

Lawsuits not over until they're over Beware Bankruptcies Rising From Dead

By Albert S. Frank, LL.B.

When plaintiffs go bankrupt, defendants rejoice.

The bankruptcy of the plaintiff usually means that any lawsuit the plaintiff owned will never proceed. Trustees in bankruptcy generally lack either the interest or the funding for pursuing litigation.

Sometimes, though, things are not so simple.

Who Owns the Lawsuit?

The *Bankruptcy and Insolvency Act* sets out in section 71 that all property of the bankrupt forthwith passes to and vests in the trustee in bankruptcy. The word "property" is defined in section 2 of the *Act* as including "things in action." A "thing in action" is a lawsuit. So when plaintiffs go bankrupt their lawsuits become the property of the bankruptcy estate, under the control of the trustee in bankruptcy.

Obviously the trustee in bankruptcy could exploit this property by pursuing

the lawsuit but, as set out above, trustees rarely do so.

Can the trustee make money for the bankruptcy estate and the creditors by selling the lawsuit?

General Prohibition Against Buying and Selling Lawsuits

Generally speaking, people are not allowed to buy and sell lawsuits. The law prohibits “maintenance” and “champerty,” which means that you cannot help finance someone else’s litigation and cannot buy a lawsuit or a share in a lawsuit.

Exception for Trustees

There is an exception, however, for bankruptcy trustees. Section 30 of the *Act* expressly authorizes them, with the permission of the inspectors, to sell or otherwise dispose of the property of the bankrupt. Trustees may sell or dispose of the property “for such price or other consideration as the inspectors may approve”. As explained above, “property” would include any lawsuits, so bankruptcy trustees may sell lawsuits.

Selling to a Stranger

Section 30 of the *Act* says the trustee may transfer the property "to any person or company". So even a stranger, who has no prior connection with the lawsuit or with the bankrupt person or company, would be able to purchase the lawsuit.

The practical problem, however, is that the new owner of the lawsuit might well need the help of the bankrupt person or company to win the lawsuit. A bankrupt who has no way to gain from a victory might well be uncooperative in providing information, preparing for trial, and so on. So a genuine stranger would rarely be interested in buying a lawsuit from the trustee.

Of course, anyone who could count on the cooperation of the bankrupt, such as family and friends, might well be motivated to pay at least something for the lawsuit.

Selling to a Creditor

Under section 38 of the *Act* a creditor may take charge of a lawsuit, but is limited to collecting the amount of the original debt plus litigation costs. The surplus, if any, belongs to the bankruptcy estate. A creditor may prefer to reduce or eliminate the estate's share, by buying the lawsuit.

In the case of *Re Rizzo & Rizzo Shoes Limited* (1998) 38 O.R. (3d) 280, the

Court of Appeal of Ontario, following earlier cases, made it plain that the trustee could sell to a creditor if authorized by the bankruptcy inspectors. On the other hand, if the inspectors chose not to accept the creditor's offer, a court would be unlikely to overrule them.

Selling to the Bankrupt

A good lawsuit could be a way for the bankrupt to get reestablished after a bankruptcy. Can the bankrupt buy back the lawsuit?

In the British Court of Appeal decision of *Ramsey v. Hartley* [1977] 2 All ER 673, a defendant argued that although a trustee can sell to "any person," this should mean any person except the person who went bankrupt. The Court of Appeal disagreed. They ruled that "any person" really means "any person," so the bankrupt could buy back the lawsuit.

I note that a bankrupt could sometimes also get the lawsuit back through another method, namely as a return of unrealized property under section 40(1) of the *Act*.

Selling to the Defendant

A defendant to a lawsuit would usually be "a person or company" and so would

also be able to buy the lawsuit from the trustee. In this way the defendant could instantly eliminate the lawsuit.

Strangely, defendants often let this opportunity pass by. Perhaps they are simply confident that once a plaintiff is bankrupt the lawsuit will never be a problem. This is unwise, given that the bankrupt, the bankrupt's creditors, or others could take ownership of the lawsuit.

For a defendant, buying the lawsuit can be a cheap form of insurance. For the bankrupt, the bankrupt's creditors, or others, buying the lawsuit can be a reasonable investment.

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The above article first appeared in the June, 2001 issue of ***The Bottom Line***.

Research has NOT been done to see if this article is still good law. Also, this is general information that might not apply to your particular situation.

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