

## BANKRUPTCY—PRESSURE AS A DEFENCE—FRAUDULENT PREFERENCES

Consideration should be given as to whether the Courts and the profession have appreciated and implemented the radical changes made in the law by virtue of what is now Section 64(2) of the present 1952 Bankruptcy Act,<sup>1</sup> which reads as follows; and was first enacted in Canada in 1919:

Where any such conveyance, transfer, payment, obligation or judicial proceeding has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed *prima facie* to have been made, incurred, taken, paid or suffered with a view to giving such creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be receivable or avail to support such transaction.

This was the first time in this type of fraudulent preference legislation that an onus in favour of the trustee was created in bankruptcy legislation.

The question arises as to what evidence can be raised to rebut the *prima facie* case of fraudulent preference or, in other words, what are the defences to rebut a *prima facie* presumption.

There has been a series of legislative enactments in England dealing with what would be classified as "voluntary" preferences and there does not seem to be a divergence of views in respect to those types of transactions which are of any importance. One must consider what type of transactions there are other than voluntary ones. One would normally come to the conclusion that there is probably only one other type and that is an "involuntary" preference because that is the only alternative to a "voluntary" preference.

In connection with Section 64(2), one would question significance of the words "or not" in the phrase "voluntary or not". Unfortunately, there do not appear to be any cases which assist us with regard to the words "or not", but it could probably safely be assumed that these words "or not" were put in more for emphasis than anything else. They don't really add anything to the section and would seem to strengthen the argument that there are only two types of cases, namely:

1. Voluntary.
2. Under Pressure.

The most significant thing about the sub-section is the clause "evidence of pressure shall not be receivable or avail to support such transaction." However, in some instances, our courts have held that the debtor did not have a view to give a creditor a preference and those decisions, in essence, are made notwithstanding what sub-section 2 says.

Not only does sub-section 2 provide for a *prima facie* case of preference; it also distinctly provides that evidence of pressure shall not be receivable. However one might conclude from some of our decisions that evidence of pressure has been used by the courts to make a ruling that the debtor did not have a view to give a creditor a preference. It could be said that the question is bypassed or ignored. It is suggested that the court should not approach the words "with a

<sup>1</sup> Bankruptcy Act, R.S.C. 1952, c. 14.

view to giving such creditor a preference" in a manner which results in the court taking into consideration "pressure".

The writer realizes that on a strict reading of sub-section 2, it becomes almost impossible to rebut this *prima facie* presumption because it is so difficult to conceive of any case which does not have an element of pressure in it. One should also be aware of what constitutes or what is meant by "pressure". It is, therefore, necessary to consider some legislative and case history in order to understand this situation.

Section 92 of the Bankruptcy Act, 1869 of Great Britain<sup>2</sup> reads as follows:

Every conveyance or transfer of property, or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken or suffered by any person unable to pay his debts as they become due from his own monies in favour of any creditor, or any person in trust for any creditor, with a view of giving such creditor a preference over the other creditors, shall, if the person making, taking, paying, or suffering the same become bankrupt within three months after the date of making, taking, paying, or suffering the same, be deemed fraudulent and void as against the trustee of the bankrupt appointed under this Act; but this section shall not affect the rights of a purchaser, payee, or incumbrancer in good faith and for valuable consideration.

By comparing this Section 92 with our Section 64, for all practical purposes, the situation can be resolved into this position:

1. That Section 92 has the following words:  
"but this section shall not affect the rights of a purchaser, payee or incumbrancer in good faith and for valuable consideration."  
Whereas Section 64 has no such proviso.
2. That Section 92 of the Act of Great Britain has no Statutory onus benefit of that which is equivalent to Section 64(2) of our act.

The first important case to consider is the decision of the House of Lords in *William Butcher v. Lawrence and Henry Stead*.<sup>3</sup> From the facts, it can readily be ascertained that the person preferred was entirely without knowledge or even suspicious of the true state of the debtor's circumstances.

In summary, the case concluded that the transaction clearly came within Section 92 of the Bankruptcy Act of 1869, and the only question was to determine whether the creditor was entitled to the benefit of the proviso which was contained in Section 92 of that Act. On the facts, the transaction was *bona fide* and the only remaining problem was as to whether it was for valuable consideration. While it may be difficult to accept that under these circumstances, valuable consideration could merely mean the discharge of an old debt, that is what the court held. It is certainly very interesting to read in this connection the dissenting judgment of Lord Selborne:<sup>4</sup>

After a careful consideration of the 92nd and 95th sections, I have been unable to satisfy myself that it was really the intention of the legislature, in such cases, to give effect to preferences, by the debtor, of favoured creditors (being creditors for valuable consideration) as against the principle of equal distribution in bankruptcy, merely on the ground of passive good faith on the part of such favoured creditors. The 95th section seems to me to be that which was intended to draw the line between those *bona fide* dispositions of the bankrupt's property, by payments or otherwise, which ought generally to be protected, and fraudulent preferences; and I should have been myself very much

<sup>2</sup> Bankruptcy Act, 32 and 33 Victoria, c. 71.

<sup>3</sup> (1874-75) L.R. 7 H.L. 839.

<sup>4</sup> *Id.*, at 852.

disposed to think that the words "a purchaser, payee, or incumbrancer, in good faith and for valuable consideration," in the 92nd section, might properly be construed as requiring, to constitute the "rights" thereby intended to be saved, not merely passive good faith on the part of any creditor for value, but some distinct consideration for the purchase, payment, or incumbrance—distinct (I mean) from the original debt; and which new consideration might proceed either from the creditor himself or from any person claiming (in good faith) under him.

The situation is very well summed up in the comments of the Lord Chancellor (Lord Cairns) where he says:<sup>5</sup>

My Lords, I cannot doubt that there was in this case, within the meaning of the 92nd section of the Bankruptcy Act of 1869, a payment, made by a person unable to pay his debts as they became due, from his own moneys, in favour of a creditor, with a view of giving that creditor (along with several others) a preference over other creditors; and that, if there was nothing more in the case, inasmuch as the person making the payment became bankrupt within three months, the payment must be deemed fraudulent and void as against the trustee of the bankrupt.

I do not forget the observations made by the counsel for the Respondents, that the goods supplied to the bankrupts, in respect of which the debt arose, were supplied in order to enable them to carry on their trade, and after they had fallen into the state of insolvency contemplated by the section in question. If the goods had been supplied for ready money, if the money had been taken in exchange for the goods, it might well be that the exchange of goods for ready money would have negatived the inference of a fraudulent preference. But the goods were here credited upon credit, and although the bankrupts, by obtaining credit on the pretence of carrying on business, might, if that pretence was false, and if a jury should not be satisfied they had no intent to defraud, have made them liable to punishment for a misdemeanour, the subsequent payment for the goods so supplied on credit, might not the less be a preference of the particular creditor, which would be deemed fraudulent and void.

The question, and the only question, appears to me to be whether the transaction, being a fraudulent preference so far as the bankrupts were concerned, is, by the last words of the 92nd section, protected quoad the Respondents, the recipients of the payment, who, as is admitted, had no knowledge of the fraudulent preference which was intended.

There is no doubt that the 92nd section of the Act of 1869 introduced a considerable change into the law on this subject. Before the Act of 1869, payments by way of fraudulent preference were held to be void, but were not forbidden by any express enactment; and the Act of 1869, possibly because the administration of bankruptcy was for the future to be taken in great part away from the Court, and placed in the hands of trustees, appears, in the case of fraudulent preferences and many other similar cases, to have endeavoured to reduce into definite propositions the law that hitherto had to be derived from a comparison of decided cases. The Act, however, did not profess to express the existing law without making considerable changes in it. In the case of fraudulent preference, for example, in place of raising an inquiry whether it was done in contemplation of bankruptcy, the Act provided certain definite tests, namely, that the bankrupt should have been at the time unable to pay his debts, as they became due, from his own moneys, and that he should become bankrupt within three months from the date of payment. The Act appears to have left the question of pressure as it stood under the old law. . . .

The section, however, contains at the end of it a provision which appears to me to introduce a new ingredient into the consideration of fraudulent preferences. Before the Act of 1869, if a payment had been made of a debt without pressure and in contemplation of bankruptcy, it would have been a fraudulent preference, even although the person receiving the payment did not know that he was being fraudulently preferred.

Particular note should, therefore, be taken of the fact that the House of Lords ruled that the question of pressure stood as it existed under the old law and that the new Act did not change that question of pressure.

Contrast this with our sub-section 2 of Section 64 which clearly excludes elements of pressure to support a transaction. In understanding

<sup>5</sup> *Id.*, at 845.

what the word "pressure" means, it is respectfully submitted that it does not have to be *de facto* pressure by the creditor, but can be any set of circumstances, whether or not it has anything directly or indirectly to do with the creditor, that puts pressure upon the debtor.

The House of Lords in the case of *Sharp v. Jackson*<sup>6</sup> reiterated the position that the question of pressure remained as it was under the old law before the 1869 Act and followed the *Butcher v. Stead*<sup>7</sup> case referred to above.

Distinctly on the question of "pressure" in the *Sharp v. Jackson* case, Earl Halsbury says:<sup>8</sup>

Just let us see what the facts were in that case. There was no threat and no application for payment of the debt coupled with anything which involved legal procedure or anything of the sort, but as a matter of fact the bankrupt in her own mind, from a mistaken sense of what was going to be done, thought that legal proceedings were going to be taken; and the assumption of the Court is that it was that mistake that induced her to do the thing. Lord Mansfield says: "A bankrupt when in contemplation of his bankruptcy cannot by any voluntary act favour any one creditor; but if, under fear of legal process, he gives a preference, it is evidence that he does not do it voluntarily." There is the principle stated—it is not a voluntary act; and, as Lord Cairns says, the word "preference" here imports in it the voluntary act of a person who can do either the one thing or the other as he prefers. Lord Mansfield proceeds: "And though the defendant in this case had taken no steps to secure himself, in case he was called upon, yet the bankrupt, acting from mistake, was under the same apprehensions of legal process as if the defendant had actually threatened her; so that her executing the warrant of attorney was not a voluntary act, but the effect of fear, however groundless that might be." My Lords, it seems to me that after that decision, which as I say, has now lasted more than a hundred years, and has never, so far as I know, been controverted or qualified, it is idle to suggest that you must have an actual threat or the actual pressure of a creditor.

And later:<sup>9</sup>

It becomes then no longer a voluntary act, but an act under pressure—pressure not the less because it is pressure upon his own mind and his own consciousness—from an apprehension of what will happen if bankruptcy takes place; not a pressure by threats of creditors to assert their rights.

A mere demand by the creditor without even a threat of legal proceedings is sufficient pressure to rebut the presumption of a preference.<sup>10</sup>

In view of the nature of pressure, it is quite difficult to reconcile some of the decisions which have been made. In *Re: Webb*, Orde J. says:<sup>11</sup>

While the evidence is not wholly satisfactory, I have come to the conclusion upon it that Lloyd was not really aware of Webb's insolvent condition when he took the assignment. The mere fact that a man is financially embarrassed is not of itself evidence of insolvency, and there is nothing improper in a creditor's pressing for payment of an overdue account, or, failing to get payment, pressing for and obtaining some security therefor. That a creditor presses for and takes security to protect himself in the event of a possible insolvency goes without saying; all security is really given for that purpose.

It is significant to note that in the case of *Re Progressive Farmer's Company Limited, Ex parte Brown Brothers & Burnstad Limited*,<sup>12</sup> it was ruled that a debtor's motive in giving a preference was to secure an

<sup>6</sup> [1899] A.C. 419.

<sup>7</sup> (1874-75) L.R. 7 H.L. 839.

<sup>8</sup> [1899] A.C. 419 at 425.

<sup>9</sup> *Id.*, at 426.

<sup>10</sup> See the case of *G. F. Stephens v. Colin McArthur and James Worthington* (1891) 19 S.C.R. 446—a decision dealing with the Manitoba Act.

<sup>11</sup> (1924) 2 C.B.R. 16 at 20.

<sup>12</sup> [1923] 1 W.W.R. 833.

extension of time which could not be secured without giving a preference, was under the equivalent of Section 64(2) not available to support the transaction.

In the case of *Ex Parte Taylor Re Goldsmid*,<sup>13</sup> it is important to note the comments of Lord Esher, M. E.:

He was actually threatened with a criminal prosecution before a magistrate.

The creditor won that case, it is submitted, because there was pressure and pressure was not excluded at that time under English jurisprudence.

The case of *Jackson v. Sharp*<sup>14</sup> was a case of a breach of trust similar to *Ex Parte Taylor*.<sup>15</sup> The result was the same, of course, and for the same reasons.

It is submitted that the case of *Salter & Arnold v. The Dominion Bank*,<sup>16</sup> in spite of its general comments, is not of much assistance in respect to this matter, because it really involves a question of set-off, which under certain circumstances would have been permissible under Section 65(3) of the Bankruptcy Act.

It is also suggested that the case of *Canadian Credit Men's Association v. Jenkins*,<sup>17</sup> is questionable because not only does it deal with the Assignment Preferences Act of Ontario,<sup>18</sup> but quite clearly, from the headnote provides:

... that both parties to the chattel mortgage honestly believed during the whole period of the payments that the chattel mortgage was a valid and binding security and that the debtor made the payments in reduction of the amount secured in the honest belief that he was merely fulfilling his obligation to the defendant and thereby preventing the seizure and sale of his operating plant and other chattels; and those circumstances are sufficient to rebut any presumption of intention to give a preference.

It is submitted that his belief that he is preventing a seizure and sale of his operating plant and chattels is pressure.

The case of *Re R. O. Clay & Sons, Ex Parte The Trustee*,<sup>19</sup> was decided under the Bankruptcy Act of 1883 and, of course, the question of pressure was still available as a defence. Consequently, one should be aware of the comments of Vaughan Williams, J.:

... but that the payment was made with the view of enabling the trader to continue carrying on business, because if he did not pay it, he could not continue to carry on business.<sup>20</sup>

And further:

... one must take into consideration the fact that the man, though at the time he knew himself to be insolvent, was intending to carry on the business; and to carry on business, even with the most willing, would have been rendered an impossibility if it had been known that these traders had given a bill at six months which had been dishonoured. That would have been fatal at once, and, therefore, whether they knew they were insolvent or not, does not conclude the question. Their knowledge of their financial condition—their insolvency must be looked at in the light of the fact that they were continuing to trade, and that unless they met this bill they would be cut off from the possibility of trading any longer.

13 (1886) 18 Q.B.D. 295.

14 [1899] A.C. 419.

15 (1886) 18 Q.B.D. 295.

16 [1926] S.C.R. 621.

17 (1928) 10 C.B.R. 77.

18 Assignment and Preference Act, R.S.O. 1927, c. 162. (Now R.S.O. 1960, c. 25.)

19 (1895) 3 Mans. 31, D.C. 5 Empire 901.

20 (1895) 3 Mans. 31, 34.

One must appreciate also that in the case of *Ex Parte Blackburn. Re: Cheesebrough*,<sup>21</sup> there are certain comments about dealing in the ordinary courts of business, but one must appreciate that this, in essence, goes to the problem of the proviso to Section 92 of the 1869 Act and the words "in good faith and for valuable consideration". So the question of payments in the ordinary course of business should not be a defence in respect to Section 64 of the Act, but in practice, may be.

It is respectively suggested that the case of *Re: Shaughnessy Super Market and Codville Company Ltd.*,<sup>22</sup> was wrongly decided and does not give a proper attention to the problem of pressure as set forth in Section 64(2).

There are some interesting comments in the judgment of Mr. Justice Nitikman:<sup>23</sup>

Codville began pressing for payment in full, threatening otherwise to take proceedings to close the business.

And later:

Their view was not to prefer Codville over other creditors; their only purpose was to compromise a lawsuit and to continue in business. The debtors were not actuated by any feelings of friendship towards Codville. Their acts were purely self-serving.

And further down:<sup>24</sup>

They hoped that by arranging for discontinuance of the lawsuit they would be able to remain in business and perhaps yet make a success of it.

Contrasting this with the decision of *Sharp v. Jackson*<sup>25</sup> as to what constitutes pressure, it is respectively submitted that the doctrine of pressure was not properly applied. Similar comments can be made in respect to the case of *Re Blenkar Planner Ltd.*<sup>26</sup>

In referring to the case of *Re Arthur J. Lennox Contractors Ltd. No. 2*,<sup>27</sup> Justice Nitikman,<sup>28</sup> quotes from part of it:<sup>29</sup>

It does not seem to me to go any further than to indicate a strong desire on the part of the creditor to protect himself and the desire on the part of the debtor to meet the demand of the creditor, to make the payment required and be able to carry on business in the ordinary way.

Again in connection with the *Eastern Trust Company v. Bank of Nova Scotia*,<sup>30</sup> Justice Nitikman<sup>31</sup> quoting from that case includes this part:<sup>32</sup>

Mr. Stewart, the aunt's solicitor, it was who alone directed the payment to the bank because of his information that the bank was enforcing its security.

Further down, Mr. Justice Nitikman's in his own comments sums up:<sup>33</sup>

That is, that the payments were made in order for the debtors to be able to carry on business in the original way.

While it is not particularly applicable, it is of interest to note the case of the *Molson's Bank v. Edward Halter and Moses E. Wismer*,<sup>34</sup>

21 (1871) L.R. 12 Eq. 358.

22 (1963) 37 D.L.R. (2d) 524.

23 *Id.*, at 525.

24 *Id.*, at 532.

25 [1899] A.C. 419.

26 (1968) 26 W.W.R. 168, 37 C.B.R. 141.

27 (1959) 38 C.B.R. 125.

28 (1963) 37 D.L.R. (2d) 524 at 534.

29 (1959) 38 C.B.R. 125 at 128.

30 (1956) 5 D.L.R. (2d) 138, 36 C.B.R. 77.

31 (1963) 37 D.L.R. (2d) 524 at 535.

32 (1956) 5 D.L.R. (2d) 138 at 144.

33 (1963) 37 D.L.R. (2d) 524 at 535.

34 (1891) 18 S.C.R. 88.

dealing with the Assignments and Preferences by Insolvent Persons Act of Ontario<sup>35</sup>—the headnote says:

. . . the preference provided against in the statute is a voluntary preference and a conveyance obtained by pressure from the grantee would not be within its terms.

And further on . . .

. . . the fear of penal consequence was sufficient pressure on him to take from the mortgage the character of a voluntary preference.

It is submitted also that the case of *Robert Gibbons, Assignee of the Estate of Andrew Morrison, and Insolvent v. Lewis McDonald and John C. Heffernan*,<sup>36</sup> is a decision again on the problem of preference in regard to the Ontario Act, which, in essence, confirms the position that pressure is a defence under the Ontario Act and since there was pressure in the *Gibbons v. McDonald* case then, of course, the creditor succeeded.

It is interesting to note in the case of *A. H. Boulton Company Limited v. The Trusts and Guarantee Company Limited*<sup>37</sup> better known as *In Re Bozanich*, that Chief Justice Duff says:

It is proper to assume that it was the statute as it had been construed by the English courts and applied in the administration of bankruptcy law in England that Parliament intended to adopt.

The Canadian Parliament in 1919,<sup>38</sup> in deliberately putting in a section negating pressure as a defence certainly must be deemed to have drastically altered the law and yet, as can be seen from the above, it is questionable as to whether it has had much, if any effect, in accomplishing that purpose.

—NEIL V. GERMAN, Q.C.\*

<sup>35</sup> Assignment and Preferences by Insolvent Persons Act, R.S.O. 1887, c. 124.

<sup>36</sup> (1892) 20 S.C.R. 587.

<sup>37</sup> [1942] S.C.R. 130.

<sup>38</sup> *Id.*, at 135.

\* B.A., LL.B. (Alta.) of the Alberta Bar (German, Coady & Goodfellow, Calgary).

## LETTER TO THE EDITOR

The Editor  
Alberta Law Review

Dear Sir:

I have read with interest the illuminating article by Stephen J. Skelly on "Refusal of Sexual Intercourse and Cruelty as a Ground for Divorce", (1969) VII Alta. Law Rev. 239, in which the recent English case law on the subject is examined.

It might be helpful in this connection to draw attention to the recent decision of the English Court of Appeal in *Slon v. Slon* [1969] 2 W.L.R. 375, [1969] 1 All E.R. 759 (C.A.), where it was held that unreasonable refusal of sexual intercourse, even without consequential injury to health, may amount to expulsive conduct and thus constitute constructive desertion.

H. R. HAHLO,  
Director,  
Institute of Comparative and Foreign Law,  
McGill University,  
Montreal.