The Debtor–Creditor Relationship

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Learning Outcomes

After reading this chapter, you will be able to:

- identify when a debtor–creditor relationship exists;
- identify what category a particular creditor falls into;
- evaluate, compare, and use different methods of debt collection;
- identify the nature of a collection file and plan the likely course of the dispute.

Relevant Legislation and Case Law

Bankruptcy and Insolvency Act, RSC 1985, c B-3
Civil Enforcement Act, RSA 2000, c C-15
Collection and Debt Repayment Practices Regulation, Alta Reg 194/1999
Consumer Protection Act, RSA 2000, c C-26.3
Land Titles Act, RSA 2000, c L-4
Law of Property Act, RSA 2000, c L-7
Maintenance Enforcement Act, RSA 2000, c M-1
Personal Property Security Act, RSA 2000, c P-7
R v Ens, [1980] 1 WWR 639
Re Laurance (1923), 55 OLR 196
Robinson v Robinson, 2006 BCSC 663
Royal Bank of Canada v Slack, [1958] OR 262
Weig v Weig, 2012 ONSC 7262
Workers' Compensation Act, RSA 2000, c W-15
Yim v Rogers Communications Partnership, 2016 ONSC 2105

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Introduction

There are creditors and debtors all around us. And it's not that these are exclusive groups, one pitted against another. It is quite common for a person or a business to be *both* a **creditor** *and* a **debtor**. Extending credit and borrowing money are an essential part of business in a market economy. Consider the following functions of credit in a society:

creditor
A party to whom another is legally obligated to pay money, such as a lender under a loan agreement or a vendor of goods and services who agrees to accept payment after delivery or performance

debtor
A party who is legally obligated to pay money to another

- It enables the purchase of significant assets, such as a house or production machinery.
- It enables the creation of and investment in businesses that provide jobs and valuable products or services.
- It enables individuals to obtain advanced education.
- It enables the government to expand its services and programs to boost the economy in a recession.

We need to be able to invest, loan, and borrow money. But for this to work, we need to protect the interests of those who risk their money on the initiatives of others. This is the role of debtor–creditor and collections law. It creates rights and obligations for both creditors and debtors; it protects debtors from exploitation and ensures creditors are willing to continue to loan to and invest in those who can make their money grow.

In this chapter, we begin by exploring how to identify a debtor–creditor relationship and how this relationship works. We consider whether every debtor–creditor relationship is equal and identify the different types of creditors—a classification that, as we will later learn, is important for determining rights and priorities. With this classification, we take an overview of different methods creditors can use to collect money owing to them, and introduce the important role that you, a provider of legal services, can play. We then look at how to classify debtors to help plan the likely course of a collections file.

In this chapter, we also introduce a hypothetical company, Magpie Custom Design Inc, which we will follow through different scenarios throughout the book. These scenarios will illustrate the principles discussed in each chapter.

The Nature of the Debtor–Creditor Relationship

Definitions are important in law. They provide a guide for assessing, and even proving, a fact. If you want to prove negligence, start with its definition: one person owed a duty to take care not to harm another, breached that duty, and thereby caused the other person harm. If evidence establishes each part, or factor, of that definition, then there was negligence. The same is true of relationships. If you want to identify a debtor–creditor relationship, you need to know how to define it.

Definitions are also a starting point for understanding something. Ask yourself: Why is that part of the definition? For example, the definition of a legally enforceable contract requires there be consensus, consideration, capacity, legality, and intent. Why does a contract require consideration? This question can lead us into exceptions, where we have a contract even without consideration, and then to understanding distinctions between contracts, promises, threats, and negotiations.

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Defining a debtor–creditor relationship will help us identify when it exists, and it will help us understand it. Identifying this relationship enables us to know which law and procedures to use to help our clients; understanding it helps us plan how to use that law as a tool to effectively advocate for our clients. To this end, let's see what the courts have to say.

The Ontario Court of Appeal defined a debtor–creditor relationship as follows:[1]

> The relation of debtor and creditor arises whenever one person, by contract or law, is liable and bound to pay another an amount of money.

This definition can be broken down into three requirements, or factors, for a debtor–creditor relationship to exist:

1. A person
2. is **liable** and bound to pay another person an amount of money
3. by contract or law.

liable
A party is liable to another party if it has an obligation to compensate or pay money to the other party

As we would expect, this relationship requires two people. These two people are related by the obligation one has to pay money to the other. Finally, this obligation must arise either by contract or law. Let's look at these factors more closely.

In law, a "person" doesn't only mean an individual human being. It also includes legally recognized organizations, such as corporations, universities, and governments. Each of these entities is a person, and each can be a creditor or a debtor (or both).

The meaning of "liable" depends on the circumstances. In a debtor–creditor relationship, a person is liable to pay money if that person has an obligation to pay that money, even if there is no present right to enforce it.[2] In this factor, we are not concerned with enforceability. We simply need a liability or obligation on the part of one person, the debtor, to pay money to another person, the creditor. This obligation and corresponding right or expectation create the relationship between the pair. A creditor always has a corresponding debtor, just as a debtor always has a creditor. The key to this relationship is the *obligation* to pay money. This means it's not enough that one person *might* have to pay money to another. If the obligation to pay is contingent on some future event, there is no debtor–creditor relationship unless and until the future event occurs.

The courts don't enforce every obligation. For the debtor–creditor relationship to have legal significance, the obligation and right must arise by either contract or law. It's not enough for one person to extort payment out of another by threat of force—that's a schoolyard bully at best. For the liability to qualify as a debtor–creditor relationship *in law*, the obligation to pay money must arise either by a legally enforceable contract, such as a debt agreement, an agreement to pay money in exchange for goods or services, or a **negotiable instrument**; or by law, such as a statute requiring payment of taxes or a court judgment ordering a **defendant** to pay damages to a **plaintiff**.

negotiable instrument
A contract, such as a cheque, in which the maker promises to pay a specified sum of money, that can be transferred to another party by delivering (and sometimes endorsing) the document to that other party

defendant
The party in a civil lawsuit alleged to have committed a wrong against another party; the party against whom a remedy is sought

plaintiff
The complainant in a civil lawsuit; the party seeking a remedy from the court for alleged wrongdoing by another party

Thus, a person buying a car using money borrowed from the bank is in a debtor–creditor relationship. That person, the debtor, is liable and bound to pay money to the bank by virtue of the financing agreement. All three factors in the definition are satisfied.

The same is true when a business performs services on behalf of a client and issues an invoice. By performing the services as agreed, the business has triggered the client's obligation to pay for those services. Even though the creditor in this case has not

1 *Royal Bank of Canada v Slack*, [1958] OR 262.

2 See *Re Laurance* (1923), 55 OLR 196.

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loaned any money, the client is liable to pay the business money for the services received, in accordance with the agreement between them.

Here is how to assess a relationship to determine whether it engages creditor and debtor law. Ask yourself:

1. Is one person obligated to pay money to the other person?
2. Is that obligation required by contract or by law?

We can see, then, that it's important to escape the fallacy that creditors and debtors have only to do with loaning and borrowing money. The definition of the relationship does not require a loan; it requires an obligation by contract or by law of one party to pay money to another. Whether that obligation arises because of a loan, services, or a court judgment to pay damages, it creates a debtor–creditor relationship. The parties in any such legally recognized debtor–creditor relationship are entitled to all the rights, and are bound by all the obligations, in debtor–creditor law.

debt
An amount of money owing by a debtor to a creditor

SCENARIO 1.1

After graduating from an industrial design program, good friends Ashley Parker and Tyler Rahm decided to start a new business together, designing and building custom furniture. In order to limit their personal liability, they incorporated their company, Magpie Custom Design Inc. Ashley and Tyler each have 50 percent of the shares.

Ashley and Tyler used your law firm's services for the incorporation. When your firm provided these legal services to Ashley and Tyler, your firm became a creditor and Ashley and Tyler became debtors—that is, because of the retainer agreement, Ashley and Tyler were obligated to pay your firm's legal fees.

Now that Magpie has been created, it will perform services for clients, expecting payment in return. This means Magpie will be a creditor to each of its clients, and each client will be a debtor to Magpie until the account is paid in full. If Magpie chooses to borrow money to finance its operations, Magpie will be a debtor.

Debtor–creditor relationships arise everywhere. As a business, Magpie will repeatedly engage in such relationships—usually as creditor, but sometimes as debtor. Ashley and Tyler will need to understand how debtor–creditor relationships work and can turn to your law firm for help.

- Are you in any debtor–creditor relationships? Identify the relationships in which you're a creditor, and those in which you're a debtor.
- What debtor–creditor relationships do you expect to enter into in the next five years?

CASE in POINT

ROBINSON V ROBINSON, 2006 BCSC 663

Facts

George and Judith Robinson divorced. In the course of the divorce, George agreed to assume responsibility for the mortgage on their condominium in exchange for Judith's interest in that condominium. However, for the bank to allow him to assume full responsibility for the mortgage, George needed to reduce his **debt** load by $15,000. Judith couldn't give him the money, so she asked her boyfriend, Stephen Sleigh, to help out. Sleigh gave George a cheque for $15,000 from a line of credit that Sleigh held jointly with his company. A few years later, George died without having paid anything to Sleigh.

There was no written agreement or any other written evidence of the terms under which Sleigh gave the

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money to George. Judith and Sleigh testified in court that George promised to repay the $15,000, but admitted Sleigh had never made a demand for payment. Judith's and Sleigh's testimony was the only evidence for Sleigh's claim that the $15,000 was a loan.

Issue

Is this a debtor–creditor relationship, in which George's estate is obligated to repay the $15,000?

Results

The Court determined the $15,000 was a loan that George, and subsequently his estate, was obligated to repay. There was no evidence rebutting Sleigh's testimony that George promised to repay. Furthermore, the circumstances indicate that there was no reason for Sleigh to provide George with $15,000 other than as a loan to enable him to assume the mortgage.

Practice Lesson

Written documentation is always the best evidence of a debtor–creditor relationship. Without it, the court must rely on the circumstances of the arrangement and the behaviour of the parties. This can make it difficult to determine what the parties intended. Absent a special relationship between the parties, the court usually presumes any advance of money is intended as a loan.

Types of Creditors

We proposed above that definitions are the starting point for questions. Some questions we can ask from the definition of a debtor–creditor relationship are: Is the relationship status affected by how the obligation to pay arises? Does a creditor have different rights depending on whether the obligation is owed by contract or by law? Can contracts confer different rights on different creditors?

Every debtor–creditor relationship must have the obligation for the debtor to pay money to the creditor, but not every debtor–creditor relationship is the same. The nature of the relationship—the rights and obligations incorporated into that liability to pay—depends on how the obligation to pay arose. For this reason, we classify creditors based on the source of the debtor's obligation to pay and the rights the creditor has in enforcing that obligation. There are three categories of creditors:

1. unsecured creditors,
2. preferred creditors,
3. secured creditors.

We will discuss each of these types of creditors in turn and end this section with a brief explanation of how to analyze the effects of a credit transaction.

Unsecured Creditors

Unsecured creditors are identified by what is lacking in the relationship. The creditor has a right to receive money from the debtor; however, the creditor has no prior rights over the debtor's assets, such as in a security agreement, and isn't given any special status by legislation.

unsecured creditor
A creditor who only has rights to receive money from the debtor; it has no rights to the debtor's property and is given no preference by statute

The law gives every creditor a toolbox for collecting money owed by a debtor. Different types of creditors have different tools. Unsecured creditors have the most basic toolbox. Their rights are governed by the *Civil Enforcement Act*[3] (CEA). This means

3 RSA 2000, c C-15.

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unsecured creditors must have a court judgment before they can use legal procedures to compel payment from a debtor. They are paid last in any collection proceedings. As a result, any proceeds from using the tools in the CEA must be used to pay secured and preferred creditors first. Finally, each unsecured creditor an equal right with every other unsecured creditor. As we will see, this means they share in any proceeds.

Preferred Creditors

preferred creditor
A creditor whom statute gives preference to, either with priority to payments from collection proceedings or with rights or interests in the debtor's property

Preferred creditors have a larger toolbox. They are creditors whom statutes give preference to for payment in collection proceedings against a debtor or when a debtor becomes bankrupt. Because of this statutory preference, they get paid before any of the unsecured creditors. Some preferred creditors, like landlords, also have collection procedures not available to unsecured creditors.

For example, from the *Workers' Compensation Act*[4] (WCA):

> 129(1) Notwithstanding anything in any other Act, any amount due to the [Workers' Compensation] Board by an employer … creates a fixed, specific and continuing charge in favour of the Board as provided in subsection (2). …
>
> (3) Subject to subsection (4) and section 131, the charge created by this section is *payable in priority* over all writs, judgments, debts, liens, charges, security interests as defined in the *Personal Property Security Act*, rights of distress, assignments including assignments of book debts and other claims or encumbrances of whatever kind of any person.

This legislation gives the Workers' Compensation Board preference over every other creditor, whether unsecured or secured, in collection proceedings against an employer who owes money to the Board under the WCA. No one else gets paid until the Workers' Compensation Board gets paid.

Not every preferred creditor is equal, and not every preferred creditor will have priority over every other creditor. Different legislation gives different creditors different preferences. For example, section 136 of the *Bankruptcy and Insolvency Act*[5] (BIA) gives priority to any wages and salaries owing by a bankrupt over any other creditor, including secured creditors; but secured creditors have priority over municipal taxes, which have priority over unsecured creditors. It is therefore important to check the relevant legislation to determine what degree of preference a preferred creditor is given.

Other examples of preferred creditors include:

- maintenance orders—*Maintenance Enforcement Act*,[6] section 20;
- landlords—CEA, section 104; BIA, section 136(f);
- employment insurance—BIA, section 136(h).

secured creditor
A creditor to whom the debtor has granted a security interest in the debtor's property to secure the debtor's payment of the money owed

Secured Creditors

Secured creditors have an arrangement with the debtor through which specified assets owned by the debtor are used as security for the debtor's obligation. This gives secured creditors more tools than unsecured creditors, but those additional tools are

4 RSA 2000, c W-15 (emphasis added).

5 RSC 1985, c B-3.

6 RSA 2000, c M-1.

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restricted to the specified assets. Secured creditors have priority over all other creditors (except some preferred creditors) for proceeds from the specified assets. They also have additional collection procedures prior to any judgment that make use of those specified assets. For any assets not used as security for the debt, the secured creditor is no better off than an unsecured creditor.

The secured creditor's priority, or **security interest**, is by virtue of the secured creditor's contract with the debtor. If the asset is **real property**, the secured creditor's rights are governed by the *Land Titles Act*[7] and the *Law of Property Act*.[8] If the asset is **personal property**, the secured creditor's rights are governed by the *Personal Property Security Act*.[9]

For example, a mortgage gives the creditor a security interest in the debtor's land. If that land is sold for payment of debts, the secured creditor gets paid from the proceeds before other creditors (except certain preferred creditors). If the debtor's car is sold, however, the creditor's status is as an unsecured creditor—that is, the creditor's contract with the debtor doesn't grant a security interest in the car.

A **purchase money security interest (PMSI)** is a special type of security interest. It arises when a person borrows money explicitly for purchasing specific personal property. As we will see in Chapter 7, secured creditors with a PMSI have some special tools that other secured creditors don't have.

security interest
The right given in a secured credit agreement by a debtor to a creditor allowing the creditor to seize and sell the debtor's assets if the debtor doesn't pay as promised

real property
Land and property that is attached to land

personal property
Any property other than real property; it is distinguished by the characteristic that it can be moved

purchase money security interest (PMSI)
A special security interest given by a debtor to a creditor when the debtor buys personal property and the creditor agrees to finance either part or all of the purchase price

SCENARIO 1.2

Ashley and Tyler quickly realized they would need a means of delivering the furniture they manufacture to their clients. They decided a flatbed truck would provide the most flexibility for transporting large items without being too extravagant. Having just graduated from school, however, neither Ashley nor Tyler had the money to pay for such a vehicle. Therefore, they had Magpie borrow money from First Bank of Alberta (FBA) to finance the purchase.

The finance agreement designates the flatbed truck as security for the loan. This means FBA is a secured creditor. It has priority over any other creditor in using proceeds from selling the truck to satisfy Magpie's debts. Furthermore, because the money was borrowed specifically to purchase the truck being used as security, FBA is a PMSI creditor. As we will see in a later chapter, FBA also has additional tools it can use to realize on the truck to satisfy Magpie's debt.

Tyler used the truck to make a delivery to Magpie's first customer. After unloading the furniture, he provided the client with an invoice for $3,325, stating payment was due within 30 days. Magpie is an unsecured creditor of this client. The parties have no agreement granting Magpie a security interest in any of the debtor's property.

- Consider the creditors identified in Scenario 1.1 and identify the type of creditor for each one.
- Suppose Ashley and Tyler have student loans to repay. What type of creditor do they have for those loans?

7 RSA 2000, c L-4.

8 RSA 2000, c L-7.

9 RSA 2000, c P-7.

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Determining the Law Governing a Credit Transaction

credit agreement
A written promise to pay money owed

To determine what kind of **credit agreement** governs a debtor–creditor relationship, ask these questions in the following order (see Figure 1.1):

1. Is it a secured or unsecured transaction? In other words, is the debtor just giving a promise to pay or is that promise to pay backed up by a grant of security over the debtor's assets?

If the transaction is unsecured, the creditor's rights are governed by the CEA. Remember to check whether any statute gives the creditor preference over other creditors. If so, that statute also applies to the creditor's rights.

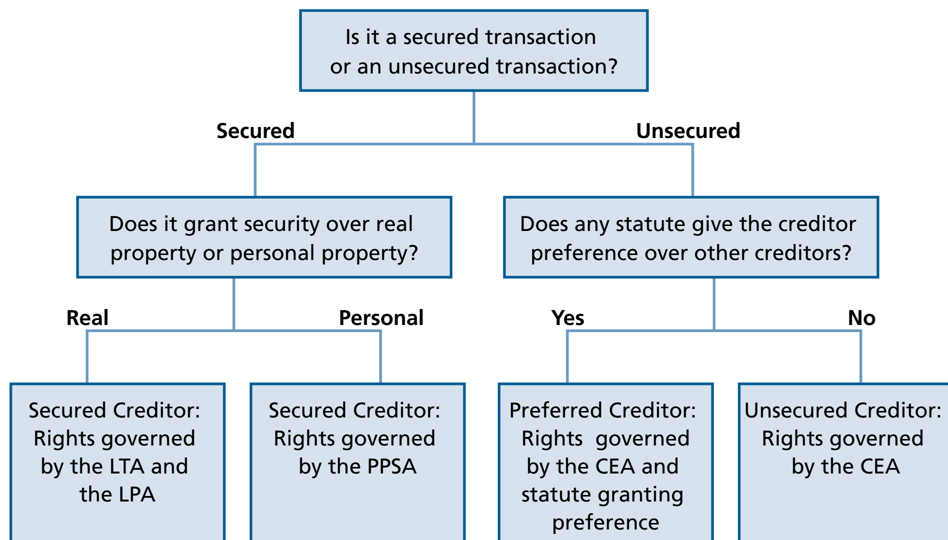
2. If it is a secured transaction, does it grant security over real property (i.e., land) or personal property?

If real property is used to secure the debt, the creditor's rights are governed by the *Land Titles Act* and the *Law of Property Act*.

3. If it's a secured transaction granting an interest in personal property, is the security instrument just a security agreement or is it a PMSI?

All security interests in personal property are governed by the *Personal Property Security Act*, but PMSIs are given special priority.

FIGURE 1.1 Credit Agreements



In collection proceedings, it will be important to recognize into which category your creditor-client fits. This way, you will know your client's priority in payment from any collection proceedings, and what tools you can use to collect on behalf of your client. Preferred creditors have priority over unsecured creditors. Secured creditors have priority over unsecured creditors, but only on the proceeds from selling the specific assets being used as security. Whether secured creditors have priority over preferred creditors on the proceeds from those assets depends on the rights granted by the relevant legislation to the preferred creditors.

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Judgment Creditors

There is one final class of creditors to recognize: judgment creditors. We treat this class separately from the others because a judgment creditor must *also* be either an unsecured creditor, preferred creditor, or secured creditor.

A judgment creditor is anyone who has a judgment from the court ordering another party, the judgment debtor, to pay money to the judgment creditor. An unsecured creditor must become a judgment creditor—that is, obtain a court judgment—before it can use the tools in the CEA to collect on the debt owed to it. A spouse granted a maintenance order by a divorce judgment is a judgment creditor with preference to unsecured creditors.

A person can become a judgment creditor even if no obligation to pay existed before the judgment. A plaintiff in a negligence lawsuit who succeeds in their claim becomes a judgment creditor. The judgment obligates the defendant to pay damages to the plaintiff. Likewise, a successful defendant in a defamation claim will likely have a judgment ordering the plaintiff to pay the defendant's legal costs, making the defendant a judgment creditor. Like other unsecured creditors with a judgment, these judgment creditors may use the CEA to enforce the court's order that the judgment debtor pay the specified sum.

How Creditors Collect on Debts

Usually, credit transactions proceed smoothly. The debtor pays as obliged, and any business relationship between the parties continues. Such situations are mutually beneficial and demonstrate the advantages of credit in a market economy.

Sometimes, however, a debtor doesn't pay money it owes to a creditor. The creditor is entitled to payment and, justifiably, wants to collect it. Such a creditor has a few options for how to proceed:

- Do-it-yourself collection.
- Use a **collection agency**.
- Get legal help.

collection agency
Section 1(b) of the *Collection and Debt Repayment Practices Regulation* gives the legal definition of a collection agency as a person or business, other than a collector or debt repayment agent, "who carries on the activities of collecting or attempting to collect a debt or debts from a debtor in Alberta under any name that differs from that of the creditor to whom the debt is or was originally owed" on behalf of another person or where that person has purchased a debt that is in arrears; it does not include the original creditor

Any debtor–creditor arrangement can end up in collections. Whether this is due to failure to pay for goods or services, default on a car loan or mortgage, or missed payments on a credit card, the creditor may employ a variety of mechanisms to enforce the debt. We'll briefly review each of the above collection strategies, as well as their advantages and risks.

Do-It-Yourself Debt Collection

Creditors will often put forward their own effort to contact a debtor and collect money. These efforts may range from sophisticated methods through the collections department of a large organization to desperate methods from a small business that needs to be paid. Unfortunately, many creditors don't know that the law puts limits on the steps they can take in their collection efforts. Creditors need to be careful in what they say or do as they pursue their own informal collection methods. If a creditor is too

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aggressive, it may expose itself to civil liability to the debtor or even to criminal charges. Risks include liability for:

- defamation,
- conversion and theft, and
- harassment.

Defamation is a tort that protects a person's reputation. If a defendant publishes words about a plaintiff that a reasonable person would consider harmful to the plaintiff's reputation, it is defamation. A debtor can sue a creditor for damages for defamation if the creditor makes untrue statements about the debtor that are communicated to third parties.

Sometimes, a creditor assumes it is entitled to simply take the debtor's assets to satisfy the debt. But the law imposes limits on when such seizures can occur and who can conduct a seizure. A creditor that helps itself to the debtor's assets may be liable to the debtor for the tort of wrongful conversion of property and may even be criminally charged for theft.

A creditor may try to harangue a debtor into compliance. However, making harassing phone calls and threatening a debtor are criminal offences. A creditor who uses such tactics may also be civilly liable under the emerging tort of harassment.

CASE *in* POINT

YIM V ROGERS COMMUNICATIONS PARTNERSHIP, 2016 ONSC 2105

Facts

Jyung Duck Yim had a contract for services from Rogers Communications Partnership (Rogers) but stopped paying his accounts. Rogers made a series of phone calls to Yim during the period of February 26, 2014 to April 28, 2014, and finally sent a collection letter. Yim found the repeated telephone calls upsetting and psychologically damaging. He presented a letter from his family doctor asserting that Yim suffered from anxiety and depression related to the telephone calls. Yim sued Rogers under the tort of intentional infliction of mental suffering.

Issue

Are repeated reminders by a creditor of an outstanding debt an intentional infliction of mental suffering?

Result

The Court dismissed Yim's claim. Intentional infliction of mental suffering requires flagrant and outrageous conduct calculated to produce harm that results in a visible and provable illness. Rogers's business necessitates the collection of overdue accounts. The calls for payment were necessary, justified, and polite. There was nothing about them that was flagrant, outrageous, or calculated to produce harm. A creditor is entitled to use reasonable methods to persuade a debtor to pay an outstanding obligation.

Practice Lesson

As creditors, your clients are within their rights to attempt to persuade their debtors to pay their obligations. However, they must ensure they use methods that are respectful and reasonable. Outrageous, coercive, or demeaning conduct may expose them to liability.

Using a Collection Agency

There are many businesses available to a creditor that will accept payment to collect debts on the creditor's behalf. When such a business collects on a debt, it remits the proceeds to the creditor less a percentage as payment, typically between 25 and 50 percent.

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There are similar businesses, sometimes called "debt buyers," that purchase overdue accounts and seek to collect on their own behalf. Typically, these are old or difficult to collect accounts. Debt buyers typically pay only around 4 percent of the face value of the accounts purchased.

Section 1(b) the *Collection and Debt Repayment Practices Regulation*[10] (Collection Regulation) defines a "collection agency" as:

> a person, other than a collector or debt repayment agent,
>
> (i) who carries on the activities of collecting or attempting to collect a debt or debts from a debtor in Alberta under any name that differs from that of the creditor to whom the debt is or was originally owed, regardless of to whom or where the payment is made,
>
> (A) on behalf of another person, or
>
> (B) where the person has purchased a debt or debts that is or are in arrears,
>
> but does not include
>
> (C) a person who is collecting or attempting to collect a debt of which the person is the original creditor or owner,
>
> (D) a business that purchases a debt or debts through acquiring or merging with a business in a transaction that includes the transfer of accounts receivable,
>
> (E) a business that acquires a debt or debts through the seizure of accounts receivable under a security agreement, or
>
> (F) a person to whom the contract that gave rise to the debt was assigned for the purpose of financing the transaction,
>
> or
>
> (ii) who carries on the activities of a debt repayment agency

In section 1(g), "debt repayment agency" is defined as:

> a collection agency that carries on the activities of offering or undertaking to act for a debtor in Alberta in arrangements or negotiations with the debtor's creditors or receiving money from a debtor for distribution to the debtor's creditors in consideration of a fee, commission or other remuneration that is payable by the debtor.

Under these definitions, both debt buyers and businesses that collect debts on commission are collection agencies for the purposes of the Collection Regulation. Perhaps more importantly, however, the definition of collection agencies does not include individuals and businesses trying to collect their own debts, lawyers acting on behalf of a client, or civil enforcement agencies. What follows applies only to collection agencies; it does not apply to these other entities.

The *Consumer Protection Act*[11] and the Collection Regulation regulate the activities of all collection agencies that operate in Alberta. The Collection Regulation prohibits a number of collection practices. Again, these prohibitions apply only to collection agencies—those collecting on a debt for which they are not the creditor to which the debt was originally owed.

10 Alta Reg 194/1999.

11 RSA 2000, c C-26.3.

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collector
The *Collection and Debt Repayment Practices Regulation* defines a collector as an individual employed or authorized by a collection agency to assist in collecting debts from a debtor

Section 12(1) of the Collection Regulation prohibits collection agencies and **collectors** from undertaking many collection practices, including:[12]

(a) making telephone calls outside of 7 a.m. to 10 p.m. in Alberta;
(b) threatening or stating an intent to proceed with any action for which the creditor has not expressly consented or for which there is no lawful authority;
(c) harassing the debtor or anyone associated with the debtor, including: (i) using threatening, profane, intimidating, or coercive language; (ii) using undue, excessive, or unreasonable pressure; (iii) using telephone or email to contact the debtor excessively;
(d) giving any false or misleading information;
(e) contacting anyone other than the debtor except to obtain the debtor's residential address, personal telephone number, or employment telephone number;
(f) contacting the debtor's employer other than to confirm employment status, business title, and business address in preparation for legal proceedings; and
(g) communicating information about the debt, including its existence, to anyone other than the debtor or creditor without express consent by the debtor.

Section 162(1) of the *Consumer Protection Act* explains that any collection agency that violates these prohibitions is guilty of an offence. The penalties can be significant:

> 164(1) Any person who is convicted of an offence under this Act or the regulations is liable to a fine of not more than
>
> (a) $300 000, or
>
> (b) 3 times the amount obtained by the defendant as a result of the offence,
>
> whichever is greater, or to imprisonment for not more than 2 years, or both.
>
> (2) Each day that an offence continues constitutes a separate offence, but the total term of imprisonment that may be imposed on a person in respect of a continuing offence may not exceed 2 years.

R V ENS, [1980] 1 WWR 639

CASE *in* POINT

Facts

The accused worked collecting on debts for a collection agency. He made six telephone calls in the course of two days with respect to collection of a debt owed by the debtor to the agency's client. Ens first called the debtor at the debtor's place of employment. Ens proposed the outstanding debt was $750, which the debtor disputed. Ens agreed to check with his client and call back. Ens called back five minutes later, claiming confirmation of the debt amount and insisting the debtor call back in less than an hour to make arrangements for payment. Ens called again at the expiration of the imposed deadline, asking why the debtor had not called. When the debtor explained he could not pay and refused to borrow money to pay, Ens referred to a previous bankruptcy by

12 See the Collection Regulation for full details of prohibited practices.

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the debtor. Ens then proposed, "If your employer finds out you could lose your job—I could go to your bank manager—I could go to the bankruptcy board—I could go to the sheriff and have your car seized." Ens was shouting in this conversation.

Ens called again 15 seconds after the debtor terminated the previous conversation. Ens stated the agency could start legal action, and that the debtor must pay the money by 2 p.m. that day or there would be legal proceedings.

Ens called at 4 p.m. that day to ask why the debtor had not paid. The debtor again explained he could not pay and expressed his view that Ens had been threatening him. By the end of the conversation, Ens was clearly agitated and shouting.

Ens called again the next morning, asserting legal proceedings would begin in two days.

Issue

Are repeated, threatening phone calls a violation of the prohibitions on tactics by collection agencies?

Result

Collection agencies need to be able to press debtors for payment, but not to the point of imposing harmful consequences. The Court explained that a collection agency "may approach a debtor, bother a debtor, inconvenience a debtor, annoy a debtor and pester a debtor, but must stop short of harassing a debtor."[13] The Court defined "harass" as "to vex, trouble or annoy, continually or chronically, as with anxieties, burdens or misfortunes."[14]

While a collection agency may impose some mental pressure on a debtor, it must stop at the point where it becomes offensive and unacceptable. In this case, Ens had the debtor in a constant state of upset over two days. He used a loud voice level, made six calls in five hours, and promoted an extreme sense of urgency. Ens's explanation of the possible consequences and legal action for nonpayment was not a friendly warning but rather a veiled threat. This was a marginal example of harassment. Ens was found guilty of an offence.

Practice Lesson

Anyone working for a collection agency must be careful in the pressure exerted on a debtor. There is an understandable desire to push for payment and to secure payment quickly, but one must never use methods and pressure that would be considered unacceptable to society.

Getting Legal Help

This book is about how legal professionals help creditors collect unpaid debts. While lawyers and law firms aren't specifically prohibited from the practices outlined in the Collection Regulation, it is good practice to abide by those prohibitions anyway. Remember, legal professionals can also be sued for defamation, harassment, and other torts.

Communications from a law firm often carry more weight than communications from a creditor. The involvement of a law firm signals that the creditor means business. Using a law firm to demand payment from a debtor is therefore often a successful tactic to secure payment.

Your law firm will also know the legal procedures for securing judicial and statutory help in compelling a debtor to pay. The following chapters will explain these procedures and how to make use of them to the benefit of a creditor-client.

13 At para 12.

14 *Ibid.*

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SCENARIO 1.3

Magpie Custom Design Inc

If Magpie Custom Design Inc has clients that don't pay their accounts when due, Ashley and Tyler will have to decide how to collect. They could do their own collections, but this will take time away from their business of designing and manufacturing furniture. A handful of unpaid accounts for a couple hundred dollars may seem like nothing compared to the next big design opportunity and are often left for another day. But overdue accounts can accumulate to dozens of delinquent clients owing, amounting to, in aggregate, thousands of dollars.

Magpie did the work and is entitled to be paid. But tracking down each individual debtor is daunting. The clients haven't paid attention to Magpie's correspondence so far; why should they in the future? Ashley and Tyler could use a collection agency. Magpie won't get the full amount owed (at best, about 75 percent of anything collected), but it will get something, and Ashley and Tyler can focus on continuing the business. The collection agency will have to follow the Collection Regulation in collecting on the overdue accounts.

If one of Magpie's clients owes a substantial amount, Magpie may do better asking your law firm to represent it in collecting the debt from that client. You will likely be able to recover a higher proportion of the debt than Magpie could by engaging a collection agency, and, unless the debtor can legitimately dispute the debt, the legal fees are reasonable. This book will teach you how to provide this kind of legal assistance.

- What information would you want from Ashley and Tyler if they came to you for help?
- What would you do to help them collect their unpaid accounts?

Classes of Debtors

If a client comes to you complaining of money owing under a contract for goods or services, a loan agreement, or a court order or judgment, you know you have a debt collection dispute. In each of these situations, your client claims the right to collect money from the debtor. In the third situation (i.e., a court order or judgment), the court has already confirmed that right.

The nature of the obligation enables you to identify whether your client is an unsecured creditor, a preferred creditor, or a secured creditor. This creditor's classification helps you determine which tools are available to you to enforce the debtor's obligation to pay. You will also want to classify the debtor. Classifying the debtor gives you insight into how you are going to use those tools.

Debtors fail to pay their obligations for a variety of reasons. Their responses to collection efforts are equally variable. Based on debtor reasons and responses, collections files can be classified into three general categories. The course the file will take will depend on which category it falls into. The three categories are:

1. The debtor cannot pay the debt and doesn't dispute it.
2. The debtor avoids payment, whether it can or cannot pay the debt.
3. The debtor has a defence to the debt and disputes it.

We'll consider each of these categories and what the collection process may look like in each.

The Debtor Does Not Dispute the Debt

Often, consumers and businesses who cannot pay their debts simply do nothing because they don't know what to do. Other times, they acknowledge the debt and

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don't bother defending against the claim. You can usually identify this type of debtor because:

- They don't avoid service of a **Statement of Claim** (Court of Queen's Bench), **Civil Claim** (Provincial Court), or other legal documents.
- They don't file a **Statement of Defence** (Court of Queen's Bench) or a **Dispute Note** (Provincial Court).
- They are at least somewhat responsive to communication.

With no Statement of Defence or Dispute Note filed, your creditor-client is entitled to **default judgment**. In summary, the usual process when representing an unsecured creditor against a debtor who doesn't dispute or avoid the claim is:

1. You send a demand letter but receive no response.
2. You file and serve a Civil Claim or Statement of Claim, but the debtor does not defend.
3. You apply for and obtain default judgment.
4. You file the judgment with the court.
5. You use mechanisms such as seizure and garnishment under the CEA to compel payment.

Most of the work for obtaining and enforcing a default judgment can be completed by a legal assistant or paralegal. You will learn more about default judgment in Chapter 4, and about collection for an unsecured creditor in Chapters 5 and 6.

If your client is a secured creditor, the most common step after sending a demand letter is to realize on the security. You will learn about enforcing security on personal property in Chapter 7, and about the foreclosure process for mortgages in Chapter 8.

Statement of Claim
The document that commences a civil lawsuit in the Court of Queen's Bench of Alberta; it sets out the plaintiff's claim and the factual basis for it

Civil Claim
The document that commences a civil lawsuit in the Provincial Court of Alberta. It sets out the plaintiff's claim and the factual basis for it

Statement of Defence
The document that a defendant files in the Court of Queen's Bench of Alberta in response to a Statement of Claim; it sets out the defendant's defence to the claim

Dispute Note
The document that a defendant files in the Provincial Court of Alberta in response to a Civil Claim; it sets out the defendant's defence to the claim

default judgment
A judgment awarded to a plaintiff if the defendant does not file and serve a Statement of Defence or a Dispute Note

The Debtor Avoids Payment

An avoidant debtor is a debtor who resorts to delay tactics to make it more difficult for the creditor to collect, to obtain a judgment, and/or to enforce a judgment. Commercial and business debtors are more likely to avoid paying their debts than consumer debtors. The tactics they use include:

(a) not responding to communication;
(b) avoiding service of the claim;
(c) asking for additional time to file a Statement of Defence or Dispute Note;
(d) filing a Statement of Defence or Dispute Note that raises invalid defences; and
(e) hiding, selling, or otherwise transferring assets.

The steps to take in acting against an avoidant debtor depend on the tactics the debtor uses. If the debtor avoids service, you can:

(a) hire a process server or even a private investigator,
(b) find information on the debtor's home and employment addresses, or
(c) apply for substitutional service.

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summary judgment
A method of obtaining judgment without trial; it is available only in the Court of Queen's Bench of Alberta; a party can apply to a master or a judge for judgment based on affidavit evidence and oral argument; the master or judge decides whether the dispute can be decided in this manner or if a full trial is required

If the debtor attempts to stall or impede judgment, you can:

(a) apply for default judgment,
(b) apply for **summary judgment**, or
(c) apply for other procedural orders.

If the debtor improperly uses its assets or attempts to prevent a secured creditor from realizing on the security, you may be able to apply to put the debtor into receivership. This process is discussed in Chapter 11.

CASE *in* POINT

WEIG V WEIG, 2012 ONSC 7262

Facts

The parties were brothers who settled a legal dispute between them by one brother (the Debtor) agreeing to pay large sums of money to the other (the Creditor). This settlement agreement was made into a court judgment.

All of the Creditor's attempts to collect the debt failed. The Debtor took steps to avoid payment, including:

(a) placing a $1.17 million mortgage on his residence and paying the proceeds of the mortgage to his corporations;
(b) causing one of his corporations to refuse to respond to a garnishee summons for enforcing the debt;
(c) giving false evidence about the value of his assets; and
(d) claiming his daughters owned real estate that he, in fact, owned.

Issue

What can be done when a debtor makes it impossible to collect on a debt?

Results

It was evident the Debtor had no intention of voluntarily paying the debt and had worked to obstruct enforcement of the judgment. He delayed finalization of the judgment until after he had secured the mortgage on his home; the games he played when questioned about his assets displayed disdain for court processes; he enlisted his wife and fellow shareholders to assist in obstructing enforcement; and he used his corporations as debt avoidance vehicles.

The Court therefore assigned all of the Debtor's assets to a receiver to manage those assets for the purpose of paying the debt.

Practice Lesson

Courts are not amused by debtors who try to avoid their obligations. They therefore provide remedies that make the debtor's situation worse than would occur by compliance. This book will help you learn what those remedies are and how to make use of them so as to enforce a debt even against the most difficult debtor.

The Debtor Has a Potentially Valid Defence

In most collection files, the fact of the debtor's liability is straightforward: money was loaned and hasn't been repaid or goods or services were provided and haven't been paid for. Any Statement of Defence is dealt with by summary judgment.

Sometimes, however, a debtor has a potentially valid defence. Such defences include:

- The goods or services the debtor purchased were defective or negligently provided.

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- The creditor breached the contract.
- The contract is unenforceable.
- The interest charged is illegal.

You and your client may not agree with the debtor's position, but if it is not frivolous, it needs to be taken seriously. You will need to convince a court that the creditor is right.

In such a situation, your creditor-client cannot collect on the debt until the debt is legally established. This requires either a settlement agreement in which the debtor acknowledges the debt or a court judgment confirming the debt and ordering payment.

Settlement agreements can be faster and cheaper to obtain, but they are just a contract. The only recourse if the debtor fails to pay is to return to court. If there is any concern that the debtor will not honour the settlement agreement, it's best to get a consent judgment. A consent judgment has the same power and authority as a judgment obtained through trial. Either type of judgment enables the creditor to use legal enforcement mechanisms, such as seizure and garnishment, to collect on the debt.

This is the most complicated class of collection files, entailing the greatest risk and greatest expense for your client. It will be important to take care to ensure the result will be worth the cost.

CHAPTER SUMMARY

The extension of credit, whether by a loan or by providing goods or services in anticipation of payment, is essential for a functioning economy. But for credit to work, the law needs to regulate the relationship. Creditors need their right to payment protected and enforced; debtors need to maintain their security and dignity and be protected from exploitation.

We began by setting out the different facets of a debtor–creditor relationship. Debtor–creditor law applies when one person, the debtor, is legally obligated to pay money to another person, the creditor. That legal obligation may be because of contract, such as in a loan agreement or contract for services, or because of law, such as a court judgment.

Different debtor–creditor relationships entail different rights and obligations and give creditors different tools. Unsecured creditors have no specific interest in the debtor's property and are not given any preference by statute. These creditors are the most common. They have the most basic tools for collection. They may attempt collection on their own or employ a collection agency. Often, legal representation will provide the most substantial collection by using legal processes to compel payment from the debtor.

Preferred creditors would be unsecured creditors except that a statute grants them preference over other creditors—sometimes even secured creditors. Preferred creditors, like landlords, may also be given extra tools for collecting the debt. Legal counsel is again helpful for ensuring preferred creditors make proper use of the tools the law provides and avoid liability for misuse.

Secured creditors have an agreement with the debtor by which the debtor grants the creditor a security interest in specific property. This gives the secured creditor special tools for using that property to satisfy the debtor's obligations. In relation to any other property, a secured creditor is in the same position as an unsecured one. As their legal counsel, you can help secured creditors ensure their security interest is enforceable and use appropriate means to realize on that interest.

Anyone engaged in debt collection needs to be careful not to infringe the debtor's rights. Statute law, such as the Collection Regulation, provides guidance on what types of behaviours to avoid. The following chapters will exhibit what can be done to legally secure payment of debt owed to your clients. How the debtor responds will determine the steps you will need to take to collect for your client.

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KEY TERMS

Civil Claim, 15
collection agency, 9
collector, 12
credit agreement, 8
creditor, 2
debt, 4
debtor, 2
default judgment, 15
defendant, 3
Dispute Note, 15
liable, 3
negotiable instrument, 3
personal property, 7
plaintiff, 3
preferred creditor, 6
purchase money security interest (PMSI), 7
real property, 7
secured creditor, 6
security interest, 7
Statement of Claim, 15
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summary judgment, 16
unsecured creditor, 5

REVIEW QUESTIONS

1. Explain how you can identify whether two parties are in a debtor–creditor relationship.
2. Explain the process for determining which class of creditor a particular creditor belongs to.
3. Identify the different types of collection cases and explain the differences between them.
4. Explain the different approaches creditors can take to collect debts and the law applicable to each.
5. Briefly discuss whether the following are lawful acts when attempting to collect a debt. Consider whether your answer differs based on who is attempting collection.
   a. Constant telephone calls between 5 a.m. and 12 a.m. to the debtor's residence and place of work to remind the debtor to pay the debt.
   b. Written threats to sue the debtor if the debtor fails to pay the debt by a given date.
   c. Telling the debtor's business associates that the debtor is a liar and a cheat.

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