How can you get paid when your client goes bankrupt?

By Brett Harrison

W hat happens when a solicitor lets a client postpay postage for services because it’s hard times? Must the solicitor stand in line with other unsecured creditors while the client slips into insolvency?

Fortunately, the answer is no, but it is a qualified no. Although solicitors can recover payment, recovery is limited to the extent that the solicitor knew about the pre-existing right to charge the client.

At common law (which most jurisdictions have codified), solicitors have the right to a charging lien for the “fruits of litigation,” including the assets or stream of income the solicitor was instrumental in creating or preserving. Recognized and enforced through the court’s equitable jurisdiction, this right allows solicitors to advance to exercise their discretion and direct whether the property stand as security for the solicitor’s lien.

Courts do not create the charging lien; the lien is an inchoate right created by the solicitor’s actions and crystallized by the court’s order. The lien attaches to the property or fund the moment the property or fund is created, rather than when the court acknowledges it.

But, this inchoate right is not absolute. A charging lien cannot be applied to funds subject to a trust in a third party’s favour. Consequently, a deemed or constructive trust that the solicitor’s efforts brought about on a client’s behalf are not subject to a charging lien.

Moreover, courts only exercise the discretion to recognize the lien when to do so would be just and proper. In Foley v. Donald (1996), 53 O.A.C.114, the Ontario Court of Appeal dismissed a motion for a charging lien because the fund the solicitors sought to charge consisted of court-ordered child and spousal support, the solicitors could recover the fees from other parties, and the individual whose funds the solicitors hoped to charge had in no way benefited from the litigation.

When a court is persuaded to recognize the lien, the court may also grant the solicitor priority over secured creditors’ claims, even where the secured interest arose before the solicitor rendered services, and the solicitor knew about the pre-existing security interest.

The bottom line is that when a solicitor’s efforts create or preserve a bankrupt client’s property, the solicitor may enliven the court’s assistance in granting a charging order over the bankrupt’s assets related to the services rendered. The solicitor should appear before the bankruptcy court, not the ordinary civil court, to seek relief against the bankrupt’s property.

Even if a solicitor does not fulfill the requirements for a charging lien, the nature of the property can affect whether a solicitor’s claim is dischargeable. In Lang v. Scoxott (1988), 68 C.B.R. (N.S.) 201 (Ont. Bkty. Ct.; C.A.), the court held that cost orders granted in alimony proceedings receive the same protection as alimony and are not discharged in bankruptcy. This reasoning could apply equally to cost orders seen SOLICITOR’S LIEN p.16

Take Eaton’s. When it filed for court protection under the CCRA in February 1997, its recent year-end statements reported losses of $170 million. Every store needed upgrading, and a full third of the stores were losing money. Yet in its initial restructuring under the CCAA, Eaton’s was able to pay all its creditors in full, plus large professional fees.

Unfortunately, the doctor arrived too late. There was almost enough value left in the organization to restructure it. But the malaise at both store and management levels was too far advanced. Even with a second refinancing of $175 million, the new management could not return the company to profitability.

In 1987, a research study about distress failure and the turnaround process was undertaken at the University of North Carolina at Chapel Hill. This led to the establishment in 1988 of the Turnaround Management Association (TMA), in which professionals in various fields — lawyers, accountants, lenders, liquidators, auctioneers — could share their knowledge about helping floundering businesses, and make contacts outside their own fields to whom they could refer clients. (See Names in the News, p.4.)

Steven Weisz, President of TMA’s Toronto chapter and a partner in the Restructuring & Insolvency Group at Blake, Cassels & Graydon LLP, puts TMA in its proper context for The Lawyers Weekly by calling it “a manifestation of what is happening in insolvency law generally.” He says, “The Canadian legal system has been very creative in the past 10 years or more to save businesses and their many stakeholders.” Weisz illustrates with examples of an interim receiver filing for a restructuring on behalf of the company or obtaining an order permitting refinancing of an insolvent company. These are done through the courts, because “we don’t have that concept in any statute, even the CCAA. The courts have developed techniques in case law to allow that kind of refinancing.”

In large part, he credits our judges with the success of the restructuring phenomenon. Calling turnaround a “gradual evolution,” Weisz says “it has really gained speed, in large part through the development of the
Retaining lien may be of little value

By Stanley Kershman

SOLICITOR’S LIEN

The few exceptions include a client’s will, original court records and a corporate client’s books, records and articles of incorporation, unless the solicitor’s office is the corporate registered office.

A retaining lien has little value if the client is insolvent; the lien is passive and provides the solicitor with no special rights in a bankruptcy.

Solici tors may also claim a retaining lien over documents in their possession, and the solicitor must deliver these documents to the trustee in bankruptcy. The solicitor is entitled to reimbursement of fees and disbursements. A retaining lien may be of little value in insolvency, the best result being a discharge and ownership of the documents. The documents would likely be of little use to enforce payment of fees.

Under the Bankruptcy and Insolvency Act, solicitors may retain files to determine whether they contain documents subject to a solicitor’s lien. The solicitor’s lien must be returned to the solicitor once administration of the estate is complete. However, by that time the documents would likely be of little use to enforce payment of fees.

Because the solicitor’s right to a retaining lien is only as great as the client’s right, the lien is also not effective against third parties with a right to seize the client’s property, including receivers.

Although Rule 68(4) does not give priority to receivers or trustees under proposals, courts have held that the right to obtain books and documents in the solicitor’s possession should be granted to these individuals for only a limited time, and the solicitor’s lien should be maintained.

Although solicitors are creditors in a bankruptcy, the solicitor’s lien is not effective against third parties with a right to seize the client’s property, including receivers. The few exceptions include a client’s will, original court records and a corporate client’s books, records and articles of incorporation, unless the solicitor’s office is the corporate registered office.

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