

THE AUDITOR AS MONITOR IN CCAA PROCEEDINGS

WHAT IS THE DEBATE?

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Introduction

There has been considerable but largely private debate amongst senior insolvency professionals regarding whether it is appropriate for the auditor of a company to act as its monitor in proceedings under the *Companies' Creditors Arrangement Act*¹ ("CCAA"). Delving below the surface of the debate inevitably leads to a more general discussion about what is the proper role of a CCAA monitor. The basic conclusions of this paper are that there are some difficult issues of substance concerning the role of monitor, that there needs to be a thorough review of the monitor's role, and that by comparison the question of whether an auditor can act as a monitor is unimportant. Unfortunately, as with many other issues of Canadian insolvency law, little has been written on these topics.

Core Objection

Those who object to auditors acting as monitors of their audit clients consider it plain and obvious that there is a conflict of interest in the dual role as they do not believe the monitor can act impartially and represent the interests of the creditors when as auditor the monitor also has duties to the company. They also point to section 13.3(1) of the *Bankruptcy and Insolvency Act*² ("BIA") which presumptively prohibits the auditor or accountant of a debtor from acting as its trustee in bankruptcy in a liquidation

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¹ *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C-36, as amended.

² *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended.

proceeding, and by extension as a proposal trustee in a reorganization proceeding. They ask if it is improper for an auditor to act as a trustee, how can it be appropriate for an auditor to act as monitor in a CCAA proceeding?

However, when the CCAA was amended in 1997 to make it mandatory to have a monitor appointed in a CCAA proceeding, the Act was specifically amended to provide that an auditor was qualified to be appointed as the monitor.³ Obviously at that time the conflict issue was not so clear to some, including Parliament.⁴ One possible explanation is that at the time the role and functions of a monitor were conceived of as being different from those of a trustee.

History of Bankruptcy Prohibition

The BIA prohibition is also of comparatively recent vintage. It was enacted as part of the 1992 amendments. Prior to that time there was no statutory prohibition on an auditor acting as a trustee under that Act.

However, there had been a view for a long time that it was inappropriate for an auditor to assume the role of trustee. That view had its roots in nineteenth-century English bankruptcy law, which provided that the appointment of a trustee in bankruptcy had to be approved by the Board of Trade as well as by the creditors.⁵ The Board of Trade had the power to object to a person being appointed as trustee on the ground, amongst other things, that “his connection with or relation to the bankrupt or his estate, or any particular creditor, makes it difficult for him to act with impartiality in the interests of creditors generally.”⁶

³ CCAA, s. 11.7(2).

⁴ Canada, Parliament, “Proceedings of the Standing Senate Committee on Banking, Trade and Commerce” Issue No. 17, February 11, 1997.

⁵ *Bankruptcy Act*, 1883 (U.K.), 46 & 47 Vict., c. 52.

⁶ *Ibid.* s. 21.

On occasion, creditors or others would ask the English Courts to overrule an objection made by the Board of Trade. The Courts considered that their role was to evaluate whether the position of the Board of Trade was reasonable, not whether it was right.

In *re Lamb*,⁷ the Board of Trade had objected to one person being appointed trustee over two estates because one estate claimed to be a creditor of the other. The Court refused to overrule the Board's conclusion that as a result of the crossclaim between the estates it would be difficult for the same person to act with impartiality with respect to both estates.

In *re Beale (R.G.F.)*,⁸ the Board of Trade had objected to an accountant acting as a trustee in bankruptcy because the accountant was owed professional fees by the debtor. One of the trustee's duties would be to investigate the appropriateness of those fees and, accordingly, the Board decided that it would be difficult for the accountant to act with impartiality. Once again the Court refused to overrule the Board's conclusion following the theory of *re Lamb* that the trustee could not have an interest in a claim against the estate.

Canadian cases applied the principle that it was improper for a creditor of the debtor or a person affiliated with a major creditor of the debtor to become the trustee in bankruptcy.⁹ As a result, it was considered improper for an auditor to act as a trustee in bankruptcy if it was owed professional fees. However, it appears that the principle that a trustee should not also be a creditor of the estate did not root deeply in Canadian practice. For example, it is now common for a single firm to act as trustee in bankruptcy for multiple entities in a corporate group notwithstanding that there are intercompany claims between the members of the group. Generally, pragmatism has won out over puritanism with the view being that it is too expensive and complicated to have multiple trustees and that more practical means can be found to resolve any issues between the estates.

⁷ [1894] 2 Q.B. 805.

⁸ [1939] 1 Ch. 761.

⁹ *Re Walter W. Shaw Co.* 16 Sask. L.R. 275, 68 D.L.R. 616, 3 C.B.R. 198, [1922] 3 W.W.R. 119 (K.B.); *Re Erie Gas Co.* (1938) 20 C.B.R. 14 (Ont. S.C.); and *Tannis Trading Inc. v. Camco Food Services Ltd.* (Trustee of) (1988), 67 C.B.R. (N.S.) 1, 63 O.R. (2d) 775, 49 D.L.R. (4th) 128 (S.C.).

Another example of that pragmatism involved a liquidator in a winding-up proceeding (which is somewhat analogous to acting as a trustee in bankruptcy of a corporation). The Court refused to disqualify a corporate trustee from continuing to act as a liquidator merely because the corporate trustee was owned by the accounting firm that had acted as the corporation's auditor.¹⁰ The Court did not believe the audit partners who had acted as a "watch-dog of the company" would attempt to influence the corporate trustee so as to deprive it of the required "independence and impartiality".¹¹

In 1986, the Colter Committee¹² recommended that auditors and accountants of a debtor be expressly prohibited from acting as a trustee, interim receiver or receiver of the debtor, on the grounds of conflict of interest. The Committee was of the view that a conflict of interest exists when a person is required either:

1. to support or reveal that which his duty to another person requires him to contest or conceal, or
2. to contest or conceal that which his duty to another person requires them to support or reveal.¹³

Although not expressly stated, it appears that the Colter Committee was of the view that an auditor or accountant would continue to owe duties to the debtor after bankruptcy, and that these duties would conflict with the duties of a trustee in bankruptcy. While the Committee's conflict formulation was not incorporated into the 1992 BIA amendments, the recommended express prohibition on auditors acting as trustee on the grounds of conflict of interest was carried forward.

In practice, the Courts have demonstrated reluctance to enforce the provisions of section 13.3(1) of the BIA with respect to auditors and accountants in the absence of evidence of "real prejudice" (see, for example, *Planta Dei Pharma Inc. (Trustee of) v. Planta Dei*

¹⁰ *Re United Fuel Investment Ltd.* (No. 1) [1964] 2 O.R. 411, 45 D.L.R. (2d) 624 (H.C.), affirmed [1966] 1 O.R. 165, 53 D.L.R. (2d) 12 (C.A.).

¹¹ *Re United Fuel Investment Ltd.* [1996] 1 O.R. 165 (C.A.) at para. 28.

¹² Canada, *Report of the Advisory Committee on Bankruptcy and Insolvency, Proposed Bankruptcy Act Amendments*, (Ottawa: Minister of Supply and Services Canada, 1985) at 5.

¹³ Report of the Advisory Committee on Bankruptcy and Insolvency, *supra* note 12 at 47.

*Pharma Inc.*¹⁴). In *re Hover*,¹⁵ the Official Receiver attempted to disqualify a firm that had acted as an accountant for the debtor from acting as trustee under a proposal. The Court gave leave to the accounting firm to continue to act stating that:

[T]he purpose of section 13.3 is to prevent a conflict of interest, to protect the debtor from an accountant who may have information that could be used to the prejudice of the debtor and to ensure that the trustee who may have a close relationship with the debtor does not work to the prejudice of the creditors. There is not evidence that the trustee has or will act in a way that would prejudice the creditors. The debtor and the majority of the creditors support the continuation of [the firm] as... trustee.¹⁶

It is clear that the issue about an auditor acting as a trustee is now seen to stem more from the auditor's relationship with the debtor than from the question of whether the auditor is owed money for fees. There is a concern that allowing auditors generally to act as trustees could put public confidence in the bankruptcy system at risk.¹⁷ However, the BIA prohibition is not absolute and depending on the facts and circumstances of a particular case, it may be appropriate for the auditor to act as trustee.

Monitors as Watchdogs

Prior to 1997, the CCAA did not require the appointment of a “monitor.” However, in the years prior to that time a practice developed of having the Court appoint an accounting firm to perform an officially sanctioned role in the CCAA proceedings. At a time when there was relatively more suspicion about the restructuring process, their role was often analogized to that of an interim receiver appointed under s. 46 of the BIA to monitor the debtor’s conduct while a disputed bankruptcy petition is outstanding. Indeed, in CCAA cases in the 1980s the monitors were often called “Interim Receivers” (see, for example,

¹⁴ (1999), 14 C.B.R. (4th) 256.

¹⁵ (2000), 21 C.B.R. (4th) 263.

¹⁶ *Ibid.* at para. 26. See also *Koskie, (Re)* (1997), 152 Sask. R. 209. Zarzeczny J. refused the application to remove the trustee, as no *actual* conflict or infringement of independence had been proven.

¹⁷ Canada, Parliament, “Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations” Issue No. 5, September 3, 1991.

*Re United Co-Operatives of Ontario*¹⁸ and *Re Northland Properties Ltd.*¹⁹). They could be selected and appointed directly or indirectly at the instigation of key creditors as a watchdog to observe the conduct of management and the operation of the business while a plan was being formulated. Wise debtors co-opted the process by appointing “their” accounting firm to forestall the appointment of a different firm selected by the creditors and in many instances, the accounting firm was also their auditor.

One practical issue that led to the court appointment of accounting firms was the protection of fees. When creditors instigated the appointment, they wanted the fees paid for by the debtor, and when the debtor instigated the appointment, the accountants wanted security of payment. After some judicial doubt, it was concluded that the Court had the jurisdiction to protect the fees on the basis that once appointed, the accounting firm was either an officer or an agent of the Court.²⁰

During the development of the 1997 round of insolvency law reform, the BIAC task force studying the CCAA recommended that the appointment of a monitor be made mandatory so as to “give creditors in CCAA applications the same protection of a professional and impartial “watchdog”, as is provided to creditors in BIA reorganizations.”²¹ When the CCAA was amended in 1997 to require the appointment of a monitor, the statutory language used to describe the monitor’s role was consistent with the watchdog concept. The basic purpose of the appointment was described as being “to monitor the business and financial affairs of the company while the [initial order] remains in effect.”²² The monitor was given express access to the debtor’s books, records and property for the purpose, and was required to report “on the state of the company’s business and financial

¹⁸ (August 1984), unreported.

¹⁹ (1988), 73 C.B.R. (N.S.) 175.

²⁰ *Starcom International Optics Corp., Re* (1998), C.B.R. (4th) 177, [1998] B.C.J. No. 506; *Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 43, 109 N.S.R. (2d) 12; *Canadian Asbestos Services Ltd. v. Bank of Montreal* (1992), 16 C.B.R. (3d) 114, [1992] G.S.T.C 15, 11 O.R. (3d) 353.

²¹ Report of the Task Force on the CCAA to the Bankruptcy and Insolvency Advisory Committee Working Group on Commercial Reorganizations, Bankruptcies and Receiverships, 1994 at 3.

²² CCAA, s. 11.7(1).

affairs”²³ if there was a material adverse change in the debtor’s projected cash-flow or financial circumstances and also prior to creditor meetings. There were no other express power or duties.

However, the Court was given the power to order the monitor “to carry out such other functions in relation to the company as the court may direct.”²⁴ This catchall provision has been used to adjust the role of the monitor on a case by case basis. It is now typical for an initial order under the CCAA to have numerous provisions dealing with the powers and duties of the monitor. The implications of this on the conflict issue are discussed below.

Discussion Points

One could take the view that acting as a watchdog in a CCAA proceeding is a natural extension of the pre-filing role of an auditor. However, it has raised perception issues. One concern that has been expressed is that often auditors become trusted business advisors to management, and are “too close to management” to be an effective watchdog for the creditors in the more adversarial CCAA context.

Another concern that some have expressed is that the behaviour of an auditor/monitor may be affected (e.g. the monitor will push too hard for a restructuring) by a desire to avoid questions about the quality of the pre-filing audits. However, no one appears able to identify any CCAA cases when this has been a problem in practice.

Several pragmatic justifications have been offered up to support an auditor being eligible to act as a watchdog monitor for its audit clients. One possible advantage is that the audit firm already knows the affairs of the debtor well. While in practice monitoring engagements are principally handled by the insolvency arms of the accounting firms, not the audit arms, this pre-existing knowledge can help the firm get up to speed more quickly.

²³ *Ibid.* s. 11.7(3)(b).

²⁴ *Ibid.* s. 11.7(3)(d).

A second practical justification is particularly applicable to small and mid-sized companies. Historically, there was a perception that management was often too reluctant to file for reorganization and that many companies filed too late. There is a hope that if the auditor is permitted to act as a monitor, it may be easier to overcome management's concerns about filing. In one reported case, the Court expressly noted this consideration.²⁵

A third justification is that the company normally wants the assistance of its auditors during the process, and it is cheaper for the company to pay for one accounting firm rather than two. This view resulted in the BIAC task force recommending that an auditor be allowed to act as monitor unless the creditors object.²⁶

Recent events, and the introduction into law of the *Sarbanes-Oxley Act* in the U.S. have lead to greater restrictions on the types of services that auditors can provide to their SEC registered public audit companies. As a result, in practice it is probable that in the larger public company restructurings it will become unusual for the auditor to be engaged as the monitor. Therefore, the auditor/monitor debate is now principally germane to the restructuring of small to mid-sized companies.

Supermonitors

In most CCAA cases the monitor plays a far broader role than watchdog, and indeed the watchdog role is largely irrelevant. While material adverse change reports were filed by the monitor in the Royal Oak and Canada 3000 cases, these reports are extremely rare. In practice, the monitor plays an expanded role that depends firstly on management and secondly, where there are key creditors or groups of creditors, on the relationship between management and those key creditors.

Examples of the expanded role of the supermonitor include the following:

²⁵ *Hickman Equipment (1985) Ltd., Re* (2002), 34 C.B.R. (4th) 203 at paras. 8, 23 and 49, 214 Nfld. & P.E.I.R. 126, 642 A.P.R. 126 [*Hickman*].

²⁶ Report of the Task Force on the CCAA, *supra* note 21 at 3.

1. Implementation of Initial Order: Usually management requires substantial assistance in adjusting to the changed circumstances of a reorganization proceeding. Accordingly, at the same time that the monitor is monitoring compliance by the debtor with the various restrictions contained in the initial order, the monitor also advises management how to adjust to the restructuring process and deal with the various stakeholder groups.
2. Financial Advisor: Particularly in respect of small or mid-sized companies, the monitor often also acts as the debtor's financial advisor. This dual role can result in substantial cost savings.
3. Facilitator/Mediator: Where the creditors have more trust and confidence in the monitor than in management, the monitor can facilitate constructive negotiations between the debtor and creditors with respect to the terms of the restructuring.
4. Manager: In some cases, the monitor has effectively replaced the board and senior management and has assumed control of the reorganization process, usually as a result of a loss of confidence in management. An example is the *Royal Oak*²⁷ case. Industry groups have recommended that the power to appoint a manager be expressly incorporated into the CCAA.²⁸
5. Receiver: In a number of cases, the monitor has either expressly or impliedly been appointed as a receiver to run a sales process for all or for a substantial part of the business or property of the debtor.

The flexible and potentially broad nature of the role of a monitor confuses the conflict analysis. For example, if it is appropriate for the monitor in substance to act as financial advisor as well as a watchdog then the concern about the auditor being too close to the debtor's management appears to be irrelevant. On the other hand, the traditional view is that it is inappropriate for an auditor to act as a receiver. That complicates the analysis in

²⁷ *Royal Oak Mines Inc. Re* (1999), 11 C.B.R. (4th) 122.

²⁸ The Insolvency Institute of Canada and Canadian Association of Insolvency and Restructuring Professionals, *Joint Task Force on Business Insolvency Law Reform: Report*, (March 15, 2002) at 50.

the cases where the monitor is directed to run a disposition process as if the monitor was a receiver.

Monitors and the Court

The role of the monitor is further confused by the role the monitor plays in Court during proceedings under the CCAA. Because the monitor is appointed by the Court, early on the Courts concluded that the monitor was either an agent of the Court²⁹ or an officer of the Court.³⁰ The Courts have also concluded that the monitor has an “obligation to act independently and to consider the interest of the petitioners and its creditors.”³¹ In one pre-1997 case, the Court commented:

It is essential for the court to ensure that neither the shareholders nor the creditors have any influence over the monitor. As an agent of the court, the monitor must not be in a “conflict of interest” situation. The monitor’s sole responsibility is to the court.³²

The fact that the monitor has been adviser to the debtor before the filing has not been considered problematic.³³ However, disclosure at the time of the appointment is the correct practice and may be required under applicable professional rules.³⁴

One of the leading insolvency judges, Mr. Justice Farley, commented in one case that the monitor “recognizes its role is to be neutral and to act in the best interests of all concerned.”³⁵ In another, he noted that there was no jurisprudence to support an

²⁹ *Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 43 per Glube C.J.T.D. at para. 75 [*Fairview*]. See also *Siscoe & Savoie v. Royal Bank* (1994), 29 C.B.R. (3d) 1 at para. 28.

³⁰ *United Used Auto & Truck Parts Ltd., Re* (1999), 12 C.B.R. (4th) 144 at para. 20 [*United*]; *Hickman*, *supra* note 25 at para. 33.

³¹ *Ibid.*

³² *Stokes Building Supplies Ltd., Re* (1992), 13 C.B.R. (3d) 10 at para. 15.

³³ *United*, *supra* note 30.

³⁴ Rules of Professional Conduct and Interpretation, Canadian Association of Insolvency and Restructuring Professionals, online: <<http://www.cairp.ca>>.

³⁵ *Royal Oak*, *supra* note 27 at para. 6.

argument that a monitor represents the interest of the creditors in the same way as a trustee in bankruptcy, receiver or liquidator.³⁶

Some Courts have viewed the monitor as a competent and independent expert providing advice to the Court on the merits of the reorganization plan,³⁷ and another stated that “[t]he monitor must be an agent of the court, it must assist the court and it must be independent of any of the parties.”³⁸

This view of the monitor has a number of indirect effects. First, the monitor can provide evidence by way of report rather than affidavit, and is generally not subject to cross-examination. The Courts understandably place great trust and confidence in the information provided by the monitor, and are unreceptive to criticisms or conflicting evidence.

As a result, where the debtor and the monitor are in agreement, debtor’s counsel endeavours to put in little or no evidence and instead relies on the monitor’s reports. In practical terms, this makes it very difficult for creditors to challenge the debtor’s position.

Second, in their reports monitors now routinely go beyond simply providing information. They will express views and make recommendations to the Court concerning matters before the Court. Once again, it is extremely difficult for creditors to challenge the monitor’s views as an independent expert and officer of the Court.

These factors have become increasingly significant as the shape of CCAA proceedings has changed. It used to be that the Courts provided a standstill while the principals negotiated. The major commercial transactions were implemented through the plan of arrangement and were therefore subject to prior creditor class approval. In effect, the CCAA operated as a mandatory ADR process that encouraged resolution of business issues through negotiations between the parties whose interests were at stake.

³⁶ *PSINet Ltd., Re* (2002), 30 C.B.R. (4th) 226 at para. 12.

³⁷ *Canadian Imperial Bank of Commerce and Bank of Montreal v. Quintette Coal Limited* (1991), 1 C.B.R. (3d) 253, 53 B.C.L.R. (2d) 34.

³⁸ *Fairview*, *supra* note 29 at para. 75.

But now major commercial transactions are implemented on an interim basis during the course of CCAA proceedings before a plan is filed, with Court approval being substituted for creditor approval. This can even entail a sale of all or substantially all of the business or assets of the debtor.³⁹ On application for approval of these transactions, invariably the monitor will file a report and make a recommendation as to whether the proposed transaction should be approved by the Court. Almost as invariably, the Courts will defer to the monitor's views. Accordingly, in substance these transactions are really subject to monitor approval and the monitor's judgment has replaced the creditors' judgment.

This has led to concerns about the evolving role of the monitor. There have been situations where it appears as if the monitor has effectively ended up acting as financial advisor, negotiator, principal witness and judge. It is important to note that the concerns about the power this gives to a monitor are equally applicable to situations where the monitor is the auditor of the debtor and where it is not the auditor of the debtor. But the result has been that monitors now play a leading role in the negotiation and execution of major commercial transactions. This in turn places monitors in a difficult position, particularly where the monitor has been acting as financial advisor to the debtor. Any commercial negotiation involves a substantial amount of discretion. On what basis should a monitor exercise that discretion?

Quite fairly, monitors state that creditors and the Court currently expect them to express opinions and make recommendations. And they use the threat of withholding their approval to negotiate with the debtor. The debtor knows that, as a practical matter, it will be next to impossible to obtain Court approval for a major transaction without having the monitor's prior approval. So the monitors can and do constructively influence the debtor's conduct. Furthermore, monitors will routinely seek the views of key creditors or groups of creditors before making recommendations about major commercial transactions and will seek a negotiated solution to any conflicts between the debtor and those key creditors.

³⁹ *Consumers Packaging Inc., Re* (2001), 27 C.B.R. (4th) 194; affirmed (2001), 27 C.B.R. (4th) 197.

However, the expanded role of the monitor forces the monitor more and more into the fray. Monitors have become less the detached observer and expert witness contemplated by the Court decisions, and more of an active participant or party in the proceedings.

One final Court related issue concerning the role of the monitor is the review of pre-filing transactions. On occasion, a monitor (with the assistance of independent counsel) is directed to review the validity of pre-filing transactions from a fraudulent conveyance, fraudulent preference or similar perspective. This function is more clearly analogous to that of a trustee in bankruptcy than other functions of a monitor. If industry insolvency law reform recommendations are adopted, the CCAA would contain preference and other provisions that would be the same as those in the BIA.⁴⁰ Reviews of pre-filing transactions would then become more common and then the distinction between the BIA and CCAA with respect to auditors would become a little harder to explain.

Constituencies

While a number of views have been expressed in meetings and conferences, little has been written on behalf of the various interested constituencies on the auditor/monitor issue. The following effort to summarize the views of various constituencies is therefore unscientific but is necessary in order to properly understand the debate concerning the issue.

Not surprisingly, there is a considerable difference of opinion amongst the insolvency accountants on the issue of whether an auditor should be a monitor. Since the reforms of the 1960s we have been blessed with an insolvency advisory industry that has been dominated by highly trained individuals who take their professional responsibilities seriously and who operate in a regulated environment. However, the practical reality is that the four big accounting firms have both the biggest audit practices and the biggest insolvency practices. The smaller firms perceive this as giving the larger firms a vested interest in the *status quo*. On the other hand, the smaller firms with smaller audit practices are perceived to have a vested interest in prohibiting auditors from acting as

monitors for their audit clients. This has made it difficult for the insolvency accountants to discuss the issue and reach a consensus. What further complicates the matter is that the debate seems to be largely theoretical – cases have not identified where issues with respect to a dual auditor/monitor have been problematic.

The senior insolvency lawyers have been relatively quiet about the issue (perhaps fearing to bite one of the hands that feed them), although there is some evidence that the majority believe that auditors should not act as monitors for their audit clients. However, to actively promote this view could fairly be considered somewhat hypocritical. It is still the standard practice in Canada for a debtor's primary corporate law firm to act as its restructuring counsel. This is at odds with US theory and practice. In US restructuring proceedings, one of the primary activities of debtor's counsel is to review and potentially challenge a variety of pre-filing transactions. In the US view, it is difficult for that review and challenge to be conducted by the debtor's pre-petition counsel and therefore the debtor should hire new bankruptcy counsel to conduct a filing. It could fairly be said that the existing Canadian practice with respect to legal counsel is arguably more problematic than the practice of auditors acting as monitors for their audit clients.

Not surprisingly, there are a variety of views expressed by the workout bankers. However, as a generalization it appears most important to the workout bankers that they have trust and confidence in the firm which is acting as the monitor and in the particular individuals at that firm who are leading the engagement. The question of whether the firm is also the auditor would generally be considered a secondary matter unless there are material issues about the quality of the audits.

It is even harder to get an accurate view of the opinion of trade creditors and other unsecured creditors. However, in 2001 one of the leading credit information agencies reported that suppliers believed that auditors should not be appointed monitors stating the following:

⁴⁰ The Insolvency Institute of Canada, *supra* note 28 at 23.

The concern is that the appointment of auditors as monitors may result in real or perceived conflict of interest that serve to undermine supplier confidence in the debtor, the monitor, and the restructuring process generally. In this regard, it is noted that auditors/monitors have fiduciary duties owing to creditors that may be impaired by their strong historical connections to and dependencies on the continuing survival of the debtor. The consensus opinion of suppliers was that the creditors' interest in having a monitor perceived as independent will usually outweigh any efficiencies that might be realized from having a debtor's auditor step into the role of the monitor and the Act should be amended accordingly.⁴¹

Those statements reflect two understandable views. Firstly, that the primary role of the monitor is to act as a watchdog for the protection of creditors. Secondly, the auditors are generally trusted business advisors of management and therefore are ill-suited to play the watchdog role. However, these views probably no longer reflect the reality of CCAA practice and the evolving role of the monitor. There is little support for monitors being restricted to the "skinny" watchdog role expressly contemplated by the CCAA. As a result, monitors often are or become trusted business advisors of the debtor whether or not they are also the auditor.

Views of the Authors

It is tempting to dismiss the auditor/monitor issue as a bit of a tempest in a teapot. From statistics gathered by Industry Canada, it appears that over the last 5 years in only approximately 25% of the CCAA cases did the auditor act as the monitor for an audit client. In the future, it is likely that auditors will act as monitors primarily in the small to mid-sized CCAA cases where cost management is at a premium. It does not appear that in practice that the dual role has been a material problem and there have been no cases where the actions of the monitor have been called into question because it is also the auditor. The issue is more one of perception about the appearance of fairness and integrity in the restructuring process rather than an issue of substance.

⁴¹ "Consensus Reforms – Q1' 2001" Insolvency Group News, An Equifax Commercial Information Solutions Publication (June 2001) at 6.

However, if the powers of the monitor are expanded to include the powers of a trustee in bankruptcy to review and challenge pre-petition fraudulent conveyances, fraudulent preferences and other reviewable transactions, it would be logical to conform the provisions of the CCAA and the BIA. From an insolvency system perspective it would be a small nuance whether it was the existing CCAA policy that was adopted or the BIA policy. The authors support the flexibility of the CCAA approach of auditors being allowed to act as monitors or trustees under proposals in the absence of material objection from interested parties.

Of greater concern is a proper analysis of the evolving role of the monitor, particularly the role of the monitor with respect to the Courts. Arguments can be made that in some situations the monitor's business judgment is replacing the business judgment of the creditors to an excessive degree. This does not justify reducing the flexible scope of the role of monitor. But it could justify the adoption of various techniques to rebalance the role of the monitor in the Court process.

For example, there could be greater clarity about and disclosure of the roles actually being performed by the monitor in each particular CCAA case. There could be less evidence from the monitor and more from the debtor. There could be situations where the Court and creditors would expect the monitor not to make recommendations, for example where the monitor has helped the debtor to negotiate a material transaction. It would then be left to the debtor and the creditors to either negotiate or litigate. And perhaps in cases where the monitor is more than a watchdog, for example also a financial advisor to the debtor, the monitor should not be treated as an officer or agent of the Court.

Conclusion

The debate about whether auditors should be able to act as monitors is not important. However, there are other more important issues about the evolving role of the monitor that need to be addressed.

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