UNIFORM LAW CONFERENCE OF CANADA

CIVIL LAW SECTION

REFORM OF FRAUDULENT CONVEYANCES AND FRAUDULENT PREFERENCES LAW (Transactions at Undervalue and Preferential Transfers)

INTRODUCTION AND PART I: TRANSACTIONS AT UNDERVALUE

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September, 2007

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INTRODUCTION

A. Purpose of Report

[1] This report is the first step in a project launched by the Uniform Law Conference of Canada to reform the Canadian law of what is generally called fraudulent conveyances and preferences.[1] Opinion is almost uniformly of the view that the implementation of modern legislation by provincial and territorial legislatures as well as by Parliament is badly needed and long overdue.[2] The case for reform was compellingly made by Professor Dunlop in his 2004 report to the Conference,[3] and will not be repeated here.

[2] The report does not offer conclusive recommendations. Rather, it is a working document designed to provide a template for reform by identifying the issues that must be addressed and the alternative approaches that might be taken to their resolution. It is anticipated that final recommendations and a draft uniform statute will be produced by a working group, the members of which will use this document as the foundation for their consultations and deliberation.

B. Terminology

[3] The question of terminology must be addressed preliminary to discussion of the subject under study, which is commonly referred to as "fraudulent conveyances and preferences." This is misleading in two respects. First, the reference is not to one but to two distinct though overlapping branches of law. Secondly, the word "fraudulent" is an anachronism, the use of which incorrectly suggests that only transactions involving maliciously intended debtor behaviour is subject to challenge. While the debtor's intention may be relevant in some circumstances, the primary consideration in cases of both kinds is the effect of the transaction in question on a debtor's creditors, rather than the intention underlying it.

[4] Further to the first point, the theme common to the distinct legal doctrines of fraudulent conveyances and fraudulent preferences is the avoidance or redress of debtor behaviour that impedes the satisfaction of creditors' legitimate claims. This accounts for the fact that both subjects may fall within the scope of a single statute. However, the problems they address are otherwise distinct.

[5] The term "fraudulent conveyance" contemplates action taken by a debtor that has the effect of hindering or defeating the right of creditors to recover on their debts by

resort to the debtor's assets. Current Canadian law is directed to a situation in which the debtor has transferred away property that would otherwise have been available to creditors through judgment enforcement measures or bankruptcy proceedings. The objectionable result is diminution of the asset pool available to satisfy unsecured (including undersecured) creditors collectively. Ordinarily, this result follows from the fact that the value received by the debtor is either nil or substantially less than the worth of the property transferred. A highly simplified example will illustrate the point. Assume that Debtor owes her creditors the cumulative sum of $100,000 but has exigible assets of only $90,000. If Debtor transfers an asset worth $10,000 to Transferee on a gratuitous basis the transfer reduces the creditors' potential recovery from 90% of what they are owed to 80%, assuming all are paid on a proportionate basis. If Transferee pays $5,000 for the asset, the creditors' recovery is theoretically reduced from 90% to 85%.

[6] A "fraudulent preference" involves a payment of money or transfer of property by a debtor to a selected creditor in circumstances such the recipient creditor will enjoy a higher rate of recovery than will other creditors not so favoured. Given that a payment or transfer in satisfaction of a debt is ordinarily given in exchange for commensurate value previously given by the creditor, the objection here is not a net reduction in the debtor's net asset base. Rather, it is that the benefiting creditor is either paid in full while other creditors go unpaid, or realizes a proportionately greater recovery. Assume, for example, that Debtor owes creditors the cumulative sum of $100,000, representing $25,000 owed to each of Creditors 1, 2, 3 and 4. Debtor's exigible assets are worth only $90,000. If each creditor received an equivalent share of debtor's assets all would recover 90% of what they are owed. However, assume that Debtor pays Creditor 1 in full, leaving $65,000 worth of assets to satisfy the claims of Creditors 2, 3 and 4. The result is that those creditors will recover only 86.7% of what they are owed, while Creditor 1 recovers 100%.[4]

[7] Even if the debtor's assets are worth less than the cumulative value of his or her debts, a payment made to one of several creditors by a debtor will ordinarily not qualify as a fraudulent conveyance as well as a fraudulent preference because the reduction in the debtor's asset pool is matched by the reduction in his or her debts.[5] However, a preference may also be a fraudulent conveyance if the selected creditor receives more than the value given to the debtor. If, in the immediately preceding case, Debtor transferred to Creditor 1 an asset worth $30,000 in payment of the $25,000 debt, the transaction could be both a fraudulent preference and a fraudulent conveyance. Nevertheless, the policy and conceptual issues associated with a fraudulent conveyance are distinct from those associated with a preference.

[8] The second terminological point requiring clarification is the use of the adjective "fraudulent" in both contexts. A transfer or payment may be subject to challenge if its effect is to reduce the collective recovery of creditors notwithstanding that the debtor was not motivated by a desire to interfere with creditors' rights.[6] For example, a transfer of property to a child for the purpose of securing the child's future may be objectionable if creditors' rights are adversely affected, notwithstanding that the transfer was not made for the purpose of defeating creditors. Similarly, a payment to a creditor may be challenged as a preference although that it was motivated by the debtor's desire to maintain the viability of his or her business through preservation of a critical commercial relationship rather than by an intention to advantage the recipient at the expense of other creditors.[7]

[9] Given that the language of fraud implies intentional harm to creditors jointly or singly as the grounds for relief, commentators have noted that it is no longer apposite as a general qualifier in this area of law.[8] Although the intention to interfere with creditors' rights may be grounds for a remedy, most of the statutory systems considered in this report offer a remedy in prescribed circumstances without reference to the debtor's intention. While the terminology is explained by the historic roots of the law responding to debt-avoiding behaviour and the normative context of the nearly seven centuries of Anglo-Canadian jurisprudence through which it has developed it will generally be avoided in this report, except in reference to the law currently employing that usage. Instead, the term "transactions at undervalue" will be applied to transactions of the first type described above; that is, those of the general type traditionally called "fraudulent conveyances." "Preferential transfer" will be substituted for "fraudulent preference." The more generic "impeachable transactions" will refer to transactions that may be challenged on either basis.

C. Approach of the Report

[10] Transactions at undervalue and preferential transfers will, for the most part, be discussed separately in this report, beginning with the former. The context for reform will be established by way of a preliminary summary of current law followed by a discussion of the policy and theoretical bases of any system of law governing transactions of the kind under consideration. Thereafter the issues to be addressed and resolved will be identified under their respective headings and alternatives to their resolution will be presented.

D. Scope of the Report

[11] This report addresses the law of the common law provinces and territories. With apologies to citizens of the territories for the lack of specificity, the word "province" and its variants as used hereafter are intended to encompass the territories as well, unless otherwise indicated. Although the policies and issues discussed have commensurate relevance in Quebec, the manner in which they are currently addressed by the CCQ and other provincial law is not considered. It is anticipated that a supplementary paper offering comment on the Quebec perspective will be prepared by another author.

[12] While this project is directed to the reform of provincial law, the relationship between provincial and federal law in this context cannot be ignored. Provisions of the Bankruptcy and Insolvency Act (hereafter the BIA)[9] addressing impeachable transactions become operative when a debtor becomes subject to that Act through the invocation of bankruptcy proceedings. The effect of these provisions and their intersection with provincial law will therefore be considered at various points throughout.

[13] The following discussion of general policy and of alternative approaches to identified issues is based primarily on Canadian commentary and proposals for reform, current Canadian law and the legislation of other jurisdictions; namely, the United States, the United Kingdom and Australia. Some of these sources are directed specifically to the problems of transactions at undervalue and preferential transfers as they are addressed by bankruptcy law. Though the invocation of bankruptcy proceedings gives rise to special considerations, these sources are relevant in the formulation of proposals for the reform of provincial law because the general issues addressed are essentially the same both within and outside of bankruptcy. Distinctive points of policy and application stemming from the difference between pre and post-bankruptcy proceedings will be noted as relevant.

PART I: TRANSACTIONS AT UNDERVALUE (FRAUDULENT CONVEYANCES)

A. Summary of Current Law

[14] The development of this branch of Anglo-Canadian law has been discussed by several authors, and need not be reiterated here. In most Canadian jurisdictions it is drawn from three sources:

1. The Statute of Fraudulent Conveyances, 1571 (hereafter, following common convention, the "Statute of Elizabeth")[10]

2. Provincial legislation

3. The Bankruptcy and Insolvency Act.

The primary features of each system of law are outlined below.

1. The Statute of Elizabeth

[15] Remarkably enough, this nearly 450 year old statute and the interpretations ascribed to it by long-dead English judges remain law in Canadian common law jurisdictions as "received" English law. Although in some provinces the statute has been replicated by legislation, its substance remains unchanged in the translation.[11]

[16] The preamble to the statute declares its purpose in prolix and emphatic terms. Essentially, it is to avoid conveyances of property intended to delay or defraud "creditors and others" of their legal entitlements. The declaration that such conveyances are void, is qualified by the proviso that the statute does not apply to any such transfer or assurance of property "upon good Consideration and *bona fide* lawfully conveyed or assured" to anyone not having at the time of the transaction notice or knowledge of the fraudulent intention accompanying it.[12]

[17] It is almost impossible to accurately summarize the law represented by the statute, as the layers of judicial interpretation deposited by generations of judges have produced a body of often ambiguous if not downright contradictory rules and principles. However, its central features may be outlined as follows:

a. Transactions Regulated by the Statute

[18] The statute avoids transfers of an interest in real or personal property.[13] The object is to prevent debtors from moving assets that would otherwise be available to satisfy creditors beyond their reach by conveying them to a third party. The statute does not address other kinds of transaction, such as a debtor's provision of services to a third party without compensation or for less than their true value, or the assumption of an obligation.

b. *Requirement of Insolvency*

[19] The statute is not limited in application to debtors who are insolvent at the time of the transfer.[14] However, the fact of insolvency may be relevant to the determination of whether the fraudulent intention providing the basis upon which a transfer may be challenged is established.

c. *Debtor's Intention*

[20] Most significantly, only transactions that are *intended* by a debtor to delay, hinder or defraud creditors are subject to challenge under the statute. The question of what sort of intention invalidates a transfer has bedeviled courts and commentators. Must the debtor have made the conveyance with the primary purpose of defeating the rights of his or her creditors, or is it sufficient that the necessary consequence of a conveyance voluntarily made is that the debtor's creditors are deprived in whole or part of their right to satisfaction?

[21] One view is that a transfer of property made while a debtor is insolvent is by definition fraudulent within the meaning of the statute, as is a transfer that renders the transferor insolvent (i.e., by reducing the value or his or her assets to less than the cumulative amount of his or her debts). A transfer of either kind necessarily hinders or defeats the right of creditors to recover their debts, since by definition the debtor does not have the means to satisfy them. The smaller the pool of the debtor's exigible assets, the less his or creditors can realize through resort to those assets. Since a person is taken to intend the necessary consequences of his or her acts, a voluntary transfer of assets in such circumstances is implicitly intended to hinder or defeat creditors. The fact that the debtor's *motive* in making the transfer might have been laudable (e.g. to provide for dependent children or for charitable purposes) does not ameliorate this intention insofar as creditors' legal rights are concerned.[15] In effect, the facts raise an irrebuttable presumption of fraudulent intent.

[22] The opposing view is that a transfer of property made by an insolvent debtor, or one that renders a debtor insolvent, raises a *rebuttable* presumption of fraudulent intent. Under this approach, the transfer can be saved if the debtor or the transferee can prove to the satisfaction of the court that the dominant purpose of the transfer was defensible, notwithstanding that it had the incidental effect of denying creditors of their right of recovery.[16]

[23] If the debtor/transferor is not insolvent at the date of the transfer, his or her intention to avoid creditors must be affirmatively proven. Affirmative evidence of intention is also required where consideration is given by the transferee, even if the transferor is insolvent at the time of the transaction.[17] Recognized categories of circumstantial evidence that will weigh towards a finding of fraud have been established by the courts.[18] The existence of one or more of these "badges of fraud" may support a rebuttable presumption of fraudulent intent.[19] However, the exercise of proving intention is notoriously difficult, particularly given that the material details are often within the exclusive knowledge of the person whose intention is in question.

d. Value Given by the Transferee

[24] Section 6 of the Statute expressly protects a transfer made by a debtor for "good Consideration," an expression that demands determination of what amount of consideration is adequate. The courts have established that value given by the transferee must be more than nominal, but need not be precisely equivalent to the value of the property transferred.[20] More problematic is the fact that consideration as a saving factor is coupled with the requirement of *bona fides*, presumably on the party of the transferee.

e. Transferee's Intention or Knowledge

[25] There is no doubt that a transfer is valid notwithstanding that the transferor may have made it with the intention of defeating creditors if the transferee (a) gave consideration reasonably equivalent in value to that of the property transferred and (b) had no knowledge, actual or constructive, of the transferor's intention. Conversely, if the transferor's fraudulent intention is established, a gratuitous transfer or one for purely nominal consideration is void, regardless of the innocence or ignorance of the transferee. However, in intermediate cases current law is lamentably obscure in terms of the relationship between the provision of consideration and the need to prove fraudulent intention, or at least knowledge of the debtor's fraud, on the part of the transferee.[21]

[26] It is reasonably clear that a transfer for consideration worth less than the value of property given by a debtor will stand if the transferee is not proven to have shared or at least known of the transferor's dishonest intention, provided the consideration is more than merely nominal.[22] However, there is room for debate on the question of whether a transfer for consideration fully equivalent to the value of the property transferred is impeachable on the basis that the transferee was aware of the transferor's intention to circumvent his or her creditors. There is authority for the view that a transfer for full consideration will stand even if the transferee knows of the debtor's fraudulent intent.[23]

In some cases, however, a transfer has been set aside on the grounds of the transferee's knowledge of the debtor's intention, notwithstanding the exchange of consideration of equivalent value.[24]

[27] In the result, the validity of a transfer where some consideration has been given by the transferee is likely to require an assessment of (a) whether the consideration was "adequate," and (b) whether and to what extent the transferee was aware of or shared the transferor's intention to avoid his or her creditors.[25]

f. Standing to Challenge a Transaction

[28] Transactions accompanied by the requisite intention may be challenged not only by those who were creditors of the person making the conveyance at the time it was made, but also by "others"; namely, by persons who subsequently become creditors and find their ability to recover affected by the unavailability of the property. Those "others" who have been found to qualify under the rather complex rules established by the judges include, most notably, (a) subsequent creditors who are allowed to piggy-back their claim on the continued existence of a debt that was extant at the time of the transaction,[26] (b) creditors who can establish that the conveyance was intended to defeat an anticipated but not yet extant debt or an unliquidated claim (e.g. a judgment debt arising from a yet-to-be litigated claim)[27] and (c) creditors whose claims arise from a speculative venture embarked upon by the debtor immediately before or after having executed the transfer under challenge.[28]

2. Provincial Legislation

[29] In some jurisdictions, the general law governing transfers for undervalue continues to reside in the Statute of Elizabeth and associated jurisprudence, supplemented in relation to a bankrupt debtor by the BIA. However, many provinces have enacted legislation designed to protect creditors from attempts by their debtors to shelter assets by transferring them away gratuitously or for less than their full value. As was indicated earlier, some statutes simply replicate the material provisions of the Statute of Elizabeth in modified form.[29] However, most offer rules that, while reflecting those of the Statute of Elizabeth, establish a number of different criteria for transaction avoidance.[30] Where this is the case, the provincial statute operates alongside the Statute of Elizabeth but does not supplant it.[31] A given transaction may therefore be challenged under either or both statutes, the result potentially differing depending on which is applied. In most cases, these provisions are included in a statute that also addresses fraudulent preferences. To complicate matters further, the case law that has developed around the Statute of

Elizabeth may be referred to in application of the provincial legislation where the issue under consideration is addressed in similar terms by both statutes, and vice versa.[32]

[30] The following summary highlights notable features of the provincial statutes, using the headings adopted in relation to the Statute of Elizabeth. However, the lack of uniformity among jurisdictions means that some of the points raised may be addressed somewhat differently in different statutes.

a. Transactions Regulated by the Statute

[31] Like the Statute of Elizabeth, the provincial statutes address alienation of property by a debtor.[33] Transactions that do not involve an interest in property therefore fall outside their scope.

b. Requirement of Insolvency

[32] Perhaps the most notable difference between the provincial statutes and the Statute of Elizabeth is the fact that the provincial statutes provide for the avoidance of transactions *only* when the transferor is "in insolvent circumstances, is unable to pay his debts in full, or knows that he is on the eve of insolvency" at the time of the impugned transaction.[34] Insolvency therefore plays a dual role under this legislation; both as a condition of the invalidity of a transaction and as grounds for a presumption of fraudulent intent on the part of the transferor.

c. Debtor's Intention

[33] As under the Statute of Elizabeth, the avoidance of a transaction under provincial legislation depends on proof that the transfer was made with malicious intent. The language defining the requisite state of mind refers to an "intent to defeat, hinder, delay or prejudice the person's creditors or any one or more of them."[35]

[34] The debate described above regarding the presumptive effect of insolvency as proof of the transferor's intention is relevant here as well as under the Statute of Elizabeth, as are other doctrines relating to proof of intention (e.g. the "badges of fraud").

d. Value Given by the Transferee

[35] Although the provincial statutes contain provisions evidently designed to overcome some of the uncertainty associated with transfers for value, their structure and

prolixity often present more than one interpretive alternative. Their general thrust is to protect transactions in which money paid or property disposed of by the debtor "bears a fair and reasonable relative value to the consideration," and payments made in the ordinary course of business. These provisions differ from the requirements of the Statute of Elizabeth as interpreted by the courts, in that only transactions in which reasonably equivalent value are given are sheltered. However, as in the Statute of Elizabeth, references to the existence of consideration are qualified by terms such as "bona fides," "good faith" and "innocent (transferee)." Hence the existence of equivalent consideration or the ordinary course nature of the transaction is a necessary but perhaps not sufficient condition for protection of a transaction that would otherwise be void on the grounds of the insolvent transferor's *male fides*.

e. Transferee's Intention or Knowledge

[36] If the transferor's intention to avoid creditors is established, the transferee's knowledge or state of mind is potentially relevant only when the transaction involves the exchange of reasonably equivalent consideration or is a sale or payment made in the ordinary course of business. However, it is not entirely clear when the transferee's knowledge of the transferor's intention will invalidate the transaction. References to *bona fides*, good faith and "innocent" transferees suggest that even a transfer for full consideration can be set aside if the transferee knows of the transferor's intention to hinder creditors. Nonetheless, some courts have concluded that similar language in the Statue of Elizabeth protects a purchaser for value who knows of the debtor's intention unless he or she is actually privy to the fraud.[36] As was observed in relation to the Statute of Elizabeth, the statutory exemption is therefore likely to require determination of both the sufficiency of consideration given and the state of mind of the transferee.

f. Standing to Challenge a Transaction

[37] The provincial legislation differs materially from the Statute of Elizabeth in the terms determining entitlement to challenge a transfer under its provisions. While the Statute of Elizabeth confers a right of action on "creditors and others" adversely affected by a transaction, the provincial statutes extend that right only to a "creditor or creditors injured, delayed or prejudiced."[37] As interpreted by the courts, this means that only persons who held a liquidated claim against the debtor at the time of the impugned transfer may seek its avoidance,[38] However, since a plaintiff may rely on either or both statutes in proceedings for avoidance of a transaction, the fact that "creditor" status is not established as at the date of transfer is rarely an obstacle to success.

3. Settlements and Reviewable Transactions under the BIA

[38] The state of the federal law dealing with transactions at undervalue is, as at the date of writing, in flux. Amendments to the pertinent provisions of the BIA were packaged with other major and minor changes to federal insolvency legislation in a 2005 statute that has lain in unproclaimed limbo since receiving royal assent shortly before the fall of the Liberal government that year.[39] The statute was recently brought back before the House and may come into force, probably with some revision, in the foreseeable future. The following therefore offers a brief survey of both the presently operative provisions of the BIA and those that would come into effect with proclamation of the currently proposed amendments.

[39] It is important to note at the outset that even when the BIA is in play by virtue of a debtor's bankruptcy, its provisions in this regard do not cover the entire field. Professors Duggan and Telfer observe that because the current BIA provisions apply only to a sub-set of transactions that diminish the value of the debtor's estate, provincial laws remain necessary to fill the gaps. Provincial law may also be invoked when the transaction under attack occurred before the onset of the pre-bankruptcy period during which the BIA provisions operate.[40]

a. Current Provisions

[40] Given the complexity and ambiguity of the principles deriving from the current legislation and its associated case law, this discussion necessarily describes them only in outline. The BIA as it presently stands distinguishes between gratuitous transfers of property and other transfers for less than full value. The former are "settlements" falling subject to s. 91, the latter "reviewable transactions," regulated by s.100.[41]

[41] A settlement is a gratuitous conveyance of property intended to be retained by the donee in identifiable form.[42] A transfer of this kind made within one year before the transferor's bankruptcy is void as against the trustee, whether or not the transferor was insolvent at the time and regardless of his or her intention. If a settlement is made within the five years prior to the transferor's bankruptcy, it is void against the trustee if the trustee can prove either that the settlor was unable to pay his or her debts without the property transferred or that the interest of the settlor in the property did not pass on the execution of the settlement. This means, in substance, that a transfer of property without consideration by an insolvent debtor who subsequently becomes bankrupt can be set aside on those grounds alone, as long as the transfer occurred within the five year period prior to bankruptcy. The second branch of the rule simply provides that a transfer that is

in reality a sham can similarly be set aside. If a settlement is made within the year prior to bankruptcy, it can be set aside even if the debtor was solvent at the time. Notably, whether or not the debtor intended to deny the property transferred to his or her creditors is irrelevant in any context. The transferee's knowledge or state of mind is similarly immaterial. The critical factors are (a) whether the transferor intended the property transferred to be retained by the transferee, (b) the time of the transfer and (c) if the transfer was made more than one year before bankruptcy, the debtor's solvency.

[42] A transfer of property for which consideration is given by the transferee can only be challenged under the BIA as a "reviewable transaction."[43] Any transaction between persons who are not at arm's length is reviewable, and related persons are deemed not to deal with each other at arm's length.[44] A reviewable transaction involving the transfer of property or services and taking place within one year prior to the bankruptcy of a party may be challenged on the ground that "the consideration given or received by the bankrupt…was conspicuously greater or less than the fair market value of the property or services." The material criteria under these provisions are (a) whether the bankrupt entered into a transaction involving the transfer of goods or services with a non-arm's length person, (b) whether the transaction occurred within one year prior to the bankruptcy and (c) whether the consideration given or received by the bankrupt was conspicuously greater or less than the fair market value of the property. It is not a condition of the remedy that the bankrupt was insolvent at the time of the transfer, nor is the bankrupt's intention or that of the opposite party material. If the court finds that the consideration given in a reviewable transaction is conspicuously incommensurate with the property or services transferred, it may give judgment to the trustee against the other party for the difference between the actual consideration given or received and the fair market value of the property or services.

b. Statute c-47 Amendments

[43] Although the present purpose is not to critique but to explain the significant features of current law, it is obvious that the current BIA regime is highly unsatisfactory. Unfortunately, the amendments proposed do not adequately remedy its deficiencies.[45]

[44] The amendments would repeal the existing settlements and reviewable transactions provisions and replace them with a new provision governing both gifts and transfers for less than equivalent consideration.[46] The threshold basis on which a transaction may be challenged is that it was a "transfer at undervalue," which is a transaction between a debtor and another person in which the consideration given by one of the parties in exchange for property or services received is conspicuously less than

their fair market value. As is currently the case with respect to reviewable transactions, the remedy provided is judgment in favour of the trustee against the party or parties to the transaction other than the debtor for the difference between the actual consideration given or received by the debtor and the fair market value of the property or services transferred.

[45] If the parties to a transfer at undervalue were at arm's length, judgment may be granted to the trustee only if (a) the transaction occurred within one year before the debtor's bankruptcy, (b) the debtor was insolvent at the time of or rendered insolvent by the transaction *and* (c) the debtor "intended to defeat the interests of creditors." If the parties to the transaction were not at arm's length, the judgment may be granted on the sole basis that the transaction occurred within a year of the debtor's bankruptcy, regardless of his or her solvency or intention. If the transaction occurred during the period between one and five years prior to bankruptcy, one of the additional conditions attaching in relation to an arm's length transaction must also be met; that is, it must be established that the debtor was insolvent at the time of or rendered insolvent by the transaction *or* that he or she intended to defeat the interests of creditors.

[46] The proposed provision retains as the basis for attacking a transaction the three general criteria currently employed in relation to reviewable transactions; namely (a) whether the bankrupt entered into a transaction involving the transfer of goods or services with a non-arm's length person, (b) whether the transaction occurred within a stipulated period of time prior to the bankruptcy and (c) whether the consideration given or received by the bankrupt was conspicuously greater or less than the fair market value of the property. However, it adds to these the further criteria of whether the debtor was insolvent at the time of or rendered insolvent by the transfer and whether the debtor intended to defeat the interests of creditors in making it, deploying the additional criteria differently depending upon the closeness of the parties' relationship.

c. Comparison with Provincial Law

[47] The existing and proposed provisions of the BIA can usefully be compared with provincial law under the headings used above:

i. Transactions Regulated by the Statute

[48] Although a "settlement" under the BIA entails a transfer of property, both the current reviewable transactions provisions and the proposed provisions regulating transfers at undervalue are applicable to a transfer of either property or services.

ii. Requirement of Insolvency

[49] Under the current law relating to settlements, the insolvency of the debtor is a relevant factor if the transfer occurred during the period between one and five years prior to bankruptcy. The debtor's solvency is not a consideration in the context of reviewable transactions. Under the proposed amendments, the debtor's insolvency must always be proven in order for a remedy to be granted in relation to an arm's length transaction, and is an alternative to *male fides* as a grounds for a judgment in relation to non-arm's length transactions occurring between one and five years prior to the debtor's bankruptcy.

iii. Debtor's Intention

[50] Whether a debtor intends to hinder or defeat his or her creditors by entering into a challenged transaction is irrelevant under the current Act. Notably, intention would become a factor under the new provisions if the opposite party is at arms' length or, if he or she is not, it took place more than a year prior to the debtor's bankruptcy. Oddly, *male fides* must always be proven in order to give rise to a remedy in relation to arm's length transactions but is an alternative to proof of the debtor's insolvency in relation to non-arm's length transactions occurring between 1 and 5 years prior to bankruptcy, while not relevant at all in relation to such transactions occurring within a year of bankruptcy.

iv. Value given by the Transferee

[51] Under both the current Act and the proposed provisions, a transfer for value can only be challenged if the value given is conspicuously incommensurate with the property or services given by the debtor. On the other hand, a gratuitous transfer of property intended to be retained by the transferee is *ipso facto* void against the trustee as a settlement under current law.

v. Transferee's Intention or Knowledge

[52] The intention of the transferee is not relevant, either under the current Act or the proposed provisions.

vi. Standing to Challenge a Transaction

[53] The BIA allows only the trustee in bankruptcy to challenge a transaction as a settlement, a reviewable transaction or, potentially, a transaction for undervalue. This is consistent with the general theory and policy of bankruptcy law, pursuant to which the

trustee acts on behalf of the unsecured creditors collectively insofar as satisfaction through resort to the bankrupt's property is concerned.

g. *Time of the Transaction*

[54] The BIA, both in its current and proposed form, departs completely from provincial law in that the time at which a challenged transaction occurs is of critical importance in the determination of whether it is void, or entitles the trustee to a judgment. This is typical of conveyances and preferences provisions of bankruptcy law generally, given that the date of bankruptcy provides a stable and arguably material reference point on which a presumption against a debtor's dealings with his or her property may be based. Time is relevant under provincial law only insofar as it affects the standing of a person seeking to challenge the transaction or brings general limitation of actions legislation into play. Under non-bankruptcy law a transaction can be challenged only by a person who was a creditor at the time of the transaction or, under the Statute of Elizabeth, who became a creditor in circumstances that have been judicially recognized as relevant.

B. Policy Considerations in the Regulation of Transactions for Undervalue

[55] Perhaps the most important dimension of any effort to reform this branch of the law is the choice and observance of clear foundational policies. Much of the uncertainty in existing law stems from the ambiguity or obscurity of its underlying principles. Even when the relevant factors are superficially clear, they often embody conflicting values unaccompanied by guidance as to which value takes precedence in a given situation.

[56] Four primary policies and one subsidiary policy that may be discerned in the various systems of law regulating transfers for undervalue are described in points (a) through (d) below. Point (e) addresses economic efficiency as an overarching factor in the development of a new system of law in this area.

1. Self-determination and Freedom of Ownership

[57] Like its antecedents and counterparts elsewhere, our legal system is premised on the view that people are entitled generally to conduct their affairs and particularly to deal with their property as they wish. Though we ordinarily think in these terms in relation to individuals, the premise by and large extends to other legal "persons," most notably corporations. We are all entitled to give our property away at will, to encumber it, dissipate it, allow it to depreciate in value or otherwise to manage or mismanage it free of

legal interference. Similarly, we are entitled to provide and acquire services or other benefits and to incur or enforce legal obligations on the terms of our choice. This policy is not and need not be articulated by statute, as it is accepted as an inherent dimension of our legal system. Nevertheless, the fact that regulatory law in this area constitutes a defined exception to the general rule must be recognized in our thinking about reform.

2. The Right to Recover Debt

[58] One of the primary limits on the freedom of action described above is the right of creditors to be paid what is owed them. Under our legal system, that right is enforceable by giving creditors access to their debtors' property to the extent necessary to satisfy their claims. Some creditors assure the repayment of debts owed them by acquiring an interest in identifiable property of their debtor. To the extent that they are able to do so they are "secured" and are therefore generally unaffected by their debtors' economic activities, other than those relating to that property. The law governing transactions at undervalue traditionally provides a remedy only to creditors who have no direct interest in their debtors' property and must therefore resort to the judgment enforcement system or to bankruptcy law to recover in the event that voluntary payment and extra-legal collection attempts fail.

[59] The judgment enforcement system enables creditors who have obtained a judgment to have exigible property of the debtor seized and sold or, if in liquid form, paid out to them. Bankruptcy proceedings vest the debtor's property in a trustee in bankruptcy, who realizes its value and distributes the proceeds to unsecured creditors. Therefore any action on the part of the debtor that reduces the value of his or her exigible asset base to less than the cumulative amount owed to unsecured creditors is in principle subject to challenge to the extent that it defeats or impedes the creditors' right of recovery. This is undoubtedly the primary policy supporting any system of law governing transactions for less than full value. Traditionally, the means of ameliorating the loss of assets that would otherwise be available to creditors is the judicial avoidance of a transaction having that effect. Though the precise form of remedy may vary, the property or its value is notionally returned to the debtor whereupon it is restored to the reach of his or her creditors.

[60] The principle that a transfer for "good consideration" is not subject to attack is consistent with the policy protecting creditors' right to resort to their debtors' assets, assuming that the consideration is property of a value reasonably equivalent to that transferred by the debtor. If the property received in exchange is exigible, the debtor's asset pool is not diminished by the transfer. However, the protection of a transaction

involving consideration in the form of something other than property must be justified on some other ground.

3. The Punishment of Socially Objectionable or "Immoral" Behaviour

[61] The preamble to the Statute of Elizabeth[47] indicates in no uncertain terms that a person who intentionally deals with his or her property in a manner intended to defeat creditors is regarded as morally reprobate. The Act is declared to be;

> For the Avolishing and Abolishing of feigned, covinous and Fraudulent [conveyances of property] devised and contrived of Malice, Fraud, Covin, Collusion or Guile, to the End, Purpose and Intent, to delay, hinder or defraud Creditors and others [of their rights] not only to the Let or Hinderance of the due Course and Execution of Law and Justice, but also to the Overthrow of all true and plan Dealing, Bargaining and Chevisance between Man and Man, without the which no Common wealth or civil Society can be maintained or continued.

[62] In addition to declaring such transactions void, the Act stipulates a forfeiture to the Crown proportionate to the property transferred and subjects the parties "being therof lawfully convicted" to a period of imprisonment. Although this portion of the Statute has fallen into disuse, the *bona fides* of the intentions of the debtor/transferor in particular remain a relevant factor under provincial law. Notably, the debtor's intention is not currently a factor under the BIA, except to the extent that the virtually automatic avoidance of non-arms' length transactions falling within a prescribed time is premised on the unstated view that such transactions are presumptively intended to avoid creditors. In light of the frequently voiced opinion that intention is notoriously difficult to prove in cases of this kind, the introduction of an intention test in the proposed transfer at undervalue provisions of Statute c-45 represents a somewhat surprising departure from current law.

[63] Perhaps the most vexing policy question that must be addressed in the formulation of new legislation is whether the debtor's intention in entering into a transaction is relevant at all. There is a strong argument for the view that a remedy should be available to creditors who are prejudiced by the transaction, regardless of whether the debtor intended that consequence.[48] This position is the subtext of the rule in *Freeman v. Pope*, discussed earlier.[49] Conversely, it can be argued that a transaction that does not in fact affect creditors should be beyond challenge, even if it was intended to obstruct them.

[64] Reliance on statutory factors relating to the debtor's state of mind will often conflict with the primary policy articulated in point (b). If transactions can only be avoided on the grounds that the transferor *intended* to prejudice his or her creditors, the right of creditors to recover from their debtors' exigible assets is compromised. Such a qualification should therefore not be imposed in the absence of a defensible policy rationale. An approach to reform that has been advanced by some would provide a remedy if a transaction has the effect of impeding creditors' rights of recovery *or* if it was intended by the debtor to do so.[50] If intention is to remain a consideration, such a system would have the advantage of avoiding the kind of direct policy conflict that in large part accounts for the ambiguous character of the case law produced by the existing legislation.

[65] A similarly problematic issue is whether the knowledge or intention of the transferee, or person dealing with the debtor, is a concern. Although both the Statute of Elizabeth and the provincial statutes raise the *bona fides* of the transferee in relation to transfers for consideration, some courts have been reluctant to recognize the transferee's intention as a relevant factor where the consideration is substantially equivalent to the value of the property transferred. The statue of mind of the person dealing with the debtor is not a factor under the BIA.

[66] If the intention of a transferee is to play a role in a reformed system it would logically operate as a secondary factor in cases in which the transaction may be challenged on the primary grounds of the debtor's intention to defeat creditors. In this context the conflict between the protection of transferees and the protection of creditors' rights could not be avoided by adopting a two-pronged test of invalidity, since state of mind would be relevant as a defence rather than as a basis for challenge. It might also be a consideration in the award of a remedy.

4. The Protection of Third Parties

[67] The competing interests in the regulation of creditor-avoiding behaviour are those of the creditors affected by a transaction and those of the person who has dealt with the debtor. The bases upon which third parties are traditionally protected are (a) the provision of value and (b) innocence of fault or knowledge of fraud. The relevance of the latter was considered immediately above.

[68] Traditionally, those who have received a debtor's property as a gift have not generally been regarded as deserving of protection, even if they are unaware that the gift was made with the primary objective of removing the property from the reach of the transferor's creditors. However, since this is true only to the extent that the property or

(in some circumstances) its traceable proceeds[51] remains in the transferee's possession, gratuitous transferees are implicitly sheltered from liability when circumstances have changed such that the property is no longer available to satisfy creditors' claims.

[69] Conversely, people who have given value for property transferred by a debtor are generally protected. The transfer is not voidable under provincial law, subject to the uncertain qualification (discussed above) that the transferee is not party to the transferor's intention to defeat his or her creditors. Transferees for full value are by definition not threatened by proceedings under the BIA.

[70] As was noted earlier, the protection of transferees who have given value in the form of property that is exigible in the hands of the debtor is consistent with policy (b). The protection of those who have given value of a kind that is not accessible to the transferor's creditors is not. However, two countervailing policies may be suggested.

[71] The first possible policy basis for protecting a transfer for value that diminishes the net worth of the debtor's exigible asset basis is an essentially ethical one. Under provincial law, the provision of value is closely linked with the issue of the transferee's *bona fides* and while the two factors are conceptually and theoretically distinct, that distinction is regularly blurred in the case law. In other words, there is an implicit if not explicit suggestion that a person who has paid for property is morally entitled to keep it without penalty on that ground alone.

[72] A more convincing policy is that in favour of the finality of transactions. Although this policy plays a greater role in relation to preferential transfers it is relevant in the present context as well. Transactional stability is an important factor in modern efficiency analyses of law and is a recognized value in private transactional law generally. However, since it operates to trump the primary policy favouring creditors' rights of recovery it should, if accepted as one of the bases of a new system, presumably be given a carefully defined scope.

5. Efficiency and Risk Avoidance

[73] The foregoing discussion offers what might be characterized as a traditional policy analysis of factors relevant to a system of law regulating transactions at undervalue. However, considerations of economic efficiency also play a role in the reform of private transactional law. Professors Duggan and Telfer suggest that this branch of law advances market efficiency by promoting the availability and minimizing the cost of credit.[52] This rationale buttresses the general policy in favour of creditor

recovery. People will more readily advance credit, and will do so on more favourable terms, if assured that the law will not permit their debtors to effectively shed debt by rendering themselves judgment-proof.

[74] This argument is premised on the enhancement of creditors' ability to assess and control the risk of granting credit. However, risk management is not a one way street. There are inherent inefficiencies in a system that impinges on the finality of transactions, particularly if the parties cannot reasonably be expected to anticipate and guard against the potential invalidity of a transaction. In such circumstances the protection of transferees has an efficiency rationale of its own. This is an increasingly weighty consideration in an economy comprised of an exorbitant number of rapidly executed transactions entered into between strangers or relative strangers.

[75] A further consideration in assessing the systemic efficiency of a system of law is what might be called legal inefficiency. Legislation that raises significant problems of proof, whether in relation to the cause of action or recognized defences, creates inefficiency of this kind. This problem is endemic to legislation that bases a cause of action or defence on proof of intention. To the extent that such a requirement makes the identification and procurement of probative evidence difficult, it both increases the expense of litigation and decreases the predictability of litigation outcomes. It is worth noting that intention is a particularly difficult standard when, as is often the case, the relevant party is a corporation or other artificial body. The development of judicial and statutory presumptions of intent is a partial response to the problem of proof of intention as it is manifested by current law.

[76] Both legal and economic inefficiency are produced by a system that is unduly complex or that employs arbitrary standards.[53] The inability of system participants to anticipate the consequences of a transaction limits their capacity to assess and respond to transactional risk, while the uncertainty of litigation outcomes promotes legal inefficiency.

[77] Efficiency does not in itself ordain an obviously right or wrong set of statutory rules. However, it is a relevant standard against which to assess alternative statutory approaches.

C. Issues for Determination

[78] The issues identified below are extracted from a review of current law and commentary. Potential approaches to their resolution are also drawn from that body of

material, taking into account legislative approaches that have been adopted in the United States, Australia and the United Kingdom, supplemented by the writer's own thinking about the subject in light of the policies discussed above. Two studies addressing reform of this area of law are considered frequently; namely, the 1988 report of the Law Reform Commission of British Columbia (the "LRCBC report")[54] and the recommendations advanced by Professor Ronald Cuming to Industry Canada in relation to modernization of the BIA.[55]

1. Transactions within the Scope of the Act

a. General Considerations

[79] We have seen that current Canadian law is addressed almost exclusively to voluntary transfers of some form of property interest by a debtor. This is the obvious starting point in determining the scope of the statute, since the primary policy of the law is to redress a diminution of the debtor's asset base that limits the ability of unsecured creditors to recover through resort to judgment enforcement measures. However, since the value of a debtor's estate may also be diminished by other kinds of transactions, all transactions that have that potential effect should logically fall within the scope of the statutory regime. For example, a debtor who agrees to provide services for less than they are worth has voluntarily reduced the value of his or her estate relative to what it would have been had he or she extracted market price. The same result flows from a contract under which a debtor overpays for the acquisition of property or services. A debtor who assumes a legal obligation, such as that arising under a guarantee or contract of indemnity, similarly reduces the pool of assets potentially available to his or her creditors.

[80] The premise that any type of transaction that reduces the cumulative value of a debtor's property should fall within the scope of the statutory regime is recognized most fully in the United Kingdom's Insolvency Act 1986.[56] The Act contains two sets of provisions addressing transactions that defeat the rights of creditors, one designated "transactions defrauding creditors" and the other "transactions at an undervalue." The former applies to all debtors and may be invoked whether or not the debtor is bankrupt or subject to insolvency proceedings.[57] The latter is divided into two subsets, one applicable to corporations that go into liquidation or become subject to insolvency administration [58]and the other to individual debtors who become bankrupt.[59] The statute provides that a "transaction" for purposes of these provisions "includes a gift, agreement or arrangement."[60] Although the essential element of this definition as incorporated in the substantive provisions is the extent of the value received by the debtor rather than the

subject of the transaction, it has been suggested that it entails some sort of "dealing" by the debtor.[61] Transactions of the kind described above would certainly qualify.

[81] The United States Uniform Fraudulent Transfers Act,[62] which applies outside bankruptcy, adopts a middle ground. It applies to a "transfer made" or "obligation incurred" by a debtor.[63] "Transfer" is defined as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of a lien or other encumbrance." "Asset" means property of a debtor excluding exempt and encumbered property, while "property" means "anything that may be the subject of ownership."[64] While the Act therefore captures transactions under which a debtor incurs an obligation, it does not extend to transactions involving the provision of services.

[82] The provisions of the Australian Bankruptcy Act 1966 apply only to transfers of property by a person who becomes a bankrupt.[65] However, the Corporations Act 2001 provisions dealing with voidable transactions extend to an "insolvent transaction," including an "uncommercial transaction."[66] The word "transaction" itself is undefined, but apparently carries a meaning similar in breadth to that attached to it under the U.K. legislation.[67]

[83] The LRCBC report would limit the application of proposed legislation to transfers of property. However, Canadian commentators have more recently noted the incongruity of exempting from regulation transactions involving the provision of services, the assumption of obligations and other forms of transaction that diminish creditors' potential ability to recover.[68]

[84] Though the flexibility of the U.K. and Australian approaches have the virtue of avoiding the definitional exclusion of transactions that fall within the mischief the legislation is intended to remedy, their very breadth requires a significant degree of judicial "in-fill" and attendant uncertainty in the determination of whether a given transaction is or is not subject to challenge. An alternative is the adoption of a definition that enumerates the types of transaction falling subject to the Act. One such list is offered by Professor Cuming in his recommendations to Industry Canada regarding the treatment of gifts and transfers at undervalue in the BIA.[69] Whichever approach is taken, it should be cast in sufficiently broad terms to capture not only direct transfers of property but other transfers of value that impinge on creditors' right to recover through resort to the debtor's assets.

b. Contingent and Unmatured Obligations

[85] Should the statute apply to transactions under which a debtor incurs a contingent obligation to transfer property, pay money or otherwise provide value, or to one that is to be performed in the future?

[86] The U.S. Uniform Fraudulent Transfers Act explicitly applies to contingent transfers of a property interest and implicitly to obligations that may or may not mature, such as those under a guarantee.[70] The U.K. Insolvency Act 1986 provisions evidently extend to such transactions as well,[71] as do the "uncommercial transaction" provisions of the Australian Corporations Act 2001. Professor Cuming's recommendations for reform of the BIA would capture transactions in which a debtor "undertakes to transfer to another person an interest in existing or later-acquired property."[72]

[87] One view is that creditors cannot be prejudiced unless and until a transaction of this kind matures, since the debtor's asset base is not affected until such time as it does. As a matter of policy, one might therefore conclude that only executed transactions and those involving unqualified obligations should be subject to the statute.

[88] On the other hand, there is little obvious reason to distinguish between a transaction that has already impeded creditors' rights of recovery and one that inevitably will do so in the future. The substantive rights of the parties should not be determined by the timing of litigation. A transaction involving an absolute but unexecuted obligation that would otherwise be subject to the statute falls within the latter category. The case is ostensibly less compelling in relation to contingent obligations because the contingency entails the possibility that the debtor's asset base will never be affected by the maturity of the obligation. However, the provision of a remedy in relation to such transactions is not without justification.

[89] The conferral of a contingent right on another person is comparable to the transfer of any other thing of commercial value. When the consideration received in exchange is worth less than the right or thing given, the giver's estate is diminished by the transaction. If the debtor has agreed to assume a contingent obligation for a significantly lower price than would ordinarily be exacted in return, creditors suffer by the diminution in the debtor's potential estate in the same way that they do if the debtor has given some other form of value for less than it is worth.

[90] Further, if the statute offers a remedial regime that includes provision for injunctive relief, the court may forestall the injury that would accompany fulfilment of the contingency by issuing an appropriate order. As will be seen later in this report, the

remedies offered by modern legislation need not be limited to simple transaction avoidance. This sort of remedial flexibility enables the law to respond to transactions that could otherwise not be addressed.

c. Exempt Property

[91] Issues of statutory scope also arise in connection with property that is exempt from judgment enforcement measures under provincial law. Should the statute apply to a transaction involving a transfer of exempt property, or one involving the conversion of non-exempt into exempt property?

[92] As we have seen, the primary test of whether a transaction is subject to challenge is its effect on the ability of unsecured creditors to recover through judgment enforcement or, potentially, insolvency proceedings. Since creditors have no right to property that is exempt from judgment enforcement measures under provincial law, transfers of exempt property have traditionally not been regarded as voidable under provincial fraudulent conveyances legislation. The assumption that creditors are not affected by the loss of property against which they have no right of recovery is reflected in the recommendations of the Law Reform Commission of British Columbia, as well as in the U.S. UFTA and the Australian Bankruptcy Act 1966,[73] all of which apply only to transactions involving non-exempt property.[74]

[93] While this is a credible view, the assumption that creditors are not affected by a conveyance of exempt assets does not always hold. For example, a debtor might give her exempt automobile away and then purchase a new vehicle with respect to which an exemption can also be claimed using funds that would otherwise be available to creditors. If neither the disposition of the exempt asset nor the conversion of non-exempt into exempt property is subject to challenge the debtor is allowed in effect to double her exemption.

[94] An alternative approach is premised on the principle that property should be unavailable to creditors only while it is held by the debtor as an asset attracting a statutory exemption.[75] Since the rationale supporting exemptions is the preservation of the basic assets required to enjoy a modest existence, a debtor who voluntarily disposes of an exempt asset may be regarded as having implicitly declared that it is not required for that purpose. In effect, the exemption has been waived insofar as the property dealt with is concerned. If that view were to prevail, a transfer of exempt property would qualify as a transaction subject to challenge under the statutory scheme.[76] Precedent for

this approach may be found in the U.K. Insolvency Act 1986 and the U.S. Bankruptcy Code[77]

[95] A related policy question is whether a debtor's conversion of non-exempt into exempt property should be subject to challenge. Generally speaking, the dominant policy expressed through exemptions legislation should govern. If assets held by a debtor are designated by statute as life essentials of which no one should be deprived, the fact that they were acquired using non-exempt property is irrelevant. However, the manipulation of exemptions law in a manner designed to defeat creditors or the protection of property in circumstances not contemplated by exemptions law may warrant redress.

[96] This is a significant issue when an asset acquired with non-exempt property has substantial exempt value. Consider, for example, a transaction under which a Saskatchewan resident invests money held in a savings account in the purchase of an R.R.S.P. Under Saskatchewan law, R.R.S.P.s are exempt, and no monetary cap is placed on the exemption.[78] In such a case, protection of the transaction may allow the debtor to defeat creditors by exploiting exemptions law.[79]

[97] An additional complexity is presented by the fact that in exceptional circumstances the transfer of a partial property interest may have the effect of converting the debtor's residual interest from non-exempt into exempt property. This result is produced where a debtor irrevocably designates a spouse, child, grandchild or parent as beneficiary under a policy of life insurance. The *Insurance Act* of Alberta is representative of that of most provinces. It provides that "the insurance money and the rights and interests of the insured in the insurance money and in the contract are exempt from writ proceedings."[80] This protection extends to annuity contracts issued by insurers by virtue of a statutory deeming provision.[81]

[98] In *Ramgotra (Trustee of) v. North American Life Assurance Co.*, the Supreme Court of Canada confirmed that the designation of a beneficiary under a contract of this kind constitutes a settlement within the meaning of the BIA, in that it entails the transfer of a future, contingent interest to the beneficiary. However, the Court concluded that while the settlement is void as against the settlor's trustee in bankruptcy, the exempt status conferred on the policy or contract by provincial law continues to operate so as to bar creditors' claims to the asset it comprises. Applied outside the context of bankruptcy, this reasoning would support the conclusion that an insurance policy or annuity contract falling within the pertinent provisions of the *Insurance Act* will remain exempt and therefore beyond the reach of creditors even if the designation of one of the prescribed

persons as beneficiary constitutes a violation of provincial law governing transactions at undervalue.

[99] The need to specifically address this issue in reformed legislation was considered by Professor Cuming in relation to the settlement provisions of the BIA. He points out that the effect of the decision in *Ramgotra* is that a debtor can transfer substantial assets to immediate family members through the use of insurance and annuity contracts,[82] and suggests that while insurance contracts that provide for dependants of a debtor might merit protection, "there is little social justification for protecting interests of a spouse, child, grandchild or parent of the bankrupt [debtor] who is not his or her dependant."[83]

[100] These problems might be addressed by shielding the disposition and acquisition of exempt assets except where the transfer is actively designed to defeat creditors. This cannot be accomplished by excluding transactions involving exempt property from the scope of the statute. It could be achieved by (a) making dealings with all property, including exempt property, subject to the Act but (b) providing that a transaction involving exempt property may be challenged only on specified grounds, those grounds presumably being that the transaction was actively intended to defeat creditors.[84] In spite of its weaknesses, an intention-based test may be appropriate in some instances even if it is not employed generally as grounds for a remedy. It would also be necessary to stipulate that a voluntary transfer of an exempt asset is not to be deemed a waiver of the exemption for purposes of the statute.

[101] The particular problem arising from the designation of a beneficiary under a contract of insurance or annuity may require special treatment. The approach recommended by Professor Cuming would bring payments made by a debtor in relation to such a contract within the scope of the legislation notwithstanding that they result in the creation of an exempt asset, except where the beneficiary designated is a dependent (as opposed to simply a relative) of the debtor.[85]

[102] Provision must also be made for maintenance claimants and others who are granted access to exempt property under provincial law. A transaction involving exempt property that may not be subject to challenge generally should not be protected where the attacking creditor is not affected by exemptions law.

d. Powers of Appointment and Disclaimers

[103] The LRCBC report considers whether proposed legislation should extend to what amounts to a refusal by the debtor to claim property to which he or she is entitled.[86] The

most obvious case affecting creditors is the debtor's disclaimer of a right to property, such as under a right of inheritance. The issue also arises where a debtor holds property under a power of appointment that may be exercised in his or her own favour. In both instances the refusal or failure to acquire the associated property affects the debtor's creditors to the extent that it would be available to satisfy their claims were the debtor to exercise his or her entitlement. The Commission notes that the debtor's actions may benefit someone who will subsequently make the property or some other advantage available to the debtor.

[104] The LRCBC report suggests that a debtor's refusal of a gratuitous benefit is qualitatively different from the concealment of assets, and notes that the settler or donor of property in cases of this kind ordinarily intends to benefit the recipient of the property directly, not his or her creditors. It concludes that a general rule with respect to powers of appointment and disclaimers would not function well, and that the conferral of a discretionary judicial remedy "would be a legislative response out of all proportion to the nature of the problem."[87] In the result, it recommends that such actions not fall subject to the statutory scheme.

[105] The legislation that has been adopted in other jurisdictions does not specifically address circumstances of this kind. It is not clear whether the disclaimer of an inheritance would constitute a "transaction" within the meaning of the U.K. Insolvency Act 1986, particularly under the suggested test that it must involve a "dealing."[88] If the interpretive exercise proceeds on the view that the goal of the legislation is fundamentally to prevent the diminution of the asset base potentially available to creditors, a disclaimer would likely qualify. This approach would be consistent with the inclusion of gifts in the definition of "transaction." However, if the intention of the testator or the perceived ethical quality of the debtor's choice is regarded as a relevant factor it may not.

[106] The Law Reform Commission's position is understandable and may well be adopted in the reform process. However, it is worth noting that property received by a debtor under an executed gift is fully available to his or her creditors under all systems. Whether there are convincing policy grounds for treating an absolute gift differently from one contingent on action by the debtor is debatable. Adherence to the primary policy said earlier to underlie this branch of law would support the inclusion of transactions of this kind within the scope of the statute. The question is whether a debtor should be permitted to deny creditors payment of their legitimate claims when he or she is in a position to satisfy them.

e. Transfers Pursuant to Court Order or by Operation of Law

[107] Traditionally, legislation dealing with transfers at an undervalue applies only to voluntary dealings by a debtor. Though the Statute of Elizabeth speaks to the avoidance of "Bonds, Suits, Judgments and Executions" as well as voluntary forms of transfer, the LRCBC report suggests that these references are "probably an anachronistic remnant of the practice and procedure formerly governing real actions," and notes that they are not the subject of modern cases.[89] Nevertheless, the report accepts the possibility of collusive proceedings or orders designed to defeat creditors as a reason for including transfers resulting from a court order or the operation of law, other than by a right of survivorship, within the scope of proposed legislation.[90]

[108] Other statutory approaches are mixed. The U.S. UFTA evidently captures transfers resulting from court orders or otherwise effected by operation of law. "Transfer" is defined to include "every mode, direct or indirect, absolute or conditional, *voluntary or involuntary*" of parting with an interest in property. On the other hand, while the breadth of the U.K. Insolvency Act 1986 has previously been noted, a transfer of this kind arguably falls outside its scope on the grounds that it is not made pursuant to a "gift, agreement or arrangement"[91] and does not, to use Professor Goode's test, involve a "dealing" by the debtor.

[109] One solution is to exclude non-voluntary transfers from the operation of the legislation entirely. A second is to include transfers arising from a court order or the operation of law, with the exception of those made under identified legislation or produced by specified rules of law. A third would be to include all such transfers, but to provide for challenge only where identified circumstances are proven. As was suggested earlier in connection with exempt property, it may be appropriate to permit such a transfer to be challenged where the debtor manipulated the legal process in order to hinder or defeat his or her creditors, even if fraudulent intention is not generally a relevant consideration.

[110] The repercussions of the inclusion of transfers arising from a judicial order within the scope of the legislation would most likely be greatest in relation to orders for maintenance and the division of family property. This subject is discussed separately below. Regardless of the general approach adopted, it may be necessary to make separate provision for orders of this kind.

f. Redemption of Shares and Declaration of Dividends by a Corporation

[111] Professor Cuming in his recommendations to Industry Canada addresses the potential implications of a share redemption or declaration of dividends in relation to the ability of a corporation's creditors to recover against its assets.[92] He asserts that a payment made to redeem shares entails a depletion of the corporation's assets without a commensurate reduction in its liabilities, since shareholders do not have monetary claims against the corporation by virtue of their share ownership alone. Accordingly, a purchase or redemption of its own shares by a corporation should fall within the scope of legislation governing transfers at undervalue.[93] Professor Cuming's recommendations would accomplish this by explicitly providing that such transactions are subject to the statute.[94]

[112] Whether or not specific reference to transactions of this kind is required will depend upon the way in which the scope of reformed legislation is defined. Arguably, a provision referring in general terms to a transfer of property or a transaction involving the transfer of value would capture a payment made to redeem shares. If equivalent value is not received by the corporation in exchange, the payment may be subject to challenge in the same manner as any other. Nevertheless, specific reference to a repurchase or redemption of shares by a corporation may be advisable for the sake of certainty.

[113] The remedies provided in relation to transactions infringing the legislation will be discussed in general terms later in this report. However, the subject merits brief comment in this context. In general, the remedies that arise from a transaction infringing legislation governing transfers at undervalue involve the recovery of property from a transferee or a monetary order against the transferee or person who has dealt with the debtor. This would be true in relation to payments made to shareholders to redeem shares; that is, the primary remedy would be recovery from the payee shareholders.

[114] However, it may also be appropriate to provide for a secondary remedy against the directors of the debtor corporation who authorized the share redemption, subject to qualifications that would protect directors who have acted in reasonable reliance on the information available to them and have not contravened relevant corporations law. Professor Cuming suggests that a remedy against directors might also be justified where a corporation pays dividends while insolvent or otherwise unable to meet the claims of its creditors, notwithstanding that the payment of a dividend would not generally meet the criteria for challenge under the legislation. Since dividend payments represent a return on the capital investment made by shareholders in the company, they are a payment for value insofar as the shareholders are concerned. In the absence of special provision there

would therefore be no basis for recourse against the recipients of a dividend notwithstanding the effect of the payment on creditors' rights of recovery.[95]

[115] The imposition of liability on directors for the payment of a dividend or redemption of shares by a corporation where creditors' rights of recovery are consequently infringed is consistent with the approach currently taken in s. 101 of the BIA. That section additionally allows the trustee in bankruptcy to seek judgment against shareholders related to the directors or the corporation.[96]

g. Family Transactions

[116] The family is often the vehicle for defeating creditors by transferring value out of the hands of the debtor and into those of a family member. The risk of such transactions is so great that some legislation presumptively invalidates transactions between family members, who are deemed not to be acting at arms' length, at least where the transaction occurs within a stipulated period of time prior to the bankruptcy of one of the parties. The relevance of the parties' relationship as a basis for challenging a transaction is discussed below. The question presently addressed is whether specific types of family transaction should or should not be protected from challenge.

i. Family Transactions Deserving of Protection

[117] Although there is an obvious potential for avoidance of creditors' claims through the transfer of property to a member of the debtor's family, in some instances intra-family transactions deserve protection.

[118] If transactions involving the provision of services are subject to challenge under the legislation, creditors would be entitled to seek a remedy where a debtor has provided services on an informal basis to a member of his or her family, unless special provision is made to the contrary. A carpenter who builds a garage for a child or an accountant who completes a spouse's income tax return will likely have engaged in a transaction that falls afoul of the statute if transactions of this kind are not sheltered. The burden of the infringement will be borne by the recipient of the benefit, since the remedy would involve an order exacting compensation from him or her. While this result may be consistent with the primary goal of the legislation it constitutes excessive interference with individual autonomy and infringes the social values associated with family relationships. Similarly, the transfer of small amounts of money or items of relatively little value to a family member should not attract the sanction of the legislation.[97]

[119] A related issue is the protection of legitimate arrangements for the provision of maintenance and the division of family property. Such transactions would be vulnerable if the basis for challenge adopted by the legislation is the equivalence of the value provided by the payee or transferee in exchange for the payment or transfer. This test is not appropriately applied to maintenance, which by definition represents the fulfilment of family responsibility rather than compensation for value received. Similarly, the division of property is generally not based strictly on a monetized assessment of the respective contribution of spouses to its acquisition. The history of modern legislation addressing this issue demonstrates that an attempt to determine property rights in the context of a spousal relationship on the basis of purely commercial values is both objectionable and futile.[98]

[120] Australia appears to have made the most comprehensive attempt among countries studied to deal with this issue legislatively. Although the Australian Bankruptcy Act 1966 addresses the problem in relation to maintenance simply by providing that transfers void against the trustee do not include a transfer to meet a liability under a maintenance agreement or order,[99] a much fuller set of provisions is found in the Family Law Act 1975. Where married partners have entered into an agreement determining how their financial resources are to be dealt with or providing for the maintenance of either of them on the breakdown of their marriage, a creditor of either of the parties may seek an order of the court setting aside the agreement.[100] The pertinent provision, with emphasis added, is as follows:

> 90K(1) A court may make an order setting aside a financial agreement or a termination agreement *if, and only if*, the court is satisfied that:
>
> (a) the agreement was obtained by fraud (including non-disclosure of a material matter); or
>
> (aa) either party to the agreement entered into the agreement:
>
> (i) for the purpose, or for purposes that included the purpose, of defrauding or defeating a creditor or creditors of the party; or
>
> (ii) with reckless disregard of the interests of a creditor or creditors of the party;
>
> . . .

[121] A different set of provisions permits a division of spousal property effected by order of the court to be challenged by creditors or by a trustee in bankruptcy who is "affected" by the order. The Act stipulates that, on application of a person affected by an order made in property settlement proceedings, the court may at its discretion vary the order, set it aside or make a new order in substitution.[101] A creditor of one of the parties qualifies as an affected person "if the creditor may not be able to recover his or her debt because the order has been made."[102] The court is entitled to exercise its discretion if it is satisfied that any of the circumstances listed are established, most materially that "there has been a miscarriage of justice by reason of fraud, duress, suppression of evidence (including failure to disclose relevant information), the giving of false evidence or any other circumstance."

[122] Neither the U.K. Insolvency Act 1986 nor the U.S. UFTA makes special provision either for the payment or maintenance or for spousal property division.[103]

[123] There is no easy solution to this problem. Voluntary arrangements between a debtor and his or her estranged spouse, whether or not embodied in a court order, may be designed to divert the debtor's assets to the spouse at the expense of creditors. The outright exemption of maintenance payments or of transfers effecting a division of family property on the breakdown of a spousal relationship facilitates the achievement of such designs. However, subjection of these transactions to a test based on the sufficiency of value provided by the benefitting party would involve extremely difficult determinations of fact and may violate important family law policies.

[124] The Australian model offers what appears to be a realistic approach to a solution. Essentially, the law makes voluntary agreements regarding maintenance and property division subject to challenge only where it can be proven that the agreement was intended to defraud creditors or was made with reckless disregard of creditors' interests. A division of property ordered by the court may also be challenged, but only in narrowly defined circumstances reflecting the presumptively thorough and balanced consideration give to the order by the court. The failure of one of the parties to bring forward evidence of creditors' claims might be regarded as a "suppression of evidence" warranting the conclusion that the order effects a miscarriage of justice.

[125] Translated into reformed legislation, this approach might be implemented by including family maintenance and division of property agreements within the general scope of the legislation, but making them subject to challenge only on the grounds of an actual intention to defeat creditors or, possibly, reckless disregard of creditors' interests.[104] A qualified version of the test might be employed in relation to payments and

transfers made by order of the court. In either case, the fact that a payment or transfer may not have involved the exchange of reasonably commensurate value would not render it vulnerable.

ii. Family Transactions Subject to Challenge

[126] Modern legislation and proposals for reform generally represent the view that there is no justification for protecting family transactions for which the consideration given by the benefitting party is a promise of marriage or natural love and affection. Although this may appear so obvious as not to require explicit provision, the inclusion of statutory language addressing the point, particularly insofar as promises of marriage are concerned, would put the matter beyond debate.[105]

2. Standing: Who may Claim a Remedy under the Statute?

[127] The determination of who should have standing to seek a remedy under the statute raises two primary questions. First, should standing be granted on the basis of a claim that is contingent or unliquidated? Secondly, must the applicant's or plaintiff's claim have existed at the date of the transaction challenged?

a. Type of Claim

[128] There is little doubt that standing should be extended to anyone who has a legal right capable of maturing into a money judgment against the debtor. The draft legislation proposed in the LRCBC Report would grant standing to a person who is:

(a) owed an obligation by the transferor which is unsecured, whether the obligation is

(i) liquidated or unliquidated;
(ii) absolute or contingent;
(iii) certain or disputed; or
(iv) payable immediately or at a future time;

(b) a secured creditor whose security is inadequate; or

(c) a guarantor of an obligation of the transferor.[106]

[129] The U.S. UFTA grants standing in similarly broad terms to a person who has a "claim," defined as "a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."[107]

b. Date Claim Accrued

[130] The more difficult question is whether the obligation or claim must have existed at the date of the challenged transaction. Currently, the law as represented by the Statute of Elizabeth permits those whose claims have arisen in recognized circumstances after the transaction in question to challenge it, though provincial legislation grants standing only to those who are a "creditor" at the time of the transaction.[108] The basis upon which those who were not creditors at the time of a transfer have been permitted by the courts to challenge it under the Statute of Elizabeth is essentially that its effect was to shelter property from claims that the debtor knew might forseeably, if not inevitably, arise in the future.

[131] The LRCBC report acknowledges that the restriction of standing to persons holding claims at the time of a challenged transfer would, for example, permit a person to impoverish himself in anticipation of the commission of a tort. However, the Commission departs from the view represented by the rule in *MacKay v. Douglas*,[109] asserting that "it is hardly blameworthy to shield assets when undertaking a new business." The report concludes by adopting the position previously advanced by the Ontario Law Reform Commission; namely, that persons should not be permitted to attack transactions which occurred before their claims against the debtor arose.[110] This approach may also be justified on the grounds of risk assessment. A person who grants credit after the transaction in question may be regarded as having accepted the risk of dealing with the debtor on the basis of his or her current financial position. The fact that a previous transaction has reduced the debtor's asset base is irrelevant.

[132] The U.S. UFTA represents a qualified version of the judicially elaborated approach taken under the Statute of Elizabeth. It provides in effect that a transfer made or obligation incurred is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if (a) it was actually intended to hinder *any* creditor or (b) if it was made for less than reasonably equivalent value in circumstances in which the debtor was embarking on a venture carrying a risk of insolvency or if the debtor intended or knew she was incurring debts beyond her ability to pay.[111] A creditor whose claim arose before the transaction in question may recover a

remedy on additional grounds not dependent upon proof of intention to defraud or the deliberate assumption of financial risk.[112]

[133] The U.K. Insolvency Act 1986 takes an even broader approach to the question of standing in relation to the provisions regulating transactions defrauding creditors, which are available both within and outside of bankruptcy.[113] If the debtor is not subject to formal insolvency proceedings, an order may be granted to "a victim of the transaction."[114] A victim of a transaction is "a person who is, or is capable of being, prejudiced by it."[115] Commentary confirms that these terms are wide enough to encompass both persons affected at the time of the transaction and those who may be affected in future by it.[116]

[134] The U.S. UFTA demonstrates the proposition that the relationship between the grounds upon which a transaction may be challenged and the definition of standing may be relevant to the approach adopted. If the basis for challenge is that the debtor entered into the transaction with the intention of defeating creditors, the time at which a person achieved that status appears immaterial.[117] On the other hand, if the transaction is challenged on the ground that it had the effect of reducing the asset pool available to creditors, a person who did not have a claim against the debtor at the time of such a transaction has no logical grounds for complaint.[118] While it would be possible to qualify standing on the basis of the grounds upon which a transaction is challenged this approach introduces a level of complexity into the legislation that in this context is likely not justified by the preservation of conceptual purity.

[135] There is no easy solution to the general policy question. On one hand, the recognition of claims arising after the challenged transaction potentially assists creditors who were in a position to assess the risk of dealing with the debtor at the expense of the finality of transactions, a value that is of some consequence in a modern economy. However, not all creditors are voluntary and some have a limited capacity to engage in meaningful risk assessment. Furthermore, the adoption of a test that would draw a bright line admitting a claim that arose the day before a transaction but excluding one that arose the day after is likely to produce arbitrary results. Finally, and perhaps most compellingly, the determination of standing on the basis of the time at which the claim arose fits poorly with the creditor sharing philosophy implemented in the common law jurisdictions by way of what is typically called creditors' relief legislation.

[136] Under provincial creditors' relief law, a judgment creditor whose has initiated judgment enforcement measures that produce a fund of money is obliged to share the fund on a roughly *pro rata* basis with other qualifying creditors.[119] Those entitled to

share include other judgment creditors who have delivered a writ of execution to the sheriff or, in some provinces, who have registered their judgment in the prescribed manner. The relative timing of claims has no bearing on creditors' right to share in the value of the realized assets. If this approach is to be maintained, a creditor who obtains a remedy under the law governing transactions at undervalue would in principle be obliged to share the fruits of the proceedings with those who, at the time the remedy is granted, have established their claim. The beneficiaries of this policy would include claimants whose claim arose after the transaction but before the outcome of the litigation challenging it.

[137] A related reason for granting standing to persons whose claims arose after the date of an impeachable transaction is the general desirability of maintaining consistency of outcomes within and outside of the debtor's bankruptcy. If a trustee in bankruptcy successfully challenges a transaction entered into before the debtor's bankruptcy the resulting funds will be distributed to those who have a provable claim at the date of bankruptcy, regardless of whether their claim arose before or after the date of the impugned transaction.

[138] Regardless of the approach adopted in relation to the time at which a claim must arise, it will be necessary to decide whether a person must have judgment on their claim in order to challenge a transaction. The LRCBC proposes that proceedings for relief may only brought by a claimant who has received judgment on the obligation owed by the debtor or "is entitled to commence proceedings to enforce the obligation,"[120] subject to the discretion of the court to order otherwise. Whether a formal qualification of this kind is desirable is an open question. Arguably, the claimant's substantive interest will be defined by the cause of action created by the statute, without the need for further qualification. This is discussed further below in relation to subject of remedies.

[139] The LRCBC report raises a specific issue of standing relating to transactions by a corporation that have a deleterious effect on a shareholder's creditors by reducing the value of his or her shares. Should the shareholder's creditors be permitted to challenge a transaction entered into by the third-party corporation? The report does not answer this question other than to note a case in which proceedings of this kind were allowed by the court.[121] Given the potentially far-reaching consequences of including a provision that would explicitly grant standing in circumstances of this kind, the problem is likely best left to the general law regarding the lifting of the corporate veil.

3. Grounds for a Remedy (Bases for Challenging Transaction)

[140] All of the current and proposed legislation in this area provides that a transaction may be challenged on the following grounds:

a. The transaction depletes the value of the asset base that would otherwise be available to creditors in circumstances such that their right of recovery is prejudiced or defeated as a result (hereafter referred to as an "asset depletion insolvency" test).

b. The transaction was motivated by the debtor's intention to hinder or defeat creditors' right of recovery (hereafter referred to as a "debtor intention" test).

[141] Some systems adopt one or the other of these as the basis for challenge, but most adopt both, either as alternatives or in combination. The key policy choice to be made in the design of new legislation is whether both are relevant and legitimate considerations. They will be addressed in turn.

a. Transactions that Deplete the Assets Available to Creditors (Asset Depletion Insolvency Test)

[142] The primary policy underlying this branch of law is the protection of creditors' right to recover debt through recourse to their debtors' assets. Pursued without qualification, this policy would dictate that any transaction that has the effect of either (a) reducing the value of a debtor's available asset base to less than the cumulative amount of creditors' claims or (b) otherwise limiting the ability of creditors to recover by resort to the debtor's assets warrants a remedy. Whether the debtor engaged in the transaction with the intention of prejudicing his or her creditors' right of recovery is irrelevant. In fact, this view is substantially implemented, with or without qualification, in many of the systems reviewed in this report.

[143] Most systems focus on the first dimension of the proposition stated above. That is, they allow creditors to challenge a transaction that has the effect of reducing the value of assets against which they can recover where the debtor's exigible asset base is worth less than the amount of his or her outstanding obligations. This approach reflects the intersection of two premises:

- The value of a debtor's assets is reduced both by a gratuitous transfer of value and by a transfer of value in exchange for consideration worth significantly less than the value transferred by the debtor,[122] and

- If the debtor is insolvent at the time of such a transaction or is rendered insolvent by it the transaction necessarily prejudices creditors' right to recover because the value of the assets available to creditors is by definition less than the cumulative amount of their claims.[123]

[144] The provisions of the U.K. Insolvency Act 1986 relating to transactions designated as "transactions at an undervalue" are based on these premises.[124] As was noted earlier, these provisions operate only in relation to a debtor who has become bankrupt or, in the case of a corporation, is subject to insolvency proceedings or is in liquidation. References hereafter to a "bankrupt" debtor are intended to include corporations subject to the Act.

[145] A remedy is provided where a person enters into a "transaction at undervalue" in prescribed circumstances. The first premise is captured by the definition of a "transaction at undervalue," which in material part comprises:

- a gift or a transaction the terms of which provide for the debtor to receive no consideration, and

- a transaction for a consideration the value of which is "significantly less than the value" of the consideration provided by the debtor.[125]

[146] The second premise is reflected in the provision that a remedy may be granted if a person has entered into a transaction at an undervalue at a time when the person was insolvent, or if the person became insolvent in consequence of the transaction. This point is qualified by three factors, which relate in part to the fact that the provisions apply only to bankrupt debtors. They are:

- Only a transaction entered into within 5 years before bankruptcy can be challenged.[126]

- If the transaction occurred less than 2 years before bankruptcy, it is not necessary to prove that the debtor was insolvent at the time or rendered insolvent by it. In effect, proximity to bankruptcy substitutes for the need to prove insolvency.[127]

- If the transaction occurred more than 2 years but less than 5 years before bankruptcy and the other party was an associate of the debtor, there is a rebuttable presumption that the debtor was insolvent at the time or rendered insolvent by it. In this instance, the relationship between the parties substitutes for the need to prove insolvency.[128]

[147] The net result of these provisions is that the depletion of the debtor's asset base is grounds for a remedy in favour of creditors acting through the trustee in bankruptcy. Insolvency is a general condition of relief, subject to the proviso that the proximity of the transaction to bankruptcy and the close relationship of the parties are recognized as substitute conditions.

[148] Notably, the intention of the debtor is not a factor in this context insofar as individuals are concerned. Although intention to defeat creditors need not be proven as grounds for an order relating to incorporated debtors, the corporation's motives are made relevant through the provision of a defence.[129] No order is to be made if the court is satisfied:

- that the company entered into the transaction in good faith and for the purpose of carrying out its business, and

- at the time of the transaction there were reasonable grounds for believing that the transaction would benefit the company.[130]

[149] Subject to that qualification, proof of intention to defeat creditors is not a requirement of a remedy under the Insolvency Act 1986, either in relation to an individual or an incorporated debtor. Intention does play a role in the provisions dealing with "transactions defrauding creditors," which provide a remedy whether or not the debtor has become bankrupt. Those provisions are discussed in the next section of this report.

[150] The factors supporting transfer avoidance under the Bankruptcy Act 1966 of Australia are essentially the same as those employed by the U.K. legislation in relation to individuals.[131] Rather than making proof of insolvency a condition of relief in relation to a transaction occurring in the period between 2 and 5 years prior to bankruptcy, the Act makes proof of solvency by the transferee a defence. The result is the same, except that the burden of proving the debtor's financial circumstances is shifted from the trustee in bankruptcy to the transferee. If the transferee is a "related entity" of the transferor, proof

of solvency may be raised as a defence only if the transaction took place more than 4 years before the debtor's bankruptcy.

[151] A very similar approach is taken in the U.S. UFTA in relation to action by a creditor whose claim arose before the transaction in question was made. A remedy is available where a debtor makes a transfer or incurs an obligation:

- If the debtor did not receive a "reasonably equivalent value in exchange for the transfer or obligation," and

- The debtor was insolvent at that time or became insolvent as a result of the transfer or obligation.[132]

[152] Again, the depletion of an insolvent debtor's asset base is grounds for a remedy. The timing of the transaction is not recognized as a substitute for the requirement of proof of insolvency in this system. This is explained by the fact that in non-bankruptcy proceedings there is no clear reference point, such as the date of bankruptcy, that can be utilized as the basis for what amounts to a presumption that the debtor was insolvent or near insolvency when the transaction occurred.

[153] The UFTA offers alternative grounds for challenge to creditors whose claims arose before *or* after the transaction in question occurred, where a debtor makes a transfer or incurs an obligation:

- If the debtor did not receive a "reasonably equivalent value in exchange for the transfer or obligation", and

- The debtor was engaged in an undercapitalized business or transaction or knew or should have known that he or she was on the verge of insolvency.[133]

In this instance, depletion of the debtor's asset base in circumstances of foreseeable rather than actual insolvency is the basis for relief.

[154] The approach embodied in the Australian Companies Act 2001 in relation to transfers by corporations is unique. As in the other systems discussed, insolvency at the time of or as a result of a transaction is a condition of the remedy offered by the Act.[134] However, the other required condition is that the transaction be an "uncommercial transaction," a determination that is not based on the relative values exchanged in the transaction as such.[135] Rather, the Act lays out a flexible test based on whether a

reasonable person in the company's circumstances would have entered into the transaction having regard to the benefits and detriments to the company of entering into the transaction, the benefits to other parties to the transaction and "any other relevant matter." In addition to these two foundational conditions, the Act requires that a further basis of invalidity be established, the most pertinent of which for purposes of this analysis is that the transaction occurred during a stipulated time period, the length of which depends in the relationship between the parties.

[155] While this model relies on factors that are roughly comparable to those employed in other systems, its effectiveness is seriously compromised by the inherent uncertainty of the "uncommercial transaction" requirement, the utilization of a three-pronged test ("uncommercial transaction", insolvency and, *inter alia*, time frame + relationship) and the complexity of the rules associated with the third prong.

[156] The adoption of a statutory test of validity based on depletion of the debtor's asset base has been recommended in Canada in the context of bankruptcy law reform. Professor Cuming's 1997 recommendations to Industry Canada would provide for challenge on the grounds that a transfer falling within one of several enumerated categories is made when the debtor is insolvent. All of the types of transaction subject to challenge on the grounds of insolvency alone entail a transfer for no value for a value "conspicuously less than the market value" of the consideration received in exchange.[136] This approach is endorsed by Professors Duggan and Telfer in their examination of the current proposals for reform of the BIA settlements and reviewable transactions provisions.[137]

[157] Two features of the Cuming model should be noted. First, it would extend the grounds for relief beyond circumstances in which the transaction is contemporaneous with the debtor's insolvency to those in which the transaction occurs at a time when the debtor intended to incur or had reasonable grounds for believing that he or she would incur debts that would be beyond his or her ability to pay. This approach parallels that adopted in the U.S. UFTA provisions described above, except that it would not offer relief on the basis that the debtor has simply embarked on an undercapitalized enterprise.[138] Secondly, the Cuming model contemplates a remedy only in respect of transactions that occur within 3 years prior to bankruptcy. This qualification is consistent with the approach customarily employed in bankruptcy legislation, under which the designation of a pre-bankruptcy time frame within with transactions are subject to challenge is standard.

[158] The reforms proposed in the LRCBC report represent a unique approach to a test based on the combined factors of asset depletion and insolvency. A transaction would be subject to challenge where the debtor is insolvent, on the eve of insolvency or rendered insolvent by the disposition and the disposition is for token value or no value.[139] "Token value" is defined as "value which is so inadequate that, when compared to a fair value for the disposition, the disposition is, in substance, a gift." Where a disposition is for "partial value" a person challenging it must also prove that the transferee knew or should have known that the transaction would impair the transferor's ability to satisfy his obligations, or that the transferee holds the property for the use or benefit of the transferor. "Partial value" is "value received for a disposition of property which is neither fair value nor token value." "Fair value" is value received that "is fair and reasonable relative to the worth of the property" *and*, unless it is the performance of an act, is of a kind such that the transferor's estate is substantially undiminished.[140]

[159] The effect of the Law Reform Commission of British Columbia approach is that asset depletion alone is grounds for challenging a transaction by an insolvent debtor only if the transaction is in substance a gift. If the consideration received is of some value but is less than equivalent to the value transferred by the debtor, a further condition based on the knowledge of the transferee is attached. The justification for this additional requirement is debatable. If the objectionable result is diminution of the asset base available to the creditors of an insolvent debtor there is no logical reason to differentiate between transactions on the basis of the degree to which they have that effect. A transaction for appreciably less than full consideration diminishes the value of the debtor's estate in the same manner as does one for no consideration.[141]

[160] On the other hand, this approach responds to the valid policy view that the law should not interfere with what might be described as a legitimate "good deal." Under the other systems described, a person who acquires property or other value on extraordinarily good terms may be forced to disgorge the benefit of his or her shrewdness, whether or not he or she knew or had reason to know that the transaction would prejudice the rights of others. The Commission's approach would protect the "good deal," provided that the person dealing with the debtor did not know that creditors would be adversely affected by it. However, it would reintroduce the uncertainties associated with an intention based test in a very substantial proportion of cases in which creditors are undeniably prejudiced by the transaction. If an approach of this kind were to be adopted, knowledge on the part of the transferee might better be addressed by way of a defence rather than in as one of the grounds for recovery, since the transferee is far better positioned than a challenging creditor to establish the former's state of mind.[142] Defences are discussed further below.

[161] The provision of a remedy on the sole basis of the asset depleting effect of a transaction in circumstances of a debtor's insolvency or foreseeable insolvency offers the following advantages:

- It represents a clear and principled implementation of the primary policy supporting the regulation of transactions for at undervalue.

- It is consistent with the historical development of the law in that it in substance embodies the approach adopted in *Freeman v. Pope* and subsequently followed by many courts, including the Supreme Court of Canada. That is, the debtor's insolvency is equated with proof of "fraudulent" intent, where the relevant intent is simply the knowing engagement in activity that will necessarily prejudice creditors' right of recovery.[143]

- It defines a clear and predictable standard of invalidity, avoiding the difficulties and consequent uncertainty involved in proving the debtor's state of mind.

- It is ethically defensible on the basis that (a) a debtor's freedom of action is legitimately constrained by his or her creditors' rights of satisfaction and (b) the claims of those who acquire value from a debtor on a substantially gratuitous basis are, subject to defined exceptions, less meritorious than those of creditors who have advanced value in the expectation of recompense that has failed.

[162] The primary components of a test embodying this approach are:

i. The transaction involves a gratuitous transfer of value by the debtor or a transfer in exchange for consideration the value of which is significantly less than that given by the debtor.

ii. The debtor is:

   a. insolvent at the time of the transaction,

   b. rendered insolvent as a result of the transaction, or

   c. (possibly) in circumstances such that the debtor knew or should have know that insolvency was foreseeable.

[163] While a system of this kind will sacrifice the exceptionally good deal, the manner in which insufficient exchange value is defined by the statute offers grounds for compromise between the interests of creditors and the interests of those who transact with the debtor. The U.S. UFTA formulation, under which a transaction may be challenged where the debtor did not receive "reasonably equivalent value" for the value given offers limited scope for a good deal. In contrast, Professor Cuming's formulation, which echoes that currently used in the BIA provisions addressing reviewable transactions, would allow a "pretty good" deal to stand, while protecting creditors against transactions that involve an excessively inadequate exchange of value. It would provide a remedy where a transaction is "for no value or value that is conspicuously less than" market value.[144]

[164] It is also worth noting that, while a good deal would be susceptible to attack under a system based on an unqualified asset depletion insolvency test, the statute can offer a remedial flexibility that would enable the court to make an order under which the person dealing with the debtor would retain or recover the value invested in the transaction. While the defendant would lose the bargain value of the transaction, his or her investment could be protected.

[165] The potential relevance of the relationship between the parties as a factor in the cause of action is discussed below.

b. Transactions Intended to Hinder or Defeat Creditors (Debtor Intention Test)

[166] Perhaps the most difficult issue associated with reform of this area of law is the relevance of the debtor's intention in entering into a transaction. The asset depletion insolvency test of validity discussed above abandons the traditional requirement of proving malicious intention on the part of the debtor as grounds for a remedy. However, this does not resolve the question of whether a remedy should be available on the grounds that the debtor *did* enter into a transaction with the objective of defeating creditors. One view is that a debtor's intention to frustrate the recovery efforts of creditors is, in itself, not grounds for challenging a transaction designed to effectuate that result. The harm to be avoided is actual interference with creditors' rights. On this view, there is no justification for providing a remedy to creditors if the debtor has enough assets to satisfy all of their claims, regardless of the intended effect of a transaction.

[167] The recommendations advanced in the LRCBC report substantially adopt this view. The Commission would not offer a remedy based solely on the intention of the debtor to obstruct creditors. The report states its position as follows:

> It is our conclusion that a disposition of property is only a fraud on creditors where it defeats their claims. A disposition of property can only have that effect where it is made by a debtor who is insolvent or where it renders the debtor insolvent.[145]

[168] Under the legislation proposed by the Commission the relevant consideration is the debtor's insolvency rather than the debtor's intention. If the transaction under review is a gift or in substance a gift, intention is irrelevant. If partial value has been given by the transferee, it is also necessary to prove either that the *transferee* had objective knowledge that the transaction would impair the transferor's ability to satisfy creditors or to that he or she accepted the property "pursuant to an understanding that it would be held for the use or benefit of the transferor." The explicit focus is on the intention of the transferee. However, the intention of the transferor appears to be inferentially relevant given that the situation contemplated is implicitly one in which the transferee either shares the transferor's knowledge that his or her ability to satisfy creditors will be impaired by the transfer, or is party to the transferor's illicit plan to retain the use and benefit of the property.[146] Shared intention is an evident if not articulated requirement in the second instance. It would in most cases be implicit in the first, since it is difficult to conceive of a case in which the transferee knows or should know that a transaction will impair the transferor's ability to pay his or her creditors while the transferor does not.

[169] To recap, the LRCBC report does not offer a remedy in any circumstances on the basis of the debtor's intention to obstruct creditors *per se*. It would offer a remedy in relation to a transaction involving more than nominal consideration on the grounds that:

- the debtor is insolvent, and
- the transferee knew or should have known that the transaction would impede satisfaction of creditors rights, or accepted property on the understanding that it would be held for the benefit of the transferor.

[170] Other statutory systems permit a transaction to be challenged on the basis of the debtor's intention to defeat creditors, coupled with the requirement that the debtor's asset base is depleted by the transaction.

[171] The U.K. Insolvency Act 1986 provisions governing "transactions defrauding creditors" are an instance of this approach.[147] The same provisions apply to individual and incorporated debtors. If a debtor has not become bankrupt, a transaction can only be challenged on the grounds that:

- the debtor received no consideration in return for the value provided by him or her, or the consideration received was worth significantly less than the value provided, *and*

- the debtor entered into the transaction for the purpose of either putting assets beyond the reach of a person presently or potentially making a claim against him, or of otherwise prejudicing the interests of such a person in relation to his claim.

[172] In the result, a debtor's intention is a relevant ground for challenge, but only when the transaction in question was for significantly less than full value. This approach differs from that taken in the context of the debtor's bankruptcy in relation to "transactions at an undervalue," discussed in the previous section of the report, in that in the latter case insolvency rather than intention operates in combination with incommensurate value as the grounds for a remedy (whether demonstrated insolvency or insolvency presumed on the basis of the proximity of the transaction to bankruptcy). In the context of "transactions at an undervalue," insolvency functions as a substitute for or perhaps a conclusively presumed indicator of the malicious intention of a bankrupt debtor. Where the debtor is solvent, malicious intention must be proved. Hence the provisions addressing "transactions defrauding creditors" do not include a presumption of intention to defeat creditors arising from the debtor's insolvency.

[173] The U.S. UFTA offers a remedy on what initially appears to be the sole ground of fraudulent intent. It provides that a transfer made or obligation incurred can be challenged by creditors, whether their claim arose before or after the transaction, if the debtor made the transfer or incurred the obligation "with actual intent to hinder, delay or defraud any creditor of the debtor."[148] The provision goes on to offer a non-exclusive list of circumstances that may be taken into consideration in determining whether the debtor had the proscribed intention.[149] However, a separate provision provides a defence to a claim advanced on this basis if the transferee took "in good faith and for a reasonably equivalent value."[150] The result is that a transaction can only be challenged on the basis of the debtor's malicious intention if he or she received less than reasonably equivalent value under the transaction or received full value from a person who did not act in good faith. In effect, the approach parallels that taken in the U.K. Insolvency Act 1986 in relation to "transactions defrauding creditors," except for its indirect recognition of bad faith on the part of a transferee as grounds for challenging a transaction for full value.

[174] Professor Cuming's proposals in relation to pre-bankruptcy transactions by bankrupt debtors operate in almost identical fashion. He would provide that a transaction may be challenged on the basis that "the debtor's main objective in engaging in the

transaction was to hinder, delay or defraud any person to which the debtor was or became, on or after the date of the transaction, indebted."[151] However, no remedy would be available if the other party to the transaction provided "value not conspicuously less than" the value provided by the debtor and "did not know or could not reasonably be expected to know at the time of the transaction of the debtor's objective…"[152] His approach differs from that of the UFTA in that, rather than providing a list of circumstances relevant to proof of the debtors intention, he would include a rebuttable presumption that the debtor acted with the proscribed intention if he or she was insolvent at the date of the transaction.[153]

[175] Since Professor Cuming's proposals are directed to reform of the BIA, they are subject to the implicit qualification that a remedy is available only if the debtor subsequently becomes bankrupt. In effect, therefore, they entail the requirement that the debtor is insolvent, though insolvency need not be established as at the time of the transaction.

[176] Professors Duggan and Telfer endorse Professor Cuming's view that proof either that the debtor was insolvent at the time of the transaction *or* that the debtor intended to defeat creditors should constitute grounds for a remedy.[154] That assertion appears to be inferentially qualified by the general proposition that the transaction diminishes the value of the debtor's estate and may affect the value of creditors' realizable claims.[155] Such an approach would be consistent with the U.K. provisions regarding "transactions defrauding creditors."

[177] In the result, the Cuming model would provide a remedy on essentially the same grounds as the U.S. UFTA, but subject to the qualification that the debtor ultimately becomes insolvent. A transaction taking place within 4 years of a debtor's bankruptcy could be challenged on the basis of the debtor's intention to obstruct creditors if he or she received significantly less than equivalent value under the transaction or received full value from a person who know or should have known of that intention.

[178] Australia's Bankruptcy Act 1966 also offers a set of intention-based provisions permitting a trustee in bankruptcy to challenge a pre-bankruptcy transfer of property by a bankrupt. The Australian Act entails the satisfaction of three requirements. The first two are articulated as the bases for avoidance. They are:

- the property would probably have become part of the transferor's estate or would probably have been available to creditors if the property had not been transferred, and

- the transferor's main purpose in making the transfer was to prevent the property from becoming divisible among his or her creditors or to hinder or delay the process of making the property available for division.

[179] The requirement that the transfer be for less than full value is added indirectly by way of the defence recognized in favour of the transferee. Like the U.S. UFTA, the Act provides that a transfer is not void if, in effect, the consideration given was worth as much as the property transferred and the transferee took without knowledge either of the transferor's purpose or that the transferor was insolvent. This means that a transfer will only justify a remedy if the first two requirements are satisfied *and* the transfer was for less than full value, unless the transferee has what might be called culpable knowledge. The fact that the third requirement is introduced by way of a defence reverses the onus of in relation to proof of the value exchanged, but does not qualify its substantive effect. The Australian model differs from the others discussed in that the effect of the first requirement is essentially that a transaction intended to obstruct creditors gives rise to a remedy only if it in fact did so (or likely did so) by removing assets from their reach, although this requirement might be equated with the explicit requirement of insolvency under the Law Reform Commission of British Columbia approach and the implicit requirement of insolvency under the Cuming approach.

[180] To sum up, the statutory approaches reviewed above present a range of possibilities insofar as the provision of a remedy on the grounds of the debtor's intention to evade his or her creditors is concerned. The dominant approach would allow a transaction to be challenged on the dual grounds of the debtor's intention to hinder or defeat his or her creditors and the insufficiency of the consideration provided by the other party to the transaction. In some systems, however, a remedy is only available where the transaction in fact does defeat creditors. This is accomplished in qualified fashion under the Australian Bankruptcy Act 1966 by the requirement that the property would probably have become part of the transferor's estate or would probably have been available to creditors if the property had not been transferred. It is accomplished under the Cuming model by the implicit requirement that the debtor ultimately become insolvent, and under the British Columbia Law Reform Commission approach by the requirement that the debtor be insolvent at the time of the transaction. The Commission's approach is otherwise unique in that it does not depend on the exchange of incommensurate value and presupposes that the debtor's intention is irrelevant except insofar as it taints the knowledge of the transferee.

[181] The objective to be achieved by including a debtor intention test of validity in the legislation must be clearly identified. If an "asset depletion insolvency" test is adopted in

the legislation, a debtor intention test that operates only when the debtor is insolvent at the time of the transaction is likely to be redundant, presuming that the exchange of less than equivalent value is a dimension of both tests. If the debtor is insolvent, the insufficiency of value exchanged will in itself constitute grounds for a remedy. A debtor intention test will catch transactions that would not be caught by the asset depletion insolvency test if it operates when a *solvent* debtor enters into a transaction for less than full value for the purpose of hindering or defeating his or her creditors. The U.S. UFTA and the U.K. Insolvency Act 1986 provisions discussed above embody that approach.

[182] However, a system that does not depend on the debtor's insolvency may operate such that a remedy is granted on the grounds that the transaction was intended to prejudice creditors, notwithstanding that it in fact did not prevent them from recovering. That eventuality is the basis for the Law Reform Commission of British Columbia's conclusion that a remedy should not be provided where the debtor is solvent, since a solvent debtor by definition has sufficient assets available to satisfy creditors' claims. [156] The objective of the legislation is to prevent interference with creditors' rights, not to punish ill-intentioned debtors. Assessed in light of the general policy discussion advanced earlier in this report, this argument has considerable force.

[183] The system proposed by Professor Cuming and that embodied in the Australia Bankruptcy Act 1966 suggest a potential middle ground approach that would provide a remedy where a *solvent* debtor engages in conduct designed to defeat creditors, but only if that result in fact materializes. That is, the debtor intention test could include a requirement that the challenging creditor establish that creditors' ability to recover was impeded or defeated by the transaction. That requirement might be satisfied by proof that the debtor became insolvent after entering into the transaction, though not necessarily as a result of it. It would not be necessary to prove that insolvency was foreseeable or imminent, since the relevant fact is simply that creditors were affected by the diminution of the debtor's asset base resulting from the transaction. The elements of a debtor intention test of this kind would therefore be that:

- the debtor received no consideration in return for the value provided by him or her, or the consideration received was worth significantly less than the value provided,

- the debtor entered into the transaction for the purpose of hindering or defeating creditors, *and*

- the circumstances are such that creditors are unable to recover their claims in full (which circumstance might be established by proof of the debtor's insolvency).

[184] A variant of this approach would also provide a remedy where the debtor has received full value but the other party to the transaction knew or should have known of the debtor's fraudulent intention.

[185] The approach taken in the U.K. Insolvency Act 1986 and the U.S. UFTA may provide a remedy where the debtor intentionally obstructs creditors in the exercise of their rights of recovery, though the transaction does not produce circumstances that entirely prevent them from recovering. This would be so where the transaction makes it more difficult but not impossible for creditors to reach assets through judgment enforcement measures. Assume, for example, that the debtor's asset base is comprised of a valuable luxury automobile and shares in a private corporation operated by the debtor with her sister, who owns the remaining shares. The debtor sells the automobile for a cash amount significantly less than its full worth and uses the money to acquire services or property of speculative or rapidly depreciating value. The debtor's purpose in so doing was to prevent her creditors from seizing the vehicle. Although the shares are nominally worth more than the claims of the debtor's creditors, it is very difficult to realize against them through judgment enforcement measures (assuming realization is possible at all under the law of the jurisdiction in which they are located). In contrast, the automobile could readily have been seized and sold to satisfy creditors' claims. A debtor intention test that does not require proof that creditors' rights are actually defeated would both facilitate creditors' ability to recover and avoid the difficult exercise of valuing property that, though technically exigible, is likely to have substantially diminished market value if sold in judgment enforcement proceedings.

[186] This illustration demonstrates that an open-ended debtor intention test may provide a partial bridge between creditors' theoretical or technical rights of recovery and the practical exercise of those rights. However, this rationalization is not entirely convincing, particularly given the fact that special judgment enforcement measures such as the appointment of a receiver may be invoked to overcome difficulties associated with realization through ordinary means.

[187] If a debtor intention test is to be adopted the two questions of onus of proof mentioned in the description of current and proposed statutory approaches must be addressed:

i. Proof of Intention

[188] In the preliminary survey of current law, reference was made to the demonstrated problems associated a cause of action based on proof of intention. While those difficulties would persist in a model that adopts a debtor intention test, they would be of relatively limited consequence in a system in which an asset depletion insolvency test is provided as an alternative. As a practical matter, it is likely that the intention-based grounds of relief would be invoked in a relatively small percentage of cases.

[189] The U.S. UFTA model requires affirmative proof of the debtor's intention to hinder, delay or defraud a creditor. However, it provides a list of circumstantial evidence (corresponding largely to the common law "badges of fraud") that may support an inference of the requisite intent. Professor Cuming's model would provide a rebuttable presumption that the debtor's "main objective" is to hinder, delay or defraud creditors if he or she is insolvent at the date of the challenged transaction.

[190] A presumption of malicious intention based on insolvency is arguably redundant. If the debtor is insolvent the transaction will presumably be caught by the asset depletion insolvency test, without proof of the debtor's intention. The asset depletion insolvency test would not catch a case in which an insolvent debtor enters into a transaction for full value and the other party to the transaction is not acting in good faith, assuming that a good faith defence is included. However, while a presumption of intention to defeat creditors may operate against the debtor in this instance it would not operate against the non-debtor party. Hence the need to affirmatively prove that the transaction was (to the knowledge of the other party) intended to obstruct creditors is not avoided by the presumption. The presumption would be material only if the transaction can be set aside on the grounds that the non-debtor party knew or should have known of the debtor's insolvency, as opposed to on the grounds that he or she know or should have known of the debtor's intention to defeat creditors.

[191] A non-exclusive list of circumstances supporting an inference of intention is of debatable value. Logically, proof of the circumstances enumerated in the U.S. UFTA would be probative of the debtor's intention without statutory recognition. Further, a statutory inventory of relevant factors carries the risk that circumstances of the kind included in the list will be given disproportionate weight and those that are not included will not be recognized or will be unduly discounted. On the other hand, the statutory inventory may contribute to the predictability of outcomes by signaling behaviour that is likely to support a remedy.

[192] A final note in relation to proof of intention is that the statutory standard in some systems is defined such that a remedy is available if the objective of hindering or defeating creditors was the primary but not necessarily the sole intention accompanying the transaction. The requirements of the Australian Bankruptcy Act 1966 and those proposed by Professor Cuming stipulate that the debtor's "main purpose" be to hinder or defeat creditors. Under this approach, a transaction cannot be defended on the ground that the debtor was motivated in part by other concerns, such as to assist a family member or a charity.

ii. Proof of Value Exchanged

[193] The U.K. model requires the person challenging a transaction to establish that no consideration was received by the debtor or that the consideration received was worth substantially less than the value given. The U.S. UFTA and Cuming models require the transferee to prove by way of defence that he or she gave value reasonably commensurate with that received from the debtor in order to avoid the award of a remedy against him or her.

[194] The UFTA/Cuming approach in effect presumes that one of the substantive grounds of the cause of action (i.e., the absence of full consideration resulting in depletion of the asset pool available to creditors) is established. The legitimacy of relieving a creditor who wishes to challenge a transaction of the obligation of proving a part of the cause of action may appear doubtful. However, there are countervailing practical and efficiency considerations. In general, a party to the transaction is likely to have ready access to the information and evidence required to establish the value of the consideration exchanged. In contrast, that information will typically be available to a creditor only through the processes of discovery and trial. The efficiencies of an approach that imposes the burden of proof on the most cost-efficient information provider are not obviously outweighed by considerations of fairness in this instance.

c. The Relevance of the Parties' Relationship

[195] We have seen that the bases upon which a transaction may be challenged is, in several systems, qualified by the nature of the relationship between the parties. In effect, a remedy is more easily obtained where the transaction is between non-arm's length parties than in other cases because proximity of relationship substitutes for proof of one of the elements of the cause of action. The idiosyncratic quality of current approaches is demonstrated by the fact that proximity of relationship operates differently in different systems; that is, there is no necessary connection between the nature of the parties'

relationship and the legitimacy of the transaction or the existence of one or another of the grounds for challenge. At best, the relationship between the parties may have evidentiary relevance.

[196] Under the U.K. Insolvency Act 1986 provisions relating to "transactions at an undervalue," the requirement of insolvency is presumptively satisfied if the transaction occurred more than 2 years but less than 5 years before bankruptcy and the other party was closely related to the debtor.[157] Since the presumption is rebuttable, the relationship between the parties substitutes in qualified terms for the need to prove insolvency.[158] The relationship between the parties does not play a role in the provisions governing "transactions defrauding creditors."

[197] The relationship between the parties is of even greater import under Australia's Bankruptcy Act 1966. If a debtor enters into a transaction for less than full value with a "related entity" within the 4 year period prior to bankruptcy, the debtor's solvency is not a defence to a challenge launched by the trustee.[159] The result is that the parties' relationship is an unqualified substitute for proof that the debtor was insolvent at the time of the transaction. However, the relationship between the parties is relevant under the Australian Corporations Act 2001 only in that it extends the window of time during which a transaction is subject to challenge from two to four years before the "relation-back" day.[160]

[198] Proximity of relationship is more than a factor under the current reviewable transactions provisions of the BIA; it is one of the bases for challenge.[161] A transaction taking place within one year of the debtor's bankruptcy gives rise to a remedy on the basis that (a) the parties were not at arms' length and (b) the transaction was for less than full value. Proximity of relationship is in effect an absolute substitute for the typical requirements of either insolvency or intention to defeat creditors.

[199] The proposed amendments to the BIA retain this approach. However, they also provide for a remedy in relation to a transaction between non-arms' length parties that occurred more than a year but less than five years prior to bankruptcy if the debtor was insolvent at the time *or* he or she intended to defeat creditors. In this context proximity of relationship does not substitute for insolvency or intention to defeat creditors, one of which must be affirmatively proven. However, it is a pre-condition of the availability of a remedy. No remedy is available in relation to an arms' length transaction occurring outside the one year window. Furthermore, while a remedy is available in relation to a non-arms' length transaction occurring within one year of bankruptcy on the sole basis of insufficient consideration, corresponding relief is available in relation to an arms' length

transaction occurring during the same time frame only if the debtor is proven both to have been insolvent at the time and to have intended to defeat his or her creditors. The rationale behind these distinctions is difficult to discern.

[200] Commentators argue with considerable credence that the relationship between the parties is simply not a relevant basis for the award of a remedy. Professors Duggan and Telfer assert that;

> The variables that matter are not the relationship between the parties to the transaction but whether the debtor intended to defeat creditors or, alternatively, whether the debtor was insolvent at the time or as a consequence of the transaction.[162]

The substantive basis upon which a transaction may be challenged should, in other words, be the same regardless of the relationship between the parties.

[201] Duggan and Telfer suggest, however, that the fact that a debtor has entered into a transaction for less than full value with a non-arms' length party may be an indicator that the debtor was in financial difficulty at the time or intended to defeat creditors.[163] If that proposition is valid, the substitution of proximate relationship for one of those factors operates as a legitimate presumption of their existence. However, the proposition is debatable and, in the view of the author, even if accepted only supports the adoption of a rebuttable presumption on either point.

[202] Under current provincial law, the nature of the parties' relationship is relevant but not determinative as proof of the required intention to defeat creditors. In the leading and often cited Supreme Court of Canada decision in *Koop v. Smith*, Duff J. expressed the view that the fact of the parties' close relationship does not shift the burden of proof of intention in the strict sense. However, suspicious circumstances coupled with relationship may be treated by the court as a sufficient *prima facie* case, calling for rebuttal by independent evidence.[164] The proximity of the parties may also operate as a "badge of fraud;" that is, as circumstantial evidence of intention to be taken into account along with other factors.[165] Although Duff J's analysis challenges the proposition that proximity of relationship alone justifies a presumption of fraudulent intent, courts have sometimes cited the case in support of that approach.[166]

[203] Notably, the relationship of the parties is not a feature of the systems proposed by either the Law Reform Commission of British Columbia, which is directed to provincial law, or by Professor Cuming in his report to Industry Canada, which is directed to

bankruptcy legislation. The omission is clearly not an oversight, as proximity of relationship is addressed in both studies.[167] The nature of the parties' relationship is addressed by the U.S. UFTA only in that the fact that the transfer or obligation was made to an "insider" is one of the list of factors that may be considered in determining the debtor's intention for purposes of the debtor intention test discussed above.[168]

[204] A final point worth noting is that where proximity of relationship justifies a difference in treatment in bankruptcy legislation it is often coupled with a prescribed time period. A transaction between related persons that occurs within a short period of time prior to bankruptcy may be more readily challenged than one involving an arms' length party. Similarly a transaction occurring more than a year (or some other prescribed period) before bankruptcy might be subject to challenge where it is between related parties but not where arms' length parties are involved, or the factors to be proven may vary. This approach may reflect the view that the presumptive weight of proximity as proof of either insolvency or fraudulent intention is greater the closer the debtor comes to formal bankruptcy. Professors Duggan and Telfer suggest that the relationship between the parties may be relevant to the length of the period of time during which a transaction may be subject to challenge on the basis that "parties who are not at arms' length may have more scope for timing the transaction to take it outside the statutory review period."[169]

[205] The foregoing review suggests that the question of the weight properly attached to the nature of the relationship between parties to a challenged transaction may be approached in one of two ways. The first is simply to disregard it as a relevant consideration. The second is to utilize it as grounds for a presumption that one of the substantive requirements of the cause of action is established. If the second approach is adopted, the further questions of whether the presumption is rebuttable and to what substantive requirement it relates must be answered.

[206] The possibility of linking proximity of relationship with a specified time period in bankruptcy legislation makes its use in this context more defensible than in other circumstances. Only transactions occurring within a narrowly defined time frame may be challenged, and that time frame may be relatively short. More importantly, the fact that the time frame is anchored to the debtor's bankruptcy lends some credence to the factual assumption that the closeness of the parties signals a real possibility that the transaction occurred while the debtor was insolvent, or that it was intended to defeat creditors. The fact that there is no equivalent temporal reference point upon which to base a time-limited approach in non-bankruptcy legislation tends to support the view that proximity

of relationship should not be adopted as a factor in a reformed provincial statute, even if it is a legitimate consideration in bankruptcy law.

[207] Aside from the possibility of adopting a time-limited approach, there is the substantive question of whether a close relationship between parties in fact justifies an evidentiary presumption of fraudulent intention or insolvency. If it does, there appears to be no legitimate basis upon which to preclude the party who has dealt with the debtor from overthrowing the presumption and avoiding liability by affirmative proof to the contrary. Hence any presumption arising from proximity of relationship should be rebuttable.

[208] This raises the further problem of the burden imposed by a shifting onus of this kind. While it may be feasible for the non-debtor party to a transaction to procure and advance evidence of the debtor's financial circumstances, it may be difficult if not impossible to prove the debtor's innocent state of mind. This consideration suggests that the adoption of even a rebuttable presumption is of doubtful merit.

4. Defences and the Protection of Third Parties

[209] In the discussion of the policies relevant to this area of law, the point was made that the competing interests to be considered are those of creditors and of the persons who deal with a debtor. The dominant policy operates in favour of creditors by providing a remedy where the debtor's conduct limits their ability to recover through resort to the debtor's assets. Statutory defences define the circumstances in which that policy is outweighed by the need to protect the interests of a person who has dealt with the debtor. The provision of defences is a response to the fact that the remedies provided by the statute affect, not the debtor, but rather the party with whom he or she entered into the challenged transaction. The remedies that might be offered are discussed below. For present purposes, it suffices to note that a remedy will likely entail either a money judgment against that party or an order that he or she otherwise relinquish property or value received under the transaction in favour of the debtor's creditors.

[210] Professors Duggan and Telfer discuss the opposing market considerations, loss avoidance considerations and administrative cost considerations associated with the deployment of defences as a means of balancing the interests of creditors and those of persons who deal with a debtor.[170] Notably, they find no clear guidance emerging from an assessment of these competing policies. Insofar as risk management and loss avoidance are concerned, the availability of defences provides an incentive for creditors to be more conservative in their credit-granting decisions and to more closely monitor the

activities of their debtors, and is likely to increase the cost of credit. Conversely, the non-availability of defences threatens the finality of transactions, thereby potentially constraining commercial dealings and creating an incentive for more thorough investigation of the circumstances of persons with whom one chooses to deal. However, risk management and monitoring practices are largely irrelevant to involuntary creditors and in general are only feasible for people who enjoy the sophistication and commercial freedom to act in accordance with those considerations. While legislative design should therefore be undertaken with a view to the potential repercussions of the strategy adopted, there is no obviously "right" approach to finding the proper balance.

[211] The nature of the remedy available against a person who has dealt with a debtor is an important consideration in the determination of whether the circumstances warrant the provision of a defence. A successful defence will completely preclude the recovery of a remedy by a creditor who challenges a transaction. This means that the provision of a defence invites an "all or nothing" outcome, at least insofar as the creditor is concerned. On the other hand, while the fact that no defence is available may allow a transaction to be successfully challenged, the provision of a remedy that takes into account the investment made by the non-debtor party offers a more nuanced and balanced result. The creditor's recovery may, for example, be limited to the difference between the value given by the debtor and the amount paid by a transferee. Other approaches that would enable the transferee to recover the value invested in the transaction are surveyed below in the discussion of remedies. Solutions of this kind are not available under current provincial law, pursuant to which a transaction either is or is not void as against creditors.

[212] The formulation of defences also depends upon the way in which the grounds for challenging a transaction are defined. While it is therefore difficult to discuss defences in the abstract, it is possible to address the considerations that may be relevant in relation to the two generic types of cause of action described above; that is, challenge based on the "asset depletion insolvency" approach and the "debtor intention" approach respectively. The circumstances recognized as supporting a defence in various systems are outlined below.

[213] For the sake of economy of language, the non-debtor party to a challenged transaction will be referred to in this discussion as the "transferee." However, it should be kept in mind that the transactions addressed by the legislation may not be limited to transfers of property. While the majority of cases are likely to involve such transactions, some may involve the assumption of an obligation or the provision of services by a debtor. The word "transferee" should therefore be understood as referable to a person who has received value from the debtor in any form.

a. Value Given by the Transferee

[214] Under both the asset depletion insolvency approach and the debtor intention approach described above, the extent of the value given by the transferee is one of the grounds for challenge. The asset depletion insolvency approach requires both that the debtor was insolvent and that he or she received less than full value in exchange for the value given, while the debtor intention approach requires that the debtor intended to hinder or defeat creditors and that he or she received less than full value in exchange for the value given.

[215] If the person challenging a transaction is required to prove that the debtor received less than reasonably equivalent value for the value given, it is redundant to offer a defence to a transferee who has given reasonably equivalent value. Put differently, if reasonably equivalent value has been given the grounds for challenge are not established and the transferee need not look to a defence. Similarly, the fact that the transferee may have given *some* value is irrelevant as a defence if the cause of action presumes that an exchange for less than reasonably equivalent value is grounds for a remedy.[171] The provision of partial value may, however, play a role in determination of the remedy granted.

[216] An alternative approach to structuring the cause of action is to require the challenger to establish only the first element and provide a defence to a transferee who can establish that he or she gave reasonably equivalent value for the benefits received. Both the U.S. UFTA and Professor Cuming's recommendations adopt this strategy, but only in relation to the debtor intention test. That is, creditors (or the trustee) are entitled to a remedy if they are able to prove that the debtor entered into the transaction with the intention of hindering or defeating his or her creditors, but proof by the transferee that he or she gave reasonably equivalent consideration is a defence, provided that the transferee can also demonstrate that she did not know of the debtor's intention.

[217] This demonstrates that whether the provision of value by the transferee is relevant as a defence depends on how the cause of action is structured. The effect of the first approach is to put the onus of establishing the value of consideration exchanged on a creditor who challenges the transaction. The second puts that onus on the defending transferee. The legislative strategy to be adopted in this regard is open to debate. The same approach may or may not be regarded as appropriate in relation to both the asset depletion insolvency test and the debtor intention test.

[218] At least two speculative reasons may be advanced for structuring the cause of action and defence elements differently in connection with the asset depletion insolvency test than in connection with the debtor intention test. The first is that if creditors are to be relieved of the need to prove that the debtor intended to defeat creditors, it is reasonable to require them to establish at least that the transaction under challenge depleted the assets available to them. It would be unfair to transferees to require them to defend proceedings that are based on proof of the debtor's insolvency alone. In contrast, if a creditor can prove that the debtor entered into a transaction in order to defeat his or her creditors it may be reasonable to require the transferee to bear the burden of establishing that the transaction was legitimate in terms of the value exchanged.

[219] A second possible reason for a differing approach is that, where it is proven that the debtor intended to hinder or defeat his or her creditors, the transferee is properly called upon to establish her innocence. This could be accomplished by assigning proof of incommensurate value to the plaintiff creditor and offering a defence to a transferee who can prove that he or she did not know, and had no reasonable grounds to know, of the debtor's intention. However, the pairing of value and good faith is a common approach in the English common law tradition. In fact, this is essentially the approach represented by current provincial law.

b. The Transferee's Intention or Knowledge

[220] As was just noted, some of the systems of law considered provide a defence to a transferee who can establish that he or she dealt with the debtor *bona fides*, in the sense the he or she was not privy to the interference with creditors' rights. Where the cause of action is based on insolvency and does not require proof of intention on the part of the debtor, the good faith of the persons who deal with him or her is generally not a consideration. However, the Australian Corporations Act 1966 is precedent for the provision of a defence based on the transferee's knowledge of the debtor's insolvent circumstances. It provides that an order shall not be made to the prejudice of a person who:

- became a party to the transaction in good faith; and
- had no reasonable grounds at that time for suspecting that the company was or would become insolvent, and
- has provided valuable consideration or changed position in reliance on the transaction.[172]

Superficially, the fact that the transferee must establish three of four conditions suggests that this defence may advance the policy of finality of transactions only minimally. On the other hand, the requirement of good faith is arguably superfluous, since it would presumably be established in virtually any case in which the transferee had no reason to suspect the company's insolvency, and some amount of consideration will be given in most cases.

[221] A defence reduced to proof that the transferee did not know and had no reasonable grounds to believe that the debtor was insolvent would make it very difficult for creditors to successfully challenge a transfer for less than full value, thereby seriously undermining achievement of the policy of protecting creditors' rights. As was suggested earlier, the burden imposed on a transferee who had no reason to doubt the debtor's solvency may be reduced by providing for a remedy that will take into account the value invested in the transaction by him or her. Though the finality of transactions is infringed in global terms by the refusal of a defence in these circumstances, an appropriately tailored remedy may achieve substantial justice as between particular parties.

[222] The relevance of the transferee's knowledge may be different when the basis upon which a transaction is challenged is the debtor's intention to obstruct creditors. We have seen that in this context some models offer a defence to a transferee who can prove that he or she did not know of and had no reason to suspect the debtor's motives. In effect, this further narrows the scope of the debtor intention cause of action by permitting a creditor to recover only where the transaction is for less than full value and *both* parties are implicated in the obstruction of their rights. However, there is an element of unfairness in interfering in a transaction on the grounds of the debtor's *male fides* where the transferee was completely innocent of fault. This perception is buttressed by the common law's traditional bias in favour of the "bona fide purchaser for value." Whether the possibility of distributing the loss through the remedy provided is sufficient reason to deny a defence in this context is an open question.

[223] If lack of knowledge of the debtor's motives is adopted as a defence it may, but need not be, paired with the requirement that the transferee prove that he or she gave substantially full consideration for the value received from the debtor. As was noted earlier, proof of value given need only be considered as a defence if the cause of action does not require the challenging creditor to prove that the consideration advanced by the transferee was worth substantially less than the value given by the debtor.

c. Change of Position by the Transferee

[224] To some extent, Canadian law implicitly recognizes change of position as a defence against avoidance of a transaction. Current provincial legislation contemplates circumstances in which the property originally conveyed to the transferee has been disposed of, providing a right of recovery against the proceeds if the transaction is avoided. However, it appears that a judgment may not be granted against the transferee if neither the original property nor traceable proceeds remain in his or her hands.[173] A conveyance can be challenged as a settlement under the BIA only where the settlor intended the property to be retained by the settlor, and case authority suggests further that the property must be retained in some form.[174] In the result, no remedy may be had against a transferee who has disposed of property received from the debtor and dissipated the proceeds.

[225] The implicit relevance of a change of position involving dissipation of the property received from a debtor is undoubtedly a result of the way in which the remedy is defined by current law; that is, the transaction is "void" or avoided as against the challenging creditor or the trustee. Since the concept of avoidance suggests a restoration of parties to their original position, a remedy cannot be granted when it is no longer possible to achieve that result. This is not an obstacle under modern systems, which provide for a range of remedies including a money judgment against a transferee.

[226] With the exception of the qualified change of position defence offered by the Australian Bankruptcy Act 1966, mentioned above, neither the legislation surveyed nor the proposed reforms offer a transferee an absolute defence on the ground that he or she has changed position after or as a result of the transaction challenged. Since recognition of change of position as a defence would seriously undermine creditors' ability to recover, there is no apparent reason to adopt a different approach. The recommendations of the Law Reform Commission of British Columbia illustrate the possibility of taking change of position into account in the award of a remedy. They would give the court discretion to refuse an order where a transferee has, in reliance on the transaction, "so changed his position that it would be inequitable to make an order for relief."[175] The fact that the recognition of change of position is discretionary means that it is not a defence as such but only a consideration.

d. Protection of Third Parties dealing with a Transferee

[227] A transferee who receives property from a debtor will often have dealt with it before the transaction under which it was acquired is challenged. Most modern systems

address the rights of creditors as against third parties who receive property or value that originated with the debtor in this indirect fashion. The predominant approach is to provide for the award of a remedy against such a person,[176] unless the person acquired his or her rights for value and, where the original transaction is tainted by the debtor's fraudulent intention, without notice of that fact.[177]

e. Transactions Advancing the Commercial Interests of the Debtor

[228] The U.K. Insolvency Act 1986 allows a person who has entered into a "transaction at undervalue" with an incorporated debtor to defend on the grounds that:

- the company entered into the transaction in good faith and for the purpose of carrying on its business, and
- at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.

[229] The effect of this provision is that an insolvent debtor is free to engage in business dealings that diminish the assets available to creditors if it can be proven that the persons acting for the company believed the transaction to be beneficial to it. Professor Goode takes the view that the requirement of good faith is not a requirement of honesty in a general sense, but relates to whether those acting for the company genuinely thought it would promote its interests. By way of illustration, he suggests that if goods are purchased in circumstances in which the company is known to be unable to pay for them, the company is acting in "good faith" for purposes of the Act.[178] The second branch of the defence implies that a transaction entered into for the purpose of defeating creditors is nevertheless in "good faith" as long as it is genuinely believed to be for the benefit of the company. This defence is apparently designed to facilitate the survival of corporations by enabling a corporation in precarious financial circumstances to offer terms that will induce others to continue to deal with it or to defer pursuing a claim against it in the hope that its financial difficulties can be overcome.

[230] Professor Goode is critical of this provision. The defence can work against a person dealing with the corporation by allowing the corporation, through its liquidator, to have a transaction set aside by alleging its own bad faith, notwithstanding that the other party acted in good faith and was unaware either that the company was insolvent or was acting in bad faith.[179] He notes elsewhere that there is no clear objective test of invalidity in relation to transactions entered into at an undervalue by an insolvent corporate debtor,

making it very difficult for creditors to mount a successful challenge.[180] This is presumably a function of the intention-based qualification incorporated by this defence.

[231] This leaves open the general question of whether it is desirable to provide a defence in relation to transactions entered into by debtors in the ordinary course of their business. The draft legislation included in the LRCBC Report would preclude the award of a remedy in relation to "a disposition of property made in the ordinary course of the transferor's business or affairs."[181] However, the legislation is designed to address both transactions at an undervalue and preferential transfers to creditors. While such a qualification may be required in the latter context, it is less clear that it is appropriate in the former.

[232] The adoption of an "ordinary course of business" defence in relation to transactions at an undervalue raises at least two concerns, both arising from the fact that there is an inherent tension if not a contradiction in the proposition that a transaction entered into by an insolvent debtor for less than full value may nevertheless be an "ordinary course" business transaction. Presumably, ordinary course business transactions by definition involve the exchange of reasonably commensurate value. Does the mere fact that a transaction is made in the course of commercial dealings make it "ordinary course," notwithstanding that the debtor has given substantially more than is received or has received no consideration at all? How is a court to resolve this problem of interpretation? If a transaction at undervalue *can* be characterized as made in the ordinary course of business simply because it takes place as part of a business operation, the scope of an "asset depletion insolvency" cause of action is dramatically reduced and the evidentiary burden of contradicting evidence that a transaction occurred in the ordinary course of business is likely to make it very difficult for creditors to succeed in challenging transactions entered into by business debtors. Neither the U.S. UFTA nor Professor Cuming's proposals include an ordinary course of business defence, nor is a defence of this nature provided by the U.K. Insolvency Act 1986 in relation to unincorporated debtors.[182]

5. Remedies

a. Form of Remedy and Relevant Factors

[233] Historically, the type of remedy available to a creditor or a debtor's trustee in bankruptcy flows from the concept that a transaction violating the statute is void as against them or may be avoided in their favour. The focus is on property that passed under the transaction, the goal being to make it available for the satisfaction of creditors'

claims by notionally undoing the transaction that placed it beyond their reach. While this approach is consistent with the conceptual and policy foundations of current law, it produces a mechanical result that in some circumstances cannot provide a practically optimal solution. Particularly troublesome is the fact that, as between creditors and the person who has dealt with the debtor, the outcome is essentially win or lose. There is no room for adjustments that take into account the legitimate interests of both parties. In some cases, the proprietary underpinning of the remedy may preclude any recovery at all, even if the cause of action is proven.[183]

[234] For the most part, the statutory regimes surveyed in this study provide a more flexible remedial regime that accommodates a panoply of orders designed to tailor the redress granted to the circumstances under consideration. The objective to be achieved through the award of the remedy may be stated, followed by a more specific listing of types of order that may be granted and factors to be taken into account. The U.K. Insolvency Act 1986 provides, for example, that the court shall "make such order as it thinks fit for restoring the position to what it would have been if the transaction had not been entered into."[184]

[235] The two primary elements of the modern remedial regimes are:

- orders allowing for recovery by resort to property transferred under the transaction in question or its proceeds (with or without avoidance of the transaction as such), and

- orders for the payment of money representing the value received by the person who dealt with the debtor or, in some circumstances by a third party who indirectly benefited from the transaction.

[236] Some regimes confer a broadly stated discretion on the court, while others confine the award to a detailed list of the types of orders that might be made in specific circumstances. For instance, section 588FF of the Australian Corporations Act 2001 offers a degree of specificity that is unusual as compared with other statutes. It provides, *inter alia*, for:

(e) an order releasing or discharging, wholly or partly, a debt incurred, or a security or guarantee given, by the company [debtor] under or in connection with the transaction;

. . .

(h) an order declaring an agreement constituting, forming part of, or relating to, the transaction, or a specified portion of such an agreement, to have been void at and after the time when the agreement was made, or at and after a specified later time;

(i) an order varying such an agreement as specified in the order and, if the Court thinks fit, declaring the agreement to have had effect, as so varied, at and after the time when the agreement was made, or at and after a specified later time;

(j) an order declaring such an agreement, or specified provisions of such an agreement, to be unenforceable.

[237] The statute may also provide that the remedy granted may be formulated to recognize any or all of the following factors:

- the investment made in the transaction by the person who dealt with the debtor or, in relation to a remedial order against a third party, by that party.[185]

- appreciation or depreciation of property transferred, expenditures that have increased the value of property subject to the transaction and obligations incurred in reliance on the transaction.[186]

- the extent to which the person dealing with the debtor or, in relation to a remedial order against a third party, that party, knew or should have known of the circumstances constituting the cause of action (i.e., the debtor's intention to defeat creditors or the debtor's insolvency or near insolvency, as the case may be).[187]

[238] In addition, provision may be made for orders that are designed to ensure that the benefits of a remedy awarded to creditors are realized. These may include:

- an order creating a charge on the property of the person against whom a remedy is granted, enforceable by the successful creditor. Ancillary orders may also be made regarding registration or enforcement of the charge.[188]

- an order in the nature of an injunction or the appointment of a receiver preventing the person against whom the order is made from dealing with the property subject to the transaction under challenge or with other property, or providing for recovery as against that person.[189]

[239] Finally, special remedies may be provided in relation to identified types of transaction. Examples include:

- an order releasing or discharging a debt or security given in relation to a transaction.[190]

- the award of a remedy against the directors of a debtor corporation that has redeemed or repurchased its own shares, issued a dividend or engaged in other activity identified by the statute,[191] subject to a "reasonable grounds" or due diligence defence.[192]

- the cancellation of a policy of insurance or annuity, accompanied by appropriate compensation to the issuing company.[193]

- orders reinstating guarantees or other forms of security that were discharged as a consequence of the transaction in question.[194]

[240] A few observations may be advanced in relation to various of the points outlined above.

i. Conceptual Basis of Remedy:

[241] A conceptual issue associated with the manner in which remedies are defined is the use of language referring to the avoidance or setting aside of the transaction. Although this is a common feature of current remedial regimes, the notion that the transaction is somehow undone may have unforeseen and undesirable consequences, both in relation to the rights and obligations of the immediate parties and in relation to third parties who are indirectly affected by the transaction. In most systems of private law remedies are not premised on transaction avoidance and, to the extent that the historical development of doctrine does entail such an approach, it often creates difficulties that the courts have struggled to overcome.[195] It may therefore be advisable not to cast the availability of a remedy in terms of "setting aside" or "avoidance" of the transaction. While one of the remedial options offered might involve the revesting of property or restoration of the transacting parties to their pre-transaction position, such an order need be based on a declaration of avoidance.

ii. Orders for the Payment of Money

[242] A system that provides a cause of action in relation to transactions other than those involving a transfer of property must provide for remedies in the form of a money judgment, since it is not possible to provide a remedy addressed to property subject to the transaction. Even where the transaction does involve a transfer of property, a monetary order may be a more suitable form of remedy than an order directed to recovery against the property itself, or its proceeds. Among other considerations, such an order may be discounted to reflect the value given or other disadvantage suffered by the person holding the property in relation to the transaction in which it was acquired.

[243] Notwithstanding the desirability of offering a multi-faceted remedial regime, it may be appropriate to state a general preference in favour of a property-based order in cases involving the transfer of property, provided that such an order constitutes a fair and effective remedy given the circumstances of the case. This approach would guard against the issuance of orders that unduly penalize a transferee by imposing obligations that do not relate directly to the loss suffered by creditors as a result of the removal of the subject property from the reach of enforcement measures. If the order contemplates the reconveyance of property to the debtor or a conveyance to a creditor or creditors, the transferee's interest may be recognized through the declaration of a lien or charge on the property to the extent of the value invested in the transaction.

iii. Protection of Persons Dealing with the Debtor and Third Parties through Qualification of the Remedy Granted

[244] As was noted earlier, qualification of the remedy granted may substitute for the provision of a defence by allowing the court to take into account circumstances identified by the statute as relevant to the award. This is most obviously so in relation to the investment made by the defendant in the transaction under challenge or as a result of the transaction. The provision of value by the party dealing with the debtor or by a third party who acquires property originally transferred by the debtor can be factored into the remedy granted without nullifying the rights arising from the creditor's satisfaction of the requirements of the cause of action.

[245] The extent to which factors other than value given should be taken into account in the design of the remedy requires careful consideration. The statutory recognition of broad "fairness" considerations in the award of the remedy may effectively cancel out the right to redress. If, for example, a creditor is entitled to a remedy on proof that (a) the debtor was insolvent at the time of the transaction and (b) the debtor received no

consideration for value given or the value exchanged was substantially incommensurate, a remedial qualification directing the court to take into account whether the defendant knew or should have known of the debtor's insolvency may take away through the back door what was offered at the front. Further, if the defendant's state of mind is identified as a factor but not a complete defence, it will be very difficult for the court to translate the relevance of that factor into monetary terms.

[246] In some systems, recognition of the value given by the defendant is paired with the extent of his or her culpability in the terms of the order that may be granted. That is, the statute may permit the order to compensate the defendant for value given *only* if he or she acted without actual or imputed knowledge of the debtor's intention to defeat creditors.[196] Under this approach the defendant's culpable state of mind does not operate to preclude the award of a remedy; rather, the defendant's innocence qualifies him or her to recover or retain the value invested in the transaction. However, since this approach does not relate directly to the extent to which creditors have been affected by the transaction, it must be justified on some other ground. Furthermore, it must be recognized that the refusal to compensate a "guilty-minded" defendant for the value conferred on the debtor allows creditors a potential double recovery.

[247] Assume, for example, that the debtor traded a truck worth $20,000 to the defendant in return for a car worth $10,000. Entirely aside from their right to challenge the transaction, the creditors have the right to recover as against the car in the debtor's hands. If the remedy awarded as a result of successfully challenging the transaction gives them the full value of the $20,000 truck transferred to the defendant on the grounds that the defendant knew of the debtor's fraudulent intention, with no discount for the value given, creditors are given a potential recovery of $30,000 rather than $20,000. The result is theoretically the same when the value contributed by the defendant is cash or otherwise in liquid form, as long the transaction puts an exigible asset in the hands of the debtor. If, therefore, the defendant's state of mind is to play any role at all in the design of the remedy, it may be desirable to recognize it as a factor that *may* be taken into account by the court in relation to the defendant's right to recover value given, rather than as an absolute pre-condition of recovery.

[248] Exculpatory considerations such as a transferee's lack of knowledge of relevant circumstances may be also recognized other than through the provision of a defence or qualification of the remedy available to creditors. This may be accomplished by giving such a person a remedy as against the debtor or the debtor's assets. For instance, Professor Cuming advances this recommendation in the context of provisions designed to function in bankruptcy:

> When a transaction is set aside, the person to whom the property was transferred or an obligation incurred and who knew or could reasonably be expected to know of the debtor's intentions but who did not collude with the debtor, should be entitled to claim as a creditor in bankruptcy an amount equal to the value of the consideration he or she gave to the debtor under the transaction.[197]

iv. Provision for Enforcement of Remedy Granted

[249] Two observations may be made in relation to the manner in which the remedy granted may be enforced. In general, an order will be enforceable against the defendant in the same way as any other remedy of its kind. A money judgment, for example, will be enforceable in accordance with the general judgment enforcement law of the jurisdiction. Variants in the remedial provisions of the legislation may be necessary to accommodate differences as among provinces relating to such matters as the registration of judgments and the availability of injunctive and other forms of relief in the specific context of judgment enforcement.

[250] A further consideration is whether it may be appropriate to provide remedies that will operate other than through the judgment enforcement system. For example, the stipulation that a charge on property granted by way of remedy may be enforced in the same manner as a security interest would allow the creditor to seize the property directly, without recourse to the judgment enforcement system.[198] Essentially the same objective would be achieved by an order vesting the property subject to the impugned transaction in a plaintiff creditor. While either or both of these approaches may be permitted as a remedial option, it is important to keep in mind that they should not be allowed to operate in a manner that would defeat the sharing principle embodied in Canadian creditors' relief legislation. One of the primary distinctions between the rights associated with a security interest and those flowing from a judgment is that, subject to considerations of priority, a security interest gives the creditor an exclusive claim to the value of the subject property while a judgment only permits the judgment creditor to claim on a *pari passu* basis with other qualifying creditors. This is discussed further under heading (d) below.

b. Persons Subject to an Order

[251] In most cases, creditors who challenge a transaction will seek a remedy against the person who has dealt with the debtor. However, all regimes provide for a remedy against third parties in appropriate circumstances. An order may be made against a person who has acquired the property subject to the transaction upon which the proceedings are based, or who has otherwise received the benefit of that transaction.

Such an order is precluded where the transferee has given full value or has no knowledge of the circumstances supporting the cause of action, or both.

c. *Availability of Remedy where Claim has not Matured or been Reduced to Judgment*

[252] The availability of a remedy must correspond to the bases upon which standing to challenge a transaction is recognized. If a person asserting a claim that has not yet matured or been reduced to judgment is granted standing to challenge a transaction, some way must be found to provide a meaningful remedy without pre-empting the requirement that the claim be established. The tension between the need to protect creditors who have a legitimate but unmatured claim and the need to ensure that a claim supporting the award of a remedy is in fact legitimate is reflected in the draft statute proposed in the LRCBC report:

> 5(1) Unless the court otherwise orders, a proceeding for relief under this part may not be commenced until the claimant
>
> > (a) has received judgment on the obligation he is owed by the transferor, or
> >
> > (b) is entitled to commence proceedings to enforce the obligation.[199]

[253] The commentary accompanying the provision suggests that while a claimant whose claim is not in good standing should not be able to upset commercial transactions, one whose claim is not yet due might be prejudiced by a disposition of property unless he is able to proceed expeditiously.

[254] The U.S. UFTA adopts a more open-textured approach. A person who holds a "claim," whether or not matured or reduced to judgment, is a "creditor" against whom a transaction may declared fraudulent; that is, the holder of the claim has a cause of action notwithstanding that the claim is inchoate in a recognized respect.[200] However, the remedial provisions are designed to offer an appropriate response where it would be premature to make an order for the payment of money or conveyance of property against the defendant. The court may "issue an injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or other property" or may appoint a receiver "to take charge of the asset transferred or of other property of the transferee."[201] The official comment notes that in the Uniform Fraudulent Conveyance Act, which was the precursor to the UFTA, these provisions applied only to a creditor whose claim was

unmatured. Though they now extend to all creditors, the need to respond to unmatured claims was the original motivation for their inclusion.[202]

[255] The USTA approach eliminates the need to obtain leave of the court before proceedings can be commenced. Since the claimant must establish his or her entitlement to a remedy in the proceedings themselves, there appears to be little danger in offering a remedy to a person whose claim has not matured as long as the remedy granted suspends actual recovery in a manner appropriate to the circumstances of the case.

d. The Operation of the Sharing Principle in the Award of a Remedy

[256] It was suggested earlier that a remedial regime based on the avoidance of a transaction and the restoration of the transacting parties to their original position offers an unacceptably limited response to the range of transactions that should be addressed in modern legislation. However, it has the advantage of avoiding the question of how to provide a remedy that does not defeat the policy of creditor sharing embodied in provincial creditors' relief legislation, which uniquely characterizes the non-bankruptcy law of the Canadian common law jurisdictions. If property simply revests in the debtor it becomes available to all the debtor's creditors through the exercise of their ordinary rights of enforcement, including through creditors' relief legislation. In contrast, an order for the payment of money by the defendant inures to the exclusive benefit of the creditor or creditors who are party to the proceedings and generates rights of enforcement, not against the debtor, but against the non-debtor defendant. There is no basis upon which creditors who are not party to the litigation are entitled to claim against the property of the defendant for satisfaction of their claim, as opposed to against the property of the debtor.

[257] This problem does not arise in bankruptcy regimes, since the trustee acts on behalf of all creditors. It is similarly a non-issue outside of bankruptcy in the United States, the United Kingdom and Australia, since none of these jurisdictions have adopted creditor-sharing laws that operate in that context.

[258] There is some confusion under current provincial legislation as to whether a creditor who wishes to challenge a transaction must commence action on behalf of all creditors or can sue on his or her own behalf. For reasons more historic than substantive, it appears that a judgment creditor may sue on his or her own behalf but a creditor who has not issued judgment must launch a class action.[203] However, as noted earlier, the fact that a creditor is not obliged to sue on behalf of other creditors may not preclude them from sharing in the fruits of a successful challenge.

[259] The LRCBC report addresses this issue by way of a brief comment accompanying the remedies section of the proposed draft legislation. One of the remedies contemplated is an order that the property subject to the transaction be sold and the money realized on the sale "be distributed among the claimants or possible claimants to the property as the court may determine." [204] The comment notes in connection with this provision that, "It would be open to a court to incorporate by reference in such an order the distribution mechanism of the *Creditor Assistance Act*."

[260] There is no clear-cut solution to this problem. Litigating creditors should not be required to carry the costs of proceedings in which the remedy granted necessarily inures to the benefit of all creditors on equal terms. Nevertheless, the existence of other creditors who would be entitled to share in a recovery obtained through judgment enforcement proceedings against the debtor's property cannot be entirely ignored.

[261] One possible approach is to require a creditor who commences an action under the statute to give notice of the proceedings to all creditors who have delivered a writ to the sheriff or, as permitted by the law of the jurisdiction, registered a judgment against the debtor. Those creditors would have the right to join as a party to the proceedings and the remedy awarded would be directed to those who are parties. Creditors who chose not to participate in the litigation may be regarded as having implicitly waived their rights. This is, however, a partial solution at best, since it does not provide for the recognition of claims that arise after the time at which notice of the proceedings is given.

[262] Another approach is to require a plaintiff creditor to provide a list of creditors who have delivered a writ or registered a judgment to the court at the time of trial or otherwise before judgment issues. The existence of other creditors may be identified in the legislation as a condition mandating a form of remedy that will accommodate their claims. However, this approach has its own weaknesses, most notably the consequent limitation of the court's discretion to award the remedy that is most appropriate as between the litigant parties. [205]

e. Limitation Periods

[263] Under current bankruptcy law, only transactions occurring within a prescribed period of time prior to bankruptcy are subject to challenge by the trustee. Since no limitation period is imposed by the Statute of Elizabeth or provincial legislation, general limitation of actions legislation governs.

[264] There appears to be a consensus that transactions should not be subject to challenge for an indefinite or extended period of time. There is, therefore, little doubt that a limitation period should be included in the statute. The question that remains is the length of the period that should be prescribed.

[265] The draft statute proposed in the LRCBC Report would offer an extremely narrow window for challenge, providing that no proceeding for relief shall be commenced more than 1 year after the date on which the disposition of property is completed.[206] This gives creditors a very short period of time within which to learn of the transaction, seek legal advice and launch proceedings. However, the running of the limitation period is suspended if the transferee "conceals, or assists or acquiesces in the concealment of, a material fact relating to the disposition of property," and does not commence to run against a claimant "until he becomes aware or ought reasonably to have become aware, acting with all due diligence, of the material facts."[207] This approach illustrates that the limitation period may defined in terms of the date of the transaction, in terms of the time at which the plaintiff knew or should have known of the facts supporting a cause of action, or some combination of the two.

[266] Though a limitation period defined in terms of the plantiff's knowledge of relevant facts appears to be more substantively fair than one based on an arbitrary period of time, it gives rise to the evidentiary problem of ascertaining when the plaintiff knew or should have known. It also raises the problem of creditor sharing. Must the benefits of an action be shared with a creditor who knew of the relevant facts but chose not to challenge the transaction?

[267] An approach common in systems operating in bankruptcy is to vary the length of the limitation period depending upon the proximity of the parties relationship, allowing for a longer reach-back where the transaction involves an associated or non-arms' length person.

D. Conclusion

[268] In spite of the length of this report, a reformed statute replacing the current system of confusing and ambiguous law governing transactions at undervalue could and should be relatively short, a point demonstrated by the appendices. The fundamental decisions that must be made to the achievement of that end are outlined above, generally accompanied by an assessment of the advantages and disadvantages associated with alternative approaches. The format of the legislation incorporating those decisions might be structured loosely as follows:

1. Scope of the legislation

- Type of transactions governed
- Who may seek a remedy
- Transactions excluded

2. Cause of action: grounds for relief

- General
- Special cases (e.g. declaration of dividends by corporate debtors, family transactions, dealings with exempt property)
- Evidentiary requirements relating to proof of grounds for relief

3. Defences

- In general
- In relation to a particular cause of action
- Distinctions between defences available to transacting parties and those available to third parties

4. Remedies

[269] It was noted at the outset that the law governing transactions at undervalue is distinct from but related to that governing preferential transfers. It is therefore desirable that both types of transaction be regulated by a single statute and that they be subject to harmonious if not uniform treatment. Some sections of the legislation could apply to both, while others would be directed specifically to one type of transaction or the other. While completion of this project in its entirety is accordingly conditional on the determination of the issues arising in relation to preferential transfers, it is the author's view that this work is properly approached sequentially, beginning with transfers at undervalue. While specific approaches adopted in the latter context may be subject to revision depending on decisions reached in relation to the former, such adjustment is likely to be minimal.

[270] Like much of commercial law, the subject of this report is to a high degree "lawyers' law." To a considerable extent, justice lies simply in the establishment of a system that produces predictable and consistent outcomes and works effectively. Market participants can and will adjust their practices and expectations accordingly. It will be the task of the working group established to move this project forward to determine the

extent of the consultation required in relation to the policy choices identified and the manner in which it is to be conducted. However, the big policy choices that must be made are relatively few in number, and the need to create an integrated and functional system the components of which work together properly cautions against deferring to external views on each of the points of detail identified above.

[271] Canada is well positioned to create a modern regime in this area of law, drawing on the best of the systems in place domestically and internationally. The achievement of reformed legislation in this area would represent a long overdue and very significant improvement in the law of creditors' remedies.

1 The project was made possible by the financial support of the Law Reform Commission of Saskatchewan. The author wishes to personally thank the Commission for having invited to me to participate in this work while I was a member of the faculty of the College of Law at the University of Saskatchewan and for supporting my continuing involvement.

2 Reform has been addressed in comprehensive terms by two Canadian law reform bodies. See Law Reform Commission of British Columbia, *Report on Fraudulent Conveyances and Preferences* (LRC 94, 1988) online at http://www.bcli.org, referred to herein as the "LRCBC report." Due to pagination discrepancies among the electronic versions of the document, pinpoint references will be to chapter and heading number rather than to page number. The draft legislation included in the report is attached as Appendix A; Ontario Law Reform Commission, *Report on the Enforcement of Judgment Debts and Related Matters – Part IV* (1983). See also The New Brunswick Department of Justice, Law Reform Division, *Third Report of the Consumer Protection Project*, vol. II, "Legal Remedies of the Unsecured Creditor after Judgment" (1976).

3 C.R.B. Dunlop, *Fraudulent Conveyances and Preferences: A Feasibility Study*, Uniform Law Conference of Canada, Proceedings of Annual Meeting (2004): www.ulcc.ca/en/poam2/Fraudulent_Preferences_En.pdf.

4 Although the general objective of fraudulent conveyances law is protection of creditors' ability to recover through resort to their debtors' assets, there are some instances under current law in which a transfer for full equivalent value may be attacked as a fraudulent conveyance. See *Ferguson v. Lastewka*, [1946] O.R. 577, [1946] 4 D.L.R. 531 (H.C.J.).

5 A transfer made in payment of a debt may, in certain circumstances, be attacked as a fraudulent conveyance under current law. For example, in *Ferguson v. Lastewka*, *ibid*., a conveyance of property to the transferor's son-in-law was set aside as a fraudulent conveyance on the ground that the transfer was evidently a sham designed to remove the property from the reach of a person who was expected to sue the transferor for damages arising from a motor vehicle accident, notwithstanding that the son-in-law was a creditor and the debt was purportedly forgiven as a result of the transfer.

6 Under current law, a transaction can only be attacked as a fraudulent conveyance on the grounds that the debtor intended to hinder or defeat creditors. However, that intention may be presumed on the basis that the necessary effect of the transaction was to prejudice creditors' rights. The relevance of the debtor's intention under current law and the manner in which intention may be proven is discussed further under heading A.1.c below.

7 A transfer that has the effect of preferring the recipient creditor relative to others may be set aside under provincial legislation if challenged within a stipulated period of time without proof that the debtor intended to create a preference. See e.g. *Fraudulent Preferences Act*, R.S.A. 2000, c. F-24, s. 3. Under some statutes, a *rebuttable* presumption of intention to prefer arises where a transfer has the effect of preferring the recipient creditor. See e.g. *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended S.C. 1997, c. 12. The extent to which intention to prefer should be the basis for a remedy under reformed legislation will be discussed in Part II of this report.

8 See e.g. LRCBC report, *supra* note 2 at Ch.VIII, A.

9 *Supra* note 7.

10 13 Eliz. I, c. 5, 1571.

11 For a useful summary of the status of the Statute of Elizabeth in Canada, see C.R.B. Dunlop, *Creditor Debtor Law in Canada*, 2nd ed. (1995: Toronto, Carswell) at 595 *et seq.*

12 *Supra* note 10, ss. 2 and 6. Additional provisions imposing penalties and criminal sanctions have fallen out of use, and their continued operation in Canada is subject to some doubt. See Dunlop, *ibid.* at 595.

13 Section 2 of the statute refers to various dealings with "Lands, Tenements, Hereditaments, Goods and Chattels," as well as to "every Bond, Judgment and Execution" made to defeat creditors. Whatever the precise intention of the latter expression, it appears to be of no modern relevance. It is clear that the transactions subject to avoidance are those involving the transfer of some form of property interest. For comment on the types of property identified in the statute and the subsequent extension of its scope to types of property not subject to execution in the 16th century, see LRCBC report, *supra* note 2, Ch. III.B note 4. See also M.A. Springman, George R. Stewart, J.J. Morrison and Michael J. MacNaughton, *Fraudulent Conveyances and Preferences* (2004: Toronto, Carswell), looseleaf, at 8-1 to 8-5.

14 Although the debtor need not be insolvent at the time of the transfer, the statute will not come into play unless he or she ultimately becomes insolvent.

15 The leading case is *Freeman v. Pope* (1870), 5 Ch. 538, and the presumption of fraudulent intent arising from insolvency is commonly known as the rule in *Freeman v Pope*. See also *Sun Life Assurance Company of Canada v. Elliott* (1902), 31 S.C.R. 91.

16 For a recent case exploring the authorities supporting both positions, see *Moody v .Ashton* (2004), 248 D.L.R. (4^{th}) 690 (Sask. Q.B.).

17 This is a product of the fact that where full value is given by the transferee, a transaction can only be set aside on proof that he or she was privy to the debtor's fraudulent intention. It is not possible for the transferee to be privy to a presumed intention. For authority, see Dunlop, *supra* note 11 at 609.

18 The circumstances that have been identified as badges of fraud are listed by Dunlop, *ibid*. at 614.

19 The weight attached to each such "badge" may vary, some being of greater consequence than others. The operation of the badges of fraud is described by Baynton J. in *Moody v. Ashton*, *supra* note 16 as follows:

> Badges of fraud are simply a collection of diverse suspicious circumstances that have been identified by the case law. The more badges of fraud that are proven, the stronger the *prima facie* case of fraudulent intent will be. But again, badges of fraud simply invoke an evidentiary presumption which will not apply where there is cogent and credible evidence to show that the conveyance is *bona fide*.

20 Note that value that may suffice as consideration for purposes of contract formation is not necessarily good consideration within the meaning of this provision. A contract that is valid in point of formation may therefore be declared void if the consideration given by the transferee is not regarded as sufficient to warrant protection of the transaction.

21 The potential permutations of value given by the transferee and intention or knowledge on the part of the transferee are helpfully discussed in the LRCBC report Ch.III.D.3.

22 *Leighton v. Muir*, (1962), 34 D.L.R. (2d) 332 (N.S.S.C). And see Springman et al, *supra* note 13 at 14-27.

23 LRCBC report, *supra* note 2, Dunlop, *supra* note 11 at 611-12.

24 See, e.g. *Ferguson v. Lastewka*, *supra* note 4.

25 The rather confused case law addressing the relationship between the provision of consideration and the transferee's intention is discussed in Springman et al, *ibid.*, at 14-30 to 14-40.

26 Dunlop, *supra* note 11 at 619. Relief may be given even where the debts in existence at the date of the transaction have been paid; e.g. where the debtor was insolvent at the time the original debts were incurred, notwithstanding an intervening period of insolvency.

27 *Ibid.* at 619-20.

28 This proposition is embodied in the so-called rule in *Mackay v. Douglas*, (1872), L.R. 14 Eq. 106.

29 E.g. *Fraudulent Conveyance Act*, R.S.B.C 1996, c. 164, *Fraudulent Conveyances Act*, R.S.O. 1990, c. F-29.

30 For historic reasons discussed by other writers, this legislation is generally found in statutes the titles of which refer to preferences rather than conveyances. See *Fraudulent Preferences Act*, R.S.A. 2000, c. F-24, *Fraudulent Preferences Act*, R.S.S. 1978, c. F-21, *Fraudulent Preference Act*, R.S.B.C. 1996, c. 164. See also the *Assignments and Preferences Act*, R.S.O. 1990, c. A.33, *Assignments and Preferences Act*, R.S.N.B. 1973, c. A-16. *Assignments and Preferences Act*, R.S.N.S. 1989, c. 25, *Fraudulent Preferences and Conveyances Act*, R.S.Y. 2002, c. 95.

31 The general view is that the Statute of Elizabeth has been implicitly repealed in those jurisdictions that have enacted fraudulent conveyances statutes as such. See Dunlop, *supra* note 11 at 597, Springman et al , *supra* note 13 at 1-25.

32 Newfoundland represents an exception to the usual pattern in that a set of provisions dealing with fraudulent and preferential transfers was included in the comprehensively reformed system introduced by the *Judgment Enforcement Act* of 1996, S. N.L. 1996, c. J-1.1, Part XIII. Though the new provisions state the law more clearly than does much of the older legislation, they retain the same primary features.

33

34 See e.g. Alberta *Fraudulent Preferences Act*, *supra* note 30, s. 1.

35 *Ibid.*

36 *Supra*, at notes 22-25.

37 E.g. Alberta *Fraudulent Preferences Act*, *supra* note 30, s. 1.

38 See e.g. *Hamm v. Metz* (2002), 209 D.L.R. (4th) 385 (Sask.C.A.).

39 *An Act to Establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies Creditors' Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47, hereafter called "Statute c-47."

40 Anthony Duggan and Thomas G.W. Telfer, Ch.7, "Gifts and Transfers at Undervalue" in Anthony Duggan and Stephanie Ben-Ishai, eds., *Canadian Bankruptcy Law Reform* (provisional title: forthcoming 2007: Lexis Nexis) text at fn 17. Although the release of this book is imminent at the time of writing, only the chapter by chapter page proofs were available to the author. Since the pagination does not correspond to that which will appear in the book pinpoint references to the text are identified by reference to the most proximate footnote number.

41 Section 94 contains provisions addressing the avoidance of assignments of book debts in circumstances not relevant to this discussion.

42 For a general discussion of the operation of the settlement provisions, see Duggan and Telfer, *supra* note 40, Ronald C.C. Cuming, *Gifts and Transfers at Undervalue: Reformulation of Section 91 of the Bankruptcy and Insolvency Act* (1997), prepared for the Corporate Law Policy Directorate of Industry Canada: www.http://strategis.ic.gc.ca/epic/site/cilp-pdci.nsf/vwapj/gift_underval.pdf/$FILE/ gift_underval.pdf. The paper includes specific recommendations for revision of the settlement and reviewable transaction provisions of the BIA. Pinpoint references are to page numbers in the PDF document or, in some instances, numbered recommendations. The Summary of Recommendations is attached as Appendix B. The paper was subsequently published in abridged form as *Transfers at Undervalue and Preferences under the Bankruptcy and Insolvency Act: Rethinking Outdated Approaches* (2002), 37 C.B.L.J. 5.

43 BIA s. 100.

44 Regarding the meaning of "arm's length," see BIA s. 3. Whether a transaction between parties dealing at arm's length can be characterized as a "reviewable transaction" is debatable, given the ambiguous wording of the provision. See Duggan and Telfer, *supra* note 40, text at fn.55-56, responding to Cuming, *supra* note 42 at 11.

45 For a general critique, see Duggan and Telfer, *supra* note 40.

46 Statute c-47, *supra* note 39, s. 96.1. Oddly, the provisions would appear with those designed to address preferential transfers under the general heading of "Preferences." See s. 71.

47 *Supra* note 10.

48 The LRCBC report expresses the view that intention is not relevant except in relation to a transfer of property for some but less than full consideration. In that instance, the debtor's intention to defeat creditors is relevant only if it is known to the transferee. The focus is, therefore, on the question of whether creditors are in fact prejudiced by a transfer, rather than on whether the debtor intended to affect them. However, the Commission would protect a transaction notwithstanding that creditors are *de facto* affected by the insufficiency of consideration given on the basis of the superior right of the innocent transferee to protection. See *supra* note 2 at Ch.VIII.B.4.(d).

49 *Supra* note 15.

50 Cuming, *supra* note 42. See also Duggan and Telfer, *supra* note 40.

51 Alberta *Fraudulent Conveyances Act*, *supra* note 30, s. 11 provides for recovery of money or other proceeds received by the transferee in exchange for the original property. Other provincial legislation contains provisions to like effect.

52 Duggan and Telfer *supra* note 40, text at fn. 6.

53 Cuming notes the relevance of the ability of persons dealing with a debtor to anticipate and protect themselves against risk. See *supra*, note 42 at 16.

54 *Supra* note 2.

55 *Supra* note 42.

56 *Insolvency Act 1986,* c. 45 (United Kingdom).

57 *Ibid*., ss. 423 – 25.

[58] *Ibid.,* ss 238, 240 – 41.

[59] *Ibid.,* ss. 339, 341 – 42.

[60] *Ibid.*, s. 436. For a discussion of the scope of the provisions, see Roy Goode, *Principles of Corporate Insolvency Law*, 3rd ed. (Sweet & Maxwell, London, 2005) at 418-23 and Rebecca Parry, *Transaction Avoidance in Insolvencies* (Oxford University Press, 2001) at 72 *et seq.*

[61] Goode, *ibid.* at 421-22 suggests that the word "transaction" is not confined to contracts but extends to gifts and other arrangements which are not based on contract, though in cases other than gifts there must be some element of dealing. Further, it may include a series of linked transactions.

[62] *Uniform Fraudulent Transfer Act,* National Conference of Commissioners on Uniform State Laws, 1984, hereafter referred to as the "UFTA". The Act has been adopted in 43 states and in the District of Columbia.

[63] *Ibid.* s. 4.

[64] For a discussion of the operation of the UFTA, along with its precursor the Uniform Fraudulent Conveyances Act (still in effect in some states) and the provisions of the Bankruptcy Code relevant to transfers at an undervalue, see Charles Jordan Tabb, *The Law of Bankruptcy* (Foundation Press, Westbury, NY, 1997) at 412-57.

[65] *Bankruptcy Act 1966*, Statutes of Australia 1966 (No. 33, 1966), s. 121.

[66] *Corporations Act 2001*, Statutes of Australia 2001 (No. 50, 2001), ss. 588FB, 588FD.

[67] See Goode, *supra* note 60 at 422.

[68] Cuming, *supra* note 42 at 17, Duggan and Telfer, *supra* note 40, text at fn. 74.

[69] Cuming, *ibid.*, Recommendation 2. The list is implicitly endorsed by Duggan and Telfer, *ibid.* It comprises any voluntary act by the debtor under which the debtor:

- transfers or undertakes to transfer to another person an interest in existing or later-acquired property (hereafter referred to as "property") for no value or for value that is conspicuously less than the market value of the property;
- incurs an obligation for no value or for value that is conspicuously less than the monetary value of the obligation;
- performs services for no value or for value that is conspicuously less than the market value of the services;
- in the case of a corporation, purchases or redeems shares of that corporation or pays a dividend, other than a dividend in the form of shares of the corporation,
- makes payments or undertakes to make future payments pursuant to a contract of insurance or annuity under which a person other than the debtor is the beneficiary annuitant, but not including a contract of insurance or annuity under which the beneficiary or annuitant is a dependent of the debtor and the payments are made pursuant to the contract which is property referred to in section 67(1)(b) of the Bankruptcy and Insolvency Act;
- grants or agrees to grant to another person a security interest, charge, hypothec or the like.

It does not include

- a payment or transfer of property to meet liability under a maintenance agreement or order of a court for the payment of maintenance;
- a payment of money or the transfer of property to a creditor in full or partial satisfaction of a debt except to the extent that the money paid or the value of the property transferred exceeds the amount of the debt satisfied;
- the replacement by the debtor of one form of the debtor's property with another form of property.

Additional forms of transaction that might be considered are:

- The waiver of a debt or compromise of a claim (Parry, *supra* note 60 at 74);
- The grant of a long-term lease that reduces the value of the property or makes it hard to sell (Duggan and Telefer, *supra* note 40, text at fn. 82);
- A transfer of property at full value subject to delayed payment (Duggan and Telfer, *ibid.*).

[70] *Supra*, note 62, §6(5) provides that an obligation is incurred (i) if oral, when it becomes effective between the parties, or (ii) if evidenced by a writing, when the writing executed by the obligor is delivered to or for the benefit of the obligee. The official comment notes that this was intended to overcome uncertainty arising from a case authority to the effect that an obligation of guarantee is incurred when advances are made rather than when the guarantee becomes effective between the parties.

[71] See Parry, *supra* note 60 at 78, fn. 34.

[72] *Supra* note 42, recommendation 2.

[73] Under s.121 of the Bankruptcy Act 1966, only transfers of property that "would probably have been available to creditors if the property had not been transferred" are void against the trustee in bankruptcy. Since property listed in s. 116(2) is not available for distribution to creditors, a transfer involving property of that kind is not subject to challenge.

[74] For judicial endorsement of this view, see *Ramgotra (Trustee of) v. North American Life Assurance Co.* (1996), 132 D.L.R. (4th) 193, [1996] 1 S.C.R. 325 *sub nom Royal Bank of Canada v. North American Life Assurance Co.* (S.C.C.).

[75] There is precedent for this approach in Canadian bankruptcy law. In *Goertz (Trustee of) v. Goertz* (1996), 37 CBR. (3d) 1, [1996] 2 W.W.R. 372, the Saskatchewan Court of Appeal concluded that a transfer of exempt property could be avoided as a settlement under the BIA. The court reasoned that since avoidance of a transfer vests the property in the trustee in bankruptcy rather than in the bankrupt, the bankrupt cannot claim an exemption in relation to property in which he or she has no interest. However, the decision was questioned in *Monteith (Trustee of) v. Monteith*, (2004), 240 D.L.R. (4th) 506, [2004] 10 W.W.R. 609, 249 Sask. R. 176, 6 C.B.R. (5th) 47 (C.A.).

[76] If the remedy provided were limited to avoidance of the transaction a challenge would be redundant if the result were that the debtor could re-assert the exemption claim with respect to the revested asset. However, the range of remedies offered by modern systems and proposals for reform would avoid this result.

[77] Tabb, *supra* note 64 at 417 argues that in bankruptcy proceedings, a debtor's voluntary transfer of exempt property prior to bankruptcy could be viewed as an implicit waiver of the exemption right. The persuasiveness of this view may be illustrated through a simple example. Assume that Debtor sells an exempt asset (a motor vehicle) for an amount ($3,000) that is both less than the value of the exemption applicable to that asset ($5,000) and conspicuously less than the market value of the asset ($10,000). The cash proceeds generated by the sale are not exempt, assuming that they are not reinvested in another exempt asset. Since the creditors could in any event reach only the non-exempt value of the vehicle the transaction deprives them of $2,000, the difference between what they could have recovered were it not sold and the proceeds available to them as a result of the transaction.

[78] *The Registered Plan (Retirement Income) Exemption Act*, S.S. 2002, R-13.01.

[79] Notably, the Saskatchewan Act, *ibid.*, provides in s. 4(3) that "A transfer of property held in one registered plan to another registered plan does not constitute a fraudulent or preferential transfer under *The FraudulentPreferences Act*." However it does not address the validity of an acquisition of a registered plan through another source of funds.

[80] R.S.A. 2000, c. I-3, s. 580.

[81] *Ibid.*, s. 555.

[82] This point is inferentially acknowledged by Gonthier J in his analysis of statutory policy and the associated case law in the decision itself.

[83] Cuming, *supra* note 42 at 18.

[84] This is essentially the approach recommended to Industry Canada by Professor Cuming in his 1997 report, *supra* note 42. Professor Cuming also recommends a provision that would protect the conversion of one form of exempt property into another. See Recommendation 7.

[85] *Ibid.*, Recommendation 2, fifth point.

[86] See LRCBC report, *supra* note 2 at 73-74.

[87] *Ibid.*, Ch. VIII.B.2.

[88] Goode, *supra* note 61.

89 LRCBC report, *supra* note 2, Ch. VIII.B.3.

90 See the definition of "disposition" in the draft legislation, *ibid.*, s. 1.

91 S*upra* note 56, s. 436.

92 *Supra* note 42 at 22-24.

93 The *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, ss. 34-36 and equivalent provincial legislation prohibits purchase or redemption of shares at a time when the corporation is insolvent. However this does not in itself provide a remedy to creditors.

94 *Supra* note 42, Recommendation 2.

95 The declaration of dividends at a time when a corporation is insolvent, like the redemption of shares, is prohibited by corporations legislation. See the *Canada Business Corporations Act*, *supra* note 93, s. 42.

96 Creditors may have a remedy under corporations law against directors who act in a manner contrary to their interests when the corporation is on the brink of insolvency. In *Re people's Department Stores Ltd. (1992) Inc.*, 2004 SCC 68, 4 C.B.R. (4th) 215, the Supreme Court of Canada rejected the argument that directors owe a fiduciary duty to creditors under circumstances of imminent insolvency, but left open the possibility that creditors can attack directors' actions through the use of the statutory oppression remedy.

97 The formulation that properly delineates those transactions that are sufficiently inconsequential to merit protection may not be easy to find. Professor Cuming would accomplish the objective by providing that the term "property" does not include "small amounts of money or items of low value transferred by the debtor to family members in the ordinary course of family relationships." The term "services" would be defined to exclude "services provided by the debtor to members of the debtor's family and non-professional or non-commercial services." See Cuming, *supra* note 42, Recommendation 2, at 26. Notably, transactions involving the provision of professional services are protected on the sole ground of family relationship, while those involving the payment of money or transfer of property are based on the value conveyed. Professor Cuming's approach also protects the provision of non-professional or non-commercial services, regardless of the relationship between the debtor and the recipient. His stated intention is to exclude circumstances such as a person looking after a neighbour's house while the neighbour is on vacation (at 17). Whether specific treatment of such transactions is required or desirable is debatable.

98 The difficulty involved in determining whether the transfer of a debtor's interest in a family home was made in return for consideration having a value approximating that of the transferred interest is demonstrated by Rebecca Parry's discussion of the application of the provisions of the U.K. Insolvency Act 1986 regarding transactions for undervalue and transactions defrauding creditors to such a transaction. See Parry, *supra* note 60 at 269 *et seq.*

99 Professor Cuming has suggested a similar approach. Cuming, *supra* note Recommendation 2, at 26.

100 Such an agreement is a "financial agreement." A financial agreement may be made before, during or after termination of a marriage. See *Family Law Act 1975*, Statutes of Australia 1975, Act No. 53, ss. 90B – D. A "termination agreement" is an agreement terminating a financial agreement.

101 *Ibid.,* s. 79A.

102 *Ibid*., s. 79A(4).

103 The vulnerability of orders for maintenance and division of property to attack as a transaction for undervalue or a transaction defrauding creditors under the U.K. Insolvency Act 1986 is discussed in general terms by Parry, *supra* note 60 at 293-301. Parry points out, however, that a trustee in bankruptcy may not be permitted to take possession of a family home where an order for exclusive possession is in effect in favour of the spouse (at 290).

104 This is essentially the approach adopted by Baynton J in his application of the law associated with the Statute of Elizabeth in *Moody v. Ashton*, *supra* note 16.

105 The Australian Bankruptcy Act 1966, s. 121(6), addresses this by specifically providing that listed benefits of this kind have no value as consideration for purposes of the Act. See also Cuming, *supra* note 42 at 4, discussing the history of the law addressing marriage settlement arrangements and at 26, Recommendation 2, providing that a promise of marriage or any other undertaking as part of a marriage contract is not "value." Cuming's approach reflects the provision in the U.K. Insolvency Act 1986, s. 339(3)(b) stating that an individual enters into a transaction at undervalue if the transaction is in consideration of marriage.

106 *Supra* note 2, draft legislation s. 1.

107 *Supra* note 62, §1(3).

108 The question of standing does not arise under bankruptcy legislation, since the trustee in bankruptcy is invariably the person entitled to challenge a transaction at under value made by a debtor prior to bankruptcy. Hence much of the legislation to which reference has been made on other points offers no guidance in this regard.

109 *Supra* note 28.

110 *Supra* note 2 at 85.

111 *Supra* note 62, §4(a).

112 *Ibid.,* §5.

113 The basis for relief is s. 423. An application may only be made by the trustee of a bankrupt individual where the basis for relief is s. 339, governing "transactions at an undervalue."

114 *Supra* note 56, s. 424(1)(c). Section 424(2) provides that an application for an order is to be treated as made on behalf of every victim of the transaction.

115 *Ibid.,* s. 423(5).

116 Parry, *supra* note 60 at 236.

117 Note that the U.S. UFTA allows a creditor whose claim arose after the transaction in question to recover a remedy if the transaction was intended to hinder *any* creditor. *Supra* note *62*, §4(a).

118 The U.S. UFTA provides a remedy to a subsequent creditor where the grounds for challenge is the incommensurate value of the consideration received by the debtor only if the debtor knew or ought to have known that she was at risk of insolvency. *Ibid*.

119 For a general overview of the philosophy behind and operation of Canadian creditors' relief legislation, see Dunlop, *supra* note 11 at 547-56. In Alberta and Newfoundland, the entitlement to share is based on the registration of a judgment in the Personal Property Registry rather than the delivery of a writ of execution to the sheriff. See *Civil Enforcement Act*, R.S.A. 2000, c. C-15, Part 11.

120 LRCBC report, *supra* note 2, draft legislation s. 5(1).

121 *Ibid.* Ch.III.F.4, referencing *Aspen Planners Ltd. v. Delshar Developments Ltd.* (1981), 11 A.C.W.S. (2d) 128 (B.C. Co. Ct.).

122 As was suggested earlier, the statute might also apply to conduct on the part of a debtor that precludes the potential enhancement of his or her asset base; for example, by disclaiming an inheritance.

123 This proposition adopts what is sometimes known as a "legal" test of insolvency, which is based on the value of a debtor's assets as compared with the amount of his or her debts. Insolvency is established under "commercial" test on the basis of whether the debtor is able to meet his or her obligations as they fall due.

124 Section 238 establishes the basis of the remedy where the debtor is a corporation. Section 339 provides for a corresponding remedy where the debtor is an individual. The material features of the provisions governing corporations and individuals respectively are the same, except as otherwise noted. The Act contains separate provisions relating to what are called "transactions defrauding creditors." These are discussed in the next section of the report.

125 *Supra* note 56, s. 339(3).

126 *Ibid.*, s. 341(1). In the case of a corporation the relevant period is two years before the onset of insolvency. See s. 240(1).

127 This provision applies to individual debtors. There is no corresponding provision relating to insolvent corporations.

128 *Supra* note 56, s. 341(2). Where the debtor is a corporation, the presumption operates throughout the 2 year period prior to insolvency during which transactions are subject to challenge. See s. 240(2).

129 This is discussed further below under the general heading of "Defences and Protection of Third Parties."

130 *Ibid.,* s. 238(5).

131 *Supra* note 65, s. 120.

[132] *Supra* note 62, §5. That section also makes special provision for dealings with a proximate party, in this case referred to an "insider." However, since the provision is directed to preferential transfers rather than to transfers at an undervalue it is not directly material to the present discussion. See §5(b), providing that a transfer by an insolvent debtor to an "insider" on account of an antecedent debt is vulnerable as a fraudulent transfer if the insider had reasonable cause to believe that the debtor was insolvent.

[133] *Ibid.* §4(2). The actual language used is "…the debtor made the transfer or incurred the obligation:

(2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

(i) was engaged in or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

(ii) intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due.

[134] *Supra* note 66, ss. 588FC, 588FE.

[135] An "uncommercial transaction" is defined in s**.** 588FB as follows:

(1) A transaction of a company is an uncommercial transaction of the company if, and only if, it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction having regard to:

(a) the benefits (if any) to the company of entering into the transaction; and

(b) the detriment to the company of entering into the transaction; and

(c) the respective benefits to other parties to the transaction of entering into it; and

(d) any other relevant matter.

[136] Cuming, *supra* note 42 at 24-27, Recommendations 2 and 3.

[137] *Supra* note 40, generally and by specific reference in text at fn.74-75.

[138] Professor Cuming expresses the view, *supra* note 42 at 27, fn. 85 that;

> …there is no justification for allowing a trustee, acting on behalf of creditors, to set aside or otherwise alter a transaction entered into when the debtor was solvent simply because the debtor at the time of the transaction or shortly thereafter was engaged in an undercapitalized business that ultimately failed. The creditors who are the intended beneficiaries of the rule grant credit with the means of knowing that the business is undercapitalized. Since they grant credit knowing the risks involved, they should not be able to attack transactions made while the debtor is solvent simply because the risk they assumed materialized in a loss.

[139] LRCBC report, *supra* note 2, draft legislation s. 3(1).

[140] *Ibid.*, s. 1.

[141] Professor Cuming, *supra* note 42 at 17, expresses the view that is not appropriate to build a system around a distinction between gifts and transfers or transactions for consideration.

[142] A parallel issue is addressed by Professor Goode in relation to the defence given by the U.K. Insolvency Act 1986 to an incorporated debtor that has entered into a transaction at an undervalue, where the acting individuals honestly believed the transaction to be in the best interests of the company. The defence defeats the objective of defining a clear and objective test of validity. See *infra* note 180.

[143] This point is valid only to the extent that the legislation applies to voluntary transactions.

[144] *Supra* note 42, Recommendation 2.

[145] *Supra* note 2 at Ch.VIII.B.4.(b).

[146] For the Law Reform Commissoin of British Columbia's discussion of the issue of intent, see *ibid.* at Ch.VIII.B.4.(d).

[147] *Supra* note 56 ss. 423 -25.

[148] UFTA, *supra* note 62, §4(a)(1).

[149] *Ibid.* §4(b).

150 *Ibid.* §8(a).

151 Cuming, *supra* note 42, Recommendation 8.

152 *Ibid.*, Recommendation 9.

153 *Ibid.*, Recommendation 8. The recommendations are also subject to the general qualification that a remedy would be available only if the debtor subsequently becomes insolvent. Duggan and Telfer, *supra* note 40, text at fn. 80, endorse Professor Cuming's view that proof of *either* the debtor's insolvency *or* that the debtor intended to defeat creditors should constitute grounds for a remedy.

154 Duggan and Telfer, *ibid.*

155 *Ibid.*, text following fn.73.

156 This is true only if the definition of insolvency adopts an asset-based test based on the value of the debtor's exigible assets, rather than the value of all assets.

157 *Supra* note 56, s. 240(2) relating to incorporated debtors. The presumption arises where the company enters into a transaction "with a person who is connected with the company." Section 341(2) is the corresponding provision relating to individual debtors. The presumption arises where a transaction at an undervalue is entered into by an individual "with a person who is an associate of his (otherwise than by reason only of being his employee)." The terms "person connected with the company" and "associate" are defined by sections 249 and 435 respectively.

158 *Ibid.*, s. 341(2).

159 *Supra* note 65, s. 120.

160 *Supra* note 66, s. 588FE(4). Section s. 588FDA contains a separate set of provisions specifically targeting payments and the issuance of securities to directors and their associates, along with other types of transaction to which a director is a party.

161 See the description of current law and the proposed amendments provided, *supra* under heading A.3.

162 *Supra* note 40, text at fn. 59. See also Cuming, *supra* note 42 at 18.

163 Duggan and Telfer, *ibid.*

164 *Koop v. Smith* (1915), 25 D.L.R. 355 at 358-59. Dunlop, *supra* note 11 at 615, suggests that the decision in this case lays down a distinct evidentiary rule. The LRCBC report, *supra* note 2, Ch.III.E.3 fn. 83 suggests that the decision treats proximity of relationship as a badge of fraud that, like any other, establishes a *prima facie* case.

165 Dunlop, *ibid.,* at 614-15.

166 *Ibid.*, at 616.

167 LRCBC report, *supra* note 2, Ch.III.E.3, fn. 83, Cuming, *supra* note 42 at 18, expressing the view that reliance on concepts of "related persons" and "arm's length" dealing in Canadian bankruptcy law are of "questionable utility."

168 This is subject to the qualification noted *supra*, fn. 132.

169 *Supra* note 40, text at fn.60.

170 *Ibid.*, text at fn. 97-100.

171 As was noted earlier, the recommendations of the Law Reform Commission of British Columbia are unique in that they would in effect provide a defence to a person who has given partial value, provided that he or she did not know that the transfer would materially impair the debtor's ability to satisfy his obligations and did not accept the property in the understanding that it would be held for the use or benefit of the debtor. It was suggested that the distinction between a complete gift and a partial gift is of doubtful value. See *supra*, text at fn. 141.

172 *Supra* note 66, s. 588FG(2).

173 For a survey of the approaches taken by the legislation and the courts in various provinces, see Springman et al, *supra* note 13, Part II, title 10 "Tracing the Property and the Proceeds."

174 Lloyd W. Houlden and Geoffrey B. Morawetz, *Bankruptcy and Insolvency Law of Canada*, 3rd ed. (Toronto, Carswell), looseleaf, F§75.

175 *Supra* note 2, draft legislation s. 4(5).

[176] The draft legislation proposed by the Law Reform Commission of British Columbia is an exception, in that the provisions governing the award of a remedy appear to contemplate only an order affecting a transferee. *Ibid.*, s. 4.

[177] See e.g. U.K. Insolvency Act 1986, s. 425(2) relating to "transactions defrauding creditors," and ss. 241(2) and 342(2), relating to "transactions at an undervalue;" U.S. UFTA §8(b)(2); Australia Bankruptcy Act 1966, s. 121(8); Australia Corporations Act 2001, s. 588FG(1). The latter also refers to a third party's lack of knowledge of the debtor's insolvency. This is consistent with the terms upon which a defence is provided to a transferee.

[178] Goode, *supra* note 60 at 439-40.

[179] *Ibid.*, at 440.

[180] *Ibid.*, at 508.

[181] *Supra* note 2, draft legislation s. 3(2).

[182] Although the Australian Corporations Act 2001 does not explicitly include such a defence, the manner in which the cause of action is framed apparently accommodates consideration of whether the transaction is in a corporate debtor's commercial best interests. See *supra* note 66, s. 588FB.

[183] This may be the result where property transferred has been disposed of by the transferee and the proceeds of disposition are no longer identifiable or traceable.

[184] *Supra* note 56, ss. 423(2)(a), 238(3), 339(2). The draft legislation proposed in the LRCBC Report, *supra* note 2, s. 4(4), states that an order for relief "shall, so far as it is possible and equitable in the circumstances to do s, restore the transferor and the transferee to the position they were in immediately before the transfer."

[185] Cuming, *supra* note 42, Recommendations 5 and 9; U.S. UFTA, *supra* note 62, §8(d).

[186] Cuming, *ibid.*

[187] Cuming, *ibid.*, Recommendation 9.

[188] U.K. Insolvency Act 1986, *supra* note 56, s. 425(1)(f), Cuming, *ibid.*, Recommendation 10.

[189] U.S. UFTA, *supra* note 62, §7(3).

[190] U.K. Insolvency Act 1986, *supra* note 56, s. 425(1)(c).

[191] E.g. Cuming, *supra* note 42, Recommendation 4.

[192] For a defence of this kind delineated in comprehensive terms, see Australia Corporations Act 2001, *supra* note 66, s. 588FGB.

[193] See Cuming, *supra* note 42, Recommendation 4.

[194] U.K. Insolvency Act 1986, *supra* note 56, s. 425(1)(e).

[195] For example, rescission of a contract on the grounds of a pre-contractual misrepresentation is limited by the traditional principle that it must be possible to effect *restitutio in integrum*, an obstacle that the courts have in recent times attempted to surmount by making orders designed to substantially if not literally restore parties to their pre-contract position. See e.g. *Kupchak v. Dayson Holdings Co. Ltd*. (1965), 53 D.L.R. (2d) 483 (B.C.C.A.).

[196] See e.g. Cuming, *supra* note 42, Recommendation 9.

[197] Cuming, *ibid*.

[198] Professor Cuming recommends giving a trustee in bankruptcy a charge on the property of the person against whom an order is made, enforceable as a security interest, mortgage or hypothec in accordance with provincial law, *ibid*., Recommendation 10. The issue of creditor sharing does not arise in this context, since the trustee acts on behalf of all unsecured creditors.

[199] *Supra* note 2, draft legislation.

[200] *Supra* note 62, §1(3) "claim" and (4) "creditor."

[201] *Ibid.* §7(a)(3).

[202] There is precedent for this approach under current provincial law. In *Petryshyn v. Kochan*, [1940] 3 D.L.R. 796 (Sask. K.B.), a conveyance of land was challenged by the plaintiff in a pending tort action. Although the court found that the conditions for avoidance under the Statute of Elizabeth were established, it ordered that the property

should remain vested in the transferee until such time as judgment was issued in the tort action in the plaintiff's favour, whereupon the transfers would be void. In the interim, the transferee was enjoined from dealing with the property except by order of the court.

203 LRCBC report, *supra* note 2 at Ch.V.C.1, Springman et al., *supra* note 13, at 5-1 to 5-6.3. *c.f. Fraudulent Preferences Act*, R.S.A. 2000, c. F-24, s. 10.

204 *Supra* note 2, draft legislation s. 4(1)(a).

205 The distribution scheme in some jurisdictions provides for *pari passu* sharing of the proceeds of judgment enforcement among creditors, but gives the creditor who initiates the enforcement proceedings a first right to recover his or her costs from the proceeds of enforcement as well as a bonus based on the amount recovered. See e.g. *Civil Enforcement Act*, R.S.A. 2000, c. C-15, s. 99. However, an approach of this kind only offers a solution where the remedy granted is a money judgment.

206 *Supra* note 2, draft legislation s. 5(2).

207 *Ibid.*, s. 5(3).

APPENDIX A

Law Reform Commission of British Columbia
REPORT ON FRAUDULENT CONVEYANCES AND PREFERENCES (LRC 94, 1988)

CHAPTER X
DRAFT LEGISLATION

A. Overview

The draft legislation in the next section is based on the conclusions we have reached in the preceding chapters respecting the features fraudulent conveyance and preference legislation should have in British Columbia. In order to ensure that this legislation operates consistently, the concept of a "prejudicial transfer," rather than a "fraudulent conveyance" or "fraudulent preference," is employed. A prejudicial transfer is a class of defined dispositions which prejudice the creditors of an insolvent. By adopting this formulation, the legislation moves away from the often inappropriate language of fraud.

The draft legislation is fully annotated, but it is useful to discuss generally the approach adopted in it. Basically, only those dispositions which have the effect of prejudicing creditors are subject to review. An exception is made where a transferee receives a bargain. In that case, his intent is relevant in determining whether the disposition should be set aside.

A number of defences, for the most part based on the needs of commerce, are identified in the draft legislation.

In Chapter XI, the operation of the draft legislation is demonstrated through a series of examples.

B. The Draft Legislation

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of the Province of British Columbia, enacts as follows:

It is recommended that this draft legislation be enacted as part of the *Court Order Enforcement Act*.

1. In this Part

"claimant" means a person who, at the time of a prejudicial transfer, is

The definition of "claimant" controls who may bring an action to set aside a disposition under the draft legislation.

(a) owed an obligation by the transferor which is unsecured, whether the obligation is

The term "claimant" is used in sections 3(1) and 5(3).

A creditor who is not fully secured is a claimant.

(i) liquidated or unliquidated;
(ii) absolute or contingent;
(iii) certain or disputed; or
(iv) payable immediately or at a future time;

The value of a security may fluctuate so that at different times a secured creditor may be fully secured or not fully secured. The relevant time for determining whether a secured creditor qualifies as a claimant is the date the prejudicial transfer is made.

(b) a secured creditor whose security is inadequate; or
(c) a guarantor of an obligation of the transferor;

"disposition" includes a court order for a transfer of property and a transfer by operation of law, other than by a right of survivorship;

Under the *Interpretation Act*, R.S.B.C. 1979, c. 206, s. 29, "dispose" means to transfer by any method and includes assign, give, sell, grant, charge, convey, bequeath, devise, lease, divest, release and agree to do any of those things. "Disposition" has a corresponding meaning: s. 28(4).

For greater particularity, the draft legislation includes other methods by which property may be transferred.

A transfer of ownership by a right of survivorship is excluded from the definition.

The Commission is examining the operation of rights of survivorship as they affect creditors: see *Working Paper on Co-ownership of Land*, (W.P. no. 58, 1987).

The term "disposition" is used throughout the draft legislation.

"fair value" means value received for a disposition of property which

"Fair value" is defined in terms of value received.

(a) is fair and reasonable relative to the worth of the property; and
(b) unless value consists of the performance of an act, is of a nature that the transferor's estate is substantially undiminished by the disposition;

The concept of "fair value" turns on whether a transferor's estate is diminished, enhanced, or unchanged by a disposition of property.

If a transferor's estate is materially diminished by a disposition, he has not received "fair value."

If a transferor's estate is substantially undiminished by a disposition, the disposition does not have the effect of prejudicing creditors. It will be immune from attack. See section 3(2).

The term "fair value" is used in this section in the definition of "partial value" and in sections 2 and 3(2).

"Fair value" may be either "fair new value" or "fair past value." See the definitions of "new value" and "past value."

"new value" means value received contemporaneously with and in exchange for a disposition of property and includes value which is to be received;

The term "new value" is used in contrast to the term "past value."

A disposition of property in exchange for new value is roughly equivalent to the kinds of dispositions currently regulated under the *Fraudulent Conveyance Act*.

The term "new value" is used in this section and in section 3(2)(a) and (c).

"New value" may be "fair value," "partial value" or "token value."

"partial value" means value received for a disposition of property which is neither fair value nor token value;

The term "partial value" identifies those dispositions the validity of which depends upon the intent of the transferee of property.

In most circumstances, intent is not relevant.

The term "partial value" is used in section 3(1).

"past value" means an obligation of a transferor that is in existence before a disposition of property, but subsequently secured or satisfied, in whole or in part, by the disposition;

The term "past value" is used in contrast to the term "new value."

A disposition for past value is roughly equivalent to dispositions currently regulated by the *Fraudulent Preference Act*.

The term "past value" is used in sections 3(1), 3(2)(c) and 3(2)(d).

"prejudicial transfer" means a disposition of property to which section 3 applies;

Section 3 defines dispositions which prejudice creditors.

The concept of a "prejudicial transfer" replaces the concepts of fraudulent conveyance and fraudulent preference.

Only dispositions of property by persons who are insolvent, rendered insolvent by the disposition or on the eve of insolvency can qualify as "prejudicial transfers."

The term "prejudicial transfer" is used in the definition of "claimant."

"proceeds" means identifiable property, in any form, derived directly or indirectly from any dealing with property or the proceeds of property and includes

The term "proceeds" encompasses property substituted for property that is the subject of a prejudicial transfer.

(a) compensation for the loss, damage or destruction of or to the property; and
(b) a proportionate share, determined according to the principles applied by courts exercising an equitable jurisdiction to trace property, of a mass, bulk or fund which results from the commingling of the property or its proceeds with similar property;

Under section 4(2), a claimant is entitled to look to the proceeds obtained from a prejudicial transfer.

If the transferee subsequently disposes of the property, a claimant may look to the proceeds received from the disposition in the hands of the transferee.

If the proceeds are commingled with other like property, the court may rely upon equitable principles to identify a proportionate share of the fund for the purposes of granting a remedy under this draft legislation.

"property" means any interest in real or personal property exigible at law or in equity and includes money;

A creditor who could not have executed against property disposed of by the transferor to satisfy his claim cannot be prejudiced by the disposition.

For that reason, property is defined to encompass virtually any kind of property, or interest in property, except property which may not be the subject of execution proceedings.

The definition of property is also significant with respect to determining the solvency of the transferor. See section 2.

Property which cannot be the subject of execution proceedings is not taken into account when determining the transferor's solvency.

The current *Fraudulent Preference Act* does not apply to a disposition of money. The definition of property refers to money to ensure that the draft legislation does apply.

The term "property" is used throughout the draft legislation.

"token value" means value which is so inadequate that, when compared to a fair value for the disposition, the disposition is, in substance, a gift;

If a disposition of property is made by an insolvent for token value, the court may make an order for relief. See section 3.

The term "token value," together with the terms "fair value" and "partial value," encompasses the range of consideration that might be given for a disposition of property.

The term "token value" is used in the definition of "partial value" and in section 3(1).

"value" includes the performance of an act.

Ordinarily, value exchanged for a disposition of property will consist of property.

The performance of a service, however, is also of value.

The term "value," consequently, is defined to encompass the performance of an act.

The term "value" is used throughout the draft legislation.

2. (1) For the purposes of this Part, a person is insolvent when his property in Canada, if disposed of at a fair value, would not realize sufficient money to satisfy his obligations.

The draft legislation regulates a disposition of property by a person who is insolvent, or rendered insolvent by it.

Insolvency is determined by reference to property when a claimant would have access to in Canada in order to satisfy his claim.

(2) A person who has ceased to meet his obligations as they generally become due is presumed to be insolvent.

The transferor's property is assessed at fair value.

If the fair value of the transferor's property is less than the total of his obligations, he is insolvent for the purposes of the draft legislation.

As a practical matter, a claimant may not be able to determine the extent of the transferor's property or obligations.

Consequently, if a transferor has ceased to meet his obligations as they fall due, he is presumed to be insolvent.

The transferor may rebut the presumption of insolvency by establishing that the value of his property, as defined, exceeds the value of his obligations.

3. (1) Where a disposition of property is made by a transferor who is

A disposition that falls within the ambit of section 3(1) is a "prejudicial transfer." See section 1.

(a) insolvent;
(b) on the eve of insolvency; or
(c) rendered insolvent by the disposition;

Essentially, property which is the subject of a disposition by an insolvent will be made available to a claimant if it is:

and the disposition is for

(d) token value or no value;

(e) partial value where the transferee

(i) in substance a gift;
(ii) a bargain where the transferee had the requisite intent; or
(iii) a payment to creditor.

(i) knew or ought reasonably to have known that the transfer would materially impair the ability of the transferor to satisfy his obligations; or
(ii) accepted the property pursuant to an understanding that it would be held for the use or benefit of the transferor; or

Even if the disposition falls into one of the categories listed above, defences may be available. See section 3(2).

Note that a disposition for fair new value is not a "prejudicial transfer" since it does not fall within the ambit of this section.

(f) past value

then the court may make an order for relief in favour of a claimant.

(2) Subsection (1) does not apply to the following dispositions:

(a) a disposition of property for fair new value;
(b) a disposition of property made in the ordinary course of the transferor's business or affairs;

A disposition of property for fair new value, by definition, does not diminish the transferor's estate. Consequently, it is immune from attack.

A person may conduct his business, or satisfy outstanding obligations, while technically insolvent. In order to do so, he must be able to make payments in the ordinary course.

The draft legislation, consequently, focuses on the exceptional disposition, that which occurs out of the ordinary course of a transferor's business or affairs.

Failing to provide a defence of this nature would place the parties in a difficult position. It might prevent the transferor from being able to continue in business and to regain solvency. It would call into question the most routine of payments.

(c) security given for past value where, by reason or on account of the giving of the security, the transferee

Arrangements of this nature are common.

It is desirable to permit a business to attempt to recover from insolvency.

(i) gives new value to the transferor; or
(ii) agrees not to enforce an obligation owed by the transferor

The extension of fresh credit to a debtor will often benefit the debtor's other creditors, particularly if it allows the debtor ultimately to become solvent.

in the *bona fide* belief that the new value or the forbearance will enable the transferor to continue his trade or business and, within a reasonable period of time, cease to be insolvent.

Failing to permit a creditor to obtain security for past indebtedness will prevent the extension of further credit.

A creditor may threaten litigation unless the debtor provides security for his indebtedness. Forbearance in these circumstances would constitute new value.

The fresh advance or forbearance, however, must be expected to allow the debtor to continue in his business and pay his debts in full.

It is contemplated that this requirement will prevent an agreement not to sue from qualifying, unless it genuinely assists the debtor in continuing his business profitably.

(d) security for past value given or made in fulfillment of a commitment undertaken by the transferor when the value was received.

A common commercial arrangement is to advance credit on the agreement that, when the creditor feels insecure, he may request security.

It is desirable to permit creditors and debtors as much latitude as possible in structuring the terms of a financial arrangement.

If this position is not recognized, lenders will be required to arrange for security at the time credit is advanced.

That will often result in needless expense to the lender and the borrower, in the many cases where the “insecurity” never arises.

4. (1) An order for relief under section 3 may include:

Section 4(1) lists orders that the court may make.

(a) an order that the property be sold and the money realized on the sale be distributed among the claimants or possible claimants to the property as the court may determine;
(b) an order that the property be reconveyed to the transferor;
(c) an order declaring that the property is exigible in the hands of the transferee to satisfy the obligations of the transferor; and
(d) any other order for the disposition of, or execution against, the property that is fair and equitable in the circumstances.

The court should be able to make an appropriate order in the circumstances.

Under section 4(1)(c) the court may make an order distributing the proceeds of a sale among claimants. It would be open to a court to incorporate by reference in such an order the distribution mechanism of the *Creditor Assistance Act*.

(2) Any order that might be made with respect to property under subsection (1) may be made with respect to the proceeds of any further disposition of the property which are in the possession or under the control of the transferee.

See the definition of “proceeds” in section 1.

A claimant entitled to a remedy under the draft legislation should not be deprived of a remedy by a subsequent disposition of the property.

(3) An order under subsection (1) may be made subject to terms and conditions that are fair and equitable in the circumstances.

Self-explanatory.

(4) An order under subsection (1) shall, so far as it is possible and equitable in the circumstances to do so, restore the transferor and the transferee to the position they were in immediately before the transfer.

The value given for a prejudicial transfer will benefit the transferor’s estate at the expense of the transferee.

The court, consequently, has jurisdiction to protect the transferee insofar as that is possible.

An order under this subsection, or the inability to make such an order, however, will not prevent the court from making an order in favour of a claimant.

(5) An order under subsection (1) may be refused where the transferee of property has, in reliance on a prejudicial transfer, so changed his position that it would be inequitable to make an order for relief.

The defence of change of position is based on the fact that parties to a transaction are often justified in relying on its validity.

In circumstances where a party was justified in relying on the validity of a transaction, it may be inequitable merely to set the transaction aside.

The court, consequently, has jurisdiction to dismiss the application.

5. (1) Unless the court otherwise orders, a proceeding for relief under this Part may not be commenced until the claimant

A claimant may not, as a matter of course, sue on a claim which is not due or in default.

(a) has received judgment on the obligation he is owed by the transferor, or
(b) is entitled to commence proceedings to enforce the obligation.

A claimant whose claim is in good standing should not be able to upset legitimate commercial transactions. The potential for abuse and for prejudice to the transferor and transferee is vast.

However, a claimant whose claim is not yet due might be prejudiced by a disposition of property unless he is able to proceed expeditiously.

The court may, therefore, give leave to proceed to a claimant whose claim is not due or in default.

(2) No proceeding for relief under this Part shall be commenced more than 1 year after the date on which the disposition of property is completed.

Transactions should not be in jeopardy indefinitely.

The policy of protecting an insolvent's creditors must be limited by commercial necessity.

Currently, under the *Fraudulent Preference Act*, some dispositions are automatically set aide if challenged within 60 days of being made. Two other events are listed, to establish a 60 day period during which a preference will be automatically set aside.

Dispositions made with an intent to prefer on creditor over others may be attacked at any time, provided the attacking creditor's claim is not statute barred. It is likely, however, that under the *Limitation Act* no disposition can be set aside after six years from its completion

Dispositions which may be attacked under the *Fraudulent Conveyance Act* are also subject to a six year limitation period.

The revised approach adopted under the draft legislation requires that a limitation period be adopted.

Under this subsection, no order may be made respecting a disposition completed more than one year before the commencement of proceedings under the draft Act.

(3) Where the transferee conceals, or assists or acquiesces in the concealment of, a material fact relating to the disposition of property, the running of time with respect to the limitation period fixed by subsection (2) is postponed and does not commence to run against a claimant until he becomes aware or ought reasonably to have become aware, acting with all due diligence, of the material fact.

In some cases, it will be appropriate to postpone the running of the limitation period under the draft Act.

Subsection (3) does this based on whether the transferee conceals, assists or acquiesces in the concealment of material facts relating to a disposition.

The transferee's activities in this respect are relevant since he is the party who is affected by whether or not the disposition is valid.

Where a material fact has been concealed, the limitation period for proceeding under the act does not begin to run until the claimant becomes aware of the material fact.

(4) Notwithstanding a postponement of the running of time under subsection (3), no proceeding shall be commenced more than 6 years from the date on which the disposition was completed.

Self-explanatory.

(5) A proceeding for relief under this Part may be commenced by writ or by petition.

Self-explanatory.

APPENDIX B

GIFTS AND TRANSERS AT UNDERVALUE
Reformulation of Section 91 of the Bankruptcy And Insolvency Act

Prepared for the Corporate Law Policy Directorate
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December 1997

SUMMARY OF RECOMMENDATIONS

RECOMMENDATION 1

Section 91 of the Bankruptcy and Insolvency Act should be totally reformulated. This reformulation would result in a consolidation of current sections 91-93, 100 and 101. It would eliminate the complexities, anomalies and lacunae of these provisions and present a socially acceptable, commercially reasonable and predictable approach to transactions that have the effect of diminishing the quantum of property that is available to creditors of a bankrupt.

RECOMMENDATION 2: DEFINITIONS

The proposed reformulated section 91 should apply, with stated exceptions, to all voluntary "transactions" that affect the quantum of a bankrupt's estate. For this purpose, the term "transaction" should include any voluntary act by the debtor under which the debtor:

- transfers or undertakes to transfer to another person an interest in existing or later-acquired property (hereafter referred to as "property") for no value or for value that is conspicuously less than the market value of the property;

- incurs an obligation for no value or for value that is conspicuously less than the monetary value of the obligation;

- performs services for no value or for value that is conspicuously less than the market value of the services;

- in the case of a corporation, purchases or redeems shares of that corporation or pays a dividend, other than a dividend in the form of shares of the corporation,

- makes payments or undertakes to make future payments pursuant to a contract of insurance or annuity under which a person other than the debtor is the beneficiary annuitant, but not including a contract of insurance or annuity under which the beneficiary or annuitant is a dependent of the debtor and the payments are made pursuant to the contract which is property referred to in section 67(1)(b) of the Bankruptcy and Insolvency Act;

- grants or agrees to grant to another person a security interest, charge, hypothec or the like.

The term "transaction" should not include:

- a payment or transfer of property to meet liability under a maintenance agreement or order of a court for the payment of maintenance;

- a payment of money or the transfer of property to a creditor in full or partial satisfaction of a debt except to the extent that the money paid or the value of the property transferred exceeds the amount of the debt satisfied;

- the replacement by the debtor of one form of the debtor's property with another form of property.
-
- [-set-off.]

The term "debtor" should mean a person who at the time of the transaction is a bankrupt or who becomes bankrupt after that date.

The term "property" should include the debtor's interest in property including property referred to in section 67(1)(b) of the Bankruptcy and Insolvency Act, but should not include small amounts of money or items of low value transferred by the debtor to family members in the ordinary course of family relationships.

The term "services" should not include services provided by the debtor to members of the debtor's family and non-professional or non-commercial services.

The term "transfer" should include the payment of money or other value under a contract to purchase property or services.

The term "value" should not include a promise of marriage or any other undertaking as part of a marriage contract or an unperformed promise to furnish support.

RECOMMENDATION 3: POWER OF THE TRUSTEE

The reformulated section 91 should provide that a trustee in bankruptcy has the power, subject to review by the court, to adjust the interests of parties to a transaction if the transaction occurred during a period beginning on the day that is [three] years before the date of the initial bankruptcy event and ending on the date that the debtor is discharged, and at the time of the transaction:

- the debtor was insolvent, or was rendered insolvent by the transaction; or
- the debtor intended to incur or had reasonable basis for believing at the time of the transaction that the debtor would incur debts that, as they matured, would be beyond the ability of the debtor to pay.

In any proceedings before the court, the onus of proof with respect to the solvency of the debtor before or after the transaction or what the debtor could reasonably be excepted to believe should be on the person seeking to establish that section 91 does not apply. The fact that the debtor was solvent at some time between the date of the transaction and the date of the bankruptcy should not affect the application of reformulated section 91.

RECOMMENDATION 4: REMEDIES

The power to adjust the interests of parties to a transaction should include the following. Where the transaction involves the provision of services, the transfer of property, the purchase or redemption of shares, the grant of a security interest or the incurring of an obligation, the trustee may:

- set aside the transaction and, where appropriate, recover from any person any money paid, property transferred by the debtor or the proceeds or value of the property transferred; or alternatively
- require the person to whom property was transferred or services performed or the person to whom the obligation was incurred to pay to the trustee an amount equivalent to the difference between the value given to the debtor and the value of the property transferred, services performed or the obligation incurred;
- terminate a contract of insurance or annuity that is a transaction but subject to the insurer’s or issuer’s right to payment of an amount equal to the lesser of the amount that could have been recovered by the insurer had the contract been repudiated by the debtor and the amount payable by the debtor upon termination of the contract or such amount as the court may order.

- in the case of the purchase or redemption of its shares by a corporation, require the seller of the shares or the person to whom the redemption payment was made to pay to the trustee any amounts received from the corporation under the transaction.

When, upon evidence presented by the trustee to the court, some or all of the amount that is to be repaid by the seller of the shares or the person who received the redemption payment will not be paid or will not be paid within a reasonable period of time or where the transaction involves the payment of a dividend, the court should have the power to order one or more of the directors of the company to pay any such amount or amount paid as a dividend; and the directors named in the order should be jointly and severally liable for such amount. An order should not be made against a director who, in accordance with the law governing the corporation, is exonerated from liability for prohibited payment of the dividend or the redemption or purchase of the shares. When determining whether or not to make such an order the court should take into consideration evidence placed before the court by a director that the director in good faith relied upon and, as a reasonable person in his or her position could be expected to rely upon:

- financial or other statements of the corporation presented to him or her by the auditor or the officers of the corporation; or

- a report prepared pursuant to a contract with the corporation by a person whose profession gave creditability to the contents of the report.

The transfer of shares to a corporation of shares issued by that corporation under a purchase and the redemption of shares issued by a corporation should not be treated as involving the giving of value by the transferor to the corporation.

The term "proceeds" should include identifiable property, in any form, derived directly or indirectly from any dealing with the property or proceeds of the property, and includes compensation for damage to or destruction of the property or proceeds and an interest determined according to the principles of tracing applied by courts exercising equitable jurisdiction.

RECOMMENDATION 5: PROTECTION OF THE INTERESTS OF PARTIES TO THE TRANSACTION

When the trustee elects to set aside a transaction, the trustee should be required to pay to the person to whom property was transferred or obligation incurred:

- an amount equivalent to the value given to the debtor under the transaction; and

- an amount that compensates the person for commercially valuable improvements in the property and for legally binding obligations incurred in reasonable reliance on continued ownership of the property or obligation.

RECOMMENDATION 6: PROTECTION OF THIRD PARTY INTERESTS

The trustee should not be able to set aside a transaction where the property or obligation has been transferred to a person who was not a party to the transaction, who acquired the property or obligation for value that is not conspicuously less than the market value of the property or obligation and who, at the time the person acquired the property or obligation, did not know or could not reasonably be expected to know that the debtor was insolvent at the time of the transaction or was made insolvent by the transaction. or that the debtor intended at the time of the transaction to incur debts that, as they matured, would be beyond the ability of the debtor to pay.

RECOMMENDATION 7: EXEMPT PROPERTY

The trustee should not be able to set aside a transaction involving the transfer of property referred to in section 67(1)(b) of the Bankruptcy and Insolvency Act if, after the transfer, the property or the proceeds of a disposition of the property would not be exigible under judgment enforcement proceedings. This recommendation should not apply to a transaction involving an insurance or annuity contract.

RECOMMENDATION 8: FRAUDULENT TRANSACTIONS

On application of the trustee, the court should have power to order that a transaction, hereafter referred to as a "fraudulent transaction", in the form of a transfer of property or an obligation incurred by the debtor occurring at any time prior to the date the debtor became bankrupt be set aside when the debtor’s main objective in engaging in the transaction was to hinder, delay, or defraud any person to which the debtor was or became, on or after the date of the transaction, indebted.

The debtor should be presumed prima facie to have as his or her main objective the hindering, delaying or defrauding his or her creditors when he or she was insolvent at the date of the transaction.

RECOMMENDATION 9: PROTECTION OF TRANSFEREES, OBLIGEES AND THIRD PARTIES

A court should not be able to order a fraudulent transaction set aside if the transferee of the property or the obligee acquired the property or obligation for value not conspicuously less than its market value and did not know or could not reasonably be expected to know at the time of the transaction of the debtor’s objective of hindering, delaying or defrauding any person to which the debtor was or became, on or after the date of the transaction, indebted.

When a court issues an order setting aside a fraudulent transaction, the trustee should be required to pay or transfer to the person to whom the property was transferred or an obligation incurred and who did not know or could not reasonably be expected to know at the time of the transaction of the debtor’s

objective an amount equivalent to the value given to the debtor under the transaction and an amount that compensates the person for commercially valuable improvements in the property and for legally binding obligations incurred in reasonable reliance on continued ownership of the property or obligation.
When a transaction is set aside, the person to whom the property was transferred or an obligation incurred and who knew or who could reasonably be expected to know of the debtor's intentions but who did not collude with the debtor, should be entitled to claim as a creditor in bankruptcy an amount equivalent to the value of the consideration he or she gave to the debtor under the transaction.

For the purposes of this Recommendation and Recommendation 6, a person knows when relevant information comes to the person's attention under circumstances in which a reasonable person would take cognizance of it. In the context of a corporation, a person is a managing director or officer of the corporation or a senior employee of the corporation with responsibility for matters to which the information relates. In the context of a partnership, a person is one of the general partners or a person having control or management of the partnership business.

RECOMMENDATION 10: THE TRUSTEE'S CHARGE

When the trustee or the court requires a person to pay money or transfer of property to the trustee, the trustee should have a charge on the property of the person to secure performance of the obligation. The charge shall be deemed to be a security interest in or mortgage or hypothec on the property and, as such, should be subject to the law of the province or territory applicable to security interests in or mortgages or hypothecs on the property.

RECOMMENDATION 11: INTEREST

When the trustee or the court requires the payment of money to the trustee, the obligation should include the payment of interest from the date that the person who is required to make the payment has been informed of the obligation to the date the payment is made. When the trustee is required to pay compensation to a person under Recommendation 5 or 9, the trustee shall pay interest on the amount from the date the property is delivered to the trustee until the payment is made. The rate of interest should be as prescribed.

RECOMMENDATION 12: PROVINCIAL FRAUDULENT CONVEYANCES LAW

A trustee should not be able to invoke provincial fraudulent conveyance law. However, a trustee should have the power, as representative of a creditor who has brought proceedings under provincial preferences law and the other creditors who would benefit from an order setting aside the transfer under provincial law, to continue the action after the invocation of bankruptcy.

RECOMMENDATION 13: REPEAL OF SECTIONS 3 AND 100

Sections 3 and 100 of the Act should be repealed since the matters addressed in them would be more effectively addressed in the proposed reformulated section 91.

RECOMMENDATION 14: APPLICATION TO BIA AND CCAA

The reformulated section 91 should apply to proceedings under Part III, Division I of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act only in the following circumstances:

- when each class of unsecured creditors at a meeting referred to in sections 51 and 54 of the Bankruptcy and Insolvency Act or section 6 of the Companies' Creditors Arrangement Act passes a resolution instructing the trustee or monitor to invoke the section, or

- when, after a proposal is approved pursuant to the Bankruptcy and Insolvency Act or sanctioned pursuant to the Companies' Creditors Arrangement Act, the debtor enters into a transaction, and each class of unsecured creditors passes a resolution at a meeting convened by the trustee for that purpose, instructing the trustee or monitor to invoke the section with respect to the transaction; and
- the trustee or monitor makes application to the court for permission to invoke section 91.

A court should not grant permission unless the potential success of a proposal or the ability of the debtor to meet the conditions of an approved or sanctioned proposal would be likely to be jeopardized by the transaction.

For the purposes of this recommendation, the term "proposal" should include an arrangement under the Companies' Creditors Arrangement Act.

RECOMMENDATION 15: REACH-BACK IN CONTEXT OF CCAA

Sections 101.1 and 101.2 of the Bankruptcy and Insolvency Act should be amended to provide that the "date of initial bankruptcy event" be deemed to be the date of filing of an initial application under subs 11(2) of the Companies' Creditors Arrangement Act where the court stay ordered under section 11 of the Act is terminated by the court and a petition is filed or an assignment is made within 30 days thereafter.

RECOMMENDATION 16: WINDING-UP AND RESTRUCTURING ACT

Sections 96-99 of the Winding-up and Restructuring Act should be repealed and the reformulated section 91 of the Bankruptcy and Insolvency Act should apply, with necessary modifications, to the proceedings under the Winding-up and Restructuring Act.

[SOURCE: http://strategis.ic.gc.ca/epic/site/cilp-pdci.nsf/en/cl00242e.html]