

**Uniform Law
Conference of Canada**

UNIFORM
REVIEWABLE TRANSACTIONS ACT

UNIFORM *REVIEWABLE TRANSACTIONS ACT*

TABLE OF CONTENTS

PART I		PART III	
General		Preferential Creditor transactions	
1	Definitions	12	Who may apply for order of relief under this Part
2	Applications for relief to be made to [superior court of jurisdiction]	13	Grounds for relief under this Part - preferential creditor transactions
3	Rights of secured creditors	14	Non-application of Part to spousal transactions
4	Relief where transaction involves property subject to a security interest or <i>[writ, enforcement charge or judgment, depending on the legislation of the enacting jurisdiction]</i>	15	Persons against whom relief may be granted under this Part
5	When applications for orders of relief may be made and claims may be established	PART IV	
PART II		Orders and Remedies	
Transactions at Undervalue and Fraudulent Transactions		16	Nature of order under Part II
6	Who may apply for order of relief under this Part	17	Nature of order under Part III
7	Grounds for relief under this Part - transactions at undervalue or fraudulent transactions	18	Forms of orders
8	Relief in certain cases	19	Security interests created under order for relief
9	Transactions involving corporate payments	20	Application of orders for relief to exempt property
10	Orders for relief respecting creditor transactions	21	Application of Part to subsequent transferees and creditors
11	Persons against whom relief may be granted under this Part	22	Order for relief in relation to corporate payments
		23	Injunctions
		24	Limitation of actions
		PART V	
		Repeals	
		25	Statute of Fraudulent Conveyances repealed
		26	Repeal

UNIFORM REVIEWABLE TRANSACTIONS ACT

Introduction

The *Reviewable Transactions Act* replaces the pre-reform statutory and common law that comprised the related branches of law generally referred to jointly as the law of fraudulent conveyances and fraudulent preferences. Like its precursors, the Act is an adjunct to judgment enforcement law and can only be properly understood with an appreciation of that linkage. In this commentary and in the Act, an individual, corporation or other legal person who is subject to a claim that has been or may be reduced to a money judgment is referred to as a debtor. A person who holds such a claim is a creditor. Variants of “he or she” used in the commentary include non-human as well as human creditors and debtors.

A creditor whose claim is secured by a security interest in the debtor’s property may take direct action against the collateral to recover the debt. Otherwise, a debt or other claim must be established by obtaining a judgment, which may be enforced in the manner allowed by judgment enforcement law if not voluntarily satisfied. Judgment enforcement law provides the means by which unsecured creditors may recover their claims through seizure or other processes against their debtors’ property. The scope and operation of that law varies among jurisdictions but, in principle, it allows for enforcement against any property of the judgment debtor that is not exempt from seizure under provincial or territorial legislation. The reformed systems recently adopted in some provinces are particularly comprehensive and effective. Similar reforms have been proposed in other jurisdictions, generally following the model of the *Uniform Enforcement of Money Judgments Act*.

Unsecured creditors are assured of recovering their claims only to the extent that property of their debtors may be reached through judgment enforcement measures. The law may therefore intervene to protect creditors when a debtor transfers away property or value in another form if the result is to preclude or limit their ability to recover, either by reducing the value of the asset base available through judgment enforcement measures or by creating other obstacles to enforcement. The Act defines the circumstances in which an unsecured creditor is entitled to recover the value lost, and prescribes the type and extent of relief that may be granted.

The Act is organized around a few basic concepts. A transfer of value in any form is a “transaction”. The person who benefits under a transaction is the “transferee.” The rules of standing and conditions of relief are established by Part II in relation to transactions that are not “creditor transactions” and by Part III in relation to “creditor transactions”. Part I applies to proceedings involving a transaction of any kind. Part IV provides for an order for relief against the transferee, who is required to restore the value lost to the applicant claimant.

The title of Part II indicates two general types of transaction that give rise to a right to apply for relief under that Part. The term “transaction at undervalue” refers to a case in which a debtor who is unable to satisfy unsecured creditors’ claims in full transfers property or otherwise gives value to another person for no consideration or for consideration worth conspicuously less than the property or value given. The recipient transferee has received what amounts to a gift at the expense of the debtor’s creditors, who are entitled to relief regardless of whether the transaction was deliberately designed to defeat their rights. The term “fraudulent transaction” refers to a case in which a debtor intentionally sets out to hinder or defeat his or her creditors by means of a dealing with property or the conferral of value on another person. Both terms are used descriptively to signal the general scope of Part II but neither appears in the provisions of the Act.

A “creditor transaction” may give rise to relief under Part III. Part III is designed to buttress the creditor sharing rules of provincial and territorial law. In the common law jurisdictions, these rules have existed for more than a century under what is typically called creditors’ relief legislation. While the relevant rules vary in scope and detail as among jurisdictions, the basic principle is that a judgment creditor who implements enforcement measures is required to share the funds generated by those measures pro rata with other qualifying judgment creditors and, in some instances, with unsecured creditors whose claims are formalized by a certificate or equivalent procedure. The creditor sharing principle is impeded or defeated when a debtor pays one creditor, leaving others unpaid in full or in part and without means to enforce their claims. If the assets of the debtor available under judgment enforcement law are insufficient to satisfy all unsecured creditors, a payment to one or the provision of security for payment is a “preference”, since the recipient creditor is preferred relative to other creditors who cannot recover through resort to the debtor’s property. The law gives unpaid creditors a remedy as against a preferred creditor in order to ensure that the creditor sharing dimension of judgment enforcement law is not eviscerated through voluntary payments made before a creditor invokes judgment enforcement measures. Part III reflects pre-reform law as well as the preference rules of federal bankruptcy law by offering relief to unpaid creditors in a relatively narrow set of circumstances.

The *Reviewable Transactions Act* does not depart radically in policy and function from the pre-reform law designed to protect unsecured creditors. However, it provides a comprehensive set of clear rules designed to overcome the uncertainty produced by more than a hundred years of incremental legislation and judicial decisions addressed to creditor-defeating dealings. The following passages drawn from the reports on which the Act is based are pertinent:

The fundamental question that is obscured by current legislation and its judicial interpretation is the wrong at which the law is or should be directed. Is the wrong the *actual* interference with creditors’ rights, however laudable the debtor’s motives,

or only the *intentional* interference with creditors' rights? The difficulty in distilling the answer to this question from the current body of statutory and case law in large part accounts for the uncertainty and inefficiency endemic to its operation.

[T]he law should be based on the premise that actual interference with creditors' rights of recovery is wrong, except to the extent that countervailing considerations mandate the protection of other legitimate interests. This view does not deny but rather subsumes the proposition that intentional interference with creditors' rights is wrong. Therefore the related policies advanced by our recommendations are the redress of loss occasioned by transactions interfering with creditors' rights of recovery and the deterrence of such transactions so as to forestall the need for redress.

...

While protection of creditors is a primary focus the rules we advance are designed to appropriately shelter those who deal with debtors by ensuring that they are able to assess and respond to the risk of transacting on the terms proposed or at all.

Any law that subjects a transaction to *ex post facto* challenge necessarily interferes with the finality of transactions to some degree but the potential disruption of settled transactions should be subject to sensible limits. The need to accommodate reasonable reliance on the finality of transactions is recognized as a countervailing policy through various features of the legislation we propose operating in combination...

The definition of predictable outcomes not only simplifies the resolution of disputes when they arise, but diminishes the likelihood that disputes will occur. Debtors, and those who deal with them, are less likely to cross the line between legitimate dealing and creditor avoidance if the line is clearly drawn. Part IV of the Act offers a nuanced and flexible remedial system that facilitates the achievement of fairer outcomes as between creditors and transferees who do engage in transactions that impede creditors' rights in a manner that justifies relief.

The Act advances the harmonization of provincial and territorial reviewable transactions law and the corresponding provisions of the federal *Bankruptcy and Insolvency Act* by adopting some of the same concepts and, in relation to preferential payments, providing rules that produce comparable outcomes.

Some of the provisions of the Act are addressed to concepts, legislation or processes that are part of the law of the common law jurisdictions, as is some of the commentary. For the most part, the Act is suitable for adoption in Québec but adaption of the legislation will be required.

PART I General

Definitions

1(1) In this Act,

“claim” means the right to satisfaction of an obligation owed by a debtor, whether the obligation is

- (a) liquidated or unliquidated,**
- (b) absolute or contingent,**
- (c) certain or disputed, or**
- (d) payable immediately or at a future time;**

Comment: The term “claim” is central to the rules that determine standing to apply for relief. A person who holds a claim at the relevant point in time is entitled to apply for relief under section 6 (Part I) or 12 (Part II). The word “obligation” implicitly refers to an obligation enforceable by law through a judgment or order for the payment of money.

A claim must be based on an existing legal obligation, but the obligation need not be immediately enforceable, certain in amount or proven by judgment. An obligation that arises in law from events that have occurred is treated as an obligation owed, even though it may be unliquidated or disputed. For example, a person who has a cause of action against another holds a claim when the actions comprising the cause of action have occurred since the obligation arises from the actions themselves. A typical case is that of a tort victim, who holds an unliquidated claim against the tortfeasor when the tort is committed.

Potential rights against another person that may or may not arise in the future from a judicial order or declaration are not a claim under the Act. A claim may be “contingent” in the sense that performance by the obligor is subject to the fulfillment of a condition, as in the case of a guarantee under which the obligation to pay arises only upon the principal debtor’s default. However, the beneficiary creditor holds legally enforceable rights that constitute a claim against the guarantor when the guarantee is given even though the guarantor’s obligation may be described as contingent until the conditions that require performance occur. A potential future right to enforce an obligation that does not exist in law until it is declared by the court is not a “contingent” claim in this sense. The position of a person who applies

for an order for division of spousal property under provincial or territorial legislation is a case in point. In most jurisdictions, the applicant does not have an interest in the respondent's property and the respondent has no legal obligation to pay money or transfer property until the court makes an order against him or her. In others, legal rights and corresponding obligations arise immediately upon the parties' separation though the court may make an order to determine the means by which those rights are enforced (see *Schreyer v. Schreyer*, 2011 SCC 35). In the first case, a spouse has a potential legal right to payment from the other but the mere status of being a spouse or the fact of having separated does not entail a claim against the other. There is no "right to satisfaction of an obligation" until a court order imposing an obligation is made. A child or spouse who has a potential right to apply for an order for financial support from the estate of his or her deceased parent or spouse under dependants' relief legislation is in a comparable position. (But see s. 6(2) regarding the standing of a person who does not have a claim but has commenced legal proceedings against a debtor.)

"confer" includes to create, grant, provide or transfer;

Comment: The Act applies when a debtor engages in conduct that benefits another person through the conferral of an interest in property or provision of value in another form. The word "confer" denotes whatever legal means of transmission or creation may be involved. For example, a person may "create" a beneficial interest in property through the declaration of a trust, "grant" a security interest or license, "provide" value through the provision of services or forgiveness of a debt, or "transfer" an interest in property. Other forms of the word confer that appear in the Act, such as conferred, confers and conferral, are given corresponding meanings by the *Interpretation Act*.

"creditor" means, subject to section 13, a person who holds a claim;

Comment: The term "creditor" appears in various provisions of the Act but is most significant in connection with the category of transactions defined as creditor transactions. A creditor transaction involves the conferral of a benefit on a person who is a creditor.

"creditor transaction" means a transaction under which a debtor directly or indirectly benefits a creditor by satisfying a claim in whole or in part or by providing security for the satisfaction of a claim in whole or in part but does not include

(a) a transaction under which a debtor

(i) satisfies an obligation that is secured by a security interest in property of the debtor to the extent that the security interest has priority over the rights of unsecured creditors of the debtor,

(ii) confers an interest in property as security for new value advanced by the transferee, or

(iii) gives a security interest in property in substitution for another security interest in property that is of equivalent value and that was given to secure the same obligation, or

(b) a transaction effected

(i) by obtaining or enforcing a court order, or

(ii) by operation of law;

Comment: A creditor transaction is a specific type or subcategory of “transaction”, defined below. An application for relief may be made in relation to a creditor transaction under Part III of the Act but not under Part II, except to the extent that the benefit received by the creditor exceeds the value of the creditor’s claim (see s. 10).

A creditor transaction will ordinarily involve a direct dealing between a debtor and the creditor to whom an obligation is owed. However, a course of action under which a creditor is “indirectly” benefitted by a debtor may also be a creditor transaction. The Act may not be avoided by routing a payment through an intermediate party or otherwise structuring events so that the creditor’s claim is satisfied or secured as a result of a debtor’s dealing with another person. For example, the payment of a secured debt owed to a senior secured creditor may release that creditor’s security interest with the result that the unsecured portion of a debt owed to a junior secured creditor becomes secured. The benefit indirectly received by the junior creditor through enhancement of his or her security originated with the debtor and is a creditor transaction between the debtor and the junior secured creditor (see further comment on s. 1(1) “transaction” clause (k)).

Clause (a) exceptions: A transaction that does not diminish the pool of assets against which creditors may enforce their claims is not objectionable. The exceptions defined by clause (a) ensure that such transactions may not be challenged.

Subclause (a)(i) determines whether a payment to a secured creditor is subject to

challenge under Part III as a “creditor transaction”. In most cases, payment of a secured debt will discharge the security interest held by the secured creditor, making the newly unencumbered value of the debtor’s property available to satisfy unsecured creditors in lieu of the money or property paid. The rights of unsecured creditors are not affected so the payment is not a creditor transaction. This is not true when unsecured creditors have rights of enforcement that have priority over a security interest discharged by payment. A payment to a secured creditor is therefore exempt from challenge only “to the extent that the security interest has priority over the rights of unsecured creditors.”

The question of priority is determined by provincial or territorial judgment enforcement law, supplemented in some jurisdictions by legislation such as the *Personal Property Security Act* or the *Land Titles Act*. Under many statutes, registration of a writ or judgment establishes a priority position for the rights of enforcement associated with the writ or judgment. In other cases, seizure or attachment of property under a writ, judgment or other judgment enforcement device may have priority consequences. The priority status of unsecured creditors relative to secured creditors is determined by (1) whether a step or event that creates a priority status has occurred (*e.g.*, registration of a judgment or seizure of property) and (2) the operation of a priority rule that applies to the enforcement rights associated with the step or event in question relative to the rights associated with a security interest (*e.g.*, the priority consequence produced by registration or seizure). If no step or event has occurred or no statutory rule gives priority to an unsecured creditor on the basis of such a step or event, a security interest will have priority over the rights of unsecured creditors and a payment to a secured creditor is not a “creditor transaction”. If such step or event has occurred and a statutory priority rule gives the rights of enforcement associated with a judgment or writ priority over a secured creditor, a payment to the secured creditor is a creditor transaction.

Example

Debtor grants a security interest in property to Secured Creditor. A writ based on a judgment against Debtor has been registered in accordance with judgment enforcement legislation. The legislation contains a rule that determines priority as between the security interest and the writ on the basis of first to register in the relevant registry. If Secured Creditor registered before the writ was registered, a payment to Secured Creditor is not a “creditor transaction” to the extent of the debt secured and may not be challenged under Part III. If Secured Creditor registered after the writ was registered, a payment to Secured Creditor is a “creditor transaction” that falls within Part III. Unsecured creditors are entitled to satisfaction to the extent of the amount recoverable under the writ before Secured Creditor is paid.

Subclause (a)(ii) recognizes that the conferral of a security interest in exchange for new value does not impinge on the rights of unsecured creditors. While the quality or type of property held by the debtor is altered by the transaction, its total value remains the same. For example, if a debtor borrows \$1,000 and grants a security interest in property to secure its repayment, the property interest conveyed to the lender is matched by the money obtained. Since there is no net loss to the debtor's asset base, a transaction under which a debtor gives a security interest for new value is not a "creditor transaction" subject to challenge under Part III. In contrast, when a debtor gives a security interest to secure antecedent (i.e. pre-existing) debt, the effect is to allocate to the benefitting creditor exclusively property that was available to unsecured creditors collectively; conferral of the security interest is a creditor transaction.

Clause (b) exceptions: Part III of the Act is designed to offer relief when a debtor performs a voluntary action that benefits one creditor, leaving other unsecured creditors unpaid. A creditor who is entitled to recover against a debtor's property under judgment enforcement law, through a right of distress or under another legal process or rule may obtain an advantage relative to other creditors, but the advantage is conferred by the law rather than by the debtor. A transaction effected by obtaining or enforcing a court order or by operation of law is therefore not a "creditor transaction". The creditor sharing principle is not undermined when a creditor recovers a claim through enforcement of a judgment, since judgment enforcement measures engage creditors' relief rules in favour of qualifying unsecured creditors.

"exempt property" means property that is exempt by law from seizure, attachment or any other measure to enforce a money judgment;

"insolvent", with respect to a person, means that

- (a) the person is for any reason unable to meet his or her obligations as they generally become payable,**
- (b) the person has ceased paying his or her obligations in the ordinary course of business as they generally become payable, or**
- (c) the aggregate of the person's property, other than exempt property, is not, at a fair valuation, sufficient to enable payment of all his or her obligations, whether or not those obligations are currently payable;**

Comment: A person whose circumstances fall within any of the three branches of the definition is demonstrably unable or unlikely to pay his or her creditors in full.

Therefore, insolvency is a factor in the grounds for relief defined by sections 7 (Part II) and 13 (Part III). Clauses (a) and (b) of the definition exactly parallel the corresponding clauses of the *Bankruptcy and Insolvency Act (BIA)* definition of the term. Clause (c) provides a balance sheet test of insolvency, which is designed to determine whether the cumulative value of a person's property is sufficient to satisfy all of his or her financial obligations. The test reflects the equivalent clause of the *BIA* definition but differs in two points of detail. First, only property of a debtor that can be reached by creditors under judgment enforcement law is included in calculating the cumulative value of his or her assets for purposes of determining creditors' rights; exempt property is explicitly excluded. Secondly, the Act resolves a debate about the application of the *BIA* balance sheet test. The issue is whether the calculation of obligations is to take into account only obligations that are currently payable, or all obligations to which a person is currently subject regardless of whether they are payable presently or in the future. The second view is adopted here. The following example illustrates the rationale for this approach.

Example

Debtor has unencumbered non-exempt assets worth \$100,000 and owes unsecured debts of \$150,000. However, \$100,000 of the debt is repayable by instalment over a period of years and Debtor is not currently in default in relation to those payments. Debtor gives away property worth \$50,000 or makes a payment of \$50,000 to a non-arm's length creditor. Shortly thereafter, Debtor defaults in paying his or her creditors. The installment debt is accelerated and becomes immediately payable in full.

Under the definition, Debtor was insolvent at the date of the transfer or payment so relief may be available under Part II or Part III, as the case may be. The transferee must restore the \$50,000 benefit obtained from Debtor under an order for relief in favour of unsecured creditors. Creditors could not claim relief if the definition of insolvency took into account only obligations that were currently payable at the date of the transaction, unless they could prove the clause 7(1)(a) or subsection 13(1) requirement that Debtor was "demonstrably at risk of insolvency" at the date of the transaction and did become insolvent within 6 months, which may be difficult or impossible.

The valuation of property under clause (c) is not based on the liquidation value that might be obtained in a sale conducted by an authorized official under judgment enforcement measures. The reference to "fair valuation" calls for a valuation based on what the property would be worth if the debtor were to sell it in the conditions prevailing at the relevant time, taking into account circumstances specific to the debtor's business or position.

“security interest” means an interest in property that secures payment or performance of an obligation and, in sections 3 and 4, includes an interest that is a security interest under [insert section number for PPSA definition relating to leases for a term of more than one year, assignments of accounts and, except in Ontario, commercial consignments] of the *Personal Property Security Act*;

Comment: This definition adopts what is often referred to as the “substance test” incorporated in the definition of “security interest” found in the *Personal Property Security Acts (PPSA)* of the common law jurisdictions. An interest in property given or retained in order to make the property directly available to a creditor for satisfaction of a debt is a “security interest”, regardless of the form of the agreement recognizing the interest in question or the legal terminology applied to it. Interpretive guidance may be drawn from the authorities addressing the *PPSA* definition, keeping in mind that the substance test applies in this Act to interests in land as well as in personal property. A mortgagee under a mortgage of land holds a security interest in the land.

The definition also incorporates the interests listed in the extended definition of “security interest” established by the *PPSA* sections indicated, but only in relation to personal property and only for the purposes of the rules in sections 3 and 4 of this Act. The extended definition encompasses interests in personal property that do not secure payment or performance of an obligation and are therefore sometimes referred to as the “deemed” security interests. They are (1) the interest of a lessor of goods under a “lease for a term of more than one year,” (2) the interest of the assignee of an account and, (3) in jurisdictions other than Ontario, the interest of a consignor of goods under a “commercial consignment”. The *PPSA* definitions for the terms “lease for a term of more than one year”, “account” and (other than in Ontario) “commercial consignment” are implicitly incorporated in the *Reviewable Transactions Act* definition, since they give content to the *PPSA* provisions adopted by reference. *PPSA* case law and commentary may also inform the interpretation of this branch of the *Reviewable Transactions Act* definition.

“separation agreement” means an agreement between a debtor and an individual who is or was the debtor’s spouse that

(a) results from or relates to the breakdown of the parties’ relationship, and

(b) provides for the division of property and financial resources or for support for the individual who is or was the debtor’s spouse or for a member of the debtor’s family;

Comment: The term “separation agreement” is a component of the definition of “spousal transaction”. Both terms refer to dealings between a debtor and a person who falls under the definition of “spouse”.

“spousal transaction” means a transaction in which the parties are or were spouses and that is effected by

(a) a separation agreement, or

(b) a court order for the division of property and financial resources or for support resulting from the breakdown of the parties’ relationship;

Comment: A spousal transaction is a particular type of transaction falling within the broader defined category of “transaction”. A transaction is a spousal transaction only if it is effected by a separation agreement or by a court order resulting from or relating to the breakdown of the parties’ relationship. A transaction between spouses whose relationship remains intact is subject to the rules that apply to transactions generally. Section 14 provides in effect that a spousal transaction that involves the satisfaction of one spouse’s claim against the other may not be challenged under Part III as a “creditor transaction,” even though it would otherwise fall within the scope of that term. However, relief in relation to such a transaction is not precluded. Subsection 10(2) ensures that relief is available in relation to a spousal transaction under Part II, whether or not the transaction involves satisfaction of or the provision of security for a claim by one spouse against another. The circumstances in which creditors may claim relief in relation to a spousal transaction are limited by subsection 8(2).

“spouse” means an individual who

(a) is married to another individual, or

(b) is cohabiting or has cohabited with another individual as spouses in a [*insert term used in provincial or territorial legislation, such as “spousal”, “conjugal” or “marriage-like”*] relationship;

Comment: The definition of “spouse” informs the terms “separation agreement” and “spousal transaction”. Persons in a relationship that gives rise to legally recognized rights and obligations approximating those of married persons under the law of the jurisdiction are regarded as spouses for purposes of the provisions of the Act that apply to spousal transactions.

“transaction” means the conferral of a benefit and includes

(a) the conferral of an interest in existing property or property to be acquired in the future, whether or not the property is exempt property in the hands of the transferor, including a settlement on the transferor as a trustee under a trust,

(b) the provision of services,

(c) the payment of money,

(d) the release of an interest or obligation,

(e) the conferral of a security interest, charge, lien or encumbrance,

(f) the conferral of a licence, quota, right to use or right to payment,

(g) the designation of a beneficiary,

(h) the voluntary purchase or redemption of its shares by a corporation or the voluntary payment of a dividend by a corporation, other than a dividend in the form of its shares,

(i) the refusal by a debtor to act under a power of appointment to confer an interest in property on the debtor,

(j) the disclaimer of an interest in property, whether before or after the interest has vested,

(k) the creation or augmentation of a security interest held by a creditor in property of a debtor as a result of the satisfaction of an obligation owed to another person that is secured by a security interest in the same property if

(i) an unsecured claim of the creditor in that property becomes secured in whole or to a greater extent, or

(ii) a claim of the creditor in that property that was unsecured in part becomes secured in whole or to a greater

extent,

(l) the satisfaction of an obligation owed by a person other the debtor,

(m) the conferral of a benefit by a court order or by operation of law;

(n) the assumption of an obligation to do or to bring about in the future any of the events or actions mentioned in clauses (a) to (m);

Comment: The term “transaction” is of central importance in the Act because it defines the foundational requirement for an application for relief. An application may be made under Part II in relation to a transaction that is not a creditor transaction. A “spousal transaction” is subject to Part II but the grounds for relief are narrower than those that apply to transactions generally. An application may be made under Part III in relation to a “creditor transaction.” Parts I and Part IV apply to all types of transaction, except as otherwise provided.

Under pre-reform law, only a transfer of property by a debtor could be challenged by creditors as a fraudulent conveyance or fraudulent preference. The definition of “transaction” recognizes that many other actions may directly or indirectly allow a person to acquire or retain value that would otherwise have been available to satisfy creditors’ claims. The phrase “conferral of a benefit” encompasses all of the ways in which this may occur. The enumerated list of actions that constitute a transaction is not exhaustive and most clauses are self-explanatory. A few merit comment.

Clause (a): Clause (a) settles the pre-reform debate over whether a transfer of exempt property is subject to challenge. Relief is available under the Act in relation to any transfer of property, whether or not the property is exempt by law from seizure or other enforcement measures to enforce a money judgment. A debtor who elects to dispose of an exempt asset has implicitly decided that it is not required for the purpose attracting the exemption and is therefore treated by the Act as having surrendered the exemption with respect to that item. The policy and legal obstacles to seizure disappear once the item is no longer used in a manner that justifies protection from creditors and, as between creditors and the transferee, creditors have a higher claim. An order for relief in relation to such a transfer therefore does not undermine the policy of exemptions law. The Act also respects the policy of exemptions law when exempt property is acquired by a debtor in exchange for non-exempt property (see comment on s. 7(1)).

Clause (h): Clause (h) makes it clear that the purchase or redemption of its own

shares by a corporation and the payment of a dividend, respectively, constitute a transaction with the recipient shareholder. Subsection 7(2) recognizes that the surrender of purchased or redeemed shares does not add value to the property of the corporation available to satisfy creditors' claims so the corporation is not to be regarded as having received consideration from the shareholder for purposes of determining whether grounds for relief under subsection 7(1) exist.

Clause (k): Clause (k) identifies circumstances that might not otherwise be recognized as a transaction. If a debtor pays a creditor who holds a security interest that has priority over another security interest in the same property, the result may confer a benefit on the subordinate secured creditor through enhancement of that creditor's security. The following examples illustrate the circumstances described by subclauses (i) and (ii) and explain the language used.

Example subclause (k)(i)

Debtor obtains a loan or credit from secured creditors SC1 and SC2 respectively and enters into a security agreement with each of them. Debtor owes \$40,000 to SC1 and \$30,000 to SC2. The security agreements give both SC1 and SC2 a security interest in the same property, which is worth \$40,000. Since SC1's security interest has priority over SC2's, SC2 is effectively unsecured – i.e. SC1 is entitled to the full value of the property to satisfy his or her debt so if Debtor defaults in paying SC2, SC2 can recover nothing through enforcement against the property.

Assume that Debtor pays \$20,000 to SC1. SC1 can claim \$20,000 of the \$40,000 value of the property to satisfy the debt remaining unpaid but now \$20,000 of the value of the property is available to satisfy SC2's claim. The result is that SC2's effectively unsecured claim has become secured in part - i.e. \$20,000 of the \$30,000 debt is recoverable through enforcement against the property. If Debtor paid out the entire amount owed to SC1, SC2's claim would become fully secured because the property is worth more than the \$30,000 debt owed to SC2.

Depending on the conceptual view of SC2's position, the payment results in either "creation" or "augmentation" of a security interest held by SC2 in property of the debtor as a result of satisfaction of the obligation owed to SC1, which was secured by a security interest in the same property. One view is that SC2 did not have a security interest in the asset before the payment but had a legal right under the security agreement to acquire a security interest that would arise if and when the asset ceased to be fully encumbered by SC1's interest. On that view, the transaction involved "creation" of a security interest held by SC2. Alternatively, SC2 may be regarded as holding a security interest in the asset before the payment to SC1, but the

security interest was of no value. Under that theory, the payment to SC1 resulted in “augmentation” of SC2’s security interest to the extent of the asset value that became available to SC2. The wording of the definition accommodates either theoretical approach.

Example subclause (k)(ii)

The facts are the same as in the previous example except that the asset is worth \$50,000. In this scenario, SC1’s \$40,000 debt is fully secured and SC2’s \$30,000 debt is secured to the extent of \$10,000, the remaining value of the property after allocation of \$40,000 to SC1. Assume Debtor pays \$10,000 to SC1. The result is to “augment” SC2’s security interest. In effect, the quantum or value of SC2’s interest has grown from \$10,000 to \$20,000. SC2’s claim was originally secured in part, but it has become secured to a greater extent.

In both of the examples given, the “transaction” described by clause (k) is the conferral of a benefit on SC2 as the transferee, not the payment to SC1. The transaction is a “creditor transaction” because the debtor benefited SC2 by providing security for the satisfaction of SC2’s claim. The creditor transaction with SC2 may be challenged under Part III if the conditions of relief defined by section 13 are established.

The payment made to SC1 is a transaction between Debtor and SC1 but, while it involved satisfaction of SC1’s claim, it is not a “creditor transaction” by virtue of subclause (a)(i) of the definition of that term. An application for relief against SC1 therefore cannot be made under Part III. An order for relief would be available under Part II only in the unlikely event that the conditions of section 7(1)(c) are satisfied. Subsections 7(1)(b) and (c) do not apply when a transferee has given full consideration for the benefit conferred (see comment on ss. 7(1)(b) and (c)).

Clause (l): Clause (l) describes a case in which a debtor pays a debt owed by another person, thereby benefitting that person.

Example

X owes \$10,000 to Y. Debtor pays \$10,000 to Y to discharge the debt owed by X.

For purposes of the Act, the example involves two distinct transactions, one under which Debtor benefits Y by the payment and one under which Debtor benefits X by relieving X of the obligation to pay Y. Clause (l) ensures that the conferral of a benefit on X is recognized as a transaction which may be challenged under Part I or, if it was an indirect means of satisfying a debt owed by Debtor to X, as a “creditor

transaction” under Part III. The transaction between Debtor and Y is not a creditor transaction because the payment was not made to satisfy an obligation owed by Debtor to Y. Grounds for relief under Part II will exist only in the unlikely event that the circumstances fall within clause 7(1)(c). Relief will not be available under clauses 7(1)(a) or (b) because Debtor received full consideration from Y (i.e. Y released his or her rights against X in exchange for Debtor’s payment).

Clause (m): Clause (m) recognizes that creditors’ rights may be threatened when a debtor assumes a present obligation to confer value in the future. An “obligation” is an obligation enforceable by law. An injunctive order may be the appropriate form of relief in such a case.

Clause (n): Clause (n) makes it clear that the conferral of a benefit under a court order or by operation of a rule of law is a transaction. Section 8(3) limits the circumstances in which relief may be granted under Part II in relation to such a transaction. Since a transaction effected by order of the court or by operation of law is excluded from the definition of “creditor transaction”, a creditor who obtains a benefit by those means is not subject to an order for relief under Part III.

“transferee” means a person who benefits under a transaction and includes a creditor who benefits under a creditor transaction.

Comment: When grounds for relief are established, the order for relief is made against the transferee, not the debtor. The objective is to restore value to the creditors to whom it was lost by means of the transaction or, through the issuance of an injunction, to prevent a transferee from receiving value to which creditors are entitled. In most cases, the benefit will be received directly from a debtor. However, a benefit may be conferred indirectly, as in the cases contemplated by clauses (k) and (l). For the purposes of the Act, a person who receives an indirect benefit is the transferee in a transaction with the debtor.

(2) A transaction may be a single event or may comprise a series of closely related events, including the provision of services over time.

Comment: Subsection 1(2) recognizes that the incremental or episodic conferral of a benefit over a period of time may comprise one transaction. The stipulation that a transaction may comprise a series of “closely related events” is designed to differentiate a single transaction spread over time from a succession of discrete events, each of which is a separate transaction. While there is no bright line test, the phrase should be interpreted in light of the objectives of the Act taking into account the consequences of alternative characterizations from the perspective of the transferee, whose liability may be determined by the conclusion reached. The

question of whether multiple events constitute a single transaction or a series of transactions is particularly significant in relation to the limitation of actions rules that run from the date of a transaction (see s. 24). When successive events are not closely related, the limitation period applicable to the first is calculated from the date it occurs, not from the date of the last event.

(3) The date of a transaction is the date on which a benefit is conferred and, if the transaction comprises a series of closely related events, the date when the events are substantially completed.

Comment: The date of a transaction comprised of a series of closely related events is the date when the events are substantially completed, which will ordinarily be the date on which the last event occurs. However, a transaction may be substantially complete even though something inconsequential remains to be done.

(4) For the purposes of this Act,

(a) an individual has knowledge when the relevant information is acquired by the individual under circumstances in which a reasonable person would take cognizance of it;

(b) a partnership has knowledge when the relevant information comes to the attention of one of the general partners or a person having control or management of the partnership business under circumstances in which a reasonable person would take cognizance of it;

(c) a corporation has knowledge when

(i) the relevant information comes to the attention of

(A) a managing director or officer of the corporation under circumstances in which a reasonable person would take cognizance of it, or

(B) a senior employee of the corporation with responsibility for the matter to which the information relates under circumstances in which a reasonable person would take cognizance of it, or

(ii) the relevant information in writing is delivered to the corporation's registered office or attorney for service;

(d) the members of an association have knowledge when the relevant information comes to the attention of

(i) a managing director or officer of the association under circumstances in which a reasonable person would take cognizance of it,

(ii) a senior employee of the association with responsibility for matters to which the information relates under circumstances in which a reasonable person would take cognizance of it, or

(iii) all members under circumstances in which a reasonable person would take cognizance of it; and

(e) a government has knowledge when the relevant information comes to the attention of a senior employee of the government with responsibility for the matter to which the information relates under circumstances in which a reasonable person would take cognizance of it.

Comment: Subsection 1(4) defines the circumstances that constitute knowledge or the state of knowing for purposes of the Act. Interpretive guidance may be drawn from case law and commentary addressing the substantially similar rules that appear in the *Personal Property Security Acts* of the common law jurisdictions and, in some jurisdictions, the reformed judgment enforcement legislation. A person who subjectively knows something clearly has knowledge. Under the “constructive knowledge” rules incorporated in these provisions, a person who has information about the fact in question is deemed to know it if the circumstances are such that a reasonable person would have taken cognizance of the information. A person who actively avoids information that would give rise to actual or constructive knowledge should not be permitted to circumvent legal consequences on the grounds that the information avoided is lacking; wilful blindness is not a defence.

Applications for relief to be made to [superior court of jurisdiction]

2 All applications for an order for relief under this Act must be made to [superior court of jurisdiction].

Rights of secured creditors

3(1) A creditor whose claim is secured by a security interest in property of the debtor may apply for an order for relief under this Act but only with respect to the amount of the claim, if any, that exceeds the value of the property against

which the security interest may be enforced.

Comment: The Act is designed to provide a remedy to unsecured creditors whose ability to enforce their claims against their debtor's property under the judgment enforcement system is defeated or impeded by the alienation of value that would otherwise have enhanced the pool of assets available to them. The transferee is obliged to restore the value lost. A creditor who holds a security interest in the debtor's property may enforce that interest through sale or collection of the subject property or by means of foreclosure. Secured creditors are therefore not entitled to relief under the Act to the extent of the value of the property against which the security interest may be enforced. However, any amount of the debt that exceeds that value is effectively unsecured and may be recovered only through the judgment enforcement system. While a secured creditor may not apply for relief in relation to the secured portion of the debt, he or she is treated as an unsecured creditor for purposes of the Act to the extent of any unsecured amount.

The word "enforced" as it is used in subsection 3(1) refers to the creditor's ability to recover the debt in relation to which the security interest is given through realization against property subject to that interest. The typical case in which a claim "exceeds the value of the property against which the security interest may be enforced" is one in which the debt owed is greater than the value of the asset or pool of assets subject to the security interest. If the debt is \$50,000 and the collateral is worth \$40,000, the secured creditor is in the same position as an unsecured creditor who is owed \$10,000. Subsection 3(1) also applies to the less obvious case of a subordinate secured creditor, who is entitled to relief under the Act to the extent that his or her ability to enforce the security interest is precluded by the rights of the secured creditor whose interest has priority. The following example illustrates this feature of the rule.

Example

Debtor owes \$30,000 to Secured Creditor 1 (SC1) and \$20,000 to Secured Creditor 2 (SC2). Both secured creditors hold a security interest in an asset worth \$40,000. The security interest held by SC1 has priority over that held by SC2. Although the debt owed to SC2 is less than the value of the collateral, SC2's ability to enforce his or her security interest is limited by the rights of SC1. Only \$10,000 of the \$40,000 collateral value is available to SC2, who is effectively unsecured to the extent of \$10,000. SC2 is entitled to relief under the Act to the extent of the unsecured debt.

(2) If a debtor transfers property that is subject to a security interest and another Act provides that the security interest is subordinated to the interest of the transferee or that the transferee takes the property free of the security

interest,

(a) the property is not to be considered property against which the security interest may be enforced for the purposes of subsection (1) in proceedings relating to that transfer or to another transaction; and

(b) if an order for relief is made under this Act in relation to the property transferred, whether in proceedings by the creditor or by another person, the creditor may not assert a claim to the property on the basis of the security interest.

Comment: A secured creditor is able to rely on his or her security interest to recover the secured debt only so long as that interest survives and is enforceable against the collateral. When a debtor transfers property subject to a security interest to another person, a priority rule provided by the *Personal Property Security Act*, the *Land Titles Act* or other legislation may either eliminate the security interest or subordinate it to the interest of the transferee. For example, some *PPSA* rules provide that a transferee of personal property “takes free of” a security interest in the property under prescribed circumstances. Some provide that the security interest is “subordinate to” the interest of the transferee. Other statutes may contain priority rules that produce one result or the other without using that language. In all such cases, the security interest can no longer be enforced against the property in the hands of the transferee. Clause 3(2)(a) makes it clear that if a debtor transfers property in circumstances that fall within a priority rule of this kind, the property transferred is not to be taken into account in determining whether the secured creditor is entitled to relief under the Act. The creditor is in the same position as an unsecured creditor to the extent that his or her claim has become effectively unsecured as a result of the operation of the priority rule.

Example 1

Secured Creditor holds a security interest in a car owned by Debtor to secure recovery of a \$20,000 debt. Secured Creditor has not taken the steps required to “perfect” the security interest under the *PPSA*. Debtor sells the car to Transferee. A *PPSA* priority rule provides that the security interest is subordinate to the interest of Transferee, so it can no longer be enforced against the car. Since the car is not to be considered property against which the security interest may be enforced for the purposes of subsection 3(1), Secured Creditor may claim relief under the Act as the holder of an unsecured \$20,000 claim.

Example 2

The facts are the same as in Example 1, but Secured Creditor also has a

security interest in a truck owned by Debtor to secure recovery of the \$20,000 debt. The truck is worth more than \$20,000. Although the value of the car has been lost to Secured Creditor as a result of the priority rule triggered by the sale to Transferee, Secured Creditor is not entitled to claim relief under section 3(1) because his or her claim does not exceed the value of the property against which the security interest may be enforced, namely, the truck.

Clause 3(2)(a) applies if proceedings are taken to challenge the transaction under which property subject to the security interest in question is transferred away by the debtor. However, it is more likely to be relevant in proceedings taken in relation to another transaction entered into by the debtor. To use the facts of Example 1, Secured Creditor has become effectively unsecured by sale of the car and is treated as an unsecured creditor for purposes of the right to relief under the Act. If Debtor gives another asset to Transferee or to another person in a separate transaction, Secured Creditor is entitled to apply for relief under the Act in relation to that transaction. Secured Creditor is treated as an unsecured creditor for purposes of the proceedings.

Clause 3(2)(b) forestalls any argument that a secured creditor whose security interest is eliminated or subordinated due to the operation of a priority rule is restored to his or her original position if an order is granted under Part IV revesting the property transferred in the debtor. A secured creditor cannot assert the rights of an unsecured creditor in proceedings to challenge a transfer of property and then reclaim the status of secured creditor when the proceedings succeed, thereby reversing the operation of the priority rule.

Example 3

Secured Creditor holds a security interest in an asset owned by Debtor. Debtor transfers the asset to Transferee under circumstances that trigger a priority rule that allows Transferee to acquire it free of the security interest. Secured Creditor or another creditor seeks an order for relief in relation to the transaction and the court grants an order revesting the asset in Debtor so it can be reached by the applicant under judgment enforcement measures. Secured Creditor cannot claim that his or her security interest reattaches and can be enforced against the asset when it reverts in Debtor. Secured Creditor has the rights of an unsecured creditor, which may entail a right or an obligation to share with other unsecured creditors under creditors' relief law.

There will be very few cases in which a transfer of property that triggers a priority rule in favour of the transferee involves circumstances that constitute grounds for relief under this Act. Section 3(2)(b) clarifies the outcome in that rare case.

The extended definition of “security interest” applies to Section 3 (see s. 1(1) “security” interest and comment). If the property in the examples above were goods held by the debtor under a lease for a term of more than one year within the meaning of the *PPSA*, the lessor would be in the position of Secured Creditor with respect to his or her “deemed” security interest in the goods.

Relief where transaction involves property subject to a security interest or [writ, enforcement charge or judgment, depending on the legislation of the enacting jurisdiction]

4(1) An application for an order for relief may be made in relation to a transaction that involves property that is subject to a security interest or a [writ, enforcement charge or judgment, depending on the legislation of the enacting jurisdiction] even if under another Act

(a) the security interest or the [writ, enforcement charge or judgment] is subordinated to the interest of the transferee; or

(b) the transferee takes the property free of the security interest or [writ, enforcement charge or judgment].

Comment: Section 4 differs in scope from section 3, though some circumstances will invoke both. Section 3 defines the rights of secured creditors in relation to transactions entered into by their debtors, regardless of whether the proceedings relate to a transaction that involves the property subject to the security interest. A secured creditor has the rights of an unsecured creditor to the extent that the debt cannot be recovered through enforcement of the security interest (see comment on s. 3). Section 4 applies to transactions that involve a transfer of property that is subject to a security interest or to the rights of judgment creditors established through the means offered by the judgment enforcement law of the jurisdiction. Section 4 determines the availability of relief when such a transaction is challenged by any creditor. A “security interest” within the meaning of this section includes a “deemed” security interest encompassed by the extended definition of the term (see s. 1(1) “security interest” and comment).

The rights of secured creditors differ conceptually and functionally from those of judgment creditors, but they are comparable in that both entail a right to satisfaction of a debt through enforcement against or appropriation of the debtor’s property in the manner permitted by law. In both instances, the rights of enforcement have a priority status relative to competing interests in or claims to the property. The determination of priority in relation to the rights of judgment creditors depends upon the type of enforcement mechanism used in a given jurisdiction and the steps that

must be taken to establish a status that has priority implications. In some jurisdictions, judgments may be enforced through a writ of execution, a writ of enforcement, garnishee summons or similar device while in others a judgment is enforceable without an interstitial formality or process if prescribed steps are taken. The term “enforcement device” is used here generically to include all such approaches.

When a debtor transfers away property that is subject to a security interest, the transferee ordinarily acquires the property subject to that interest. However, a security interest may be eliminated or subordinated to the rights of the transferee under a statutory priority rule found in the *Personal Property Security Act* or *Land Titles Act* of a common law jurisdiction (see comment on section 3) or in other legislation. Similarly, priority rules exist under judgment enforcement legislation in relation to whatever enforcement device is used to establish the priority of judgment enforcement rights. Under many systems, the priority of the enforcement device depends on registration of a judgment or writ in a public registry. In some cases, priority is based on seizure or attachment of the debtor’s property. Those who acquire an interest in a property that is subject to a judgment enforcement device generally take subject to the rights of judgment creditors but, as with security interests, exceptions may be created by a priority rule. In jurisdictions that have reformed their judgment enforcement legislation, the priority rules that apply to a judgment enforcement device affecting personal property roughly parallel those that apply to a security interest in the same type of property. A transferee of property from the judgment debtor may acquire it free of the rights of judgment creditors associated with the enforcement device, or those rights may be subordinated to the interest of the transferee. The fact that a transferee takes free of a security interest or enforcement device or has priority under a statutory rule does not preclude an order for relief. This approach is justified by the fact that priority rules serve a limited purpose within the confines of the statute in which they are located and do not override rights offered by other statutes or rules of law. In practice, a transaction that invokes a priority rule in favour of the transferee will rarely involve circumstances that constitute grounds for relief under the Act.

(2) If a transaction involves property that is subject to a security interest at the date of the transaction, an order for relief may be made only if the transaction reduces the amount or value of property that would have been available to unsecured creditors under judgment enforcement measures if the transaction had not occurred.

Comment: The Act is designed to provide relief to unsecured creditors when property against which they might have enforced their claims is lost through a transaction entered into by their debtors. Unsecured creditors are not affected if a

transaction involves property that is subject to a security interest that has priority over any rights they might be entitled to assert against that property under a judgment enforcement device. The effect of subsection 4(2) is to limit or preclude an order for relief if the transaction does not reduce the amount or value of property that would have been available under judgment enforcement measures. If a security interest that has priority over the rights of unsecured creditors secures a debt in an amount less than the value of the property transferred, unsecured creditors are entitled to relief to the extent of the surplus value lost to them as a result of the transaction. Conversely, if a judgment enforcement device has priority over a security interest to the extent of an amount less than the value of the property, relief is available to the extent of that amount but not for the full value of the property. Only the amount that could have been recovered by judgment creditors if the transaction had not occurred is recoverable under the Act.

The following examples illustrate the operation of subsection 4(2).

Example 1: security interest has priority

Debtor owns an asset that is subject to a security interest held by Secured Creditor. A judgment enforcement device (*e.g.*, a writ or judgment) has been registered against Debtor or against the asset, as the case may be. The security interest has priority over the judgment enforcement device under judgment enforcement legislation or another applicable statute (*e.g.*, because it was registered first). Debtor transfers the asset to Transferee in circumstances that constitute grounds for relief under the Act.

Variation A

The asset is worth \$30,000 and Secured Creditor is owed \$35,000. Unsecured creditors could not have recovered their claims through seizure of the asset under a judgment enforcement measure if it had not been transferred to Transferee because the full value of the asset is encumbered by the security interest. An order for relief may not be made under the Act because unsecured creditors' rights of recovery are not affected by the transaction.

Variation B

The asset is worth \$30,000 and Secured Creditor is owed \$10,000. Unsecured creditors could have recovered their claims through seizure of the asset under judgment enforcement measures to the extent of \$20,000 if it had not been transferred to Transferee. Since recovery is limited but not precluded by the security interest, relief is available against the transferee to the extent of the \$20,000 value lost as a result of the transaction.

Example 2: security interest is subordinate

Debtor owns an asset that is subject to a security interest held by Secured Creditor. A judgment enforcement device (*e.g.* a writ or judgment) has been registered against Debtor or against the asset, as the case may be. The security interest is subordinate to the judgment enforcement device under judgment enforcement legislation or another applicable statute (*e.g.* because the judgment enforcement device was registered first). Debtor transfers the asset to Transferee in circumstances that constitute grounds for relief under the Act.

Variation A

The asset is worth \$30,000 and the judgment enforcement device is based on a judgment in the amount of \$35,000. Unsecured creditors could have recovered their claims through seizure of the asset under a judgment enforcement measure in spite of the security interest if it had not been transferred to Transferee. An order for relief may be made under the Act because alienation of the asset reduces the amount or value of property that would have been available under judgment enforcement measures if the transaction had not occurred.

Variation B

The asset is worth \$30,000 and the judgment enforcement device is based on a judgment in the amount of \$10,000. Unsecured creditors could have recovered their claims through seizure of the asset under judgment enforcement measures to the extent of \$10,000 if it had not been transferred to Transferee. If the amount owed to Secured Creditor is more than the remaining \$20,000 value of the asset, unsecured creditors are not entitled to recover against that value even if additional but subordinate judgment enforcement devices exist in relation to other judgments. An order for relief may be made under the Act to the extent of the \$10,000 value that would have been available under judgment enforcement measures if the transaction had not occurred.

(3) In determining under subsection (2) whether or not property would have been available to unsecured creditors under judgment enforcement measures if the transaction had not occurred,

(a) no regard is to be had to whether or not the property is or was exempt property; and

(b) if the security interest is subordinated to the interest of the transferee or the transferee takes free of the security interest, the security interest is to be considered unenforceable against unsecured creditors.

Comment: Subsection 4(3) responds to two factors that may affect the operation of section 4(2). Clause 4(3)(a) deals with a transfer of exempt property. Since exempt property cannot be reached under judgment enforcement measures while it remains in the hands of the debtor, a transfer of exempt property does not “reduce the amount or value of property that would have been available to unsecured creditors under judgment enforcement measures if the transfer had not occurred.” However, the Act adopts the general policy that a transfer of exempt property is not immune from challenge (see comment on subsection 1(1) “transaction”). The debtor is treated as having surrendered the exemption. If relief is available in relation to a transfer of exempt property that is not subject to a security interest it should similarly be available in relation to a transfer of property that is. Clause 4(3)(a) achieves that result. If a transaction involves a transfer of exempt property, the property is to be treated as if it were not exempt for purposes of the rule in subsection 4(2).

Clause 4(3)(b) deals with a transfer of property that is subject to a security interest that is eliminated or subordinated to the transferee under a priority rule contained in legislation such as the *Personal Property Security Act* of a common law jurisdiction (see comment on s. 3). Subsection 3(2) recognizes that the holder of the security interest has become effectively unsecured and allows him or her to challenge that transaction or another transaction entered into by the debtor on the same basis as any unsecured claimant. Clause 4(3)(b) qualifies the operation of subsection 4(2) in such a case. The property transferred is to be treated as if the security interest were unenforceable against unsecured creditors before the transfer occurred, making it available under judgment enforcement measures for the purposes of subsection 4(2).

The combined effect of subsections 4(3)(b) and 3(3) may be demonstrated by reference to Example 1 in the comment on subsection 4(2). If Transferee takes free of Secured Creditor’s security interest, Secured Creditor is treated as the holder of an unsecured claim for purposes of the right to relief under the Act. There will be few cases in which a transaction that attracts the operation of a priority rule in favour of the transferee involves circumstances constituting grounds for relief. However if grounds are established, the formerly secured party or any other unsecured claimant may seek an order for relief even though the property would not have been available to unsecured creditors under judgment enforcement measures if the transaction had not occurred due to the pre-transfer status of the security interest. The security interest is treated as if it were unenforceable against unsecured creditors for the purposes of determining the availability of relief under the Act.

When applications for orders of relief may be made and claims may be established

5(1) An application for an order for relief under this Act may be made whether or not the person who applies for relief has commenced proceedings or obtained a judgment against the debtor in relation to a claim.

(2) A person who applies for an order for relief under this Act is entitled to a benefit under an order for relief only if a judgment has been granted against the debtor on the person's claim.

(3) If a person does not have a judgment against the debtor in relation to a claim,

(a) the person may make the debtor a defendant in the proceedings and the court may

(i) grant judgment against the debtor for the amount of the claim that is proven in the proceedings or that is not contested by the debtor, or

(ii) direct a separate trial to determine the validity and amount of the claim; and

(b) the court may

(i) stay the proceedings or suspend the operation of an order for relief until a judgment is obtained either as part of the proceedings related to the application for relief or in another action, and

(ii) make any supplementary orders that the court considers appropriate.

Comment: A person has standing to apply for relief under the Act if he or she holds a claim against the debtor who engaged in the transaction that is the subject of the application (see ss. 6 in Part II and 12 in Part III). Subsection 5(1) makes it clear that a person who has standing may commence proceedings under the Act regardless of whether judgment has issued on his or her claim. However, subsection 5(2) requires an applicant to prove his or her claim by obtaining judgment against the debtor before he or she can benefit under an order for relief against the transferee.

Subsection 5(3) enables the court to manage the proceedings in whatever fashion may be appropriate to ensure that a claim against the debtor is established while

protecting the applicant's potential right to relief under the Act until it is. A stay of proceedings is likely to be granted if the material before the court indicates that the applicant's claim is doubtful. The transferee should not be forced to defend an application for relief in those circumstances. If an order for relief is suspended or a stay of proceedings granted, the court may make such orders as may be required to preserve the property required to satisfy the existing or potential order for relief. Section 23 provides for the issuance of an injunction.

Some or all of the rules provided in subsection 5(3) may be omitted from the Act if the law of the enacting jurisdiction empowers the court to make orders and issue directions of the kind contemplated.

PART II

Transactions at Undervalue and Fraudulent Transactions

Introductory comment: The function of Part II is described in summary fashion in the introduction to the Act. It offers relief if a transaction prevents unsecured creditors from recovering their claims through enforcement against property of the debtor that would otherwise have been available to them, or if a transaction materially hinders their recovery. Section 6 identifies the persons who have standing to apply for relief and section 11 identifies those against whom relief may be granted. Sections 7, 8 and 9 define the circumstances in which relief is available. Section 10 deals with the relationship between Parts II and III. The terms of the order for relief are determined by Part IV. The provisions of Part I also apply to an application under Part II.

Who may apply for order of relief under this Part

6(1) An application for an order for relief under this Part may be made by

(a) a person who holds a claim that existed at the date of the transaction that is the subject of the application for relief; and

(b) in the case of relief claimed on the grounds of relief mentioned in clause 7(1)(b) or (c), a person who holds a claim that arose after the date of the transaction that is the subject of the application for relief.

(2) For the purposes of permitting an application for relief to be made under this section

(a) a person who has commenced legal proceedings seeking an interest in the property of a debtor or an order for the payment of money against a

debtor is to be regarded as a person who holds a claim; and

(b) a person who is a defendant in the legal proceedings mentioned in clause (a) is to be regarded as a debtor whether or not a judgment has been granted against that person at the time the application is made.

Comment: Section 6 provides the rules that determine whether a person has standing to apply for relief in relation to a transaction that involves circumstances constituting grounds for relief under Part II. The date of a transaction is determined in accordance with subsection 1(3). Clause 6(1)(b) recognizes that relief should be available in some circumstances to a person who did not hold a claim at the date of a transaction but whose claim could be anticipated. A person who acquires a claim after a transaction has occurred may apply for relief only on the grounds specified in clauses 7(1)(b) or (c). Proceedings by a person whose claim arises more than 1 year after the date of a transaction will be barred by the limitation of actions rules in section 24.

A person has a “claim” as defined in the Act only if he or she is entitled to satisfaction of an obligation owed by a debtor. Subsection 6(2) is addressed to a case in which a person may take legal action against another but any obligation owed by the defendant will arise only if an order is made against him or her by the court (see comment on subsection 1(1) “claim”). Without special provision, the person who commences the action would not have standing to challenge a transfer of property or other transaction by the defendant if the transaction occurs before judgment issues in the underlying litigation. Subsection 6(2) allows a person who has commenced legal proceedings seeking an interest in property or a money judgment to seek relief under clause 6(1)(a) in relation to a transaction that occurs after those proceedings are commenced. If the litigation is launched after a transaction occurs, the plaintiff has standing under the terms of clause 6(1)(b). Clause 6(2)(b) deems the defendant in the proceedings described in clause (a) to be a debtor even though an order giving rise to an obligation to the applicant has not been made.

A person who has standing under section 6 may be prevented by other provisions from obtaining relief. Section 3 precludes an order for relief in favour of a creditor whose claim is fully secured. Subsection 4(2) may bar or limit an order for relief in favour of any claimant if a transaction involves a transfer of property that is subject to a security interest. Section 5 prevents a person who has standing from benefiting under an order for relief against a transferee without proving his or her claim against the debtor through procurement of a judgment.

Grounds for relief under this Part - transactions at undervalue or fraudulent transactions

7(1) Except as otherwise provided, an order for relief may be made under this Part

(a) in relation to a transaction in which the debtor receives no consideration or consideration worth conspicuously less than the value conferred by the debtor under the transaction, if the debtor

(i) is insolvent at the time of the transaction,

(ii) becomes insolvent as a result of the transaction, or

(iii) enters into the transaction in circumstances in which the debtor is demonstrably at risk of insolvency and the debtor becomes insolvent within 6 months after the date of the transaction;

(b) in relation to a transaction in which the debtor's primary intention is to hinder or defeat the right of a creditor or creditors to recover in whole or in part claims that, at the time of the transaction, were existing or were reasonably foreseeable, if

(i) the ability of the creditor or creditors to recover their claims is materially hindered as a result of the transaction, and

(ii) the debtor receives no consideration or consideration worth conspicuously less than the value conferred by the debtor under the transaction; or

(c) in relation to a transaction in which the debtor's primary intention is to hinder or defeat the right of a creditor or creditors to recover in whole or in part claims that, at the time of the transaction, were existing or were reasonably foreseeable, if

(i) the ability of the creditor or creditors to recover their claims is materially hindered as a result of the transaction, and

(ii) the transferee knew of the debtor's intention and intended to assist the debtor by entering into the transaction.

Comment: Clauses (a), (b) and (c) of subsection 7(1) define three sets of conditions that constitute grounds for relief under Part II against a transferee who has benefitted

under a transaction with a debtor. Any of the three is generally available to a person who holds a claim at the date of the transaction, including a person described in clause 6(2)(a). An applicant whose claim arises after a transaction occurs is prevented by clause 6(1)(b) from claiming relief under clause 7(1)(a). Only a transferee who benefits under a transaction that was intended to hinder or defeat the rights of a creditor within the meaning of clauses (b) or (c) is liable to a post-transaction claimant. The availability of relief is also restricted in relation to certain types of transaction by section 8. Section 10 provides that relief is available in relation to a creditor transaction only under Part III, except to the extent provided. Section 9 provides grounds for relief that are uniquely available in relation to transactions involving payments by corporations that do not fall within section 7.

A person who seeks relief under any of the causes of action defined by subsection 7(1) must establish that a debtor participated in a “transaction” which, by definition, involves the conferral of a benefit on a transferee. The term “debtor” is not defined, but clearly refers to a person who owes an obligation to the applicant under a claim or, where an applicant has standing to commence proceedings on the basis of subsection 6(2) before an obligation has arisen, to the person who potentially owes an obligation to the applicant in the underlying litigation.

Clause 7(1)(a) defines conditions under which the ability of unsecured creditors to recover their claims is inherently defeated or impeded by a transaction. A person who is insolvent is by definition unable to or has ceased to satisfy creditors’ claims (see s. 1(1) “insolvent”). Since a transaction directly or indirectly diminishes the asset base against which creditors may enforce their claims, a transaction under which an insolvent debtor receives no compensating value or value worth less than the value conferred on the transferee will adversely affect creditors. The same result follows if the debtor is rendered insolvent by the transaction or becomes insolvent shortly thereafter while creditors remain unsatisfied.

The grounds for relief prescribed by both clauses 7(1)(a) and (b) refer to the amount of “consideration” received by the debtor. This usage should not be read too narrowly. It does not assume that the transaction in question involves a contractual relationship or voluntary exchange between the debtor and the transferee, but refers more generally to receipt by the debtor of something that constitutes value in law. For example, if a debtor pays a debt secured by a security interest in his or her property, the release of the security interest constitutes consideration received by the debtor in the relevant sense. The value of the consideration in such a case is commensurate with the benefit conferred on the transferee creditor through payment. Although the transaction involves satisfaction of a claim, it is by definition not a creditor transaction (see s. 1(1) “creditor transaction” clause (b)) so it cannot be challenged under Part III. While the transaction may be the subject of an application

under Part II, relief could not be granted under clauses 7(1)(a) or (b) because the lack-of-consideration requirement is not satisfied.

The requirement that the debtor received no consideration or consideration “conspicuously less than” the value conferred on the transferee means relief is available only if the transferee is in a position to recognize that he or she is dealing with the debtor on such unreasonable terms that the transaction may have adverse ramifications. The concept is not unique. Under the reviewable transaction rules of the federal *Bankruptcy and Insolvency Act*, a transfer at undervalue “means a disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is *conspicuously less than* the fair market value of the consideration given by the debtor (emphasis added).” Authorities that address the meaning of the *BIA* definition may be relevant to the corresponding terms of this Act.

Clauses 7(1)(b) and (c) require proof that the debtor’s primary intention in relation to the transaction was to hinder or defeat the right of a creditor or creditors to recover an existing claim, or a claim that was reasonably foreseeable at that time. If the debtor is insolvent or verging on insolvency, that fact may be evidence of an intention to avoid creditors’ claims (see s. 7(3)(a)). However insolvency is not a condition of relief under these clauses; an order may be granted against a person who has accepted a benefit from a perfectly solvent debtor if the debtor’s intention is in fact realized as provided by subclause (b)(i) or (c)(ii), as the case may be.

The phrase “primary intention” recognizes that a transaction may be intended both to defeat creditors and to achieve some other purpose, such as to assist a friend or family member or to realize a tax advantage. The question of whether the “primary” intention was to defeat or hinder creditors should be approached objectively, taking into account the actual effect of the transaction and factual indicia of intention, including those listed in subsection 7(3). If the debtor entered into a transaction that would obviously defeat creditors’ claims, the attainment of that outcome may be regarded as the debtor’s primary intention in spite of the presence of other motives. However, there are cases in which an intended result other than to defeat creditors should be recognized, even though a transaction may have that effect. This is particularly so in relation to a transaction between spouses or former spouses prompted by the collapse of the spousal relationship and effectuated by a genuine separation agreement or a court order (see comment on s. 8(2)).

Relief is available under clauses 7(1)(b) or (c) only if creditors’ ability to recover their claims against the debtor was materially hindered as a result of the transaction. This requirement will rarely be met if the debtor is solvent, since a solvent debtor ordinarily has exigible assets that are worth enough to satisfy creditors’ claims (see

s. 1(1) “insolvent” clause (c)). Nevertheless, creditors may be materially hindered in the relevant sense if a transaction converts assets that can be reached under judgment enforcement measures into assets that are removed from the jurisdiction or against which enforcement is otherwise prohibitively difficult. The question is whether the result of the transaction was to make it significantly difficult if not entirely impossible for creditors to enforce their claims.

The grounds for relief defined by clause 7(1)(c) will rarely be established, since the applicant must prove both that the debtor intended to hinder or defeat creditors and that the transferee knew of and intended to assist in achieving that objective. Again, the intention of both parties must be determined objectively. Subsection 7(3) provides a non-exhaustive list of factors that may be relevant. If the intention requirements are met and the transaction in fact materially hinders the ability of creditors to recover their claims, an order for relief may be made regardless of whether the transferee gave full consideration for the benefit received under the transaction.

The Act does not allow a transaction to be challenged simply because it results in the exchange of non-exempt for exempt assets. Such a transaction will ordinarily not fall within clauses 7(1)(a) or (b) because the exempt asset acquired will constitute full consideration received by the debtor in exchange for the property transferred to the transferee. For example, the investment of exigible funds in an exempt RRSP involves an exchange of equivalent value between the investing debtor and the financial institution holding the investment; the obligations owed to the debtor by the institution after the funds are received are worth roughly the amount invested. Relief may be available under clause 7(1)(c) in relation to the acquisition of exempt property if the transferee participated in the exchange with the intention of assisting the debtor’s intention to defeat creditors. The fact that the transferee gave full consideration is not an obstacle to relief if the requisite intention is proven.

(2) For the purposes of subsection (1), if the transaction involves a corporation repurchasing or redeeming shares issued by the corporation, neither receipt of the shares by the corporation nor their surrender by the holder is to be regarded as consideration received by the corporation under the transaction.

Comment: Subsection 7(2) deals with the special case of a transaction under which a corporation pays a shareholder to repurchase or redeems its own shares (see s. 1(1) “transaction” clause (h)). The return or surrender of the shares adds nothing to the asset base of the corporation and should not be regarded as consideration for the payment received by the shareholder transferee. An order for relief is available against a benefitted shareholder if the circumstances fall within any of the grounds of relief established by subsection 7(1). Section 9 provides for a supplementary order

for relief against a director of the corporation. Subsections 9(5) and 9(7) are designed to ensure that a shareholder is not liable to disgorge a payment received from the corporation both under this Act and corporations legislation (see comment on s. 9).

(3) The court may consider the following factors, among others, in determining the intention of the debtor or the transferee:

(a) in the case of the debtor, whether the debtor was insolvent at the date of the transaction or became insolvent as a result of the transaction;

(b) in the case of the transferee, whether the transferee knew that the debtor was insolvent at the date of the transaction or would likely become insolvent as a result of the transaction;

(c) whether the transaction occurred at a time when the debtor or the transferee, as the case may be, knew of the existence of a claim against the debtor or had reasonable grounds to anticipate that a claim would arise in the foreseeable future;

(d) if the transaction was effected by a court order,

(i) in the case of the debtor, whether the debtor failed to disclose to the court in the proceedings under which that court order was made

(A) an existing or reasonably foreseeable claim that may be prejudiced by the order, or

(B) the extent of an existing or reasonably foreseeable claim, or

(ii) in the case of the transferee, whether the transferee failed to disclose to the court in the proceedings under which that court order was made

(A) an existing or reasonably foreseeable claim that may be prejudiced by the order and that was known to the transferee, or

(B) the extent of an existing or reasonably foreseeable claim;

- (e) whether the value of the consideration received by the debtor was less than the value of the benefit conferred on the transferee;**
- (f) whether the parties to the transaction were related or closely affiliated;**
- (g) whether the debtor retained the possession, use or benefit of property or value transferred under the transaction;**
- (h) whether the transaction was entered into in haste;**
- (i) whether the debtor or the transferee attempted to keep the transaction or circumstances material to the availability of relief under this Act hidden from creditors or others;**
- (j) whether the transaction was not documented in the manner that would ordinarily be expected in relation to a transaction of that kind.**

Comment: Subsection 7(3) lists factors that may be taken into account by the court in determining whether a debtor or transferee entered into a transaction with the intention indicated in clause 7(1)(b) or (c). Many of the factors listed reflect the “badges of fraud” often referred to in pre-reform cases as evidence that a debtor intended to hinder, defeat, delay or prejudice creditors. The existence of one or more of the circumstances identified does not raise a presumption of intention but rather weighs in the balance of evidence before the court. However, evidence of a listed factor may be accepted by the court as proof of the intention required if no credible countervailing evidence is presented. Clause 7(3)(d) may be of particular significance in relation to a spousal transaction effected by a court order, which may only be challenged under clause 7(1)(c) (see comment on s. 8(1)).

Relief in certain cases

8(1) In this section, “contingent obligation” means an obligation to pay money, transfer property or otherwise give value, the performance of which is contingent on an event that may or may not occur, and includes an obligation under a guarantee or an agreement to indemnify against loss occasioned by the default or non-performance of another person.

(2) An order for relief may be made in relation to the following transactions only if the grounds for relief mentioned in clause 7(1)(c) are established:

(a) a spousal transaction;

(b) a transaction involving the refusal by a debtor to act under a power of appointment to confer an interest in property on the debtor or the disclaimer of an interest in property before the interest has vested; or

(c) a transaction involving the assumption of a contingent obligation by the debtor.

Comment: Subsection 7(1) establishes three sets of conditions that warrant an order for relief in relation to a transaction entered into by a debtor. Section 8 limits the application of subsection 7(1). Relief is available only under the provisions identified in relation to a transaction described in subsection 8(2) or 8(3).

Subsection 8(3) is broader in scope than 8(2). If a transaction falls within both, the more restrictive rules of subsection 8(2) apply.

Subsection 8(2) restricts the grounds of relief to those defined by clause 7(1)(c) if a transaction is one of the three types indicated. The applicant must prove both that the debtor's primary intention was to defeat or hinder a creditor or creditors and that the benefitting transferee knew of and intended to assist in the achievement of that intention.

Clause (a): Clause 8(2)(a) applies to a spousal transaction, defined in subsection 1(1). A transaction between family members that is not a spousal transaction may be challenged under any of the provisions of subsection 7(1). However, the transferee may be sheltered in appropriate cases by the court's discretion under subsection 18(4) to deny or adjust an order where a transferee has acted in reasonable reliance on the finality of the transaction (see comment on s. 18(4)).

The restriction of relief to circumstances falling within clause 7(1)(c) in relation to a spousal transaction is designed to ensure that a bona fide settlement of affairs between separating spouses is not readily disrupted. The essential question for the court is whether the transaction was intended by the parties as a creditor avoidance device or a legitimate settlement of spousal and family affairs necessitated by the breakdown of their relationship. Although the grounds for relief under clause 7(1)(c) are difficult to establish, the question of intention may be determined objectively on the basis of the factors indicated in subsection 7(3) and any other relevant circumstances. Clause 7(3)(d) is of particular significance when a transaction is effected by a court order. Parties to spousal litigation are routinely expected to disclose debts as well as assets and the failure to do so will be a strong indication that the order was obtained primarily to defeat creditors. Clause 7(3)(e) may be relevant but should be applied with discretion in relation to spousal transactions. An

obvious lack of consideration from a benefitted spouse may be an indication of intention to avoid creditors but the release of a spousal claim is often prompted by emotional and pragmatic considerations that are impossible to value properly in monetary terms.

Section 14 and subsection 10(2) address the fact that a spousal transaction may be regarded as a creditor transaction to the extent that the benefit conferred represents satisfaction of an obligation owed to the transferee spouse. Section 14 states that the creditor transaction rules in Part III do not apply to a spousal transaction and subsection 10(2) confirms that relief is available under Part II, regardless of whether the transaction is a creditor transaction in whole or in part.

Clause (b): Clause 8(2)(b) applies if a debtor refuses property to which he or she is legally entitled under a bequest or on some other basis, or declines to exercise a power of appointment that could have been exercised in his or her own favour (see s. 1(1) “transaction” clauses (i) and (j)). The transaction in such a case is between the debtor and the person or persons who benefit as a result of the debtor’s disclaimer or refusal (see s. 1(1) “transferee”). Relief is available only if the debtor intended to keep the property that he or she would have received out of the reach of his or her creditors and the benefitting party (transferee) knew of the debtor’s intention and assisted in its fulfilment by accepted the property.

Clause (c): Clause 8(2)(c) applies when a debtor assumes a contingent obligation as defined by subsection 8(1). A contingent obligation entails a present legal obligation to perform in the future if a condition that may or may not occur does occur. The most common cases are those in which a debtor guarantees payment of a debt owed by another person or agrees to indemnify against loss occasioned by another person’s default. The person for whom the debtor acts as surety typically benefits by the procurement of a new loan or credit or through forbearance by an existing creditor. The debtor’s assumption of the obligation to make good the debt or indemnify against loss may therefore be regarded as a transaction between the debtor and the principal debtor or the person whose non-performance is the basis of the debtor’s liability (see s. 1(1) “transaction” clause (m) and “transferee”). Relief is available in relation to such a transaction if it was intended by the debtor to hinder or avoid his or her creditors and the transferee knowingly participated in the achievement of that result.

Example

Debtor and Associate are related companies. Debtor guarantees Associate’s debt to Bank. Associate defaults in paying Bank and Debtor pays on the guarantee. The result is an indirect transfer of the amount paid from Debtor to Associate and a corresponding reduction of the assets available to Debtor’s

creditors. If Debtor and Associate acted under a joint plan to avoid Debtor's creditor's through the guarantee arrangement, an order for relief may be made against Associate.

(3) If a transaction, other than a spousal transaction, is effected by a court order or by operation of law, an order for relief may be made only if the grounds for relief mentioned in clause 7(1)(b) or (c) are established.

Comment: The definition of "transaction" recognizes that a debtor may be obliged to confer a benefit on a transferee under a court order or due to the operation of a rule of law. This ensures that a debtor cannot avoid the Act through the stratagem of obtaining a court order to effect a transfer of value that would otherwise be caught, or by arranging his or her affairs in a way that will activate a rule of law to achieve that result. Subsection 8(3) provides that a transaction effected by those means may only be challenged if the conditions specified in clause 7(1)(b) or (c) are established. Both require proof that the debtor participated in procurement of the order or in arranging events to activate the rule of law with the primary intention of hindering or defeating the rights of a creditor or creditors generally. Clause 8(1)(a) applies to a spousal transaction effected by an order of the court.

(4) If a transaction is effected by a court order, an order for relief may be made by any court having jurisdiction to grant relief under this Act, whether or not that court is the court that made the order effecting the transaction.

Transactions involving corporate payments

9(1) This section applies to a transaction that consists of the purchase or redemption of its shares by a debtor corporation or the declaration of dividends by a debtor corporation.

(2) If an order for relief is made against a shareholder as transferee in a transaction, the court may make an order for relief against a director or directors of the corporation, jointly and severally, [*for jurisdictions based on the civil law* - solidarily], to take effect if and to the extent that the order against the shareholder is not satisfied within 6 months after the date that the order is made.

(3) An order for relief must not be made under this section against

(a) a director who is not liable in relation to the actions constituting the transaction under any applicable Act or other law governing the corporation that provides for a remedy against a director in relation to a

resolution or action authorizing the purchase or redemption of shares or the declaration of a dividend; or

(b) a director who had reasonable grounds to believe that the circumstances of the transaction were such that the transaction did not give rise to a remedy under the Act or law mentioned in clause (a).

(4) In determining whether a director had reasonable grounds within the meaning of subsection (3), the court must consider whether the director in good faith relied on, and whether a reasonable person in the director's position could be expected to rely on,

(a) financial statements of the corporation represented to the director by an officer of the corporation or in a written report of the auditor of the corporation to reflect fairly the financial condition of the corporation; or

(b) a report of a lawyer, accountant, engineer, appraiser or other person whose position or profession lends credibility to his or her statement.

(5) An order for relief must not be granted against a shareholder who, in proceedings taken under the *Canada Business Corporations Act* or the [insert name of provincial or territorial business corporations statute] by the corporation or another person, has been ordered to restore to the corporation or to a director of the corporation any amount paid or the value of property distributed under the transaction.

(6) An order for relief must not be granted against a director who, in proceedings taken under the *Canada Business Corporations Act* or the [insert name of provincial or territorial business corporations statute] by the corporation or another person, has been ordered

(a) to restore to the corporation any amount paid or the value of property distributed under the transaction; or

(b) to satisfy an order for contribution in favour of another director who has been ordered to restore to the corporation any amount paid or the value of property distributed under the transaction.

(7) If an order for relief is made against a shareholder or a director in relation to a transaction,

(a) the order is not enforceable against that person if the person is

subsequently ordered in proceedings under the *Canada Business Corporations Act* or under the [insert name of provincial or territorial business corporations statute]

(i) to restore to the corporation an amount paid or the value of property distributed under the transaction, or

(ii) to satisfy an order for contribution; and

(b) the court may suspend enforcement of the order for relief until proceedings against that person under the *Canada Business Corporations Act* or under the [insert name of provincial or territorial business corporations statute] are concluded.

Comment: The payment of a dividend by a corporation or the voluntary purchase or redemption of its shares is a “transaction” between the corporation and the benefitting shareholder (see s. 1(1) “transaction” clause (h)). An order for relief may be made against the shareholder under subsection 7(1) if grounds for relief are established (and see comment on s. 7(2)). However, subsections 9(5) and 9(7) may be relevant (see below). The former restricts the availability of relief and the latter restricts enforcement of an order already obtained.

When relief is granted against a shareholder in relation to a transaction described in subsection 9(1), subsection 9(2) authorizes the court to make a supplementary order against a director of the corporation who is responsible for authorizing the payment. A director may also be liable to the corporation in relation to the declaration of a dividend or the repurchase or redemption of shares under a federal or provincial corporations statute if the corporation is insolvent at the time of the payment or is likely to become insolvent as a result. Creditors of the corporation are generally not entitled to relief under such legislation. Section 9 offers relief to creditors in circumstances that approximate those under which a director might be liable to the corporation. However, qualifications are imposed on the right to relief.

Subsection 9(3) provides in effect that if a director is not liable under an applicable federal or provincial corporations statute in relation to the action in question, or if the director had reasonable grounds to believe that he or was not liable under that law, he or she is similarly not liable under this Act. Directors are not obliged to consider whether a course of action that is valid under the law governing the corporation may give rise to liability under reviewable transactions law.

Subsection 9(6) deals with the possibility that an application for relief may be made under this Act against a director who is liable under a corporations statute for the

same course of conduct. The objective is to avoid imposing liability twice for the same action. If an order has been made against a director under the corporations statute, relief may not be granted under this Act. Subsection 9(5) provides similar protection to a shareholder, who may be obliged under corporations legislation to return a dividend payment made by an insolvent corporation or a sum paid by an insolvent corporation for the repurchase or redemption of its shares.

Subsection 9(7) applies when an order for relief has been made against a director or shareholder under this Act but not satisfied or enforced before proceedings are taken under the corporations statute. The court may suspend an order for relief under this Act until proceedings under the corporations law are concluded and an order made under this Act ceases to be enforceable if relief is granted under the corporations statute. The Act does not provide for a case in which an order for relief under this Act has been made and satisfied or enforced before proceedings are taken under the corporations statute. Relief under corporations law could be precluded by amendment of the corporations legislation to that effect.

The provisions of Part IV that apply generally to relief under Part II apply to an order made against a shareholder. Subsection 22(2) provides a separate rule for relief against a corporate director.

Orders for relief respecting creditor transactions

10(1) Subject to subsection (2), if a transaction is a creditor transaction, an order for relief may be made under this Part only to the extent that the value of the benefit conferred on the creditor exceeds the claim satisfied or secured by the creditor transaction.

(2) This Part applies to a spousal transaction, whether or not the spousal transaction is a creditor transaction in whole or in part.

Comment: An order for relief may be granted only under Part III in relation to a transaction that falls within the definition of “creditor transaction”. However, if the benefit conferred on a creditor is worth more than the debt owed, any surplus value received is treated as a separate transaction that may be challenged under Part II.

Example

Debtor owes Creditor \$50,000. Debtor transfers an asset worth \$75,000 to Creditor in satisfaction of the debt. The transaction is a creditor payment to the extent of \$50,000 and may only be challenged under Part III. The \$25,000 benefit gratuitously conferred on Creditor may be challenged as a transaction under Part II and an order for relief made against Creditor to the

extent of that amount if grounds for relief are established.

Subsection 10(1) implicitly allows the court to determine the actual value of a claim owed to a creditor for purposes of determining the availability of relief under Part II. In the example given, Debtor and Creditor could not avoid Part II by agreeing to an exorbitant rate of interest on the debt or by inflating its amount to \$75,000 through other untenable accounting or payment practices. The court may find on the evidence that the actual amount owed to a creditor is less than the amount declared by the parties.

Subsection 10(2) provides an exception to subsection 10(1) in the case of a transaction falling within the definition of “spousal transaction”. A payment or transfer of property made to achieve a division of property or provide financial support may be regarded as a creditor transaction to the extent that it involves the satisfaction of a claim held by the benefitting spouse. However, section 14 provides that an order for relief may not be made under Part III in relation to a spousal transaction. The result is that a spousal transaction may be challenged under Part II but not under Part III.

Persons against whom relief may be granted under this Part

11(1) If grounds for relief mentioned in section 7 are established, the court may make an order for relief against either or both of the following:

- (a) a transferee who received a benefit from the debtor under the transaction;**
- (b) subject to subsection (2), a person who has received all or part of the benefit conferred under the transaction from a person described in clause (a) or a subsequent transferee.**

(2) An order for relief must not be made against a person mentioned in clause (1)(b) if the person gave consideration that, in the opinion of the court, is worth not conspicuously less than the value of the benefit received and

- (a) if the grounds for relief fall within clause 7(1)(a), the person did not know that the benefit derived from a transaction that occurred in the circumstances described in that clause; or**
- (b) if the grounds for relief fall within clause 7(1)(b) or (c), the person did not know that the benefit derived from a transaction in which the debtor’s primary intention was to hinder or defeat the enforcement of the**

rights of a creditor or creditors.

(3) If grounds for relief mentioned in section 9 are established, the court may make an order for relief against a director of a corporation.

Comment: Clause 11(1)(a) provides for an order for relief against a transferee, who is by definition a person who benefits under a transaction (see s. 1(1) “transferee”). A transferee usually receives property or value in some other form directly from a debtor. In some cases, a transferee is a person who benefits indirectly as the result of a debtor’s dealing with someone else (see comments on s. 1(1) “transaction” and s. 8(2)(c) for examples). However the transaction is effected, an order for relief may be made against the transferee and implicitly not against the debtor. The objective is to restore the value of the benefit obtained by the transferee to the debtor’s creditors. Part IV determines the terms of the order.

Clause 11(1)(b) deals with a case in which the debtor confers a benefit on a transferee who then transfers the benefit to a second person. The second transferee may transfer the benefit to a third, and so on. An order may be made against a person who has obtained the benefit originally conferred on a transferee as the result of a secondary or subsequent transfer. Creditors’ rights could be seriously compromised if they could only follow value alienated by a debtor into the hands of the first recipient. Relief may be granted against a secondary or subsequent transferee only if the circumstances of the original transaction constituted grounds for relief under Part II and only subject to the limitations imposed by subsection 11(2). An order may not be made against those who have given consideration worth not conspicuously less than the value of the benefits they themselves have received and who do not know that the benefit derived from a transaction that involved circumstances giving rise to a right to relief under subsection 7(1). The rules in subsection 1(4) apply in determining whether a person has knowledge of the relevant facts.

Example

Debtor, who is insolvent, transfers property to Transferee for no consideration. Grounds for relief against Transferee under clause 7(1)(a) are established. Transferee gives the property to Transferee 2, who sells it to Transferee 3 for a price approximating its market value.

In the example, clause 11(1)(a) allows for an order against Transferee. Clause 11(1)(b) allows for an order against Transferee 2. Subsection 11(2) does not bar relief because Transferee 2 gave no consideration for the benefit received under the transaction, regardless of whether he or she knew of the circumstances of the original transaction. Since Transferee 3 has given consideration worth not conspicuously less

than the benefit received, an order for relief is precluded unless he or she knew that the property was originally transferred away by an insolvent debtor for no consideration. A similar approach is taken under the federal *Bankruptcy and Insolvency Act* provisions that apply to a transfer at undervalue or preference, which allow the trustee to recover against a secondary transferee who has not “paid or given in good faith adequate valuable consideration.”

PART III

Preferential Creditor Transactions

Introductory comment: The rationale for Part III is explained briefly in the introduction to the Act. Relief under this Part is designed to buttress the creditor sharing rules of provincial and territorial law. In the common law jurisdictions, these rules are generally referred to as creditors’ relief law. Under creditors’ relief law, funds generated by judgment enforcement measures against a debtor’s property must be shared *pro rata* among qualifying unsecured creditors. Those who qualify are generally judgment creditors who have taken a prescribed procedural step to establish their claims, though in some jurisdictions unsecured creditors who hold liquidated claims may be eligible under a certificate filed with the sheriff or distributing authority. Part III offers relief when a creditor transaction infringes on the unrealized sharing rights of unsecured creditors by allowing one creditor to recover a claim while others cannot. Section 12 identifies the persons who have standing to apply for relief and section 15 identifies those against whom relief may be granted. Section 13 defines the circumstances in which relief is available. Section 14 excludes spousal transactions from this Part. The terms of the order for relief are specified by Part IV. The provisions of Part I also apply to an application under Part III.

Part III applies only to transactions that fall within the section 1(1) definition of “creditor transaction”. The adjective “preferential” in the title to this Part signals the rationale for relief; namely, that the transaction has the effect of preferring one creditor over others in terms of their ability to recover debts owed by a common debtor. However, not all transactions that have that result are subject to challenge. The routine payment of debts is generally not affected by anti-preference law, even though the paid creditor may be advantaged relative to those who remain unpaid. Part III is designed to achieve a substantial degree of consistency between provincial law and federal insolvency law.

Who may apply for order of relief under this Part

12(1) Subject to subsection (2), an application for an order for relief under this Part may be made by a person who holds a claim that existed at the date of the creditor transaction that is the subject of the application for relief.

(2) If a claim is a right to satisfaction of an obligation that is contingent on a future uncertain event, the person who holds the claim may apply for relief only if, at the date of the creditor transaction that is the subject of the application for relief, it was reasonably foreseeable that the event would occur.

Comment: Section 12 provides the rules that determine whether a person has standing under Part III to apply for relief in relation to a creditor transaction. However, the availability of relief may be affected by sections 3, 4 and 5 of Part I, which apply generally to proceedings under the Act.

Subsection 12(1) allows a person who has a “claim” against a debtor at the date of the transaction that is the subject of the application to apply for relief. “Claim” is defined in subsection 1(1) and the date of the transaction is determined under subsection 1(3). Although the definition of “claim” is not limited to an unsecured claim, section 3 precludes an order for relief in favour of a creditor whose claim is fully secured. Subsection 4(2) may bar or limit an order for relief in favour of any claimant in the special case of a creditor transaction involving a transfer of property that is subject to a security interest. Section 5 allows a person who does not have judgment on a claim to apply for relief but requires the applicant to obtain judgment before he or she can benefit under an order against the transferee.

A claim is the right to satisfaction of an obligation owed by a debtor, whether or not the right to satisfaction is absolute or contingent. Subsection 12(2) applies when a person holds a claim that exists at the date of the creditor transaction but the right to satisfaction of the obligation represented by the claim is contingent on an event that may or may not occur. Such a person has standing to seek relief under Part III only if it was reasonably foreseeable at the date of the transaction that the contingent event would occur.

Example

Debtor owes money to Bank. Guarantor guarantees the debt. Debtor, who is insolvent, pays a debt owed to Related Company. Debtor defaults in paying Bank and Bank seeks recovery from Guarantor.

The payment by Debtor to Related Company is a “creditor transaction”. At the time of the transaction, Debtor owed an obligation to indemnify Guarantor against any payment that might be made to Bank under the guarantee but Guarantor’s right to satisfaction of that obligation was contingent on a payment being made. Guarantor has standing to apply for relief against Related Company under Part III if it was reasonably foreseeable at the date of the creditor transaction that Guarantor would be required to pay Bank under the guarantee and become entitled to enforce Debtor’s obligation to indemnify. The mere possibility that Guarantor may be required to pay

Bank is not enough to give Guarantor standing under the rule in subsection 12(2). Subsection 12(2) would not be relevant if Guarantor had already paid under the guarantee at the date of the transaction. In that case, Guarantor would have standing to apply for relief under subsection 12(1) because Debtor's obligation to indemnify would no longer be contingent.

Grounds for relief under this Part - preferential creditor transactions

13(1) An order for relief may be made under this Part in relation to a creditor transaction if

(a) the creditor receiving the benefit conferred under the creditor transaction is not dealing at arm's length with the debtor; and

(b) the debtor

(i) is insolvent at the time of the creditor transaction,

(ii) becomes insolvent as a result of the creditor transaction, or

(iii) enters into the creditor transaction in circumstances in which the debtor is demonstrably at risk of insolvency and the debtor becomes insolvent within 6 months after the date of the creditor transaction.

(2) Persons who are related to each other are presumed not to deal with each other at arm's length while so related but the presumption may be rebutted by proof that they are dealing at arm's length.

(3) It is a question of fact whether persons not related to one another were at a particular time dealing with each other at arm's length.

(4) Persons are related to each other when they are related to each other for the purposes of the *Bankruptcy and Insolvency Act* (Canada).

(5) Persons are deemed to be dealing with each other at arm's length with respect to the following:

**(a) a margin deposit made by a clearing member with a clearing house;
or**

(b) a transfer, charge or payment made in connection with financial

collateral and in accordance with the provisions of an eligible financial contract.

(6) In this section,

“clearing house” means a body that acts as an intermediary for its clearing members in effecting securities transactions;

“clearing member” means a person engaged in the business of effecting securities transactions who uses a clearing house as intermediary;

“creditor” includes a surety or guarantor for the debt due to the creditor;

“financial collateral” and “eligible financial contract” have the meaning ascribed by the *Bankruptcy and Insolvency Act* (Canada);

“margin deposit” means a payment, deposit or transfer to a clearing house under the rules of the clearing house to assure the performance of the obligations of a clearing member in connection with security transactions, including, without limiting the generality of the foregoing, transactions respecting futures, options or other derivatives or to fulfil any of those obligations.

Comment: Subsection 13(1) defines the grounds for relief under Part III. The application must relate to a “creditor transaction”, the person benefiting under the creditor transaction must be a “creditor” who was “not dealing at arm’s length with the debtor” and the debtor must be “insolvent” at one of the three points in time identified in clause (b). Each requirement is informed by other provisions of the Act. A “creditor transaction” is defined in subsection 1(1) as a transaction under which a debtor directly or indirectly benefits a creditor by satisfying a claim or providing security for the satisfaction of a claim, subject to certain exceptions. A “creditor” is defined in subsection 1(1) as a person who holds a claim. A guarantor or surety qualifies as a creditor under the general definition because he or she holds a contingent claim against the principal debtor but the definition is explicitly supplemented by section 13(6) for the purposes of Part III to avoid any uncertainty and to clearly parallel the preference rules of the *Bankruptcy and Insolvency Act* (*BIA*). Subsections 13(2) through (5) establish rules that determine whether the creditor and the debtor are dealing with each other at arm’s length. “Insolvent” is defined in subsection 1(1).

A solvent debtor is ordinarily in a position to satisfy all his or her financial obligations. Conversely, an insolvent debtor cannot satisfy all such obligations or

has ceased to do so - a fact that itself is generally an indication of financial incapacity. When an insolvent debtor pays one creditor leaving others unpaid, the paid creditor is inherently preferred to the extent of the payment because the debtor's financial circumstances are such that the unpaid creditors will not be able to recover fully or at all through enforcement against the debtor's property. The policy basis for legislation that obliges a preferred creditor to disgorge a preferential payment in favour of creditors generally is founded on the legal entitlement of unsecured creditors to recover their claims against property of a common debtor on a *pro rata* basis. Transactions that undermine that entitlement are objectionable. Since *pro rata* sharing rights ordinarily arise only when a debtor becomes bankrupt, anti-preference rules are typically found in bankruptcy legislation. The existence of a *pro rata* sharing scheme under the creditors' relief rules of judgment enforcement law is a uniquely Canadian phenomenon among common law jurisdictions (see Part III introductory comment).

Section 13 reflects a policy choice to define provincial and territorial law in terms that will produce outcomes that are substantially consistent with those produced by the anti-preference rules of the *BIA*. Like the *BIA*, subsection 13(1) offers relief when a payment is made or security for payment given by an insolvent or nearly insolvent debtor to a non-arm's length creditor. Harmonization of outcome is advanced by adopting the *BIA* rules that determine whether persons are at arm's length. Subsections 13(2), 13(3) and 13(5) emulate the *BIA* rules and subsection 13(4) refers the question of whether persons are related to the relatively lengthy *BIA* provisions that determine that issue. Subsection 13(6) adopts the *BIA* definitions that inform the rules in subsection 13(5) as well as the definition applied to the term "creditor" in relation to preferential payments.

The approach taken in subsections 13(2) through (6) means that a transaction that is not at arm's length under the *BIA* is similarly not at arm's length under this Act. Whether a debtor is or is not related to a creditor who benefits under a creditor transaction is an important factor in determining whether the creditor was dealing at arm's length with the debtor for purposes of clause 13(1)(a) but is not conclusive. Although related persons are presumed under subsection 13(2) not to deal with each other at arm's length, the court may find that a transaction between related persons was in fact an arm's length transaction if the evidence so indicates. Conversely, subsection 13(3) makes it clear that unrelated persons may not be dealing at arm's length with respect to a creditor transaction though they deal at arm's length in other respects. The availability of relief depends on whether the benefitting creditor was dealing at arm's length with the debtor with respect to the creditor transaction in question.

The Act differs from the *BIA* in that it does not offer relief when a payment is made

or security given to a creditor who is dealing with the debtor at arm's length in relation to the transaction. The rules that define the circumstances in which arm's length transactions may be avoided under the *BIA* are narrowly drawn and, unlike those that apply to non-arm's length transactions, require proof of intention to prefer. The presumption of intention that arises under the *BIA* from preferential effect may be, and often is, rebutted, with the result that ordinary course transactions and those motivated by normal commercial considerations are generally beyond challenge. The practical difference in outcome between the approach taken to arm's length transactions under the *BIA* and that adopted by the Act is therefore likely to be relatively small.

Non-application of Part to spousal transactions

14 This Part does not apply to a spousal transaction, notwithstanding that the spousal transaction may be a creditor transaction in whole or in part.

Comment: Section 14 applies to a “spousal transaction” as defined in subsection 1(1). The effect of section 14 is explained in the comment on section 10.

Persons against whom relief may be granted under this Part

15 If grounds for relief under this Part are established, the court may make an order for relief against either or both of the following:

- (a) the creditor receiving the benefit conferred under the creditor transaction;**
- (b) a person who has received all or part of the benefit conferred under the creditor transaction**
 - (i) in a transaction with the creditor mentioned in clause (a), if the person was not dealing at arm's length with the creditor, or**
 - (ii) in a transaction with a transferee who received all or part of the benefit from the creditor mentioned in clause (a) or a subsequent transferee, if the parties to each transaction leading to receipt of the benefit by the person against whom relief is claimed were not dealing at arm's length.**

Comment: Section 15 is the Part III counterpart of section 11 in Part II. A “creditor transaction” is one in which a debtor directly or indirectly benefits a creditor (see comment on s. 1(1) “creditor transaction”). Clause 15(a) provides for relief against

the creditor transferee who initially received the benefit from the debtor. Clause 15(b) allows an order to be made against a person to whom that benefit is transmitted by the creditor transferee, or a person who acquires the benefit under a transaction linked through a chain of transactions with the first. Assume for example that Debtor transfers property to X in circumstances that give rise to relief under section 13. X transfers the property to Y who transfers it to Z. Section 15 allows an order for relief to be made against any of X, Y or Z. However, secondary transferees in the position of Y or Z are liable only if all of the transactions in the chain of dealings were not at arm's length. Y is liable only if he or she was not dealing at arm's length with X. Z is liable only if both the transaction between X and Y and the transaction between Y and Z were not at arm's length.

PART IV

Orders and Remedies

Introductory comment: The remedy offered under the pre-reform law of fraudulent conveyances and fraudulent preferences flowed from the statutory prescription that the transaction in question was void as against creditors. Although the implications of that approach were not entirely clear, it was generally understood that property gained by the transferee was to be made available to satisfy the claims of the transferor's creditors. Part IV of the Act offers a more nuanced form of relief and detailed rules that define the rights of those who are involved in a transaction or may be affected by an order.

The court is directed to craft an order for relief that will achieve a result stated as a general principle. Section 16 applies to relief under Part II and section 17 to relief under Part III. Subsection 18(2) offers a non-exhaustive list of types or forms of order that might be granted by the court alone or in combination to achieve the result prescribed by sections 16 and 17. Subsections 18(4) and 18(6) identify factors that the court should take into account in tailoring the order for relief. Subsection 18(3) ensures that the benefit of an order for relief is shared by all creditors of the debtor who are entitled to participate in the proceeds of judgment enforcement measures under the creditors' relief rules of the judgment enforcement system (see Part III introductory comment and the comment on s. 18(3)). Section 19 deals with the status of a security interest granted under subsections 18(4) or (6) as an element of an order for relief. Section 23 allows the court to grant injunctive relief before a final order is made and section 24 contains the limitation of actions rules.

The other provisions of Part IV address specific issues that will arise in only a few cases. Section 22 deals with the special case of an order for relief made against the director of a corporation under section 9.

Part II provides for relief in relation to a "transaction", including the subcategory "spousal

transaction”. Part III provides for relief in relation to a “creditor transaction”, which is also a subcategory of “transaction”. Since most of the provisions of this Part refer generally to an order for relief or to relief in relation to a “transaction”, they apply to relief under both Part II and Part III except as otherwise provided.

Nature of order under Part II

16 In granting relief under Part II, the court shall make any orders that it considers necessary to make available to the person who applies for relief the value conferred on the transferee under the transaction to the extent of that person’s claim against the debtor, taking into account the provisions of section 18.

Comment: Section 16 reflects the rationale for relief under Part II. A transaction is objectionable when it has the effect of reducing the amount or value of a debtor’s property that is available through the judgment enforcement system to satisfy the claims of unsecured creditors. The transferee who receives property or value that detracts from the debtor’s estate has gained at the creditors’ expense. If the circumstances are such that grounds for relief are established, the order for relief requires the transferee to disgorge the value obtained under the transaction in favour of the applicant claimant to the extent of his or her claim. Section 18 provides detailed rules regarding the terms through which the objective stated in section 16 may be achieved. Subsection 18(4) makes it clear that, except as provided by section 18(5), the transferee is not obliged to enhance creditors’ recovery by relinquishing property or value for which consideration was given. The objective is to restore to creditors the value gained by a transferee and thereby lost to them, but no more.

Example 1

Debtor owns property worth \$100,000 before entering into a transaction with Transferee. Debtor sells an asset that has a market value of \$40,000 to Transferee for \$20,000. The result is to reduce the net value of Debtor’s estate by \$20,000. Transferee has received a gratuitous benefit to the extent of the \$20,000 value received in excess of the amount paid. Creditor, who holds a \$30,000 claim against Debtor, applies for relief under Part II. If grounds for relief are established, the order should require Transferee to pay \$20,000 to Creditor or to otherwise make property worth \$20,000 available to satisfy Creditor’s claim. If Creditor’s claim against Debtor was only \$10,000, the order against Transferee should be limited to that amount.

Example 2

Debtor owns property worth \$100,000 before entering into a transaction with Transferee. Debtor provides professional services that have a market value of

\$40,000 to Transferee for \$20,000. Since Debtor could have obtained full value for the services either from Transferee or from another person, the result of is to reduce the net value of Debtor's estate by \$20,000. As in Example 1, Transferee has received a gratuitous benefit to the extent of the \$20,000 value received in excess of the amount paid and if grounds for relief are established, the order should be designed to achieve the same result.

The orders for relief in the two examples given are designed to achieve the same result but their terms may differ. We will assume that the applicant creditor holds a claim worth \$20,000 or more so is entitled to recover in that amount. The court could achieve that result in both cases by granting a \$20,000 money judgment against Transferee. In Example 1 there are a number of other alternatives. The court could order that the asset be sold and \$20,000 of the proceeds paid to Transferee with the balance to the applicant. Alternatively, it could allow the applicant to take judgment enforcement measures against the asset in the hands of Transferee. In the further alternative, the court could (1) order that the asset revert in Debtor where it would be subject to judgment enforcement measures taken by the applicant and (2) grant judgment in the amount of \$20,000 against Debtor in favour of Transferee as compensation for the \$20,000 paid for the asset. The court will chose the order that is most likely to be effective in satisfying the applicant creditor's claim at the least cost while taking into account the repercussions suffered by the transferee under the available alternatives. If the debtor has creditors other than the applicant, the need to formulate an order in terms that will make property recovered available to those who qualify to participate in a distribution under the creditors' relief rules of judgment enforcement law will be a factor (see s. 18(3)).

Section 16 limits the extent of the order for relief to the amount of the applicant's claim. The applicant is not required to prove the existence or extent of other claims but others may join in the proceedings. Joint proceedings will be to the applicant's advantage if they allow for a greater recovery based on the cumulative value of the applicants' claims, since whatever is recovered will be subject to the creditors' relief rules.

Nature of order under Part III

17(1) In granting relief under Part III, the court shall make any orders that it considers necessary to set aside the creditor transaction, taking into account the provisions of section 18.

Comment: Section 17 reflects the rationale for relief under Part III. When a payment or the provision of security has the effect of allowing the benefitting creditor to recover a claim while others remain unpaid, the remedy offered is

designed to set aside or reverse the payment or the provision of security to the extent of the applicant's claim. In effect, the applicant creditor is entitled to recover from the transferee what could have been recovered from the debtor if the creditor transaction had not occurred. Section 18 lists a range of orders that might be granted to set aside the payment and make the value received available to the applicant and indirectly to other creditors entitled to share under creditors' relief law. The fact that consideration was given by the transferee is not taken into account in the framing of the order since the objective of relief is not to restore to creditors generally a gratuitous benefit received by one but to ensure that all creditors obtain an equivalent measure of satisfaction.

Like section 16, section 17 limits the extent of the order for relief to the amount of the applicant's claim. The applicant is not required to prove the existence or extent of other claims but others may join in the proceedings. Joint proceedings will be to the applicant's advantage if they allow for a greater recovery based on the cumulative value of the applicants' claims, since whatever is recovered will be subject to the creditors' relief rules.

(2) If an order for relief is made under Part III in relation to a creditor transaction that had the effect of discharging an obligation under a guarantee or indemnity or an obligation secured by a guarantee or indemnity, the obligation so discharged is revived to the extent that the payment is set aside, subject to any defences that the person who owes the obligation may otherwise be entitled to assert.

Comment: Subsection 17(2) is relevant when a creditor transaction relates to a debt that is secured by a guarantee or an indemnity agreement. In the case of a guarantee, the guarantor assumes an obligation to pay a debt owed by a principal debtor to the creditor to whom the guarantee is given in the event of the principal debtor's default. An indemnity agreement involves an agreement under which one person agrees to indemnify a second person against loss occasioned by a third person's failure to perform an obligation owed to the second. We will use the case of the guarantee as the point of reference for purposes of explanation.

Subsection 17(2) deals with two potential scenarios. A payment made by a principal debtor to a creditor in satisfaction of a debt guaranteed by a guarantor is a creditor transaction. A payment made by the guarantor to the creditor in satisfaction of the obligation assumed under the guarantee is also a creditor transaction. Either type of transaction might be challenged by the creditors of the paying party if grounds for relief under Part III exist.

When a principal debtor pays a debt that is secured by a guarantee, the result is

generally to discharge the guarantor's obligation to the creditor to the extent that the debt is satisfied. Subsection 17(2) ensures that if the payment is set aside on application by a creditor of the principal debtor, the guarantor's obligation under the guarantee is revived. The transferee creditor loses the value of the payment but is restored to the position he or she was in before the payment was made. Similarly, when a guarantor pays a creditor pursuant to an obligation under a guarantee, the result of the payment is to discharge the principal debtor to the extent that the debt is satisfied. Subsection 17(2) ensures that if the payment is set aside on application by creditors of the guarantor, the obligation of the principal debtor is revived. Again, the transferee creditor loses the value of the payment but is restored to the position he or she was in before the payment was made. Revival of an obligation under subsection 17(2) does not affect defences against payment that would nullify the obligation on other grounds.

Forms of orders

18(1) In this section, "proceeds" means

(a) identifiable or traceable property that is derived directly or indirectly from any dealing with

(i) the property that is the subject of the transaction, or

(ii) the proceeds of the property that is the subject of the transaction; and

(b) the right to an insurance payment or any other payment as indemnity or compensation for loss of or damage to

(i) the property that is the subject of the transaction, or

(ii) the proceeds of property that is the subject of the transaction.

Comment: Clauses 18(2)(a), (b) and (c) provide for an order of the court affecting property transferred under a transaction. The property may be revested in the debtor, making it available to the applicant under judgment enforcement measures, made subject to judgment enforcement measures taken by the applicant while still owned by the transferee or simply sold to generate funds that will be distributed in the manner required by the principle established in section 16 or 17, as the case may be. The concept of proceeds becomes relevant when the transferee has disposed of the property received from the debtor. Although it may no longer be possible to make an order against that property, the court may make an order against "proceeds" property derived from it. An order affecting identified property of the transferee may be

preferable to a money judgment, which does not confer rights that may be enforced directly against a specific asset but must be enforced against the property of the transferee through the usual judgment enforcement measures if it remains satisfied.

If a transferee who has received property under a transaction sells or trades it for another item or type of property or otherwise deals with it in such a way as to convert it into another form, the new property is proceeds of the original property. For example, if a car received under a transaction is traded by the transferee for a truck, the truck is proceeds of the car. If money received under a transaction is deposited in a bank account, the account is proceeds of the money. Subclause 18(1)(a)(ii) provides for multiple generations of proceeds. If proceeds property derived from the original property is in turn exchanged for other property, the new property is proceeds of the original property as well as proceeds of the proceeds property. Clause 18(1)(b) provides for a case in which the property subject to a transaction or the proceeds of that property is damaged or destroyed. A resulting right to an insurance or similar payment is proceeds of the original property.

The definition of proceeds tracks the central terms of the definition used in the *Personal Property Security Acts* of the common law jurisdictions, though it applies here to land as well as personal property. The authorities interpreting the *PPSA* provisions replicated in section 18(1) may be applied by extension. Those addressing the requirement that property be “identifiable or traceable” are particularly pertinent. As in the *PPSA*, the term “identifiable” refers in this Act to a case in which property is traded for another item or collection of property that can be identified as a direct substitute. In the first example given above, the truck received in trade for the car is identifiable proceeds of the car. The term “traceable” refers to a case in which the original property has been exchanged for or converted into a form of property that is commingled with other property so that it is not possible to identify which part of the resulting pool was derived from the original property. In the second example above, money received from the debtor was deposited in an account. If the account contained funds from other sources, the account is proceeds of the money only to the extent that it is traceable.

The principles that may be applied or developed to trace property under the *PPSA* are not limited to the common law and equitable rules of tracing. The essential question is whether property in another form is connected with the original property in such a close and substantial way that it may properly be regarded as a substitute for the original. The concept of tracing should be understood here as it is under the *PPSA*, taking into account the policy and function of the Act and informed by but not limited to the conventional non-statutory tracing rules.

(2) In making an order for relief, the court may make an order or orders that may be required to achieve the result indicated in sections 16 and 17, including

- (a) an order vesting in the debtor, or in another person, property that is the subject of the transaction or the proceeds of the property;**
- (b) an order declaring that property that is the subject of the transaction or the proceeds of that property be subject to judgment enforcement measures in the hands of the transferee;**
- (c) an order directing that property that is the subject of the transaction or the proceeds of the property be sold and the money realized on the sale distributed 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) except in the case of an order made under Part III, an order requiring the transferee to pay a sum in recognition of income earned through the use or exploitation of property or of a licence, quota, right to use or right to payment received under the transaction;**
- (f) an order directing the release or discharge of any debt incurred, or security or guarantee given, by the debtor under the transaction;**
- (g) an order reviving any obligation or security released by the debtor under the transaction;**
- (h) an order setting aside a designation in favour of a beneficiary;**
- (i) an order declaring that property that would otherwise be exempt as against creditors is subject to judgment enforcement measures;**
- (j) an order setting aside or varying a court order if the order constitutes a transaction giving rise to the entitlement to relief;**
- (k) an order appointing a receiver to take possession of and deal with property in the manner directed;**
- (l) an order granting an injunction against the debtor or another person.**

Comment: Section 18 provides guidance regarding the specific terms through which

the relief prescribed by sections 16 and 17, respectively, may be achieved. Subsection 18(2) offers a comprehensive but not exhaustive list of types of order that may be made by the court. The order for relief may comprise a combination of the orders listed and may include other terms. Subsections (3), (4) and (6) must also be taken into account to the extent that they are relevant.

In most cases, the order for relief will simply strip the transferee of the benefit received under a transaction in terms that make its value available to the applicant creditor or creditors. Clause 18(2)(e) goes a step further where an order for relief under Part II relates to a transfer of property that has generated income in the hands of the transferee. The order for relief should make both the property or its value and the income produced by the property after the transfer available to the applicant creditor or creditors. Such an order is justified to the extent that the property could have generated income if it had remained in the hands of the debtor, since the transaction had the effect of depriving creditors of both the property and the income against which they might have enforced their claims had it not occurred. The provision also applies to a transaction involving a license, quota, right to use or right to payment, any of which similarly may generate income in the hands of the transferee but might not be regarded as property under general principles of property law. Subclause 18(4)(a)(ii) directs the court to take into account expenditures made by the transferee to generate that income as well as non-monetary investments, such as labour. The order should deprive the transferee only of the profit obtained.

Clause 18(2)(a) provides that the court may order that property transferred away under a transaction revert in the debtor-transferor, making it subject to judgment enforcement measures taken by the applicant or any judgment creditor. This approach effectively unwinds the transaction but may be less desirable than other approaches contemplated by subsection 18(2) if judgment enforcement measures against the property will be affected by priority competitions associated with security interests held by other creditors. The court should be cognizant of potential priority issues when framing the terms of an order. Those associated with a security interest granted in favour of a transferee under clause 18(4)(b) or 18(6)(b) are discussed in the comment on section 19. The Act does not deal with a different issue that may arise as the unforeseen consequence of a vesting order. The question is whether the existence of a security interest in the property involved, other than one granted under section 18, will limit or preclude judgment enforcement measures against the property. The answer depends on whether a priority rule created by legislation such as the *Personal Property Security Act* or the *Land Titles Act* applies. The following examples illustrate the problem.

Example 1

Debtor transfers an item of personal property to Transferee. After the transfer

occurred, Debtor granted a security interest in all present and after-acquired personal property to Secured Creditor, who registered a financing statement in the relevant Personal Property Registry. When the asset reverts in Debtor, the security interest attaches and is perfected. The asset may be seized under judgment enforcement measures but only subject to the security interest, which has priority over the rights of judgment creditors.

Example 2

Debtor transfers an asset to Transferee. A judgment, writ or similar judgment enforcement device was registered against Debtor before the asset was transferred. The asset was also subject to a security interest that was perfected but subordinate to the rights associated with the judgment enforcement device under an applicable statutory priority rule (e.g. giving priority to the first to register). Neither the security interest nor the registered judgment enforcement device are cut off or subordinated to the interest of Transferee under an applicable priority rule. Judgment enforcement measures against the asset will not be affected by the security interest *to the extent of the amount outstanding on the judgment that has priority*. Enforcement measures will produce proceeds that may be allocated to additional judgments only if the asset is worth more than enough to satisfy the claims associated with both the judgment enforcement device that has priority and the security interest.

An order vesting property in the debtor will not create priority problems if the property in question was subject to a security interest that was cut off or subordinated to the interest of the transferee under a priority rule that applied to the transaction. The secured creditor cannot assert rights based on the security interest when the debtor acquires the property under the vesting order (see s. 3(2)(b)).

(3) An order for relief must be made in those terms or subject to those conditions that the court considers necessary to make money payable or the value of property to be transferred under the order available for distribution to the persons qualified under [insert name of province's or territory's creditors' relief statute] to share in the proceeds of judgment enforcement measures taken against the debtor.

Comment: Those who apply for relief under the Act are not required to sue on behalf of creditors generally. However, an order for relief should be designed to ensure that the creditors' relief rules of judgment enforcement law that would operate if a judgment were enforced against the property of the debtor operate in similar fashion when relief is granted against a transferee from the debtor. The effect of subsection 18(3) may be explained by a simple example.

Example

Debtor transfers property to Transferee. Transferee gives no consideration and the circumstances constitute grounds for relief under Part II. Applicant Creditor, whose unsecured claim is worth more than the value of the property, seeks an order against Transferee.

If the transaction had not occurred, Applicant Creditor could have enforced a judgment against Debtor through seizure and sale of the property. However, the proceeds of sale would have been distributed to creditors qualified to share under the distribution system of judgment enforcement law, which include the rules generally referred as creditors' relief rules (see the introduction to the Act and Part III introductory comment). The objective of an order for relief is to make available to Debtor's creditors the property lost to Transferee, or its value. The order should produce an outcome similar to that which would follow if judgment enforcement measures were taken against the property in Debtor's hands. This might be achieved by various means.

If the order for relief directs that property revert in the debtor, the creditors' relief rules will be automatically engaged in favour of other qualifying creditors when the applicant creditor enforces a judgment against the property. If the order for relief directs that the property is subject to judgment enforcement measures in the hands of the transferee, it should also direct that the proceeds of enforcement be distributed under the judgment enforcement rules to creditors of the debtor rather than to creditors of the transferee. If the order for relief directs the transferee to pay a sum of money, the result should be the same. The court should direct that the money paid by the transferee be dealt with in the manner required to invoke the creditors' relief rules that would operate in relation to a judgment against the debtor. This might be accomplished by directing payment to the sheriff, clerk of the court or other enforcement official for distribution under the judgment enforcement law rules. The order could provide that if the transferee fails to pay a money judgment, the proceeds recovered through enforcement measures against property of the transferee should be paid out by the distributing authority to creditors of the debtor rather than creditors of the transferee, as would otherwise be the case. The transferee's creditors should not be enriched by the property received from the debtor at the expense of creditors of the debtor.

(4) In granting relief under Part II,

(a) subject to subsection (5), the court may refuse an order or adjust the terms of an order, or make an order in favour of the transferee for recovery of an identified sum against the debtor, in recognition of the

following:

- (i) the value given by the transferee,**
- (ii) expenditures and non-monetary investments made by the transferee that have increased the value of property received by the transferee under the transaction, or that have generated income through the use of property or of a licence, quota, right to use or right to payment conferred by the debtor, to the extent of the expenditures made or the value invested,**
- (iii) actions taken by the transferee in reasonable reliance on the finality of the transaction under which a benefit was received; and**

(b) if the court orders that property received by the transferee under a transaction or the proceeds of the property be vested in the debtor, the court may grant the transferee a security interest in the property that secures

- (i) the value given by the transferee under the transaction, to the extent of that value, and**
- (ii) expenditures and non-monetary investments made by the transferee that have increased the value of the property, to the extent of the expenditures made or the value invested.**

Comment: Clause 18(4)(a) directs the court to consider the factors listed in framing an order for relief to ensure that the legitimate interests of transferees who have acquired a benefit from a debtor are not unfairly sacrificed to the interests of the debtor's creditors. Subsection 18(5) provides that these factors may not be taken into account when relief is granted against a transferee who knowingly acted to accommodate a debtor's deliberate plan to defeat or hinder creditors.

The opening flush of clause 18(4)(a) allows the court to refuse an order or adjust the terms of an order. The discretion to deny relief is designed to respond to circumstances falling within subclause (iii), discussed further below. The factors identified in subclauses (i) and (ii) will affect the amount or type of order made against a transferee, but the refusal of an order on the basis of those factors would undermine the right to relief itself. For example, if an application is made under clause 7(1)(a) or (b), the fact that the transferee has given some consideration should be taken into account in determining the extent of recovery allowed against him or her but is not grounds for denial of an order.

Subclause 18(4)(a)(i) responds to the fact that an order for relief under Part II may be made against a transferee who has given some consideration for the benefit received under a transaction. A transferee who has not knowingly facilitated the obstruction of creditors is obliged to relinquish only that portion of the benefit not matched by the consideration given. The court may frame the order in various ways. A money judgment against the transferee should be based on the value of the benefit received by the transferee minus the consideration given for that benefit. Alternatively, if the court orders that property transferred under a transaction revert in the debtor so as to make it available to creditors under judgment enforcement measures, it should make “an order in favour of the transferee for recovery of an identified sum against the debtor”, that sum being the value of consideration given by the transferee. If the court orders that property received under a transaction should be sold or made subject to judgment enforcement measures in the hands of the transferee, it should direct that the transferee be paid a portion of the proceeds of sale or enforcement representing the consideration given. Clause 18(4)(b) is relevant when the order is cast in terms that require the debtor to pay a sum to the transferee.

Example

Assume that a transferee pays a debtor \$40,000 for property worth \$100,000. The terms of the order should enable the applicant to recover property or money equivalent to \$60,000 from the transferee. The court might order:

- (1) that the transferee keep the property but pay \$60,000;
- (2) that the property be sold and the purchase price of \$40,000 repaid to the transferee;
- (3) that the property be subject to judgment enforcement measures in the hands of the transferee and \$40,000 of the proceeds of enforcement be paid to the transferee before a fund is constituted for distribution to the applicant and other creditors of the debtor qualified to participate; or
- (4) that
 - (a) the property revert in the debtor, and
 - (b) the debtor pay \$40,000 to the transferee. The debt owed to the transferee may be secured by a security interest in the property reverted in the debtor or in other property.

An order for relief should also allow the transferee to retain or recover any value invested in improvement of the property received from the debtor or in generating income that is stripped from the transferee under the order. Subclause 18(4)(a)(ii) directs the court to draft an order in terms that will allow a transferee to retain that value “to the extent of the expenditures made or the value invested”. When an investment increases the value of property received, the relevant value is the amount invested rather than the increase in value. If the investment is in monetary form, the

relevant amount is the sum expended by the transferee. If it is in the form of labour or other non-monetary enhancements, the value of the investment must be assessed. An order may recognize the transferee's investments by reducing the amount of a monetary award against the transferee, by allocating proceeds generated from sale of the property to the transferee or by including an order for payment against the debtor in the transferee's favour.

Subclause 18(4)(a)(iii) gives the court discretion to take into account special circumstances that warrant the moderation or denial of an order for relief even though grounds for relief are established. That discretion should be exercised sparingly to ensure that the predictability of outcomes that the reformed law aims to achieve is not undermined and that extraneous criteria are not imported into the statutory grounds for relief by judicial practice. A case involving the routine conferral of a moderate benefit on a family member might qualify, as where a reasonable living allowance has been spent or services such as childcare assistance or home improvement are provided on a personal basis.

Clause 18(4)(b) applies when the court makes an order in favour of the transferee against the debtor for recovery of consideration paid for property received under a transaction or for recovery of investments that have increased the value of property received. The problem to which the provision is addressed arises only when the property is revested in the debtor, since in other cases the order of the court will protect the transferee's investment by subtraction from a monetary order against him or her or by an order that he or she receive a portion of the proceeds of sale of the property involved. Although section 19 provides rules that determine the priority of a security interest granted under subsections 18(4) or (6), an order vesting property in the debtor might best be avoided if it would produce a priority competition (see examples given in the comment on s. 19). The court might instead elect to grant an order in terms that allow the transferee to recover or retain his or her investments without requiring a payment by the debtor.

(5) The factors mentioned in subsection (4) are not to operate in favour of a transferee who knew that the debtor entered the transaction with the primary intention of hindering or defeating the enforcement of the rights of a creditor or creditors.

(6) In granting relief under Part III

(a) the court may, in recognition of expenditures and non-monetary investments made by the creditor that have increased the value of property received under the creditor transaction,

(i) adjust the terms of an order, or

(ii) make an order in favour of the creditor receiving the benefits conferred under the creditor transaction for recovery of an identified sum against the debtor; and

(b) if the court orders that property received by the creditor under the creditor transaction or its proceeds be vested in the debtor, the court may grant the creditor a security interest in the property securing expenditures and non-monetary investments made by the creditor that have increased the value of the property, to the extent of the expenditures made or the value invested.

Comment: Clause 18(6)(a) operates in the same way as subclause 18(4)(a)(ii). A creditor who has received a transfer of property under a creditor transaction is entitled to retain or recover investments made in the property that have increased its value. There is no counterpart to clause 18(4)(a)(i) because recovery of the consideration given by the transferee creditor is not appropriate in relation to an order for relief against a creditor transaction. Relief is not based on the gratuitous receipt of value from the debtor but on interference with the entitlement of unsecured creditors generally to share in the benefit received. Clause 18(6)(b) parallels subclause 18(4)(b)(ii).

Security interests created under order for relief

19(1) A security interest granted under subclause 18(4)(b)(i) has priority over the rights of creditors of the debtor that exist in relation to the property when the property vests in the debtor or that arise as a result of the vesting, other than rights associated with a perfected security interest that attached to the property before the transaction occurred.

Comment: Section 19 is relevant only when a transaction involves a transfer of property that is revested in the debtor under an order for relief that includes an order for payment to the transferee secured by a security interest granted under clause 18(4)(b) or 18(6)(b). The rules provided determine the priority of such a security interest relative to a security interest granted by the debtor or to another charge or encumbrance through which creditors' rights may be asserted, such as a judgment enforcement charge or writ.

Subsection 19(1) deals with a case in which the security interest granted by the court secures recovery of the consideration paid for the property acquired under a transaction giving rise to relief under Part II. If the property was subject to a

perfected security interest before it was transferred to the transferee, that security interest has priority over a security interest granted to the transferee under clause 18(4)(b)(i). Subsection 19(1) preserves the priority of a security interest in property that was not cut off or subordinated by a priority rule that operated in favour of the transferee but does not result in reinstatement of a security interest that was. When a security interest is cut off or subordinated by a priority rule contained in legislation such as the *Personal Property Security Act* or the *Land Titles Act*, the holder of the security interest may not assert a claim to property recovered in proceedings under this Act on the basis of that interest. The secured party is in the position of an unsecured creditor (see s. 3(2)).

A “perfected” security interest is one that is enforceable against third parties and has a priority status relative to competing interests in the collateral. In the common law jurisdictions, the *Personal Property Security Act* provides rules that determine whether a security interest in personal property is perfected. Although the legislation governing the priority of an interest in land generally does describe a security interest as “perfected”, the term should be understood in that context in the generic sense described. A mortgagee’s interest in land is a perfected security interest if the mortgage is registered and thereby acquires priority over subsequent interests.

Example 1

Debtor transfers a piece of equipment worth \$100,000 to Transferee, who pays \$50,000 for it. The equipment was subject to a perfected security interest held by Secured Creditor before it was transferred and the security interest was not cut off or subordinated as a result of the transfer. The court orders that the equipment be revested in Debtor so it can be seized under judgment enforcement measures and orders Debtor to pay \$50,000 to Transferee, secured by a security interest in the equipment. Subsection 19(1) provides that Transferee’s security interest is subordinate to the security interest held by Secured Creditor. The same result would follow if the transaction involved a transfer of land subject to a registered mortgage held by Secured Creditor.

A security interest granted to the transferee under subclause 18(4)(b)(i) has priority over unperfected security interests and over other charges or encumbrances through which creditors’ rights may be asserted, provided the competing interest or encumbrance exists when the property revests in the debtor or arises upon revesting.

Example 2

Debtor transfers a piece of equipment worth \$100,000 to Transferee, who pays \$50,000 for it. After the transfer, Debtor enters into a security agreement with Secured Creditor giving Secured Creditor a security interest

in all present and after-acquired personal property of Debtor. The court orders that the equipment be revested in Debtor so it can be seized under judgment enforcement measures and orders Debtor to pay \$50,000 to Transferee, secured by a security interest in the equipment. Secured Creditor's security interest will attach to the equipment when Debtor acquires rights in it under the revesting order. Subsection 19(1) provides that the security interest held by Transferee has priority over that held by Secured Creditor, regardless of whether Secured Creditor's interest is perfected.

The result in this example would be the same in the case of a priority competition involving a writ or judgment rather than a security interest. A judgment or writ registered against Debtor that attaches to the equipment when it vests in Debtor is subordinate to a security interest granted to the transferee under subclause 18(4)(b)(i).

Subsection 19(1) speaks to the priority of a security interest granted to a transferee relative to other interests in the property that exist at the date of revesting or that arise automatically when the debtor acquires rights under the vesting order (as in Example 2). The transferee's interest need not be registered or perfected in order to have priority over such interests. However, the rule does not otherwise supplant the priority rules of other legislation that require registration or perfection of a security interest (or some other step) as a condition of priority. The transferee's security interest must be perfected or registered to have priority under such external rules over an interest that arises after the property reverts in the debtor. Subsection 19(3) allows the security interest to be registered under the *PPSA* or Land Titles legislation and subsection 19(4) determines the priority status of a security interest so registered.

(2) A security interest granted under subclause 18(4)(b)(ii) or clause 18(6)(b) has priority over the rights of all creditors of the debtor that exist in relation to the property when the property vests in the debtor or that arise as a result of the vesting, including the rights of secured creditors.

Comment: Subsection 19(2) applies to relief under either Part II or Part III, where the court makes an order under subclause 18(4)(b)(ii) or 18(6)(b) granting the transferee a security interest to secure recovery of an investment that has increased the value of property acquired under the transaction. Such a security interest has priority over the rights of all creditors in relation to property revested in the debtor, including a creditor who held a perfected security interest before the transaction occurred. The increased value produced by the transferee's investment is treated as property of the transferee, which he or she is permitted to retain. A prior secured creditor would realize a windfall at the transferee's expense if a pre-existing security interest were given priority over the transferee's interest.

As noted in the comment on subsection 19(1), the transferee's security interest need not be perfected or registered to have priority over interests in the property that exist when the property vests in the debtor or that arise as a result of the vesting, but perfection or registration may be required to establish priority over interests that arise thereafter. Subsections 19(3) and (4) allow the transferee to establish a priority position in relation to subsequent interests.

(3) A security interest in property granted under subsection 18(4) or (6) may be registered

**(a) in the Personal Property Registry if the property is personal property,
or**

(b) in the Land Titles registry if the property is land.

[Alternative provisions to similar effect will be required in relation to land in jurisdictions that do not use a land titles system.]

(4) Subject to subsections (1) and (2), a security interest granted under subsection 18(4) or (6)

(a) that is registered in the Personal Property Registry under clause (3)(a) has the status of a security interest perfected by registration under the *Personal Property Security Act*, or

(b) that is registered in the Land Titles registry under clause (3)(b) has the status of an interest in land registered under the *Land Titles Act*

[or alternative language required in some jurisdictions as noted in relation to subsection (3)].

Comment: Registration of the transferee's security interest in the Personal Property Registry or the Land Titles registry gives it a priority status in relation to interests in the property other than those that fall within subsections 19(1) and (2). A security interest that is not registered may be subordinated to interests in the property that arise after it reverts in the debtor. In jurisdictions in which priority is not based on a registry system, these provisions must be adapted to achieve the same result.

Example

Debtor transfers a piece of equipment worth \$100,000 to Transferee, who pays \$50,000 for it. The court orders that the equipment be reverted in

Debtor so it can be seized under judgment enforcement measures and orders Debtor to pay \$50,000 to Transferee, secured by a security interest in the equipment. After the equipment reverts in Debtor and before it is sold under judgment enforcement measures taken by the applicant or another judgment creditor, Debtor borrows money from Bank and gives Bank a security interest in the equipment to secure repayment. Bank perfects its interest by registration under the *PPSA*.

Transferee's security interest will have the status of a security interest perfected by registration under the *PPSA* if it is registered in the Personal Property Registry. As between the security interests held by Bank and Transferee, the first to register will have priority under the relevant *PPSA* priority rule. Transferee's security interest will also have priority over the trustee in bankruptcy in the event that Debtor becomes bankrupt after the interest is registered.

If the property involved is land, registration in the Land Titles registry gives the transferee's security interest the priority status generally associated with a registered interest in land.

Although the security interest held by a transferee may be subordinated to subsequent interests if it is not registered, that will rarely occur in practice. In most cases, the property in question will be sold under judgment enforcement measures before a subsequent interest arises.

Application of orders for relief to exempt property

20 If an order for relief is granted in relation to a transaction involving exempt property and the debtor continues to use the property in the manner that attracted the exemption, the court

(a) may suspend enforcement of the order for relief until the time that the debtor ceases to use the property in that manner; and

(b) if the enforcement of an order for relief is suspended under clause (a), may order that a [*writ or judgment - depending on the terminology used in provincial judgment enforcement legislation*] be registered against the transferee or the property of the transferee.

Comment: An order for relief may be made in relation to a transaction involving a transfer of property that is exempt from seizure under judgment enforcement measures (see comment on s. 1(1) "transaction"). A debtor who voluntarily disposes of property is presumed not to require it for a purpose attracting an exemption so the

fact that the property was exempt before the transaction occurred does not preclude the subsequent enforcement of creditors' claims against it. However, that presumption may not be valid when a debtor transfers away the ownership of property but continues to use it thereafter as he or she did before. For example, a debtor may transfer the title to a house that is exempt as a homestead or personal residence to his or her wife or child but continue to live in it after the transfer. Some courts have dealt with cases of this kind under pre-reform law by directing that a writ be registered against title to the house but suspending enforcement of the writ until the house ceases to be the judgment debtor's residence. Section 20 applies a similar approach to transactions involving exempt property generally.

In most cases, exemptions are based on the use of personal property or land for a purpose that is regarded by the legislature as essential to a basic standard of living. Section 20 applies only when a debtor continues to "use" the property in the relevant fashion. It does not apply if a transaction involves a dealing with an exempt investment such as a registered retirement savings plan, since the debtor does not "use" that type of property after it is transferred to another person.

Section 20 is permissive. A court is not obliged to make an order of the kind indicated though it may do so if the debtor would otherwise be cast out of his or her home, lose the use of his or her only motor vehicle or be seriously affected in some other manner.

Application of Part to subsequent transferees and creditors

21 This Part applies, with any necessary modification, to an order for relief made against a person mentioned in clause 11(1)(b) or 15(b).

Comment: An order for relief will ordinarily be sought against a transferee who has benefitted under a transaction with a debtor and Part IV is addressed primarily to that case. However, clauses 11(1)(b) and 15(b) also provide for relief against a person who has received the benefit obtained by the first transferee through subsequent transactions. Section 21 makes it clear that the provisions of Part IV apply with such modification as may be required when an order is made against a secondary or subsequent transferee.

Order for relief in relation to corporate payments

22(1) If an application for relief is made in relation to a transaction mentioned in subsection 9(1), subsections 9(2) to (7) must be taken into account in the making or refusal of an order for relief.

(2) If an order for relief is made against a director under section 9, the order must require the director to pay a sum of money equivalent to the amount paid by the corporation under the transaction, and the provisions of this Part, other than subsection 18(3) and sections 23 and 24, do not apply.

Comment: Section 9 contains special rules that apply to an application for relief with respect to a transaction involving the purchase or redemption of its own shares by a corporation or the declaration of dividends by a corporation. Relief may be granted against the shareholder who benefits under the transaction and against a director who has authorized it. Subsection 22(1) flags the provisions of section 9 that may affect the availability of relief in relation to a transaction of that kind.

For the most part, an application for relief against a shareholder is subject to the provisions of the Act that apply to transactions generally. The provisions of Part IV governing an order for relief under Part II apply, subject to the limitations imposed by subsections 9(5) and (7).

Applications for relief against a corporate director are treated differently. The grounds for relief are defined by section 9 and subsection 22(2) provides a special rule governing the terms of an order for relief. In addition, the court must be cognizant of the limitations on relief imposed by subsections 9(2), (3), (4), (6) and (7).

Injunctions

23(1) Whether or not an application for an order for relief has been made, the court may grant an injunction to a person who is, or who may become, entitled to apply for an order for relief under this Act if the court is satisfied that there is a reasonable likelihood that a transaction giving rise to a right to relief has occurred or is about to occur.

(2) In granting an injunction, the court may make any orders against the debtor or another person that the court considers necessary to

- (a) preserve the benefit of any final order for relief that may be granted;**
- (b) allow an appropriate order for relief to be made; or**
- (c) prevent a transaction from occurring.**

(3) Any interested person may apply to the court to vary or terminate an order made under this section.

Comment: Clause 18(2)(1) provides for injunctive relief as part of a final order. Section 23 gives the court jurisdiction to grant an injunction before a final order is granted, whether or not an application for relief has been commenced. An injunction may be required to prevent a transaction that would give rise to relief under the Act from occurring or, if such a transaction has already occurred, to prevent further action on the part of the debtor or another person that would prejudice the ability of a creditor challenging the transaction to obtain an effective remedy. The principles that govern the granting of injunctions generally will apply to an application for injunctive relief under the Act.

Limitation of actions

24(1) Subject to subsections (2) and (3), no application for an order for relief is to be commenced more than 1 year after the date of a transaction.

Comment: The date of a transaction is determined under subsection 1(3).

(2) If the transferee conceals or assists in the concealment of the transaction that is the subject of the application for relief or of facts material to the grounds for relief, the 1-year period mentioned in subsection (1) commences at the time that the person making the application knew of the transaction or the material facts, but no application for relief is to be commenced more than 5 years from the date of the transaction.

Comment: An order for relief impacts the transferee, not the debtor. Therefore concealment of facts by the debtor does not affect the limitation period if the transferee is not involved.

(3) If the debtor becomes bankrupt before the end of the 1-year period mentioned in subsection (1), the debtor's trustee in bankruptcy may bring an application for an order for relief if the transaction that is the subject of the application for relief occurred during the period that begins on the day that is 1 year before the date of bankruptcy and that ends on the date of bankruptcy, but no application for an order for relief is to be commenced by the trustee more than 1 year after the date of bankruptcy.

Comment: Subsection 24(3) responds to the fact that the trustee in bankruptcy of a bankrupt debtor may challenge transactions at undervalue and preferential transfers to creditors under both the *Bankruptcy and Insolvency Act (BIA)* and provincial law. The trustee may consider proceedings under this Act if relief is not available under federal law. Under the *BIA*, the trustee may challenge transactions that occurred

within a period of time calculated from the date of bankruptcy and reaching back a specified number of months or years. The time that elapses after the date of bankruptcy before proceedings are commenced is not relevant. This enables the trustee to investigate the bankrupt's affairs, identify suspect transactions and take action. Subsection 24(3) allows the trustee to apply for relief under this Act in relation to a transaction that occurs within 1 year prior to the date of bankruptcy, giving him or her a similar opportunity to consider whether relief may be available under provincial law. Without such a rule, the limitation period might expire within days of the trustee's appointment and before any investigation has been made, thereby precluding relief. Unlike the *BIA*, subsection 24(3) imposes an end date on the period of time during which proceedings must be commenced by the trustee.

PART V

Repeals

Statute of Fraudulent Conveyances repealed

25 The Act of the Parliament of England commonly called The Statute of Fraudulent Conveyances, being 13 Eliz. I, c. 5 (1571), is repealed to the extent that it applies to subject matters within the legislative jurisdiction of [name of jurisdiction].

[in jurisdictions where that Act is still in effect]

Repeal

26 [insert name of relevant legislation] is repealed.