# FRAUDULENT CONVEYANCES: SELF DEFENCE 101

**Ian Speers**

While fraud involving real estate has become something of a hot-button issue of late, it is by no means new. Fraudulent conveyances -- dealing with property, real or personal, in such a way to try to put it beyond the reach of creditors -- have centuries of legal history behind them, stretching back to English legislation from 1571.[1] *Twyne's Case*, still one of the fundamental decisions underpinning the area of law, is more than 410 years old.[2]

The purpose of the paper is not to condense four-and-a-half centuries of substantive law into a six-minute presentation; rather, it seeks to provide an essay of a solicitor's professional obligations, in the context of substantive law, when approached by a client seeking to make a potentially fraudulent conveyance.

## FRAUDULENT CONVEYANCES ACT

Fraudulent conveyances in Ontario are governed by the *Fraudulent Conveyances Act ("FCA")*, the key provision of the act being set out section 2:

> Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties or forfeitures are void as against such persons and their assigns.[3]

Under the *FCA*, a conveyance with fraudulent intent, made without consideration, may be reversed by a creditor. Conveyances made for good consideration, to a third party without notice, are not subject to such reversal. The burden of proving fraudulent intent rests with the creditor seeking to reverse the conveyance.

## A TYPICAL SCENARIO

In carrying on a general conveyancing practice, the writer has encountered prospective clients trying to find a lawyer to help put property beyond the reach of creditors.

In a typical scenario, the prospective client is being chased, often sued by creditors and wishes to protect his or her property by being removed from title in favour of a close friend or relative. In more creative conditions, the prospective client wishes to strip virtually all equity from the property by having a relative take a mortgage on the property for an unusually large sum. Speedy turn-around is essential.

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[1] 13 Eliz 1, c 5
[2] (1601), 76 E.R. 809
[3] RSO 1990, c. F 29, s. 2

## BADGES OF FRAUD

In four centuries of jurisprudence, courts have identified factors that may show that a transaction is fraudulent in intent. These are commonly referred to as "badges of fraud". Although there is no universally accepted list of these badges, they have been summarized and cited by Ontario courts as follows:

> The judges in *Twyne's Case* listed six 'signs and marks of fraud' present in the facts before them:
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> (1) The gift was general 'without exception of his apparel, or any thing off necessity'.
> (2) The donor continued in possession and used the goods as his own, including selling them.
> (3) The transaction was secret.
> (4) The transfer was made pending the writ.
> (5) The transfer amounted to a trust of the goods 'and fraud is always apparelled and clad with a trust, and a trust is the cover of fraud'.
> (6) The deed contained the self-serving and unusual provision 'that the gift was made honestly, truly, and bona fide'.
>
> Later judges and writers have added other fact situations which raise one's suspicions of fraud:
>
> (7) The deed gives the grantor a general power to revoke the conveyance.
> (8) The deed contains false statements as to the consideration.
> (9) The consideration is grossly inadequate.
> (10) There is unusual haste to make the transfer.
> (11) Some benefit is retained under the settlement by the settlor.
> (12) Cash is taken in payment instead of a cheque.
> (13) A close relationship exists between the parties to the conveyance.[4]

While these badges will not be discussed in any great detail herein, they are included as part of a general reference.

The earlier example of a prospective client seeking to transfer or encumber title to evade obvious creditor(s) is something of an extreme example. The purpose of the client's proposed conveyance, and thus the lawyer's potential retainer, can have little hope of not offending the *FCA*. The creditors already exist, and in the stated situation, are pursuing the debtor. Multiple badges of fraud are present. The writer can see no reasonable redeeming spin to be put on the proposed conveyance, and has declined all such proposed retainers.

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[4] *Canadian Imperial Bank of Commerce v. Graat* (1992), 5 B.L.R. (2d) 271 at para. 45 (Ont. Gen. Div.), quoting from C.R.B. Dunlop, *Creditor-Debtor Law in Canada* (Toronto, Carswell, 1981)

## CREDITORS

What of a situation in which there are no creditors at the time of the conveyance? Or if the transfer is made in contemplation of segregating assets from claims of future creditors? In isolation, one might plausibly (and wrongly) deduce that creditors not in existence at the time of the conveyance cannot have recourse to the provisions of the *FCA.*

The intent of the grantor at the time of the conveyance has proven critical to court decisions on fraudulent conveyances. The mere effect of placing property beyond a current or future creditor's reach is not it itself sufficient to prove this intent[5], but it may factor into a more detailed analysis of the *mens rea* of the grantor.

In *Canadian Imperial Bank of Commerce v. Boukalis*[6], the British Columbia Court of Appeal rejected the notion that a creditor must have existed at the time of the conveyance to be able to set a side it aside. Instead, the Court interpreted the wording of that province's *Fraudulent Conveyances Act*, and held that the language "creditors and others" may include those who might become creditors after the conveyance.[7]

In *Boukalis*, the defendant had given a second mortgage to his brother while his business was failing, in the process exhausting the equity in the encumbered property, and rendering the security of the plaintiff (also the first mortgagee) inadequate to cover amounts owing. The defendant's intent at the time of making the conveyance proved determinative in determining the conveyance to be fraudulent:

> It is a question to be decided upon the proper inference to be drawn from the facts and circumstances of the particular case as to whether there was an intention to defeat creditors or not, and if there was the intention to defeat creditors, then it does not matter whether it was to defeat present or future creditors.[8]

As the BC and Ontario acts contain the same language, *Boukalis* has been followed in Ontario.[9]

Conveyances that put a businessperson's property beyond the reach of future creditors (what today is often branded as an "asset protection" plan, devised by lawyers or other professional advisors) have likewise long attracted negative treatment by the courts, if there is a future shielding of the asset intended:

> A voluntary settlement whereby the settlor takes the bulk of his property out of the reach of his creditors, shortly before engaging in trade of a hazardous

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[5] see *Commerce Capital Mortgage Corp. v. Jemmett* (1981), 37 C.B.R. (N.S.) 59 at para 51 (Ont. SC)
[6] (1987), 44 RPR 55 (BC CA); leave to appeal refused by SCC
[7] i*bid*., at 59
[8] *ibid.*, at 63, quoting from *Newlands Sawmills Ltd. v. Bateman* (1922), 31 BCR 351 at 354 (BC CA)
[9] e.g. *Prodigy Graphics Group Inc. v. Fitz-Andrews*, [2000] OJ No. 1203 (Ont. SCJ); Pirbhai v. Singh, 2012 ONSC 345 (CanLII)

> character, may be set aside in a suit on behalf of creditors who become such after the settlement, though there are no creditors whose debts arose before the date of the settlement, and though when the settlement was made it was doubtful whether the arrangements under which the settlor was to engage in the business would take effect. ***10***

The breadth of this traditional approach has been mitigated by the Ontario Superior Court of Justice decision in *Genereux v. Carlstrom*[11]. In this case, the defendant had transferred his title interest in a matrimonial home to his wife for nominal consideration, having specifically become aware that his business structure potentially exposed the asset to future creditors. His creditors at the time of the conveyance were minimal, and there was no finding that the conveyance was intended to defeat their claims. Despite the defendant having a clear and express desire to shield assets from future liabilities, the Court found that the requisite intent of fraud was lacking, as the defendant "had an income and prospects of future income sufficient to meet his current and anticipated liabilities"--a reasoning that was affirmed by the Ontario Court of Appeal in a brief oral endorsement.[12]

In expanding on this reasoning, the trial-level judge distinguished earlier case law to note that the circumstances surrounding the specific conveyance did not show evidence of a conscious attempt to evade liabilities that might otherwise have precluded the defendant from restructuring his assets at that time:

> In the authorities cited to me, I see nothing to prevent a person from reordering his affairs to isolate his personal assets from future, as opposed to present, liabilities to creditors generally provided it is not established that the settlor had reason to believe at the time of the settlement that his creditors at the time or within the near to intermediate future in respect of a specific risk or risky enterprise would cease to be able to look to the settled assets.[13]

As such, while the intent of the transfer was clearly to put the asset beyond the reach of future creditors, the absence of knowledge of future financial deficiencies did not make the transferor's intent rise to that of a fraudulent conveyance against future creditors.

The decision has not been widely considered in other cases[14], but it remains good law. (It also bears note that the creditor seeking to reverse the conveyance in *Genereaux* was, in fact, the solicitor who had acted on the transfer, and was seeking to secure an unpaid account that had arisen post-transfer.)

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[10] *Ottawa Wine Vaults Co. v. McGuire* (1912), 27 O.L.R. 319 (Ont. CA) at pp. 322-323, quoting from a headnote to *Mackay v. Douglas* (1872), L.R. 14 Eq. 106

[11] *Genereux v. Carlstrom*, [2002] OJ 1841 (Ont. SCJ)

[12] *ibid.*, at para 45; Genereux v. Carlstrom, 2003 CanLII 27023 (Ont. CA)

[13] *Genereux v. Carlstrom*, *supra*, note 11, at para 46

[14] The writer can find two decisions that consider it, one of which, *Woodley v. Edwards* (2002), 32 B.L.R. (3d) 155 (Ont. SCJ), is more widely cited in secondary literature, though not in any located reported court decisions, but lacks *Genereux's* analysis of the underlying case law

Post-*Genereux*, the availability of the *FCA* to future creditors creates a more nuanced balancing act of trying to determine the mind of the grantor at or about the time of the conveyance. By extension, the lawyer acting at the time of the conveyance may be well advised to take steps to determine this state of mind before proceeding.

## PROFESSIONAL OBLIGATIONS

In considering how to approach potentially fraudulent conveyances, a lawyer must be mindful of obligations under the *Rules of Professional Conduct.* Particularly pertinent are the following portions of Rule 2.02:

> (5) A lawyer shall not:
> (a) knowingly assist in or encourage any dishonesty, fraud, crime, or illegal conduct;
> (b) advise a client or any other person on how to violate the law and avoid punishment.
>
> (5.0.1) A lawyer shall not act or do anything or omit to do anything in circumstances where he or she ought to know that, by acting, doing the thing or omitting to do the thing, he or she is being used by a client, by a person associated with a client or by any other person to facilitate dishonesty, fraud, crime or illegal conduct.
>
> (5.0.2) When retained by a client, a lawyer shall make reasonable efforts to ascertain the purpose and objectives of the retainer and to obtain information about the client necessary to fulfill this obligation.

It is the writer's position that Rules 2.02(5) and 2.02 (5.0.1) bar a lawyer from participating a conveyance that is definitively fraudulent in nature. Likewise, Rule 2.02 (5.0.2) places an onus on the lawyer to take steps to determine why he or she has been retained in each and every retainer. Enquiring as to the purpose of the retainer may reveal whether a lawyer may be professionally prohibited from acting as requested.

Independent of these professional obligations, a lawyer may find itself at the receiving end of a lawsuit if actively participating in a fraudulent conveyance.

In *Canbook Distribution Corp. v. Borins*[15], which saw creditors seeking to set aside a grant of security alleged to be fraudulent, the creditors sought damages against the law firm that had acted for the debtor at the time of the alleged fraudulent conveyance. The reported decision adjudicated (and rejected) a motion for summary judgement made by the law firm. As such, while it did not address whether the lawyers were liable to these specific creditors, it conceded that the firm might be liable in circumstances of recklessness or wilful blindness being established:

[15] (1999), 45 O.R. (3d) 565(Ont. SCJ)

> Any liability on the part of [the lawyers] would have to be founded, assuming that fraud or breach of fiduciary duty on the part of the Borins defendants will be established, on a finding that [the] lawyers were reckless or wilfully blind in the manner in which they participated in the challenged transaction granting security.[16]

It also bears mention that if a *prima facie* fraudulent conveyance is made out, solicitor-client privilege may be set aside by the courts in relation to communications relating to the impugned transaction.[17] One should therefore not take any comfort in any misguided hope that legal advice relating to a potentially fraudulent conveyance will be beyond scrutiny by the courts.

Dove-tailing with Rule 2.02 (5.0.2), the writer thinks it clear that there is an onus on real estate solicitors not to participate blindly in conveyances that might be (or clearly are) in contravention of the *FCA*. It is not sufficient to tell one's client, "I don't want to know."

The writer does not propose that the intention of the Rules, or *Canbook*, is to force the solicitor acting in each and every real estate transaction to act as an inquisitor of every new client, seeking to disprove a rebuttable presumption that each transaction is prima facie fraudulent. The Rules require "reasonable efforts"; *Canbook* requires an absence of recklessness and wilful blindness.

Rather, the writer's view of the appropriate standard is for a conveyancing lawyer to be aware of the badges of a fraudulent conveyance, and, if they are evident in a transaction, make and document appropriate enquiries to show that the lawyer has satisfy himself or herself that the intent underlying the conveyance is not inappropriate. In the absence of such comfort, or in the face of evasive client responses, it may be prudent (or even required) for the lawyer to decline to participate in the conveyance.

Certain classes of transactions should attract a higher level of scrutiny as a matter of form, because of the inherent presence of badges of fraud. In a general conveyancing practice, the most common would include the following:

- Non-arms-length transfer removing a party from title
- Intra-familial (and other non-arm's-length) mortgages

Both of these classes of conveyances can have entirely innocent intent, and the greater majority of them doubtless are without a hint of fraud, but these represent the simplest way for a debtor to put assets beyond the reach of creditors.

Unless the principles in *Genereux* are expressly overturned, the writer believes that a lawyer might safely act on a certain transfers of a proactive asset-protection nature against future creditors, but it is incumbent upon any solicitor so acting to take steps to

[16] *ibid.*, at para 22
[17] see Prudential Securities Credit Corp. v. Cobrand Foods Ltd., 2003 CanLII 25725 at para 2 (ON SCJ)

become intimately familiar with the client's current and foreseeable financial outlook in relation to creditors, and be satisfied that the client is not in any risk of defaulting on current or foreseeable creditors. In light of *Genereux* standing somewhat alone in the wilderness, it would also be more than prudent to advise the client that the conveyance may not be beyond attack by future creditors. The lawyer may also wish to expressly clarify in the client retainer that the lawyer's advice will be predicated on the client having made a complete and honest disclosure of his or her affairs.

There can be any number of grey areas that do not offer easy answers, many which come up with some frequency. What of a new mortgage lender in a refinance insisting that a spouse be removed from title because he or she has a poor credit rating and/or unsatisfactory debt-to-income ratio? Presumably the lender's concern about party coming off title often relates to actual, current creditors. The mortgage may be for good consideration, but what of the transfer? Certainly, if the purpose of the transfer is to pay off all of the creditors of the indebted spouse's the transaction may well be entirely appropriate, but what of a transaction with no debts being paid off and the owners pocketing the money? Further enquiries as to the intent of the parties would certainly be merited in such circumstances.

More than anything else, the foregoing discussion on fraudulent conveyances underscores our professional responsibility to be engaged in, and take steps to have an understanding of our conveyancing retainers. Even a superficially simple "quickie title transfer" contains potential landmines.

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