IN THE SUPREME COURT OF NOVA SCOTIA
IN BANKRUPTCY AND INSOLVENCY
Citation: Zinck (Re), 2012 NSSC 114

Date: March 21, 2012
Docket: B 35658
Registry: Halifax

District of Nova Scotia
Division No. 01 - Halifax
Court No. 35658
Estate No. 51-1444762

In the Matter of the Bankruptcy of Toby Marlon Zinck

D E C I S I O N

Registrar: Richard W. Cregan, Q.C.

Heard: November 29, 2011

Present: Darryl D. Haley, representing the Trustee, Haley & Associates Inc.

Richard A. Bureau, representing McMullin and Associates Limited

Stephen Dickey, representing the Office of the Superintendent of Bankruptcy, appearing by telephone

[1] Introduction

This is an application by McMullin and Associates Limited (McMullin) a secured creditor, to have determined whether the Trustee, Haley & Associates Inc., Toby Marlon Zinck's Trustee in Bankruptcy, was right in retaining the Superintendent's levy under Section 147 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (*BIA)*, from the amount settled between the two as the payout of McMullin's secured claim.

[2] Facts

On November 6, 2008 Mr. Zinck delivered a promissory note for $38,500 to McMullin and executed a General Security Agreement whereby he pledged various fishing licenses to McMullin as security for this note.

[3] Mr. Zinck defaulted under the note and the agreement. McMullin commenced an action with respect to this debt and on September 13, 2010 a default judgment was obtained for the sum of $49,192.47, plus interest of $1703.48 and costs of $1,075.41. Efforts were made to enforce this judgment and realize on the security. However, Mr. Zinck made an assignment in bankruptcy on December 20, 2010. Haley & Associates Inc.

was appointed Trustee.

[4] On January 24, 2011 McMullin filed a Proof of Claim as a secured creditor without specifying therein the amount claimed. The claim was subsequently amended to show a secured claim of $73,926.77.

[5] On February 7, 2011 Mary Ann Marriott, an administrator in the Trustee's office, sent an email to Bonnie Burke, an employee of McMullin. I quote the relevant part:

> I met with Darryl on the file this morning. We are prepared to take possession of the licenses and list them for sale and pay out Blair's interest from the proceeds. Please advise if you/Blair are agreeable to this process.

Darryl is Darryl Haley, the personal Trustee, and Blair is Blair McMullin, the President of McMullin.

[6] On February 17, 2011 Ms. Burke emailed Ms. Marriott to say that she had instructions from Mr. McMullin and his lawyer to advise the Trustee to proceed with the sale of the licenses. Later in the day Ms. Marriott replied by email as follows:

> Thanks Bonnie. I am waiting to hear back from DFO. You indicated you had spoken to someone there. If so, can you forward

> your contact so I can coordinate any work/effort done so far?

[7] On August 10, 2011 a letter of disallowance was sent by the Trustee to McMullin advising it was prepared to admit a secure claim of only $57,815.70.

[8] This was followed by discussion which resulted in the Trustee admitting a secured claim for $62,506.07, with a *per diem* of $27.40 from December 20, 2010 and an unsecured claim for $734.50.

[9] On August 10, 2011 the Trustee wrote to McMullin:

> We are in receipt of two offers on the District 33 Lobster License, one in the amount of $75,000 and the second in the amount of $85,000.00. We are prepared to accept the offer of $85,000.00. Given that this is the highest offer we have received and we are nearing the start of the lobster season in that area, we are requesting and recommending that you release your lien on the license and allow us to accept this offer with the agreement that we hold the funds in trust, pending resolution of your claim amount.

[10] The Trustee on or about September 30, 2011 sold the fishing licenses for $85,000. To facilitate the sale, McMullin delivered a release which stated that in consideration of the payment of $62,506.07 and a *per diem* of $27.40

from December 20, 2010 to date of payment, it discharged The Estate of Toby Zinck from all claims with respect to the security it held on the fishing licenses owned by the estate.

[11] On October 17, 2011 Mr. McMullin emailed Mr. Haley as follows:

> I would appreciate receiving an update of the Zinck bankruptcy. I emailed to you the release on October 5 and have yet to receive payment to which you had left me with the impression was imminent.

[12] Later in the day Mr. Haley emailed Mr. McMullin as follows:

> I picked up the cheque for the sale of the lobster license the Friday before last. By copy of the email I am asking Mary Ann to look into processing your request and see if we can't get a payment to you. We are required to withhold a 5% levy for the Superintendent in the payment to you. Hopefully we can get this portion dealt with.

Apparently this was the first time the requirement for the levy was raised.

[13] An hour or two later Mr. McMullin emailed Mr. Haley as follows:

> I am expecting payment in full, that is 70,808.25 62,506.07 plus 8,302.18 per diem (Dec 20, 2010 - October 18, 2011 303 days at $27.40) if received by Wednesday. As the secured creditor this is the amount plus formula agreed to by you and I.
>
> When we negotiated in good faith the above amount plus per diem, I assumed that you had taken into account any third party obligations that you would incur.

[14] On October 19, 2011 Mr. McMullin emailed Mr. Haley as follows:

> I believe you had an obligation to inform me of this charge prior October 17th. You may be obligated to make the remittance but we had agreed that it that the amount coming to me was as laid out in our negotiated agreement and in the release.
>
> I will accept nothing less that what you had agreed to.

[15] Minutes later Mr. Haley emailed Mr. McMullin with a copy to Stephen Dickey of the Office of the Superintendent of Bankruptcy as follows:

> What we negotiated was the amount of your claim. We agreed on that amount and that claim entitles you to a payment less the levy involved. I don't believe I owed you an extraordinary duty. I was not retained by you. In fact, you had retained legal counsel. Perhaps you should look to them, after all this is the application of the laws of Canada as has already been heard a number of times.
>
> Again, I await your decision to appeal or accept.

[16] On October 20, 2011 the Trustee wrote to Mr. McMullin. I quote the relevant part:

> Further to your email of October 17, 2011, we are enclosing a cheque for the amount of $67,267.84 representing the payment in full of your secured claim of $62,506.07 plus $8,302.18 in per diem costs less the 5% levy required by the Superintendent of Bankruptcy".

[17] Statutory Authority

Section 147 of the *BIA* directs that payments made by trustees be subject to a levy in favour of the Superintendent. I quote it:

> 147(1) For the purpose of defraying the expenses of the supervision by the Superintendent, there shall be payable to the Superintendent for deposit with the Receiver General a levy on all payments, except the costs referred to in subsection 70(2), made by the trustee by way of dividend or otherwise on account of the creditor's claims, including Her Majesty in right of Canada or of a province claiming in respect of taxes or otherwise.
>
> (2) The levy referred to in subsection (1) shall be at a rate to be fixed by the Governor in Council and shall be charged proportionately against all payments and deducted therefrom by the trustee before payment is made.

[18] On May 22, 2009 the Superintendent issued Directive No. 10R to clarify the operation of the Section 147 levy where encumbered assets are liquidated. I quote the relevant sections:

> 4. Under section 147 of the Act, a levy is payable to the Superintendent of Bankruptcy on all payments (except the cost referred to in subsection 70(2) of the Act) made by the trustee by way of dividend or otherwise on account of the claims of creditors whether unsecured, preferred or secured. *The levy is payable when the payments are made by the trustee in its capacity as a trustee in the course of an administration under the Act.*
>
> 5. Except in the cases listed in paragraph 7 of this Directive, *the section 147 levy is payable on all payments by a trustee to a secured creditor.* This principle stands even if a third party, such as a notary public, a liquidator or an auctioneer, makes the payment to the secured creditor for and on behalf of the trustee.
>
> 6. Since the redemption is not a "consensual operation", but rather a unilateral action taken by the trustee with the intention of obtaining an advantage for the estate, it excludes the case of the

> trustee acting as agent, receiver or mandatary for the secured creditor.
>
> 7. Exception - The section 147 levy is *not payable* on payments by a trustee to a secured creditor in situations where:
>
> > (a) The trustee has acted as agent, receiver or mandatary for the secured creditor in selling the encumbered assets;
> >
> > (b) The trustee proceeded with redemption of the security within the meaning of subsection 128(3) of the Act.

[19] I quote Section 128 of the *BIA:*

> 128. (1) Where the trustee has knowledge of property that may be subject to a security, the trustee may, by serving notice in the prescribed form and manner, require any person to file, in the prescribed form and manner, a proof of the security that gives full particulars of the security, including the date on which the security was given and the value at which that person assesses it.
>
> (1.1) Where the trustee serves a notice pursuant to subsection (1), and the person on whom the notice is served does not file a proof of security within thirty days after the day of service of the notice, the trustee may thereupon, with leave of the court, sell or dispose of any property that was subject to the security, free of that security.
>
> (2) A creditor is entitled to receive a dividend in respect only of the balance due to him after deducting the assessed value of his security.
>
> (3) The trustee may redeem a security on payment to the secured creditor of the debt or the value of the security as assessed, in the proof of security, by the secured creditor.

[20] <u>Case Law</u>

Let me review some cases which deal with the levy on payments by a trustee to secured creditors.

[21] *Seeley (Trustee of)* v. *Canadian Imperial Bank of Commerce*, 2008 NWTSC 77 (V.A. Schuler J.)

The bankrupt prior to assignment had listed a cabin for sale. The bank held security on it. There was extensive correspondence between the Trustee and the bank mainly to update each other. The sale was eventually concluded with the Trustee paying out the bank security from the proceeds. No levy was deducted. The Trustee then sought to recover the amount of the levy from the bank. The bank refused to pay. It took the position that the transaction was a redemption for which a levy is not payable.

[22] The issue is expressed simply in paragraph 27 and 28, which I quote:

> 27 In *Aberant Arnold*, the secured creditors chose to rely on the BIA process rather than realize on their security; they were paid but the payment was found not to amount to a redemption and they were liable for the levy. In *Cutting Edge*, on the other hand, the trustee intervened to stop the secured creditors from realizing on their security as the trustee thought it could make a better deal for the estate; the secured creditors were paid, the payment was found to amount to a redemption and they were not liable for the levy.
>
> 28 The difference, in my view, is that in the first scenario the secured creditors are not taking action to realize on their security

> and therefore there is no need for the trustee to redeem the debt to preserve the security for the bankrupt's estate; the trustee simply pays out the debt in the normal course of the bankruptcy. In the second scenario, the trustee has to take steps to redeem because otherwise the security will be dealt with by the enforcement proceedings taken by the secured creditors outside the bankruptcy.

[23] The bank had done nothing to enforce its security. It elected simply to leave it to the Trustee to take appropriate action and rely on the normal bankruptcy procedure. For there to be a redemption there must be some pressure on the trustee to take action to maintain control of the situation. Such pressure was lacking. This was not a redemption. The levy was payable.

[24] *Alger Press Ltd., Re* (1994), 25 C.B.R. (3d) 154 (Ont)

This is a decision of Farley J. It is helpful in that it applies *Kop Beverages Ltd., Re* (1952), 32 C.B.R. 221 (Ont.), a leading case on the point. I repeat the quotation which Farley J. made from this case in Paragraph 10 of his decision:

> It may seem a rather hard provision against a secured creditor who has a security and would be entitled to realize from that security in certain circumstances and receive full satisfaction of his claim against the bankrupt, in any event, if he had taken proceedings before the bankruptcy, but I do not think the Court is concerned with that. The provision is obviously a form of taxation, and the section states that there shall be a "levy on all payments excepting the costs referred to in subsection two of section forty-one made by the trustee by way of dividend or otherwise on account of the

> claims of creditors, whether unsecured, preferred or secured creditors, and including Her Majesty in right of Canada or a province claiming in respect of taxes or otherwise; the levy shall be at a rate to be fixed by the Governor in Council from time to time and shall be charged proportionately against all payments and deducted therefrom by the trustee before payment is made.

and I quote his application of it in Paragraph 11:

> It seems to me that the present situation is governed by *Hart, supra,* and *Kop, supra.* It does not appear that the fact that Algonquin did not file a claim with the trustee is dispositive of the matter. The trustee had no other relationship with Algonquin than as trustee; it was not an agency relationship as was the case in *Colonial, supra.* It took no action to realize upon its security even to the extent of taking possession. It seems that PMT did the sale as trustee.

The levy was required to be paid.

[25] In *re Hart Equipment Corporation Limited* (1957), 36 C.B.R. 103 (Ont. Smily J.)

This case points out that one must carefully review the facts to determine whether any sale of secured goods is primarily pursuant to the act of the secured creditor to realize on its security or is primarily the act of the Trustee in realizing on the property of the estate. If the former no levy is payable. If the latter, the levy is payable. The annotation in the head note by Lloyd W. Houlden is instructive:

> To avoid payment of the levy, a bank must be careful in the light of this decision to take possession of goods covered by S.88 security before permitting a trustee in bankruptcy to act as its agent in

processing or realizing on such goods.

[26] Analysis

In practice a trustee must be very careful with assets subject to a security interest. The secured creditor has the right to realize on its security notwithstanding the bankruptcy. Its only interest is to have its secured claim paid in full. It has no interest in any surplus which may arise from realization of the security, unless it is also an unsecured creditor. If there is equity in the secured asset, the trustee is bound to deal with it as best it can to assure that the equity is not lost. If the trustee leaves it to the secured creditor to realize its claim, the equity may be lost, the creditor having incentive only to sell the asset at a sufficient price to cover the secured claim. Accordingly, where there is equity, the trustee will want to take control of the disposition of the assets to assure the best possible price is obtained. This is the reason for Subsection 128(3). It gives the trustee the right to redeem and thus to control the disposition of the asset. The trustee may take the middle course as was done in *Seeley*, that is, simply work with the secured creditor. The risk for the trustee is that the secured creditor may take the initiative by realizing on its security resulting in the equity being lost. As well the levy would not be

payable. The risk for the secured creditor is that it will be subject to the levy.

[27] As stated in the directive at Paragraph 6, a redemption is a unilateral act of a trustee for the good of the estate. The creditor has no choice in the matter. If the correct secured amount is tendered, the creditor must accept it. Its interest is thereby released and the claim discharged. Either the trustee will have the funds needed for the redemption in the estate account or they may flow through from the sale which the trustee has arranged, proper escrow arrangements having been made.

[28] In light of these considerations do either of the exceptions in Paragraph 7 of the Directive apply in the present matter?

[29] First let me consider whether the Trustee acted as agent, receiver or mandatory. As to receiver or mandatory, there would have to be some formality of appointment such as a specific written direction to the Trustee to act as such under the terms of the security documents or as may be required under the *Personal Property Security Act*, or by a court order. There is nothing of this nature.

[30] As to an agency relationship, again there is no formal documentation to create it. However, an agency relationship may arise without such.

[31] G.H.L. Fridman: *Canadian Agency Law*, Lexis Nexis, 2009, at page 2 provides the following definition of agency:

> Agency is the relationship that exists between two persons when one, called the agent, is considered in law to represent the other, called the principal, in such a way as to be able to affect the principal's legal position by the making of contracts or the disposition of property.

[32] What has happened is that the Trustee by virtue of an assignment acquired the equity in the fishing licenses of the bankrupt. It had the obligation to realize on this equity for the benefit of creditors. The Trustee did not find it necessary to redeem the licenses in the manner which has been considered. The Trustee sought the cooperation of the secured creditor. The payout of the security was settled. The Trustee checked with the Department of Fisheries so that its requirements for transfer of the licenses would be met. McMullin took no exception to the Trustee proceeding with the sale. Two offers were made. The Trustee asked McMullin to provide a release so that good title could be given. The sale was completed and McMullin received

the payout of the security less the Superintendent's levy.

[33] It was the Trustee who effected the sale. It was not the creditor's sale. McMullin simply received the payout of its security in the course of the sale. The Trustee was acting as principal. McMullin took no active role in it. Basically it said to the Trustee, "Do what you want with the sale. I shall release my interest when you provide me with my payout." McMullin was not party to any contract with the purchaser through any agency or otherwise. No relationship of agent and principal was established.

[34] The act of redeeming the equity of redemption in collateral secured by a general security agreement or a mortgage is a right with roots in equity as well as under the *Personal Property Security Act*, S.N.S. 1995-96, c.13 and the *BIA*. It is simply described in the following passage from Cumming, Walsh & Wood: *Personal Property Security Law*, Irwin Law, 2005 at page 536:

> Redemption of the collateral occurs when the debtor tenders the obligation secured by the collateral or otherwise cures the default. This has the effect of extinguishing the security interest in relation to the collateral that has been redeemed.

[35] Was there a redemption? What happened was very much a joint effort by McMullin and the Trustee. McMullin was asked by the Trustee whether it was agreeable to it taking possession of the licenses and listing them for sale. The Trustee proceeded with McMullin's permission. The pay out of the claim did not take place until the sale was completed. The work was substantially done by the Trustee. The overall thrust of it was to realize the equity for the estate. The work involved was the Trustee's work in administering the estate. This process was with the concurrence of McMullin. There is no evidence that McMullin was threatening to realize on its security so as to threaten the equity and thus cause the Trustee to unilaterally redeem it. The situation is very similar to that in *Alger Press*. I would reach the same conclusion as did Farley J. This was not a redemption. Throughout the Trustee was doing trustee's work, and concluded the sale as such. It paid out McMullin's secured claim from the proceeds in order to give good title to the licenses, but first having deducted the Superintendent's levy as directed by Section 147 of the *BIA*.

[36] As a result the transaction does not fall under either of the two exceptions in

paragraph 7 of the Directive.

[37] McMullin's counsel submitted that it had a binding understanding with the Trustee that it would be paid the full amount of its secured claims. Mr. McMullin knew nothing of the levy requirement. I think the answer to this is that in dealing with trustees it must be assumed that any arrangements made are subject to the provisions of the *BIA*. It is similar to commercial practice dealing with taxes such as Harmonized Sales Tax, where unless there is provision to the contrary, such will be payable in addition to the sale price. The levy in effect is a tax on the payout by a trustee of a secured claim. This is recognized in the quotation from *Kop Beverages* in Paragraph [24] above. The Trustee retained the levy. The balance is all that McMullin was entitled to receive.

[38] Accordingly, I am satisfied that the levy was properly retained by the Trustee. The application is therefore dismissed.

R.

Halifax, Nova Scotia
March 21, 2012