
Reform of Fraudulent Conveyances and Fraudulent Preferences Law: Transactions at Undervalue and Preferential Transfers

Working Group Progress Report
Uniform Law Conference of Canada
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Submitted by Tamara M. Buckwold

Reform of Fraudulent Conveyances and Fraudulent Preferences Law:

- **Part I:** Transactions at Undervalue (Fraudulent Conveyances)
 - **Part II:** Preferential Transfers (Fraudulent Preferences)
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The Working Group

- **Tamara M. Buckwold** (Chair), Faculty of Law, University of Alberta
 - **Thomas G. Anderson**, Q.C., Anderson Pension Consulting, Vancouver
 - **Élise Charpentier**, Faculté de droit, Université de Montréal
 - **Sarah J. Dafoe**, Alberta Justice, Legislative Reform
 - **Anthony Duggan**, Faculty of Law, University of Toronto
 - **Robert A. Klotz**, Klotz Associates, Toronto
 - **Michael J. MacNaughton**, Borden Ladner Gervais LLP, Toronto
 - **Tim Rattenbury**, Office of the Attorney General, Government of New Brunswick
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Substance of the Report

- A. Underlying Policies of Reformed Law
 - B. General Policies in the Design of a New Statute
 - C. Grounds for a Remedy: Definition of the Causes of Action
 - D. Scope of the Act: Transactions falling subject to the Act
 - E. Standing to Seek a Remedy under the Act
 - F. Remedies
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A. Underlying Policies of Reformed Law

1. Interference with creditors' rights of recovery is wrong and warrants redress

creditors = unsecured creditors – includes judgment creditors

Typical case: debtor's assets are inadequate to satisfy creditors claims, i.e. debtor is insolvent.

Therefore transfer of property by debtor necessarily defeats creditors' right to recover through resort to debtor's assets.

Debtor is insolvent at date of transfer

Exigible assets = \$500,000

Debts = \$600,000 → creditors recover 83 cents/dollar

Transfer leaves exigible assets = \$400,000 → creditors recover 66 cents/dollar

Debtor becomes insolvent as result of transfer

Exigible assets = \$700,000

Debts = \$600,000 → creditors recover fully

Transfer leaves exigible assets = \$400,000 → creditors recover 66 cents/dollar

A. Underlying Policies of Reformed Law

1. Interference with creditors' rights of recovery is wrong and warrants redress (*whether or not the interference was intentional*)

Case 1

I owe you \$50,000. I don't repay you. I have a friend who is slowly dying of a chronic disease. I give her \$50,000 to make her and her family more comfortable. The gift renders me insolvent - i.e. the value of the exigible assets I have left is insufficient to satisfy a judgment for the \$50,000 I owe you.

A. Underlying Policies of Reformed Law

1. Interference with creditors' rights of recovery is wrong and warrants redress (*whether or not the interference was intentional*)

Case 2

I run a small business. I owe you \$50,000, which I borrowed for the business. I don't repay you. I also owe money to several other people. I don't have enough assets to satisfy all my creditors – i.e. I am insolvent. Desperate for cash, I sell my \$100,000 BMW on eBay for \$50,000.

A. Underlying Policies of Reformed Law

1. Interference with creditors' rights of recovery is wrong and warrants redress (*whether or not the interference was intentional*)

2. The law should deter transactions that interfere with creditors' rights of recovery.

(Persons dealing with debtor should be in a position to respond to the risk of a proposed transaction.)

Deterrence may be addressed to the debtor and/or the transferee.

C. Grounds for a Remedy: Definition of the Causes of Action

[20] Creditors will be entitled to a remedy where a transaction falls within one of three causes of action, the elements of which are subsumed in the formulation that follows. This dimension of the legislation was subjected to extensive discussion and refinement by the working group, since it effectuates the core policy and structure of the reformed system of law.

Note: transaction may involve a transfer of property or a transfer of value by other means where the result is to diminish the asset base available to creditors.

C. Grounds for a Remedy: Definition of the Causes of Action

[22] **Cause of action #1**: Defined by paragraphs 1(a) and (b) above (insolvency + conspicuously inadequate consideration/asset depletion)

- Debtor receives no consideration for value given or receives consideration that is worth **conspicuously** less than the value given by debtor.
- Debtor is insolvent at the time of the transaction, becomes insolvent as result of the transaction or enters into the transaction when insolvency is a foreseeable risk, if insolvency in fact ensues within 6 months of the transaction.

C. Grounds for a Remedy: Definition of the Causes of Action

[24] **Cause of action #2**: Defined by paragraphs 2(a), (b) and (c)(i) above (debtor intention to hinder + conspicuously inadequate consideration/asset depletion)

- Debtor enters into transaction with the intention of hindering or defeating a creditor or creditors.
- The transaction in fact materially hinders creditors' ability to recover.
- The transferee gave no consideration for value received or gave consideration worth **conspicuously** less than the value received from Debtor.

C. Grounds for a Remedy: Definition of the Causes of Action

[26] **Cause of action #3**: Defined by paragraphs 2(a), (b) and (c)(ii) above (shared intention or “conspiracy” to hinder)

- Debtor enters into transaction with the intention of hindering or defeating a creditor or creditors.
- The transaction in fact materially hinders creditors’ ability to recover (whether or not any or adequate consideration is received by Debtor).
- The transferee knew of Debtor’s intention and intended to assist in its achievement.

F. Remedies

[72] ...The general principle tentatively proposed to guide the court in the formulation of an appropriate remedy is:

When grounds for relief are established the court shall make such order or orders as may be necessary to satisfy the creditor's claim to the extent

- (a) that the claim could have been satisfied through proceedings against the debtor if the transaction had not occurred, or**
- (b) of the market value of the benefits transferred or conferred under the transaction.**

F. Remedies

In granting relief under [the general principle stated above] the court may make one or a combination of the following orders:

- (a) An order vesting in the debtor, or in another person, property transferred by the debtor under the transaction, or the proceeds of property so transferred.**
- (b) An order declaring that property transferred by the debtor under the transaction or its proceeds is subject to judgment enforcement measures in the hands of the transferee.**

...

F. Remedies

- (c) An order directing that property transferred by the debtor under the transaction or its proceeds be sold and the money realized on the sale distributed to the creditor or other person as the court may direct.**
- (d) An order requiring the transferee to pay a sum equivalent to the value of property or other benefits received under the transaction.**
- (e) An order requiring the transferee to pay a sum in recognition of income earned through the use or exploitation of property, a license, quota, right to use or right to payment received under the transaction.**

...etc.

F. Remedies

The “Qualifying Factors”

Where the transferee has not conspired with the debtor to defeat creditors the court should take into account:

- the consideration paid by the transferee
 - expenditures and non-monetary investments made by the transferee that have increased the value of property transferred. (If the order requires the transferee to account for revenue earned, the court should also take into account investments that have generated that revenue.)
 - obligations incurred by the transferee in reasonable reliance on the finality of the transaction.
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Other issues

Transactions between family members

- Transfers under a separation agreement
- Transfers effected by a court order for property division or maintenance.

Other issues

Transactions that convert non-exempt into exempt property in the debtor's hands

Case 1

Debtor lives in a province in which funds invested in an RRSP are fully exempt. Debtor takes money from a GIC and invests it in an RRSP with Trustco.

Case 2

Debtor designates a family member as beneficiary under a policy of insurance or annuity issued by an insurance company. The policy or annuity is thereby rendered exempt under the Insurance Act.

Other issues

Interface between reformed Act and creditors' relief law

Debtor transfers property to Transferee. Debtor has a number of creditors. Creditor A seeks a remedy under the new Act. The requirements of one of the causes of action are met. If the court orders that the property be restored to Debtor, Creditor A may have it seized under judgment enforcement law. However Creditor A is obliged to share the proceeds of enforcement action with all other qualifying creditors.

Next steps

- Part I: complete report, circulate to CAIRP (Canadian Association of Insolvency and Restructuring Professional) and IIC (Insolvency Institute of Canada), final report to Conference 2010
 - Part II: commence work 2010, report to Conference 2011
 - Drafting: Draft Act completed 2012
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Motion requested

That the working group be directed to:

- a. continue its work based on the Report and discussions at the Conference.
- b. finalize policy recommendations on Part I: Fraudulent Conveyances/Transfers at Undervalue.
- c. report back to the Conference at the 2010 meeting.

Contact me:

Faculty of Law, University of Alberta
780-492-8414
tbuckwold@law.ualberta.ca