Date of Release: March 5, 1992

No. 139190 3580/91
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN BANKRUPTCY

1992 CanLII 203 (BC S.C.)

IN THE MATTER OF THE BANKRUPTCY OF K.S. & D. ENGINEERING LTD.	REASONS FOR JUDGMENT OF THE HONOURABLE MR. JUSTICE DONALD (IN CHAMBERS)

Counsel for Trustee in Bankruptcy, Price Waterhouse Limited:	J.J. Shatford & Angela Thiele
Counsel for Hongkong Bank of Canada:	Clive S. Bird
Counsel for Wai Kin Wong:	H. Dahmi
Counsel for Elite Bailiff Services Ltd. and Zom Parelli Construction Ltd.:	Colleen J. Cattell
In person:	Gino Ferranato
Dates and Place of Hearing:	January 17 & February 7, 1992 Vancouver, B.C.

The Trustee in Bankruptcy and the Hongkong Bank of Canada apply pursuant to s. 95 of the ***Bankruptcy Act***, R.S.C. 1985, c. B-3 to set aside a distress sale of the bankrupt's assets which occurred two days prior to the making of bankruptcy and receiving orders in this proceeding by Master Patterson on January 10, 1992.

The Hongkong Bank of Canada held a General Security Agreement, a general assignment of book debts, and a s. 178 ***Bank Act*** security

in relation to the bankrupt. It appointed Price Waterhouse Limited as receiver of the bankrupt on December 19, 1991 under the authority of the General Security Agreement when the bankrupt failed to meet a demand by the bank for payment of monies due. Master Patterson appointed Price Waterhouse Limited as trustee in bankruptcy on January 10, 1992.

Wai Kin Wong is the sole officer, director and shareholder of the bankrupt.

Zom Parelli Construction Ltd. was the bankrupt's landlord. It engaged Elite Bailiff Services ltd. to seize the bankrupt's assets under a distress warrant for overdue rent and to sell those assets. Elite sold them to Gino Ferranato.

ISSUES

There are two principal issues in this application:

1. Do the provisions of s. 95 of the ***Bankruptcy Act*** render the sale void as a deemed fraudulent preference?

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2. If the sale is void, can the Trustee recover the assets under ss. 98(1) & (2) of the ***Act*** or is it limited by s. 98(3) to recovery of the sale proceeds only?

I have decided that the sale is void and that the Trustee can recover the assets rather than just the sale proceeds. It is, therefore, unnecessary for me to decide an additional issue raised by the applicants namely, whether the distress was rendered invalid when the landlord changed the locks on the premises.

RELEVANT ENACTMENTS

Section 95 of the ***Act*** provides:

> 95. (1) 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 insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving that creditor a preference over the other creditors shall, if the person making, incurring, taking, paying or suffering it becomes bankrupt within three months after the date of making, incurring, taking, paying or suffering it, be deemed fraudulent and void as against the trustee in the bankruptcy.
>
> (2) Where any conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in subsection (1) has the effect of giving any creditor a preference

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> over other creditors, or over any one or more of them it shall be presumed, in the absence of evidence to the contrary, to have been made, incurred, taken, paid or suffered with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be admissible to support the transaction.
>
> (3) For the purposes of this section, the expression "creditor" includes a surety or guarantor for the debt due to the creditor. R.S., c. B-3, s. 73.

If the transaction or process is void then s. 98 applies. It reads as follows:

> 98. (1) Where a person has acquired property of a bankrupt under a transaction that is void or under a voidable transaction that is set aside and has sold, disposed of, realized or collected the property or any part thereof, the money or other proceeds, whether further disposed of or not, shall be deemed the property of the trustee.
>
> (2) The trustee may recover the property or the value thereof or the money or proceeds therefrom from the person who acquired it from the bankrupt or from any other person to whom he may have resold, transferred or paid over the proceeds of the property as fully and effectually as the trustee could have recovered the property if it had not been so sold, disposed of, realized or collected.
>
> (3) Notwithstanding subsection (1), where any person to whom the property has been sold or disposed of has paid or given therefor in good faith *adequate valuable consideration*, he is not subject to the operation of this section but the trustee's recourse shall be solely against the person entering into the

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> transaction with the bankrupt for recovery of the consideration so paid or given or the value thereof.
>
> (4) Where the consideration payable for or on any sale or resale of the property or any part thereof remains unsatisfied, the trustee is subrogated to the rights of the vendor to compel payment or satisfaction. R.S., c. B-3, s. 76 [Emphasis added].

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The definition of the key phrase in ss. 3 "adequate valuable consideration" can found in s. 97(2):

> (2) The expression "adequate valuable consideration" in paragraph (1)(c) means a consideration of fair and reasonable money value with relation to that of the property conveyed, assigned or transferred, and in paragraph (1)(d) means a consideration of fair and reasonable money value with relation to the known or reasonably to be anticipated benefits of the contract, dealing or transaction.

Section 70(1) gives precedence to receiving orders and assignments in bankruptcy in these terms:

> (1) Every receiving order and every assignment made in pursuance of this Act takes precedence over all judicial or other attachments, garnishments, certificates having the effect of judgments, judgments, certificates of judgment, judgments operating as hypothecs, executions or other process against the property of a bankrupt, except those that have been completely executed by payment to the creditor or his agent, and except the rights of a secured creditor.

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The principal contention advanced on behalf of the landlord and bailiff is that since the distress of the assets occurred in August, 1991, more than three months before the receiving order, and the proceeds of the distress sale were paid before that order was made:

1. the process falls outside the three month period provided in s. 95(1);

2. it was "completely executed" within the meaning of s. 70; and,

3. the presumption of fraudulent preference under s. 95(2) is rebutted by the fact that distress was taken several months before bankruptcy.

FACTS

The facts are:

1. The bankrupt was a small boat manufacturer carrying on business on property in Surrey owned by the landlord.

2. When the bankrupt fell into arrears of rent in the amount of $111,791.70, the landlord had the bailiff levy a distress against the bankrupt's assets on the leased premises. The distress warrant is dated August 6, 1991.

3. Discussions between the representatives of the bankrupt and the landlord resulted in an understanding that the bankrupt would pay $50,000 by October 1991 and the landlord would take no steps to sell the assets. The bailiff did not remove any of the assets from the premises.

4. On December 10, 1991 the bank issued a demand to the bankrupt for payment of $305,000. On December 19, having received no payment, the bank appointed Price Waterhouse Limited as receiver under the General Security Agreement.

5. The bankrupt ceased business in mid-December.

6. The receiver changed the locks on the premises on December 23, as part of taking control of the business and gave a copy of the keys to the landlord.

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7. On the landlord's instructions the bailiff changed the locks again later that day but did not inform the receiver.

8. When the receiver returned to the premises on January 6, 1992 he found the locks changed.

9. The bailiff says it warned the receiver that it was going to sell the assets under a distress warrant.

10. The receiver disagrees and says his solicitor was induced by the bailiff to believe that the application for receiving order could be safely be made on January 10, when in fact the bailiff intended to sell the assets beforehand and did so on January 8. Had the receiver known of the bailiff's true intentions, the application would have been brought ahead.

11. Gino Ferranato, the buyer, first looked at the assets on December 16, 1991. The next dealings he had with the landlord and bailiff were on January 8. They were eager to make a sale in order to recover what rent they could before bankruptcy. The deal with the buyer was made on a single day. The buyer paid $71,000 plus tax for the assets.

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12. The bailiff produced two appraisals:

(a) Marvel Auctions Ltd. purporting to be made on January 3, sworn on January 9, expressing an opinion of value in the amount of $70,130;

(b) Auctogon Sales Corp. (a related company of the plaintiff's) purporting to be made on January 2, also sworn on January 9, giving a value of $69,100.

Section 8 of the ***Rent Distress Act***, R.S.B.C. 1979, c. 362, requires that two appraisals must be obtained before sale and that they must be sworn.

13. The assets consist of office furnishings and equipment, manufacturing equipment, shop tools, forklifts, and 63 boats in various stages of completion.

14. The applicant's filed the following evidence of value:

(a) Coopers & Lybrand valuation dated January 20: appraising the "hard" assets at $103,330;

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(b) United Welco Auctions Ltd. valuation dated January 20 giving a value of $50,000 for the 63 boats alone; and,

(c) a firm offer from Kaiser International Development Ltd. dated January 24 to buy the assets for $150,000.

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ANALYSIS

Preference

The landlord and bailiff argue that since the distress was levied on August 6, 1991 the process fell outside the three month period set by s. 95(1). The fact that the sale pursuant to the distress occurred within the period does not invalidate the process. They refer to a number of cases where the courts have upheld the validity of lending transactions where the monies were advanced before or during the period and security was given after the period began: ***Re Blenkarn Planer Limited*** (1958), 37 C.B.R. 147 (B.C.S.C.); ***Re Mac-Wall Contracting Limited*** (1970), 14 C.B.R. (N.S.) 52 (Ont. S.C.); ***Re Viteway Natural Foods Ltd.*** (1986), 63 C.B.R. (N.S.) 157 (B.C.S.C.); and ***Re Port Hardy Properties Ltd.*** (1985), 56 C.B.R. (N.S.) 117 (B.C.C.A.).

In those cases the presumption of fraudulent preference was rebutted by a demonstration that the lending was *bona fide* and the security was a legitimate part of that lending; therefore, the security was not granted "with a view" to giving a preference.

I find that those cases are not analogous to the circumstances at bar. The facts in the instant case plainly show that the landlord and bailiff made the sale in a great hurry precisely for the purpose of getting paid before other creditors. This is wholly unlike a lending transaction for purposes related to the business of the bankrupt.

The contention that the distress taken in August established a preference in favour of the landlord at that point cannot hold. While it is true that the distress was never formally released, the landlord took no steps to complete the process by selling the assets until bankruptcy was imminent. The landlord was quite content to stay its hand and await the outcome of the bankrupt's efforts to save its business. I find that the distress was not complete until the sale occurred and that, therefore, the process is caught by the three month rule. Section 70 exempts from bankruptcy those processes "completely executed" before receiving orders are made. Distress is not completely executed until the

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proceeds of sale are in the hands of the bailiff: ***Re Southern Fried Foods Ltd.*** (1976), 21 C.B.R. (N.S.) 267 (Ont. S.C.) at p. 269.

Distress in this case was completely executed two days prior to bankruptcy, but the timing does not assist the landlord. The British Columbia Court of Appeal has held that the three month rule in s. 95 takes precedence over s. 70(1), so that even completely executed processes come within s. 95. In ***Thorne, Ernst & Whinney Inc. v. Gazzola*** (1986), 60 D.L.R. (4d) 590 (B.C.C.A.), Hinkson J.A. said at p. 594:

> When s. 70 and 95 are read in the context of the Act as a whole, in my opinion, while s. 70(1) is unqualified, it is nevertheless subject to the provisions of s. 95 when the bankruptcy occurs within three months after the completely executed transaction.

Where the effect of a distress is to grant a preference to a landlord, it falls upon him to rebut the presumption of a fraudulent preference by showing that it was not his intention by taking the process to achieve a preference. In this case, the landlord did not completely execute the distress until after the three month period began and so it is unable to take advantage of s. 70(1). ***Gazzola****, supra*, stands for the further proposition that the party obtaining the preference bears the onus of rebutting the presumption of intent under s. 95(2): see p. 595. As earlier

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stated, the completion of the process at the time and in the way it was done makes it obvious that the landlord intended to get the jump on the other creditors. The fact that the process began several months earlier does not help the landlord in rebutting the presumption. What is relevant is the landlord's intention at the time that the impugned process is completed. In this case the landlord's intention obviously changed from the point at which he was prepared to accept a payment from the bankrupt and to hold the distress in abeyance; it changed in a hurry so that the landlord could obtain a preference - the very thing that s. 95 was designed to prevent. For these reasons I hold that the sale is void.

Recovery: Assets or Proceeds?

The question to be determined is whether Mr. Ferranato paid a fair and reasonable money value for the assets as the phrase "adequate valuable consideration" is defined in s. 97(2). If he did the trustee can recover only the proceeds of sale from the landlord or its agent, the bailiff; if he did not, then the trustee can recover the assets themselves.

What value is fair and reasonable can vary with the circumstances. In ***Westinghouse (Canada) Limited v. Caldwell*** (1979), 31 C.B.R. (N.S.) 276 (B.C.S.C.) Taylor J. (as he then was)

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construed the words "fair and reasonable relative value" as used in s. 4(1) of the ***Fraudulent Preferences Act***, R.S.B.C. 1960, c. 156, in such a way as to accommodate different conditions of sale. He rejected the contention that the phrase was equivalent to "market value". He observed at p. 286 that a forced sale of assets by a debtor on the brink of insolvency is less likely to fetch as good a price as one conducted "without duress and by a solvent owner", and held that a less than market price but one that might reasonably be expected given the conditions, was sufficient to comply with that ***Act***.

The landlord, bailiff and Mr. Ferranato argue that the sale should stand because the price was reasonable for a quick distress sale.

I am unable to apply the reasoning in ***Westinghouse***, *supra*, to these facts because the landlord and bailiff created the conditions of sale that they now use to explain the price paid for the assets. There is no evidence that other buyers were sought or that the assets were otherwise exposed to the market. Mr. Ferranato was persuaded to buy them in one day. The circumstances show great haste. The time pressure on the vendors occurred because of their desire to accomplish the sale and obtain a preference which the ***Bankruptcy Act*** deems fraudulent. Hasty action taken in pursuance

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of a fraud cannot justify a price lower than that which would have been obtained in a more orderly sale.

Counsel referred to ***Cameron v. Eldorado Properties Ltd.*** (1980), 22 B.C.L.R. 175 (S.C.) at p. 180, where Locke J. (as he then was) referred with approval to the following passage taken from 13 ***Hals***. (4th) 185-6, para. 372:

> "The distrainor is not bound to calculate very nicely the value of the property seized. He must take (due) care that a reasonable proportion is kept between the value of the property and the sum for which he entitled to take".

That was a case for damages against a landlord for irregular distress. At bar the problem of value does not go to the regularity of the distress. The standard for determination here is that set by the ***Bankruptcy Act***, in particular, s. 98(3) "adequate valuable consideration" and which is defined in s. 97(2) as "fair and reasonable money value".

Each side challenges the other's evidence of value. While I am suspicious of the genuineness of the bailiff's appraisals, I find that the applicant's valuation done by Coopers & Lybrand can also be questioned on the basis that the value assumes that the machinery could be used in a fibreglass moulding process which Mr.

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Wong, the principal of the bankrupt, controls. He may not permit a buyer to use the process. The other valuation by United Appraisals deals only with the boats. As such it is incomplete and leaves me to guess at the value of the balance of the assets. The most reliable evidence comes from the unconditional offer by Kaiser International Developments Ltd. to buy the assets for $150,000. I accept that as the value of the assets.

The finding that the assets are worth $150,000 makes it impossible to say that the bailiff sold the assets for adequate valuable consideration. An arms length offer for twice the amount paid shows how unreasonable and inadequate the consideration was. In the result, I hold that the Trustee can recover the assets themselves.

The applicants ask for special costs because of the circumstances of the sale and, in particular, the bailiff's alleged trick in misleading counsel for the bank in order to get time to sell the assets before bankruptcy. I give the applicants the option of taking an order for costs at Scale 3 or speaking further to a claim for special costs. If the latter course is taken, they will have to provide the court with a basis for resolving the conflicting versions on the affidavits. I am unable to decide on the present state of the evidence whether the bailiff engaged in

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sharp practice. The parties have leave to cross-examine the deponents who swore affidavits addressing that subject.

There shall be judgment accordingly.

"IAN DONALD, J."

Vancouver, B.C.
March 5, 1992

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