

Does a Discharge of a Receiver Mean Liability of the Receiver is at an End?

A recent decision of Justice McEwen dealt with an interesting issue concerning whether a party in receivership can sue the Receiver after an order discharging the Receiver.



Barry A. Cohen
Partner, Banking & Financial Services

PHONE
416 777 5434

EMAIL
bcohen@torkinmanes.com

Barry is a partner in our Banking and Insolvency groups. He provides counsel to banks, leasing companies, factoring companies, asset-based lenders and other lenders in commercial loan transactions secured by real estate, debentures, security instruments, *Bank Act* Security and personal property.

In the case at hand (Canadian National Railway Company (“CN”) and Scott Holmes (“Holmes”) et al – Court File CV-08-7670-00CL citation 2015 ONSC3038), CN obtained both a Mareva Order and Anton Pillar Order against Holmes, Jennifer Lynn Flynn (“Flynn”) and various corporations controlled by them. On August 26, 2008 Schonfeld Inc. (“Schonfeld”) on consent was appointed as a Monitor.

The Monitor’s powers were set out in paragraph 2 of the Monitor Order and were primarily for managing assets of the Monitored Parties and paying legal fees and disbursement of the Monitored Parties.

The Monitor’s powers included:

“2. THIS COURT ORDERS that the Monitor is hereby empowered and authorized, but is not obligated, to act at once in respect of the Property. The Monitor is granted this power in

order to facilitate the management of the assets of the Monitored Parties pursuant to a Mareva Injunction granted by the Honourable Justice Lederman on August 8, 2008, as continued and amended by Order of the Honourable Justice Newbould dated August 18, 2008 (“Mareva Injunction”) and the documents reflected in the Anton Piller Order granted by the Honourable Justice Lederman on August 8, 2008, as continued by the Order of the Honourable Justice Newbould on August 18, 2008, (“Anton Piller Order”) and as more particularly reflected in a Supplementary Interim Agreement dated August 14, 2008 between the plaintiff and the Monitored Parties. Without in anyway limiting the generality of the foregoing, the Monitor is expressly empowered and authorized to do the following:

(a) To monitor and review the

Property and any and all proceeds, receipts and disbursements arising out of or from the Property;

(b) To enter into and assess, on satisfactory disclosure by the Monitored Parties, the business and undertaking of the Holmes Companies and related entities and the assets of Holmes, Flynn and the Trusts;

(c) To make a recommendation as to the future of any or all of the Holmes Companies, including the wind-down of any or all of them, and to supervise the implementation of those steps;

(d) To determine and recommend the necessary expenditures for purposes of achieving such recommended steps, including wind down, and meeting the necessary ongoing obligations of the Holmes Companies, including:

(i) Who the necessary employees of the Holmes Companies are; and

(ii) Who is on the payroll of the Holmes Companies, but not providing necessary services to them....."

(k) To take any steps reasonably incidental to the exercise of these powers,

and in each case where the Monitor takes any such actions or steps, it shall be exclusively authorized and empowered to do so, to the exclusion of all other Persons (as defined below)

and without interference from any other Person....."

The Monitor Order also contained usual protective language given to Monitors and Receivers. In particular, paragraph 7 and 8 of the Monitor Order provided:

"6. The Monitor Order also provided the usual types of protections afforded to monitors in paragraphs 7 and 8:

NO PROCEEDINGS AGAINST THE MONITOR

7. THIS COURT ORDERS that no proceeding or enforcement process in any court or tribunal shall be commenced or continued against the Monitor except with the written consent of the Monitor or with leave of this Court;

LIMITATION ON THE MONITOR'S LIABILITIES

8. THIS COURT ORDERS that the Monitor shall incur no liability or obligations as a result of its appointment or the carrying out of the provisions of this Order, save and except for any gross negligence or wilful misconduct on its part..."

Subsequent to the Monitor reporting to the Court, the Monitor was appointed as a Receiver of the Monitored Parties. The Receivership Order authorized the Receiver to liquidate certain identified assets of the Monitored Parties and to pay a fixed amount to Holmes and Flynn for living expenses and for their

professional advisors.

The Receivership Order contained a limitation of liability and, as part of the Receivership Order, there was a provision relating to the prior Monitor Order which stated:

"LIMITATION ON THE RECEIVER'S LIABILITY

25. THIS COURT ORDERS that the Receiver shall incur no liability or obligation as a result of its appointment or the carrying out of the provisions of this Order, save and except for any gross negligence or wilful misconduct on its part. Nothing in this Order shall derogate from the protections afforded by the Receiver by section 14.06 of the Bankruptcy and Insolvency Act ("BIA") or any other applicable legislation.

GENERAL

26. THIS COURT ORDERS that this order should be read in conjunction with the Monitor Order and that nothing in this Order shall derogate from the powers of and protections of the Monitor/Receiver described in the Monitor Order. All the provisions of the Monitor Order shall continue to apply to activities of the Receiver in respect of this Order."

The Receiver, having completed its duties, obtained a Discharge Order on September 26, 2011 (not opposed) which order included:

"DISCHARGE OF RECEIVER, MONITOR AND FEE ASSESSOR OFFICER

8. THIS COURT ORDERS AND

DECLARES that the Receiver has duly and properly discharged all of its duties, liabilities and obligations as Monitor/Receiver of the Monitored Parties (as defined in the Order of Spence J., dated August 26, 2008 and the Order of Campbell J., dated December 4, 2008).....

10. THIS COURT ORDERS that the Receiver is discharged from its duties, liabilities and obligations, in its dual capacity as either Monitor or Receiver of the Monitored Parties property and assets is discharged, save for its duties with respect to the Claim, and is also released from any duties, liabilities and obligations arising from the Mareva Order of Lederman J., dated August 8, 2008 (as amended).

11. THIS COURT ORDERS that upon filing the Initial Completion Certificate the Receiver shall continue to remain Receiver and continue to have authority as Receiver in order that it may complete its ongoing duties with respect to the Claim until such matters are complete. The Receiver shall continue to have the full benefit of the provisions of all Orders made in this Monitor/Receivership, including all approvals, protections and stay of proceedings in favour of the Schonfeld Inc. in its dual capacity as Monitor/Receiver.

12. THIS COURT ORDERS that upon completion of all Claim matters, the Receiver shall file a Supplementary Certification of Completion with this Court and shall at that time be forever discharged and released of

any further Receivership duties and obligations.”

In February 2014, Holmes and Flynn commenced an action in Hamilton against Schonfeld and the Holmes/Flynn accounting firm, seeking \$2,500,000 in damages arising from potential tax liabilities that CRA claimed against them for failure to repay shareholder loans for the 2006-2009 tax years. These assessments became known to Holmes and Flynn in 2012 as a result of a series of correspondence between them and CRA.

Of note is that the loans were all made to Holmes and Flynn prior to the appointment of Schonfeld as Monitor.

Claim of Holmes and Flynn Against Receiver

Holmes and Flynn claimed Schonfeld failed to exercise a reasonable duty of care, supervision and control over management of their affairs and claimed Schonfeld was obliged to engage in reasonable tax planning while handling their assets and assets of their corporations. Holmes and Flynn asserted that Schonfeld should be liable for the tax liability that Holmes and Flynn only became aware of after the Discharge Order.

Schonfeld brought a motion to have the claim dismissed for failure to seek leave of the Court to allow the claim to be issued against Schonfeld.

Holmes and Flynn Position on Receiver’s Motion

Holmes and Flynn argued no leave was required because they only sued Schonfeld as Receiver and the Receivership Order did not specify the usual leave of the Court provision regarding suing the Receiver.

Schonfeld’s Position

Schonfeld acknowledged the Receiver Order did not contain the usual “leave of the Court” wording but relied on paragraph 26 of the Receivership Order and asserted it preserved to the Receiver the leave requirement spelled out in the Monitor Order.

Paragraph 26 provided that nothing in the Receiver Order derogates from the powers and protections of the Monitor/Receiver described in the Monitor Order and that all provisions of the Monitor Order continue to apply to the activities undertaken by the Monitor/Receiver as Receiver.

Paragraph 7 of the Monitor Order contained a prohibition against any proceeding against the Monitor except with leave of the Court.

In addition, the Discharge Order contained inter alia the following release of liability wording:

“RELEASE OF LIABILITY

17. THIS COURT ORDERS AND DECLARES that the Receiver is hereby released and discharged from any and all liability that the Receiver now has or may hereafter have by reason

of, or in any way arising out of, the acts or omissions of the Receiver while acting in its capacity as Receiver and/or Monitor herein, save and except for any gross negligence or wilful misconduct on the Receiver's part. Without limiting the generality of the foregoing, the Receiver is hereby forever released and discharged from any and all liability relating to matters that were raised, or which could have been raised, in the within Receivership/Monitor proceedings, save and except for any gross negligence or wilful misconduct on the Receiver/Monitor's part."

Justice McEwen held that the Receivership Order, by virtue of the language in paragraph 11 of the Receiver Discharge Order, had the benefit of the leave requirement included in it and therefore leave was required.

Nunc Pro Tunc Argument

Holmes and Flynn then argued that if leave was required, it should be granted nunc pro tunc.

The test for granting leave to institute a claim involves:

1. is there any prejudice or substantial injustice to Schonfeld if an order granting leave is given; and
2. if no prejudice or substantial injustice would result, would leave have been granted had it been initially sought.

Justice McEwen found no prejudice or substantial injustice would result by granting leave nunc pro tunc.

As to the second part of the test, Justice McEwen stated that leave will be generally granted unless it is clear there is no foundation for the claim or the claim is frivolous or vexatious.

A stricter standard under which a plaintiff must demonstrate a strong prima facie case may be appropriate where issues raised in the action could have been raised in the discharge provisions.

Holmes and Flynn argued they did not know about the CRA claim until after the Discharge Order and therefore the strong prima facie standard did not apply.

Justice McEwen reviewed paragraph 17 of the Discharge Order (the release of liability position) and held it was sufficiently broad to encompass a release of the alleged misconduct of the Receiver.

The Court went on to state that when seeking leave to sue a Court appointed Receiver, a plaintiff must establish a factual basis for the proposed claim and the proposed claim must disclose a cause of action.

On the basis of the wording of the Monitor/Receiver Orders, Holmes and Flynn needed to establish a factual basis for gross negligence/wilful misconduct by the Receiver.

The Court found that nowhere in the Monitor/Receiver Orders was there

any requirement for the Receiver to provide any form of accounting services or tax planning to Holmes and Flynn or their corporations.

Holmes and Flynn had argued the Receiver failed to take reasonable care of their assets by not minimizing tax liabilities while managing their assets and by failing to maintain a sufficient reserve to ensure there was funds in the estate to cover future tax liabilities.

The Court found no foundation for the claim that the Receiver's conduct constituted a marked departure from the standards by which a reasonable and competent Receiver in similar circumstances would have acted.

The Court found:

1. The liabilities of Holmes and Flynn began prior to the appointment of the Monitor/Receiver
2. Holmes/Flynn knew about the shareholder loans
3. Holmes/Flynn had received accounting services and tax advice from their own accountants (who were also being sued).
4. There was no mandate for the Monitor/Receiver to provide tax and accounting services to Holmes/Flynn
5. Holmes/Flynn either consented or didn't oppose any orders that limited the Receivers liability, nor did they oppose the Discharge

Order.

In the absence of gross negligence/wilful misconduct, the wording in paragraph 17 of the Discharge Order covered the matters now complained of and thus no reasonable cause of action was advanced.

Points to Note

When drafting the appointment order, counsel needs to be aware of the “leave” provision as well as the mandating authority and obligations granted to the Monitor or Receiver.

One wonders how often the standard Commercial Court Receiver Order is drawn up with a mere glossing over of these provisions as “standard” and only become important, when things go wrong.

When acting for a Receiver, the language of the Discharge Order needs to be carefully reviewed and drafted as wide as possible in favour of the Receiver. Counsel for a Respondent must carefully review the release language and try to limit it to usual Commercial Court language.

In addition, the time to raise issues is prior to, or at the discharge motion (preferably having objected prior thereto) as failure to do so can come back to, in essence, bar the claim.

Of other interest in the decision is the finding that matters outside the scope of the appointment order are not obligations of the Receiver.

Consider if the same result would occur if they involved tax issues arising from a significant tax orientated disposition of assets by a Receiver to a third party purchaser.