

BUSINESS OWNERS AND THEIR CREDITORS

The Implications of Insolvency

Dennis Kish and Robert Ryan

Anne's business, Trucking Inc., has hit hard times: customers aren't paying their bills and debts are mounting. Anne is considering having Trucking Inc. file for protection under the *Bankruptcy and Insolvency Act*. One of Trucking Inc.'s creditors is Anne's father, Bill, who loaned Trucking Inc. \$50,000 to help it get started many years ago. Bill didn't ask for any security on the loan, such as a mortgage or a security agreement. Anne is also considering having Trucking Inc. transfer a truck worth about \$50,000 to Bill before the bankruptcy in repayment of his loan.

However, in the eyes of the law, Bill is an unsecured creditor and should be treated the same as Trucking Inc.'s other unsecured creditors. Therefore, if Trucking Inc. transfers the truck to Bill in repayment of his loan before the bankruptcy, the transfer may be attacked by the bankruptcy trustee as a "preference". Because Anne is Bill's daughter and is the owner of Trucking Inc., Bill is not at "arm's length" to Trucking Inc. As a result, if the transfer to Bill takes place within 12 months of the bankruptcy and has the effect of preferring Bill over Trucking Inc.'s other creditors, the bankruptcy trustee may bring a legal action against Bill to recover the truck or recoup the \$50,000. If Bill were at "arm's length" to Trucking Inc., then the trustee would be able to bring a legal action only if the transfer occurred within three months of the bankruptcy. If Bill is forced to return the truck to the trustee, he may file a proof of claim in Trucking Inc.'s bankruptcy for the \$50,000, but he will likely receive only pennies on the dollar—or even nothing—in the bankruptcy.

Both Anne and Bill need to be aware of the implications of the *Bankruptcy and Insolvency Act*. A preference can be a payment made by an insolvent debtor to an unsecured creditor with the intent—or merely the effect—of giving preferential treatment to that creditor over the other creditors. Under recent amendments to the *Bankruptcy and Insolvency Act*, a preference can also be a cash payment or a "provision of services", a term that has not yet been defined in the courts. There are also several other very important amendments to the Act.

Anne and Bill should have considered using a legal strategy to protect Bill. For example, Bill could have required Trucking Inc. to grant him a security interest in the truck when he lent Anne the \$50,000. Had he done so, and followed all the rules necessary to ensure that his security interest was perfected, then the transfer of the truck to Bill would likely not have



been considered a preference and would have been protected from the trustee in bankruptcy.

While the economy seems to be recovering, many businesses continue to struggle financially and will need to make decisions about the future of their businesses and assets. If you have any questions about bankruptcy and insolvency law or your position as a debtor or creditor, you should get professional advice on your rights and obligations immediately.



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