

February 2006

GUILE

When debtors start to feel the breath of their creditors on their necks, they often do foolish things. For example, they convey their property to someone else, usually their spouse, to frustrate the attempts of their creditors to collect their debts. Usually, they are caught; sometimes, they are not. However, the debtors almost invariably act surreptitiously; they do not advertise what is being done. Accordingly, the case of Chan v. Stanwood, a 2002 British Columbia Court of Appeal decision that just came to our attention, rather surprised us.

The Scheme

The creditors had just obtained a judgment against the debtors, spouses of each other, for \$260,000. The debtors had other additional debts, but only the creditors were pressing for payment. The debtors' assets - the family home, three lots, two vehicles, and interests in a limited partnership - were easily exigible. The debtors were facing bankruptcy and did not like what they saw.

The debtors consulted a lawyer, but not just any lawyer. This lawyer had written a paper, which read more like an advertising blurb, trumpeting that, by way of the use of a family holding company, he could protect assets from seizure. The paper, from which the court quoted extensively, boasted about his methods. It said, for example, *"What the creditor is entitled to get though is the preferred shares you got from the family holding company. There is a way to make it hard for the creditor to collect on the shares but you will have to ask me in person ...*

this way we know if you have actually read this."

The debtors jumped at the chance to protect their assets and the lawyer set in motion a convoluted method to make it very difficult for the creditors to seize any of the assets of the debtors. What was the scheme, you ask?

The lawyer incorporated a corporation and the debtors transferred all of their major assets to it. The debtors then took back preferred shares with a par value that was equal to the fair market value of the transferred assets. This gave the impression that the property was transferred for the same value that the debtors received. But it was only an illusion. The preferred shares were retractable (i.e. the holder could call for payment) only after the shareholder had held the shares for 5 years. Further, the shares could not be transferred without the unanimous consent of the directors, who were, surprise, the debtors.

The scheme ensured that the debtors continued to use their assets for at least 5 years and stymied any creditor who attempted to seize the shares and take control of the corporation.

Not Playing

The creditors decided that they were not going to play the debtors' game. Instead of trying to seize the shares, they commenced a fraudulent conveyance action, claiming that the lawyer concocted the scheme and the debtors transferred the property in order to delay, hinder, and defraud the creditors. The creditors relied on the B.C. Fraudulent Con-

veyances Act, which is very similar to the Ontario Fraudulent Conveyances Act.

The trial judge and the Court of Appeal had no difficulty in determining that the debtors had made a fraudulent conveyance. Even when consideration is given for the transfer of property, the court must still determine whether the parties involved in the transfer intended to delay or defeat the creditors.

For example, the Ontario statute states that a transfer is unimpeachable if it is made *"upon good consideration and in good faith to a person not having, at the time of the conveyance to the person, notice or knowledge of the intent"* to hinder or delay.

The Court held that the exchange of the assets for the preferred shares, delayed, hindered, or defrauded the creditors and did so by design. The design or purpose constituted the fraudulent intent that the Act required. Accordingly, the Court set aside the transfer.

Lawyer

The creditors had also joined the lawyer in the action. They alleged that the lawyer wrongfully advised and induced the debtors to transfer the assets and that the lawyer had a legal obligation or fiduciary duty not to advise or assist the debtors in breaching the Act.

The Court agreed that the lawyer had intentionally assisted the debtors in breaching the Act. The court felt that the lawyer could not have reasonably believed that the preferred shares had equal value to the transferred assets. The entire purpose of the transaction was to delay the creditors for at least 5

years.

Although lawyers have duties to their clients, they cannot hide behind their professional duties to commit or assist someone to commit an illegal act.

This all sounded promising for the creditors, but they still lost against the lawyer. The problem was that in the statement of claim, the solicitors for the creditors alleged breach of fiduciary duty and negligence, but they never alleged the real causes of action that would give the creditors redress. They could have pleaded fraud or conspiracy to commit an illegal act. Since they did not do so and since they did not prove the causes of action that they did plead, they lost.

This loss against the lawyer may or may not have been important. If the assets had sufficient value after their re-transfer and sale to pay the creditors and all of the other creditors of the debtors, the loss was not horrific. If there was insufficient money to repay the debt in full, then the creditors may have lost a chance to have the lawyer pay their shortfall.

Duties

Lawyers cannot take part in illegal acts. If a creditor can prove that lawyers assisted a debtor in a fraudulent conveyance, the lawyers are responsible for the losses of the creditor. Most lawyers understand this and will not knowingly be involved in a fraudulent conveyance. Unfortunately, there are some exceptions and lawyers sometimes find themselves in trouble.

TRUST

A trustee in bankruptcy

or an execution creditor wants to increase the pie to be applied to the debt. Sometimes, however, some of the assets are not what they seem to be. This was demonstrated in Kajtar (trustee of) v. Bannerman, a 2005 decision of the Ontario Superior Court of Justice.

Whose Money

Unmarried male and female purchase a house with a \$36,000 down payment from the female. They agree in writing that they will hold the house as tenants in common and that, if they separate, the female gets the \$36,000 and the net proceeds of sale are then divided equally.

The couple separates, the house is sold, a solicitor holds the net proceeds of sale of \$50,000, and then the male goes bankrupt. His trustee claims entitlement to \$25,000. The female claims \$36,000 plus one-half of the balance of

\$14,000.

Decision

The judge noted that three certainties are necessary for a valid trust: certainty of intention, certainty of subject matter, and certainty of object (or beneficiary). He held that each of those certainties applied to the agreement that the couple made. They intended a trust; the trust related to the house; and the beneficiary of the \$36,000 was apparent. Accordingly, the trustee lost because the trustee gets no more than the bankrupt would have received. The female received \$43,000.

The real fight in many of these situations is not whether, based on the interpretation of the trust document, a trust exists, but whether the trust document that mysteriously materialises is legitimate. Was it really signed before the bankruptcy or seizure or was it concocted afterwards?

Speigel Nichols Fox LLP

44 Peel Centre Dr., Suite 400
Brampton, Ontario L6T 4B5
Tel: 905-791-6262
Fax: 905-791-6446
www.ontlaw.com

Jonathan Speigel*+
Brian Nichols
Irving Fox*
Ian Latimer*
Robert McIntyre
Susanne Balpataky*
Michael Ballantyne
Carrie Kennedy*
Paul Roth

* members of litigation/collection group
+ certified by Law Society as a specialist in both civil litigation & construction law
+ roster mediator – Ontario Mandatory Mediation program – Toronto

MISSION

STATEMENT

OUR CLIENTS COME FIRST. EVERYTHING ELSE FOLLOWS.

Debt Beat is provided as information to our clients and friends on new developments and legal issues of significance. The information is not intended to provide legal services. Readers should seek professional legal advice on any issues that directly concern them.