ADVISING THE INSOLVENT DEBTOR: LEGAL AND ETHICAL ISSUES

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Webinar Objectives

The objective of this webinar is two-fold. Firstly, in the context of certain scenarios, the current state of the law is examined and secondly, in the context of those scenarios, the role of the lawyer is examined with reference to ethical considerations and the criminal and civil liability to which the lawyer may be exposed to as a result of the advice, service or other representation provided to the insolvent debtor.

PART I - THE LEGAL ISSUES

A. Relevant Legislation

For the purposes of this Part, the following statutes are relevant to advising the insolvent debtor:

1) the *Statute of Elizabeth* (the *Fraudulent Conveyances Act*), 1571, (13. Eliz. 1), c.5;
2) *The Fraudulent Preferences Act, R.S.S 1978, c. F-21*;
3) the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3;
4) *The Saskatchewan Insurance Act, R.S.S. 1978, c. S-2;*
5) *The Registered Plan (Retirement Income) Exemption Act, S.S. 2002, c.R-13.01*;
6) *The Enforcement of Money Judgments Act, S.S. 2010, c. E-9.22*,
7) *The Saskatchewan Farm Security Act*, S.S. 1988-89, c. S-17.

(the "Legislation")

B. Discussion

Theoretically any conduct or action taken by an insolvent debtor to transfer property or pay a creditor which has the effect of reducing the assets available to the unsecured creditors of such insolvent debtor should be reversed by the courts at the behest of the unsecured creditors or their representatives. For the purposes of this webinar this approach will be referred to as the "Strict

Theory" [1]. As is often the case, practice departs from theory and both the examination of the conduct of an insolvent debtor and the reversal of conduct or actions affecting the rights of the unsecured creditors are limited by a number of factors including:

(a) at common law preferring a creditor was permitted[2];

(b) the legislation affecting the actions of an insolvent debtor is fraught with numerous issues of timing, applicability and exemption; and

(c) the courts do not appear to have universally adopted the Strict Theory as the foundation for the analysis of actions taken by insolvent debtors and in certain instances are quite prepared to adopt a technical approach (the "Technical Approach") to such actions. The writer suggests that one of the leading decisions adopting the Technical Approach is the judgment of the Supreme Court of Canada in *Royal Bank of Canada v North American Life Assurance Company and Balvir Singh Ramgotra*[3]. The result of this case was to permit *Ramgotra* to move RRSP funds (which were not exempt at that time) to a RRIF with the insurance company which was exempt by virtue of *The Saskatchewan Insurance Act.*

A short summary of certain applicable legislative provisions will perhaps shed some light on the issues which face a lawyer when he or she sets out to advise the insolvent debtor.

Early legislative intervention, the *Statute of Elizabeth,* provides that **any conveyance** made for the purpose and intent to delay, hinder or defraud creditors is void. The courts have adopted a liberal interpretation of the term "conveyance," allowing it to mean "every method of disposing of, or parting with property or an interest therein, absolutely or conditionally."[4]

The Fraudulent Preferences Act includes a provision (s. 3) that essentially replicates the prohibition of fraudulent conveyances in the *Statute of Elizabeth*. The net created by the *Statute of Elizabeth* is wider in the sense that the provision in *The Fraudulent Preferences Act* requires that the debtor be 1) in insolvent circumstances, 2) unable to pay his debts in full, or 3) knows that he is on the eve of insolvency. Under the *Statute of Elizabeth*, all that is required is that the conveyance be made with the intent to delay, hinder or defraud creditors, **even if those creditors are not in existence at the**

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[1] An example of this approach is the decision of the British Columbia Court of Appeal in *Abakhan & Associates Inc. v. Braydon* [2009] B.C. J 2315 (BCCA), leave to appeal to SCC refused, [2010] S.C.C.A. No. 26, File No. 33545 (June 24 2010). For a discussion of this decision see *Funt & Peters* article in National Creditor/Debtor Review March 2011, Volume 26, No. at Pg. 3.

[2] Transactions at Undervalue and Preferences Under the Bankruptcy and Insolvency Act: Rethinking Outdated Approaches - Professor R.C.C. Cuming Volume 37 C.B.L. J 20.

[3] [1996] 1 S.C.R. 325 (SCC)

[4] *Nicholson v. Milne* (1989), 74 C.B.R. (NS) 263 (Alta QB) quoted in *Ramgotra* at para 61.

time of the conveyance. [5]

As its name suggests, however, *The Fraudulent Preferences Act* is primarily concerned with preferential payments or transfers to a particular creditor. This legislation includes provisions prohibiting both a transfer intended to prefer a creditor (s. 4) and a transfer having the effect of preference (s. 5). Section 6 defines the transactions that will be deemed preferential:

> A transaction shall be deemed to be one that has the effect of giving a creditor a preference over other creditors, within the meaning of section 5, if by that transaction a creditor is given or realizes or is placed in a position to realize payment, satisfaction or security for the debtor's indebtedness to him or a portion thereof greater proportionately than could be realized by or for the unsecured creditors generally . . .

The prohibition of transfers under *The Fraudulent Preferences Act* does not extend to *bona fide* sales, payments or deliveries of property (s. 8).

A very important implication in Saskatchewan is the effect of a payment made by an insolvent debtor to a secured creditor. It appears that such a payment is not subject to attack as a fraudulent preference pursuant to *The Fraudulent Preferences Act.* This position is supported by the decisions which conclude that secured creditors are unable to use this legislation[6] and the fact that at least notionally, the unsecured creditor asset pool is not reduced by such payment.

The third relevant piece of legislation, the federal *Bankruptcy and Insolvency Act*, contains several important provisions that deal specifically with a party in bankruptcy and actions taken by such party prior to the bankruptcy. Firstly, s.95 deals with preferences which are void as against the trustee. Transactions entered into more than Three (3) months prior to the bankruptcy in the case of an arm's length transaction and Twelve (12) months prior to the bankruptcy in the case of a non-arms length transaction are excluded. Secondly, s. 96 of the Act deals with transfers at undervalue, permitting a court either to declare that a transfer at undervalue is void as against the bankruptcy trustee or to order that a party or parties privy to the transfer pay the difference between the value of the consideration received by the bankrupt and the value of the consideration given by the bankrupt. As with *The Fraudulent Preferences Act*, a payment or transfer to a secured creditor is not a preference under s. 95 of the *Bankruptcy and Insolvency Act*[7].

In Saskatchewan, *The Enforcement of Money Judgments Act*, *The Saskatchewan Farm Security Act*, *The Saskatchewan Insurance Act* and *The Registered Plan (Retirement Income) Exemption Act*

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[5] *Moody v. Ashton* [2004] SKQB at paras. 122-123.

[6] *Barrett v. Baron* [1925] 1 D.L.R. 474 (Sask. CA)

[7] *Imperial Lumber Ltd. v. Coast Mill Works Ltd.* (1956) 36 C.B.R. 36 (BCSC).

provide that certain property of is exempt from seizure by creditors. Exemptions in most other Canadian jurisdictions are minimal and accordingly some of the issues arising from the fact scenarios presented during this webinar are simply not applicable in other jurisdictions.

Pursuant to s. 67(1)(b) of the *Bankruptcy and Insolvency Act,* a bankrupt is permitted to claim the exemptions available under provincial laws, provided that the laws are those of the bankrupt's province of residence and the property is situated in that province. The *Bankruptcy and Insolvency Act* also provides for an additional exemption for property held in a registered retirement savings plan, a registered retirement income fund or any prescribed plan other than property contributed to such plan in the Twelve (12) month period prior to the date of bankruptcy[8].

The primary source of exemptions is Part X of *The Enforcement of Money Judgments Act*, which came into force in May, 2012. The Act includes provisions on categories of exempt property (s. 93), proceeds of exempt property (s. 94), employment remuneration and other income (ss. 95-96), and non-exempt property (s. 97). The categories of exempt property that are identified in s. 93 of the Act are numerous and include a **house, house trailer or equivalent facility**.

Exemptions with respect to farm property are covered in Part V of *The Saskatchewan Farm Security Act*. In addition to the categories of exempt property identified in *The Enforcement of Money Judgments Act*, farmers can claim several other types of exemption, including:

a) farm produce sufficient to provide food and heating until the next harvest,
b) all "reasonably necessary" livestock, farm machinery and equipment,
c) books related to the farmer's profession,
d) tools, implements and office equipment related to the farmer's profession,
e) seed grain equal to two bushels per acre,
f) the farmer's crop, and
g) **the "homestead".**

The Registered Plan (Retirement Income) Exemption Act creates an exemption for three types of registered plans: DPSPs, RRIFs and RRSPs. Prior to the coming into force of this statute, the exemption for these plans was limited to plans purchased from insurance companies and covered by *The Saskatchewan Insurance Act.* This rather bizarre situation created a substantial advantage for insurance companies and fostered the litigation in *Ramgotra.*

[8] This provides a universal exemption for RRSP's and RRIFS a result which was long overdue.

C. The Scenarios

Scenario #1:

Dr. Jones has a good medical practice consistently making in excess of $250,000 per annum. He and a friend entered into a business venture in 2008 and guaranteed the indebtedness of the venture to a maximum of $7 million dollars. The business venture has failed and on October 30,2012 ABC Bank demanded payment of the shortfall of $5 million from Dr. Jones. The friend has few exigible assets. Dr. Jones has the following assets:

1. A medical professional corporation (the "MPC") controlled by Dr. Jones as sole director with retained earnings of $300,000. His wife is a shareholder of the MPC and the corporation is permitted to declare dividends to one class of shares, to the exclusion of other classes. The MPC has for some time been paying an annual salary of $100,000.00 to Dr. Jones and the MPC has been declaring annual dividends of $60,000.00 on the shares owned by Mrs. Jones.

2. Dr. Jones and his wife own a home in Saskatoon worth $700,000, with $400,000 owed to DEF Trust, secured by a mortgage that matures on November 1, 2012.

3. Dr. Jones is 42 years old and has $500,000 invested in non-registered investments.

4. Dr. Jones has $400,000 invested in RRSPs with $80,000 in unused contributions available.

5. Dr. Jones and his wife own a cottage at Emma Lake worth $400,000. Dr. Jones transferred the cottage to himself and his wife in 2005.

At this time it is safe to assume that Dr. Jones is insolvent. His liabilities significantly exceed his assets and he has no ability to meet the demand made by ABC Bank.

Scenario #2

Fearing the worst, on July 30, 2012, Dr. Jones cashed in the unregistered investments and on August 10, 2012 he contributed $100,000 to his RRSP, using up his contribution room and making his current-year contribution. He is left with $400,000 in cash.

Application of the Strict Theory would result in the contribution being returned to a trustee in bankruptcy or ABC Bank. Given the Legislation this may not be the outcome. *The Registered Plan (Retirement Income) Exemption Act* of Saskatchewan has established powerful protection for the RRSP and other registered plans, providing that such plans are exempt from "any enforcement process." In addition, RRSP funds are also exempt from creditors under s. 67(1)(b.3) of the

Bankruptcy and Insolvency Act save for contributions made within Twelve (12) months prior to the date of bankruptcy.

The Statute of Elizabeth and s. 3 of the *The Fraudulent Preferences Act* deal with conveyances or transfers to third parties and hence these statutes do not apply to the transfer by Dr. Jones of his own funds into his RRSP (even if it is clearly for the purpose of shielding those funds from creditors). The Technical Approach is likely to produce a bad result for ABC Bank unless ABC Bank obtains its bankruptcy order prior to August 10, 2013 and can successfully persuade a court that the provincial exemption should not apply to the contribution made on August 10, 2012. The provincial legislation does not leave ABC Bank with a particularly strong argument.

Scenario #3

> Dr. Jones arranges to pass the necessary resolutions of the MPC to declare dividends to his shareholder wife in the amount of $300,000 in the two fiscal periods ending December 31, 2012 and December 31, 2013. The MPC was set up to allow the sole director to "sprinkle" dividends to a particular shareholder to the exclusion of other shareholders and that has been the practice in the past.

The legal result of this scenario is far from certain.

The *Bankruptcy and Insolvency Act* does not assist ABC Bank or a trustee in bankruptcy in these circumstances as Section 101 deals only with dividends paid by an insolvent corporation and the MPC is not insolvent. Subject to "piercing the corporate veil" Section 96 would not apply as the payment of the dividend is made by the MPC and not Dr. Jones.

This action could potentially violate the *Statute of Elizabeth*, as well as s. 3 of *The Fraudulent Preferences Act*. Although the law generally recognizes the independent existence of corporate entities, it is well established that the courts may "pierce the corporate veil" in certain situations, particularly where a corporation is found to be a mere agent.[9] The issue of whether a debtor can use a corporation to transfer assets to his spouse was considered by the Saskatchewan Court of Queen's Bench in *Moody v Ashton*.[10] The court found that the defendant's transfer of funds to his wife through the corporation was a fraudulent act intended to shield those funds from his creditors.

In this scenario, the application of *Ashton* is questionable. In that decision, the court found that the defendant Ashton was the corporation's "alter ego": he was its sole officer, director and shareholder. On behalf of the corporation, the defendant Ashton executed a demand floating charge debenture in favour of his wife, who purported to realize on her security pursuant to the debenture by seizing assets held by the corporation. The security did not appear to secure any debt owing to his wife by

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[9] *Nedco v Clark* [1973] 6 W.W.R. (SaskCA) 425 at para 19.

[10] [2005] 6 W.W.R. 642 (Sask Q.B.) paras 38-49, 172-173, 199-204

the corporation. The circumstances in the present scenario are quite different. Dr. Jones' wife is a shareholder who is eligible to receive dividends, and resolutions passed to "sprinkle" dividends to her do not amount to conduct that is plainly contrary to the interests of the MPC and this has been the practice in the past. The MPC is not insolvent and will not become insolvent as a result of the transaction. Application of the Technical Approach may produce a bad result for ABC Bank and other un-secured creditors.

Following Strict Theory it is submitted that this is an appropriate instance where the court should "pierce the corporate veil".[11] The value of the shares held by Dr. Jones in the MPC has been effectively reduced to zero depriving ABC Bank of property interests which would have been available to ABC Bank and other un-secured creditors immediately prior to the transaction.

Scenario #4

> On October 12, 2012, Dr. Jones conveys his share of the Emma Lake cottage to his wife. Dr Jones does not receive any payment for his share in the cottage.

Does this transaction violate any provisions of the Legislation? The answer to this question is "yes." *Bona fide* sales are protected under s. 8 of *The Fraudulent Preferences Act* but this transaction is anything but "bona fide" and accordingly s. 3 of the Act will apply. Similarly, the *Statute of Elizabeth* applies in the event that the transaction involves no consideration or nominal consideration[12] and accordingly this transaction should be reversed on the application of ABC Bank. Finally, as the Emma Lake cottage has a market value of $400,000, Dr. Jones' conveyance of his half share of the property worth $200,000 for no consideration will invoke Section 96 of the *Bankruptcy and Insolvency Act*. The Technical approach will produce a positive result for ABC Bank and other un-secured creditors in this scenario. In addition ABC Bank may wish to consider whether it can employ the *Statute of Elizabeth* to reverse the transfer made in 2005 even though the ABC Bank debt did not exist in 2005.

Scenario #5

> On November 1, 2012, Dr. Jones pays $300,000 to DEF Trust and his wife pays $100,000.00 to DEF Trust to obtain a discharge of the mortgage on the house owned by he and his wife.

In this instance, Dr. Jones is attempting to take advantage of the exemption under s. 93(2) of *The Enforcement of Money Judgments Act*, by which a debtor's house is exempt from seizure so long as

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[11] *Tridont Leasing (Canada) Ltd. v Saskatoon Market Mall Ltd.* [1995] 6 W.W.R. 641 (SaskCA).

[12] *Proulx v Proulx* (2002) AB Q.B. 151 at para 14.

he or she maintains it as an active residence.

Is this substantial payment by Dr. Jones to DEF Trust prohibited as a preference? Both *The Fraudulent Preferences Act* and the *Bankruptcy and Insolvency Act* contain provisions dealing with preferences. As earlier stated, there is substantial authority for the proposition that payment to a secured creditor is unaffected by the provisions of these two statutes and such payment will not be reversed. The fact of the exemption may simply not be relevant. The trustee for Dr. Jones will be in a position to file a caution or other instrument to provide notice of its interest in the house. At some point the trustee may recover the equity which Dr. Jones has in the house, less the exemption amount of $50,000.00, but it could be a long wait.

On the Technical Approach, notwithstanding that for practical purposes the un-secured creditor pool is reduced substantially, there does not appear to be a technical basis for a finding in favour of ABC Bank or a trustee in bankruptcy. On application of the Strict Theory, an exception created by judicial intervention is the only hope for ABC Bank.

Scenario #6

> On November 1, 2012, Dr. Jones pays $100,000 to XYZ law firm as a retainer to cover the cost of defending the ABC Bank action and other potential actions.

Can a retainer paid to a lawyer be seized by either ABC Bank or a bankruptcy trustee? The following decisions assist:

Capozzi Enterprises Ltd v Tower Enterprises Inc (1983), 50 BCLR 100 (BCSC).

Re Mearns, (2000) ABCA 189 (Alta CA).

The *Capozzi* decision is to the effect that a creditor is unable to obtain the un-used portion of a retainer paid by a debtor to a law firm. Conversely in *Mearns*, the Alberta Court of Appeal makes it clear that a trustee in bankruptcy steps into the shoes of the debtor, can terminate the retainer and require the law firm to refund the un-used portion of the retainer to the trustee. The practical difficulty in the case of Dr. Jones is that the retainer may be fully used during the course of the battle with ABC Bank and the trustee in bankruptcy.

This discussion of the aforementioned scenarios clearly underscores the considerable difficulty arriving at a consensus on the appropriate legal result to be obtained with respect to certain conduct of an insolvent debtor. This difficulty impacts upon the ethical considerations.

PART II - THE ROLE OF THE LAWYER

A. Ethical Considerations

1. Professional Duties: The Law Society of Saskatchewan's *Code of Professional Conduct*

The Law Society through the ***Code of Professional Conduct*** has attempted to provide lawyers with some guidance on this difficult subject. The following extracts deal with the approach which is to be adopted by a lawyer dealing with a client contemplating illegal conduct.

(a) *Dishonesty or fraud by client* (2.02(7), p. 25).

"When acting for a client, a lawyer must never knowingly assist in or encourage any dishonesty, fraud, crime or illegal conduct, or instruct the client on how to violate the law and avoid punishment."

The commentary on this section makes four additional points:

> 1) "A lawyer should be on guard against becoming the tool or dupe of an unscrupulous client, or of others."
> 2) "A lawyer should be alert to and avoid unwittingly becoming involved with a client engaged in criminal activities . . ."
> 3) " . . . if a lawyer has suspicions or doubts about whether he or she might be assisting a client in dishonesty, fraud, crime or illegal conduct, the lawyer should make reasonable inquiries to obtain information about the client and about the subject matter and objectives of the retainer."
> 4) "A bona fide test case is not necessarily precluded . . ."

(b) *Dishonesty or fraud when the client is an organization* (2.02(8), p. 26).

This section creates professional duties for "a lawyer who is employed or retained by an organization to act in a matter." Specifically, where such a lawyer knows that the organization has acted, is acting or intends to act dishonestly, fraudulently or illegally, that lawyer should:

> a) advise the person from whom the lawyer takes instructions, the chief legal officer and possibly the chief executive that the organization's proposed conduct would be dishonest, fraudulent or illegal,
> b) if such persons refuse to cause the conduct to be stopped, advise the next highest authority, including the board of directors or board of trustees, and
> c) if the organization continues with the proposed wrongful conduct in spite of the lawyers's advice, withdraw from acting in the matter.

Drawing upon this authority, the writer would suggest that a lawyer proceed on the following basis:

(a) Be on guard for the unscrupulous client;
(b) In the event that a lawyer is concerned about the conduct or proposed conduct of his or her client, the lawyer should make further reasonable enquiries about the financial position and objectives of the client;
(c) Consult with colleagues or mentors; and
(d) Following such investigation and consultation, the lawyer should withdraw unless he or she is satisfied that both the action and the intent of the client are legitimate.

Apart from the potential liability faced by a lawyer, the reputation of the lawyer and the bar generally are at stake and hence it is vital to the profession that lawyers avoid assisting or encouraging a client contemplating illegal conduct.

2. Discussion

Any discussion of **"ethics"** should properly begin with reference to the Oxford dictionary. The writer is using a very old version as the participants might expect. This version sets out the following definitions: **"1. relating to morals, treating of moral questions, 2. Science of morals, treatise on this, moral principles, rules of conduct, whole field of moral science".**

Morality, at least within the confines of legitimate conduct, is a personal and quite subjective matter. The conduct of a lawyer providing advice and assistance to a client, particularly the insolvent client, will be judged objectively with reference to the *Code of Professional Conduct* and of necessity, the standard will be high**.**

As Brotman and Phoenix have pointed out, it is possible for a lawyer to act "unethically" without attracting either civil or criminal liability[13]. These authors found it quite difficult to write on the subject of "ethics" and the writer shares that view. The answer to specific ethical questions, particularly in the context of the insolvent debtor are "neither black nor white but grey".

For this writer any ethical considerations and the dilemma created by those considerations have a simple solution. My clients are creditors and I simply would not act for an insolvent debtor contemplating arranging his or her affairs to avoid creditors. However, the insolvent debtor should have sound legal advice and hence my personal solution has rather limited application to the profession generally.

One of the policy objectives of the BIA is the rehabilitation of the bankrupt[14] and leaving the bankrupt with some assets (by exemption or otherwise) is certainly in line with this policy. The friction between this aspect of public policy and the objective of treating un-secured creditors in a

[13] Ethics and Advising the (Nearly) Insolvent Client Stuart Brotman and R. Graham Phoenix (2009) Nat. Insol. Review Issue #4 p. 41.

[14] Bennett on Bankruptcy 9th Ed. 2007 at pg. 26.

fair and equitable manner, fosters the legal uncertainty and the consequent difficult ethical considerations faced by a lawyer providing advice to an insolvent debtor. A lawyer is obligated to advance the interests of his or her client, save where such advice or other action crosses the "ethical line". As previously stated, for this writer, the point at which this occurs is in some circumstances quite difficult to discern. One particular author[15] suggests that, at least for him, the "ethical line" is relatively easy to draw and while Brotman and Phoenix[16] admit considerable difficulty with the issue. Given adoption of the Technical Approach by some courts and the significant exemptions in Saskatchewan, the ethical considerations for Saskatchewan lawyers are complex.

With reference to the Dr. Jones scenarios, the writer wishes to make an attempt at determining at what point a lawyer acting for Dr. Jones would cross the "ethical line". Characterizing a particular action or conduct of a debtor can prove to be quite difficult where such action or conduct is not unlawful *per se.* The actions or conduct of Dr. Jones may be unlawful as a result of the circumstances in which the actions or conduct have been taken by Dr. Jones. Timing is critical. Any conduct or action by Dr. Jones at a time when he is insolvent or on the eve of insolvency is suspect and will garner the attention of his creditors and ultimately the courts.

In the event that Dr. Jones consults a lawyer **after** Dr. Jones has proceeded with the action specified in scenarios #2, #3, #4 and #5 and is simply asking for advice with respect to the potential outcome, it is submitted that the lawyer providing advice in this instance is not crossing the "ethical line".

The writer would suggest that the following scenario is at the opposite end of the "ethical spectrum".

Scenario #7

> Dr. Jones shows up at a lawyer's office and requests advice. The lawyer reviews the assets, the guarantee in favour of ABC Bank and devises a strategy. This strategy involves the defence of the ABC Bank, delay of the ABC Bank claim for at least one year and the implementation of scenarios #2, #3, #4, #5 and #6.

To the extent that the lawyer then proceeds to delay the ABC Bank claim with a view to the implementation of this strategy and implements the strategy or assists the client with such implementation, the writer is of the opinion that the lawyer has crossed the "ethical line" and at minimum has exposed himself or herself to regulatory action and potential civil and criminal liability. **A lawyer should not provide this advice and participate in this strategy under any circumstances.**

The more difficult ethical questions arise from circumstances which cannot be classified as being

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[15] The Ethics of Creditor Proofing Robert A. Klotz 2011 Pitblado Lectures Winnipeg, Manitoba, November 25, 2011.

[16] Brotman and Phoenix at p. 50.

at either end of the "ethical spectrum".

To the extent that any lawyer is consulted by an insolvent debtor and the lawyer is unsure about whether he or she is approaching or crossing the "ethical line", he or she should:
(a) consult with an experienced and trusted senior lawyer; and/or
(b) consult the appropriate party at the Law Society of Saskatchewan.

B. Potential Criminal Liability

The *Bankruptcy and Insolvency Act* establishes criminal sanctions for a debtor's fraudulent conduct with respect to bankruptcies in particular, while the *Criminal Code*[17] provides sanctions for the broader fraudulent conduct of debtors[18]. Section 392 of the *Code* in particular makes a conveyance of property with intent to defraud creditors an indictable offence. This section reads as follows:

> 392. Disposal of property to defraud creditors
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> Every one who,
>
> (a) with intent to defraud his creditors,
>
> (i) makes or causes to be made any gift, conveyance, assignment, sale, transfer or delivery of his property, or
>
> (ii) removes, conceals or disposes of any of his property, or
>
> (b) with intent that any one should defraud his creditors, receives any property by means of or in relation to which an offence has been committed under paragraph (a),
>
> is guilty of an indictable offence and liable to imprisonment for a term not exceeding two years.

Section 380 of the *Code* (the generic fraud section) is applicable as well and carries a 14 year maximum prison term where the matter involves property valued in excess of $5000.00.

Accordingly when a lawyer is considering providing advice to an insolvent debtor with respect to protecting assets from creditors and the disposition of property for such purpose, a lawyer may risk acting as a party to an offence (s. 21 of the *Code*), counselling an offence (s. 22 of the *Code*) or conspiracy to commit an offence (s.465(1)(c) of the *Code*). Prosecution of a lawyer may result from evidence obtained from the client in a civil action brought by creditors to reverse transactions which

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[17] R.S.C. 1985, c. C-46.

[18] The leading decisions on criminal fraud are *R. v Theroux* [1993] 2 S.C.R. 5 (SCC) and *R. v Zlatic* [1993] 2 S.C.R. 29 (SCC).

have had a negative impact on such creditors. **A lawyer should not be taking this risk under any circumstances.**

C. Potential Civil Liability

Providing advice to an insolvent debtor and engaging in activity which negatively impacts the creditors of an insolvent debtor may lead to action against the lawyer in question. An example of this potential liability is the Alberta case of *Mraiche Investment Corp. v Paul*[19]. In this case the lawyer and his firm were alleged to have conspired with the defendant *Paul* to defraud the plaintiff by virtue of the transfer of four properties (all of which were encumbered) from the insolvent company to another related company for nominal amounts. In *Mraiche* the claim was dismissed on a summary judgment application and confirmed in the Court of Appeal[20]. The lower court had accepted that the transfers involved were an effort on the part of *Paul* to effect a fraudulent conveyance to the detriment of the plaintiff. There was no evidence that the lawyer was aware of the claims of the plaintiff or that the transferor company was insolvent or near insolvent.

In dismissing the appeal, the Alberta Court of Appeal adopted the test for the tort of civil conspiracy set out in *Canada Cement LaFarge Ltd. v British Columbia Lightweight Aggregate Ltd.*[21]. The elements of the claim are set out at page 472 as follows:

> 33. Although the law concerning the scope of the tort of conspiracy is far from clear, I am of the opinion that whereas the law of tort does not permit an action against an individual defendant who has caused injury to the plaintiff, the law of torts does recognize a claim against them in combination as the tort of conspiracy if:
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> (1) Whether the means used by the defendants are lawful or unlawful, the predominant purpose of the defendants' conduct is to cause injury to the plaintiff; or,
> (2) Where the conduct of the defendants is unlawful, the conduct is directed towards the plaintiff (alone or together with others), and the defendants should know in the circumstances that injury to the plaintiff is likely to and does result.
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> 34. In situation (2) it is not necessary that the predominant purpose of the defendants' conduct be to cause injury to the plaintiff but, in the prevailing circumstances, it must be a constructive intent derived from the fact that the defendants should have known that injury to the plaintiff would ensue. In both situations, however, there must be actual damage suffered by the plaintiff.

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[19] *Mraiche Investment Corp. v Paul* [2011] A.W.L.D. 2955 (Alta Q.B.).

[20] *Mraiche Investment Corp. v Paul* [2012] A.W.L.D. 2395 (Alta CA).

[21] [1983] 1 S.C.R. 452 (SCC).

In *Mraiche* the plaintiff was unable to establish that there was any evidence to support a case of civil conspiracy on the part of the lawyer or his firm.

With reference to the facts in Scenario #7, the writer submits that there is considerable support for a finding of liability in the tort of conspiracy on either branch of the test set out in *Lafarge.*

Apart from the fact that the conduct of the lawyer in Scenario #7 is unethical and in violation of the *Code of Professional Conduct,* there remains the question of the further consequences of such conduct. The liability for damages in conspiracy are limited to actual damages (see *LaFarge*) and hence the recovery of transferred assets would reduce any such claim. However, the recovery process, as exhibited in *Ashton*, can be lengthy, tortuous and expensive providing a plaintiff creditor with significant actual damages even in the event of partial or full recovery. If the conduct of the lawyer was particularly reprehensible, the writer would expect a court to tack on aggravated damages.

In the event that a lawyer is sued in circumstances similar to Scenario #7, is he or she covered by the professional liability insurance administered by SLIA. The writer is advised that there is no specific exclusion for this situation but SLIA would review on a case by case basis. **The bottom line is that a lawyer proceeding on the basis set out in Scenario #7 is taking a considerable risk that he or she is not covered by insurance.**

In summary, when advising a client in financial difficulty or contemplating any transaction which would alter the client's position *vis a vis* the creditors of the client, you must **keep your head up and your eye on the puck.**