Lawyers as Debt Collectors – How Far is too Far?

Introduction

When we think of society's traditional debt collectors, more often then not, we picture the dreaded collection agency, made up of an army of faceless people on the other end of an incessant stream of telephone calls, backed up by burly thugs, walking out of a front door carrying a newly repossessed television, balanced precariously on top of a newly repossessed couch.

Very rarely do we think of lawyers as debt collectors.

Yet lawyers who are retained to recover money for creditors are by definition 'debt collectors'. As insolvency lawyers we tend not to go knocking on debtor's doors, but we are often asked to demand payment on behalf of a creditor client, commence an action for payment on a debt, take steps to realize on security and, on occasion, we may also be asked to initiate a bankruptcy application.

How far can a lawyer go in representing the interests of his or her client? What are the legal and ethical boundaries?

In this brief paper, we shall limit our discussion to the constraints imposed upon a lawyer by the Rules of Professional Conduct**[1]** (the "Rules") which have been established by the Law Society of Upper Canada (the "Law Society") and address the question of when it is appropriate to utilize the bankruptcy process on behalf of a client.

Rules Of Professional Conduct

While the debt collection practices of non-lawyers are governed by various statutes, including, the Collection Agencies Act (Ontario) and the Debt Collections Act (Ontario)**[2]**, lawyers are specifically exempted from the CAA and are bound only by the common law and by the Rules.**[3]** The expectation is that lawyers will conduct themselves to a higher standard than non-lawyers and the Rules are intended to provide lawyers with some guidance on what is expected from members of the profession.

Rules 6.01 and 6.03 provide the primary guidelines for lawyers. Rule 6.01(1) provides that "a lawyer shall conduct himself or herself in such a way as to maintain the integrity of the profession".

Unfortunately, but understandably, the Rules do not provide any specific guidance on how integrity may be maintained, or what constitutes offensive behavior.

In the commentary for Rule 6.01(1), the Law Society notes that:

> Integrity is the fundamental quality of any person who seeks to practice as a lawyer. If a client has any doubt about his or her lawyer's trustworthiness, the essential element in the true lawyer-client relationship will be missing. If integrity is lacking, the lawyer's usefulness to the client and reputation within the profession will be destroyed regardless of how competent the lawyer may be.
>
> Public confidence in the administration of justice and in the legal profession may be eroded by a lawyer's irresponsible conduct. Accordingly, a lawyer's conduct should reflect credit on the legal profession, inspire the confidence, respect and trust of clients and the community, and avoid even the appearance of impropriety.

Rule 6.03(1) provides that:

> S. 6.03(1) A lawyer shall be courteous, civil, and act in good faith with all persons with whom the lawyer has dealings in the course of his or her practice. [Our emphasis]

Finally, Rule 6.03(5) provides that:

S. 6.03(5) A lawyer shall not in the course of professional practice send correspondence or otherwise communicate to a client, another legal practitioner, or any other person in a manner that is abusive, offensive, or otherwise inconsistent with the proper tone of a professional communication from a lawyer. [Our emphasis]

Against this backdrop, it is fair to say that a lawyer must be careful when demanding payment from a debtor to ensure that the form of the demand (and any subsequent communication) is not framed in such a manner as may be construed to be threatening, abusive or offensive.

In the event that the lawyers courteous and civil correspondence is not sufficient to elicit payment of the outstanding debt owing to the client, which is almost always the case, recourse must then be had to other collection methods.

In this regard, the lawyers collection tools are predominantly derived from statute – the Rules of Civil Procedure**[4]**, the Personal Property and Security Act**[5]** and, in certain circumstances, the provisions of the Bankruptcy and Insolvency Act**[6]** (the "BIA"). These statutes provide guidelines as to how and when creditors' rights may be enforced.

It is beyond the scope of this paper to discuss the litigation process and the rules surrounding the enforcement of security. Instead, we will focus on the bankruptcy system and, in particular, the role of the lawyer in upholding the integrity of the process while still advocating for the interests of his or her creditor client.

Bankruptcy As A Collection Tool

As strange as it may sound to the lay person, the Courts have long held that the BIA is not to be used as a collection tool.**[7]**

While there is no common law or statutory requirement that a creditor must exhaust all other remedies available for the collection of a debt before having recourse to the BIA, **[8]** the Court will not approve a bankruptcy application that is found to be filed for the purpose of obtaining some improper collateral advantage such as putting a competitor out of business.**[9]** This should not be taken to mean that it is unlawful or improper for lawyers to use the bankruptcy laws as a way of improving their client's priority position**[10]**, or even as a way of ensuring the collection of monies owed to creditors of the debtor generally. Rather, the point is that where the law has created such opportunities for creditor recovery, it has also developed checks and balances to prevent an abuse of process.

Bankruptcy creates a common asset pool, which bankruptcy law addresses by substituting a mandatory system of collective debt collection for the individual first-come, first-served debt collection system that operates outside a bankruptcy.**[11]** In essence, bankruptcy legislation aims to subordinate individual self-interest to the collective interest of all similarly situated creditors.

Lawyers who are instructed by their clients to attempt to collect a debt through the issuance of a bankruptcy application would do well to remember subsections 43(1) and 43(7) of the BIA which provide as follows:

s. 43(1) Subject to this section, one or more creditors may file in court an application for a bankruptcy order against a debtor if it is alleged in the application that:

(a) the debt or debts owing to the applicant creditor or creditors amount to one thousand dollars; and

(b) the debtor has committed an act of bankruptcy within the six months preceding the filing of the application…..

s. 43(7) If the court is not satisfied with the proof of the facts alleged in the application or of the service of the application, or is satisfied by the debtor that the debtor is able to pay their debts, or that for other sufficient cause no order ought to be made, it shall dismiss the application.**[12]**

Clearly, the legislative rationale for the inclusion of these sections is to prevent the use of the BIA and the court as a form of collection agency and to minimize the potential for creditors attempting to extort money from debtors through the threat of a bankruptcy.

A lawyer should not, on behalf of a client, file an application for bankruptcy unless it is clear that the minimum indicia set forth in section 43 of the BIA have been met. To do otherwise is to invite the court to refuse to grant the application.**[13]**

The discretion to refuse to make a bankruptcy order under section 43(7) of the BIA is typically exercised in two categories of cases: the first where the petitioner is viewed by the Court as having an ulterior motive in seeking the order, and the second where the order would not serve any meaningful purpose.

For example, in the case of Re: De La Hooke**[14]**, the Court found that the principal purpose of the petition (as it was then called) was to put a competitor out of business. Accordingly, the Court exercised its discretion and refused to grant the petition. Similarly, where an applicant creditor is found to have acted improperly, the Court is loathe to reward such conduct and will likely refuse to grant the requested bankruptcy order. Such was the case in Re: Kudin Food Group**[15]** where the applicant creditor had effected an illegal distress that had the affect of closing down the debtor's business. Although the Court was satisfied that the debtor had committed an act of bankruptcy, it dismissed the petition. Further, where the Court determines that the debtor has no assets, and no possibility of having any assets in the future, or when there is nothing to be gained by the bankruptcy, the Court may refuse to issue the bankruptcy order.**[16]**

In deciding whether or not to refuse to make a bankruptcy order under subsection 43(7) of the BIA, the Court is mindful of the necessity for preserving the integrity of the bankruptcy system and preventing it from being brought into disrepute.**[17]**

Similarly, lawyers who have filed a bankruptcy application should not delude themselves into thinking that the application can easily be withdrawn should the creditor and debtor reach agreement on a repayment plan or some other bilateral compromise of debt arrangement. The Court takes a dim view of creditors attempting to withdraw a bankruptcy application after having used the system to leverage the debtor into improving the applicant creditor's recovery.

Simply put, an application for leave to withdraw a bankruptcy application will not be taken lightly by the Court.**[18]** For example, in the case of Re: Nurmohamad,**[19]** the debtor, after receiving a bankruptcy application, managed to 'negotiate' with the applicant creditors and agreed to an arrangement where such creditors would be granted 'preferential security' with respect to the payment of the debt owed. Together, the debtor and applicant creditors presented the terms of their arrangement to the Court with a motion to dismiss the bankruptcy application. The motion for dismissal was refused on the grounds that the bankruptcy application had been filed solely for the benefit of the applicant creditors, and the attempt to now dismiss the same was found to be "quite offensive to the integrity of the insolvency system, and to [the] Court's process".**[20]** The Court held that "the Applicant Creditors [were] not entitled to use a bankruptcy Order or the threat of same to further their own collection efforts"**[21]**, and subsequently ordered the bankruptcy application to proceed in the ordinary course, on notice to the other creditors of the debtor.

It is worth noting that the Court has recognized as acceptable the intention of a creditor to bankrupt a debtor for the sole purpose of reversing statutory crown priorities. Specifically, section 86 of the BIA, provides that "in relation to a bankruptcy or proposal, all provable claims, including secured claims, of Her Majesty in right of Canada or a province or of any body under an Act respecting workers' compensation, …, rank as unsecured claims" [our emphasis]. As a consequence, there are many occasions where it may well be beneficial for a secured creditor to initiate (provided that such creditor has at least $1,000 of unsecured debt) or encourage the bankruptcy of a debtor in order to reverse the crown priorities that are otherwise provided for in other statutes outside of a bankruptcy. This form of 'strategic bankruptcy' was found by Justice Laskin, as he then was, in Re: Ivaco Inc.**[22]**, to be an appropriate use of the bankruptcy system.**[23]**

Part of the challenge for insolvency practitioners is to determine what the Court will consider to be offensive behavior. Apart from the broad maxims discussed above, the Court will view each case on its

facts, and it is an open question respecting how far a lawyer can push the limits of the bankruptcy law to advance the position of a creditor client, while at the same time ensuring that the integrity of the system is maintained. Indeed, is a lawyer who opportunistically petitions a debtor into bankruptcy after discovering the first ranking secured creditor had erred when perfecting its security (and stands to rank as an unsecured creditor unless reperfection occurs) abusing the system? If so, would it still be an abuse of process if that same debtor had committed multiple acts of bankruptcy? In the context of a BIA proposal or a Companies' Creditors Arrangement Act**[24]** plan of arrangement, is a lawyer who advocates for the structuring of classes of creditors in specific groupings so as to gerrymander the vote on a proposal or plan of arrangement abusing the process? How far is too far?

For a lawyer acting as a debt collector, it can be a challenge sometimes to differentiate between an innovative recovery strategy which furthers a client's interests, and an approach that may be viewed by a court to be so manipulative of the process as to threaten the integrity of the system.

Conclusions

What are a lawyer's responsibilities, professional, ethical, or otherwise, when attempting to recover indebtedness owing to a client?

As discussed earlier in this paper, it is fair to conclude that the overarching responsibility of the lawyer is to ensure that his or her conduct conforms to the civil, courteous and professional standards as prescribed by the Rules. Lawyers who choose to ignore the high ethical standards set out therein do so at their professional peril. No lawyer should resort to aggressive and threatening correspondence or conduct in an attempt to coerce payment from a debtor to his or her client. Clearly, what constitutes "aggressive" and "threatening" conduct is subjective, but we have found that, for the most part, insolvency practitioners successfully balance adherence to the Rules with forcefully advocating for their creditor clients' interests.

When asked by a client to commence a bankruptcy application, a lawyer must always consider that the bankruptcy system is not designed to be a collection tool for the benefit of an applicant creditor.

Care should be taken to ensure that the minimum requirements for a bankruptcy have been met and that the same can be proven. Creditor clients should also be counseled before embanking on a bankruptcy application that the same is not easily withdrawn or dismissed even with the co-operation of the debtor.

Obviously, the gold standard lies in preserving the integrity of the bankruptcy system, and ensuring that it is not brought into disrepute while still being able to utilize every possible advantage that is offered by the statutes and the common law to advance the interest of a client. In the main, it has been our experience, at least with members of the insolvency bar, that this balance is achieved notwithstanding the disputes and adversarial proceedings that can characterize bankruptcy matters.

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[1] Adopted by Convocation on June 22, 2000, and as amended current to June 2009, effective date: November 1, 2000.

[2] R.S.O. 1990, C. c. 14, as amended. Also, please note the Debt Collections Act, R.S.O. 1990, C. c. D4, as amended, which is composed of one section which prohibits the issuance of imitation court forms as a means of collecting debt.

[3] Pursuant to section 2 of the CAA, lawyers are specifically exempt from the standards contained therein.

[4] R.R.O. 1990, Reg. 194

[5] R.S.O. 1990, C. P.10

[6] R.S., 1985, c. B-3

[7] Re Montreal Alberta Petroleums Ltd. (1939) 20 C.B.R. 135 (Ont. S.C.) ["Re Montreal"]

[8] SCM Farms Ltd. v. W-4 Holdings Ltd. (2007), 2007 MBWB 268; Re Cappe (1993) 18 CBR (3d) 229 (Ont. Gen. Div.) affected (1994) (Ont. CA)

[9] Re De La Hooke (1939), 15 CBR 485 (Ont. S.C.)

[10] Re: Ivaco Inc. 2006 CarswellOnt 6292, 47 C.C.P.B. 62, 12 C.B.R. (5th) 213 (Ont. S.C.J. [Commercial List]) ["Ivaco"]

[11] Thomas H. Jackson, The Logic and Limits of Bankruptcy Law (Cambridge, MA: Harvard University Press, 1986) Chapters 1 and 2.

[12]See Re Churchill Forest Industrial (Manitoba) Ltd. (1971), 16 CBR (N.S.) 158 (Man. Q.B.). In Re: Churchill, Justice Nitikman quotes McFarlane J.A. in Approving Officer of Corporations of District of Burnaby v. Mutual Development Corporation, [1971] S.W.W.R. 97 at 100: "The exercise of that discretion must be for "other sufficient cause" and, as is basic to every exercise of discretion by the Court, must be founded on sound judicial reasoning arrived at from the credible evidence adduced and "must be exercised judiciously according to common sense and justice, and in a manner which does not occasion a miscarriage of justice".

[13] Re Montreal, supra note 8. Justice Ungerhist wrote at para. 8 that "I do not approve of the habit of making the Bankruptcy Court a collection agency and petitions should not be launched unless there is undoubted liability in some tangible form."

[14] (1934), 13 C.B.R. 485 (Ont. S.C.)

[15] (1996), C.P.R. (3d) 272 (N.S.S.C.)

[16] See Re: Benon (1936) 18 C.B.R. 94 (Ont. S.C.) and Poulin c. 160401 Can Inc. (1989) 80 C.B.R. (N.S.) 238 (Que. S.C.)

[17] Re: Kenwood Hills Development Inc. (1995), 30 C.B.R. (3d) 44 (Ont. Gen. Div.)

[18] Subsection 43(14) of the BIA provides that "[a]n application shall not be withdrawn without leave of the Court. In Re: Bankruptcy of Host Restaurateurs Limited (1991) (N.S.S.C.) (Trial Division), In Re: Host Registrar Smith wrote: "One of the primary objects of the bankruptcy that is to secure to creditors an equitable distribution of the debtor assets, and the Court has the power to sanction the withdrawal of a petition, if it is of the opinion that sufficient cause has been shown that it shall not proceed… [t]he withdrawal of a petition in all cases shall not be lightly undertaken by the Court."

[19] 21 C.B.R. (5th) 42, 2006 CarswellOnt 2425

[20] Ibid, at paragraph 21.

[21] Supra, note 19, at paragraph 21

[22] Supra note 11

[23] See also Re: CB Distributions Ltd. (2004), 49 C.B.R. (4th) (Ont. S.C.J.) 180. In same, the Court held that it is not improper for a creditor to make a bankruptcy application for the purpose of investigating the circumstances surrounding the creation of a debt or the questionable sale of the debtor's assets on the eve of bankruptcy.

[24] R.S., 1985, c. C-36