LAW REFORM COMMISSION OF BRITISH COLUMBIA

REPORT ON
FRAUDULENT CONVEYANCES AND PREFERENCES

LRC 94

JANUARY 1988

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Canadian Cataloguing in Publication Data
Law Reform Commission of British Columbia
Report on fraudulent conveyances and preferences

"LRC 94".
Includes bibliographical footnotes.
ISBN 0-7718-8631-4

1. Fraudulent conveyances - British Columbia.
2. Bankruptcy - British Columbia.
3. Debtor and creditor - British Columbia.
I. Title.

KEB267.A72L38 1988 346.711077 C88-092071-8

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TO THE HONOURABLE BRIAN R.D. SMITH, Q.C.
ATTORNEY GENERAL OF THE PROVINCE OF BRITISH COLUMBIA:

The Law Reform Commission of British Columbia has the honour to present the following:

REPORT ON
FRAUDULENT CONVEYANCES AND PREFERENCES

A person who is unable to pay his debts in full, or who is faced with satisfying a substantial obligation, is often tempted to shield or hide his assets. He may attempt to pay some creditors in preference to others, or convey his property to a friend or relation and put it beyond the reach of persons who have claims against him.

Problems of this kind have been recognized by the law for hundreds of years and, British Columbia, are addressed by both provincial and federal legislation.

Two provincial Acts are primarily aimed at preventing debtors from dealing with their property in a manner which will prejudice their creditors. These are the *Fraudulent Conveyance Act* and the *Fraudulent Preference Act*. The federal *Bankruptcy Act* also contains provisions which have the same purpose.

The *Fraudulent Conveyance Act* is based on English legislation enacted in 1571, and its antiquity is obvious in a number of respects. Although the *Fraudulent Preference Act* is somewhat more recent, being little more than a century old, it too reveals its age.

Review of this area of the law is long overdue. One particular matter of concern is the overlapping nature of the provincial and the federal legislation. Not only is the operation of the two provincial acts inconsistent, but they also conflict with the provisions of the *Bankruptcy Act*.

For reasons canvassed at length in this Report, the Commission recommends the repeal of the *Fraudulent Conveyance Act* and the *Fraudulent Preference Act*, and their replacement with modern legislation to be enacted as part of the *Court Order Enforcement Act*.

CHAPTER I INTRODUCTION

A. Generally

Most people are concerned to pay their debts as they come due. If, for whatever reason, a person refuses to honour his debts, his creditor must seek a legal remedy. A creditor may, for example, take judgment in order to levy execution against the debtor's property. If the debtor is insolvent, bankruptcy proceedings may be necessary for the orderly satisfaction of the debtor's obligations.

Occasionally, a person determined to avoid meeting his obligations takes steps to frustrate legal remedies that may be asserted against him. He may, for example, transfer property to a trusted friend or associate, perhaps on the understanding that it will be returned when the danger of its being seized has vanished. A disposition of this kind is known as a fraudulent conveyance.

In other cases, a person may owe money to a number of creditors. If he satisfies a debt owed one creditor in circumstances where the other creditors will not be paid, the transfer of property is characterized as a fraudulent preference.

B. Scope of this Report

A transaction to prejudice creditors or to prefer one creditor over others is subject to review by a court. Depending on the intent of the debtor and, sometimes, of the recipient of property, the transaction may be set aside.

A number of Acts govern the law in this area, but three are of particular significance. They are the *Fraudulent Conveyance Act*, the *Fraudulent Preference Act* and the federal *Bankruptcy Act*. The *Fraudulent Conveyance Act* protects remedies available to a creditor, so that his claims are not defeated by a debtor simply divesting himself of property. The *Fraudulent Preference Act* and the *Bankruptcy Act* have a different purpose. They are aimed at recovering an insolvent's property so that it may be divided even-handedly among his creditors.

This Report examines the law governing fraudulent conveyances and preferences in British Columbia. Much of the law governing these transactions is obscure and not immediately apparent upon reviewing the provisions of the statutes.

Discussion of the law governing fraudulent conveyances and preferences is complicated by the division of legislative jurisdiction over this matter between the provincial and federal governments. A further source of uncertainty is the ongoing reconsideration of the federal *Bankruptcy Act*.

The discussion of the current law in this Report is not exhaustive. It is confined to those areas of greatest interest in the context of the law and practice of British Columbia.

C. The Working Paper

Working Paper No. 53 on *Fraudulent Conveyances and Preferences* was issued by the Commission in September, 1986. It was circulated widely among persons interested or expert in this area of the law and considered by several sections of the British Columbia branch of the Canadian Bar Association. Responses received by the Commission will be referred to later in this Report.

In addition to written comments, a number of individuals experienced in this area of the law met with the Commission to discuss the proposals made in the Working Paper.

The Commission is very grateful to those who devoted their time and talents to a consideration of our work. It is only through that process that effective and practical law reform can be promoted, particularly when the area of law under examination, such as fraudulent conveyances and preferences, is highly technical and, in many respects, obscure.

CHAPTER II THE LEGISLATIVE FRAMEWORK

A. The Fraudulent Conveyance Act

Notwithstanding its modern language, the *Fraudulent Conveyance Act* is over 400 years old. Until the appearance of the 1979 Revised Statutes of British Columbia, it was framed in language derived from the Statute of Elizabeth, enacted in 1571. The Act of 1571 constituted a restatement of the common law and earlier enactments. Not surprisingly, in view of its antiquity, the *Fraudulent Conveyance Act* is encrusted with case authority. Its meaning and the practice which has grown up under it cannot be derived solely from the words of the enactment.

As a modern restatement, the present *Fraudulent Conveyance Act* is serviceable. However, its interpretation depends in many respects on cases which consider the wording of prior Acts based on the Act of 1571. The 1979 and 1960 revisions of the Act are to be found in Appendices A and B to this Report.

B. The Fraudulent Preference Act

The *Fraudulent Preference Act* is a relatively new statute. It was originally enacted in 1880 in order to partially fill the void left by the repeal of all federal insolvency legislation. Its operation is predicated on insolvency. Like the *Creditor Assistance Act*, the intent of the Act is to promote equal distribution of an insolvent's assets among his creditors. The *Creditor Assistance Act* accomplishes this by permitting all creditors who file proper claims with the sheriff to participate in the proceeds of execution. The *Fraudulent Preference Act* enhances that end by limiting the extent to which a debtor can prefer one creditor over another so that his property is not equally available to all.

Ensuring the equal distribution of an insolvent person's assets among his unsecured creditors is a function normally reserved to bankruptcy legislation. Nevertheless, the re-entry of the Dominion government into this field in 1919 with the passage of a new *Bankruptcy Act* did not precipitate the repeal of the *Fraudulent Preference Act*. A version of this Act has appeared in every set of British Columbia revised statutes published since its first enactment.

The version of the *Fraudulent Preference Act* currently in force was substantially rewritten for the 1979 statute revision. Like the *Fraudulent Conveyance Act*, much of the law surrounding it is better explained in terms of the wording of the Act as set out in the 1960 Revised Statutes of British Columbia. The 1979 and 1960 versions of the *Fraudulent Preference Act* are to be found in Appendices C and D to this Report.

C. The Bankruptcy Act

Bankruptcy legislation has long been recognized as a necessity in leading commercial nations. In England, the concept of bankruptcy was introduced in 1571, the same year as the precursor to the *Fraudulent Conveyance Act*. This legislation applied only to traders and merchants, and was concerned solely with the orderly distribution of the bankrupt's goods. It did not provide for discharge of the underlying debt.

English bankruptcy legislation was extensively modified in the 19th century. These modifications were adopted in part by the Colonies of Vancouver Island in 1862 and British Columbia in 1865. The colonial legislation remained in force after Confederation until the enactment of federal insolvency legislation in 1875. This legislation contained provisions invalidating fraudulent conveyances and preferences.

In 1880, federal bankruptcy legislation was repealed. It was not replaced until 1919, when the *Bankruptcy Act* was enacted. Sections 29-35 of that Act made void a number of transactions whose effect was either to prefer one creditor over another, or to remove property from the debtor's estate in a manner unfair to his creditors. These basic provisions, somewhat modified, have been carried forward into the current *Bankruptcy Act*.

In recent years, various proposals for the reform of the *Bankruptcy Act* have been advanced. These proposals culminated in the introduction of a proposed new *Bankruptcy Act* in 1975, 1980, and 1984. Attempts to enact new bankruptcy legislation have failed, and it appears that the current focus is to amend the existing Act.

D. The Criminal Code

Section 350 of the *Criminal Code* provides:

> 350. Every one who,
>
> (a) with intent to defraud his creditors,
>
> (i) makes or causes to be made a gift, conveyance, assignment, sale, transfer or delivery of his property, or
>
> (ii) removes, conceals or disposes of any of his property, or
>
> (b) with intent that any one should defraud his creditors, receives any property by means of or in relation to which an offence has been committed under paragraph (a),
>
> is guilty of an indictable offence and is liable to imprisonment for two years.

It is an offence both to make and to receive a fraudulent conveyance of property with the intent to defraud creditors.

This section has been narrowly interpreted. In *R.* v. *Crew*, 77. Everyone commits a crime who, for the purpose of defrauding the creditors of any person, receives property that has been transferred, concealed of disposed of for the purpose of defrauding those creditors. Riddell J.A. held that it did not prohibit the giving of a preference to a creditor. The law encourages debtors to pay off or secure creditors. The section prohibits a debtor from avoiding his creditors altogether. A debtor does not commit an offence under this section if he defrauds a single creditor. The defrauding of creditors must be proved by the Crown. Moreover, the word "conceals" requires an overt, positive act. A mere failure to disclose the existence of an asset is not an offence.

E. Constitutional Issues

Both the federal *Bankruptcy Act* and the provincial *Fraudulent Preference Act* purport to regulate the validity of transfers of property by an insolvent person. Section 91 of the *Constitution Act, 1867* empowers the federal government to enact legislation respecting bankruptcy and insolvency. Two issues have arisen concerning the validity of provincial fraudulent preference legislation:

(1) May a province enact legislation touching upon insolvency?

(2) If a province may enact legislation touching upon insolvency, what result follows in the event of a conflict between federal and provincial legislation?

Prior to the decision of the Supreme Court of Canada in *Robinson* v. *Countrywide Factors Ltd.*, there existed considerable doubt about the proper answer to be given to these questions.

In *Robinson* the appellant, a trustee in bankruptcy, sought to set aside a debenture given by the bankrupt to a creditor and to recover a payment due to the bankrupt diverted to the creditor. The receiving order against the bankrupt was made two years after the payment was diverted, and 20 months after the debenture was executed. Since these transactions occurred more than three months before the receiving order was made, they could not be attacked under the *Bankruptcy Act*. They could only be set aside under provincial fraudulent preference legislation.

The majority judgment of the Supreme Court of Canada was given by Spence J. After reviewing previous decisions on point, he concluded that the provinces and the federal government could validly enact fraudulent preference legislation. The provinces had jurisdiction since a fraudulent preference was a matter of property and civil rights. The federal government could enact legislation invalidating fraudulent preferences as part of its jurisdiction over bankruptcy and insolvency.

One aspect of the *Robinson* decision is ambiguous. It is clear that insofar as provincial fraudulent preference legislation does not conflict with federal bankruptcy legislation it is intra vires. Where there is a conflict, however, it is uncertain whether provincial legislation will apply. Under the *Fraudulent Preference Act*, a preference is deemed void if attacked within 60 days of its making. There is no necessity of proving fraudulent intent. Moreover, no limitation is contained in the *British Columbia Act* to prevent an attack on a transfer at any time. In contrast, under the *Bankruptcy Act* a transfer cannot be attacked as a fraudulent preference unless the transaction occurred within three months of bankruptcy. It is also open to the defendant to defend the transaction by showing that it was not made with a view to prefer.

In *Henfrey & Co.* v. *A Law Firm* McEachern, C.J.S.C. said that "a transaction occurring within the three-month period mentioned in s. 73 must be attacked, if at all, under the provisions of s. 73 of the *Bankruptcy Act*." This suggests that provincial legislation may not be applied to set aside a transaction valid under the *Bankruptcy Act*. It appears to rest on the conclusion that the federal legislation occupies the field respecting fraudulent preferences occurring within three months of bankruptcy. The Chief Justice's remarks were *obiter dicta* since, in any event, the disposition in question was not a fraudulent preference within provincial legislation.

The issue would appear to rest on the proper construction of section 50(6) of the *Bankruptcy Act* which provides that a trustee in bankruptcy may rely on provincial enactments insofar as they are not in conflict with the provisions of the *Bankruptcy Act*. If a disposition of property made within three months of bankruptcy may not be attacked under provincial legislation because it is valid under the *Bankruptcy Act*, it is difficult to see how a disposition made more than three months before bankruptcy may be attacked under provincial legislation, since it too is valid under the *Bankruptcy Act*.

Bankruptcy cases in which provincial legislation is relied upon appear to proceed on the view that a conflict between federal and provincial legislation will only arise where provincial legislation purports to validate a transaction which is void under the *Bankruptcy Act*.

It may be argued, however, that the position suggested in *Henfrey & Co.* is correct. Preference legislation must protect the interests of the insolvent and his creditors. It necessarily defines which preferences are valid and which invalid. It would be surprising if federal legislation, which protects a particular disposition, could be frustrated by provincial legislation.

A. Introduction

As a general rule, a person may deal with his property as he desires. The law restricts that general rule when a person, unable or unwilling to meet his obligations, attempts to shield his property from execution.

The British Columbia *Fraudulent Conveyance Act* provides a claimant with a means of setting aside a disposition of property made with the intention of delaying, hindering or defeating creditors and others of their just and lawful remedies. It attempts to distinguish between legitimate transactions relating to property, and those which should be set aside as a fraud on creditors. The Act is based upon the Statute of Elizabeth, enacted in 1571, which was a codification of the common law and equity to that date as it related to frauds on creditors.

The structure and approach of fraudulent conveyance legislation is surprisingly elegant. The law only becomes baffling when one considers the 400 odd years of jurisprudence surrounding this legislation. Complexity in this area of the law is due to a number of factors:

(i) Over 400 years, views concerning what is a legitimate, and what is a fraudulent, conveyance have varied. For example, the conclusion that a person who divests himself of property before entering business commits a fraud on his future creditors does not sit well with modern commerce which approves conducting business through a company with limited liability. Outdated views such as this, however, remain current.

(ii) An essential element of a fraudulent conveyance is the intent to defeat creditors. Proving intent usually involves drawing inferences from the circumstances surrounding the transaction. This has led to many evidentiary problems. These evidentiary problems have not been subjected to modern analysis. Many cases deal with certain issues as if they involved fundamental principles of the law governing fraudulent conveyances when, in fact, the concern is sufficiency of evidence.

(iii) Some cases are determined by a close reading of fraudulent conveyance legislation. Others have treated the legislation as a statement of the common law, and paid little attention to it. The law in British Columbia governing fraudulent conveyances is more accurately stated without paying too close attention to the provisions of the *Fraudulent Conveyance Act*.

(iv) The terminology that has been developed to describe fraudulent conveyances represents a discrete subset of legal language, with the meanings assigned technical words in the context of a fraudulent conveyance differing significantly from the meanings assigned these same technical words in other legal contexts. Examples which will be encountered in this chapter include the terms "voluntary" and "good consideration."

B. What is a Fraudulent Conveyance?

The *British Columbia Act* provides that a disposition of property... lands, tenements, hereditaments, goods, and chattels, or of any of them or of any lease, rent, common, or other profit or charge out of the same lands, tenements, hereditaments, goods, and chattels, or any of them, by writing or otherwise ...
The omission of choses in action and money from this list reflects the history of the *Fraudulent Conveyance Act*. In 1571, most creditors were concerned with execution by sale of land or tangible personal property. In fact, money could not be taken in execution of s. 2, judgment until 1838: *Judgments Act*, 1 & 2 Vict., c. 110. Despite the limited ambit of s. 2, courts used the broader wording of the preamble to the 1960 Act, and the intent underlying it, to extend the application of the Act to any form of property transferable at law or in equity, whether or not that form of property could have been subject to execution in 1571: *Barrack* v. *M'Culloch*, (1856) 3 K. & J. 110, 69 E.R. 1043; *Edmunds* v. *Edmunds*, [1904] P. 362; *May*, 16 *et seq*.; Parker, 21 *et seq*. made with the intent to delay, hinder or defraud creditors and others of their just and lawful claims is void.

Glossed by judicial decisions, the Act is taken to mean that a fraudulent conveyance is a transaction relating to property, (i) Property exempt from execution: *See, e.g., Amourgis* v. *Anastasiadis*, (1931) 32 O.R. (2d) 312 (Ont. Co. Ct.); *Salter* v. *Wyo-Ben Products Inc*., (1972) 25 D.L.R. (3d) 626, (Alta. S.C.T.D.); *Banque Canadienne Nationale* v. *Tench*, [1928] S.C.R. 26, [1927] 4 D.L.R. 665; *Re Henwood*, (1962) 37 D.L.R. (2d) 156, 40 W.W.R. 81, 4 C.B.R. 286 (Alta. S.C.); *Russian Mercantile Co. Ltd.* v. *Sloboda*, [1927] 4 D.L.R. 931, [1927] 3 W.W.R. 451(Alta. S.C.A.D.); *Northwest Thresher Co.* v. *Fredricks*, (1911) 44 S.C.R. 318; *J.R. Watkins Medical Co.* v. *Gray*, [1920] 2 W.W.R. 588 (Alta. S.C.T.D.). In British Columbia, a debtor may choose goods to the value of $2,000 which, at his option, are exempt from execution: *Court Order Enforcement Act*, R.S.B.C. 1979, C. 75, S. 65. It may be possible for a debtor to convey safely goods to a value of $2,000.00. As the exemption is optional, in the absence of an execution it would appear to have little significance. It also differs significantly from property which is by definition exempt from execution. Under the *Homestead Act*, R.S.B.C. 1979, c. 173, s. 4 a homestead, as defined in the Act, is exempt from "seizure or sale by any process for or on account of a debt of liability" provided it is registered as such in the appropriate land title office. If the homestead has a value in excess of $2,500 only the first $2,500 of value is exempt. Registration under the *Homestead Act* be repealed in *Report on Execution Against Land*, (LRC 40, 1978) at 15.

(ii) Property held by the grantor as trustee: *C.I.B.C.* v. *Fenner*, (1983) 47 C.B.R. 156 (Ont. S.C.); *Austin Marshall* v. *Bennie*, (1985) 33 A.C.W.S. (2d) 36 (Ont. H.C.); *Hall* v. *Quensel*, (1922) 68 D.L.R. 80 (B.C. Co. Ct.); *Higgins Co. Ltd.* v. *Roguski*, (1973) 40 D.L.R. (3d) 519 (Ont. H.C.); *Bank of Nova Scotia* v. *Brickell*, (1980) 4 A.C.W.S. (2d) 197 (B.C.S.C.); *Serenity Farms Ltd.* v. *Traversa*, (1985) 55 C.B.R. 214 (Ont. S.C.). Even in this situation, however, the conveyance may be set aside if there are other badges of fraud: *see Northland Bank* v. *Smetaniuk*, (1986) 62 C.B.R. 113 (B.C.S.C.); *cf. Kish Equipment Ltd.* v. *A.W. Logging Ltd.*, [1986] B.C.D. Civ. 3867-02. which is made with the intention, and has the effect, of impairing a person's ability to satisfy his claim by execution. Such a transaction is valid between the parties to it but voidable as against the prejudiced claimant.

The provisions of the *Fraudulent Conveyance Act* provide only very general clues to the law governing fraudulent conveyances.

C. Transactions That Are Fraudulent Conveyances

1. INTRODUCTION

Methods of attempting to shield property from a debtor's creditors are limited only by the debtor's ingenuity. The *Fraudulent Conveyance Act* refers to these transactions as either a "disposition of property" or a "bond, proceeding or order."

2. A DISPOSITION OF PROPERTY

The reference in the *Fraudulent Conveyance Act* to a "disposition of property" embraces virtually any transaction relating to property involving some positive act by the debtor."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;

The word "disposition" has a corresponding meaning. The *Interpretation Act* provides as follows:

28. (4) Where a word or expression is defined in an enactment, other parts of speech and grammatical forms of the same word or expression have corresponding meanings. The Act is less concerned with the nature of the transaction than with whether it was intended to, and does, prejudice creditors and others protected under the Act.

3. SOME EXAMPLES

An examination of cases discloses a variety of dispositions that have been characterized as fraudulent conveyances. These include an outright transfer of property or of an interest in it, and the granting of a security interest against property.

A disposition of property will not qualify as a fraudulent conveyance unless it was made with the intent to, and has the effect of, delaying, hindering or defrauding creditors of their just and lawful remedies. Whether a disposition will have that effect often depends on the consideration given by the transferee in exchange for it. A disposition is likely to delay, hinder or defraud creditors where the consideration given for it:

(i) represents less than the full value of the property;

(ii) consists of payments over a period of time;

(iii) consists of payments deferred to a particular time; or

(iv) is either unavailable to a creditor or difficult to seize.

It has been stated in *obiter dicta* that changing a beneficiary designation of an insurance policy from the debtor's estate to his wife constitutes a fraudulent conveyance, as do cheques and payments made by a husband to improve his wife's property. Forgoing the collection of a debt is a fraudulent conveyance. Payments made on life insurance policies also may be caught.

4. EXAMPLES OF TRANSACTIONS WHICH ARE NOT FRAUDULENT CONVEYANCES

There are some methods by which a debtor may enrich the estate of another and yet escape any sanction under the *Fraudulent Conveyance Act*. For example, a husband's time and labour expended to improve his wife's property creates no right in his creditors to execute upon that property.There is no law which compels him [the husband] to work for his creditors if he chooses to live in idleness, or which prevents him from giving away his time and services, or devoting them towards satisfying one creditor's demand. The arrangement [that he should work for his wife alone, she receiving the whole of the proceeds and he getting nothing but his board] which the plaintiff complins of was neither unreasonable nor illegal; and I am unable to comprehend on what principle it can be said to be a making away of property in order to defeat or defraud creditors. Where creditors fail to act during a debtor's lifetime, they may not invoke the Act after his death in an attempt to prevent joint tenants taking the property by right of survivorship.

5. FORGOING OR DISCLAIMING AN INTEREST IN PROPERTY

Typically, a fraudulent conveyance involves the transfer of an interest in property from the debtor to another. In some cases, the debtor has no interest in property, but can determine its ownership by forgoing a right of collection, by refusing to accept property to which he is otherwise entitled, or by exercising a right which allows him to designate ownership.

A debtor who neglects to exercise a general power of appointment in his own favour, so that he never receives the property, has been held to engage in a fraudulent conveyance. In contrast, courts in Alberta, Manitoba and Ontario have held that a disclaimer of a legacy does not constitute a fraudulent conveyance.

6. "A BOND, PROCEEDING OR ORDER"

The *Fraudulent Conveyance Act* refers to transactions in the form of a "bond, proceeding or order." The reason for their inclusion would appear to be that legal process may not be used to authorize a transaction intended to prejudice creditors.

Examples of using legal process to transfer an interest in property are easy to imagine. A person may consent to a judgment for a fictitious debt and allow execution against his property to effect a transfer. Such a transaction should be no more immune from attack than a straightforward conveyance.

Under the *Family Relations Act* property vested in the name of one person may, by operation of law, become unavailable to satisfy that person's debts. Section 43 of the *Family Relations Act* provides that a *prima facie* undivided half interest in family assets vests in each spouse when one of a number of "triggering events" occurs. These triggering events include a separation agreement, decree of divorce or nullity, or an order under section 44 of the *Family Relations Act* declaring that the spouses have no reasonable prospect of reconciliation. Obtaining a declaration that the spouses have no reasonable prospect of reconciliation would, in effect, transfer an interest in one spouse's property to the other spouse.

D. Intent

1. INTENT, EFFECT, CONSIDERATION AND BONA FIDE PURCHASERS

So far, the discussion has focused on the general elements of transactions which may be set aside as a fraudulent conveyance. To qualify as a fraudulent conveyance, however, two further elements are essential.

First, the transaction must have been made with the intent to delay, hinder or defraud creditors and, second, it must have that effect, before it will be set aside as a fraudulent conveyance. In this regard, the consideration received by the grantor plays a dual role. Consideration is significant with respect to the intent underlying the transaction since a sale at an undervalue raises suspicions concerning the motive for it. Consideration is also significant with respect to the effect of the transaction, since the amount of the consideration will affect the net value of the debtor's estate.

A factor linked to the consideration received by the grantor significantly affects whether a transaction will be characterized as a fraudulent conveyance. An exception is made for *bona fide* transfers for valuable consideration, notwithstanding the grantor's intent or the effect of the transaction. The principles applied by the courts to determine whether a transaction is a fraudulent conveyance differ depending on whether the consideration given for it is nominal or valuable.

2. TRANSACTIONS FOR NOMINAL CONSIDERATION

(a) Generally

Where a disposition is made for nominal consideration, it is frequently referred to as a "voluntary" conveyance in the sense that the disposition was essentially a gift. This term is potentially confusing, since the ordinary meaning of voluntary suggests an act or choice independently determined. It has that meaning in the context of fraudulent preferences.

In the case of a disposition for nominal consideration, the "creditor or other" seeking to avoid the transaction need only show that the transferor intended it to delay, hinder or defraud him of his remedies. To set aside a disposition for valuable consideration, both the transferor and transferee must have the requisite intent.

As one writer has noted:

> Assuming [the debtor's] intent to be fraudulent ... it does not matter whether or not the donee had knowledge or notice of that intent; for the donee is not within the exception...in favour of *bona fide* purchasers. A volunteer cannot be said to be injured by the gift to him being defeated; no loss is inflicted on him; he is only deprived of a gain to which others had a better right.

There are two classes of conveyances for nominal consideration.

In the first class of conveyances, the transaction renders the grantor insolvent, and his fraudulent intent is presumed. The leading case on this point is *Freeman* v. *Pope*, in which it was held:

> ... [when] a person owing debts makes a settlement which subtracts from the property which is the proper fund for the payment of those debts, an amount without which the debts cannot be paid, then, since it is the necessary consequence of the settlement (supposing it effectual) that some creditors must remain unpaid, it would be the duty of the Judge to direct ... [the settlor's intent] to have been to defeat or delay his creditors, and that the case is within the statute.

In the second class of conveyances, fraudulent intent must be proved as a matter of fact. It is open to the recipient of the property to adduce evidence that no fraudulent intent existed. The necessity of proving fraudulent intent arises in every disposition for inadequate consideration which does not have the effect of making the grantor insolvent.

(b) The Presumption of Fraudulent Intent

The presumption of fraudulent intent is often said to be one "of law." As a presumption of law, can it be rebutted? The language used in *Freeman* v. *Pope* is somewhat ambiguous on this point. In the later English decision of *Re Wise*; *Ex parte Mercer*, the Court of Appeal held that the presumption was rebuttable. Even so, in the decision of the Supreme Court of Canada in *Sun Life Assurance Co.* v. *Elliott*, Sedgewick J. stated that:

> ... where at any time a person is solvent and then makes a voluntary conveyance the effect of which is to make him insolvent, the settlement is void, and that too, no matter what the intent of the settlor was.

The authority of this decision may be questioned, since no affirmative evidence capable of rebutting the presumption had been adduced at trial. In *Mandryk* v. *Merko*, the Manitoba Court of Appeal held that the presumption of fraud arising from an insolvent's transfer for inadequate consideration was capable of being rebutted:

> In the present case we have actual evidence, accepted by the learned trial Judge, that the transfers were not made with any fraudulent intent. That evidence cannot be ignored and has to be placed in the scale for consideration along with the *Freeman* v. *Pope* presumption. However strong the presumption may be that if the necessary effect of a voluntary transfer is to delay or defeat creditors an intention to do so should be inferred, it is not conclusive. In an appropriate case the presumption may have to yield in favour of cogent and affirmative evidence establishing an honest purpose in the making of the transfer, a purpose in no way designed to prejudice creditors. The present is such a case.

In *Mandryk* v. *Merko*, the defendant transferred three properties. With respect to two of the conveyances, the presumption of fraudulent intent was rebutted by establishing that the disposition was to the true owner. The presumption was rebutted with respect to the third property by establishing that the defendant transferred it to his wife as a result of illness and in anticipation of his death.

There are numerous British Columbia cases in which the presumption has been applied either without apparent consideration being given to whether it could be rebutted, or where the presumption is said to be conclusive. In another line of authority, exemplified by cases such as *Tempo Building Supplies Ltd.* v. *Pitura* and *Re Martineau*, it is held that the presumption can be rebutted by affirmative evidence. This confusion is in part the result of courts relying on a particular line of authority without considering conflicting authority. In *Tempo Building Supplies Ltd.*, Esson J. applied *Mandryk* v. *Merko* and held that a conveyance by an insolvent husband to his wife could not be avoided if made without the requisite fraudulent intent. It would not appear that contrary authority was cited to the court.

3. TRANSACTIONS FOR VALUABLE CONSIDERATION

(a) Section 4

Section 4 of the *Fraudulent Conveyance Act* provides:

> 4. This Act does not apply to a disposition of property for good consideration and in good faith lawfully transferred to a person not having, at the time of the transfer to him, any notice or knowledge of collusion or fraud.

Judicially glossed, this section carries a meaning quite different from what might be expected. It has been taken to mean that a disposition of exigible property for valuable consideration, which is not a sham transaction, is valid unless the transferee actively participated in the fraud.

(b) Valuable Consideration

The requirement for good consideration in section 4 has been interpreted as importing a need for "valuable consideration." It is not enough that the transferee supplied consideration which would be sufficient in a simple contract case. A peppercorn will not do. A promise to discharge the encumbrances on real property would constitute good consideration in contract, but does not in a fraudulent conveyance case. Similarly, a promise by A to maintain B for life in exchange for B's property would be perfectly good consideration inter partes, but such an arrangement was upheld against creditors in *Burr* v. *Casady* only because the grantor was physically incapable of caring for herself.

At common law, when considering whether a contract is binding, the courts are concerned with whether there is consideration and not with its adequacy. Where, however, a transaction is attacked as a fraudulent conveyance, the manner in which section 4 has been interpreted requires the courts to assess the adequacy of the consideration for the conveyance. This task is often disguised in semantic debates concerning whether consideration is "good," and whether that term includes "valuable," "non-valuable" or "meritorious" consideration. In one case, the British Columbia Court of Appeal opposed "good and valuable" consideration to "merely nominal or entirely inadequate" consideration. "Inadequate" appears to be the common characterization of consideration which does not satisfy the requirements of section 4 or an equivalent section, so that the transaction is set aside.

The test of inadequacy of consideration has been expressed in a number of different ways. It has been said that the inadequacy must be "so palpable that it must be taken to have been a fraudulent contrivance." Other cases have referred to "gross inadequacy," but temper that test by refusing in cases of sales between relatives to call consideration grossly inadequate if it is supplemented by considerations of "natural love and affection," even though such "meritorious consideration" will not bring a conveyance within section 4 of the *Fraudulent Conveyance Act* on its own.

Whatever formula is used to distinguish "good" consideration from "inadequate" consideration, the policy is clear. To bring a transaction within section 4, it is unnecessary to show that there exists a one-to-one correspondence between the market value of the property transferred and the consideration supplied. To do so would constitute too great a restraint on the transferability of property. The question is, therefore, one of degree, in which the subjective position of grantor and grantee cannot be entirely overlooked.

(c) Concurrent Intent

It seems quite plain on the wording of section 4 that mere notice of the debtor's fraudulent intent should be sufficient to make a transaction for value voidable. On occasion, some courts have adopted such an interpretation of the Act, but the preponderance of authority is clearly against that approach. As long ago as 1880, Fry J. stated in *Re Johnson* that if mere notice or knowledge of the fraudulent intent of the debtor were sufficient to avoid the transaction:

> ... it would be the overthrow of all true and plain dealing and bargaining between man and man; for, as a purchaser cannot know the circumstances of the vendor, it would prevent all dealing and bargaining ... and counteract the object of the statute ...

The British Columbia Court of Appeal adopted this view of the statute in *Meeker Cedar Products Ltd.* v. *Edge*, a decision later affirmed by the Supreme Court of Canada, without reasons. In the Court of Appeal, MacFarlane J.A. held:

> I think it is clear as a matter of interpretation of the statute as a whole and upon authority that where a sale is made for good and valuable consideration the transaction will not be void by reason of the purchaser's having notice or knowledge of the vendor's intent to delay, hinder, or defraud creditors and others unless it be proved that the purchaser was actually privy to the fraud, i.e., a party to carrying out the fraudulent intention and purpose. The *Fraudulent Conveyances Act*, to the extent to which it is not ultra vires, is a part of the law of this Province by reason of the introduction here of the Statute of Elizabeth, 13 Eliz., c. 5 (see *English Law Act*, R.S.B.C. 1960, c. 129), and subsequent inclusion of parts thereof in revisions of the provincial statutes. The earlier authorities are collected conveniently and discussed in May, Law of Fraudulent and Voluntary Conveyances, 3rd ed., pp. 53 to 69. I think it unnecessary to discuss any of them because the principle has been adopted and approved by the Supreme Court of Canada dealing with an Ontario statute, indistinguishable in relevant aspects, in *Perkins Electric Co.* v. *Orpen* (1922), 70 D.L.R. 397.

The test set out by MacFarlane J.A. in the Meeker Cedar case is known variously as the "dual," "double," or "concurrent" intent test. It has been adopted and applied on numerous occasions by courts in British Columbia and elsewhere, and represents the law of British Columbia at this time.

It must be noted, however, that the "concurrent intent" test has been applied in a number of different ways. It has been suggested, for example, that the grantee must himself intend to defeat, hinder or delay the grantor's creditors, that he need only concur in the grantor's intent, or that he must be both privy to that intent and a party to a fraudulent conspiracy. In practice the different formulations appear to have had little impact on the results of reported cases. Nothing seems to turn on the precise formula adopted in any particular case.

One commentator has suggested that the decision of the Supreme Court of Canada in *Hudson* v. *Benallack* to the effect that the concurrent intent test did not apply to the fraudulent conveyance provisions of the *Bankruptcy Act* could induce courts to abandon that test in the context of provincial legislation. However, the Supreme Court of Canada was careful in Hudson to exclude from its judgment the operation of provincial legislation dealing with fraudulent conveyances and preferences.

(d) Not a Sham Transaction

Section 4 of the Act refers to both "good faith" and "notice or knowledge of collusion or fraud." Any person having notice or knowledge of the fraudulent intent underlying the disposition of property could hardly be said to be acting in good faith if he accepted the property. This reasoning has lead some commentators to conclude that the reference to good faith is redundant.

The term "good faith" only has meaning if it is used to characterize the intent of the parties with respect to the passing of property under the disposition. When a debtor transfers his property away, he may wish only to present the appearance of a transfer. His true intent may be to reserve some interest to himself, by way of a secret instrument, oral agreement, or understanding with the transferee. In such a case the conveyance is not made in good faith, since it is a sham. The New Brunswick Department of Justice, Law Reform Division adopted this view:

> The requirement that protected transactions must be in good faith seems interpreted to mean that there must be a genuine transfer of the real interest in the property involved in the transaction from the debtor to his grantee.

This interpretation of the words "good faith" probably lies at the root of a number of cases in which courts have held that a conveyance is barred by the *Fraudulent Conveyance Act* if the grantor intended to retain some interest in the property transferred. In *Mulcahy* v. *Archibald*, the following observations were made:

> The statute of Elizabeth, while making void transfers, the object of which is to defeat or delay creditors, does not make void but expressly protects them in the interest of transferees who have given valuable consideration therefor, and it has been decided over and over again that knowledge on the part of such a transferee of the motive or design of the transferor is not conclusive of bad faith or will not preclude him from obtaining the benefit of his security. So long as there is an existing debt *and the transfer to him is made for the purpose of securing that debt and he does not either directly or indirectly make himself an instrument for the purpose of subsequently benefitting the transferor, he is protected* and the transaction cannot be held void. (emphasis added)

E. Evidentiary Issues

1. PROVING FRAUDULENT INTENT BY DIRECT EVIDENCE

Proving that a party adverse in interest had a fraudulent intent is a formidable undertaking. In *Re Johnson*, Fry J. stated:

> ... those who undertake to impeach for *mala fides* a deed which has been executed for valuable consideration, have, I think, a task of great difficulty to discharge.

Even so, on occasion admissions can be obtained which will be sufficient to establish the requisite intent. For example, the relationship between creditor and debtor may be acrimonious, and the debtor may advise of his intent to see that a creditor is not paid.

It is open to the debtor to give evidence of an innocent motive for the conveyance to rebut any allegation of fraudulent intent. No matter how prejudicial a conveyance may be in fact, it can only be avoided under the *Fraudulent Conveyance Act* if there was the requisite fraudulent intent. In *Devlin* v. *Hean*, for example, the trial judge accepted that a transfer of shares in a corporation was not made with the intent to delay, hinder or defraud creditors, but rather to relieve their owner of the onerous duty of pursuing a complicated and expensive lawsuit. In *Tempo Building Supplies Ltd.* v. *Pitura*, the court refused to avoid a disposition of the matrimonial home by a husband in favour of his wife when both honestly believed that he no longer had any equity in it. Similarly, it is open to debtors, who have previously undertaken to grant security or transfer property, to do so, even though the transaction follows by a considerable period of time the judgment on which execution is sought. There are numerous cases to this effect.

2. PROVING FRAUDULENT INTENT BY INFERENCE: BADGES OF FRAUD

Fraud is generally a secret exercise. In the vast majority of cases, the intent to delay, hinder or defraud can only be inferred from circumstances surrounding the conveyance and the effect it had on the parties to it and on their creditors. In response to this evidentiary problem, courts have identified a number of suspicious circumstances surrounding dispositions of property which justify drawing an inference of fraud. Parker states:

> Secrecy has always been the accompaniment of fraud, and for this reason circumstantial evidence must usually be the main dependence of creditors attacking a transaction. From the earliest cases to the present time we find certain circumstances recurring which have been so often repeated and have become so commonly known in fraudulent transactions that they have been catalogued as "badges of fraud." They are, in short, facts calculated to throw suspicion on the transaction and to call for an explanation.

The concept of badges of fraud originated in *Twyne's* case, decided in 1601. The following is a list of badges of fraud identified in various cases:

1. the gift comprises everything the donor owned;
2. the donor continues in possession, uses the goods as his own, or takes advantage of the item transferred;
3. the gift was made secretly or with undue haste;
4. the gift was made when a writ was outstanding;
5. the deed contains elaborate protestations that it is made honestly, truly and *bona fide*;
6. inadequate consideration;
7. payment to a person not a party to the disposition;
8. falsely stating a down payment;
9. lack of security for promissory notes issued by a purchaser;
10. the conveyance is absolute in form, but is effectively a security;

11. gross excess of value of mortgaged property over the indebtedness secured;

12. sales on long periods of credit;

13. formality (and informality!);

14. failure to procure receipts;

15. sales of chattels without examination;
16. employment of vendor by vendee after sale;

17. transferring property to a grantee without his knowledge;

18. destruction or loss of relevant papers;

19. taking cash instead of a cheque;

20. antedating the instrument.

3. THE EFFECT OF ESTABLISHING A BADGE OF FRAUD

There are two views on the effect of establishing a badge of fraud. The first is that proof of a badge of fraud is sufficient evidence of fraud to entitle the court to find that the plaintiff has made a case suitable for hearing by a trier of fact. The second view is that once a badge of fraud is established, the onus shifts to the defendant to establish that the transaction was not made with any fraudulent intent. On the first view, the court would not be obliged to avoid a transaction if the evidence is equivocal. Not all badges of fraud are clear and unambiguous, and the weight of the inference to be drawn will vary from case to case. On the second approach, however, the defendant's failure to rebut the inference or adduce positive evidence of a lawful intent will cause judgment to be issued against him. Doubts would be resolved in favour of the plaintiff. Both approaches find support in case law.

The concept of shifting burdens of proof is one that bedevils the law of evidence. In the context of fraudulent conveyances, it may be doubted whether it serves any useful purpose. If the badge of fraud is ambiguous, it is difficult to see why a finding of fraud should necessarily follow, unless the evidence as a whole otherwise justifies that conclusion.

The position adopted in *Meeker Cedar Products Ltd.* v. *Edge*,The question of intent to defraud creditors is one of fact which the Court has to decide on the merits of each particular case, after taking into account all the circumstances surrounding the making of the conveyance ... Mere suspicious circumstances are not sufficient to establish actual fraud ... by the British Columbia Court of Appeal would appear to correctly state the appropriate weight to be assigned a badge of fraud:

> It must be observed that *Twyne's* case was a case of a fraudulent gift of goods which remained in the possession of the donor and that the result of *Twyne's* case was that *Twyne* was convicted of fraud. Moreover the case cannot be considered as setting up an authoritative list of badges or indicia from which fraud ought to be inferred. Fraudulent intent in a transferee is essentially a matter of fact to be proved in the circumstances of each particular case.

Nevertheless, there is case law that suggests that certain indicia of fraud are either irrebuttable or shift the burden of proof to the person defending the disposition.

F. Standing Under the Fraudulent Conveyance Act

1. CREDITORS AND OTHERS

The phrase "creditors and others" is used in the 1979 Act to describe persons who have standing under the Act.

The term "creditor," as a term of art, refers only to those with liquidated or ascertained monetary claims. The phrase "creditors and others" extends standing to anyone with any type of a claim, including unliquidated claims in tort or contract, or for the division of matrimonial property. Even a guarantor who has yet to be called upon to pay the principal sum has been held to be an "other." The key element is legal obligation. A claim based on the possible exercise of the court's discretion, such as a claim under dependant's relief legislation, does not constitute the disappointed survivor a creditor or other.

2. SECURED CREDITORS

A secured creditor is not a creditor under the Act except to the extent his security is inadequate. A secured creditor cannot be prejudiced by the transfer of property unless he has some expectation of looking to it to realize the money owing to him. The burden lies on the creditor to prove that his security is inadequate. To do so, he must rebut the presumption of adequacy which applies. An important distinction must be drawn, however, between two issues: whether a disposition qualifies as a fraudulent conveyance and whether a person has standing to challenge a disposition. When a disposition is made, the court may draw an inference that the debtor intended to defraud creditors or others from the fact that a creditor's security was inadequate at the time of the disposition. A creditor whose security becomes inadequate after a disposition, however, may still challenge the disposition if there is other evidence that it was intended to defraud creditors or others.

3. FUTURE CREDITORS

The focus of the law governing fraudulent conveyances is to prevent a debtor from defrauding his creditors. The requirement for intent suggests that the obligation the debtor seeks to avoid exists at the time of the disposition. Often, however, it is possible to anticipate a future obligation or liability. In a number of cases a creditor whose rights arose after a disposition of property has been permitted to attack its validity.

(a) No Express Scheme to Defraud

If no express scheme to defraud subsequent creditors can be shown, the position of a subsequent creditor depends on the state of accounts between the debtor and his existing creditors at the date of the conveyance. In such cases, the subsequent creditor's right is said not to arise by statute, but rather from his equitable right to participate equally with prior creditors. This equity is defeated if the prior creditors could not have complained of the transaction or if they were paid before the date the transfer was challenged. Nor may a subsequent creditor proceed if his claim impairs the claims of prior creditors. The mere fact of subsequent insolvency alone does not attract the operation of the Act.

(b) Intent to Defraud

Where the debtor intends to hinder the challenging creditor specifically or future creditors generally, they will have standing to challenge a prior disposition.In the absence of actual fraud, a voluntary settlement made by a person who is not indebted at the time, and not contemplating the incurring of debts, cannot be set aside merely because at some later date he happens to become indebted and has no other property where with to pay the debt.
See also Bank of British North America v. *Rattenbury*, (1859) 7 Gr. 383; *Clinton* v. *Sellars*, (1908) 1 Alta. L.R. 135, 146, 7 W.L.R. 615, 617 (Alta. S.C.); *Stileman* v. *Ashdown*, (1742) 2 Atk. 477, 26 E.R. 688, *aff'd*. (1743) 2 Atk. 608, 26 E.R. 763; *Dancey* v. *Brown*, (1914) 19 D.L.R. 862 (Ont. S.C.); *Robert Dollar Co.* v. *Walker*, (1925) 36 B.C.R. 405 (B.C.C.A.). However, an intent to defeat existing creditors is not in itself evidence of an intent to defeat future creditors: *Gauthier* v. *Woolatt*, [1940] 1 D.L.R. 275 (Ont. S.C.). Such an intent will be inferred where the debtor conveys away his property on the eve of entering into business. In some cases, it has been suggested that the business must be of a hazardous nature, or one in which the debtor has no experience. In British Columbia, however, it would appear that the general principle is not limited in this way. The key element is the contemplation of future creditors who will be defrauded.

(c) Other Circumstances

Subsequent creditors have been permitted to attack a disposition of property where the transferor was rendered insolvent as a result of, or shortly after, the disposition, and where the transferor paid off existing debts in order to substitute a fresh set.

4. THE CORPORATE VEIL

In *Aspen Planers Ltd.* v. *Delshar Developments Ltd.*, it was held that an action lay under the *Fraudulent Conveyance Act* against a company which had conveyed its property away to frustrate execution on the shares of one of its prime shareholders. The term "creditor" was said not to be confined to creditors of the disposing grantor. This case may be explained as a situation in which the court pierces the corporate veil, so that a disposition by the company is regarded as a disposition by the debtor.

G. "Of Their Just and Lawful Remedies"

The remedy most often invoked under the Act is access to property to satisfy a judgment debt. However, the term "remedies" is broad enough to cover any form of remedy which might be stultified by a disposition of property. In *Kapicki* v. *Andriuk*, for example, it was held that a conveyance of farmland was void on the ground that the transfer was made to nullify the effect of an injunction which the transferors anticipated would issue against them in a nuisance action. This case appears to be unique. The *Fraudulent Conveyance Act* is seldom invoked in aid of non-monetary remedies.

CHAPTER IV THE *FRAUDULENT PREFERENCE ACT*

A. Introduction

The relatively recent origins of the *Fraudulent Preference Act* were reflected in the more modern drafting style of the 1960 Act. In the 1979 revision, the language of the Act was further modified in what can only be regarded as a less than satisfactory exercise in statutory revision. The result has been to introduce ambiguity into the Act where it otherwise was clear, and perhaps even to alter its effect.

A fraudulent preference is, in essence, a transfer of property by a debtor to a creditor with the intent that the creditor who receives it will be in a position to use it to satisfy obligations owed him, and thereby steal a march on other creditors. There are obvious limits to how far the law can go in avoiding payments to a creditor. The common law always encouraged the payment of debts, and it is trite law that nothing in the *Fraudulent Conveyance Act* prevents a debtor from preferring his creditors as he will. Moreover, it is the essence of any satisfaction of an obligation to a creditor that at the moment of payment he is preferred to all other creditors. Modern commerce would grind to a halt if a creditor could never be sure that payment on account, or security taken for an advance of money, was not liable to be set aside at the instance of another creditor.

The policy of the law, therefore, has been to limit the application of the Act by introducing into it a number of preconditions to the avoiding of a transaction which differ significantly from those found in the *Fraudulent Conveyance Act*, as well as by introducing a number of statutory defences which, while often ignored in practice, have the potential to significantly confine the scope of the Act. Canadian courts have further restricted the range of transactions caught by the Act by interpreting it narrowly. The introduction of the defence of "pressure" and of the "concurrent intent" test are examples of this process.

B. Preconditions to Avoiding the Transaction

1. INTRODUCTION

The *Fraudulent Preference Act* requires a creditor who seeks to avoid a preference to prove the existence of a number of facts:

1. That a debtor is insolvent or on the eve of insolvency;

2. That the debtor made a disposition of property or agreed to a judgment;

3. That the disposition or judgment was in favour of a creditor;

4. That the debtor intended to prefer that creditor (or alternatively, in some cases, that the disposition had the effect of preferring that creditor).

In the following discussion, each of these matters will be examined separately.

2. INSOLVENCY AND THE "EVE OF INSOLVENCY"

Under section 3 of the *Fraudulent Preference Act*, a preferential transaction is void if the debtor is "in insolvent circumstances, is unable to pay his debts in full, or knows that he is on the eve of insolvency." It is now settled that the phrase "is unable to pay his debts in full" is synonymous with "insolvent circumstances."

It might be expected that courts would look exclusively to the debtor's ability to pay his debts to determine whether he was insolvent. Some courts have adopted a "commercial" test for determining insolvency, which depends upon whether the debtor is able to meet his obligations as they fall due. Other courts adopt instead a "legal" or "book value" test which involves a comparison of the value of the debtor's liabilities to the forced sale value of his assets. Only assets located within the jurisdiction are brought into the equation.

So me courts are content to make a finding of insolvency without addressing the question of which test is to be applied. Other courts apply both tests concurrently. If the debtor has either adequate assets to satisfy his debts, or a history of meeting his debts as they fall due, there would seem to be little reason to jeopardize the validity of any disposition of property he might make.

The burden of proving insolvency lies on the creditor impugning the transfer. This can be a difficult task. Although a transaction may be both suspicious on its face and preferential, the plaintiff is not relieved of the burden of proving insolvency. Often the plaintiff loses sight of this. If insolvency is not proved, the action must be dismissed.

The difficulties inherent in proving insolvency are, on occasion, intensified if the proceedings are commenced by petition under section 9 of the *Fraudulent Preference Act*. The petitioner would have no right to discovery and, for that reason, may not have access to the debtor's financial records. These may be the most direct means of proving insolvency.

A transaction made "on the eve of insolvency" occurs when the debtor knew that in the very near future he would be unable to meet his obligations as they fell due. In particular situations, courts may also infer that a defendant was on the eve of insolvency by reference to the realization procedures taken by creditors at or about the date of the impugned transfer. In *Bank of B.C.* v. *G. Uebelhard & Sons Farms Ltd*. the respondent's assets were insufficient to repay the petitioner, who had commenced foreclosure proceedings at the date of the transfer. The debtor was held to be "on the eve of insolvency."

3. A DISPOSITION OF PROPERTY OR AGREEMENT TO A JUDGMENT

(a) A Disposition of Property

(i) Interpretation

There is little authority on the construction of the phrase "disposition of property." It is probable that it will be accorded the same broad meaning as the same phrase in the *Fraudulent Conveyance Act*. Section 3 of the 1960 *Fraudulent Preference Act* provided a fairly comprehensive list of property to which the Act applied. It extended to:

> goods, chattels, or effects, bills, bonds, notes, or securities, shares, dividends, premiums, bonuses in any bank, company or corporation, or...any other property, real or personal ...

Only property amenable to execution falls within the scope of the *Fraudulent Preference Act*. Similarly, a transfer of a legal interest by a trustee is not caught, although an assignment by a beneficiary of his equitable interest would be.

In *John MacDonald & Co.* v. *Crombie*, the Supreme Court of Canada considered the effect to be given to the words "gift, conveyance, assignment or transfer" found in the Ontario *Assignments and Preferences Act*. In return for a discount, a debtor agreed that a debt should become immediately due and payable. The creditor then obtained a default judgment. Ritchie C.J.C. held:

> [I cannot] understand how anything the debtor did in this case can be held to operate as a gift, conveyance or transfer of goods or effects, when in fact, no gift, conveyance or transfer was made, nor anything done which, either at law or in equity, can be held to amount to a gift, conveyance or transfer ... The transaction was no more ... than saying ... "if I can get a judgment against you in regular course and an execution in the sheriff's hands before other creditors, that not being prohibited, the law will give me a priority."

An arrangement of this nature is unlikely to be a "disposition" within the meaning of the *Fraudulent Preference Act*.

(ii) Payments

Section 6(1) provides that "payments to a creditor" are not subject to attack under the Act. The payment must be of a value commensurate with the consideration for which it was paid.

The term "payments" is broad and possibly embraces a payment consisting of any kind of asset. A more likely interpretation, however, is that payments are restricted to payments of money, the formulation used in section 4(1) of the 1960 Act.

On its face, the exclusion of money payments would appear to permit a debtor to pay his creditors in money, preferring whomsoever he will. The Ontario Law Reform Commission expressed the following view in its discussion of Ontario fraudulent preference legislation.

> ... the provision is a startling one indeed, since it effectively legitimizes the most common type of preference - the payment of money to a creditor in respect of an antecedent debt - and flies in the face of the very purpose of the *Assignments and Preferences Act*. The bizarre nature of this interpretation is made even clearer when one reflects on the apparent absence of any good faith requirement respecting the debtor's payment to his creditor.

The Ontario report proceeds on the assumption that the requirement that the payment of money "bear a fair and reasonable relative value to the consideration" received removes most money payments from the ambit of this exception. Why this would be is not clear, since the Ontario provision, as with section 6 of the *British Columbia Act*, is not restricted to fresh consideration. A payment up to the amount the debtor owes would "bear a reasonable relative value to the consideration" received. Any amount paid beyond that would qualify as a fraudulent conveyance. Moreover, case authority buttresses a broad reading of the exemption. In 1891, the Ontario Court of Appeal made the following observations in *Campbell* v. *Roche*:

> The learned Chancellor appears to have treated the preferential payment of a debt as a *malum prohibitum* - something illegal and wrong. But the payment of money to a creditor in discharge of his debt is not forbidden; on the contrary it is expressly excepted from the operation of sec. 2, even though it is manifestly a preference. It may be said to be an evasion of the statute to borrow money in this way and apply it to the payment of preferred creditors, but that can scarcely be successfully urged if the act intended to be done does not fall within the prohibition.
>
> He seems to have considered that the words "made in the ordinary course of trade or calling," to be found in the exception of a *bona fide* sale or payment so made to innocent purchasers or parties should be read into this exception of payment to a creditor; but I think with great deference that we are not entitled to take that liberty with the statute, and the point was not pressed before us; and it is, I think, made clear that no such restriction was intended when we refer to the previous legislation on the subject, when such payments were protected only if an assignment for the benefit of creditors was not made within a month after the payment.

In a concurring judgment, Osler J.A. held that there was no requirement that the payment be made or received *bona fide* or without notice or knowledge of fraud.

This judgment was affirmed by the Supreme Court of Canada, and was followed in the recent Ontario High Court decision of *Re Pontiac Forest Products Ltd*. In that case, Anderson J. held:

> It may be an anomaly that payments of money to a creditor should be singled out for separate and different treatment than other preferences. The law is full of anomalies. If there is an anomaly, I do not find its existence warrants departing from what is to me the clear effect of the Act. Mine is a judicial, not a legislative function.

In *Jones* v. *Thorpe*, a British Columbia decision, a creditor sought to avoid a payment made by an insolvent debtor to reduce the principal sum due on a mortgage. Locke J. held that:

> I dispose of the first issue by adopting defence counsel's argument that ... the *Fraudulent Preferences Act* ... permits a debtor, even though insolvent, to apply assets to any *bona fide* previously incurred debt: there is no proof of insolvency, the wife had no knowledge, and the credit union mortgage was such a debt. The transaction cannot be attacked on any ground.

It should be observed that in a number of recent cases payments of money to creditors are assumed to qualify as fraudulent preferences. Unfortunately, earlier authority on this issue does not appear to have been cited to the courts in these cases. It would appear that some modern courts have lost sight of a very well established limitation on the *Fraudulent Preference Act*.

The rationale for excluding money from the list of assets caught by the Act is not clear. It may be that it was thought wise to encourage the payment of creditors generally, and that it placed too high a burden on trade creditors to expect them to question every payment in cash. Alternatively, the exception may reflect the origin of Canadian preference legislation in pre-1838 English insolvency legislation. Prior to 1838, money was not exigible, and hence a payment of money could not prejudice a creditor.

A transfer of cash will obviously constitute a payment. Other forms of payment may equally be considered as equivalent to the payment of money. It has been held, for example, that a cheque payable to a creditor constitutes a payment of money, although a cheque payable to a debtor endorsed to a creditor does not. Conversely, the payment to a creditor by a person who purchases property from the debtor is a payment of money. In one Ontario case, it was held that if the creditor receiving the cash had actually sold the goods on behalf of the debtor, he is to be treated as having received the goods, rather than the proceeds of their sale, even though the creditor did not appear to ever have had possession of them.

(b) An Agreement to a Judgment

Section 2 of the *Fraudulent Preference Act* refers to two kinds of instruments preferring creditors. These are an agreement to a judgment and a power of attorney to enter judgment in favour of a creditor.

This formulation replaces the rather longer one used in the 1960 Act. Section 2 of that Act invalidated "a confession of judgment, *cognovit actionem*, or warrant of attorney to confess judgment." The last two devices are archaic security instruments which, in effect, constitute a consent to judgment before action is commenced. In the case of a warrant of attorney, the creditor was constituted the debtor's agent for the purpose of consenting to judgment.

In England, such instruments were required to be registered with the clerk of the court of King's Bench at Westminster by virtue of the *Warrants of Attorney Acts* of 1822 and 1843. There is no authority whether this legislation was in force in British Columbia, which is not surprising since as a form of security these instruments had long been regarded as obsolete. In any event, cognovit actionem and warrants of attorney to confess judgment were abolished in British Columbia in a recent amendment to the *Law and Equity Act*, which now provides in section 53:

> No Cognovit Actionem or Warrant of Attorney to confess judgment has any force or effect.

At one time judgment creditors enjoyed an enhanced priority over general creditors so that obtaining a debtor's agreement to judgment resulted in a preference to the creditor. The sheriff was obliged to satisfy fully each writ of execution in the order in which it was received, irrespective of the date on which the obligation crystallized in the judgment was incurred. The first person to put a writ in the sheriff's hands was thereby assured priority in the debtor's goods over all other unsecured creditors. Moreover, filing a judgment in any court of law constituted a lien on any land owned, or subsequently acquired, by the debtor.

Taking judgment no longer confers a priority on the judgment creditor. The single advantage of an agreement to judgment, consequently, is that the judgment creditor may commence execution proceedings with dispatch. The *Creditor Assistance Act*, however, limits even this opportunity to obtain a preference.

The *Creditor Assistance Act* provides that there shall be no priority among creditors by execution. That Act provides a mechanism by which all creditors can share in the proceeds of execution by a judgment creditor. In view of the types of execution proceedings to which the *Creditor Assistance Act* does not apply, it cannot yet be said that obtaining judgment promptly has ceased to confer any advantage to a judgment creditor, and thereby rendered the extension of the *Fraudulent Preference Act* to "agreements to judgment" superfluous.

The reference in section 2 of the *Fraudulent Preference Act* to an agreement to judgment was probably intended to embrace a *cognovit actionem* or warrant of attorney, referred to in the 1960 Act. The abolition of these instruments leaves open the question of what other kinds of agreements to judgment are caught by section 2. The 1960 Act referred to "a confession of judgment." Case law on the meaning of that phrase is helpful.

It is clear that no debtor is under an obligation to defend an action. Merely permitting judgment to go by default is not a "confession of judgment," even where the debtor chooses to defend other actions. Should the decision not to defend be made specifically to prefer the plaintiff, an order or judgment obtained by default will still not be set aside if the plaintiff acted *bona fide*.

A consent judgment might constitute an "agreement to a judgment." In *Edison General Electric Co.* v. *The Bank of British Columbia*, the Full Court of the British Columbia Supreme Court held that a consent to judgment fell within the *Fraudulent Preference Act*. However, in that case, the consent filed by the defendant's solicitors was pursuant to a pre-existing arrangement. The case might be distinguished from an ordinary consent judgment on that basis.

Focusing on the instrument or means of obtaining judgment is arguably misleading. It would appear that section 2 is aimed at collusive arrangements between debtor and creditor by which the creditor receives a preference. Consenting to judgment is in itself unlikely to constitute a preference.

4. "CREDITORS"

The *Fraudulent Preference Act* provides a remedy to a creditor where the debtor has transferred property to another creditor. The meaning of "creditor" controls when a fraudulent preference has been made and who has standing under the Act.

(a) In Favour of a Creditor

The word "creditor" is not exhaustively defined in the Act. Section 1 provides only that the term "creditor" includes sureties, endorsers of bills of exchange or promissory notes, and beneficiaries of trusts or other objects of equitable duties.

At common law, the term "creditor" bears a restricted meaning. It does not include a person with an unliquidated claim, nor one whose claim is contingent or future. Neither a trustee nor his beneficiary is at common law a creditor of the other. On occasion, as in *Gibb* v. *Lombank Scotland Ltd.*, it has been suggested that the word might be sufficiently flexible to encompass any person with a pecuniary claim, but it is unlikely that courts will significantly expand the definition. A transfer of property to a person who is not a creditor cannot be a fraudulent preference.

(b) Standing

The discussion above of the meaning of "creditor" also applies to the issue of what persons may proceed under the *Fraudulent Preference Act* to attack a disposition made in favour of a creditor. It would appear that only persons who have liquidated claims have standing.

Courts have refused to permit secured creditors to take advantage of the Act except to the extent that their security is inadequate. There is a presumption that security held by a person impugning a transaction is adequate. The burden lies on the secured creditor to establish his standing. The date the preference is conferred is the relevant date for determining the adequacy of security.

In Canada, neither a person with a claim for damages in tort nor the victim of a theft is said to be the creditor of the person who wronged him.

A creditor whose debt arises after the date of the impugned payment has no status to proceed under the *Fraudulent Preference Act*. This position differs from the position under the *Fraudulent Conveyance Act*. Under that Act, a "creditor and other," whose claim arises after a fraudulent transfer, may apply to set it aside, for example, if other creditors were defrauded.

5. AN INTENT TO PREFER A CREDITOR

(a) The Doctrine of Pressure

Courts have restricted the meaning of the word "preference" to cases of dispositions of property by the debtor made with the intent that one creditor steal a march on other creditors. Where a debtor satisfies a creditor's claim or provides security to him as a result of being subjected to legitimate commercial pressure, courts have consistently held that the transaction cannot be avoided under the Act. A disposition in that case is made primarily in response to the pressure, not with the intent of preferring the creditor.

The doctrine of "pressure" is an ancient one. In *Stephens* v. *McArthur*, Strong J. stated:

> As I have said the doctrine had its origin as far back as the time of Lord Mansfield ... and the books are full of cases down to recent times all recognizing the doctrine and treating it as one necessarily arising from the primary and natural import of the word "preference" as meaning a voluntary act on the part of the debtor and therefore as a term which is not applicable to an act brought about by the active influence of the creditor ...

Courts have taken a very broad view of what constitutes pressure. In *Stephens* v. *McArthur*, Strong J. suggested that a bare demand by a creditor unaccompanied by any legal action or threat of legal action could constitute pressure, a view adopted by Bouck J. in *Bank of Montreal* v. *Ngo*. No particular degree of pressure is required, provided the dominant intention of the debtor was to relieve the pressure and not to prefer the particular creditor paid. The pressure applied must be *bona fide* and not collusive. The real inquiry is whether or not the transaction was voluntary, in the sense that the decision to prefer was independently arrived at by the insolvent debtor. A disposition made as a result of pressure is not voluntary.

(b) Cases in Which an Intent to Prefer Must be Proved

(i) Whose Intent is Relevant?

Sections 2 and 3 require proof of an intent to prefer a creditor before a disposition will constitute a fraudulent preference. The creditor must prove more than that the transaction had the effect of a preference. The fact that a transaction has the effect of giving a preference may, however, be cogent evidence of the intention of the parties, where the case can be proved only by circumstantial evidence. Some courts have recognized a presumption of an intent to prefer when a debtor conveys all his property to a creditor for a past due debt.

On the express wording of sections 2 and 3, and in view of the doctrine of pressure, it appears logical to conclude that the relevant intent is that of the debtor. That would be an error. It seems fairly well settled that a transaction may not be attacked unless the parties had a concurrent or dual intent to give and receive a preference. In bankruptcy, by way of contrast, only the intent of the bankrupt is relevant. The decision of the Supreme Court of Canada in *Hudson* v. *Benallack*, has led some commentators to suggest that the law under provincial legislation should also be regarded as requiring proof of the debtor's intent alone.

(ii) Proof of Fraudulent Intent

Determining whether a transaction was primarily motivated by pressure, and hence valid, or fraudulent intent, and hence void, may present problems. In some cases the two so overlap that it is difficult to tell what was the dominant motive of the parties to the transaction.

The onus is on the plaintiff to establish that the preference was made with the requisite fraudulent intent. The defendant, however, may adduce evidence of an honest intent.

It has been held that where the debtor "honestly in his own mind believed that he could pull through if only he were given an opportunity" no fraudulent preference occurs, notwithstanding the prejudicial nature of the transfer and the creditor's intent to gain a preference. If the disposition of property was made pursuant to an agreement to give security made before the insolvency, no fraudulent intent exists. In *Royal Bank* v. *First Pioneer Investments*, the court declined to set aside an undoubtedly preferential debenture because other creditors were fully advised by the respondent of its efforts to save the insolvent company issuing it.

A creditor cannot complain merely because another creditor who had an equitable mortgage, unregistered legal charge or undertaking to grant security, obtains a registered legal charge.

6. CASES IN WHICH NO INTENT TO PREFER NEED BE PROVED?

Section 4 of the 1979 Act is cryptic. It provides:

> 4. Subject to section 6, where, without intent, the disposition gives the creditor a preference over some or all of the other creditors, section 3 (b) also applies
>
> (a) in a proceeding brought to set aside the disposition within, where there is a document evidencing the disposition registered under an Act, 60 days after registration, or, in other cases, 60 days after the disposition, as against the creditor injured;
>
> (b) where the debtor, within 60 days after the disposition, makes an assignment for the benefit of his creditors, as against the assignee or a creditor authorized to take proceedings to set the disposition aside.

The reference to a disposition being made "without intent" conveys the notion that it is the effect of the conveyance that is in issue, rather than the intent with which it is made. This interpretation is buttressed by section 5 of the Act, which negates the defence of pressure in a transfer of property falling within section 4 and provides that "the preference shall not be dependent on the intent or motive of the debtor ..." Even so, the reference to section 3(b) leads to the illogical result that a transaction made "without intent" is void if made "with intent to give a creditor a preference."

A review of the equivalent provisions in the 1960 Act confirms that these sections were designed to render void any transaction which has the effect of giving a creditor a preference, provided it is attacked within 60 days of its disposition, the registration of a necessary document, or assignment for the benefit of creditors. The combined operation of sections 4 and 5 of the *Fraudulent Preference Act* would appear to place a creditor in a much stronger position than he would occupy if he were obliged to proceed under section 3. It is important that the effect of these sections be clear, but the present language of the Act does not lend itself to a sensible reading. Nevertheless, it is well established that in an attack under sections 4 and 5 intent is irrelevant. Only the preferential effect of the transaction and the insolvency of the grantor are in issue.

Section 4 requires a proceeding to be "brought to set aside the disposition" within 60 days of the disposition or its registration. A defendant may not plead any equitable right arising from the transfer to advance the date from which the 60 days runs. It is the date of the actual conveyance, and not the date the defendant was in a position to call for it, that is relevant.

The rationale for having a strict rule for transactions attacked within 60 days of disposition or registration is not immediately apparent. The policy in favour of section 4(b) which voids a preference made within 60 days of an assignment for the benefit of creditors is more easily identified. The conclusion would appear to be that transfers made within 60 days of insolvency are so inherently suspicious and objectionable that intent should be irrelevant. Moreover, the operation of bankruptcy legislation is facilitated by prohibiting a debtor from unilaterally disposing of his assets to creditors before a receiving order is pronounced.

Sections 4 and 5 do not, on their face, give rise to any presumption concerning the intent with which the parties enter into a transaction. A transaction falling within section 4 is deemed to be a preference. This position may be contrasted with that in Ontario, where the statute casts a presumption of fraudulent intent rather than makes intent irrelevant. Subsections 4(3) and (4) of the Ontario *Assignments And Preferences Act* provide:

> (3) Subject to section 5, if such a transaction with or for a creditor has the effect of giving that creditor a preference over the other creditors of the debtor or over any one or more of them, it shall, in and with respect to any action or proceeding that, within sixty days thereafter, is brought, had or taken to impeach or set aside such transaction, be presumed *prima facie* to have been made with the intent mentioned in subsection (2), and to be an unjust preference within the meaning of this Act whether it be made voluntarily or under pressure.

> (4) Subject to section 5, if such a transaction with or for a creditor has the effect of giving that creditor a preference over the other creditors of the debtor or over any one or more of them, it shall, if the debtor within sixty days after the transaction makes an assignment for the benefit of his creditors, be presumed *prima facie* to have been made with the intent mentioned in subsection (2), and to be an unjust preference within the meaning of this Act whether it be made voluntarily or under pressure.

Ontario cases, therefore, are not a sure guide to the interpretation of sections 4 and 5 of the British Columbia *Fraudulent Preference Act*.

There is no authority which would constrain a court to hold that the word "deemed" contained in section 5, of the Act means that only transactions which satisfy the words of that section are "preferences" within subsections 4(a) and 4(b) which may be avoided because of their prejudicial effect. It would be open to a creditor to rely on the fact that the creditor allegedly preferred gained some unfair advantage by the transaction. A creditor who intends to rely on the deeming provision of section 5 must first establish the debt owing to the preferred creditor, the percentage of his recovery, the value of the debtor's total unsecured debts, the identity of his other creditors, and what percentage recovery the unsecured creditors might expect if they took execution proceedings. This could prove a daunting task even if the law concerning creditors' rights were crystal clear.

C. Statutory Defences and Limitations

1. INTRODUCTION

A defendant in a *Fraudulent Preference Act* may defend himself by disproving any of the allegations the plaintiff must prove. The *Fraudulent Preference Act* also provides a number of statutory defences and limitations to the plaintiff's right of action. One limitation which has already been discussed, and about which nothing further will be said in this part, is the exception contained in subsection 6(1) respecting a payment to a creditor. There are numerous other exceptions, however, and each bears separate examination.

2. THE POLICY OF THE FRAUDULENT PREFERENCE ACT

The provisions of the *Fraudulent Preference Act* reflect two competing policies. The first is that of discouraging individuals from acquiring an undeserved priority over other creditors. This policy is illustrated by section 5 of the Act, which deems certain transactions to be preferential.

A preference is not undeserved if it is conferred as a result of a creditor's activities which enhance the debtor's estate, or if the creditor makes it possible for the debtor to continue in business and eventually to pay off all his creditors. In *Empire Sash & Door Co.* v. *Maranda*, Robson J. held:

> There was no defeating of the creditors by this arrangement, for the pecuniary interest of the debtor, Mrs. Vanzant, in the goods and chattels, remained the same, and as an equity of redemption it was exigible for her creditors. The burden imposed by the mortgage was represented and counterbalanced by an equivalent increase in her stock of goods. Nor was this a preference given to the Gouldings over the other creditors, because it was of the essence of the transaction that the Gouldings should not become her creditors unless on the terms of being protected by this security. The Act is levelled at a case where all creditors being on an equal footing, one by means of a security gets an advantage over the others. But here the Gouldings were not on a par with the others at the outset, and but for the protection of this security they would not have become her creditors at all in respect of this $620.

A second policy underlying the exceptions to the Act favours the transferability of property in the normal course of business. This policy explains in part both the defence of pressure and the statutory defences to a *Fraudulent Preference Act*.

3. GENERAL CONSIDERATIONS

Several conditions must be satisfied before a defendant may rely on a statutory defence. These relate to whether the transaction was made in good faith and the adequacy of consideration advanced by a creditor receiving the alleged preference. In some cases the preferred creditor is entitled to a return of consideration advanced for a preference.

(a) "In Good Faith"

Section 6 of the *Fraudulent Preference Act* contains numerous invocations of the term "in good faith." This phrase may have one of two meanings. The first is that the transaction must be genuine in that the property transferred is not held on trust for, or used for the benefit of, the transferor. In other words, the transaction must not be a mere sham.The Legislature has chosen to except from the operation of the Act "any payment of money to a creditor," and I do not think we should be justified in interpolating the expression "*bona fide*" in that clause in order to infer that if the creditor had notice that the debtor was in a state of insolvency when he made it, it was a payment *mala fide* and forbidden by the Act. The enactment is on this very point distinguishable from the 92nd section of the *Imperial Bankrupt Act*, dealt with in *Tomkins* v. *Saffery*, 3 App. Cas. 213, at p. 236. By the latter part of that section it was enacted that the section should not "affect the rights of a payee in good faith and for valuable consideration." And it was held that a creditor receiving payment with knowledge that he who made it was a person unable to pay his debts as they became due from his own moneys, was not a payee in good faith within the meaning of the Act.

The second possible interpretation of this phrase is that the transferee must not know of, or share, the fraudulent intent of the transferor. As was noted earlier, the transaction can only be avoided under sections 2 and 3 of the *Fraudulent Preference Act* if the transferee shared the transferor's fraudulent intent. If he did, then he must have had the requisite notice or knowledge, and the statutory defences could not assist him. With respect to sections 2 and 3, consequently, the concept of good faith is consistent with, but adds little to, the dual intent test. The protection of transactions made in good faith is clearly of more significance in cases falling under section 4 of the *Fraudulent Preference Act*, under which a transaction may be avoided even though neither party had any fraudulent intent.

The relationship between the defences listed in section 6 and the "dual intent" test has been described as follows:

> For the most part, these exemptions are designed to protect transactions entered in good faith for consideration with innocent third parties. Many such transactions would be found not to involve any improper intent. To this extent, application of the exemptions tends to be pre-empted by the role of factors such as consideration and the debtor's solvency in rebutting inferences of improper intent. Although it owes its origins to the express exemptions, the double intent requirement has also tended to pre-empt application of the exemptions by creating an additional element - some actual involvement of the grantee in the improper intent - to be established by creditors challenging a transaction in most cases where the exemptions are relevant. However, in cases where there is evidence of the debtor's improper intent, the exemptions can be important, and they will increase in importance if the double intent requirement is eliminated.

(b) Consideration

Section 6 of the *Fraudulent Preference Act* provides a test for determining the adequacy of consideration required to support a statutory defence. The property disposed of must bear a fair and reasonable relative value to the consideration for the transaction. This requirement applies to all the exceptions listed in section 6(1).

(c) Return of the Property Transferred by a Preferred Creditor

The *Fraudulent Preference Act* is silent on what should happen to a payment or transfer made by a preferred creditor which does not satisfy the test for adequate consideration under section 6.

Two subsections of section 6 contemplate the return of some of a creditor's property as a precondition to relief under the Act. Sections 6(3) and (4) provide:

6. (3) In case a payment has been made which is void under this Act, and valuable security was given up in consideration of the payment, the creditor is entitled to have the security restored or its value made good to him before, or as a condition of, the return of the payment.

> (4) Nothing in this section prevents a debtor providing for any payment of money to a creditor where the creditor, by reason or on account of the payment, has lost or been deprived of or has in good faith given up a valid security which he held for the payment of the debt so paid, unless the value of the security is restored to the creditor, or the substitution in good faith of one security for another security for the same debt, so far as the debtor's estate is not lessened in value to the other creditors ...

The scope of these provisions is difficult to determine. Section 6(1) provides that a payment to a creditor is not a preference within the meaning of the Act. Section 6(3) contemplates a void payment to a creditor. In view of section 6(1), a void payment is probably more appropriately characterized as a fraudulent conveyance than a preference.

Section 6(4) appears to provide that a payment to a creditor which results in the discharge of a valid security is immune from attack as a fraudulent preference. This is inconsistent with section 6(3) which appears to provide that where such a transaction is void as a fraudulent preference, the creditor is entitled to the return of his security or its value. That concept also appears to be embodied in section 6(4).

While the relationship among sections 6(1), (3) and (4) is confusing it does not appear to have presented problems in practice. Since the transaction is either immune from attack or the creditor is restored to the position he occupied before the transaction, the creditor would not appear to be prejudiced whichever interpretation is adopted.

In *Beattie* v. *Wenger*, Osler J. in the Ontario Court of Appeal stated in *obiter dicta*:

> ... there is no injustice in refusing to order repayment by the creditor to the assignee without the return or making good by the latter of any security which he had from the debtor's estate and which he had given up in consideration of the payment and this even although the creditor had deliberately intended to obtain a preference, and had actively done what is forbidden and declared to be invalid by the Act. There can be no reason why the debtor's estate should profit by the transaction or why the creditor should be punished by the loss of his security in addition to his being compelled to repay what he had given it up for.

Sections 6(3) and (4) would appear to apply only to compel the return of the property when the debtor paid a sum over and above what was required to discharge the underlying debt. It is difficult to see when such a case would arise. Even if it did, provided the excess cash payment discharged unsecured debt, then it is in any event a payment to a creditor and valid under subsection (1). One is driven to the conclusion that these subsections could only apply when the excess payment is a gift. In that case, it is a fraudulent conveyance, not a preference, and the plaintiff need not invoke the *Fraudulent Preference Act* to have it set aside. Confining the action to the *Fraudulent Conveyance Act* would avoid any need to return security.

It should also be noted that the opening phrase of section 6(4) ("nothing in this section") is an erroneous transliteration of section 4(4) of the 1960 Act. That section provided that "nothing herein" affected the types of transactions identified in present section 6(4). In the 1979 Act, that phrase would have been properly rendered as "nothing in this Act." On its face, section 6 avoids nothing out of which section 6(4) can carve an exception.

Unless a creditor who receives a payment can bring himself within these cryptic statutory provisions, it would appear that he must rely on the general law to recover consideration paid out in a voidable transaction. It is unlikely that the court would assist him in recovering property or security transferred with the intent to give and receive a preference. The presence of such a fraudulent intent would render the entire transfer an illegal transaction. Courts will entertain an action to recover benefits conferred under an illegal transaction only in exceptional cases.

D. Specific Statutory Defences

1. INTRODUCTION

Section 6 incorporates a number of specific defences. Their self-contradictory nature can only be explained historically. Section 6, in its entirety, dates from 1905, when the *Fraudulent Preference Act* was expanded and rewritten. It is possible that these exceptions were derived from earlier Ontario legislation, which they seem to incorporate. These Ontario provisions were added to the Ontario Assignments for the *Benefits of Creditors Act*, first enacted in 1885, and later modified by a series of Acts evidently intended to further the purpose of remedying the "great difficulty ... experienced in determining cases arising under the present law relating to the transfer of property by persons in insolvent circumstances." Presumably, the amendments were thought necessary to deal with particular questions which had arisen in practice in Ontario, although our research does not indicate what these questions might have been. In any event, it does not appear that their incorporation into British Columbia legislation arose out of any particular British Columbia case, or that the wording of the Ontario amendments was examined closely. It appears to be part and parcel of the hasty response of the provinces to the repeal without replacement of federal insolvency legislation.

2. SALES IN GOOD FAITH

Subsection 6(1) exempts from the Act all sales made in good faith, provided that the consideration received bears a fair and reasonable relative value to the asset disposed of. The combined effect of this exemption and the exemption respecting payments to creditors may be to permit a debtor to liquidate his assets, and use the money to pay his creditors in any order he chooses, at least under provincial legislation. In one Ontario case it was held that if the creditor who is paid assists in liquidating his debtor's assets, the transaction may be avoided. The implication is that if the debtor acts independently, he may prefer one creditor to another by the use of these two exceptions.

(a) Payment Made in the Ordinary Course of Business to Innocent Persons

The exemption of all payments to creditors from the ambit of the *Fraudulent Preference Act* renders this provision superfluous in part. It may have relevance where a person cannot be classed as a creditor. For example, a debtor may give away property to attract customers. Parker suggests that to give this section meaning "payment" probably refers to transfers of goods or securities.

(b) Dispositions of Property in Good Faith and in Consideration of the Present Actual Payment in Good Faith in Money

In many cases transactions which fall within this head will also fall within the rubric "sale in good faith." This exemption, however, is restricted to cash sales. It may also cover security given for a cash advance. It is an important exception which is useful in protecting innocent customers who deal with an insolvent.

In *Bank of Montreal* v. *Ngo*, section 6(1)(a) was cited in part to validate a conveyance by a debtor to his common law wife. This judgment, which also relies on section 6(1)(c), loses sight entirely of the requirement that there be a present actual payment. The only consideration cited by the court was the release of a past debt.

(c) Disposition in Good Faith of Property by way of Security for a Present Actual Advance of Money in Good Faith

Sections 6(1)(b) and 6(4) both deal with this type of transaction. Section 6(1) protects the security taken only to the extent that money is actually advanced. Section 6(4) goes further and protects the security for all monies advanced, past or present, provided that the creditor sought by a present advance to maintain the debtor in business or made it in the expectation that the debtor would be able to stay in business and pay off his creditors. Under section 6(1), it is not necessary to prove that the borrower had any intention to use the money to benefit his creditors by saving his business. Although this position appears settled, it is hard to see how a creditor who knows that the money he loans will not be applied to pay off other creditors could be acting *bona fide*. Section 6(1)(b) does use the words "in good faith," which is arguably redundant, since sham transactions would appear to be caught by the requirement that there be an "actual advance." However, in *India Films Overseas Ltd.* v. *Keefer Investments Ltd.*, the respondent advanced $50,000 to an insolvent company, took a debenture, demanded repayment, and appointed a receiver. The purpose of the exercise was found by the trial judge to secure priority over funds paid into court under a garnishing order obtained by an execution creditor. It was held that the security was not granted in good faith even though there was an actual cash advance. Similarly, in *Re David* the court held a security partly invalid because the defendant failed to prove that it had any *bona fide* belief in the ability of the debtor to carry on its business.

If the advance is partly colourable, the security may be enforced to the extent that there was an actual advance.

(d) Dispositions in Good Faith in Consideration of the Present Actual Disposition in Good Faith of any Property

This exception apparently covers transactions by way of barter, or perhaps any exchange of securities, again provided that the security or property exchanged has a fair and reasonable relative value. Section 6(1)(c) also duplicates a provision in subsection (4) which permits the substitution of securities.

CHAPTER V PRACTICE, PROCEDURE AND REMEDIES

A. Introduction

The *Fraudulent Conveyance Act* deals generally with fraudulent dispositions of property, with one important limitation. A disposition of property to repay a creditor in preference to other creditors is immune from attack under that Act.

The *Fraudulent Preference Act* deals with preferential dispositions of property to creditors. That Act, however, also contains provisions which apply equally to fraudulent preferences and conveyances.

For the most part, practice and procedure, and available remedies, are the same whether a fraudulent conveyance or preference is involved. Differences between the two Acts are due to either specific statutory provisions or the fact that, as a relatively modern statute, the *Fraudulent Preference Act* does not carry with it the equitable baggage which accompanies the *Fraudulent Conveyance Act*.

B. Form of the Proceeding

1. WRIT

Both a fraudulent conveyance and a fraudulent preference proceeding may be commenced by writ of summons. When proceeding by writ, all normal pre-trial procedures apply, including examination for discovery and discovery of documents.

2. PETITION

Section 9 of the *Fraudulent Preference Act* authorizes an "application to the court" by a judgment creditor who complains of a fraudulent conveyance of land, or by a creditor who seeks to set aside a fraudulent preference. It provides:

> 9. (1) Where a judgment creditor alleges that the debtor or person who has to pay has made a conveyance or other disposition of any of his land, which conveyance or other disposition is void, as being made to defeat, hinder, delay, prejudice or defraud creditors or where a creditor or assignee for the benefit of creditors alleges that a disposition is void under sections 2 to 6, it is not necessary to institute an action to set aside the disposition. An application may be made to the Supreme Court by the judgment or other creditor or assignee or person entitled to the money, calling on the judgment debtor or person who is to pay, and the person to whom the conveyance or other disposition has been made or who has acquired any interest under it, to show cause why the land, or a competent part of it, should not be sold to realize the amount payable under the judgment, or, as the case may be, why the disposition or payment should not be set aside and the property returned or otherwise dealt with as the court may direct.
>
> (2) In an application under this section, a judgment creditor may claim he is entitled to register the judgment against the land in respect of which the application is made, or against the judgment debtor's or another person's interest in the land.

Under Rule 10, an application to the court authorized by statute may be commenced by petition.

The relatively speedy procedure contemplated by section 9 of the *Fraudulent Preference Act* is not as useful as it might appear at first glance. Despite the wording of the section, in practice the defendant is not required to "show cause" why the transfer should not be set aside. The burden of establishing the invalidity of the disposition remains on the plaintiff. The problems posed in proving matters such as fraud and insolvency are compounded by the absence of discovery, which may be had as of right in a proceeding commenced by writ.

A claimant seeking to set aside a fraudulent conveyance, may rely on section 9 of the *Fraudulent Preference Act* to commence his proceeding by petition, where:

(i) he is a judgment creditor prejudiced by a fraudulent conveyance of land; or

(ii) he is a creditor (not a "creditor and other") proceeding under section 3(a) of the *Fraudulent Preference Act*.

In a proceeding involving a fraudulent conveyance in which section 3(a) of the *Fraudulent Preference Act* is invoked, a number of statutory defences, discussed in Chapter IV, are available to a defendant which do not apply to proceedings brought under the *Fraudulent Conveyance Act*.

3. CONSIDERATIONS WHEN SELECTING THE APPROPRIATE PROCEDURE

The selection of the procedure appropriate in the circumstances may be dictated by practical considerations. If it is necessary to commence an action quickly, a writ is superior. Moreover, having commenced the action by writ, the plaintiff will be entitled to discovery of documents and examinations for discovery, which could be of considerable assistance in proving his case. If proceedings are commenced by writ, however, the trial could be much delayed. In contrast, if an application is made to the court by petition, a hearing may be held relatively swiftly. Allegations of fraud must be made, however, and courts are, in general, most reluctant to find fraud on the part of any defendant. It may be expected that a vigorous defence to the petition will often result in the matter being set down for trial as if it had been commenced by writ.

C. Parties to the Action

1. FRAUDULENT CONVEYANCES

Although the grantor may be a proper party to a *Fraudulent Conveyance Act*ion, he is not always a necessary one. In fact, in *Gallagher* v. *Beale*, it was held that the grantor is neither a necessary or proper party when the plaintiff is a judgment creditor. The *Fraudulent Conveyance Act* provides that the conveyance is void as against "creditors and others." As between grantor and grantee, the conveyance is perfectly valid. If, however, some relief is claimed directly against the grantor (for example, damages), he would be a necessary and proper party.

The law is not so well settled as to who is the proper plaintiff in a *Fraudulent Conveyance Act* commenced by writ. It has long been established that a creditor who wishes to sue on his own behalf to set aside a conveyance must be a judgment creditor. Some cases go so far as to say that the plaintiff must have a writ of execution in the hands of the sheriff. A person who is not a judgment creditor may only commence a *Fraudulent Conveyance Act* in the form of a class action on behalf of all of the debtor's creditors.

The reasoning underlying this rule is best explained in a judgment of the Saskatchewan Court of Queen's Bench in *St. Gregor Mercantile Co.* v. *Halbach*. The Act of 1571 was a consolidation of the common law and equity to that date. A court of equity would only permit a person who had not issued execution on his judgment to commence an action to set a conveyance aside if he did so on behalf of all creditors. The court would not exercise its inherent jurisdiction to set aside a conveyance on behalf of a particular plaintiff until he had exhausted his legal rights.

In the case of *Drinkle* v. *Regal Shoe Co.*, MacDonald J. stated:

> Objection was taken by the defendant Company that the plaintiff, in any event, had no status to attack the chattel mortgage or the sale of stock in trade. This point was not raised in *Thompson* v. *Nelson* ... but in my opinion is well taken as the plaintiff is not a judgment creditor. An application was then made to amend the statement of claim and allege that the action was brought by the plaintiff on behalf of himself and all other creditors of the defendant Endacott. I allow the amendment, though the application was only made during the course of the argument, as I do not think the defendants would be prejudiced ...

The requirement that those who are not judgment creditors should issue their writs on behalf of all creditors is often ignored. The irregularity appears to be one of form only, which can be cured at trial or even on appeal. It is difficult to imagine circumstances in which the defendant would be prejudiced by a conversion of the action into a class action.

It may not be necessary, however, to commence a class action if proceedings are commenced under section 9 of the *Fraudulent Preference Act*. This section appears to permit a proceeding by a single creditor who relies on section 3(a) of the Act.

2. FRAUDULENT PREFERENCES

Only a "creditor" has standing to sue under the *Fraudulent Preference Act*. It is unlikely that courts would compel a fraudulent preference proceeding to be prosecuted as a class action. The language of sections 3 and 4 of the *Fraudulent Preference Act*, for example, contemplate a transaction being void as against a single creditor.

D. Remedies

1. INTRODUCTION

In British Columbia, the practice of asking the court to rescind the transaction and to order the reconveyance of the property and the rectification of land title office records, appears to be the remedy most often sought, and granted, in fraudulent conveyance and preference proceedings. That remedy is only appropriate when the fraudulent grantee retains the property. It is, therefore, equally important to canvas interlocutory proceedings intended to preserve the status quo and protect the creditor of a fraudulent debtor, or to assist him in realizing upon assets disposed of by a fraudulent grantee.

In this part, a number of orders which can be sought in a British Columbia proceeding are canvassed. A preliminary matter, which has some significance in determining an appropriate order, must be discussed, and that is the effect of a fraudulent disposition of property.

2. EFFECT OF A FRAUDULENT CONVEYANCE OR PREFERENCE

Both the *Fraudulent Conveyance Act* and the *Fraudulent Preference Act* are silent on the effect of the conveyance as between the fraudulent grantor and grantee. Both Acts provide merely that the disposition is void as against the successful claimant.

A transaction made between grantor and grantee for an illegal or fraudulent purpose is in essence an illegal transaction. The question of the passing of title under an illegal transaction was canvassed at some length in our *Report on Illegal Transactions*. After noting a number of conflicting authorities, it was observed that:

> The authorities would accordingly appear to favour the view that title will pass under an illegal transaction, although that approach has not received universal approbation. It has been noted that these cases depend to some extent upon the exception to the general rule respecting the pleading of an illegal contract. If a contract is fully executed, title, and in most cases possession, will have passed. The transferor seeking restitution will be compelled to seek the avoidance of an illegal contract as the foundation of any remedy he may seek, and will for that reason, be obliged to refer to the contract in his pleadings.

The question of the passing of title in a conveyance made to defraud creditors was considered by the Supreme Court of Canada in *Elford* v. *Elford*. The husband transferred certain land to the wife in order to defeat his creditors. Subsequently, the wife gave her husband her power of attorney, which he used to reconvey the property to himself. The wife sued to have the transfer to the husband set aside as a fraud on the power. She was successful. Duff J. held:

> The respondent was the registered owner of the lands under dispute. She had given her husband a power of attorney conferring upon him a wide general authority to deal with them, but this general authority did not embrace the power to execute a conveyance in favour of the agent himself. Any attempt to acquire a title by such a use of the authority vested in him would be a fraud upon the power. *Prima facie*, therefore, the wife is entitled to have the husband declared trustee for her.
>
> The question therefore arises whether the husband can displace this prima facie right of the wife by alleging that she held her title to the property for his benefit, but for the purpose of protecting it from his creditors. In other words, whether her title was acquired in pursuance of an unlawful design and plan to defeat the creditors of the husband.
>
> It is quite clear, I think, that such a defence is not competent to the husband. As Lord Hardwicke said in *Cottington* v. *Fletcher*, 2 Atk. 156, as long ago as 1740 such "fraudulent conveyances" are "absolute against the grantor." It is quite clear that the husband would not be heard in an action to impeach the wife's title brought by himself to set up a claim based upon an arrangement of the character he now seeks to rely upon. If authority were needed for such a proposition it would be found in the judgment of Lord Selborne in *Ayerst* v. *Jenkins*, L.R. 16 Eq. 275, 42 L.J. Ch. 690, and it is equally clear that the wife is entitled to assert her rights as owner, that is to say, the rights incidental to her ownership against the husband as well as against a stranger, so long as it is not necessary for the purpose of her case to rely upon the fraudulent arrangement with her husband. The principle is illustrated admirably in the judgment of Mr. Justice Maclennan in *Hagar* v. *O'Neil*, 20 O.A.R. 198, at p. 218, and in the decision of the Court of Appeal in *Gordon* v. *Metropolitan Police Commissioner* [1910] 2 K.B. 1080, 79 L.J.K.B. 957.

On several occasions the Supreme Court of Canada has reconsidered the rules which ought to apply when a person seeks to recover property he transferred to another in an attempt to evade creditors. Although the Supreme Court of Canada in *Scheuerman* v. *Scheuerman* affirmed that the intent to defraud creditors could not be used to rebut a presumption of advancement from husband to wife, in *Goodfriend* v. *Goodfriend* a more sophisticated approach was adopted.

In *Goodfriend*, the husband reluctantly transferred his interest in certain realty to the wife, who persuaded him that it was necessary to protect it from an action which she alone foresaw. No creditor was in fact ever prejudiced by the transfer. The majority of the Supreme Court of Canada held that *Scheuerman* was still good law, but that the husband was permitted to establish a trust in his favour when the evidence indicated that the fraudulent scheme was concocted and implemented by the grantee. In such a case, the parties were not in *pari delicto*. In contrast, the minority thought that even if the grantor had the requisite fraudulent intent, the court would enforce a trust in his favour if no creditor was in fact prejudiced.

The enforceability of a trust in favour of a fraudulent grantor where no creditor is prejudiced has yet to be established. A number of cases on point have been decided, with mixed results. It would appear that the cases may be divided into three categories:

(a) The Transfer is Made at the Instance of the Grantee for the Ostensible Benefit of the Grantor

So long as creditors are not prejudiced, the grantor may enforce the trust contemplated by the grantee despite his fraudulent intent.

(b) No Creditor is Harmed

If the minority in *Goodfriend* is correct, then notwithstanding the reasons for the transfer, the grantor may recover the property on a resulting trust or by rebutting the presumption of advancement.

(c) The Transfer Prejudices Creditors

In such a case, the property cannot be recovered. Canadian courts have exhibited a clear bias against permitting the fraudulent grantor to recover the property. These cases proceed on the basis that legal title in fact vests in the recipient of the property.

3. AN ORDER FOR THE RETURN OF THE PROPERTY

Most proceedings based on a fraudulent conveyance or preference commenced in British Columbia request property be returned to the debtor. The purpose is generally to make the property available for execution. If the property is land, the reconveyance is presumably seen as a way of facilitating its sale pursuant to sections 84 to 109 of the *Court Order Enforcement Act*.

This practice may be questioned in logic and law. While the transaction is void as against creditors, case law appears to favour the view that the fraudulent grantee is entitled to retain the land transferred. His title is absolute as against the fraudulent grantor. Even on the minority view in *Goodfriend*, the grantor cannot have the return of the property if a creditor is prejudiced.

In *Adams* v. *Adams*, Disbery J. refused to order that the conveyance be delivered up or cancelled. Instead, he held that the proper form of order was that the grantee "do all things necessary to make the property ... available for satisfying the claims of the creditors ..." Similarly, the decision of Manson J. in *Fuhr* v. *Fuhr* appears to have been largely overlooked in British Columbia. In that case, it was held that:

> There will be a declaration, therefore, that the conveyance is void against the plaintiff and the other creditors of the defendant *Fuhr*. As to the form of the judgment reference might be had to *Bott* v. *Smith* (1856), 21 Beav. 511 at p. 517 [52 E.R. 957] and *In re Maddever*, *supra*, at 529 and May, [3rd ed.] 316.

In *Bott* v. *Smith*, it was held by Romilly M.R. that:

> I am of opinion, therefore, that I must declare this deed to be void; that is to say, under the statute. The deeds will not be cancelled, but the Defendant must concur in raising the amount due to the creditors.

An abstract of the order made is included with the report:

> Abstract of Order. - Declare, that the indentures are void as against the Plaintiff and all other the [sic] creditors of Ely Smith; and order the Defendants to join and concur in all necessary acts, conveyances, &c., for the purpose of raising the amount due to the Plaintiff and all the other creditors, out of the estates, and the rents; direct an account to be taken of the rents.

In re Maddever, and *Holmes* v. *Holmes* are to the same effect.

The form of the order is of some importance. If there is a surplus after sale, or rents payable, the form of order adopted in *Fuhr* would leave those in the hands of the grantee rather than the grantor. It suggests, moreover, that the interests of the grantor and grantee are not identical, and that representation by separate counsel may be advisable.

On the other hand, there is no doubt that an order for the reconveyance of the property may be made when the proceedings are commenced under section 9 of the *Fraudulent Preference Act*. That section authorizes the court on an application to sell the land, to order the disposition set aside and the property returned or otherwise to deal with it "as the court may direct."

4. A DECLARATION THAT THE PROPERTY IS EXIGIBLE IN THE GRANTEE'S HANDS COUPLED WITH A DIRECTION TO MAKE IT AVAILABLE TO THE GRANTOR'S CREDITORS

This is the proper form of relief as granted in cases such as *Adams* v. *Adams* and *Fuhr* v. *Fuhr*. The order contemplates that further execution proceedings will be taken against the property in the grantee's hands. The question which must then be answered is how execution proceedings may be maintained in these circumstances. The answer may depend on the manner in which the proceedings are commenced.

Sections 9, 10 and 11 of the *Fraudulent Preference Act* and section 79.1 of the *Court Order Enforcement Act* provide for the enforcement of a judgment creditor's judgment against land when a proceeding is commenced by petition under section 9 of the *Fraudulent Preference Act*. Under subsection 9(2), the petitioner may apply for an order entitling him to register his judgment against the grantee's land. Under subsection 10(2), the court is authorized to issue such an order. Section 11 provides for the issuance and cancellation of a *lis pendens*.

Section 79.1 provides that the original judgment obtained by the plaintiff may be registered against the grantee's title. The judgment creditor may then apply for an order for a reference respecting the eventual sale of the land, under section 84.

The provisions of the *Court Order Enforcement Act* respecting the sale of land require as a precondition the registration of a judgment against the land. That Act provides for the registration of a judgment where the judgment creditor proceeded by petition under section 9 of the *Fraudulent Preference Act*, but is silent on registration of a judgment where the judgment creditor proceeded by writ. It is uncertain whether, in the latter case, the judgment creditor would be able to register his judgment against lands registered in the name of the grantee. He may not be able to invoke the *Court Order Enforcement Act* execution process. The only alternative, then, would be for the court to order the sale of land. Such orders can be made in equity as a form of equitable execution.

Legislation is also silent on the procedure for executing against chattels declared to be exigible in the grantee's hands. The *Court Order Enforcement Act* and Rule 42 merely authorize the plaintiff to issue a writ of seizure and sale. Writs of seizure and sale authorize the seizure of "goods and chattels" of the debtor. Presumably, after a declaration is made that property is exigible in the grantee's hands, the sheriff would be authorized to treat the goods and chattels fraudulently conveyed to the grantee as the judgment debtor's property for the purposes of execution.

5. AN ORDER FOR SALE

British Columbia courts have three sources of jurisdiction to order the sale of property fraudulently conveyed away. It would appear that courts of equity and common law were prepared to grant such relief to a judgment creditor, although it does not appear that the source of that power was expressly determined. This would appear to be an inherent power.

The second source of jurisdiction is rule 43 of the Rules of Court. Subrule 43(1) provides:

> 43. (1) Where in a proceeding it appears necessary or expedient that property be sold, the court may order the sale and may order a person in possession of the property or in receipt of the rents, profits or income therefrom to join in the sale and transfer thereof and deliver up the possession or receipt to the purchaser or person designated by the court.

Under subrules 43(3) and (4) the court may appoint any person to conduct the sale, as well as determine how the sale will be conducted and completed. This discretion is broad and would appear to apply in fraudulent conveyance proceedings.

Section 9 of the *Fraudulent Preference Act* is the third head of jurisdiction. It makes specific provision for orders for sale. The court is empowered to require the grantee to show cause why the property should not be sold to realize the judgment debt. Section 9 is available to judgment creditors suing in respect of the fraudulent conveyance of land or to creditors who successfully invoke the fraudulent conveyance provisions of the *Fraudulent Preference Act*. The court has a general discretion to make orders respecting how the property should be dealt with.

It is unlikely that a court would order the sale of property on an interlocutory application under Rule 43, or on the motion of a plaintiff who is not a judgment creditor. Both the common law and equity have consistently refused to countenance prejudgment execution.

6. FOLLOWING PROPERTY INTO THE GRANTEE'S HANDS

Orders for sale, declarations of exigibility coupled with mandatory injunctions, and orders for the reconveyance of property are all based on the assumption that the grantee retains control of the property. This is not necessarily the case, as a fraudulent grantee may himself dispose of the property. Since the creditor has no equitable interest in the property conveyed away, and is unlikely to be in a fiduciary relationship with the fraudulent grantee, he cannot seek to trace the property into the hands of the third party recipient. Tracing, in any event, would be unavailable when the third party is a *bona fide* purchaser for value. Moreover, Canadian courts have consistently held that nothing in the *Fraudulent Conveyance Act* permits a creditor to execute upon any assets substituted for, or purchased with, the funds received by the fraudulent grantee. In *Davis* v. *Wickson*, it was held:

> The right of the plaintiff in this class of cases is to have any impediment removed or declared invalid which intercepts the action of his writs of execution. So long as the property of his execution debtor remains distinguishable, and so long as no purchaser for value without notice intervenes, so long may the Court award relief against that property in the hands of fraudulent or voluntary holders. But where, as here, the first holder sells the property obtained from the debtor and receives the proceeds in a shape that cannot be earmarked, there is no jurisdiction to go beyond the further remedy which the Statute of Elizabeth prescribes, namely that all parties to fraudulent conveyances aliening or assigning thereunder shall forfeit a year's value of the lands and the whole value of the goods, whereof half shall go [to] the Crown and half to the party aggrieved ..

The decision in *Davis* v. *Wickson* appears to leave open the possibility that the court will permit tracing into the hands of a person who gave no consideration for the disposition. Such an order was in fact made in the Newfoundland case of *Carew* v. *Power*.

Section 7 of the *Fraudulent Preference Act* provides that where the recipient of property under a fraudulent conveyance or preference disposes of it, a creditor may recover the proceeds from the disposition, or their value, from him.

A creditor who has a judgment (or is otherwise entitled to seize or recover property) may execute on the "exchange product" of the transaction. In *Re Allen and Allen*, the property fraudulently conveyed was converted to cash and spent improving realty. The court ordered the grantee to repay the $200.00 he had received, stating that the proceeds need not be "ear-marked," and that the *bona fides* of the subsequent trans action were rrelevant.

Section 7 of the *Fraudulent Preference Act* provides only a limited remedy. The opening words limit its application to cases in which the disposition is invalid against a creditor (a person with a liquidated claim). The provisions of section 7 are unavailable to a person whose claim is not liquidated. Moreover, section 7 does not permit a creditor to claim against the original asset transferred into the hands of a subsequent transferee. It is limited to property held by the fraudulent grantee.

7. RESERVATION OF PROPERTY

(a) The General Rule

As a general rule, a plaintiff may not take any steps to secure property owned by the defendant so that it will be available to satisfy an anticipated judgment. Prejudgment execution may too easily be used to harass the defendant.

(b) Exceptions

The general rule is subject to a number of exceptions.

(i) Specific and Proprietary Claims

A plaintiff may be able to obtain an interlocutory injunction to restrain the disposition of property to which he asserts a specific or proprietary claim. Similarly, Rule 46(1)(a) of the Rules of Court provides that the "court may make an order for the detention, custody, or preservation of any property that is the subject matter of a proceeding or as to which a question may arise."

(ii) Prejudgment Garnishment

A plaintiff may garnish funds owed the defendant by a third party.

(iii) Fraudulent Dispositions

Where property has been transferred to another, and the transfer is attacked as a fraudulent conveyance or preference, the court may grant an interlocutory injunction to restrain further dispositions of the property until the conclusion of litigation. In *Campbell* v. *Campbell*, for example, it was said:

> ... where a fraudulent disposal has actually been made of the defendant's property ... the court will intercept the further alienation of the property, and keep it in the hands of the grantee under the impeached conveyance, until the plaintiff can obtain a declaration of its invalidity, and a recovery of judgment for the amount claimed.

Courts have normally refused an application for an injunction when sought by a plaintiff whose claim was not reduced to judgment, although such an injunction was granted in *City of Toronto* v. *McIntosh*. In that case, the defendant had been convicted of theft, the transaction was essentially a gift and it was made during the defendant's trial on criminal charges. The evidence of fraud was irresistible, and the action was undefended. The case was a special one. The law in this respect is in a considerable state of flux. The development of the *Mareva* injunction, discussed in greater detail below, appears to have significantly altered the court's approach to these issues.

(iv) Lis Pendens

A claimant may also protect his position by filing a *lis pendens* against land. Having done so, the courts will not compel him to proceed expeditiously if he is making *bona fide* efforts to pursue debtors in separate proceedings.

(v) Receivers

In *NEC Corporation* v. *Steintron International Electronics Ltd.*, Southin J. held that an order appointing a receiver is appropriate in cases in which the defendant is clearly dissipating its assets. Such an order will only issue in exceptional cases.

(vi) Mareva Injunction

The *Mareva* injunction is an interlocutory order which restrains a defendant from dealing with his assets in such a way as to frustrate an eventual judgment against him. In its inception, the *Mareva* injunction was used to prevent a foreign defendant from removing assets from the jurisdiction. It has since been granted to prevent a defendant who resides within the jurisdiction from removing, disposing of or dissipating his assets.

The *Mareva* injunction represents a significant exception to the general policy against prejudgment execution. Before such an injunction will be granted, however, the plaintiff must establish, among other things, a prima facie case and provide evidence of a real risk that the defendant will remove assets from the jurisdiction, or dispose of or dissipate them.

There is some question whether the courts should restrain the removal of assets from one Canadian province to another having the same legal system and reciprocal provisions for the enforcement of judgments. In *Aetna Financial Services Ltd.* v. *Feigelman*, the Supreme Court of Canada observed that in some cases transporting property from one province to another would not constitute removal from the jurisdiction:

> In some ways, 'jurisdiction' extends to the national boundaries, or, in any case, beyond the provincial boundary of Manitoba. For other purposes, jurisdiction no doubt can be confined to the reach of the writ of the Manitoba courts.

The *Mareva* injunction is a recent judicial innovation. Jurisprudence in this area of the law must be regarded as unsettled. Whether the *Mareva* injunction will be available generally to restrain dealings with property designed to avoid execution on an anticipated judgment, or confined to exceptional circumstances, remains to be seen.

8. FORFEITURE: THE QUI TAM ACTION

Since publication of the Working Paper section 2 of the *Fraudulent Conveyance Act* has been repealed. It provided that any person who knew of a fraudulent conveyance, but nevertheless maintained, justified and defended it as true and made in good faith or for good consideration, would forfeit

> one year's revenue or the profits of the land and the whole value of the goods and of money contained in an invalid bond, 50% to Her Majesty and 50% to the person harmed, to be recovered as a debt in a court of competent jurisdiction

if his defence was unsuccessful.

9. IMPRISONMENT OF THE GRANTOR OR GRANTEE

The *Fraudulent Conveyance Act* formerly provided that a fraudulent disposition was an offence punishable on conviction by six months imprisonment. Since publication of the Working Paper, that provision has been repealed.

E. Limitations

Proceedings may be commenced under fraudulent conveyance or preference legislation after a disposition is made. It has been held that so long as the underlying claim which is sought to be enforced is not barred by the expiration of a limitation period, the right to set aside the disposition is available. In British Columbia, however, it is likely that no action to set aside a disposition may be brought if six years have elapsed since it was made.

CHAPTER VI REVIEWABLE TRANSACTIONS UNDER THE BANKRUPTCY ACT

A. Introduction

The *Bankruptcy Act* provides a number of remedies to creditors faced with a fraudulent conveyance or preference. These remedies parallel those available under provincial legislation. There are, however, significant differences in both the preconditions to relief and the extent to which a transaction may be avoided. Moreover, the remedies provided in the *Bankruptcy Act* are only available once the transferor is placed into bankruptcy. This chapter concerns the manner in which a bankruptcy order may be obtained, the nature of the remedies provided by the *Bankruptcy Act* and, lastly, the manner in which those remedies may be invoked.

The relevant sections of the *Bankruptcy Act* discussed in this Chapter are to be found in Appendix E to this Report.

Our discussion will not go beyond a general outline of the existing law. Other treatises on the subject should be consulted for a more extensive review of the applicable legislation.

B. Placing the Debtor into Bankruptcy

The *Bankruptcy Act* contemplates both voluntary and involuntary bankruptcies. A debtor may become bankrupt voluntarily by making an assignment of all his property to a trustee for the general benefit of his creditors. Alternatively, an insolvent person may make a proposal for repayment of his creditors which, if not accepted, is given the effect of an assignment into bankruptcy.

Part II of the *Bankruptcy Act* deals with receiving orders. A receiving order may be made at the instance of one or more creditors of a debtor if his debts amount to $1,000.00 or more, and if he has committed an act of bankruptcy. The order is obtained in a proceeding commenced by petition in the British Columbia Supreme Court in Bankruptcy. The petition must be filed within six months following the act of bankruptcy. It must be supported by affidavit evidence which, if controverted by the debtor, may result in a stay of the petition and a trial of the issue. Whether or not a trial ensues, if a receiving order issues the bankruptcy is deemed to commence at the date the petition is filed. The petition is for the benefit of all creditors and may not be withdrawn without leave of the court.

Section 24 of the *Bankruptcy Act* sets out a number of "acts of bankruptcy." These include acts which would qualify as fraudulent conveyances or preferences under provincial legislation.

The types of transfers caught by section 24 are relatively straightforward. A transfer of property from one spouse to an other would be an act of bankruptcy, if the intent underlying it was to avoid creditors. The omission of any reference to "payments of money" in section 24(1)(c) has given rise to some doubts about whether a preferential payment of money constitutes an act of bankruptcy, even though section 73 of the *Bankruptcy Act* specifically avoids such payments once a receiving order has been made.

In determining whether an act of bankruptcy has occurred, sections 24(1)(b) and (c) appear to require a finding on the balance of probabilities that a transaction was a fraudulent conveyance or fraudulent preference. This position was rejected in *Re D.W. McIntosh Ltd*. It was held that there need be only a prima facie case that the impugned transfer was fraudulent. This decision could lead to the anomalous result of a person being petitioned into bankruptcy as a result of a transaction which the court later refuses to set aside. It may be expected, therefore, that a very strong *prima facie* case indeed will be required of a petitioner relying on sections 24(1)(b) and (c).

C. Reviewable Transactions

1. INTRODUCTION

The *Bankruptcy Act* deals with a number of different categories of reviewable transactions. Some of these categories have no exact counterpart in provincial legislation. It is therefore useful to treat each category separately.

2. SETTLEMENTS

Section 69 of the *Bankruptcy Act* provides that a settlement of property made within one year of bankruptcy is void against the trustee. Any settlement of property made within five years of bankruptcy is void against the trustee if the settlor retained an interest in it, or the settlor was, at the time the settlement was made, unable to pay all of his debts.

This section puts the trustee in a particularly powerful position. A settlement may be avoided without reference to any fraudulent intent. An application to set aside a settlement is nevertheless often coupled with an action under provincial fraudulent conveyance legislation. The pre-1949 *Bankruptcy Act* defined "settlement" as including any conveyance or transfer of property. The current *Bankruptcy Act* is bereft of any definition of the term. Accordingly, courts have resorted to the more technical meaning of the word settlement.

As a term of art, the word "settlement" has traditionally imported the notion of a gift, or a trust of some kind. It generally involves a transfer of property owned by the person making the settlement to a trustee or to a person with the intention that there be some limitations on the use to which the property may be put. Property transferred pursuant to a settlement need not be retained in its original form, provided that its retention in some form is contemplated. In other words, it is not a settlement if the recipient may immediately dispose of, or consume, it. It is not necessary, however, for the trustee to prove that the bankrupt continued to have some beneficial interest in the property. The necessary restriction is on the use of the property, and not its beneficial ownership. When a *prima facie* case has been made out, the burden is on the recipient of the property to prove that the transaction was not a settlement.

Given the restrictive meaning of "settlement," the exception in subsection 69(3) concerning a settlement "in favour of a purchaser or encumbrancer in good faith for valuable consideration" is difficult to understand. Such a transaction would not appear to be a "settlement."

When a settlement is made within five years preceding bankruptcy, subsection 69(2) places a heavy onus of proof on the trustee. The trustee must show that the debtor was not meeting his obligations generally as they became due at the time of the transfer, whether or not in a formal winding up of the bankrupt's affairs his assets would have equalled his liabilities. The term "debts" in section 69(2) has been given a broad interpretation. In *Re Shickele*, for example, the British Columbia Supreme Court held that the term included the contingent liability under a guarantee, and an amount owing on a promissory note, even though no demand had been made for payment.

The provisions of section 69(3), and the interpretation placed on these saving provisions by Canadian courts, merit some comparison with section 4 of the *Fraudulent Conveyance Act*. In particular, the interpretation placed on section 69(3)(b) respecting transactions for good consideration and in good faith is much more favourable to the trustee in bankruptcy than the equivalent provision of section 4. In this exception, the intent of the transferor is not relevant. If the transferee did not act in good faith, the exception cannot be relied on. Accordingly, if the purchaser knows of the intent of the grantor to defraud his creditors, the mere fact that he has paid consideration will not save the transaction. "Consideration" in this context means valuable and not merely nominal consideration.

3. CONTRACTS MADE IN CONSIDERATION OF MARRIAGE

Section 70 of the *Bankruptcy Act* provides that executory agreements to confer a future benefit on the settlor's spouse or children are void as against the trustee.

The purpose of section 70 is to prevent an equitable claim from being raised to a share in the assets of a settlor obliged by a marriage contract to settle future property on a spouse or children. It applies only to executory settlements. The disappointed spouse and children have a claim on the bankrupt's estate, but their interests are expressly subordinated to the claims of general creditors. As volunteers, the satisfaction of their claims must await the payment in full of creditors who gave good consideration to the bankrupt.

4. PAYMENTS OF MONEY/TRANSFERS OF PROPERTY BY A SETTLOR

Section 71 governs the recovery of past payments of money or transfers of property made under marriage contracts and applies to all payments of money or transfers of property made by a settlor in consideration of marriage within six months of bankruptcy.

These dispositions are void against the trustee unless:

(a) made outside of the six-month period preceding bankruptcy;

(b) at the date of the payment the settlor was able to pay all his debts without the aid of the money paid or property transferred; or,

(c) made pursuant to an agreement respecting an inheritance, and took place within three months of the property coming into the settlor's control.

Where the payment or transfer is declared void, the persons to whom it was made are deprived of the property, but are entitled to claim a dividend in the estate of the bankrupt instead.

5. ASSIGNMENT OF BOOK ACCOUNTS

Section 72 deals with a specific type of fraudulent conveyance. Assignments of existing or future book accounts are a common form of commercial security. An assignment of existing book debts is effective to transfer title immediately to the charge holder, who may collect the book debts by giving notice to those people who owe money to his debtor. An assignment of future book debts constitutes a floating charge, which may be crystallized by notice. As a general rule the assignment is void as against the trustee in respect of any book debts outstanding at the date of bankruptcy. Section 72 provides that three kinds of assignments are effective against the trustee:

(a) an assignment of book debts registered pursuant to a provincial statute;

(b) an assignment of specific debts; and

(c) an assignment of book debts included in *bona fide* transfers of businesses for adequate valuable consideration.

6. FRAUDULENT PREFERENCES

Sections 73 and 74 of the Act provide as follows:

> 73. (1) Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving such creditor a preference over the other creditors shall, if the person making, incurring, taking, paying or suffering the same becomes bankrupt within three months after the date of making, incurring, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee in the bankruptcy.
>
> (2) Where any such conveyance, transfer, payment, obligation or judicial proceeding has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed *prima facie* to have been made, incurred, taken, paid or suffered with a view to giving such creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be receivable or avail to support such transaction.
>
> (3) For the purposes of this section, the expression "creditor" includes a surety or guarantor for the debt due to such creditor.
>
> 74. Where the conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in section 73 is in favour of a person related to the insolvent person, the period limited in subsection 73(1) shall be twelve months instead of three months.

Sections 73 and 74 have several features in common with provincial fraudulent preference legislation. No specific act of bankruptcy is required to invoke section 73. It is only necessary that the person making the payment be insolvent. The payment must be made in favour of a creditor "with a view" to giving him a preference over other creditors. The section extends to both dispositions of property and to judicial proceedings which prefer one creditor over others. Like the provincial legislation, the term "creditor" is deemed to include a surety or guarantor for the debt due to such a creditor.

There are, however, some significant differences between sections 73 and 74 and their provincial counterparts. Subsection 73(2) provides that where the effect of the transaction is to prefer, then it is *prima facie* presumed to have been made with a view to giving a preference. As a result of the presumption raised by subsection (2), the onus is on the recipient of the property to satisfy the court that the transaction was made without fraudulent intent. For example, he may show that the transfer was made pursuant to a pre-existing obligation. Section 73 also characterizes a payment of money to a creditor as a preference. Payments of money are exempt under the *Fraudulent Preference Act*.

These provisions are subject to a three-month or a twelve-month limitation. Generally, the preference must have occurred within three months preceding bankruptcy. In the case of preferences in favour of persons related to the bankrupt, the preference may be set aside if it occurred within twelve months preceding the date of bankruptcy. As Houlden and Morawetz note:

> The result is that if the statutory period has [passed] and if the only remedy available is the one under ss. 73 or 74, no matter how flagrant a preference may have been the transaction will stand ...

Although the preference must actually occur within the three or twelve-month period, as the case may be, it is not necessary that the intent to prefer be present within those periods. The intent can be formulated at any time.

Until the decision of the Supreme Court of Canada in *Hudson* v. *Benallack*, it was generally thought that a dual or concurrent intent had to be shown. In *Hudson*, however, it was held that there was no need to make a finding that the debtor and his creditor shared the intent to give and receive a preference. Only the intention of the debtor is relevant.

The defence of pressure is removed by subsection 73(2). Evidence of pressure is not sufficient to rebut the presumption of fraudulent intent.

Section 73 is subject to another gloss of considerable importance. In *Re Pacific Mobile Corporation*, the Quebec Court of Appeal held that section 73 did not apply to payments made in the ordinary course of business even when the payment was made after considerable delay on the part of the debtor. This judgment was affirmed by the Supreme Court of Canada.

7. PROTECTED TRANSACTIONS

Section 75 provides:

> 75. (1) Subject to the foregoing provisions of this Act with respect to the effect of bankruptcy on an execution, attachment or other process against property, and with respect to the avoidance of certain settlements and preferences, nothing in this Act invalidates, in the case of a bankruptcy
>
> (a) any payment by the bankrupt to any of his creditors,
> (b) any payment or delivery to the bankrupt,
> (c) any conveyance or transfer by the bankrupt for adequate valuable consideration, or
> (d) any contract, dealing, or transaction by or with the bankrupt for adequate valuable consideration,
>
> if both the following conditions are complied with, namely:
>
> (e) that the payment, delivery, conveyance, assignment, transfer, contract, dealing, or transaction, as the case may be, is in good faith and takes place before the date of the bankruptcy, and
> (f) that the person, other than the debtor, to, by, or with whom the payment, delivery, conveyance, assignment, transfer, contract, dealing or transaction was made, executed or entered into, has not at the time of the payment, delivery, conveyance, assignment, transfer, contract, dealing or transaction, notice of any act of bankruptcy committed by the bankrupt.
>
> (2) The expression "adequate valuable consideration" in paragraph (1)(c) means a consideration of fair and reasonable money value with relation to that of the property conveyed, assigned or transferred, and in paragraph (1)(d) means a consideration of fair and reasonable money value with relation to the known or reasonably to be anticipated benefits of the contract, dealing or transaction.
> (3) The law of set-off applies to all claims made against the estate and also to all actions instituted by the trustee for the recovery of debts due to the bankrupt in the same manner and to the same extent as if the bankrupt were plaintiff or defendant, as the case may be, except in so far as any claim for set-off is affected by the provisions of this Act respecting frauds or fraudulent preferences.

This section conditionally protects four separate types of transactions. Unfortunately, it is difficult to say any more about it with confidence. The section is ambiguous and difficult to interpret. The relationship between sections 73 and 75, for example, is not particularly clear. Is section 75 intended to save transactions which would otherwise be avoided by the preceding sections of the *Bankruptcy Act*?

Houlden and Morawetz suggest that sections 73 and 75 must be read separately, and that nothing in section 75 relates back to section 73, or protects any transaction which would be avoided by the earlier reviewable transaction provisions of the *Bankruptcy Act*. Section 75 applies only to payments made after the debtor has become bankrupt.

In the case of *Re Pic-N-Save Ltd*., it was affirmed that the purpose of section 75 was to authorize transactions by a bankrupt in the period between the date that a petition is filed and the date the receiving order is made. In arriving at this conclusion, the court referred to the history of section 75(1) of the *Bankruptcy Act*, noting that it was intended, and has generally been applied in both England and in Canada, to mitigate the harshness which would otherwise flow from the doctrine that a bankruptcy dates from the date a petition is filed. It was also noted that in its various revisions, the wording of section 75(1)(e) has been changed to refer to the "date of bankruptcy" rather than the "date of the receiving order" or the assignment. If the phrase "date of bankruptcy" is read as "date of the receiving order," there is considerably less difficulty in interpreting section 75. Even so, in view of the express protection offered by section 77 of the Act to transactions entered into by a bankrupt after the bankruptcy, it is difficult to see why section 75 was thought necessary.

It would appear that the effect of section 75 is to validate transfers made in the period preceding the making of a receiving order, but after the presentation of a petition. In the absence of such a provision, every transaction after the date a petition is filed would be invalidated. The *Bankruptcy Act* contains little in the way of a defence to a proceeding under its reviewable transaction provisions. On the other hand, the limitation periods provided are, in the case of standard commercial transactions, exceedingly short.

Subsection 75(3) preserves the law of set-off. The right of set-off has always been recognized by bankruptcy courts exercising their equitable jurisdiction. Cases in which the claim of set-off constitutes a fraudulent preference or reviewable transaction are excluded. This exclusion will not apply where the agreement giving rise to the set-off is *bona fide* made with a view to carrying on a debtor's business, or where the set-off is pursuant to an agreement which precedes any act of bankruptcy.

8. REVIEWABLE TRANSACTIONS FOR INADEQUATE CONSIDERATION

Section 78 of the *Bankruptcy Act* allows the trustee to recover from a person dealing with a bankrupt the value received by him in excess of the consideration supplied. The trustee may state what, in his opinion, the fair market value of the property or service was, and then call upon the other party to the transaction to disprove the assertion and establish a different value.

This section has no parallel in provincial fraudulent conveyance or preference legislation. Under the relevant provincial Act, a transaction is either wholly void or wholly good.

The application of section 78 depends upon there being a "reviewable transaction" within the 12 months preceding the date of bankruptcy. Section 3 defines what is a reviewable transaction:

> 3. (1) For the purposes of this Act, a person who has entered into a transaction with another person otherwise than at arm's length shall be deemed to have entered into a reviewable transaction.

The purpose of section 78 of the *Bankruptcy Act* was explained by Houlden and Morawetz in the following terms:

> The notion of reviewable transactions was introduced to capture transactions, disadvantageous to the bankrupt and therefore to his creditors, where the bankrupt was either related, within the definitions contained in the Act, to his co-contracting party, or was not dealing at arm's length with him. The meaning of "otherwise than at arm's length" is, however, elusive. The court has wide discretion to say whether or not persons who are not related were dealing at arm's length when a particular transaction took place.

The difference between the consideration given and received should be "conspicuously greater or less than the fair value of the property." This has been interpreted to mean that the difference must be "striking," "notable" or "flagrant or gross."

9. REVIEWABLE TRANSACTIONS BY A CORPORATION

Section 79 of the *Bankruptcy Act* permits the court to review dividends or transactions affecting the capital stock of a corporation which were either made at a time when the corporation was insolvent, or which render the corporation insolvent. When such a finding is made, the court is entitled to give judgment to the trustee against the directors of the company for the monies expended, with interest, or against any shareholder who is related to any one or more of the directors in respect to the consideration received by him and not repaid to the corporation. By subsection (5), the onus of proving that the corporation was solvent lies upon the directors and shareholders of the corporation. In one controversial case, it was held that the court was not bound by the treatment of a payment as a dividend by the corporation and the recipient, if in fact it was a payment for services rendered.

10. TRACING PROPERTY TRANSFERRED IN A VOIDABLE TRANSACTION

Section 76 of the *Bankruptcy Act* provides:

> 76. (1) Where a person has acquired property of the bankrupt under a transaction that is void or under a voidable transaction that is set aside and has sold, disposed of, realized or collected the property or any part thereof, the money or other proceeds, whether further disposed of or not, shall be deemed the property of the trustee.
>
> (2) The trustee may recover the property or the value thereof or the money or proceeds therefrom from the person who acquired it from the bankrupt or from any other person to whom he may have resold, transferred or paid over the proceeds of the property as fully and effectually as the trustee could have recovered the property if it had not been so sold, disposed of, realized or collected.
>
> (3) Notwithstanding subsection (1), where any person to whom the property has been sold or disposed of has paid or given therefor in good faith adequate valuable consideration he is not subject to the operation of this section but the trustee's recourse shall be solely against the person entering into the transaction with the bankrupt for recovery of the consideration so paid or given or the value thereof.
>
> (4) Where the consideration payable for or upon any sale or resale of such property or any part thereof remains unsatisfied the trustee is subrogated to the rights of the vendor to compel payment or satisfaction.

It was noted earlier that courts had no power at law to trace property conveyed away by a fraudulent transferee. The right to trace property depends on the existence of an equitable relationship. This position has been modified to some extent by the provisions of section 7 of the *Fraudulent Preference Act*, which permits a creditor to execute on the proceeds of such a transfer in the hands of the transferee from the insolvent.

Section 76 gives a more extensive remedy to the trustee. Once the recipient of the property under a void or voidable transaction is shown to have sold, disposed of, realized or collected property formerly that of the bankrupt, any proceeds in the recipient's hands are deemed to be the property of the trustee. Subsection (2) authorizes the trustee to recover any property or the proceeds of its disposition, not only from the fraudulent grantee, but also from any other person who received the property of the bankrupt. Subsection (3), however, limits this right to cases in which the sale or disposition of the property was not in good faith for adequate valuable consideration. Otherwise, the trustee may only look to proceeds from the disposition in the hands of the transferee from the bankrupt.

CHAPTER VII THE NEED FOR FRAUDULENT PREFERENCE LEGISLATION

A. Introduction

The *Fraudulent Conveyance Act* and the *Fraudulent Preference Act* are rightly perceived as companion pieces of legislation. Their many similarities, however, mask some differences in purpose and application.

The *Fraudulent Conveyance Act* is designed to prevent a debtor from evading payment of his lawful debts. As such, it is a necessary part of the law of execution. It is difficult to question the need for legislation to prevent fraudulent conveyances, although certainly the current Act requires revision. The proper operation of fraudulent conveyance legislation is discussed in the next chapter.

The *Fraudulent Preference Act* (except for those portions which deal with fraudulent conveyances) is designed to achieve equality among a debtor's creditors. This only has relevance when the debtor is, or is about to become, insolvent. The *Fraudulent Preference Act* is really a companion to bankruptcy legislation. In fact, it duplicates remedies available to creditors under bankruptcy legislation. An issue explored in greater detail in this chapter is whether provincial legislation is necessary in this context.

B. The Fraudulent Preference Act

1. INTRODUCTION

Since the *Fraudulent Preference Act* applies only between creditors, its main impact is upon the validity of commercial transactions. In terms of general policy, commercial transactions should not be overturned lightly.

Fraudulent preference legislation reflects the conclusion that creditors ought to be dealt with even-handedly. In many cases the only means of accomplishing that is by making the debtor's property equally available to all.

As a practical matter, equality among creditors is ensured so long as the debtor is solvent. It is unnecessary, and impractical, to ensure that specific items of a debtor's property are equally available to all of his creditors provided the whole of his estate or income will satisfy their claims as required.

It is insolvency, or its imminence, which triggers the need to ensure equality among creditors. The issue is whether there is a need for both provincial and federal legislation to achieve this object.

In gauging the utility of the current *Fraudulent Preference Act*, a number of questions arise:

1. Does the Act provide meaningful protection to creditors?
2. To the extent that transactions are not protected, is the avoidance of a preference a fair result?
3. What would be the result if the Act were repealed?

In the balance of this chapter, consideration is given to whether there is a need for provincial fraudulent preference legislation, focusing on these questions.

2. DOES THE ACT PROVIDE MEANINGFUL PROTECTION

The *Fraudulent Preference Act* purports to prevent a debtor, in circumstances of insolvency, from satisfying the claims of some creditors in preference to those of others. A payment of money to a creditor is not a fraudulent preference. The Act, consequently, is aimed at only two kinds of transactions. An insolvent debtor may not grant a creditor a security interest against his property to secure repayment of a prior debt, nor may he satisfy a debt obligation by transferring property other than money.

Even these two kinds of forbidden transactions, however, may be valid if the creditor did not share the debtor's fraudulent intent, security was granted pursuant to a prior agreement, the debtor had no intent to prefer the creditor or the creditor extracted the preference through pressure.

The defence of pressure is significant. The Act can be avoided by any creditor who makes a practice of seeking prompt payment. In *Bank of Montreal* v. *Ngo*, Bouck J. held:

> To a large extent the race still belongs to the swift. If one creditor pursues his debtor and collects the debt owing to him, while another creditor stands idly by, then the first creditor is normally entitled to keep what he gets. One way of avoiding this result is for the second creditor to take proceedings against the debtor and the first creditor within 60 days of the disposition. Otherwise, he may be out of luck.
>
> That means Linda Wong may retain the property conveyed to her by Ngo because she was more active in collecting the debt owed her by Ngo than was the bank and the bank failed to proceed within 60 days of 16th August 1982.

The *Fraudulent Preference Act* also provides a series of other specific defences, in section 6. These defences appear to have little significance, however. They have been considered in very few cases. Some of them, such as sales in good faith at an undervalue, seem aimed at fraudulent conveyances rather than preferences.

The *Fraudulent Preference Act* does not provide effective protection to creditors. Its scope is limited, and the manner in which it has been interpreted by the courts has further narrowed the range of transactions caught by it. The Act is, moreover, easily avoided by sophisticated creditors.

3. IS SETTING ASIDE A PREFERENCE A FAIR RESULT

Can the policy underlying the avoidance of payment by barter, or the granting of security for past consideration, withstand close examination? The granting of security for past debts does not always represent an unconscionable act. The truth may be quite the reverse. A creditor may take security for a past due debt in return for a promise to hold off proceeding to judgment or taking execution. Under the *Fraudulent Preference Act*, such a transaction may be saved if coupled with a further advance, but the Act does not recognize the commercial legitimacy of transactions involving intangible consideration such as forbearance. The *Fraudulent Preference Act* encourages a creditor to press forward his claim, obtain judgment and execute upon it, whatever the cost to the debtor might be.

Even in cases in which the entire intent underlying a disposition of property is to enable a creditor to receive payment in preference to others, the avoiding of the preference may not be an appropriate result. Not every creditor has equal access to information about a debtor. He may not know that the debtor is insolvent. In fact the insolvency may be temporary, even fleeting. If the creditor is pressing for payment, then he will be protected by the doctrine of pressure. Yet if he accepts property from his debtor in lieu of cash, and no pressure is applied, the Act will penalize him.

It is open to question whether legislation which inhibits creditors from accepting a debtor's freely given payment in kind performs a useful social function. It would appear to represent a standard of morality out of keeping with the times or the needs of commerce. Similarly, compelling creditors to take judgment for a past due debt and levy execution does not appear to be a reasonable alternative to permitting the debtor to satisfy a pressing creditor by granting him security over his unencumbered assets. The law should encourage accommodations between creditor and debtor.

It was noted earlier in this Report that the *Fraudulent Preference Act* is companion legislation to the *Creditor Assistance Act*. The latter enactment provides for equal distribution among a debtor's creditors of assets seized on an execution. The role of the *Fraudulent Preference Act* is to ensure that this process is not short circuited by the debtor giving his property to one creditor and thereby avoiding execution.

In the Commission's *Report on Creditors' Relief Legislation: A New Approach*, the repeal of the *Creditor Assistance Act* was recommended. The Commission, as then constituted, was of the view that, in the context of execution, there was little to be gained by compelling the equal distribution of a judgment debtor's assets. That was more naturally the goal of bankruptcy legislation.

The *Creditor Assistance Act* has not yet been repealed. Should that take place, the impact on the operation of the *Fraudulent Preference Act* would be considerable. There would be little point in avoiding a preference when that would only permit another, who has issued a writ of execution, to claim a preferred interest in the property.

4. THE CONSEQUENCES OF REPEAL

It is doubtful that repeal of the *Fraudulent Preference Act* would encourage preferential transfers. First, where a transfer results in a preference, in most cases it is unlikely that either party to it turned his mind to whether the transaction might be set aside as fraudulent. Second, even if a preference is made, it would still be subject to attack under bankruptcy legislation.

The role of bankruptcy to ensure creditors are dealt with fairly would likely be enhanced by the repeal of the *Fraudulent Preference Act*. In principle, this is as it should be. The *Bankruptcy Act* provides a sophisticated regime dealing with the distribution of an insolvent's estate. The priorities of various classes of creditors are dealt with in a logical and consistent manner.

Lastly, it should be observed, Canadian jurisdictions enacted fraudulent preference legislation in response to the repeal of federal bankruptcy legislation in the latter part of the 19th century. Fraudulent preference legislation outside of bankruptcy is really an anomaly. Other commonwealth jurisdictions do very well without pre-bankruptcy fraudulent preference legislation.

5. ARGUMENTS IN FAVOUR OF RETAINING PROVINCIAL PREFERENCE LEGISLATION

In the Working Paper that preceded this Report, it was tentatively concluded that the *Fraudulent Preference Act* should be repealed. The arguments in favour of repeal, canvassed above, suggested that it was inappropriate to revise provincial preference legislation to work correctly when this area of the law was properly the subject of bankruptcy legislation and was, in fact, already addressed by the federal *Bankruptcy Act*.

Comment on this aspect of the Working Paper was evenly divided. Some of our correspondents, agreeing with the Working Paper, felt that it was inappropriate to have a federal bankruptcy regime and a provincial pre-bankruptcy regime, both aimed at essentially the same object, a fair distribution of the debtor's assets among his creditors.

Other correspondents were opposed to repeal of provincial preference legislation, for three principal reasons. The first was that, however desirable it was, in theory, to leave issues of this nature to be resolved in bankruptcy proceedings, it was impractical. Bankruptcy legislation is inadequate for this purpose and far too costly. Moreover, it is unavailable in several circumstances addressed by provincial legislation. It may be that, in due course, the federal legislation will be revised to overcome these limitations. As a practical matter, however, that goal has not been achieved over the last two decades, despite a great deal of effort to do so. Even if bankruptcy proceedings are the appropriate vehicle to attack a preference, adopting that course will have the practical consequence of making most preferences too expensive to attack, so long as the *Bankruptcy Act* remains in its current form.

The second reason for opposition to repeal of provincial preference legislation was also based on a pragmatic concern. In many cases, an aggrieved creditor often need do no more than commence, or threaten, proceedings under the *Fraudulent Preference Act* to achieve his goal. The creditor will refund the preference, the debtor will satisfy the attacking creditor's claim, or the matter will be settled through negotiation. As a practical matter, settlement is impossible once bankruptcy proceedings have been commenced.

The third reason involved problems of determining whether a conveyance or preference is involved, particularly where the recipient is "related" to the debtor. We were told that this is frequently impossible to determine until the process of litigation is well advanced. A creditor who commences an action to set aside a conveyance is in a difficult position if he is met with the defence that it was actually a repayment of a debt. Should he continue his action to determine whether that is the case? Or should he attempt to petition the transferor into bankruptcy to attack the preference?

In our view, these are all sound reasons for retaining some form of provincial preference legislation.The matter is not free from doubt as the decisions are conflicting. There are really two views on the matter. It is suggested that the Act exists for the benefit of creditors of a class and not for the benefit of a single creditor who has available to him all ordinary civil remedies of recovery and collection ... I am far from certain that this is a proper interpretation of a very worthwhile and usually effective piece of legislation. Nowhere can I find that intent in the Act.
See also Houlden and Morawetz, Bankruptcy Law in Canada pp. D-21 - D-29. Several cases including *Hudson* v. *Old Dutch Foods Ltd.*, [1986] 3 W.W.R. 715, (1985) 37 Man. R. (2d) 276, 62 C.B.R. 129 (C.A.), have held that fraud by the debtor constitutes special circumstances. So too will breach of the trust provisions of the *Builders' Lien Act: Royal Trust Corp. of Can.* v. *James Furniture Ltd.*, (1984) 53 C.B.R. 75 (B.C.S.C.). "Special circumstances" have also been held to exist where "suspicious non-disclosures" or unexplained transfers of assets of journal entries take place even in the absence of any proof of fraud: *Re Electra Importing & Distributing Ltd.*, (1986) 60 C.B.R. 210 (Ont. S.C.). Moreover, a single petitioner may apply for a receiving order based on some other act of bankruptcy under s. 24. For example, a single petitioner obtained a receiving order when his writ of execution was returned *nulla bona: Re Maitland; Can. Imperial Bank of Commerce* v. *Maitland*, (1982) 44 C.B.R. 184 (B.C.S.C.) (s. 24(1)(e)). When bankruptcy reform is completed, consideration should then be given to whether it is practical to consolidate procedures to achieve fairness among a debtor's creditors. Nevertheless, the current *Fraudulent Preference Act* should not be retained. It should be replaced by modern legislation.

The Commission recommends that:

1. The *Fraudulent Preference Act* be repealed and replaced by modern legislation.

The point raised by our correspondents, that disputes concerning dispositions by a debtor frequently involve problems of determining whether the disposition qualifies as a conveyance or a preference, suggests that it would be desirable to consolidate provincial legislation dealing with these issues. It is interesting to note that, in fact, the *Fraudulent Preference Act* deals with both preferences and conveyances, but this early attempt at consolidation failed, primarily because the provisions of the *Fraudulent Preference Act* were less useful than the provisions of the *Fraudulent Conveyance Act*.

The next chapter considers reform of the *Fraudulent Conveyance Act*. Once the features of new legislation in that context are set out, we will return to the consideration of the principles that should be part of provincial preference legislation.

CHAPTER VIII REFORM OF FRAUDULENT CONVEYANCE LEGISLATION

A. Introduction

The *Bankruptcy Act* addresses both fraudulent preferences and conveyances. For that reason, whether there is a need for provincial fraudulent conveyance legislation deserves some consideration. It is our conclusion, however, that repeal of the *Fraudulent Conveyance Act* without replacement is undesirable. The Act is not concerned with the orderly winding up of a debtor's obligations. Fraudulent conveyance legislation is a necessary adjunct to the law of execution. Provincial fraudulent conveyance legislation, consequently, performs a function that the *Bankruptcy Act* cannot.

Our review of the law under the *Fraudulent Conveyance Act* suggests that the legislation must be revised to accommodate current needs. Moreover, many transactions which are open to attack under fraudulent conveyance legislation are not, strictly speaking, fraudulent. Modern legislation need not employ terminology which characterizes these transactions as fraudulent. Comment on the Working Paper endorsed this approach. It was also observed that some problems result from the current legislation because various transactions are inappropriately characterized as fraudulent.

In the Working Paper, it was tentatively proposed that a new Act replace the *Fraudulent Conveyance Act*. Upon reconsideration, however, we have concluded that new legislation should be enacted as part of the *Court Order Enforcement Act*. A proliferation of statutes dealing with a particular subject is generally undesirable.

In this chapter, we set out the principles which ought to govern transfers of property intended to defeat the claims of creditors.

The Commission recommends that:

2. *(1) The* Fraudulent Conveyance Act *be repealed and replaced by modern legislation.*

(2) The new legislation should move away from the language of fraud.

(3) The new legislation should be enacted as part of the Court Order Enforcement Act*.*

B. Prerequisites to an Order

1. A DISPOSITION OF PROPERTY

The present law governing the phrase "disposition of property" is generally satisfactory. It undoubtedly extends to any form of exigible asset, and "disposition" includes every type of conveyance or transfer.

> The term "property" in the current Act would appear to catch any form of property. The Ontario Commission adopted the phrase "real property or personal property of any kind." Under the current law, neither of these general formulations would include property exempt from execution.

The New Brunswick Law Reform Division considered the rule that property exempt from execution can be transferred with impunity. It was proposed that property fraudulently conveyed away be deemed to have been chosen for exemption from execution. The object of this proposal is to prevent the exemption from being raised in defence of a number of dispositions of property which collectively exceed the limit for such exemptions, but which individually do not.

Creditors in British Columbia are unlikely to think it worthwhile to attack a fraudulent conveyance if the only goods transferred are, in any event, exempt from execution. The limit of $2,000.00 contemplated for such an exemption by section 65 of the *Court Order Enforcement Act* and the costs of litigation are also a substantial barrier to frivolous litigation. It is our conclusion that legislation need not provide rules to deal with a disposition of property exempt from execution.

2. POWERS OF APPOINTMENT AND DISCLAIMERS

There are several instances where a debtor may direct the disposition of property in which he has no interest. For example, he may hold property under a power of appointment. Depending on the nature of the power, he may be able to direct that he, or someone else, receive the property. Similarly, he may be entitled to receive property under a will or on an intestacy.

If, in the first case, the debtor appoints the property to someone other than himself or, in the second case, disclaims the property, he effectively disposes of it so that it will not be available to his creditors. Because he had no interest in the property, however, the disposition may not qualify as a fraudulent conveyance.

These actions resemble in many respects transactions which are clearly fraudulent conveyances. For that reason, it is tempting to characterize them as dispositions of property. The debtor's actions may, for example, benefit someone who will later make the property available to the debtor.

On the other hand, refusing a gratuitous benefit is far removed from the evil that fraudulent conveyance legislation is aimed at. Clearly, concealing property from one's creditors is wrong and arrangements which attempt to do so are properly open to attack. The position with respect to the refusal of a benefit is not so obvious. Moreover, the settlor or donor of property most frequently intends to benefit the recipient of property and not his creditors. When property is subject to a power of appointment, for example, it is usually so that the most deserving or needy of a designated class will benefit. Setting aside an appointment to someone other than the debtor because it prejudices his creditors will usually frustrate the settlor's intentions.

It appears, consequently, that a general rule with respect to powers of appointment and disclaimers will not function well. In the Working Paper, it was our tentative conclusion that conferring discretion on courts to review these cases would be a legislative response out of all proportion to the nature of the problem. Comment on this issue was invited. Two submissions concluded that creditors should have access to benefits refused by a debtor, but did not address the problems of devising a legislative scheme to permit that. The balance of comment felt that it was unnecessary to address powers of appointment and disclaimers. The submissions received on this issue have not pursuaded us to depart from our earlier position.

3. A BOND, PROCEEDING OR ORDER

In Chapter III it was noted that the reference in the present *Fraudulent Conveyance Act* to a proceeding or order was probably an anachronistic remnant of the practice and procedure formerly governing real actions. The reference to a bond is equally obscure. There appears to be no modern case in which the effect of a bond as a fraudulent conveyance has been considered.

In view of the limited use to which they have been put in cases concerning fraudulent conveyance legislation it is probably unnecessary to include any reference to bonds or proceedings. Both references appear archaic.

The inclusion of "orders" would permit a creditor to attack a judgment to which he was not a party, on the ground that it was obtained by fraud. Strictly speaking, however, no statutory authority is required to permit a collateral attack to be mounted on an order on the ground that it was procured by fraud.

Ownership of property may change by operation of law or court order in circumstances which would not be coloured by fraud. An example mentioned earlier involved a vesting of rights in family assets under the *Family Relations Act* on the occurrence of a triggering event such as a declaration under section 44 of that Act. Perhaps a disposition of this nature should be reviewable by the courts. It should be observed, however, that the *Family Relations Act* is aimed at special circumstances. Arguably, the vesting of an interest in family property on the occurrence of a triggering event alters legal title to the property to conform with the beneficial ownership of it.

The Working Paper recorded our tentative conclusion that reforming legislation need not specifically refer to bonds, proceedings and orders. Our correspondents agreed that the reference to "bonds" need not be retained. Two submissions, however, favoured retention of the reference to "proceedings and orders":

> We think that there may be some merit in retaining a reference to "proceedings and orders". Third parties ought to be able to attack proceedings or orders taken or obtained as a result of collusion. The commission has given some examples of how collusive legal proceedings may result in a fraudulent preference.
>
> ... If there be no other reason for retaining a direct reference to "proceedings or orders" under the new legislation at least it will indicate that there has been no retreat from the principle that conveyances arising from collusive proceedings or orders may still be struck down as fraudulent conveyances. On the other hand the deletion of that reference might inspire some to think that such conveyances are no longer within the ambit of the legislation. In our opinion, nothing should be done which might encourage such a view.

We have reconsidered this matter and agree that it would be useful to ensure that new legislation refers to dispositions of property that result from a court order.

4. MADE TO DELAY, HINDER OR DEFRAUD

(a) "Delay, Hinder or Defraud"

The words "delay, hinder or defraud" have been a feature of British Columbia fraudulent conveyance legislation since the *Fraudulent Conveyance Act* was first enacted in British Columbia. They are derived from the Act of 1571. They have a potentially broad ambit and justify applying the *Fraudulent Conveyance Act* to cases in which property is hidden or exchanged, as well as cases in which there has been an outright and prejudicial transfer of property.

The current Act characterizes a fraudulent conveyance both in terms of the effect it has on creditors and the intent with which it was made. A disposition of property which is intended to delay, hinder of defraud creditors, and has that effect, is a fraudulent conveyance.

Certainly, there is a need to protect creditors where a debtor's property is wrongfully placed beyond their reach. It is more difficult to identify the policy in favour of upsetting transactions where a disposition only makes it more difficult to satisfy a creditor's claims.

It may be that property is transferred into a form which may not be readily seized in execution. If that is so, then revision of the law governing execution is desirable. It is undesirable to distort fraudulent conveyance legislation to remedy defects in other areas of the law, and inappropriate to set aside a legitimate commercial transaction merely to render the operation of the law governing the enforcement of judicial orders more efficient.

The different approaches adopted by the New Brunswick Law Reform Division, the Ontario Law Reform Commission and the (U.S.) *Uniform Fraudulent Transfer Act* reflect the problems inherent in defining exactly what constitutes a fraudulent conveyance. The New Brunswick Law Reform Division proposed that the intent with which a disposition was made should be the controlling factor. The Ontario Law Reform Commission abandoned intent and proposed that the effect of the conveyance alone should determine whether it was a fraud on creditors. The (U.S.) *Uniform Fraudulent Transfer Act* essentially adopts both positions. A conveyance is a fraud on creditors if it is made with that intent or if it has that effect. Both the Ontario Law Reform Commission and the (U.S.) *Uniform Act* adopt the view that a disposition by an insolvent debtor, or which renders the debtor insolvent, has the requisite effect to qualify as a fraudulent conveyance.

The Ontario Commission also proposed that proof of insolvency was not the only means of establishing the prejudicial effect of a conveyance. The examples provided consist of situations where the debtor transforms assets into forms which are more difficult, or impossible, to execute upon. In our view, this is a factor which has little or no relevance in determining whether the disposition prejudices creditors.

(b) Insolvency

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.

The Ontario Commission concluded that insolvency should be defined to include insolvency in its commercial and its legal sense. Under this approach, a debtor would be considered to be insolvent if he failed to pay his debts as they became due or if he lacked sufficient assets to satisfy his liabilities. As a practical matter even if a debtor fails to pay his debts as they come due, claimants are unlikely to be prejudiced if the debtor possesses sufficient assets to satisfy his liabilities.

The (U.S.) *Uniform Fraudulent Transfer Act* essentially adopts this approach. The *Uniform Act*, however, recognizes that the transferor's insolvency will often be difficult for the claimant to prove. For that reason, a transferor is presumed to be insolvent if he is generally not paying his debts as they become due. This approach places the onus of rebutting the presumption of insolvency on the transferor or the recipient of the property. This would also appear to be a useful refinement.

A concern echoed in several submissions on the Working Paper was whether the legal test should be based on a forced sale, rather than a fair market, value:

> The Commission has followed the Ontario Law Reform Commission and the (U.S.) *Uniform Act* by adopting the view that a disposition by an insolvent debtor, or which renders the debtor insolvent, has the requisite effect to qualify as a fraudulent conveyance. The Commission however has given preference to the legal and not the commercial measure of insolvency (cf. p. 118 WP No. 53 and compare the definition of "insolvent" in the B.C. *Company Act* where the commercial method is used). The legal measure of insolvency suggests that a debtor would be considered to be insolvent if he lacked sufficient assets to satisfy his liabilities (the legal test of insolvency is also known as the Balance Sheet Test of Insolvency or the Realization Test). The Commission, while giving preference to the legal measure of insolvency, also adopts a fair market value method of valuation for this test.
>
> At common law no definite method of valuation was ever determined, however the Ontario Commission (Ontario Law Reform Commission, supra, p. 131) suggested that the majority of the commentators and judges appeared to favour an execution sale valuation. The B.C. Commission has stated,
>
> > "A person is insolvent when he does not have sufficient property subject to enforcement measures to pay all his debts in full if such property were sold at fair market value" (page 123 W.P. No. 53).
>
> Firstly, fair market value seems to be something different than the "fair valuation" test of the Federal *Bankruptcy Act* used in the definition of "insolvent person."
>
> Secondly, it is not that clear whether the fair market value test is the proper method of valuation in these circumstances. As Professor Kerr points out (Debtor Creditor Law - Practice and Doctrine, editors Springman and Gertner, (1985) at page 221),
>
> > "Since recourse to assets under the voidable transactions legislation may ultimately involve resort to legal process and a forced sale, valuation on that basis seems appropriate insofar as insolvency is a necessary condition to set aside a transaction under the assignments legislation."
>
> Otherwise a "fraudulent" conveyance could be achieved by some debtors as long as assets having a normal market value equal to the creditors' claims were retained. Professor Kerr points out that the normal market value is irrelevant for creditors forced to resort to legal process; therefore, some claims would be prejudiced if valuation for the purpose of bringing the legislation into operation is based on a normal market value.

Selecting the appropriate measure for valuing a debtor's property is fundamental to structuring reviewable transaction legislation based primarily on the effect of the transaction. There is certainly merit in the position that the fair market value of a debtor's assets is of little significance to a creditor who, if forced to execute against them, will receive only a fraction of that value.

Section 2 of the *Bankruptcy Act* defines an insolvent person as follows:

> "insolvent person" means a person who is not bankrupt and who resides or carries on business in Canada, whose liabilities to creditors provable as claims under this Act amount to one thousand dollars, and
>
> (a) who is for any reason unable to meet his obligations as they generally become due, or
> (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
> (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.

This definition incorporates both the legal and commercial tests and adopts two distinct methods of valuing the debtor's property. The court may apply any test that is appropriate in the circumstances. It does not appear that any need has arisen to settle whether fair market value, or a forced sale value, should be considered when determining whether the debtor is insolvent.

As a practical matter, when the issue of a person's solvency arises, it is usually clear that his debts significantly outweigh his assets. The *Bankruptcy Act*, consequently, adopts a flexible approach to determining whether a person is insolvent. That is probably as it should be. An approach which attempts to define insolvency with mathematical precision is unlikely to work well. A disposition by a person who is a few dollars short of being solvent, for example, should not be subject to attack. Experience under bankruptcy legislation suggests that not a great deal turns on whether insolvency is determined by reference to the fair market value of a debtor's property or the value it would have on a forced sale.

(c) Property Subject to Enforcement Measures

A further concern is what property should be taken into the equation to determine solvency. Should the law distinguish between property that is available to satisfy a creditor's claim as opposed to property that is not subject to execution? In the absence of specific legislation, *Royal Bank* v. *Kirkpatrick* suggests that only property within the jurisdiction would be considered subject to enforcement measures. *Aetna Financial Services Ltd.* v. *Feigelman*, however, suggests that the courts might take a broader view, and take into account property in other Canadian jurisdictions that have reciprocal enforcement of judgments legislation.

In the Working Paper, it was suggested that flexibility in assessing whether the transferor was insolvent at the time of the disposition might be useful. The proposal in the Working Paper was formulated so that the court could consider whether or not property in another jurisdiction should be taken into account. Comment was invited on whether a more precise formulation would be desirable.

A response from one group favoured an expanded definition of property that is subject to enforcement measures:

> We would prefer more certainty with regard to the issue of whether "property" is restricted to property within the jurisdiction or not. We believe that the debtor's assets outside the jurisdiction in a reciprocating Province or State should be included in the "property."

The need for certainty in this respect was also urged in several other submissions.

In our view, the approach adopted by the Supreme Court of Canada in the *Feigelman* case is correct in principle. There is no need to confine the definition of property to that which is within the province. Moreover, in light of modern commerce, many businesses conduct their affairs in a number of provinces, and have property throughout Canada. A judgment obtained in one Canadian jurisdiction may be proceeded upon in any other Canadian jurisdiction. It is our conclusion, consequently, that the court, when determining whether a transferor is insolvent, should take into account all of the transferor's property situate in Canada.

(d) The Role of Intent

Not every transaction involving an insolvent debtor should be subject to attack. A debtor's insolvency should be regarded as a precondition which must be satisfied before the courts consider other factors to determine whether a disposition of property qualifies as a fraudulent conveyance. These other factors are discussed in the following sections.

(i) Generally

In Ontario and New Brunswick, the role of intent in vitiating a transfer which has the effect of delaying, hindering or defrauding creditors or others proved to be one of the most contentious issues surrounding the reform of fraudulent conveyance legislation. Two questions may be raised:

1. Should intent be required or should the effect of the transaction alone be sufficient to vitiate it?

2. Whose intent should be relevant?

Under the current law, concurrent or double intent to delay, hinder or defraud is required in cases in which valuable consideration is given for a disposition of property. In contrast, transactions for nominal or inadequate consideration are said to give rise to a presumption of fraudulent intent if the result is to render the debtor insolvent. The status of this "presumption" is a matter of some controversy. If applied broadly, it renders superfluous the need to prove fraudulent intent in a transaction for inadequate consideration.

The Ontario Law Reform Commission was of the view that fraudulent conveyance legislation should favour the interests of creditors over those of the recipient of property. They recommended that a conveyance of property, other than one to a creditor, be void if it has the effect of delaying, hindering or defrauding creditors. Generally, a transaction would have such an effect if it was made by the debtor when he was insolvent, or it rendered him insolvent. The Ontario proposals, however, do not rule out the possibility that a conveyance may have the effect of delaying, hindering or defrauding creditors even if the issue of insolvency does not arise. It is inevitable that any transfer of property has the potential to delay, hinder or defraud creditors. It is the very essence of the transfer that it removes an asset from the debtor's pool of exigible property, which may or may not be replaced by a new asset.

Consequently, reviewable transaction legislation might adopt one of three different approaches. Under the first, intent would be irrelevant. A disposition which has the effect of delaying, hindering or defrauding creditors would be void. If this approach were adopted, it would be necessary to identify exceptions or defences to the general rule.

The second approach would require a creditor to establish that the debtor had the intent to delay, hinder or defraud creditors before the disposition would be set aside as a fraudulent conveyance. The third approach would require proof that both the debtor and the recipient of the property had the intent to delay, hinder or defraud creditors.

In terms of policy, the first option rests on the conclusion that the claims of the debtor's legitimate creditors are to be preferred over those of the recipient of the property. The third approach adopts the antithesis of this view in order to protect commercial transactions. The second approach, in which only the debtor's intent is relevant, is directed at an element which takes the transaction in issue out of the run of normal, everyday commercial transactions.

These are merely background considerations concerning the proper operation of reviewable transaction legislation. It is our view that no general rule will operate appropriately in all cases in which a conveyance to prejudice creditors is suspected. The nature of the transaction itself will dictate the factors which determine whether it should stand or be set aside. In this respect, we think there are three general categories of transactions.

The first is the transaction for fair and reasonable consideration. The second is the transaction which is essentially a gift. The third is the transaction for consideration which, while less than the value of the asset transferred, is still substantial. We do not think that it is possible to stipulate a general rule respecting the intent of the debtor and creditor in a manner which applies equally to each of these three types of transactions. In our view, it is more appropriate to address each category of transaction separately.

(ii) A Disposition of Property for Fair an d Reasonable Consideration

We think it can be fairly said that any disposition of property for consideration which bears a fair and reasonable relative value to that conveyed away should never be impeached. In such cases, the intent which underlies the transaction is irrelevant. No creditor is prejudiced if fair and reasonable consideration is received, notwithstanding the debtor's insolvency.

(iii) A Disposition of Property Which is Effectively a Gift

The transferee may only give token consideration for the disposition of property. In other words, the recipient of the property receives a bargain or gift.

Where a disposition of property is essentially a gift, there is little merit in protecting the transaction if the consequence is to prejudice creditors. As between the recipient of the property and the grantor's creditors, the creditors should be preferred. In this situation, a disposition of property made by an insolvent or which renders the transferor insolvent should not be allowed to stand. Again, the intent which underlies the transaction is irrelevant.

(iv) A Disposition of Property For Valuable or Substantial Consideration

A more difficult situation is where the recipient of the property has given less than fair market value for it but has still provided valuable or substantial consideration.

To set aside a transaction of this nature, proof of intent should be required. The fact that consideration is less than fair market value gives rise to a suspicion that the transaction is not a genuine one. However, where the transaction is genuine, in the sense that no fraudulent intent was involved, then there is no reason to deprive an innocent transferee of the benefit of the property.

(e) Whose Intent Should be Relevant?

Our conclusion is that the validity of a disposition of property for less than fair and reasonable consideration should be governed by the intent which accompanies it. The question then is whose intent should be relevant. The current law requires that, where valuable consideration is given for the disposition, the debtor and the recipient of the property must share the intent to defraud creditors before the disposition will be set aside. Where the disposition is essentially a gift, only the debtor's intent is relevant. In transactions prohibited by the *Bankruptcy Act*, it has been held by the Supreme Court of Canada in *Hudson* v. *Benallack* that the intent of the debtor alone is relevant.

A debtor who has transferred his property away has no interest in the security of the transaction. It is the position of the recipient of the property which is in issue. For that reason, the relevant question is whether the recipient of the property in some way shared the intent that the transaction prejudice creditors. Under the current Act, mere notice or knowledge of the debtor's fraudulent intent is not reason to void the transaction. It may be desirable to adopt a stricter approach in respect of suspicious circumstances, such as the acquisition of property at an undervalue, than does the present law. In our view, only a *bona fide* transferee should be entitled to rely on the validity of the disposition. He cannot be considered *bona fide* where he has knowledge or notice of the fraudulent purpose underlying the transaction, or where he holds the property for the use or benefit of the transferor.

One submission on the Working Paper raised the issue of burden of proof in this context. Our correspondent's remarks neatly encapsulate the concern and the policy issues:

> Some of us think that the recipient of a transfer is treated much too leniently in proposal 7. Proponents of that view think that the onus should be on the recipient to establish that the transaction is one which ought not to be impeached. It is argued that the recipient is in the best position to show that no prejudice was intended to claimants, and that the recipient was not a party to a transaction which was intended to prejudice claimants or to benefit the transferor. The other view is that fraud or an allegation of conspiracy, which underlies proposal 7(b) and (c), are serious allegations, the proof of which should be on the person who asserts them. It is argued that it would be unfair to a recipient, who did not know of the insolvency or potential insolvency of the transferor, and who has merely purchased something at less than its full market value, to require him to prove that he was not a party to fraud. However, it is recognized that it is most difficult in bankruptcy matters to establish fraudulent intent, and that it is not unreasonable to require a recipient to establish his *bona fide*s. The recipient is not being charged with fraud, but is only being asked to justify his purchase at an under value.

It is our conclusion that the burden of proof in this respect must be on the person attacking the disposition. Certainly, difficulties will be encountered in establishing intent, but that is not sufficient reason to require the recipient of a bargain to assume the more challenging task of proving his *bona fide*s or innocence. For example, knowledge that the debtor is in need of money should not be reason to avoid the transaction. Many people sell assets at an undervalue in order to raise funds quickly. This type of transaction should not be caught, unless the recipient of property knew that the intent of the debtor was to prejudice creditors. The burden of proving that must lie with the claimant attacking the disposition. He will, in many cases, be assisted by "badges of fraud" so that, in effect, both claimant and transferor will usually have to address the issue of intent.

(f) Proof of Fraudulent Intent

Currently, proof of fraudulent intent may be made either by direct evidence, or by inference arising out of circumstantial evidence presented by the plaintiff. Many such inferences have been dignified by the rubric "badges of fraud."

The Ontario Commission suggested that the law surrounding badges of fraud was unduly complicated, and amounted in fact and in practice to a presumption of fraudulent conduct. In our view, whether one considers that the onus of proof has shifted or that the plaintiff has made out a *prima facie* case seems to make little difference in practice. The concept of badges of fraud is little more than an acknowledgement of the value of circumstantial evidence. We see no reason to forbid reliance upon circumstantial evidence when the intent of the recipient of property is in issue.

(g) The Recipient of Property

Where a recipient of property gave value for the disposition which is set aside under fraudulent conveyance legislation, it seems unduly harsh to deprive him of the property without providing a remedy for the recovery of the consideration advanced for the disposition.

A number of approaches have been suggested to deal with this problem. The courts might, in certain circumstances, have power to order the return of the consideration. Or, the recipient might retain the property to secure repayment of the consideration he advanced for it. Lastly, the courts might have jurisdiction to return the parties to the positions they occupied before the disposition. That approach was adopted in the last bankruptcy bill introduced in the federal Parliament. It was also endorsed by the Ontario Law Reform Commission.

A fraudulent conveyance is a category of illegal transaction and we addressed appropriate remedies in *Report on Illegal Transactions*. The common law has limited tools for adjusting the rights and obligations of parties to an illegal transaction. We recommended the enactment of legislation to allow the courts more flexibility in this regard. The general principles identified, and the legislation recommended, in *Report on Illegal Transactions* adequately address these issues.

It is wise, however, to provide a specific remedy in reviewable transaction legislation which will serve until the Commission's recommendations on illegal transactions are implemented. It is our conclusion that the courts should have jurisdiction to return parties to their original position.

Such a jurisdiction, however, will not answer all problems that may arise. As a result of our conclusions concerning the consequences of the debtor's insolvency it is possible that the recipient of property under a vitiated transaction may be entirely innocent. The recipient may have changed his position in such a manner that it would be inequitable to compel him to make the property available to creditors at all. An innocent recipient of property who has changed his position in reliance on the validity of the disposition should be able to raise that as a defence to a creditor's action. Alternatively, it may be possible to safeguard adequately the interests of the innocent recipient by permitting access to the property only on terms or conditions. The court should be permitted to exercise such a power.

One submission received on the Working Paper was concerned that legislation should protect only an innocent recipient of property:

> We agree that as per recommendation #10 that the Court should be empowered to "undo" what was wrongfully done... [where] a transfer of property falls within recommendations 6 and 7. We would like to require the recipient to give up the property and of course because the recipient had intent to receive the property for less than fair market value to prejudice creditors or knew this was the transferror's purpose, then he also loses whatever consideration he gave to the transferror/debtor.
>
> An alternative is to require the recipient to pay the difference between what he originally paid and fair market value ...
>
> The placing the recipient in the situation he was before the transfer and requiring him to give up the property would apply in our view only to the innocent recipient.

Under our recommendations, there are only two kinds of dispositions which may be attacked by a creditor. First, a recipient of property may have received it by gift from an insolvent, or only paid a token price for it. Second, he may have acquired property from an insolvent at a bargain price. In the latter case, the claimant must prove that the recipient of the property intended to assist the debtor in prejudicing claimants.

While there may be circumstances where a transferee should not be returned to the position he occupied before the disposition, it is difficult to see why these issues should not be left to the court's discretion. Where a recipient of property pays less than full value he should be entitled to its return when the disposition is set aside, unless the debtor no longer has it. A recipient of property who has acted collusively with a debtor to evade creditors may not be entitled to much sympathy, but in many cases, denying him a remedy will only unjustly enrich creditors. For example, R buys Blackacre, worth $100,000 from D, an insolvent, for $50,000. If R is not entitled to the return of the $50,000, D's creditors will have access to it as well as Blackacre. This might appear to be just retribution if R is a scoundrel. It would be unfair, however, if R is a *bona fide* purchaser who thought he had made a good deal. Suppose R paid $75,000. As the consideration paid by the transferee approaches a reasonable value, the unfairness of denying him a remedy becomes more apparent. In our view, these are matters which can only be addressed by the courts on a flexible basis.

Our correspondent's suggestions for further refinements in the court's ability to redress the consequences of a reviewable transaction are well taken. Nevertheless, the specific provisions contemplated are aimed at providing remedies which will serve until legislation implements the Commission's recommendations on illegal transactions. It is useful to list some of those recommendations from the *Report on Illegal Transactions*:

> 14. In a proceeding respecting an illegal transaction, or property affected by it, a court should have the power to grant any remedy which it could have granted at common law or in equity, in respect of the transaction or property, as if the transaction were not illegal, and, in particular, the court should have the power to make an order for one or more of the following remedies:
>
> (a) restitution;
> (b) compensation, by way of damages or otherwise;
> (c) apportionment of loss arising from the formation or performance of the transaction provided that no loss of profit shall be so apportioned;
> (d) a declaration;
> (e) an order vesting property in any person, or directing any person to assign or transfer property to another person;
> (f) an order that:
>
> (i) certain rights or obligations arising out of the illegal transaction are not binding on the parties and that the remainder of the rights and obligations constitute a binding and enforceable transaction; or
> (ii) the obligations arising out of an illegal transaction may be discharged in a lawful manner specified by the court provided that the court is satisfied that the remaining rights or obligations under the transaction, or the obligations to be performed, are reasonable.
>
> 15. Relief may be granted under an *Illegal Transaction Act* subject to such terms and conditions as the court sees fit to impose.
>
> 16. An *Illegal Transaction Act* should specify that in granting or denying relief, a court should consider:
>
> (a) whether granting relief would be contrary to the public interest;
> (b) the facts and circumstances, including the intent, conduct, knowledge, and relationship of the parties, in relation to the formation or performance of the transaction;
> (c) whether any party was, at a material time, acting under a mistake of fact or law;
> (d) the object of an enactment giving rise to an illegality;
> (e) the extent to which the illegal transaction has been performed;
> (f) whether there has been substantial compliance with the enactment giving rise to the illegality;
> (g) the consequences to any person of denying relief;
> (h) any other relevant factor.

Legislation based on these recommendations will enable the courts to provide a comprehensive range of remedies when a disposition is set aside.

5. "CREDITORS AND OTHERS"

The term "creditors and others," used in the 1979 revision, faithfully duplicates the terms of the preamble to the older versions of the Act. These words are derived directly from the Act of 1571.

It is not necessary to use the term "creditors and others" in new legislation provided the issue of standing is clearly addressed.

The phrase "creditors and others" extends to anyone with a liquidated or unliquidated claim. A "creditor" or "other" whose claim arises after the date of the transaction in dispute, however, may not have standing under the Act. It depends upon whether he was foreseen as an object of the fraudulent transaction or, alternatively, whether he has an equity to set aside the transfer as a result of the existence of prior creditors who could have complained of it.

The Ontario Law Reform Commission concluded that subsequent creditors should not be permitted to attack a transaction:

> In the first place, we are of the view that subsequent voluntary creditors cannot be heard to complain of their disentitlement, since they extended credit on the basis that the property comprehended by the conveyance no longer belonged to the debtor. We do acknowledge that it is mainly the large institutional lenders or other creditors similarly situated that have the means of investigating the debtor's financial circumstances before credit is extended. Clearly, some creditors either do not have ready access to credit information or, because of the financial burden, stiff competition, or some other reason, believe they cannot investigate every potential borrower. However, where for whatever reason no investigation is undertaken, and no security is demanded, creditors must be taken to have assumed a certain risk in doing business; in this respect, their potential loss as a result of a prior conveyance is no different than their potential loss because, for example, they have been involved in unsuccessful products liability litigation as a consequence of their unwillingness to establish an adequate product control procedure.
>
> We now turn to consider the position of involuntary subsequent creditors - for example, tort claimants whose causes of action arose subsequent to the conveyance in question. Given the broad scope of our earlier proposal in respect of existing creditors entitled to impeach a conveyance, there would not likely be many situations where, as a matter of policy, an involuntary subsequent creditor reasonably should be given the right to sue. Ordinarily, one would have thought that, at the date of the conveyance, a person entitled to sue at least should have a cause of action, even if his claim is unliquidated, disputed, or contingent, if he properly ought to be comprehended by the legislation. If no such cause of action exists, we believe that the subsequent involuntary creditor must, in a sense, take his debtor as he finds him.

The Ontario Commission recommended that:

> 6(1) The term "creditor," as it relates to the entitlement to impeach a conveyance, should be defined broadly to mean a person who, at the time of the conveyance, has a judgment or cause of action against the debtor, whether the claim in respect of the cause of action is liquidated or unliquidated, absolute or contingent, certain or disputed, or payable immediately or at a future time.
>
> (2) A creditor whose judgment or cause of action arose subsequent to a conveyance should not have the right to impeach that conveyance.

This recommendation was not unanimous. One Commissioner dissented. He pointed out that the New Brunswick report recommended that future creditors have standing. The U.S. Uniform *Fraudulent Conveyance Act* also provided that future creditors have standing in defined circumstances. He concluded:

> To deprive subsequent creditors entirely of a right to challenge a conveyance is an invitation to fraudulent persons to make themselves "judgment-proof" so that they can commit actionable wrongs, such as libel or slander, with impunity. Accordingly, ss. 5 and 6 of the American Uniform *Fraudulent Conveyance Act* should be adopted.

Sections 5 and 6 of the American Uniform *Fraudulent Conveyance Act* provided as follows:

> Section 5. [Conveyances by Persons in Business]
> Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to his actual intent.
>
> Section 6. [Conveyances by a Person About to Incur Debts.]
> Every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors.

There is much force in both positions. The issue is not an easy one to resolve. On one hand, there is merit in giving future claimants standing under the Act. A person, for example, should not be permitted to impoverish himself in anticipation of the commission of a tort. On the other hand, it is hardly blameworthy to shield assets when undertaking a new business. That is one reason why people are permitted to conduct business through corporate entities. On the whole, it is our conclusion that future claimants not be able to attack transactions which occurred before their claims against the debtor arose.

6. "CLAIMS" AND "CLAIMANTS"

In the Working Paper, it was proposed that standing should be given to a person with a claim which was liquidated or unliquidated, absolute or contingent, certain or disputed, or payable immediately or at a future time. This formulation was designed to encompass virtually any kind of claim. Two correspondents suggested that it might not catch a claim against a guarantor who has not yet been called upon to honour the guarantee. That would, however, be characterized as a contingent claim. Nevertheless, for greater certainty, legislation might clarify the position of guarantors.

7. LEAVE TO PROCEED

A submission received from one group suggested that the Commission's proposals on who should have standing would be too restrictive:

> Proposal 12 gives us some concern. We think that some claimants whose claims have arisen subsequent to a disposition of property should have the right to impeach a transaction ... If a "subsequent claimant" may move to impeach a disposition and commence an action to do so, with leave of the court before his claim has matured, such leave could be granted if the court was satisfied that the effect of the conveyance sought to be impugned could reasonably be expected to impair the ability of the creditor to meet the applicant's claim when it falls due.

In the Working Paper, "claimant" was defined in terms of a person who has a claim at the time a disposition is made. The claim, however, may represent an obligation which is not yet due or which is still in good standing. As a general rule, a claimant should not be able to bring an action to set aside a disposition until the obligation has accrued due, or is in default. This approach ensures that a claimant may not bring unfair pressure to bear on the transferor to seek, for example, payment of a debt before it is due.

Nevertheless, there can be no objection to granting courts a discretion to permit an application to be brought at an earlier time. Perhaps the debtor is under an obligation to make annual payments to the creditor. Eleven months before the next payment is due, the creditor learns that his debtor is ridding himself of property. In these circumstances, it would be useful for the court to be able to allow an immediate proceeding to take place.

8. "EVE OF INSOLVENCY"

We have concluded that the effect of the transaction when it is made is a crucial factor for determining whether or not it should be set aside. This approach is designed, essentially, to balance the rights of both creditors and debtors. For example, D transfers Blackacre to X at a time when D's sole creditor is C, who is owed $50,000. D still owns Whiteacre which is worth $50,000. Under our recommendations, the disposition to X, even if it is a gift, may not be set aside since D has sufficient as sets to satisfy his outstanding debts. If later the value of Whiteacre falls to $40,000, that would not alter the validity of the disposition to X. It should not matter whether C is unsecured or has a mortgage against Whiteacre for the full amount of the debt he is owed.

Having said that, it should be observed that the timing and order of various dispositions may be such that this approach, if strictly adhered to, might permit fraud. For example, D owes C $40,000. D owns Whiteacre (worth $20,000), Blackacre (worth $20,000), and has $20,000 in cash. If D transfers Whiteacre as a gift, the disposition is valid. If he later transfers Blackacre as a gift, that disposition may be attacked, since it renders D insolvent. If these dispositions occur within minutes or days of each other, the law might well appear naive or impotent unless they are regarded as part of the same transaction. Rigorously adhering to the timing element may well cause the law to look foolish.

The current *Fraudulent Preference Act* addresses this problem with the concept of "eve of insolvency." This concept has been described as addressing the situation:

> Where the settlor was, after the execution of the instrument, in perfectly solvent circumstances, but has since divested himself of so much of the property which was reserved out of the settlement that there is not enough left to pay the debts which he owed at the time the settlement was made.

Essentially, transactions which are sufficiently contemporaneous or a transaction which, when combined with forseeable economic events, reduces the value of remaining property, and which render a person insolvent, have the same effect as a single transaction which renders the transferor insolvent. This would be a useful addition to reviewable transaction legislation.

C. Remedies

1. GENERALLY

The current *Fraudulent Conveyance Act* provides only that the disposition of property is void "as against creditors and others." This leads to the conclusion that the transaction is perfectly valid as between the parties to it. While authority is not clear beyond doubt, it would appear that title does pass under an illegal transaction such as a fraudulent conveyance. This position is sometimes overlooked.

A number of orders may be made in a *Fraudulent Conveyance Act*.

One form of relief frequently granted is an order for the return of the property. The intent is that the property will be made available for execution in the normal manner. When that is done, most forms of execution will render the proceeds subject to the *Creditor Assistance Act*.

We see no reason to prevent a court from ordering a return of the property to the transferor. In making such an order, however, the court ought not to lose sight of the possibility that the transferee may wish to assert his rights to the property. Presumably, when such an assertion is made, the court will have both of these parties before it. The issue of the proper order as between the parties may thus be litigated, and it is to be expected that the order for the return of the property at the instance of the creditor would only be made in cases in which the court would be justified in ordering its return as between the transferor and transferee. If the legislation recommended in *Report on Illegal Transactions* is implemented, this would include a case in which an application for relief by the transferor is made under the terms of that enactment.

Another order which might be made is a declaration of exigibility coupled with an order for sale. An order for sale need not be made with such a declaration. It could be left to the parties to issue execution relying on the declaration as founding a right in rem to the land or chattels.

Orders for sale are only one form that a direction from the court as to execution on the property may take. Other methods of execution may suggest themselves. The marketing of an asset to obtain maximum benefit for the creditors is a matter which cannot be pre-determined. We think the court should have a broad power to direct the manner in which the property is subject to execution. This power should not be restricted to forms of execution and proceedings presently authorized by one or another enactment.

As was noted earlier in this Report, applications for injunctions and other forms of interlocutory relief, damages, and restitutionary orders are also possible under the *Fraudulent Conveyance Act*. It is unnecessary to say anything about these particular forms of relief, as they are part of the general law.

D. Tracing the Property

Nothing in the *Fraudulent Conveyance Act* permits access to property fraudulently conveyed away when it has passed into the hands of a third party, whether for value, and whether the third party was aware of the circumstances in which the property came into the hands of his transferor. This position is subject to section 7 of the *Fraudulent Preference Act*, which allows the court to order execution on the proceeds of any such transaction. In other words, while the property conveyed away by a fraudulent transferee cannot be recovered, the creditor may be entitled to execute against the consideration received for the disposition.

Section 7 of the *Fraudulent Preference Act* permits the court to order that the value of proceeds received by a transferee from a subsequent disposition may be made available to creditors. Arguably, this goes too far. An innocent transferee, for example, may have spent the proceeds unwisely and received no real benefit from them. In such a case, it would be inappropriate to make the value of the proceeds available. The defence of change of position may or may not be sufficient protection in these circumstances.

In our view, a claimant should be entitled to the traceable proceeds from a subsequent disposition. Perhaps this was the concept underlying the reference in section 7 to "value." In some cases, mixing property with other similar property may make the identification of the original property impossible. Nevertheless, principles have been developed to "identify" property in these circumstances. Legislation should adopt this approach instead.

CHAPTER IX REFORM OF FRAUDULENT PREFERENCE LEGISLATION

A. Introduction

Earlier, it was concluded that provincial legislation should continue to regulate preferences made to creditors, although the current *Fraudulent Preference Act* should not be retained for that purpose. The identification of the features of fraudulent preference legislation was deferred to this chapter. At the heart of this enquiry is the need to determine the role provincial legislation has in areas of the law usually reserved to the federal *Bankruptcy Act*. It would be inappropriate, and beyond the province's capacity, to enact legislation amounting to an alternative bankruptcy regime. Provincial legislation must be less ambitious.

B. Preference and Conveyance Legislation

1. DISTINCTIONS

It bears repeating that fraudulent conveyance legislation differs from fraudulent preference legislation in several respects. Fraudulent conveyance legislation seeks to prevent a debtor from evading his creditors. Fraudulent preference legislation seeks to ensure that one creditor is not preferred over others.

The chief distinctions between fraudulent conveyance legislation and fraudulent preference legislation arise from the different status of the recipients of property. A creditor who attacks a fraudulent conveyance is in competition with the transferee. A creditor who attacks a fraudulent preference is in competition with another creditor.

The law must distinguish between those transactions which ought to be set aside and those which ought to be protected. The goal of protecting creditors should not prejudice those who deal in good faith with the debtor. It was concluded in the last chapter, with respect to conveyances, that legislation should not vitiate a disposition for full value. Moreover, even if the disposition was for a bargain price, it should still stand if the purchaser acted in good faith. Other dispositions should be set aside to protect creditors.

With respect to fraudulent preferences, different issues arise in determining which recipients of property should be protected. A preference occurs when a creditor receives property to satisfy a debt. The creditor, consequently, gives full value for the disposition of property. In what circumstances should the creditor lose the rights he has gained, in order to deal with other creditors fairly? The proper operation of preference legislation is the subject of this chapter.

2. SIMILARITIES

Despite serving different purposes, and balancing different competing interests, statutes regulating fraudulent preferences and conveyances operate similarly. In each case the debtor rids himself of property. In each case the disposition prejudices creditors. In each case the court is asked to set aside the disposition and make the property available to creditors. The fact that these two enactments are essentially concerned with the voiding of prejudicial transfers suggests that they might usefully be combined.

Many of the issues addressed in the last chapter in the context of fraudulent conveyance legislation also arise in the context of fraudulent preference legislation. Once the policy of fraudulent preference legislation has been settled, it is important that, so far as possible, legislation which authorizes the courts to review dispositions on the basis that they prejudice creditors operate consistently. This chapter, consequently, addresses only those issues peculiar to fraudulent preference legislation. Issues common to both preference and conveyance legislation should be resolved by similar solutions.

C. Provincial and Federal Preference Legislation

1. THE PURPOSES OF PREFERENCE LEGISLATION

Fraudulent preference legislation must balance the interests of:

1) the debtor,
2) his creditors who have not been paid,
3) his creditors who have been paid, and
4) third parties dealing with the debtor or his creditors.

Two general policies are in competition. From a commercial perspective, it is appropriate to encourage debtors to pay creditors. It is also important that a creditor be able to rely on the validity of a payment. Commercial transactions should not be lightly interfered with. On the other hand, when a debtor can no longer carry on business, it is important to ensure that creditors are dealt with equally, each sharing in the debtor's assets and bearing a proportionate share of any resulting shortfall. The debtor benefits by legislation which regulates preferences. Creditors are discouraged from taking extreme measures in order to satisfy outstanding obligations. A creditor gains little by extracting payment, perhaps putting the debtor out of business in doing so, if the payment will have to be shared with other creditors. Consequently, a debtor should not be permitted to decide which creditors to pay when not all will be.

2. DIFFERENCES BETWEEN CURRENT PROVINCIAL AND FEDERAL LEGISLATION

Both federal and provincial legislation govern preferences to creditors made by an insolvent, but slightly different approaches are taken to balancing the interests of the various parties involved. Some dispositions which are valid under the *Bankruptcy Act* are invalid under provincial legislation. Viewed from the perspective of the attacking creditor, it is convenient to have legislation invalidate the greatest number of dispositions. If the disposition is valid under federal legislation, it is useful that it can still be attacked under provincial legislation. From the viewpoint of the defending creditor, it is desirable that the greatest number of dispositions be protected.

The different approaches adopted under federal and provincial legislation reflect the difficulties of devising legislation in this context. These approaches reflect different views concerning the appropriate method of balancing the interests of the parties affected by a debtor's insolvency. Professor Weisberg, in a useful article on the history of preference legislation, notes a recurring cycle among approaches that have been adopted to determine which kinds of preferences should be protected and which set aside for the general benefit of the insolvent's creditors. At the heart of this issue lies a competition between moral and legal concerns.

3. MORAL AND LEGAL APPROACHES

The test applied under the *Bankruptcy Act* to determine whether a preference should be set aside is based on the debtor's insolvency and the intent with which the preference is made. In British Columbia, a different approach has been adopted for particular transactions. Preferences made by an insolvent within a defined period are automatically set aside. Preferences falling outside of that period, as under the *Bankruptcy Act*, are vulnerable only if made with the intent to give a preference.

Legislation based on the intent with which a preference is made is chiefly concerned with moral issues. An intention to prefer is what takes the disposition of property out of the ordinary course of business and so colours it that it should be set aside. Such legislation is to be contrasted with legislation based on the effect the disposition of property has. Legislation of that nature proceeds on the view that a disposition of property should be set aside if it diminishes the debtor's estate and confers on one creditor more than his proportionate share while leaving other creditors with less than their proportionate shares. Such legislation adopts an objective approach, based solely on legal, as opposed to moral, values.

Professor Weisberg refers to a useful classification of the kinds of debtors and creditors that preference legislation must have regard to, prepared by Daniel Defoe in 1697:

> 1. There is the Honest Debtor, who fails by visible Necessity, Losses, Sickness, Decay of Trade, or the like.
> 2. There is the Knavish, Designing, or Idle, Extravagant Debtor, who fails because either he has run out his Estate in Excesses, or on purpose to cheat and abuse his Creditors.
> 3. There is the Moderate Creditor, who seeks but his own, but will omit no lawful Means to gain it, and yet will hear reasonable and just Arguments and Proposals.
> 4. There is the Rigorous Severe Creditor, that values not whether the Debtor be Honest Man or Knave, Able, or Unable; but will have his Debt, whether it be to be had or no; without Mercy, without Compassion, full of Ill Language, Passion, and Revenge.

To Defoe's cast of players should be added the "Related Creditor," the lender who, by reason of close association, is likely to be preferred over institutional lenders. There is also the "Related Debtor," who pays one creditor to protect another debtor from liability on the same obligation. For example, a company's debts may be guaranteed by a director. The director may have the company pay the creditor in order to protect himself from liability on the guarantee.

It is interesting to analyze the British Columbia *Fraudulent Preference Act* by reference to these players. The automatic setting aside of a disposition by an insolvent within 60 days of its having been made makes no distinction between the Honest, Knavish or Related Debtor, nor the Moderate, Rigorous or Related Creditor. After 60 days, the disposition will be set aside only if it was made with the intent to prefer the creditor. At that time, the legislation tends to single out for attention transactions between Knavish Debtors and Rigorous Creditors, and transactions by Related Debtors and Related Creditors, protecting honest transactions between Honest Debtors and Moderate Creditors. Curiously, the defence of pressure primarily protects the Rigorous Creditor who, "full of Ill Language," extracts a preference from his debtor.

The federal Act is based entirely on the intent with which the preference is made, and the defence of pressure is not available. In theory, this gives the courts substantial flexibility in determining which preferences, morally, ought not to stand. In practice, intent-based schemes tend to produce unpredictable results. Personal views held by judges determine whether a disposition should be protected or set aside.

The competing policies of treating creditors even-handedly and of protecting commercial transactions are given different weight by different judges.

The starting point for devising new fraudulent preference legislation is to settle on the approach for determining which transactions should be protected and which set aside. Should such legislation depend upon the effect of the transaction (a legal, objective regime), the intent with which it was made (a moral, subjective regime), or some combination of these two separate tests?

D. The Role of Intent

1. GENERALLY

In the last chapter, it was concluded that in the context of conveyances the question of whether a disposition should be set aside ought to be resolved by reference to the effect it had. An objective test, depending on the debtor's solvency, should be applied. An exception was made for persons receiving a bargain. There is nothing inherently blameworthy in paying less than full value for property. Such a disposition should only be set aside where the recipient knew that the debtor was impairing his ability to satisfy his creditors' claims. It was our conclusion, consequently, that it was appropriate to devise legislation based primarily on the effect of the transaction. The principal thrust of the legislation should be based on an objective approach.

In the context of fraudulent preferences, there is nothing blameworthy in a creditor accepting payment of a debt. The only factor that makes the transaction vulnerable is the policy decision that, in certain circumstances, creditors must share proportionally in the debtor's assets. It is difficult to see, consequently, what role intent has to play to resolve these issues. Nevertheless, the *Bankruptcy Act* and most provincial legislation apply the test of intent.

2. SUBJECTIVE OR OBJECTIVE TEST

Intent to confer or receive a preference is usually acknowledged as an essential ingredient before it may be set aside. This approach is based on the view that an intent to prefer one creditor over another takes the transaction out of the ordinary course. It is a means of distinguishing between preferences which should be protected and those which should be set aside. In terms of Defoe's categories of players, it allows distinctions to be drawn between Honest, Knavish and Related Debtors and Moderate, Rigorous and Related Creditors. This line of analysis, however, is not particularly satisfying. Whatever the intent with which a preference is made, its effect is the same. The debtor's other creditors are prejudiced.

Arguably, the test of intent masks a different issue. It is premised on the view that it is acceptable for an insolvent to pay some creditors, but not others. As a general rule, it serves to distinguish between arms-length and non-arms-length transactions. The view is held that it is blameworthy to pay a Related Creditor, or to pay a creditor to protect a Related Debtor, but not other kinds of creditors. At the heart of this distinction is the view that the payment to a Related Creditor (a closely held company or a family member) is more likely to be a sham transaction, in the sense that the debtor will in one way or another, immediately or eventually, profit from the preference, than is a payment to an unrelated creditor. Even if the concern is not with the possibility that the preference is a sham transaction, many would contend that there is something wrong in paying a Related Creditor. For one thing the related creditor is likely to be better informed, and better able to protect himself than the unrelated creditor.

The tests adopted by the current law, masking as they do incompletely conceptualized concerns, are responsible for a good deal of uncertainty in the operation of fraudulent preference legislation. It is useful to review the lessons of history. When first enacted, British Columbia's fraudulent preference legislation was largely ineffectual. The test of intent permitted most preferred creditors to defend successfully preferences they had received. In response, the legislation was amended to provide that certain transactions made by an insolvent were to be set aside if attacked within 60 days of having been made. In this way, fraudulent preference legislation actually operated to set aside preferences.

In the last chapter, it was concluded that a principal defect in fraudulent conveyance legislation was the use of the term "fraud." Many conveyances which should be set aside are not, strictly speaking, fraudulent. Similarly, in the context of preference legislation, it is important to note that the paying of a creditor is not fraudulent. The reason why a preference is set aside is to ensure that all creditors are treated equally, including the creditor who initially received the preference. From this perspective, it is difficult to see how the intent with which a disposition is made figures in any respect in the reasons for setting it aside.

It is not our intention to repeat the discussion in the previous chapter concerning whether an objective or subjective approach should be adopted to determine when a disposition by an insolvent should be set aside. The issues and the policies are the same in this context. It is our conclusion that an objective test should be adopted. That test should be whether other creditors are prejudiced by the disposition, something which can only occur where the disposition is made by an insolvent.

That is not to say that every disposition of property by an insolvent should be set aside. The current *Fraudulent Preference Act* lists a number of situations where a disposition by an insolvent to a creditor is immune from attack. These situations are objectively defined and, for the most part, identify commercial transactions which should be upheld. We will return later in this chapter to a consideration of the kinds of defences that should be available in a proceeding to set aside a preference.

3. VOLUNTARY AND INVOLUNTARY TRANSACTIONS AND THE DEFENCE OF PRESSURE

Under the current law, a distinction is drawn between dispositions made by an insolvent of his own volition, and those which are made involuntarily. The test of intent requires that only those dispositions by which an insolvent intends to prefer one creditor over others should be set aside. It follows that dispositions not motivated by that intent should be protected. In this respect, a preferred creditor can raise the defence of pressure. If the insolvent made the disposition to relieve himself of pressure exerted by the creditor, he did not intend to prefer the creditor. He intended to relieve himself of the pressure.

The availability of this defence demonstrates the flaw in an intent based scheme. Such an approach requires that only those dispositions which are intended to be preferences should be set aside. As we mentioned before, however, this approach tends to favour the Rigorous Creditor over the Moderate Creditor which, in principle, would appear to be inappropriate. The law should encourage reasonable accommodations between lender and borrower, and not competition between lenders to ensure their priority. Moreover, it is difficult to see how pressure alters the effect of the disposition. These distinctions and defences should not be part of the law governing preferences.

4. CLASS ACTIONS

Preference legislation, in theory, is designed to protect all of the insolvent's creditors. That is the only reason for setting aside a preference. From this perspective, the *Fraudulent Preference Act* operates in a curious manner. Often all that occurs is that the creditor initially preferred loses the benefit of the disposition of property to another creditor. Even if the first creditor and the attacking creditor share in the disposition of property, they are preferred over all of the other creditors of the insolvent. What justification is there for depriving one creditor of a preference in favour of another? The policy of treating all creditors equally is not met by the current *Fraudulent Preference Act*, although it is by bankruptcy legislation.

It was mentioned earlier that a province does not have the capacity to create an alternative scheme of provincial bankruptcy legislation. Moreover, ensuring that all of an insolvent's creditors are dealt with fairly would, in most cases, be prohibitively expensive. Recasting fraudulent preference legislation to protect an insolvent's creditors generally would likely involve duplicating many of the provisions of bankruptcy legislation, with their attendant expense. To protect all of an insolvent's creditors, procedures would have to be developed to give them notice of the preference proceedings and an opportunity to prove their claims. It is difficult to see how this can be done without creating a fully fledged bankruptcy regime, with a trustee to perform these functions.

Provincial preference legislation must necessarily adopt a more limited scope. It must be viewed in the nature of a "self-help" remedy. A creditor concerned that he has been prejudiced should be permitted to take steps to protect his own interests. It is not his responsibility to ensure that other creditors are being treated fairly. Within the limits of provincial legislation, it is likely that one or several creditors may take part in proceedings to set aside a preference and, if successful, the property should be divided among them. Where a large number of creditors are concerned, however, the only route available must be bankruptcy proceedings, which are designed to deal with these problems. A creditor who will not be protected by proceedings under provincial legislation may apply to petition the insolvent into bankruptcy. Alternatively, the court should consider whether, because of the large number of creditors involved, the proceedings should be stayed to permit an application to petition the insolvent into bankruptcy, or to order that the property be preserved pending such an application. In this respect, provincial legislation may be resorted to by creditors to protect themselves, but in some circumstances the proceedings will be essentially in the nature of conservatorship, to protect the insolvent's property from being disposed of until bankruptcy proceedings can be commenced.

E. Defences

An effect-based regime must be tailored to ensure that common commercial arrangements are not discouraged or disrupted by the goal of treating fairly all creditors of an insolvent. Many commercial transactions entered into by an insolvent should be upheld, to protect his business interests and those of people dealing with him. It is necessary to define and protect a number of commercial arrangements which, although technically preferences, are generally of benefit to business, the parties and the community. Provincial legislation should recognize circumstances where, as a practical matter, a preference has not prejudiced other creditors, or where a superior policy is the protection of commercial arrangements. The current act identifies a number of these situations and the reader should refer to Chapter IV for a full discussion of them. In this section are identified commercial arrangements that we have concluded should be protected by provincial preference legislation.

1. TIME LIMITS

Subject to certain defences, a disposition should be set aside and the property divided fairly between all of the insolvent's creditors known to the court. It is impractical, however, for legislation to permit all dispositions to be set aside. After time passes, the parties will have relied on the validity of the disposition. It would be far too unsettling to commerce to permit any disposition to be attacked at any time. It was mentioned earlier that the current *Fraudulent Preference Act* provides that dispositions may be automatically set aside where they are attacked within 60 days of

(i) the registration of a document evidencing the disposition;
(ii) the disposition; or
(iii) an assignment for the benefit of creditors.

Sixty days would appear to be too short a period for creditors to ascertain whether a disposition has taken place, the debtor is insolvent, and they have been prejudiced by it. Although every time limit has an element of arbitrariness, a period of one year from completion of a disposition would appear to be appropriate. This position is essentially a compromise. Under the current legislation, a creditor would appear to be able to attack a disposition at any time, so long as his claim is not statute barred, although it is likely that he would not be able to proceed after six years from the completion of the disposition. The effect-based regime we recommend would be disruptive to commerce if the validity of transactions were in doubt for anything like six years. As a practical matter, a year is a reasonable time during which a creditor may act to protect himself.

Some dispositions will take place without anyone other than the transferor and transferee being aware of it. One may expect creditors to act to safeguard their own interests, so that it is unlikely that dispositions involving property of significant value will go unnoticed, particularly when the transferor is in default or it is known that he borders on insolvency. Nevertheless, in some cases the parties to the disposition will attempt to conceal it from creditors. A limitation period should not serve to protect the unscrupulous.

The *Limitation Act* addresses problems of this nature by providing that in certain circumstances a limitation period does not begin to run against a person until he is in a position to assess whether or not he should bring an action. It would be useful to adopt a similar approach when the parties attempt to conceal material facts relating to a disposition that prejudices creditors.

In virtually every case, the integrity of a disposition is of importance to the transferee, not the transferor. In the interests of commerce, it is important that an innocent transferee be able to rely on the validity of the disposition. Consequently, in our view, it is only when the transferee conceals, attempts to conceal or acquiesces in the concealment of material facts relating to a disposition that the running of the limitation period should be postponed.

It is unwise to provide that the running of time may be postponed indefinitely. Legislation should also provide that, in any event, no action may be brought after a sufficiently long period of time passes. Six years after a disposition is made would appear to be enough time for a creditor to discover material facts and assess his legal position. Little is gained, and much is lost, if the validity of transactions is placed in doubt indefinitely.

2. ORDINARY COURSE OF BUSINESS

The current Act protects preferences made in good faith in the ordinary course of business. The Ontario Law Reform Commission recommended that such preferences should continue to be protected:

> The Commission believes that such a provision has an expressly commercial flavour to it and, therefore, ought to be preserved in an area of the law so vital to the business community. Accordingly, we recommend that a preference should be upheld and the preferred creditor protected in any case where it is shown that the transaction between the debtor and the preferred creditor occurred in the normal course of business or affairs of the debtor in relation to that creditor. In addition, to avoid rigidity in the application of our proposal, we recommend that this exception should not be restricted to cases in which the debtor and the preferred creditor have dealt with each other on a regular basis. Rather, the exception should be equally operative where the preference given by the debtor to the preferred creditor was the first occasion, after contracting the original debt, when the two parties dealt with each other. In the latter case, the court should have regard, for example, to the normal or commercially accepted conduct of parties in a position similar to that of the debtor and the preferred creditor.

It may be desirable to permit a person who is technically insolvent to continue in business. Many businesses go through periods of solvency and insolvency, particularly when involved in a cyclical or seasonal endeavour. A decision not to protect preferences made in the ordinary course might prevent the debtor from staying in business, resulting in an otherwise avoidable bankruptcy or liquidation. Moreover, the real concern is not regular, recurring payments by an insolvent. It is the exceptional disposition of property of significant value which requires regulation. Preference legislation should adopt this exception, although we are not convinced that the test is as inflexible as suggested by the Ontario Law Reform Commission, or that the courts need guidance on transactions made in the ordinary course between parties whose business relationship is fairly recent.

If there is a problem, it lies in formulating the test in terms of the ordinary course of business. If a distinction is to be drawn between unexceptional transactions and extraordinary dispositions, then the test should be stated in terms of dispositions made in the ordinary course generally.

3. NEW VALUE

In some cases, a creditor may advance new funds to the debtor but, concerned over the amount of the debt, require security for a portion of it. Where the security is identifiable with the fresh advance, it is not a preference. Where, however, the security is arranged for past debt, it would qualify as a preference. These kinds of arrangements are often crucial to a debtor's ability to continue in business. So long as the fresh advance was made in the *bona fide* belief that the debtor would be able to continue in his business and eventually satisfy all of his creditors, it should be protected. This defence is recognized under the current Act, and it should be equally available under revised preference legislation. The Ontario Law Reform Commission reached a similar conclusion, but added several refinements to this defence:

> ... the creditor must honestly believe that his advance will not simply enable the debtor to rescue his business and pay his creditors, but that it will actually be used by the debtor to this end. Blind and reckless faith in an obviously fraudulent debtor will not suffice, however honestly the creditor is motivated. Secondly, we wish to note the retention of the requirement to prove the bona fides of the preferred creditor. Given the extraordinary nature of this exception to the general rule, and given the absence of any statutory limit placed on the extent of the security given up relative to the advance offered, we believe that the remaining creditors ought at least to be shown that the transaction was part of an honest, commercially reasonable, attempt to revivify the debtor's enterprise.

We agree with the refinements recommended by the Ontario Law Reform Commission, but have a further observation. A creditor may threaten litigation to satisfy an outstanding obligation, unless he is provided with security. In such a case, forbearance may qualify as fresh consideration for the security. A qualification such as "the transaction was part of an honest, commercially reasonable, attempt" to revive the debtor's business should ensure that this exception does not create a loophole by which every preference can be supported.

4. PRIOR AGREEMENT

An other defense is also recognized under the current Act. In some cases, a creditor will advance money on the condition that he may later request security for the debt. This kind of commercial arrangement requires protection. If the creditor calls for security based on a prior agreement, the giving of it should not qualify as a preference. Any other approach requires the creditor to obtain as much security as possible whenever debt is incurred. That often entails expense and inconvenience to both lender and borrower. It is important for the law to recognize and protect reasonable commercial arrangements.

Certain arrangements may resemble an agreement to give future security. For example, the lender may advance money on the agreement that specific property will later be conveyed to him. Arrangements of this nature, however, are more properly regarded as conveyances or options to purchase, and whether they should be protected depends upon the correlation between the value exchanged and the worth of the property conveyed.

5. OTHER FEATURES OF PREFERENCE LEGISLATION

This chapter has been chiefly concerned with identifying the general features that provincial preference legislation should adopt. We have been at pains, however, not to unnecessarily duplicate the discussion of identical issues that arise in fraudulent conveyance legislation and which were canvassed in the last chapter. As was mentioned earlier, it is desirable to adopt a unified approach to the regulation of dispositions of property by an insolvent that prejudice his creditors. For that reason, many of the features of fraudulent conveyance legislation should be part of legislation regulating preferences. The next chapter sets out draft legislation designed to govern both conveyances and preferences.

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.

CHAPTER XI EXAMPLES

The operation of the draft legislation set out in Chapter X is demonstrated in this chapter by applying its provisions to a number of fact patterns. In each of the following examples, unless otherwise noted, B has a claim against A, who is insolvent, rendered insolvent by the disposition, or on the eve of insolvency.

1. *A gives a promissory note to B payable one year later. A gives away his only asset three months after making the note.*

Under the draft legislation, the usual rule is that a claimant may not attack a prejudicial transfer unless his claim is due. The court, however, may grant leave to proceed before that time (s. 5(1)).

2. *A mortgages his property to B. The property value decreases and is insufficient to cover the amount secured by mortgage. A disposes of all his other property with the effect that he will be judgment proof when B takes judgment on the personal covenant in the mortgage.*

A secured creditor is a claimant under the draft legislation to the extent he is unsecured (s. 1). The usual rule, however, is that a claimant may not attack a prejudicial transfer unless his claim is due. If the debt secured by the mortgage is neither due nor in default, B may not proceed, unless the court grants leave (s. 5(1)). See also example 1.

3. *B is the creditor of a company that has paid dividends to its shareholders while insolvent.*

In many cases, shareholders of an insolvent company are anxious to shield its assets from creditors. The payment of dividends is one method that has been attempted in the past. A threshold question is whether problems of this nature should be addressed under the draft legislation. There would appear to be a principle of company law which prevents a company from paying dividends when it is insolvent. Moreover, under s. 151 of the *Company Act*, directors declaring a dividend while the Company is insolvent, are jointly and severally liable to the Company. Under s. 151(8) a person receiving the dividend is also liable. If company law does not deal adequately with problems of this nature, the draft legislation may provide a remedy. As a general rule, a disposition of property by an insolvent to satisfy an existing obligation is a prejudicial transfer for which relief is available (ss. 1 and 3(1)(f)). The draft legislation, however, identifies several defences. Whether a dividend payment will be set aside under the draft legislation depends upon a number of factors. For example, it is not a prejudicial transfer if the disposition is made in the ordinary course of business (s. 3(2)(b)).

4. *A company which is insolvent repays shareholder loans.*

Essentially, the company is satisfying the claims of creditors when it repays shareholder loans. It is a disposition of property for past value and would qualify as a prejudicial transfer (s. 3(1)(f)). Defences, however, are available under the draft legislation, and one of them may apply in these circumstances (s. 3(2)).

5. *A company which is insolvent is indebted to C1 and C2. The company's obligations to C2 are guaranteed by its directors. The company satisfies the debt owed to C2.*

The payment to C2 is a disposition of property for past value and would qualify as a prejudicial transfer (s. 3(1)(f)).

6. *A owes B money. C owes A money. A is insolvent. A declines to proceed against C for the money he is owed.*

A' s refusal to collect money C owes him would not qualify as a prejudicial transfer. It is not a disposition. B may proceed against A, and garnishee C. Alternatively, B may be able to petition A into bankruptcy. One of the roles performed by a trustee in bankruptcy is to collect money owed the bankrupt.

7. *A owes B $10,000. A owes C $10,000. B brings an action against A to recover the $10,000. A consents to judgment. B satisfies the judgment by execution against A's property.*

It is difficult to see how the use of court process in this example will qualify as a prejudicial transfer. There is nothing blameworthy in itself in consenting to judgment for an obligation that is due and owing.

8. *A owes B $10,000. A does not owe C any money. C brings an action against A for $10,000. A consents to judgment. C satisfies the judgment by execution against A's property.*

In this case, the use of court process would not protect the disposition of property. Essentially A has made a disposition of property to C for token value (s. 3(1)(d)). The disposition should qualify as a prejudicial transfer.

It should be observed that the actions of A and C are clearly fraudulent, so that it is unlikely the courts would have to rely on legislation to deal with a problem of this nature.

9. *A owes B $10,000. A owes C $10,000. A transfers Blackacre, worth $20,000, to B to satisfy the debt obligation.*

Under the draft legislation, any disposition of property by an insolvent for past value qualifies as a prejudicial transfer (s. 3(1)(f)). It does not matter whether the property was worth more or less than the amount owed.

10. *A owes B $10,000 and, under the terms of the loan agreement, A is to pay B $500 a month until the debt is satisfied. A owes C $10,000. A pays B $500 a month to satisfy the debt.*

An arrangement like this is often made in the ordinary course of business. Under the draft legislation, the payments would be protected (s. 3(2)(b)).

11. *A owes B $10,000. A transfers Blackacre, worth $20,000, to C under an Agreement for Sale.*

(a) The Agreement for Sale requires that C pay monthly payments which will result in paying the full purchase price in 5 years.

This is an ordinary business arrangement and as such may be protected under the draft legislation (s. 3(2)(b)). The problem is whether the disposition by agreement for sale was for fair or part value. Deferring payment of a purchase price may, in some circumstances, affect whether or not the price to be paid qualifies as fair, part or token value. In this case, the court may find that the disposition was for fair value. A factor which might affect this determination is whether interest is payable by C. The payment of $20,000 over a period of years, without interest, is significantly less than paying $20,000 immediately. If the agreement does not call for the payment of interest, the court may find that the disposition was for part value. In that case, C's intent becomes relevant (s. 3(1)(e)).

(b) The Agreement for Sale requires that C pay monthly payments which will result in paying the full purchase price in 10 years.

The same considerations discussed in (a) above apply in this example. Moreover, deferring full payment over a period of 10 years will also affect the determination of whether the disposition was for fair or part value (s. 1). If the disposition was for fair value, it will be protected (s. 3(2)(a)). If it was for part value, C's intent becomes relevant (s. 3(1)(e)).

12. A, who is insolvent, owes B $10,000.

(a) A transfers Blackacre, worth $20,000, to C in exchange for Whiteacre, worth $20,000, which is located in Alberta.

This would qualify as a disposition for fair value. A's estate is substantially undiminished by the disposition (s. 1). It would be protected under the draft legislation (s. 3(2)(a)). It is useful to point out that, if A was solvent when this disposition was made, it could not have rendered him insolvent, since insolvency is determined by reference to property located in Canada (s. 2(1)).

(b) A transfers Blackacre, worth $20,000, to C in exchange for Whiteacre, worth $20,000, which is located in Jamaica.

The definition of "fair value" requires that a transferor's estate be substantially undiminished by the disposition (s. 1). Property located outside of Canada received for a disposition may not qualify as fair value. The problems a creditor will have in executing upon the property in Jamaica may distinguish this case from (a) above, so that the disposition qualifies as a prejudicial transfer.

It should be observed that the location of property received in exchange for a disposition is primarily of significance with respect to determining the transferor's solvency (s. 2(1)).

13. A owes B $10,000. A transfers Blackacre, worth $50,000, to his brother D, for $25,000.

The disposition to D is for part value. It will only be set aside if D has the requisite intent (s. 3(1)(e)). D's intent may be difficult to establish, but for centuries the courts have looked to suspicious circumstances which suggest intent. For example, if Blackacre was transferred in haste at the same time B commenced proceedings against A, the court may find that D knew that the transfer would materially impair the ability of the transferor to satisfy his obligations. Similarly, if A continues to reside on, or have the use of, Blackacre, the court might find that D accepted the property pursuant to an understanding that it would be held for A's use or benefit.

14. *A owes B $10,000. C has guaranteed payment of A's debt. C makes a gift of Blackacre to D. The gift renders C insolvent.*

B qualifies as a claimant under the draft legislation. C owes him a contingent obligation (s. 1). (If A defaults on the debt owed B, C will be liable for its repayment). Consequently, B has standing to attack the gift of Blackacre. However, if he is unable to commence proceedings against C on the guarantee, he must apply to the court for leave to attack the gift (s. 5(1)).

A gift is a disposition for token value (ss. 2 and 3(1)(d)). It is a prejudicial transfer if it renders insolvent the person making it.

15. *A owes B $10,000. A transfers Blackacre, worth $50,000, to C for $15,000.*

B is a claimant under the draft legislation and he may attack the disposition (s. 1). It is either for token value or for part value (ss. 3(1)(d) and (e)). If it is characterized as a disposition for token value it is a prejudicial transfer. If, however, it is characterized as a disposition for part value, B must establish that C had the requisite intent before it will qualify as a prejudicial transfer. In the circumstances of this case, that is likely to be easy to do. The value given by C is so inadequate that the arrangement, in itself, is suspicious. As a practical matter the adequacy of the value exchanged for a disposition will affect the onus on the claimant who has to establish intent. If C had paid $40,000, B would find it very difficult to establish that C knew the disposition would impair A's ability to pay creditors or that the property was to be held for A's benefit.

The draft legislation provides little guidance concerning the dividing line between token and part value. Token value is defined to encompass more than value which is nominal or purely symbolic. The ratio between the value actually given and fair value will control whether or not it is token or part value. Even value which is clearly more than nominal may qualify as token value.

16. *A owes B $10,000. The debt B is owed is partly secured with a mortgage for $5,000 against Blackacre. A repays B $10,000. B discharges the mortgage.*

The payment to B may be characterized as a disposition of property for past value (s. 3(1)(f)). As such, it may be attacked under the draft legislation.

Even if the conditions for making an order for relief are satisfied, however, the court must consider two particular factors, which may protect B in this case.

First, in making an order, the court "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" (s. 4(4)). The court might do so in this case by reviving the mortgage against Blackacre in favour of B.

Second, these events may be characterized as a change of position so that it would be inequitable to make an order under the draft legislation. In that case, the court may refuse to make an order (s. 4(5)). For example, if the mortgage in favour of B cannot be restored, then the court might consider it appropriate to decline to make an order.

An alternative analysis is open to the court. Discharging the mortgage may qualify as partial new value (s. 1). In that case, the disposition would only qualify as a prejudicial transfer if B has the requisite intent (s. 3(1)(e)).

17. *A owes B $10,000. A transfers Blackacre, worth $50,000, to C as a gift. C sells Blackacre to D for $40,000. C deposits the $40,000 in his bank account, which has a balance of $10,000.*

In this example, the disposition of Blackacre could have been attacked under the draft legislation (s. 3(1)(d)). C, however, no longer has Blackacre.

Under the draft legislation, the court may make any order respecting the proceeds derived from property that it could have made with respect to the property (s. 4(2)). Strictly speaking, the property is no longer identifiable since it has been commingled with other like property. However, long ago, equity developed principles for "identifying" property in a mixture. Under the draft legislation, proceeds is defined to include a proportionate amount of a fund into which the proceeds of property have been mixed (s. 1). B, consequently, may look to 4/5 of the fund to realize the money he is owed.

18. *A, while solvent, borrows money from B. The debt is unsecured, but A agrees that he will provide B with security upon demand. A becomes insolvent. B demands, and A provides, security for the debt.*

The granting of security in this situation cannot be attacked under the draft legislation (s. 3(2)(d)). It is protected because it was given pursuant to an agreement entered into when the debt now secured was incurred.

19. *The facts are the same as in example 18, except A is insolvent when money is borrowed and the agreement to provide security upon demand is made.*

The granting of security in this situation cannot be attacked under the draft legislation (s. 3(2)(d)). It is no different from granting security at the same time the money is borrowed, which would be protected (s. 3(2)(a)).

20. *A owes B $10,000. A owes C $10,000. A pays B in full. It is not until 18 months later that C learns about the payment to B.*

Had C attacked the payment within one year, the court might have made an order under the draft legislation. C cannot attack the payment, however, after one year has elapsed (s. 5(2)). Where the transferee conceals, or assists or acquiesces in the concealment, of material facts concerning a disposition, the limitation period will not begin to run against a claimant until a claimant learns of those facts. But that is not the case in this example.

21. *A owes B $10,000. A owes C $10,000. A conveys Blackacre to B in full satisfaction of the debt B is owed. B does not register the conveyance until 18 months later. It is not until the conveyance is registered that C learns about the satisfaction of B's debt.*

In this case, B's failure to register the conveyance may prevent a claimant from learning of the disposition. If the court finds that the failure to register amounts to concealing material facts concerning the disposition, C would have one year from learning of those facts to attack the disposition under the draft legislation (s. 5(3)).

CHAPTER XII CONCLUSION

A. Summary

The Commission is charged, by the legislation which constituted it, with keeping the law of the province under review and seeing to its systematic development and reform. One of the goals of law reform is the simplification and modernization of the law. The Commission is also required to repeal obsolete and unnecessary enactments and reduce the number of separate enactments.

The subject of this Report has been the *Fraudulent Conveyance Act* and the *Fraudulent Preference Act*. Both statutes are out of date. The *Fraudulent Conveyance Act* was originally enacted in 1571. Its language was modernized in the 1979 revision of British Columbia legislation, but its effect was left unchanged. This gave the appearance, but not the substance, of law reform.

The *Fraudulent Preference Act* was first enacted in the latter part of the nineteenth century. It has a more modern appearance than the *Fraudulent Conveyance Act* but it too is seriously outmoded. An interesting aspect of the *Fraudulent Preference Act* is that it also addresses fraudulent conveyances, but its provisions have never really been applied in that context, primarily because they are less useful than the provisions of the *Fraudulent Conveyance Act*.

British Columbia, consequently, has two statutes, heavily stained with the patina of age, which overlap to a large, although undefined, extent. Both statutes are long overdue for review. Our research disclosed a series of defects in the legislation, one of the most notable being that neither act can be understood without a close study of the cases decided under it. The language of the legislation has more or less been replaced with judicial dicta concerning the setting aside of dispositions which, by design or effect, prejudice creditors.

The Commission has recommended that both the *Fraudulent Conveyance Act* and the *Fraudulent Preference Act* be repealed. The reasons for their repeal are too numerous for them to be usefully summarized. It is sufficient to observe that both statutes are out of step with contemporary needs and must be replaced with modern legislation. Since both acts deal with dispositions that prejudice creditors, it is desirable to replace them with a single act that addresses this problem uniformly and consistently. It is to be hoped that the draft legislation recommended in this Report will restore order to the law of British Columbia, and provide an appropriate balance between the interests of persons who rely on the validity of dispositions and of creditors whose rights are affected by them.

The Commission wishes to acknowledge the work and assistance of a number of people who contributed to this project.

First, we would like to thank the many people who commented on the Working Paper. The comments and criticisms we received were thoughtful and assisted greatly in the formulation of our final recommendations.

We also wish to record our indebtedness to the work conducted in New Brunswick by the Law Reform Division of the Department of Justice and by the Ontario Law Reform Commission on fraudulent conveyance and preference legislation. The law in this area is complex,a nd the work done in New Brunswick and Ontario in describing the Canadian law, and formulating policy, must be regarded as ground breaking.

We would also like to express our appreciation to a number of members of the Commission's legal staff who worked on this project. Frederick W. Hansford conducted the original research for this project and prepared the initial drafts of he Working Paper. His mastery of this area of the law was invaluable. Harbans Dhillon conducted further research for this project and assisted in the technical editing of the Working Paper. Tim Delaney performed similar services for the preparation of this Report.

Finally, we would like to acknowledge the contribution of Thomas G. Anderson, Counsel to the Commission. Mr. Anderson, subject to the direction of the Commission, drafted both the Working Paper and this Report.

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APPENDIX A

FRAUDULENT CONVEYANCE ACT
R.S.B.C. 1979, c. 142

Fraudulent conveyance made to avoid debt or duty of others

1. A disposition of property, by writing or otherwise, and a bond, proceeding and order, at any time made, to delay, hinder or defraud creditors and others of their just and lawful remedies, shall be void and of no effect as against a person, his personal representative and assignee whose rights and obligations by collusion, guile, malice or fraudulent devices and practices are or might be, in any way, disturbed, hindered, delayed or defrauded, notwithstanding a pretence or other matter to the contrary.

RS1960-155-2.

Forfeiture

2. [repealed]

Offence

3. [repealed]

Application

4. This Act does not a ply to a disposition of property for good consideration and in good faith lawfully transferred to a person not having, at the time of the transfer to him, any notice or knowledge of collusion or fraud.

RS1960-155-4.

APPENDIX B

FRAUDULENT CONVEYANCES ACT
R.S.B.C. 1960, c. 155

CHAPTER 155
Fraudulent Conveyances Act

For the avoiding and abolishing of feigned, covinous, and fraudulent feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments, and executions, as well of lands and tenements as of goods and chattels, more commonly used and practised in these days than hath been seen or heard of heretofore: Which feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments, and executions have been and are 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 just and lawful actions, suits, debts, accounts, damages, penalties, forfeitures, heriots, mortuaries, and reliefs, not only to the let or hindrance of the due course and execution of law and justice, but also to the overthrow of all true and plain dealing, bargaining, and chevisance between man and man, without the which no commonwealth or civil society can be maintained or continued:

Her Majesty, by and with the advice and consent of the Legislative Assembly of the Province of British Columbia, enacts as follows: -

1. This Act may be cited as the *Fraudulent Conveyances Act*. R.S. 1948, c.131, s. 1.

2. All and every feoffment, gift, grant, alienation, bargain, and conveyance of lands, tenements, hereditaments, goods, and chattels, or of any of them, by writing or otherwise, and all and every bond, suit, judgment, and execution, at any time heretofore had or made, or at any time hereafter to be had or made, to or for any intent or purpose before declared and expressed, shall be from henceforth deemed and taken (only as against that person or persons, his or their heirs, successors, executors, administrators, and assigns, and every of them whose actions, suits, debts, accounts, damages, penalties, forfeitures, heriots, mortuaries, and reliefs, by such guileful, covinous, or fraudulent devices and practices as is aforesaid, are, shall, or might be in any ways disturbed, hindered, delayed, or defrauded) to be clearly and utterly void, frustrate, and of none effect; any pretence, colour, feigned consideration, expressing of use, or any other matter or thing to the contrary notwithstanding. [13 Eliz., c. 5, s. 2]; R.S. 1948, c. 131, s. 2.

3. All and every the parties to such feigned, convinous, or fraudulent feoffment, gift, grant, alienation, bargain, conveyance, bonds, suits, judgments, executions, and other things before expressed, or being privy and knowing of the same, or any of them, which at any time shall wittingly and willingly put in ure, avow, maintain, justify, or defend the same, or any of them, as true, simple, and done, had, or made bona fide and upon good consideration, or shall alien or assign any the lands, tenements, goods, leases, or other things before mentioned to him or them conveyed as is aforesaid, or any part thereof, shall incur the penalty and forfeiture of one year s value of the said lands, tenements, and hereditaments, leases, rents, commons, or other profits of or out of the same, and the whole value of the said goods and chattels, and also so much money as are or shall be contained in any such covinous and feigned bond, the one moiety whereof to be to the Queen s Majesty, her heirs and successors, and the other moiety to the party or parties grieved by such feigned and fraudu-

lent feoffment, gift, grant, alienation, bargain, conveyance, bonds, suits, judgments, executions, leases, rents, commons, profits, charges, and other things aforesaid, to be recovered in any of the Queen s Courts of Record by action of debt, bill, plaint, or information, wherein none essoin, protection or wager of law shall be admitted for the defendant or defendants; and also, being thereof lawfully convicted, shall suffer imprisonment for one-half year without bail or mainprize. [13 Eliz., c. *5,* s. 3]; R.S. 1948, c. 131, s. 3.

4. This Act, or anything therein contained, shall not extend to any estate or interest in lands, tenements, hereditaments, leases, rents, commons, profits, goods, or chattels had, made, conveyed, or assured, or hereafter to be had, made, conveyed, or assured, which estate or interest is or shall be upon good consideration and bona fide lawfully conveyed or assured to any person or persons, or bodies politic or corporate, not having, at the time of such conveyance or assurance to them made, any manner of notice or knowledge of such covin, fraud, or collusion as is aforesaid, anything before mentioned to the contrary hereof notwithstanding. [13 Eliz., c. 5, s. 6]; R.S. 1948, c. 131, s. 4.

APPENDIX C

FRAUDULENT PREFERENCE ACT
R.S.B.C. 1979, c. 143

Interpretation

1. In sections 3, 4 and 5 "creditor” includes a surety and the endorser of a promissory note or bill of exchange who would, on payment by him of the debt, promissory note or bill of exchange for which the suretyship was entered into or endorsement was given, become a creditor of the person giving the preference within the meaning of the sections. The word also includes the beneficiary of a trust or other person to whom liability is equitable only.

Instruments preferring creditors

2. Where a person in insolvent circumstances, unable to pay his debts in full, or knowing that he is on the eve of insolvency, voluntarily or by collusion with a creditor, agrees to a judgment against him, with or without time to pay, or gives a power of attorney to do so, with intent to defeat or delay his creditors wholly or in part, or to give one or more of his creditors a preference over other creditors, or over some of them, the judgment or power is void against the creditors of the person.

Transfers which prejudice creditors

3. Subject to section 6, a disposition of property by a person at a time when he is in insolvent circumstances, is unable to pay his debts in full, or knows that he is on the eve of insolvency, is void as against an injured creditor, if made

   (a) with intent to defeat, hinder, delay or prejudice creditors or some of them; and
   (b) to or for a creditor with intent to give the creditor preference over other creditors or some of them.

Transfers having effect of preference

4. Subject to section 6, where, without intent, the disposition gives the creditor a preference over some or all of the other creditors, section 3 (b) also applies

(a) in a proceeding brought to set aside the disposition within, where there is a document evidencing the disposition registered under an Act, 60 days after registration, or, in other cases, 60 days after the disposition, as against the creditor injured; or
(b) where the debtor, within 60 days after the disposition, makes an assignment for the benefit of his creditors, as against the assignee or a creditor authorized to take proceedings to set the disposition aside.

What transactions to be deemed preferential

5. A disposition is deemed to give a creditor a preference over the other creditors under section 4, if the creditor is given, recovers or is placed in a position to recover payment, satisfaction or security for all or part of the debtor s indebtedness, greater proportionately than could be recovered by unsecured creditors generally, or on the unsecured portion of the liabilities, out of assets of the debtor left available to judgment. ‘l he preference shall not be dependent on the intent or motive of the debtor or on the disposition being entered into voluntarily or under pressure. No pressure by a creditor, or want of notice to the creditor alleged to have been preferred of the debtor s circumstances, or of the effect of the disposition, protects it except as provided by section 6.

Sales and transfers in good faith

6. (1) Nothing in sections 3,4 and 5 applies, if the money paid, or the property disposed of bears a fair and reasonable relative value to the consideration, to a sale in good faith, to a payment made in the ordinary course of business to innocent persons, to a payment to a creditor, or to a disposition in good faith of property of any kind made

(a) in consideration of a present actual payment in good faith in money;
(b) by way of security for a present actual advance of money in good faith; or
(c) in consideration of a present actual disposition in good faith of any property.

(2) In case of a valid sale of property, a payment or transfer of some or all of the consideration by the purchaser to a creditor of the vendor, under circumstances which would render void the payment or transfer by the debtor personally and directly, the payment or transfer, valid as respects the purchaser, is void as respects the creditor to whom it is made.

(3) In case a payment has been made which is void under this Act, and valuable security was given up in consideration of the payment, the creditor is entitled to have the security restored or its value made good to him before, or as a condition of, the return of the payment.

(4) Nothing in this section prevents a debtor providing for any payment of money to a creditor where the creditor, by reason or on account of the payment, has lost or been deprived of or has in good faith given up a valid security which he held for the payment of the debt so paid, unless the value of the security is restored to the creditor, or the substitution in good faith of one security for another security for the same debt, so far as the debtor s estate is not lessened in value to the other creditors. Nothing in this section invalidates a security given to a creditor for an existing debt where, by reason or on account of the giving of the security, an advance in money is made to the debtor by the creditor in the belief in good faith that the advance will enable the debtor to continue his business and to pay his debts in full.

Following proceeds of property fraudulently transferred

7. In the case of a disposition of any property which in law is invalid against creditors, if the person to whom the disposition was made has disposed of, realized or collected all or some of the property, the money or other proceeds or the value of it may be seized or recovered in an action by a person who would be entitled to seize and recover the property if it had remained in the possession or control of the debtor or of the person to whom the disposition was made.

Conveyances void as against registered judgment

8. A disposition which, by the *Fraudulent Conveyance Act* or this Act or by any statute in force in the Province relating to conveyances prejudicial to creditors, is declared to be void, is void as against the lien and charge created by the registration in any land title office of a judgment under the *Court Order Enforcement Act.*

Setting aside fraudulent conveyances

9. (1) Where a judgment creditor alleges that the debtor or person who has to pay has made a conveyance or other disposition of any of his land, which conveyance or other disposition is void, as being made to defeat, hinder, delay, prejudice or defraud creditors or where a creditor or assignee for the benefit of creditors alleges that a disposition is void under sections 2 to 6, it is not necessary to institute an action to set aside the disposition. An application may be made to the Supreme Court by the judgment. or other creditor or assignee or person entitled to the money, calling on the judgment debtor or person who is to pay, and the person to whom the conveyance or other disposition has been made or who has acquired any interest under it, to show cause why the land, or a competent part of it, should not be sold to realize the amount payable under the judgment, or, as the case may be, why the disposition or payment should not be set aside and the property returned or otherwise dealt with as the court may direct.

(2) In an application under this section, a judgment creditor may claim he is entitled to register the judgment against the land in respect of which the application is made, or against the judgment debtor s or another person s interest in the land.

Determination of disputed questions

10. (1) On an application under section 9, the proceedings may be brought either in a summary way or by the trial of an issue, or by inquiry before an officer of the court, or by an action or otherwise, as the court believes necessary or convenient, for the purpose of ascertaining the truth of the matters in question, and whether the land, or the debtor or other person s interest in it, is liable for the satisfaction of the judgment.

(2) The court may, on application by a judgment creditor under section 9, order that the judgment creditor is entitled to register the judgment against the land in respect of which the application is made, or against the judgment debtor s or another person s interest in the land.

Certificate of proceedings

11. A notice of motion for an order under section 9 may contain a description of the land in question, and on filing it with the proper officer, signed by the applicant s solicitor, a certificate of a court proceeding may be issued for registration, and in case the motion is refused in whole or in part, a certificate for registration of the order may be issued.

Costs in discretion of court

12. The costs of and incident to proceedings authorized by sections 9, 10 and 11 are in the discretion of the court.

APPENDIX D

FRAUDULENT PREFERENCES ACT
R.S.B.C. 1960, c. 156

CHAPTER 156
Fraudulent Preferences Act

1. This Act may be cited as the *Fraudulent Preferences Act*.
R.S. 1948, c. 132. s. 1.

2. In case any person, being at the time in insolvent circumstances or unable to pay his debts in full, or knowing himself to be on the eve of insolvency, voluntarily or by collusion with a creditor or creditors gives a confession of judgment, cognovit actionem, or warrant of attorney actionem, or warrant of attorney to confess judgment, to defeat or delay his creditors wholly or in part, or with intent thereby to give one or more of the creditors of any such person a preference over his other creditors, or over any one or more of such creditors, every such confession, cognovit actionem, or warrant of attorney to confess judgment shall be deemed and taken to be null and void as against the creditors of the party giving the same, and is invalid and ineffectual to support any judgment or writ of execution.

R.S. 1948, c. 132, s. 2.

3. (1) Subject to section 4, every gift, conveyance, assignment, transfer, delivery over or payment of goods, chattels, or effects, or of bills, bonds, notes, or securities, or of shares, dividends, premiums, or bonus in any bank, company, or corporation, or of any other property, real or personal, made by a person at a time when he is in insolvent circumstances, or is unable to pay his debts in full, or knows that he is on the eve of insolvency, is,

(a) if made with intent to defeat, hinder, delay, or prejudice his creditors or any one or more of them, utterly void as against the creditor or creditors injured, delayed, or prejudiced; and
(b) if made to or for a creditor with intent to give such creditor preference over his other creditors or over any one or more of them, utterly void as against the creditor or creditors injured, delayed, prejudiced, or postponed.

(2) Subject to section 4, every such gift, conveyance, assignment, or transfer, delivery over or payment as aforesaid, made to or for a creditor by a person at any time when he is in insolvent circumstances, or is unable to pay his debts in full, or knows that he is on the eve of insolvency, and which has the effect of giving such creditor a preference over the other creditors of the debtor or over one or more of them, is,

(a) in and with respect to any action or proceeding that, where any document evidencing the transaction is registered under the provisions of any Act of the Legislature, is within sixty days after the date of registration brought, had, or taken to impeach or set aside the transaction, or that, in any other case, is within sixty days after the date of the transaction brought, had, or taken to impeach or set aside such transaction, utterly void as against the creditor or creditors injured, delayed, prejudiced, or postponed; and

(b) if the debtor, within sixty days after the transaction, makes an assignment for the benefit of his creditors, utterly void as against the assignee or any creditor authorized to take proceedings to avoid the same.

(3) A transaction shall be deemed to be one which has the effect of giving a creditor a preference over the other creditors within the meaning of subsection (2), if by such transaction a creditor is given or realizes, or is placed in a position to realize, payment, satisfaction, or security for the debtor s indebtedness to him, or a portion thereof, greater proportionately than could be realized by or for the unsecured creditors generally of such debtor, or upon the unsecured portion of his liabilities, Out of the assets of the debtor left available and subject to judgment, execution, attachment, or other process, and such effect shall not be deemed dependent upon the intent or motive of the debtor or upon the transaction being entered into voluntarily or under pressure; and no pressure by a creditor or want of notice to the creditor alleged to have been so preferred of the debtor s circumstances, inability, or knowledge as aforesaid, or of the effect of the transaction, shall avail to protect the transaction, except as provided by section 4.

(4) When the word "creditor" or creditors" occurs in subsections (1), (2), and (3), the word shall be deemed to include any surety and the endorser of any promissory note or bill of exchange who would, upon payment by him of the debt, promissory note, or bill of exchange, in respect of which such suretyship was entered into or such endorsement was given, become a creditor of the person giving the preference within the meaning of the said subsections, and the word includes a cestui que trust or other person to whom the liability is equitable only.

R.S. 1948, c. 132, s. 3.

4. (1) Nothing in the last preceding section applies to any bona fide sale or payment made in the ordinary course of trade or calling to innocent purchasers or parties; nor to any payment of money to a creditor, to any bona fide conveyance, assignment, transfer, or delivery over of any goods, securities, or property of any kind as above mentioned, which is made

(a) in consideration of any present actual bona fide payment in money; or
(b) by way of security for any present actual bona fide advance of money; or
(c) in consideration of any present actual bona fide sale or delivery of goods or other property,

if the money paid, or the goods or other property sold or delivered, bear a fair and reasonable relative value to the consideration therefor.

(2) In case of a valid sale of goods, securities, or property, any payment or transfer of he consideration of part thereof by the purchaser to a creditor of the vendor, under circumstances which would render void such payment or transfer by the debtor personally and directly, the payment or transfer, even though valid as respects the purchaser, is void as respects the creditor to whom the same is made.

(3) In case a payment has been made which is void under this Act, and any valuable security was given up in consideration of the payment, the creditor is entitled to have the security restored or its value made good to him before, or as a condition of, the return of the payment.

(4) Nothing herein contained shall prevent a debtor providing for any payment of money to a creditor where there creditor, by reason or on account of the payment, has lost or been deprived of or has in good faith given up any valid security which he held for the payment of the debt so paid, unless the value of the security is restored to the creditor, nor the substitution in good faith of one security for another security for the same debt, so far as the debtor s estate is not thereby lessened in value to the other creditors. Nor shall anything herein contained invalidate a security given to a creditor for a pre-existing debt where, by reason or on account of the giving of the security, an advance in money is made to the debtor by the creditor in the bona fide belief that the advance will enable the debtor to continue his trade or business and to pay his debts in full.

R.S. 1948, c. 132, s. 4.

5. In the case of a gift, conveyance, assignment, or transfer of any property, real or personal, which in law is invalid against creditors, if the person to whom the gift, conveyance, assignment, or transfer was made has sold or disposed of, realized, or collected the property or any part thereof, the money or other proceeds or the amount or value thereof may be seized or recovered in any action by a person who would be entitled to seize and recover the property if it had remained in the possession or control of the debtor or of the person to whom the gift, conveyance, transfer, delivery, or payment was made.

R.S. 1948, c. 132. s. 5.

6. Every gift, grant, conveyance, alienation, assignment, or transfer which by the *Fraudulent Conveyances Act*, or by this Act, or by any Statute in force in the Province relating to conveyances prejudicial to creditors, is declared to be void, is void as against the lien and charge created by the registration in any land titles office of a judgment under the provisions of the *Execution Act.*

R.S. 1948, c. 132, s. 6; 1978, c. 25, s. 334 (proc. eff. Oct. 31, 1979).

7. Where a judgment creditor who has registered a judgment alleges that the debtor or person who has to pay has made a conveyance or other other disposition is void, as being made to defeat, hinder, delay, prejudice, or defraud creditors or a creditor, or where a creditor or assignee for the benefit of creditors alleges that any transaction is void under section 2, 3, or 4, it is not necessary to institute an action for the purpose of setting aside the conveyance or other disposition or transaction, but an application may be made to the Supreme Court by the judgment or other creditor or assignee or person entitled to the money, calling upon the judgment debtor or person who is to pay, and the person to whom the conveyance or other disposition has been made or who has acquired any interest thereunder, to show cause why the lands embraced therein, or a competent part thereof, should not be sold to realize the amount payable under the judgment, or (as the case may be) why the gift, conveyance, assignment, transfer, delivery, or payment should not be set aside and the property returned or otherwise dealt with as the Court may direct.

R.S. 1948, c. 132, s. 7; 1976, c. 33, s. 89 (proc. eff. Jan. 3, 1977, revoked by B.C. Reg. 641/76, proc. eff. Feb. 1, 1977. B.C. Reg. 642/76); 1978, c. 25, s. 333 (proc. eff. Oct. 31, 1979).

8. Upon any application under the last preceding section, such proceedings shall be had, either in a summary way or by the trial of an issue, or by inquiry before an officer of the Court, or by an action or otherwise, as the Court may deem necessary or convenient, for the purpose of ascertaining the truth of the matters in question, and whether the lands, or the debtor or other person s interest therein, are liable for the satisfaction of the judgment.

R.S. 1948, c. 132, s. 8; 1976, c. 33, s. 89 (proc. eff. Jan. 3, 1977, revoked by B.C. Reg. 641/76, proc. eff. Feb. 1, 1977, B.C. Reg. 642/76).

9. Any notice of motion for an order under section 7 may contain a description of the land in question, and upon filing the same with the proper officer, signed by the solicitor of the applicant, a certificate of lis pendens may be issued for registration; and in case the motion is refused in whole or in part, a certificate for registration of the order may be issued.

R.S. 1948, c. 132, s. 9.

10. The costs of and incident to all the proceedings authorized by sections 7, 8, and 9 shall be in the discretion of the Court.

R.S. 1948, c. 132, s. 10; 1976, c. 33, s. 89 (proc. eff. Jan. 3, 1977, revoked by B.C. Reg. 641/76, proc. eff. Feb. 1, 1977, B.C. Reg. 642/76).

APPENDIX E

BANKRUPTCY ACT
R.S.C. 1970, c. B-3

Selected provisions

20. (1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, upon notice being given the other creditors of the contemplated proceeding, and upon such other terms and conditions as the court may direct, and upon such order being made the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.

(2) Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.

(3) Where, before an order is made under subsection (1), the trustee, with the permission of the inspectors, signifies to the court his readiness to institute the proceeding for the benefit of the creditors, the order shall fix the time within which he shall do so, and in that case the benefit derived from the proceeding, if instituted within the time so fixed, belongs to the estate.

24. (1) A debtor commits an act of bankruptcy in each of the following cases:

(a) if in Canada or elsewhere he makes an assignment of his property to a trustee for the benefit of his creditors generally, whether it is an assignment authorized by this Act or not;
(b) if in Canada or elsewhere he makes a fraudulent conveyance, gift, delivery, or transfer of his property or of any part thereof;
(c) if in Canada or elsewhere he makes any conveyance or transfer of his property or any part thereof, or creates any charge there on, that would under this Act be void as a fraudulent preference.
(d) if with intent to defeat or delay his creditors he does any of the following things, namely, departs out of Canada, or, being out of Canada, remains out of Canada, or departs from his dwelling-house or otherwise absents himself;
(e) if he permits any execution or other process issued against him under which any of taken in execution to remain unsatisfied until within four days from the time fixed by the sheriff for the sale thereof or for fourteen days after such seizure, levy or taking in execution, or if the property has been sold by the sheriff, or if the execution or other process has been held by him for fourteen days after written demand for payment without seizure, levy or taking in execution or satisfaction by payment, or if it is returned endorsed to the effect that the sheriff can find no property whereon to levy or to seize or take, but where interpleader proceedings have been instituted in regard to the property seized the time elapsing between the date at which such proceedings were instituted and the date at which such proceedings are finally disposed of, settled or abandoned shall not be taken into account in calculating any such period of fourteen days;
(f) if he exhibits to any meeting of his creditors any statement of his assets and liabilities that shows that he is insolvent, or presents or causes to be presented to any such meeting a written admission of his inability to pay his debts;
(g) if he assigns, removes, secretes or disposes of or attempts or is about to assign, remove, secrete or dispose of any of his property with intent to defraud, defeat or delay his creditors or any of them;
(h) if he gives notice to any of his creditors that he has suspended or that he is about to suspend payment of his debts;
(i) if he defaults in any proposal made under this Act;
(j) if he ceases to meet his liabilities generally as they become due.

69. (1) Any settlement of property, if the settlor becomes bankrupt within one year after the date of the settlement, is void against the trustee.

(2) Any settlement of property, if the settlor becomes bankrupt within five years after the date of the settlement, is void against the trustee if the trustee can prove that the settlor was, at the time of making the settlement, unable to pay all his debts without the aid of the property comprised in the settlement or that the interest of the settlor in the property did not pass on the execution there of.

(3) This section does not extend to any settlement made

(a) before and in consideration of marriage,
(b) in favour of a purchaser or incumbrancer in good faith and for valuable consideration, or
(c) on or for the wife or children of the settlor of property that has accrued to the settlor after marriage in right of his wife or of his children.

70. Any convenant or contract made by any person (herinafter called “the settlor”) in consideration of his or her marriage, either for the future payment of money for the benefit of the settlor s wife or husband or children, or for the future settlement on or for the settlor s wife

or husband or children, of property wherein the settlor had not at the date of the marriage any estate or interest, whether vested or contingent, in possession or remainder, and not being money or property in right of the settlor s wife or husband, if the settlor becomes bankrupt and the covenant or contract has not been executed at the date of the bankruptcy, is void against the trustee except so far as it enables the persons entitled under the covenant or contract to claim for dividend in the settlor s bankruptcy proceedings under or in respect of the covenant or contract, but any such claim to dividend shall be postponed until all claims of the other creditors have been satisfied.

71. (1) Any payment of money, not being payment of premiums on a policy of life insurance in favour of the husband, wife, child or children of the settlor, or any transfer of property made by the settlor in pursuance of a covenant or contract mentioned in section 70, is void against the trustee unless the person to whom the payment or transfer was made proves that

(a) the payment or transfer was made more than six months before the date of the bankruptcy,
(b) at the date of the payment or transfer the settlor was able to pay all his debts without the aid of the money so paid or the property so transferred, or
(c) the payment or transfer was made in pursuance of a covenant or contract to pay or transfer money or property expected to come to the settlor from or on the death of a particular person named in the covenant or contract and was made within three months after the money or property came into the possession or under the control of the settlor.

(2) Where any payment or transfer mentioned in subsection (1) is declared void, the persons to whom it was made are entitled to claim for dividend under or in respect of the covenant or contract in like manner as if it had not been executed at the date of the bankruptcy.

73. (1) Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving such creditor a preference over the other creditors shall, if the person making, incurring, taking, paying or suffering the same becomes bankrupt within three months after the date of making, incurring, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee in the bankruptcy.

(2) Where any such conveyance, transfer, payment, obligation or judicial proceeding has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed *prima facie* to have been made, incurred, taken, paid or suffered with a view to giving such creditor a preference over other creditors, whether or not it. was made voluntarily or under pressure and evidence of pressure shall not be receivable or avail to support such transaction.

(3) For the purposes of this section, the expression “creditor” includes a surety or guarantor for the debt due to such creditor.

74. Where the conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in section 73 is in favour of a person related to the insolvent person, the period limited in subsection 73(1) shall be twelve months instead of three months.

75. (1) Subject to the foregoing provisions of this Act with respect to the effect of bankruptcy on an execution, attachment or other process against property, and with respect to the

avoidance of certain settlements and preferences, nothing in this Act invalidates, in the case of a bankruptcy

(a) any payment by the bankrupt to an y of his creditors,
(b) any payment or delivery to the bankrupt,
(c) any conveyance or transfer by the bankrupt for adequate valuable consideration, or
(d) any contract, dealing, or transaction by or with the bankrupt for adequate valuable consideration,

if both the following conditions are complied with, namely:

(e) that the payment, delivery, conveyance, assignment, transfer, contract, dealing, or transaction, as the case may be, is in good faith and takes place before the date of the bankruptcy, and
(f) that the person, other than the debtor, to, by, or with whom the payment, delivery, conveyance, assignment, transfer, contract, dealing or transaction was made, executed or entered into, has not at the time of the payment, delivery, conveyance, assignment, transfer, contract, dealing or transaction, notice of any act of bankruptcy committed by the bankrupt.

(2) The expression “adequate valuable consideration” in paragraph (1)(c) means a consideration of fair and reasonable money value with relation to that of the property conveyed, assigned or transferred, and in paragraph (l)(d) means a consideration of fair and reasonable money value with relation to the known or reasonably to be anticipated benefits of the contract, dealing or transaction.

(3) The law of set-off applies to all claims made against the estate and also to all actions instituted by the trustee for the recovery of debts due to the bankrupt in the same manner and to the same extent as if the bankrupt were plaintiff or defendant, as the case may be, except insofar as any claim for set-off is affected by the provisions of this Act respecting frauds or fraudulent preferences.

76. (1) Where a person has acquired property of the bankrupt under a transaction that is void or under a voidable transaction that is set aside and has sold, disposed of, realized or collected the property or any part thereof, the money or other proceeds, whether further disposed of or not, shall be deemed the property of the trustee.

(2) The trustee may recover the property or the value thereof or the money or proceeds therefrom from the person who acquired it from the bankrupt or from any other person to whom he may have resold, transferred or paid over the proceeds of the property as fully and effectually as the trustee could have recovered the property if it had not been so sold, disposed of, realized or collected.

(3) Notwithstanding subsection (1), where any person to whom the property has been sold or disposed of has paid or given therefor in good faith adequate valuable consideration he is not subject to the operation of this section but the trustee s recourse shall be solely against the person entering into the transaction with the bankrupt for recovery of the consideration so paid or given or the value thereof.

(4) Where the consideration payable for or upon any sale or resale of such property or any part thereof remains unsatisfied the trustee is subrogated to the rights of the vendor to compel payment or satisfaction.

78. (1) Where a person who has sold, purchased, leased, hired, supplied or received property or services in a reviewable transaction becomes bankrupt within twelve months of the transaction, the court may, upon the application of the trustee, inquire into whether the bankrupt gave or received, as the case may be, fair market value in consideration for the property or services concerned in the transaction.

(2) Where the court in proceedings under this section finds that the consideration given or received by the bankrupt in the reviewable transaction was conspicuously greater or less than the fair market value of the property or services concerned in the transaction, the court may give judgment to the trustee against the other party to the transaction, or against any other person being privy to the transaction with the bankrupt, or against all such persons, for the difference between the actual consideration given or received by the bankrupt and the fair market value, as determined by the court, of the property or services concerned in the transactions.

(3) In making an application under this section the trustee shall state what in his opinion was the fair market value of the property or services concerned in the transaction and what in his opinion was the value of the actual consideration given or received by the bankrupt in the trans action, and the values on which the court makes any fin ding pursuant to this section shall be the values so stated by the trustee unless other values are proven.

APPENDIX F

Bill C-17

Bill C-17 was the last draft of proposed new bankruptcy legislation. It was introduced in the second session of the 32nd Parliament on January 31,1984

Section 168 and 169 replace the “settlement” provisions of the present *Bankruptcy Act.* Section 168 establishes three classes of gifts which may be set aside by a court on the application of a trustee. Gifts of property made by a donor who is insolvent or unable to pay his debts without the aid of the property are void. Where the donor of the gift is solvent, or the gift does not incur insolvency, the gift may still be set aside. If the donor and donee were not acting at arm s length, the court may set aside a transaction if title to the property did not pass irrevocably at least one year before the date a bankruptcy petition is filed. In an arm s length transaction the gift may be set aside if it did not pass irrevocably at least six months before the date of the bankruptcy petition.

Section 169 is not restricted to gifts. It applies to any kind of a transfer between persons dealing at arms-length. The court, on the application of the trustee, may review any transfer out of the normal course of affairs, entered into three months preceding the date of filing the petition. Alternatively, it may be reviewed if made six years preceding the date of filing the petition, with the intent of both parties to “impede, obstruct, delay or defraud” a creditor. Subsection 169(2) provides that if the parties were not dealing at arm s length, the court may review a transaction entered into six years preceding the date of filing the petition.

In either case, it is open to the trustee to estimate the fair value of the consideration flowing from each party to the transfer. Where the consideration flowing from the bankrupt is “conspicuously greater than the other to the detriment of the bankrupt,” judgment may be given for the difference. The court may also order that the claim of one party against the estate be reduced or that the transfer is void and that the property be returned.

Section 169(5) contains a new provision permitting the court to "set aside the transfer" and restore each party to it to the state that he was in immediately prior to the transfer. This would presumably permit the court in appropriate cases to return to the transferee the consideration paid by him, rather than merely leaving him to his claim, if any, in the bankruptcy. It is difficult to see in what cases the claim of the transferee should prevail over that of innocent creditors. Together, sections 168 and 169 of Bill 0-17 provide an effective means of attacking fraudulent conveyances. The remedies provided in section 169 are, in particular, much more flexible than those contained in the present *Fraudulent Conveyance Act.* Section 170 of Bill 0-17 permits the trustee to recover dividends (other than share dividends) and amounts paid in redemption of the company shares by an insolvent corporation or payments which rendered the corporation in solvent. In these cases, a trustee may recover judgment for the amount paid out by the corporation. Section 171 avoids assignments by a debtor for the benefit of his creditors other than in accordance with the *Bankruptcy Act.*

Section 172 permits the court to set aside preferential transfers in favour of creditors dealing at arms-length with a debtor. Three preconditions are established:

> the transfer was made less than three months before the date of filing the petition;
> the debtor was insolvent at the time of the transfer; and
> the transfer was made with the intent of the debt or to give a preference.

Section 173 deals with preferences to a creditor not dealing at arm s length with a debtor. The trustee must prove both insolvency at the time of the transfer and the intent to give the creditor a preference. The time limit established by section 173 is three years preceding the date of the petition, rather than the three months specified for arm s length transactions. The efficacy of section 173 is enhanced by two presumptions. Section 173(2) provides that a transfer to a creditor made more than 45 days or less than one year before the filing of the petition is deemed to have been made with the intent to give a preference. It is up to the creditor to prove that the transfer was made in the normal course of the affairs of the debtor. Under subsection (3), if the arm s length transaction is made in the 45 days preceding the date of filing of the petition, the creditor must prove both that the transaction was made in the normal course of affairs of the debtor, and in satisfaction of a debt incurred within 45 days of the transfer. Otherwise, it is void.

Section 174 deals with preferences in favour of guarantors. Where a debtor whose debts are guaranteed transfers property which has the effect of releasing a guarantor in whole or in part from his guarantee, the transfer is deemed to be a preference given by the debtor to the guarantor. Subsection 174(1) deems the guarantor to be a creditor. The court may order the guarantor to pay to the trustee an amount equal to the benefit received, if the preference may be set aside under either section 172 or 173. "Guarantor" is defined to include a partner of the debtor or any person who is jointly and several liable for the debt.

The powers of the court where a transfer is set aside are listed in section 175. The court is given extensive powers to make remedial orders unknown under the present provincial legislation dealing with fraudulent conveyances and preferences:

> 175. (1) Where the court, pursuant to this Part, sets aside a transfer, the court may make an order
>
> (a) empowering the trustee to recover the property or the value thereof from the person to whom the bankrupt transferred the property or, subject to subsection (2), from any other person to whom the property has been transferred;
> (b) assigning to the trustee the rights of the creditor in property subject to a security interest that is set aside pursuant to this Part;

(c) subrogating the trustee to the rights of the transferor to compel payment or satisfaction where the consideration payable for or on a transfer of property or any part thereof remains unsatisfied;

(d) restoring insofar as possible each party to the transfer to the state that he was in immediately prior to the making of the transfer; or

(e) vesting in the trustee any rights or powers required by the trustee for the benefit oft he estate.

(2) Subsection (1) does not apply where any person to whom property has been transferred paid or gave in good faith adequate valuable consideration for the property and any recourse of the trustee is solely against the person party to the transfer with the bankrupt.

The balance of this part of Bill 0-17 deals with a number of particular concerns. Section 176, for example, deals with the manner in which the value of a preference is to be determined for the purposes of section 175. Section 177 permits the substitution of property or securities taken by a creditor. Section 178 provides for the recovery of an accelerated payment of premiums, or the payment up of an insurance policy by a debtor.

Section 179 of the Act provides for a defence where the transfer, payment of dividend or redemption or purchase of shares is attacked. Proof that at any time after the transfer, payment or redemption the company was solvent is sufficient to save the transaction.

Section 180 applies to donees of gifts set aside pursuant to section 168. If the donee surrenders property or its value to a trustee voluntarily or as a result of a court order, the donee has an admissible claim in bankruptcy for the value of the gift. Similarly, where with respect to a transaction reviewable under section 169, a person pays the difference between the consideration he received and that which he gave, he has a claim in bankruptcy for the amount surrendered. A creditor who surrenders property obtained by a preference may claim the value of the property in the bankruptcy under section 180(3). Subsection 180(4) prohibits persons with claims under section 180 from setting off debts payable to the estate against their claim.

Section 182 abolishes pressure as a defence.

Section 184 provides a limitation period for setting aside a reviewable transaction under sections 168 to 182. That limitation is set at three years from the date of bankruptcy.

These provisions represent a considerable improvement over the corresponding sections of the current *Bankruptcy Act.* The straightforward language of the legislation, combined with the consideration given to the interests of the transferor, transferee, and competing creditors would permit the court to balance the interests of these competing parties on a much finer scale than do the present provisions of either the *Fraudulent Conveyance Act* or the *Fraudulent Preference Act.*

APPENDIX G

(U.S.) *UNIFORM FRAUDULENT TRANSFER ACT*
National Conference of Commissioners on Uniform State Laws, 1984

§ 1. Definitions

As used in this [Act]:

(1) “Affiliate” means:

(i) a person who directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than a person who holds the securities,

(A) as a fiduciary or agent without sole discretionary power to vote the securities; or
(B) solely to secure a debt, if the person has not exercised the power to vote;

(ii) a corporation 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by the debtor or a person who directly or indirectly owns, controls, or holds, with power to vote, 20 percent or more of the outstanding voting securities of the debtor, other than a person who holds the securities,

(A) as a fiduciary or agent without sole power to vote the securities; or
(B) solely to secure a debt, if the person has not in fact exercised the power to vote;

(iii) a person whose business is operated by the debtor under a lease or other agreement, or a person substantially all of whose assets are controlled by the debtor; or

(iv) a person who operates the debtor s business under a lease or other agreement or controls substantially all of the debtor s assets.

(2) “Asset” means property of a debtor, but the term does not include:

(i) property to the extent it is encumbered by a valid lien;

(ii) property to the extent it is generally exempt under non-bankruptcy law; or

(iii) an interest in property held in tenancy by the entireties to the extent it is not subject to process by a creditor holding a claim against only one tenant.

(3) “Claim” means 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.

(4) “Creditor” means a person who has a claim.

(5) “Debt” means liability on a claim.

(6) “Debtor” means a person who is liable on a claim.

(7) “Insider” includes:

(i) if the debtor is an individual,

(A) a relative of the debtor or of a general partner of the debtor;
(B) a partnership in which the debtor is a general partner;
(C) a general partner in a partnership described in clause (B); or

(D) a corporation of which the debtor is a director, officer, or person in control;

(ii) if the debtor is a corporation,

(A) a director of the debtor;
(B) an officer of the debtor;
(C) a person in control of the debtor;
(D) a partnership in which the debtor is a general partner;
(E) a general partner in a partnership described in clause (D); or
(F) a relative of a general partner, director, officer, or person in control of the debtor;

(iii) if the debtor is a partnership,

(A) a general partner in the debtor;
(B) a relative of a general partner in, a general partner of, or a person in control of the debtor;
(C) another partnership in which the debtor is a general partner;
(D) a general partner in a partnership described in clause (C); or
(E) a person in control of the debtor;

(iv) an affiliate, or an insider of an affiliate as if the affiliate were the debtor; and

(v) a managing agent of the debtor.

(8) "Lien" means a charge against or an interest in property to secure payment of a debt or performance of an obligation, and includes a security interest created by agreement, a judicial lien obtained by legal or equitable process or proceedings, a common-law lien, or a statutory lien.

(9) "Person" means an individual, partnership, corporation, association, organization, government or governmental subdivision or agency, business trust, estate, trust, or any other legal or commercial entity.
(10) "Property" means anything that may be the subject of ownership.

(11) "Relative" means an individual related by consanguinity within the third degree as determined by the common law, a spouse, or an individual related to a spouse within the third degree as so determined, and includes an individual in an adoptive relationship within the third degree.

(12) "Transfer" means 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.

(13) "Valid lien" means a lien that is effective against the holder of a judicial lien subsequently obtained by legal or equitable process or proceedings.

§ 2. Insolvency

(a) A debtor is insolvent if the sum of the debtor s debts is greater than all of the debtor s assets at a fair valuation.
(b) A debtor who is generally not paying his [or her] debts as they become due is presumed to be insolvent.

(c) **A** partnership is insolvent under subsection (a) if the sum of the partnership s debts is greater than the aggregate, at a fair valuation, of all of the partnership s assets and the sum of the excess of the value of each general partner s non-partnership assets over the partner s non-partnership debts.

(d) Assets under this section do not include property that has been transferred, concealed, or removed with intent to hinder, delay, or defraud creditors or that has been transferred in a manner making the transfer voidable under this [Act).

(e) Debts under this section do not include an obligation to the extent it is secured by a valid lien on property of the debtor not included as an asset.

§ 3. Value

(a) Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied, but value does not include an unperformed promise made otherwise than in the ordinary course of the promisor s business to furnish support to the debtor or another person.

(b) For the purposes of Sections. 4(a)(2) and 5, a person gives a reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, non-collusive foreclosure sale or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement.

(c) A transfer is made for present value if the exchange between the debtor and the transferee is intended by them to be contemporaneous and is in fact substantially contemporaneous.

§ 4. Transfers Fraudulent as to Present and Future Creditors

(a) A transfer made or obligation incurred by a debtor 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 the debtor made the transfer or incurred the obligation:

(1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or
(2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

(i) was engaged 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.

(b) In determining actual intent under subsection (a)(1), consideration may be given, among other factors, to whether:

(1) the transfer or obligation was to an insider;
(2) the debtor retained possession or control of the property transferred after the transfer;
(3) the transfer or obligation was disclosed or concealed;
(4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
(5) the transfer was of substantially all the debtor s assets;
(6) the debtor absconded;
(7) the debtor removed or concealed assets;
(8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
(10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and
(11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

§ 5. Transfers Fraudulent as to Present Creditors

A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made of the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.
A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent.

§ 6. When Transfer is Made or Obligation is Incurred

For the purposes of this [Act]:

(1) a transfer is made:

(i) with respect to an asset that is real property other than a fixture, but including the interest of a seller or purchaser under a contract for the sale of the asset, when the transfer is so far perfected that a good-faith purchaser of the asset from the debtor against whom applicable law permits the transfer to be perfected cannot acquire an interest in the asset that is superior to the interest of the transferee; and
(ii) with respect to an asset that is not real property or that is a fixture, when the transfer is so far perfected that a creditor on a simple contract cannot acquire a judicial lien otherwise than under this [Act] that is superior to the interest of the transferee;

(2) if applicable law permits the transfer to be perfected as provided in paragraph (1) and the transfer is not so perfected before the commencement of an action for relief under this [Act], the transfer is deemed made immediately before the commencement of the action;

(3) if applicable law does not permit the transfer to be perfected as provided in paragraph (1), the transfer is made when it becomes effective between the debtor and the transferee;

(4) a transfer is not made until the debtor has acquired rights in the asset transferred;

(5) 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.

§ 7. Remedies of Creditors

(a) In an action for relief against a transfer or obligation under this [Act], a creditor, subject **to** the limitations in Section 8, may obtain:

(1) avoidance of the transfer or obligation to the extent necessary to satisfy the creditor s claim;
[(2) an attachment or other provisional remedy against the asset transferred or other property of the transferee in accordance with the procedure prescribed by [ ];
(3) subject to applicable principles of equity and in accordance with applicable rules of civil procedure,

(i) an injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property;
(ii) appointment of a receiver to take charge of the asset transferred or of other property of the transferee: or
(iii) any other relief the circumstances may require.

(b) If a creditor has obtained a judgment on a claim against the debtor, the creditor, if the court so orders, may levy execution on the asset transferred or its proceeds.

§ 8. Defenses, Liability, and Protection of Transferee

(a) A transfer or obligation is not voidable under Section 4(a)(1) against a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee or obligee.
(b) Except as otherwise provided in this section, to the extent a transfer is voidable in an action by a creditor under Section 7(a)(1), the creditor may recover judgment for the value of the asset transferred, as adjusted under subsection (c), or the amount necessary to satisfy the creditor s claim, whichever is less. The judgment may be entered against:

(1) the first transferee of the asset or the person for whose benefit the transfer was made; or
(2) any subsequent transferee other than a good faith transferee who took for value or from any subsequent transferee.

(c) If the judgment under subsection (b) is based upon the value of the asset transferred, the judgment must be for an amount equal to the value of the asset at the time of the transfer, subject to adjustment as the equities may require.
(d) Notwithstanding voidability of a transfer or an obligation under this [Act], a good-faith transferee or obligee is entitled, to the extent of the value given the debtor for the transfer or obligation, to

(1) a lien on or a right to retain any interest in the asset transferred;
(2) enforcement of any obligation incurred; or
(3) a reduction in the amount of the liability on the judgment.

(e) A transfer is not voidable under Section 4(a)(2) or Section 5 if the transfer results from:

(1) termination of a lease upon default by the debtor when the termination is pursuant to the lease and applicable law; or
(2) enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code.

(f) A transfer is not voidable under Section 5(b):

(1) to the extent the insider gave new value to or for the benefit of the debtor after the transfer was made unless the new value was secured by a valid lien;
(2) if made in the ordinary course of business or financial affairs of the debtor and the insider; or
(3) if made pursuant to a good-faith effort to rehabilitate the debtor and the transfer secured present value given for that purpose as well as an antecedent debt of the debtor.

§ 9. Extinguishment of [Claim for Relief] [Cause of Action]

A [claim for relief] [cause of action] with respect to a fraudulent transfer or obligation under this [Act] is extinguished unless action is brought:

(a) under Section 4(a)(1), within 4 years after the transfer was made or the obligation was incurred or, if later, within one year after the transfer or obligation was or could reasonably have been discovered by the claimant;
(b) under Section 4(a)(2) or 5(a), within 4 years after the transfer was made or the obligation was incurred; or
(c) under Section 5(b), within one year after the transfer was made or the obligation was incurred.

§ 10. Supplementary Provisions

Unless displaced by the provisions of this [Act], the principles of law and equity, including the law merchant and the law relating to principal and agent, estoppel, laches, fraud, misrepresentation, duress, coercion, mistake, insolvency, or other validating or invalidating cause, supplement its provisions.

§ 11. Uniformity of Application and Construction

This [Act] shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this [Act] among states enacting it.

Library References

Fraudulent Conveyances = 5.
C.J.S. Fraudulent Conveyances §§ 5, 474.

§ 12. Short Title

This [Act] may be cited as the Uniform Fraudulent Transfer Act.

Library References

Statutes 109, 109.1.
C.J.S. Statutes §§ 219, 220.

§ 13. Repeal

The following acts and all other acts and parts of acts inconsistent herewith are hereby repealed: