COURT COUNSELS ENGAGEMENT WITH CREDITOR BEFORE RULING ON PROOFS OF CLAIM

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A Manitoba Court recently offered guidance on how to approach an appeal from a notice of disallowance or determination of a claim under section 135(4) of the *Bankruptcy and Insolvency Act,* RSC 1985, c B-3 ("**BIA**"). Existing jurisprudence provided conflicting positions on whether to treat such appeals as true appeals or a hearing *de novo*. True appeals generally restrict the evidentiary record before the court to the evidence that was before the trustee. In a *de novo* hearing, the appeal court considers fresh evidence as a matter of course.

Three lines of cases exist. One line of cases holds that appeals from a notice of disallowance are *de novo* appeals. A second line of cases holds that such appeals are true appeals and are determined on the record as presented to the trustee. Third, certain cases have called for a hybrid approach where the appeal is treated as a *de novo* hearing only where required in the interests of justice.

In *Re 5274398 Manitoba Ltd o/a Cross Country Manufacturing (Bankrupt)*, 2019 MBQB 89 ("**Cross Country**"), the Manitoba Court of Queen's Bench concluded that a hybrid approach was best. The Court allowed the filing of further evidence on the facts of the case.

Background

The debtor company, Cross Country, filed a proposal pursuant to the BIA. Bellhop Express Corp ("**Bellhop**") submitted its proof of claim a day before the creditors' meeting and registered its vote against the proposal. Prior to the meeting, the trustee disallowed Bellhop's claim for voting purposes and, therefore, disregarded Bellhop's vote. Subsequently, the court approved the proposal. Following the approval, the trustee further considered Bellhop's proof of claim on the strength of an affidavit of Bellhop's president filed in support.

As part of its consideration of the claim, the trustee requested and received certain information from representatives of Cross Country. The trustee then disallowed Bellhop's claim partly based on the new information received. However, Bellhop was not privy to the information of Cross Country disclosed to the trustee, and thus had no opportunity to respond to it.

Bellhop appealed the trustee's decision. At the appeal hearing, Bellhop sought to introduce another affidavit

from the president setting out evidence that had not been provided to the trustee before it ruled on the claim. Before deciding whether the disallowance was proper, the Court considered whether the fresh evidence ought to be admitted on appeal.

The Court's Analysis

The Manitoba Court noted that the trustee must maintain an even hand between the various stakeholders, including the claimants whose claim is then under consideration, when assessing proofs of claim. The Court observed that it is not unusual in the course of assessing a proof of claim for a trustee to engage in negotiation with a claimant with a view to finding a compromise. With this practice in mind, the Court went through an analysis of the amendments to the BIA, authorities addressing appeals prescribed by statute and conflicting policy interests as to whether an appeal from a notice of disallowance should be a true appeal or a hearing *de novo*.

The Court adopted a hybrid approach. In this compromise approach, by default the appeal is on the record that was before the trustee. However, a party will be granted leave to file additional materials if the interests of justice require it. The Court acknowledged the risk of "the interests of justice" being too wide a concept which may encourage claimants to seek leave to file additional supporting evidence in every case. But the Court concluded that the pre-condition of obtaining leave should act as an incentive for a claimant to be diligent in the provision of support filed together with its proof of claim.

In *Cross Country*, the interests of justice called for the granting of leave to file further evidence, because the claimant should not have been deprived of an opportunity to address information the trustee had received when making its own investigation about Bellhop's proof of claim. After all, *audi alteram partem* – or "hear the other side" – is a principle of natural justice that should not be denied without good reason.

Takeaway

In the end, the Court in *Cross Country* dismissed the appeal, holding that the trustee had come to a reasonable conclusion on each aspect of the claim even having considered the fresh evidence. The case is nevertheless helpful for the extensive guidance it offers trustees as to the treatment of claims which have the appearance of some substance. In particular, the Court counseled as follows:

> *31…Rather than dealing with it primarily on the basis of the gaps in the materials attached to the Proof of Claim, it would have been prudent for the Trustee to raise its specific concerns with counsel for Bellhop before simply casting the claim aside. Relying too heavily on the proposition that a claimant has the onus of proving its claim upon its initial filing will many times result in an appeal in which the claimant is entitled to file additional material because it did not anticipate the concerns expressed in*

the Notice of Disallowance.

32 In my respectful view, one of the ways that a Trustee might avoid the claimant's use of additional evidence in an appeal would be to telegraph its decision to the claimant in advance of the formal Notice of Disallowance and seek the claimant's comments, if any, before issuing its decision. If the claimant failed to respond, or respond appropriately, then it will have a more difficult task in obtaining leave to give further evidence if it launches an appeal to the court. Alternatively, the use of the examination sections under the BIA might assist the Trustee in cases in which the evidence provided with the Proof of Claim is deficient, since then, the Trustee might invite the claimant to fill in the gaps and avoid the argument at a subsequent time that the claimant was not given enough opportunity to advance its position. Neither of these two alternatives are mandated, and in many cases may not be appropriate. However, in some cases, taking advantage of them may save the Trustee (and the estate) additional time and expense in the long run.

by Jeffrey Levine and Guneev Bhinder

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.