Reviewable Transactions in Insolvency
the recognition of creditors' interests
in “subjective” and “objective” insolvency regimes

by

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ABSTRACT

A person on the eve of bankruptcy may enter into transactions or arrangements that are intended to, or that have the effect of, preserving its property from being seized and distributed among creditors. Such transactions may provide a bankrupt with collateral benefits such as the continued use and enjoyment of property, or they may benefit third parties such as members of the bankrupt's family, or they may benefit selected creditors to the detriment of others. The effect of such transactions is to frustrate the legislative scheme which provides for the distribution of a bankrupt's residual property. This effect may be desired by a bankrupt or by a recipient of the bankrupt's property, or it may be unintended.

Insolvency legislation confers wide powers upon a trustee in bankruptcy to "review" such transactions by bringing proceedings to reverse their effect and recover the value lost to the bankrupt's estate. Reviewable transactions comprise two main categories: dispositions or unequal transactions in which a debtor parts with property for no or insufficient consideration (such as a transfer of property to a spouse or a sale in which a bankrupt does not receive a fair price) and preferential repayments of debts owed to certain creditors to the detriment of others.

Reviewable transaction laws in Canada and England have a subjective basis in that they focus upon the intent of a debtor to defeat creditors or prefer one creditor over others. In contrast, relevant Australian and New Zealand laws have an objective focus and provide remedies where the effect of a transaction, rather than the intent of a debtor, is to defeat the interests of creditors.

This paper conducts a comparative critique of reviewable transaction regimes. It makes the argument that subjective regimes tend to reflect their historical origins in fraud law and a desire to punish and frustrate the fraudulent intent of a bankrupt; an inappropriate policy foundation that fails to address the competing interests and policy considerations which should form the basis of reviewable transaction law. Objective regimes, which focus upon the effect of impugned transactions, provide more appropriately for the balancing of creditors' and recipients' interests and the making of provision for policy considerations. This paper also considers collateral effects of reviewable transaction regimes upon creditors' interests (such as effects upon claims to property recovered by a trustee) in a variety of circumstances and concludes that the results are often inconsistent and undesirable. In this respect the relative positions of secured and unsecured creditors are described in detail and proposals for reform are ventured.
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CHAPTER ONE: INTRODUCTION

The trustee of a bankrupt's residual estate or the liquidator of an insolvent company¹ may seek to overturn or reverse transactions entered into by the debtor prior to bankruptcy which have a detrimental effect upon the interests of unpaid creditors, or some of them. A common feature of such transactions is that they have the effect of removing value from the bankrupt's estate, typically by disposing of or otherwise dealing with property in such a way that it becomes unavailable for distribution among creditors. Such disposals may take many forms including gifts of property by a debtor to friends or relatives, transactions in which a debtor parts with property for a fraction of its value, grants of security over a debtor's assets and preferential repayments to selected creditors. A debtor may enter into such a transaction with an intent to defeat creditors, to obtain a collateral benefit for itself, to benefit the recipient, or to confer a benefit upon a particular creditor, or it may act quite innocently with no thought (or even knowledge) of its own insolvency. Where it comes to the notice of a trustee that such a transaction has occurred, the trustee owes a duty to creditors to investigate the transaction and, where possible, recover the value removed from the bankrupt estate.

This paper examines transactions which are capable of becoming the subject of recovery action² instituted by a trustee in bankruptcy, which shall be referred to generally as "reviewable transactions". The causes of action in common law jurisdictions share a common origin in early English law and while in Canada and England the relevant laws have survived relatively unscathed for centuries, in Australia and New Zealand an extensive and ongoing reform process has resulted in fundamental changes. This paper explains the interests and principles which reviewable transaction laws are required to address and the different emphasis placed upon those interests in regimes which emphasise the intent of a debtor in entering into a transaction, compared with those that focus upon the effect of a transaction. The development of reviewable

¹ A natural person is typically declared "bankrupt" and a "trustee" is appointed to administer the estate, whereas a corporation is put into "liquidation" or "wound up" and a "liquidator" is appointed. Where the distinction is immaterial this paper employs the terms "bankrupt" and "trustee" generally, and where necessary reference is made to "natural persons" as distinct from "companies". The term "debtor" is used to refer to a person or company prior to its bankruptcy.
² A trustee may issue proceedings to re-open and effectively reverse a reviewable transaction, e.g. by recovering money or other property disposed of by a debtor or by obtaining a declaration that a security executed by a debtor is void.
transaction law is traced and the present law in each of the four jurisdictions under study is described and discussed. A comparative critique of the relevant legislation is undertaken, along with an examination of issues which arise in the course of that critique, with a view to determining an appropriate legislative structure.

In addition to examining the effect of reviewable transaction regimes as between creditors and recipients of value from a bankrupt, their effect upon the relative interests of secured and unsecured creditors is equally important and this aspect of reviewable transaction law is also considered in this paper. The differences between subjective and objective review regimes do not in this context assume the significance they have with respect to the relative interests of creditors and recipients, although there are circumstances in which the difference is important. Instead, the differences between the regimes under study, which are significant, reflect differing responses to particular policy issues raised by the convergence of reviewable transaction law and securities law, or in some cases, apparently unexpected collateral effects. The effect of the enactment of a Personal Property Security regime in some of the jurisdictions under study, and the likely effect of proposals to enact similar legislation elsewhere, is considered.

Reviewable transaction regimes in England and Canada (and New Zealand, in the bankruptcy of natural persons) strongly reflect their origins in eighteenth century fraud law, and the fraudulent intent of a debtor in entering into an impugned transaction remains the primary element in a reviewable transaction claim. A debtor's intent is equally significant in the review of preferences, the rules for which are based largely upon the rules for the review of dispositions even though the applicable policy considerations differ significantly. The intent of a debtor to defeat or prefer creditors features to a much lesser extent in Australia, where its significance is limited to extending the time period during which transactions may be attacked by a trustee. The intent of a debtor is not relevant for the purposes of New Zealand's company provisions except where a recipient of a debtor's property knows of such an intent.

In Australia (and New Zealand with respect to companies) there has been a fundamental shift in the basis of reviewable transaction legislation from a subjective focus upon the intent of a debtor to an objective focus upon the effect of a transaction upon the interests of creditors. Objective
regimes are generally regarded as being more "pro-creditor" than subjective regimes as it is
normally easier to prove the effect of a transaction than to prove that a debtor held the requisite
intent. In either form of regime defences are provided for the relief of innocent recipients of the
debtor's property. The potential for objective regimes to disadvantage deserving recipients is
addressed by defences which reflect policy considerations such as the maintenance of confidence
in outwardly normal business transactions and the protection of family maintenance payments.
Unfortunately, the existence of a defence where a transaction occurs "in the ordinary course of
business" has given rise to considerable interpretative difficulties, exacerbated by the absence of
any legislative guidance as to what the phrase is expected to achieve. In Australia this defence
has recently been excised from the companies legislation, although oddly it remains in effect
with respect to transactions involving natural person debtors, who are less likely to be carrying
on "business" than corporations. While noting the theoretically "objective" nature of the test, the
courts have interpreted "in the ordinary course of business" in a manner which in effect admits
as relevant the existence or otherwise of an intent to prefer on the part of the debtor.

While it may be tempting to view the introduction of objective reviewable transaction regimes in
common law jurisdictions as the inevitable outcome of reform, this is not the case. Recent
 commissions formed to investigate the status of insolvency law in Canada and England have
considered and rejected proposals to enact an objective regime of the type in force in Australia,
New Zealand and the U.S.A. While this paper notes the strong influence of historical origins
upon present-day reviewable transaction law in Canada and England, the continued existence of
subjective regimes in those jurisdictions must be viewed as the product of deliberate policy
decisions rather than a reflection of legislative inertia.

This paper makes the argument that the intent of a debtor is not relevant to the policy issues that
should underlie reviewable transaction law, and that the objective approach provides more
appropriately for the balancing of the respective interests of creditors and recipients and the
recognition of public interest considerations. An alienation of property shortly before
bankruptcy should not be permitted to frustrate creditors' legitimate claims. This principle
applies equally where a recipient is itself a creditor. Balanced against creditors' claims are the
interests of innocent recipients of a bankrupt's property who have an expectation that a
transaction entered into in good faith will not be overturned, and upon whom review of a
transaction may work an injustice where they give value or alter their position in reliance upon the transaction. In addition to the interests of individual recipients, a wider public interest in the maintenance of confidence in outwardly normal commercial transactions must be recognised. Even where a party to a transaction with an insolvent debtor knows of the debtor’s difficulties there is a public interest in permitting persons in financial trouble an opportunity to trade their way out of it, and a reviewable transaction regime should not operate to discourage other parties from assisting them. The intention of a debtor when entering into impugned transactions is not obviously relevant to any of these considerations; even in transactions which confer a collateral benefit upon a bankrupt it is the knowledge of the bankrupt as a recipient of the benefit, rather than its knowledge as a provider, that is relevant to the balancing of interests. It is submitted that reviewable transaction regimes should be founded upon the proposition that unsecured creditors are prima facie entitled to share proportionally in a bankrupt’s estate, subject to priority claims (see Appendix), and that situations in which it may be considered inequitable or would have undesirable consequences to require a creditor or any other transferee to make restitution are best dealt with by specific exceptions and defences.

With respect to the effect of reviewable transaction regimes upon the respective interests of secured and unsecured creditors, the objective review regimes in Australia and New Zealand are generally more aggressive than the subjective regimes in Canada and England in the sense that they are more likely to operate to the detriment of secured creditors. While specific provisions for the review of securities themselves are seldom of significant effect in any of the jurisdictions under study, securities are more likely to be declared void in objective regimes under general provisions for the review of preferences or dispositions. In some jurisdictions provisions intended to deal with particular circumstances, such as repayments to creditors who hold both secured and unsecured debt, or repayments to creditors whose security is subsequently declared void, have unfortunate consequences. Ironically, most of these issues would be more properly addressed by a general review of reviewable transaction principles. In circumstances where money or property is repaid or returned to a creditor or a trustee the rights of creditors often depend upon fine distinctions which result from inconsistent developments in the common law. A number of the deficiencies identified in this paper may be satisfactorily addressed by the enactment of a Personal Property Security regime of the type in force in many of Canada’s provinces.
CHAPTER TWO: ORIGINS AND HISTORY OF REVIEWABLE TRANSACTION LAW

2.1 Origins of reviewable transaction law in Roman law and English common law

The problem of the debtor who, aware of impending financial collapse, transfers its property to third parties and out of the reach of creditors, is ancient. An early example of legislation designed to prevent dispositions of property made to defraud creditors appears in the Institutes promulgated by the Roman Emperor Justinian. Early English laws designed to prevent debtors from disposing of their property to defeat creditors describe prohibited conduct with remarkable precision. The earliest English statute dealing with dispositions to defeat creditors was enacted in 1376 to permit the seizure by execution process of property transferred by a debtor to its acquaintances in an attempt to defeat creditors and so "... live a great Time with an high Countenance of another Man's Goods." A statute of 1379 encapsulated the problem of fraudulent conveyances in providing for the situation where:

"... the Debtors make feigned Gifts and Feoffments of their Lands and Goods to their Friends and others, and after withdraw themselves, and flee into Places of Holy Church privileged, and there keep themselves a long Time, and take the Profit of their said Lands and Goods so given by Fraud and Collusion, whereby their Creditors have long been and yet be delayed of their Debts and Recovery, wrongfully and against good Faith and Reason."

The founding legislation for modern reviewable disposition law is the Statute of Elizabeth of 1571 which provided for the review of "feigned, covinous or fraudulent" conveyances, gifts, grants and other dispositions "devised and contrived of malice, fraud, covin, collusion and guile" to or for an intent or purpose to delay, hinder or defraud creditors and others. In addition to the "hindrance of the due course and execution of law and justice", the likely result of such conduct

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4 Fraudulent Assurances of Lands or Goods, to Deceive Creditors, shall be void, 1376-7 (50 & 51 Edw. 3), c. 6.
5 For Relief of Creditors against fraudulent Deeds made by Debtors, 1379 (2 Rich. 2), c. 3. A number of similar statutes were subsequently enacted, e.g. An Act against Fraudulent Deeds of Gift, 1487 (3 Hen. 7), c. 4, which rendered void deeds given with intent to defeat creditors. See generally C. R. B. Dunlop, Creditor-Debtor Law in Canada, 2nd ed. (Ontario: Carswell, 1995) at 593.
6 An Act against fraudulent deeds, alienations etc. 1571 (13 Eliz. 1), c. 5 perpetuated by 1586-87 (29 Eliz. 1), c. 5. The Statute was amended by the Law of Property Amendment Act 1924 and repealed and replaced by the Law of Property Act 1925, c. 20.
was said to be nothing short of “the overthrow of all true and plain dealing, bargaining and chevisance between man and man, without the which no commonwealth or civil society can be maintained or continued.” The Statute of Elizabeth grounded the action for review of a disposition firmly in criminal fraud law and provided that persons who were parties to a transaction in contravention of the Statute were liable to be imprisoned for half a year and forfeit the value of the property involved (or a year’s value, in the case of land) which was to be divided equally between the Crown and the aggrieved creditors. Such was the emphasis placed upon the punishment of fraudulent conduct that until it was held otherwise in Mannocke’s Case it was arguable that the sole purpose of the Statute was to enact criminal penalties and that it did not provide for the re-opening and reversal of offending transactions for the benefit of creditors. The Statute appears to have been claimed by the courts as a development of the common law, although the basis of the action was clearly statutory and development was interpretive.

The frustration of a debtor’s fraudulent ambitions was not to be achieved at the expense of innocent recipients of the debtor’s property. The Statute provided that a conveyance would not be reviewed where a recipient gives good consideration, in good faith, having no notice or knowledge of the fraud committed by the debtor. This defence survives in some form in almost all modern reviewable transaction laws.

The evolution of rules for the avoiding of preferences occurred much later than the action for review of dispositions. The reason for this was that at common law transactions which preferred a genuine creditor over others were unobjectionable. The law provided methods by which creditors could obtain repayment of debts and their use was not thought fraudulent. As a result, where a debtor neared insolvency the race among creditors was to the swiftest; priority was determined by the order in which creditors filed writs against a debtor’s property. The undesirable effects of competition among creditors for the property of an insolvent resulted in a

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7 (1571), 73 E.R. 661. In Connors v. Egli et al., [1924] 1 W.W.R. 1050 (Alta. C.A.) the Court noted at 1052 that the Statute of Elizabeth did not pretend to grant a civil remedy for damages.

8 In Cadogan et al. v. Kennett et al. (1776), 2 Cowp. 433, 98 E.R. 1171 (K.B.) at 1172 Lord Mansfield expressed the view that the law of fraudulent conveyances was tantamount to a development of the common law on the basis that the common law was “so strong against fraud in every shape” that it would have developed every provision made by the statute in any event.

9 Statute of Elizabeth, section 6.
1542 statute which provided for a rateable distribution of a bankrupt's assets among creditors. The disadvantage suffered by individual creditors who did not proceed with sufficient haste against an insolvent debtor was regarded as less of a concern than the "unseemly scramble" which resulted when a debtor's insolvency became known and which reduced the overall value realised from the debtor's assets. Furthermore, the common law rule provided a strong disincentive for creditors to allow temporarily insolvent debtors the necessary time to arrange their affairs and trade out of financial difficulties, and it was recognised that there was a public interest in allowing them to do so.

If the principle of equal treatment of creditors was to have any real effect then pre-bankruptcy transactions which preferred creditors and thereby subverted the equality principle required to be addressed. While the Statute of Elizabeth was thought to be of broad application it did not prevent transactions which preferred a creditor over others unless the transaction was designed to provide a collateral benefit to the bankrupt. During the eighteenth century, in the absence of statutory provision rules for the review of preferences developed at common law. The purpose of these rules was to maintain the principle of equality in the bankruptcy statutes. The rules were similar in many respects to modern "subjective" preference laws in that they focused upon the intent of the debtor and provided defences where a debtor's intent was overborne by pressure from a creditor or where a transaction occurred in the ordinary course of business.

The first statutory provision for the review of preferences was section 76 of the Joint Stock Companies Act 1856 which provided for the review of preferences given by companies. It was soon followed by section 92 of the Bankruptcy Act 1869 which provided similarly for

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10 An Act against such Persons as make Bankrupt, (34 & 35 Hen. 8), c. 4, provided "... to every of the Said Creditors a Portion Rate and Rate alike, according to the Quantity of their Debts." The Act also imposed criminal penalties upon persons who assisted a debtor to remove property from the jurisdiction.

11 See e.g. T. H. Jackson, "Of Liquidation, Continuation and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules" (1986), 60 American Bankruptcy Law Journal 399 at 402 to 403.

12 Lord Mansfield said that the Statute "cannot receive too liberal a construction, or be too much extended in suppression of fraud." See Cadogan v. Kennett, supra n8.


14 For a short discussion of the history of this development see Re Wilcoxon: ex parte Griffith (1883), 23 Ch. D. 69 at 74 (C.A.) per Bowen LJ.

preferences given by natural person debtors. These statutes, which did not depart significantly from the common law, set the pattern for reviewable preference law which in England and Canada has survived fundamentally unchanged to the present day by providing for the review of preferences where there is proof of a fraudulent intent on the part of the debtor, with defences for persons who receive property in good faith and give valuable consideration.

2.2 The distinction between dispositions and preferences

Reviewable transactions fall into two distinct categories. The first of these is “dispositions” which are transactions in which a debtor parts with property or otherwise gives value for no or insignificant consideration, such as transfers of property into the name of a debtor’s spouse or to a friend. A debtor’s intention in making a disposition may be to obtain some collateral benefit (such as the ability to continue living in a house) or it may be to confer a benefit upon the recipient (e.g. a friend or family member). Akin to dispositions are “unequal transactions” in which a debtor receives valuable, but inadequate consideration. Unequal transactions may be shams by which a debtor intends to transfer value to another party, but they also include genuine transactions such as desperate sales of property to raise much-needed cash, in which both the debtor and the recipient may be innocent of any intent to prejudice creditors.

The second category of reviewable transactions are “preferences”, which are transactions between debtors and creditors which have the effect of allowing those creditors to recover proportionately more of their debt than other creditors. Preferences typically take the form of selective repayments of debts to preferred creditors but may also comprise grants of security or transfers of property. A debtor may give a preference with intent to benefit a particular creditor out of friendship or shared interest, or may do so under pressure from a creditor, or the preference may be an unplanned outcome of the debtor’s normal dealings. Reviewable transaction regimes also provide separately for the review of transactions in which a debtor

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16 (19 & 20 Vict.), c. 47.
17 (32 & 33 Vict.), c. 71. Earlier reference to (but not provision for) preferences appears in section 82 of the Bankruptcy Act 1825 (6 Geo 4), c. 16.
18 Re Wilcoxson; ex parte Griffith, supra n14.
grants a security interest over its property to a creditor, which provisions operate concurrently with general provisions for the review of preferences.

While dispositions prejudice all creditors, preferences benefit some creditors to the detriment of others. The courts have historically been reluctant to review payments of debt to legitimate creditors. This reluctance has lessened over time but a clear distinction between dispositions/unequal transactions and preferences remains.

2.3 Reviewable transaction law in Canada, Australia and New Zealand

The English model was adopted in Canada, the USA, Australia and New Zealand and the Statute of Elizabeth was recognised as effective with respect to fraudulent dispositions.19 In Canada, a Relief of Insolvent Debtors Act20 passed in Ontario in 1859 dealt in part with fraudulent preferences. The federal government asserted its constitutional jurisdiction over bankruptcy21 with the passage of Insolvent Acts in 186922 and 187523 to deal with insolvent traders, but those statutes were repealed in 1880.24 In the absence of federal legislation, an Act to Abolish Priorities Of and Amongst Execution Creditors25 was passed in Ontario in 1880 which included provision for fraudulent preferences, followed by An Act Respecting Assignments for the Benefit of Creditors26 in 1885, and by 1903 all other provinces except Prince Edward Island had enacted similar legislation. A federal Bankruptcy Act27 was again passed in 1919, but relevant

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19 For authorities with respect to the adoption of the Statute of Elizabeth in Canada and the USA see Dunlop, supra n 5 at 595, n21 and n22. In New Zealand see the Imperial Laws Application Act 1988 and sections 60 and 61 of the Property Law Act 1952. In Australia see A. R. Keay, Avoidance Provisions in Insolvency Law, (Sydney: LBC Information Services, 1997) at 17.

21 Section 91 of the Constitution Act, 1867.
22 1869 (32 & 33 Vict.), c. 16.
23 1875 (38 Vict.), c. 16.
25 1880 (Ont.), c. 10.
26 1885 (Ont.), c. 26.
27 1919 (Can.), c. 36.
portions of the provincial legislation remained in force. Although the legislation has been amended and replaced from time to time, this basic legislative structure remains in place today with concurrent operation of federal and provincial assignments, conveyances and preference legislation. The federal Bankruptcy and Insolvency Act ("BIA") provides for the review of dispositions (as "settlements"), unequal transactions (as "reviewable transactions") and preferences.

In addition to an action under the BIA, review proceedings may be brought under complementary provincial legislation. This paper will consider in particular British Columbia’s Fraudulent Preference Act ("FPA") and Fraudulent Conveyance Act ("FCA") which are similar to legislation enacted in other provinces. The original form of the FCA repeated the Statute of Elizabeth word for word, and although it has been revised to a limited extent the existing caselaw remains relevant.

The incorporation of the criminal sanctions in the Statute of Elizabeth into Canadian law has been doubted as a result of the enactment of Canadian legislation to similar effect and similar statutes passed in Canadian provinces provide only for civil remedies. This does not signify a rejection of the basis of the cause of action in fraud law, however, as the statutes in Canada continued to rely upon the intent of a debtor and refer to "fraud" and "fraudulent" conveyances,

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28 See Dunlop, supra n5 at 596, n31. Some provinces repealed all but the fraudulent conveyance and preference sections of their statutes.


31 R.S.B.C. 1996, c. 163.


33 Fraudulent Conveyance Act, R.S.B.C. 1960, c. 155.


35 The existence of penal provisions was accepted in Millar v. McTaggart (1891), 20 O.R. 617 (C.A.) but rejected in Connors v. Egl., supra n7 on the basis that the Fraudulent Preference Act impliedly repealed the Statute of Elizabeth even though it did not include criminal penalties. The Court observed at 1055 that the offences in the Statute of Elizabeth were on a level with minor misdemeanors in modern times and that criminal penalties for fraudulent conveyances were enacted in the Criminal Code, R.S.C. 1886, c. 173, section 28.
and both the BIA and the Criminal Code enact criminal sanctions with respect to fraudulent dispositions, separately from the sections which provide civil remedies.\textsuperscript{36}

Reviewable transactions in both personal and corporate insolvency are governed by a single piece of legislation in Canada, England (as a result of a recent amendment) and in the USA.\textsuperscript{37} This is not the case in Australia and New Zealand, where reviewable transactions in personal and corporate insolvency are provided for separately (and not consistently).

In Australia and New Zealand, as will be seen in the following chapters, the basis of reviewable transaction law has been dramatically altered from a basis in subjective fraud law to an inquiry into the effect of a transaction, and a debtor's intent or wrongdoing is of little or no relevance. While this may appear to be a result of greater interest in reform in those jurisdictions,\textsuperscript{38} in England and Canada official papers and reports on the state of bankruptcy law have been undertaken and relevant statutes have been amended in recent years, yet the opportunity to adopt an objective regime of the type in effect in Australia, New Zealand and the U.S.A. has not been taken. The retention of the subjective review regime thus appears to reflect a conscious policy decision rather than legislative inertia.

\begin{footnotesize}
\begin{enumerate}
\item See Part VIII of the BIA.
\item In the USA a Uniform Fraudulent Conveyance Act and a Uniform Fraudulent Transfer Act have been widely adopted and the Bankruptcy Code is also relevant.
\item Dunlop, \textit{supra} n5 at 599 with respect to Canada complains of the "... glacial speed of reform of these creaky statutes".
\end{enumerate}
\end{footnotesize}
Transactions in which a debtor disposes of its property prior to bankruptcy without receiving valuable consideration in return have an obvious potential to disadvantage creditors, as such transactions reduce the value of the estate available for distribution. The same is true of transactions in which a debtor receives some value, but is disadvantaged by a significant disparity between the value of property disposed of and the value of the consideration received.

3.1 Review of dispositions and unequal transactions under Canadian provincial legislation

It is appropriate to begin an examination of present day reviewable transaction laws with those of earliest origin, and then consider provisions of later development. In Canada, in the absence of federal bankruptcy statutes between 1880 and 1919 bankruptcy legislation was enacted at a provincial level. Provision for the review of dispositions and unequal transactions was made by legislation in terms similar to the Statute of Elizabeth, which legislation remains in place today. In British Columbia the relevant statute is the Fraudulent Conveyance Act ("FCA").

The FCA is a model of legislative brevity which comprises two short sections. The ambit of the FCA is substantially similar to that of the Statute of Elizabeth in that it provides for the review of dispositions entered into with intent to delay or defraud creditors. Section 1 of the FCA provides that a disposition of property, bond, proceeding or order, if made to delay, hinder or defraud creditors and others of their just and lawful remedies, is void against a person whose rights and obligations “by collusion, guile, malice or fraud” are or might be disturbed, hindered, delayed or interrupted.

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39 Ontario and other provinces passed several statutes to replace the federal legislation, including Creditors’ Relief Acts (or Creditors’ Assistance Acts), Assignments and Preferences Acts, chattel security registration statutes and Bulk Sales Acts.

40 See supra n32 for examples of Canadian provincial legislation.

41 Supra n31.

42 This includes a grant of security, see McRae v. Gifford, [1993] B.C.J. No. 36 (alt. cit. B.C.J. No 660) (B.C.S.C.), online: QL (BCJ). In Nova Scotia a “transfer of property” has been held to include the granting of a debenture for the purposes of the Nova Scotia Assignments and Preferences Act, see Wilson Equipment Ltd. & Ors v. Union Construction Ltd. (1979), 41 N.S.R. (2d) 1 (N.S.S.C.).
defrauded, despite a pretence or other matter to the contrary. Where a recipient gives no or nominal consideration the requisite intent need only be held by the debtor, but where valuable consideration is given both the debtor and the recipient must share a fraudulent purpose of conferring some benefit upon the debtor and thereby defrauding creditors. There is no cause of action under the FCA where the purpose of the parties is to confer a benefit upon a party other than the debtor, such as the conferring of a preference or other benefit upon a creditor. It is not necessary to prove that creditors were in fact disadvantaged by the transaction; all that must be proved is that there was an intent to delay, defeat or defraud them, an indication that the FCA is fundamentally a punitive statute under which the relief of creditors is a collateral objective. The FCA is not limited by an express review period.

Section 2 provides a defence for a recipient of property who gives good consideration, in good faith, having no knowledge of collusion or fraud at the time of the transfer. Good faith in this context requires only that a recipient not share in a scheme for conferring an advantage upon a debtor; where the object of a transaction is to benefit a recipient creditor rather than a debtor, the requisite good faith will still be present. Valuable consideration for the purposes of the section requires more than nominal consideration, but the consideration need not bear any relation to the value of the property received.

43 Oliver v. McLaughlin et. al. (1893), 24 O.R. 41 (C.A.) at 51; Bank of Montreal v. Ngo and Wong supra n34 at 73.


45 Dunlop supra n3 at 599 argues that the decision of the Ontario Court of Appeal in Optical Recording Laboratories Inc. v. Digital Recording Corp. (1990), 1 O.R. (3d) 131 (C.A.) runs contrary to the long-established view that the FCA does not prevent a debtor preferring one creditor over another unless the preference is a mere cloak to secure a benefit to the debtor. A closer reading of the case reveals that it is not authority for the proposition that a preference may be reviewed under the FCA; the finding was only that the FCA was not rendered inapplicable by reason only that the recipient was a creditor, and a cause of action could lie where the debtor obtained a benefit from the transaction.


48 Dunlop, supra n5 at 608 cites authorities for the proposition that consideration need not be adequate to support the transaction, although it must be more than nominal. While there is some question as to whether the existence of prior debt is sufficient consideration, recent decisions indicate that the courts may imply a forbearance to sue as amounting to sufficient consideration. See First Royal Enterprises Ltd. v. Armadillo's Restaurant Ltd., ibid.
Unequal transactions are actionable under the FCA only where the recipient lacks good faith, as the consideration required by section 2 need not reflect the value of the property received.

3.2 Review of dispositions and unequal transactions under federal Canadian legislation

Canada's federal bankruptcy legislation distinguishes between dispositions in which the debtor receives no significant consideration at all, and unequal transactions in which the consideration received does not reflect the value of the transferred property. The BIA provides separately for review of dispositions as "settlements" which (subject to certain limitations) are transactions in which a debtor receives no significant consideration in return for a disposition of property, and "reviewable transactions" (for clarity, referred to in this paper as "unequal transactions") which are transactions not at "arm's length" in which a debtor fails to receive fair market value for property disposed of. The distinction between settlements and unequal transactions no longer features in other jurisdictions, which make general provision for the review of transactions in which a bankrupt does not receive adequate value.

Section 91 of the BIA provides for the review of "settlements." A definition of the term "settlement" has recently been inserted in the BIA to include a number of forms of transaction in which value may be transferred. While the inclusive nature of the statutory definition has suggested to some that the decided cases will continue to influence the interpretation of the provision, the statutory definition eliminates an important distinction previously recognised in the caselaw between a settlement (in which a donor intends that property settled be retained in some form for the donee or the donor) and a gift (in which a donor intends that the donee should

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49 Section 2 of the BIA provides that a "settlement" includes a contract, covenant, transfer, gift or designation of beneficiary in an insurance contract, to the extent that it is gratuitous or made for merely nominal consideration. This definition was inserted by amendment in 1992, prior to which there was no statutory definition.

50 L. W. Houlden & C. H. Morawetz, The 1995 Annotated Bankruptcy and Insolvency Act, (Canada: Carswell, 1995) at 234. The authors note the importance of distinguishing between a settlement and a gift, citing pre 1992 authorities which explain the distinction. With respect, it is submitted that as a result of the statutory definition this distinction is no longer present.
be free to do with the property as the donee sees fit) by including "a gift" within the definition of a settlement. Settlements will continue to include transfers recognised by the caselaw such as a transfer in which a debtor retains a total or partial ability to control the use or disposition of the property,\textsuperscript{51} a transfer whereby the debtor retains some benefit from the property (such as where the family home is transferred into the debtor's spouse's name and the debtor continues to live in it) and gifts to charity.\textsuperscript{52} A grant of security is reviewable as a settlement of property for the purposes of section 91.\textsuperscript{53}

A feature of the section 91 action which is unusual in Canadian reviewable transaction law is that the intent of a debtor is not the central element of the cause of action. Section 91 provides that a settlement is reviewable if made within a one year review period, extended to five years where a trustee can prove that a debtor was unable to pay its debts without the aid of the property settled, or that the interest of the debtor in the settled property did not pass on the execution of the settlement.\textsuperscript{54} The action depends upon the effect of the transaction being to convey value away from the estate of the debtor, and the intention of the debtor is not relevant.\textsuperscript{55} This is in marked contrast to other reviewable transaction actions in Canada, which generally focus upon the intent of the debtor in entering into the impugned transaction. The power to review transactions which occur up to five years prior to bankruptcy is extensive compared with other review periods under the BIA,\textsuperscript{56} but in a practical sense it is mitigated by the increasing difficulty a trustee will face in


\textsuperscript{52} T.D. Bank v. Miller (1990), 1 O.R. (3d) 528 (Gen. Div.).

\textsuperscript{53} A mortgage was held capable of being the subject of a section 91 settlement in Re Kingsbury Properties, [1999] A.J. No 559 (Alta. Q.B.), online QL (OJRE) at 11. Section 2 defines "settlement" inclusively and a grant of security will presumably be a "contract" or a "transfer" of an interest (section 97(d) expressly includes a giving of security as a "contract, dealing or transaction") and section 91(3)(b) provides an exception for an "incumbrancer" in good faith and for valuable consideration. In Australia the relevant legislation no longer refers to settlements, but prior to amendment the giving of a floating charge was held not to be a settlement as no proprietary interest is created until crystallisation, see Lyford v. Commonwealth Bank of Australia (1995), 130 A.L.R. 267 at 273. (Prior to the enactment of the section 2 definition it was held in A. H. Boulton Co Ltd. v. Trusts and Guarantee Co. Ltd.; Re Bozanich, supra n51 at S.C.R. 140 that a chattel mortgage was not a settlement and it was doubted whether an arrangement between debtor and creditor could ever be a settlement within the meaning of the Act.)

\textsuperscript{54} The review period runs from one year (or five years, as described above) prior to the initial bankruptcy event to the date of bankruptcy.


\textsuperscript{56} The review period for many preference actions, for example, is only three months prior to bankruptcy.
proving the elements of an action (and refuting elements of a defence) the greater the time period between the settlement and the bankruptcy.

A defence is available where a settlement is made in favour of a purchaser or incumbrancer in good faith and for valuable consideration. It is the purchaser or incumbrancer who must act in good faith and the intention of the debtor is irrelevant. The requirement for valuable consideration seems somewhat redundant when it is considered that a transaction will not be a settlement in the first place unless it is gratuitous or for merely nominal consideration, and it has been held that the “valuable consideration” element of the defence will not be satisfied where the consideration given is merely nominal. The section further provides specific defences where a settlement is before and in consideration of marriage, and where a settlement is on or for a spouse or children of the debtor, of property that accrued to the debtor in right of the debtor’s spouse or children. Review of settlements in consideration of marriage is provided for separately under section 92 of the BIA.

Where property has been transferred in a reviewable settlement the property is deemed to be property of the bankrupt, which the trustee may recover. Where a recipient has disposed of settled property, the proceeds of sale are deemed to be the property of the trustee. The trustee may recover the property or proceeds from a third party who received it from the original

57 BIA, section 91(3)(b).
58 In most authorities the requirement of good faith means without knowledge of the debtor’s intent or insolvency. In Springridge Farms Ltd. (Trustee of) v. Spence (1991), 7 C.B.R. (3d) 228, 95 Sask. R. 193 (Q.B.) at C.B.R. 236 it was held that good faith meant simply “honestly”, but it is submitted that the Court’s unusual reliance upon dictionaries and non-bankruptcy cases in coming to this interpretation renders this dicta of questionable authority.

61 BIA, section 91(3)(a). The marriage must not have been entered into for the purpose of defeating creditors, see Bulmer v. Hunter (1869), L.R. 8 Eq. 46, 38 L.J. Ch. 543.
62 BIA, section 91(3)(a) and (c).
63 Section 92 provides for the review of covenants or contracts to make settlements upon a spouse or children in consideration of marriage, in respect of property in which the debtor had no interest as at the date of the marriage, if the covenant or contract had not been executed at the date of the initial bankruptcy event (although a beneficiary may claim after all other creditors are paid).
recipient, although such a third party will have a defence if it received the proceeds or property in good faith and for adequate valuable consideration (in which case the trustee may recover the value of the property from the original recipient).\textsuperscript{65}

Section 100 of the BIA provides for the review of unequal transactions.\textsuperscript{66} Where a debtor sells, purchases, leases, hires, supplies or receives property or services in a transaction which is otherwise than at “arm’s length”\textsuperscript{67} during a one year review period,\textsuperscript{68} and the value given or received (as the case may be) by the debtor is “conspicuously”\textsuperscript{69} greater or less than the fair market value of the property or services, the transaction will be reviewable and a court may give judgment against any other party to the transaction for the difference in value. This section is an effective tool for the reversal of unequal transactions, its primary restriction being that it is applicable only where the parties are not at arm’s length.

No defence is provided for the benefit of persons who happen to have obtained a good deal from the debtor, in good faith and for valuable consideration, although this apparently arbitrary feature is ameliorated by the requirements that the transaction be otherwise than at arm’s length (so that some form of shared undertaking between the parties is very likely) and that the difference in value be conspicuous or flagrant, so that both the debtor and a recipient of property should realise that something is amiss. While the remedy provision is framed permissively (“may”) the Court has a duty to grant a remedy for the benefit of creditors where the elements of the action are satisfied.\textsuperscript{70}

\textsuperscript{65} BIA, section 98.

\textsuperscript{66} As previously noted, the BIA terms such transactions “reviewable transactions”.

\textsuperscript{67} BIA, section 3. Persons related to each other are deemed not to deal with each other at arm’s length.

\textsuperscript{68} The review period pursuant to section 100(1) runs from the date one year prior to the initial bankruptcy event to the date of bankruptcy, both dates included.

\textsuperscript{69} Conspicuously means in a striking, notable, flagrant or gross manner, see \textit{Re Pacific Mobile Corp. v. Robitaille v. American Biltrite (Can.) Ltd.} (1979), 34 C.B.R. (N.S.) 8 (Que. S.C.) rev’d (1982), 44 C.B.R. (N.S.) 190 (Que. C.A.).

While the causes of action under sections 91 and 100 of the BIA and under the FCA all address transactions in which a debtor disposes of property or value without receiving adequate consideration in return, transactions are actionable under the three provisions in quite different circumstances. The FCA action is based upon the intent of the parties to a transaction to defraud or delay creditors. The action under the BIA for the review of settlements focuses primarily upon the effect of the transaction, and although as a result of the defence for innocent recipients the nature of the transaction must be known by or apparent to a recipient, the intent of the debtor is not an element of the action. The BIA unequal transaction action effectively requires that both parties be aware of the nature of the transaction, as the transaction must be other than at arm’s length and the difference in value must be conspicuous. It is noteworthy that Canadian legislation does not provide for review of unequal transactions entered into at arm’s length, which are actionable in other jurisdictions. A trustee may bring proceedings under both the BIA and the FCA concurrently, with the effect that a disposition may be challenged either on the basis that the debtor and creditor intended to defeat creditors, or that it has the effect of defeating creditors in the case of a “settlement.”

3.3 Dispositions and unequal transactions: a combined approach in other jurisdictions

In jurisdictions outside Canada review legislation commonly provides for the review of dispositions and unequal transactions together, as both forms of transaction fundamentally involve a debtor receiving inadequate consideration. Provisions for the review of dispositions and unequal transactions in other jurisdictions do not differ from the Canadian legislation to the same extent as do provisions for the review of preferences, but there are significant points of distinction. Provision is typically made for transactions which have the effect of transferring value from a debtor, and while in some jurisdictions provision is made for transactions in which a debtor intends to defeat creditors (as under the FCA) this does not normally take the form of a separate action, but instead extends the length of a review period. The most significant differences occur with respect to whether a recipient who deals with a debtor in good faith and for valuable consideration may escape review, and whether consideration given by a recipient must bear some relation to the value of the property disposed of by a debtor.
In England section 339 of the Insolvency Act ("IAE") provides for the review of unequal transactions (including dispositions) involving insolvent natural persons, and section 238 provides in materially identical terms for the review of unequal transactions involving insolvent corporations. A transaction which occurs within a six month review period (extended to two years where the parties are connected)\(^1\) at a time when the debtor is unable to pay its debts or becomes unable to do so as a result of the transaction,\(^2\) may be reviewed where the terms of the transaction provide that the debtor will receive no consideration\(^3\) or where the value of the consideration in money or money's worth is "significantly less" than the value of the consideration provided by the debtor. Where the debtor and the other party to the transaction are "connected" it is presumed unless the contrary is proved that the debtor was unable to pay its debts or became unable to do so as a result of the transaction.\(^4\) Where a transaction is reviewable a court may make an order to restore the position to what it would have been if the debtor had not entered into the transaction.

Where the debtor is a company, section 238(5) provides a defence where the debtor entered into the transaction in good faith and for the purpose of carrying on its business, if at the time of the transaction there were reasonable grounds for believing that the transaction would benefit it. No such defence is available where the debtor is a natural person. Defences are also provided for third parties who do not deal directly with the debtor company but acquire property or receive a benefit in good faith and for value from a person other than the debtor company.\(^5\) In each case there is no defence for a recipient who enters into a transaction with a debtor in good faith and for valuable consideration. The availability of a defence where a debtor company enters into a transaction in good faith renders the intent of the debtor relevant to the action to a limited extent.

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\(^1\) The review period runs from six months prior to the presentation of a petition to the date of the bankruptcy order (or where applicable the six months prior to the date of voluntary liquidation) extended to two years where the company and the other party to the transaction are connected (i.e. related), see IAE, section 341 for natural persons and section 240 for companies.

\(^2\) IAE, section 341(2) for natural persons and 240(2) for companies.

\(^3\) In the case of a natural person, including transactions in consideration of marriage.

\(^4\) See supra n72.

\(^5\) IAE, section 342(2) in the case of natural persons and section 241(2) in the case of companies. IAE, section 342(2A) in the case of natural persons and section 241(2A) in the case of companies provide that where a person has knowledge of the relevant surrounding circumstances (i.e. the undervalue and the liquidation proceedings) or was connected with the insolvent, the requisite good faith is presumed absent unless the contrary is proven.
The English legislation makes separate provision for transactions in which a debtor intends to defraud creditors, similarly to the action under the FCA. Section 423 of the IAE provides in both personal bankruptcy and corporate insolvency\textsuperscript{76} for the review of unequal transactions\textsuperscript{77} in which a debtor receives no consideration, or in consideration of marriage, or where the value of the consideration in money's worth is significantly less than the value of the consideration provided by the debtor, and which are entered into with the purpose\textsuperscript{78} of putting assets beyond the reach of or otherwise prejudicing the interests of creditors or potential creditors. The section is not limited by an express review period. Section 425(2) provides a defence for third parties who acquire property or receive a benefit from a transaction in good faith for value and without notice of the circumstances, from a person other than the debtor. Certain market transactions and default proceedings entered into by clearing houses or investment exchanges are exempted.\textsuperscript{79}

The primary advantage of the section 425 action over the unequal transaction provisions of the IAE is that the section 425 action is not limited by a review period. However, the further in time a transaction is removed from a bankruptcy the more difficult it is likely to be for a trustee to prove the requisite intent to defraud creditors. In addition, a trustee need not prove that a debtor was insolvent at the time of a transaction for the purposes of a section 425 action, although proof of an intent to defraud creditors will seldom be present where a debtor is solvent. The practical significance of proof of an intent to defraud is therefore limited.

In Australia, section 120 of the Bankruptcy Act 1966 (Cth) ("BA")\textsuperscript{80} provides for the review of unequal transactions, including dispositions, entered into by natural persons. The section is similar to the English provision. A transaction\textsuperscript{81} is reviewable if the recipient gives no

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\textsuperscript{76} The term used is "person", which unless a contrary intention appears includes an incorporated body, pursuant to section 5 of the Interpretation Act 1978 (Eng).

\textsuperscript{77} The term "transaction" is very wide and appears to include a grant of security; IAE, section 425(c) includes the release or discharge of security among the remedies a court may grant.


\textsuperscript{79} Section 165(1)(c) of the Companies Act 1989 (Eng).

\textsuperscript{80} The relevant provisions of the BA were extensively amended in 1986 and prior authorities must be read with caution. The new provisions appear to have been based upon the English IAE, see Keay, supra n19 at 201.

\textsuperscript{81} "Transaction" appears to include a grant of security, see Explanatory Memorandum to the Bankruptcy Legislation Bill 1996, para 85.1. Under prior legislation, the definition of a settlement included reference to an "encumbrance",
consideration\(^2\) or consideration worth less than the market value\(^3\) of the property received, and the transaction occurs within a two year review period (or within five years where the debtor was insolvent at the time of the transaction).\(^4\) There is a curious defence for a third party who acquires property from the original recipient in good faith and for consideration at least as valuable as the market value of the property transferred\(^5\) which is considerably less generous than defences made available in other statutes for the protection of innocent third parties, and indeed such a transaction would not fall within the ambit of the review provision in the first place. There is no defence for a person who receives property in good faith for valuable consideration, but obtains a bargain. Further defences are provided to protect specific classes of payments including tax and maintenance payments.\(^6\)

Prior to amendment in December 1996, the focus of section 120 differed significantly from that of the present provision. The unamended provision focused upon particular forms of transaction rather than general descriptions of transactions which disadvantage creditors, including the review of “settlements” which had a similar meaning to that under Canada’s BIA prior to the enactment of a statutory definition.\(^7\) The amended provision merges provision for dispositions with all other forms of unequal transaction.

Where there is proof of a debtor’s intent to deprive creditors of the value of property transferred in an unequal transaction, section 121 of the BA is the Australian equivalent in relation to natural persons of section 423 of the IAE. As under the English provision, there is no review period. A

\(^2\) Familial relationships and agreements to marry have no value as consideration, see BA, section 120(5).

\(^3\) BA, section 120(7). Market value is defined as the value if disposed of to an unrelated purchaser bidding in a market on an ordinary commercial basis without any discount or incentive for purchase being offered, and does not include a “fire sale” at discounted prices because of a need by the insolvent person to liquidate assets.

\(^4\) The review period is two years prior to the bankruptcy, extended to five years where the transferee cannot prove that the transferor was solvent at the time of making the transfer. See BA, section 120(3).

\(^5\) BA, section 120(6).

\(^6\) BA, section 120(2).

\(^7\) "Settlement" was not exhaustively defined and attracted much discussion. In short, it meant a dealing with property for the purpose of the property being held and enjoyed by some other person (ie. not immediately disposed of).
transfer of property\textsuperscript{88} may be reviewed where the property would probably have become part of a bankrupt's estate or available to creditors had it not been transferred, and the bankrupt's main purpose in making the transfer was to prevent the property from becoming available to creditors or to hinder or delay the process of making it available. A trustee is assisted by a presumption that this purpose is present if it can reasonably be inferred from the circumstances that the bankrupt was or was about to become insolvent at the time of the transfer, a presumption absent from the English legislation. Section 121(4) provides a defence for a recipient who gives consideration\textsuperscript{89} which is at least as valuable as the market value of the property, does not know of the debtor's purpose in making the transfer and could not have reasonably have inferred that the debtor was or was about to become insolvent. Where the transfer is reviewable, section 121(5) provides that the recipient is entitled to the return of any consideration given.

Dispositions and unequal transactions entered into by companies in Australia are governed by section 588FB of the Corporations Law 1991 (Cth) ("CL"),\textsuperscript{90} as "uncommercial transactions". A transaction may be reviewed under this section if the debtor company is insolvent at the time of the transaction or becomes insolvent as a result of it, the transaction occurs within a two year review period (extended to four years where the parties are related)\textsuperscript{91} and a reasonable person in the company's circumstances would not have entered into the transaction taking into account the benefits for and detriment to the company, the respective benefits to other parties to the transaction and any other relevant matter. The section is noteworthy for its objective standard regarding whether a reasonable person would view the transaction as uncommercial; a liquidator need not prove bad faith.

A recipient will have a defence where it became a party to the transaction in good faith, without having reasonable grounds to suspect that the company was insolvent or would become so (and that a reasonable person in the recipient's circumstances would have had no grounds for so suspecting), and either provided valuable consideration or changed its position in reliance upon

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\textsuperscript{88} The concept of transfer of property is identical to that in section 120.

\textsuperscript{89} BA, section 121(6). As with section 120, familial relationships have no value as consideration.

\textsuperscript{90} The CL was substantially amended by the Corporate Law Reform Act 1992 (Cth).

\textsuperscript{91} The review period is two years prior to the presentation of a liquidation application (together with the period from the application to the liquidation order) or the date of voluntary liquidation, extended to four years where the company and the other party to the transaction are related, see CL, section 588FE.
the transaction. A defence is also provided for third persons who are not parties to the transaction if they either received no benefit from the transaction, or received a benefit in good faith without having reasonable grounds to suspect that the company was insolvent or would become so. The defence does not require that the consideration given by a recipient bear any relation to the value of the benefit obtained provided that the extent of any disparity is not such that it would cast doubt upon the recipient’s good faith. This defence is considerably more generous to innocent recipients than the corresponding defence under the BA in the case of natural persons.

Where a corporate debtor intends to deprive creditors of the value of property transferred in an unequal transaction, section 588FE(5) of the CL provides similarly to section 423 of the IAE. Where an insolvent company enters into a transaction which is an uncommercial transaction for the purposes of section 588FB of the CL (or, incidentally, a reviewable preference) for the purpose of, or purposes including, defeating, delaying or interfering with the rights of its creditors, the review period is extended to ten years. Where a recipient of property gives good consideration, the trustee is required to prove the requisite intention on the part of both the company in liquidation and the recipient. As under the corresponding provision of the IAE, proof of an intent to prefer will seldom have any practical effect as the extension of the review period will not normally make a significant difference; the two or four year review period provided for the review of uncommercial transactions in general will cover most instances in which an intent could be proved and proving insolvency many years before a liquidation is often difficult.

92 This section differs from section 121, which provides for natural person debtors who intend to defeat creditors, in that under section 588FE the requisite intent may be one of several purposes of the debtor rather than its main purpose. However, insolvency must be proved in an action under section 588FE(5), which is not the case under section 121.

93 While the section, which requires that "... the company became a party to the transaction for the purpose ..." of defeating creditors, appears to refer only to the intent of the debtor company the case authorities indicate that the requisite intent must be shared by debtor and recipient where good consideration is given, see Re Johnson (1881), 20 Ch. D. 309; Re Barnes, ex parte Stapleton, (1962) Qd. R. 231; (1961), 19 A.B.C. 126 (S.C).

94 Intention to defeat creditors is not easily proved, see Keay, supra n19 at 237.

The Australian provisions for the review of dispositions and unequal transactions are based primarily upon the effect of a transaction rather than a fraudulent intent. It is noteworthy that in the enactment of section 588FE(5) of the CL all references to “fraud” were eliminated thereby removing any imputations of criminality. The knowledge and intention of the recipient are of lesser importance than is the case under the Canadian legislation as the BA provides no defence for a recipient of property unless the value of the consideration given is relative to that of the benefit received, although under the CL a recipient need only have given valuable consideration or altered its position. Where an intent by a debtor to defeat creditors can be proved, the resulting extension of review periods has the effect of increasing the likelihood (albeit minimally) that a recipient of property will be required to make restitution to a trustee. This distinction, based solely upon the debtor’s intent, may appear somewhat arbitrary to a recipient who acts in good faith and gives valuable consideration, as it is a recipient rather than the debtor who is obliged to account to the trustee where a transaction is reviewable.

In New Zealand the Insolvency Act 1976 ("IA") governs the review of transactions involving debtors who are natural persons and the Companies Act 1993 ("CA") governs reviewable transactions where the debtor is a corporation. Section 54 of the IA provides for the review of dispositions and unequal transactions in the bankruptcy of natural persons. The predecessor of the IA provided for the review of “settlements” in a similar manner to Canada’s BIA but the ambit of the section was broadened to include a wide range of transactions as “gifts” or as “dispositions”. Any disposition is reviewable if it is also a “gift” which is defined in section 54(6) as a disposition made otherwise than in good faith and for valuable consideration, and it is made within a two year review period (extended to five years where the debtor is unable to pay its debts both on and after the date of the transaction). The requirement of good faith appears

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96 Keay, supra n19 at 237 argues that the removal of the term “fraud” had no effect upon the action, which remains dependent upon proof of a purpose of defeating, delaying or interfering with the rights of creditors. It should be noted, however, that the intent of a debtor is relevant under the Australian provisions only for the limited purpose of extending the review period and, as Keay recognises, the provision is seldom used. The significant point is that the debtor’s intent is irrelevant for the purposes of the primary reviewable transaction actions in Australia, and in this context the removal of reference to fraud is both significant and appropriate.

97 “Dispositions” are defined in section 2 of the IA to include (inter alia) any conveyance, assignment, transfer, settlement, delivery, payment or other alienation of property, creation of a trust, grant of lease, mortgage, charge, licence, right, power, estate, interest, or any other transaction entered into by a person with intent to diminish the value of its estate and increase the value of another. “Disposition” includes a grant of security.

98 The review period is the two years prior to the date of bankruptcy, extended to five years where the recipient cannot prove that the bankrupt was able to pay its due debts at the time of the disposition or at any time thereafter prior to the bankruptcy.
to be that of the recipient of the property, rather than the debtor; good faith for the purposes of
the section means that the recipient has no notice that the debtor’s actions are injurious to its
creditors.99 Valuable consideration need not reflect the value of the property transferred, but its
adequacy may be inquired into to determine whether the transaction is a sham.100 A court may
accept past consideration as valuable consideration if it thinks it just and equitable to do so.

Section 58(6) of the IA provides a defence for persons who receive a disposition101 in good faith
and alter their position in a reasonably held belief that the transaction is validly made and will
not be reviewed, but only where it would be inequitable if relief was not granted either in whole
or in part. The effect of this provision is to allow a recipient which did not give valuable
consideration to escape review where it has changed its position in reliance upon the receipt.
Section 58(5) provides a defence for third parties who receive a disposition from a person other
than the bankrupt in good faith and for valuable consideration. As under section 91 of the BIA,
section 54(4) provides an exception for covenants or contracts to make settlements upon a
spouse or children in consideration of marriage in respect of property in which the debtor had no
interest as at the date of the marriage, if the covenant or contract had not been executed at the
date of the initial bankruptcy event (although a beneficiary may claim after all other creditors are
paid).102

99 In Mackintosh v. Pogose [1895] 1 Ch. 505 the Court held that it is sufficient if there is good faith on the part of the
recipient, and this rule was approved in Re Hume, ex parte Official Assignee (1909), 28 N.Z.L.R. 793 at 803; see
Spratt and McKenzie’s Law of Insolvency; (Wellington: Butterworths, 1972) at para 54/2a argues that in this context
a reliance upon the debtor’s intention would be unfair and it is the recipient’s bona fides which should determine
whether the transaction is actionable. While this seems sensible, reliance upon the intent of a debtor rather than that
of a recipient is a common feature of subjective reviewable transaction law. McKenzie observes that the question
remains open, as in Re Hume the relevant provision referred to a settlement made “... in favour of a purchaser or
incumbrancer in good faith ...” whereas section 54 omits reference to a purchaser or incumbrancer. It is submitted
that the distinction is not significant; a disposition must be made in favour of someone.

100 Re Hume, ex parte Official Assignee (1909), 28 N.Z.L.R. 793 at 803; Ex parte Benjamin and Jacobs, Re Benjamin
and Jacobs (1890), 10 N.Z.L.R. 110.

101 This defence is also available in the review of preferences, see infra n182 and accompanying text.

102 IA, section 54(4). Section 54(5) further provides that a payment of money pursuant to such a covenant is
reviewable if made within a two year review period, if the debtor is unable to pay its due debts at the time of the
payment, unless the payment is pursuant to a covenant or contract to pay money or transfer property expected to
come to the debtor from or on the death of a particular person named in the covenant or contract and is made within
three months of the money or property coming into the possession or control of the debtor.
Unequal transactions are construed as dispositions to the extent that the value of the property received exceeds the value of the consideration given to the debtor. Where a debtor intends the difference to be a gift and it would itself be a reviewable disposition, the transaction is reviewable.

Section 297 of the CA provides for the review of dispositions and unequal transactions in the liquidation of companies in New Zealand, as "transactions at an undervalue". A transaction entered into within a one year review period is reviewable if the company receives no consideration or benefit or the value of the consideration or benefit received is less than the value of that provided, and either the company is unable to pay its due debts or becomes unable to do so as a result of the transaction, or is engaged in business for which its financial resources are unreasonably small, or incurs an obligation which it knows it will not be able to perform. The other party to the transaction must have known, or ought to have known, of the company's inability to pay the debts, carry on the business or fulfil the obligation (as relevant). Where a transaction is reviewable a liquidator may recover the difference in value between the consideration provided to and that received from the company. There are no specified defences, although the requirement that the recipient have knowledge or constructive knowledge of the company's position effectively provides a defence for innocent parties who act in good faith, even where inadequate consideration is given.

Neither the IA nor the CA make special provision for circumstances where an intent by a debtor to defraud creditors can be proved, although section 298 of the CA makes special provision for the review of unequal transactions involving directors and other specified persons related to a debtor company. Where a company acquires or disposes of a business, property, services or shares from or to a director of the company or nominee, a person with control of the company, another company controlled by the same person or a related company, within a three year review

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103 The term "transaction" is defined inclusively in section 297(3)(a) but only the giving of a guarantee is specifically included (cf. section 292 in which the term is defined to include a giving of a security or charge over a company's property). It is generally thought that the term encompasses the giving of security, see Brown et al, infra n109 at para CA297.04.

104 The review period runs from one year prior to the date of commencement of the liquidation (or the date of the liquidation application to the Court, as the case may be) to the date of liquidation, see CA, section 297(3)(b).
period a liquidator may recover any difference in value as a reviewable transaction. There is no requirement for a liquidator to prove insolvency, and there are no defences against a liquidator's review action.

In summary, the cause of action under the FCA is the most fraud-orientated of the laws providing for the review of dispositions and unequal transactions under consideration in this paper. The action for review of unequal transactions under section 100 of the BIA does not expressly require a fraudulent intent on the part of the debtor, but the requirement that the parties to the transaction be otherwise than at arm's length imputes an element of shared fortune and collaboration. The BIA action for the review of settlements, on the other hand, does not rely upon a debtor's intent in any respect. The actions for the review of dispositions or unequal transactions involving natural person debtors in England and Australia do not rely upon a debtor's intent, although in both jurisdictions an intent of a corporate debtor to defraud creditors has some relevance; in England to the defence available where a company believes in good faith that a transaction will assist it to carry on its business, and in Australia to the defence available where a reasonable person in the company's position would have entered into a transaction having regard to all its detriments and benefits. In both England and Australia separate provision is made concerning the review of transactions in which an intent to defeat creditors may be proved, but the practical effect of the resulting time extensions is limited. In New Zealand, the intent of a debtor is not relevant in an action for the review of a disposition or an unequal transaction.

In general, jurisdictions which rely upon the effect of a transaction rather than a debtor's intent as the basis for a cause of action tend to minimise the protection available to an innocent recipient of property who gives valuable consideration, although there is no necessary connection between the two. In most cases the innocent recipient of a transfer in Canada who gives valuable consideration, even if it is inadequate compared with the value of the property received, will not be subject to a trustee's review action. An innocent recipient who gives valuable consideration is protected from review under the BIA's settlement provision (this defence will seldom be necessary as by definition a settlement is a transfer which is gratuitous or

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103 The review period runs from three years prior to the date of commencement of the liquidation, or the date of the liquidation application to the Court as the case may be, to the date of liquidation, see CA, section 298(4).
for merely nominal consideration) and under the FCA. A recipient is protected under the BIA unequal transaction provision only where the value of consideration given is not conspicuously less than that received, although a transaction will not be reviewed in the first place unless it is not at arm’s length which in most cases will imply some knowledge on the part of a recipient. Protection for innocent recipients is less comprehensive in England and Australia where an unequal transaction may be reviewable even where a recipient is innocent and gives good (although inadequate) consideration, although in Australia a “change of position” defence is available to an innocent recipient of property from a corporate debtor. In New Zealand there is a defence for a recipient from a natural person debtor who gives valuable consideration in good faith, and a defence for a recipient from a corporate debtor who acts without knowledge or constructive knowledge of the debtor company’s insolvency.

Review periods under the English, New Zealand and Australian legislation are generally similar to those in Canada. In England and New Zealand, as under Canada’s BIA, third parties who receive property from a debtor are protected if they act in good faith and give valuable consideration. In Australia third parties are protected under the personal bankruptcy provisions if they act in good faith and give consideration equal to the value of the property received, and under the companies provisions if they act in good faith without reason to suspect insolvency.

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106 See IAE, section 341(2) and 240(2) (six months, or two years where parties connected); BA, section 120(3) (two years, or five years where debtor insolvent); CL, section 588(FE) (two years, or four years where parties connected); CA, section 297(3)(b) (one year); IA, section 54 (two years, or five years where debtor insolvent).

107 See IAE, sections 342(2A) and 241 (2A); IA, section 58(5). The relevant provision under the CA, section 297, provides no power for a liquidator to recover from third parties in the first place.

108 BA, section 120(6); CL, section 588FG.
Preferences are transactions which allow certain creditors to recover proportionately more in a debtor's bankruptcy than the general pool of creditors. Some transactions may be reviewed both as dispositions or unequal transactions and as preferences.

Preference issues typically arise where a creditor receives a repayment of debt or takes security over existing unsecured debt, as these are both transactions capable of placing a recipient creditor in a better position than other unsecured creditors. Where a creditor gives equal value in a transaction to that received from the debtor, such as a cash sale of property, the receipt by the creditor is not normally viewed as a reviewable preference as while preferential in the sense that the seller receives immediate payment while other creditors go unpaid, the transaction taken as a whole does not reduce the pool of assets available to other creditors.109

4.1 Review of preferences under Canadian provincial legislation

In many provinces legislation has been enacted to provide for the review of transactions which confer preferences upon creditors.110 This paper examines British Columbia's Fraudulent Preference Act, R.S.B.C. 1996, c. 164; Fraudulent Preferences Act R.S.S. 1978, c. F-21; Fraudulent Preferences and Conveyances Act, R.S.Y.T. 1986, c. 72; Fraudulent Preferences Act R.S.A. 1980, c. F-18; Assignments and Preferences Act, R.S.O. 1990, c. A-33.

109 The exemption of this type of transaction from review tends to be explained differently depending upon whether the review legislation focuses upon the effect of a transaction or the intent of a debtor as the basis for review. In jurisdictions which focus upon a debtor's intent to prefer a creditor, such as Canada's BIA, it seems to be accepted that such transactions do have the effect of conferring a preference upon a recipient creditor (after all, a recipient creditor will receive payment of at least part of its debt in full, while other creditors recover nothing or only a percentage of their debt) but they are regarded as non-reviewable on the basis that the intention of the debtor in such circumstances is to give the payment or disposition in order to obtain the new goods or services, not to prefer the creditor; see e.g. Re Mac-Wall Contracting Ltd. (1970), 14 C.B.R. (N.S.) 52 (Ont. S.C) at 52. In jurisdictions which focus upon the effect of a transaction, such as Australia (and New Zealand, with respect to company liquidations) such transactions are regarded as non-reviewable on the basis that the indebtedness contemplated by the legislation is past indebtedness, so that a person who gives fresh value in return for a payment or disposition from a debtor does not receive a preference because the positions of other creditors are unaffected by the transaction; see section 122 of the Bankruptcy Act 1966 (Cth) and Burns v. Stapleton (1959), 102 C.L.R. 97; sections 588FA to FG of the Corporations Law 1991 (Cth); also D. Brown et al., Insolvency Law, looseleaf (Wellington: Brooker's, 1996) para CA292.11.

Preference Act which is similar to legislation enacted in other provinces and territories. The FPA provides that a disposition of property may be reviewed if the debtor is insolvent or on the eve of insolvency at the time of the transaction and that the transaction was entered into with an intent to “defeat, hinder, delay or prejudice creditors or some of them” or to “give the creditor preference over other creditors or some of them.” Authorities diverge as to whether, unlike an action under the BIA, the requisite intent to prefer must be shared by both the creditor and the debtor. An intent to prefer on the part of the debtor may be proved absent by evidence that the debtor granted security under genuine pressure from a creditor or had some other intention in entering into the transaction. Section 4 of the FPA provides that it is unnecessary to prove an intent to prefer where a transaction has the effect of conferring a preference and within 60 days of the transaction either a proceeding to review the transaction is brought, or the debtor makes an assignment for the benefit of creditors (ie. becomes voluntarily bankrupt). This provision does not merely raise a presumption of intent to prefer, but removes the element of intent entirely so that proof that a debtor lacked an intent to prefer, such as evidence of pressure, cannot preserve a transaction. Section 6(2) ensures that where a debtor sells property and arranges for the purchaser to pay the purchase price directly to a creditor, the payment will be reviewable as though the money had passed through the hands of the debtor.

111 Supra n30. The FPA may be used by a trustee in bankruptcy, see Re Davidson (1922), 52 O.L.R. 244 (S.C); Re Panfab Corp., [1971] 2 O.R. 202 (S.C.).

112 Sections 6(4) and 6(5) indicate that a granting of security is contemplated as a “disposition of property”. In Toronto-Dominion Bank v. Terrace Bavarian Inn Ltd. (1977), 24 C.B.R. (N.S.) 214 (B.C.S.C) the provision was held applicable to a mortgage.

113 In Adams & Burns v. Bank of Montreal & Ors, [1899] 8 B.C.R. 314 (Full Court) at 337, aff’d (1901), 32 S.C.R. 719 (S.C); fil’d in Bossin v. Vancouver Folk Music Festival Society, supra n48 at 18, it was held that proof of the requisite intent was required for both debtor and recipient. The requirement that a recipient share a debtor’s intent is not present in an action under the BIA, and Dunlop, supra n5 at 632 observes that there is no reason why the intent of the recipient should be relevant under the FPA either. In the New Brunswick case of Federal Business Development Bank v. Van Klaveren (1979), 51 A.P.R. 79 at 84 (N.B.Q.B.); fil’d Bank of N.S. v. MacDonald (1982), 41 C.B.R. (N.S.) 140 at 144 (N.B.Q.B.) it was held that the intention of a recipient under an identical provision was not relevant on the basis that the BIA provision had so been interpreted.


115 Section 5(2)(b) of the FPA removes any doubt by providing expressly that evidence of pressure by a creditor cannot protect a disposition from review under section 4 (although the defences in section 6 still apply). See Bank of Montreal v. Ngo & Wong, ibid. at 185. Cf. section 95 of the BIA, discussed below, pursuant to which evidence of pressure by a creditor is never admissible to disprove an intent to prefer.

116 Cf. Ontario’s Assignments and Preferences Act which provides a rebuttable presumption of intention to prefer whereas the B.C. legislation provides that intention is not a requirement at all. In Alberta and Saskatchewan, as in B.C., either proof of fraudulent intent is not required or where such proof is required the presumption as to its existence is irrebuttable.
A significant limitation upon the ambit of the FPA is that it does not enable the review of payments of money by a debtor to a creditor, but applies only to transfers of property other than cash and grants of security.\footnote{117}{See Law Reform Commission of British Columbia, \textit{Working Paper No. 53, Fraudulent Conveyances and Preferences}, (Vancouver: The Commission, 1986) at 103.}

Section 6 provides defences for a recipient creditor. The defences are limited in scope and are seldom used.\footnote{118}{Ibid. at 104.} Section 6(1) provides that a transaction will not be reviewable where money or property transferred bears a fair and reasonable relative value to the consideration, to a sale in good faith, to a payment made in the ordinary course of business to innocent persons, to a payment to a creditor, or to a disposition of property in good faith, provided that the transfer (or security) is given in consideration of a present actual payment of money or disposition of property in good faith.\footnote{119}{The section is poorly drafted; for an interpretation of the elements of this defence see McRae v. Gifford, supra n42 at 20 to 21. The requirement of a present actual payment of money or transfer of property is present in each of the circumstances in which the defence applies.} The requisite good faith will be absent where the creditor has knowledge of the debtor's insolvency or of circumstances from which an ordinary person of business would conclude that the debtor was insolvent, but mere negligence by the creditor will not suffice to affix knowledge.\footnote{120}{Toronto-Dominion Bank v. Terrace Bavarian Inn Ltd., supra n112 at 217; Gulf Fraser Fishermen's Credit Union v. W. R. Menchions & Co Ltd. (1965), 55 W.W.R. 191 (B.C.C.A.) at 192; Jack Ceve Ltd. v. Irving et al (1978), 26 C.B.R. (N.S.) 142 (S.C.B.C.) at 149 to 150.} Other defences protect the position of secured creditors. Section 6(3) provides that a creditor who gives up security in consideration for a transaction which is subsequently declared reviewable is entitled to the return of the security, section 6(4) provides a defence for a creditor who gives up a security in return for a repayment of debt so that the value of the estate available to other creditors is not lessened and section 6(5) provides that a security given in respect of an existing debt will not be void where the giving of the security caused an advance of money by the creditor to the debtor in a belief in good faith that the advance would enable the debtor to continue in business and pay its debts in full. The defences do not apply where a debtor consents to an entry of judgment with intent to defeat or delay creditors.
4.2 Review of preferences under Canadian federal legislation

As is the case with unequal transactions, preferences may be reviewed under the federal BIA, under provincial legislation, or both. Section 95 of the BIA provides for the review of preferences in the bankruptcy of individuals and corporations in Canada. A conveyance, transfer, charge or payment given by a debtor in favour of a creditor within a three month review period (or one year where the creditor and debtor are related)\(^\text{121}\) prior to the bankruptcy will be reviewable where the debtor intends\(^\text{122}\) to give the creditor a preference and the debtor is insolvent\(^\text{123}\) at the time of the transaction. While it was once thought difficult for a creditor with knowledge of a debtor’s insolvency to rebut the presumption that the debtor held an intent to prefer\(^\text{124}\) it is now clear that a creditor’s knowledge or intention is irrelevant.\(^\text{125}\) Where a transaction has the effect of conferring a preference (which will always be the case in a section 95 action as there must be a preference in fact for the transaction to be reviewable)\(^\text{126}\) the

\(^{121}\) The review period is three months prior to the initial bankruptcy event, extended to one year where the debtor and creditor are related, see BIA, section 96. “Related” is defined in section 4 in terms of blood, marriage or adoptive relationships for natural persons, and in terms of de jure control with respect to corporations. The date of the transaction is the date on which the security becomes effective. In some cases this has been held to be the date of registration of the security, see *Re Can Corp Financial Services Ltd. (1992)*, 10 C.B.R. (3d) 12 (Ont. C.J.) at 15, but in other cases it has been held to be the date of execution of a binding agreement, see *Re Yorkville Homes Ltd. (1986)*, 62 C.B.R. (N.S.) 70, 46 Alta. L.R. (2d) 281, [1986] 6 W.W.R. 54, 73 A.R. 223 (Alta. Q.B.).


\(^{123}\) “Insolvent person” is defined in section 2 of the BIA to mean a person whose debts exceed $1,000 and who is unable to pay, has ceased to pay, or whose property is of insufficient value to enable it to pay, its debts as they become due. The elements of inability to pay debts and insufficiency of property to meet debts are common in statutory definitions of insolvency.


\(^{126}\) *Re Taylor; ex parte Mason (1922)*, 3 C.B.R. 454, 23 O.W.N. 293; *Peat Marwick Thorne Inc. v. Malasic, supra n122* at C.B.R. 61.
requisite intent to prefer is presumed to exist in the absence of evidence proving the contrary.\textsuperscript{127} This effectively requires a recipient creditor to prove the absence of intent of another person (the bankrupt) who is not a party to the review action.\textsuperscript{128}

A creditor may rebut the presumption of intent by showing that the debtor did not know it was insolvent,\textsuperscript{129} or that the debtor entered into the transaction with some other intention. A wide range of alternative intentions have been successfully proved in order to defeat preference actions. Where the debtor's intent is to obtain fresh consideration from a creditor\textsuperscript{130} it has been held that there is no intent to prefer for the purposes of the BIA. Where a creditor continues to supply a debtor after a preferential transaction this may show that the debtor's intention was to carry on business in the usual way rather than to prefer the creditor\textsuperscript{131} and similarly where a creditor refuses to supply goods or services to a debtor until a transaction occurs is given it is likely that the debtor's intent will be to obtain the goods or services rather than to prefer the creditor.\textsuperscript{132} Where the preferential transaction is a giving of security by a debtor, the requisite intent to prefer will be absent where the debtor's intent is to honour a prior agreement to give security.\textsuperscript{133} Proof that a creditor pressured a debtor into a preferential transaction was once a

\textsuperscript{127} BIA, section 95(2). The presumption of intent is rebuttable, see Peat Marwick Thorne Inc. v. Malasic, supra n122 at C.B.R. 61. (Section 95(2.1) exempts margin deposits made by members in clearing houses from the operation of this presumption).


\textsuperscript{129} A debtor cannot intend to prefer a creditor unless the debtor knows that other creditors will go unpaid, see Peat Marwick Thorne Inc. v. Malasic, supra n122.

\textsuperscript{130} Re Mac-Wall Contracting Ltd., supra n109.


\textsuperscript{132} Re Coopers & Lybrand Ltd. v. Deloitte Haskins & Sells, supra n125 (refusal to complete tax returns); Re Kovalcik (1973), 18 C.B.R. (N.S.) 69 (Ont. S.C) (refusal to ship merchandise); Davis v. Duncan Industries Ltd. (1983), 45 C.B.R. (N.S.) 290 (Alta. Q.B.) (refusal to provide further supplies); although a mere expression of willingness to make further supplies available was held insufficient to disprove an intent to prefer in Re Spectrum Interiors (Guelph) Ltd. (1979), 29 C.B.R. (N.S.) 218 (Ont. H.C.).

\textsuperscript{133} Security given for an existing debt pursuant to a prior agreement made outside the three month limit from the bankruptcy will usually be protected, see Re Blenkarn Plainer Ltd (1958), 37 C.B.R. 147, 14 D.L.R. (2nd) 719, 26 W.W.R. 168 (B.C.S.C.); Coopers & Lybrand Ltd. v. Royal Bank (1977), 25 C.B.R. (N.S.) 118 (N.S.T.D.); provided the prior agreement adequately sets out the terms of the security (rather than a general promise to give security), see Re Carpet Warehouse (Saskatoon) Ltd. (1983), 49 C.B.R. (N.S.) 220 (Sask. Q.B.); and the debtor was not insolvent at the time the prior agreement was made, see In re Farrar (1964), 6 C.B.R. (N.S.) 235 (Ont. S.C); Re Bowering, supra n125. A prior agreement will not rebut an intent to prefer where the agreement was entered into with the intention of conferring a preference, see Re Marathon Music Inc., R.C.A. Ltd v. Canadian Imperial Bank of Commerce (1977), 24 C.B.R. (N.S.) 20, 1 B.L.R. 325 (Ont. S.C). Courts are generally skeptical of prior agreements, see Re Bowering at C.B.R. 202 and editorial comment upon In re Farrar at C.B.R. 240.
favourite means of establishing the absence of an intent to prefer, but in most jurisdictions this
defence has been removed by legislative amendment; a creditor is precluded from bringing
evidence that a debtor was pressured into a transaction in order to rebut the presumption of an
intent to prefer for the purposes of the BIA.\textsuperscript{134} An intent to prefer may also be absent if the
transaction took place in the “ordinary course of business”.\textsuperscript{135} The section does not provide a
defence for a recipient of a preference who acts in good faith, although where good consideration
is given it will often be possible to show that the debtor’s intention was to obtain the
consideration rather than to confer a preference.

Where a transaction occurs between the initial bankruptcy event (typically, the date of filing of a
bankruptcy petition) and the date of bankruptcy it will be rendered void unless it was given for
adequate valuable consideration and in good faith,\textsuperscript{136} as well as being subject to review under
section 95 as a preference.

Where a transaction is successfully reviewed under the BIA (whether as a preference or
otherwise) the trustee may recover the property, its value, or any proceeds from the person who
acquired it from the bankrupt\textsuperscript{137} or treat as void any security given in the transaction.\textsuperscript{138} The
trustee may also recover from a third party who did not acquire directly from the bankrupt, but a
third party has a defence where it gave adequate valuable consideration in good faith.\textsuperscript{139}

\textsuperscript{134} BIA, section 95(2). While in \emph{Houston v. Thornton} (1973), 18 C.B.R. (N.S.) 102 (Ont. S.C.) such evidence was
admitted to show that a payment was merely a response to pressure from an aggressive creditor so that there was no
“fraudulent scheme” to prefer the creditor, other authorities confirm that evidence of pressure is entirely irrelevant,
see \emph{Re Cadieau} (1927), 63 Que. S.C. 526, aff’d 7 C.B.R. 694, 40 Que. K.B. 386; \emph{Re Bridal Boutique Ltd.} (1980), 36
C.B.R. (N.S.) 134, aff’d 38 C.B.R. (N.S.) 95 (Ont. S.C.). On the other hand, proof of pressure does not indicate the
existence of an intent to prefer, see \emph{Re Arthur J. Lennox Contractors Ltd.}, supra n131 at C.B.R. 126 to 127.

\textsuperscript{135} \emph{Re Pacific Mobile Corp.; Robitaille v. American Biltrite (Can.) Ltd.}, supra n69.

\textsuperscript{136} BIA, section 97. In most cases transactions which occur between the date of filing of the petition and the date of
bankruptcy will not be more susceptible to review than transactions occurring before the date of filing of the petition
provided they are entered into in good faith. See \emph{Re Pick-N-Save Ltd.} (1973), 19 C.B.R. (N.S.) 42, 36 D.L.R. (3d)
344 (Ont. C.A.), discussed in F. Bennett, \emph{Bennett on Creditors’ and Debtors’ Rights and Remedies} (4th ed)
(Toronto: Carswell, 1994) at 716.

\textsuperscript{137} BIA, section 98(1) and (2).

\textsuperscript{138} The definition of “property” under section 2 of the BIA is wide enough to encompass a security interest.

\textsuperscript{139} BIA, section 98(3).
The BIA and FPA preference provisions are complementary in many respects. Under both statutes the cause of action is based upon an intent to prefer on the part of the debtor (with the exception of transactions within the 60 day period under the FPA) and require that the debtor be insolvent. Creditors may escape review in a variety of circumstances in which a debtor’s intent to prefer may be overborne by other pressures or interests. The BIA generally places the onus upon a creditor to prove that the requisite intent to prefer was absent whereas the FPA places the onus upon the trustee, but in other respects the FPA is normally the more potent weapon in the hands of a trustee. The ambit of the BIA is limited by an unusually short three month review period so that unless the recipient is related to the debtor (in which case the review period is one year) only preferences given in the last desperate months prior to bankruptcy are subject to review. In contrast, the FPA has no express review period and the review of transactions is limited only by general limitations principles and the increasing difficulties of proving a cause of action the further back in time a transaction occurred. The FPA is especially potent where a transaction occurs during the 60 day period in which intention need not be proved, as such a transaction will be reviewable unless the elements of a section 6 defence can be satisfied.

4.3 Review of preferences in other jurisdictions

Canada’s reviewable transaction provisions share a common ancestry with similar legislation in New Zealand, Australia and England. In most respects the Canadian model has remained true to its historical origins. In England a debtor’s intent remains an element of a preference action, but its significance has been reduced. In New Zealand and Australia the focus of preference legislation has moved from the intent of a debtor to the preferential effect of a transaction, with defences for the benefit of innocent creditors. This shift in focus from the intent of the debtor to the preferential effect of a transaction is the most significant point of distinction evident in jurisdictions outside Canada.
In England, an intent to prefer was originally required in an action for review of preferences involving natural person or corporate debtors. The IAE now requires only that a debtor be "influenced" into entering into a transaction by a desire to confer a preference, which is a lesser test as the requisite desire may be but one of several influences upon a debtor. Where the debtor and creditor are associates it is presumed unless the contrary is shown that the debtor was influenced into entering into the transaction by a desire to confer a preference. Proof that a debtor had no desire to confer a preference or was not influenced by such a desire will prevent review of a transaction but this will be more difficult than proving that it was not the debtor's dominant intent, as under the BIA. A transaction will be reviewable where the debtor is influenced by a desire to prefer a creditor, within a six month review period (extended to two years if the creditor is an employee of the debtor). The presumption does not apply where the creditor is an employee of the debtor.

Section 340 of the IAE provides for the review of preferences conferred by a natural person and section 239 and associated sections provide in materially identical terms for the review of preferences involving companies.

It will not be enough that a preference is the natural and probable consequence of the debtor's actions in the absence of the requisite "desire", see Re M C Bacon Ltd., [1991] Ch. 127, [1990] B.C.L.C. 324 at B.C.L.C. 335 to 336.

Section 340(3) defines a preference as where a debtor does or suffers anything to be done which has the effect of putting a creditor into a position which, in the event of the debtor's bankruptcy, is better than the position that creditor would otherwise have been in.

"Influenced by a desire" appears to be a lesser test than "intended" as the desire may be but one of several influences upon a debtor company, see Re M C Bacon Ltd., supra n41 at B.C.L.C. 335. Keay, supra n19 at 131, n92 deduces from the numbers of reported cases on point that few preference claims tend to be initiated in England, but this may be merely a reflection of greater rates of settlement in a jurisdiction where awards of costs contribute significantly to litigation risk.

Older English authorities must be read with caution in the light of the legislative amendment but will be relevant to the extent that a complete absence of desire or influence may be proved. The trustee bears the onus of proving the influence of a desire to prefer, see Re Hoyle, ex p Trustee, [1924] B. & C.R. 22, Re M Kushler Ltd, [1943] Ch. 248, [1943] 2 All E.R. 22. Proof of pressure upon the debtor to enter into the transaction may negate the requisite desire, see Re Walker, ex p Topham (1873), 8 Ch. App. 614, [1861 - 73] All E.R. Rep. 954; cf. Re Cooper, ex p Hall (1882), 19 Ch. D. 580, 51 L.J. Ch. 556; as will proof that the company's motivation was to perform a pre-existing agreement, see Re William Hall (Contractors) Ltd (in lig), [1967] 2 All E.R. 1150, 1 W.L.R. 948 at All E.R. 1159; or proof that the debtor's dominant intention was to keep on good terms with the creditor in the hope of obtaining continued services in the future as in Re FLE Holdings Ltd, [1967] 3 All E.R. 553, 1 W.L.R. 1409 at All E.R. 559; or that the transaction was in the ordinary course of business, see Re Cheesebrough, ex p Blackburn (1871), L.R. 12 Eq. 358. In one case it was even held that where a debtor who had committed a breach of trust made a preferential payment to a victim to repair the breach and assuage his feelings of guilt, his motivation was to repair the breach rather than to confer a preference and the transaction was not reviewable, see Re Lake, ex parte Dyer, [1901] 1 K.B. 710. It is submitted that this case was wrongly decided in that it confuses the debtor's motive for giving the preference (guilt) with his intent (to prefer), see Houlden & Morawetz, supra n50 at 249; for authority that moral motives do not remove an intent to prefer see Re Vingoe and Davies, ex parte Viney and Norton (1894), 1 Mans. 416; Re Aston (a bankrupt), ex parte Official Assignee, [1956] N.Z.L.R. 703. Cases in which a defaulting trustee was held not to have intended a preference may be distinguished on the basis that the trustee's intention in those instances was to avoid punishment rather than to assist the creditor, see Sharp v. Jackson [1899] A.C. 419, [1895-89] All E.R. Rep. 755; Re Fraser (1910), 29 N.Z.L.R. 1004; Official Assignee of Taylor v. Moorhouse (1885) N.Z.L.R. 4 S.C. 420.
years where the parties are associated) at a time when the debtor is insolvent or becomes so as a result of the transaction. Section 342(2) provides a defence for third parties who acquire property or receive a benefit in good faith and for value from a person other than the company. The review period, requirements of insolvency and the third party defences which apply in the case of preferences are the same as those that apply in the case of unequal transactions under the IAE.

Australian and New Zealand preference legislation differs significantly from that in Canada and England in that it focuses upon the preferential effect of a transaction rather than the intent of a debtor.

In Australia section 122 of the BA provides for the review of preferences where the bankrupt is a natural person. A transfer of property is reviewable if made by an insolvent debtor in favour of a creditor within a six month review period and the transaction has the effect of giving the creditor a preference, priority or advantage over other creditors. Section 122(2) provides a

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146 The review period is six months prior to the presentation of the bankruptcy petition, extended to two years where the bankrupt and the other party to the transaction are associated (other than by reason of the other party being an employee of the bankrupt), see IAE, section 341.

147 IAE, section 341(2).

148 Section 342(2A) of the IAE imposes a rebuttable presumption of lack of good faith where the recipient had knowledge of the circumstances of the preference or was connected to the company.

149 Section 341 of the IAE governs these elements for dispositions, unequal transactions and preferences.

150 In Australia, this has been the case since 1933, see S Richards & Co Ltd v. Lloyd (1933), 49 C.L.R. 49. New Zealand adopted the Australian approach comparatively recently and only with respect to company liquidations; preferences given by natural persons are governed by section 56 of the Insolvency Act 1967 which is similar to the Canadian legislation.

151 The inclusion of reference to an "encumbrancer" means that the section will apply to a grant of security, see Explanatory Memorandum to the Bankruptcy Legislation Bill 1996, para 85.1; see also BA, section 124(1).

152 Section 5(2) provides that persons are solvent only if able to pay all their debts as and when they become due.

153 The recipient of the security must be an existing creditor so the provision applies only to past indebtedness, see Burns v. Stapleton, supra n109.

154 The review period runs from six months prior to the presentation of the petition to the date of bankruptcy. Where the debtor is declared bankrupt on the debtor's own petition at a time when there is a creditor's petition outstanding, the review period runs from the earliest act of bankruptcy upon which the creditor's petition was founded, or which occurred during the six months prior to the debtor's petition, see BA, section 122(1).

155 BA, section 122. The test for determining whether there has been a preference in effect is whether the transaction would result in the debtor receiving a greater payment than it would have received had the bankruptcy occurred (hypothetically) at the time of the transaction, see Burns v. Stapleton supra n109 at 104; authorities cited by Keay, supra n19 at 132 n103; Harkness v. Potts (1993), 10 A.S.C.R. 517 at 521; Ferrier & Knight v. CAA, supra n172 at
defence for a purchaser, payee or incumbrancer who acts in the ordinary course of business, in
good faith,\textsuperscript{156} and gives consideration at least as valuable as the market value of the property. The “ordinary course of business” element has given rise to considerable uncertainty. Keay identifies five different judicial approaches to determining whether a transaction took place in the ordinary course of business.\textsuperscript{157} The most common approach is to determine whether the transaction “falls into place as part of the undistinguished common flow of business done”.\textsuperscript{158} The determination of whether a transaction was entered into in the “ordinary course of business” is theoretically objective but in some cases has been characterised by the courts’ willingness to have regard to the knowledge and intentions of the parties although the relevance of a debtor’s intent to prefer a creditor is controversial.\textsuperscript{159} Further defences are provided for transactions

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\textsuperscript{156} Section 122(4) of the BA provides that good faith is presumed not to exist where a transaction occurs in circumstances which lead to an inference that the creditor knew or had reason to suspect that the debtor was insolvent and that the transaction would have the effect of giving the creditor a preference. In general, good faith in the context of bankruptcy means that the creditor did not intend to circumvent the laws of insolvency by obtaining an unfair preference or colluding with the debtor to defraud creditors, and had no knowledge that it was receiving a preference, see Keay, \textit{supra} n19 at 155. The requirement for good faith is generally encompassed by the wider requirement that the transaction be in the ordinary course of business, see \textit{Re Lee Furniture Pty Ltd (in liq)} (1983), 8 A.C.L.R. 251 at 253.

\textsuperscript{157} Keay, \textit{supra} n19 at 143 to 154.

\textsuperscript{158} \textit{Downs Distributing Co Pty Ltd v. Associated Blue Star Stores Pty Ltd (in liq)} (1948), 76 C.L.R. 463 at 477. This case was followed in New Zealand in \textit{Countrywide Banking Corporation Ltd. v. Dean} (1997), 8 N.Z.C.L.C. 261,325, and on appeal, [1998] 1 N.Z.L.R. 385 (P.C.) the Privy Council did not make a comprehensive statement of the criteria for determining when a transaction will fall within the ordinary course of business, but said that the transaction would be examined from the perspective of an objective observer in the actual factual setting of the transaction with regard to the ordinary operational activities of business as going concerns, not responses to unusual financial difficulties.

\textsuperscript{159} Knowledge by a creditor of a debtor’s insolvency was regarded as especially significant in \textit{Downs Distributing Co Pty Ltd v. Associated Blue Star Stores Pty Ltd (in liq)}, ibid. at 480, but is relevant only where that knowledge caused the impugned transaction, see \textit{Spedley Securities Ltd (in liq) v. Sparad (No 100) Ltd} (1993), 12 A.S.C.R. 32 at 43. Opinions appear divided as to whether it is the intent to prefer of the debtor which is relevant, see \textit{Taylor v. White} (1964), 110 C.L.R. 129 at 151 to 153, or the knowledge and intentions of both parties, as in \textit{Taylor v. White} at 159 to 161. In \textit{Kyra Nominees Pty Ltd (in liq) v. National Australia Bank Ltd} (1986), 4 A.C.L.R. 400 at 409 to 410 the Court held that where a debtor intended to prefer a creditor the transaction could not be in the ordinary course of business, but this finding has been criticised, see eg. Keay, \textit{supra} n19 at 149. J. O’Donovan, “The Kyra Nominees Case: A Chill from the Overdraft” (1987) 5 C & S.L.J. 50. The Court in \textit{Downs Distributing} at 480 referred only to the creditor’s knowledge as relevant. In some cases the Court has refused to accept that a debtor’s knowledge or intention is relevant in any respect, see \textit{Harkness v. Partnership Pacific Ltd} (unreported, Abadee AJA, Priestly and Clarke JJA, 14 February 1997, N.S.W.C.A.).
pursuant to maintenance agreements and orders, debt agreements and payments of tax. The section also provides a defence for third parties who take from persons other than the debtor in good faith and give consideration at least as valuable as the market value of the property. This defence will apply only in very unusual circumstances, as preferences typically involve a receipt by a creditor of value in reduction of a debt, which will not be the case where a creditor gives equal value.

Where the debtor is a corporation the CL provides for the review of transactions which have a preferential effect. The cause of action under the CL is substantially similar to that under the BA. A transaction between a debtor company and a creditor is reviewable if it takes place during a six month review period, the debtor is insolvent at the time of the transaction or becomes insolvent as a result of it, and the transaction results in the creditor receiving more in respect of an unsecured debt than it would receive if the transaction were reviewed and the creditor proved for the debt in the liquidation of the debtor company. Where a transaction is an integral part of a continuing business relationship in the course of which the company’s indebtedness rises and falls as a result of a series of transactions, those transactions are taken to be a single transaction for the purpose of determining whether they collectively constitute a preference.

As is the case with the review of dispositions and unequal transactions under the CL, section 588FE provides that where an insolvent company gives a reviewable preference for the purpose of, or purposes including, defeating, delaying or interfering with the rights of its creditors, the review period is extended to ten years. The practical effect of this extension is limited by the increasing difficulty of proving elements of the cause of action (such as insolvency and absence of good faith by a recipient) the further in time a transaction is removed from the bankruptcy.

160 CL, sections 588FA, 588FC, and 588FE to 588FG. Prior to 1993 reviewable transactions relating to corporations were governed by the same provisions which governed personal bankruptcy, see authorities discussed by Keay, supra n19 at 208 n2.

161 Section 588FE(2)(b) provides that the review period runs from six months prior to the date of filing of a petition to the date of liquidation.

162 CL, section 588FC.

163 CL, section 588FA(3).

164 See above n92 and accompanying text.
The CL provides a uniform set of defences which are common to all reviewable transaction actions brought under its provisions, including actions for the review of preferences and unequal transactions.\(^{165}\) A defence is provided for a recipient who enters into a transaction in good faith,\(^{166}\) without reasonable grounds to suspect\(^{167}\) insolvency (and a reasonable person in the recipient’s circumstances would have had no reasonable grounds for so suspecting) and either gives valuable consideration or changes its position\(^{168}\) in reliance upon the transaction.\(^{169}\) Unlike the defence available under the corresponding provision of the BA, the defence does not require that the transaction take place in the “ordinary course of business” thus making it marginally more difficult for a liquidator to review a preferential transaction under the CL.\(^{170}\) A defence is provided for a third party recipient who takes from a person other than the debtor in good faith and without reasonable grounds to suspect insolvency, provided a reasonable person in the recipient’s circumstances would have had no reasonable grounds for so suspecting.\(^{171}\) A further defence is also recognised where a “running account” operates between creditor and debtor involving mutual credits and debits from each side; in such a case the overall effect of the account is assessed rather than the effect of individual payments, to determine whether it has a preferential effect and if so to what extent.\(^{172}\) The running account defence is not available

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165 CL, section 588FG.

166 Keay, supra n19 at 257 observes that the requirement of good faith is absent from the UK legislation and is likely to prove irrelevant in the application of the Australian provisions because the objective review provisions of the CL take precedence, citing Downs Distributing Co Pty Ltd v. Associated Blue Star Stores Pty Ltd (in liq), supra n158; Yeomans v. Lease Industrial Finance Ltd (1987), 5 A.C.L.C. 103 at 155.

167 “Suspect” requires a positive feeling of actual fear or misgiving that the debtor will be unable to pay the debt rather than a mere reason to consider it as a possibility, see Queensland Bacon Pty Ltd v. Rees (1966), 115 C.L.R. 266 at 303 with respect to the term as used in section 122 of the BA, fil’d Yeomans v. Lease Industrial Finance Ltd, ibid. and Harkness v. Potts, supra n155.

168 The “change of position” defence is similar to that in section 296 of New Zealand’s Companies Act 1993, which requires that the person make a conscious act to enter into commitments (such as delivery of goods as in Re Bee Jay Builders Ltd (in liq), [1991] 3 N.Z.L.R. 560) or alternatively, decide not to take action (such as a decision not to pursue a guarantor as in Westpac Banking Corp v. Nangeela Properties Ltd, [1986] 2 N.Z.L.R. 1), in reliance upon the transaction.

169 CL, section 588FG(2).

170 See Trevor v. William Adams & Co. (1987), 5 A.C.L.C. 282 and Re MacFarlane Constructions Pty Ltd (in liq) (1993), 11 A.S.C.R. 748 in which although the recipients established good faith the defences failed because the transactions were outside the ordinary course of business.

171 CL, section 588FG(1).

where the account is being run in order to reduce the available credit or bring the business relationship to an end.¹⁷³

There are two significant differences between the defence available under the BA and that available under the CL. The CL defence is objective in nature; an innocent person may suffer the consequences of review if a reasonable person in that person's position would have suspected that the debtor company was insolvent. The BA, defence, in contrast, is subjective. In addition, unlike the BA the CL defence does not require that a transaction be within the ordinary course of business, so it is somewhat more difficult for a liquidator to review a transaction under the CL, although factors which would take a transaction outside the ordinary course of business are also likely to be determinative of whether a reasonable person would have had grounds to suspect insolvency.

In New Zealand the Insolvency Act 1976 ("IA") governs the review of preferences involving debtors who are natural persons and the Companies Act 1993 ("CA") applies where the debtor is a corporation. The governing principles of the two statutes are quite different; the IA preference provision is similar to section 95 of Canada's BIA in that it requires proof of an intent to prefer and a preference in fact whereas the CA preference provision draws upon the Australian model in focusing upon the preferential effect of the impugned transaction. While the Australian authorities appear divided with respect to the relevance of the parties' intentions, the CA provides that a debtor's intent to prefer is not relevant to the ordinary course of business issue unless the creditor had knowledge of that intention.¹⁷⁴

Section 56 of the IA provides for the review of preferences. A transaction¹⁷⁵ by a debtor unable to pay its due debts from its own money¹⁷⁶ in favour of a creditor¹⁷⁷ with a view to giving that

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¹⁷⁴ CA, section 292(4).
¹⁷⁵ Section 56 of the IA refers to "every conveyance or transfer of property, every charge made on any property, any obligation incurred, every execution under judicial proceeding suffered and every payment made".
¹⁷⁶ The debtor's debt/asset position is relevant to this determination, in addition to liquidity, so the test is really one of overall solvency. See e.g. Ebbett v. Official Assignee (1992), 4 N.Z.B.L.C. 102,516. This is consistent with the Australian position, see Sandell v. Porter (1966), 115 C.L.R. 666 at 670.
creditor (or any surety or guarantor) a preference, within a two year review period, will be reviewable if a preference in fact is conferred. Where the transaction occurred within one month of bankruptcy it is unnecessary to prove an intention to prefer unless the transaction is in respect of a liability incurred or accruing due during or after the one month period. As in Canada and England, proof that the debtor held some other intention will preserve the transaction. Evidence of pressure upon a debtor may be admitted to negate the requisite intent although (as under British Columbia’s FPA) evidence of pressure cannot preserve a transaction which occurred within the one month period as intention is not then a required element of the cause of action. A defence is provided for recipients who act in good faith and alter their position in a reasonably held belief that the transaction was validly made and will not be reviewed, and it would be inequitable if relief was not granted either in whole or in part. A

178 The review period is the two years prior to the date on which the debtor was voluntarily declared bankrupt, or in the case of a debtor declared bankrupt on a creditor’s petition the period from two years prior to the date of the petition to the date of bankruptcy.

179 In Re Estate of Wix, ex parte Borrie (16/12/96, Fisher J, HC, Auckland B1595/94) it was held that there must be an advantage to a creditor for a transaction to be reviewable under section 56 of the IA.

180 IA, section 56(2). Proof of intention to prefer is not required where the transaction took place in the one month prior to the date on which the debtor was voluntarily declared bankrupt, or in the case of a debtor declared bankrupt on a creditor’s petition (or while a petition is being heard), from one month prior to the date of the petition to the date of bankruptcy.

181 The requisite intent may be absent where a transaction is entered into under a real threat of legal action as in Cowan v. Official Assignee (17/5/89, McGechan J, HC, Nelson, B15/86), or where the debtor’s dominant intention is not to prefer a recipient creditor, but to deny payment to another creditor (e.g. the debtor’s estranged husband) as in Re Gerbes; FAI (NZ) General Insurance Co Ltd v. Official Assignee (15/12/97, Neazor J, HC, Napier, B78/96). The requisite intention will be absent where a transaction is entered into in a real hope of a benefit to the debtor, as in O.A. v. Wairarapa Farmers’ Co-op. Assn. Ltd., [1925] N.Z.L.R. 1; Re Trotman (1910), 12 G.L.R. 797; O.A. of Farrow v. Auckland Glass Works (1913), 15 G.L.R. 395; but not where the hope is based only on vague promises as in O.A. of Stansell v. Kennedy and Co. Ltd. (1911), 14 G.L.R. 332. Awareness that a transaction will produce a preferential result does not by itself prove the requisite intent, see Ebbett v. Official Assignee, supra n176. See also New Zealand authorities cited above at n145. In general, the English authorities regarding circumstances in which the element of intention will be absent are applicable, with the proviso that the New Zealand legislation has not been amended along the lines of the English IAE which requires only that a debtor have been “influenced by a desire”.

182 Such a recipient must have honestly believed that the transaction would not involve any element of undue preference; see Re Orbit Electronics Auckland Ltd (in liq) (1989), 4 N.Z.C.L.C. 65,170; 3 B.C.R. 333; Mainland Medical Supplies (Waikato) Ltd. v. Swanson Street Chemist Ltd (in liq) (7 July 1998, Doogue J, HC, Hamilton, M112/96).

183 A recipient must show that it acted to its detriment on the strength of the transaction, see Baker Timber Supplies v. Apollo Building Assocs (Tauranga) Soc Ltd (in liq) (1990), 5 N.Z.C.L.C. 66,791 at 66,793. Delivery of supplies will suffice, as in Re Bee Jay Builders Ltd (in liq), [1991] 3 N.Z.L.R. 560, 5 N.Z.C.L.C. 67,143 but mere use of money received in the course of business will not, see Baker Timber Supplies at 66,794.

184 “Inequitable” requires injustice or unfairness, such as where a recipient would be left in a worse position than had the transaction never taken place. See MacMillan Builders Ltd (in liq) v. Morningside Industries Ltd, [1986] 2 N.Z.L.R. 12, 3 N.Z.C.L.C. 99,879 (C.A.).
defence is also provided for third parties who receive a disposition from a person other than the bankrupt in good faith and for valuable consideration.\textsuperscript{186} Section 51 of the IA also provides a defence peculiar to New Zealand which in certain circumstances protects dealings with dairy farmers regarding assignments of milk from review as preferences.

Where a debtor is a corporation section 292 of the CA provides for the review of preferences. A transaction\textsuperscript{187} by a company is reviewable if it was made at a time when the company was unable to pay its due debts, during a two year review period,\textsuperscript{188} outside the ordinary course of business and it enabled a creditor to receive more towards satisfaction of a debt than that creditor would have received in the liquidation (i.e. conferred a preference). Where a transaction is made within six months of the date of liquidation there is a rebuttable presumption that the company was unable to pay its due debts and that the transaction was outside the ordinary course of business. As under the IA, there is a defence for persons who receive a preference in good faith and alter their position in a reasonably held belief\textsuperscript{189} that the transaction is validly made and will not be reviewed, if it would be inequitable if relief was not granted either in whole or in part.\textsuperscript{190} There is also a defence for third parties who receive (inter alia) security from a person other than the company in liquidation for valuable consideration without knowledge of the circumstances in which the security was acquired from the company (i.e. in good faith).\textsuperscript{191}

\textsuperscript{185} IA, section 58(6). The section is a codification of a common law defence, see \textit{Re Brall, ex parte Norton}, [1893] 2 Q.B. 381.

\textsuperscript{186} IA, section 58(5).

\textsuperscript{187} "Transaction" means a conveyance or transfer of property, giving of a security or charge, incurring of an obligation, an acceptance of execution under a judicial proceeding and a payment of money, by a company; see CA section 292(1).

\textsuperscript{188} The review period is the two years prior to the date on which the company was put into voluntary liquidation, or in the case of a company put into liquidation by the Court, the period from two years prior to the date of the liquidation application to the date of liquidation.

\textsuperscript{189} \textit{Re Chisum Services Pty Ltd} (1982), 7 A.C.L.R. 641 discusses when the knowledge of officers of a company may be attributed to the company; see also \textit{Jorgensen Marine Services Ltd v. McLean} (17 November 1996, Penlington J, HC, Hamilton (New Zealand) M73/95).

\textsuperscript{190} CA, section 296(3).

\textsuperscript{191} CA, section 296(1).
Intention to prefer was discarded as an element of the action in the course of replacing the predecessor to the CA, the Companies Act 1955. The “ordinary course of business” requirement has always been present, but has become more significant since proof of absence of intent to prefer became unavailable as a defence, especially as under the New Zealand Act a recipient need not also prove good faith or valuable consideration to obtain protection.\textsuperscript{192} The determination of when a transaction will be within the ordinary course of business has proved difficult.\textsuperscript{193} While the Australian cases interpreting ordinary course of business interpreted it as involving an element of the debtor's intention to prefer a creditor,\textsuperscript{194} the CA provides that a debtor's intention to prefer is not relevant to the ordinary course of business issue unless the creditor had knowledge of that intention,\textsuperscript{195} and the debtor’s intent is irrelevant to the issue of whether a transaction has a preferential effect.\textsuperscript{196}

In summary, there exists a fundamental difference between reviewable preference regimes in which the cause of action is based upon proof of a debtor's intent to prefer a creditor or creditors, and those in which the preferential effect of a transaction is the basis of an action. Canada, England and New Zealand (in personal insolvency) are examples of the former and Australia and New Zealand (in corporate insolvency) are examples of the latter type of regime. In Canada, under the BIA the requisite intent is presumed, absent evidence to the contrary, where a transaction has a preferential effect but an action may be defended by proof that the debtor entered into the transaction with some other intention irrespective of the knowledge or motives of the recipient creditor. The removal of the “pressure” defence by amendment to the BIA has the appearance of a piecemeal effort to address the apparent unfairness of permitting informed creditors to avoid making restitution while innocent creditors are held liable, a response which fails to recognise this as an outcome of the basis of the cause of action rather than an evidential question. Under the FPA the basis of the preference action is the same as that under the BIA, with the exception of transactions within the 60 day limit where intent is not required. In

\textsuperscript{192} The Australian “ordinary course of business” exception (now removed by amendment to the CL) also required that a transaction take place in good faith and for valuable consideration, which requirements are not present in the corresponding New Zealand defence. However, Brown \textit{et al}, \textit{supra} n109 at para CA 292.16(2) notes that the difference was more apparent than real as each element involves consideration of the creditor’s knowledge of the debtor’s insolvency.

\textsuperscript{193} See \textit{supra} n157 and accompanying text.

\textsuperscript{194} \textit{Kyra Nominees Pty Ltd (in liq) v. National Australia Bank Ltd.}, \textit{supra} n159.

\textsuperscript{195} CA section 292(4).

\textsuperscript{196} \textit{Ferrier v. Civil Aviation Authority}, \textit{supra} n172.
England the difficulty of establishing the intent element has been ameliorated by reducing the requisite intent to only one of several influences upon a debtor, but the conceptual basis of the action remains a species of fraud by the debtor upon its creditors.

In Australia and New Zealand (in company insolvency) the basis of a preference action is the preferential effect of a transaction, which is generally much easier to establish than an intent to prefer on the part of a debtor. While some Australian authorities indicated a willingness to incorporate aspects of a debtor’s intent into the “ordinary course of business” element, the removal of that element from the Australian companies provisions have prevented such a potential regression and there has been no indication of a similar interpretation in New Zealand. As is the case with actions for review of dispositions and unequal transactions, provisions in Australia which extend the review period where there is proof of a debtor’s intent to prefer are significant only in rare cases, as the difficulty of proving elements of the cause of action (such as insolvency and a recipient’s lack of good faith) increases the further in time a transaction is removed from the bankruptcy and the requirements of an objective reviewable transaction action must still be satisfied.

In Australia and New Zealand defences for the relief of recipients focus upon the circumstances in which review would work an injustice upon a deserving recipient, rather than the state of mind of the debtor. No such defences feature in the BIA (although a similar defence appears in the FPA) or in the English legislation. In Australia’s personal bankruptcy legislation the provision of a defence for recipients who act in good faith without notice of insolvency or a preference is rendered almost inconsequential by a further requirement that the creditor give consideration of equal value to that received, in which case there would not have been a preference in any event. The defence provided in the Australian company provisions is more reasonable, requiring only that a recipient act in good faith without relevant knowledge and either give valuable consideration or change its position in reliance upon the receipt. This defence indicates an interest in the preservation of outwardly normal commercial transactions in addition to the protection of innocent recipients, as it provides for review both where a recipient has actual knowledge and where a recipient ought to have known of a preference. The defences available in New Zealand (including those provided under the personal bankruptcy provisions which require an intent to prefer) are almost identical to the Australian companies provisions, with the
exception that the New Zealand legislation does not impute constructive knowledge to recipients. In all the jurisdictions under study preference provisions also provide a defence for third parties who acquire property (or receive a benefit) from the creditor in good faith and for valuable consideration.¹⁹⁷

¹⁹⁷ See section 342(2) of the IAE, section 588FG of the CL, section 122(2) of the BA (in Australia the consideration must equal the value of the benefit received), section 58(5) of the IA and section 296(1) of the CA.
CHAPTER FIVE  POLICY INTERESTS ADDRESSED BY REVIEWABLE TRANSACTION REGIMES

The previous chapters of this paper are largely descriptive of the reviewable transaction regimes in the jurisdictions under study and the essential differences between the "subjective" and "objective" approaches to reviewable transaction law. The purpose of this chapter is to consider the objectives of reviewable transaction law and assess the extent to which those objectives are met by the subjective and objective models.

5.1 Objectives of reviewable transaction law

While an analysis of reviewable transaction law would be incomplete without a discussion of its underlying rationale there does not appear to be a standard theory for the existence of reviewable transaction provisions against which their effectiveness may be measured. Discussion tends to centre around interests and policy concerns, which tend to be described in different ways by different authors. Despite the apparent absence of a unified theory, however, there does not appear to be serious disagreement with respect to the objectives of reviewable transaction law.

It is submitted that five primary interests may be identified as relevant to the objectives of reviewable transaction laws:

a) the interests of a bankrupt’s unpaid creditors;

b) the interests of recipients of value from a debtor, from whom recovery is sought;

198 Jackson, supra n11.

199 Keay bemoans the absence of such a theory, supra n19 at 31.

200 For example, a suggestion that the law of reviewable preferences assists in maintaining "commercial morality" upon closer examination reflects the concern with the maintenance of confidence in commercial dealings, see R. Tasse, J. D. Housberger Q.C. & P. Carignan Q.C., Report of the Study Committee on Bankruptcy and Insolvency Legislation, (Ottawa: Information Canada, 1970) at 116.
c) a wider public interest in the maintenance of confidence in outwardly normal commercial transactions;

d) a public interest in the prevention and punishment of conduct entered into by an insolvent with intent to defraud or disadvantage creditors, or the frustration of such an intent; and

e) an interest in enabling insolvents to trade out of financial difficulties and avoid bankruptcy (to some extent this interest overlaps with that of creditors).

These interests conflict and it is a function of reviewable transaction law to recognise each of them in an appropriate manner in a variety of circumstances. While there are significant differences between the overall purpose of the law with respect to the review of dispositions and that with respect to the review of preferences, the abovementioned interests are generally relevant to each although to differing extents.

It is submitted that the abovementioned interests (a), (b), (c), (e) and (d) are of descending importance, in that order. The most important interests are those of unpaid creditors, which must be balanced against the merits of recipients’ claims and other policy considerations. This paper makes the argument that “subjective” reviewable transaction regimes which focus upon the intent of a debtor, as in England and Canada, do not appropriately provide for the balancing of these interests. A more appropriate model for reviewable transaction law is the “objective” model as found in Australia and New Zealand, which starts from a presumption that transactions in which value is removed from a bankrupt’s estate to the detriment of creditors should be reviewed, subject to defined and exclusive defences and exceptions which recognise the interests of recipients and wider policy objectives. This chapter first sets out the reasons why creditors’ interests should take prima facie priority, subject to recipients’ claims and policy considerations. It then describes the reasons why those respective interests and claims are inadequately provided for by the subjective form of reviewable transaction regime and why the objective model is more appropriate.

201 The Australian Law Reform Commission, supra n213 at para 629 recognised that the competing claims of recipients and creditors are the interests required to be balanced by reviewable transaction law.
The interests of unpaid creditors

Unpaid creditors are the obvious beneficiaries where transactions are reviewed and value is recovered by a trustee, as the fundamental effect of review is to recover value for creditors. The interests of creditors are best served by laws which make it easier for transactions to be reviewed. In addition to the simple recovery of value, preference laws also protect creditors' interests in a broader sense by protecting the statutory scheme for the orderly realisation of a bankrupt's estate, which scheme exists to maximise the value of the estate for creditors. 202

It is submitted that the protection of unpaid creditors' interests, which interests incorporate the preservation of the efficacy of the statutory management and distribution scheme, is the primary purpose of reviewable transaction law. Reviewable transaction regimes should operate from a presumption that value disposed of by a debtor shortly prior to bankruptcy will be recovered by a trustee for distribution in accordance with the statutory scheme unless there is some cogent reason why this should not be done. This is not to say that creditors' interests will always take precedence over other interests and considerations; they will often be outweighed by competing interests. However, as a matter of practicality and reflecting the basic purpose of reviewable transaction regimes as being to recover value for creditors where appropriate, relevant legislation should provide for recovery of value for creditors unless there is some reason why their interests should be outweighed by the interests of a recipient or some wider public interest.

There are several reasons why the starting position of reviewable transaction regimes should be the recovery of value for creditors. First, with respect to dispositions and unequal transactions, such a rule would recognise that debtors who are deeply and hopelessly in debt effectively hold their assets in trust for their creditors, and it is consistent with this trust that property disposed of in breach of it should be recovered. As noted by the Court in Freeman v. Pope,203 persons must be just before they can be generous: debts must be paid before gifts are made. Secondly, creditors have a legal claim upon the assets of a non-paying debtor, in contrast to the recipients of dispositions and unequal transactions who in effect receive a windfall at the expense of

202 See e.g. Cork Report supra n213 at para 1209.
203 (1870), 5 Ch. App. 538 at 540.
This logic is also applicable (although to a lesser extent) with respect to the recipients of preferences who, while having a genuine claim to the debtor’s property, receive a windfall in comparison with other creditors who go unpaid. Thirdly, a presumption in favour of the review of transactions which prejudice creditors protects the viability of the statutory distribution and management scheme. The policy interests recognised by the statutory distribution scheme, such as the protection of employees and child support payments, enjoy little real protection if the scheme may be readily circumvented by disposals of value prior to bankruptcy. Equally, the sober management of a bankrupt’s estate by a trustee for the benefit of all creditors, which is an important aim of bankruptcy law, cannot be achieved where a debtor disposes of its property prior to bankruptcy. In addition, there is a benefit in discouraging a race by creditors to seize a debtor’s property in the “anxious scramble” which early bankruptcy statutes were enacted to prevent. Finally, there are practical and conceptual advantages in beginning from a presumption that transactions which defeat creditors should be reviewed and providing exceptions which reflect policy considerations, compared with providing for review in a number of discrete circumstances each of which would require a distinct set of elements and exceptions.

A possible disadvantage of such a presumption is that it may discourage creditors who receive a part payment of debt from bringing bankruptcy proceedings, although unpaid creditors would have a corresponding incentive to do so. To some extent a creditor must hold altruistic motives to bring proceedings which will ultimately benefit all creditors, although a priority claim for legal costs will limit a petitioning creditor’s loss.

The conception of reviewable transaction regimes as existing primarily for the benefit of creditors enjoys wide acceptance, especially when it is considered that bankruptcy management and distribution schemes, the protection of which is a primary purpose of reviewable transaction law, exist to protect creditors interests. The Ontario Law Commission has described creditors’

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204 The Law Reform Commission of British Columbia noted that where a disposition is effectively a bargain or a gift the interests of creditors should be preferred, see supra n117 at 120.


206 See e.g. Keay, supra n19 at 49.
interests as the first priority of reviewable transaction law and the English reviewable transaction rules have been described as existing for the protection of creditors. In Australia the Explanatory Memorandum to the Corporate Law Reform Bill 1992 gives the protection of unsecured creditors from prejudice resulting from dispositions of property, unequal transactions and the giving of preferences as the sole reason for the enactment of review legislation. Other authors typically give the recovery of value for the benefit of creditors priority in explaining the purpose of reviewable transaction regimes.

The primacy of creditors’ interests is supported in the authorities by the heavy emphasis placed upon the preservation and protection of the management of the bankrupt’s estate and the statutory distribution scheme, both of which exist to protect creditors’ interests. As early as the 1758 case of Worsley v. Demattos the Court held that the two main objects of bankruptcy law were the management of a bankrupt’s estate and an equal distribution among creditors. The protection of creditors’ interests by these principles of collectivism (i.e. the subsuming of creditors’ rights in a trustee for the general benefit of all creditors) and equality in the realisation and distribution of a bankrupt’s estate, has been recognised by law commissions in England and Australia and by the courts in Canada as a primary goal of reviewable transaction law. The principle of equality was introduced because the common law rule which permitted creditors to take priority according to the order in which they seized a bankrupt’s property resulted in a rapid dismemberment of the bankrupt’s estate, which reduced its overall value to creditors.

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208 Cork Report, *infra* n213 at para 1200 and 1209.

209 Explanatory Memorandum to the Corporate Law Reform Bill 1992 (Cth.), para 1035.

210 See e.g. K. C. Chiah, “Voidable Preference” (1986) 12 N.Z.U.L.R. 1 at 1 (see also at 22 to 23 where the author cites protection of the distribution scheme and asset maximisation as the most important goals of reviewable preference law); see also McLaren, *supra* n205 at 359.


212 For the term “collectivism” see E. Warren, “Bankruptcy Policy” (1987) 54 University of Chicago Law Review 775 at 776. It has since been widely used, see e.g. Keay, *supra* n19 at 36.


214 See above *supra* n10 and accommodating text. See also *Ferrier & Knight v. CAA*, *supra* n172 at A.L.R. 484; *Re Feldmanis Finance Pty Ltd (in liq)* (1983), 1 A.C.L.C. 823 at 830.
second purpose of the equality principle is to promote a fair distribution among creditors\textsuperscript{215} who it is thought should bear losses proportionately, although this principle is less evident in modern legislation which provides for extended classes of priority creditors (see Appendix). What is clear is that a primary purpose of reviewable transaction law is to protect the integrity of the statutory scheme, which scheme exists to protect the value of a bankrupt’s estate and distribute it among creditors.

Recipients’ interests and the maintenance of public confidence in commercial transactions

A recipient of value from a debtor has an interest in retaining that value rather than returning it to a trustee for distribution among creditors. Depending upon the rules in a particular jurisdiction, a recipient may resist review on the basis that it would be unfairly prejudiced (such as where it has relied upon the receipt to its detriment) or on the general policy basis that it should be entitled to rely upon what outwardly appeared to be a normal commercial transaction. These arguments are also relevant where a recipient is itself a creditor, and has received a preference rather than a disposition.

In addition to defences and exceptions which provide for recipients’ interests, those interests are affected to a large extent by the level of difficulty faced by a trustee in bringing a review action. In jurisdictions where the elements of a review action are difficult to satisfy, the interests of recipients are protected at the expense of creditors even where recipients’ individual circumstances may not merit protection. As discussed above, it is submitted that the interests of recipients are most appropriately addressed by particular and exclusive defences and exceptions. By such means the entitlement of creditors to property disposed of by a debtor may be denied only where a recipient can show a compelling reason why its entitlement to the value received should outweigh creditors’ claims.

\textsuperscript{215} The “fairness” aspect of equality of distribution goes also to minimising the potential for “downstream” business failures which are more likely to occur where a disproportionate loss is suffered by individual creditors, see T. H. Jackson & A. T. Kronman, “Voidable Preferences and Protection of the Expectation Interest” (1976) 60 Minnesota Law Review 971 at 989.
The maintenance of public confidence in commercial transactions is often cited as a primary reason for protecting recipients' interests.\textsuperscript{216} The interests thus protected are twofold; the interests of a particular debtor who claims an entitlement to rely upon a transaction (generally on the basis that the transaction appeared normal and the recipient was innocent), and the interests of a commercial community which relies upon being able to do business without the risk that transactions may be overturned by a trustee.\textsuperscript{217} Both of these interests are genuine and both may readily be provided for by means of exceptions or defences in a reviewable transaction regime based upon a presumption that favours creditors' interests. That the protection of public confidence in outwardly normal commercial transactions should not be undermined by insolvency law is recognised in other areas of law, e.g. the provisions whereby persons may take property free of security interests of which they were not aware under Personal Property and Security or Sale of Goods legislation. The inclusion of a requirement that a recipient must have no reason to suspect a debtor's insolvency or the fraudulent nature of a transaction, as in the Australian legislation, should ensure that most transactions in which the debtor's estate suffers dramatic losses through significant differences in value will not be protected from review.

Punishment of fraudulent conduct and frustration of fraudulent intent

Subjective reviewable transaction regimes reflect a public interest in punishing fraudulent conduct and preventing commercial impropriety. This is primarily the case only with respect to dispositions and unequal transactions, as the recipient of a preference is normally a legitimate creditor with a genuine claim to a debtor's property.\textsuperscript{218} However there may be circumstances in which a debtor hopes to engineer a benefit from a preference such as where it is given to a family member.

\begin{itemize}
\item \textsuperscript{216} See e.g. Law Reform Commission of British Columbia, \textit{supra} n117 at 102: “In terms of general policy, commercial transactions should not be overturned lightly.”
\item \textsuperscript{217} An example of the manner in which a threat of review may prejudice commercial transactions is the reluctance of lenders to release guarantors of repaid debts until the review period has passed. The continued existence of the guarantee may prejudice the guarantor's ability to obtain credit and engage in further transactions during this period.
\item \textsuperscript{218} Keay, \textit{supra} n19 at 55 observes that the focus of preference law is equality among creditors, not the punishment of opprobrious conduct.
\end{itemize}
The flaw in the reasoning which holds this punitive interest to be significant in reviewable transaction law is that it is generally not the wrongdoer, i.e. the bankrupt, who is punished by review of an impugned transaction. Academic writing on the subject discloses occasional comment to the effect that dispositions and preferences which defeat creditors should be reviewed irrespective of the interests of creditors and recipients, on the basis that such transactions offend against morality. Keay comments that provisions for the review of dispositions and unequal transactions are designed to prevent debtor misbehaviour in disposing of assets without first fulfilling legitimate claims by creditors that “strikes at the heart of commercial morality.” The difficulty with this notion is that review in these circumstances does not strike at anything other than the interests of a recipient, who may have done nothing improper. The notion owes more to the historical origins of reviewable disposition and unequal transaction law in criminal fraud law than to an examination of the interests of persons affected by the review of transactions.

This is not to say that the punishment of wrongdoing forms no part of the civil law. In some circumstances the civil law provides sanctions against wrongful conduct in addition to the compensation of injured persons, such as awards of punitive or exemplary damages where awards of compensation are not considered sufficient to adequately punish defendants or prevent future wrongful conduct. It is submitted that such sanctions are not appropriate in reviewable transaction law except where a debtor’s fraudulent designs are shared or conspired in by a recipient. The distinction between typical cases in which an award of exemplary damages is made and reviewable transaction claims lies in the characteristics of the defendant. The defendant in a reviewable transaction claim is typically not a wrongdoer, but a person who has received value from a wrongdoer, and who will often be innocent of the bankrupt’s wrongful intentions. By way of an example (putting aside the various defences, as the focus here is upon who is punished), a debtor descending into bankruptcy may have two creditors, an aggressive moneylender and a supplier who has cultivated a personal friendship with the debtor. The debtor may make a preferential repayment of debt to the “friendly” supplier (it being innocent of the debtor’s impending bankruptcy) with an intent that the supplier’s friendship and support should not go unrecognised. In such a case the frustration of the debtor’s desire to prefer the “friendly” creditor or the punishment of its intent to defraud the “unfriendly” one would be pointless as neither outcome would affect the bankrupt debtor. Any punishment or sanction would instead be

219 ibid.
visited upon the innocent "friendly" recipient. For this reason, the punishment or frustration of a debtor's fraudulent designs cannot be achieved in practice to the extent that they might be recognised as a significant purpose of reviewable transaction law. It may be possible to achieve some element of punishment in circumstances where a debtor personally receives some collateral advantage from an impugned transaction, but this distinction is not apparent in reviewable transaction laws which focus upon the intent of the debtor rather than upon the recipient.

It is submitted that this element of punishment and prevention is most appropriately provided by dedicated criminal law provisions\(^{220}\) rather than the review of transactions in which the debtor, upon whom a preventative sanction is expected to apply, has no immediate interest. The advantage of criminal proceedings is that they may be visited directly upon wrongdoers, i.e. bankrupts, rather than recipients who may be innocent. Where recipients have participated in fraudulent schemes, they too may be subject to criminal penalties. The criminal forum ensures that only those who are genuinely deserving of sanction face punitive action.

Debtors' interests

Another objective of reviewable transaction law is to prevent a debtor's financial decline being hastened as a result of creditors seizing its property.\(^ {221}\) There is a wider public interest in the preservation of a debtor's property (especially a business) from premature dismemberment by creditors who are unwilling to permit a debtor an opportunity to trade out of financial difficulties. While this may benefit a debtor who is able to recover from temporary financial difficulties, this objective also reflects a concern with creditors' interests.

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\(^{220}\) See Chapter Seven below for a detailed discussion of criminal penalties relating to reviewable transactions.

\(^{221}\) See sources cited by Keay, supra n19 at 42, n82.
5.2 **Subjective regimes - the inappropriate focus upon a debtor's intent to defraud or prefer**

Creditors' interests

Although empirical data is lacking, it is widely accepted that trustees seldom succeed in reviewing any but the most obviously fraudulent transactions under “subjective” review regimes in which a debtor’s intent is the key element in determining whether a transaction is reviewable.²²² The reason for this is that proving an intent to prefer on the part of a debtor is often very difficult.²²³ As a result, subjective regimes do not adequately provide for the interests of creditors, who suffer prejudice when transactions in which value is lost from the bankrupt’s estate are not reviewed.²²⁴

Subjective regimes fail to facilitate review of many transactions in which fairness would indicate that property should be recovered for the benefit of creditors. While subjective review legislation has always included provision for the relief of recipients who give valuable consideration (or in some jurisdictions, consideration of equal value) in good faith, this defence can only prevent review; it cannot enable review of a transaction where the requisite intent is absent. The difficulty of proving that a debtor held the requisite intent is considerably greater than proving the existence of a benefit to a recipient, and this difficulty is exacerbated by the plethora of factors which may go to show that a debtor held some other intent in entering into the transaction, such as an intent to obtain a continued supply of goods and services, or that the transaction occurred in the ordinary course of business.²²⁵ In some jurisdictions attempts have been made to reduce the difficulty of proving the requisite elements of a review action. In Canada this difficulty has been lessened to some extent by placing the onus of proof upon a recipient who wishes to defend a transaction and by rendering evidence of pressure inadmissible to prove absence of intent. In England the requisite intent need no longer be a debtor’s primary motivation, but need only “influence” a debtor into entering into an impugned transaction.

²²² K. C. Chiah, *supra* n210 at 23.
²²³ Ibid.
²²⁴ See e.g. comments to this effect by the Law Reform Commission of British Columbia, *supra* n117 at 104 with respect to the FPA.
²²⁵ See *supra*, n145.
These piecemeal efforts fail to adequately address the underlying flaw in the subjective form of action, which is a reliance upon the state of mind of the debtor (who as a bankrupt is not a party to review litigation) rather than upon the merits of the respective claims of recipients and creditors.\footnote{226}

The difficulty of proving a debtor's intent raises the question of whether intent is a necessary or desirable element of a reviewable transaction action.\footnote{227} A debtor's intent is not relevant to the merits of unpaid creditors' claims, nor is it relevant to the claims of innocent recipients. Furthermore, it has no bearing upon the public interest in preserving confidence in the reliability of commercial transactions. A debtor's intent is relevant only to the frustration of the debtor's wrongful designs, which, it is argued in this paper, is the least significant of the interests that reviewable transaction regimes are required to address. The subjective model is unsuited to addressing the balancing of the relevant interests because it is not relevant to any of them.

The lack of relevance of a debtor's intent to the underlying purpose of reviewable transaction laws is apparent from the apparently arbitrary manner in which subjective review regimes operate, from the perspective of both unpaid creditors and innocent recipients. Subjective regimes appear arbitrary from the perspective of unpaid creditors because recoveries depend upon the intent of a debtor whose interests may be unaffected by review rather than upon the knowledge or intent of recipients from whom recovery is sought. By way of example, a creditor who is aware of a debtor's financial difficulties and refuses to provide essential supplies until it receives a preferential repayment of the whole amount of its debt may escape review on the basis that the debtor's intent to prefer was overborne by an intent to obtain the supplies,\footnote{228} whereas an innocent creditor who receives a preference may be subject to review on the basis that the debtor


\footnote{227} \textit{Ibid.}

\footnote{228} Some jurisdictions have amended relevant legislation to provide that evidence of pressure may no longer be admitted to prove absence of intent (although this may not apply to a withholding of supply). Such piecemeal amendments do not repair the underlying flaw in the legislation, which is that intent is not relevant in the first place to the underlying interests served by reviewable transaction law. Other means of proving absence of intent, such as proof that the debtor did not know of its insolvency, produce equally arbitrary results.
held an intent to prefer. Similarly, in the case of dispositions a transaction in which a debtor makes a disposition without knowledge of its own insolvency will not be reviewable even where the recipient knew that the transaction would prejudice creditors, whereas a disposition made by a debtor to an innocent recipient who relies upon the disposition may be reviewed if the debtor intends to defraud its creditors by the disposition. These odd results are possible because the debtor’s intent, being the basis of the review action, is not relevant to the bona fides of either the innocent recipient or the disadvantaged creditors.

Creditors who have received preferences are recipients for the purposes of reviewable transaction laws, but their position has never been regarded as quite the same as that of recipients of dispositions and courts have traditionally been more reluctant to review preferential transactions than dispositions. In early bankruptcy cases recipients of preferences were regarded as entitled to receive repayment of their debt, in contrast to recipients of dispositions who had no prior claim to the property conveyed. To some extent this aspect of bankruptcy law persists to the present day in jurisdictions where the action for review of preferences is based upon a debtor’s intent to prefer and proof of pressure is still admissible to prove absence of intent. This has been justified on the basis that “diligent” creditors who are rigorous in their pursuit of repayment are deserving of the fruits of their diligence, more so than those who are “less diligent” and perhaps adopt a gentler approach or who obtain payment through a personal relationship with the debtor, although this rationale has no necessary connection with the intent of the debtor. In some jurisdictions the relevant legislation has been amended to prevent evidence of pressure being admitted to disprove the requisite intent to prefer. A debtor’s intent to prefer has no more relevance to the interests balanced by reviewable transaction regimes than does a debtor’s intent to defraud in the case of dispositions.

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229 Some jurisdictions have enacted a defence where a recipient changes its position, but these tend to be jurisdictions which have abandoned intent to prefer as an element of a review action. The exception is New Zealand, which retains intent to prefer as an element of its personal bankruptcy regime and also provides a change of position defence.

230 See Dunlop, supra n5 at 592.

231 See e.g. Cork Report, supra n213 at para 1256(b).
Recipients' interests and the preservation of confidence in commercial transactions

Recipients generally benefit from subjective reviewable transaction regimes because of the difficulty of satisfying the elements of an action. However, this is not always the case and from the perspective of a recipient the determination of its position by reference to a matter outside its knowledge or control, i.e. the intent of a debtor, will often appear arbitrary. In order to defend a trustee's claim a recipient must prove the absence of intent on the part of another person (the debtor) which presents obvious evidential challenges. The same is true with respect to preference actions; an innocent creditor who is unaware that a debtor intended to confer a preference may be liable to make restitution to the trustee, yet a creditor who pressures a debtor into giving a preference in full knowledge of the debtor's insolvency may escape review on the basis that because of the pressure the debtor lacked an intent to prefer. The relief provisions may not assist recipients of gifts (such as charities) who rely upon the receipt to their detriment, nor do they assist honest recipients of "bargains" in jurisdictions where the defence requires that a recipient give consideration comparable to the value received. The subjective form of reviewable transaction regime thus provides for recipients' interests in an arbitrary manner.

Aside from the difficulty of proving a debtor's intent, protection for deserving recipients is provided by defences and exceptions. In most respects these provisions are appropriate as they bear directly upon the respective interests which reviewable transaction laws ought to balance. The defence for innocent recipients in the Statute of Elizabeth required only good faith and simple consideration in a contractual sense, and so enabled recipients to retain the benefit of unequal transactions in many circumstances even where the consideration was not comparable in value to the property received (although an obvious disparity could render it difficult to establish good faith). In Canada the Statute of Elizabeth defence has been retained in the BIA and the

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232 In many circumstances reviewable transaction regimes, including Canada's BIA, place the onus of proving that a debtor lacked the requisite intent upon a recipient who wishes to defend a transaction. Where a trustee bears the onus of proving the debtor's intent, a recipient is still faced with defending the trustee's allegation in that respect.

233 This paradox drew adverse comment from the New Zealand Department of Justice, Department of Justice, Submissions to the Justice and Law Reform Select Committee: Companies Bill - Liquidations, (Wellington: Dept. of Justice, 1992) at 2.

234 See e.g. Betty Shop Ltd (Trustee of) v. Hansen Investments Ltd et. al., supra n51 at 179 where good faith was found absent in a settlement action in which consideration of $12,100 was given for property worth $160,000; see also Cannane v. Official Trustee (1996), 136 ALR 406 at 146.
FCA although the FPA defence requires that the property disposed of bear a “fair and reasonable relative value” to the consideration. In New Zealand a valuable consideration/good faith defence is available with respect to personal bankruptcies (in company liquidations lack of knowledge of insolvency is the sole requirement) and with respect to preferences there is a defence where a recipient acts in good faith and either gives valuable consideration or alters its position in good faith in reliance upon the receipt.

The relevant defences in England and Australia are more difficult to satisfy, although they still have the effect of protecting genuinely deserving recipients. In Australia in the case of natural persons consideration is a defence only where its “market value” equals that of the property received, and in the case of companies a recipient must refund the difference in value between that given and that received unless the recipient has altered its position in reliance upon the receipt such that it would be inequitable to order recovery. As in England, Australian legislation prior to amendment in 1996 permitted review of settlements where the debtor failed to receive “valuable consideration” in good faith. The comparable Australian provision with

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235 See BIA, section 91(3)(b) and FCA section 2 with respect to settlements. Section 95 of the BIA does not provide a good faith/valuable consideration defence but where good consideration is given it will often be possible to prove that the debtor intended to obtain the consideration rather than give a preference. With respect to unequal transactions there is no action under the BIA in the first place unless the parties are not at arm’s length.

236 FPA, section 6; Bossin, supra n48 at 19. See also Jack Cewe Ltd. v. Irving et. al., supra n120 in which the Court held that forbearance to sue was sufficient consideration for the purposes of the Nova Scotia version of the FPA (and also the FCA), although the Court did not advert to the “fair and reasonable relative value” required by the provision.

237 IA, section 54, and CA, section 297 with respect to dispositions and unequal transactions; IA section 58(6) and CA section 296. In provisions for the review of securities, however, the defence is more limited; under section 57 of the IA mere forbearance will seldom protect a recipient who will need to show that it has a “real and substantial value” and even then the protection would extend only to the extent of that value, see Meo v. Official Assignee, [1987] 2 N.Z.L.R. 1 (C.A.) at 4. Section 293 of the CA, which provides for the review of company securities, provides a defence only where the security secures the consideration supplied so that no past indebtedness will be protected (although undertakings by a creditor to continue to supply a debtor and not to deal directly with other creditors have been held sufficient), see Re C & D Webster Lid (in lig) (1995), 7 N.Z.C.L.C. 260,907.

238 “Market value” is defined in section 120(7) of the BA in terms of the value of the consideration if disposed of to an unrelated purchaser bidding in a market on an ordinary commercial basis, a concept quite unsuited to assessing the value of a forbearance to sue or a forgiveness of debt.

239 BA, section 120 and 122(2), and CL, section 588FB.

240 Section 120 of the BA; Bankruptcy Legislation Amendment Act 1996 (Cth).

241 “Valuable consideration” had to be substantial, and more than nominal, trivial or colourable (Barton v. Official Receiver (1986), 161 C.L.R. 75, 66 A.L.R. 355 (H.C.A.), at C.L.R. 86) but it did not have to equal, or nearly equal, the value of the property received (Official Trustee in Bankruptcy v. Mitchell (1993), 110 ALR 484 at 490) and forbearance to sue could amount to sufficient consideration (Official Trustee in Bankruptcy v. Racovitis, unreported, Fed. Ct. Of Aust. (FC), Davis, Lockhart and Spencer JJ, 28 November 1995).
respect to companies in liquidation has not been amended so presumably the old rules as to the sufficiency of consideration will continue to apply with respect to corporations.\textsuperscript{242}

In addition to the interests of innocent recipients, the abovementioned defence of good faith and valuable consideration (or adequate consideration, depending upon the jurisdiction) protects a wider public interest in the maintenance of confidence in apparently normal commercial transactions. As noted above, this interest is adequately met by specific provisions which permit a defence to innocent recipients who give valuable consideration. The protection of these provisions has recently been reduced by a move away from defences that require only simple consideration toward a requirement that the value of the consideration given bear some degree of relativity to that of the property obtained. Under the newer provisions it is possible to contemplate circumstances in which an apparently normal transaction may be reviewed on the basis that inadequate consideration has been given, although in most such cases the consideration will be so manifestly deficient that the transaction will not have appeared normal to a reasonable observer in any event. The formulae employed to assess value may give rise to difficulties, particularly where the consideration is in a form other than a money advance such as a forbearance to sue, a partial forgiveness of debt or an undertaking to continue supply to the debtor. Such consideration may be of considerably more practical value to a struggling debtor than to a creditor, and may be practically worthless where a debtor faces inevitable bankruptcy.

In England a transaction is reviewable where the value of the consideration in money or money’s worth is “significantly less” than the value of the property.\textsuperscript{243} The predecessor of the IAE required only “valuable consideration”, and a compromise of a bona fide claim, even if not measurable in money terms, could suffice\textsuperscript{244} although there had to be some degree of a quid pro quo in a commercial sense.\textsuperscript{245}

\textsuperscript{242} Section 588FB of the CL; see Keay, \textit{supra} n19 at 204 to 205.

\textsuperscript{243} IAE, sections 238 and 339. The phrase “significantly less” has been criticised for ambiguity, see Keay, \textit{supra} n19 at 206. The value of a compromise of a bona fide claim must be assessed in money’s worth, considering the value of the claim forgone, see \textit{Re Kumar (a bankrupt) ex parte Lewis v. Kumar & Ors}, [1993] 2 All E.R. 700 (Ch D).

\textsuperscript{244} \textit{Re Abbot (a bankrupt)}, [1982] 3 All E.R. 181, referring to section 42(1) of the Bankruptcy Act 1914 (Eng) (repealed).

\textsuperscript{245} \textit{Re Windle (a bankrupt)}, [1975] 3 All E.R. 987.
Punishment and frustration of fraudulent intent

While “intent-based” reviewable transaction laws might appear superficially capable of defeating debtors’ fraudulent designs, the difficulty of proving fraudulent intent is such that debtors’ wrongful intentions often go unpunished and unfrustrated. Ironically, the objective form of reviewable transaction regime, pursuant to which review is considerably more likely, is in many circumstances more likely to result in the frustration of a debtor’s fraudulent intent than legislation referring expressly to that intent.

In any event, as noted above the punishment and frustration of fraudulent intent are not appropriate goals of civil reviewable transaction law where the debtor is not a party to the litigation.

Constructive intent in early subjective reviewable transaction law

The history of subjective reviewable transaction law reveals a lost opportunity to render the law more responsive to the interests of creditors and recipients by introducing an objective element into the interpretation of relevant statutes. Early case authorities indicated that where the effect of a transaction is to confer a preference it is unnecessary to prove actual intent, as the requisite intent may be presumed as a matter of law where the natural and ordinary consequence of a transaction is to defraud or prefer creditors, rather than being proved as a matter of fact. However, the opportunity this interpretation offered to escape the confines of the subjective cause of action has not survived.

Dunlop\textsuperscript{246} examines an apparent divergence in the early English authorities with regard to the circumstances in which intent may be proved as a matter of “presumption of law”, in particular whether a person is deemed to intend the necessary consequences of its acts. In \textit{Twyne’s Case}\textsuperscript{247}

\textsuperscript{246} Dunlop, supra n5 at 601 to 607.

\textsuperscript{247} (1601), 3 Co. Rep. 806, 76 E.R. 809.
the fraudulent intent of a debtor was permitted to be proved by reference to suspicious surrounding circumstances or “badges of fraud” and in *Freeman v. Pope*\(^{248}\) it was held that in the absence of direct proof, the requisite intent of a debtor would be inferred where it was a necessary consequence of a disposition that creditors would go unpaid. However, in *Re Wise, ex parte Mercer*\(^{249}\) while some dicta is confusing\(^{250}\) it was held that a person does not necessarily intend the natural consequences of its actions. Dunlop notes that in Canada, while both *Freeman v. Pope* and *Re Wise; ex parte Mercer* have been ostensibly followed, wherever the distinction between the two authorities has been examined the rule in *Re Wise; ex parte Mercer* (intent may not be presumed as a matter of law from the effect of a transaction) has been preferred.\(^{251}\)

A more significant indication than the repetition or otherwise of terms used in the older cases is the existence of many case authorities in which the effect of an impugned transaction was clearly to disadvantage creditors, and that effect was the natural and expected consequence of a debtor’s act, but it was held that the debtor did not intend that result. Examples include cases in which a debtor acted under pressure from a creditor or where a transaction occurred in the ordinary course of business.\(^{252}\) It has been held that the requisite intent may be proved from circumstantial evidence of suspicious circumstances in the absence of a credible explanation,\(^{253}\) but this goes to proof of intent as a matter of fact which is not the same as a legal presumption of intent based solely upon the effect of a transaction. In the recent English case of *Re M C Bacon Ltd.*\(^{254}\) it was held that it is not sufficient for a preference to be the natural and probable consequence of a debtor’s actions in the absence of proof of the requisite “desire”. The opportunity offered in *Freeman v. Pope* to develop a law of reviewable transactions which did not depend upon the intent of the debtor, but upon a presumed intent based upon the effect of the

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\(^{248}\) *Supra* n203.

\(^{249}\) (1886), 17 Q.B.D. 290 (C.A.).

\(^{250}\) Lord Esher M.R. indicates at one point of his judgment that intent may be inferred from effect, but otherwise appears to accept that no such presumption exists, nor is a person deemed to intend the natural consequences of its acts. See discussion by Dunlop, *supra* n5 at 604 and 606.


\(^{252}\) See e.g. *supra* n145.

\(^{253}\) *Koop v. Smith* (1915), 25 D.L.R. 355 at 358 to 359.

\(^{254}\) See *supra* n143 at B.C.L.C. 335 to 336.
debtor’s acts being to defraud or prefer creditors, was not taken. It must be noted, however, that
the loss of this opportunity to render subjective reviewable transaction laws more responsive to
the underlying interests of the relevant parties is a reflection of developments relating to proof of
intention in the criminal law generally, rather than a development particular to the present
inquiry.

The conception of “fraud” in subjective reviewable transaction law

Although subjective reviewable transaction laws reflect their historical origins in criminal fraud
law, with an emphasis upon the wrongful character of a debtor’s acts, there is wide acceptance of
the notion that “fraudulent” intent for the purpose of reviewable transaction legislation means
“constructive” or “legal” fraud characterised as “fraud” only because it has a tendency to damage
the public interest, rather than actual fraud in the sense of a reprehensible criminal or quasi-
criminal act. However, the notion does not enjoy universal acceptance, and some frauds
committed upon creditors are quite criminal in nature. In Lloyd’s Bank v. Marcan & Ors dicta
of Pennycuick V-C to the effect that “fraud” in this context did not equate with actual deceit or
dishonesty was strongly disapproved on appeal, Cairns and Russell L.JJ. holding that under the
Statute of Elizabeth “fraud” involves dishonesty. Similar dicta may be found in New
Zealand. To the extent that a civil remedy is contemplated a “constructive fraud” analysis may
be appropriate but the action for reviewable transactions developed to a large extent from the
criminal law and debtors who intentionally act to defraud creditors remain subject to criminal
penalties. In some instances reference to “debtor misbehaviour” is preferred to “fraud” on the
basis that while the debtor’s conduct does not amount to actual fraud it is still wrongful in that it
intentionally harms creditors. The notion that subjective reviewable transaction regimes are

254 See Houlden & Morawetz, supra n50 at 245; Re Pacific Mobile Corp.; Robitaille v. American Biltrite (Can.) Ltd.,
supra n69; American Law Institute, Transnational Insolvency Project, International Statement of Canadian


256 In Official Trustee v. Marchiori (1983), 69 F.L.R. 290 (F.C.A.) at 298 Fisher J cited the dicta of Pennycuick V-C to
the effect that “fraud” in this context was not truly criminal, but His Honour apparently did not realise that this dicta
had been disapproved on appeal.

257 See G. & M. Cook Ltd. v. Savoy Restaurant Ltd. (1982), 1 N.Z.C.L.C. 98,508 at 98,523 where the Court admitted to
a reluctance to find intent in the absence of clear evidence because it involves an element of “moral turpitude”.

258 See Keay, supra n19 at 35.
not really about criminal fraud is true in some respects, but has the unfortunate effect of diverting attention from the inappropriate focus of intent-based reviewable transaction legislation. It is submitted that an approach preferable to engaging in linguistic exercises with regard to when “fraud” really means “fraud” would be to replace the relevant laws with provisions that do not rely upon a debtor’s intent in any respect.

5.3 Objective regimes - effect of a transaction

In response to the deficiencies of reviewable transaction regimes based upon a debtor’s intent to defraud or prefer, some jurisdictions have enacted “objective” reviewable transaction laws which focus instead upon the effect of a transaction being to disadvantage creditors. Provision for other relevant interests is made by means of exceptions and defences. Conceptually, the objective approach starts from the proposition that the property of a bankrupt both as at the date of bankruptcy and also during a period of insolvency prior to that date should be available to a trustee for distribution among creditors, subject to any reasons why that should not be so in particular cases. The objective regime structure is thus entirely consistent with the presumption that the starting position of a reviewable transaction regime should be the recovery of value for creditors unless there is a compelling reason to the contrary. The focus is directly upon the competing claims and interests of recipients and unpaid creditors which, it is submitted, addresses those interests and public policy concerns more directly and effectively than the traditional subjective method.

Creditors’ interests

Objective reviewable transaction regimes provide for creditors’ interests much more comprehensively than subjective regimes. The reason for this is simply that it is much easier for trustees to review transactions in objective regimes, where there is an effective presumption in favour of review subject to any competing interest which might outweigh creditors’ interests.

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260 For example, Brown describes New Zealand’s objective company provisions with respect to preferences as having the effect that all preferential transactions within the review period are *prima facie* invalid, see Brown, *et. al., supra* n109 at para LQ.4.01.
Recipients’ interests and the protection of confidence in commercial transactions

The presumption in favour of creditors’ interests apparent in objective reviewable transaction regimes need not prejudice deserving recipients or otherwise have effects which are contrary to public policy, as such interests may be provided for by exceptions and defences. The advantage of providing for these interests only by means of specific exceptions or defences is that circumstances in which it is considered desirable for value to remain in the hands of recipients may be provided for specifically and exclusively. A recipient wishing to defend a transaction would need to prove that its claim to the value received has merit in relation to its own circumstances, e.g. where it has innocently relied upon the receipt to its detriment and would suffer unfair prejudice if the transaction were reviewed, or where as a matter of policy it should be entitled to rely upon an outwardly normal commercial dealing. This is not the case in reviewable transaction schemes based upon proof of a debtor’s intent to defraud or prefer, where although there exist specific defences and exceptions a recipient will typically defend a review action by attempting to show that the debtor lacked the requisite intent, an issue relevant to neither the merits of a recipient’s claim to the value received, nor the interests of creditors (who are prejudiced by the effect of a transaction, not by the intent with which it is made).

Defences recognise the interests of innocent recipients and the need to protect confidence in the reliability of commercial transactions by protecting recipients of debtors’ property who take in good faith, without knowledge of insolvency, and give valuable consideration. As discussed above, an increasingly common requirement is that such consideration may not differ obviously in value to the property received (and in such a case the pool of unpaid creditors is not disadvantaged by the transaction in any event). This has the effect of protecting recipients who had no reason to suspect that their receipt would have the effect of disadvantaging creditors. As an alternative to proof of valuable consideration, a defence is commonly provided for recipients who rely upon a receipt of property to their detriment, a similar defence to that available to recipients of property under the law of restitution.261 Thus, the interests of recipients and the

need to protect confidence in commercial transactions is balanced directly against the interests of unpaid creditors.

Punishment and frustration of fraudulent intent

The desire to frustrate or punish debtors does not feature significantly, if at all, in objective reviewable transaction legislation. Keay argues that the objective Australian provisions for the review of dispositions reflect "disreputable commercial behaviour" which is not commercially moral, but this analysis is inconsistent with the fact that in modern Australian legislation the intent of the debtor is not an element of the cause of action. Keay cites the Cork Report in support of his argument that this legislative purpose, i.e. the prevention of commercial impropriety, exists to meet the demands of commercial morality, but the Cork Report refers to the English subjective regime in which the intent of a debtor to defraud creditors remains the central element of the cause of action. Australian statutes do make provision extending review periods where an intent by a debtor to defeat creditors may be proved, but these provisions are of little practical importance. The objective approach is consistent with the argument made in this paper that the punishment and prevention of a debtor’s wrongful acts are best left to the criminal law. In addition, as noted above the greater ease with which transactions may be reviewed under objective regimes increases the likelihood that a debtor’s wrongful intentions may be frustrated by review of a transaction.

Debtors’ interests

The public interest in preventing a debtor’s financial decline being hastened as a result of premature dismemberment by creditors, which also reflects a concern with creditors’ interests, is better protected by a reviewable transaction regime that renders it more likely that such transactions will be reviewed by a trustee. While the extent to which such a regime is capable of

262 Ibid., at 56.
263 Cork Report, supra n213.
264 See above, page 23.
dissuading creditors from enforcing repayment of their debts is debatable, creditors may take some comfort in the knowledge that if they are not first in line to obtain repayment the review scheme will permit them an opportunity to share in the proceeds of others’ diligence, making it more likely that creditors will risk providing accommodations to debtors in difficulty.

5.4 Conclusion

Subjective reviewable transaction regimes reflect a historical conception of reviewable transactions as involving a fraud by a debtor against its creditors. Regimes which focus upon a debtor’s intent to defraud or prefer creditors retain an emphasis upon the frustration of debtors’ intentions, which together with the relief of creditors, was a primary objective of early bankruptcy and reviewable transaction law. The expression of these dual interests is apparent in section 3 of the Statute of Elizabeth which provided that half of any property recovered was to be payable as a fine to the Crown (in addition to the possible imprisonment of the debtor) and the remainder was to be divided among defrauded creditors. It was even once argued that the Statute of Elizabeth was solely criminal in nature and did not entitle creditors to the proceeds of a fraudulent disposition.265 The punishment of fraudulent intent is apparent in related legislation; when the first statutes for the relief of imprisoned debtors were enacted in England relief was denied to debtors who had conveyed away their property to defeat creditors.266 In Canada, early legislation was aimed as much at punishing debtors as providing a remedy for creditors.267

The punishment of debtors’ wrongful acts and the frustration of their fraudulent intentions is no longer the primary focus of reviewable transaction law, and modern descriptions of the meaning of “fraud” in this context tend to avoid notions of criminal wrong. Furthermore, subjective reviewable transaction regimes are comparatively ineffective to punish debtors and frustrate their intentions. In the absence of punishment and frustration as primary goals of reviewable transaction law the focus must turn to the interests of the parties involved in review litigation. The emphasis in subjective regimes upon debtors’ intentions results in inadequate provision for

265 See above, supra n7 and accompanying text.
266 An Act for the Relief and Release of Poor Distressed Persons for Debt, 1670-71 (22 & 23 Car. 2), c. 20.
267 Dunlop, supra n5 at 120, referring to the recovery of unpaid judgments as well as fraudulent dispositions.
the interests which must be balanced in reviewable transaction law, particularly the competing claims of creditors and recipients. The inability of an essentially penal regime to adequately provide for those interests has been recognised and addressed to a greater or lesser extent by legislation in the jurisdictions under study. The regimes which most appropriately balance competing interests in reviewable transaction claims are those in which the intent of a debtor has been abandoned as the basis for a review action.
CHAPTER SIX  THE RESPECTIVE INTERESTS OF SECURED AND UNSECURED CREDITORS

In balancing the competing interests of recipients and unpaid creditors, including cases in which the recipients are themselves creditors, the operation of reviewable transaction laws is affected by differences in creditors' status. This chapter examines the effect of reviewable transaction laws upon the respective interests of secured and unsecured creditors. It investigates the circumstances in which pre-bankruptcy transactions involving secured creditors, particularly transactions in which creditors receive grants of security and repayments of debt, may be reversed by a trustee in bankruptcy. It also examines instances in which reversal of transactions to which secured creditors are not parties may affect their interests. Consideration is given to the effect of a personal property and security regime of the type in place in a number of Canada's provinces and the likely effect upon creditors' interests in jurisdictions where the introduction of a similar regime is contemplated.

It is the contention of this paper that the effects of reviewable transaction laws with respect to the interests of secured creditors are inconsistent and undesirable in many respects. In addition, piecemeal attempts to provide for instances in which reviewable transaction laws do not appear to properly account for securities have had undesirable results. Intended outcomes would be better achieved by properly drafted general review provisions rather than piecemeal responses to perceived problems, some of which are illusory.

6.1  Security interests and reviewable transaction regimes

Creditors commonly obtain security interests over debtors' property to protect their ability to obtain repayment. Creditors may obtain security to protect fresh advances or existing debt which was previously unsecured. Creditors may take security in respect of some debt, but hold other debt unsecured. Where a debtor becomes bankrupt secured creditors are generally entitled to satisfy their debts out of the property which is subject to the security interest, or "collateral", in preference to the claims of other creditors, as such property does not, to the extent of the security interest, become available to a trustee for distribution among creditors. A valid security interest will protect a creditor's right to realise the collateral in the event of default by the debtor, and in
most cases will also protect debt repayments received by the creditor from a trustee’s preference action.

A trustee may challenge the validity of a security interest on the basis that the transaction in which it was granted is reviewable. In general, review legislation seeks to prevent the granting of security interests that confer post-bankruptcy benefits upon insolvent debtors, and the granting of security interests or preferential repayments of debt which confer preferences upon unsecured creditors. Transactions in which security is given or debt repayments are made are commonly reviewed as preferences because of their typically preferential effect, but they may also be reviewed as dispositions or unequal transactions or pursuant to review provisions that provide especially for the review of securities.

Preference issues typically arise where security is obtained wholly or partially in respect of existing unsecured debt as security which is taken only in respect of fresh advances, while preferential in the sense that it will put the creditor in a better position than unsecured creditors, does not reduce the pool of assets available to those creditors. As is the case with other

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268 Section 95 of the BIA provides for review of a “charge”; with respect to the FPA see supra n112; with respect to the IAE sections 239 and 340 provide for review where a person “does anything” with a preferential effect and sections 241 and 342 include review of securities within the orders a court may make; with respect to Australia’s BA and CL see supra n151; and in New Zealand section 56 of the IA provides for the review of any “charge” made on any property and section 292(1)(b) of the CA provides for the review of a security or charge.

269 Under section 91 of the BIA see supra n53; under the FCA see supra n42; under the IAE see supra n77; under Australia’s BA and CL see supra n81; in New Zealand see section 2 of the IA. The CA does not provide a definition of “transaction” for the purposes of section 297 but a guarantee is clearly included and this should also be true of a grant of security, see Brown, et. al., supra n109 at para 297.04(1).

270 Where fresh security is given to cover both existing unsecured debt and fresh advances, only that which secures the fresh advances will be safe from attack by a trustee, see Re Candie Maid Ltd. (1975), 20 C.B.R. (N.S.) 106 (Ont. S.C.). The same is true under British Columbia’s FPA but not necessarily under the FCA, see Telegraph Cove Venture Inc. v. Telegraph Cove Holdings Ltd., [1996] B.C.J. No. 24 at 11, noted [1996] B.C.W.L.D. 453, online: QL (BCJ). This principle is also accepted in Australia, see section 588FA(2) of the Corporations Law 1991 (Cth) and Robertson v. Grigg (1932), 47 C.L.R. 257.

271 A time delay between the advance and the granting of security will not necessarily be fatal provided that the security is given with the intention of honouring the original agreement to give security for the loan, rather than with an intent to prefer the recipient creditor. See Re Blenkarn Planer Ltd (1958), 26 W.W.R. 168 (B.C. S.C.); Re Mac-Wall Contracting Ltd., supra n109 and Re F A Stanton Ltd (No 2), [1929] 1 Ch. 180. The requirement that the advance be contemporaneous appears to be more strictly applied in Australia, see Re Shoe Lace Ltd., [1993] B.C.C. 609 aff’d [1993] B.C.C. 367.

272 See supra n109.
transactions capable of being investigated by a trustee, grants of security and repayments of debt are more likely to be reviewed under objective review regimes than under subjective regimes.

Even where security interests are not themselves subject to review, there are many circumstances in which reviewable transaction regimes affect the respective interests of secured and unsecured creditors. These circumstances reflect the variety of forms security interests may take and the consequences which follow from different aspects of security regimes (such as partial repayments and the significance of failure to register or “perfect” security interests). The effect of reviewable transaction regimes upon secured creditors, and corresponding effects upon the interests of unsecured creditors, depend upon a number of factors. These include the state of the security itself (its validity, state of perfection or registration), the form in which the security takes and the interest which a creditor wishes to protect (e.g. in collateral, proceeds of sale, reclaimed property or repayments of debt) and whether the interest is claimed in a bankruptcy or obtained prior to bankruptcy. Each of these circumstances is examined in this chapter.

Legislation providing expressly for the review of security interests

Legislation which provides expressly for the review of security interests tends to reflect a concern with preferences. As the sole purpose of a security interest is to put a creditor in a priority position, provisions for the review of preferences generally include securities among the interests capable of being the subject of a review action. It is not clear why additional legislative provision dealing specifically with securities is thought necessary.

In the case of Canada’s BIA one such provision is highly specific and appears to reflect a particular policy interest. Section 94 provides for the review of general assignments of book debts to the extent that those debts are unpaid as at the date of bankruptcy. Assignments which are registered pursuant to a provincial statute (such as British Columbia’s Personal Property Security Act) are exempted. Only general assignments are covered by the section; assignments of debts due at the date of the assignment from specific debtors and debts falling due under specified contracts are excluded, as are assignments of book debts included in a transfer of business made in good faith and for valuable consideration. This provision for review of
unregistered securities is consistent with British Columbia’s Personal Property Securities Act, which renders void unregistered securities as against a trustee.\textsuperscript{273} The section does not affect any payments made under the assignment prior to the bankruptcy, although such payments may be reviewable as preferences.

The BIA also provides that mortgages or charges over real property given to a bona fide recipient for adequate valuable consideration are effective as if an assignment in bankruptcy had not taken place, provided that no notice of the assignment had been registered prior to the mortgage or charge.\textsuperscript{274} The provision does not give a trustee priority over an unregistered charge.\textsuperscript{275} No similar provision is made with respect to personal property securities.

In England, section 245 of the IAE provides for the review of floating charges, including crystallised charges which were originally floating charges.\textsuperscript{276} A floating charge created within a twelve month review period (or two years where the parties are connected)\textsuperscript{277} is void except to the extent that it secures money paid or goods supplied to the debtor company at the time of or after the creation of the charge, or the discharge or reduction of debt owed by the company at the time of or after the creation of the charge, together with any interest owing. The IAE does not specifically provide for the review of fixed charges, although they are subject to review as preferences. The section provides only for review of floating charges as from the date of liquidation, and does not affect the validity of repayments of debt made prior to liquidation\textsuperscript{278} although such repayments may be reviewed as preferences.\textsuperscript{279}

\textsuperscript{272} See infra n298 and n308.
\textsuperscript{273} BIA, section 75.
\textsuperscript{274} Houlden & Morawetz, supra n50 at 226.
\textsuperscript{275} IAE, section 251.
\textsuperscript{277} The review period in the case of floating charges is twelve months prior to the presentation of an insolvency petition (together with the period from presentation of the petition to the liquidation order) or the date of voluntary liquidation, extended to two years where the company and the other party to the transaction are connected.
\textsuperscript{278} Mace Builders (Glasgow) Ltd v. Lunn, [1987] Ch. 191, [1986] 3 W.L.R. 921 at Ch. 199; Power v. Sharp Investments, [1994] 1 B.C.L.C. 111, [1993] B.C.C. 609 (CA) (in the latter case payments made under a floating charge declared invalid under section 245 of the IAE were held to be reviewable only because they had been made after the liquidation petition).
\textsuperscript{279} In Re Parkes Garage (Swadlincote) Ltd., [1929] 1 Ch. 139 a claim for recovery of payments brought solely on the basis that the security for those payments was void was dismissed, but the Court expressly noted that the dismissal was without prejudice to the right of the trustee to bring further proceedings to recover the payments as preferences.
In New Zealand, prior to 1980\textsuperscript{280} only floating charges were susceptible to review under the CA provision which dealt specifically with securities, as remains the case in England.\textsuperscript{281} Section 293 of the CA now provides for the review of both fixed and floating securities where the debtor is a corporation. A security given within a one year review period\textsuperscript{282} is reviewable where the company is unable to pay its debts immediately after the security is given\textsuperscript{283} unless it secures money, property or other valuable consideration given in good faith at the time of or after the giving of the security (or within 30 days if given to secure the unpaid purchase price of property)\textsuperscript{284} or it is in substitution for (and does not exceed the value of) a security given before the review period. The section does not apply to a security which has been discharged at the time of liquidation even if it would have been reviewable if still in existence,\textsuperscript{285} and does not confer a right to review debt repayments made prior to liquidation although such debt repayments may be subject to review as preferences.\textsuperscript{286} It is possible that the general defence provided in the CA where a person receives property in good faith and alters its position in the reasonably held belief that the transaction is valid and will not be reviewed, and review would be inequitable,\textsuperscript{287} may not apply to the voiding of a security under section 293 as this may not be considered a “recovery ... of property or its equivalent value” by a liquidator, although the corresponding defence under the IA does apply in these circumstances. There appears to be no authority on point.

\textsuperscript{280} Companies Amendment Act 1980 (N.Z.).

\textsuperscript{281} In England the Cork Committee took the view that floating charges required legislative attention on the basis that unlike fixed charges, the security provided by a floating charge was capable of swelling as the debtor acquired more property on credit, to the increasing detriment of other creditors, see Cork Report, \textit{supra} n213 at para 1553. The New Zealand Department of Justice rejected this argument on the basis that the feared effect had not been evident from existing review provisions relating to charges, see New Zealand Department of Justice, \textit{Insolvency Law Reform - A Discussion Paper}, (Wellington: Law Reform Division - Dept of Justice, 1988).

\textsuperscript{282} The review period runs from one year prior to the presentation of a liquidation application to the date of the liquidation order, or in the case of a voluntary liquidation, one year prior to the date of voluntary liquidation.

\textsuperscript{283} The CA imposes a rebuttable presumption that a company is unable to pay its due debts where a security is given within 6 months of the date of liquidation.

\textsuperscript{284} CA, section 293(4).


\textsuperscript{286} \textit{Ibid.} at 45.

\textsuperscript{287} CA, section 296(3).
Section 299 of the CA enacts a broad discretion for the review of securities executed by a company in favour of directors and other specified persons who are related to the company. Such a security is reviewable if having regard to the circumstances in which the security was created, the conduct of the recipient in relation to the affairs of the company and any other relevant circumstances, it is just and equitable that the security be declared void. There is no review period and no requirement for a liquidator to prove insolvency. The section provides a defence for the benefit of a third party who receives a security from a director (or other related person) in good faith and for valuable consideration.

Section 57 of New Zealand's Insolvency Act provides for the review of securities in the bankruptcy of natural persons. A security given within a twelve month review period is reviewable except to the extent that it secures money, property or other valuable consideration given in good faith at the time of or after the giving of the security (or within 21 days if given to secure the unpaid purchase price of property, whether the security is over the supplied property or not) or it is in substitution for and does not exceed the value of a security given before the review period. Securities given pursuant to an agreement made prior to the review period are exempted from the operation of the section. A recipient of security will have a defence if it receives it in good faith and alters its position in the reasonably held belief that the transaction is valid and will not be reviewed, if review of the transaction (or review in full) would be inequitable. A third party who receives security from a creditor in good faith for valuable consideration will also have a defence.

Although the CA and IA provisions relating to the review of securities are superficially similar, there are odd inconsistencies. It is difficult to see why a grace period of 30 days should apply in the registration of a security for the purchase price of property supplied to a corporation, when

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288 Whereas section 293 of the CA refers to a "charge" section 57 of the IA applies to a "security or charge". In the light of the broad definition of "charge" given in the CA it is submitted that the distinction is immaterial.

289 The review period runs from 12 months prior to the filing of a bankruptcy petition to the date of the bankruptcy order, or the 12 months prior to the date of voluntary bankruptcy, as the case may be. The original review period (under a 1908 Act) was only four months.

290 IA, section 57(4)(a).

291 IA, section 58(6).

292 IA, section 58(5).
the corresponding period with respect to a natural person is 21 days. More significantly, the CA provision enables a securityholder to escape review where a debtor company is solvent at the time the security was given, but the IA does not similarly provide with respect to security given by a natural person. The IA provides a defence where a security is given pursuant to a prior agreement, but the CA does not (in the absence of express provision the existence of a prior agreement is irrelevant, as intent to prefer is not an element of the action). It also appears that a defence for a recipient which alters its position in good faith in reliance upon the transaction may not be available under the CA, although this is not clear.

In Australia section 588FJ of the CL provides for the review of floating charges. Unless it can be proved that a company in liquidation was solvent immediately after giving a charge, a charge given within a six month review period is void except to the extent that it secures advances made to, liabilities incurred for, or the purchase price of property or services supplied to the company at or after the date of the charge, together with interest. The section recognises the potential for a creditor to effectively exchange unsecured debt for secured debt by giving fresh secured advances to enable repayment of existing unsecured debt, and provides that where an advance made by a creditor is applied to discharge an unsecured debt owed to the same creditor or a related entity, the fresh advance (together with interest) will not be protected by the security. In many cases the use of fresh advances to repay existing debt will not be obvious or easily proved, as repayment arrangements typically involve a debtor company making repayments over time and continuing to receive other income in the course of its business so that proving that the fresh advances are the source of the repayments would involve an impossible tracing exercise. The New Zealand legislation ensures that fresh secured advances are not used to repay unsecured debt in a sweeping fashion, by deeming that any repayments are applied first to the fresh secured debt. The two approaches are described in detail below, at page 96.

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293 A floating charge for the purposes of this section includes a floating charge which has become a fixed charge, see CL, section 9 definition of "floating charge" and Re Eastern Retreads Wholesale Pty Ltd (1979), 4 A.C.L.R. 136.

294 The review period runs from six months prior to the date of filing of a petition to the date of liquidation.

295 In Cosmas Fish Processors International Pty Ltd v. M Hoffman Nominees Pty Ltd (1982), 1 A.C.L.C. 52 the Court held that the reason for an exception being given for new advances was a policy decision that persons who lend to a failing company should be entitled to their security. Equally plausible, however, is the consideration that persons who give fresh advances and take security for their value do not obtain a preference over other creditors.

296 CL, section 588FJ(4), see e.g. Re Orleans Motor Co, [1911] 2 Ch. 41 where a floating charge taken by directors to secure an advance they made to the company, which was then applied to repay a company debt the directors had guaranteed, was held invalid. Only a charge intended bona fide to benefit the company and not to confer a preference will be protected, see Re Matthew Ellis Ltd, [1933] Ch. 458.
Where a security is reviewable under the Australian provision the liquidator is entitled to recover any payments made by the company to the chargeholder in reduction of the (now unsecured) debt whether or not the requirements of a preference action are satisfied.\textsuperscript{297} This rather draconian provision is discussed in detail below, at page 98.

### 6.2 Secured creditors' rights in collateral

Reviewable transaction regimes affect the interests of secured and unsecured creditors in a number of ways other than the voiding of a security. Repayments of debt made to secured creditors or recoveries of collateral by secured creditors may be reviewed, and secured creditors' claims in a bankruptcy may be affected by the application of reviewable transaction laws upon other parties' interests. The interaction between the legal principles which govern the operation and validity of securities and reviewable transaction legislation are considered in the remainder of this chapter. Where security over personal property is concerned, there are significant differences between jurisdictions which have enacted Personal Property Security regimes and those which retain traditional personal property security rules, and these differences are considered in the course of this analysis.

**Personal Property Security legislation**

As reference is made to distinctions between jurisdictions which have adopted a comprehensive Personal Property Security regime ("PPSA regime") based upon Article 9 of the United States Uniform Commercial Code and jurisdictions which retain "traditional" personal property or "chattel" security rules (such as Australia, New Zealand and England), a brief description of the two types of security regime is appropriate. British Columbia’s Personal Property Security Act\textsuperscript{298} ("PPSA") is similar to PPSA legislation in force in other provinces of Canada.\textsuperscript{299} While

\textsuperscript{297} CL, section 588FJ(6).

\textsuperscript{298} R.S.B.C. 1996, c. 359. In limited circumstances involving the taking by a bank of certain types of personal property security from certain types of debtor, the governing statute is the federal Bank Act, S.C. 1991, c. 46.
the various failings of traditional security regimes are outside the scope of this paper, some jurisdictions with traditional security regimes (e.g. New Zealand) are considering or preparing to enact a PPSA regime and some of the resulting changes will be relevant to the effect of reviewable transactions upon security interests. These changes are specific and are discussed in relation to particular issues.

In British Columbia the PPSA governs the granting and enforcement of security interests, including certain forms of lease and conditional sale agreements, over personal property. The PPSA regime provides two stages of personal property security protection. The first stage requires that a security “attach” to property intended as collateral, which requires an agreement between creditor and debtor giving the creditor rights to the collateral. Failure of the security to attach to the property will result in the creditor having no rights to the collateral, effectively leaving the debt unsecured. Once attached, the security is valid as between debtor and creditor so that the creditor is entitled to exercise remedies against the collateral in the event of breach by the debtor. Attachment by itself, however, does not protect a creditor’s interest in the collateral from competing claims by other creditors, or by a trustee in bankruptcy should the debtor become bankrupt. A creditor may obtain protection from such third parties by attaining the second stage contemplated by the legislation, which is “perfection” of the security. Perfection requires either registration of a financing statement in the Personal Property Registry or the taking of possession of the collateral by the creditor “as collateral”.


300 See e.g. New Zealand Law Commission, infra n309 at 1.

301 At the time of writing this paper a Personal Property Securities Bill 1998 (“PPSA Bill”) is currently before a select committee and appears likely to be passed into law. In 1989 a Bill based on British Columbia’s PPSA was presented to the New Zealand Parliament but failed to become part of the Government’s legislative programme, probably as a result of the need to deal with sweeping changes then being made to New Zealand’s companies legislation. The present Bill differs from its 1988 predecessor in that it is based upon the Saskatchewan PPSA 1993, c. P-6.2 rather than the British Columbia PPSA, although the two Canadian statutes are very similar in effect (if not in format).

302 Section 12 of the PPSA requires that value be given by the creditor for the security, that the debtor have rights in the property to be the security, and that certain writing requirements (set out in section 10) be satisfied.

303 The taking of possession of the collateral by the creditor will fulfill the requirement of perfection only where the collateral is taken “as collateral”, i.e. to secure payment, for the purposes of section 24 of the PPSA. The creditor’s purpose in taking possession must have been to guarantee repayment of the debt, not to obtain repayment by realising the collateral, see Re Bank of Nova Scotia and Royal Bank of Canada et al. (1987), 42 D.L.R. (4th) 636 (Sask. C.A.).
In New Zealand personal property security interests are governed by a variety of enactments and separate registration schemes operate under each. Many security arrangements which under the PPSA require registration to confer an unassailable priority over other claimants, such as reservation of title clauses, leases and hire purchase agreements, do not require registration under present New Zealand legislation. As in Canadian provinces prior to the enactment of PPSA regimes, the rules governing security interests (or interests having the effect of security interests) in personal property are recognised in different ways depending upon the nature of the debtor (natural person, incorporated society or company), the form of the security documentation (whether the security interest is expressed as a fixed or floating charge, floor plan agreement, chattel mortgage, hire purchase agreement, lease, conditional sale or reservation of title agreement) and the nature of the collateral. The attraction of the PPSA regime is that it provides a relatively comprehensive set of rules which do not distinguish between the various forms of security arrangement and the various types of debtor but governs priorities and claims generally by reference to the concepts of attachment and perfection.

Collateral in the possession of a debtor

The holder of a valid security interest is entitled to deal with collateral in the manner contemplated by the security agreement in the event of default by a debtor (bankruptcy and receivership are typically specified as events of default). The most common remedy exercised by a secured creditor with respect to collateral is to sell the collateral and satisfy the debt out of the proceeds of sale. Such a recovery will not be a reviewable transaction, provided the security interest is valid.


305 BIA, section 69.3(2) provides that the bankruptcy of a debtor does not prevent a creditor from realising a valid security. Creditors' rights in relation to seizure and sale of collateral are limited in some respects by statute, see eg. Part 5 of the PPSA (see supra n298) and sections 69, 69.1, 69.2, 69.3 and 244 of the BIA.
Collateral in the possession of a third party or a trustee

Where collateral has passed from a debtor to a third party a security interest may follow the collateral,\(^ {306} \) may continue in the proceeds of sale of the collateral which are held by the debtor,\(^ {307} \) or may be extinguished. Aside from cases where the collateral is recovered by the debtor or a trustee in bankruptcy or where the creditor receives repayments after the collateral has been disposed of by the debtor (both of which are discussed later in this paper) the effect of review legislation is especially significant where collateral passes to a trustee upon the debtor’s bankruptcy.

Perfection of a security interest under the PPSA is especially significant where a debtor is declared bankrupt because an unperfected security will not bind a debtor’s trustee in bankruptcy.\(^ {308} \) This means that a creditor will not be able to rely upon such a security interest to assert a right to collateral, which will form part of a bankrupt’s estate. This rule is consistent with the position under a traditional regime as in New Zealand where securities which are subject to registration such as chattel mortgages and charges (but not reservation of title interests, hire purchase arrangements or other title retention devices), will be void as against the debtor’s trustee in bankruptcy if the collateral is in the debtor’s possession and the security is unregistered.\(^ {309} \) The rationale for this rule is that it preserves the status quo with respect to the rights of unsecured creditors to make claims against a debtor’s assets which are subject to an

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\(^ {306} \) For the circumstances in which a security interest may bind a third party transferee see sections 30 to 34 of the PPSA and clauses 36 to 40 and 57 to 61 of New Zealand’s PPSA Bill. In general, a transferee who does not know of a security interest will take free of it whether it is perfected or unperfected, where the collateral is transferred in the ordinary course of the seller’s business, or the transferee gave value and the goods were consumer goods, or a security interest is temporarily perfected, or the collateral is equipment/serial numbered goods which are not registered as such. In a traditional security regime an unregistered security interest will not attach to collateral in the hands of a third party purchaser without notice, see e.g. the Mercantile Law Act 1908 (NZ) and section 91 of the Chattels Transfer Act 1924 (N.Z.).

\(^ {307} \) For the circumstances in which a security interest may attach to proceeds of sale see section 28 of the PPSA and clauses 40 and 46 to 48 of New Zealand’s PPSA Bill. Under a traditional security regime proceeds of sale may be attached where a floating charge is taken over the after-acquired property of a company or a reservation of title interest follows through into proceeds of sale.

\(^ {308} \) PPSA, section 20(b)(i); Re Giffen, [1998] 1 S.C.R. 91 (S.C.C.).

\(^ {309} \) For natural person debtors see section 18 of the Chattels Transfer Act 1924 (N.Z.), and for corporate debtors see section 103(2) of the Companies Act 1955 (N.Z.) (which remains in force pursuant to section 2 of the Companies (Registration of Charges) Amendment Act 1997). See also New Zealand Law Commission, *A Personal Property Securities Act for New Zealand*, NZLC R8 (Wellington: Law Commission, 1989) at 114 to 115.
Prior to bankruptcy unsecured creditors may employ legal processes to seize and sell assets subject to an unperfected security, but upon bankruptcy their rights against the debtor’s assets are subsumed in the powers of the trustee, who acts as their representative. The rule ensures that unsecured creditors do not lose their ability to claim (albeit through a trustee) against a debtor’s assets which are not subject to perfected securities.

A noteworthy feature of the New Zealand PPSA Bill is that it provides for unperfected security interests to remain effective against a trustee in bankruptcy. The report of the New Zealand Law Commission which recommended this departure from the Canadian and US model did not explain its reasons other than to say that the consequences for insolvency proceedings were left to be determined as a matter of insolvency law. The PPSA Bill also provides that an execution creditor will have priority over the holder of an unperfected security interest, a provision which the New Zealand Law Society has described as a “half way house” intended to reduce the disadvantage to unsecured creditors which results from their inability to proceed against the debtor’s property once bankruptcy has commenced. The proposal is sufficiently controversial that two members of the Law Commission’s Advisory Panel have written articles advocating opposing views and a number of arguments for and against the proposal have been advanced. The issue is presently under consideration by a parliamentary select committee and

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310 Re Giffen, supra n308.

311 See clauses 8 and 28 of the 1988 version of the PPSA Bill and clauses 36 and 62 of the present PPSA Bill. Unlike the Canadian statutes (see e.g. section 20 of the British Columbia PPSA) the New Zealand draft legislation does not expressly set out the status of unperfected securities with respect to trustees in bankruptcy but leaves it to be deduced from the provisions relating to the effect of securities against third parties and priority of security interests in collateral.

312 New Zealand Law Commission, A Personal Property Securities Act for New Zealand, supra n309 at 115. The lack of explanation appears to reflect a difference of opinion among the Commissioners on the issue, see New Zealand Law Society, Submissions on the Personal Property Securities Bill, (Wellington: NZLS, 1999) para 4.68 and the articles cited infra n314.

313 PPSA Bill, clause 102; New Zealand Law Society, ibid, at para 4.68.


315 See generally, New Zealand Law Society, supra n312 at para 4.71. Arguments in favour of the proposal include that the Canadian approach provides a “windfall” for unsecured creditors (although unperfected securities do not prevent unsecured creditors from seizing collateral under an execution process), unsecured creditors have an opportunity to obtain a priority by obtaining and perfecting securities, few securities require registration under current law (although there is a purpose to registration and many forms of security require registration in New Zealand), and the Canadian approach encourages liquidators to attack registered securities on the basis of minor defects in registration (a matter easily addressed by legislative guidelines, and seriously misleading registrations should be invalid in any event). Arguments in opposition to the proposal include that creditors who wish to ensure their priority should perfect their interests, most secured creditors will register (not necessarily the case in New Zealand), and
it remains to be seen whether the Law Commission’s proposal will survive the committee’s deliberations.

Proceeds of sale of collateral

The continued existence (or otherwise) of a security interest in collateral and/or its proceeds is relevant to reviewable transaction law because it affects whether recoveries of that collateral by a creditor, as well as debt repayments made to a creditor, will be reviewable. The PPSA provides for a security interest to extend to the proceeds of sale of collateral in certain circumstances. Where this is the case the secured creditor will be entitled to those proceeds after bankruptcy or retain them in the face of a trustee’s claim. In some cases a security interest may continue in both the collateral in the hands of a third party and in its proceeds.

Section 28 of the PPSA provides that where collateral is sold or otherwise gives rise to proceeds the security interest will continue in both the collateral and in the proceeds (although in many circumstances a third party will take free of a security interest) unless the secured creditor expressly or implicitly authorises the transaction. Where a creditor proceeds against both collateral and proceeds, the total amount secured is limited to the market value of the collateral as at the date of the transaction. The state of perfection of a security interest in proceeds depends upon the extent to which the proceeds are accurately described in the registered financing statement.316 “Proceeds” of collateral includes any identifiable personal property derived directly or indirectly from any dealing with collateral or proceeds in which a debtor has an interest.317 Tracing into proceeds is permitted where there is a close and substantial connection between the original collateral and the property which replaced it, even where this was not the form of the

Zealand where creditors are not accustomed to registering title-security interests), requiring perfection assists lenders who rely upon negative pledges (i.e. agreements not to grant further security) to verify compliance, the proposal would encourage creditors to forge fraudulent security documents (pointless if prior registration were required) and that the proposal reflects a substantial change from current law. On balance, the writer prefers the arguments in favour of adopting the Canadian approach (which is consistent with existing New Zealand law) and rejecting the Law Commission’s proposal.

316 PPSA, section 28(2).
317 PPSA, section 2, “proceeds”.

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transaction and the transaction "chain" included a payment of debt (which in equity would constitute a bar to the tracing remedy).\textsuperscript{318}

Collateral recovered from a third party by a trustee; the \textit{Re Yagerphone} principle

Reviewable transaction law has a remarkable effect upon the relative interests of secured and unsecured creditors in circumstances where collateral disposed of by a debtor prior to bankruptcy is subsequently recovered by a trustee on the basis that the transaction in which the collateral was disposed of is reviewable as a preference, settlement or unequal transaction.

Where a debtor, rather than a trustee, recovers collateral which the debtor had previously disposed of, the PPSA makes express provision for reattachment of the security interest to the collateral.\textsuperscript{319} New Zealand's PPSA Bill provides similarly\textsuperscript{320} but under present New Zealand law there is no equivalent provision. However, where it is a trustee in bankruptcy (rather than the debtor) who recovers collateral in a reviewable transaction action a security interest will not reattach and the collateral will be realised for the benefit of unsecured creditors. The rules appear to be different again where a trustee recovers the collateral in a right of action which exists irrespective of the bankruptcy, such as the bankrupt's right to recover property which a third party transferee has not paid for; in such a case a floating chargeholder will be entitled to the benefit of the recovery (although a reservation of title interest will not reattach, nor will an unregistered fixed security interest). Where a security interest continues in proceeds of sale or in a debt owed to the debtor by a sub-purchaser, it appears reasonably arguable that the security interest in the proceeds or sub-debt may likewise continue in the recovered property (which recovered property replaces its own proceeds).

\textsuperscript{318} See \textit{Agricultural Credit Corp. of Saskatchewan v. Pettyjohn} (1991), 1 P.P.S.A.C. (2d) 273 (purchase of new cattle with the general effect that they replaced old cattle).

\textsuperscript{319} Section 29 provides that where collateral is sold or leased by a debtor such that the transferee or lessee takes free of the security interest (which may be the case whether or not the security interest is perfected) and the collateral is subsequently returned to, seized by or repossessed by the debtor, the security interest will reattach to the collateral. The state of perfection of the reattached security interest is then determined as though the collateral had never been sold or leased.

\textsuperscript{320} PPSA Bill, clauses 49 to 54 and 83 to 85.
The first question is whether a security interest remains attached to collateral transferred by a debtor and recovered by a trustee. The answer appears to be that it does not unless the security binds the person to whom the collateral was transferred by the debtor. Where a security interest remains attached to collateral so as to bind a third party transferee, the subsequent recovery of the collateral by a trustee should have no effect upon the position of the secured creditor (assuming the security is not void against the trustee for non-perfection). However, where a security interest does not bind a third party transferee, an issue arises as to whether the security interest reattaches upon recovery by the trustee. Sections 28 and 30 of the PPSA provide for circumstances in which recipients and lessees of collateral “take free” of a security interest, a phrase which suggests that the security interest becomes detached from the collateral. This is consistent with section 29, which provides that a security interest may “reattach” to collateral recovered by a debtor. Given the consequences of a failure of security to “attach” to property in the first place under the PPSA it seems that a security interest in collateral “taken free” of a security interest ceases to exist altogether. The same terms are employed in New Zealand’s PPSA Bill so the same result should follow. It appears that this will also be true under a traditional property security regime; Bailey and Groves observe that a seller’s title disappears and is replaced by a buyer’s statutory title under section 25 of the Sale of Goods Act 1979 (Eng). It is therefore unlikely that such a security interest will revive in the absence of express statutory provision.

A recovery of collateral by a trustee in a reviewable transaction action is conceptually distinct from a recovery by a debtor because reviewable transaction law imputes special characteristics to recoveries by a trustee. The distinction is apparent when the claims of floating chargeholders upon property recovered by a trustee are considered. Early review legislation provided that the recipient of recoveries resulting from the review of transactions was the trustee, which the courts interpreted as having the result that the benefit of any recovery flowed to unsecured creditors. The case authorities are inconsistent with regard to whether such recoveries are impressed with a trust for the benefit of unsecured creditors, or whether they form part of the general assets under the control of the liquidator which are available for paying the claims of

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322 Ex parte Cooper; In re Zucco (1875), 10 Ch. App. 510 at 511 and 512; Wilmott v. London Celluloid Co (1866), 34 Ch. D. 147 at 150; Sanguinetti v. Stueky's Banking Co, [1894] 1 Ch. 176 at 180; Re Yagerphone Ltd, [1935] 1 Ch. 392 at 396; Re Quality Camera Co Pty Ltd (in liq) v. Tucker (No 2) (1968), 123 C.L.R. 295, [1968] A.L.R. 616 at C.L.R. 300; Campbell v. Michael Mount PPB (1995), 13 A.C.L.C. 506 at 509 and on appeal (1996), 14 A.C.L.C. 218 at 226. The case authorities are inconsistent with regard to whether such recoveries are impressed with a trust for the benefit of unsecured creditors, or whether they form part of the general assets under the control of the liquidator which are available for paying the claims of...
The most well known authority is the English case *Re Yagerphone Ltd.*\(^{323}\) in which it was held that money recovered by a trustee as a result of a reviewable transaction claim was impressed with a trust for the benefit of unsecured creditors, so the holder of a floating charge had no security interest in the recovered property. Despite the enactment of section 239(3) of the Bankruptcy Act 1986, which now provides that an order under review legislation should restore the position to what it would have been had the reviewable transaction not taken place (an amendment which *prima facie* would appear to entitle a floating chargeholder to a reinstatement of its priority position) it has been held that the *Re Yagerphone* principle remains good law in England.\(^{324}\)

An important distinction is drawn between property recovered in a reviewable transaction action in which the debtor’s bankruptcy is an element of the cause of action, and recoveries on behalf of the bankrupt where the cause of action exists irrespective of the bankruptcy. In *Re Oasis Merchandising Services Ltd.*\(^{325}\) it was held that where money was recovered from company directors pursuant to the “wrongful trading” provision of the IAE\(^{326}\) (a right of action which, like reviewable transaction actions, arises only upon liquidation) the unsecured creditors were entitled to the benefit of the recovery. However, the Court noted that where money is recovered by the liquidator through a misfeasance action against directors, which is a right of action arising independently of the liquidation that could be brought by a company itself prior to liquidation, a floating chargeholder would be entitled to the benefit of the recovery. This is consistent with early case authority in England.\(^{327}\)

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\(^{323}\) *Ibid.*

\(^{324}\) *Re M C Bacon Ltd.*, supra n141.

\(^{325}\) [1998] Ch. 170 (C.A.) at 181.

\(^{326}\) IAE, section 214.

\(^{327}\) *Re Anglo-Austrian Printing and Publishing Union*, [1895] 2 Ch. 891. See also Bailey *et. al*, supra n321 at para 14.18.
Re Yagerphone has been followed in Canada. Where the recovery is of a simple debt due to the bankrupt, which is not a reviewable transaction claim dependent upon bankruptcy, a creditor with an assignment of book debts will be entitled to the benefit of the recovery. The distinction in Re Oasis Merchandising Services Ltd is especially significant in Canada because of a conceptual difference between a reviewable transaction recovery pursuant to the BIA compared with a recovery under provincial legislation such as the FPA. In Re J. K. Campbell & Associates Ltd the Court observed that whereas under the BIA a right of action subsists only in a trustee in bankruptcy, under the FPA any person may bring an action and a debtor’s bankruptcy is not a required element of the cause of action. Accordingly, while the proceeds of a review action under the BIA flow to unsecured creditors, the proceeds of a review action under the FPA should accrue to the holder of a floating charge (even if the transaction is subsequently reviewed by a trustee under the BIA) and a securityholder will be entitled to bring an action under the FPA in priority to a trustee's right to commence action under the BIA.

Re Yagerphone has also been followed in New Zealand and in Australia. The distinction in Re Oasis Merchandising Services Ltd between rights of action which arise irrespective of the liquidation and reviewable transaction rights of action which arise in the liquidation is recognised in Australia, although it was held in one case that where a liquidator recovers property in specie which is subject to a floating charge the chargeholder will be entitled to the benefit of the recovery even where the property is recovered pursuant to a voidable transaction provision. The conceptual distinction between property recovered in specie and recovery of money is, with respect, difficult to accept and is not explained or justified in the judgment. Similarly to the position in England, section 588FF of Australia's CL has recently been amended

331 Re Hibiscus Coast Marine Centre Ltd (in liq) (1986), 3 N.Z.C.L.C. 99,615; 2 B.C.R. 27. Section 58 of the IA provides that property recovered in a reviewable transaction is recovered by the trustee, and section 295 of the CA provides that the Court may make an order requiring a person to restore property “to the company” or pay restitution “to the liquidator”.
to provide that money recovered by the trustee is now returned to the company, not to the trustee, but recent authorities indicate that this will not affect the status quo.\textsuperscript{334}

Sanborn\textsuperscript{335} suggests that a secured creditor should be entitled to the benefit of property recovered by a trustee on the basis that this would be the position had the impugned transaction never been entered into. This is a compelling argument and is certainly more consistent with the legislative provisions which describe the nature of recoveries in reviewable transactions than the approach in Re Yagerphone. Keay’s response to this suggestion, which is that bankruptcy “changes everything” and “produces a whole new set of relationships”\textsuperscript{336} is, with respect, inadequate and his assertion that unsecured creditors would otherwise be prejudiced by the review of a transaction fails to recognise that a secured creditor would have taken priority over unsecured creditors had the transaction never occurred. Re Yagerphone results in a windfall for unsecured creditors where property of the bankrupt has been appropriated in a reviewable transaction and recovered by a trustee, because had the transaction never occurred the floating chargeholder would have enjoyed a priority interest in the property. Indeed, the Yagerphone principle may encourage unsecured creditors to enter into flagrantly reviewable transactions in which they obtain property from an insolvent, in the knowledge that even if they are required to return the property to a trustee they will subsequently be entitled to share in its distribution among unsecured creditors\textsuperscript{337} whereas a secured creditor would otherwise have taken priority. Furthermore, the Re Yagerphone principle fails to recognise that in practice trustees in bankruptcy typically require to be put in funds to bring reviewable transaction proceedings and the most likely source of those funds is a secured creditor who expects to receive a priority in

\textsuperscript{334} In Campbell v. Michael Mount PPB, supra n322 at (1996), 14 A.C.L.C. 226 the Court suggested that recovery “by the company” does not mean that secured creditors will be able to exercise a charge over the recovered property because recovery of a preference is for the benefit of unsecured creditors. See also comments made obiter in Hamilton v. National Australia Bank Ltd (1996), 13 A.C.L.C. 1202 to the effect that a secured creditor cannot claim the benefit of recoveries under section 588FE of the CL, following Re Yagerphone Ltd., supra. See also Re Movitor Pty Ltd. v. Sims, supra n332.

\textsuperscript{335} N. C. Sanborn, “Avoidance Recoveries in Bankruptcy: For the Benefit of the Estate of the Secured Creditor?” (1990) 90 Columbia Law Review 1376 at 1398 to 1400. In the USA the Re Yagerphone principle is accepted, see section 550 of the Bankruptcy Reform Act 1978 which provides that any recoveries are preserved for the benefit of the estate.

\textsuperscript{336} Supra n19 at 344 to 345.

\textsuperscript{337} A creditor who is required to refund a payment which has been held to be a voidable preference may prove for that amount as a debt in the bankruptcy, see Re Stephenson, ex p Official Receiver (1888), 20 Q.B.D. 540. However, in New Zealand the extent of such a creditor’s recovery may be subject to the Court’s discretion, see section 295(f) of the CA, and in Australia the claim of such a creditor is postponed until after other creditors are paid in full, see supra n381 and accompanying text.
any recovery. Where a recovery will be shared among unsecured creditors there is no incentive for a secured creditor to fund a review action and unsecured creditors will rarely possess the organisation and shared commitment to contribute rateably to a fighting fund. The writer has experience of company liquidators who disregard Re Yagerphone and pay out recoveries to secured creditors who have underwritten the costs of the recovery action. However, whatever its failings the Yagerphone principle appears to be accepted law in the jurisdictions under study.

Reservation of title agreements

Reservation of title agreements are capable of circumventing reviewable transaction regimes by ensuring that title to collateral never passes to a debtor and thus does not form part of a debtor’s estate in bankruptcy. In most common law jurisdictions sellers commonly supply goods on credit under contracts of sale which contain a reservation of title or conditional sale clause. Such clauses provide that legal title to the goods does not pass from the seller to the purchaser until the purchase price is paid in full. Reservation of title agreements are widely accepted as effective provided certain requirements are satisfied. Where the requirements of a valid reservation of title agreement are met an unpaid seller will be entitled to recover collateral from a debtor in default or a debtor’s trustee in bankruptcy, and recovery of collateral from a debtor prior to bankruptcy will not constitute a reviewable preference because title to the collateral will never have passed to the debtor.

Agreements providing that the seller reserves equitable and beneficial ownership in goods, including mixed items, have been held to be charges which are void against a trustee if unregistered, see Re Bond Worth Ltd., [1980] Ch. 228; see also Hals. (4th) vol 41 para 707.

Reservation of title agreements vary widely in their terms. The classic example is that in the case of Aluminium Industrie Vaassen B.V. v. Romanpa Aluminium Ltd., [1976] 1 W.L.R. 676 at 688. Some contain an “all sums due” clause which provides that title to goods supplied does not pass until all debts owed by the purchaser to the seller are paid; such clauses are generally recognised as effective, see Armour v. Thyssen Edel-stahlwerke AG, [1991] 2 A.C. 339; Chattis Nominees Pty Ltd v. Norman Ross Homeworks Pty Ltd (In rec and In liq) (1992), 28 N.S.W.L.R. 338 at 345; Puma Australia Ltd v. Sportsman’s Australia Ltd, [1994] 2 Qd. R. 149 at 157; New Zealand Forest Products Ltd. v. Pongakawa Sawmill Ltd., [1991] 3 N.Z.L.R. 112, aff’d in part [1992] 3 N.Z.L.R. 304. Agreements may also provide that where the purchaser on-sells the chattels the seller’s title follows through to the proceeds of sale.

Requirements include that the goods claimed must be clearly identifiable as the vended goods which have not been paid for, the clause must be properly incorporated into the contract of sale, and the goods must not have become mingled with other goods or attached as fixtures. Where applicable PPSA regimes provide further requirements including a requirement that the agreement be perfected by registration.

Re Gilbert (1979), 30 C.B.R. (N.S.) 291 (Ont. S.C.)
In Canada, unlike most other common law jurisdictions, the effectiveness of reservation of title clauses has not been determined.342 The likely reason for this is that under PPSA regimes, which are common in Canadian provinces, a reservation of title interest must be perfected by registration to be effective. As the absence of a registration requirement is the primary attraction of reservation of title agreements as compared with other forms of personal property security (the nature of title reservations as undisclosed securities was the primary issue of contention in the early cases concerning reservation of title agreements) it is not surprising that a reservation of title jurisprudence has not developed in Canada.

The rules governing reservation of title agreements vary significantly between traditional personal property security regimes and PPSA provisions.343 In traditional security regimes reservation of title agreements are regarded as having the effect of determining title to property rather than being a form of security interest, and in most cases are not required to be registered.344 PPSA regimes recognise that reservation of title agreements effectively operate as undisclosed securities, and require compliance with the requirements of attachment and perfection which govern other forms of personal property security. Where a seller fails to perfect a reservation of title agreement the seller’s position will be the same as that of any other creditor with an unperfected security interest. One consequence of non-perfection will be that the reservation of title security interest will not be good against a trustee in bankruptcy.345

The PPSA will not govern every transaction in which property is supplied under a reservation of title agreement. Where property is supplied “on consignment” such that a potential purchaser is not required to purchase it, and the supply is made for reasons other than to provide security over

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343 In jurisdictions where introduction of a PPSA regime is proposed it is contemplated that reservation of title interests will be included in a register of personal property interests. See Australian Law Reform Commission, Personal Property Securities, interim report No. 64 (Sydney: Australian Law Commission, 1993) para 5.10, and New Zealand’s PPSA Bill, clause 18(2).

344 Hals. (4th) vol 7(2) (Reissue) para 1301.

the property, the PPSA will not apply because the arrangement will not be a “consignment intended as security” within the meaning of section 2 of the PPSA. Where goods were supplied to a potential purchaser’s warehouse on terms that the purchaser did not have to pay for them unless and until they were either sold or moved to one of the purchaser’s retail stores, the PPSA was held not to apply.\footnote{Re Toyorama (1980), 1 P.P.S.A.C. 126 (Ont. S.C.).} The seller was accordingly entitled to recover the goods from the trustee in bankruptcy of the potential purchaser despite its failure to perfect its interest. In limited circumstances Canadian suppliers may be able to structure their affairs so that they have protection similar in some respects to that available in other jurisdictions under a reservation of title agreement.

In Canada section 81.1 of the BIA provides rights for unpaid sellers\footnote{Section 81.2 makes specific provision for the recovery of produce supplied by unpaid farmers, fishermen and aquaculturalists.} similar to those enjoyed by sellers under reservation of title agreements. These rights arise where goods are supplied for use in the purchaser’s business if within 30 days of supply the purchaser is declared bankrupt and the seller gives notice of intent to recover the goods. As with reservation of title agreements the goods must be readily identifiable, unpaid for, in the trustee’s possession, and must not have been on-sold. Provision for the relief of unpaid sellers in sale of goods legislation is not uncommon but seldom goes to the extent of permitting recovery of goods to which the purchaser has taken title upon possession.\footnote{In New Zealand a seller has limited rights to retain goods or stop goods in transit where a purchaser becomes insolvent, but there is no remedy once the goods are in the possession of the insolvent purchaser, see Sale of Goods Act 1908 (N.Z.), sections 41, 42 and 45.} It is relevant to note that the PPSA regime confers a special priority position upon securities given in respect of the purchase price of collateral, whether it is the supplier or another party who supplies the purchase price and takes the security.\footnote{PPSA, section 34.} This protection is available irrespective of the form of security taken. The provision applies only with respect to priorities between holders of security interests in the same collateral.

Collateral which is subject to a reservation of title agreement may be disposed of by a purchaser to a third party sub-purchaser before repayment in full is made. In such a case title to the goods will pass from the seller to the sub-purchaser where the sub-purchaser has no knowledge of the
reservation of title interest, leaving the seller effectively unsecured (unless the seller can claim title to proceeds of sale or a sub-debt). Such on-selling is especially common where the goods are the purchaser’s stock in trade, in which case a seller may expressly authorise on-sales.

A reservation of title agreement may provide that in the event of an on-sale of the collateral the seller will retain title to the proceeds of sale or to a sub-debt owed by the sub-purchaser to the purchaser. In such a case the seller will effectively remain a secured creditor. Such an agreement should not provide that the seller retains title to proceeds or a sub-debt to a value in excess of the amount of the principal debt, as this may constitute a charge which may be void for want of registration. Where a reservation of title agreement provides for a seller’s title to vest in the proceeds of sale but does not oblige a purchaser to keep the proceeds separate, the seller’s title will normally take effect only if the proceeds are kept in a separate account rather than being mingled with the purchaser’s finances, and otherwise the seller’s right to proceeds becomes a mere unsecured debt. Where the agreement expressly obliges the purchaser to keep the proceeds separate, but in breach of that trust the purchaser mingles the proceeds with its own money, the creditor will normally be entitled to trace into the mixed account to recover the proceeds, provided that an equitable right to trace arises. The proceeds may have been paid into an overdrawn bank account, in which case the rule in Clayton’s case often makes it impossible to identify the proceeds. Tracing a reservation of title interest into the proceeds of sale of collateral is somewhat easier under the PPSA which expressly provides for a security

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351 Such a provision will not necessarily protect a seller’s interest in proceeds of sale, especially where the purchaser is not required by the agreement to keep the proceeds separate and not mingle them with the purchaser’s own money. See Re Andrabelle Ltd. (in lig); Airborne Accessories Ltd. v. Goodman, [1984] 3 All E.R. 407; E. Pfeiffer Weinkellerei-Weineinkauf GmbH & Co v. Arbuthnot Factors Ltd., [1988] 1 W.L.R. 150; Tatung (U.K.) Ltd. v. Galex Telesure Ltd. (1989), 5 B.C.C. 325.


interest (including a reservation of title interest) to extend to the proceeds of sale of collateral, and in some circumstances, to remain in the collateral itself in the hands of a sub-purchaser.\textsuperscript{357}

Collateral subject to a reservation of title agreement may be disposed of by a purchaser, and subsequently recovered by either the purchaser or the purchaser’s trustee in bankruptcy. Where a purchaser recovers the collateral, the seller’s reservation of title interest may revive where a PPSA regime is in effect as the PPSA provides for the reattachment of security interests (including reservation of title interests) where collateral is returned to or repossessed by a debtor and the obligation secured remains unfulfilled.\textsuperscript{358} However, where the collateral is recovered by a trustee in bankruptcy a reservation of title interest will not reattach.\textsuperscript{359} Under a traditional security regime a reservation of title interest will not survive a sub-sale of the collateral to an innocent sub-purchaser\textsuperscript{360} so a seller’s title cannot revive upon recovery of the collateral by the purchaser or a trustee, although it may continue in the proceeds of sale or a sub-debt and, possibly, allow a seller to trace its title back into the recovered collateral. Should collateral be disposed of in such a way that the seller’s title remains in effect, such as where a sub-purchaser has notice of the reservation of title interest, then the seller’s title may survive recovery of the collateral by the purchaser or the purchaser’s trustee in bankruptcy as the purchaser will recover the collateral with knowledge of the reservation of title interest.

“Floating” securities

The characteristics of “floating” charges in the context of reviewable transaction claims are significant where property disposed of by a debtor prior to bankruptcy is recovered by a liquidator. As previously discussed, where a liquidator recovers property disposed of by a debtor in a reviewable transaction a floating chargeholder will lose the priority entitlement to that property it would have enjoyed had the property remained in the hands of the debtor, but where

\textsuperscript{357} PPSA, section 28. See also n317 above and accompanying text. For the position in Australia see Collier, \textit{supra} n350 at 63 to 64.

\textsuperscript{358} See above, page 83. The same applies where the goods are recovered by a transferee of chattel paper created by a sale or lease of the goods.

\textsuperscript{359} The PPSA makes no provision for the reattachment of security interests where collateral is recovered by a trustee, and reservation of title interests do not otherwise reattach, see above page 83.

\textsuperscript{360} See above, text accompanying n350.
property is recovered in an action which is not dependent upon the liquidation (such as a misfeasance action against directors or recovery of goods from a defaulting debtor) a floating chargeholder will enjoy a priority.\textsuperscript{361} However, there is New Zealand authority which suggests that where a liquidator recovers property in specie, a floating chargeholder will enjoy a priority even where the property is recovered in a reviewable transaction action.\textsuperscript{362}

Floating charges are commonly employed where a security interest is required in property of a corporate debtor\textsuperscript{363} which changes in composition over time. A common example is a debtor’s stock in trade or book debts, which the debtor must be free to deal with in the course of its business without the need to deal with the attachment and release of security interests. Floating charges over such property identify the collateral by reference to broad classes of property rather than specific chattels, and commonly apply with respect to all of the debtor’s property and undertaking (which means all present and future property of the debtor).\textsuperscript{364} Upon the occurrence of certain defined events (such as receivership or bankruptcy) the charge is said to “crystallise” and attach to all property within the specified categories which is in the possession of the debtor.

While a full examination of the operation of floating charges in bankruptcy is outside the scope of this paper it is relevant to describe the manner in which floating charges operate with respect to PPSA attachment and perfection requirements. A floating charge “attaches” to particular items of the debtor’s property for the purposes of the PPSA at the time the debtor obtains those items and is perfected upon registration, but prior to crystallisation of the charge its attachment gives the chargeholder only an equitable right in particular items of the debtor’s property which will not survive the debtor disposing of or otherwise dealing with those items.\textsuperscript{365} A floating charge will be effective to secure a creditor’s interest in property held by the debtor at the time of crystallisation of the charge, unless the charge was obtained in a reviewable transaction. Keay observes that in Australia floating charges which are reviewed by a liquidator are “void” rather

\textsuperscript{361} See above, page 83.

\textsuperscript{362} Lucky Investments Ltd v. Official Assignee, supra n285.

\textsuperscript{363} A floating charge may be given only by a company, not by a natural person, see G. Morse et al, Palmer’s Company Law, looseleaf (London: Sweet & Maxwell, 1997) para 13.119.

\textsuperscript{364} Re Panama, New Zealand and Australia Royal Mail Co (1870), 5 Ch. App. 318.

\textsuperscript{365} Re Huxley Catering Ltd., supra n329 at 26 and 27.
than "voidable" and suggests that as a result such charges are void from inception and may be invalid in the hands of third party transferees, but reference to securities being "void" in the Statute of Elizabeth and subsequent New Zealand bankruptcy legislation was interpreted as meaning "voidable".

6.3 Review of debt repayments received by secured creditors

Trustees in bankruptcy commonly review repayments of debt made to creditors prior to bankruptcy. Subject to satisfaction of the elements of the reviewable transaction claim itself, whether such a review action will succeed may depend upon the ability of a creditor to claim the protection of a security interest. Circumstances may be complicated by the creditor holding both secured and unsecured debt, securities which are declared invalid or which are released during a course of payments, special rules relating to payments of the purchase price of goods, floating securities and set-off claims.

Repayments of debt to secured creditors

A valid security interest will, in addition to protecting a secured creditor's priority claim in collateral, also protect payments made in reduction of the secured debt to the extent that the payments do not exceed the value of the security. Repayments of secured debt are not reviewable as preferences because in the absence of the payments the creditor would have been entitled to satisfaction of the debt from the collateral; as a debtor makes repayments its equity in the collateral increases accordingly. Where intent to prefer is an element of a preference action

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366 See Keay, supra n19 at 245; see also section 588FJ of the CL discussed above at n293 and accompanying text.


the debtor may be held to have intended only to transfer what the creditor was entitled to receive under the security, rather than to prefer the creditor.\textsuperscript{369}

The rule in \textit{Clayton's case} where debt is partially secured and partially unsecured

An existing unsecured creditor may make further, secured advances to a debtor. This is not uncommon where a creditor is unwilling to lend more than a certain amount unsecured, or where a creditor wishes to advance further funds, without risk, to enable a debtor to trade out of financial difficulty and so repay the original debt. The rule in \textit{Clayton's case}\textsuperscript{370} provides that in these circumstances repayments are attributed to reduction of the oldest debt, which is typically unsecured debt, leaving the fresh secured advances unpaid.

In England, the Cork Committee\textsuperscript{371} took the view that the rule in \textit{Clayton's case} effectively defeated the purpose of the reviewable preference provision by allowing creditors to replace unsecured debt with secured debt (which is the effective outcome where a debtor uses fresh secured advances to repay old unsecured debt). The difficulty with this view is that in such a case the repayments of unsecured debt will be subject to review as preferences, and the preference rules should be adequate to address any prejudice to other creditors resulting from the repayments. The Cork Committee’s apparent failure to recognise that security given in such circumstances secures only genuine new value given to the debtor, and does not affect repayments of unsecured debt, has been justifiably criticised.\textsuperscript{372} Where fresh secured advances are used to repay prior unsecured debt, particularly where there is a scheme in place to this effect, this may assist in proving the elements of a preference action to recover those payments including (depending upon jurisdiction) proof of an intent to prefer, lack of good faith, solvency of the debtor and whether the repayments were made "in the ordinary course of business".


\textsuperscript{370} \textit{Clayton's case; Devaynes v. Noble} (1816), 1 Mer. 572; 35 E.R. 781.

\textsuperscript{371} Cork Report, \textit{supra} n213.

The possibility that the rule in *Clayton's case* may permit creditors to convert unsecured debt into secured debt has resulted in specific legislative provision in New Zealand. The sections which govern the review of securities reverse the rule in *Clayton's case* by providing that any payments received by the secured creditor are deemed to be appropriated towards repayment of the fresh secured advances, leaving the unsecured debt unpaid. These provisions operate to the detriment of existing unsecured creditors who take security for fresh advances because they delay repayment of the unsecured debt until the secured debt is repaid in its entirety. Repayments of unsecured debt are therefore deemed to commence much closer to the date of liquidation than would have been the case had the secured advance not been made, and so are more likely to be reviewable. The provisions unfairly prejudice holders of unsecured debt who make fresh secured advances by delaying the repayment of their unsecured debt until the fresh advances are repaid, even while other unsecured creditors may be receiving payments facilitated by the fresh advances. In Australia the possibility that creditors may replace unsecured debt with secured debt by using fresh secured advances to repay unsecured debt is addressed by a provision which simply states that where fresh secured advances are used to repay old unsecured debt owed to the same creditor or a related entity, the new security is void. This provision is less likely than the New Zealand provision to prejudice deserving creditors who wish to assist a troubled debtor by means of fresh secured advances, although where a debtor is trading as a going concern with a variety of receipts and outgoings it will be difficult to prove a link between the fresh advances and the repayment of the unsecured debt in other than the most blatant cases. No similar provision has been made in England or in Canada. It is submitted that the rule in *Clayton's case* is appropriate where a creditor is receiving repayment of both unsecured and subsequent secured debt and that any resulting conversion of unsecured debt to secured debt is

373 IA, section 57(3) and CA, section 293(5). Section 57 provides an exception for registered trading banks who act in good faith without negligence in the ordinary course of business, a test similar to that governing the review of preferences under the CA. It is difficult to see why trading banks should benefit from a special exemption which is unavailable to creditors generally. In Australia it has been acknowledged that trading banks may deserve protection where they give credit to assist debtors in circumstances of temporary financial difficulty, see Report of the Committee Appointed by the Attorney-General, *Bankruptcy Law of the Commonwealth*, (Australia: Commonwealth Govt. Printer, 1962) at para 175, but the same could be said of any assisting creditor.

374 Review typically becomes increasingly likely the closer to the date of bankruptcy a payment is made because of the increasing likelihood that elements of the action will be provable; e.g. that the payment occurred within the review period, an intent to prefer, the insolvency of the debtor, and that the payment was outside the ordinary course of business. This effect is exacerbated in New Zealand by legislative presumptions that the requisite elements are present (absent evidence to the contrary) where the payments are made within six months of the liquidation, and the effective abrogation of time limits in Canada (such as the absence of the requirement to prove intent to prefer under British Columbia’s FCA for payments made within 60 days of liquidation).

375 See *supra* n296 and accompanying text.
best dealt with by preference legislation. The provisions to the contrary in Australia and New Zealand are inappropriate.

Review of debt repayments where security is invalid

Where a security is successfully reviewed by a trustee as a preference, and thus rendered void, it cannot protect repayments of the (unsecured) debt from review as preferences. Although in jurisdictions where intent to prefer is a required element it might be argued that payments will not be reviewable where a debtor believes a security to be valid, authority suggests otherwise. A debtor’s belief in the validity of a security is certainly irrelevant in objective regimes where the basis of a review action is the preferential effect of the transaction. A preference in New Zealand is defined as a transaction in which the creditor received more than it would have received by way of dividend in the bankruptcy, and on this basis payments made to a creditor holding an invalid security will not be protected from review as preferences. In Australia the preferential effect of a transaction is assessed by considering whether a creditor would have received a preference in a hypothetical liquidation occurring at the time of the transaction, which produces the same result as a security will be reviewable as a preference irrespective of when the bankruptcy occurred.

A distinction exists between securities which are reviewed as preferences, which are void from inception, and securities which are reviewed pursuant to specific statutory provisions which have the effect of rendering them void only from the date of liquidation. In the latter case, debt repayments made prior to liquidation are not reviewable by reason only that the security has been declared invalid, and the requirements of a preference action must be satisfied if they are to be

376 In re Gibson, ex parte Bolland (1878), 8 Ch.D. 230; Mace Builders (Glasgow) Ltd. v. Lunn, supra n278 at Ch. 925.

377 The element of an intent to prefer should not be affected by a debtor’s incorrect belief that a creditor is a secured creditor, as a payment to a secured creditor is a preference and is protected only because the creditor is entitled to the preference by virtue of the security. It may be arguable that a debtor in such a case has no intent to prefer a creditor but intends only to give the creditor its perceived entitlement under the security, but this argument is inconsistent with authority to the effect that secured creditors are protected only to the extent of their security interest, e.g. Re Royal City Chrysler Plymouth, supra n368 at 193.

378 See supra n278 and accompanying text.
reviewed. It has been argued that as a result of this a creditor with a reviewable security who obtains repayment prior to liquidation may thereby obtain a preference, but this argument fails to account for the fact that the preference rules will apply to any such repayments. Interestingly, the corresponding Australian legislation takes the entirely opposite approach by declaring that where a security has been declared void under the relevant section, the liquidator is entitled to recover any payments made pursuant to the charge without the need to satisfy the requirements of a preference action, which prior to the enactment of this provision was the only method of recovering such payments. It seems unreasonable to require repayment where the requirements of a preference action cannot be met, such as where payments are made in the ordinary course of business; this rather draconian provision places a creditor in a worse position than it would be in had the security never existed at all.

Payments of purchase price of collateral supplied under a reservation of title agreement

Where a seller of goods under a valid reservation of title agreement receives payments in reduction of the purchase price debt, those payments will not be reviewable as the seller is effectively a secured creditor.

Where a PPSA regime is in effect, as noted previously an unperfected reservation of title interest will not be good against a trustee in bankruptcy, but debt repayments received under the reservation of title agreement will be protected from review as preferences because the reservation of title security interest is valid until bankruptcy. Unperfected reservation of title

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379 In Re Parkes Garage (Swadlincote) Ltd., supra n279 at 145, where a debenture was declared invalid as being obtained within the review period pursuant to a provision dealing specifically with securities, the Court held that the liquidator would need to bring a separate action to recover debt repayments as preferences. See also Mace Builders (Glasgow) Ltd. v. Lunn, supra n278; Commissioners of the State Bank of Victoria v. Judson (1985), 3 A.C.L.C. 576.

380 The argument was dismissed out of hand by the Court in Mace Builders, ibid at Ch. 199 to 200.

381 CL, section 588FJ(6).

382 In the absence of this specific provision, review of a security under this section would not give rise to a right to recover payments made under the security, see Mace Builders (Glasgow) Ltd v. Lunn, supra n278.


384 Re Gilbert, supra n341. This case also states that such a security interest is perfected by possession with respect to each payment received, but this cannot be correct as such payments are not received "as collateral" for the purposes of the PPSA. This point does not, however, otherwise affect the validity of the decision.
interests are accordingly somewhat analogous to securities which are rendered void by specific legislative provisions as from the date of bankruptcy. 385

Where a purchaser under a reservation of title agreement on-sells or otherwise disposes of collateral before full repayment is made, such that title to the collateral passes from the original seller, subsequent payments received by the seller will presumably not be safe from review as the seller no longer has a security interest in the collateral. However, a seller may retain a protective security interest by retaining title to the proceeds of sale of the goods or to unpaid sums owed by the sub-purchaser to the purchaser, either pursuant to the reservation of title agreement or by virtue of the PPSA. 386 Where a bankrupt purchaser holds the proceeds of sale in trust for the seller, they will not form part of the purchaser's property available for creditors and repayment from such proceeds will not be a reviewable preference because the money paid is not the debtor's money but money held in trust for the creditor. 388

Repayments of debt secured by floating securities

Floating charges are capable of protecting creditors from preference claims with respect to repayments of debt, although an issue may arise as to the extent of the security conferred by a floating charge as a security is capable of protecting repayments only to the extent of its value. 389 Whether the preferential effect (or otherwise) of a transaction is determined in a hypothetical bankruptcy at the time of the transaction, or in the actual bankruptcy, may affect whether repayments of debt secured by floating charges are reviewable. If the preferential effect of a transaction is determined in a hypothetical bankruptcy occurring at the time of the transaction this may assist a floating chargeholder who has received repayments because subsequent events

385 See supra n378 and accompanying text; also supra n278.
386 See supra n351 and n357.
387 A debtor will normally be considered to hold proceeds on trust when the debtor is required by the reservation of title agreement to keep the proceeds separate from its own money, see supra n353 and n355. Section 67 of the BIA provides that property of a bankrupt does not include property held by the bankrupt in trust.
389 Re Royal City Chrysler Plymouth, supra n368 at 193.
such as the accrual of preferential debts will not be considered,\textsuperscript{390} whereas by the time of the bankruptcy (and crystallisation of the charge) the total value of property secured by the floating charge may have diminished.

Set-off of remaining debt against a trustee’s review claim

Insolvency set-off provisions \textit{prima facie} appear to allow creditors to set off debts owed to them by a bankrupt against reviewable transaction claims against them brought by the bankrupt’s trustee. However, this is normally not the case.

Creditors who receive preferential repayments are commonly not paid in full. Section 97(3) of the BIA preserves creditors’ rights of set-off at common law and in equity against claims made by a trustee for debts due to the bankrupt, but the section expressly excludes claims to the extent that they are affected by the preference provisions of the BIA. Bennett suggests that a creditor may claim a set-off to preserve a repayment of debt which would otherwise be a preference,\textsuperscript{391} but this suggestion is inconsistent with the express exclusion of rights of set-off where the effect of a set-off would be to give a creditor a preference. The authorities indicate that a creditor will not be permitted to raise a set-off to defend a preference claim brought by a trustee.\textsuperscript{392}

In other jurisdictions similar rules apply to prevent set-off claims from defeating preference actions brought by trustees. In New Zealand the IA provides for set-off of mutual debts without expressly excluding reviewable transactions,\textsuperscript{393} but English authorities indicate that the provision does not permit the set-off of a transaction which is reviewable as a preference or otherwise.\textsuperscript{394}

\textsuperscript{390} Goode, \textit{supra} n372 at 169; Brown \textit{et al}, \textit{supra} n109 at para CA292.11.

\textsuperscript{391} Bennett, \textit{supra} n136 at 716.

\textsuperscript{392} \textit{Re Longmore (Moon Motor Sales Co.) Trustee v. Rider; Trustee v. Royal Bank} (1923), 3 C.B.R. 818 (Ont. S.C); \textit{Re/Max City Metro-City Realty Ltd. v. Baker (Trustee of)} (1993), 16 C.B.R. (3d) 308 (Ont. G.D.).

\textsuperscript{393} IA, section 93. The section does provide that set-off is not permitted where the creditor knew at the time of giving credit that the debtor had committed an act of bankruptcy.

\textsuperscript{394} \textit{Re Washington Diamond Mining Co.,} [1893] 3 Ch. 95; \textit{Lister v. Hooson,} [1908] 1 K.B. 174 (C.A.) where the recipient of a settlement was not permitted to set off a debt owed to her by the settlor against the trustee’s claim to recover the settlement as a reviewable transaction.
An arrangement to create a set-off may itself create a reviewable preference and as such will be invalid. With respect to companies in liquidation the CA provides that debts owed by a company in liquidation to a creditor may be set off against debts owed by the creditor to the company, but a creditor cannot claim the benefit of a set-off arising from a transaction which occurred within a six month review period (or two years where the parties are related) unless at the time of the transaction the creditor did not have reason to suspect that the company was insolvent. As under the IA, a creditor cannot set off a debt which is itself reviewable at the suit of the liquidator against a claim by the liquidator. The set-off provisions are not aligned entirely with the preference provisions, as set-off depends upon the creditor's constructive knowledge rather than an "ordinary course of business" requirement, but in any event reviewable preferences cannot be the subject of insolvency set-off.

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395 Re Hardy (1901), 19 N.Z.L.R. 845 at 849.
396 CA, section 310. Prior to 1993 the IA provision applied to both companies in liquidation and bankrupt natural persons.
397 The review period runs from six months prior to the liquidation application to the date of liquidation, or two years where the creditor is a related person.
398 Re Austro-Rest Furniture (in liq) (No 2) (1986), 3 N.Z.C.L.C. 99,837 at 99,846, citing Flitcroft's Case; Re Exchange Banking Co (1882), 21 Ch. D. 519 (C.A.) and Re A Debtor (No. 82 of 1926), [1927] 1 Ch. 410.
399 Re Austro-Rest Furniture (in liq) (No 2), ibid. This case was decided prior to the enactment of section 310 of the CA, but that section does not differ in a relevant sense from the IA provision pursuant to which the case was decided.
CHAPTER SEVEN CRIMINAL SANCTIONS

The first statutory provisions relating to reviewable transactions were primarily penal in nature and provided civil remedies incidentally.\textsuperscript{400} The Statute of Elizabeth provided that an offender was liable to imprisonment for half a year and forfeiture of the value of the property improperly obtained (or a year's value in the case of land). While the civil remedies available to creditors under the Statute and succeeding legislation gradually expanded in scope and effect, transactions in which a debtor intends to defraud creditors remain punishable as criminal offences. However, this does not mean that a criminal offence has been committed in every case in which a transaction is reviewable as a "fraudulent conveyance" or a "fraudulent preference" for the purposes of civil law, as the intent required to meet the civil standard is not the same as the mens rea required in the criminal offence.\textsuperscript{401}

Bankruptcy, criminal law and company law statutes enact criminal sanctions in respect of many types of prohibited conduct relating to bankruptcy. The first solely criminal statute was the Debtors Act 1869 (Eng.).\textsuperscript{402} While most such provisions are beyond the scope of this paper the existence of criminal sanctions with respect to reviewable transactions is relevant to the extent to which it is necessary for the civil law to focus upon prevention and punishment of fraudulent conduct in bankruptcy. It is submitted that provisions which enact criminal offences are an appropriate means of imposing punishment upon debtors and others who perpetuate frauds upon creditors, and that complementary provision in civil provisions is unnecessary and undesirable.

The punishment of a debtor or frustration of its intentions has traditionally been of considerably greater concern in the case of fraudulent dispositions than in the case of preferences. In general, criminal provisions concentrate upon transactions in which creditors as a whole are defrauded by dispositions of property, and only rarely do they impose criminal sanctions with respect to

\textsuperscript{400} See \textit{supra} n7 and accompanying text.

\textsuperscript{401} See M. Beckman Q.C. & S. Ross, "Fraudulent or wrongful trading" (1991) 141 New L.J. 1744 at 1744.

\textsuperscript{402} The Debtors Act 1869 (32 & 33 Vict.), c. 62 (Eng.) was the first separate provision to enact criminal sanctions for fraudulent conveyances. Section 13 provides that a person who, with intent to defraud creditors, makes or causes to be made any gift, delivery, transfer of or charge upon its property is guilty of a misdemeanour and is liable to be imprisoned for a maximum of one year. The Act also enacts offences in the case of debtors who remove property with intent to defraud creditors.
preferences. The reason for this is that parties to preferences are often considered to have done nothing deserving of criminal sanction; the debtor pays a genuine debt and the creditor accepts its due.\footnote{C. R. Morris, "Bankruptcy Law Reform: Preferences, Secret Liens and Floating Liens" (1970) 54 Minnesota Law Review 737 at 738.}

7.1 Canada

In Canada relevant offences are enacted in the BIA and in the Criminal Code ("Code").\footnote{Criminal Code, R.S., 1985, c. C-46.} Section 392 of the Code provides that anyone who with intent\footnote{The mens rea of the offence is knowledge by the debtor of the prohibited conduct and intent to defraud creditors, see B. Nightingale, The Law of Fraud and Related Offences, (Ontario: Carswell, 1996) at 12-23.} to defraud its creditors\footnote{The intent must be to defraud all of the person's creditors; an intent to defraud one creditor will not suffice, see R. v. Gingras (1957), 117 C.C.C. 356 (Que. S.P.).} makes or causes to be made any gift, conveyance, assignment, transfer or delivery of, or removes, conceals\footnote{"Conceals" imports a positive act and does not include a failure to disclose the existence of property to a trustee, see R. v. Goulis (1981), 60 C.C.C. (2d) 347, 20 C.R. (3d) 360 (Ont. C.A.). A separate offence is enacted with respect to failure to disclose.} or disposes of its property\footnote{Section 588 of the Code deems certain persons who have management, control or custody of property to have a property interest in it.} commits an indictable offence with a maximum penalty of two years imprisonment. Where such an offence is committed the section further provides that a recipient of the property who intends that creditors be defrauded also commits an offence. It is not necessary that the transaction have the effect of defrauding creditors as long as the requisite intent is present.\footnote{R. v. Crew (1926), 46 C.C.C. 123, 59 O.L.R. 201, [1926] 4 D.L.R. 841 (Ont. C.A.). A giving of security may be a conveyance.} A more general provision having concurrent effect is section 341 of the Code which provides that everyone who for a fraudulent purpose takes, removes, obtains or conceals anything is guilty of an indictable offence with a maximum penalty of two years imprisonment. This provision is capable of applying with respect to conduct well outside the realms of reviewable transaction law, such as concealment of property with an intent to make a false insurance claim.\footnote{R. v. Goldstaub (1895), 5 C.C.C. 357, 10 Man. R. 497 (Q.B.).} While the Code provisions do not prohibit preferences,\footnote{R. v. Goldstaub (1895), 5 C.C.C. 357, 10 Man. R. 497 (Q.B.).} conveyances to creditors with a fraudulent intent to provide a benefit to the debtor may be prohibited.

\footnote{C. R. Morris, "Bankruptcy Law Reform: Preferences, Secret Liens and Floating Liens" (1970) 54 Minnesota Law Review 737 at 738.}
Part VIII of the BIA enacts offences relating to bankruptcy. While the BIA does not impose criminal penalties upon recipients of a bankrupt's property, persons who assist a bankrupt to commit an offence under the BIA may be subject to prosecution under aiding and abetting provisions of the Code.\textsuperscript{412} Section 198(1)(a) provides that a bankrupt who (inter alia) makes any fraudulent disposition of its property before or after the initial bankruptcy event commits an offence.\textsuperscript{413} While only a person who is already a bankrupt may commit some of the offences enacted by section 198,\textsuperscript{414} the section 198(1)(a) offence is not so restricted.\textsuperscript{415} The Crown is required only to make a \textit{prima facie} case of intent to defraud, upon which the evidential burden of rebutting the allegation shifts to the defendant although the Crown retains the overall burden of proving the offence beyond reasonable doubt.\textsuperscript{416} It has been suggested that a fraudulent disposition of property constituting an offence may include a section 95 preference, but support for this proposition in the decided cases takes the form of passing comments on unrelated questions and it is submitted that the proposition must be regarded as doubtful.\textsuperscript{417}

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\textsuperscript{411} R. v. Crew, supra n409 at C.C.C. 124.
\textsuperscript{413} An offender is liable on summary conviction to a maximum penalty of one year’s imprisonment and a fine not exceeding five thousand dollars, or three years and ten thousand dollars if convicted on indictment. The offence is prosecuted in the criminal courts, not the Bankruptcy Court, see L. W. Houlden & G. B. Morawetz, \textit{Bankruptcy and Insolvency Law of Canada}, 3rd ed., looseleaf, (Ontario: Carswell, 1998) at 7-94.
\textsuperscript{414} “Bankrupt” is defined in section 2 of the BIA as a person who has made an assignment or against whom a receiving order has been made so a reference to a “bankrupt” means that only a person already bankrupt may commit the relevant offence unless the section otherwise indicates, see \textit{Re Electric Motor & Machinery Co.} (1932), 12 C.B.R. 413, aff’d 13 C.B.R. 280, rev’d 13 C.B.R. 527 (S.C.C.).
\textsuperscript{417} Houlden & Morawetz, \textit{Bankruptcy and Insolvency Law of Canada, supra} n413 at 7-96 cite \textit{Re B.C. Boat Sales Ltd.; Casson v. Redisco Ltd.}, supra n415 in support of the proposition. In that case the Court observed at D.L.R. 561 that the criminal provision included any fraudulent disposition, and “not just a preference” but the Court was concerned only with deciding whether the civil action for preferences required intent on the part of both parties. In \textit{R. v. Laschuck}, [1988] B.C.J. No. 99, online: QL (BCJ), a sentencing decision, the Court referred to dispositions made by a debtor as “essentially offences of creating fraudulent preferences” but the dispositions in question were to members of the debtor’s family and were intended to allow the debtor the continued use of the property after bankruptcy, rather than repayments of debt. While on its face the provision appears capable of including “dispositions” which are preferences, the decision in \textit{R. v. Crew, supra} n409 indicates otherwise.
In addition to section 198, section 201(3) of the BIA provides that where a bankrupt enters into a transaction with any person for the purpose of obtaining a benefit to which either of them would not be entitled, the bankrupt commits an offence. Hoilden and Morawetz note that there are no reported cases on this section and observe that it is difficult to imagine a case which would fall within its terms; presumably a reference to the lack of precision in its wording as on its face the provision appears to be of potentially broad application. The BIA also enacts offences where a bankrupt conceals the commission of a reviewable transaction. Section 198(1)(f) provides that a bankrupt who fraudulently conceals or removes any property worth more than fifty dollars or any debt due to the bankrupt after or within one year of the initial bankruptcy event commits an offence, but a reviewable transaction constitutes an offence under this section only where the bankrupt also attempts to conceal the existence of the transferred property from the trustee. The Crown must prove all elements of this offence as the evidential burden does not move to the defendant as it does under section 198(1)(a).

Where an offending bankrupt is a corporation, section 204 of the BIA provides that an officer, director or agent or a person who had control of a corporation who authorises, assents to, acquiesces in or participates in the commission of an offence by the corporation is also guilty of the offence. The aiding and abetting provisions of the Code also apply to bankruptcy offences.

An order for compensation of a person who has suffered loss as a result of one of the abovementioned offences may be made under section 204.3(1) of the BIA, although an order against an undischarged bankrupt will typically be of little utility. The Code provides similarly for the making of compensation orders and where a solvent recipient has been convicted of an offence a compensation order may be more useful. These provisions appear to be directed primarily to circumstances in which particular persons have suffered loss rather than detriment.

418 The offence is punishable on summary conviction with a fine of up to five thousand dollars and imprisonment for up to one year.
419 Hoilden & Morawetz, Bankruptcy and Insolvency Law of Canada, supra n413 at 7-104.
420 In several cases a significant disparity between stock on hand and inventory has been held sufficient to prove the elements of this offence. See e.g. R. v. Nassif (1925), 5 C.B.R. 653, 39 Que K.B. 5, 44 C.C.C. 280, [1925] 3 D.L.R. 1013 (Que. C.A.); R. v. Steinfield, supra n416.
421 See Crema v. R. (1981), 38 C.B.R. (N.S.) 18 (Ont. Dist. Ct.) in which a bankrupt who sold an $8,000 vehicle for $100 but informed the trustee of its whereabouts was held not to have committed an offence under section 198(1)(f).
suffered by the general pool of creditors, and it is submitted that where creditors as a group suffer prejudice a civil remedy should be sought under the reviewable transaction provisions of the BIA.

7.2 England

English law makes provision similar to that in Canada in respect of criminal offences involving reviewable transactions. The IAE, which enacts a number of criminal offences involving bankruptcy, distinguishes between fraud in personal and corporate bankruptcy. Section 357 provides that a natural person who makes or causes to be made any gift or transfer of or charge on its property within five years of bankruptcy commits an offence, and an offence is also committed where a debtor conceals or removes its property after or within two months prior to entry of an unsatisfied judgment against it. In either case such a person may escape conviction by proving that it lacked an intent to defraud. The old offence under section 13(3) of the Debtor’s Act 1869 remains in force in England although as the Crown bears the burden of proof of fraudulent intent and the penalties are comparatively light it is seldom employed. Persons who abscond from the jurisdiction with property within six months of bankruptcy, or who conceal property from a trustee or dispose of property which they have on credit and have not paid for, also commit offences.

With respect to corporations, sections 206 and 207 of the IAE provides similarly to section 357. Section 207 provides that where within five years of liquidation an officer of a company makes or causes to be made any gift or transfer of, or charge on the company’s property, causes or connives in an execution against the company’s property or conceals or removes any property within two months of an unsatisfied judgment, that officer commits an offence unless it can

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423 The offence is punishable on conviction on indictment with a maximum of two years imprisonment and a fine.
424 IAE, section 352.
425 IAE, section 357.
426 IAE, section 359.
427 The offence is punishable on summary conviction with a maximum of six months imprisonment and a fine, or two years imprisonment and a fine upon conviction on indictment.
prove absence of an intent to defraud creditors.\footnote{424}{See A. Arlidge QC, J. Parry & I. Gatt, Arlidge and Parry on Fraud, 2nd ed., (London: Sweet & Maxwell, 1996) at 331, n34.} Section 206 provides that a past or present officer of a company commits an offence if within twelve months of liquidation, the officer conceals or fraudulently removes property worth five hundred pounds or more, or disposes of property obtained on credit which is unpaid for, unless the officer proves absence of intent to defraud. The section further provides that it is an offence to be privy to another person committing such an offence. Relevant provision is also made in the Companies Act 1985 (Eng.), section 458 of which provides that every person who is knowingly a party to the carrying on business of a company with intent to defraud creditors commits an offence. A disposal of assets for no or inadequate consideration may amount to a fraud on creditors under this provision.\footnote{429}{Ibid., at para 2-069.}

While transactions to defraud creditors invite criminal sanctions in England, it appears that the same is not true of preferences which favour genuine creditors over others.\footnote{430}{Glegg v. Bromley, [1912] 3 K.B. 474 at 485.} Even where an insolvent company prior to liquidation paid its parent company (to the benefit of its directors, as they held shares in the parent company) and other creditors in full to the detriment of one major creditor, it was held that intent to defraud the unpaid creditor had not been proved.\footnote{431}{Re Sarflax Ltd., [1979] Ch. 592 at 602 and 612.} While the Court in that case left open the possibility that a preference could give rise to a prosecution it appears that this will be the case only in very unusual circumstances.

\textbf{7.3 \textit{Australia}}

In Australia Part XIV of the BA enacts offences relating to personal bankruptcy. Section 266(3) provides that a debtor who within 12 months prior to bankruptcy disposes of or creates a charge on any of its property with intent to defraud its creditors is guilty of an offence\footnote{432}{The offence is punishable by a maximum of three years imprisonment on conviction on indictment. Section 273 provides that all of the BA offences are punishable either on indictment or on summary conviction, but the maximum period of imprisonment on summary conviction is one year.} and section 268(7) provides similarly with respect to voluntary bankruptcy. Section 265(7) enacts offences where a bankrupt within one year prior to bankruptcy disposes of or gives security over property

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\textit{\footnote{429}} Ibid., at para 2-069.


\textit{\footnote{431}} Re Sarflax Ltd., [1979] Ch. 592 at 602 and 612.

\textit{\footnote{432}} The offence is punishable by a maximum of three years imprisonment on conviction on indictment. Section 273 provides that all of the BA offences are punishable either on indictment or on summary conviction, but the maximum period of imprisonment on summary conviction is one year.
\end{footnotesize}
obtained on credit which it has not paid for, otherwise than in the ordinary way of business, although in some cases a bankrupt may escape conviction by proving that the prohibited act was done without intent to defraud creditors. Sections 265 and 268(5) impose penalties upon a bankrupt who fails to disclose any disposition of property made within two years of bankruptcy.\textsuperscript{433} Section 272 provides that it is an offence for a debtor to leave Australia with an intent to defeat creditors within six months prior to bankruptcy.\textsuperscript{434}

Section 263(1)(b) provides that a person who receives property from a debtor who subsequently becomes bankrupt with intent to defraud, or to assist the debtor to defraud, its creditors commits an offence. Section 263(1)(1) provides that a person who with intent to defraud creditors of a debtor who subsequently becomes bankrupt conceals its property, commits an offence. In both cases an offender is liable to three years' imprisonment.

The CL provides offences relating to conduct by companies and their officers prior to liquidation. Section 596 of the CL provides (inter alia) that an officer of a company who with intent to defraud (inter alia) creditors of the company or of a related body corporate, makes, purports to make or causes any gift, transfer of, or charge on or causes or connives at the levying of any execution against property of the company or of a related body corporate, commits an offence. The section also provides that an offence is also committed by an officer who with intent to defraud the company or (inter alia) its creditors conceals or removes any property of the company or of a related body corporate after or within 2 months before the date of any unsatisfied judgment against the company or a related body corporate. Section 590(1)(c) enacts offences for officers who fraudulently conceal or remove property of a company worth more than $100 or who conceal debts due to the company within 10 years prior to liquidation.

\textsuperscript{433} An offender faces a potential penalty of imprisonment for one year.

\textsuperscript{434} Unlike the Canadian provision the taking of property out of the jurisdiction is not an element of the offence. An offender is liable to imprisonment for a maximum term of 3 years.
The Australian Law Reform Commission recommended in 1988 that the insolvency offences in the BA and CL be reviewed with a view to removing any criminal sanction for non-fraudulent conduct and moving insolvency offences to the general criminal law as part of fraud law.\(^{435}\)

7.4 **New Zealand**

New Zealand’s criminal provisions are similar to those in Canada. Section 126 of the IA enacts a number of offences which may be committed by bankrupt natural persons, several of which relate to reviewable transactions. A bankrupt who with intent to defraud its creditors or any of them makes or causes to be made any gift, delivery or transfer of or any charge on its property commits an offence.\(^{436}\) A bankrupt also commits an offence under the section where it conceals or removes its property within two months before or at any time after entry of an unsatisfied judgment, or where it conceals or fraudulently removes property worth more than fifty dollars or any debt due to the bankrupt, unless (in either case) it proves that it had no intent to defraud creditors. The section also provides that where a bankrupt leaves or attempts to leave New Zealand after or within two years prior to presentation of a bankruptcy petition with property worth more than one hundred dollars, it commits an offence unless it proves that it had no intent to defraud creditors.

Section 128(e) of the IA is unusual in that it enacts an offence where a debtor gives a preference. A debtor who within two years prior to bankruptcy, while unable to pay its due debts, gives a reviewable preference to any of its creditors with intent to defraud its creditors, commits an offence. The penalty is comparatively light; an offender is liable on summary conviction to imprisonment for a term not exceeding three months, which indicates that the commission of a fraudulent disposition is regarded as a more serious offence than the giving of a fraudulent preference.

\(^{435}\) Australian Law Reform Commission, *supra* n213 at para 34.

\(^{436}\) An offender is liable on conviction on indictment to imprisonment for a term not exceeding three years.
Part XXI of the CA enacts offences relating to dealings by companies by listing provisions of the CA a violation of which constitutes a criminal offence. The most relevant for present purposes is section 380 which provides that a director who (inter alia) with intent to defraud creditors of a company gives, transfers, or causes a charge to be given on property of the company, property to be given or transferred to any person, or execution being levied against property of the company, commits an offence. The section also provides that every person who is knowingly a party to a company carrying on business with intent to defraud its creditors or any other person, or for a fraudulent purpose, commits an offence. Section 378 provides that a director, shareholder or employee of a company who fraudulently takes or applies property of the company for its own use or benefit, or fraudulently conceals or destroys such property, commits an offence. Although New Zealand's Crimes Act 1961 does not contain provisions relevant to reviewable transaction offences, section 375 of the CA avoids "double jeopardy" by providing that no person shall be convicted of an offence under both the CA as well as under any other Act in respect of the same conduct.

7.5 Criminal sanctions and the principles of civil review regimes

The Australian Law Reform Commission in a 1978 discussion paper noted in the course of discussing the abolition of the remedy of imprisonment for debt that in circumstances where penalties are appropriate the criminal law should provide such penalties, especially where fraud is alleged, and that the civil law is not an appropriate means of imposing sanctions. It is submitted that the same logic applies to the review of dispositions and preferential transactions. The New Zealand Law Society Committee on Insolvency Law Reform has made suggestions to this effect.
The significance of the provisions described in this chapter is that they make detailed provision for circumstances in which punitive sanctions relating to reviewable transaction-type conduct are merited. In circumstances where punitive sanctions are not regarded as appropriate, such as the case of preferences in most jurisdictions, they are absent from the criminal regime. It is submitted that the existence in bankruptcy and company law statutes of detailed and comprehensive criminal sanctions against persons who act to defraud creditors of a bankrupt removes any need for a punitive element or purpose in legislation which provides civil reviewable transaction remedies. In any event, in most cases the review of a transaction for punitive purposes is unlikely to affect a debtor, who is the person most likely to be deserving of punishment or in respect of whom preventative provision is most desired. A debtor, being already bankrupt, will generally suffer no financial disadvantage from the review of fraudulent transactions so unless the debtor obtains some form of collateral advantage from the transaction (e.g. the right to remain in a house transferred to a relative) the punitive value of civil review is limited. Even where a collateral advantage is obtained the removal of that advantage merely puts the debtor back in the position it would have been in had the transaction never taken place, which without more has little disincentive value.
Reviewable transaction regimes in which the fraudulent intent of a debtor is the primary element of a trustee's claim are not an appropriate means of providing for the various interests which require to be considered in reviewable transaction law. Subjective reviewable transaction provisions retain many of the characteristics of their criminal law predecessors. The punitive functions of a reviewable transaction regime are, it is submitted, more appropriately addressed by criminal statutes than in the context of a civil bankruptcy and insolvency regime which exists to provide for the interests of creditors and other persons with an interest in the bankrupt's affairs. In particular, the position of unpaid creditors, while improved by amendments to the subjective provisions in England and Canada, remains inadequately protected. It is too easy for a creditor or recipient of a debtor's property to circumvent intent-based review provisions for reasons which often have little relevance to the merits of creditors' and recipients' competing claims.

The objective reviewable transaction regimes of the type in place in Australia and New Zealand are more appropriate to address and balance relevant interests. Such regimes are not concerned with the intent of a debtor who is not a party to review proceedings (and frequently has no direct interest in the outcome of those proceedings) but are based upon the effect of an impugned transaction and relevant policy considerations. Where the effect of a transaction is to defeat creditors, whether the transaction is reviewable may be determined by reference to criteria which relate directly to the interests at stake in the decision, viz. the respective interests of unpaid creditors and recipients of property from the bankrupt, and wider policy interests relating to the maintenance of public confidence in commercial transactions and to the provision of assistance to a debtor who may have an opportunity to avoid bankruptcy.

In addition to the review of transactions in which a debtor disposes of or grants property or security, reviewable transaction laws are capable of affecting the respective interests of secured and unsecured creditors in many respects which are not directly related to the review of security interests. The voiding of security interests has an obvious effect upon creditors' entitlements, but equally significant is the effect upon the rights of secured creditors where reviewable
transactions have affected the composition of the property available for distribution, the position of creditors who have received debt repayments and the collateral effects which result from the application of reviewable transaction principles upon other parties with whom creditors are not directly connected.

With respect to a creditor's rights in collateral, in many instances the existence of PPSA legislation has as significant an effect as reviewable transaction legislation. Under a PPSA regime many instruments which effectively operate as securities are void against a trustee if unregistered, the most significant of these being reservation of title agreements. However, the PPSA provides creditors with a number of rights which may not otherwise arise, including rights to trace into proceeds of sale and collateral recovered by a debtor. With the exception of reservation of title agreements, secured creditors are generally in a better position to defend reviewable transaction claims under PPSA regimes than in jurisdictions where traditional security principles remain in effect. This will certainly be the case in New Zealand if the PPSA Bill is enacted in its current form, as the Bill provides all of the PPSA's creditors' rights and remedies without imposing many of its registration requirements.

In many instances a creditor's entitlement to collateral or proceeds of sale may depend upon fine distinctions in reviewable transaction law. The courts have struggled with a distinction between recovery of collateral by a trustee, as opposed to a debtor; a distinction which seems academic yet in most cases will determine the entitlement of a secured creditor. Further confusion is evident in New Zealand where the rule may be different again where collateral is recovered in specie by a trustee. In all of the jurisdictions considered in this paper the principle in Re Yagerphone Ltd., which is that voidable transaction recoveries are distributed for the benefit of unsecured creditors, is accepted as good law. It is submitted that this principle strains the wording of reviewable transaction provisions, is inconsistent with other rights in insolvency and should be rejected. Rights to trace into proceeds of sale and sub-debts and possible back into collateral, whether under PPSA regimes or in general contract law, further complicate the law in this area.
Reviewable transaction laws which are founded upon principles which relate directly to the respective interests of relevant parties should be capable of dealing with transactions involving secured creditors without the need for special provision. The piecemeal enactment of specific provisions designed to address perceived deficiencies in reviewable transaction rules relating to securities has resulted in unfair and undesirable outcomes. With regard to repayments of debt to secured creditors, concerns about the effect of the rule in *Clayton’s case* are unfounded and attempts to modify the operation of that rule by legislative amendment have the effect of disadvantaging deserving creditors without any corresponding benefit. It is submitted that repayments of debt to a secured creditor should be assessed as reviewable or otherwise pursuant to preference provisions which have general effect. Any deficiencies in the operation of those provisions in that respect should be addressed by amendment to the preference provisions rather than by the enactment of piecemeal and reactive provisions which deal with particular circumstances in which review provisions are perceived to be operating inadequately. There is some irony in the fact that where such provisions have been enacted the review provisions were generally operating satisfactorily, whereas in other respects obvious deficiencies which might have been remedied by general reform of the operative provisions have been left unaddressed.
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APPENDIX - PRIORITIES IN BANKRUPTCY DISTRIBUTIONS

At common law unsecured creditors obtained priority according to the time at which they filed writs of execution against a debtor's assets. Legislation providing for a rateable distribution of a bankrupt's property among its creditors was passed in 1542\(^{440}\) but since then a complex statutory scheme has developed which assigns priorities to certain types of debts ahead of the claims of unsecured creditors. A primary reason for the existence of rules for the review of preferences is to protect the integrity of this priority scheme. The statutory priority scheme does not provide for the claims of secured creditors as they already have a priority by virtue of their security.

The types and ranking of claims which enjoy a priority over unsecured creditors vary between jurisdictions. In general, priority schemes reflect three interests: meeting the costs of the administration, protecting particularly vulnerable debtors such as wage earners, and postponing the claims of persons closely associated with a bankrupt who are likely to have been involved with the bankrupt's affairs or have had notice of the bankrupt's financial difficulties. A priority exists for the trustee's reasonable fees and expenses, as a trustee must be confident of payment if an orderly administration of the bankrupt's assets is to take place. Secondary priorities reflect policy interests such as the protection of employees' wages and child support payments; these are typically subject to a monetary or time limitation. Some jurisdictions postpone claims of persons who have been forced to repay preferences until all other creditors have been paid. In some jurisdictions the tax liabilities of the bankrupt also take a priority but a trend towards removal of this priority is evident in the jurisdictions under study.

It is unfortunately rare for unsecured creditors to receive a significant dividend, especially in corporate liquidations where the entire estate is typically employed in meeting priority tax liabilities.\(^{441}\)

This Appendix is intended as a reference schedule of priority structures in the four jurisdictions under study. They are substantially similar in effect, although they vary in complexity.

\(^{440}\) See supra n10 and accompanying text.

\(^{441}\) Morris, supra n403 observes at 738 that unsecured creditors sometimes receive a "pittance" but seldom more. The writer's experience is consistent with this description.
In Canada priorities are governed by sections 136 to 141 of the Bankruptcy and Insolvency Act. The Canadian priority scheme is complex, so the following schedule summarises the significant aspects of the priority structure:

1. Funeral and testamentary expenses of the bankrupt, if deceased;
2. Costs of administration of the bankrupt’s estate including legal costs incurred by the trustee (the fees and expenses of a person appointed under section 14.3(1)(a) rank first, then the trustee’s expenses and fees, and lastly legal costs);
3. Levy payable to the Superintendent for supervision expenses (a percentage of the estate);
4. Claims of employees for arrears of wages to a maximum of two thousand dollars or the sum due for the six months preceding the bankruptcy, whichever is greater, plus a thousand dollars of travelling salesperson’s expenses (a spouse, former spouse or specified relative of a bankrupt, or an officer or director of a corporation in liquidation, is not entitled to claim a priority in connection with wages or other compensation in connection with the bankrupt’s business);
5. Claims for alimony, spousal or child maintenance or support limited to a year’s periodical amounts and any lump sum payable;
6. Personal liability of directors and officers for unpaid wages, termination, severance and vacation pay (officers may be liable to a limited extent under section 119 of the Canada Business Corporations Act);
7. Municipal taxes levied within two years preceding the bankruptcy, to the extent of the property in respect of which the taxes were imposed;
8. Landlords’ claims for arrears of rent for the three months preceding the bankruptcy and accelerated rent of not more than three months after the bankruptcy (in other respects landlords’ priorities may be determined by provincial legislation);
9. Solicitors’ costs for execution against the bankrupt’s property;
10. Claims by injured employees of the bankrupt (but not to the extent that any workers’ compensation applies) to the extent of moneys received from persons guaranteeing the bankrupt’s liability to the injured persons;
11. Unsecured creditors;
12. Creditors who entered into a “reviewable transaction” for the purposes of the BIA with the bankrupt prior to bankruptcy (unless in the opinion of the court or trustee the transaction was a “proper transaction”).

442 Such a transaction is actionable under section 100 of the BIA if insufficient value was given. A “reviewable transaction” for the purposes of the BIA refers to any transaction in which the parties were not at arm’s length; a much more restricted meaning than the phrase as used in this paper.
443 BIA, section 137(1).
There are some exceptions to the above priority structure. Provincial statutes may afford a priority to persons with a claim against a bankrupt for damages for personal injury or death or property damage caused by a motor vehicle, to have the proceeds of a liability insurance policy applied against that claim. Special rules exist where the bankrupt is a member of the Canadian Payments Association under the Act of the same name, which gives a priority to holders of unpaid cheques and priority payment contracts certified or issued prior to the bankruptcy.

A priority for indebtedness of a bankrupt under workers’ compensation or unemployment insurance or any obligation to pay sums so deducted to the Crown, along with a priority for claims of the Crown in right of Canada or any province, were removed with effect from November 1992.444

444 BIA, sections 86 and 97 provide that such claims may be secured claims if appropriate securities are executed.
In England the IAE provides for priorities in the distributions of the estates of bankrupt natural persons and companies in materially identical terms. The order of priority is as follows:

1. The fees and expenses of the trustee;
2. Preferential debts incurred prior to liquidation, which rank equally among themselves. Preferential debts are specified in Schedule 6 of the IAE and include:
   a) Taxes and gaming duty (limited to between four and twelve months depending upon the type of tax);
   b) Social security and pension scheme contributions;
   c) Remuneration (including holiday pay) due to employees, to a maximum of four months;
   d) European Community levies due on coal and steel production;
   e) Wages of miners working in certain specified regions;
3. Debts secured by a floating charge;
4. Unsecured debts;
5. Interest (including interest on debts in categories 3 and 4 above).

Any surplus is distributed among the contributories, or in the case of a natural person, to the bankrupt. Local authorities are no longer preferential debtors under the IAE.

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443 In the case of natural persons section 328 provides for all priorities, and in the case of companies sections 115, 175, 154 and 189 provide for priorities in that respective order.

446 Schedule 6 applies to both natural persons and companies: IAE, section 386.
In Australia priorities in personal bankruptcy are governed by section 109 of the BA and priorities in corporate liquidations are governed by section 556 of the CL. Section 109 of the BA enacts priorities in bankruptcy distributions in the following order:

1. Legal costs of the petitioning creditor and the costs, charges and expenses of the trustee;
2. Remuneration, costs, charges and expenses of a controlling trustee (if any) appointed by the bankrupt prior to bankruptcy;
3. Payment of any amounts deducted from an employee's wages or salary pursuant to section 47 of the Child Support (Registration and Collection) Act 1988 (Cth.) (see section 50 of that Act);
4. In the case of a bankruptcy that occurs within 2 months after a deed of assignment or arrangement or composition executed by the bankrupt and accepted by creditors has been declared void, annulled or terminated, payment of any liabilities, commitments, expenses or remuneration incurred under such a deed, arrangement or scheme;
5. Funeral and testamentary expenses of a deceased bankrupt;
6. Wages and salary (but not long service leave, extended leave, annual leave, recreation leave or sick leave) to a limit of $1,500 (a person who pays such debts on behalf of a bankrupt is entitled to assume the employees’ priority);
7. Workers’ compensation the liability for which accrued before the date of the bankruptcy (but not to the extent that the bankrupt is indemnified and not with respect to payments due from the bankrupt to a compensation fund);
8. Amounts due to employees for long service leave, extended leave, annual leave, recreation leave or sick leave in respect of a period before the date of the bankruptcy;
9. Repayment of money paid by an apprentice to a bankrupt in an amount the trustee thinks reasonable;
10. Payment of such preferences, priorities or advantages in favour of any creditor or group of creditors and expenses incurred in the interests of creditors before the date of the bankruptcy, as resolved by special resolution in a meeting of the creditors;
11. Unsecured creditors.

In addition to an agreed priority under paragraph 10 above, where creditors have assumed a risk of costs in supporting litigation on behalf of the company a court may award those creditors a priority in respect of any property so recovered in consideration of the risk they assumed. In the case of joint debtors, whether partners or not, their joint estate is applied in priority payment of their joint debts, and each separate estate is applied in priority payment of separate debts.
In the case of companies in liquidation, section 566 of the CL provides similarly to the BA except in the following respects:

- Trustee’s expenses take priority over costs of a petitioning creditor, but trustee’s fees and other fees and expenses of a “relevant authority” are deferred in priority to the position held by funeral and testamentary expenses in the case of a deceased bankrupt;

- No reference is made to child support liabilities (for obvious reasons);

- Priorities are conferred respectively for the cost of a report commissioned by the liquidator under section 475 of the CL, the cost of an audit under section 539 of the CL and any other expenses properly incurred by a relevant authority including a committee of inspection, all of which take the same priority afforded to funeral and testamentary expenses in the case of a personal bankruptcy;

- There is no priority for injury compensation where the company is being liquidated for the purpose of reconstruction or amalgamation and the injury entitlement will survive or is insured;

- Retirement contributions are afforded a priority together with wages;

- Leave of absence payments are given priority over retrenchment allowances, and dollar limits are placed upon certain specified employee entitlements;

- Section 562 provides for the proceeds of liability policies to be paid to the parties in respect of whom the liabilities were incurred;

- Section 563A provides that claims by members of the company are subordinated to all other claims;

- Section 563B provides for the payment of interest on admitted debts.
Priorities in New Zealand are governed by Part IV, section 104 of the IA in the case of natural person bankrupts and by the Seventh Schedule of the Companies Act 1993 in the case of corporations in liquidation. Section 104 of the IA provides for the distribution of a bankrupt’s assets in the following order:

1. Trustee’s expenses and disbursements;
2. Petitioning creditor’s (or, as the case may be, the debtor’s solicitor’s) legal costs in accordance with a costs scale;
3. Commission payable to the trustee under Rule 49 and the Second Schedule of the Insolvency Regulations 1970;
4. Arrears of wages or salary (including debts owing by the bankrupt to a worker under section 15(1)(a) of the Volunteers Employment Protection Act 1973) of the debtor’s employees due for the four months preceding the bankruptcy, including all holiday pay, to a maximum of $1,500 (a person who pays such debts on behalf of the bankrupt is entitled to assume the employees’ priority);
5. Fees paid to the bankrupt by an apprentice and ordered by the Court to be repaid to the apprentice;
6. Fees owed by the bankrupt for services connected with deeds, instruments, books of account etc. in respect of which the holder is denied a lien by section 73 of the IA;
7. Claims by purchasers of goods on layby (section 11(2)(c) of the Layby Sales Act 1971);
8. Tax debts, and all amounts payable under New Zealand’s “no-fault” accident insurance scheme to the Accident Rehabilitation and Compensation Insurance Corporation (section 169 of the Accident Rehabilitation and Compensation Insurance Act 1992);
9. Unsecured creditors;
10. Claims of an employee who was also the bankrupt’s spouse and any other deferred debts;
11. Interest on all debts admitted in the bankruptcy;
12. Repayment of loans between the bankrupt and its spouse, and repayments of any voidable dispositions, together with interest;
13. Any surplus remaining is paid to the bankrupt.
The priority scheme enacted by the Second Schedule of the CA is substantially similar to that under the IA, except for the following differences:

- No commission is payable to a trustee; instead, the equivalent priority is given to the actual costs of a liquidation committee;
- The priority for arrears of wages is not subject to a monetary limit, and the priority includes workers' compensation payments, sums deducted from the employee's wages to satisfy the employee's obligations and child support payments payable to the taxation authority;
- Following the priority of an apprentice, a priority is afforded to sums the Motor Vehicle Dealers Institute Inc. is entitled to recover from a defaulting licensee company under the Motor Vehicle Dealers Act 1975;
- No priority is provided with respect to fees of persons who provide services in connection with books of account etc.;
- The priority scheme applies to any property distrained by a landlord within one month of bankruptcy.