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Commonwealth Investors Syndicate Ltd. (Re)

[1986] B.C.J. No. 3112

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(1986), 61 C.B.R. (N.S.) 147

69 B.C.L.R. 346

British Columbia Supreme Court (In Bankruptcy)

Gibbs J.
(In Chambers)

Heard: January 10, 14, 23, 1986.
Judgment: January 28, 1986.

(16 pp.)

Bankruptcy -- Trustee in bankruptcy occupying positions of trust with preferred shareholders of bankrupt -- Trustee organizing preferred shareholders to apply for winding-up of bankrupt -- Removal of trustee -- Bankruptcy Act, R.S.C. 1970, ss. 10(4), 115, 140(1), 142(2), 162(1)(c).

This was an application to remove and replace a trustee in bankruptcy. The trustee of the bankrupt, Commonwealth, occupied positions of trust in three corporations that were either direct or indirect preferred shareholders of the bankrupt. When the bankrupt's creditors had been paid, a surplus remained; but the trustee opposed an application for discharged from bankruptcy, for the express purpose of perpetuating the bankruptcy until a winding-up petition by some of the preferred shareholders had been adjudicated upon. The petition had been instigated by the trustee to enable the preferred shareholders to protect their position and realize $12 per share.

HELD: The application was allowed. Under s. 115 of the Bankruptcy Act the surplus funds belonged to the bankrupt and in respect of those funds the trustee became accountable to the bankrupt as cestui que trust. In his capacity as trustee he could not put forward the interest of the other companies as justification for denying the bankrupt access to its property. Cause had been shown for the removable of the trustee: he had placed himself in a position of irreconcilable conflict and pursued a course of action contrary to his fiduciary duty to the bankrupt.

Counsel:

J.N. **Laxton** and M.E. Baird, for Commonwealth Investors Syndicate Ltd., in bankruptcy.
John Coles. B. Williams, Q.C., and S.R. Ross, for Harold S. Sigurdson, trustee.
H.A. Hollinrake and M.B. Hetherington for certain preferred shareholders.
K.S. Fawcus, for the Crown in right of British Columbia.

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1 **GIBBS J.**:-- This is an application by Commonwealth Investors Syndicate Ltd. in bankruptcy ("the bankrupt") and John Coles, recorded owner of all of the issued common shares of the bankrupt, for an order under s. 10(4) of the Bankruptcy Act, R.S.C. 1970, c. B-3, removing Harold S. Sigurdson as trustee of the estate of the bankrupt and replacing him with another trustee. The other parties who appeared oppose the application.

2 Section 10(4) of the Bankruptcy Act provides:

> "(4) The court on application of any interested person may 'for cause' remove a trustee and appoint another licensed trustee in his place. [The italics are mine.]"

3 The involvement of the courts with the affairs of the bankrupt date back to late 1968 and early 1969. At that time the bankrupt was the parent company of a group of some 30 subsidiaries in which the percentage of share control varied from 100 per cent to 50.01 per cent. The controlling mind and driving force behind this corporate empire was one A.G. Duncan Crux. Irregularities, including illegal financial manipulation, led to the flight of Duncan Crux to the Bahamas to evade prosecution. In due course he was extradited to Canada, faced trial, was convicted of fraud, false pretences and theft, and on 6th July 1971 committed to prison for seven years. He has long since served his sentence and been released.

4 Preceding, or perhaps approximately coincident with, the flight of Duncan Crux to the Bahamas, the corporate empire headed up by the bankrupt collapsed. Bankruptcy orders were made in respect of the major companies including the bankrupt.

5 The outstanding share capital of the bankrupt is divided into 10,000 common voting shares all now owned, as pointed out above, by John Coles, and 634,537 non-cumulative preferred shares owned by a variety of shareholders. It is common ground that all of the shares, whether common or preferred, rank equally in the distribution of the assets of the bankrupt if it is wound up. All of the bankrupt's creditors have been paid and it now has assets in cash or the equivalent of approximately $7.750 million. Apart from the trustee's fees and disbursements, there would appear to be a relatively small income tax claim - relatively small in relation to $7.750 million that is - but no other liabilities of note.

6 Three of the bankrupt's subsidiaries are pertinent to this application.

7 Commonwealth Savings Plan Ltd. is 80 per cent owned by the bankrupt. Harold Sigurdson and one Peter Stanley are co-liquidators. It was through the management of the estate of this company by Harold Sigurdson, while occupying the office of trustee in bankruptcy, that the major part of the $7.750 million surplus available to the bankrupt was generated. It was paid up as a consequence of the liquidation of the company which was decided upon in late 1982. Commonwealth Savings still

retains, as an asset, 17,100 non-cumulative preferred shares of the bankrupt worth, on a winding-up of the bankrupt, approximately $205,500.

8 Commonwealth Acceptance Corporation is 84 per cent owned by the bankrupt. Harold Sigurdson was appointed trustee in bankruptcy on 6th March 1969, the same day as he was appointed trustee of the estate of the bankrupt. Commonwealth Acceptance owns 46,206 non-cumulative preferred shares of the bankrupt worth, on a winding-up of the bankrupt, approximately $554,400. Harold Sigurdson has sworn in an affidavit that if the winding-up value is realized the creditors of Commonwealth Acceptance will receive about 30 cents on the dollar, otherwise they will receive about 10 cents on the dollar.

9 Commonwealth Leasing Company Ltd. is a 100 per cent owned subsidiary of Commonwealth Acceptance. Dunwoody Limited is the liquidator of the company. Harold Sigurdson is a vice-president of Dunwoody Limited and a senior partner of Dunwoody & Company. According to an affidavit sworn by Harold Sigurdson in action A850747 ("the winding-up action"), Commonwealth Leasing owns 48,206 non-cumulative preferred shares of the bankrupt. The winding-up value of those shares is approximately $578,500.

10 Although Harold Sigurdson has sworn, in different affidavits, to the respective preferred share holdings of Commonwealth Acceptance and Commonwealth Leasing, it appears from other portions of the affidavits that he may be referring to the same block of shares. However, whether there are two blocks or one does not affect the merits or otherwise of the application or the outcome.

11 In summary, Harold Sigurdson occupies these positions of trust: he is trustee in bankruptcy of Commonwealth Investors, the bankrupt; he is co-liquidator of Commonwealth Savings; he is trustee in bankruptcy of Commonwealth Acceptance; and he is vice-president of the liquidator of Commonwealth Leasing. And each of the last three companies is a direct or indirect preferred shareholder of the bankrupt.

12 The applicants say that Harold Sigurdson has put himself in a position of intolerable conflict; and that, in his trust capacity with each of Commonwealth Savings, Commonwealth Acceptance and Commonwealth Leasing, he has committed, and is continuing to commit, acts so contrary to his fiduciary duty to the bankrupt that there is cause for his removal and replacement as trustee in bankruptcy of the bankrupt. They say further that, even apart from the conflict, Harold Sigurdson has otherwise acted, and is continuing otherwise to act, contrary to his fiduciary duty as trustee of the bankrupt and has thereby given cause for removal.

13 The applicants contend, and it is not disputed, that by early 1983 all of the creditors of the bankrupt had been paid. Under s. 115 of the Bankruptcy Act, the surplus funds belonged thereafter to the bankrupt:

> "115. The bankrupt or the legal personal representative of a deceased bankrupt is entitled to any surplus remaining after payment in full of his creditors with interest as by this Act provided and of the costs, charges and expenses of the bankruptcy proceedings."

14 The applicants further contend that, upon it becoming clear that there was a surplus remaining after payment of the creditors, Harold Sigurdson, as trustee, became accountable to the bankrupt, as cestui que trust. That principle of law is clearly stated in the judgment of Farwell J., in Bird v. Philpott, [1900] 1 Ch. 822 at 828, and at p. 829 where he says:

> ". . . that the property remaining undistributed, being no longer required for any function of that Court, falls under the general rule of law, which raises, on the part of the legal owner of property no longer required for the purposes of the conveyance to him, a trust and obligation to restore that which is not wanted to the original owner, from whom it was taken for a limited purpose."

15 And Lord Blackburn, delivering the judgment of the Privy Council in Letterstedt v. Broers (1884), 9 App. Cas. 371, said at p. 386 that: "It must always be born in mind that trustees exist for the benefit of those to whom the creator of the trust has given the trust estate".

16 The obvious question is: Why was an order not obtained in 1983 to discharge the company from bankruptcy? One reason was that the company had been struck from the register. However, the trustee rectified that problem by causing the company to be restored to good standing on 28th March 1983. Another reason put forward by the trustee, referring to 1981, and apparently continuing through 1983, was:

> "Handing the surplus to C.I.S. itself was ruled out because at that time 3 of its 6 directors were dead or convicted of a crime. Also I was concerned because of the unusual length of the bankruptcy administration, and that I had no knowledge of the capacity of qualifications of the remaining directors or of what proceedings had been taken by them or by C.I.S. shareholders since the date of filing of the last annual report which might have affected their position of powers. In addition I was concerned about the position of the unrelated preferred shareholders of C.I.S., and about C.S.P. and C.A.C."

17 That explanation, insofar as it relates to 1981, is unconvincing and, insofar as it relates to 1983, it disingenuous. By 1981 Duncan Crux had served his sentence and regained his civil rights and freedoms. The trustee had no right or authority to pass moral judgment upon his qualification to act as a director. Neither did he have any right or authority to set himself up as the judge of whether the three "remaining directors" had capacity or qualifications. At the very least, one would have expected the trustee to have ascertained the wishes of the shareholders or taken some concrete step leading to the creation of a corporate management team, if none then existed, to whom he could deliver the assets of the company. By 1983 any difficulty there might have been in that regard had disappeared because in February 1983 the trustee, in his capacity as co-liquidator of Commonwealth Acceptance, received a letter from the agent of Garantee Establishment, a company which, to his knowledge, owned 50 per cent of the shares of the bankrupt. And in late March 1983 Duncan Crux attended at the trustee's office on behalf of Garantee Establishment. The trustee was therefore in communication with the common shareholders of the bankrupt in early 1983, at a time when the financial statements of the bankrupt show that it had cash in excess of liabilities to an approximate amount of $1.6 million. Apparently the trustee did not disclose then that the bankrupt was solvent, and neglected to advise or recommend that the corporate affairs be put in order so that there should be an orderly hand-over of books, records and assets upon discharge from bankruptcy.

18 Judging from subsequent events, it would appear that the real reason why there was no discharge from bankruptcy in 1983 was that the trustee was able to predict that the then surplus would increase to the point where about $12 per share would be realized on a winding-up and that the subsidiaries of which he was, and is, trustee or co-liquidator would receive a substantial benefit on a

winding-up. In the explanation quoted above he expressed his concern about Commonwealth Savings and Commonwealth Acceptance. Two paragraphs later in the affidavit he said that he concluded that the company should be wound up, giving essentially the same reasons, and expressing the last reason in these words: "all shareholders - common and preferred - would share pro-rate upon a winding up of C.I.S. ". He allowed that conclusion to dominate his thinking thereafter and to deflect him from his duty to the bankrupt. It cannot be a proper discharge of the fiduciary obligation to the beneficiary to eliminate the beneficiary entirely in the interest of, or at the behest of, some of the members of one of two classes of shareholders. The shareholders are not the beneficiaries but, even if they are so regarded, the trustee is prohibited from being a partisan of one class as against another. See Halsbury, 3rd ed. (1962), vol. 3, art. 1677, ". . . and he must not set up an adverse title or claim of another person against his cestui que trust . . .", and art. 1683, ". . . it is the duty of a trustee to hold an even hand between the parties interested under the trust, and to look at the interests of all and not to those of any particular beneficiary or class of beneficiaries . . . "

19 If matters had not proceeded further, the trustee, although mistaken in his understanding of his duty, could not be accused of more than being mildly delinquent in effecting the return of the company assets to the control and management of the directors. But steps were taken to implement the winding-up solution at a time when there was known to be a board of directors in place, and in direct opposition to the wishes of that board of directors. At about the same time the trustee opposed an application that the company be discharged from bankruptcy, for the express purpose of perpetuating the bankruptcy until a winding-up petition by some of the preferred shareholders had been adjudicated upon, and to that end he filed a trustee's report which he believed would justify, if not require, the court "to refuse or suspend discharge of C.I.S. pursuant to Section 142(2) of the 'Bankruptcy Act'". Those are activities which the applicants say put the trustee into a position of conflict, and which they say were contrary to his fiduciary duty to the bankrupt.

20 Any doubt the trustee may have entertained about a properly constituted board of directors for the bankrupt was dispelled in late 1984. On 29th November 1984 John Coles, one of the applicants, became a director along with Ralph Diamond and Duncan Davies. John Coles immediately arranged for a meeting with the trustee. That meeting occurred in early December. John Coles advised the trustee that he was a director of the bankrupt, that he represented the bankrupt, that he wished to have access to the financial information, and that if the bankrupt was solvent he would like to know when a discharge order would be obtained. The trustee indicated that he would be proceeding with the discharge within about 60 days. A few days later, on 17th December 1984, the trustee wrote a letter to the shareholders of the bankrupt, saying the shares would have value, explaining that the winding-up of the subsidiaries had taken longer than expected, and ending: "I expect to report in 60 to 90 days telling you when I will be turning the surplus cash over to the company". There is some dispute about whether this was the first advice to the shareholders that the shares would have value, or whether a letter of 14th April 1981, marked "DRAFT" had, in fact, gone out to the shareholders saying that it was probable that there would be a surplus for the benefit of the shareholders.

21 On 9th January 1985 John Coles was appointed president of the bankrupt and Duncan Davies secretary. On 17th January 1985 John Coles again met with the trustee to discuss the bankrupt's affairs. At that time he obtained a copy of the trustee's 17th December 1984 letter to the shareholders. Surprisingly, he had not been provided with a copy when it went out to the shareholders. There followed a course of conduct by the trustee which was in clear violation of his duty to the bankrupt. Halsbury says in art. 1677 that: "A trustee must not connive at or knowingly facilitate any act or conduct of another person which would involve a breach of trust or occasion loss or risk to the trust

property . . . " But the trustee here did. He initiated action which put the trust property at risk. On 22nd January 1985, five days after the meeting with John Coles, and without the knowledge of John Coles whom he knew to be the president and a director, he called a meeting of what he refers to as "several major preferred shareholders". The purpose of the meeting was "to ensure that the preferred shareholders understood their position regarding the surplus, and to give them an opportunity to protect their position through the winding up procedure". At the meeting he also informed the selected group that on a winding-up some $12 per share would be payable. The uninvited preferred shareholders were not given this share value information until a month later, so there may be question of the insider role of the trustee in releasing the projected values to a restricted group. The meeting voted to proceed with winding-up proceedings and appointed the trustee to the office of "Secretary, C.I.S. Preferred Shareholders Committee".

22 The trustee says that he convened the 22nd January 1985 meeting in his capacities as trustee of Commonwealth Acceptance, co-liquidator of Commonwealth Savings, and vice-president of the liquidator of Commonwealth Leasing, and that he did so because a winding-up would be beneficial to those companies. Accepting that as so, it must have been evident to a person with the bankruptcy experience of Harold Sigurdson that he could not serve those interests and continue to perform his fiduciary duty to the bankrupt. As Halsbury says in art. 1675, it is the trustee's duty to preserve the trust estate and secure it from loss, and in art. 1677: ". . . he must not . . . undertake a duty or put himself in a position which is inconsistent with his duty as a trustee, or act in a manner inconsistent with that duty". The trustee ought to have taken himself out of the conflict position by resigning his office when he decided to ally himself with a group of preferred shareholders and to take an active part in proceedings to dissolve the cestui que trust.

23 The trustee continued to preserve the facade of normalcy while working towards dissolution. On 13th February 1985, three weeks after the winding-up meeting but before the fact of its occurrence was known to other than those in attendance, the trustee wrote to John Coles. He spoke of steps being taken to provide company records, of the income tax assessors, and said: ". . . as soon as they have given us a clearance we will make application to the Superintendent of Bankruptcy and to the courts to have our accounts taxed and the discharge granted. I will press to have that done as soon as possible". He did not disclose that he was an active participant in a group which would seek to obtain a winding-up order before there was a discharge from bankruptcy. That did not become known until ten days later when, on 22nd February 1985, on his letterhead of "Trustee in Bankruptcy for Commonwealth Investors Syndicate Ltd.", and signing as "Secretary, C.I.S. Preferred Shareholders Committee", the trustee wrote to all shareholders reporting what had occurred at the 22nd January 1985 meeting, and seeking to enlarge the preferred shareholders' group by recruits who would make a cost-sharing commitment. John Coles and the other directors learned what was afoot through John Coles' then solicitors who received a copy of the trustee's letter sent to their office as the address for one of the common shareholders. It was then obvious to them that the trustee had not been candid and that he was bent on a course of action which, if successful, would prevent the $7.750 million from being returned to the bankrupt except under circumstances where it would flow directly through to individual shareholders. The lines were drawn. Thereafter the trustee proceeded in open opposition to the directors.

24 On 25th February 1985 John Coles caused the bankrupt's then solicitors to advise all parties that the company intended to apply for a discharge from bankruptcy. On 13th March 1985 the trustee, on the letterhead of Dunwoody Limited, liquidator of Commonwealth Leasing, advised interested parties that the registrar in bankruptcy had fixed 3rd April 1985 as the date to hear the applica-

tion for discharge. On 22nd March 1985 the trustee's solicitors advised the bankrupt's solicitors that Dunwoody Limited would oppose the application and seek to have it refused until the winding-up petition had been heard and determined. The winding-up petition had not then been filed. Also on 22nd March 1985 the trustee completed the report required to be filed by him, and subsequently filed by him in accordance with s. 140(1) of the Bankruptcy Act. The trustee must have known that by reason of s. 162(1)(c) of the Bankruptcy Act the registrar lacks jurisdiction to grant a discharge order when the application is opposed. In the result, when the application came on for hearing before the registrar he adjourned it generally.

25 Given the trustee's belief that the contents of his report would justify, if not require, refusal or suspension by the court of the discharge application pursuant to s. 142(2) of the Bankruptcy Act, the inaccuracies in the report are of serious concern. He says that the conduct of the bankrupt was subject to censure, but provides by way of detail an account of the offences and convictions of principal officers and directors only. He says that the bankrupt committed the offences committed by the officers and directors, knowing that the bankrupt was never charged or put upon its defence. Included in the circumstances he says would justify refusal by the court of an unconditional order of discharge is an allegation that the bankrupt has been guilty of fraud. He knows that the bankrupt was not even charged. He says that the bankrupt has committed bankruptcy offences, knowing that the bankrupt has never been convicted or even charged under Pt. VIII of the Bankruptcy Act. Throughout the report he equates the bankrupt with Duncan Crux and Cornelius Polvliet (the other director who was sentenced to prison) on a basis of attributing the guilt of the convicted directors to the company. The report, as a whole, does not reflect favourably upon the author.

26 Having safeguarded against an order of discharge by the registrar, on 27th March 1985 a winding-up petition was filed in the registry by two individuals and by "Dunwoody Limited, Liquidator for Commonwealth Leasing Company Limited, Harold S. Sigurdson and AD. Stanley, Co-Liquidators for Commonwealth Savings Plan Ltd., and Harold S. Sigurdson, Trustee in Bankruptcy of Commonwealth Acceptance Corporation Ltd." The petition says in para. 20 that "the petitioners have no confidence in the management of C.I.S.". In para. 27 it identifies the petitioners as "Harold S. Sigurdson, Robert H. Chatwin and Klapstock Holdings Ltd." on their own behalf and on behalf of the preference shareholders listed in a schedule. All of the holders of preference shares are listed. It appears therefore to be intended to be a kind of class action. An affidavit in verification of facts in the petition was sworn by Harold S. Sigurdson.

27 The next relevant event in the continuing contest between the trustee and the bankrupt was the filing by the bankrupt of three applications in the winding-up proceedings. One of the three requested an order that the winding-up application be dismissed on the ground that, in law, the company could not be would up while it was still in bankruptcy. The application was opposed by the trustee. It came on before Davies J. of this court on 15th November 1985. He granted the application to dismiss, giving written reasons therefor. Evidently the decision is now under appeal. On this application the trustee was adamant in his opposition to the unconditional release of the surplus funds to his cestui que trust, the bankrupt, until the appeal has been heard and decided.

28 In the numerous affidavits that have been filed by the opposing parties there is a variety of charges and counter charges, and allegations and replies to the allegations. Issues are raised which are more appropriately resolved in other proceedings, but the fact of the issues and the allegations highlights the depth of antipathy, distrust and suspicion which exists between the bankrupt and the trustee. And the suspicion is reciprocated. Indeed, the constant thread that can be traced through the

trustee's affidavits is his apprehension that somehow Duncan Crux would obtain the surplus funds and spirit them out of Canada, thereby preventing the other companies for which Harold Sigurdson is trustee or liquidator from realizing the winding-up value of their preference shares. No facts are put forward in support of that suspicion. In any event, in his capacity as trustee for the bankrupt, Harold Sigurdson cannot put forward the interest of the other companies as justification for denying the bankrupt access to its property. And whatever foundation there may have been for the suspicion, it disappeared in mid-1985 when John Coles became owner of 51 per cent of the common shares, a fact which was disclosed in an affidavit sworn by him and filed in the winding-up action on 20th June 1985. In the same affidavit he disclosed that he expected to become owner of the balance of the common shares within two weeks, and he swore that Duncan Crux had no legal or beneficial interest in the shares. In an affidavit sworn 27th September 1985 in the winding-up action John Coles swore that he was by then the owner of all of the common shares of the bankrupt. Accordingly, whatever moral justification there may have been for the trustee's stance, it was gone by the end of September 1985. But that did not persuade the trustee to deviate from his course.

29 The applicants have made out their case. Cause has been shown. Cause is not synonymous with dishonest conduct; cause exists if there is conduct showing that it is no longer fit that a man continue as trustee: Re Mansel; Ex parte Newitt (1884), 14 Q.B.D. 177 at 181, Bowen L.J. Cause exists if there is danger to the trust property; if there is a want of reasonable fidelity, if circumstances prevent the beneficiaries from working in harmony with the trustee: Letterstedt v. Broers, supra, Lord Blackburn at p. 386. The main principle upon which the jurisdiction of the court is exercised is the welfare of the beneficiaries and of the trust estate; Lord Blackburn's judgment applies in British Columbia: Re Dickinson (1892), 2 B.C.R. 262 at 263, McCreight J. Cause exists if it is shown that the trustee cannot act impartially: Re Lamb; Ex parte Bd. of Trade, [1894] 2 Q.B. 805, Lord Esher M.R. There is cause if there has been an excess of power, or a lack of bona fides, or unreasonable conduct by the trustee in relation to the trust estate: Re Groves-Raffin Const. Ltd., [1978] 4 W.W.R. 451, Macfarlane J. Excepting in the most unusual circumstances, a trustee will not be permitted to sue himself; he must resign in favour of another trustee: Re 286301 Ont. Ltd. and First Can. Metal Laboratories Ltd. (1981), 31 O.R. (2d) 765. And see generally Halsbury, Pt. 3, s. 1 "Duties of Trustees". All of these instances of cause apply in this case.

30 The trustee has placed himself in a position of irreconcilable conflict from which he must be removed unless he voluntarily removes himself by resignation. Furthermore, the trustee is pursuing a course of action contrary to his fiduciary duty to the bankrupt. Apart from the conflict, he seems still not to understand that his duty is to facilitate the return of the assets to the bankrupt, to facilitate the discharge of the bankrupt, and to leave it to the contesting groups of shareholders to pursue whatever remedies each selects as appropriate. And the trustee has no mandate, for so long as he is trustee, to side with either of the contesting groups.

31 The applicants will have leave to put forward the name of a licensed trustee to replace Harold Sigurdson and, upon appointment of the new trustee, Harold Sigurdson will cease to hold that office.

GIBBS J.

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