BIA and CCAA "Lookback Periods" for Preferential Transactions

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Lenders should be cognizant that the granting of security by a debtor may be subject to challenge as a fraudulent preference in the event the debtor subsequently files for liquidation or proposal proceedings under the *Bankruptcy and Insolvency Act* (Canada) (the “BIA”) or restructuring proceedings under the *Companies’ Creditors Arrangement Act* (Canada) (the “CCAA”). Such risk arises if the debtor is insolvent the time the security was granted. Accordingly, lenders would be prudent to request financial and other information from the debtor to ascertain the debtor’s financial health prior to entering into any such transaction.

Challenging a Transaction as Preferential

A Trustee in bankruptcy or a proposal Trustee may challenge the granting of security by an insolvent debtor as a fraudulent preference under Section 95 of the BIA. Similarly, a CCAA Monitor may also challenge such a transaction as the CCAA incorporates by reference the BIA preference provisions. In order to challenge any such transaction, the Trustee or Monitor must establish a *prima facie* case that the following three factors exist:

1. the debtor was insolvent at the time of the transaction;
2. the transaction took place during the applicable statutory review period; and
3. the transaction was taken with a view to giving that creditor a preference over other creditors as discussed in more detail below.

If the court is satisfied that this onus has been met, the onus then shifts to the transferee/creditor to rebut the presumption of a fraudulent preference. At that point the court will review the evidence adduced by the transferee/creditor to see whether it rebuts that *prima facie* case. To be successful, the transferee/creditor must convince the court, on a balance of probabilities, that at least one of the three factors did not exist when the debtor made the payment. If the court concludes that there has been a fraudulent preference, the transaction will be void as against the Trustee (or Monitor in a CCAA proceeding).

The Applicable Lookback Period

The applicable lookback period will be three months from the initial bankruptcy event (being the date of bankruptcy, BIA proposal proceedings or CCAA proceedings, as applicable) if the creditor receiving the alleged preference was dealing at arm’s length with the debtor, or one year from the initial bankruptcy event if the creditor receiving the alleged preference was not dealing at arm’s length with the debtor. Related persons are deemed not to be dealing at arm’s length with one another absent evidence to the contrary. With respect to unrelated persons, it is a question of fact whether they were dealing at arm’s length at any particular point in time. Two parties will be deemed to be related if they are under common *de jure* control of the same entity or group of entities.

In connection with arm’s length transfers, transactions that have the effect of giving a creditor a preference during the avoidance period are, in the absence of evidence to the contrary, presumed to have been made with a view to giving such creditor a preference. The transferee/creditor must establish that there was no dominant intention on the part of the debtor to prefer one creditor over another, based on an objective assessment of the debtor’s circumstances at the time the debtor made the alleged preference.

In connection with non-arm’s length transfers, the debtor’s intention during the avoidance period is irrelevant - one only considers whether the impugned transaction had the effect of giving the transferee/creditor a preference over other creditors.

In the ordinary course where security is taken in connection with a new lending relationship with a new advance and does not secure past indebtedness, preference risk is reduced.

Transfers at Undervalue – "TUV"

One should note that in addition to the foregoing, a Trustee (or Monitor in a CCAA proceeding) may also attempt to challenge the granting of security as a transfer at undervalue ("TUV") in accordance with the test set out in Section 96 of the BIA and incorporated by reference into the CCAA. This TUV concept is still a relatively new one and it is unclear how broadly the courts will interpret its scope when considering transactions that are already covered by preference provisions. The applicable lookback period for TUVs is one year before the initial bankruptcy event, if the parties are dealing at arm's length, the debtor was insolvent at the time of the transfer and the debtor intended to defraud, delay or defeat its creditors. For parties that are not dealing at arm's length, the applicable lookback period is one year regardless or five years if the debtor was insolvent at the time of the transfer and intended to defraud, delay or defeat its creditors.