Sale by judicial authority: conflict of interest rules governing the designation of the officer entrusted with the sale

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Recently, the Superior Court rendered a decision[1] which 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 Superior Court had to render judgment in five cases involving very similar facts. In each case, the loan granted to the debtor (the "**Debtor**") was secured by a hypothec in favour of the lender (the "**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:

2791 C.C.Q. 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.

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.[2]

THE QUESTION IN DISPUTE
The Court framed the issue in each case in the following terms:

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“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?”[3] [Translation]

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.[4]

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.[5]

In that respect, the *Code of Ethics of Advocates*[6] (the “***C.E.***”) stipulates at the first paragraph of section 3.06.07, that a lawyer is in a situation of conflict of interest where he represents conflicting interests. The Superior 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. Therefore, every situation must be analyzed according to whether there appears to be a potential or apparent conflict, and not whether an actual conflict exists.[7]

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

2793 C.C.Q. 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.

The Court explained that in order to properly fulfill this mandate, the 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 (articles 1299 to 1370 C.C.Q.). In his or her role as an administrator, the person has an obligation of loyalty, prudence and impartiality.[8]

Justice Julien referred to several decisions in which courts agreed to allow a representative of the creditor to conduct a sale by judicial authority.[9] However, those cases did not consider the issue from the standpoint of the notion of conflict of interest.

According to Justice Julien, the issue is whether there exists a real or potential risk 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 its debtor if there is a shortfall between the proceeds of sale and the amount stipulated in the hypothec.

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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[10] and explained the following:

"[55] 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 (section 3.06.06 *C.E.*) but also [those] that give the appearance of such a conflict.

[56] 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 *C.E*. Moreover, the lawyer cannot concomitantly represent a trustee in bankruptcy or a liquidator as well as the debtor or creditor in question (third paragraph of section 3.06.07 *C.E*.). 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 *C.E*. 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 (sections 3.05.05 (a) and 4.01.01 *C.E*.).

[57] Furthermore, the lawyer must avoid "all methods and attitudes likely to give to his profession a profit-seeking or commercial character" (section 3.08.03 *C.E*.). 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 appearance of unethically profiting monetarily in this case."[11] [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, a court should not ratify a creditor's proposal 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.

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[1] *Compagnie de fiducie AGF* v. *Soulières*, 2013 QCCS 83 (single judgment applicable to five cases) [Soulières].

[2] Louis Payette, *Les sûretés réelles dans le Code civil du Québec*, 4th ed., Cowansville, Éditions Yvon Blais, 2010, para 3541; also see *Montréal Trust Co. of Canada* v. *Regletex Inc.*, J.E. 98-883 (S.C.) (appeal dismissed, J.E. 98-1874 (C.A.)).

[3] Supra, note 1, para 38.

[4] *Id*., para 30; see also Louis Payette, supra, note 2, at paragraph 1851.

[5] *Id*., para 33.

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R.R.Q., c. B-1, r. 3.

[7] Supra, note 1, para 35; see also *Castor Holdings Ltd. (Syndic de)*, [1995] R.J.Q. 1665 (C.A.) (application for leave to appeal dismissed, S.C.C., 25-04-1996, No. 24910).

[8] Articles 1309, 1310 and 1317 *C.C.Q.*; article 1310 *C.C.Q*. expressly state 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”.

[9] Supra, note 1, paras 47 and 48.

[10] 2008 QCCS 4788, para 30.

[11] Supra, note 1, para 55 to 57.

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