

# National Insolvency Review

General Editor: Adam M. Slavens, B.A., LL.B.

VOLUME 30, NUMBER 5

Cited as (2013), Nat. Insol. Review

OCTOBER 2013

## • SALE BY JUDICIAL AUTHORITY: CONFLICT OF INTEREST RULES GOVERNING THE DESIGNATION OF THE OFFICER ENTRUSTED WITH THE SALE •

Benjamin D. Gross and Étienne Guertin  
Lavery, de Billy LLP

Recently, the Québec Superior Court rendered a decision<sup>1</sup> that clarifies the extent of the discretion a court has when asked to ratify a

hypothecary creditor’s recommendation to appoint an employee of its legal counsel to act as the officer of the court entrusted with the sale by judicial authority of the collateral secured in its favour.

### Context


The Québec Superior Court had to render judgment in five cases involving very similar facts. In each case, the loan granted to the debtor (“Debtor”) was secured by a hypothec in favour of the lender (“Creditor”).

Following the Debtor’s failure to make its monthly loan repayments, the Creditor applied to the court for ratification of the process it proposed for the sale by judicial authority (by agreement) of the collateral secured in its favour. As part of the process, the Creditor proposed that an employee of its legal counsel be appointed to conduct the sale by judicial authority.

Justice Carole Julien first noted the extent of the court’s power in connection with a sale by judicial authority process and referred to the following legal provision:

• In This Issue •

SALE BY JUDICIAL AUTHORITY: CONFLICT OF INTEREST RULES GOVERNING THE DESIGNATION OF THE OFFICER ENTRUSTED WITH THE SALE <i>Benjamin D. Gross and Étienne Guertin</i> .....	57
CONSIDERING THE COLLATERALIZATION OF OIL AND GAS LEASES <i>Andrea Lockhart</i> .....	61
SELF-DEALING BY SECURED CREDITORS <i>Peter C. Lee</i> .....	65

 LexisNexis®

## NATIONAL INSOLVENCY REVIEW

The **National Insolvency Review** is published bi-monthly by LexisNexis Canada Inc., 123 Commerce Valley Drive East, Suite 700, Markham, Ontario L3T 7W8

**Design and Compilation © LexisNexis Canada Inc. 2013. Unless otherwise stated, copyright in individual articles rests with the contributors.**

All rights reserved. No part of this publication may be reproduced or stored in any material form (including photocopying or storing it in any medium by electronic means and whether or not transiently or incidentally to some other use of this publication) without the written permission of the copyright holder except in accordance with the provisions of the *Copyright Act*.

ISBN: 0-409-91078-3 ISSN: 0822-2584  
 ISBN: 0-433-44393-6 (Print & PDF)  
 ISBN: 0-433-44694-3 (PDF)

Subscription rates: \$425/year (Print or PDF)  
 \$515/year (Print & PDF)

Please address all editorial inquiries to:

Boris Roginsky, Journals Editor  
 LexisNexis Canada Inc.  
 Tel. (905) 479-2665; Toll-Free Tel. 1-800-668-6481  
 Fax (905) 479-2826; Toll-Free Fax 1-800-461-3275  
 E-mail: nir@lexisnexis.ca.

## EDITORIAL BOARD

### GENERAL EDITOR

**Adam M. Slavens, B.A., LL.B.**  
 Torys LLP

### EDITORIAL BOARD MEMBERS

**Gerald N. Apostolatos**, Langlois Kronström Desjardins S.E.N.C.R.L./LLP, Montréal • **Patrick Shea**, Gowling Lafleur Henderson LLP, Toronto • **Christopher W. Besant**, Baker & McKenzie LLP, Toronto • **Joseph Marin**, Miller Thomson LLP, Toronto • **Hubert Sibre**, Davis LLP, Montréal • **Steven Graff**, Aird & Berlis LLP, Toronto • **David R.M. Jackson**, Taylor McCaffrey LLP, Winnipeg • **Chris D. Simard**, Bennett Jones LLP, Calgary • **Robert P.W. Sloman**, Farris Vaughan, Wills & Murphy, Vancouver • **John R. Sandrelli**, Dentons, Vancouver

**Note:** This newsletter solicits manuscripts for consideration by the General Editor, who reserves the right to reject any manuscript or to publish it in revised form. The articles included in *National Insolvency Review* reflect the views of the individual authors. This newsletter is not intended to provide legal or other professional advice and readers should not act on the information contained in this report without seeking specific independent advice on the particular matters with which they are concerned.

A sale takes place by judicial authority where the court designates the person who will proceed with it, fixes the conditions and charges of the sale, indicates whether it may be made by agreement, a call for tenders or public auction and, if it considers it expedient, after enquiring as to the value of the property, fixes the upset price.<sup>2</sup>

Pursuant to this article, the hypothec vests the Creditor with the power to exercise its right to proceed with a sale by judicial authority, and a court cannot deny it that right. However, the court must ensure that the Creditor complies with the legal conditions attached to that right and must rule on the conditions of the sale. For example, the court will determine who will proceed with the sale, the extent of that person's responsibilities, his or her remuneration, the date of the sale, the extent to which the sale must be publicized, and the date at which the balance of sale price and the transfer duties must be paid, if any.<sup>3</sup>

## The Question in Dispute

The court framed the issue in each case in the following terms:

Is there a conflict of interest if the person designated by the Court to conduct the sale by judicial authority is the legal counsel (or one of its employees) of the hypothecary creditor? [translation]<sup>4</sup>

## Analysis

At the outset, the court explained that the Creditor's recommendation to entrust a particular individual with the sale by judicial authority of the hypothecated property is not binding on the court. The court has the power to designate any other person that it deems more impartial, independent, and competent to do so.<sup>5</sup>

As such, the person entrusted with the sale by judicial authority becomes an appointed officer of the court. To meet the requirements of that role, the appointed person must be both objectively and subjectively competent. While "objective competence" refers to the ability and competence needed to successfully conduct the sale by judicial authority, "subjective competence" refers to the ability to place the interests of each party, including those of the holder of

the hypothec and those of its grantor, on equal footing in order to prevent a situation of conflict of interest.<sup>6</sup>

In that respect, the *Code of Ethics of Advocates [CE]*<sup>7</sup> stipulates at the first paragraph of s. 3.06.07 that a lawyer is in a situation of conflict of interest where he represents conflicting interests. The court clarified the scope of that provision by explaining that the existence of a conflict of interest must be appreciated in light of a lawyer's duty of loyalty and confidentiality towards his or her clients.

When evaluating an alleged conflict of interest, courts must bear in mind the three criteria (or values) developed in *MacDonald Estate v. Martin*,<sup>8</sup> namely—(1) the preservation of the demanding standards of the legal profession and the integrity of the judicial system, (2) every individual's entitlement not to be unreasonably denied the right to hire the lawyer of his or her choice, and (3) the desirable mobility within the legal profession. In an attempt to preserve the balance between these fundamental values, every situation must be analyzed according to whether a potential or apparent conflict appears to be, not whether an actual conflict exists.<sup>9</sup>

The *Civil Code of Québec [CCQ]* stipulates that the person entrusted with the sale by judicial authority acts as the legal mandatary of the owner of the property sold:

The person entrusted with the sale of the property is bound to observe the rules prescribed in the Code of Civil Procedure (chapter C-25) for the sale of the property of another and, in addition to inform the interested parties of the steps he is taking if they require him to do so.

The person acts in the name of the owner and is bound to declare his quality to the purchaser [emphasis added].<sup>10</sup>

The court explained that in order to properly fulfill this mandate, such person must act prudently and must respect the competing interests at stake in accordance with the rules governing the administration of the property of another (*CCQ*, arts. 1299–1370). In his or her role as an

administrator, such person has an obligation of loyalty, prudence, and impartiality.<sup>11</sup>

Justice Julien referred to several decisions in which courts agreed to allow a representative of the creditor to conduct a sale by judicial authority.<sup>12</sup> However, those cases did not consider the issue from the standpoint of the notion of conflict of interest.

According to Julien J.C.S., the issue is whether a real or potential risk exists in allowing an employee of the Creditor's legal counsel to proceed with the sale by judicial authority and whether that person would favour the legal counsel's economic interests over those of the Debtor, even though the employee would also be the Debtor's legal mandatary.

The parties involved in a sale by judicial authority usually have several convergent interests. However, even if the creditor and the debtor have a mutual interest in ensuring that the hypothecated property is sold at the highest possible price, it is important to remember that regardless of the sale price, the creditor retains the right to sue the debtor if there is a shortfall between the proceeds of sale and the amount stipulated in the hypothec.

In the case at hand, the court held that the Creditor's proposed appointee could not act as an officer of the court in the sale by judicial authority. In support of its position, the court referred to the principle established in *ADR Capital Inc. v. Weinberg*<sup>13</sup> and explained the following:

[69] As discussed above, the person designated by the Court is granted "a portion of the court's authority" and becomes "an extension of the Court and of its authority". Where that person is a lawyer, or the lawyer's employee, and acts as the creditor's representative, his or her duty of impartiality and neutrality could be called into question. Lawyers must not only avoid any situation of conflict of interest (*CE*, s. 3.06.06) but also [those] that give the appearance of such a conflict.

[70] By acting for both the creditor and the debtor in a sale by judicial authority, the lawyer represents conflicting interests, which is in breach of the first paragraph of section 3.06.07 *CE*. Moreover, the lawyer cannot concomitantly represent a trustee in bankruptcy or a

liquidator as well as the debtor or creditor in question (CE, para. 3, s. 3.06.07). That prohibition would also apply to the conflicting role played by a lawyer acting as the person designated to proceed with sale by judicial authority while representing the creditor or the debtor in the matter. The CE further prohibits a lawyer from acting as a bailiff or exercising judicial or quasi-judicial functions while acting as a lawyer in the same matter (CE, ss. 3.05.05 (a) and 4.01.01).

[71] Furthermore, the lawyer must avoid “all methods and attitudes likely to give to his profession a profit-seeking or commercial character” (CE, s. 3.08.03). Although the lawyer may wish to provide full services to his or her client, he or she must assess the impact of doing so in relation to the need to maintain an appearance of justice at all times. By recommending a paralegal from his firm to act as the designated person in proceedings instituted for the benefit of his client, the creditor, the lawyer may give the impression that he is making a profit in an unethical manner in this case [emphasis added].<sup>14</sup>

[Editor’s note: Translation]

## Comment

In *Soulières*, the court clarifies the role of the person designated as the officer of the court entrusted with a sale by judicial authority. It asserts that even though a hypothecary creditor remains free to decide the nature of its hypothecary recourse, courts should not ratify creditors’ proposals regarding the conditions of sale without ensuring that the person appointed to conduct the sale is in a position to respect his or her duty of impartiality and independence.

More recently, in *Caisse Desjardins du Nord de Sherbrooke c. Jetté*,<sup>15</sup> the Québec Superior Court, citing *Soulières*, reiterated the importance of preserving the integrity of the judicial system. It noted that in the context of a sale by judicial authority, this principle allowed the court to permit the hypothecary creditor to make repairs to the immovable before it was sold and that the cost of said repairs would be secured by the hypothec existing in favour of said hypothecary creditor. The goal of the judicial sales process is to allow for the realization of the creditor’s security under the most favourable conditions that include price. The court stressed that although the rules pertaining to sale by

judicial authority provide the court with a broad discretion, this discretion should always be exercised in such a manner as to balance the interests of the creditor with those of the debtor.

[Editor’s note: **Benjamin D. Gross** and **Étienne Guertin** are members of the Financing and Financial Services Group of Lavery, de Billy LLP. Their practice focuses on drafting and negotiating commercial and consumer loans and security documents, leases, and instalment sales and includes real estate and securitizations. They work with traditional industry as well as in specialized financings, such as mining, aircraft, film, and cross-border. They also provide counsel in non-litigious areas of creditor rights, enforcement and bankruptcy, and insolvency. Their clients include large and small financial institutions, private lenders, and debtors.]

<sup>1</sup> *Compagnie de fiducie AGF v. Soulières*, [2013] J.Q. no 201, 2013 QCCS 83 (single judgment applicable to five cases) [*Soulières*].

<sup>2</sup> *Civil Code of Québec*, L.R.Q., c. C-1991, art. 2791 [CCQ].

<sup>3</sup> Louis Payette, *Les sûretés réelles dans le Code civil du Québec*, 4th ed. (Cowansville: Éditions Yvon Blais, 2010), para 3541 (“Louis Payette”); also see *Montreal Trust Co. of Canada v. Regletex Inc.*, J.E. 98-883 (S.C.) (appeal dismissed, [1998] J.Q. no 2740, J.E. 98-1874 (C.A. Qc.–Qc. C.A.)).

<sup>4</sup> *Supra* note 1, para. 38.

<sup>5</sup> *Ibid.*, para 30; see also Louis Payette, *supra* note 3, para. 1851.

<sup>6</sup> *Ibid.*, para 33.

<sup>7</sup> CE, R.R.Q., c. B-1, r. 3.

<sup>8</sup> [1990] S.C.J. No. 41, [1990] 3 R.C.S. 1235.

<sup>9</sup> *Supra* note 1, para. 35; see also *Coopers & Lybrand c. Castor Holdings Ltd. (syndic)*, [1995] J.Q. no 510, [1995] R.J.Q. 1665 (C.A. Qc.–Qc. C.A.) (application for leave to appeal dismissed, [1995] C.S.C.R. no 411, No du greffe: 24910).

<sup>10</sup> *Supra* note 2, art. 2793.

<sup>11</sup> CCQ, arts. 1309, 1310, and 1317. Article 1310 expressly states that

No administrator may exercise his powers in his own interest or that of a third person or place himself in a position where his personal interest is in conflict with his obligations as administrator. If the administrator himself is a beneficiary, he shall exercise his powers in the common interest, giving the same consideration to his own interest as to that of the other beneficiaries.

<sup>12</sup> *Supra* note 1, paras. 47–48.

<sup>13</sup> [2008] J.Q. no 10100, 2008 QCCS 4788, para 30.

<sup>14</sup> *Supra* note 1, paras. 69–71.

<sup>15</sup> [2013] J.Q. no 2135, 2013 QCCS 1365.