THE TRUSTEE AS SHERLOCK HOLMES:

EXAMINATIONS UNDER SECTION 163 OF THE BIA

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Introduction

The *Bankruptcy and Insolvency Act*[1] ("BIA") contains powerful provisions that provide a trustee in bankruptcy and creditors of a bankrupt with the ability to conduct examinations of, and require the provision of documentation by, a bankrupt and other parties who may have information about the bankrupt. These provisions are found in Sections 163, 164 and 167 of the BIA.

The relevant portions of Section 163 of the BIA provide:

> **163. (1)** **Examination of bankrupt and others by trustee** – The trustee, on ordinary resolution passed by the creditors or on the written request or resolution of a majority of the inspectors, may, without an order, examine under oath before the registrar of the court or other authorized person, the bankrupt, any person reasonably thought to have knowledge of the affairs of the bankrupt or any person who is or has been an agent, clerk, servant, officer, director or employee of the bankrupt, respecting the bankrupt, his dealings or property and may order any person liable to be so examined to produce any books, documents, correspondence or papers in his possession or power relating in all or part to the bankrupt, his dealings or property.
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> **(2)** **Examination of bankrupt, trustee and others by a creditor** – On the application to the court by the Superintendent, any creditor or other interested person and on sufficient cause being shown, an order may be made for the examination under oath, before the registrar or other authorized person, of the trustee, the bankrupt, an inspector or a creditor, or any other person named in the order, for the purpose of investigating the administration of the estate of any bankrupt, and the court may further order any person liable to be so examined to produce any books, documents, correspondence or papers in the person's possession or power relating in all or in part to the bankrupt, the trustee or any creditor, the costs of the examination and investigation to be in the discretion of the

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[1] R.S.C. 1985, c. B-3, as amended.

court.

Section 164 of the BIA provides:

164. (1) **Trustee may require books and property of bankrupt to be produced** – Where a person has, or is believed or suspected to have, in his possession or power any of the property of the bankrupt, or any book, document or paper of any kind relating in whole or in part to the bankrupt, his dealings or property, or showing that he is indebted to the bankrupt, he may be required by the trustee to produce the book, document or paper for the information of the trustee, or to deliver to him any property of the bankrupt in his possession.

(2) **Examination on failure to produce** – Where a person fails to produce a book, document or paper or to deliver property as required by this section within five days after being required to do so, the trustee may, without an order, examine the person before the registrar of the court or other authorized person concerning the property, book, document or paper that the person is supposed to possess.

(3) **Compelling attendance** – Any person referred to in subsection (1) may be compelled to attend and testify, and to produce on his examination any book, document or paper that under this section he is liable to produce, in the same manner and subject to the same rules of examination, and the same consequences of neglecting to attend or refusing to disclose the matters in respect of which he may be examined, as would apply to a bankrupt.

Finally, Section 167 states:

167. **Questions must be answered** – Any person being examined is bound to answer all questions relating to the business or property of the bankrupt, to the causes of his bankruptcy and the disposition of his property.

These provisions provide a powerful investigative tool for the trustee to acquire information and documentation that will assist in the administration of the estate. Specifically, these provisions allow the trustee (as well as creditors under Section 163(2)) to collect information that will allow a determination of whether there have been any inappropriate dealings with the property of the bankrupt, and whether actions should be commenced on behalf of the creditors under sections of the BIA involving fraudulent preferences, fraudulent conveyances, settlements, reviewable transactions, payments of dividends and share redemptions.

This paper will focus on examinations by trustees in bankruptcy, however, the final section of the paper briefly addresses examinations by creditors. The paper will first provide an overview of the mechanics and the scope of Section 163. Specific issues that have recently arisen with respect to these provisions will then be examined, including: constitutional concerns; the ability to examine solicitors and the balancing by courts of the right to examine and the existence of solicitor-client privilege; the examination of accountants/auditors; and the rights of creditors to examine and to use information gleaned as a result of the examinations as well as the production of documents.

Practical Strategies

The arsenal at the Trustee's disposal provides creditors with ample ability to at least commence a forensic review of the debtor's activities. However, time, cost, international borders and the need for cooperation of third parties place practical limits on the Trustee's efforts.

Timing can often play an important role in conducting an effective investigation. The key goal of any investigation, especially where fraud may be suspected, is to locate and freeze cash before the debtor or the fraudster has an opportunity to move the funds in such a way so as to obscure the trail or avoid detection. Catching money before it has left the country is particularly important. The Trustee's ability to enforce its orders and carry out its investigative powers decline dramatically once foreign enforcement proceedings are required. Therefore, a very quick strike at the cash can often have great rewards.

This may not necessarily involve attempts to gain a full understanding of the situation by examining the principal wrongdoers. Wide ranging examination of those with incentive to avoid the truth require careful preparation and substantial background knowledge which is often

unavailable at the outset of a case. Instead, counsel are well-advised to consider a series of very quick examinations of lower level employees who may have actually carried out the instructions which led to the debtor's failure. Subordinate employees, fearing personal exposure and witnessing the former employers' fall from power, are motivated to cooperate in order to protect their own positions. Secretaries, accounting clerks, or the employee who took daily receipts to the bank, may often provide leads to find cash.

One also cannot over-estimate the ability of a good detective to provide early leads which may not otherwise be available. Experienced detectives, often with police experience, may be able to locate individuals, provide leads to bank accounts or other helpful information early on.

On difficulty which can stymy an investigation is the administrative hurdles erected by banks which limit access to bank statements. Notwithstanding orders of the court or lawful directives from a trustee in bankruptcy, banks charge high administrative fees and can take literally months to produce bank account records. Therefore quick access to a comprehensive set of financial records to allow a forensic auditor to seek to track funds is often simply unavailable. This difficulty is compounded when foreign banks are involved. Swiss banks, in particular, are nearly impregnable in civil matters. A request through the criminal process gets far better results in Switzerland, but is not simple to attain by civil litigants here.

In cases of sophisticated fraud, the practical outcome is often to commit a budget to a first strike to try to capture some cash to fund further investigations. If this does not succeed, clients need to understand that being in for the long haul is just that. Obtaining information, seeking relief, and then taking enforcement proceedings are fraught with expenses, delays and opportunities for the wrongdoers to defend or obscure the course of justice. One cannot expect to see recovery against a wrongdoer until the very end of the very last process. Therefore, it is especially

poignant for the client to understand at the outset that it cannot expect to spend a portion of its budget in order to seek proportional recovery. In the ordinary course of a large, sophisticated fraud, one must commit a large budget and be prepared to stay-the-course in order to see any recovery at all.

This is not necessarily the case for the run-of-the-mill bankruptcy where a clumsy debtor who may have moved assets in desperation. In many smaller cases, enforcement activities bring the debtor readily to account or at least to a settlement. Unfortunately, it is in the larger cases where the system simply all-too-often fails as the blunt tools available cannot readily produce a cost-effective remedy.

Practicality demands that speedy efforts to capture cash provides the best hope of success. Section 163 examinations need not be long drawn out affairs. Several can be conducted in a day at a business site even, for example, where the Trustee tells the employees to attend – perhaps before the business is ever shut down. Early examinations under Section 163 of the BIA to understand the flow of cash through a business and to seek evidence of sources of quick recovery in Canada can be a crucial determinate of success.

A. Scope of Section 163

Section 163 creates an investigatory process that allows the trustee to collect information without having to commence litigation and conduct discoveries. The powers of examination under the section are very wide[2], but not unlimited. While the parameters of the section, described below, are quite broad, an examination by a trustee under Section 163 must be for the sole purpose of assisting the trustee in the administration of the estate. As discussed in Section E below, the

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[2] *Re D.W. McIntosh Ltd.* (1939), 21 C.B.R. 206 (Ont. S.C.).

examination provisions are not to be used to further the private purposes of a creditor of the estate.[3]

(i) Who may be examined

Section 163(1) of the BIA permits a trustee to examine, under oath, the bankrupt, any person reasonably thought to have knowledge of the affairs of the bankrupt or any person who has been an agent, clerk, servant, officer, director or employee of the bankrupt. As is discussed in detail in Section C, below, both the solicitors and auditors of a bankrupt can be examined as persons who may reasonably be thought to have knowledge of the affairs of the bankrupt, however, solicitor-client privilege limits what a solicitor can be compelled to disclose. In addition, the spouse of a bankrupt can be required to submit to an examination under Section 163(1), however, the trustee may only ask questions of the spouse that are relevant to the bankrupt's conduct and are not oppressive.[4]

Pursuant to Section 163(2), a third party may obtain an order to examine the trustee, the bankrupt, or any other interested person, upon sufficient cause being shown. As referenced above and in Section E, below, the ability of a third party to conduct an examination under Section 163(2) is limited to those examinations that are for the general benefit of creditors and involve the general administration of the estate. Third parties will not be allowed to examine the bankrupt or other interested parties under this section to assist in private proceedings.[5]

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[3] *Re Nominal Holdings Ltd.* (1989), 73 C.B.R. (N.S.) 44 (Ont. S.C.) and *GMAC Commercial Credit Corp. – Canada v. TCT Logistics Inc.* (2003), 37 C.B.R. (4th) 267 (Ont. S.C.J.) [hereinafter *TCT Logistics*].

[4] *Ibid.*

[5] *Hartland Pipelines Services Ltd. (Trustee of) v. Jones* (2000), 18 C.B.R. (4th) 28 (Alta. Q.B.) and *TCT Logisitics, supra* note 3.

(ii) Scope of the Examination

The provisions in the BIA are much wider in scope than the examinations available under the *Rules of Civil Procedure.* The scope of the examination under Section 163 is determined through the interaction of Sections 163 and 167.[6] Section 163(1) permits an examination respecting the bankrupt, his dealings or property. Section 167 requires any person being examined to answer all questions relating to the business or property of the bankrupt, the causes of the bankruptcy and dispositions of the bankrupt's property.

There is no temporal limit on the examination. As long as the questions deal with matters that fall within the boundaries created by Section 167 and are not oppressive, the party being examined must respond.[7] Section 167 has been interpreted to mean:

> no question asked on examination which relates to the business and property of the bankrupt, the cause of bankruptcy and the disposition of property of the bankrupt whenever acquired or disposed of can be irrelevant and [the examination] cannot be confined to matters for which there are grounds for believing have actually occurred. In summary, the investigation is meant to be a searching enquiry.[8]

(iii) Practice

In order to conduct an examination under Section 163(1), the trustee must obtain an ordinary resolution of creditors or a written request or resolution of a majority of the inspectors of the bankrupt estate. In practice, it is customary for a trustee to first examine the affairs of the bankrupt, which may include a review of the books and records of the bankrupt by an

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[6] L.W. Houlden and G.B. Morawetz, *Bankruptcy and Insolvency Law of Canada* (3d ed.) (Carswell: Scarborough, 1989+) at 6-18.2.

[7] *Re McDonough* (2001), 27 C.B.R. (4th) 279 (Ont. S.C.J.).

[8] *Ibid* at 280.

accountant, with a view to disclosing any questionable transactions and prepare a report. The inspectors will then review this report and discuss the questionable transactions, at a duly called meeting of inspectors. If further action is necessary, the trustee will request the approval of the inspectors to examine certain named individuals and the resolution will be passed. The trustee will then instruct its solicitor to take out an appointment with the Official Examiner and the appointment will be served on the person sought to be examined. The appointment must be served two clear days before the day of the examination.[9]

The Saskatchewan Court of Queen's Bench has recently held that an authorization to conduct an examination pursuant to Section 163(1) can only be granted by creditors or inspectors of the estate and that Parliament has left no room for a court to intervene and order an examination,[10] confirming that the above process would have to be followed by a trustee seeking to conduct examinations in connection with a bankruptcy.

B. Constitutional Concerns

Individuals wishing to avoid examination under Sections 163 and 164 of the BIA have attempted to rely on the *Canadian Charter of Rights and Freedoms* (the "Charter") to argue that various provisions of the Charter may be offended by the powers of examination and production conferred by Section 163 and 164.

In *Re Leard*[11], a major investor (the "Applicant") in an allegedly fraudulent pyramid scheme sought to avoid examination by the trustee and the related production of documents. The

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[9] L.W. Houlden, "Discovery in Criminal Prosecutions in Bankruptcy Matters", 50 Can. Bar. Rev. 486.

[10] *Re Pratchler Agro Services Inc.* (2002), 34 C.B.R. (4th) 87 (Sask. Q.B.).

[11] (1993), 23 C.B.R. (3d) 233 (Ont. Gen. Div.), affirmed (1994), 25 C.B.R. (3d) 210 (Ont. C.A.).

Applicant argued that Sections 163 of the BIA violated Section 7 of the Charter and further that Section 164 of the BIA violated Section 8 of the Charter. The Court concluded that the safeguards designed to protect individual freedoms incorporated in the Charter did not protect a private citizen from the power of examination by a trustee appointed under the BIA. The Court noted that the Charter was enacted to protect the rights of individuals from the government of Canada and the provinces, and was not intended to regulate relations between private persons. The Court stated that the BIA was legislation that effected a balance between the competing rights of private concerns and was not in the nature of legislative authority. The fact that bankruptcy law has been described as "quasi criminal" in nature was not sufficient to invoke Charter protection. The Court observed that there was nothing prohibiting the Applicant from seeking protection under evidentiary statutes to protect himself against the possibility of incrimination. Accordingly, the Court concluded that "it stretches [my] imagination to the extreme to suggest that the Charter protection would apply... in the circumstances of this proposed examination".[12]

In *Re Bookman,*[13] a bankrupt (the "Applicant") moved for an order quashing an appointment for the examination of the Applicant on the grounds that Section 133 (now Section 163) was contrary to Sections 11(c) and 13 of the Charter. Section 11(c) of the Charter states that any person charged with an offence has the right not to be compelled to be a witness in proceedings against that person in respect of the offence. The Applicant had been petitioned into bankruptcy by a bank to which the Applicant was indebted in the approximate amount of $2 million. The

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[12] *Ibid* at 242.

[13] (1984), 49 C.B.R. (N.S.) 267 (Ont. S.C.)

indebtedness was the result of the Applicant's alleged "cheque kiting" activities and, as a result, there were also criminal charges against the Applicant.

The Applicant argued that Section 133(1) (now section 163(1)) was open-ended, with no restriction on the questions that could be asked, and carried the sanction of imprisonment for failing to answer questions. The Applicant postulated that where a bankruptcy and criminal charges resulted from the same alleged factual foundation, the right against self-incrimination found in Section 11(c) of the Charter would be seriously eroded if an accused could be compelled to testify in the bankruptcy proceedings before the disposition of the criminal charges.

The Court found that the plain meaning of Section 11(c) was not consistent with the interpretation put forth by the Applicant. The Court noted that the plain meaning of the section confined the non-compellability to proceedings in respect of the offence and provided no privilege in respect of other proceedings, such as an examination under Section 133(1).

As in *Re Leard, supra,* the Court also addressed the "quasi criminal" nature of the BIA and concluded that, in essence, proceedings under the BIA are civil proceedings and so not themselves directly affected by Section 11(c) of the Charter.

The Court then considered the Applicant's argument that Section 133(3) (now Section 163(3)), which section allows for the evidence garnered under the section to be filed in the court and read into any proceedings under the BIA to which the person examined is a party, was contrary to Section 13 of the Charter. Section 13 states that a witness who testifies in any proceedings has the right not to have any incriminating evidence so given used to incriminate that witness in any other proceedings, except in a prosecution for perjury or giving contradictory evidence. The Court concluded that Section 13 had little to do with the scope of the application as it did not

relate to the question of whether the Applicant was a compellable witness at an examination under the BIA.

In both *Re Leard* and *Re Bookman*, the Court made reference to Section 5 of the *Canada Evidence Act*. Section 5(2) of the *Canada Evidence Act* states that with respect to any question that a witness objects to answer on the ground that his answer may tend to incriminate him, or may tend to establish his liability in a civil proceeding, and but for the *Canada Evidence Act* or any provincial act, the witness would have been excused from answering the question, then although the witness is compelled to answer, the answer given is not admissible in evidence against him in any criminal trial or other criminal proceeding taking place thereafter against the witness. On examination under Section 163, the witness is entitled to claim the protection of Section 5(2) of the *Canada Evidence Act.* As Section 167 is silent on the matter of self-incrimination, there is no reason to imply any provision in that regard that is inconsistent with the protections provided in Section 5(2) of the *Canada Evidence Act*. Accordingly, if a witness is asked a question, the answer to which is incriminating, Section 5(2) would come into play to compel a response and, at the same time, protect against use of the answer in a criminal proceeding.[14]

Accordingly, while it appears that the Charter does not provide protection to witnesses examined under Section 163 of the BIA, there is some protection provided by the *Canada Evidence Act* in situations where the witness may be facing criminal proceedings.

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[14] *Rusin v. Selman et al.* (1980), 35 C.B.R. (N.S.) 141 (B.C.C.A.).

C. Solicitors and Section 163

(i) Examinations of Solicitors

The solicitor of a bankrupt may be served with an appointment for examination under Section 163(1). In the examination, the solicitor will be required to disclose all information regarding the affairs of the bankrupt, transactions completed by the bankrupt and the whereabouts of property, which does not require the disclosure of communications made to the solicitor by the bankrupt for the purpose of receiving legal advice.[15] The communication of legal advice is excluded from the scope of the examination as these communications are protected by solicitor-client privilege.[16]

(ii) Solicitor-Client Privilege

The British Columbia Supreme Court conducted a thorough review of the legal developments with respect to solicitor-client privilege in the context of a Section 163 examination in *Re Taylor Ventures Ltd.*[17] In this case, a trustee sought directions as to whether it should be provided with files from the bankrupt's former solicitors and whether the trustee was at liberty to provide to the inspectors of the bankrupt estate unrestricted access to those files. The former solicitors objected and argued that the trustee was under an obligation to respect the confidentiality of the documents produced. The trustee argued that it now stood in the shoes of the bankrupt and accordingly, although communications between the bankrupt and his solicitors were privileged,

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[15] *Re Dilawri; Clarkson Co. v. Chilcott* (1984), 53 C.B.R. (N.S.) 251 (Ont. C.A.) affirming (1983), 47 C.B.R. (N.S.) 93 (Ont. S.C.) and *Re Lauzier* (1996), 43 C.B.R. (3d) 207 (Ont. Gen. Div.).

[16] *Re Lauzier, ibid.*

[17] (1999), 9 C.B.R. (4th) 136 (B.C.S.C.).

the trustee could waive that privilege if it chose to do so. In short, the trustee argued that the confidential files, as well as the privilege, belonged to the trustee.

The Court held that the former solicitors were to deliver to the trustee all documents and information relating to the affairs of the bankrupt, with the exception of communications between the bankrupt and the former solicitors which were made for the purpose of providing legal advice to the bankrupt.

With respect to the waiver of privilege by the trustee, the Court reviewed the relevant precedents. *Re Cirone*[18], the first case considered by the Court, stood for the proposition that the trustee stepped into the shoes of the bankrupt and was in a position to waive privilege in order to require the solicitor of a bankrupt to be examined. The trustee in *Re Cirone* was attacking the payment by the bankrupt of pre-petition legal fees as amounting to a fraudulent preference. The court in *Re Cirone* noted that the trustee should be permitted a wide scope in cases where it is obliged to take an action in court on behalf of creditors to try and recover funds. Similarly, in *Re Abacus Cities Ltd.*[19], the court also allowed a trustee to waive privilege if, in the trustee's belief, such a waiver would not be to the prejudice of the interests that the trustee represented.

This position was rejected by the Ontario Court of Appeal in *Re Dilawri*[20] in which the Court of Appeal disagreed with the proposition that a trustee in bankruptcy possesses the legal right to waive privilege with respect to legal advice given to the bankrupt respecting his former property. The Court of Appeal determined that the decision in *Re Cirone* should be limited to its own facts,

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[18] (1965), 8 C.B.R. (N.S.) 237 (Ont. S.C.).

[19] (1981), 40 C.B.R. (N.S.) 172 (Alta. Q.B.).

[20] *Supra* note 15.

specifically that in that case the proposed examination of a solicitor involved allegations of fraudulent preference regarding the solicitor's own conduct. While the Court of Appeal did not state definitively whether there may be circumstances in which the trustee may waive the bankrupt's privilege, the Court concluded that the goal of protection of creditor's rights was not sufficient to overcome the solicitor-client privilege that existed in connection with the provision of legal advice.

The British Columbia Supreme Court summarized the current state of the law as follows:

> (a) solicitors or former solicitors can be compelled to disclose to the trustee all information regarding the property and affairs and transactions of the bankrupt which do not require the disclosure of communications made for the purpose of giving legal advice. Specifically, questions which deal with assets, the disposition of assets, the tracing of assets or sale proceeds or the flow of funds in and out of trust or otherwise are matters which are not subject to solicitor-client privilege.
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> (b) communications made for the purposes of giving legal advice are not privileged where the purpose of the communication was made to further a criminal purpose. All other communications for the purpose of giving legal advice are privileged and must not be disclosed to the trustee or others and this privilege cannot be waived by the trustee or others on behalf of the bankrupt.
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> (c) the trustee can, pursuant to sections 16(5), 163(1) and 165(1) of the BIA, require the examination of a former solicitor and the delivery of documents in the possession of the former solicitor providing those documents and that examination does not relate to matters which are privileged.[21]

It should be noted, as can be seen from the above, that solicitor-client privilege has a narrow application in the context of examinations under the BIA. As an illustration of this point, the Ontario Superior Court of Justice recently held that an individual being examined under Section 163 and 164 cannot invoke solicitor-client privilege to protect the contents of a conversation that

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[21] *Re Taylor Ventures, supra* at 147.

occurred between a third party and its legal counsel in the presence of a person being examined.[22]

In this case, during the course of the examination by the trustee in bankruptcy of the accountant of the bankrupt company, counsel objected to the accountant answering questions regarding a meeting held with the principal of the bankrupt company and the principal's counsel. Counsel took the position that what was discussed at the meeting was subject to solicitor-client privilege. The meeting was held to consider whether the accountant should be appointed to replace the current trustee. The Court noted that the determination of the existence of solicitor-client privilege with respect to third parties depended on the function of the third party. The Court concluded that the fact that the principal of the bankrupt company and his solicitor may have discussed strategy in the presence of the accountant did not afford that conversation the protection of solicitor-client privilege. Accordingly, the accountant was ordered to answer all questions pertaining to the meeting.[23]

(iii) Fraud

The treatment of solicitor-client privilege may differ in the situation where there are allegations of fraud against the bankrupt. In circumstances where fraud is alleged against the bankrupt, courts may refuse to recognize the solicitor-client privilege and allow the examination of a solicitor on communication with a client.[24] However, solicitor-client privilege will only be circumvented where there is "a prima facie case that the communications between the solicitor

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[22] *Re Apple & Spice Fruit & Vegetables Wholesale (1997) Inc.* (2001), 22 C.B.R. (4th) 171 (Ont. S.C.J.).

[23] *Ibid.*

[24] *Re Kostiuk* (1999), 13 C.B.R. (4th) 81 (B.C.S.C.).

and client were made in preparation for or in furtherance of a crime or fraud, regardless of whether the solicitor is aware of the purpose".[25] The mere allegation of fraud in a pleading will not be sufficient to displace the privilege.

The Court in *Canbrook* considered the meaning of the phrase "a prima facie case of fraud must be made out in fact". The Court referred to the following passage from a decision of Lord Denning:

> No privilege can be invoked so as to cover up fraud or iniquity. But this principle must not be carried too far. No person faced with an allegation of fraud could safely ask for legal advice. To do away with the privilege at the discovery stage there must be strong evidence of fraud such that the court can say: "This is such an obvious fraud that he should not be allowed to shelter behind the cloak of privilege."[26]

The Court ultimately found it unnecessary to express a view on how strong a prima facie case of fraud must be to defeat a claim of privilege but did note that something exceptional was called for. The Court found on the facts that a prima facie case of fraud sufficient to set aside solicitor-client privilege had not been made out. Steps taken by the bankrupt that were alleged to be fraudulent, which included withholding payment to suppliers while repaying indebtedness to a subsidiary corporation pursuant to a shareholder loan agreement and a general security agreement, were found to be equally consistent with a legitimate business transaction. In reaching this decision, the Court relied on authorities that indicated that, in the event of any doubt, a court should err on the side of protecting solicitor-client privilege.[27]

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[25] *Canbrook Distribution Corp. v. Borins* (1999), 7 C.B.R. (4th) 121 (Ont. Gen. Div.) [hereinafter *Canbrook*], quoting R.D. Manes and M.P, Silver, *Solicitor-Client Privilege in Canadian Law* (Markham: Butterworths, 1993) at 83.

[26] *Buttes Gas and Oil Co. v. Hammer,* [1980] 3 All E.R. 475 (H.L.).

[27] See *3173763 Canada Inc. v. Dearab Holdings Inc.,* [1997] O.J. No. 2905 (Ont. Gen. Div.).

The displacement of solicitor-client privilege with respect to communications for the purpose of obtaining professional advice in these circumstances has been described as appropriate for policy reasons:

> The denial of privilege in such circumstances is not based on waiver by the client, express or implied, but simply on the policy basis that the benefits of maintaining the privilege are outweighed by the benefits to be derived, in cases where fraud is a germane issue, from full disclosure of all circumstances relevant to resolving that issue including those circumstances contained in documents which are usually protected from disclosure by reason of the solicitor-client privilege.[28]

Accordingly, if a court is satisfied that there is sufficient evidence of a prima facie case of fraud on the part of the bankrupt, solicitor-client privilege will not protect communications between the bankrupt and his or her solicitor, even when those communications involve the provision of legal advice.

D. Examination of Auditors

An accountant/auditor may be examined pursuant to Section 163 and may be required to produce materials pursuant to Section 164. There is no evidentiary privilege attaching to the relationship between an accountant and the bankrupt as there is where a solicitor is involved. Accountants are considered by the courts to be useful sources of information, especially when the bankrupt is lacking in complete records.[29]

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[28] *Pax Management Ltd. v. Canadian Imperial Bank of Commerce* (1987), 14 B.C.L.R. (2d) 257 (B.C.C.A.) at 265.

[29] *Re Sun Squeeze Juices Inc.* (1994), 27 C.B.R. (3d) 98 (Ont. Gen. Div.).

A recent decision of the Ontario Superior Court is illustrative in this regard. In *Re Network Forest Products Ltd.*[30] the trustee in bankruptcy was investigating an inventory variance between the book value and the actual physical inventory of the bankrupt. The trustee repeatedly requested that the bankrupt's auditor provide certain working papers relating to an audit of the bankrupt, however, the auditor refused to provide the materials on the basis that the working papers were its own documents and were not the property of the bankrupt. The Court determined that Section 164(1) of the BIA was sufficiently broad to encompass the right to inspect documents which are the property of an auditor. The Court stated that the public policy reason for this was based on that fact that it was in the public interest to ensure transparency with respect to the business operations and property of the bankrupt for the protection of creditors.

The Court did not accept the assertion by the auditor that it was precluded from having to provide the requested documents due to the "confidentiality of information" provisions of the *Institute of Chartered Accountants Rules.* The Court observed that these rules recognize the possibility of a court order and provide an exception where the information is required to be disclosed by "order of lawful authority". Irrespective of the exception, the Court noted that professional conduct rules cannot override the provisions of the BIA. Finally, the Court stated that there was no privilege which attached to the requested documents as the documents did not relate to communications between a bankrupt and a solicitor for the purpose of obtaining legal advice.

Similarly, in *GMAC Commercial Credit Corp.-Canada v. TCT Logistics Inc.*[31] Mr. Justice Farley stated that "documents produced by an auditor are not protected by any privilege recognized by

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[30] (2002), 31 C.B.R. (4th) 297 (Ont. S.C.J.).

[31] *TCT Logistics, supra* note 3.

Canadian law which prevents their production to a trustee in bankruptcy".[32] Justice Farley also stated that it was not for the auditor to decide which materials should be provided to the trustee and that it was not appropriate for the auditor to attempt to hold back materials on the grounds that they were not relevant. Justice Farley noted that for an order to issue under Section 164, all that was required was a good faith request by the trustee for production from the third party.

However, Mr. Justice Farley placed limitations on the use of information produced by the auditor. The auditor had challenged to right of the trustee to obtain the material it sought if the material could subsequently be used against the auditors in an action for negligence. After considering whether he should exercise his discretion to restrict the trustee from making the material obtained pursuant to Section 164 available to creditors, Mr. Justice Farley concluded that while creditors may inspect the books, records and documents of the estate, this is to be done in their capacity as creditors of a bankrupt and not with a view to advancing their claims outside of bankruptcy. Mr. Justice Farley determined that it would be a dereliction of duty by a trustee to provide material which it has obtained pursuant to Section 164 to others, including creditors, such that, in effect, the trustee would be assisting other litigants in competition with the trustee. Mr Justice Farley stated that it was inappropriate to allow creditors, in their individual capacities, to "piggyback" on the trustee's rights under Section 164 and use the material produced for non-bankruptcy litigation.

Materials prepared by an accountant may be privileged in very specific circumstances. Where the material was prepared by the accountant at the request of the bankrupt's solicitor to be used in connection with litigation, or for the purpose of obtaining legal advice or assistance, the material

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[32] *Ibid.* at 271.

can be privileged and the accountant cannot be examined on it.[33] Further, if an accountant is used as a representative of a client for the purpose of placing a factual situation or a problem before a lawyer in order to obtain legal advice or assistance, the fact that the individual is an accountant does not make the communications any the less the communication of the client and similarly communications received by such a representative from a lawyer whose advice has been sought are none the less communications from the lawyer to the client that may be subject to a claim for privilege.[34]

However, apart from the very narrow circumstances described above, in most situations, material prepared by accountants relating to the bankrupt's affairs, property and transactions will be required to be produced under Section 164 of the BIA and the accountant will be examinable under Section 163.

E. Rights of Creditors

As discussed above, in addition to examinations by the trustee, pursuant to Section 163(2) of the BIA, a creditor or other interested person may apply to the court, and on showing sufficient cause, may be allowed to examine the trustee, the bankrupt, an inspector or creditor, or any other person named in the order for the purpose of investigating the administration of the estate of the bankrupt.

It will be unusual for a Court to allow an examination by a creditor as there is rarely articulable cause for a creditor to be conducting an investigation of the administration of the estate, unlike the very broad power granted to the trustee to examine anyone on a broad test of relevancy

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[33] *Wolch's Guaranteed Foods Ltd. (Trustee of) v. Wolch* (1994), 24 C.B.R. (3d) 268 (Alta. Q.B.).

[34] *Ibid.*

relating to the affairs of the bankrupt. Rather, the Section 163(2) examination is more of a check and balance mechanism which can be made available to creditors by the Court.

Two issues arise in connection with this provision. The first issue is whether the potential examiner has demonstrated "sufficient cause" and the second is whether the purpose of the examination involves "investigating the administration of the estate of the bankrupt".

(i) Sufficient Cause

The court's discretion to grant an order under Section 163(2) will not be exercised without sufficient reason.[35] The Nova Scotia Supreme Court held, in *Re NsC Diesel Power Inc.*[36], that a "strong possibility" that an inspector may have had information respecting the assets of the estate, with no other evidence to support the assertion, did not amount to sufficient cause. The Nova Scotia Court noted that the burden is on the would-be examiner to demonstrate sufficient cause and that sufficient cause must be directly related to the person sought to be examined. The assertion by the would-be examiner in this case that he "must start somewhere" did not satisfy the requirements of Section 163(2). The Court observed that there must be a demonstrated connection between the evidence of something being amiss and the ability of the named person to provide some insight, as it relates to the administration of the estate.

The high water mark of a Section 163(2) examination is found in a case of the Alberta Court of Queen's Bench, *Hartland Pipeline Services Ltd. (Trustee of) v. Jones.*[37] In this case a secured lender brought an application for an order allowing the examination of the former chairman of a

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[35] M.A. Springman et al., *Fraudulent Conveyances and Preferences* (Carswell: Toronto, 1994+) at 19A-4.

[36] (1997), 49 C.B.R. (3d) 213 (N.S.S.C.), affirmed (1998), 6 C.B.R. (4th) 96 (N.S.C.A.).

[37] (2000), 18 C.B.R. (4th) 28 (Alta. Q.B.).

bankrupt corporation. The trustee in bankruptcy had already examined the chairman and had indicated to the court that it had no further need to examine. The Court first considered whether an examination under Section 163(2) should only be allowed in circumstances where the trustee has not undertaken the necessary examination. The Court noted that in most cases, an examination is granted "on the basis that either the trustee has decided not to pursue an action despite the existence of irregularities in the administration of the bankrupt's estates or the trustee has not had the funds to properly investigate the matter."[38] However, the Court was satisfied that Section 163(2) permitted examinations even where the trustee has already conducted examinations under Section 163(1). The Court stressed that the onus remained on the would-be examiner to demonstrate sufficient cause for the additional examination. The Court noted that the threshold for sufficient cause was fairly low, however, the applicant examiner must provide some evidence, usually in affidavit form, in support of the Section 163(2) examination. The evidence should show that the additional examination is not frivolous, superfluous nor oppressive, is for the general benefit of creditors and involves the general administration of the bankrupt's estate.

In sum, provided a creditor or interested party has valid grounds on which to believe that the party it wishes to examine may be able to provide information connected with the administration of the estate, courts may make an order to this effect, even in the situation where the trustee has already conducted an examination of the person in question.

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[38] *Ibid.* at 32.

(ii) Purpose of Section 163(2) Examination

An examination under Section 163(2) is meant to be an examination for the general benefit of creditors. Accordingly, it must relate to the general administration of the bankrupt estate. An examination may not be used by a creditor to pursue a private remedy.[39] For example, in *Re Assef* [40] the Court held that a creditor could not examine a bankrupt for the purposes of attempting to locate a missing chattel, a rug, that had been listed on a chattel mortgage. The Court held that Section 163(2) was not intended to be used to facilitate private proceedings outside of the bankruptcy. The Court stated:

> The Section provides a means for the examination of the bankrupt and other persons by those interested in the administration of the estate and not for the private purposes of any person whether a creditor or otherwise. The words used in the Section "for the purpose of investigating the administration of the estate of any bankrupt", are very significant. It is an examination for the general interest and for the demonstrable general benefit of creditors and not, as I have mentioned, for creditors to pursue a private remedy.

Similarly, in *Re Witkowski* [41], a secured creditor wished to examine the bankrupt for the sole purpose of gaining information relating to the disappearance of an automobile over which the creditor was secured. The Court dismissed the motion of the secured creditor and stated that any examination it undertook would have been for its sole and exclusive benefit.

The limited nature of the rights of creditors to examine, or to have access to materials in connection thereto, was, as discussed above, emphasized by Mr. Justice Farley in *TCT Logisitics* Mr. Justice Farley made it clear that while the statute provides a right to creditors to examine the

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[39] *Hartland Pipeline, supra* note 37.

[40] (1976), 23 C.B.R. (N.S.) 14 (Ont. S.C.)

[41] (1987), 63 C.B.R. (N.S.) 271 (Ont. S.C.).

books, records and documents relating to the administration of the bankrupt estate, such an examination is to be done by creditors in their capacity as creditors of the bankrupt and not with a view to advancing non-bankruptcy claims.[42] Accordingly, the usefulness of Section 163(2) from the perspective of creditors is limited to ensuring that the trustee is administering the estate in an appropriate manner.

It should also be noted that when a trustee is conducting an examination under Section 163(1), or is collecting materials pursuant to Section 164, the trustee does not have the authority to conduct the review to obtain information that would be solely of use to third parties. The trustee's efforts must be spent for the benefit of creditors only to the extent that the interest of the creditors relates to the property, dealings and affairs of the bankrupt.[43] To allow otherwise would mean, in effect, that the trustee, who is charged with maximizing the estate of the bankrupt for the appropriate distribution to creditors, would be assisting other litigants in competition with the trustee.[44]

Conclusion

Armed with an understanding of the breadth of the powers available under Section 163, the trustee can plan a series of examinations aimed at understanding the movement of cash, the sources of the failure of the bankrupt and exploring causes of action which may provide recovery for the estate. Solicitors may be examined to gain access to transaction documents. Auditors working papers will often highlight the judgment calls which

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[42] *TCT Logistics, supra* note 3.

[43] *Re Taylor Ventures, supra* note 18.

[44] *TCT Logistics, supra* note 3.

underpin crucial accounting manoeuvres. Whether it be used for a quick surgical strike or an all out investigation of every aspect of the affairs of the debtor, Section 163 examinations are a key strategic arrow in the trustee's quiver.

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THE TRUSTEE AS SHERLOCK HOLMES:

EXAMINATIONS UNDER SECTION 163 OF THE BIA

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