

Fraud and Bankruptcy

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Bankruptcy

Presented by:

Craig McMahon

Field LLP

Calgary, Alberta

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Bankruptcy is a process intended to give the “honest but unfortunate debtor” financial rehabilitation and a second chance, economically. But what about those debtors that are something less than honest or unfortunate and are simply using bankruptcy to absolve themselves of past transgressions? In an effort to balance society’s interests to provide financial rehabilitation and economic second chances and not letting those who have committed fraud to be seen to get away with it, the legislators drafted provisions in the *Bankruptcy and Insolvency Act*¹ (the “*BIA*”) to deal with these individuals. For example, there are provisions allowing a creditor’s judgments against the bankrupt in fraud to survive bankruptcy and voiding preferential payments and transfers of assets by a debtor prior to bankruptcy.

This paper reviews the *BIA* with respect to fraud and the various tools provided to trustees and creditors under the *BIA*.

1. Fraud, Misrepresentation, and Discharge from Bankruptcy

If a creditor can establish that a bankrupt has committed a fraud in relation to their claim against the bankrupt, that creditor can argue that the bankrupt’s discharge should be refused, suspended or granted conditionally under s.173(1)(k) and/or that such creditor’s claim survive any discharge under s.178(1)(d) and (e) of the *BIA*.

Section 173(1) provides a list of fifteen facts, which if proved, allow for a bankrupt’s discharge from bankruptcy to be refused, suspended or granted conditionally. Among the facts is s. 173(k), “the bankrupt has been guilty of any fraud or fraudulent breach of trust”.

Under s. 178, an order of discharge does not release the bankrupt from specified debts, liabilities, fines and penalties. Pursuant to s. 178(1)(d) and (e), debts or liabilities arising out of fraud, fraudulent misrepresentation, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity survive a discharge from bankruptcy. This means that the creditor can pursue the bankrupt after the bankrupt and the trustee have obtained their discharge from bankruptcy and the general stay of enforcement provided by s. 69 to s. 69.3 is lifted.

In a recent decision, the Registrar opined that the appropriate time for a creditor (who has no fraud judgment) to bring an application to declare that its claim survives bankruptcy pursuant to s. 178(1)(d) is at the bankrupt’s discharge from bankruptcy unless the creditor can show prejudice and equitable grounds for proceeding earlier.² Prejudice and equitable grounds are the conditions required under s. 69.4 of the *BIA* to lift a stay of enforcement.

1.1 Proving Fraud

What does a creditor have to prove in fraud? In a criminal context, the legal requirements to prove fraud are:

1. evidence of the prohibited act (e.g. deceit, falsehood, etc.);
2. an actual loss or other deprivation suffered by, or at risk to, a victim;
3. the fraudster’s knowledge of his actions; and

¹ R.S.C. 1985, c. B-3.

² *Re Bischke*, 2011 ABQB 422.