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Expedient and Just: B.C. Court of Appeal Addresses Approval of Claims by Trustee in Bankruptcy

Under the *Bankruptcy and Insolvency Act*[1], trustees have considerable discretion to administer a bankrupt's estate in an expedient manner. However, the British Columbia Court of Appeal recently confirmed that trustees must exercise such discretion within the limits of relevant statutory provisions and common law principles.

In *Roberts v. E. Sands & Associates Inc.*[2], the Court of Appeal allowed an appeal from a decision confirming the trustee's approval of approximately 650 proofs of claim despite the appellant's contention that the claims were barred by a statutory limitation period. While it was appropriate to expeditiously deal with the claimants as a group, the trustee and the lower court erred in allowing the claims by postponing the limitation period contrary to well-established discoverability principles.

Background

The *Roberts* decision arises from the bankruptcy of Vancouver businessman, Cem Ali, and his Horizon group of investment firms. The Horizon group solicited investments pursuant to an offering memorandum, as required by the *Securities Act*. The investors' funds were then placed with a New York investment firm, Razor FX Inc., for trading on the foreign exchange market. Unfortunately for the investors, Razor FX was a Ponzi scheme. In January 2008, the

[1] RSC 1985, c B-3[*BIA*].

[2] 2014 BCCA 122 [*Roberts* BCCA].

investors received an email from Horizon informing them of the fraud.

One of the investors, Mr. Roberts, immediately sought legal advice and shortly thereafter commenced an action for damages for misrepresentations in the offering memorandum pursuant to section 132.1(1) of the *Securities Act*. Section 140 of the *Securities Act* requires that if such an action is commenced within six months of the plaintiff learning of the misrepresentations, then the plaintiff is not required to prove that they relied on the misrepresentations, merely that such misrepresentations were made in the offering memorandum. In February 2009, Mr. Roberts obtained judgment against Mr. Ali and two Horizon group companies.

In August 2009, Mr. Ali and the Horizon group made a proposal under the *BIA* to their creditors, supported by the trustee's report which informed the investors that the offering memorandum was not prepared with appropriate due diligence by Horizon's lawyers. The proposal was not accepted and Mr. Ali and the Horizon group firms were deemed to have assigned into bankruptcy.

In the bankruptcy, Mr. Roberts claimed approximately $330,000 based on his judgment while another over 650 investors (the "Other Investors") filed claims totalling approximately $22 million. The Other Investors had failed to commence an action for damages for misrepresentation prior to the bankruptcy. Nonetheless, the trustee approved the Other Investors' claims, without evidence regarding their reliance on the misrepresentations in the offering memorandum, on the basis that the *Securities Act* limitation period did not begin to run until the August 2009 trustee's report. The trustee also treated the Other Investors as one group, rather than address their claims individually, relying on the principle that the *BIA* is meant to provide for an expeditious and inexpensive method of distributing the bankrupt's property amongst the creditors.

The British Columbia Supreme Court dismissed Mr. Roberts application to disallow the trustee's approval of the Other Investors' claims under section 135(5) of the *BIA*.[3] The Court did not accept his position that the *Securities Act* limitation period commenced in January 2008 when Horizon informed investors of the fraud. The Court also addressed the unsettled procedure for such an application and determined that it was appropriate to hold a fresh hearing of the evidence, not an appeal limited to the evidence before the trustee, with the onus on the applicant to establish on a

[3] *Roberts v. E. Sands & Associates Inc.*, 2013 BCSC 902 [*Roberts* BCSC].

balance of probabilities that the claims should be expunged.[4] This procedure was not challenged on appeal.[5]

The Appeal

The Court of Appeal allowed Mr. Roberts's appeal and ruled the limitation period under the *Securities Act* began to run in January 2008, expiring before the bankruptcy commenced. While the lower court had correctly stated that a limitation period does not begin to run until the claimant knows the necessary material facts and the claimant must be diligent in discovering those facts, the Court of Appeal held it had erred in how it applied those principles to this case.

Noting that the trustee's report referred to the fraud becoming public knowledge in January 2008, the Court of Appeal stated that the Other Investors should have reviewed the offering memorandum for misrepresentations when Horizon informed them of the fraud.[6] An offering memorandum, according to the Court of Appeal, is not merely an advertisement without binding force but an offer which creates a contractual duty on the investor to read and understand the offering memorandum. Moreover, the right of action provided for in the *Securities Act* requires the investor to exercise reasonable diligence in their review of the offering memorandum. It would have been reasonable to expect, as a matter of diligence, that the Other Investors would review the offering memorandum in January 2008 when they learned of the fraud.[7]

While the Court of Appeal set aside the trustee's approval of the Other Investors' claims, it did concur that the trustee was within its discretion to treat the Other Investors as a group. However, that discretion must be exercised within the confines of relevant statutory provisions and common law principles. "The duty of the trustee," the Court of Appeal said in its decision, "is to deal with proofs of claim in accordance with the law of limitations, and then, having sorted them out, to process them according to the principles of expediency."[8]

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[4] *Roberts* BCSC, at paras 35-37, citing *Alberta Permit Pro Inc., Re* (2011), 79 CBR (5th) 169 (Alta QB) and *Ted Leroy Trucking Ltd., Re*, 2012 BCCA 511, at para 16.

[5] *Roberts* BCCA, at para 26.

[6] *Roberts* BCCA, at paras 34-35.

[7] *Roberts* BCCA, at paras 37-39.

[8] *Roberts* BCCA, at para 49.

The Court of Appeal's decision in *Roberts* is a reminder that expediency does not trump the proper application of relevant law in the administration of a bankrupt's estate.

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a cautionary note