TRANSFERS AT UNDERVALUE UNDER SECTION 96 OF THE BANKRUPTCY AND INSOLVENCY ACT – A PRIMER

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Part I. Introduction and Overview

I began writing this paper shortly after arguing an appeal[1] of the recent Ontario Superior Court decision *Mercado Capital v. Qureshi*[2], in which Mr. Justice Hainey declined to make an order under section 96 of the *Bankruptcy and Insolvency Act*[3] (which I'll refer to as the "**BIA**") despite facts which suggest that a Transfer at Undervalue had occurred. The Court of Appeal released its decision in the Qureshi matter in September of 2018.[4] This paper is not intended to be a comprehensive statutory review nor merely a case comment. Rather, it is my hope to familiarize the reader with the Transfer at Undervalue provisions in section 96 of the BIA by highlighting section 96's strengths and shortcomings. And despite various imperfections (to be discussed) I intend to demonstrate that section 96 can be a very effective tool to increase distributable assets in the bankrupt estate.

In this author's experience, the Transfer at Undervalue provisions of the BIA are both very powerful and yet underutilized. Powerful, because the BIA provisions impugning a Transfer at Undervalue give a trustee (or a creditor with a section 38 Order[5]) the ability to ask a court to divest a non-bankrupt third party (who I will refer to as a "**Recipient**") of her or his property (that was recently acquired from the now bankrupt debtor under a Transfer at Undervalue) often without proving that the bankrupt had any fraudulent intention at the time that the Transfer at Undervalue was made. The elimination of the need to prove fraudulent intent (on the part of the bankrupt transferor) is a significant lowering of the threshold that is found in provincial fraudulent conveyance statutes. This is a noteworthy policy shift away from the *intent* of the debtor/transferor (which has always been the backbone of the provincial fraudulent conveyance legislation) towards the *effect* of the impugned transfer (being the diminution of the assets in the bankrupt estate to the prejudice of the creditors of the estate). And it is a radical departure from the historic norms of common law jurisdictions, where property ownership has always been jealously protected by Parliament, the legislatures and the courts.

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[1] As a matter of full disclosure, I unsuccessfully argued this matter before Mr. Justice Hainey in the Ontario Superior Court and again unsuccessfully before the Ontario Court of Appeal in February of 2018, and

[2] *Mercado Capital Corporation v. Qureshi,* 2017 ONSC 5572

[3] *Bankruptcy and Insolvency Act*, RSC 1985, c B-3

[4] *Mercado Capital Corporation v. Qureshi,* 2018 ONCA 711

[5] A section 38 Order references section 38 of the BIA which allows a creditor to obtain an order of the court to take ownership of litigation from a trustee in circumstances where the trustee fails or refuses to litigate

And yet, despite there being legislation allowing trustees and creditors to deprive a Recipient of her or his vested property rights without having to prove fraudulent intent, Transfer at Undervalue litigation is still not commonplace. One can only presume that trustees are slow to initiate Transfer at Undervalue litigation because there are often few, if any, assets available in the estate to fund any litigation. Creditors typically have more resources available to fund Transfer at Undervalue litigation. But trustees with larger estates and creditors alike appear to be reluctant to bring Transfer at Undervalue proceedings, perhaps because the lower threshold established by section 96 of the BIA is not yet widely appreciated. Few trustees or creditors appear to be alive to the fact that the courts are now empowered to void a Transfer at Undervalue (or order repayment to the estate by a Recipient) even when there was no fraudulent intent on the part of the bankrupt transferor.

Transfer at Undervalue legislation has now been included in the BIA for the past nine years. A body of case law is emerging that demonstrates the court's willingness to reverse many Transfers at Undervalue (especially Transfers at Undervalue to spouses, children and to other non-arm's length Recipients). However, the court's robust enthusiasm to reverse Transfers at Undervalue has stopped short when an economically disadvantaged spouse's share of a matrimonial home is the property that was transferred, even though section 96 of the BIA does not differentiate between "family assets" and "non-family assets". In the Qureshi matter[6] cited above, the court tempered its willingness to impugn a Transfer at Undervalue of this sort based upon subjective factors including the good faith of both the debtor and the Recipient and also based on the intent of the debtor. And the recently released Court of Appeal decision[7] in this matter neither approved nor overturned the lower court's reasoning (dismissing the appeal on entirely different grounds). And the dearth of other reported appellant court decisions analyzing Transfers at Undervalue of matrimonial homes between spouses has resulted in trustees and creditors being unable to predict with any degree of accuracy whether a court will be willing to void a Transfer at Undervalue when an economically disadvantaged spouse is the Recipient (and when the property transferred is her or his only remaining asset).[8]

Part II. Legislative History and Evolution of Section 96

The law has long recognized the need to protect creditors from insolvent debtors who give away assets to third parties instead of using those assets to repay their debts. In fact, legislation prohibiting debtors from fraudulently dissipating their assets when heavily indebted was first enacted in England during the reign of

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[6] *Supra*, note 2, @ para 29

[7] *Supra*, note 4

[8] Compare *Re Paul W. Lee,* 2017 ONSC 388 and *Re Rehman,* 2015 ONSC 188

Queen Elizabeth I in the 1500s and has been embodied into the *Fraudulent Conveyances Act*[9] of Ontario since the late 1800s. The principle underpinning the prohibition against fraudulent conveyances was poetically expressed in the oft quoted 1870 case of *Freeman v Pope*[10] in which Lord Hatherley LC said that "*A debtor must be just before he can be generous - and that debts must be paid before gifts can be made*."

Sections 95 and 96 of the BIA codify this "just before generous" rule. Preferential *debt repayment* by a debtor on the verge of bankruptcy is dealt with in section 95 of the BIA, which is sufficiently complex to warrant its own examination. *Gifts and asset sales at reduced prices* by a debtor on the verge of bankruptcy are called Transfers at Undervalue and are dealt with in section 96 of the BIA.

But section 96 of the BIA is a relatively new section, having been enacted in 2009. Before then, the BIA included provisions that were also intended to prevent debtors from gifting assets and from selling assets at less than fair market value prior to bankruptcy. These now repealed provisions (section 91 prohibited "Settlements" and section 100 prohibited "Reviewable Transactions") were generally considered to be cumbersome and difficult to use in a practical manner. Case law under these sections 91 and 100 focused on good faith and intent — but those considerations were based on the subjective intention of the bankrupt and as such, were often illusive concepts which were difficult to prove.[11] These sections were repealed and replaced in 2009 with section 96 — both to combine and simplify the provisions and also to eliminate redundancies that were inherent in them. The new section 96 was enacted to promote fairness, uniformity and predictability into the BIA system.[12]

Any analysis of section 96 of the BIA must begin with a review of the primary purposes of the BIA, which is to allow honest but unfortunate debtors a fresh start, while ensuring that creditors share their losses ratably. This fresh start is accomplished by releasing and forgiving the bankrupt's debts upon discharge from bankruptcy. However, accomplishing this "fresh start" goal comes with a cost. And this cost is borne directly by the bankrupt's creditors who lose the right to pursue full repayment of their debt from their (now bankrupt) debtor.[13]

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[9] *Fraudulent Conveyance Act*, RSO 1990, c F.29
[10] (1870), L.R. 5 Ch. App 538
[11] *Fraudulent Preferences and Transfers at Undervalue* by Robyn Gurofsky – Annual Review of Insolvency Law 2011 (Thomson Reuters Canada Limited)
[12] Senate of Canada, Standing Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden* (Ottawa: Senate of Canada, 2003) @ page 122
[13] *Supra*, note 3, @ section 178

The *quid pro quo* for the statutory imposition of this heavy burden foisted on the creditors, is the BIA's provisions ensuring the entitlement of all creditors of the same class to share ratably in a maximized pool of the bankrupt's assets. In exchange for forfeiting the ability to pursue full payment of their debt, the BIA ensures that all creditors of the same class are treated equally and share their losses ratably.[14] This goal cannot be achieved if a bankrupt is permitted to remove assets (by effecting a Transfer at Undervalue) from her or his estate prior to bankruptcy.[15]

The BIA therefore includes various provisions giving the trustee the power to call in, preserve and protect the bankrupt's assets and then to liquidate and distribute those asset to the creditors as part of the administration of the bankrupt estate. But what is fundamental to this scheme, and to the achievement of the BIA's two main goals enumerated above, is that the bankrupt's assets that are to be distributed to the unsecured creditors of the bankrupt's estate must include not only the assets owned by the debtor on the date of bankruptcy, but also those assets given away by the bankrupt prior to bankruptcy, whether by (section 95) preferential debt repayment or by way of a (section 96) Transfer at Undervalue by gift or by the sale of assets (or the provision of services) for less than their fair market value. These two sections are the foundation of the fairness offered to creditors under the current bankruptcy system. They were included in the 2009 amendments to the BIA in order to prevent preferential debt repayment and Transfers at Undervalue, because both diminish the value of the assets remaining in the bankrupt estate to the prejudice of the bankrupt's creditors. Specifically, a Transfer at Undervalue causes creditors to suffer even greater losses than would otherwise be the case, while at the same time it allows the Recipient of the Transfer at Undervalue to keep the improperly transferred asset for his or her own account in priority to the unsecured creditors of the bankrupt.

The section 96 Transfer at Undervalue provisions of the BIA are the federal equivalent of provincial statutes which prohibit fraudulent conveyances, but with three significant differences. First, under the Ontario *Fraudulent Conveyance Act*[16] (merely using Ontario's act as an example) a fraudulent conveyance is not tied into the bankruptcy of the transferor. Any creditor is permitted to bring a fraudulent conveyance action under the Ontario legislation, whether or not the debtor is a bankrupt.

[14] *R v Fitzgibbon*, [1990] 1 S.C.R. 1005 at pg 1015
[15] *Pitblado LLP v Houde* 2015 MBQB 85 @ para 35 and *Re WF Canada*, 2017 ONSC 3074 @ para 44
[16] *Supra*, note 6

Secondly, under Ontario's *Fraudulent Conveyance Act*[17], the court only has the power to declare a fraudulent conveyance to be void. Under section 96 of the BIA, not only can the court declare a Transfer at Undervalue to be void, but the court can also order that the Recipient pay back to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor.

Lastly, under the Ontario *Fraudulent Conveyance Act*[18], a conveyance is "fraudulent" only if the creditor challenging the conveyance can prove that the debtor/transferor intended to defeat, hinder, delay or defraud her or his creditors. The BIA, on the other hand, does not always require the debtor making the Transfer at Undervalue to have any "fraudulent" intent at all, in order for the Transfer at Undervalue to be impugned (for example, when the Transfer at Undervalue occurs between parties who do not act at arm's length with each other within one year immediately prior to the bankruptcy).

The overriding obligation of the courts to promote the objects of the BIA by protecting the creditors of the bankrupt estate requires the courts to recognize and accept Parliament's policy shift diminishing the need to look for and find a fraudulent *intent* on the part of the debtor/transferor. Parliament has clearly begun the process of shifting its focus towards the *effect* of the impugned transfer, being the diminution of the assets in the bankrupt estate to the prejudice of the creditors of the estate. It will undoubtedly take some time for the judiciary to fully accept the need to step back from its historical position as the protector of property rights (in this case, the rights of the Recipient) and to step up to the plate (to use a baseball reference) in order to protect the interests of the bankrupt's creditors who have been unfairly deprived of an asset, while the Recipient, who is often a close relative to the bankrupt, scores a home run and acquires that asset (prior to the bankruptcy) in priority to the creditors and often, without paying fair market value for that asset.

<u>Part III. Transfers at Undervalue and other Defined Terms</u>

A "Transfer at Undervalue" is defined in section 2 of the BIA as "*a disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor"*.

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[17] *Ibid*
[18] *Ibid*

This definition is awkwardly drafted. It includes 2 words (‘*debtor’* and ‘*property’)* that are themselves defined in the BIA. It also deals with two separate types of transactions that may be undertaken by a debtor: one being a “disposition of property”; and the other being the “provision of services”. And finally, at the same time, it also sets out two different measures of consideration that may be received by the debtor on account of the “disposition of property” or the “provision of services”, the first being “no consideration” and the second being consideration that is “conspicuously less than the fair market value of the consideration given by the debtor”.

In essence, this definition of Transfer at Undervalue identifies four separate impugned transactions that may be undertaken by a debtor in contravention of section 96 of the BIA, being:

- a *disposition of property* by a debtor for which *no consideration* is received by the debtor;

- a *disposition of property* by a debtor for which *the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor;*

- a *provision of services* by a debtor for which *no consideration* is received by the debtor; or

- a *provision of services* by a debtor for which *the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor*.

It will, no doubt, take many years for the courts to fully explore each of these Transfer at Undervalue permutations and combinations. However, for most estates, it is the disposition of property (either for no consideration or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor) that will be the more common and most likely to raise a flag, be investigated and give rise to a section 96 Transfer at Undervalue proceeding in the courts. For the balance of this paper, for ease of drafting purposes only, I intend to only reference “dispositions of property”. However, for the most part, one may substitute “provision of services” in its stead.

As a preliminary matter, in order to determine whether a Transfer at Undervalue has occurred, a trustee or creditor must consider at the onset whether:

- the bankrupt is a *debtor* within the meaning of the BIA; and

- *property* was disposed of (or services were provided) within the meaning of the BIA.

The word "*debtor*" is defined in section 2 of the BIA as "*including an insolvent person and any person who, at the time an act of bankruptcy was committed by him, resided or carried on business in Canada and, where the context requires, includes a bankrupt*". Clearly, every bankrupt appears to be a "debtor" under this definition and, as such, is capable of having participated in or effected a Transfer at Undervalue.

"Property" is also defined in section 2 of the BIA to mean "*money, goods, things in action, land and every description of property, whether real or personal, legal or equitable, as well as obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, in, arising out of or incident to property".* As this definition of property is very broad, virtually every asset owned by a debtor (but disposed of prior to the bankruptcy) will certainly be "*property"* within the meaning of this definition and, as a result, may be the subject matter of a disposition of property within the meaning of a Transfer at Undervalue.

The analysis under section 96 of the BIA becomes more challenging for a trustee or creditor who then must determine whether:

- there was a *disposition* of that property within the meaning of the BIA (and the timing of that disposition);
- and if so, was *any consideration received* by the debtor;
- and if so, was the consideration received by the debtor *conspicuously less* than the fair market value of the consideration given by the debtor.

Unfortunately, the word "disposition" is not defined in the BIA. There are many statutes in Canada that use the word "disposition". As a consequence, its meaning has been judicially considered in many contexts. It is usually given a broad and expansive (rather than a restrictive) interpretation. However, the word "disposition" has not been the subject of extensive judicial consideration within the context of section 96 of the BIA. As such, the full extent of its meaning in section 96 is not yet clear. But that being said, one can be fairly certain that any transfer of property, whether by gift or a sale, to a third party Recipient (prior to bankruptcy) will fall within the ambit of a “disposition of property” and, as such, will be capable of triggering a Transfer at Undervalue under section 96[19].

But not all changes of ownership of property will necessarily be a “disposition” of that property. For example, on the death of a joint owner of property (that is, a property owned by two individuals as joint tenants and not tenants in common) , the law provides that the surviving “joint” owner takes title to the entire property automatically, and that the jointly owned property does not pass through the deceased’s intestate or testamentary estate. This automatic vesting in the surviving joint owner was held to be an extinguishment of the deceased’s (joint) ownership and not to be a disposition of the property by the deceased debtor.[20] As a result, the death of a joint owner of property (and the resulting 100% ownership befalling the survivor) was not a “disposition of property” and therefore did not give rise to a Transfer at Undervalue within the meaning of the BIA. No doubt, over time, case law will delineate exactly what is and what is not a “disposition of property” under section 96.

Whether dealing with a disposition of property or the provision of services, the trustee (or creditor) must also determine whether the now bankrupt debtor received any consideration for the disposition. If the debtor did receive consideration, the trustee (or creditor) must then determine whether the value of the consideration received by the debtor was conspicuously less that the fair market value of the consideration given by the debtor. Again, there is not yet a significant body of case law decided under section 96 of the BIA to assist a trustee or a creditor who is attempting to determine this issue.

Under predecessor legislation[21], the Supreme Court of Canada did examine a disposition of property and did not take issue with the proposition that a sale of an asset at 94% of its fair market value was not “conspicuously less” that the fair market value of that asset.[22] Presumably, the Supreme Court was aware that a typical sales commission charged by a broker to its seller client might be in the 6% range. So a seller, selling without a broker, who sells for 94% of fair market value, is getting the exact same net return as a seller selling for 100% of fair market value while using the services of a broker (assuming a 6% commission).

[19] In *Mercado Capital Corporation v. Qureshi*, the Ontario Court of Appeal held that the date on which a debtor entered into an agreement of purchase and sale, as purchaser, to acquire a new matrimonial home was the date on which that debtor made a “disposition of property” under section 2 of the BIA. More on this unusual finding in the last section of this paper.

[20] *Cameron (Re)*, 2011 ONSC 6471

[21] The now repealed s100(1) and s100(2) of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3

[22] *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68

Fair market value is generally considered to be the highest price that a prudent and informed buyer would pay to an arm's length prudent and informed seller in an open and unrestricted market, assuming that neither party is under any compulsion to act. One can only presume that this definition of fair market value will be applied to Transfer at Undervalue matters. Of course, subsection 96(2) of the BIA is also of assistance to trustees. It obligates a trustee who initiates a Transfer at Undervalue proceeding to state for the court what, in its opinion,

- was the fair market value of the property or services; and
- was the value of the actual consideration given or received by the debtor.

Courts have consistently held that the opinions of value proffered by the trustee are to be accepted by the court as being accurate absent a finding that the trustee's values are not accurate. However, the court is not limited to accepting the trustee's opinion of value, on the one hand, or the evidence of value adduced by the Recipient on the other hand.[23] Rather, it is open to the court to arrive at its own conclusions of value once the court is satisfied that the trustee's opinion ought not to be accepted as accurate. This is because subsection 96(2) of the BIA allows courts to rely on and to accept a trustee's opinion of value only so long as no evidence to the contrary is adduced by the Recipient. But once additional evidence of value is provided by the Recipient that contradicts the opinions proffered by the trustee, it is the court's role as finder of fact to decide what the proper value for the consideration is to be. This judicial deference (afforded to the trustee's opinion) is not available to a creditor who brings a Transfer at Undervalue proceeding under section 38 of the BIA (following a court-sanctioned assignment of the cause of action from the trustee). While the trustee is an officer of the court, the creditor is not, and subsection 96(2) is simply unavailable to a creditor.

Part IV. Section 96 Transfers at Undervalue

Section 96 of the BIA uses the phrase "Transfer at Undervalue" which, for most estates, will be either (i) a gift of an asset or (ii) a sale of an asset for less than its fair market value by a bankrupt to a third-party Recipient. More technically, the exact definition of Transfer at Undervalue is "*a disposition of property or provision of services for which no consideration is received by the debtor or for which the consideration*

[23] *Randen v. HPCB-Online Ltd.*, 2018 BCCA 123 @ para 25. This 2018 decision interpreted the now repealed subsection 100(3) of the BIA. However, as the language in subsection 96(2) is virtually identical to the language in subsection 100(3), it is reasonable to presume that this reasoning will continue to be followed by the courts.

received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor”.

Ontario has long recognized that an insolvent debtor on the verge of bankruptcy ought not be permitted to give away assets, especially to a related (non-arm’s length) Recipient. The rationale for this prohibition is two-fold. First, giving away assets prior to bankruptcy prejudices the unsecured creditors of the bankrupt estate by reducing the value of the assets in the bankrupt estate that are available for distribution by the trustee. And second, the Recipient is bestowed a benefit (equal to the value of the asset received in excess of the amount, if any, paid by the Recipient for such asset) that is unjust for the Recipient to retain. This benefit essentially gives the Recipient priority to the transferred asset over the other unsecured creditors of the bankrupt, which runs afoul of one of the BIA’s primary goals: which is to ensure that all unsecured creditors share their losses ratably.

Section 96 of the BIA empowers a court to void three types of Transfer at Undervalue transactions or, alternatively, to grant monetary judgment against a Recipient of a Transfer at Undervalue, in each of the following three scenarios (depending upon the relationship of the parties to the transfer and depending on the timing of the transfer):

1. **Arm’s Length parties – within one year prior to bankruptcy:** if the Transfer at Undervalue was between parties dealing with each other at arm’s length within one year before the bankruptcy and **if the trustee (or creditor) can prove <u>both</u>:**

    (i) the debtor was insolvent at the time of the transfer (or was rendered insolvent by it); **and**

    (ii) the debtor intended to defraud, defeat or delay a creditor.

2. **Non-Arm’s Length parties – between one and five years prior to bankruptcy:** if the Transfer at Undervalue was between parties not dealing with each other at arm’s length (for instance, if they are related to each other) more than one but not more than five years before the bankruptcy and **if the trustee (or creditor) can prove <u>either</u>:**

(i) the debtor was insolvent at the time of the transfer (or was rendered insolvent by it); **or alternatively**

(ii) the debtor intended to defraud, defeat or delay a creditor.

3. **Non-Arm's Length parties – within one year prior to bankruptcy:** if the Transfer at Undervalue was between parties not dealing with each other at arm's length (related parties, for instance) within one year before the bankruptcy. **In this scenario, no "insolvency test" and no "intention test" is required.** This is an "effects-based test", meaning that the Transfer at Undervalue, in and of itself, (between non-arm's length parties within one year of the bankruptcy) ought to be impugned because of its negative impact on the creditors of the bankrupt estate.[24]

These three distinct classes of impugned Transfers at Undervalue have been summarized thusly by Professor Roderick J. Wood:[25]

Transaction	Transfer at Undervalue		
Relationship	Arm's Length	Non-Arm's Length	
Timing	Within one year	Within one year	Outside one year but within five years
Additional Elements	Insolvency **and** Intention to Defeat Creditors	None	Insolvency **or** Intention to Defeat Creditors

What immediately stands out here is that the most difficult Transfer at Undervalue to prove is one in which the debtor making the Transfer at Undervalue and the Recipient are dealing with each other at arm's length. In the arm's length scenario, the trustee or creditor must prove both the debtor's insolvency as well as the debtor's intention to defraud, defeat or delay a creditor. And the Transfer at Undervalue must occur within one year of the bankruptcy, and not before that period.

However, the test for attacking a Transfer at Undervalue between parties who are not dealing with each other at arm's length (I like to think of this relationship as being one of closely connected persons) is much less

[24] Lloyd W. Houlden, Geoffrey B. Morawetz & Janis. P. Sarra, The 2018 Annotated Bankruptcy and Insolvency Act, (Toronto: Carswell, 2018) p. 588,

[25] Roderick J. Wood, Transfers at Undervalue: New Wine in Old Wineskins?, (Edmonton: University of Alberta – Faculty of Law, 2017) p.4

difficult to establish. The trustee or creditor can look back at transactions occurring within five years of the bankruptcy. When the Transfer at Undervalue took place more than one year and less than five years before the bankruptcy, the trustee or creditor must prove **either** the debtor's insolvency **or** the debtor's intention to defraud, defeat or delay a creditor. There is no need to prove both of these pre-conditions. And when the Transfer at Undervalue took place less than one year before the bankruptcy, there is nothing more to prove - other than the disposition of property or provision of services itself, for which no consideration is received by the debtor or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor.

Parliament has given specific thought as to whether spouses ought to be considered to be dealing with each other at arm's length. Section 4 of the BIA provides that persons who are related to one another, which includes married and common law spouses, are deemed not to be (dealing with each other) at arm's length for the purposes of this section 96(1)(b) of the BIA. However, spouses may adduce evidence to the contrary if, in fact, they were acting at arm's length at the relevant time (presumably, following separation or divorce).

This leads one to the inevitable conclusion that transfers of property for no consideration or for consideration conspicuously less than the property's fair market value, within one year prior to bankruptcy by a debtor to her or to his spouse or child, is a Transfer at Undervalue which falls squarely into the class of impugned transaction described above (and particularized in subsection 96(1)(b)(i) of the BIA). Voiding this class of impugned Transfers at Undervalue does not require proof of insolvency and does not require proof of intent on the debtor's part. As a result, a court generally should have no difficulty finding that a debtor's Transfer at Undervalue to a spouse or other non-arm's length person within one year of the bankruptcy is void. And the court also has the power to order that the Recipient of such a transfer pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor.

As stated in the recent Ontario Superior Court decision of *Re: Lee*[26]:

"The ultimate purpose of the section [96 of the BIA] *is to ensure that the property of a bankrupt is treated fairly and justly balancing the rights of all stakeholders…….. Section 96 imposes a strict test to remedy non-arm's length transfers among family members………. on proof of the requisite facts, relief should be granted at the amount calculated in accordance with* [the] *statute, in all but the most exceptional circumstances. This*

[26] *Re Paul W. Lee, a Bankrupt*, 2017 ONSC 388

is especially so in the case of a non-arm's length transaction that is attacked within one year. Section 96 sets out different rules for different types of transactions. For a non-arm's length transaction that is attacked within one year, the transaction may be avoided without any consideration or proof of an intention to defraud, to prefer, or any other fact other than the simple existence of the transaction at an undervalue. In my view, judgment should be nearly automatic in such cases."

There have been quite a number of decisions from judges (in addition to the *Re: Lee* decision quoted from above) that have voided a Transfer at Undervalue (and ordered a Recipient to pay funds to the estate) when the Recipient of the Transfer at Undervalue is the spouse or child of the debtor or some other non-arm's length individual related or closely connected to the debtor. In these rather common circumstances, the court has not had any difficulty impugning the Transfer at Undervalue without any consideration of the solvency (or insolvency) of the debtor at the time of the transfer, and without any consideration of the debtor's intention to defraud, defeat or delay a creditor at the time of transfer. A Transfer at Undervalue between non-arm's length people within one year of bankruptcy ought to be voided. The Recipient ought to be ordered to give the value received back to the bankrupt estate (as if the Transfer at Undervalue did not occur).

Part V. Non-Arm's Length and Fraudulent Intent

The concept of being at arm's length is not only embedded in commonly-used definitions of fair market value, (for instance ….. "*the highest price that a prudent and informed buyer would pay to an arm's length prudent and informed seller in an open and unrestricted market; assuming that neither party is under any compulsion to act"*) but it has also been built into the language of subsection 96(1) of the BIA. In this subsection, a Transfer at Undervalue to an arm's length third party Recipient is treated very differently than is a Transfer at Undervalue to a Recipient with whom the debtor was more closely connected; that is, not dealing at arm's length.

You will recall that under subsection 96(1)(a) of the BIA, a Transfer at Undervalue to an arm's length recipient is impugned if the transfer took place within one year of the bankruptcy AND if the trustee or creditor can establish **BOTH** *that the debtor was insolvent* **AND** *that the debtor intended to defraud, delay or defeat a creditor*. This is the most difficult of all Transfers at Undervalue for the trustee or creditor to prove.

The threshold for impugning a Transfer at Undervalue to a non-arm's length recipient is much lower under subsection 96(1)(b) of the BIA. First, the trustee or creditor can seek to impugn a Transfer at Undervalue (to a non-arm's length Recipient) that occurred up to five years before the bankruptcy (rather than the much shorter one year period for an arm's length Transfer at Undervalue). Secondly, the statutory preconditions for non-arm's length Transfers at Undervalue are easier to establish, as the trustee or creditor does NOT have to prove insolvency AND intent. In fact, the court is empowered to impugn a non-arm's length Transfer at Undervalue:

- *without* evidence of insolvency and *without* evidence of fraudulent intent if the Transfer at Undervalue occurred within one year of the bankruptcy

- *with* evidence of **either** insolvency **or** fraudulent intent (but not both) if the Transfer at Undervalue occurred between one year and five years before the bankruptcy.

Section 4 of the BIA provides the simple rule that persons who are related to each other are deemed not to be acting at arm's length with each other. This section sets out a comprehensive set of rules to delineate when a debtor and a Recipient are deemed to be related to each other (and thus, when they are deemed not to be acting arm's length with each other). The list of related persons includes individuals connected by:

- blood relationship
- marriage
- common-law partnership
- adoption

Additionally, an individual is related to an entity (such as a corporation) if she or he:

- controls the entity or
- is a member of a group that controls the entity or
- is related (by blood, marriage, common-law or adoption) to someone who controls the entity or who is a member of the controlling group for that entity.

However, for the purposes of a Transfer at Undervalue under subsection 96(1)(b), the presumption that spouses and other related persons are not acting at arm's length becomes rebuttable, no doubt to allow for the harsh reality that on a marriage breakdown, spouses (and their relatives) can and do become bitter adversaries and thus act at arm's length with each other. It would be unfair to presume that two adversarial parties (although related) were nonetheless not acting at arm's length with each other. Section 4 of the BIA also goes on to provide that it is a question of fact whether persons who are not related to each other were acting at arm's length with each other when the Transfer at Undervalue occurred.

The courts have shown a willingness to support trustees' and creditors' positions that a debtor and a Recipient who were not related to each other were still not acting at arm's length. As previously discussed, a finding that the debtor and an unrelated Recipient were not acting at arm's length increases from one to five years the period prior to the bankruptcy that the Transfer at Undervalue may be examined, and it significantly lowers the threshold for a Transfer at Undervalue to be impugned by subsection 96(1)(b).

The common law will consider unrelated parties not to be acting at arm's length when one of them is able to exercise some degree of control or influence or moral pressure in the other, as this might affect the free decision making of the other party.[27] For instance, the Ontario Court of Appeal[28] used the following language to help determine when unrelated parties are not acting at arm's length with each other: *"Where one of the co-contracting parties is, by reasons of his influence or superiority, in a position to pervert the ordinary rule of supply and demand and force the other to transact for a consideration which is substantially different than adequate, normal or fair market value, the transaction in question is not at arm's length."*

In one Transfer at Undervalue application[29] in which I was acting for the trustee, we successfully argued and obtained an order of the court to the effect that two unrelated business associates were not dealing with each other at arm's length when the debtor (transferor) was insolvent and simply gave away a valuable asset to her (unrelated) business partner, because her extreme insolvency took away all incentive for the debtor to maximize the consideration for the asset transferred.

It is this willingness of the courts to continue to expand upon the concept of unrelated parties not dealing with each other at arm's length that is empowering trustees and creditors alike to more easily attack a Transfer at Undervalue that occurred outside of a family relationship, with the obvious beneficiaries being the creditors of

[27] *UrbanCorp Toronto Management Inc. (Re)*, 2018 ONSC 2965
[28] *Montor Business Corporation v. Goldfinger*, 2016 ONCA 406 at para 67
[29] *Juhasz Estate v. Cordeiro,* 2015 ONSC 1781

the bankrupt estate. Similarly, courts have developed ways to assist trustees and creditors who have the burden of proving a debtor's intent to defraud, delay or defeat a creditor.

One must recall that when the debtor and Recipient are dealing with each other at arm's length, the Transfer at Undervalue is only impugned if:

- the disposition occurred within one year before the bankruptcy;
- the debtor was insolvent or rendered insolvent by the disposition; and
- the debtor intended to defraud, delay or defeat a creditor.

Of course, this intention of the debtor (to defraud, delay or defeat a creditor) is very difficult for a trustee or a creditor to prove. Few debtors will willingly admit to intending to defraud, delay or defeat a creditor. And there is no mechanism for a trustee or creditor to adduce actual evidence of the debtor's subjective intention to do so. However, the law has long acknowledged this hurdle to relief and has established the concept of 'badges of fraud', which, if established, allow the court to infer the existence of the debtor's subjective intention to defraud, delay or defeat a creditor[30].

The burden of proving these badges of fraud lies with the trustee or the creditor, and they include:

- the debtor continued to keep possession of the property disposed of after the disposition
- the disposition was kept secret
- the disposition was made after legal proceedings were threatened
- the consideration for the disposition was grossly inaccurate
- there was unusual haste in making the disposition

Clearly, Transfer at Undervalue litigation becomes easier when the parties to the transfer are related to one another and were not acting at arm's length with each other. But even unrelated parties can be found not to be acting at arm's length in a variety of circumstances which assists trustees and creditors alike when seeking compensation under section 96 of the BIA. Additionally, with both arm's length and non-arm's length transactions, courts are helping section 96 applicants obtain relief by impugning Transfers at Undervalue based

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[30] *Supra*, note 28 @ para 73

on the establishment of badges of fraud (to infer fraudulent intent) in order for the court to be satisfied that the debtor had the requisite intention to defraud, delay or defeat a creditor in suspicious transactions.

Part VI. Interpreting the word 'MAY'

First, a quick look at the wording of subsection 96(1) of the BIA, which provides that…

"On application by the trustee, a court ***may*** *declare that a transfer at undervalue is void as against ……. the trustee — or order that a party to the transfer …….. pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor —* ***if*** *……* The important words here (shown in bold) is that the court *'**may**'* impugn a Transfer at Undervalue *'**if**'* the conditions in subsections 96(1)(a) or 96(1)(b) are establish by the trustee or creditor.

I personally found it surprising to discover that the meaning of the word 'may' that is used in a statute (as in section 96 of the BIA) has been the subject of debate and judicial interpretation for many decades. Some have argued that the word "may" gives a court a broad discretion to make an order under section 96 of the BIA having regard to unfettered equitable principles of fairness. Others have proposed that the word "may" is to be interpreted as being imperative (or equivalent to the word "shall") so that the court has no discretion at all and must make an order if one of the conditions in subsections 96(1)(a) or 96(1)(b) is establish. And yet a third posit is that when one of these section 96 conditions is established, the inclusion of the word "may" in section 96 of the BIA gives the judge a limited discretion to decide:

- whether or not to make an order at all, and
- if an order is to be made, whether the order will be:
    - to just void the Transfer at Undervalue, or
    - to just require the Recipient of the Transfer at Undervalue to "*pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor"*, or
    - to make both orders.

With at least three distinct interpretations, the meaning of the word "may" is clearly equivocal. Fortunately, the Supreme Court of Canada has set out clear principles detailing the manner in which statutes are to be interpreted when ambiguities are discovered.[31] The courts our now obliged to interpret the meaning of an ambiguous word or phrase:

- having regard to the context in which the word or phrase is used
- in its grammatical and ordinary sense
- harmoniously with the scheme of the act, the object of the act and the intention of Parliament (or the legislature).

This is known as Dreiger's Modern Principle but is sometimes referred to as the Modern Approach (to statutory interpretation).

And equally as fortunately, the Supreme Court of Canada has used the Modern Approach to shut down this debate over the meaning of the word "may", by deciding in *R v. Johnson*[32] and in *R v. Lavigne*[33] that the conditional use of the word "may" in a statute does not give the court a broad unfettered discretion, and does not mean "shall". Rather, these and other Ontario Court of Appeal cases[34] have decided that the use of the word "may" in a statute such as section 96 of the BIA gives the judge a limited discretion when enforcing that provision. And that that limited discretion is to be guided by equitable principles[35] (sometimes referred to as a "principled exercise of discretion"), the scope of which (limited discretion) can be inferred from the purpose and scheme of the act or from other contextual factors.[36]

To recap, the word "may" has various meanings, but when the Modern Approach to statutory interpretation is employed, its meaning in section 96 becomes clear. The use of the word "may" in section 96 (coupled with the use of the word "if") gives the court hearing a Transfer at Undervalue matter a limited discretion as to whether or not a remedy ought to be imposed and if one is to be imposed, which remedy (voiding or ordering payment, or

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[31] *Rizzo & Rizzo Shoes Ltd. (Re),* [1998] 1 S.C.R. 27
[32] 2003 SCC 46
[33] 2006 SCC 10
[34] See also *Stelco Inc. (Re)*, 2005 CanLII 8671 @ para 44
[35] *Supra*, note 22 @ para. 81
[36] *Supra*, note 32 @ para. 17

both) is appropriate in the circumstances. This discretion must be exercised in a principled manner, meaning that it is not an unfettered discretion. Rather, the limited discretion afforded to the judge has to be exercised in a manner which promotes the object and scheme of the BIA.

The Ontario Court of Appeal has twice[37] repeated with approval a test first identified in Dreiger's seminal text on statutory interpretation[38], with which one can assess the appropriateness of the court's interpretation. Most recently, in 2017, the Ontario Court of Appeal[39] said that: *"As Ruth Sullivan*[40] *notes, statutory interpretation is a multi-dimensional exercise and requires a court to consider whether a particular interpretation complies with the legislative text, promotes the intention of the legislature, and produces a result that is reasonable and just, in compliance with accepted legal norms.*"

I take this to mean that a principled exercise of discretion afforded to a judge hearing a Transfer at Undervalue is one which:

- promotes fairness among the unsecured creditors of the bankrupt
- maximizes the assets in the bankrupt estate
- does not allow debtors to dispose of property (whether by gift or sale at less than fair market value) within certain time frames prior to bankruptcy
- does not condone Recipients (of the property disposed of) to benefit unjustly from their receipt of such property

That being said, how this judicial discretion actually works in practice is another matter. For instance, how is a judge to decide a section 96 Transfer at Undervalue matter? If we are to assume one of the most straight-forward (and common) of fact scenarios, where both spouses are the owners of their matrimonial home, and one spouse transfers her or his ½ interest in the matrimonial home to her or his non-arm's length spouse within one year of

[37] *Price Waterhouse Ltd. v. Standard Trust Co.*, 1995 CanLII 3508 (ONCA) and *R v. Del Mastro*, 2017 ONCA 711
[38] Elmer A. Dreiger, *The Construction of Statutes* (Toronto: Butterworths, 1974)
[39] *R v. Del Mastro*, 2017 ONCA 711 @ para. 61
[40] Ruth Sullivan, *Sullivan on the Construction of Statutes*, 6th ed. (Markham: LexisNexis, 2014), at pp. 7-10

bankruptcy? What options are available to the judge who must decide this case and exercise equitable jurisdiction in a principled manner?

These were the facts in the 2017 *Re Lee*[41] decision, where the judge wrote …… *"the bankrupt argues that the court has a residual discretion to decline to grant relief under* [section] *96 in light of the use of the word "may" in the opening words of the section…… The ultimate purpose of the section is to ensure that the property of a bankrupt is treated fairly and justly balancing the rights of all stakeholders. The bankrupt and his family's rights are provided for in statutory exemptions from seizure, family income rules, and in other provisions of the bankruptcy and insolvency regime.* *<u>Section 96</u> imposes a strict test to remedy non-arm's length transfers among family members. While* [section 96] *allows relief using the word "may", in my view, on proof of the requisite facts, relief should be granted at the amount calculated in accordance with the statute, in all but the most exceptional circumstances. This is especially so in the case of a non-arm's length transaction that is attacked within one year... In my view, judgment should be nearly automatic in such case."*

But this has to be contrasted with the decision of Mr. Justice Hainey in the *Mercado Capital v Qureshi*[42] decision, which took a very different approach to the interpretation of section 96 of the BIA. One hopes that any ambiguity in the use of the word "may" in section 96 of the BIA and the extent of the discretion afforded to a judge in this section will be clarified by the courts in due course, so that trustees, creditors and bankrupts alike will better understand just what assets (if any) may be transferred by a debtor to her or to his non-arm's length spouse prior to bankruptcy.

<u>Part VII. The No Benefit/No Prejudice Principle</u>

A new principle appears to be emerging as a guide for the judiciary when called upon to exercise discretion under section 96 of the BIA. Professor Roderick J. Wood appears to be the first author to identify this principle in his excellent article entitled *Transfers at Undervalue: New Wine in Old Wineskins*[43]. Somewhat ineloquently, I will refer to Professor Wood's principle as the No Benefit / No Prejudice Principle.

[41] *Supra*, note 26 @ para. 16
[42] *Supra*, note 2
[43] *Supra*, note 25 @ pp 22 - 24

In the previous chapter, judicial discretion in statutory interpretation was reviewed. This discretion must be exercised in a principled manner, so as to promote the object and scheme of the enactment in question. As suggested by Ruth Sullivan's text on the interpretation of statutes,[44] this limit on the exercise of judicial discretion can be tested by ensuring that the ultimate decision is *appropriate*, meaning that it is justifiable in terms of:

- its *plausibility*; that is, its compliance with the legislative text
- its *efficacy*; that is, its promotion of the legislative purpose, and
- its *acceptability*; that is, the outcome must follow established legal norms and must be reasonable and just.

That is, when the essential elements of a Transfer at Undervalue have been proven by a trustee or a creditor, the judicial discretion to be exercised by the court must, on the one hand, be in compliance with the wording of section 96 (be plausible), and promote the purpose of section 96 and the BIA generally (be efficacious), while at the same time the court's decision must be reasonable and just (be acceptable).

The operative words of section 96 are relatively straight-forward; impugning Transfers at Undervalue by a debtor:

- *without* proof of insolvency and *without* proof of fraudulent intent if the Transfer at Undervalue was to a non-arm's length Recipient within one year of the bankruptcy
- *with* proof of **either** insolvency **or** fraudulent intent (but not both) if the Transfer at Undervalue was to a non-arm's length Recipient between one year and five years before the bankruptcy
- *with* proof of **both** insolvency **and** fraudulent intent if the Transfer at Undervalue was to an arm's length Recipient within one year of bankruptcy.

The purpose of section 96 (within the context of the BIA) has been established to be the fair treatment of all unsecured creditors of the bankrupt estate[45] by assuring that a Recipient of a Transfer at Undervalue not be permitted to retain the property unfairly disposed of by the debtor, in priority to the other unsecured creditors of

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[44] *Supra*, note 40 @ para 2.9
[45] *Supra*, note 14 @ pg 1015

the bankrupt estate or to the prejudice of the interests of these unsecured creditors. How then is a court to make its decision plausible and efficacious while at the same time being just and reasonable?

The answer may be found in Professor Wood's No Benefit / No Prejudice Principle. It provides that when a Transfer at Undervalue is found, the court can nonetheless exercise its discretion in a principled manner:

- by refusing to order that the Recipient of the disposition reimburse the bankrupt estate if the Recipient received NO BENEFIT from the Transfer at Undervalue; or

- by refusing to void the Transfer at Undervalue if there would be NO PREJUDICE suffered or incurred by the bankrupt estate or the unsecured creditors in so doing.

The No Benefit / No Prejudice Principle allows a court to make 'appropriate' decisions that are justifiable in terms of their plausibility and efficacy (that is, following the wording of section 96 and promoting the legislative purpose) while at the same time being equitable, and ensuring a just and reasonable decision.

By way of example, in *Re Anderson*[46] the court found that a Transfer at Undervalue took place when a debtor transferred assets to a Recipient as bare trustee only. The debtor/transferor remained the beneficial owner of the property disposed of in this manner. It would have been both plausible and efficacious for the court to have ordered the Recipient to reimburse the estate for the amount transferred. However, because the Recipient received NO BENEFIT from the Transfer at Undervalue (having merely been the bare trustee of the property disposed of), it was acceptable for the court to exercise its equitable discretion by refusing to make a reimbursement order against that bare trustee Recipient. That result is clearly appropriate according to Ruth Sullivan's test and is an example of what is meant by a *principled exercise of judicial discretion*.

Similarly, in *WF Canada*[47] an Ontario court found that a Transfer at Undervalue occurred when a corporate debtor transferred money into a bank account jointly owned by a business associate of the debtor and his spouse. It would have been both plausible and efficacious for the court to have ordered that the Recipient (spouse) reimburse the estate for the amount transferred into this jointly owned bank account. However, because the Recipient spouse was not involved in the operation of this bank account and because she did not receive any of the funds that were actually deposited into this joint account, the court cited with approval the *Re Anderson* decision and held that the Recipient spouse was not required to reimburse the bankrupt estate as the Recipient spouse received NO

[46] *Re Anderson*, 2013 BCSC 317
[47] *WF Canada*, 2017 ONSC 3074

BENEFIT from the Transfer at Undervalue. This *principled exercise of judicial discretion* is also appropriate according to Ruth Sullivan's test.

This NO BENEFIT principle was approved in obiter by the Supreme Court of Canada in the *Peoples Department Store*[48] decision back in 2004.

The NO PREJUDICE principle works in a similar manner, and arises when the property disposed of at undervalue is exempt property under subsection 67(1)(b) of the BIA[49]. As an example, in Manitoba a debtor's homestead is exempt from seizure under this subsection and is therefore not distributable to the creditors of the bankrupt. The theory underlying this NO PREJUDICE principle being, of course, that if a Transfer at Undervalue of exempt property was declared void under section 96 of the BIA and the exempt assets then was returned to the trustee, the creditors of the bankrupt estate would be no better off. The creditors would not be entitled to require the trustee to liquidate the exempt asset nor to distribute the proceeds to the creditors. Accordingly, there is NO PREJUDICE to the creditors of the bankrupt estate if a court exercised its discretion and refused to void a Transfer at Undervalue of exempt property. The outcome of such a decision would meet the appropriate test laid out in Professor Sullivan's text.

The Ontario Court of Appeal in the Qureshi matter[50] recently had an opportunity to examine the extent of judicial discretion afforded to a judge when deciding whether the court ought to void a Transfer at Undervalue under section 96 of the BIA, and whether the NO BENEFIT / NO PREJUDICE principle was an appropriate tool to guide that exercise of discretion. The balance of this article will look at this Court of Appeal decision.

Part VIII. Epilogue - Mercado Capital v. Qureshi[51]

In September of 2018 the decision of the Ontario Court of Appeal in the *Mercado Capital v. Qureshi*[52] matter was released. Unfortunately, this case does not advance our understanding of section 96 in any satisfactory manner, but it does identify an unresolved conflict between family law concerns supporting economically disadvantaged spouses on the one hand, and the BIA's goal of treating equally all unsecured creditors (including spouses who may also be a creditor of the bankrupt estate).

[48] *Supra*, note 22 @ para. 92
[49] *Royal Bank of Canada v. Racher,* 2017 ABQB 181 @ para. 69
[50] *Supra*, note 4
[51] *Ibid*
[52] *Ibid*

The facts in the Qureshi matter are straightforward and may be summarized as follows:[53] Mr. Qureshi alone owned a home. It was registered solely in his name, but was used by Mr. and Mrs. Qureshi as their matrimonial home. Mr. Qureshi sold this home (with Mrs. Qureshi's consent) and the closing of this sale transaction was June 30, 2015.

Some four months earlier, in February of 2015, Mrs. Qureshi signed an agreement of purchase and sale (hereinafter called the "**Property Acquisition Agreement**") to acquire a new family home on Davina Circle on her and her husband's behalf. The closings of the sale of Mr. Qureshi's home and the purchase of Mr. and Mrs. Qureshi's Davina property under the Property Acquisition Agreement took place on the same day, being June 30, 2015, when title to the Davina property was transferred from the seller to Mr. and Mrs. Qureshi as joint tenants.

Mrs. Qureshi did not contribute any funds towards the purchase price of the Davina property. The entire purchase price was paid for by Mr. Qureshi[54] who was petitioned into bankruptcy less than one year later. It was alleged that Mr. Qureshi effected a Transfer at Undervalue less than twelve months before his bankruptcy when he used his own funds to pay for Mrs. Qureshi's purchase of her 50% interest in the Davina property.

Mr. Justice Hainey of the Ontario Superior Court dismissed the Transfer at Undervalue application by exercising the judicial discretion afforded to him by the use of the word *may* in section 96 of the BIA.[55] In doing so he relied on equitable findings of good faith of Mr. and Mrs. Qureshi, no intention to defeat creditors, and non-monetary contributions to the family unit by Mrs. Qureshi, who appeared to be an innocent spouse. Mr. Justice Hainey based the exercise of this discretion on 1995 case law[56] interpreting the now repealed section 100 of the BIA.

One of principle grounds of appeal was that the cases decided before the 2009 amendments to the BIA which included the enactment of section 96 for the first time, and which examined the extent of judicial discretion afforded to a judge by the use of the word *may* in the now repealed section 100 of the BIA, were inapplicable to the interpretation of section 96. Not only because statutes must be interpreted contextually[57], and the context of the now repealed section 100 was very difference from the context of section 96. But also, section 96 incorporates the concepts of intention and fair value into its text, which makes those equitable factors statutory imperatives. As a result, it was argued that the court ought not use intention and fair value as equitable factors in interpreting

[53] An agreed statement of facts was attached as a schedule to Mr. Justice Hainey's decision at 2017 ONSC 5572
[54] There was some controversy about a $89,000 contribution to the purchase price by Mrs. Qureshi's parents. However, nothing turns on this issue
[55] *Supra*, note 2
[56] *Price Waterhouse Ltd. v. Standard Trust Co.*, 1995 CanLII 3508 (ONCA)
[57] *Supra*, note 31

subsection 96(1)(b) (where such concepts were specifically omitted by Parliament). Additionally, extensive case law was proffered to the Court of Appeal which stand for the proposition that the discretion given to a judge in section 96 of the BIA (by the use of the word *may*) is not a broad and expansive discretion but rather, is a limited discretion that must be exercised in a principled manner; and in compliance with the legislative text in order to promote the legislative objects of section 96 and of the BIA generally.

The Court of Appeal dismissed the appeal on other grounds, and in doing so opted not to provide any guidance on the extent of discretion afforded to a judge under section 96. The question of whether a judge hearing a section 96 Transfer at Undervalue matter has as a broad and expansive discretion or alternatively, is limited to the exercise of her or his discretion in a principled manner, will have to be addressed by other courts in future cases. So, too, must we wait for another case to review and assess the applicability of the NO BENEFIT / NO PREJUDICE principle as a tool to guide a court's exercise of judicial discretion in Transfer at Undervalue matters under section 96 of the BIA.

The Court of Appeal did correctly decide that equitable title to the Davina property passed to Mr. and Mrs. Qureshi when the Property Acquisition Agreement was signed (during February of 2015) some 16 months before the bankruptcy. That is a clear statement of real property law well known to real estate practitioners. According to the Court of Appeal's reasoning, because the equitable title to the Davina property passed to Mr. and Mrs. Qureshi when the Property Acquisition Agreement was signed, the "disposition of property" (presumably from Mr. Qureshi to Mrs. Qureshi?) mentioned in the definition of Transfer at Undervalue in section 2 of the BIA also occurred in February of 2015 when Mrs. Qureshi signed the Property Acquisition Agreement.

This conclusion resulted in Mr. Qureshi's Transfer at Undervalue occurring *between one year and five years* before the bankruptcy, rather than within a one year period. This put the onus on the trustee or creditor to establish that the debtor either was insolvent or possessed a fraudulent intent at the time of the Transfer at Undervalue in February of 2015. As no such evidence was recognized, the Court of Appeal dismissed the appeal leaving the bankrupt estate some $360,000 poorer than it otherwise would have been, but for Mr. Qureshi's payment of Mrs. Qureshi's share of the Davina property purchase price on June 30, 2015, less than one year before his bankruptcy.

It appears to be strange indeed to consider the date of the acquisition of a property to be the *date of disposition* for the purposes of a Transfer at Undervalue. This reasoning ignores the factual reality that June 30, 2015, being the closing date of the Property Acquisition Agreement, was the date on which Mr. Qureshi paid the entire purchase price for the Davina property for both his half interest and also for Mrs. Qureshi's half interest, despite

Mr. Qureshi only being a 50% owner of that property (Mrs. Qureshi, of course, being the other 50% owner). It is surprising that the Court of Appeal did not find that transaction (the payment of the purchase price) to have been a disposition of property at all.

And so, in future Transfer at Undervalue cases involving the purchase of a matrimonial home and the payment of its purchased price, the question then becomes: When did the disposition of property referred to in section 2 of the BIA actually take place? Was it on the day that an agreement of purchase and sale was signed? Or, alternatively, was it when the purchase price was paid for by the bankrupt on the date of closing of the purchase transaction?

I do not see how Mr. and Mrs. Qureshi's agreement to acquire a 50% interest in the Davina property from an arm's length vendor can be said to be a *disposition of property* (or of value) from one spouse to the other. On closing many months later, Mrs. Qureshi might have paid for her interest in full (whether from her own savings or by borrowing or by gift from her parents, for example). Had Mrs. Qureshi fully paid for her own 50% interest in the Davina property, then the transaction would not have involved any section 96 issue at all. Instead however, it was on closing that Mr. Qureshi paid 100% of the purchase and essentially gifted to Mrs. Qureshi 50% of the purchase price of the Davina property. That payment by Mr. Qureshi on behalf of and for the benefit of Mrs. Qureshi is the disposition or transfer of value as between the non-arm's length parties that is of interest to the creditors of Mr. Qureshi's estate, and is impugned by the BIA.

By equating the acquisition of the Davina property some months earlier with the transfer of funds used to pay the purchase price on closing, the Court of Appeal seems to have mischaracterized the transactions and failed to consider whether the gift of one-half the value of the Davina property to Mrs. Qureshi ought to be voidable by creditors because of her non- arm's length relationship as a spouse (quite separate and distinct from any inchoate family law rights that either spouse might be entitle to).

What can one make of a decision that defines a debtor's acquisition of property as a "disposition"? This kind of Humpty-Dumpty logic[58] provides no assistance to trustees or counsel who look to judicial decisions for a better appreciation of the nuances of the BIA. Nor will this decision provide any helpful assistance in assessing future fact scenarios in order to determine whether a Transfer at Undervalue, particularly between spouses and relating to their matrimonial home, has occurred.

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[58] In Lewis Carroll's classic "*Through the Looking Glass*" Lewis Carroll's iconic character Humpty Dumpty said to Alice: "When *I* use a word …….it means just what I choose it to mean -- neither more nor less".

Of course, on a more technical note, the Court of Appeal's use of the bankrupt's *acquisition* of the Davina property as the *disposition* date appears to run afoul of the Modern Principle[59] of statutory interpretation requiring the word "disposition" (in section 2 of the BIA) to be interpreted having regard to the context in which it is used, in its grammatical and ordinary sense, harmoniously with the scheme of the act, the object of the act and the intention of Parliament.

In its grammatical or ordinary sense, *disposition* is a noun derived from the verb "*to dispose*", meaning to distribute or to get rid of. Mr. Qureshi did not dispose of (or get rid of) any of his property when the Property Acquisition Agreement was entered into. In fact, it would be more accurate to say that Mr. Qureshi *acquired* property when the Property Acquisition Agreement was entered into. These two words (acquired and disposed) are antonyms, not synonyms.

The context in which disposition is used is also relevant to its interpretation under the Modern Principle. The definition of Transfer at Undervalue in section 2 of the BIA, is:

"*a* ***disposition of property*** *……… for which no consideration is received by the debtor or for which the* ***consideration received by the debtor*** *is conspicuously less than* ***the fair market value of the consideration given by the debtor****"*.

When defining "disposition" as occurring on the date that a debtor enters into an agreement of purchase and sale, the Court of Appeal has made it impractical if not impossible to determine the quantum of *consideration received by the debtor* (on that date). And it is equally impractical if not impossible to then compare that consideration received to *the fair market value of the consideration given by the debtor*. This unusual definition of "disposition" appears to make the definition of Transfer at Undervalue in section 2 of the BIA meaningless. And, of course, it is a well-established principle of statutory interpretation that the legislature does not intend to produce absurd consequences.[60] It is not supposed to yield a result that makes the statute ineffective. Doing so has been called an "absurd" consequence.

[59] *Supra*, note 31
[60] *Supra*, Note 31 @ para 27

Interestingly, this issue (defining when a disposition occurred in relation to a purchase of real property) was considered by the Ontario Court of Appeal in a previous case[61] (although in another context). In this case Mrs. Hommel purchased a home and Mr. Hommel paid the entire cash (non-mortgaged) purchase price on the closing date. The Ontario Court of Appeal held that there was no "disposition" of the home by Mr. Hommel to Mrs Hommel, and that the only "disposition" was the payment of the cash purchase price, which the Court of Appeal said was property that passed from Mr. Hommel to Mrs. Hommel to enable the purchase to be completed.

The exact same logic applies in the Qureshi matter. The acquisition of the home when the Property Acquisition Agreement was signed was just that, an acquisition (not a disposition). And defining that acquisition date as a disposition makes it impossible to give effect to the definition of Transfer at Undervalue in section 2 of the BIA. It was only when Mr. Qureshi paid the cash (non-mortgage) portion of the purchase price to the seller, that those funds became property disposed of by Mr. Qureshi to his wife within one year of his bankruptcy.

It is important to also note that the date of the disposition issue was not argued by counsel (neither in written submissions nor at the initial hearing nor at the Court of Appeal) nor was this issue raise by Mr. Justice Hainey or by the Court of Appeal at the hearings. This issue was identified and then relied on by the Court of Appeal after oral argument, and counsel were made aware of this issue for the very first time upon reading its judgment release in September of 2018. This unusual process undertaken by the Court of Appeal was clearly a means to an end, being the dismissal of the appeal in order to assist Mrs. Qureshi who (the judges apparently considered) was an economically disadvantaged spouse in need of judicial intervention (notwithstanding the plain wording of section 96 of the BIA).

The fact that the timing of the disposition was not included in any pleadings nor raised by counsel in oral submissions (nor raised by any of the judges at all) is important because in prior cases, the Ontario Court of Appeal has stated emphatically that judicial findings and conclusions ought to be based on the evidence and on the pleadings as well as submissions of counsel. And that it is procedurally unfair and a denial of natural justice for a court to do otherwise.[62] Yet this is exactly what the Court of Appeal has opted to do in the Qureshi matter.

[61] *Re: Hommel Estate*,1953 CanLII 139 (ON CA)
[62] *Moore v. Sweet*, 2017 ONCA 182 @ para. 39

My last comment relates to the references to family law issues raised by the courts in the Qureshi matter and to the protection of economically disadvantaged spouses, which seems to have been the guiding principle underpinning both the lower court and Court of Appeal decisions.

It goes without saying that Mrs. Qureshi added value to her marriage and to her family unit. So did Mr. Qureshi, for that matter. That premise, that both spouses are deemed to have contributed equally to the marriage (financially or otherwise) is embodied in subsection 5(7) of the *Family Law Act*[63] and is the reason why each spouse is entitled to the equalization of net family assets under that enactment. The Court of Appeal quoted a rather lengthy passage from the *Re: Cameron*[64] decision dealing with spousal non-monetary contributions. What is disconcerting about the Court of Appeal's comments from the *Re: Cameron* case is:

- these comments considering spousal non-monetary contributions are *obiter*, meaning that they are not part of the pith and substance of the rationale for the Court of Appeal's decision. At the same time, these comments were neither explanative nor relevant to the manner in which the Qureshi matter was ultimately decided

- the *Re: Cameron* decision (quoted from by the Court of Appeal) deals with the death of a spouse who owned real estate as a joint tenant with the surviving spouse. On the spouse's death, the real property held by the spouses (as joint tenants) automatically vested in the surviving joint tenant. The language dealing with spousal contributions in *Re: Cameron* was also *obiter*, and was used to explain why it was fair for the law to permit a surviving spouse (who did not contribute to the purchase of a property) to nonetheless become the sole owner of that property by right of survivorship on the death of the other.

The purpose for the Court of Appeal to have included these *Re: Cameron* comments at all is therefore an enigma, as they do not contribute to the court's decision that the *disposition of property* took place when the Property Acquisition Agreement was signed.

The essence of the Qureshi matter was whether a debtor (Mr. Qureshi) ought to be permitted to unilaterally reduce his net worth (and the value of his bankrupt estate) by paying (less than one year before bankruptcy) the entire purchase price of a new family home while putting half of the ownership of that home into the name of his (non-bankrupt) spouse? That lessening of the bankrupt estate and the corresponding increase in the non-

[63] *Family Law Act*, RSO 1990, c F.2
[64] *Supra*, note 20

bankrupt spouse's net worth prejudices the creditors of the bankrupt while at the same time gives the recipient spouse a priority over those creditors to the extent of the assets so transferred. The effect of the BIA on economically disadvantaged spouses has been litigated previously in Ontario, when a spouse with a judgment for an equalization payment against a bankrupt spouse attempted to obtain a proprietary interest in the bankrupt's assets or to seek some other priority over the other unsecured creditors. The courts have had the following comment:

- Ontario is an equalization of net family assets and not a division of property jurisdiction. As a result, the *Family Law Act* is considered by the courts to be a complete code for the distribution of assets between spouses upon the breakdown of a marriage. And Ontario courts have cautioned against awarding property interests to separated spouses in all but the most extraordinary of cases, lest the courts unwittingly turn Ontario into a division of property regime[65]

- the Supreme Court of Canada[66] cited with approval an Ontario Court of Appeal[67] case each deciding that a spouse who is an unsecured creditor of a bankrupt under a judgment for an equalization payment can get no proprietary interest and no priority interest in the bankrupt estate's assets – and, in fact, cannot obtain any preferential treatment at all - over and above the interests of the other unsecured creditors

- the Supreme Court of Canada[68] noted that when equitable help from the courts is sought by a spouse who is a creditor, the courts must always look to the effect on third parties of the requested equitable order sought – referring, of course, to the third party creditors of the bankrupt estate. In denying equitable assistance to the spouses, the Supreme Court of Canada noted that it is up to Parliament to reverse the priorities enjoyed by the bankrupt estate over those of any one creditor

- the Supreme Court of Canada[69] has also made it clear that that courts should not use the law of equity to re-arrange the priorities that Parliament has established because that is a matter of policy where the courts must defer to the legislature.

[65] *Thibodeau v. Thibodeau*, 2011 ONCA 14
[66] *Schreyer v. Schreyer*, 2011 SCC 35
[67] *Supra*, note 15
[68] *Supra*, note 15
[69] *Sun Indalex Finance, LLC v. United Steelworkers*, 2013 SCC 6 @ para. 82 and 178

In conclusion, while the reasons for the decisions in the Qureshi matter (lower court and Court of Appeal) are, at least in this writer's opinion, less than savory, both decisions appear to be premised on the need for the courts to assist an economically disadvantaged ex-spouse, notwithstanding the wording of section 96 of the BIA. What affect then will this decision have on future Transfer at Undervalue litigation?

While no one can predict the future with any degree of certainty, I do not believe that the Qureshi case should act as a deterrence to any trustee or creditor in most Transfer at Undervalue matters. Section 96 of the BIA is still very powerful legislation. Trustees and creditors can use its powers to have courts take away assets from third party Recipients and to return those assets to the bankrupt estate or to the creditor directly. My firm has successfully litigated a number of section 96 applications over the past couple of years with literally hundreds of thousands of dollars being paid by Recipients to bankrupt estates and to creditors.

Perhaps the only qualification would be when the asset sought to be recovered is an interest in a matrimonial home that was given by the debtor to, and is now owned by, an economically disadvantaged ex-spouse and this interest in the matrimonial home is the only asset of the recipient ex-spouse. While the BIA is supposed to be blind to the type of asset improperly given away by the debtor, the emotional pull of taking the matrimonial home away from an ex-spouse – especially when it is the ex-spouse's only asset, appears to be too great. Of course, it is trite to say that hard cases make bad law. I suppose that the Qureshi matter is just that, a hard case. I do not envision the Qureshi matter being of significant probative value in future Transfer at Undervalue matters where the fact are not identical, and thus the Qureshi decision will, from a practical point of view, not have the weight of a precedent. This will allow future cases to be determined on their merits and hopefully more consistently with the vast majority of section 96 cases cited, where the BIA goals of protecting creditors were held to be paramount.