Litigation - Canada

Test for granting leave to sue court-appointed receiver

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Authors

Norm Emblem

Soloman Lam

Introduction

After becoming the custodian of a company in receivership, a court-appointed receiver may face lawsuits of varying degrees of merit from creditors, shareholders and even former officers or directors who may have their own ideas on how to manage and distribute the company's assets. Court-appointed receivers in Canada receive a measure of protection by virtue of Section 215 of the Bankruptcy and Insolvency Act, which provides that no proceeding may be commenced against an official receiver or interim receiver without first obtaining leave of the court.

Canadian courts have recognised two different tests for granting leave to commence an action against a receiver: the 'frivolous or vexatious' test and the more stringent 'strong *prima facie* case' test. The question of which test applies depends on whether the receiver's impugned activities, which are the subject of the proposed action, have already been approved by the court.

'Frivolous or vexatious' test

If the receiver's activities have not yet received court approval, then in order to be granted leave the plaintiff need only establish that the proposed action is not frivolous or vexatious. The plaintiff can do so by providing sufficient evidence that:

- there is a factual basis for the proposed claim; and
- the proposed claim discloses a cause of action.(1)

In *GMAC Commercial Credit Corporation – Canada v TCT Logistics Inc*(2) the Supreme Court of Canada endorsed the following principles, which were first enunciated by the Ontario Court of Appeal in *Mancini (Trustee of) v Falconi:*(3)

1. *"Leave to sue a trustee* [*or a receiver*] *should not be granted if the action is frivolous or vexatious. Manifestly unmeritorious claims should not be permitted to proceed.*
2. *An action should not be allowed to proceed if the evidence filed in support of the motion, including the intended action as pleaded in draft form, does not disclose a cause of action against the [receiver]. The evidence typically will be presented by way of affidavit and must supply facts to support the claim sought to be asserted.*
3. *The court is not required to make a final assessment of the merits of the claim before granting leave."*

The Supreme Court also noted the following:

> *"[T]he threshold for granting leave to commence an action against a receiver or trustee is not a high one ... The gatekeeping purpose of the leave requirement … is to prevent the trustee or receiver 'from having to respond to actions which are frivolous or vexatious or from claims which do not disclose a cause of action' so that the bankruptcy process is not made unworkable. On the other hand, it ensures that legitimate claims can be advanced."*(4)

Given the low bar that must be met, a plaintiff in these circumstances will generally be

granted leave to sue the receiver even if the proposed action has questionable merit, as long as the action does not go so far as being frivolous or vexatious.

'Strong *prima facie* case' test

In situations where a plaintiff seeks to sue a receiver over activities that the court has already approved, the court may apply a more stringent test for leave: the 'strong *prima facie* case' test.

This test requires the plaintiff to establish through evidence that its proposed action has a reasonable chance of success at trial. The test necessarily requires the court to give a preliminary assessment of the case's overall merit.

Justice Blair, then at the Ontario Court (General Division), explained the necessity of a stricter test in *Bank of America Canada v Willann Investments Ltd:*(5)

> *"In my opinion the 'normal' test [i.e. the 'frivolous or vexatious' test] referred to above sets a threshold which is too low in cases where the activities of the Receiver, including the conduct sought to be impugned by the creditor seeking leave to proceed, have already been approved by the Court. In such circumstances, I prefer the analogy to the test for the granting of an interlocutory injunction … I would endorse the more stringent 'strong* prima facie *case' test.*
>
> *Were it otherwise there would be little point in a receiver or receiver/manager seeking an Order approving its conduct and activities in the exercise of its duties as an officer of the Court. The very purpose of the granting of such an Order is to afford the receiver some measure of judicial protection. To say that that shield may be readily pierced unless the receiver can show that 'it is perfectly clear' there is no foundation to the proposed claim, or that it is frivolous or vexatious, is to render such protection virtually meaningless in situations where the approved conduct and the conduct subject to the proposed attack are in substance the same."*

However, since *Willann,* the courts have shown an aversion to the 'strong *prima facie* case' test and have narrowed its application. It now applies only if both:

- the receiver's impugned activities have received previous approval by the court; and
- the plaintiff raised or had the opportunity to raise the same issues in the earlier court proceedings as it now seeks to do in its proposed lawsuit.(6)

If these conditions are not met, the court will apply the 'frivolous or vexatious' test.

For example, in *Gallo v Beber*(7) the court had issued an order discharging the receiver and approving its activities before the plaintiff brought its leave application. Nonetheless, the court applied the lower 'frivolous or vexatious' test and granted leave to the plaintiff to sue the receiver, because the plaintiff did not have notice of the earlier discharge application and therefore could not have brought the issues now raised in its proposed action to the attention of the judge at the discharge hearing.

Applying the same test for leave

Once the appropriate test for leave has been determined, the court will apply it to each cause of action that the plaintiff seeks to assert and strike those that fail to meet the test. This prevents a plaintiff from moving forward with a claim containing a host of meritless causes of action merely because it has managed to plead one that meets the test for leave. For instance, in *Mortgage Insurance Co of Canada v Innisfill,*(8) two individual plaintiffs sought leave with respect to five causes of action against a receiver-manager. The court applied the 'strong *prima facie* case' test to each cause of action and granted leave on only some of those claims, barring the rest from proceeding.

Receiver's appointment and discharge orders

It is a common practice for the receiver to obtain limited liability protections by way of court order when being appointed as receiver, seeking court approval of its activities and being discharged of its responsibilities.

For example, the Ontario Superior Court of Justice's standard form for a receivership order suggests inclusion of the following:(9)

> *"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 the Receiver by the* Bankruptcy and Insolvency Act *or by any other applicable legislation."*

The standard form for a discharge order, meanwhile, suggests inclusion of the following:(10)

> *"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 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 proceedings, save and except for any gross negligence or wilful misconduct on the Receiver's part."*

Incorporating such language in the court orders adds another layer of protection for the receiver and helps to narrow its exposure to claims by recognising that the receiver is often not a legitimate target for the competing creditors, save for clear acts of misconduct.(11)

Comment

In drafting orders for the court's review and approval, receivers should include language that expressly limits their own liability as much as the court will allow. Further, given the significantly higher threshold for leave that a plaintiff may have to meet if the court has already approved the activities that are the subject of its claim, receivers would be wise to be as broad, inclusive and timely as possible when reporting to or seeking court approval in respect of its activities. They should also ensure that all potentially affected parties receive notice of the receiver's court appearances, in order to preclude potential plaintiffs from subsequently suing the receiver personally on issues that they should have raised at an earlier proceeding. Meanwhile, plaintiffs hoping to assert an action against a receiver personally should act as swiftly as possible to issue their leave application before the receiver has had opportunity to obtain court approval of its activities.

For further information on this topic please contact Norm Emblem or Soloman Lam at Dentons Canada LLP by telephone (+1 416 863 4511), fax (+1 416 863 4592) or email (norm.emblem@dentons.com or soloman.lam@dentons.com). The Dentons website can be accessed at www.dentons.com.

Endnotes

(1) *Mancini (Trustee of) v Falconi* (1993), 61 OAC 332 (CA). See also *Marsh Engineering Limited v Deloitte & Touche Inc*, 2008 CanLII 68125 (Ont SC) at para 32.

(2) *GMAC Commercial Credit Corporation – Canada v TCT Logistics Inc*, 2006 SCC 35.

(3) *Mancini*, *supra* note 1.

(4) *GMAC Commercial Credit Corporation*, *supra* note 2 at paras 55, 58, 59 (citations omitted).

(5) *Bank of America Canada v Willann Investments Ltd* (1993), 23 CBR (3d) 98 (Ont Gen Div) at paras 9-10.

(6) *80 Aberdeen Street Ltd v Surgeson Carson Associates Inc* (2008), 40 CBR (5^{th}) 109 (Ont SC) at para 49.

(7) *Gallo v Beber* (1998), 116 OAC 340 (CA).

(8) *Mortgage Insurance Co of Canada v Innisfill* (1996), 3 OTC 44 (Gen Div).

(9) Ontario Superior Court of Justice, Practice Directions and Policies (Toronto), Standard Form Template Receivership Order.

(10) Ontario Superior Court of Justice, Practice Directions and Policies (Toronto), Standard Form Template Discharge Order.

(11) *Ibid*.