a trustee under a proposal to disallow a claim has always been assumed in Ontario: See *Re McKay* (1922), 2 C.B.R. 462 (Ont. S.C.); *Re Jacobs* (1922), 3 C.B.R. 419 (Ont. S.C.); or in New Brunswick: *Re McIntyre* (1922), 2 C.B.R. 396 at 408 (N.B. S.C.), and has now been settled by the *Toronto Permanent Furniture* case, *supra*. On the other side is the Quebec decision of *Re Marcotte Inc.* (1959), 38 C.B.R. 129 (Que. S.C.). However, this decision appears rather isolated and seems based on rather exceptional circumstances and, although considered by the court in Ontario in the *Toronto Permanent Furniture* case, was not followed.
>
> The powers of a trustee with regard to the allowing or disallowing of claims in a proposal is the same as the powers of the trustee acting in a bankruptcy."

Under a heading "Disallowance of Secured Claims" (1994 - Release 2) the authors state at p. 5-90:

> "By reason of the changes made in s. 135 in 1992, the trustee can now disallow a secured claim by the summary procedure in s. 135: s. 135(2)(c).
>
> It was held in *Bruncor Leasing Inc. v. Zutphen Bros. Construction Ltd. (Trustee of)* (1993), 21 C.B.R. (3d) 1 (N.S. S.C.) that, by reason of the changes in s. 135(2), the trustee under a proposal may disallow the claim of a secured creditor. In the *Bruncor* case, the interests of the debtor in its equipment was vested in the trustee under proposal for realization and distribution of the proceeds to creditors; the result can therefore be justified. However, if the debtor is continuing in business and using the equipment of a secured creditor, it is difficult to see why a trustee under a proposal should be able to disallow a secured claim, and, if the trustee is successful in the disallowance, only pay the secured creditor the same settlement that unsecured creditors are receiving under the proposal."

With the exception of the above reference to the Registrar's decision in this proceeding the quoted authorities for the foregoing statements from Houlden and Morawetz' text were made

before the 1992 amendments to the **Act**.

In face of the uncertainty of the law respecting whether a trustee acting under a proposal had power to disallow claims to security for non perfection of registration requirements of provincial statutes it would seem to me that in 1992, when considering the substantial amendments to the proposal sections of the **Act**, that had Parliament intended that trustees acting under proposals be empowered to disallow such claims, as a trustee can now clearly do when administering a bankrupt estate, Parliament would have expressly stated that a trustee acting in a proposal have this power, just as Parliament did with respect to extending the power to attack preferences and settlements to trustees when administering a proposal. Other than the Registrar's decision in this proceeding we have not been referred to any authority which has expressly held that a trustee acting under a proposal has power to disallow or challenge a security claim unless it was a fraudulent preference or settlement as in the **Scalbania** proposal. In the annotation to the decision of **Mercantile Steel** previously referred to, Morawetz obviously approved the approach taken by Anderson J. in the statement I have quoted from his decision in that case; that is that a trustee under a proposal represents the creditors only to the extent necessary to assure performance of the proposal and not any broad general sense.

Counsel for the respondent has referred us to **Re Sefel** (1989), 76 C.B.R. (N.S.) 49 (Alta. Q.B.). In that case a proposal had been filed and accepted by the creditors and approved by the court. It provided that the wife of the debtor was to be the recipient of $1.5 million when received by the trustee. This provision was agreed to by the creditors, including Clarkson Gordon. Approximately three years later, Clarkson Gordon moved for leave to issue a statement of claim asserting that it had discovered a potential cause of action which might give them a higher entitlement to the funds than that of Mrs. Sefel. The court concluded that to permit Clarkson Gordon to do so after the proposal was voted on and

approved would be manifestly unfair and wrong. At p. 50 McPherson, J., stated:

> "A proposal is a contract between a debtor and his creditors. It settles the creditors' rights if there are differences in priorities or treatment amongst them. It becomes a binding contract to that extent amongst the creditors themselves. They enter into the contract by voting on it and either assenting to it or defeating it. Clarkson Gordon, as trustee of the estate of Sefel Geophysical, deliberated upon this matter, negotiated on it at some length and then entered into that agreement with full knowledge that they were giving and settling upon Mrs. Sefel certain funds from designated sources to a maximum of $1,500,000. On her part, Mrs. Sefel limited her entitlement by agreeing to accept that term of the proposal.
>
> For Clarkson Gordon to come back years later and say that they have now discovered a potential cause of action that might given them some higher entitlement to the moneys than that of Mrs. Sefel would be manifestly unfair and wrong."

This case is merely illustrative of the concept that a proposal once accepted and approved by the court is binding on the creditors; their rights are spelled out in the proposal.

As a general rule, claims to security other than those which are fraudulent preferences or settlements, should not be disallowed or challenged by a trustee named in a proposal unless so authorized by the terms of a vesting proposal. In the most recent release to Houlden and Morawetz text (Release 4 - 1994) the following appears at p. 2-144.21 and 2-144.22:

> "A proposal can provide that all the assets of the debtor shall vest in the trustee under the proposal and that the trustee shall have all the powers of a trustee in bankruptcy to disallow secured claims. In the absence of such a provision, it is doubtful whether the trustee under a proposal possesses such a power, since the debtor will after the approval of the proposal, be continuing in business, and there is no reason why secured claims should not continue to be valid as against him.
>
> In *Bruncor Leasing Inc. v. Zutphen Bros. Construction Ltd. (Trustee of)* (1993), 23 C.B.R. (3d) 70 (N.S.S.C.), a proposal designated a creditor as a secured creditor and provided that the interest of the debtor in the equipment covered by the security would vest in the trustee. The proposal further provided that the trustee

> would sell the equipment and pay the claim of the secured creditor from the proceeds of the sale. There was nothing in the proposal which permitted the trustee to disallow the claim for security. It was held that, in these circumstances, the trustee could not make use of s. 135(2) to disallow the claim of the secured creditor."

This last paragraph is a reference to the decision under appeal in this proceeding.

Given the nature of a proposal, the most recent statement in Houlden and Morawetz accords with my view as to the proper role of the trustee in administering this proposal and accords with the similar views of this Court in the **Neiff Joseph** decision and with the Quebec Court of Appeal in the **Toronto-Dominion Bank v. Seward** (1991), A.Q. No. 1250.

Section 66(1) of the **Act** states that all the provisions of the **Act** insofar as they are applicable apply with such modifications as the circumstances require to proposals. Therefore, it might be reasonable to interpret **s. 135(2)** as authorizing a trustee named in a proposal to disallow claims to security for non-compliance with the registration requirements of provincial legislation. However, in every case one must look to the terms of the proposal to ascertain the intention of the insolvent person and the creditors as to the role and duties of the trustee named therein.

It is not necessary to decide if **s. 3(1)** of the **Conditional Sales Act** applies to a trustee acting under a proposal because it was never the intention of the parties to the Zutphen Proposal that the trustee was to disallow or challenge security that was valid as between Zutphen and its creditors. The role of the trustee was not one of enforcing rights of creditors but in supervising the Proposal to see that it was carried out according to its terms; this did not include a directive to challenge securities for improper registration as if the trustee were an assignee for the general benefit of the creditors or "a trustee under the **Bankruptcy Act**." Therefore, in this case, **s. 3(1)** of the **Conditional Sales Act** does not

come into play even if one were to conclude that a trustee named in a proposal falls within the scope of **(d)** and **(e)** of **Section 3(1)**. The provisions of that section do not preclude insolvent persons and their creditors from making an arrangement to settle debts in any manner they choose as set out in a proposal.

SUMMARY

Zutphen proposed that the creditors that held security against equipment would be paid out of the proceeds of the sale of the equipment. As between Zutphen and the respondent, the latter had security against the Volvo pursuant to the conditional sales contract. The respondent could have enforced its security against Zutphen if the latter was in default. Zutphen's secured creditors allowed their security to be sold by the trustee. All the creditors agreed that those creditors with security would be paid out of the proceeds of realization of the sale of the equipment; this was approved by the court. In the absence of a direction in the Zutphen Proposal that the trustee was to assess the validity of security, vis-a-vis other creditors, the trustee did not have authority to disallow the respondent's claim to security. While the trustee had a duty to determine the proper amount of secured creditors' claims and whether the creditor held security from the insolvent person that was enforceable against it, if the trustee was satisfied on both these matters, such a creditor ought to have been paid in accordance with the terms of the Proposal, assuming the security granted did not violate those sections of the **Bankruptcy and Insolvency Act** dealing with preferences and settlements. This is not a case of depriving unsecured creditors of statutory rights to have trustees challenge security claims of a creditor but, simply, a matter of requiring that the creditors be bound by their contract as contained in the Proposal and that the trustee carry out the terms of the Proposal. Whether the respondent's security might be set aside by other creditors or a trustee in bankruptcy in other circumstances is irrelevant so long as the security is valid as between Zutphen and the respondent the latter ought to be paid in accordance with the intention of the parties as expressed in the Proposal. Given the terms of the Zutphen

Proposal and the absence of a clear direction in the Proposal that the trustee was to have the same power of disallowance of security as if there had been an assignment in bankruptcy, **s. 66.1** of the **Act** and **s. 135(2)** did not authorize the trustee to disallow or challenge the respondent's claim to security. To countenance this would be to undermine the very essence of a proposal, "consensus", as between the creditors respecting payment of their claims by an insolvent person. Zutphen's intention, as expressed in the Proposal, was to pay those creditors with security. The Proposal was accepted. The trustee should have carried out the proposal in accordance with its terms. In challenging the security claimed by the respondent, the trustee misinterpreted the Proposal and his role as trustee of this Proposal.

I would dismiss the appeal with costs to the respondent in an amount equal to 40% of the costs awarded by Anderson J.

Hallett, J.A.

Concurred in:

Matthews, J.A.

Chipman, J.A.

C.A. No. 02977

NOVA SCOTIA COURT OF APPEAL

BETWEEN:

COOPERS & LYBRAND LIMITED, Trustee under the proposal filed by Zutphen Bros. Construction Limited Appellant	)	
- and -	)	R E A S O N S
FOR	)	JUDGMENT
BY: BRUNCOR LEASING INC.	)	
	)	HALLETT, J.A.
Respondent	)	