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FRAUDULENT CONVEYANCES AND PREFERENCES: A FEASIBILITY STUDY

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EXECUTIVE SUMMARY

[1] This paper reviews the law of fraudulent conveyances and preferences in Canada.[i] I conclude that reform is needed. The statute and case law has been flawed from the passage of the Statute of Elizabeth[ii] in 1571 and no amount of patching will cure the archaic legislation, fundamental confusions, logical problems, redundant sections, unclear policy and inept drafting. The legal problems complicate the work of litigators, solicitors, judges, and other business and professional people grappling with reviewable transactions issues. The law can be reformed by a uniform statute which will fit comfortably into the aims of the Commercial Law Strategy.

[2] My conclusion is that the ULCC should do a report and uniform statute on the law of fraudulent conveyances and preferences if two conditions are satisfied:

1. The ULCC should ascertain before the study begins that some provincial and territorial governments are actively interested in considering the results of our study. There must be evidence that government and to a lesser extent the relevant professions are on side.
2. The ULCC should agree to a budget and timetable adequate to accomplish the detailed research, consultation and writing outlined in this paper. The study must be founded on solid research and consultation or no one will be convinced by it.

[3] If these hurdles can be cleared before the project begins, then the ULCC should undertake it. Otherwise, it should go on to other projects.

REPORT

BACKGROUND

[4] Earlier this year, I was asked by Jennifer Babe and Tony Hoffmann to prepare "a feasibility study with respect to the need for reform and harmonization of the law of fraudulent preferences and conveyances in Canada." It was noted during our discussion that "a comprehensive survey and analysis would not be possible or, indeed, feasible." I assume that the purpose of this report and the discussion of it is to decide if the ULCC should undertake the preparation of a uniform fraudulent conveyance and preference statute for

Canada. I completed this report before the end of February. While some consultation was carried out before that date, more will have been done since. I will report on the results in August.

HISTORY

[5] The problem which is sought to be addressed by fraudulent conveyance and preference legislation is described by the British Columbia Law Reform Commission in its report on the subject:[iii]

> 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, in British Columbia, are addressed by both provincial and federal legislation.

[6] English law on fraudulent conveyances dates back to the Middle Ages, but the first comprehensive attempt at prohibition may be the *Fraudulent Conveyances Act, 1571*,[iv] usually referred to as the Statute of Elizabeth. The Statute sought to avoid "feigned, covinous and fraudulent" transfers of land and personalty entered into with the intent to "delay, hinder or defraud creditors and others" of their just and lawful claims. S. 2 provided that such conveyances should be "clearly and utterly void, frustrate and of no effect" as against "creditors and others" whose claims might be delayed by such conveyances. S. 6 contained the important proviso that the Act did not extend to a conveyance for "good consideration" entered into bona fide and without notice of the fraud. The Statute of Elizabeth on its face created a criminal offence, but the courts quickly saw its potential as the foundation for a civil action to avoid fraudulent conveyances of exigible property by debtors. Since 1571, the courts have been active in creating a large and complex body of law which purports to interpret the Statute but which in reality constructs a new right in "creditors and others" to challenge and avoid fraudulent conveyances.

[7] The Statute of Elizabeth was generally held not to prohibit a debtor from preferring one creditor over others. In the context of bankruptcy, however, the courts from the time of Lord Mansfield held that

> [A] fraudulent preference by a debtor, if made on the eve of, and followed by, the bankruptcy of the debtor, has been void against his

> creditors; because it aims at preventing that equal distribution of assets among the creditors, which has always been the object of those laws.[v]

[8] The Canadian courts early decided that the Statute of Elizabeth and the accompanying body of judge-made law had become part of the law of Canada. Some jurisdictions replaced the Statute with a local Fraudulent Conveyances Act which usually followed the basic ideas of the English model while modernizing the language. Other jurisdictions, like Alberta, simply relied on the Statute of Elizabeth without patriating it. Similar provisions exist in the *Bankruptcy and Insolvency Act* (*BIA*).[vi]

[9] The Canadian history of fraudulent preference law is more complex. The federal government had asserted its constitutional power over bankruptcy by passing Insolvent Acts in the 1860s and 1870s, but it repealed those statutes in 1880. From that date to the passage of the Bankruptcy Act of 1919, there was no federal legislation on the subject. Several provinces sought to occupy the void by passing, among others, statutes legislating against fraudulent preferences. Most Canadian jurisdictions continue to have fraudulent preference acts today alongside the comparable provisions in the *BIA*. The reviewable transactions provisions of the *BIA* have been the subject of regular amendments. However, provincial fraudulent conveyance and preference law has, since the 1880s, been neglected, despite at least three law reform reports[vii] and numerous texts and articles recommending either narrow or sweeping reform.

PROBLEMS IN THE LAW OF FRAUDULENT CONVEYANCES

[10] In my book, I described the policy problems underlying the law of fraudulent conveyances. These problems explain much of the confusion and uncertainty in the present law, and will need to be confronted by anyone engaged in a reform project.

> It is clearly desirable that an insolvent person should not be able to shelter assets from the legitimate claims of creditors by assigning them to a convenient friend. On the other hand, the law is prepared to permit a person embarking on a risky business to protect personal wealth from subsequent claims by incorporating the enterprise as a separate legal entity. To what extent should a debtor have to retain assets so that subsequent creditors will have something to seize? Can and should a distinction be drawn between fraudulent and innocent transfers and, if so, whose intention is significant? The law cannot go to any lengths to protect creditors: the *bona fide* purchaser of assets from a debtor has some claim to be saved harmless from

> unforeseeable risks. Where should the law draw the line between freedom of commerce and the security of the purchaser's title on the one hand and the legitimate claims of creditors on the other?[viii]

[11] Those who have studied and written about the law are unanimously critical. One correspondent wrote to me:

> First, is reform desirable? I think views on this question are pretty unanimous among those who have looked at the area at all. The existing law is anachronistic and inaccessible. It should be replaced by a modern statute that restates and revises this body of law.

Texts and essays on the law are full of criticisms of confused rules, redundant statutory provisions, perplexing and contradictory decisions, antiquated rules and ideas, and opaque policy. Fraudulent conveyances and preferences problems have not produced far-reaching and imaginative judicial decisions. The vast majority of the cases say little or nothing about the law, simply copying passages from leading decisions. The cases which do address the law have often caused more trouble than they should have.[ix] Not surprisingly, calls abound for a complete rewriting of the law.

[12] In this section, I list some of the areas of fraudulent conveyance law which have raised criticism. I make no attempt to document fully the many relevant cases and statutory provisions. There is a good literature on the subject.[x] Nor do I analyze the issues at length, much less suggesting solutions. That is the job of the consultation memorandum and the final report.

[13] **Who can challenge?** – The Statute of Elizabeth extended the benefits of the legislation to "creditors and others" whose claims might be hindered or delayed by the impugned transaction. Canadian acts followed the English formula with minor variations. The courts developed a conservative interpretive approach which gave status to sue to existing judgment creditors, claimants whose claims would likely end in a judgment, secured creditors where their security was inadequate to satisfy the claim[xi] and some future creditors. The law is judge-made and reveals substantial ambiguities. One might think that, after more than 400 years, the formula in the Statute might be replaced with a rule which clearly sets out the claimants who can challenge a fraudulent conveyance.

[14] **Conveyance** – The Statute is often said to strike down "conveyances" although the courts have thrown the net much more widely. There have been some puzzling cases on disclaimers of legacies[xii] among other situations.

[15] **Property** – The conveyance must be of "property." The term is generally interpreted to include any exigible real or personal property, although the Springman book has an interesting discussion of the non-application of the Statute to exempt property.[xiii]

[16] **Insolvency** – As a matter of law, it is not necessary to establish that a debtor was insolvent at the date of a fraudulent conveyance. However, as the Ontario LRC Report and the Springman book observe, proof of insolvency may be of "critical importance." The BCLRC Report proposes that insolvency be a necessary ingredient in commencing a fraudulent conveyance action. How insolvency is defined is discussed below.

[17] **Fraudulent intent** – Where the debtor transfers property for nothing or a nominal consideration, the courts require proof that the debtor had a fraudulent intent. The requirement may flow from the origins of the fraudulent conveyance remedy in a criminal statute. Where the transaction is for consideration, the plaintiff must also establish that the transferee was privy to the debtor's intent. Several problems arise.

1. Proving intent – The root problem is to prove the intent of the debtor and the transferee. The courts have over the centuries developed aids to assist them in making this finding, including the badges of fraud, rebuttable and irrebuttable presumptions of law or fact, inferences, the requirement in some situations for corroborating evidence, and rules regarding the shifting of the evidentiary onus of proof. The cases are complex and not easy to reconcile.
2. Abandon intent as a requirement? – Some writers and law reform commissions have suggested abandoning intent as a necessary element, at least in the voluntary transaction situation. In its place, they propose creating an objective standard for voidable transactions, whatever the parties intended. The test is sometimes said to consider the effect of the transaction rather than the intent of the parties. Such a change would force the lawmakers to describe more precisely the transactions which they view as offensive rather than engaging the courts in a fruitless search for a will-o'-the-wisp. No law reform agencies have gone so far as to eliminate intent from all fraudulent conveyances and preferences.
3. Why is the transferee's intent relevant? – Even if intent is retained as a necessary element, why is the transferee's intent so significant that it must be proven? It is helpful evidence to show that the debtor and the transferee agreed on a scheme to defraud creditors, but should the law take the next step and require that the transferee's intent be a threshold requirement?
4. The dominant intent? – Debtors on the eve of financial disaster may have more than one thought going through their minds. How significant must the fraudulent intent be?

5. Two classes or three? – The law described above creates a different rule for voluntary transactions and transactions supported by consideration. The BCLRC report argues that the better approach is to identify three classes of transactions: (1) those with no or minimal consideration, (2) those with full consideration, and (3) those supported by some but inadequate consideration. The BCLRC develops different rules for each of the three situations.

[18] **Transactions for consideration must be "bona fide" to a transferee without notice** – S. 6 of the Statute of Elizabeth provides that the Statute does not extend to a conveyance "upon good consideration and bona fide lawfully conveyed or assured to any person or persons ... not having ... notice or knowledge of such covin, fraud or collusion."[xiv] The requirements of good faith and absence of notice are perplexing. The Ontario LRC Report,[xv] followed by the Springman book,[xvi] note that the requirement of good faith may refer to the debtor or the creditor-transferee or may "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."[xvii] There are difficulties with each reading. Nor is the notice requirement may more clear in the context of the whole Statute. Rewriting is essential.

[19] **Void or voidable** – The Statute of Elizabeth, followed by its Canadian paraphrases, describes fraudulent conveyances as void. The courts have usually read (or amended) the statutory language to say "voidable."[xviii] The judicial amendment should be incorporated into a new act, although the Conference might ask if it wants to insert more judicial discretion by describing the transaction as "reviewable."

[20] **Interlocutory and final remedies** – Fraudulent conveyance acts are generally silent on interlocutory or final remedies. The judges have attempted to build an arsenal, but the cases are contradictory and unclear. Legislation could deal with several issues:

1. Should a plaintiff in a fraudulent conveyance action be able to use prejudgment remedies, *Mareva* injunctions[xix] or preservation orders to tie up the property which is the subject of the lawsuit?
2. Where the property remains in the hands of the transferee from the debtor, what should the court be able to order (retransfer to the debtor? seizure in the hands of the transferee? other remedies?) Should the court in such an order be able to order compensation for the transferee for the loss of the property? If so, from whom?
3. When can the property be traced into the hands of subsequent transferees?
4. Can the plaintiff realize on the proceeds of the original sale by the debtor? What about the proceeds of subsequent resales?

[21] **"Fraudulent"?** – Many of the transactions impugned under fraudulent conveyance legislation are not fraudulent in the sense in which the term is used elsewhere in the law. Another term might be found, e.g., reviewable or voidable transactions.

PROBLEMS IN THE LAW OF FRAUDULENT PREFERENCES

[22] The policy conflict underlying fraudulent preference statutes is more acute than in the case of conveyances intended to defeat creditors generally.

> At common law, creditors had no responsibility to share the fruits of execution equally with other creditors, and we would expect that the debtor's voluntary payment of some but not others should be equally acceptable. However the first come first served policy of the common law has been rejected in favour of *pari passu* sharing in bankruptcy statutes and, in this country, in creditors' relief legislation. As a corollary, Canadian legislatures have passed Fraudulent Preference Acts, the purpose of which is to prohibit at least some preferential transfers, no matter how valid or meritorious the claim of the preferred creditor. The courts have however been more hesitant to strike down the preference of a legitimate creditor than they have a conveyance designed to defeat all creditors alike.[xx]

There is a half-hearted and tentative quality about the legislation which shows in the creation of exceptions so large as to exclude most transactions which would otherwise fall under the prohibition. The cases display a similar hesitancy. The result is a melange of confusing and contradictory rules.

[23] As above, I list some areas of fraudulent preference law which can be criticized. I do not list again issues common to fraudulent conveyances and preferences. Examples are the difficulty of proof of intent, and the use in the legislation of "void" instead of voidable or reviewable.

[24] **Who can challenge** – Unlike the Statute of Elizabeth and Canadian substitute legislation, the fraudulent preference statutes can be used only by "creditors." The term has been interpreted narrowly.

[25] **Requirement that the debtor be insolvent** – Unlike fraudulent conveyances, fraudulent preference statutes require that the impugned transaction must be "made by a person when insolvent or unable to pay the person's debts in full or when the person knows

that he, she or it is on the eve of insolvency."[xxi] While the legislation sets out three alternatives, the courts have concluded that there is no real difference between the first two. The courts have raised several problems with the insolvency requirement, none of which has been clearly resolved.

1. Some judges distinguish "between legal insolvency, *i.e.*, not having sufficient property to pay one's debts if sold under legal process, and commercial insolvency, namely, not having the means to pay off and discharge one's commercial obligations as they become due in the ordinary course of business."[xxii] Other courts have resisted the forced sale as the method to decide the value of assets.
2. There is uncertainty whether the determination of insolvency should take into account future and contingent assets and liabilities.[xxiii]
3. It might be possible to find a more precise formula than "the eve of insolvency."
4. "In some cases, the courts have been strangely reluctant to draw reasonable inferences from facts that usually indicate insolvency."[xxiv] Problems of proof and the standard which the court will apply create real uncertainty for plaintiffs.

[26] Transactions not attacked within 60 days – All Canadian fraudulent preference acts draw a distinction between transactions which occur within 60 days[xxv] of the attack by the creditor or an assignment by the debtor, and transactions which occur outside the 60 day limit. As to the latter class of cases, the plaintiff must establish that the voluntary and dominant intention of the debtor was to prefer the creditor to whom the transfer is made. There is much law on debtors with different intentions which do not satisfy the statutory test. The plaintiff must also prove that the transferee-creditor (1) knew of the debtor's insolvency at the time of the transfer or knew facts which should have shown the debtor's inability to meet his or her obligations, and (2) participated in the fraud in the sense that he or she knowingly and willingly accepted the preference over other creditors.[xxvi] Any law reform project will need to ask:

1. Should the test be the intent of the debtor or the nature and effect of the transaction?
2. Should the knowledge, conduct or participation of the creditor-transferee be a relevant consideration?[xxvii] If so, it would be useful to say if notice or knowledge by the creditor is enough, or if some kind of participation or intent to accept the preference is needed.

[27] **Transactions attacked within 60 days** – "All provincial preference statutes include sections where proof of the preferential effect of the transfer and timely commencement of proceedings (typically, within sixty days of the date of the impugned transfer) will trigger either voidability or a presumption that the transfer was made with the requisite intent."[xxviii] The Springman book distinguishes two types of provisions. The Ontario section provides

only a *prima facie* presumption which the defendant can rebut by showing an intent other than to prefer. Springman also says that concurrent intent remains a requirement, as does insolvency. On the other hand, the sections from some of the Western provinces provide that transactions are void if they have the effect of preferring the transferee-creditor, and that the intention of the parties to the transfer is irrelevant. Insolvency still must be proven. Various questions arise:

1. Should there be any statutory presumption section? What circumstances should trigger the presumption? Should the law create a rebuttable presumption or should the rule simply declare transactions with certain characteristics to be voidable?
2. Should the intent of the debtor be required? Should the intent or conduct of the transferee be a requirement as well?
3. Should the statutory presumption be replaced by a distinction based on arm's length and non-arm's length transactions, as proposed by the Ontario LRC Report?[xxix]
4. If the statutory presumption is retained, a uniform statute will have to make a choice among the available models. An example is the length of the time period.
5. These provisions, like the protected transactions sections, are especially poorly drafted. The BCLRC says of the relevant B.C. section that it is "cryptic" and "illogical" and that "the present language of the Act does not lend itself to a sensible reading."[xxx] The section remains substantially unchanged today.

[28] **Protected transactions** – Every fraudulent preference statute includes a list of transactions which cannot be challenged even though they fit within the general prohibition. The sections often exempt the following transactions, although the legislation varies widely:[xxxi]

1. A sale or payment made in good faith in the ordinary course of the trade or calling to an innocent purchaser or person;
2. Payment of money to a creditor;
3. A bona fide conveyance of property made in good faith
   (1) in consideration of a present actual payment in money, or
   (2) by way of security for a present actual advance of money, or
   (3) made in consideration of a present actual sale or delivery of property

   where the money paid or the property sold or delivered bears a fair and reasonable relative value to the consideration therefor.

Interpretation problems abound.

1. The references to good faith and innocence raise the question whether the exceptions are redundant. A fraudulent preference is likely in bad faith and not innocent. If such a

transaction is not a fraudulent preference, what do the exceptions which use those terms add?

2. What do the words "trade or calling" mean? They have been interpreted in a limited way in exemptions from execution legislation.
3. Is the exception for payment of money unlimited (in which case it excepts most fraudulent preferences) or is it limited by the proviso requiring "fair and reasonable relative value." The effect of the proviso is problematic for all of the exceptions. The drafting varies across Canada.
4. Several of the exemptions overlap.
5. The exemptions regarding security on personalty were drafted a hundred years before the PPSA. What is the relationship of the two statutes?

[29] **"Fraudulent"?** – As we noted above, many, perhaps most, fraudulent preferences are not fraudulent and should be called something more representative of what is happening, e.g., reviewable or voidable preferences.

[30] **Fraudulent conveyance provisions** – The fraudulent preference acts usually include a section which is a summary of the fraudulent conveyance legislation. The sections have nothing to do with fraudulent preference statutes, are redundant and should be eliminated from any uniform act.

[31] **Repeal fraudulent preference legislation?** – Underlying the above issues is the fundamental question whether payments or transfers to creditors should be treated like fraudulent conveyances and struck down. The Law Reform Commission of British Columbia in its working paper[xxxii] proposed repeal of the fraudulent preference legislation, but received complaints and changed its recommendation in the final report to repealing the existing statute and replacing it by modern legislation.[xxxiii] Repeal remains a possible recommendation for the ULCC. A more modest proposal is to consider whether the same principles or concepts can be applied to both fraudulent conveyances and preferences.

[32] **Determining policy and rewriting the act to represent that policy clearly** – Even if fraudulent preference legislation is retained, the existing statutes are hopelessly confusing, repetitive, illogical and unclear as to policy. The first step is to decide what attitude the law should take to fraudulent preferences and then construct a statute which clearly and simply represents that policy. Patchwork amendment is not enough.

SHOULD ANY LAW REFORM COMMISSION UNDERTAKE THE REFORM OF FRAUDULENT CONVEYANCES AND PREFERENCES?

[33] In this section, I ask whether the reform of the law of fraudulent conveyances and preferences is a useful and necessary project for any Canadian law reform commission. My conclusion will be that, if there is clear evidence of interest and support from government and, to a lesser extent, the relevant professional groups, such a reform project is a good idea. I do not consider here whether the ULCC should undertake this project. That question raises additional and difficult issues which I address in the last section of this paper.

1. Arguments for reform

[34] **The law is broken** – Jennifer Babe asked me to answer the question whether the law is "broken." My answer is that it was broken the moment the Statute of Elizabeth was drafted. Like a bad computer program, the law was flawed from the outset and no amount of patching could cure the fundamental confusions, logical problems, redundant sections, unclear policy and bad drafting. The existing acts should be repealed and replaced with a new statute. Comments by authors and law reformers, as well as feedback to this point, support this conclusion.

[35] **The broken state of the law affects practice and business** – The legal problems outlined above complicate the work of litigators and judges grappling with reviewable transactions cases. Trustees in bankruptcy and other non-lawyer professionals would prefer legislation more readily comprehensible than the Statute of Elizabeth or Canadian imitations. The law makes more difficult the work of solicitors giving opinions on the potential vulnerability of transactions to be set aside as fraudulent conveyances or preferences. A solicitor's problem is complicated by ethical pitfalls in advising clients on what may be avoidable transactions.[xxxiv] The ethical and legal difficulties can be eased somewhat if the law is made more coherent, logical and understandable.

[36] **The statute law is archaic** – Some provinces like Alberta have not gotten around to writing a version of the Statute of Elizabeth as a provincial statute. There are serious problems in relying on an old Imperial act: the difficulty of amendment, the archaic language, the fact that the statute was intended primarily to create a crime, not a civil cause of action. While the Assignments and Preferences and Fraudulent Preference Acts are comparatively modern, dating from the late nineteenth century, they were drafted in a

confusing and hesitant way which leaves real doubt what the drafters intended. These confusions continue untouched in the modern legislation.

[37] **Research and reform scholarship exists** – At least three law reform commissions or government departments have recently proposed the reform of reviewable transactions law. Their thoughtful and well-researched reports will be of great assistance to writers of any new report. The researcher will also benefit from the American *Uniform Fraudulent Transfer Act*[xxxv] as well as the large Canadian scholarly literature which has been written in the last twenty-five years.

[38] **Lawyers and trustees want legislation to reverse *Ramgotra*** – Lawyers and trustees in bankruptcy are currently interested in the reform of narrow aspects of fraudulent conveyance and preference law. During the past year, I have been discussing with lawyers and trustees the proposals of the Alberta Law Reform Institute for the exemption of future income plans. During these conversations, practitioners without invitation criticized the *Ramgotra* decision of the Supreme Court of Canada,[xxxvi] especially its interpretation of the settlement provisions of the *BIA*. I did not hear any general unhappiness with provincial reviewable transactions law. I will be canvassing the relevant national and provincial sections of the Canadian Bar Association for opinions and will relay them to the meeting in August.

[39] **Lawyers and trustees dislike the cost, delay and uncertainty of litigation** – Another criticism I heard from lawyers and trustees was less about principle and more about those hardy perennials: cost of litigation, delay and uncertainty of result. Two trustees told me that they refused to recommend litigation under provincial or federal reviewable transactions legislation because they could not be sure what would happen, and they were afraid that they would end up paying costs instead of realizing assets for the estate. These lawyers and trustees often expressed support for the recommendation of the Personal Insolvency Task Force[xxxvii] that, even if RRSPs are exempt in bankruptcy, they should be subject to a three-year clawback of contributions to such plans.[xxxviii] Such clawback, in the words of the Task Force, should "be an irrebuttable vesting: that is, it will not be dependent upon any fraud test or judicial determination."[xxxix] In other words, reviewable transactions law is so flawed that it should be replaced by a mechanical transfer to the trustee of any money paid within three years of the bankruptcy, regardless of the bankrupt's financial state, much less his or her intention. Concerns over cost, delay and uncertainty are significant to any reform project, although it is doubtful whether any principled discussion of reviewable transactions law would go as far as these critics seem to want.

2. Arguments against reform

[40] **The law is settled in hundreds of year of judicial decisions** – The arguments for reform exaggerate the significance of the legislation. The Statute of Elizabeth was only the pretext for a judge-made body of law which has been perfected over the centuries. It is important that legal rules governing commercial and property disputes be settled, especially as fraudulent conveyance and preference litigation is aimed at unsettling ownership by depriving transferees of property which in many cases they bought and paid for. The danger in rewriting hundreds of years of case law is that we will create new problems, or revive old ones which the judges saw and overcame during the long history of the law.

[41] One might respond that the legislation has created some problems which can be solved by legislative change. The formula "creditors and others" has bedevilled the law since its inclusion in the Statute of Elizabeth. Surely we can do better. As to the sanctity of case law, one is tempted to quote Justice Holmes' famous aphorism: "It is revolting to have no better reason for a rule than that so it was laid down in the time of Henry IV."[xl] While settled rules are important, it is also important that they be fair, comprehensible and principled, qualities lacking in the present law.

[42] **In most cases, the law is clear and uncontroversial** – Most fraudulent conveyance and preference cases turn on the facts, and the law consists of boilerplated quotations from leading cases. In most lawsuits, the law is clear and not the subject of controversy; it works well and cannot be described as "broken." The real problem is the inherent uncertainty of fact finding, an issue broader than this project. This argument assumes that the facts required to be found, e.g., the intent of the debtor and transferee, are reasonable requirements. If we replace intent requirements with rules concentrating on the effect of the transaction, the fact finding exercise may be easier. The argument concentrates on litigation and ignores completely the difficulties in giving opinions or advising clients as to the legality of a particular transaction.

[43] **Judges and practitioners seem prepared to accept the law with all its known flaws** – My review of the case law for the second edition of my book did not leave me with an impression that judges were up in arms about the decrepit state of the law. To find loud judicial criticism of the rules, one has to go back one hundred years to a line of Canadian cases attacking the ease with which the doctrine of pressure could be used by a creditor to defend a fraudulent preference action. In many jurisdictions, pressure has been either eliminated or weakened as a defence by one of the few twentieth century substantial

amendments to fraudulent preference legislation. The profession may be disturbed by cases like *Ramgotra* but it is otherwise neutral on reform.

[44] This argument, if true, creates a real problem for the ULCC which, like all law reform agencies, needs to choose its projects carefully. On the other hand, the function of such agencies is in part to alert the profession to problems in the law and to solicit the support of the bar and bench in urging law reform. They have a limited leadership role. My canvass of Canadian Bar Association subsections between the writing of this paper and August may give us some help in gauging the Bar's interest in the subject.

[45] **Restrict the law reform project to problem cases like *Ramgotra*** – If practitioners are generally happy with the law but dislike cases like *Ramgotra*, the better course is to create a limited reform project limited to the problem areas. Such a limited study will be faster and cheaper and will respond to the specific areas of concern.

[46] Four comments may be made.

1. This criticism assumes that the profession is satisfied with the law as it stands. It is not clear that this assessment is right.
2. We earlier documented the confusions, redundancies and archaisms in the present law. If this critique is accepted, then the solution is to attack the problem generally, including problem cases like *Ramgotra* in the study.
3. The third point is that *Ramgotra* is a case on the *Bankruptcy and Insolvency Act*, and much of the heated criticism I heard was aimed at that act. Reform of the *BIA* should take place elsewhere.
4. In provinces like Alberta, the law of fraudulent conveyances will be difficult to amend unless the Statute of Elizabeth is patriated. That activity necessitates rewriting the Statute in two senses: (1) the language will need to be brought up to date, and (2) the ideas in the Statute, along with four centuries of judicial exposition, will need to be revised and articulated in a logical form. Enacting a provincial fraudulent conveyance statute involves thinking out what fraudulent conveyances are and how we want modern law to deal with them. Such a study is broader than *Ramgotra*.

[47] **A reform report on reviewable transactions is likely to be controversial** – Here, as elsewhere, the policy problems are complex and opinions may vary. For example, the approach of trustees in bankruptcy to reviewable transactions may be different from that of the lawyers. The trustees may want the process to be simple, workable and certain, while the lawyers insist that issues such as intent, insolvency or the effect of the impugned transaction

must be addressed and decided, even if the result is inherently uncertain. Any reform project on fraudulent conveyances and preferences is unlikely to please everyone and may annoy substantial groups who can and will make their views known. The response is that any reform project worthy of the time of the ULCC is likely to be controversial. The goal of proposing better law outweighs the danger of disagreement.

[48] **Governments are disinterested** – In my discussions with Jennifer Babe and Tony Hoffmann, it was decided that I should not survey government interest. The thought was that governments would be represented at the ULCC meeting in August and could express their views at that time. Such evidence as I have suggests that governments are not particularly excited by the reform of reviewable transactions law. New Brunswick, Ontario and British Columbia have apparently done nothing with the three well researched and thoughtful law reform reports presented to them in the last thirty years. Other governments have been similarly quiet. In my view, this is a very serious objection to a law reform project on reviewable transactions. There should be clear evidence of government interest and willingness to consider favourably the results of such a project before the ULCC wastes time, resources and energy flogging a dead horse.

3. Conclusion

[49] There is little doubt that the law of fraudulent conveyances and preferences is in disrepair. What is needed is a thorough reform by a statute which would articulate the fundamental policy, repeal the older legislation and resolve the ambiguities. If all that had to be considered was the state of the law, there would be little difficulty in recommending to any reform commission that reviewable transactions should be high on the list of reform projects.

[50] However, the relevant professions are apparently not demanding a wholesale reform so much as a tinkering with specific decisions. Governments can best be described as disinterested in the subject, at least at the time of writing. In my view, a law reform commission should hesitate long over embarking on a project without some show of professional and governmental interest. Law reform commissions need projects which are attractive to government or which involve the correction of fundamental and obvious injustice.[xli] Absent some evidence that the law reform report will be read and acted upon, I would doubt whether the ULCC or any other reform body should try again where two law reform commissions and one government department have failed.

SHOULD THE ULCC UNDERTAKE THIS PROJECT?

[51] In the last section, I expressed guarded support for a Canadian law reform commission undertaking the reform of the law of fraudulent conveyances and preferences. In this last section of the paper, I ask if the ULCC should undertake this project.

1. Arguments for

[52] **The law is broken** – In the previous section, I argued that the law is a mess and should be entirely rewritten. This is the strongest reason for the ULCC undertaking the job.

[53] **The law can be fixed by a uniform statute** – This is not an area where different jurisdictions have deeply held historical, political or economic differences. There are variations among acts at present, but the abstract goals are much the same. A uniform statute has been developed in the United States by the National Commissioners on Uniform State Laws,[xlii] and it or its predecessor[xliii] has been accepted in forty-three states.

[54] **The project would advance the aim of the Commercial Law Strategy** – The aim of the Commercial Law Strategy, set out on the ULCC website, is "to modernize and harmonize commercial law in Canada, with a view to creating a comprehensive framework of commercial statute law which will make it easier to do business in Canada ...." The reviewable transactions project fits nicely into this program. Business is done across provincial borders, and it would be helpful for counsel advising on potential litigation or solicitors giving opinions on proposed transactions to know that the law is roughly the same throughout the country. At present, the legislation varies from province to province, and the judges have developed differing approaches to the interpretation of that legislation. These differences create artificial and unnecessary obstacles to decision-making. Uniform legislation would go a long way to removing these obstacles.

[55] One consultant was uncertain about the need for uniform legislation on reviewable transactions. He argued that the law was applied after the fact and tended to be driven by litigation. "It is not one of those areas where business people will wish to prepare legal documentation for use nationally ...." He agreed that there were exceptions such as a business seeking to dispose of a national asset. He noted that uniformity might diminish choice-of-law arguments. On the whole, he came down in favour of uniform legislation. He noted that we have a uniform model already in the *BIA*.

2. Arguments against

[56] **Active interest and support from government and the relevant professions are essential** – I argued earlier that, without demonstrated interest and support from several governments and the affected professions, this project should not be undertaken. This argument applies to any decision by the ULCC. The need for active support from the Bar and other affected professional and business groups means that extensive consultation will be necessary to gather ideas and insight but also to build consensus. One consultant argued that governments might be more attracted to reform of fraudulent conveyance and preference law if it was bundled into "a larger package of commercial and enforcement law reform." One possibility is to present it as part of your ongoing project on the enforcement of money judgments.

[57] **The law is complex and difficult, and much work will be needed** – In the centuries since the Statute of Elizabeth, fraudulent conveyance law has become complex, intricate and confused. While fraudulent preferences legislation has a shorter history, it is, if anything, more confused and inconsistent than the Statute. The legal complexities reflect real and substantial factual and policy problems. Any project on reviewable transactions will require a lot of spade work to understand the present law, much less the policy and technical issues which will need to be decided.

[58] **Any report and draft statute produced by ULCC will be complex and long** – This is not an area where a simple solution will work. Assuming that the ULCC does not opt for repeal, our report will need to decide, among other things, who can challenge conveyances, what transactions are challengeable, what intent is required and how is it proven, what evidence of harmful effect of the transaction is relevant and sufficient, what is insolvency, and what remedies are available and appropriate. These problems are unavoidable; the report and legislation must address them.

[59] **ULCC cannot adopt an existing law reform report or uniform statute** – It is inviting for ULCC to simply adopt an existing law reform report or the American Uniform Fraudulent Transfer Act, make minor changes and claim it as our own. The invitation should be rejected for several reasons. The ULCC draft act must speak to all Canadian jurisdictions and accommodate to their differing legal environments Even if the ULCC wants to adopt, say, the BCLRC report, it must work through the issues discussed there and any other issues which occur to us, and it must be convinced at every step that BC came to the right result. Adopting the American draft act is dangerous because of the very different legal world in

which it was developed. There seems no shortcut to the ULCC doing the grunt work of mastering all the issues and coming to a reasoned response to all of them.

[60] **Differences in the law of different provinces must be resolved** – While the common law provinces derive their fraudulent conveyance and preference law from the same English roots, the law of different jurisdictions has diverged. For example, the fraudulent preference acts in western Canada are more generous to the creditor than the equivalent legislation in Ontario. In a uniform act, these policy and legal differences must be resolved.

[61] **Making the uniform act applicable and useful in Quebec requires substantial work** – If uniformity means what it says, a statute must be drafted which is acceptable and workable in Quebec and in English Canada. This means that the research and thinking referred to above must also be done about Quebec law. Then an effort must be made to find a common basis of ideas and policies which find expression in a uniform act acceptable to English and French Canada. The difficulty of this endeavour should not be underestimated and is illustrated by the intensely English character of this paper. A truly national report must explain what Quebec law now is, and how the uniform act improves on the existing remedies in that province. All of this must be written in terms which are helpful or at least recognizable to Quebec lawyers.

THE WORK INVOLVED IN THE PROJECT SHOULD NOT BE UNDER-ESTIMATED

[62] To do the project outlined above, substantial time and work will be needed. I detail below some of the elements.

[63] **Researchers** – Because of the complexity of the legal and policy issues and the volume of writing, two researchers will be needed, one to work on the common law provinces and the second to work on Quebec law. Both will need to review the relevant statutes, cases, secondary literature, continuing legal education lectures, law reform reports and some comparative and international material. The statutes from different provinces differ; researchers cannot assume that the case law from one jurisdiction tells them anything about the law elsewhere. The research has to be complete and thorough if the resulting report and recommendations are to convince its readers. Once the research is done, it has to be analyzed and thought about. The law reform documents need to be read very carefully as possible models. The two researchers need to discuss their respective discoveries in order to see if there is any common ground for a uniform statute which can apply to Quebec and the

common law provinces. The aim is to have both counsel agree on a final report or at least to agree on separate Quebec and non-Quebec recommendations with as much overlap as possible.

[64] **Consultation** – Consultation is essential to learn more about this complex area of law, to try out policy ideas and to build a consensus for reform. Consultation can take the form of articles in professional journals, notes on the ULCC and CBA websites, notices, e-mails and so on, but some personal contact is necessary. My recent work for the Alberta Law Reform Institute benefited enormously from conversations I had with lawyers in Edmonton and Calgary, talks to CBA subsections and the resulting feedback, and other personal contacts. If this model is accepted, some limited travel will be needed.

[65] **Consultation with the federal government** – The *BIA* also has fraudulent conveyance and preference provisions. The *BIA* is currently under review by the Superintendent of Bankruptcy. It would be useful to consult with the Superintendent's office on whether changes to the reviewable transactions sections are contemplated. In any event, consultants have pointed out that harmonizing federal and provincial reviewable transactions provisions has advantages.

[66] **Consultation Memorandum** – After the research, analysis and limited consultation, the researchers should write a consultation memorandum for general circulation. The report should be revised and approved by the Conference. The memorandum should raise questions and alternatives but should not suggest that the ULCC has decided on the answers.

[67] **Analysing responses to the consultation memorandum and writing the final report** – Once the responses are read and thought about and the researchers have done any further research and consultation, they will be in a position to write a final report. Again, the report should be revised and approved by the Conference.

[68] **Draft statute** – Ideally the report should be accompanied by the draft statute. If this proves difficult, then the two can be separated. The draft statute should result from discussions between the researchers and the drafter, which may lead to modifications to the draft and to the final report.

[69] **Management** – The researchers will need someone to manage their work. The Alberta Law Reform Institute creates a management committee, some of whom are board members. The management committee might approve the consultation memorandum before publication

and the draft final report. The final version of the report should be approved by the Conference. The role of the management committee is to manage, not to do the research or writing.

[70] **Advisory committee; working group** – In addition to the management committee, the Alberta Law Reform Institute uses advisory committees composed of knowledgeable lawyers and non-lawyers. They can be helpful with the substance of the project although the research, consultation and writing will be done by the researchers. There can be more than one advisory committee located in different jurisdictions.

[71] **The project as outlined will take a minimum of three years to complete** – Assuming that the proposal was approved by this meeting, one might anticipate the following timetable:

2004 – 2005	research and consultation are done, consultation memorandum is approved by management committee or the Conference.
2005 – 2006	consultation memorandum is published and circulated, comments are received and reviewed, final report is written and approved by management committee and Conference.
2006 – 2007	final report and uniform act are drafted and published.

[72] **The budget for the project will be substantial** – One consultant noted the scope of the undertaking and indicated a need for "significant financial backing." He said that he would support "a well-funded, two or three year project." I note below the principal items in a budget for this project.

[73] **Researchers' pay** – The major issue is whether the ULCC can and should pay the researchers to do the substantial and necessary work outlined above. The line item for pay will be substantial. The researchers will spend the equivalent of several full months on the research, consultation and writing. It is unreasonable to expect this kind of time and work commitment for nothing. While volunteers may be found, they will be less amenable to close management or frequent revisions.

[74] **Drafter's pay** – If the drafter is paid, the item should be included in the budget.

[75] **Pay for research assistant, secretary and office staff** – A research assistant is probably not useful, but office and administrative support will be necessary for the

production of letters, documents, xeroxing, organization of meetings and so on. This work may be done in part by the ULCC office, but it is still a cost to the ULCC.

[76] **Researchers' travel expenses** – Travel will be necessary for consultation, meetings with committees (unless done by telephone or videoconference) and the Conference. The two researchers may need to meet.

[77] **Other Items**

1. Management and advisory committees – Some travel or videoconference expenses are likely.
2. Purchase of supplies, books, xeroxing, etc.
3. Publication of consultation memorandum, final report and uniform statute – The cost should be included in the overall cost of the project.

RECOMMENDATION

[78] My conclusion is that the ULCC should do a report and uniform statute on the law of fraudulent conveyances and preferences if two conditions are satisfied:

1. The ULCC should ascertain before the study begins that some provincial and territorial governments are actively interested in considering the results of our study. There must be evidence that government and to a lesser extent the relevant professions are on side.
2. The ULCC should agree to a budget and timetable adequate to accomplish the detailed research, consultation and writing outlined above. The study must be founded on solid research and consultation or no one will be convinced by it.

[79] If these hurdles can be cleared before the project begins, then the ULCC should undertake it. Otherwise, it should go on to other projects.

i. The following confines itself to an account of Anglo-Canadian law and makes no attempt to describe the law of Quebec. Creating a uniform statute which will be appropriate to Quebec raises special problems which are discussed below. For a brief treatment of the paulian action, see Roderick A. MacDonald, "Privileges and Other Preferences upon Moveable Property in Quebec: Their Impact upon the Rights and Recourses of Execution Creditors," in M.A. Springman and Eric Gertner, eds. *Debtor-Creditor Law: Practice and Doctrine* (Toronto: Butterworths, 1985) at 255, 269-271. I have a brief memorandum from Frédérique Sabourin which the ULCC office may wish to distribute.

ii. The *Fraudulent Conveyances Act, 1571* (13 Eliz. 1), c. 5, usually referred to as the Statute of Elizabeth.. See C.R.B. Dunlop, *Creditor-Debtor Law in Canada*, 2d ed. (Toronto: Carswell, 1995) at 593 to 595 [Dunlop book].

iii. Law Reform Commission of British Columbia, *Report on Fraudulent Conveyances and Preferences* (LRC 94) (Vancouver: The Commission, 1988) at vii [LRCBC Report].

iv. *Supra* note 2.

v. Kerr on the Law of Fraud and Mistake (7th ed. 1952), p. 394; *Re Wilcoxon, Ex parte Griffith* (1883), 23 Ch. D. 69 at 74 (C.A.).

vi. R.S.C. 1985, c. B-3.

vii. LRCBC Report, *supra* note 3; Karl Dore and Robert Kerr, *Third Report of the Consumer Protection Project: Legal Remedies of the Unsecured Creditor after Judgment* (Fredericton: Government of New Brunswick, 1976) [NB Report]; Ontario Law Reform Commission, *Report on the Enforcement of Judgment Debts and Related Matters*, Part 4 (Toronto: Ontario Ministry of the Attorney General, 1983) at 125 to 247 [Ontario LRC].

viii. Dunlop book, *supra* note 2 at 592.

ix. The cases on fraudulent intent are good examples. See *Freeman v. Pope* (1870), 5 Ch. App. 538; *Re Wise; Ex parte Mercer* (1886), 17 Q.B.D. 290 (C.A.). There are exceptions. See, e.g., *Mandryk v. Merko* (1971), 19 D.L.R. (3d) 238 (Man. C.A.).

x. The leading text is M.A. Springman, George R. Stewart, J.J. Morrison and Michael J. MacNaughton, *Fraudulent Conveyances and Preferences*, looseleaf (Toronto: Carswell, 2002) [Springman book]. See also Dunlop book, *supra* note 2, c. 18; Robert W. Kerr, "Fraudulent Conveyances and Unjust Preferences," in M.A. Springman and Eric Gertner, eds. *Debtor-Creditor Law: Practice and Doctrine* (Toronto: Butterworths, 1985) at 191 to 253. There are three useful law reform reports. See *supra* note 7.

xi. Although cf. Springman book, *supra* note 10 at 12-8.6 to 12-13.

xii. E.g., *Sembaliuk v. Sembaliuk* (1984) 15 D.L.R. (4th) 303 (Alta. C.A.). See Springman book, *supra* note 10, at 8-14 to 8-32.

xiii. Springman book, *supra* note 10 at 8-1 to 8-14.

xiv. "Covin" is defined in P.G. Osborn, *A Concise Law Dictionary* 4th ed. (London: Sweet & Maxwell, 1954) at 103 as "a secret assent determined in the hearts of two or more to the defrauding and prejudice of another (Coke)." J.B. Sykes, ed., *The Concise Oxford Dictionary* 7th ed. (Oxford: Clarendon Press, 1982) at 219 defines the word more concisely as "fraud, deception" or in law "conspiracy, collusion" and describes it as archaic. As used in the Statute, it is also redundant.

xv. Ontario LRC, *supra* note 7 at 137 to 139.

xvi. Springman book, *supra* note 10 at 14-1 to 14-15; 14-29 to 14-39.

xvii. NB Report, *supra* note 7 at 125, quoted in Ontario LRC, *supra* note 7 at 139.

xviii. There is ample authority, although the word "void" may be read more literally in *Ramgotra (Trustee of) v. North American Life Assurance Co.*, [1996] 3 W.W.R. 457 (S.C.C.) [*Ramgotra*]. If *Ramgotra* stands for the proposition that such transactions are void, the need for reform is pressing. Finding these transactions to be void creates automatic, mechanical and unacceptable consequences and removes any judicial control and discretion.

xix. The remedy is named after one of the earliest decisions of the English Court of Appeal which invented the process. See *Mareva Campania Naviera S.A. v. International Bulk Carriers S.A.*, [1980] 1 ALL E.R. 213 (C.A.).

xx. Dunlop book, *supra* note 2 at 592.

xxi. *Assignments and Preferences Act*, R.S.O. 1990, c. A.33, s. 4(1). The other Canadian jurisdictions with fraudulent preference legislation usually copy this formula.

xxii. Dunlop book, *supra* note 2 at 628.

xxiii. Springman book, *supra* note 10 at 9-7 to 9-12.

xxiv. Springman book, *supra* note 10 at 9-13.

xxv. The period of time is longer in Western Canada statutes.

xxvi. Some courts have not required proof of the transferee's intent or conduct, and Prince Edward Island has abolished the need to prove concurrent intent. See *Frauds on Creditors Act*, R.S.P.E.I. 1988, c. F-15, s. 2(5).

xxvii. The requirement of proving the participation of the transferee is not part of the legislation but was added by the courts.

xxviii. Springman book, *supra* note 10 at 18-12.

xxix. Ontario LRC, *supra* note 7 at 226 to 227, 242 to 243.

xxx. LRCBC Report, *supra* note 3 at 45 to 46.

xxxi. I follow the organization in the Springman book, *supra* note 10 at c. 19.

xxxii. Law Reform Commission of British Columbia, *Working Paper No. 53: Fraudulent Conveyances and Preferences* (Vancouver: The Commission, 1986) at 101 to 108.

xxxiii. LRCBC Report, *supra* note 3 at 86 to 92.

xxxiv. See e.g. Springman book, *supra* note 10, c. 2.

xxxv. National Conference of Commissioners on Uniform State Laws, 1984. The Uniform Act, or its predecessor the *Uniform Fraudulent Conveyance Act* of 1918, has been adopted by 43 states. The Act can

be found on the NCCUSL website: <http://www.nccusl.org/nccusl/DesktopDefault.aspx>.

xxxvi. *Supra* note 18. *Ramgotra* decides that, where the debtor transferred property from exigible RRSPs to an exempt RRIF and named his wife as beneficiary, he committed a settlement under *BIA* s. 91 but that the trustee could not gain access to the RRIF as it was exempt because of s. 67 of the *BIA*, taken together with the exemptions in the Saskatchewan Insurance Act. The court suggests strongly that creditors can attack such transfers under provincial fraudulent conveyance and preference legislation. These dicta are troubling as a statement of law and policy. The issue should be expressly dealt with in any uniform act.

xxxvii. The Superintendent of Bankruptcy created the Task Force in 2000 to consider changes to the *BIA*. The Task Force reported two years later. See Personal Insolvency Task Force, *Final Report* (Ottawa: Industry Canada, 2002) at 17 to 23 [Task Force or Task Force Report].

xxxviii. The recommendations of the Task Force have been approved with modifications by the Standing Senate Committee on Banking, Trade and Commerce in its report *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa: The Committee, 2003) at 24 to 29. The Committee agreed with the clawback idea but would reduce the period to one year.

xxxix. Task Force Report, *supra* note 37 at 23.

xl. Oliver Wendell Holmes, Jr., *Collected Legal Papers*, p. 187; quoted in Lord Lloyd of Hampstead, *Introduction to Jurisprudence* 4th ed. (London: Stevens & Sons, 1979) at 453.

xli. The exemption of future income plans from creditors' remedies is an example of unjust treatment of similar plans as well as a project of considerable topical interest to society.

xlii. See the *Uniform Fraudulent Transfer Act*, *supra* note 35.

xliii. The *Uniform Fraudulent Conveyance Act* of 1918, *supra* note 35.