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ISSUES INVOLVING INSOLVENT ESTATES

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Introduction

Historically, insolvent Estates are dealt with in the context of the provisions of the *Bankruptcy Act.*[1]

Widdifield on Executors Accounts[2] notes:

> As between executors and creditors, the executors are entitled to their full costs, charges and expenses out of the Estate in priority to the payment of debts, although the Estate is insolvent, unless they improperly deny assets. The Courts have considered this provision and noted[3] if the Court were to find this principle as not applicable to the Estate of a deceased bankrupt, there would be great difficulty in getting executors and solicitors to assume the obligations of an Estate if there were any questions about its solvency. The question of priority was then considered under the new *Bankruptcy and Insolvency Act*[4] in the *Re: Ladner Estate*[5].

In the *Re: Ladner Estate* there was a petition under the updated *Bankruptcy and Insolvency Act* which was filed in respect of an Estate and delivered to counsel representing the Estate. The petition was not heard or otherwise disposed of and ultimately an application was brought by the Estate for payment of an account of counsel for the Estate and asking for monies payable from trust to be paid for such fees. The Court considered the priority of solicitor's accounts for work performed as solicitor for the Estate and held that they constituted a testamentary expense of the Estate within the meaning of Section 44(2) of the *Bankruptcy and Insolvency Act.* In coming to its conclusion the Court (at paragraph 7) reviewed much of the historical law relating to the question of priority with respect to Estates and noted that it was not in dispute that the preparation of financial statements and income tax returns for the Estate and in this case the

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[1] Section 107.
[2] 5th Edition, page 103 notes.
[3] See *Re: Bertram* 18 CBR 64 (Supreme Court in Bankruptcy) Houlden J. at page 66-67.
[4] R.S.C. 1985, c.B-3.
[5] (2001) B.C.S.C. 943, 39 E.T.R. (2nd) 253 (B.C.S.C.) Scarth J.

three named companies to which the deceased had an interest, constitute the proper "testamentary expenses". The Court went on to state[6]:

> The cases and texts to which I have referred to indicate:
>
> (1) that executorship expenses, testamentary expenses and administration expenses are in essence synonymous terms which relates to the proper performance of the duties of the executor of the Estate;
>
> (2) such expenses include the costs incurred in obtaining the advice of solicitors or counsel with respect to ascertaining the debts and liabilities due from the Estate, the payments of such debts and liabilities, and the legal and proper distribution of the Estate among the persons entitled.

It should also be noted that a creditor has the right to call upon an administrator to call for an inventory and to account even where the administration has expired.[7]

There seems to be no reason why one of two or more executors might not submit his own dealings with the Estate for Court approval, independently of the other or others per MacLennan J. A. in *Cunnington v. Cunnington* (1901), 2 O.L.R. 511 (Ont.C.A.) at 516.

Devastavit

Disaffected beneficiaries may wish to consider proceedings against their trustees to seek restitution to the trust fund or equitable compensation on the basis that the trustees have acted in violation of their duties as trustees toward the beneficiaries.

Devastavit is the breach by an executor or administrator of his duty to administer the Estate and has been generally described as mismanagement of the Estate, squandering and misapplying assets contrary to the duty imposed on them. Devastavit can either be deliberate or reckless and of course can include negligence. The liability is of course personal as with all breaches of fiduciary duty.

The delay to discharge debts may well give rise to a claim for Devastavit. For example, non payment of a debt which is regarded as a remote contingent liability, for personal representative

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[6] At paragraph 9.
[7] *Taylor v. Newton* (1752), 1 Lee 15 (Prerogative Court).

of discharges of moral obligation which is not in fact a debt, if a personal representative pays a debt that is statute barred and personal representatives will be liable if they discharge debts in an insolvent Estate out of order such as by paying ordinary debts before funeral, testamentary and administration expenses.

After accomplishing the task of determining what the assets and liabilities of the Estate are, one of the primary obligations of an executor is the payment of the debts and liabilities. The proper performance of these duties by an executor are often overlooked in a standard administration where there are sufficient assets to pay relatively simple liabilities.

At the outset, most clients and most executors do not understand that an executor has a fiduciary obligation and duty to protect the creditors of the Estate.[8] Furthermore, a creditor of an Estate cannot be prejudicially affected by the terms of a Will. Those rights are fixed and determined by the law and not by any manner controlled by the Will of the debtor.[9]

Plene Administravit

Another important doctrine to consider is that of *Plene Administravit* which was set out in the Ontario Court of Appeal decision of *Commander Leasing Corp. v. Aiyede.*[10] The Court of Appeal noted at page 358 that it has long been established that if an executor or administrator has no assets to satisfy the debt upon which an action is brought, in the absence of a plea of no assets or *Plene Administravit*, he will be taken to have conclusively admitted that he has assets to satisfy the judgment and will be personally liable for the debt and costs if they cannot be levied on the assets of the deceased. Furthermore, in *Edwards v. Law Society of Upper Canada*[11], the Ontario Court of Appeal also noted that if the executor has some, but insufficient, assets to satisfy the judgment and costs, a plea of *Plene Administravit Praeter* will render him liable only to the amount of assets proved to be in his hands as executor.

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[8] *Ontario (Attorney General) v. Ballard Estate* (1995), 6 E.T.R. (2nd) 311 (Ont. Gen. Div.); *MacCulloch Estate v. MacCullock* (1986), 22 E.T.R. 34 (N.S.C.A.), leave to appeal refused (1986), 70 N.R. 81 (S.C.C.).
[9] Widdifield on Executors and Trustees (6th ed.) Carswell at p. 3-1.
[10] (1983), 44 O.R. (2nd) 356 (Ont.C.A.).
[11] (2000), 48 O.R. (3rd) 321, 36 E.T.R. (2nd) 192 (C.A.).

The Duty to Pay Debts and Compromise Claims

Most Wills include a clause that states that an executor is to pay all the debts of the Estate. Section 48 of the *Ontario Trustee Act* specifically gives authority to a personal representative to pay or allow any debtor claim on any evidence that a representative thinks is sufficient.

Unfortunately, Section 48 of the *Trustee Act* does not provide much guidance with respect to the nature and extent of that duty.

The leading case is the Ontario Court of Appeal decision in *Commander Leasing Corp. v. Aiyede Estate.*[12] In this case, the executrix and the deceased's spouse, paid part of the money owed by the Estate pursuant to two outstanding lease agreements and then distributed the remainder of the assets of the Estate without paying the balances of the money owing to the creditor. The creditor commenced an action against the executrix, both personally and in her representative capacity. The Court of Appeal held that in distributing the entire Estate, to the benefit of the surviving spouse, the executrix acted in clear disregard of the creditor's outstanding claim and was in breach of her duty as executrix of the Estate.[13] It should be noted that a compromise, on the part of an executor, can only be on things doubtful and contestable. Its object must be the ending or preventing of litigation.[14] In *Vanek v. O'Hara*[15] the Court held that it should not easily override the discretion of executors in making compromises in relatively minor matters.

A creditor of an Estate cannot be prejudicially affected by the terms of the will. His or her rights are fixed and determined by the law and not in any manner controlled by the will of his debtor.[16] Furthermore, although it is the duty of the Executor to pay the just claims against the testator's Estate, it is clearly his duty not to waste an Estate that he is administering for the benefit of others, in satisfying demands which are equally untenable in law or in equity.[17] An executor who distributes the Estate knowing of an outstanding claim is liable personally to the creditor.[18]

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[12] (1984), 44 O.R. (2nd) 356, 16 E.T.R. 183 (C.A.).
[13] Ibid, at p. 187 (A.T.R.).
[14] Widdifield on Executors and Trustees (6th ed.) Carswell at p. 3-50.
[15] (1995), 7 E.T.R. (2nd) 187 (Ont. Gen. Div.) at p. 193
[16] Widdifield on Executors and Trustees p. 3.1.
[17] Ibid.
[18] Ibid, at p. 3.1.

Estates Act[19]

The *Estates Act* provides for an expeditious way of dealing with money claims or demands made against the Estate. These summary procedures allow the personal representative to resolve any doubtful debts against the Estate. If a party wishes to make a claim against an Estate pursuant to the *Estates Act*, reference should be made to Rule 75.08 of the Rules which prescribes the form (75.14) to be utilized when making a claim. This form sets out the amount of the claim together with the grounds for the claim.

(a) Notice of Contestation

If the estate of a deceased person of the estate trustee knows of a claim against the estate before distributing the assets, the estate trustee should follow the steps set out in the *Estates Act.* For a liquidated debt, Section 44 applies and for unliquidated debts, Section 45 applies.

Under Section 44 of the *Estates Act*, the personal representative may serve the claimant with a written notice contesting the claim in whole or in part where the claim has been made against the estate, or where the personal representative has notice of a claim or debt, including one that is not presently payable. A prescribed form for such notice is the Notice of Contestation (Form 75.13). The form should include a brief statement of the grounds for contesting the claim and should refer to the section of the *Act* under which the notice is being sent.

Service of the notice on the claimant should be personal, although a judge may order substitutional service or service by mail where appropriate.

(b) Application for Order allowing claim

The claimant has thirty days after receipt of the Notice of Contestation to apply for an Order allowing the claim if it is a liquidated amount. Failure to file the application within this time limit bars the claim forever. However, the judge may grant permission to file a late application where the claimant applies for the extension within three months after being served with the Notice of Contestation.

The application must be accompanied by a Statement of Claim with proof of prior service on the estate trustee and a copy of the Notice of Contestation. An affidavit verifying the Statement of

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[19] R.S.O. 1990, c. E.21.

Claim and showing the names and addresses, where possible, of all beneficiaries of the Estate, including residual beneficiaries and indicating which are infants, must also be included.

When the Statement of Claim and Notice of Contestation are filed, the Court Registrar shall fix a date for the hearing.

Notice of the application must be served not less than seven clear days before the date scheduled to hear the application on all those persons interested in the Estate as the Court directs, as well as to the personal representative.

If the claim is a liquidated amount under $800, the judge may hear the claim on the return of the application. Where it is $800 or more, with the consent of the parties, the judge may hear the matter under the *Estates Act* provisions. Or the judge may direct the claimant to bring an action for the recovery of his or her claim and set a date for the hearing. If so, the Notice of Appointment must be served on those interested persons specified by the judge.

In cases where an unliquidated claim is made, the application involves applying for an Order for directions. The judge may hear the application for directions and make an Order he or she considers just, or he or she may direct the applicant to bring an action for recovery of the claim.

If the claim is not presently recoverable, the judge may prescribe the time after which the claimant may proceed. The Order of the judge is not enforceable by execution until the claim becomes payable.

No proceedings may be taken to enforce payment of a claim without the permission of the judge where the claim is established under the provisions of the *Estates Act*.

Priority of Claims and the Insolvent Estate

There are certain expenses which are treated in priority in respect of payment on the assets of the Estate.

The first is, of course, the costs of the burial and those expenses are first charged upon the assets of the Estate.

Insolvent Estates may be administered according to provisions set out in the *Bankruptcy and Insolvency Act*, or in accordance with the legislative provisions concerning insolvent Estates such as the procedures set out in the *Trustee Act*. There are other procedures available, for

example, an estate trustee may bring an application pursuant to Rule 65 of the Rules of Civil Procedure to administer the Estate of the deceased and obtain judgment for administration. Furthermore, the trustee has the option of bringing an application for the opinion, advice and direction of the Court in respect of any question relating to the management or administration of the trust pursuant to Section 60 of the *Trustee Act* and Rule 14 of the Rules of Civil Procedure.

Bankruptcy

Section 136(1) of the *Bankruptcy and Insolvency Act* provides that, in the case of a deceased bankrupt, subject to the rights of secured creditors, reasonable funeral and testamentary expenses incurred by the legal personal representative of the Estate are paid in priority.

(a) *Trustee Act*

Section 50(1) of the *Trustee Act* sets out a scheme whereby the estate trustees can take tentative steps to bankruptcy proceedings. This particular provision includes the right of a trustee to pay debts proportionately without preference or priority.

Secured creditor protection is dealt with in section 57 and 58 of the *Trustee Act*.

Section 57(2) provides that a personal representative can compel the secured creditor to prove his or her claim and provide particulars and Section 58 allows the personal representative to apply to the Court for an Order requiring the creditor to value his or her security within a specific timeline.