2000 CarswellAlta 1068
Alberta Court of Queen's Bench

YBM Magnex International Inc., Re

2000 CarswellAlta 1068, [2000] A.J. No. 1118, 275 A.R. 352, 99 A.C.W.S. (3d) 962, 9 B.L.R. (3d) 296

# In the Matter of in Re s.234 of the Business Corporations Act, R.S.A. (1980) c. B-15 as Amended

In Re s.13(2) of the Judicature Act, R.S.A. (1980) c. J-1

In Re the Matter of YBM Magnex International, Inc.

Paperny J.

Heard: August 15, 2000
Judgment: September 15, 2000
Docket: Calgary 9801-16691

Counsel: *Alan D. MacLeod, Q.C.* and *Roger F. Smith*, for Applicant.
*Peter F.C. Howard* and *Glenn Zacher*, for Respondent.
*Clint Docken* and *Mark Freeman*, for Plaintiffs' Executive Committee.
*Earl A. Cherniak, Q.C.*, for Royal Trust Corporation.
*J.L. McDougall, Q.C.*, for Deloitte & Touche LLP.

Subject: Corporate and Commercial; Insolvency

**Related Abridgment Classifications**
**Debtors and creditors**

VII Receivers
VII.9 Discharge of receiver
VII.9.b Grounds for discharge

**Headnote**
**Receivers --- Discharge of receiver — Grounds for discharge**

Receiver was auditor of underwriters or predecessor of underwriters prior to being appointed receiver of company Y Inc., currently in receivership — Receiver was privy to Y Inc.'s confidential information, including litigation assets — Receiver acknowledged potential conflict of interest by drafting carefully considered receivership order — Receiver initially relied on its client confidentiality policy but later took additional security measures, including requiring staff to sign confidentiality agreement — Receiver's counsel had been retained by institutional shareholders on matters related to Y Inc. — Underwriters brought application to remove receiver and receiver's counsel for conflict of interest — Application dismissed — Receiver recognized and disclosed potential for conflict of interest at outset and adequately addressed it by creating receiver as separate entity and delegating certain tasks to receiver's counsel — Underwriters failed to prove receivers favoured other stakeholders to underwriters — Prejudice factors were significant and replacement receiver did not have background information to effectively take over Y Inc.'s extremely complicated and highly unusual estate — Underwriters' delay in bringing motion was significant factor as much money and time had been expended by receiver — Receiver's counsel's retainer for institutional shareholders ended prior to receiver's retainer — Institutional shareholders were not concerned about receiver's

  

counsel's involvement with Y Inc. — Receiver's counsel not tainted by either receiver's potential conflict or by involvement with institutional shareholders.

**Table of Authorities**

**Cases considered by *Paperny J.*:**

*Bolkiah v. KPMG* (1998), [1999] 2 W.L.R. 215, [1999] 1 All E.R. 517, 45 B.L.R. (2d) 201 (U.K. H.L.) — considered

*Canada Trustco Mortgage Co. v. York-Trillium Development Group Ltd.* (1992), 12 C.B.R. (3d) 220 (Ont. Gen. Div.) — applied

*Canadian Commercial Bank v. Pilum Investments Ltd.* (February 10, 1987), Doc. 48/87 (Ont. C.A.) — referred to

*Confederation Treasury Services Ltd., Re* (1995), 37 C.B.R. (3d) 237 (Ont. Bktcy.) — considered

*Drabinsky v. KPMG* (1998), 41 O.R. (3d) 565, 45 B.L.R. (2d) 196 (Ont. Gen. Div.) — considered

*Drabinsky v. KPMG* (1999), 10 C.B.R. (4th) 130, 33 C.P.C. (4th) 318 (Ont. Div. Ct.) — referred to

*Ernst & Young Inc. v. Royal Trust Corp. of Canada* (1997), 208 A.R. 244 (Alta. Q.B.) — not followed

*Hodgkinson v. Simms*, [1994] 9 W.W.R. 609, 49 B.C.A.C. 1, 80 W.A.C. 1, 22 C.C.L.T. (2d) 1, 16 B.L.R. (2d) 1, 6 C.C.L.S. 1, 57 C.P.R. (3d) 1, 5 E.T.R. (2d) 1, [1994] 3 S.C.R. 377, 95 D.T.C. 5135, 97 B.C.L.R. (2d) 1, 117 D.L.R. (4th) 161, 171 N.R. 245 (S.C.C.) — referred to

*MacDonald Estate v. Martin* (1990), [1991] 1 W.W.R. 705, 77 D.L.R. (4th) 249, 121 N.R. 1, (sub nom. *Martin v. Gray*) [1990] 3 S.C.R. 1235, 48 C.P.C. (2d) 113, 70 Man. R. (2d) 241 (S.C.C.) — considered

*Minister of National Revenue v. Burlingham Associates Inc.*, (sub nom. *R. v. Burlingham Associates Inc.*) 49 C.B.R. (3d) 69, (sub nom. *Koskie (Bankrupts), Re*) 159 Sask. R. 81, [1997] 10 W.W.R. 199 (Sask. Q.B.) — considered

*Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd.*, 8 C.B.R. (3d) 31, 81 Alta. L.R. (2d) 45, [1991] 5 W.W.R. 577, 81 D.L.R. (4th) 280, 7 C.E.L.R. (N.S.) 66, 117 A.R. 44, 2 W.A.C. 44 (Alta. C.A.) — applied

*Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd.* (1992), 8 C.B.R. (3d) 31n, 7 C.E.L.R. (N.S.) 66n, 83 Alta. L.R. (2d) lxvi, 86 D.L.R. (4th) 567n, 137 N.R. 394, 127 A.R. 396, 20 W.A.C. 396, 3 C.P.C. (3d) 100n (S.C.C.) — referred to

*R.J. Nicol Homes Ltd. (Trustee of) v. Nicol* (1995), 30 C.B.R. (3d) 90, 77 O.A.C. 395 (Ont. C.A.) — considered

*Scarth v. Northland Bank (Liquidator of)* (1996), 43 C.B.R. (3d) 254, 114 Man. R. (2d) 314 (Man. Q.B.) — considered

  

*Scarth v. Northland Bank (Liquidator of)* (1997), (sub nom. *Northland Bank (Liquidation), Re)* 115 Man. R. (2d) 107, (sub nom. *Northland Bank (Liquidation), Re)* 139 W.A.C. 107 (Man. C.A.) — considered

*Tannis Trading Inc. v. Camco Food Services Ltd. (Trustee of)* (1988), (sub nom. *Camco Food Services Ltd., Re)* 67 C.B.R. (N.S.) 1, 63 O.R. (2d) 775, (sub nom. *Tannis Trading Inc. v. Thorne Ernst & Whinney Inc.)* 49 D.L.R. (4th) 128 (Ont. S.C.) — applied

*United Fuel Investment Ltd. (No. 1), Re* (1965), (sub nom. *United Fuel Investment (No. 2), Re)* [1966] 1 O.R. 165, 53 D.L.R. (2d) 12 (Ont. C.A.) — considered

APPLICATION by underwriters to remove receiver and receiver's counsel for conflict of interest.

***Paperny J*:**

**Introduction**

1 This is an application by Griffiths McBurney & Partners ("Griffiths") and National Bank Financial Inc. ("National Bank") (together, the "Underwriters"). The Underwriters seek removal of Ernst & Young YBM Inc. (the "Receiver"), and of Stikeman Elliott and Voorheis & Co. (the "Receiver's Counsel") on the grounds of conflict of interest. The removal sought is only for the limited purpose of dealing with the "Litigation Assets" (described below). The Underwriters are content for the Receiver and Receiver's Counsel to remain in place to supervise all other aspects of the receivership. The amended notice of motion seeks the following:

> 1. Ernst & Young YBM Inc. (the Receiver), or any other Ernst & Young LLP (Ernst & Young) affiliate, be prohibited from acting as the receiver and manager of YBM Magnex International, Inc. (YBM) in respect of the litigation assets (the Litigation Assets), being those assets of YBM described in subparagraphs 3(n) and 3(o) of the Order of this Honourable Court dated December 8, 1998 (the December 8 Order) and a new receiver and manager be appointed to administer the Litigation Assets.
>
> 2. Stikeman Elliott and Voorheis & Co. be prohibited from acting as counsel to the new receiver and manager which is given responsibility for the Litigation Assets.
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> 3. The new receiver and manager shall only be entitled to use the report prepared in conjunction with paragraph 3(o) of the December 8 Order (the 3(o) Report) after the Applicants and their counsel have reviewed the 3(o) Report to ensure that it does not contain any confidential information which may have been disclosed as a consequence of Ernst & Young having been engaged as the auditors of Griffiths McBurney and First Marathon Securities Limited (FMSL).
>
> 4. The issue of the Applicants' claims shall be referred to the new receiver and manager, and any disputes arising on that issue shall be determined by the Ontario Court.

**Facts**

2 On June 7, 1999, YBM Magnex International Inc. ("YBM") pleaded guilty in the United States to a multi-object conspiracy to commit fraud. This fraud was perpetrated by YBM through certain officers and directors who, among other acts, caused YBM to disseminate materially false and misleading information to the investing public, securities regulators and other stakeholders.

3 The Receiver, appointed on December 8, 1998, is an affiliate of Ernst & Young LLP ("Ernst & Young"). Ernst & Young is currently the auditor of Griffiths, and was the auditor of First Marathon Securities Limited ("FMSL") from

  

May 1990 to August 1999. FMSL is National Bank's predecessor. As auditor, Ernst & Young is privy to certain material, including summaries of outstanding litigation issues, specifically those relating to YBM.

4 Concerns over the potential business conflicts inherent in the Receiver's relationship to Ernst & Young led to careful consideration and drafting of the Receivership Order. In particular, paragraph 3(o) was intended to ensure the independent pursuit of potential causes of action against certain parties, including the Underwriters. Paragraph 3(o) reads, in part:

> 3. Without limiting the powers set out in paragraph 1, the Receiver is hereby authorized and empowered to do all or any of the following acts or things if in its opinion it is necessary or desirable:
>
> . . . . .
>
> (o) to assess the existence and merits of any causes of action or other intangible proprietary rights which YBM Magnex may have, including without limitation, in respect of advice and/or assistance previously provided to YBM Magnex and in respect of all matters arising out of it historical financial statements and other public disclosure documents issued by YBM Magnex and, if it considers advisable, to seek the direction of this Honourable Court as to a mechanism and methodology for reporting the results of that assessment on a confidential basis to relevant stakeholders and to transfer any such causes of action or other intangible proprietary rights to one or more of the stakeholders as may wish to pursue such claims on such terms and conditions as this Honourable Court thinks fit provided that the Receiver is not itself obliged to initiate or maintain any such action or claim;

The granting of this Receivership Order was widely publicized.

5 The Receiver engaged the Receiver's Counsel, whose role is, of necessity, larger than one might expect in an "ordinary" receivership, due to the Receiver's potential business conflicts.

6 In a letter dated February 23, 1999 to the Receiver's Counsel, the Receiver states that business relationships of Ernst & Young "could give rise to perceived or real conflicts of interest if [the Receiver] were to become directly involved in the assessment and pursuit of such causes of action." Accordingly, and pursuant to paragraph 3(o) of the December 8, 1998 order the Receiver requested the Receiver's Counsel to perform certain tasks usually done it.

- Assess the existence and merits of any causes of action YBM may have, including all matters arising out of YBM's historical financial statements and other public disclosure documents, and relating to advice and/or assistance previously provided to YBM by others;
- Compile and organize any relevant YBM records and documents with respect to such causes of action;
- Interview third parties to facilitate the analysis; and
- Prepare a preliminary report concerning the potential causes of action, including recommendations on appropriate mechanisms to allow stakeholders to pursue these causes of action outside of the receivership proceedings.

7 The Receiver limited its own role in preparing the report to assisting its counsel in obtaining access to information and third parties. The report, with results and recommendations, was to be provided directly to this Court. The Receiver's Counsel was to submit its accounts weekly, along with a "very brief progress report".

8 At the beginning of the YBM receivership, no special confidentiality measures were taken, apart from Ernst & Young's already extant policies. Ernst & Young has a standard written policy relating to client confidentiality. All employees are required to sign annually an acknowledgement and undertaking regarding the policy. In cross-examination, Brian Denega, a senior vice president of the Receiver, states that Ernst & Young's unwritten policy is not to take assignments which would cause Ernst & Young to get into litigation with audit clients or with auditors. Regarding the fact that the Underwriters were audit clients, he stated that:

  

A. We decided that if the form and structure of the receivership could be set up appropriately to remove us from the role involving any litigation or contested actions for or against the company involving audit clients or auditors, then we were comfortable that we could act.

9 Two additional measures were implemented. In the spring of 1999, all of the YBM files were moved to a secure location within the office, with restricted access. This move was taken out of concern for security regarding the pending sale of certain YBM subsidiaries.

10 In October 1999, the Receiver initiated a policy where all members of the "YBM team" executed a specific confidentiality agreement. This restricted them from disseminating information regarding YBM and from seeking information regarding any Ernst & Young clients that may have been involved with YBM at any time. Denega states that this was not implemented earlier because the standard confidentiality policy and the provisions of paragraph 3(o) made it irrelevant.

11 Denega also deposes that he learned through inquiries that no Ernst & Young audit personnel have communicated any confidential information to Ernst & Young insolvency personnel assigned to YBM, nor to Stikeman Elliott or VC.

12 Adina Masson-Crocker, Chief Financial Officer of Griffiths, deposes that she was advised by an Ernst & Young employee who has worked on Griffiths' audit that he was moving to the insolvency group at Ernst & Young. Denega believes this is a reference to Jordan Sleeth, who has been specifically reminded of his confidentiality obligations.

13 The Underwriters were aware that Ernst & Young simultaneously acted as auditors for the Underwriters and some of the Underwriters' competitors. However, the Underwriters did not fear the release of confidential information among the audit clients, relying on Ernst & Young's professional obligations and policies. The Receiver submits that the confidentiality issue is no different in the context of Ernst & Young and its affiliate, the Receiver. In both situations, Ernst & Young is professionally and ethically obliged not to disclose confidential information.

14 The Underwriters filed two affidavits relating to certain initial discussions about the potential for a conflict of interest. Certain portions of Kym Anthony's July 6, 2000 affidavit were based on information he received from F. Michael Walsh. Those matters are also in Walsh's July 6, 2000 affidavit. I have taken this portion of the evidence from Walsh's affidavit, as it reflects the knowledge of a person directly involved. Anthony is the president and chief operating officer of National Bank; Walsh was a senior vice-president and director at FMSL until December 1999.

15 Walsh deposes that he became aware in 1998 that a group of institutional shareholders, led by Conner Clark and Lunn ("CCL") had appointed Wes Voorheis (of VC) and Steve Coxford to represent its interests. It became apparent later that Stikeman Elliott was also on CCL's retainer at that time. The group was seeking the resignation of certain directors and the creation of an Independent Committee to oversee YBM's activities. Walsh states that he learned of the Receiver's appointment in 1998.

16 Walsh deposes that he and Lawrence Bloomberg (FMSL's CEO) became concerned by a December 18, 1998 newspaper article which stated the Receiver was weighing whether to sue FMSL. Walsh states that he immediately raised this concern with Barry Rowland, the Ernst & Young audit partner for FMSL. Rowland sent Walsh a fax dated December 21, 1998, which states, in part: "The order of the court appointing EY receiver was specifically drawn in order that we would not be obliged to initiate or maintain any such action or claim [Article 3(o)]. As the order is a public document a copy has been attached at Lawrence's request." Therefore, FMSL was aware of the potential conflict of interest and of paragraph 3(o) of the December 8 order by late December 1998. There is no indication as to Griffiths' awareness at this time.

17 Walsh further deposes that Rowland and David Richardson (also of Ernst & Young) told him during a January 13, 1999 conversation that Ernst & Young had no requirement or intention to bring an action against FMSL or to

  

recommend that others do so. According to Walsh, they stated that they saw no reason for the company to bring such an action, and it was up to shareholders to do so if they wished.

18 On January 15, 1999, however, FMSL received a letter from the Receiver's Counsel stating that one of the Receiver's obligations:

> is to assess and make recommendations with respect to any causes of action YBM Magnex may have with respect to 'all matters arising out of its historical financial statements and other public disclosure documents issued by YBM Magnex'. As you will appreciate, this will include the services and advice rendered to YBM Magnex by your firm.

19 Walsh's affidavit attaches his notes from a conversation with Rowland on January 28, 1999 regarding the January 15 letter. According to those notes, Rowland told Walsh not to respond, that the Receiver's Counsel had not been instructed to send the letter, and that Denega and Richardson were not aware the letter had been sent out.

20 In conclusion, Walsh deposes:

> 14. We were led to believe that Ernst & Young recognized its obligation to FMSL, the nature of the conflict that it would put itself in were it to act for a party with interests contrary to those of FMSL and that it could not act in a manner which was contrary to the interests of FMSL.
>
> 15. With these assurances, we resolved to monitor the situation to ensure that the commitments made by Mr. Rowland and Mr. Richardson were adhered to.

21 Subsequently, the Receiver's Counsel sent letters to Griffiths and to FMSL's counsel (dated February 25, 1999), which contained additional wording, referring specifically to the conflict issue and its proposed resolution:

> In order to anticipate the possibility that there could be real or perceived conflicts in the receiver carrying out this responsibility, it has delegated the task to us as its counsel. The receiver will not be involved in the assessment other than through the use of the powers conferred in the Order. The report and recommended course of action will be delivered directly to the Court in Alberta. Further directions, if any, with respect to the mandate will come from the Alberta Court of Queen's Bench.

22 The Receiver and Receiver's Counsel clearly recognized the conflict or potential conflict inherent in the situation. The February 25, 1999 correspondence outlines that fact, as well as the steps being taken by the Receiver and Receiver's Counsel to deal effectively with the conflict. By that time, FMSL was represented by counsel. It chose not to pursue the matter further.

23 FMSL was aware of the Receiver's mandate in December 1998. Griffiths was certainly aware by February 25, 1999.

24 Anthony deposes that "Although National Bank Financial had initially determined that there was likely no conflict in E&Y YBM acting as the Receiver, the actions recently taken by the Receiver now indicate that it is acting in a manner which is adverse to the interests of National Bank Financial." He points to several actions by the Receiver, stating that they "raise the appearance that the interests of shareholders of YBM are being preferred to the interests of creditors" like National Bank. Such actions include not contesting claims advanced by innocent former shareholders, disallowing National Bank's claim for indemnity (to preserve the position until an Independent Litigation Supervisor, if and when appointed, can review the matter), and applying to court to enable the Receiver to provide the report prepared pursuant to paragraph 3(o) of the December 8, 1998 order (the "3(o) Report") to certain shareholders.

25 Anthony also notes that Stikeman Elliott and VC had formerly (in 1998) both been retained by CCL on matters relating to YBM. These events, where CCL led a group of institutional investors, culminated in an order by this court reconstituting YBM's board of directors.

  

26 Walsh states that FMSL remained uncomfortable with the Receiver's distancing mechanism, which was the reason FMSL continued discussions with the Receiver and with FMSL's own counsel on the point throughout January and February 1999. Walsh did not explain why the Underwriters seemed content after February 1999, particularly in light of the February 25 letter clarifying the Receiver's Counsel's enhanced responsibilities to deal with the conflict or potential conflict situation. The Underwriters' counsel, in argument, stated that the Underwriters were entitled to rely on the Receiver to put proper anti-conflict measures in place. He submitted that the Underwriters were under no obligation to monitor or review such measures.

**Issue**

27 Should the Receiver and Receiver's Counsel be removed for conflict of interest?

**Analysis**

***1. Parties' Positions***

28 The Underwriters raise several concerns regarding the Receiver: (1) the Underwriters' initial concerns regarding conflict of interest; (2) acting against the Underwriters' interests by treating shareholders with net losses as ordinary creditors and by sharing the 3(o) Report with certain shareholders for their own use; (3) using the same counsel as previously used by CCL on matters relating to YBM; and (4) the unavoidable interaction between the Receiver and Ernst & Young.

29 The Receiver submits that the Underwriters knew or had the means to know about certain matters from at least January 1999, such that they cannot now complain of a conflict and seek the Receiver's removal. These matters are: (1) the history of the Receiver's appointment; (2) the contacts with innocent shareholders; (3) the fact of and structure for assessing potential claims of YBM's estate; (4) large expenses incurred by YBM's estate in performing the assessment; and (5) the approximate completion date for the assessment, at which point the company would be in a position to initiate action, if warranted. The Receiver complains that the Underwriters waited until July 2000 to bring their motion, at which stage removing the Receiver and Receiver's Counsel would cause maximum expense, disruption and prejudice to the estate.

30 Regarding the Receiver's Counsel, the Underwriters are concerned that they were formerly engaged by CCL, which is still an interested party. The Underwriters submit that this former connection creates a perceived conflict when the Receiver's Counsel gives advice relating to CCL, as Receiver's Counsel owes a fiduciary duty to CCL and cannot act contrary to CCL's interests. As evidence of this, the Underwriters claim that various decisions have favoured CCL over the Underwriters, such as decisions relating to the 3(o) Report.

31 The Receiver's Counsel submits that the CCL retainer is over, so that it owes no continuing duty to CCL. Further, if any party has a right to complain about the Receiver's Counsel acting for the Receiver, it is CCL, the former client. The evidence is clear that CCL has no difficulty with Receiver's Counsel being involved, even if, at some point, the Receiver or Receiver's Counsel take a position adverse in interest to CCL.

***2. Obligations of a Court-Appointed Receiver***

32 *Canada Trustco Mortgage Co. v. York-Trillium Development Group Ltd.* (1992), 12 C.B.R. (3d) 220 (Ont. Gen. Div.) sets out the obligations of a court-appointed receiver (at 221):

> (a) it is a fiduciary as to all interests of concerned parties and as such it is to act as an appointee of the Court in good faith; with candour; disclosing all relevant material facts affecting the parties; avoiding any real or objectively perceived conflicts of interest; and
>
> (b) it has a general duty to exercise it obligations with prudence, diligence, due care and skill.

  

33 Other phrases used to describe a court-appointed receiver's obligations are "to act with utmost good faith, complete disclosure and scrupulous avoidance of conflict of interest toward all parties to a receivership or bankruptcy" (M.V. Ellis, *Fiduciary Duties in Canada* (Scarborough: Carswell, 2000) at 11-4.1); and "the standard required because of that status [as an officer of the court] is one of meticulous correctness" (*Panamericana de Bienes y Servicios S.A. v. Northern Badger Oil & Gas Ltd.* (1991), 117 A.R. 44 (Alta. C.A.) at 55 (leave to appeal refused [(1992), 127 A.R. 396 (S.C.C.)])).

34 As with a trustee in bankruptcy, a court-appointed receiver is an officer of the court and is expected and presumed to act as such. In *Confederation Treasury Services Ltd., Re* (1995), 37 C.B.R. (3d) 237 (Ont. Bktcy.), the court highlighted the differences between a privately appointed receiver, a trustee in bankruptcy and a court-appointed receiver. The latter two share many characteristics, such as the duty to represent impartially the interests of all creditors, the obligation to act even-handedly, and the need to avoid any real or perceived conflict between their interest and their duty (248-50).

35 In that case, certain parties were opposing a nominee for trustee, as the nominee had done extensive forensic investigation on behalf of a group of creditors. The court emphasized that it had discretion in determining whether a trustee would be unfit (at 247). The court allowed the nominee, finding that the former relationship with the creditors' group had ended. It stressed that the trustee must be indifferent among all creditors and demonstrate this neutrality throughout the trusteeship (at 258).

***3. Test for Removing a Receiver for Conflict of Interest***

36 In *Canada Trustco Mortgage Co.*, the defendants unsuccessfully applied to remove the receiver, alleging conflict of interest, lack of neutrality, and improper and imprudent management. The court noted that the onus to remove a receiver is heavier than the onus to oppose an appointment in the first place (at 222). The court also stated that a receiver's actions must be examined as they unfold, not in hindsight. For example, a receiver will be removed if it engages "in blatant intentional action contrary to the interests of one involved group" (at 222). The court acknowledged that the receiver there could have made certain disclosures to the defendants at the same time as it did to the lenders. However, the defendants suffered no disadvantage from receiving the information later. Moreover, the receiver did not attempt in any way to hide the issue from the defendants (at 224).

37 In *Tannis Trading Inc. v. Camco Food Services Ltd. (Trustee of)* (1988), 67 C.B.R. (N.S.) 1 (Ont. S.C.), the court removed a trustee because there was both the potential for and the appearance of conflict in the circumstances (at 7). Before reaching this conclusion, the court cautioned (at 6):

> In the complex context of insolvency, it is perhaps trite to say that each case will depend on its own facts. It is not, in my view, possible or necessary to attempt to define where the line should be drawn. No hard and fast rule can be laid down. It is a matter of degree. A firm that it the auditor of one or more of the creditors will not ordinarily be precluded from acting as a trustee. [emphasis added]

38 I agree with the above statement from *Tannis Trading Inc.*. Accordingly, I must examine the specific facts in order to reach a conclusion based on the entirety of the circumstances.

***4. Factors Considered in Removing a Receiver for Conflict of Interest***

39 The factors typically considered by courts as relevant to deciding whether to exercise their discretion to remove a receiver for conflict of interest are listed below. The court must balance the interests of the receivership as a whole with the factors favouring removal. They are:

(a) the gravity of the conflict or potential conflict;

(b) the receiver's qualifications, and the experience and familiarity already gained by the receiver;

  

(c) the prejudice to the estate in removing the receiver, in particular, the knowledge which would be lost and the time and costs which would be incurred in substituting a new receiver and bringing that person up to speed;

(d) the receiver's conduct, in particular, whether the receiver: (i) has disclosed the conflict or potential conflict from the outset; (ii) has established measures to reduce the dangers of conflicts or potential conflicts; and (iii) has in any way acted improperly;

(e) delay by the applicant in alleging conflict and bringing the motion for removal;

(f) tactical reasons for bringing the motion for removal; and

(g) the wishes of various stakeholders.

40 In submissions before me, counsel for the Underwriters agreed with this list of factors. He did caution that the wishes of stakeholders not be over-emphasized, as parties will often act in their own self-interest. I agree with that observation.

41 Obviously, there may be additional factors in other circumstances. Ultimately, of course, the decision is one of judicial discretion, based on all of the particular circumstances of a case. For cases discussing these factors, see, for example, *Tannis Trading Inc.*; *United Fuel Investment Ltd. (No. 1), Re* (1965), [1966] 1 O.R. 165 (Ont. C.A.); *Confederation Treasury Services Ltd.*; *Scarth v. Northland Bank (Liquidator of)* (1996), 114 Man. R. (2d) 314 (Man. Q.B.), leave to appeal denied (1997), 115 Man. R. (2d) 107 (Man. C.A.); *Minister of National Revenue v. Burlingham Associates Inc.*, [1997] 10 W.W.R. 199 (Sask. Q.B.); *Canada Trustco Mortgage Co.*; and *R.J. Nicol Homes Ltd. (Trustee of) v. Nicol* (1995), 30 C.B.R. (3d) 90 (Ont. C.A.).

***5. Application of the Test and Factors***

42 After balancing the factors listed above and discussed below, I am dismissing the Underwriters' application to remove the Receiver. While there was, at least, the potential for a conflict from the outset, the measures taken, in addition to the Underwriters' knowledge and delay, convince me that it is inappropriate to remove the Receiver in these circumstances.

*(a) Nature of Conflict or Potential Conflict*

**(i) existence of conflict**

43 The test for whether there is a conflict of interest is whether it is difficult for the trustee to act impartially, not whether the trustee has or will continue to act impartially (see *Tannis Trading Inc.* at 6; and *Confederation Treasury Services Ltd.* at 250).

44 It is clear from the evidence, the parties' submissions and the very structure of this receivership that there was, from the outset, a recognized conflict or potential for conflict in having the Underwriters' auditor (and former auditor) involved with the receivership. That was the reason for creating the Receiver as a separate entity and delegating certain tasks to Receiver's Counsel. Given that there are few firms capable of taking on such a large, complex receivership, it is not surprising that it was difficult to find candidates for receiver who were not in a potential conflict situation.

45 It is likewise obvious that the Receiver saw the potential conflict and recognized that it needed to be adequately addressed. This is clear from the measures taken at the start and throughout the course of the receivership (the adequacy of which is confirmed later in these Reasons), and from the planned future application for an Independent Litigation Supervisor.

**(ii) alleged favouritism by the Receiver**

  

46 The Underwriters state that they were satisfied at the outset with the apparent resolution of the conflict issue, only becoming concerned later when the Receiver, in their view, began to prefer the interests of other stakeholders to those of the Underwriters. For example, they claim that the Receiver is treating the shareholders as creditors and trying to release the 3(o) Report to shareholders. It was only then, in their submission, that they concluded the Receiver's conflict avoidance and confidentiality measures were inadequate from the outset.

47 There is nothing in the evidence to suggest that the Receiver has been acting contrary to the Underwriters' interests. On the contrary, it appears that the Receiver is taking its responsibilities seriously and trying to carry out its duties with integrity. Because a party does not like a receiver's decision does not mean that the receiver is being unfair or is "playing favourites". As stated elsewhere in these Reasons, the nature of insolvencies suggests that a receiver's decisions will not always be popular with all creditors or potential creditors. The decision taken must be objectively in the best interests of the estate a whole. A decision made in the best interests of YBM's estate cannot be equated with a decision made deliberately and for an improper purpose against one of the players. In any event, the Receiver sought court directions on matters such as the release of the 3(o) Report, as it is entitled to do.

**(iii) nature of conflict for auditors affiliated with receivers**

48 The Underwriters state that an auditor, as a fiduciary, owes a duty not to disclose confidential information, a duty of good faith and loyalty, and a duty not to act against the interests of the client, as found in *Drabinsky v. KPMG* (1998), 41 O.R. (3d) 565 (Ont. Gen. Div.) at 567, appeal dismissed (1999), 10 C.B.R. (4th) 130 (Ont. Div. Ct.). There, the Motions Judge granted Drabinsky an injunction preventing KPMG, the accounting firm of which Drabinsky was a client, from further participating in a forensic investigation into the accounts of Livent Inc. The investigation was undertaken on behalf of Livent Inc. to determine whether financial statement irregularities stemmed from fraudulent activity. Drabinsky was a senior officer of Livent Inc., whose suspension was announced along with the investigation.

49 On the injunction application, the court did not determine whether KPMG had breached its fiduciary duty to Drabinsky, but did find that there was a serious issue to be tried. While stating that the breach issue was up to a trial court, the court outlined its views on fiduciary relationships in this context (at 567):

> I am of the view that the fiduciary relationship between the client and the professional advisor, either a lawyer or an accountant, imposes duties on the fiduciary beyond the duty not to disclose confidential information. It includes a duty of loyalty and good faith and a duty not to act against the interests of the client. I am further of the view that the scope of these duties is not defined by the nature of the original retainer between the fiduciary and the client but, rather, by the nature of the activities in which the fiduciary proposes to engage in the face of such fiduciary duties.

50 According to the court, other issues for trial would include whether the Chinese Wall (information barrier) erected by KPMG absolved it of any breach, and whether KPMG should have disclosed the Livent Inc. retainer to Drabinsky, allowing Drabinsky to voice objections, consent, or reject the Livent Inc. retainer (at 568).

51 On appeal, the court held the Motions Judge correctly set out the broad scope of KPMG's fiduciary duty in the circumstances. The court also confirmed (at 131) that the scope of a fiduciary duty depends on the particular facts of a case, citing *Hodgkinson v. Simms* (1994), 117 D.L.R. (4th) 161 (S.C.C.).

52 It is interesting that both courts emphasized a distinction found in *Bolkiah v. KPMG* (1998), [1999] 1 All E.R. 517 (U.K. H.L.) between accountants' forensic and audit functions. The Divisional Court in *Drabinsky* noted (para.5) that the fiduciary duty owed to a client may be narrower (*i.e.*, limited to preserving confidentiality) where the accounting firm is engaged as auditors, rather than in conducting a forensic investigation.

53 In *Bolkiah*, the issue was whether, and in what circumstances, an accounting firm which possesses confidential information gleaned from providing litigation support services to a former client may undertake work for another client with an adverse interest. There, the appellant, Prince Jefri, was involved in personal litigation. He had KPMG's forensic

  

accounting department carry out litigation support, including investigating facts, interviewing witnesses, searching for documents, reviewing pleadings and preparing ideas for cross-examination. During the course of this investigation, KPMG learned confidential details of Prince Jefri's personal financial situation.

54 This investigation was terminated after the litigation settled. KPMG subsequently took on an assignment to discover and trace certain funds. It was apparent from July 1998 that this further assignment was at least in part adverse to Prince Jefri's interests. However, KPMG did not inform Prince Jefri of the new assignment, nor did it seek his consent to KPMG accepting the project. KPMG did erect Chinese Walls in an attempt to ensure that none of Prince Jefri's confidential information was released to those involved in the new assignment.

55 The court held that there was a need to preserve confidentiality, and that the Chinese Walls were inadequate in the circumstances. It granted Prince Jefri an injunction. I note that at 530, the court commented on the effectiveness of separating different functions in different situations:

> It is one thing, for example, to separate the insolvency, audit, taxation and forensic departments from one another and erect Chinese walls between them. Such departments often work from different offices and there may be relatively little movement of personnel between them. But it is quite another to attempt to place an information barrier between members all of whom are drawn from the same department and have been accustomed to work with each other. I would expect this to be particularly difficult where the department concerned is engaged in the provision of litigation support services, and there is evidence to confirm this. Forensic accountancy is said to be an area in which new and unusual problems frequently arise and partners and managers are accustomed to share information and expertise. [emphasis added]

56 Throughout *Bolkiah* is a recognition that the present financial world has several dominant accounting firms, who commonly provide services in a number of areas to a number of clients. It is inevitable that there will be some overlap of services and clients. This overlap is, to a large extent in many circumstances, adequately addressed by Chinese Walls.

57 The Underwriters also invite me to equate the conflict or potential conflict in the present situation with that of solicitor/client confidentiality in *MacDonald Estate v. Martin* (1990), 48 C.P.C. (2d) 113 (S.C.C.), as was done in *Ernst & Young Inc. v. Royal Trust Corp. of Canada* (1997), 208 A.R. 244 (Alta. Q.B.). At 252 of *Royal Trust Corp. of Canada*, the court found a conflict of interest:

> ...it is my view that the principles emanating from **McDonald** [sic], supra, have some play when an accounting firm acts as a litigation agent for parties it represents. In **McDonald** [sic], supra, the Court found that the use of confidential information is not usually susceptible to proof. It held that the appropriate test must be such that the public, represented by the reasonably informed person, would be satisfied that no use of confidential information would occur. In my view, there is always a risk where matters involving credibility are before the Court, and credibility almost invariably arises in any litigation, the risk being that information might be available to a party because of its special relationship with the opposing party. Secondly, there is no objectively verifiable method of determining that any such information would not be used for that purpose. This is especially the case where a large accounting firm has available electronic records and data which may be stored in many forms. It may well be that Ernst & Young has confidential, relevant information but is not even aware that it possesses such information. I accordingly conclude that an accounting firm which has been the auditor of a Defendant should not sue that Defendant where that accounting firm might have obtained information which might assist the accounting firm during the course of the audit. [emphasis added]

58 In *Royal Trust Corp. of Canada*, the receiver was Ernst & Young Inc.; no separate affiliate was established as in the present case. The company there provided extended warranties to automobile purchasers, which it funded through investment contracts held with Royal Trust, the applicant. The receiver sued Royal Trust to recover certain money allegedly improperly paid to the company by Royal Trust in breach of trust. One of the predecessor accounting firms which by then comprised Ernst & Young Inc. had been Royal Trust's auditor.

  

59 I would not apply the conclusion from *Royal Trust Corp. of Canada* in the present circumstances. The factual background there is distinguishable from the present case. The process in YBM's situation was established specifically to prevent the Receiver from being in the position of suing its audit clients, including the Underwriters. For example, a separate affiliate was set up to be the "Receiver", and paragraph 3(o) was included in the receivership order. Perhaps the process could have been established and communicated more clearly, but it was established. In addition, the evidence shows that standard and specific informational safeguards were implemented, although some were at a later date than others.

60 Despite the factual differences, I would be hesitant to apply the broad statement made in the emphasized portion of *Royal Trust Corp. of Canada* to this case. In my view, it is crucial to reflect on the difference between the audit function of accounting firms and other functions, such as forensic investigations. I prefer the reasoning in *Bolkiah*, as cited in *Drabinsky*, where the court made such a distinction. In my view, the issue of conflict ought to be dealt with on a case by case basis, depending, in part, on the nature of the relationship.

**(iv) conclusion on nature of conflict**

61 I find that the potential for a conflict always existed, as was recognized by the parties from the outset. However, the concern regarding possession of confidential information was adequately addressed (as detailed later in these Reasons), as was the concern regarding suing an audit client. In light of the authorities and given practical considerations, I am convinced that a conflict based on the Receiver's affiliate's audit relationships is less serious than a conflict based on a forensic accounting or investigative function. Finally, the evidence indicates that the Receiver has not favoured the interests of some stakeholders over others, but has always acted in what it believed to be the best interests of YBM's estate.

62 Therefore, the conflict or potential conflict here was not a grave one, in light of the circumstances and the measures taken.

*(b) Receiver's Qualifications*

63 The Underwriters did not challenge the Receiver's qualifications. The Underwriters acknowledged that the Receiver has extensive experience and familiarity with YBM's estate by agreeing that it would be appropriate for the Receiver to continue as receiver in all aspects of YBM's estate, other than for the Litigation Assets.

*(c) Prejudice to the Estate*

64 The Underwriters submit that there would be minimal prejudice to YBM's estate by replacing the Receiver for the Litigation Assets, as the Receiver itself is planning to apply for an Independent Litigation Supervisor, to further distance itself from the future anticipated litigation. It is true that an Independent Litigation Supervisor would have a learning curve, as would a new receiver.

65 The Receiver notes that, to the application date, YBM's stakeholders have over 14,400 hours and millions of dollars invested in the Receiver and the Receiver's Counsel. The Receiver submits that the Receiver and the Receiver's Counsel have knowledge and experience with the complicated issues of YBM's estate, such that great cost, delay, inefficiency and prejudice would result from their removal.

66 All of the prejudice factors are very significant, in the YBM's estate is extremely complicated and highly unusual. I agree with the Receiver that a new receiver could not be brought up to speed merely by reading the 3(o) Report, as suggested by the Underwriters. Not only did the Receiver not generate the 3(o) Report, but the Receiver (and Receiver's Counsel) have a great deal of background information that would not be contained in any report and would not be easily transferrable, if at all.

*(d) Receiver's Conduct*

  

67 I must also examine the Receiver's conduct — for example, whether the Receiver has: (i) disclosed the conflict or potential conflict; (ii) established measures to reduce the dangers of conflicts or potential conflicts; and (iii) in any way acted improperly.

68 As already discussed, the Receiver disclosed the potential for conflict from the start. It was disclosed to the court at the time the receivership order was sought. It was clearly set out in the February 25, 1999 letters to FMSL's counsel and to Griffiths. FMSL's awareness also obviously preceded that letter.

69 Ernst & Young and the Receiver implemented measures to reduce the danger of conflicts. Regarding the potential problem of suing one's own audit client, the initial Receivership Order relieved the Receiver of the obligation to initiate any actions. The subsequent delegation to the Receiver's Counsel of the entire assessment process further isolated the Receiver from participation, either by gathering information or by assessing it. Regarding the confidentiality concerns, the Receiver had its standard confidentiality policies in place. In addition, it moved YBM files to a secure location in the spring of 1999. In October 1999, it went even farther, requiring specific confidentiality agreements for those working on the project.

70 I am satisfied that the Receiver's steps to reduce the danger of conflicts were clear and effective.

71 I do not find that the Receiver has acted improperly in these difficult circumstances. As stated elsewhere, I do not accept the Underwriters' claims that the Receiver has been preferring or favouring one group over another. Nor do I agree with the Underwriters' insinuations that the Receiver somehow contrived to mislead the Underwriters into thinking that they would never be investigated or sued for any of their actions. Paragraph 3(o) of the receivership order is clear that litigation is contemplated, but that the Receiver will not bring it. In addition, Walsh (upon whose evidence both of the Underwriters rely) admitted in cross-examination that he understood that the bankruptcy process required someone to determine against whom claims could be brought.

*(e) Delay*

72 The Receiver submits that the Underwriters' delay in bringing this conflict of interest application is so unreasonable that the application should be dismissed on this basis alone. While I will not go that far, the delay is an extremely significant factor in my decision to dismiss this application.

73 A case closely on point is *Canadian Commercial Bank v. Pilum Investments Ltd.*, [1987] O.J. No. 29 (H.C.J.); appeal quashed (February 10, 1987), Doc. 48/87 (Ont. C.A.). There, a motion to remove the receiver was brought at the same time as the receiver's motion for the sale of certain property. The court held that such a motion for removal, if made at all, should have been made sooner. The judge also held that the matters advanced as the basis for removal had been known for some time. The applicant knew of the lack of harmony between it and the receiver, had processes available to investigate the receiver's conduct, and could observe the receiver's alleged mismanagement throughout the course of the receivership.

74 The motion in the present case is also made at a very late stage, after considerable time, effort and monies have been expended. The potential or perceived conflict of interest was obvious to everyone from the beginning or soon after, particularly to the Underwriters. This is evident from the fact that the Underwriters initially expressed concerns, then appeared to be satisfied in the resolution of those concerns.

*(f) Tactics*

75 The Receiver also encourages me to dismiss the application as it states that the Underwriters' motive is to gain a tactical advantage. In my view, there is too little evidence on this point to justify a lengthy discussion. In any event, it is unnecessary to my disposition of this matter.

*(g) Wishes of Stakeholders*

  

76 In addition to the Underwriters, oral submissions were presented by several other stakeholders. Deloitte & Touche LLP conducted YBM's 1996 audit, but refused to complete the 1997 audit. Although admittedly a potential "target" of future litigation, it submits there should be no barrier to the Receiver continuing to act because there was never a conflict in these circumstances, and because any conflict was fully disclosed early on.

77 The Plaintiffs' Executive Committee (for one of the class actions) does not support removing the Receiver. It emphasized that the current application is adversely impacting the Receiver's effectiveness. Counsel for the Ontario prospectus class action plaintiffs, in which action CCL is a named plaintiff, understands that the Receiver may take a position contrary to CCL's interests. It cites tremendous prejudice if the Receiver were to be removed at this late stage. The Underwriters suggest these submissions are largely driven by self-interest. I have considered their submissions in that light, but do recognize a potential prejudice to them nonetheless. It is not a material fact in my consideration.

***6. Conclusion on Receiver's Removal***

78 In these circumstances, I am satisfied that the Receiver should not be removed. The Receiver's affiliate was (or still is) the auditor for the Underwriters. It is not and was not involved in a forensic investigation, such as in *Bolkiah*. Moreover, I acknowledge the commercial reality, particularly in these complex and unusual circumstances, that very few firms would have the ability to be YBM's receiver, with the willingness to do so and no audit history with any potential "target". As well, appropriate measures were taken to deal with the conflict concerns presented by the situation.

79 It is unnecessary, inconvenient and prejudicial to YBM's estate to remove the Receiver. I would not necessarily have reached the same conclusion had this application been made at the time of the Receiver's initial appointment. However, the Underwriters had concerns at that time, raised their concerns, and did nothing further while the receivership progressed.

***7. Removal of Receiver's Counsel***

80 I have also concluded that the application to remove the Receiver's Counsel must be dismissed. The application appears to be grounded on two bases: (1) because it is tainted with the Receiver's conflict of interest; and (2) because it owes loyalties to its former client, CCL.

81 Dismissal on the first ground is self-evident because I have already found that the Receiver itself should not be removed for conflict of interest.

82 Regarding the second basis, there are two important principles. First, it is clear from *MacDonald Estate* that parties are not to be deprived of counsel of their choice without good cause (at 254). Second, there is a need to prevent the possibility of a lawyer subsequently using against a client, confidential information obtained through the solicitor-client relationship. This stems from the concern to maintain the legal profession's high standards and the integrity of the justice system.

83 In the present circumstances, the Underwriters do not allege that the Receiver's Counsel is in danger of misusing CCL's confidential information. Even if the Underwriters were to have the standing to make such an allegation on behalf of another party, it is contrary to their submission that the Receiver and the Receiver's Counsel have been favouring CCL's position ahead of others such as the Underwriters.

84 I am satisfied that CCL's retainer of the Receiver's Counsel ended prior to the Receiver's Counsel becoming involved as counsel for the Receiver. I am also satisfied that the Receiver's Counsel has not been party to any favouritism directed against the Underwriters, nor has there been any such favouritism. Finally, I am satisfied that CCL itself, the only party that could be harmed by the Receiver's Counsel's possession of any confidential information, is not concerned with the Receiver's Counsel's continuing to act.

***8. Release of 3(o) Report to Underwriters***

  

85 The Underwriters asked that a new receiver not be able to use the 3(o) Report until the Underwriters had vetted it for confidential information learned by Ernst & Young as auditors. As there is to be no new receiver, this portion of the application is also dismissed. As the evidence indicates that confidentiality measures were in place, with no complaints from the Underwriters until this late date, I am also satisfied that the Underwriters should not have access to the 3(o) Report, unless at some point the Receiver decides that it is in the best interests of YBM's estate.

**Conclusion**

86 There is no evidence that the Receiver here has preferred the interests of some groups of creditors over others. The Underwriters are contingent creditors who disapprove of or dislike certain of the Receiver's recent decisions, such as its application to court for release of the 3(o) Report and the Receiver's Counsel's disallowance of the Underwriters' proof of claim at this stage (pending review by an Independent Litigation Supervisor, if and when appointed). While the Underwriters may disagree with some of the Receiver's applications, or the outcome of them, that disagreement can hardly be taken as evidence of bias.

87 A receiver is often obliged to make difficult decisions that are not universally accepted. Those decisions will naturally be unpopular in some quarters. If it were otherwise, there would rarely be contested court applications, as all potential stakeholders would have identical interests and agree on a mutually beneficial course of action. A court must presume that its receiver, as an officer of the court, acts properly and impartially, unless there is clear evidence to the contrary. Further, the Receiver has decided to bring applications for directions to the court, and left those decisions in the court's hands. It is difficult to suggest any preferential treatment by the Receiver when it is merely a request for court direction.

88 The Underwriters have not met their heavy burden to convince me to exercise my discretion to remove the Receiver. This is clearly not the type of situation described in *Canada Trustco Mortgage Co.* where there has been "blatant intentional action contrary to the interests of one involved group". In weighing the factors to reach the conclusion not to remove the Receiver, I am greatly influenced by the lengthy delay in bringing this conflict application, when the potential for conflict was apparent and was discussed among the parties from the very beginning. Also highly relevant are the most significant measures taken to deal with the potential for conflict.

89 One cannot help but speculate that if the Underwriters were genuinely concerned with the Receiver's motives and decisions, they would not likely be comfortable with the Receiver retaining authority over any aspect of the YBM assets. However, the Underwriters state that they only seek the Receiver's removal relating to the Litigation Assets.

90 It is inappropriate to replace the Receiver's Counsel for either of the two reasons put forward by the Underwriters. First, the Receiver's Counsel is not tainted by the Receiver's potential conflict, as I have found that there is no conflict justifying removal in these circumstances. Second, the Receiver's Counsel is not tainted by its prior association with CCL, as that retainer was over before the Receiver's Counsel took on its present role.

91 Finally, the Underwriters are not entitled to review the 3(o) Report before the Receiver uses it in the best interests of YBM's estate.

92 The application is dismissed, with leave to speak to costs.

*Application dismissed.*