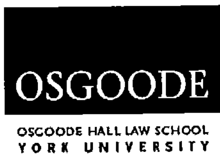


Professional Development
CLE

*The Osgoode Short Course in*

# Debtor-Creditor Litigation

May 29, 2014

OSGOODE
OSGOODE HALL LAW SCHOOL
YORK UNIVERSITY

Professional Development
CLE

*The Osgoode Short Course in*

# Debtor-Creditor Litigation

May 29, 2014

## TABLE OF CONTENTS


**Tab A** **Agenda**

**Tab B** **Faculty List and Biographies**

**Tab 1** **Early Warning Signs — What to Do?**
**Shayne Kukulowicz,** Cassels Brock & Blackwell LLP

**Tab 2** **When and How to Use the Commercial List**
**Tom Curry,** Lenczner Slaght Royce Smith Griffin LLP

**Tab 3** **The Essentials of Receiverships:**
**Opportunities, Pitfalls, Best Practices**
**Robert Kofman,** Managing Director, Duff & Phelps Canada Restructuring Inc.
**The Hon. Justice Fred Myers,** Superior Court of Justice (Ontario)

**Tab 4** **Judgments - Pre- and Post- Judgment Strategies**
**Sarit E. Batner,** McCarthy Tétrault LLP

**Tab 5** **Commercial Fraud and Creditors' Remedies**
**George Benchetrit,** Chaitons LLP

**Tab 6** **Ethical and Professional Considerations for Counsel**
**Brian H. Greenspan,** Greenspan Humphrey Lavine
**Francy Kussner,** Goodmans LLP

**Tab 7** **The Creditor's Expectations and the Debtor's Strategies**
**Milton A. Davis,** Davis Moldaver LLP
**Jacqueline L. King,** Shibley Righton LLP
**Rod Moran,** Director, Group Risk Management, RBC
**Steven L. Graff,** Aird & Berlis LLP

**Tab 8** **Notes**

**Tab 9** **CPD/MCLE Information for Lawyers**

OSGOODE
OSGOODE HALL LAW SCHOOL
YORK UNIVERSITY

Professional Development
CLE

*The Osgoode Short Course in*

# Debtor-Creditor Litigation

May 29, 2014

## AGENDA

| | |
|---|---|
| **8:30 a.m.** | **Registration and Continental Breakfast** |
| **9:00 a.m.** | **Chair's Welcome & Introductory Remarks** |
| **9:10 a.m.** | **Early Warning Signs — What to Do?**<br>**Shayne Kukulowicz,** Cassels Brock & Blackwell LLP |
| **9:40 a.m.** | **When and How to Use the Commercial List**<br>**Tom Curry,** Lenczner Slaght Royce Smith Griffin LLP |
| **10:30 a.m.** | **Refreshment Break** |
| **10:45 a.m.** | **The Essentials of Receiverships:**<br>**Opportunities, Pitfalls, Best Practices**<br>**Robert Kofman,** Managing Director, Duff & Phelps Canada Restructuring Inc.<br>**The Hon. Justice Fred Myers,** Superior Court of Justice (Ontario) |
| **11:45 a.m.** | **Judgments - Pre- and Post- Judgment Strategies**<br>**Christopher A. Wayland,** McCarthy Tétrault LLP |
| **12:30 p.m.** | **Networking Luncheon** |
| **1:15 p.m.** | **Commercial Fraud and Creditors' Remedies**<br>**George Benchetrit,** Chaitons LLP |
| **2:15 p.m.** | **Refreshment Break** |
| **2:30 p.m.** | **Ethical and Professional Considerations for Counsel**<br>**Brian H. Greenspan,** Greenspan Humphrey Lavine<br>**Francy Kussner,** Goodmans LLP |

**3:30 p.m.** **The Creditor's Expectations and the Debtor's Strategies**
**Milton A. Davis,** Davis Moldaver LLP
**Jacqueline L. King,** Shibley Righton LLP
**Rod Moran,** Director, Group Risk Management, RBC
**Steven L. Graff,** Aird & Berlis LLP

**4:30 p.m.** **Course Concludes**

OSGOODE
OSGOODE HALL LAW SCHOOL
YORK UNIVERSITY

Professional Development
CLE

*The Osgoode Short Course in*

# Debtor-Creditor Litigation

May 29, 2014

## FACULTY LIST

## Chair


**Milton A. Davis**
Davis Moldaver LLP
438 University Avenue
Suite 2100
Toronto, ON M5G 2K8
**Tel:** 416-860-6901
**Email:** mdavis@davismoldaver.com


## Faculty


**The Hon. Justice Fred Myers**
Superior Court of Justice (Ontario)
361 University Ave.
Toronto, ON M5G 1T3
**Tel:** 416-327-5284

**George Benchetrit**
Chaitons LLP
5000 Yonge Street
10th Floor
Toronto, ON M2N 7E9
**Tel:** 416-218-1141
**Email:** george@chaitons.com

**Tom Curry**
Lenczner Slaght Royce Smith Griffin LLP
130 Adelaide Street West
Suite 2600
Toronto, ON M5H 3P5
**Tel:** 416-865-3096
**Email:** tcurry@litigate.com

**Steven L. Graff**
Aird & Berlis LLP
Brookfield Place
181 Bay Street, Suite 1800, Box 754
Toronto, ON M5J 2T9
**Tel:** 416-865-7726
**Email:** sgraff@airdberlis.com

**Brian H. Greenspan**
Greenspan Humphrey Lavine
15 Bedford Road
Toronto, ON M5R 2J7
**Tel:** 416-868-1755
**Email:** bhg@15bedford.com

**Jacqueline L. King**
Shibley Righton LLP
250 University Avenue, Suite 700
Toronto, ON M5H 3E5
**Tel:** 416-214-5222
**Email:** jking@shibleyrighton.com

**Robert Kofman**
Managing Director
Duff & Phelps Canada Restructuring Inc.
Bay Adelaide Centre
333 Bay Street
14th Floor
Toronto, ON M5H 2R2
**Tel:** 416-932-6228
**Email:** Bobby.Kofman@duffandphelps.com

**Rod Moran**
Director, Group Risk Management
RBC
Toronto, ON
**Email:** rod.moran@rbc.com

**Shayne Kukulowicz**
Cassels Brock & Blackwell LLP
Suite 2100, Scotia Plaza
40 King Street West
Toronto, ON M5H 3C2
**Tel:** 416-860-6463
**Email:** skukulowicz@casselsbrock.com

**Christopher A. Wayland**
McCarthy Tétrault LLP
5300-66 Wellington St. West
PO Box 48, Stn. Toronto Dom.
Toronto, ON M5K 1E6
**Tel:** 416-601-8109
**Email:** cwayland@mccarthy.ca

**Francy Kussner**
Goodmans LLP
Bay Adelaide Centre
333 Bay Street, Suite 3400
Toronto, ON M5H 2S7
**Tel:** 416-597-4188
**Email:** fkussner@goodmans.ca

OSGOODE

OSGOODE HALL LAW SCHOOL
YORK UNIVERSITY

Professional Development
CLE

*The Osgoode Short Course in*
**Debtor-Creditor Litigation**

**May 29, 2014**

# Ethical and Professional Considerations for Counsel

Prepared for the Osgoode Short Course in Debtor-Creditor Litigation
May 29, 2014

# Improper Asset Transfers: Ethical and Professional Considerations for Counsel

Francy Kussner
Jonathan Edge[1]

## OVERVIEW

I. INTRODUCTION ..... 1
II. THE ROLE AND DUTIES OF LAWYERS ..... 2
1. Two Competing Theories ..... 2
2. The Rules: They Operate as a Compass, Not a Roadmap ..... 3
III. STATUTORY AND REGULATORY FRAMEWORK FOR IMPROPER TRANSFERS ..... 9
1. Fraudulent Conveyances Act ..... 9
2. Assignment and Preferences Act ..... 10
3. Bankruptcy and Insolvency Act ..... 11
4. Companies' Creditors Arrangement Act ..... 13
5. Common Law Tort ..... 13
6. Criminal and Quasi-Criminal Sanctions ..... 14
IV. LAWYERS' EXPOSURE FOR IMPROPER TRANSFERS ..... 16
1. Professional Sanctions ..... 16
2. Criminal and Quasi-Criminal Sanctions ..... 17
3. Civil Liability ..... 18
V. PRACTICAL TIPS TO MANAGE THE RISK ..... 19
1. Forming an ethical legal opinion ..... 20
2. Employing protective measures ..... 20
3. Influencing the conduct of the client ..... 21
VI. CONCLUSION ..... 22

## I. INTRODUCTION

Aristotle once said, "All persons ought to endeavor to follow what is right, and not what is established." While this is a noble thought, it is difficult to adhere to in practice. As lawyers, we rely on convention to guide us through the complex array of ethical issues we face on a regular

[1] Francy Kussner is a partner in the Litigation Department of Goodmans LLP. Jonathan Edge is an associate in the Litigation Department with Goodmans LLP. The authors gratefully acknowledge the considerable assistance of Cathy Costa and Heather Gallagher, both of Goodmans LLP.

basis. We are held by each other, and society at large, to a strict moral standard based not only on the law, but on our own set of professional rules and values.

Yet, established standards and rules rarely provide a clear answer to the moral dilemmas lawyers may face. Nor are such moral dilemmas always readily apparent. Lawyers are frequently required to make complex moral decisions without full information and without the aid of clear rules to guide them. Within this murky landscape, lawyers must balance their duties to their clients with established ethical standards and their own sense of what, in Aristotle's words, is "right." In few areas of practice is this more apparent than when advising on asset transfers, as lawyers must consider a client's intention and attempt to avoid facilitating fraudulent conduct.

This paper examines the role of the lawyer advising on asset transfers and the competing professional duties inherent in the asset transfer context, including new rules implemented to protect third parties. It provides a review of the statutory and regulatory landscape governing asset transfers. Particular attention is paid to the manner in which lawyers might be implicated in the wrongful acts of their clients. Lastly, this paper provides lawyers advising on asset transfers with practical tips and guidelines for navigating the risk that asset transfers present.

## II. THE ROLE AND DUTIES OF LAWYERS

### 1. Two Competing Theories

There are two competing theories on the role of the lawyer advising a client engaging in questionable legal or moral conduct.[2] These theories are relevant to lawyers advising clients on asset transfers, especially clients approaching insolvency.

The first theory, known as the "law book" approach, characterizes the lawyer as a provider of legal information sought by a client. The lawyer is a repository of information, which clients pay to access. On this theory, the lawyer is required to provide the client with any beneficial information to which the client would have access if he or she had similar training. This

---

[2] See Robert A. Klotz, *The Ethics of Creditor Proofing* (Winnipeg: Pitblado Lectures, 2011) at 10-12, which forms the basis of this discussion.

approach to the practice of law is "value-free" in that the lawyer does not impose his own ethics on the client. The lawyer may freely discuss all potential options for action with the client and may "assist the client in good faith to determine the meaning, applicability or scope of the law."[3] However, the lawyer may not encourage dishonesty, fraud, crime or illegal conduct.

Under the law book view, the lawyer does not engage in any unethical conduct until he or she takes concrete steps to implement or act upon any morally questionable instructions from a client. In the insolvency sphere, this means that lawyers counselling debtor clients are able to advise them on issues such as creditor proofing and transferring assets, including options in the so-called moral gray zone. This theory of the role of the lawyer draws a distinction between the fulfillment of a lawyer's duties to fully inform the client, and the actual implication of the lawyer as an actor to any questionable conduct.

The second theory, known as the "moralist approach," characterizes the lawyer as not only a repository of information, but an individual able to share his or her moral positions. Under this view, where an option is legal but morally questionable, the lawyer may attempt to persuade the client to follow the lawyer's own moral evaluation of the situation and follow steps consistent with that position. The lawyer is not required to remain indifferent, but should seek to guide the client towards conduct that is both legal and ethical. This requires the lawyer to be upfront and candid regarding his or her own views and biases. Any advice that ventures from legality into the realm of morality must be clearly identified as such by the lawyer during his discussions with clients.

### 2. The Rules: They Operate as a Compass, Not a Roadmap

The *Rules of Professional Conduct* (the "Rules"),[4] adopted by the Law Society of Upper Canada ("LSUC") as part of its self-regulatory regime, are the primary source of direction for lawyers in managing their practice. However, while the Rules provide guidance for lawyers on how best to fulfill their professional responsibilities, they are not a roadmap. They do not address every scenario or moral dilemma a lawyer may face. They do not provide a checklist for determining

[3] *Ibid.* at 11.

[4] (Toronto: The Law Society of Upper Canada, 2000).

whether a client's intentions, for example, are legitimate. Instead, they serve as a compass, guiding lawyers in the direction of what is "right."

*Duties to the Client and Beyond*

The principles guiding a lawyer's relationship to his or her client are detailed in Rule 2. These principles, traditionally viewed as the lawyer's primary duties, are well known and obvious. They include the duty to provide competent representation,[5] to be honest and candid with the client,[6] to maintain the confidentiality of client communications[7] and to avoid conflicts of interest.[8]

The Rules also clarify, however, that a lawyer's duties extend beyond his or her relationship with clients. The Rules provide for a broad scope of responsibilities and obligations, based on a lawyer's relationship to the administration of justice,[9] to society and the profession[10] and to students and non-lawyer employees.[11] While conventional principles of confidentiality and loyalty to the client are still central to the lawyer-client relationship, in some cases, they must be compromised to achieve justice.

*Duty to Avoid Facilitating Improper Acts*

Rules 2.02(5), (5.0.1) and (5.0.2) require lawyers to avoid playing a facilitative role in the improper acts of their clients. These Rules provide:

---

[5] Rule 2.01(2). A lawyer shall perform any legal services undertaken on a client's behalf to the standard of a competent lawyer.

[6] Rule 2.02(1). When advising clients, a lawyer shall be honest and candid.

[7] Rule 2.03(1). A lawyer at all times shall hold in strict confidence all information concerning the business and affairs of the client acquired in the course of the professional relationship and shall not divulge any such information unless expressly or impliedly authorized by the client or required by law to do so.

[8] Rule 2.04(2). A lawyer shall not advise or represent more than one side of a dispute.

Rule 2.04(3) A lawyer shall not act or continue to act in a matter when there is or is likely to be a conflicting interest unless, after disclosure adequate to make an informed decision, the client or prospective client consents.

[9] Rule 4 - Relationship to the Administration of Justice.

[10] Rule 6 - Relationship to the Society and Other Lawyers.

[11] Rule 5 - Relationship to Students, Employees, and Others.

*Dishonesty, Fraud etc. by Client or Others*

> 2.02(5) A lawyer shall not (a) knowingly assist in or encourage any dishonesty, fraud, crime, or illegal conduct; (b) advise a client or any other person on how to violate the law and avoid punishment.
>
> (5.0.1) A lawyer shall not act or do anything or omit to do anything in circumstances where he or she ought to know that, by acting, doing the thing or omitting to do the thing, he or she is being used by a client, by a person associated with a client or by any other person to facilitate dishonesty, fraud, crime or illegal conduct.
>
> (5.0.2) When retained by a client, a lawyer shall make reasonable efforts to ascertain the purpose and objectives of the retainer and to obtain information about the client necessary to fulfill this obligation. (Emphasis added.)

The commentary to Rules 2.02(5), (5.0.1) and (5.0.2) states that a lawyer must be "on guard against becoming the tool or dupe of an unscrupulous client or persons associated with such a client or any other person." This cautionary note is accompanied by examples of transactions for which particular vigilance is required: "establishing, purchasing or selling business entities; arranging financing for the purchase or sale or operation of business entities; arranging financing for the purchase or sale of business assets; and purchasing and selling real estate." Accordingly, asset transfers are identified as particular areas in which lawyers could find themselves vulnerable to clients with improper motives and objectives.

Though the lawyer's "knowledge" of the client's intentions and conduct in the context of improper transfers would appear to be key to a determination that a lawyer has breached the Rules, cases suggest that actual knowledge is not required. The 2008 LSUC Appeal Panel decision in *Kazman v. Law Society of Upper Canada* interpreted Rule 2.02(5)(a) to include behaviour that is "wilfully blind or reckless."[12] In *Kazman*, the appellant lawyer was accused of knowingly participating in a dishonest mortgage financing scheme. His client disguised mortgage refinancing as arm's length sales to new purchasers through the use of a power of attorney authorizing him to do business on behalf of others. When the client was unable to keep the new mortgages in good standing, the scheme fell apart and both the mortgagors and the individuals who authorized the power of attorney realized they had been duped. The evidence demonstrated that Kazman was not experienced in real estate matters and did not actually know

---

[12] 2008 ONSLAP 7 [*Kazman*] at para. 48.

the transactions he facilitated were fraudulent. However, he did have knowledge that the client had previously forged a fraudulent document in a seperate real estate transaction and that this alone necessitated further inquiries by the him.[13]

The Panel held that the evidence "left no doubt that a reasonably prudent solicitor would have been put on inquiry in the peculiar circumstances of the transactions that [Kazman] was being asked to facilitate, and that the failure to make those inquiries fell well below the standard of practice expected of solicitors and the duty they owe to their clients, including mortgage lenders."[14] As "any prudent solicitor would have known about fraud risks at the relevant times" and Kazman was "sufficiently experienced to have known better,"[15] the Panel found that the LSUC had proven "wilfull blindness," and thus the element of "knowledge," on a balance of probabilities. As such, the disbarment of Kazman for professional misconduct was upheld.[16]

In the aftermath of *Kazman*, the commentary to Rule 2.02(5)(a) was amended in October 2012 to explicitly provide that "knowledge" for the purposes of the Rule is actual or imputed through wilful blindness or recklessness. Rule 2.02(5.0.1), added to the Rules in April 2012, applies a purely objective test to the inquiry; if the lawyer "ought to know" that his or her actions are facilitating improper conduct, he or she can be found to have breached the Rules and could face professional sanctions. As will be discussed later, an emerging line of case law has found lawyers liable for failing to take objectively reasonable steps to ascertain whether an asset transfer was legitimate.

The Rules provide limited practical guidance for determining when lawyers ought to know, or how they should come to know, that they are at risk of facilitating an improper transfer. Lawyers are urged to "obtain information about the client, the subject matter and objectives of the retainer" and to verify ownership of any property being transferred.[17] The Rules were amended in October 2012 to address an increasing concern regarding real estate transfers. A new list of

---

[13] *Law Society of Upper Canada v. Kazman*, 2005 ONLSHP 32.

[14] *Kazman, supra* note 12 at para. 55.

[15] *Ibid.*

[16] The decision was also subsequently upheld in *Law Society of Upper Canada v. Kazman*, 2011 ONSC 3008 (Ont. Div. Ct.).

[17] See commentary to Rules 2.02(5), (5.0.1) and (5.0.2).

"red flags" hint at when a transaction might be fraudulent.[18] These "red flags" include: purchase price manipulations, a nominal role for one or more parties, the purchaser contributing no funds or only a nominal amount towards the purchase price or the balance due on closing, signs that the parties are concealing a non-arm's length relationship or are colluding with respect to the purchase price; suspicious or repeated third-party involvement, and the proceeds of sale being disbursed or directed to be paid to parties who are unrelated to the transaction.

While the list is a positive move toward providing lawyers with greater direction, it falls short of providing a roadmap. The list is not exhaustive and reminds lawyers that they have a professional obligation to educate themselves on an ongoing basis regarding the risks of real estate fraud. Further, while many of the red flags are applicable beyond the real estate context, the list does not specifically address personal property transfers.

*Duty to Whistle-blow*

Representing an organization, as opposed to an individual, can present the lawyer with unique challenges in the context of asset transfers. The lawyer has the added responsibility of blowing the whistle when the client, or its agents, are acting in a manner contrary to the legal or regulatory environment. As with all clients, a lawyer will experience conflicting duties in this case; he or she must uphold the law, but owes his or her client the duties of loyalty and confidentiality.

Important in the context of corporate clients is the rule that lawyers represent the organization as a whole, not individual employees. Any duties owed to the client under Rule 2 are to the corporation, not the agent giving instructions. The relevant subsections of the Rules are:

> *Dishonesty, Fraud, etc. when Client an Organization*
>
> (5.1) When a lawyer is employed or retained by an organization to act in a matter and the lawyer knows that the organization intends to act dishonestly, fraudulently, criminally, or illegally with respect to that matter, then in addition to his or her obligations under subrule (5), the lawyer for the organization shall

[18] *Ibid.*

(a) advise the person from whom the lawyer takes instructions that the proposed conduct would be dishonest, fraudulent, criminal, or illegal,

(b) if necessary because the person from whom the lawyer takes instructions refuses to cause the proposed wrongful conduct to be abandoned, advise the organization's chief legal officer, or both the chief legal officer and the chief executive officer, that the proposed conduct would be dishonest, fraudulent, criminal or illegal,

(c) if necessary because the chief legal officer or the chief executive officer of the organization refuses to cause the proposed conduct to be abandoned, advise progressively the next highest persons or groups, including ultimately, the board of directors, the board of trustees, or the appropriate committee of the board, that the proposed conduct would be dishonest, fraudulent, criminal, or illegal, and

(d) if the organization, despite the lawyer's advice, intends to pursue the proposed course of conduct, withdraw from acting in the matter in accordance with rule 2.09.
(Emphasis added.)

To address the issues of agency inherent in the representation of the corporate client, the Rules provide steps for ensuring that the interests of the organization are protected by its leaders. The lawyer should advise the person from whom he regularly takes instructions if the organization is engaged in any improper conduct, and slowly work his or her way up the organizational structure if warnings are not properly heeded. If all levels of the organization refuse the lawyer's advice, he or she is instructed to withdraw from representation of the organization.[19]

The lawyer is never advised to breach his or her duty of confidentiality by approaching individuals outside of the organization, such as the Ontario Securities Commission, unless the lawyer has reasonable grounds to believe that a crime is likely to be committed. However, any extra-corporate disclosure should be as limited as possible, and only to the extent necessary to prevent the crime.[20]

---

[19] See Rule 2.09 – Withdrawal from Representation.

[20] Gavin MacKenzie, *Lawyers & Ethics: Professional Responsibility and Discipline* (Toronto: Carswell, 1993) at 20-14.

## III. STATUTORY AND REGULATORY FRAMEWORK FOR IMPROPER TRANSFERS

Improper asset transfers typically fall into two categories: (i) those intended to defeat creditors, and (ii) those intended to prefer one creditor or a group of creditors. While the risk of improper asset transfers are heightened as a client approaches insolvency, there are other contexts in which improper transfers could be attempted. The lawyer advising on asset transfers must be aware of the statutory and regulatory framework addressing improper transfers.

There are six major sources of civil or criminal exposure for clients conducting asset transfers. These are: (1) the *Fraudulent Conveyances Act*,[21] (2) the *Assignment and Preferences Act*,[22] (3) the *Bankruptcy and Insolvency Act*,[23] (4) the *Companies' Creditors Arrangement Act*,[24] (5) common law tort, and (6) criminal and quasi-criminal sanctions.

### 1. Fraudulent Conveyances Act

Under the *Fraudulent Conveyances Act* ("FCA"), creditors and "others" may pursue remedies against a debtor who transfers property with an intent to "defeat, hinder, delay or defraud". Importantly, there is no requirement under the statute to demonstrate that the transferor is insolvent. The relevant section of the FCA provides:

> *Where conveyances void as against creditors*
>
> 2. Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties or forfeitures are void as against such persons and their assigns. (Emphasis added.)

The FCA requires: i) a conveyance of real or personal property, and ii) intent to defraud or defeat creditors. A "conveyance" is defined in the FCA as a "gift, grant, alienation, bargain, charge,

---

[21] R.S.O. 1990, c. F.29, as amended.

[22] R.S.O. 1990, c. A.33, as amended.

[23] R.S.C. 1985, c. B-3, as amended.

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

encumbrance, limitation of use or uses of, in, to or out of real property or personal property by writing or otherwise."[25]

The most significant barrier to relief under the FCA is proving the intent to defraud or defeat creditors. Ontario courts have yet to clearly delineate whether fraudulent intent must be proven on a subjective or objective basis, and whether traditional creditor proofing outside of the insolvency context might qualify as intent to defeat creditors. However, the British Columbia ("B.C.") Court of Appeal decision of *Abakhan & Associates Inc. v. Braydon Investments Ltd*[26] found that under the B.C. equivalent to the FCA, no dishonest or morally blameworthy intent is required to avoid a conveyance, merely an intent to put assets out of reach of one's creditors, present or future. Leave to appeal to the Supreme Court of Canada was denied in June 2010.[27] Ontario case law suggests, however, that intent to defeat creditors must be proven on a subjective basis, whereby so-called "badges of fraud" create a presumption of subjective intent.[28]

Once a fraudulent conveyance has been established, the transaction is deemed void as to the creditor or person whom the conveyance was meant to harm. As such, the recipient of the fraudulent transfer may face the execution or seizure of the subject-matter at issue by the aggrieved party. It is important to note, however, that the FCA provides an exception protecting bona fide purchasers for value without notice.[29]

### 2. Assignment and Preferences Act

Under the *Assignment and Preferences Act* ("APA"), a court may set aside a transaction that prefers one creditor to another. Unlike the FCA, however, the APA only applies in situations where the debtor is insolvent or approaching insolvency. Further, relief under the APA is only

---

[25] *FCA, supra* note 21 at s.1.

[26] 2009 BCCA 521.

[27] [2010] SCCA No. 26.

[28] Badges of fraud identified by the courts include: the conveyance was of substantially all of the transferor's property, secret, made pending the writ, or amounted to a trust of the goods; the transferor continued in possession and used or benefited from the property; the deed contained the self-serving and unusual provision "that the gift was made honestly, truly and bona fide", gave the transferor a general power to revoke a conveyance, contained false statements as to the consideration; the consideration was grossly inadequate; unusual haste in making the conveyance; cash taken in payment instead of a cheque; and a close relationship between the parties to the conveyance.

[29] *FCA, supra* note 21 at s.3.

available to those parties who were creditors at the time of the preferential transfer. The relevant section pertaining to unjust preference provides:

> *Unjust preferences*
>
> (2) Subject to section 5, every such gift, conveyance, assignment or transfer, delivery over or payment made by a person being at the time in insolvent circumstances, or unable to pay his, her or its debts in full, or knowing himself, herself or itself to be on the eve of insolvency, to or for a creditor with the intent to give such creditor an unjust preference over other creditors or over any one or more of them is void as against the creditor or creditors injured, delayed, prejudiced or postponed. (Emphasis added.)

Establishing an unjust preference under the APA requires: i) a transfer by the debtor, ii) when the debtor is approaching insolvency, and iii) with intent to give a creditor an unjust preference. Again, the most difficult element to establish is often the requisite intent to injure or prejudice a creditor through an unjust preference. However, when a creditor brings proceedings within 60 days of a transfer, such intent is presumed. Like the FCA, the APA also addresses transfers intended to defeat creditors and, in both situations of fraudulent transfers and unjust preferences, relief under the APA is sought against the recipient, not the transferor. Again, protection is provided to bona fide purchasers meeting certain criteria.[30]

### 3. Bankruptcy and Insolvency Act

The *Bankruptcy and Insolvency Act* ("BIA") is the primary statutory instrument governing bankruptcies and insolvencies in Canada. Its purpose is to preserve the assets of the debtor for creditors and, where possible, to rehabilitate the debtor through the forgiveness of debt, restoring it to a productive entity.

Fraudulent preferences are also subject to scrutiny under the BIA. A transfer of property made by an insolvent person in favour of an arm's length creditor, with intent to give that creditor preference over others, is void as against the trustee in bankruptcy when made less than 3 months before bankruptcy. When the effect of the transfer is preferential, there is a rebuttable presumption that such effect was intended. This includes payments made in settlement of litigation[31] and other transactions beyond those traditionally considered to be conveyances.

---

[30] *APA, supra* note 22 at s.5.

[31] *Re Dilollo,* 2013 ONSC 578.

Where the transfer is made in favour of a non-arm's length creditor, such as related parties, proof of intent is not required. A non-arms length transfer is void as against the trustee when made less than 12 months before bankruptcy. The relevant subsection of the BIA reads:

> *Preferences*
>
> 95. (1) A transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person
>
> (a) in favour of a creditor who is <u>dealing at arm's length</u> with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor is void as against... the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is <u>three months</u> before the date of the initial bankruptcy event and ending on the date of the bankruptcy; and
>
> (b) in favour of a creditor who is <u>not dealing at arm's length</u> with the insolvent person... during the period beginning on the day that is <u>12 months</u> before the date of the initial bankruptcy event and ending on the date of the bankruptcy. (Emphasis added.)

Second, the BIA aims to prevent transfers at undervalue. It allows the trustee in bankruptcy to challenge a disposition of property made for conspicuously less than fair market value, or for no consideration whatsoever. A transfer at undervalue to an arm's length creditor is void where: (i) the debtor was insolvent at the time of the transfer, (ii) the transfer occurred within one year before the initial bankruptcy event, and (iii) the debtor had intent to defraud or delay a creditor. A transfer to a non-arm's length creditor is automatically void where the transfer occurred within one year prior to the bankruptcy; neither proof of insolvency nor intent to defraud is required. If the transfer occurred between one and five years prior to the bankruptcy, and was made to a non-arm's length party, either intent or insolvency must be established. The operative provision reads:

> *Transfer at undervalue*
>
> 96. (1) On application by the trustee, a court may declare that a transfer at undervalue is void as against... the trustee... if
>
> (a) the party was <u>dealing at arm's length</u> with the debtor and (i) the transfer occurred during the period that begins on the day that is <u>one year</u> before the date of the initial bankruptcy event and that ends on the date of the bankruptcy, (ii) the debtor was <u>insolvent</u> at the time of the transfer or was rendered insolvent by it, and (iii) the debtor <u>intended to defraud, defeat or delay a creditor</u>; or

> (b) the party was not dealing at arm's length with the debtor and (i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and ends on the date of the bankruptcy, or (ii) the transfer occurred during the period that begins on the day that is five years before the date of the initial bankruptcy event and ends on the day before the day on which the period referred to in subparagraph (i) begins and (A) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, or (B) the debtor intended to defraud, defeat or delay a creditor. (Emphasis added.)

### 4. Companies' Creditors Arrangement Act

The *Companies' Creditors Arrangement Act* ("CCAA") is another statutory instrument governing insolvency in Canada. It allows insolvent corporations owing their creditors in excess of $5 million to restructure their business and financial affairs. It adopts by reference the fraudulent preferences and transfers at undervalue provisions of the BIA.[32] Asset transfers therefore will be subject to the same scrutiny whether the client is insolvent under the CCAA or bankrupt under the BIA.

### 5. Common Law Tort

Distinct from the remedies addressing fraudulent or preferential transfers are common law torts that establish civil liability for fraudulent behaviour. These include fraudulent misrepresentation, deceit and conspiracy, and may arise when a client misrepresents his financial position to business associates, such as suppliers or investors.[33] Fraudulent misrepresentation is established where an individual makes a false statement: i) with knowledge of its falsity, ii) with an intent to deceive, iii) that the plaintiff has relied on, and iv) that has resulted in damages. Conspiracy arises where i) an agreement is made between two or more persons, ii) the defendants acted in furtherance of that agreement, iii) the predominant purpose of the agreement is to injure the plaintiff, and iv) the plaintiff is injured as a result.[34] These common law torts can be employed by creditors for recovery of damages against a debtor client conducting an improper asset transfer.

---

[32] *CCAA, supra* note 24 at s.36.1 which reads: Sections 38 and 95 to 101 of the Bankruptcy and Insolvency Act apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

[33] See *Klotz, supra* note 2 at 10; Stuart Brotman & R. Graham Phoenix, *Ethics and Advising the (Nearly) Insolvent Client* (Toronto: Ontario Bar Association, 2009) at 6 [*Brotman*].

[34] *Brotman, supra* note 33 at 6.

### 6. Criminal and Quasi-Criminal Sanctions

Lastly, a client could face criminal or quasi-criminal sanctions for engaging in fraudulent conduct, including fraudulent asset transfers. The *Criminal Code of Canada* ("Criminal Code")[35] establishes two indictable offences that have been applied successfully to attempts by a debtor client to avoid payment to his creditors. The first addresses fraudulent conduct generally, and the second specifically deals with fraudulent conduct towards creditors. Both require that the accused: i) knowingly undertake conduct constituting a dishonest act, and ii) with subjective appreciation that the consequences of such conduct could be the loss of a pecuniary interest. The operative provisions are:

> *Fraud*
>
> 380. (1) Every one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretence within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service,
>
> (a) is guilty of an indictable offence and liable to a term of imprisonment not exceeding fourteen years, where the subject-matter of the offence is a testamentary instrument or the value of the subject-matter of the offence exceeds five thousand dollars; or
>
> (b) is guilty (i) of an indictable offence and is liable to imprisonment for a term not exceeding two years, or (ii) of an offence punishable on summary conviction, where the value of the subject-matter of the offence does not exceed five thousand dollars. (Emphasis added.)
>
> [...]
>
> *Disposal of property to defraud creditors*
>
> 392. 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. (Emphasis added.)

---

[35] R.S.C. 1990, c. C-46, as amended.

Thus, while a debtor may be liable in tort for fraudulent conduct, and the recipient of a preferential transfer may face execution of the subject-matter of the transfer by an injured creditor, serious criminal penalties also apply to these actions on the part of the transferor and a conspiring recipient. However, the Criminal Code is not the only source of penalties. The BIA also establishes "quasi-criminal" sanctions. It specifically provides that a creditor who effects a fraudulent disposition of assets may be criminally liable. The relevant section states:

> *Bankruptcy offences*
>
> 198. (1) Any bankrupt who
>
> (a) makes any fraudulent disposition of the bankrupt's property before or after the date of the initial bankruptcy event,
>
> [...]
>
> (g) after or within one year immediately preceding the date of the initial bankruptcy event, hypothecates, pawns, pledges or disposes of any property that the bankrupt has obtained on credit and has not paid for, unless in the case of a trader the hypothecation, pawning, pledging or disposing is in the ordinary way of trade and unless the bankrupt had no intent to defraud,
>
> is guilty of an offence and is liable, on summary conviction, to a fine not exceeding five thousand dollars or to imprisonment for a term not exceeding one year or to both, or on conviction on indictment, to a fine not exceeding ten thousand dollars or to imprisonment for a term not exceeding three years, or to both. (Emphasis added)

The offences established in the BIA thus reinforce the Criminal Code provision prohibiting fraudulent dispositions intended to injure creditors, albeit with more modest penalties. Case law makes clear that charges can be brought under both the BIA and Criminal Code for fraudulent behaviour in the context of a bankruptcy or insolvency.[36] Further, the BIA specifically provides for the authorization of criminal proceedings by the court or trustee in certain circumstances[37] and obliges the trustee or receiver to report offences under the Criminal Code.[38]

---

[36] See *Re White* (2010), 63 C.B.R. ($5^{th}$) 135 (Ont. S.C.J.).

[37] See *BIA*, *supra* note 23 at s.205(3) and (4) which read: (3) Whenever the court is satisfied, on the representation of the Superintendent or any one on his behalf, of the official receiver or trustee or of any creditor, inspector or other interested person, that there is ground to believe that any person is guilty of an offence under this Act or under any other statute, whether of Canada or a province, in connection with the bankrupt, his property or transactions, the court may authorize the trustee to initiate proceedings for the prosecution of that person for that offence; (4) Where a trustee is authorized or directed by the creditors, the inspectors or the court to initiate proceedings against any person

## IV. LAWYERS' EXPOSURE FOR IMPROPER TRANSFERS

The previous section of this paper presented some of the key legislative and regulatory provisions under which asset transfers could be challenged, and the liability or criminal sanction that could be imposed on clients. This section examines how a lawyer advising such a client might become exposed to professional or criminal sanction or attract civil liability.

### 1. Professional Sanctions

A lawyer that engages in "professional misconduct" or "conduct unbecoming a barrister or solicitor" could be subject to disciplinary measures.[39] These terms are defined in the Rules as follows:

> *1.02 Definitions*
>
> "conduct unbecoming a barrister or solicitor" means conduct, including conduct in a lawyer's personal or private capacity, that tends to bring discredit upon the legal profession including, for example, (a) committing a criminal act that reflects adversely on the lawyer's honesty, trustworthiness, or fitness as a lawyer, (b) taking improper advantage of the youth, inexperience, lack of education, unsophistication, ill health, or unbusinesslike habits of another, or (c) engaging in conduct involving dishonesty or conduct which undermines the administration of justice;
>
> [...]
>
> "professional misconduct" means conduct in a lawyer's professional capacity that tends to bring discredit upon the legal profession including (a) violating or attempting to violate one of the rules in the Rules of Professional Conduct or a requirement of the Law Society Act or its regulations or by-laws. (Emphasis added.)

Therefore, a violation of Rules 2.02(5), 5.0.1 and 5.02 (requiring lawyers to avoid playing a facilitative role in the improper acts of their clients) could constitute "professional misconduct".

believed to have committed an offence, the trustee shall institute the proceedings and shall send or cause to be sent a copy of the resolution or order, duly certified as a true copy thereof, together with a copy of all reports or statements of the facts on which the order or resolution was based, to the Crown Attorney or the agent of the Crown duly authorized to represent the Crown in the prosecution of criminal offences in the district where the alleged offence was committed.

[38] See *BIA*, *supra* note 23 at s.206(1) which reads: Where the official receiver or trustee believes on reasonable grounds that an offence under this Act or the Criminal Code relating to the property of the bankrupt was committed either before or after the date of the initial bankruptcy event by the bankrupt or any other person, the official receiver or trustee shall make a report thereon to the Deputy Attorney General or other appropriate legal officer of the province concerned or to such person as is duly designated by that legal officer for that purpose.

[39] See Rule 6.11 - Discipline.

Beyond that, any conduct on the part of the lawyer that discredits the legal profession, even if it falls short of conduct prohibited by the Rules, will be punishable by professional sanction. These sanctions can include a formal warning, temporary suspension, fine or disbarment.

### 2. Criminal and Quasi-Criminal Sanctions

The Criminal Code includes two provisions that could implicate a lawyer providing a client with inappropriate or illegal advice. The first provision deems anyone aiding or abetting a person committing a crime to be a party to that offence. Therefore, a lawyer facilitating an inappropriate transfer or concealing evidence of fraudulent conduct could be implicated in the crimes of his client. The second provision deems anyone counselling another to engage in an offence to be a party to that offence. Interestingly, the provision extends to acts that are committed in a method different from what was counselled, and to acts that are reasonably foreseeable consequences of the counselling. The relevant provisions are:

> *Parties to offence*
>
> 21. (1) Every one is a party to an offence who
>
> (a) actually commits it;
>
> (b) does or omits to do anything for the purpose of aiding any person to commit it; or
>
> (c) abets any person in committing it.
>
> [...]
>
> *Person counselling offence*
>
> 22. (1) Where a person counsels another person to be a party to an offence and that other person is afterwards a party to that offence, the person who counselled is a party to that offence, notwithstanding that the offence was committed in a way different from that which was counselled.
>
> (2) Every one who counsels another person to be a party to an offence is a party to every offence that the other commits in consequence of the counselling that the person who counselled knew or ought to have known was likely to be committed in consequence of the counselling.

*Definition of "counsel"*

(3) For the purposes of this Act, "counsel" includes procure, solicit or incite. (Emphasis added.)

As these sections of the Criminal Code are quite broad, lawyers advising clients transferring assets must be mindful of the fraud-based offences discussed in the previous section, aim to prevent their clients from committing them, and attempt to avoid being implicated by aiding or counselling the perpetrator client.

### 3. Civil Liability

Lawyers have not traditionally faced civil liability for the acts of their clients. Recent Ontario case law, however, suggests that in certain circumstances a lawyer could attract civil liability for the harm caused to third parties arising out of any improper transfer on which they advised. In *Canbook Distribution Corp. v. Borins,*[40] Ground J. of the Ontario Superior Court of Justice refused to grant summary judgment in favour of a law firm against whom a third party sought damages arising out of a fraudulent transaction. In *Canbook,* an unsecured creditor of a chain of book stores, Edwards Books, obtained an order transferring to it the rights of the trustee in bankruptcy for the purposes of commencing an action against the ultimate owners of the chain, Edward and Eva Borins. The action also named the lawyers for the Borins, the firm Fasken Campbell Godfrey, who allegedly facilitated the taking of security for a loan by the Borins to the chain *subsequent* to the completion of the original lending transaction, an improper act.

Though not stated explicitly in the judgment, Ground J. in *Canbook* suggested that a court will at least consider civil liability when a lawyer fails to prevent its client from engaging in improper conduct that injures third parties. This appears to be the situation even when the lawyer, as in *Canbook,* does not know that a transaction is intended to defeat the interests of creditors, and where there is no allegation of fraud on the part of the lawyer.

*Canbook,* and the earlier decision of Day J. of the Ontario Superior Court of Justice in *Yamada v. Mock,*[41] depart from the traditional view of the lawyer owing his or her primary responsibility to

---

[40] [1999] 45 O.R. (3d) 565 [*Canbook*].

[41] (1996) 136 D.L.R. (4th) 124 (Ont. S.C.J.) [*Yamada*].

the client. In *Yamada*, a lawyer acting on both sides of a mortgage transaction was duped by an imposter acting as the mortgagor's spouse. Day J. held that in failing to ask for identification from the imposter, the lawyer created a risk of foreseeable harm and had therefore not taken reasonable steps to protect the interests of the mortgagee. As the lawyer was in a better position than the mortgagee to bear this risk, the lawyer was held liable.

Lastly, in *Stone v. Stone et al.*,[42] the Ontario Court of Appeal upheld the setting aside of a conveyance made by a dying man to the children of his first wife, on the basis that it defeated the interests of a creditor, his second wife. The wife was not a creditor at the time of the man's death, but became one under the *Family Law Act* after the man died. The decision suggests that there is a duty placed on lawyers to consider even future creditors who might be defeated by a particular transfer of assets.

As a result of these legal developments, the "law book" approach, wherein a lawyer may provide morally indifferent legal advice to the client short of promoting or facilitating illegality, is now fraught with a significant amount of risk.

## V. PRACTICAL TIPS TO MANAGE THE RISK

It is clear that there is an extensive statutory and regulatory framework governing asset transfers, particularly those made in a near insolvency situation. Further, the duty imposed on lawyers advising on transactions that might impact third parties, appears to be broadening and is increasingly being enforced by the courts. This section provides several practical tips for mitigating this risk and navigating the moral gray zone in a manner consistent with legal and professional duties. These tips can be divided into three separate categories: (1) forming an ethical legal opinion, (2) influencing the conduct of the client, (3) employing protective measures, [43] and (4) dealing with the obstructive lawyer.

---

[42] [2001] O.J. No. 3282.

[43] See *Klotz, supra* note 2 at 15-25, which forms the basis of the discussion of items (1), (2) and (3).

### 1. Forming an ethical legal opinion

By incorporating these steps into their practice, lawyers can enhance their ability to formulate a morally sound opinion on the proposed transaction and their client's intentions:

- Become familiar with the case law and statutes governing asset transfers. This will reduce uncertainty concerning the parameters imposed by law, and shrink the moral gray zone.
- Develop a sense of the conduct and practices that are deemed acceptable in the legal community in which the advice is to be given.
- Consult colleagues, including both senior practitioners and juniors, and the LSUC for advice on how to best confront gray issues and ensure the right questions are being asked to reduce the likelihood of implication in a fraudulent or improper act. The LSUC operates a confidential *Practice Management Helpline* (416-947-3315), providing lawyers with assistance in interpreting their obligations under the Rules.
- Build a practice environment that is mindful of ethical concerns.

### 2. Employing protective measures

Further, lawyers should take these protective measures to mitigate the risks associated with clients' improper conduct and a potential challenge to their advice:

- Keep detailed notes of discussions with the client, as well as a written record of any steps taken to determine the appropriate course of conduct.
- Make appropriate inquiries. As set out in Rule 2.02(5), obtain information about the client, the subject matter and objectives of the retainer and verify the ownership of any property being transferred.
- Be mindful of suspicious circumstances: odd provisions regarding the purchase price, a strange relationship between the transferee and transferor, third party involvement in the transaction, an urgency to complete the transaction (which could suggest fraud or an impending insolvency).

- Identify any professionals (lawyers, accountants, etc.) associated with the file who are of questionable character or who have a history of setting up artificial structures; that alone might warrant a lawyer taking additional precautions to ensure a transaction is not improper or fraudulent.

- Draft documents that are reliable on their face by incorporating preambles into any key documents detailing the facts of the transaction and any legal theory justifying a given approach to a transaction.

- Presume that all elements of the file will be individually scrutinized if the transaction is challenged.

- Act formally in any consultations with the client regarding a creditor-proofing or a transfer of assets.

### 3. Influencing the conduct of the client

Lastly, translating moral advice into moral conduct on the part of their clients is a challenge for lawyers, especially those facilitating asset transfers for clients on the brink of insolvency. These additional tips are useful for lawyers attempting to positively influence the conduct of their clients:

- Remind clients that lawyers have professional duties to uphold the law and promote ethical conduct, dispelling the notion that the lawyer's role is to promote the client's financial interests at all costs.

- Inform the client of the practical reasons for staying onside the law, including:

    - the risk of years of litigation that might be imposed on them and their loved ones;

    - the legal costs that might be incurred in defending a questionable transaction; and

    - the feeling that their sense of self has been compromised for a potential financial gain.

- Admit to clients that Canada's record of criminal prosecution in the area of fraudulent conveyances has been limited, but that this could change at any time given the right conditions, and that successfully defending a claim requires the negative quality of being able to lie effectively.

- Tell the client that if they choose to follow a path of unethical or illegal conduct, they will have to seek representation from another lawyer.

## VI. CONCLUSION

We should all endeavor to follow what is right. However, in the legal profession, following what is right is often a difficult task. Lawyers must make complex moral decisions and face competing duties to clients, society and the profession. Often they do not have full information on which to base these decisions. The civil obligations now imposed on lawyers by the courts appear to be expanding, as is the scope of the professional sanctions imposed by self-regulation. The Rules, which serve as the primary source of guidance for lawyers in Ontario, often fail to provide sufficient direction. They serve as a compass, not a roadmap, and present aspirational principles with only limited practical commentary.

From the discussion contained herein have emerged several practical tips and considerations for use by lawyers in their daily practice. They indicate that following convention is no longer a shield to liability or sanction. Lawyers must remain vigilant when conducting asset transfers, know the legal framework governing the area, and let the Rules serve as a basis for their actions. Most importantly, they must be guided by their own moral compasses.

**HYPOTHETICALS**

**Consider the legal and ethical implications for lawyers in these scenarios:**

1. A lawyer represents a husband and wife, who are prospective purchasers of residential property. The lawyer arranges for title to be taken in the name of the wife alone for the sole purpose of preventing the lien of a previous judgment against the husband from attaching to the property.

2. A lawyer represents the same clients. She arranges for the husband and wife to enter into a contract to purchase residential property as joint owners. However, after the disclosure of a judgment against the husband, the lawyer arranges for the assignment of the contract to the wife alone and for title to be taken in her name alone to avoid having the judgment attach as a lien against the interest of the husband in the property.

3. A lawyer represents a client with a large outstanding debt to a family member. This client has recently experienced the breakdown of his marriage and his only major asset is the matrimonial home. The client wishes to transfer ownership of the home in exchange for his wife agreeing to care for their young children and waive any future rights to child care.

4. A lawyer represents a corporate client looking to take advantage of favourable tax deductions. On the advice of his client, he transfers assets from the corporate client to a holding company. The corporate client then engages in a high-risk new venture and enters bankruptcy, leaving several major creditors.

6197480