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I. INITIAL DISCUSSIONS WITH THE CLIENT [§1.1]

Principles for effective client file management and client relations apply equally to collections clients. It is important at the outset to clarify client objectives, conflicts, fees, and any retainer conditions. Limitation dates must be identified and acted on. Instructions should be confirmed in writing, a file should be organized, and a bring-forward and client-reporting schedule should be recorded.

A lawyer who is retained to take steps to try to collect a debt must keep in mind that there are both legal and practical considerations if the client's needs are to be served. The ultimate goal of the client, normally to collect the debt owed, is really just the starting point for the lawyer. This chapter provides an overview of the preliminary issues a lawyer must consider when attempting to meet the client's goals.

Among the most fundamental issues that must be discussed with the client are the ability to collect the debt owed and the legal fees and other costs to be incurred in collecting the debt. The client typically begins by asking, "What are my chances of recovering the debt owed?" followed by, "How much will it all cost?" These are difficult questions to answer, because the answers depend on a myriad of factors, including the liquidity of the debtor and the ability to retrieve the assets of the debtor through the legal process.

To assess these issues, a lawyer must obtain as much information as possible from the client, and consider further sources of information, such as background searches and investigations. With the collected information in hand, the lawyer should try to determine:

(1) the nature of the cause of action;

(2) the parties who are potentially liable; and

(3) the likelihood of recovery from those parties.

These are challenging endeavours. However, if the lawyer continuously maintains a broad perspective of these key issues, the client's goals may be met.

II. INITIAL STEPS IN ASSESSING THE CLAIM [§1.2]

The client intake process has two very important steps: the lawyer must consider conflicts and take client verification steps.

A. CONFLICTS OF INTEREST SEARCHES [§1.3]

In a collection case, the first step to be taken before agreeing to act for the creditor is to conduct appropriate conflict of interest searches in your law firm. Conduct conflict searches not only with respect to the debtor, but also your client.

You must ensure that your firm is not acting for the debtor, but you will also wish to be satisfied that the firm is not acting against the same debtor for a different creditor. Acting for two different creditors could place the law firm in a conflict of interest if, for example, the debtor does not have sufficient assets to satisfy all of its creditors.

You must also conduct conflict searches to ensure that your law firm is not acting in a claim against the creditor (the "potential new client"). The law firm could be placed in a conflict of interest if, for example, you gain knowledge about one of the potential new client's assets consisting of the proposed claim against the debtor.

Rules 3.4-1 to 3.4-11, and associated commentary under the Law Society of British Columbia's *Code of Professional Conduct for British Columbia* (the "*BC Code*", available at www.lawsociety.bc.ca/support-and-resources-for-lawyers/act-rules-and-code/code-of-professional-conduct-for-british-columbia/), provide the guidelines for: avoiding conflicts, obtaining

the consents of affected parties when there is a conflict, protecting confidential information where there is a concurrent representation, joint retainers, and acting against former clients. Where such issues exist, the lawyer will need to take steps to address the conflicts or refuse the engagement.

B. CLIENT VERIFICATION AND FRAUD RISK [§1.4]

Client verification procedures should also be followed, both to comply with regulatory obligations as arise for all British Columbia lawyers following *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*, S.C. 2000, c. 17 requirements, and to mitigate the risk of being duped to "collect a debt" for a new client in circumstances that lead to the lawyer depositing a counterfeit cheque to their own trust account and paying out the proceeds before learning of the fraud.

Law Society of British Columbia Rules 3-98 to 3-110 require lawyers to follow client identification and verification procedures when retained by a client to provide legal services, subject to various exceptions. The client *identification* rules require that lawyers make reasonable efforts to obtain basic identification information about clients. Additionally, client *verification* rules apply when a lawyer receives, pays, or transfers money on behalf of a client, or gives instructions on behalf of a client in respect of the receipt, payment, or transfer of money.

Lawyers should use the Law Society's checklist (included in this manual) and follow the law firm's client intake policy for all new engagements. At the outset of the engagement, conduct appropriate third-party Internet searches on prospective new clients to gain information about them and their businesses. This helps to uncover fraud risk and benefits legitimate clients through knowing their business. Cross-reference and make note of any differences in address or contact numbers provided to you relative to third-party directories. Investigate any discrepancies. Reference should also be made to the Law Society webpage "Bad Cheque Scam: List of Names and Documents" to determine if the proposed client appears on the list (available by searching "bad cheque scam list of names" at www.lawsociety.bc.ca).

A "hold" policy on deposit items at financial institutions may provide some protection, but even that is not a guarantee. Materially altered or counterfeit items can take many months to be returned through the clearings. If you have a concern about the validity of an item, inquire

with the drawee directly. Do not rely on the telephone number printed on the instrument. Recent frauds against lawyers have involved printed counterfeit items with bogus telephone numbers and employed bogus call centres purporting to be reputable Canadian financial institutions as lawyers attempt to confirm the validity of the item by phone. Look up a contact number for the drawer's branch of account independently through an Internet search engine, or disclose your concerns to your banker and seek the assistance of your bank branch to coordinate verification of the item.

C. INITIAL DISCUSSIONS WITH THE CLIENT REGARDING FEES AND THE CLIENT'S EXPECTATIONS [§1.5]

The lawyer should have a detailed initial discussion with the client about the manner of calculation of the account, including fees, disbursements, and taxes, as well as the method and timing of payment and the conditions upon which the lawyer proposes to act.

The lawyer should then discuss the procedure involved in taking legal proceedings, including:

(1) the manner of obtaining judgment;

(2) the inevitable difficulties in collecting on the judgment once it is obtained; and

(3) the various court costs.

Clients must be fully advised of all of these issues before their needs and objectives can be assessed effectively. It is particularly vital to educate clients who are unfamiliar with the litigation process. Creditors normally want to collect as much as they are entitled to, collect that amount with the least cost, and collect it as quickly as possible. The reality is that there are often major hurdles. The debtor may be evasive, unreasonably litigious, or judgment-proof. Competing secured or unsecured creditors may frustrate the client's ability to collect. The costs of litigation are not fully recoverable.

See the Law Society of British Columbia's retainer agreements at www.lawsociety.bc.ca/support-and-resources-for-lawyers/law-office-administration/ under Support and Resources for Lawyers. See also rules 3.6-1 to 3.6-12 of the *BC Code*.

D. PERSONAL INFORMATION ABOUT THE DEBTOR [§1.6]

The lawyer should try to obtain from the client the full name, address, telephone number, and other personal information about the debtor. For an individual debtor, this information should include age, marital status, name of spouse, occupation, and the location of any bank accounts, land, or personal property owned by the debtor. In the case of a corporate debtor, the lawyer should obtain the proper corporate name as well as trade names.

The lawyer should then obtain the details of the transaction or events leading up to the debt being owed. Standardized instruction forms can be prepared for high-volume clients, to ensure that all relevant information is provided in written form.

E. DETAILS OF THE TRANSACTION [§1.7]

1. RELEVANT DOCUMENTS [§1.8]

The lawyer should obtain all files related to the claim and decide which documents are relevant. Relevant documents will include, for example:

(1) those evidencing the debt, such as copies of invoices, statements of account, promissory notes, cheques or bank statements, or invoices;

(2) the client's calculations of the amounts and interest due;

(3) any written demands made by the client for payment; and

(4) any notes of discussions or meetings with the debtor.

The lawyer should also obtain copies of any settlement agreements or agreements to forbear or postpone, along with any security agreements granted by the debtor in this regard.

2. NATURE OF THE DEBT [§1.9]

An understanding of the nature of the indebtedness will affect the course of action the lawyer follows to enforce repayment.

a. Direct vs. Indirect Debt [§1.10]

If the obligation is from the person who received funds or was supplied with goods and services, it is known as a direct obligation. If the obligation is from a third party, such as a guarantor, it is known as an

indirect obligation. The distinction is important because certain rights are available to guarantors which are not available to a direct obligant. The following is a list of some of those rights:

(1) If the guarantor pays a portion of the debt to the creditor, the guarantor is entitled to be subrogated to the rights of the creditor (*Re Hammond Organ Studios of Kelowna Ltd.* (1981), 40 C.B.R. (N.S.) 293 (B.C.S.C.)). If the guarantor pays the whole of the debt, the guarantor is entitled to have assigned to the guarantor any security held by the creditor (*Law and Equity Act*, R.S.B.C. 1996, c. 253, s. 34). If, as a result of the fault of the creditor, the guarantor is deprived of his subrogation or assignment of security rights, the guarantor may be discharged from his obligations (*Traders Finance Corp. v. Ross*, 1942 CanLII 102 (ON SC)).

(2) When a guarantor is called on to pay under the guarantee, the guarantor will generally have a right to claim back against the principal obligant (*Nicholas v. Ridley*, [1904] 1 Ch. 192 (C.A.)).

(3) If one of a number of joint guarantors is called on to satisfy the joint guarantee obligation, that guarantor has an implied right of contribution over other joint guarantors for their share of the payment (*Manu v. Shasha*, 1983 CanLII 1733 (ON CA)). This has been codified in s. 53(2) and (3) of the *Law and Equity Act*.

(4) If one of a number of joint guarantors has been released from his obligations by the creditor, another guarantor may also be discharged wholly or partially (*Tropic Holdings Ltd. v. Mah*, 2000 BCSC 152; *Toronto-Dominion Bank v. Higgott*, 1984 CanLII 2081 (ON SC); *Drucker, Inc. v. Gui*, 2009 BCSC 542). This is the reason a "covenant not to sue" is used instead of a release in these circumstances.

(5) Where the contract between the creditor and the debtor has been materially altered without the knowledge or consent of the guarantor, the guarantor may be discharged from his obligations under the contract (*Holland-Canada Mortgage Co. Ltd. v. Hutchings*, 1936 CanLII 20 (SCC)). This can include the failure of the creditor to disclose certain material information to the principal debtor or guarantor (*Bank of Montreal v. Collum*, 2004 BCCA 358, leave to appeal refused [2004] S.C.C.A. No. 412 (QL)). Where, on the other hand, the language of the guarantee specifically permits the creditor to unilaterally increase the risk to the guarantor, for example, by increasing the amount of the indebtedness or by changing the credit terms, then the creditor may do so without jeopardizing the enforceability of the

guarantee (*Gough Electric, Division of Guillevin International Inc. v. Labyrinth Lumber Ltd.*, 2001 BCSC 535; *Canadian Imperial Bank of Commerce v. Shire*, 2000 BCCA 528).

Actions based on guarantees are discussed in chapter 10 (Guarantees and Indemnities).

b. Term vs. Demand Loan [§1.11]

Monies advanced by a financial institution are often repayable "upon demand". What this means is that monies are repayable at the discretion of the lender. This is to be contrasted with a term loan. This type of loan is not repayable at the sole discretion of the lender. There must be default under the terms of the loan before the lender can require repayment of the full loan amount; this is known as "accelerating the balance". The most common example of a term loan is the normal residential first mortgage loan.

c. Joint Obligation [§1.12]

When two or more persons are liable for the same debt, this is known as a joint obligation. If an obligation is "joint and several" it means that each of the joint obligants is also liable individually for the full amount of the debt.

If the obligation is merely joint, all of the joint obligants do not have to be joined in an action on the obligation. It is sufficient if *any* of the obligants is served in order to obtain a court order and execution can proceed against the obligant served even if the other obligants may not have been served or sued or may not be within the jurisdiction of the court (*Law and Equity Act*, s. 53(1)).

Obtaining an order against any one person who was jointly liable does not release the other joint obligants who have been sued in the action, whether they were served or not. The joint obligant against whom the order was obtained and who satisfies the order, is entitled to demand and recover contribution from the other joint obligants (*Law and Equity Act*, s. 53(2) and (3)).

For an expanded discussion of joint obligations, see "Joint/Joint and Several Debtors—Special Considerations" in chapter 2.

d. Promissory Notes and Cheques [§1.13]

Section 176(1) of the *Bills of Exchange Act*, R.S.C. 1985, c. B-4, defines a promissory note as:

> … an unconditional promise in writing made by one person to another person, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer.

Section 179(2) provides that where a promissory note bears the words "I promise to pay" and is signed by two or more persons, it is deemed to be their joint and several note. If a debt is evidenced by a promissory note, a separate cause of action exists based on the instrument itself. Therefore, pleadings should claim both in debt and based on the instrument.

Under the *Limitation Act*, S.B.C. 2012, c. 13, which came into force on June 1, 2013, the limitation period for a demand promissory note is two years from the first day after the debtor fails to pay after a demand for payment has been made (ss. 6 and 14). A term promissory note is subject to a two-year limitation running from the date on which the note comes due (ss. 6 and 8). Some notes have a "delayed demand" feature, in which case a demand on the note after an event may be a prerequisite to bringing a claim (*Zeitler v. Zeitler Estate*, 2008 BCSC 775). For promissory notes in which the default occurred before June 1, 2013, the transition rules will apply (s. 30 of the new *Limitation Act*). In such cases, earlier decisions on the enforcement of promissory notes, in particular demand notes, should be considered.

e. Secured or Unsecured Debt [§1.14]

After the lawyer has analyzed the nature of the debt, it is important to consider whether the creditor holds security for the obligation. In most instances, it is fairly easy to ascertain whether security is held. For example, a real property mortgage securing an advance used to purchase the property is usually easy to identify. However, often the security document provides that all advances are secured and what may be ostensibly an unsecured loan is actually secured because of the broad wording in the security document. An example of the type of wording often used is "all obligations, debts and liabilities, present or future, direct or indirect, absolute or contingent, matured or not, extended or reviewed, whether incurred alone or with another or others".

On the other hand, what appears to be secured because of broad security document language may be unsecured because of other documentation. For example, the terms of a commitment letter where certain loan segments are expressed to be secured by certain security may fetter the general language in the security document. It is important for the lawyer to carefully analyze all the documentation before definitively advising the client regarding the coverage of its security.

The following are some of the primary types of security:

(1) *Real property mortgage.* A charge against real property.

(2) *Security agreement.* An agreement between a secured party and a debtor which gives rise to a security interest in specific personal property.

(3) *General security agreement.* An agreement between a secured party and a debtor which gives rise to a security interest in all of the debtor's present and after acquired personal property.

(4) *Section 427 Bank Act security.* An assignment to a bank of certain assets pursuant to s. 427 of the *Bank Act*, S.C. 1991, c. 46.

(5) *General assignment of book debts.* An assignment to a creditor of all of the debts owing to the debtor from third parties.

(6) *Floating charge.* A type of security that is frequently found within a general security agreement. It is a present security charge that hovers over all the assets expressed to be included in it. The assets are charged in such a way that the borrower can deal with them without the concurrence of the secured creditor. A floating charge attaches to the assets when it "crystallizes," which usually happens when a receiver is appointed. Floating charges are generally only used to capture real property that is not specifically mortgaged.

For detailed information about remedies under the *Personal Property Security Act*, R.S.B.C. 1996, c. 359 (the "*PPSA*"), see the *British Columbia Personal Property Security Act Practice Manual* (CLEBC, 1995–), particularly chapter 22 (Enforcement of Security Interests—Steps and Practice).

F. REALIZABLE ASSETS OF THE DEBTOR [§1.15]

As part of the initial discussions with the client, the lawyer should canvass with the client the most significant and practical difficulty