

UNCERTAINTY SURROUNDING ASSET PROTECTION

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The refusal of the Supreme Court of Canada earlier this year to grant leave to appeal a decision from the British Columbia Court of Appeal may make it more difficult in the future for individuals and businesses to plan their affairs and protect their assets.

The decision in the case, *Botham Holdings Ltd. (Trustee of) v. Braydon Investments Ltd.*, held that the transfer of assets from Botham Holdings Limited (BHL) to Braydon Investments Limited (Braydon) was a fraudulent conveyance and was void as against the claims of a bankruptcy trustee, *even though it was conceded that there was no fraudulent intention*. In 2004, BHL sold one of several properties it owned, triggering a large capital gain tax obligation. To reduce this exposure, BHL invested as a general partner in a car leasing business that would generate capital cost allowance claims which would offset the capital gain and enable BHL to receive a refund of the tax it had paid.

Unwilling to leave other assets in BHL, its principal, William Botham, “rolled” the remaining holdings out of BHL to a newly formed company, Braydon Investments. At the time of the rollover the car leasing business was not under financial pressure. Eventually, however, the car leasing business did fail, BHL went bankrupt, and its creditors looked to Braydon to satisfy the liabilities.

In the original B.C. Supreme Court trial, Mr. Botham gave evidence that the establishment of Braydon was intended to take advantage of the taxfree roll over available under the *Income Tax Act* and to remove assets from the reach of future creditors of the newly formed car leasing business (which was then solvent). The bankruptcy trustee conceded that Mr. Botham had no dishonest intent to defraud creditors. Despite this lack of intent on the part of Mr. Botham, the trial judge concluded that the asset transfer was a fraudulent conveyance.

Deliberating on this apparent inconsistency, the British Columbia Court of Appeal framed the question as: “. . . whether a transfer of property made with a view to protecting assets from creditors, present or future, if made honestly, without moral blameworthiness, and for other legitimate business purposes, is prohibited by the *Fraudulent Conveyance Act*.”

The statutory provision that the Court of Appeal had to consider was Section 1 of this Act, which reads in part:

... if made to delay, hinder or defraud creditors ... a disposition of property ... is void and of no effect against a person ... whose rights and obligations by collusion, guile, malice or fraud are or might be disturbed, hindered, delayed or defrauded, despite a pretence or other matter to the contrary.

The Court of Appeal cited numerous cases in support of its interpretation and reviewed the history of the Act to its genesis (the 1571 *Statute of Elizabeth*). The heart of the Court's analysis considered what meaning, if any, be given to the words "by collusion, guile, malice or fraud" (the 1571 Statute made such transfers a crime and included these exact words as required evidence of *criminal* intent). The Court concluded that the cases it reviewed supported the legislation's remedial purpose and essentially ignored these words. Consequently the words no longer perform a meaningful function in the text and should be struck.

The proof of the required intent, the Court held, need not be direct evidence — intent could be demonstrated by drawing an inference from the transferor's conduct, the effect of the transfer, or other circumstances. Accordingly, when the transfer of assets from one person to another results in the transferor's assets becoming unavailable to creditors, this effect may be all that is needed to prove the requisite intent within the Act.

Additionally, as in Mr. Botham's situation, protecting one's assets from creditors need not be the only or even the primary purpose of the transfer. As the result can be proof of the intent, any transfer that has the effect of delaying, hindering or defrauding creditors can be a fraudulent conveyance and thus void and of no effect against creditors.

Following this ruling it appears that a person's act whose effect is to "put one's assets out of the reach of one's creditors" is now all that is necessary to ensnare a transaction in the modern version of the *Fraudulent Conveyance Act*. No further dishonest or morally blameworthy intent is required. This decision raises a serious question — how does someone now include the time honoured goal of creditor proofing in his or her financial planning efforts?

The Court's ruling specifically stated that BHL could have limited its liability by incorporating a new company to enter into the partnership; however, this adds little clarity since this maneuver would not have achieved BHL's tax saving objectives which drove the entire transaction. It should also be noted that the transfer was made *after* BHL entered the leasing business and the relevant business financing was in place. It is reasonable, therefore, to assume on general business principles that, if the transfer had taken place *before* BHL started the leasing business and acquired the debt, the Court's ruling might have been different, though this is not clarified in the decision.

The Court's decision that the *Fraudulent Conveyance Act* applies to future creditors, as well as its finding that dishonest intent is not necessary to invoke the Act, is far reaching and troubling in the

context of financial and business planning. The prudent implication is that all rollovers, freezes and business reorganizations must deal with the spectre of a future challenge under the Act by unforeseen future creditors.

Moreover, current business decisions must include consideration of past transactions due to the retroactive effect of the decision. On first reading, the case would appear to put a serious dent in the well established business goal of asset protection. Until the broad ambit of the *Botham* decision is tempered, it would appear to inject substantial uncertainty into both past and future business planning processes.

The Court's decision suggests that (at least until it is further clarified and, hopefully, limited) farsighted proactive planning is now a necessity for persons wishing to limit the exposure of their assets to current or future creditors. They should also recognize that reorganizing their assets for tax purposes may have expensive unforeseen consequences.

Finally, the criteria set out in Section 2 of the *Fraudulent Conveyance Act* were not examined. It appears that a transfer of assets "for good consideration and in good faith lawfully transferred to a person who, at the time of transfer, has no notice or knowledge of collusion or fraud" remains valid. Even so, it would appear to be a necessary implication that the meaning of "fraud" in Section 2 requires reexamination to conform with the decision in *Botham*.

The decision also raises an interesting issue relating to lawyers' conduct. The *Professional Conduct Handbook* holds that a lawyer "must not engage in any activity that the lawyer knows or ought to know assists in or encourages any dishonesty, crime, or fraud, *including a fraudulent conveyance, preference, or settlement.*" [authors' emphasis]

Arguably, a lawyer ought to be aware that any asset transfer, business plan or reorganization could, under *Botham*, be later held to be caught by the Act. Given the uncertainty introduced by *Botham*, it is to be hoped that the words "fraudulent conveyance" are intended to only be applicable as a subcategory of "dishonesty, crime, or fraud." In other words, the client's expressed intention remains relevant in assessing the solicitor's conduct. It is also to be hoped that this can be clarified promptly by the Benchers of the B.C. Law Society.