

The Treatment of *Ipsa Facto* Clauses in Canada

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Résumé de l'article

Lorsqu'un débiteur devient insolvable, qu'il s'agisse d'un individu ou d'une institution financière complexe, la question se pose à savoir si son insolvabilité affecte les droits des parties avec lesquelles le débiteur a conclu un contrat. La partie non-défaillante pourrait-elle ainsi mettre fin ou modifier le contrat sur la base de l'insolvabilité du débiteur? Pourrait-elle demander un paiement accéléré? Il est commun que les parties maintiennent leurs droits contractuels à travers des clauses *ipsa facto*, leur permettant de modifier, de mettre fin aux contrats ou de demander un paiement accéléré lorsqu'une autre partie au contrat devient insolvable. Malgré de récentes modifications à la *Loi sur la faillite et l'insolvabilité (LFI)* et à la *Loi sur les arrangements avec les créanciers des compagnies (LACC)*, la validité des clauses *ipsa facto*, en dehors du contexte des contrats dérivatifs, est un problème qui n'a pas encore été adressé en profondeur par la doctrine canadienne. Cet article retracera le parcours du principe légal de non-appauvrissement en Angleterre, ayant abouti à la Cour suprême du Royaume-Uni dans l'arrêt *Belmont Park Investments PTY Ltd. v. BNY Corporate Trustee Services Ltd. and Lehman Brothers Special Financing Inc.*, avant d'examiner dans quelle mesure les modifications récentes à la *LFI* et à la *LACC* ont supplanté la règle de *common law* au Canada à ce sujet. La *LFI* et la *LACC* ont toutes deux invalidé les clauses *ipsa facto* dans plusieurs situations, exceptés pour les cas de faillite d'entreprise et de mise sous séquestre. Cet article analysera finalement les exceptions codifiées aux principes de *common law* et l'intégration potentielle à la jurisprudence canadienne de certaines modifications de la règle du non-appauvrissement introduites par Lord Collins dans l'arrêt *Belmont*.

THE TREATMENT OF *IPSO FACTO* CLAUSES IN CANADA

*Adrienne Ho**

Whether a debtor is an individual or a sophisticated financial institution, a common issue that arises is whether its insolvency alters the rights of the parties with whom the debtor has entered into contracts. Could the non-defaulting party to the contract, on the basis of the debtor's insolvency, terminate or amend the contract? Could it demand accelerated payment? Many parties preserve contractual rights, through what are commonly known as *ipso facto* clauses, to terminate and amend contracts or to demand an accelerated payment in the event that a counterparty to the contract becomes insolvent. Despite recent amendments to the *Bankruptcy and Insolvency Act (BIA)* and the *Companies' Creditors Arrangement Act (CCAA)*, the validity of *ipso facto* clauses, outside the context of derivatives contracts, is an issue that has not been thoroughly addressed in the Canadian literature. This article will trace the anti-deprivation rule in England, culminating in the United Kingdom Supreme Court's leading case: *Belmont Park Investments PTY Ltd. v. BNY Corporate Trustee Services Ltd. and Lehman Brothers Special Financing Inc.* It will then explore to what extent recent amendments to the *BIA* and the *CCAA* have displaced the common law rule in Canada. Both the *BIA* and the *CCAA* have nullified *ipso facto* clauses in some but not all situations, the most notable exceptions being cases involving corporate bankruptcies and receiverships. This article will conclude with a discussion of the codified exceptions to the common law principles and whether the Canadian jurisprudence might incorporate some of the modifications to the anti-deprivation rule introduced by Lord Collins in *Belmont*.

Lorsqu'un débiteur devient insolvable, qu'il s'agisse d'un individu ou d'une institution financière complexe, la question se pose à savoir si son insolvabilité affecte les droits des parties avec lesquelles le débiteur a conclu un contrat. La partie non-défaillante pourrait-elle ainsi mettre fin ou modifier le contrat sur la base de l'insolvabilité du débiteur? Pourrait-elle demander un paiement accéléré? Il est commun que les parties maintiennent leurs droits contractuels à travers des clauses *ipso facto*, leur permettant de modifier, de mettre fin aux contrats ou de demander un paiement accéléré lorsqu'une autre partie au contrat devient insolvable. Malgré de récentes modifications à la *Loi sur la faillite et l'insolvabilité (LFI)* et à la *Loi sur les arrangements avec les créanciers des compagnies (LACC)*, la validité des clauses *ipso facto*, en dehors du contexte des contrats dérivatifs, est un problème qui n'a pas encore été adressé en profondeur par la doctrine canadienne. Cet article retracera le parcours du principe légal de non-appauvrissement en Angleterre, ayant abouti à la Cour suprême du Royaume-Uni dans l'arrêt *Belmont Park Investments PTY Ltd. v. BNY Corporate Trustee Services Ltd. and Lehman Brothers Special Financing Inc.*, avant d'examiner dans quelle mesure les modifications récentes à la *LFI* et à la *LACC* ont supplanté la règle de *common law* au Canada à ce sujet. La *LFI* et la *LACC* ont toutes deux invalidé les clauses *ipso facto* dans plusieurs situations, exceptés pour les cas de faillite d'entreprise et de mise sous séquestre. Cet article analysera finalement les exceptions codifiées aux principes de *common law* et l'intégration potentielle à la jurisprudence canadienne de certaines modifications de la règle du non-appauvrissement introduites par Lord Collins dans l'arrêt *Belmont*.

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Introduction

Whether a debtor is an individual or a sophisticated financial institution, a common issue that arises is whether its insolvency alters the rights of the parties with whom the debtor has entered into contracts. Several questions arise. Could the non-defaulting party to the contract, on the basis of the debtor's insolvency, terminate or amend the contract? Could there be a demand for accelerated payment? Many parties preserve contractual rights, through what are commonly known as *ipso facto* clauses, to terminate and amend contracts or to demand an accelerated payment in the event that a counterparty to the contract becomes insolvent. Despite recent amendments to the *Bankruptcy and Insolvency Act*¹ and the *Companies' Creditors Arrangement Act*,² the validity of *ipso facto* clauses, outside the context of derivatives contracts,³ is an issue that has only received limited attention in the Canadian literature.

This article will focus on the treatment of contracts in cases involving individual and corporate bankruptcies as well as proceedings under the *BIA* and the *CCAA*. Unlike both England and the United States, Canadian insolvency law is unique because both common law principles and statutory provisions could apply, depending on the nature of the debtor involved and the particular facts of each case. Whereas the common law principle, known as the "anti-deprivation rule" or "fraud upon the bankruptcy law rule," is over two hundred years old, statutory developments in this area have only materialized significantly in Canada over the last two decades. Thus, this article will explore to what extent these statutory developments have codified or displaced common law principles. The *BIA* and the *CCAA* have provided some welcomed clarity that *ipso facto* clauses are generally void in cases involving Division I proposals, consumer proposals, proceedings under the *CCAA*, and individual bankruptcies. The status of such clauses with respect to corporate bankrupts and receiver-ships is less clear, but recent jurisprudence suggests that the common law anti-deprivation rule is still very much a facet of Canadian law.

This article has been divided into three main parts. Part I begins with a brief overview of the insolvency regimes in both England and Canada. It then provides a foundation as to why the issue of the treatment of a debt-

¹ RSC 1985, c B-3 [*BIA*].

² RSC 1985, c C-36 [*CCAA*].

³ See e.g. Rupert H Chartrand, Edward A Sellers & Martin McGregor, "Selected Aspects of the Treatment of Derivatives in Canadian Insolvency Proceedings: Time for a Re-Set?" (2011) *Ann Rev Insolv L* 1. Derivative contracts, swap agreements, etc. are eligible financial contracts under both the *BIA* and *CCAA* and are largely exempted from many of the provisions discussed in Part III of this article (see *BIA*, *supra* note 1, ss 65.1(7), 66.34(7), 84.2(7); *CCAA*, *supra* note 2, s 34(7)).

or's contract in the event of its insolvency is important. Part II will trace the development of the anti-deprivation rule in England, and it will conclude with a categorization of cases where the rule has been found not to apply, with a particular focus on the changes to the scope of the rule as a result of the United Kingdom Supreme Court's decision in *Belmont Park Investments PTY Ltd. v. BNY Corporate Trustee Services Ltd. and Lehman Brothers Special Financing Inc.*⁴

This article will then move on to the Canadian context in Part III and start with an overview of the anti-deprivation rule in Canadian jurisprudence. Then, using the concepts explored in Part II as a framework for discussion, this article will explore to what extent the recent amendments to the *BIA* and the *CCAA* have displaced the common law in Canada. Both the *BIA* and the *CCAA* have nullified *ipso facto* clauses in some but not all situations, the most notable exceptions being cases involving corporate bankruptcies and receiverships. Part III will discuss the codified exceptions to the statutory principles and explore the issue of whether the Canadian jurisprudence might incorporate some of the modifications to the anti-deprivation rule introduced by Lord Collins in his seminal decision in *Belmont*, before concluding.

I. Overview of Insolvency Law Regimes

A. England

I begin by briefly elucidating the various types of insolvency regimes available. In England, individuals, companies, and partnerships are largely governed by the *Insolvency Act 1986*.⁵ Insolvent individuals can be subject to debt relief orders,⁶ voluntary arrangements, or bankruptcy orders. Under an individual voluntary arrangement (IVA), creditors can agree to a debtor's proposal in satisfaction of his or her debts; the process is supervised by a nominee.⁷ Alternatively, the individual or other parties, includ-

⁴ [2011] UKSC 38, [2012] 1 AC 383 [*Belmont*].

⁵ (UK), c 45. Note that companies may also be subject to the *Companies Act 1985* (UK), c 6. The *Insolvency Act 1986* has also been amended by the *Insolvency Act 1994* (UK), c 7; the *Insolvency Act (No 2) 1994* (UK), c 12; the *Insolvency Act 2000* (UK), c 39; and the *Enterprise Act 2002* (UK), c 40. See also Roy Goode, *Principles of Corporate Insolvency Law*, 4th ed (London: Sweet & Maxwell, 2011) at para 1-20 [Goode, *Principles*].

⁶ Individuals who cannot afford to pay back their debts may be eligible for a debt relief order (see *Insolvency Act 1986*, *supra* note 5, Part 7A).

⁷ See *ibid*, Part VIII (especially s 253). See also Halsbury's Laws of England, *Bankruptcy and Individual Insolvency*, "Individual Voluntary Arrangements" at para 43; Donna McKenzie Skene & Adrian Walters, "Consumer Bankruptcy Law Reform in Great Britain" (2006) 80:4 Am Bank LJ 477 at 484–86.

ing creditors,⁸ can petition the individual debtor into bankruptcy provided that certain prerequisites are satisfied.⁹ In the case of such a bankruptcy order, all of the property belonging to the debtor at the commencement of the bankruptcy is vested in a trustee.¹⁰ The trustee then liquidates the assets and distributes them in accordance with various statutory rules.¹¹

As for companies, there are a few possible outcomes. Upon the application of a petition to a court, a company can be wound up.¹² As in cases involving personal bankruptcies, the liquidator obtains control of the company's assets and then realizes and disposes of them in accordance with the statutory scheme.¹³ Alternatively, with company voluntary arrangements (CVAs),¹⁴ administrations,¹⁵ and reorganizations,¹⁶ a company attempts to come to an arrangement with its creditors with the objective to survive as a going concern.¹⁷ If these efforts fail, however, the company will be dissolved and wound up.¹⁸ Finally, debenture holders can enforce their security by way of an administrative receivership although, nowadays, many would opt for an administration instead.¹⁹

In the case of a court-initiated winding-up order, there is a statutory stay against the company during which no actions or proceedings can be commenced or continued without the court's permission.²⁰ A similar form of protection, known as a moratorium, is available where there is either a

⁸ See *Insolvency Act 1986*, *supra* note 5, s 264(1) for a list of parties that can petition an individual into bankruptcy.

⁹ For the grounds on which a creditor may petition a debtor into bankruptcy, see *ibid*, s 267(1). As for the grounds on which debtors can file for bankruptcy, see *ibid*, s 272.

¹⁰ See *ibid*, s 306. There are exceptions as to what falls within the bankrupt's estate (see *ibid*, s 283).

¹¹ See *ibid*, ss 328–29; *Insolvency Rules 1986*, SI 1986/1925, Part 6.

¹² Petitions can be presented by a number of parties, including the company itself or its creditors (see *Insolvency Act 1986*, *supra* note 5, ss 73ff).

¹³ See *ibid*, ss 165ff.

¹⁴ See *ibid*, Part I.

¹⁵ See *ibid*, Part II.

¹⁶ In England, the difference between restructurings and administration is that the former is arranged contractually outside the formal framework of corporate insolvency law (see Goode, *Principles*, *supra* note 5 at paras 1-35, 1-51).

¹⁷ See *ibid* at paras 1-31 to 1-32.

¹⁸ See *ibid* at paras 1-31, 1-39.

¹⁹ See *ibid* at para 1-38 for a description of the different categories of receivership.

²⁰ See *Insolvency Act 1986*, *supra* note 5, s 130.

CVA or an administration order.²¹ Parallel forms of protection are also available when the debtor is an individual. Once a bankruptcy order has been made, there is usually a stay against the debtor's creditors, with an exception made for its secured creditors.²² It is also an industry standard that IVAs provide for a stay against the debtor's creditors.²³

B. Canada

Despite some differences in nomenclature, similar insolvency regimes and procedures exist in Canada. Under the *BIA*, both natural persons and legal persons, including companies, can be petitioned voluntarily or involuntarily into bankruptcy.²⁴ Once a bankruptcy order has been made, the debtor's property vests in the trustee, who then proceeds to liquidate and distribute the assets in accordance with the scheme laid out in the *BIA*.²⁵ Alternatively, both individuals and companies can file proposals under the *BIA* in an attempt to gain their creditors' approval of an alternative plan to satisfy their debts.²⁶ Companies with more than \$5 million in debt, though, can also opt to restructure under the *CCAA*, which is characterized by a higher degree of court involvement than proposals under the *BIA*.²⁷ The *BIA* also governs receiverships.²⁸ Like its English counterpart, Canadian insolvency legislation provides the debtor with a stay against its creditors. Whereas a stay under the *BIA* is automatic,²⁹ a stay under the *CCAA* is usually derived from a court order.³⁰

²¹ See *ibid*, Schedules A1, B1 (especially paras 42–43). In the case of CVAs, the moratorium is only effective against those creditors who are bound by the CVA (see Goode, *Principles*, *supra* note 5 at para 11-51).

²² See *Insolvency Act 1986*, *supra* note 5, ss 285(3)–(4).

²³ See Adrian Walters, "Individual Voluntary Arrangements: A 'Fresh Start' for Salaried Consumer Debtors in England and Wales?" (2009) 18:1 Intl Insolv Rev 5 at 19–20.

²⁴ *BIA*, *supra* note 1, ss 43, 49.

²⁵ *Ibid*, ss 71, 136–47.

²⁶ For commercial and consumer proposals, see *ibid*, Part III, Division I and Part III, Division II respectively. Although known as a commercial proposal, Division I proposals can be used by both businesses and individuals (see Office of the Superintendent of Bankruptcy Canada, "You Owe Money: Process for Division I Proposals", online: Industry Canada <www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02052.html>).

²⁷ See *CCAA*, *supra* note 2. See also Roderick J Wood, *Bankruptcy and Insolvency Law* (Toronto: Irwin Law, 2009) at 13–14 [Wood, *Bankruptcy*].

²⁸ See *BIA*, *supra* note 1, Part XI.

²⁹ *Ibid*, ss 69, 69.3(1).

³⁰ *CCAA*, *supra* note 2, s 11.02.

C. *The Effect of Bankruptcy and Insolvency Proceedings on the Debtor's Contracts*

The principles discussed in this article, with some exceptions, are generally applicable in both the bankruptcy and reorganization proceedings described above. This article will focus on how these insolvency proceedings alter parties' contractual rights, with a particular emphasis on the Canadian context. There are two possible viewpoints. The first is the debtor's rights in relation to the contract—that is, the right to disclaim, affirm, and assign contracts—a topic that has been thoroughly scrutinized in the literature.³¹ The second, which will be explored in this article, is the counterparty's rights upon learning that the debtor has become insolvent. To ensure clarity, the term “debtor” will denote the party, whether an individual, corporation, or a partner in a partnership agreement, that has entered into insolvency proceedings. The counterparty to the contract will be referred to as the “non-defaulting party”. Although this article's focus is on Canadian law, it is useful to reference its American counterpart to better elucidate some of the concepts discussed.

Generally, bankruptcy itself neither terminates a contract nor does it constitute a breach of contract.³² Parties, however, can use *ipso facto* clauses to preserve certain contractual rights in the event that one of the contracting parties has entered into bankruptcy or insolvency proceedings, including the right to terminate the contract.³³ *Ipsa facto* clauses can also provide, upon one of the parties' insolvency, a right to amend or cancel an agreement, to demand the return of goods, or to make a liquidated damages claim.³⁴ The term “*ipso facto* clause” stems from the American context, where they are largely prohibited; Title 11 of the *United States Code*³⁵ nullifies contractual clauses that prohibit debtors from using, selling, or leasing property as a result of an insolvency or filing under a

³¹ See e.g. R Graham Phoenix & Aubrey E Kauffman, “Enhancing the Prospects of a Viable Recovery: Ontario Court Reinforces the Use of CCAA Disclaimer Provisions in the Context of a Sale Process” (2013) 28:3 BFLR 549; Pamela Kraus, “Unsettled Existence: The Fate of Licensed Intellectual Property Rights upon the Bankruptcy or Insolvency of the Licensor” (2005) 19:1 IPJ 149; David B Bish, “Who's in the Driver's Seat? A Landlord Perspective on a Retail Tenant's Insolvency Proceedings” (2008) 42 CBR (5th) 159; Daniel Frajman, “Leases and Intellectual Property: Counter-Intuitive Amendments” (2011) 77 CBR (5th) 175.

³² See Wood, *Bankruptcy*, *supra* note 27 at 160. For a discussion on executory contracts, see Thomas H Jackson, “Translating Assets and Liabilities to the Bankruptcy Forum” (1985) 14:1 J Legal Stud 73 at 104.

³³ See Wood, *Bankruptcy*, *supra* note 27 at 163–64.

³⁴ See Anthony Duggan et al, *Canadian Bankruptcy and Insolvency Law: Cases, Text, and Materials*, 3rd ed (Toronto: Edmond Montgomery, 2015) at 296.

³⁵ 11 USC (2010) [*Bankruptcy Code*].

Bankruptcy Code provision.³⁶ The *Bankruptcy Code* also prohibits parties from contracting to prevent the debtor's property from forming part of its estate because of it entering into insolvency proceedings.³⁷

Ipsa facto clauses, indeed, can be problematic. First, where such clauses reserve the right of a non-defaulting party to terminate a contract upon a debtor's insolvency, a debtor's ability to reorganize and survive as a going concern may be stymied if the non-defaulting party supplied goods and services vital to the debtor's business. *Ipsa facto* clauses may also prevent a trustee from affirming the contract unless the non-defaulting party consents.³⁸ The term "executory contract" originates from the American context. Although its meaning has been disputed in both the literature and the jurisprudence, American courts have largely agreed that a situation would be characterized as an executory contract where both parties have outstanding obligations and a party's failure to perform would be a material breach.³⁹

For example, a party agrees to sell 1,000 widgets for \$1,000 to a debtor with delivery to be made in thirty days. On the date of the debtor's bankruptcy, neither side has performed its obligations, making the arrangement an executory contract. The debtor, or its trustee, has the option of affirming, disclaiming, or assigning the contract.⁴⁰ The trustee would prefer to affirm the contract if its completion would benefit the debtor's estate because, in this case, the non-defaulting party would need to deliver the widgets. The trustee would then be obligated to pay the purchase price. An *ipso facto* clause, which allows the non-defaulting party to terminate the contract immediately upon learning the debtor has become insolvent, would in turn prevent the trustee from exercising its option to affirm the

³⁶ *Ibid.*, § 363. See also Paul Rubin, "Not Every *Ipsa Facto* Clause is Unenforceable in Bankruptcy" (2013) 32:7 *Am Bankr Inst J* 12 at 12.

³⁷ *Bankruptcy Code*, *supra* note 35, § 541(c)(1). See also Rubin, *supra* note 36 at 12.

³⁸ See Wood, *Bankruptcy*, *supra* note 27 at 164.

³⁹ See Carl N Pickerill, "Executory Contracts Re-Revisited" (2009) 83:1 *Am Bank LJ* 63 at 64–66. Executory contracts are governed by the *Bankruptcy Code*, *supra* note 35, § 365. Pickerill's article provides a useful survey of the two main approaches to the issue of executory contracts. The first is the "material breach" analysis which stems from Countryman's seminal articles on the topic (see Vern Countryman, "Executory Contracts in Bankruptcy: Part I" (1973) 57:3 *Minn L Rev* 439; Vern Countryman, "Executory Contracts in Bankruptcy: Part II" (1974) 58:3 *Minn L Rev* 479). The second approach, which was adopted by Westbrook and Andrew, is the "functional" analysis (see Jay L Westbrook, "A Functional Analysis of Executory Contracts" (1989) 74:2 *Minn L Rev* 227; Michael T Andrew, "Executory Contracts in Bankruptcy: Understanding 'Rejection'" (1988) 59:4 *U Colo L Rev* 845; Michael T Andrew, "Executory Contracts Revisited: A Reply to Professor Westbrook" (1991) 62:1 *U Colo L Rev* 1).

⁴⁰ See Wood, *Bankruptcy*, *supra* note 27 at 367.

contract later on—a reason why the *Bankruptcy Code* in the United States also nullifies *ipso facto* clauses in cases involving executory contracts.⁴¹ *Ipsa facto* clauses, however, are enforceable in certain types of agreements such as securities contracts, as well as commodities and forward contracts.⁴² As will be seen in Part III, Canadian insolvency legislation provides a similar exemption for these types of agreements.

Second, *ipso facto* clauses may compel the debtor to transfer a portion of its assets or to make an accelerated payment to the non-defaulting party. In both situations, the value of the debtor's estate is reduced, which is contrary to the general objective of insolvency legislation to maximize the value of assets available to be paid out to the debtor's creditors.⁴³ Finally, *ipso facto* clauses provide a mechanism by which a non-defaulting party could circumvent the statutory scheme of distribution. That is, such clauses would compel the debtor to pay the non-defaulting party even if it would not otherwise have had a valid claim under the relevant insolvency statute.

II. The Anti-Deprivation Rule in England

A. Introduction

In England, the treatment of a debtor's contracts upon its insolvency has largely been crafted by the common law in the form of the "fraud upon the bankruptcy law principle" or the "anti-deprivation rule". Briefly, the purpose of the rule is to prevent contractual arrangements designed to remove assets at the commencement of the bankruptcy or winding-up process, that are held by the debtor, on the ground that such arrange-

⁴¹ *Bankruptcy Code*, *supra* note 35, §§ 365(e)(1), 365(b)(2). The exception being that, in certain situations, the performance or assignment of a contract by the debtor can be opposed by a non-defaulting party. In cases where the debtor has assumed an executory contract, the counterparty cannot demand payment on the basis of an *ipso facto* clause. See also Rubin, *supra* note 36 at 12.

⁴² See *Bankruptcy Code*, *supra* note 35, §§ 555–61. Other types of agreements include repurchase agreements, swap agreements, master netting agreements, and safe harbor contracts. The exemption for safe harbor contracts only applies to Chapter 15 proceedings. See also Rubin, *supra* note 36 at 12.

⁴³ See UNCITRAL, *Legislative Guide to Insolvency Law* (New York: UN, 2005) at 10–11, online: UNCITRAL <www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf>. The United Nations General Assembly recommended that member states consider the UNCITRAL guide when it came to revising or adopting their insolvency legislation (see *Legislative Guide on Insolvency Law of the United Nations Commission on International Trade Law*, GA Res 40, UNGAOR, 59th Sess, Supp No 49, UN Doc A/Res/59/40 (2004)).

ments are contrary to public policy.⁴⁴ As seen in Part I.C., the term “*ipso facto* clause” is an American one. Since that term is largely absent in the English jurisprudence, it will not be employed in this section on English law. This Part will first explain the differences between the anti-deprivation rule and two similar but distinct concepts—the *pari passu* rule and statutory anti-avoidance provisions. Then, drawing guidance from *Belmont*, it will highlight situations where the anti-deprivation rule has been applied and conclude with comments on the implications of Lord Collins’ judgment in *Belmont*.

B. The Pari Passu Principle

Despite being two distinct concepts, the *pari passu* principle and the anti-deprivation rule are often discussed collectively in English jurisprudence.⁴⁵ It is a long-standing principle that debts are to be paid equally—that is, a debtor’s liabilities should be satisfied *pari passu*, subject only to secured creditors’ claims and priorities given by statute.⁴⁶ Provisions that attempt to contract out of the *pari passu* principle are void as being contrary to public policy, which is known as the common law *pari passu* rule.⁴⁷

To distinguish between the two principles, Goode suggests that the *pari passu* rule could be characterized as preventing a creditor from jumping ahead of the other creditors for a slice of the pie. Satisfying this creditor’s liabilities results in a corresponding diminution in the debtor’s liabilities on its balance sheet. Thus, the size of the pie—that is the debtor’s net asset value—remains unchanged. In Goode’s view, though, the anti-deprivation rule only applies where the party that benefits from the deprivation is not a creditor, so the debtor’s liabilities remain untouched. That is, the improper removal of an asset from the debtor’s estate would reduce the debtor’s overall net asset value, which would in turn reduce the size of the pie.⁴⁸ Although Goode’s analogy is helpful in illustrating

⁴⁴ See Goode, *Principles*, *supra* note 5 at para 7-01.

⁴⁵ See *Belmont*, *supra* note 4 at paras 9ff.

⁴⁶ This principle was established in a statute of Henry VIII in 1542 and is found today in the *Insolvency Act 1986*, *supra* note 5, s 107. See also Goode, *Principles*, *supra* note 5 at para 7-03; Colin Bamford, *Principles of International Financial Law* (Oxford: Oxford University Press, 2011) at para 10.89. Like the anti-deprivation rule, the substance and the role of the *pari passu* rule have similarly been challenged (see e.g. Rizwaan Jameel Moka, “Priority as Pathology: The Pari Passu Myth” (2001) 60:3 Cambridge LJ 581).

⁴⁷ The seminal *pari passu* case is *British Eagle International Airlines Ltd v Compagnie Nationale Air France*, [1975] 1 WLR 758, [1975] 2 All ER 390 (HL (Eng)) [*British Eagle* cited to WLR]. See also *Belmont*, *supra* note 4 at paras 6–8.

⁴⁸ Goode, *Principles*, *supra* note 5 at para 7-03.

the conceptual differences between the two principles, it causes some problems in the Canadian context since, as will be seen in Part III, the provisions in the *BIA* and the *CCAA*, which nullify *ipso facto* clauses, do not distinguish creditors from non-creditors.

C. *Statutory Anti-Avoidance Provisions*

As Goode explains, both the anti-deprivation rule and the *pari passu* principle could fall under the umbrella of avoidance transactions, which also encompasses transactions at an undervalue, preferences, and dispositions made without the court's permission.⁴⁹ The anti-deprivation rule, however, is seen to be distinct from the statutory anti-avoidance provisions. Agreeing with this viewpoint in *Belmont*, Lord Collins recognized that in early cases where the anti-deprivation rule had been applied, little statutory protection existed against avoidance transactions.⁵⁰ Despite legislative developments aimed at prohibiting avoidance transactions, Lord Collins found the anti-deprivation rule still to be useful since it is not subject to the time limitations inherent in the statutory anti-avoidance provisions.⁵¹ Neither Lord Collins nor the literature has thoroughly compared the anti-deprivation principle with the statutory anti-avoidance provisions. The following discussion will focus on those anti-avoidance provisions with Canadian counterparts: transactions at an undervalue and preferences.⁵²

First, as Part II.D. will explain, the anti-deprivation rule is applied to void a contractual provision for being contrary to public policy. That is, the parties contractually arranged *ex ante* what would happen should one of them become insolvent. In contrast, the application of statutory anti-avoidance provisions hinges on the transaction having taken place, rather than the parties' contractual arrangements. For instance, a gift from the debtor could qualify as a transaction at an undervalue whereas it would not fall under the anti-deprivation rule since the recipient of the gift was not in a contractual relationship with the debtor.⁵³ A second difference,

⁴⁹ *Ibid* at para 13-11.

⁵⁰ *Belmont*, *supra* note 4 at para 16. Although some anti-avoidance provisions, such as transactions at undervalue, were not introduced in England until 1986, other concepts, such as preferences, originated in the common law from the eighteenth century (see Professor David Milman, "Transactional Avoidance on Insolvency: An Update on Recent Developments" (2013) 26:6 *Insolvency Intelligence* 81 at 81–83).

⁵¹ See *Belmont*, *supra* note 4 at para 88.

⁵² See *BIA*, *supra* note 1, ss 95–96. These provisions relating to preferences and transfers at an undervalue also apply under the *CCAA* (*supra* note 2, s 36.1).

⁵³ A gift would be a transaction at an undervalue (see *Insolvency Act 1986*, *supra* note 5, ss 238, 339).

and one that Lord Collins briefly alluded to,⁵⁴ is that the statutory anti-avoidance provisions define relevant time periods, such as in the two years leading up to the insolvency, where the transfer had to have taken place.⁵⁵ This time element, however, is not a characteristic of the anti-deprivation rule; its focus is on whether a contractual provision should be found void on public policy grounds.

A third dissimilarity relates to the procedural elements of an application. With both transactions at an undervalue and preferences, there are strict conditions that must be satisfied for the onus of proof to be met, such as when the transaction was made and the nature of the transaction.⁵⁶ In contrast, as will be seen in Part II.D., the requirements for the application of the anti-deprivation rule have varied from case to case, but it is not necessary for the transfer to have taken place. Under the anti-deprivation rule, the remedy being sought is a finding that a contractual provision is void for public policy. The desired remedy in cases involving statutory anti-avoidance provisions, however, would be that the transfer was void and that it should be reversed.⁵⁷ Although the transfer of an asset may be reversed in an anti-deprivation case, the court could limit its remedy to declaratory relief that a contractual provision is void.⁵⁸

Finally, the statutory anti-avoidance provisions and the anti-deprivation rule differ in their views on the role of good faith. The defence of good faith is generally unavailable to defendants in transactions at an undervalue and preferences cases, except in the case of bona fide purchasers.⁵⁹ In contrast, after *Belmont*, the presence of good faith is one of the

⁵⁴ See *Belmont*, *supra* note 4 at para 88.

⁵⁵ See *Insolvency Act 1986*, *supra* note 5, ss 238–40, 341. There are different requirements depending on whether the person was in an arm’s-length relationship with the debtor and whether the debtor is bankrupt.

⁵⁶ See *Insolvency Act 1986*, *supra* note 5, ss 238–40, 339–40. See also Goode, *Principles*, *supra* note 5 at paras 13–15.

⁵⁷ See *Insolvency Act 1986*, *supra* note 5, ss 238(3), 239(3), 339(2), 340(2). That is, the asset is returned to the company as if the purported disposition had not taken place. Goode points out that in cases where the transfer in question does not override a charge in the property, the charge continues to attach to the recovered property. See Goode, *Principles*, *supra* note 5 at paras 13-140 to 13-142 for a discussion on the application of recoveries in statutory anti-avoidance cases.

⁵⁸ For instance, in *Belmont*, *supra* note 4 at para 33, the UK Supreme Court granted only declaratory relief—a move that was likely motivated by the Court’s worry about the conflict that would arise between the differing decisions given by the two jurisdictions involved in the dispute: the UK Supreme Court in England and the Bankruptcy Court in New York.

⁵⁹ See Goode, *Principles*, *supra* note 5 at para 13-98; *Insolvency Act 1986*, *supra* note 5, s 241(2)(b).

factors considered when deciding whether the anti-deprivation rule should apply—a point further discussed in Part II.E.3.⁶⁰

D. Early Applications of the Anti-Deprivation Rule

The remainder of this Part traces the development of the anti-deprivation rule, which will help put the Canadian application of this principle, discussed in Part III, into context. The anti-deprivation rule first appeared in personal bankruptcy cases. As explained in Part I.A., in a personal bankruptcy, all of the property belonging to the debtor on the date of its bankruptcy vests in its trustee. After liquidating the assets, the trustee distributes the proceeds to creditors in accordance with the statutory scheme of distribution. Thus, contractual provisions that seek to prevent certain assets from being vested in the trustee, which in turn reduce the amount of assets available for liquidation and distribution, could trigger the application of the anti-deprivation rule.

From the eighteenth century until very recently, the anti-deprivation rule was largely known as “the fraud upon the bankruptcy law principle.” The term “deprivation” was not adopted in England in this context until 2002 in *Money Markets International Stockbrokers Ltd. v. London Stock Exchange Ltd.*⁶¹ In fact, as seen in Part III, Canadian jurisprudence similarly refers to the rule as “the fraud upon the bankruptcy law principle;” the term, “the anti-deprivation rule”, seems to have only first appeared in Canada in the dissenting judgment of a 2012 Alberta Court of Appeal decision.⁶² Nevertheless, for consistency purposes, this article will refer to the principle as the anti-deprivation rule.

As Lord Collins observed in *Belmont*, referring to the seminal decision in *Higinbotham v. Holme*,⁶³ the anti-deprivation rule is premised on the idea that there had been some sort of a fraud upon the bankruptcy laws.⁶⁴ *Higinbotham* involved a provision in a marriage settlement that reserved for the wife a life interest in her husband’s property, in the form of an annuity, should he become bankrupt.⁶⁵ Lord Eldon held the provision to be

⁶⁰ See *Belmont*, *supra* note 4 at paras 74–79, 104.

⁶¹ [2002] 1 WLR 1150, [2001] 4 All ER 223 (ChD (Eng)) [*Money Markets* cited to WLR]. See also *Belmont*, *supra* note 4 at para 2.

⁶² 1183882 *Alberta Ltd v Valin Industrial Mill Installations Ltd*, 2012 ABCA 62 at para 33, 64 Alta LR (5th) 163, McDonald JA (dissenting) [*Valin Industrial*], leave to appeal to SCC refused, 34792 (25 April 2012). A search of the term “anti-deprivation” on CanLII does not come up with any additional results.

⁶³ (1812), 34 ER 451, 19 Ves Jr 88 (Ch (Eng)) [*Higinbotham* cited to ER].

⁶⁴ *Belmont*, *supra* note 4 at para 75, citing *Higinbotham*, *supra* note 63.

⁶⁵ *Higinbotham*, *supra* note 63 at 451.

void as it was “a direct fraud on the bankruptcy laws.”⁶⁶ The anti-deprivation rule has since been applied in a wide variety of cases, making its precise scope difficult to define—a challenge recognized by Lord Collins in *Belmont*.⁶⁷ Nevertheless, highlighting some of the most relevant cases will provide a useful backdrop to the discussion in Part III on the anti-deprivation rule in Canada.

The anti-deprivation rule is often applied to void contractual provisions that provide for the divestment of ownership in an asset on a debtor’s bankruptcy.⁶⁸ A classic example mentioned by Lord Collins is *Ex parte Jay*,⁶⁹ which involved a landowner who contracted a builder to construct houses on his property.⁷⁰ They agreed that if the builder, prior to the completion of the homes, became bankrupt, the landowner could take possession of the materials on his property.⁷¹ The Court of Appeal held that the contractual provisions that purported to forfeit the building materials to the landlord on the builder’s bankruptcy were void.⁷²

There are numerous variations on the above example. Another well-known case discussed by Lord Collins is *Ex parte Mackay*,⁷³ where Jeavons entered into a series of linked agreements with Brown & Co. and Cammell & Co. In the first agreement, Jeavons sold a patent to Brown in exchange for royalties. In the second agreement, Jeavons granted Brown a security interest in a lease in exchange for a loan. In the third, Brown agreed to retain half of the royalties in satisfaction of Jeavons’ debt. If Jeavons became insolvent or bankrupt, Brown could retain all of the royalties. It was this aspect of the third agreement that was challenged before the court.⁷⁴

The court held that Jeavons could validly create a charge in favour of Brown for half of the royalties in order to repay his loan, but that the cre-

⁶⁶ *Ibid* at 453.

⁶⁷ Lord Collins in *Belmont*, *supra* note 4 at para 58 agreed with this point made by Lord Neuberger MR in his judgment for the same case before the Court of Appeal: *Perpetual Trustee Company Ltd v BNY Corporate Trustee Services Ltd*, [2009] EWCA Civ 1160 at para 32, [2010] Ch 347 [*Perpetual Trustee*].

⁶⁸ See Goode, *Principles*, *supra* note 5 at para 7-09.

⁶⁹ See *Belmont*, *supra* note 4 at para 62, citing *Ex parte Jay*, *Re Harrison* (1880), 14 ChD 19 (CA) (available on WL UK) [*Jay*].

⁷⁰ See *Jay*, *supra* note 69 at 22–23.

⁷¹ See *ibid*.

⁷² See *ibid* at 25–27.

⁷³ See *Belmont*, *supra* note 4 at paras 11–12, 61, citing *Ex parte Mackay*, *Re Jeavons* (1873), LR 8 Ch App 643 (available on WL UK) [*Mackay*].

⁷⁴ See *Mackay*, *supra* note 73 at 643–45.

ation of a charge in Brown's favour for the other half of the royalties was an attempt to evade the insolvency laws.⁷⁵ That is, Jeavons could not contractually arrange to prevent his property from being distributed in accordance with the bankruptcy laws.⁷⁶ The court concluded that, had Brown been allowed to keep the royalties, it would have created an unlawful "additional advantage".⁷⁷

Lord Collins characterized *Ex parte Mackay* as belonging to a category of cases where there was an "unsuccessful attempt to create a charge."⁷⁸ *Ex parte Jay* would also fall under this category.⁷⁹ Alternatively, the situation in *Ex parte Mackay* could be viewed as one where the impugned contractual provision amended the agreement by increasing the security given to a creditor or by triggering the obligation to make accelerated payments. In the event of Brown's insolvency, Jeavons could keep all the royalties rather than just half of them. As Lord Mance, who wrote the minority judgment in *Belmont*, observed:

[T]here is no conceptual difference between removing specific property from the bankrupt estate for no consideration (*Whitmore v Mason*), increasing the security given to a particular creditor (*Ex p Mackay*) and increasing the bankrupt estate's liability to a particular creditor (*In re Johns* [1928] Ch 737). All these fall within the anti-deprivation principle.⁸⁰

In *In re Johns*, under a loan agreement, the son, in the event he became bankrupt, had to increase the payments made to his mother.⁸¹ The agreement was considered void as it was designed to secure more money to the mother on her son's bankruptcy than what would have been available had he remained solvent.⁸² Although Lord Mance's observation was not pivotal in *Belmont*, it can help elucidate some of the concepts underly-

⁷⁵ See *ibid* at 647–49.

⁷⁶ See *ibid*.

⁷⁷ *Ibid* at 648.

⁷⁸ *Belmont*, *supra* note 4 at para 61. Lord Collins also mentions *Ex parte Williams*, *In re Thompson* (1877) LR 7 ChD 138 (available on WL UK) [*Williams*] as another case that would fit this category (see *Belmont*, *supra* note 4 at para 61).

⁷⁹ In *Jay*, *supra* note 69 at 26–27, Lord Justice Cotton was careful to note that there was nothing in the agreement that purported to give the landlord a lien on the materials.

⁸⁰ *Belmont*, *supra* note 4 at para 149. Lord Mance also observed that the situations in *Whitmore v Mason* (1861), 70 ER 1031, 2 J&H 204 (KB) and *Mackay*, *supra* note 73 could be analyzed within the framework of the *pari passu* principle, again demonstrating the considerable overlap between these two rules.

⁸¹ *Re Johns*, *Worrel v Johns*, [1928] 1 Ch 737 at 737–38 (available on WL UK).

⁸² See *ibid* at 748.

ing the Canadian statutory response to the anti-deprivation principle (see Part III.C.).

E. Where the Anti-Deprivation Rule Has Not Been Applied

Having reviewed some English cases where the anti-deprivation rule has been applied,⁸³ it will also be useful to examine judgments where the principle has been found not to apply. Lord Collins' holding in *Belmont*, however, has further narrowed the scope of the anti-deprivation rule, and in doing so, has attracted its share of both support and criticism.

1. Limited and Absolute Interests

English law distinguishes between absolute and limited interests. A party who transfers to a debtor an absolute interest in an asset and gives itself a right to recapture the asset would fall afoul of the anti-deprivation rule.⁸⁴ This result occurs because the non-defaulting party is attempting to remove an asset from the debtor's estate, in turn depriving the asset from the debtor's creditors.⁸⁵ The examples discussed in Part II.D. would fall under this first category. As Lord Collins characterized it, an absolute interest is defeasible on bankruptcy or liquidation by a condition subsequent⁸⁶—that being the party's insolvency. In contrast, a contractual right to terminate a limited interest in an asset conferred on another party would not infringe the anti-deprivation rule; bankruptcy is simply an event that terminates the limited interest.⁸⁷ As Gabriel Moss points out, here, the debtor's proprietary interest in the asset could be seen as being subject to a condition precedent.⁸⁸

The distinction between absolute and limited interests has been criticized because it often turns on the wording of the provision, prompting Goode, quoting from an Irish decision, to describe the distinction as “little short of disgraceful to our jurisprudence” when it is applied to “a rule pro-

⁸³ See Goode, *Principles*, *supra* note 5 at paras 7-09 to 7-13 for a discussion on additional examples where the fraud upon the bankruptcy law principle has been applied.

⁸⁴ See *ibid* at para 7-05. As Goode observes, though, where the beneficiary of the re-transfer of the asset is a creditor, it is deemed to have contravened the *pari passu* rule instead.

⁸⁵ See *ibid*.

⁸⁶ See *Belmont*, *supra* note 4 at para 87.

⁸⁷ See Goode, *Principles*, *supra* note 5 at para 7-05. Goode also notes that this would not fall afoul of the *pari passu* rule either (*ibid*).

⁸⁸ Gabriel Moss, “Should British Eagle Be Extinct?” (2011) 24:4 *Insolvency Intelligence* 49 at 53.

fessedly founded on considerations of public policy.”⁸⁹ Moss is more forgiving in his analysis, suggesting that, from the perspective of property law, the differing treatment of conditions subsequent and conditions precedent makes sense. He does, however, agree that to use this distinction to determine whether a contractual provision was subject to the anti-deprivation rule is difficult to reconcile with the rule’s objective as being one based upon public policy.⁹⁰ Lord Collins, though, pointed out that the distinction is one that is “too well established to be dislodged otherwise than by legislation.”⁹¹

Some common examples of limited interests that are terminable on the debtor’s insolvency—that is, where the anti-deprivation rule would not apply—include provisions for the forfeiture of a lease upon winding up⁹² and the termination of intellectual property licenses.⁹³ Although at face value there does not seem to be an outright deprivation of the debtor’s estate, Goode brings up the valid concern that a debtor’s lease is likely to be one of its most valuable assets.⁹⁴ Goode believes that allowing the non-defaulting party to terminate the debtor’s lease is equivalent to removing an asset from the debtor’s estate, which leads Goode to suggest that England should follow the American practice of banning such clauses altogether.⁹⁵ England, however, has not taken steps in this direction.

The term “flawed assets”, which is often used interchangeably with the term “limited interests”, further adds to the confusion. Flawed assets originally described mechanisms used in financing arrangements to manage the risk of owning assets denominated in foreign currency.⁹⁶ These ar-

⁸⁹ Roy Goode, “Perpetual Trustee and Flip Clauses in Swap Transactions” (2011) 127 LQR 1 at 8 [Goode, “Perpetual Trustee”], citing *Re King’s Trust* (1892) 29 LR IR 201 at 410, Porter MR. Lord Collins references Goode’s remarks in his judgment as well (see *Belmont*, *supra* note 4 at para 87).

⁹⁰ Moss, *supra* note 88 at 53.

⁹¹ *Belmont*, *supra* note 4 at para 88.

⁹² See Lord Collins’ discussion in *Belmont*, *supra* note 4 at para 85 of Vice-Chancellor Page Wood’s remarks in *Whitmore*, *supra* note 80 at 1033–35, where Vice-Chancellor Wood observed that land being returned to a bankrupt’s landlord is not a fraud upon the bankruptcy laws. In *Whitmore*, a provision in a partnership agreement purporting to transfer a partner’s interest in a lease to his partners upon his bankruptcy was, however, found to be void.

⁹³ See e.g. the *Butters v BBC Worldwide Ltd* appeal in *Perpetual Trustee*, *supra* note 67 at paras 3–4, 23–31, 79–89. The *Butters* case was heard jointly with the Lehman Brothers dispute in *Perpetual Trustee* at the Court of Appeal.

⁹⁴ Goode, *Principles*, *supra* note 5 at para 7-05.

⁹⁵ *Ibid.*

⁹⁶ For a helpful explanation of flawed assets, see Bamford, *supra* note 46 at paras 10.03–10.94. An English company with a US\$100 million asset would borrow US\$100 million

rangements were not considered to have contravened the anti-deprivation rule.⁹⁷ As Cleary explains, flawed assets simply allowed a party to “limit the negative consequences of a counterparty failing to perform its reciprocal obligations under the contract.”⁹⁸

Lord Collins’ decision in *Belmont*, however, provides welcomed clarity. Lord Collins explained that the “‘flawed asset’ theory” meant that if “it is an inherent feature of an asset from the inception of its grant that it can be taken away from the grantee (whether in the event of his insolvency or otherwise), the law will recognize and give effect to such a provision.”⁹⁹ As Lord Collins observed, if the flawed asset theory were always applied, the anti-deprivation rule would be of little use.¹⁰⁰ It is easy to see why Lord Collins is worried; parties would draft their contractual provisions just to confer flawed assets as a means of evading the application of the anti-deprivation rule.¹⁰¹ Concluding that the flawed asset theory is not always applicable, Lord Collins sidestepped the problem of distinguishing between absolute and limited interests as well as flawed assets. As Worthington observes, Lord Collins finds that the termination of leases and licenses is legitimate, while agreements that end all other limited interests on bankruptcy are upheld unless they were made in bad faith and with the attempt to defeat the insolvency laws.¹⁰²

In a sense, the court is moving toward a substance over form approach by sidestepping the absolute and limited interest distinction, which often,

from an American company, who in turn would borrow an equivalent amount in sterling from its English counterpart. The English company’s US\$100 million asset is now offset by the liability of a US\$100 million loan and the English company is also a creditor of a sterling-based asset. This helps offset the risk in currency fluctuations when the English company has to report all its dollar-denominated assets in sterling. The arrangement, however, provides that if the English company went bankrupt, its liquidator could not demand the American company to repay the sterling-denominated loan unless the liquidator also repaid the full amount of the dollar loan. As Bamford explains, “the loan asset of each company [was] ‘flawed’ in the sense that it was repayable only if a condition precedent was met” (*ibid* at para 10.94).

⁹⁷ See *ibid* at para 10.95.

⁹⁸ Timothy Cleary, “Perpetuating Uncertainty: The Anti-Deprivation Principle and Contractual Rights in the Post-Lehman World” (2011) 20:3 Intl Insolv Rev 185 at 197.

⁹⁹ *Belmont*, *supra* note 4 at para 89.

¹⁰⁰ See *ibid*.

¹⁰¹ See Timothy Cleary, “Financial Derivatives and the Anti-Deprivation Principle” (2011) 26:8 J Intl Banking Law & Reg 379 at 388. Although Cleary wrote this article before the UK Supreme Court handed down the decision in *Belmont*, many of his observations on flawed assets are still useful since the UK Supreme Court agreed with the Court of Appeal, whose decision had already been released, on a number of grounds.

¹⁰² Sarah Worthington, “Good Faith, Flawed Assets and the Emasculation of the UK Anti-Deprivation Rule” (2012) 75:1 Mod L Rev 112 at 118.

as rightly pointed out by Goode, turns on fine verbal distinctions.¹⁰³ Furthermore, by incorporating the element of good faith, Lord Collins has simplified the conditions for the application of the anti-deprivation rule to cases involving flawed asset arrangements, with the exception of leases and licensing agreements. Worthington, however, observes that the effectiveness of the anti-deprivation rule has been stymied since it would be difficult to ascertain *ex post* whether the parties had been acting in bad faith.¹⁰⁴

Lord Collins, though, was likely cognizant of the prominent role that flawed assets play in ISDA master agreements, which govern over-the-counter swaps and other derivative contracts, and that these agreements are usually governed by English law.¹⁰⁵ Although writing before the release of the *Belmont*, Moller, Noland, and Goldwasser believe that judicial recognition of flawed asset arrangements would encourage the use of that jurisdiction as the governing law for international financial transactions.¹⁰⁶ Though Lord Collins did not explicitly endorse the use of flawed assets, his decision sends a clear message that these financing agreements would likely fall outside the scope of the anti-deprivation rule since it would be difficult to prove *ex post* that the arrangement was made in bad faith and with the view to defeating creditors.

2. Deprivation Took Place for Reasons Other than Bankruptcy

As Lord Collins observed in *Belmont*, the anti-deprivation rule is inapplicable if the deprivation occurred for reasons other than the debtor's bankruptcy, such as the debtor breaching another provision in the contract.¹⁰⁷ A difficulty can arise, however, if the order of the events is unclear. Lord Collins used the example of *Ex parte Newitt*,¹⁰⁸ which has facts similar to *Ex parte Jay*, where the provision for forfeiture was triggered by a contractual breach. The problem was that it was unclear when the

¹⁰³ Goode, "Perpetual Trustee", *supra* note 89 at 8.

¹⁰⁴ Worthington, *supra* note 102 at 118.

¹⁰⁵ See Carl Baker, "Rethinking the ISDA Flawed Asset" (2012) 27:6 J Intl Banking L & Reg 250 at 250, 252. Flawed assets have been part of an ISDA master agreement for over twenty-five years as a mechanism for managing counterparty credit risk.

¹⁰⁶ Stephen H Moller, Anthony RG Nolan & Howard M Goldwasser, "Section 2(a)(iii) of the ISDA Master Agreement and Emerging Swaps Jurisprudence in the Shadow of Lehman Brothers" (2011) 26:7 J Intl Banking L & Reg 313 at 324. For an alternative view on the utility of flawed assets in ISDA master agreements, see Baker, *supra* note 105.

¹⁰⁷ *Belmont*, *supra* note 4 at para 80.

¹⁰⁸ See *Belmont*, *supra* note 4 at paras 81–82, citing *Ex parte Newitt*, *Re Garrud* (1880), 16 ChD 522 (available on WL UK).

breach occurred.¹⁰⁹ Unfortunately, Lord Collins provides little commentary on this issue, but Goode suggests that this is now a moot point. After *Belmont*, the anti-deprivation rule only applies if there has been bad faith and a deliberate intention to evade the insolvency laws. Goode concludes that if the deprivation took place to avoid the application of insolvency laws and after bankruptcy had occurred, then the conditions for the application of the anti-deprivation rule are satisfied.¹¹⁰

3. Good Faith and the Parties' Intentions

Perhaps the most influential aspect of Lord Collins' decision is his move to introduce a new categorical exemption to the anti-deprivation rule. Concluding that "commercial sense and absence of intention to evade insolvency laws have been highly relevant factors in the application of the anti-deprivation rule,"¹¹¹ Lord Collins observed that the policy could be given "a common sense application which prevents its application to bona fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties on bankruptcy."¹¹²

Lord Collins believed that what mattered were the parties' objective intentions, and in borderline cases, where the parties entered into a commercially sensible transaction in good faith, the anti-deprivation rule would not be offended.¹¹³ Despite Lord Collins' thorough discussion on the anti-deprivation rule, the result in *Belmont* simply turned on whether the impugned agreement was a bona fide commercial transaction.

The complex facts of *Belmont* are largely irrelevant given how Lord Collins came to his conclusion. Briefly, Lehman Brothers set up special purpose vehicles ("the Issuer"), which in turn issued Notes to investors ("the Noteholders"), including the respondents. The Issuer used the Notes' proceeds to purchase secure investments ("Collateral") while simultaneously entering into a credit default swap agreement with Lehman Brothers Special Financing (LBSF). LBSF agreed to pay the Issuer premiums in exchange for the latter's credit protection on loans owned by Lehman

¹⁰⁹ See *Belmont*, *supra* note 4 at para 82.

¹¹⁰ Roy Goode, "Flip Clauses: The End of the Affair?" (2012) 128:2 LQR 171 at 175 [Goode, "Flip Clauses"].

¹¹¹ *Belmont*, *supra* note 4 at para 103.

¹¹² *Ibid* at para 104.

¹¹³ See *ibid* at para 79.

Brothers. The premiums the Issuer received from LBSF were then paid to the Noteholders. The agreements were governed by English law.¹¹⁴

On the basis that Lehman Brother Holdings and LBSF's Chapter 11 filings in 2008 were Events of Default as outlined in the contract, the Noteholders directed the Trustee to terminate the swap agreements. The Collateral, which was held by the Trustee, provided security for the Issuer's obligations to the Noteholders and LBSF. Although the latter had priority to the Collateral, the contract contained a provision, commonly referred to as a "flip clause", that would reverse the priorities in favour of the Noteholders if an Event of Default, as defined under the agreement, occurred.¹¹⁵ LBSF argued the flip clause was invalid for two reasons. First, it deprived LBSF of property that it would have been otherwise entitled to in its bankruptcy. Second, the clause offended the anti-deprivation rule by reversing LBSF's and the Noteholders' respective priorities on the basis of LBSF's bankruptcy.¹¹⁶

Writing the leading judgment for the United Kingdom Supreme Court, Lord Collins upheld the flip clause on the basis that it was "a complex commercial transaction entered into in good faith"¹¹⁷ and that the impugned provisions were not used deliberately to evade the application of insolvency law.¹¹⁸ On this basis, Lord Collins dismissed the appeal and found in favour of the Noteholders.¹¹⁹ Lord Collins, however, did not indicate that his comments on the application of the anti-deprivation rule

¹¹⁴ See *ibid* at paras 18–22, 25, 36.

¹¹⁵ See *ibid* at paras 18–22, 25, 28, 135. See also Simon Bishop, "The 'Anti-Deprivation' Rule and 'Flip' Clauses", *Personal Insolvency Regulator Newsletter* (January 2012), online: Australian Financial Security Authority <www.afsa.gov.au/practitioner/pir-newsletter/january-2012-pir-newsletter/7.-the-201canti-deprivation201d-rule-and-201cflip201d-clauses>.

¹¹⁶ See *ibid* at paras 49–50.

¹¹⁷ *Ibid* at para 108. Lord Walker agreed with Lord Collins' decision, adding only what he described as footnotes to the latter's judgment (*ibid* at para 122). The remaining judges, with the exception of Lord Mance, agreed with Lord Collins' and Lord Walker's judgments without additional comment. Although agreeing in the result, Lord Mance reached his decision on the basis that the purpose of the flip clause was not to evade insolvency law. Rather, it was to protect contracting parties by only obliging them to perform if the counterparty was able to do so too; the flip clause simply terminated the future reciprocal obligations of the parties. Lord Mance held that not only had LBSF been deprived of any priority but it had not even acquired it in the first place (*ibid* at paras 177–79, 185).

¹¹⁸ See *ibid* at paras 109, 115. As the case was decided on this basis, the issue of whether the flip clause was triggered by Lehman Brothers Holdings Inc., the parent company of the Lehman Brothers group, or LBSF's bankruptcy, did not arise.

¹¹⁹ See *ibid* at paras 114, 120.

were confined to cases involving swap agreements, suggesting that they could be applied in cases of personal and corporate insolvency.

Lord Collins' decision has been both criticized and commended. Windsor and Sidle, for instance, believe that the scope of the anti-deprivation rule could have been expanded in accordance with the public policy objective of preserving the debtor's estate or narrowed to ensure greater commercial certainty.¹²⁰ They conclude that Lord Collins was wise to opt for the latter.¹²¹ In contrast, Calnan questions the sudden relevance of whether the parties intended to evade insolvency law. He finds this approach difficult to justify since the intention of the parties is irrelevant in determining whether the *pari passu* rule applies.¹²² Furthermore, both Worthington and Goode question the degree to which Lord Collins' holding is supported by the jurisprudence—a point that the remainder of this section will focus on.

For instance, Lord Collins cited *Borland's Trustee v. Steel Bros & Co Ltd*.¹²³ as an example of where the anti-deprivation rule was not applied due to the parties' good faith and the commercial sense of the transaction.¹²⁴ At issue was a clause in a company's articles of association that provided that a shareholder, on his bankruptcy, must transfer his shares to either a manager or assistant at a fair value, as determined in accordance with the company's articles.¹²⁵ The trustee of Mr. Borland, a bankrupt shareholder, argued that the clause was a fraud upon the bankruptcy law as it forced the trustee "to part with the shares at something less than their true value, and the result is that the asset is not fully available for the creditors."¹²⁶ In summarizing Justice Farwell's decision to uphold the clause, Lord Collins focused on a few points: there was a fixed sum for the shares; the event of bankruptcy did not change the share price; and the clause would have been void had it required a transfer price that was less than what would have been otherwise obtained.¹²⁷

¹²⁰ Jo Windsor & Paul Sidle, "The Anti-Deprivation Rule and Insolvency Linked Termination Rights Post *Belmont*: Where Are We Now?" (2011) 26:8 Butterworths J Intl Banking & Fin L 451 at 454.

¹²¹ *Ibid.*

¹²² Richard Calnan, "Anti-Deprivation: A Missed Opportunity" (2011) 26:9 Butterworths J Intl Banking & Fin L 531 at 533. See also *British Eagle*, *supra* note 47.

¹²³ [1901] 1 Ch 279 (available on WL UK) [*Borland's Trustee*].

¹²⁴ *Belmont*, *supra* note 4 at para 77, citing *Borland's Trustee*, *supra* note 123.

¹²⁵ See *Borland's Trustee*, *supra* note 123 at 280–84.

¹²⁶ *Ibid* at 286.

¹²⁷ See *Belmont*, *supra* note 4 at para 70; *Borland's Trustee*, *supra* note 123 at 290–93.

Worthington, however, suggests that what underpinned Justice Farwell's decision in *Borland's Trustee* was that the trustee received a fair value for the shares, so this was not a case of deprivation at all.¹²⁸ She observes that the anti-deprivation rule was not applied in six out of the eleven precedents cited by Lord Collins.¹²⁹ Worthington concludes that, in these six cases, the court was moved not by the parties' good faith but by the fact that there had not been a deprivation, or if there was one, it was not triggered by the debtor's insolvency.¹³⁰

Worthington's criticism might be too harsh. Returning to *Borland's Trustee*, which was also instrumental in the development of the anti-deprivation rule in Canadian jurisprudence, it is important to examine the basis on which the transfer price was found to be fair. A point that Worthington overlooks and that Lord Collins fails to highlight is that Justice Farwell concluded that he was "dealing with a company whose assets are really in a sense incapable of valuation, but in which the parties have agreed on a basis of valuation which seems to [him] to be fair."¹³¹ Given that the agreement was "come to between the parties after discussion and discontent on the part of some of them," Farwell J held that it would strain the fraud upon the bankruptcy law principle to use it to overturn the parties' joint decision.¹³²

By focusing on how the parties must have negotiated the terms of transfer since the company's shares could not be valued by ordinary means, Justice Farwell seems to be persuaded by the fact that the arrangement was a bona fide commercial agreement. These points, rather than the ones Lord Collins cited, would likely better substantiate his argument that Justice Farwell's decision turned on the parties' good faith and the commercial nature of the transaction.

Lord Collins discussed two additional cases that involved organizations whose interests cannot be divorced from their membership in a body, such as when only member firms of a particular stock exchange are able to hold shares in the exchange.¹³³ For instance, in *Money Markets*, a clause requiring members of a stock exchange to lose their membership—that is their share in the exchange—if they defaulted on their obligations

¹²⁸ Worthington, *supra* note 102 at 116.

¹²⁹ *Ibid.*

¹³⁰ *Ibid.*

¹³¹ *Borland's Trustee*, *supra* note 123 at 292.

¹³² *Ibid.*

¹³³ See *Belmont*, *supra* note 4 at paras 71–72, citing *Bombay Official Assignee v Shroff* (1932), 48 TLR 443 (PC); *Money Markets*, *supra* note 61. See also Goode, *Principles*, *supra* note 5 at para 7-07.

was challenged in court. In that case, Justice Neuberger emphasized the importance of examining the rationale underlying the impugned provision, agreeing that it is reasonable to expel members who have not honored their commitments.¹³⁴ Again, the commercial nature of the agreements seemed to have played an important part. Although Justice Neuberger held that freedom of contract was not sufficient to uphold the validity of the clause,¹³⁵ Lord Collins' test solves this problem by incorporating an additional factor—that being whether the parties were deliberately attempting to deprive one of the parties of its property on its bankruptcy. Thus, Lord Collins' approach could be regarded as only an incremental change in the law.

Nevertheless, both Goode and Worthington are rightly concerned over the difficulty in applying Lord Collins' formulation of the anti-deprivation rule. For instance, it is unclear as to what constitutes a "borderline case"—a situation where Lord Collins held the anti-deprivation rule would not apply.¹³⁶ Goode suggests that Lord Collins intended that parties should be given the benefit of the doubt when it comes to questions of good faith.¹³⁷ Worthington, in contrast, believes that Lord Collins intended the decisive factor to be proof of deprivation.¹³⁸ Furthermore, as observed in Part II.E.1., there is also the difficulty of determining *ex post* whether there has indeed been bad faith.¹³⁹ On the facts of *Belmont*, Lord Collins likely felt some pressure to give deference to the parties' contractual rights; after all, as explained in Part II.E.1., flawed assets have long played a prominent role in international financing agreements.

Finally, as will be further explored in Part III.C.6., an anti-deprivation rule that applies in a range of cases, though providing consistency, may not always be ideal. Whereas the anti-deprivation rule was first developed in cases of personal bankruptcies, the decisions Lord Collins relied on mostly involved large, sophisticated financial institutions. Different considerations apply in each of those situations. Although consistency across insolvency regimes is important, as will be seen, Canada's differing approaches to individual and corporate bankruptcies as well as to situations involving eligible financial contracts may be preferable.

¹³⁴ See *Money Markets*, *supra* note 61 at paras 130–35.

¹³⁵ See *ibid* at paras 119–20.

¹³⁶ *Belmont*, *supra* note 4 at para 79. Lord Collins presumed that the borderline case involved "a commercially sensible transaction entered into in good faith" (*ibid*).

¹³⁷ Goode, "Flip Clauses", *supra* note 110 at 173.

¹³⁸ Worthington, *supra* note 102 at 117.

¹³⁹ See *ibid* at 118.

III. The Treatment of *Ipsa Facto* Clauses in Canada

A. Introduction

Much like England, Canada also has its own statutory provisions relating to fraudulent transactions and preferences.¹⁴⁰ The differences between them and the anti-deprivation rule are similar to the ones explored in Part II.C., so they will not be repeated here. Writing the minority judgment in *Belmont*, Lord Mance remarked that “any general rule invalidating ipso facto termination clauses ought to be a matter for legislative attention, rather than novel common law development.”¹⁴¹ Unfortunately for Lord Mance, England’s approach to *ipso facto* clauses has stemmed from the common law. Rather, Lord Mance’s view more aptly describes the situation in the United States, where the *Bankruptcy Code* has declared *ipso facto* clauses with respect to executory contracts and unexpired leases to be unenforceable.¹⁴²

Canada is unique in having taken the middle ground. Like its English counterpart, Canadian jurisprudence recognizes the anti-deprivation rule; however, its validity in Canada, as will be explained in Part III.B., is debatable. Canada has also followed the United States in enacting legislative provisions that explicitly deal with a non-defaulting party’s rights when a debtor becomes insolvent. Both the *BIA* and the *CCAA* have largely nullified *ipso facto* clauses, except in the cases of corporate bankruptcies and receiverships. Another similarity between Canadian legislation and its American counterpart lies in an exemption for certain types of financial contracts. As seen in Part I.C., the *Bankruptcy Code*’s prohibition on *ipso facto* clauses does not apply to agreements such as commodities and forward contracts.¹⁴³ Both the *BIA* and the *CCAA* contain carve-outs for eligible financial contracts—an umbrella term, now defined by regulation, that encompasses similar arrangements.¹⁴⁴

Canadian commentary on *ipso facto* clauses and the anti-deprivation rule is limited.¹⁴⁵ Shea references *ipso facto* clauses in his comprehensive

¹⁴⁰ See *BIA*, *supra* note 1, ss 95–97; *CCAA*, *supra* note 2, s 36.1.

¹⁴¹ *Belmont*, *supra* note 4 at para 174.

¹⁴² *Bankruptcy Code*, *supra* note 35, §§ 365(b)(2), 365(e)(1).

¹⁴³ *Ibid.*, §§ 555–56.

¹⁴⁴ See *Eligible Financial Contract General Rules (Bankruptcy and Insolvency Act)*, SOR/2007-256, s 2.

¹⁴⁵ See Margaret Grottenthaler & Elizabeth Pillon, “Financial Products and the Anti-Forfeiture Principle” (2012) Insolvency Institute of Canada (WLNext Can), which briefly discusses the treatment of contracts in insolvency in England, Canada, and the United States.

overview on the treatment of executory contracts in insolvency.¹⁴⁶ Duggan et al., in addition to providing a brief overview of the case law, have also summarized some of the differences between section 84.2 of the *BIA*, which applies in the case of individual bankruptcies, and the anti-deprivation rule.¹⁴⁷ Wood, in a recently published case comment, examines both the anti-deprivation and the *pari passu* rules, along with section 84.2 of the *BIA*, within the context of direct payment clauses.¹⁴⁸

Nothing in the literature, however, comprehensively treats the interplay between Canada's statutory provisions and the common law. Drawing from the above discussion on the anti-deprivation rule as it developed in England, this article seeks to add to the literature by exploring the interaction between both the common law and statutory provisions in the *BIA* and the *CCAA* in Canada. Part III.B. will first examine the current status of the anti-deprivation rule in Canada. Despite the principle's long-standing history in English jurisprudence, the rule has not been widely applied by Canadian courts. Some have even suggested that the Supreme Court of Canada has overruled it. Part III.C. will then provide an overview of the provisions in the *BIA* and the *CCAA* that explicitly prohibit *ipso facto* provisions, which are applicable in cases of Division I proposals for insolvent persons, consumer proposals for individuals, personal bankruptcies, and proceedings under the *CCAA*. By using the concepts described in Part II as a guide, this article will examine the degree to which these provisions are a codification of the English anti-deprivation principle. Since the statutory prohibition does not extend to all types of insolvencies, the anti-deprivation rule is still relevant. Thus, in Part III.C., as each aspect of the statutory provisions is examined, this article will also discuss how the same issue might be decided at common law. Since little Canadian case law that applies the anti-deprivation rule exists, the English jurisprudence may provide some useful insight.

¹⁴⁶ E Patrick Shea, "National Report for Canada" in Dennis Faber et al, eds, *Treatment of Contracts in Insolvency* (New York: Oxford University Press, 2013) 67 at 104.

¹⁴⁷ Duggan et al, *supra* note 34 at 297.

¹⁴⁸ Roderick J Wood, "Direct Payment Clauses and the Fraud upon the Bankruptcy Law Principle: *Re Horizon Earthworks Ltd. (Bankrupt)*" (2014) 52:1 *Alta L Rev* 171 [Wood, "Direct Payment Clauses"]. Direct payment clauses, which are typically used in construction contracts to enable an employer to pay subcontractors directly when the main contractor becomes insolvent, have been found to contravene the *pari passu* rule (see *ibid* at 178–79; Goode, *Principles*, *supra* note 5 at paras 8–11). Direct payment clauses are outside the scope of this article; it should be noted that Lord Collins did not discuss them in *Belmont* while Lord Mance stated that *Belmont* "say[s] nothing about ... direct payment clauses" (*Belmont*, *supra* note 4 at para 148).

B. The Anti-Deprivation Rule in Canadian Jurisprudence

As briefly highlighted in Part III.A., neither the *BIA* nor the *CCAA* prevents non-defaulting parties from relying on *ipso facto* clauses when a debtor files for corporate bankruptcy, is placed in receivership, or is a party to an eligible financial contract. The common law becomes relevant in these situations. Canadian courts still refer to the concept as the fraud upon the bankruptcy law principle, as the practice of using the term “deprivation” in this context was not, as explained in Part II.D., adopted in England until 2002. To maintain consistency, though, this article will continue to refer to the principle as the anti-deprivation rule.

Although the Supreme Court of Canada first recognized the anti-deprivation rule as early as 1890,¹⁴⁹ the modern application of this principle in Canadian jurisprudence largely stems from *Canadian Imperial Bank of Commerce v. Bramalea Inc.*,¹⁵⁰ a decision from the Ontario Court of Justice (General Division). Canadian courts have gone on to consider the anti-deprivation rule in cases relating to the distribution of property,¹⁵¹ the transfer of shares at a discounted value,¹⁵² and the distribution of pension plan surpluses.¹⁵³ The following section will begin by outlining *Bramalea* and then examine what effect, if any, the Supreme Court of Canada’s ruling in *Coopérants, Mutual Life Insurance Society (Liquidator of) v. Dubois*¹⁵⁴ has on the principle’s validity in Canadian law. This section will also discuss some of the jurisprudence following *Bramalea*, culminating in the recent Ontario Court of Appeal decision, *Aircell Communications Inc. (Trustee of) v. Bell Mobility Cellular Inc.*¹⁵⁵

In *Bramalea*, a group of companies (referred to as “the moving parties”) were in a partnership agreement with Trizec to develop and operate a shopping mall. *Bramalea Inc.* would later succeed to Trizec’s interest in

¹⁴⁹ See *Hobbs v Ontario Loan and Debenture Co*, 18 SCR 483 at 487, 1890 CanLII 10. The justices discussed the case *Williams*, *supra* note 78, which was also cited by Lord Collins in *Belmont*, *supra* note 4 at para 61.

¹⁵⁰ 33 OR (3d) 692, 1995 CanLII 7262 (Ct J (Gen Div)) [*Bramalea* cited to OR].

¹⁵¹ See e.g. *Re Wetmore*, [1924] 4 DLR 66 at 75–76, 51 NBR 452 (SC (AD)).

¹⁵² See e.g. *Re Fréchette* (1982), 138 DLR (3d) 61 at 67–69, 42 CBR (NS) 50 (Que Sup Ct); *Bramalea*, *supra* note 150.

¹⁵³ See e.g. *Re Knechtel Furniture Ltd*, 56 CBR (NS) 258 at 264–65, 1985 CarswellOnt 190 (SC (Bank)) [*Knechtel*]. Note that the case law surrounding pension plan surpluses has admittedly grown more complex. See Ari Kaplan & Mitch Frazer, *Pension Law*, 2nd ed (Toronto: Irwin Law, 2013) at 601–604 for a table of cases in this area.

¹⁵⁴ [1996] 1 SCR 900, 133 DLR (4th) 643 [*Coopérants* cited to SCR].

¹⁵⁵ 2013 ONCA 95, 14 CBR (6th) 276 [*Aircell Communications*].

the partnership, but, in 1995, Bramalea was placed into receivership and bankruptcy.¹⁵⁶

At issue before the court was a provision in the partnership agreement that provided that if a partner became insolvent, a non-insolvent partner could purchase the insolvent partner's interest at the lesser of book or fair market value.¹⁵⁷ The moving parties argued that the partnership agreement was an arm's-length commercial transaction that was freely entered into in good faith. They also submitted that the court's interference was not warranted simply because the contract contained onerous obligations that may not have been considered when the contract was signed.¹⁵⁸

Justice Blair agreed with Bramalea's receiver. He found a contractual provision purporting to give certain parties something of value that would have been otherwise available to creditors to be void; his reasoning was that such an arrangement would violate "the public policy of equitable and fair distribution amongst unsecured creditors in insolvency situations."¹⁵⁹ Here, Justice Blair seems to be referring to the *pari passu* principle rather than the anti-deprivation rule, illustrating how easily the two principles can be confused. He then refers to the English case, *Borland's Trustee*, where Justice Farwell stated that a provision that allowed for the purchase of shares at a price less than fair market value in the event of bankruptcy was repugnant to bankruptcy law.¹⁶⁰ Justice Blair characterized the anti-deprivation rule as follows:

[T]he principle which underlies the notion is the deprivation of the creditors' interests in a bankruptcy as a result of a contractual provision that is triggered only in the event of bankruptcy or insolvency and which results in property that would otherwise be available to the bankrupt and the creditors, for its value, being diverted to which is in effect, a preferred unsecured creditor.¹⁶¹

Although Justice Blair recognized that the impugned provision in the partnership agreement may have made sense between the contracting parties to protect their interests, the provision was void as it violated the anti-deprivation rule.¹⁶² Justice Blair's language from the quoted passage implies that the principle could be applied to creditors; however, the moving parties were not Bramalea's creditors but its partners in a partner-

¹⁵⁶ *Bramalea*, *supra* note 150 at 693.

¹⁵⁷ See *ibid.*

¹⁵⁸ See *ibid* at 694.

¹⁵⁹ *Ibid.*

¹⁶⁰ See *ibid* at 694–95.

¹⁶¹ *Ibid* at 695.

¹⁶² *Ibid.*

ship agreement. The decision in *Bramalea* demonstrates one significant difference between Canadian and English law. As explained in Part II.B., the anti-deprivation rule in England is not applied to creditors. Justice Blair's remarks, however, suggest that in Canada, the anti-deprivation can be applied to creditors and non-creditors alike—an issue that will be further discussed in Part III.C.2.

In addition to *Bramalea*, another notable Canadian decision is *Coopérants*.¹⁶³ Whereas the United Kingdom Supreme Court engaged in a detailed discussion on the development of the anti-deprivation rule in *Belmont*, the Supreme Court of Canada did not make an explicit reference to the principle. Akin to the situation in *Bramalea*, at issue in *Coopérants* was whether a transfer, triggered by insolvency, at below fair market value was void.¹⁶⁴ In *Coopérants*, an agreement provided that if one of the co-owners defaulted and refused a counter-offer from a co-owner, he must sell his interest in the immovable to the other co-owner at seventy-five per cent of its value.¹⁶⁵ The Supreme Court of Canada upheld the impugned provision on the basis that contracts signed in good faith should be respected unless they contain provisions that would prejudice other creditors.¹⁶⁶

The impact of the *Coopérants* decision is less clear. In *Bramalea*, Justice Blair references the scenario in *Coopérants* as an example of where the anti-deprivation rule has been applied to cases involving transfers, triggered by insolvency, at below fair market value.¹⁶⁷ It is important to note, however, that at the time *Bramalea* was decided, the Supreme Court of Canada had yet to issue a decision in *Coopérants*. One can only speculate whether the result in *Bramalea* might have been different had Justice Blair had the benefit of knowing the result in *Coopérants*.

Subsequent jurisprudence has also disagreed about the validity of the anti-deprivation rule after the Supreme Court of Canada's decision in *Coopérants*. A situation similar to *Bramalea* arose a few years later in Alberta. In *Re Westerman*, a law firm's partnership agreement provided that in the event of a partner's bankruptcy, the partner would be expelled and

¹⁶³ *Supra* note 154.

¹⁶⁴ *Ibid.*

¹⁶⁵ *Coopérants*, *supra* note 154 at para 4.

¹⁶⁶ *Ibid* at paras 1, 41, 47.

¹⁶⁷ At the time *Bramalea* (*supra* note 150) was decided, the *Coopérants* appeal was pending before the Supreme Court of Canada. In fact, Justice Blair refers to the Quebec Court of Appeal decision: *Raymond, Chabot, Fafard, Gagnon Inc c Dubois* (1993), [1994] RJQ 55, 37 CBR (3d) 207 (CA), rev'd *Coopérants*, *supra* note 154 (*Bramalea*, *supra* note 150 at para 9).

would only receive half of the value in his capital account.¹⁶⁸ The result in this case is of less importance than the comments made by the court. As Justice Agrios pointed out, the facts in *Re Westerman* were unusual in that a bank also had a security interest in the bankrupt partner's capital account, and there was some dispute as to whether the bank had the authority to discharge its security interest.¹⁶⁹

Agreeing with the decision in *Bramalea*, Justice Agrios held that, were it not for the issue over the bank's authority to discharge its security interest, the contractual arrangements between the law firm and the bankrupt partner would have been invalid.¹⁷⁰ What is striking is how Justice Agrios' view on *Coopérants* differs from that of Registrar Quinn, who heard *Re Westerman* at first instance. The *Coopérants* decision was decided with respect to the *Winding-up and Restructuring Act*.¹⁷¹ Registrar Quinn suggests that if *Coopérants* were extended to cases falling under the *BIA*, the anti-deprivation principle as established by the *Bramalea* line of cases was effectively overruled.¹⁷² Justice Agrios disagreed, holding that the judgment in *Coopérants* was confined to the *WURA* and not the *BIA*.¹⁷³ Justice Agrios' stance is bolstered by the fact that the Supreme Court of Canada in *Coopérants* did not mention the line of Canadian cases that have applied the anti-deprivation rule.¹⁷⁴

Both judgments in *Westerman*, however, mischaracterize the *Coopérants* decision. The Supreme Court of Canada did not overrule the anti-deprivation rule. Although the *WURA* differs from both the *BIA* and the *CCAA* as it applies to only certain entities such as federal corporations

¹⁶⁸ 1999 ABQB 708 at paras 1–4, 275 AR 114 [*Westerman* (1999)].

¹⁶⁹ *Ibid* at paras 7–15.

¹⁷⁰ *Ibid* at para 16.

¹⁷¹ RSC 1985, c W-11 [*WURA*].

¹⁷² *Re Westerman*, 1998 ABQB 946 at para 20, 234 AR 371 [*Westerman* (1998)]. Registrar Quinn was referring to the *Bramalea* (*supra* note 150), *Fréchette* (*supra* note 152), and *Knechtel* (*supra* note 153) line of cases.

¹⁷³ *Westerman* (1999), *supra* note 168 at para 20. The Supreme Court in *Coopérants* stated that there was a difference in the *WURA*'s treatment of property upon liquidation than that under the *BIA*. Under the *WURA*, *supra* note 171, s 33 the liquidator takes custody but not ownership of the company's property whereas under the *BIA*, *supra* note 1, s 71(2) the property vests in the trustee. Note that Registrar Quinn of the Alberta Court of Queen's Bench who heard the first *Westerman* decision assumed "for the sake of argument (but without deciding)" that the *Coopérants* holding applied (*Westerman* (1998), *supra* note 172 at para 22; see also *Coopérants*, *supra* note 154 at paras 27–30).

¹⁷⁴ This observation was made by the court in *Westerman* (1998), *supra* note 172 at para 20.

and banks,¹⁷⁵ the decision in *Coopérants* did not turn on a provision unique to the *WURA*. Rather, the Supreme Court of Canada's comments could be confined to the specific facts in *Coopérants*; it observed that the subject matter was "a unique, non-fungible and indivisible property."¹⁷⁶ It also found that the sale of the asset to this particular co-owner would not diminish the assets available to creditors and that the failure to sell the asset to the co-owner would only harm him without any benefits to the bankrupt's other creditors.¹⁷⁷ The Supreme Court of Canada held that it could not determine whether the selling price was necessarily below fair market value since the contract required the appraisers to determine the value of the immovable as a whole, despite the fact it was held in undivided co-ownership.¹⁷⁸ Finally, the Supreme Court of Canada held that it was not established creditors would be harmed as no evidence was brought forward demonstrating that the proposed selling price would be less than fair market value.¹⁷⁹

Given the Supreme Court of Canada's language and the facts in *Coopérants*, an analogy can be drawn between this case and *Borland's Trustee*. As noted above, *Borland's Trustee* was the English decision that underpinned the formulation of the anti-deprivation rule in the Ontario Court of Appeal's judgment in *Bramalea*. In *Borland's Trustee*, Justice Farwell stated that shares were incapable of being valued by ordinary means, but he held that the contract provided for a fair way to arrive at a price.¹⁸⁰ Similarly, in *Coopérants*, the unique property could only be valued by reference to the partnership agreement. There was nothing before the Supreme Court of Canada that illustrated that either a deprivation had taken place or that the sale would harm other creditors. *Coopérants* could be distinguished from the classic cases, highlighted in Part II.D., where there was a clear deprivation of the debtor's assets. Thus, the *Coopérants* decision did not overrule the anti-deprivation rule.

¹⁷⁵ The *WURA*, *supra* note 171 applies to certain entities like federal corporations, banks, and trust companies (see Wood, *Bankruptcy*, *supra* note 27 at 15–16). See also Thomas GW Telfer & Bruce Welling, "The *Winding-Up and Restructuring Act*: Realigning Insolvency's Orphan to the Modern Law Reform Process" (2008) 24:1 BFLR 233 (discussing problems with the *WURA* and potential reforms).

¹⁷⁶ *Coopérants*, *supra* note 154 at para 38.

¹⁷⁷ See *ibid* at para 40.

¹⁷⁸ See *ibid* at para 44.

¹⁷⁹ See *ibid*.

¹⁸⁰ See *Borland's Trustee*, *supra* note 123 at 292.

The anti-deprivation rule, however, has not been widely used in Canadian jurisprudence.¹⁸¹ It was held not to apply where the impugned provision could be exercised at any time and was not necessarily linked to bankruptcy¹⁸² as well as where the agreements were bona fide arrangements that were not designed to create a preference.¹⁸³ Sometimes, the anti-deprivation rule was not even mentioned, and a provision that could have been challenged under the rule was upheld on the basis that the agreements were entered into in good faith.¹⁸⁴ The potential role of good faith will be explored in greater detail in Part III.D.2.

Nevertheless, the anti-deprivation rule was recently affirmed by the Ontario Court of Appeal in *Aircell Communications*.¹⁸⁵ In this case, Aircell, an independent dealer of Bell's telecommunication products and services, bought inventory from Bell and was paid commissions in relation to services that Aircell sold. As Aircell owed Bell nearly \$64,000, Bell gave notice to Aircell that their agreement would be terminated if the outstanding amount was not paid in thirty days. Bell, however, was unaware that Aircell had filed a Notice of Intention to make a proposal under the *BIA*. Prior to the expiry of the thirty-day notice period, Aircell was deemed a bankrupt.¹⁸⁶

Bell and Aircell's agreement contained a clause that provided that if Bell terminated the agreement due to Aircell's failure to remedy a default in payment within thirty days of receiving notice, or otherwise in accordance with the agreement, Bell's obligations to pay Aircell commissions "shall cease immediately."¹⁸⁷ Bell relied on this clause to withhold paying Aircell's trustee in bankruptcy \$188,981 in commissions. Applying

¹⁸¹ See e.g. *Re Song Corp.*, (2002) 31 CBR (4th) 97 at para 61, 19 CPR (4th) 235 (Ont Sup Ct J (Commercial List)) [*Song Corp.*] (where the court held that the principle cited in *Bramalea*, *supra* note 150 was not needed to resolve the contractual issues in question). See also Norman Siebrasse & Anthony Duggan, "Protection of Creators' Rights in Insolvency" (2014) 26:3 IPJ 269 for a discussion of some of the issues raised in this case.

¹⁸² See *Central Guaranty Trust Co v Hees International Bancorp Inc.*, 2001 CarswellOnt 3329 (WL Can) at paras 157–58, [2001] OJ No 3681 (QL) (Sup Ct J). Note that this case was considered under the *WURA*, *supra* note 171.

¹⁸³ See *S Funtig & Associates Inc v Windsor (City)* (2008), 46 CBR (5th) 283 at paras 63–66, 49 MPLR (4th) 47 (Ont Sup Ct J) [*Funtig*].

¹⁸⁴ See *Re Atlantic Cultural Constructing Ltd* (1985), 70 NSR (2d) 26 at paras 12–16, 56 CBR (NS) 266 (SC), *aff'd* (1986), 74 NSR (2d) 89, 59 CBR (NS) 205 (CA) [*Atlantic*] where the court upheld a provision requiring a publisher, upon bankruptcy, to pay any sales proceeds due and deliver unsold prints to a certain group of investors.

¹⁸⁵ *Supra* note 155 at para 12.

¹⁸⁶ See *ibid* at paras 4–8.

¹⁸⁷ *Ibid* at para 8.

Bramalea, the Court of Appeal found the clause to be invalid.¹⁸⁸ The Court of Appeal held that, although the impugned provision could be triggered when the agreement was terminated for “any number of reasons, and not only upon insolvency or bankruptcy, it was in fact triggered as a consequence of Aircell’s insolvency.”¹⁸⁹

Although the Ontario Court of Appeal reaffirmed *Bramalea* and confirmed the validity of the anti-deprivation rule in Canadian law, it is unfortunate that it did not discuss the effect, if any, of the Supreme Court of Canada’s decision in *Coopérants*. Furthermore, the relationship between the common law principle and the provisions in the *BIA* and the *CCAA* that prohibit *ipso facto* clauses has yet to be clearly elucidated by the courts. The Court of Appeal in *Aircell Communications* did not address the trial judge’s alternative conclusion that the impugned provision would have been void either under the *BIA* provisions relating to *ipso facto* provisions or preferences, on the basis that neither of those sections applied.¹⁹⁰ Furthermore, only a dissenting opinion from an Alberta Court of Appeal decision has commented on the relationship between the anti-deprivation rule and the provisions in the *BIA* and *CCCA*, stating that the latter codified the common law.¹⁹¹ Part III.C. of this article seeks to explore to what extent the *BIA* and the *CCAA* have codified or displaced the anti-deprivation rule.

C. A Codification of the Anti-Deprivation Rule?

Despite the anti-deprivation’s rule long-standing place in English jurisprudence and the fact that the United States *Bankruptcy Code* introduced provisions relating to *ipso facto* clauses in the late 1970s to early 1980s,¹⁹² in Canada, Parliament did not respond until the 1990s. Section 65.1 of the *BIA*, which nullified *ipso facto* clauses when a debtor files a proposal or a notice of intention to do so, was enacted in 1992.¹⁹³ This was

¹⁸⁸ See *ibid* at paras 11–13.

¹⁸⁹ *Ibid* at para 12.

¹⁹⁰ See *ibid* at paras 11–13. The *BIA* prohibits *ipso facto* clauses (*supra* note 1, s 65.1). It also prohibits transfers of property to a creditor with the intention of giving that creditor a preference over another creditor where the transfers are made in a certain time period leading up to the date of the debtor’s bankruptcy—the duration of the period being requisite on whether there is an arm’s-length relationship between the transferee and the transferor (*ibid*, s 95).

¹⁹¹ See *Valin Industrial*, *supra* note 62 at paras 33–41.

¹⁹² See Robert L Ruben, “Legislative and Judicial Confusion Concerning Executory Contracts in Bankruptcy” (1985) 89:4 *Dick L Rev* 1029 at 1029, 1033, nn 16–17.

¹⁹³ See Ellen L Hayes, “Executory Contracts in Debt Restructuring” (1994–1995) 24 *Can Bus LJ* 44 at 45.

the first time that a statutory provision directly dealt with a non-defaulting party's rights when a debtor becomes insolvent. As in the United States, subsection 65.1(7) contained an exemption for eligible financial contracts.¹⁹⁴

The remaining statutory provisions invalidating *ipso facto* clauses were enacted as part of the extensive reforms to the *BIA* and the *CCAA* between 2005 and 2009.¹⁹⁵ Neither the House of Commons nor the Senate closely scrutinized Bill C-55, which introduced these amendments, as Parliament was dissolved only a few months after the Bill's introduction due to imminent elections.¹⁹⁶ The Senate hastily approved the Bill partially because of its reluctance to further delay the approval of wage earner protection provisions that were packaged with the Bill. The Senate was also moved by a promise from the Paul Martin government that it would have another opportunity to examine the Bill thoroughly prior to its proclamation.¹⁹⁷ In fact, in its November 2005 report on Bill C-55, the Standing Senate Committee on Banking, Trade, and Commerce drew attention to the protection of eligible financial contracts during insolvency proceedings as well as executory contracts as areas that required further study.¹⁹⁸

The newly-elected Harper government, however, enacted Bill C-55 without further study by the Senate although the bulk of the provisions did not come into force until 2009.¹⁹⁹ Although the Standing Senate Banking, Trade and Commerce Committee did later hold hearings on the enacted bill, it did not issue a final report.²⁰⁰ Ziegel believes that the bills did

¹⁹⁴ See *BIA*, *supra* note 1, s 65.1(7).

¹⁹⁵ See E Patrick Shea, *Bankruptcy and Insolvency Act, Companies' Creditors Arrangement Act: Bill C-55 & Commentary* (Markham: LexisNexis Canada, 2006) (which provides versions of the *BIA* and *CCAA* before and after the 2005 and 2007 amendments).

¹⁹⁶ See Duggan et al, *supra* note 34 at 23.

¹⁹⁷ See *ibid.*

¹⁹⁸ Senate, Standing Committee on Banking Trade and Commerce, *Seventeenth Report* (24 November 2005) Parliament of Canada: online <www.parl.gc.ca/Content/SEN/Committee/381/bank/rep/rep17nov05-e.htm>.

¹⁹⁹ The delay was due to a number of reasons. The Harper government, in response to some critics and to rectify some drafting errors, introduced a Ways and Means motion to amend the law in December 2006, which was in turn delayed due to opposition from members of Parliament representing Quebec who opposed provisions relating to Registered Retirement Savings Plans (RRSPs). The motion was eventually passed, but the bill containing the amendments, Bill C-62, died on order paper. Bill C-62 was reintroduced as Bill C-12 in the following session. The Senate Banking, Trade and Commerce Committee again approved the bill with little study as the government wished to pass Bill C-12 so that the much-desired wage earner protection provisions could come into force. See Duggan et al, *supra* note 34 at 23; Jacob Ziegel, "Canada's Dysfunctional Insolvency Reform Process and the Search for Solutions" (2010) 26:1 BFLR 63 at 71–75.

²⁰⁰ See Ziegel, *supra* note 199 at 75.

not receive “detailed, nor for that matter, any meaningful, scrutiny in the Commons or the Senate and their respective committees before these bills received Parliamentary approval.”²⁰¹

At present, the relevant provisions are sections 65.1, 66.34, and 84.2 of the *BIA* as well as section 34 of the *CCAA*. Sections 65.1 and 66.34 apply to proposals for insolvent persons (Division I) and consumer proposals (Division II) respectively.²⁰² Section 84.2 applies in cases involving individual bankrupts while section 34 of the *CCAA*, as explained in Part I, applies to companies with more than \$5 million of debt. These provisions prohibit *ipso facto* clauses that purport to allow the non-defaulting party to terminate or amend agreements, or to claim an accelerated payment or forfeiture under any agreement, including security agreements.²⁰³ Each of the four sections also contains a catch-all provision that states that any contractual clause that, in substance, is contrary to the provision as a whole is of no force or effect.²⁰⁴ Corporate bankrupts and receiverships are notable exceptions from these provisions governing *ipso facto* clauses in the *BIA* and the *CCAA*, which suggests that such clauses are still enforceable in both of these cases.

Despite its troubled legislative history, these provisions in the *BIA* and the *CCAA* are probably beneficial to Canadian insolvency law. Wood believes that the amendments to the *BIA* and the *CCAA* not only aligned their approaches to *ipso facto* clauses but were a statutory codification of the rules in this area.²⁰⁵ Wood, however, does not address the role, if any, the anti-deprivation rule might continue to play. The following sections will explore how these relatively new statutory provisions might interact with the existing common law jurisprudence.

²⁰¹ *Ibid.*

²⁰² *BIA*, *supra* note 1, ss 65.1, 84.2. See *ibid.*, s 2 for definitions of “insolvent person” and “person”. Insolvent persons are not bankrupt but have failed to meet the cash flow or balance sheet tests. A person includes “a partnership, an unincorporated association, a corporation, a cooperative society or a cooperative organization, the successors of a partnership, of an association, of a corporation, of a society or of an organization and the heirs, executors, liquidators of the succession, administrators or other legal representatives of a person” (*ibid.*).

²⁰³ See *ibid.*, ss 65.1(1), 66.34(1), 84.2(1); *CCAA*, *supra* note 2, s 34(1). Coincidentally, the provisions in the *BIA* and the *CCAA* would address some of the concerns raised by Lord Mance in *Belmont*. Lord Mance observed that attempts to remove property from the bankrupt estate for no consideration, increasing the security given to a particular creditor, and increasing the bankrupt’s estate liability are all situations that fall within the scope of the anti-deprivation rule (see Part II.D., above).

²⁰⁴ See *BIA*, *supra* note 1, ss 65.1(5), 66.34(5), 84.2(5); *CCAA*, *supra* note 2, s 34(5).

²⁰⁵ Wood, *Bankruptcy*, *supra* note 27 at 369–70.

1. The Application of the Statutory Provisions and the Anti-Deprivation Rule

The application of each of the four sections discussed is triggered by some act of insolvency or bankruptcy under the relevant statute. These acts include the filing of a notice of intention or proposal,²⁰⁶ bankruptcy for individuals,²⁰⁷ the debtor qualifying as insolvent under the *BIA* or the *CCAA*, or a proceeding commenced under the *CCAA*.²⁰⁸ A debtor is considered insolvent if it fails the cash flow tests by being unable to meet current obligations as they generally become due or has not been able to do so in the past, or by failing the balance sheet test such that its assets are insufficient to satisfy its liabilities.²⁰⁹ In this respect, not only is Canadian law much clearer than its English counterpart, but the statutory provisions are wider in scope than the anti-deprivation rule.

Goode criticizes Lord Collins' decision in *Belmont* for its lack of clarity on whether the rule applied in cases of "mere factual insolvency".²¹⁰ The English anti-deprivation cases described in Part II.D. involved a formal act of insolvency, such as a personal bankruptcy or a foreign proceeding, as in *Belmont*. In contrast, a formal act of insolvency is not always required under Canadian law. Under section 84.2 of the *BIA* and section 34 of the *CCAA*, a debtor's insolvency is sufficient to trigger the application of the statutory provision.²¹¹ The tests for insolvency, however, do not require a formal act of insolvency such as the filing of a proposal or a bankruptcy order. Thus, in some situations, the *BIA* and the *CCAA* arguably provide greater protection to a debtor than the common law. Once a debtor has been deemed insolvent by failing to pass the balance sheet or cash flow tests, this would be sufficient to trigger the application of these sections even though it has yet to file a proposal, a notice of intent, or be peti-

²⁰⁶ See *BIA*, *supra* note 1, ss 65.1(1), 66.34(1). Only section 65.1 can be triggered by the filing of a notice of intention.

²⁰⁷ See *BIA*, *supra* note 1, s 84.2(1).

²⁰⁸ Although the *CCAA*, *supra* note 2 does not define when a company is considered insolvent, Justice Farley held in *Re Stelco Inc* (2004), 48 CBR (4th) 299 at para 19, 129 ACWS (3d) 1065 (Ont Sup Ct J) that a longer time horizon must be used since *CCAA* proceedings tend to take at least a year. As Wood points out, this creates some degree of uncertainty of when a company would be considered insolvent under the *CCAA* (Wood, *Bankruptcy*, *supra* note 27 at 22–23). See also *BIA*, *supra* note 1, ss 66.34, 84.2; *CCAA*, *supra* note 2, s 34(1).

²⁰⁹ See the definition of "insolvent person" in *BIA*, *supra* note 1, s 2. Subsections (a) and (b) are known as cash flow tests. Subsection (c) is the balance sheet test. See Wood, *Bankruptcy*, *supra* note 27 at 18–22 for an explanation of these tests.

²¹⁰ Goode, "Flip Clauses", *supra* note 110 at 174.

²¹¹ *BIA*, *supra* note 1, s 84.2(1); *CCAA*, *supra* note 2, s 34(1).

tioned into bankruptcy. As this issue has yet to arise before Canadian courts, these provisions remain largely untested.

The result in *Re Nautical Data International*²¹² may provide some insight into this issue. In that case, the court examined section 65.1(1) of the *BIA*, which is only triggered where the debtor has filed a notice of intention or a proposal. That said, the court found that it still had the jurisdiction to determine whether a contract had been terminated on the basis of the insolvency of one of the contracting parties.²¹³ Given that the language in section 34 of the *CCAA* and section 84.2 of the *BIA* is much broader than section 65.1 of the *BIA*, in the sense that they can be triggered by the debtor's insolvency, it seems that a court might be open to the idea of making a factual finding of insolvency under these provisions.²¹⁴

Whether that same breadth of protection is available for the other provisions examined is less clear. Despite the finding in *Nautical Data*, section 65.1 of the *BIA* is really only supposed to be triggered if the debtor filed a notice of intention or proposal.²¹⁵ Similarly, under section 66.34 of the *BIA*, the debtor must have filed a consumer proposal for the section to apply.²¹⁶ Thus, if a court were only to apply the statutory provisions strictly and ignore the common law, a non-defaulting party could, in some situations, rely on *ipso facto* clauses when the debtor could be merely characterized as insolvent under the *BIA* and has yet to file a notice of intention or proposal.

Aircell Communications, however, suggests that the anti-deprivation rule would determine the non-defaulting parties' rights in the period between the debtor becoming insolvent and the filing of a notice of intent or proposal. The facts in this case were addressed in Part III.B. What is relevant to the discussion here is that the Court of Appeal expanded the scope of the anti-deprivation rule to apply to situations where a provision was triggered as a "consequence of Aircell's insolvency"—that is, in this case, Aircell's impending insolvency was the reason that it was unable to remedy a default of payment.²¹⁷ When Bell purported to withhold its obligations, it did so on Aircell's failure to remedy a default under their agree-

²¹² 2005 NLTD 79, 11 CBR (5th) 127 [*Nautical Data*].

²¹³ *Ibid* at para 13.

²¹⁴ *BIA*, supra note 1, s 84.2(1); *CCAA*, supra note 2, s 34(1).

²¹⁵ *BIA*, supra note 1, s 65.1(1).

²¹⁶ *Ibid*, s 66.34(1).

²¹⁷ *Aircell Communications*, supra note 155 at para 12.

ment, not on Aircell becoming bankrupt.²¹⁸ The Court of Appeal did observe that the trustees conceded that section 65.1 of the *BIA* was inapplicable.²¹⁹ Thus, where the statutory provisions do not apply or have not yet been triggered, the decision in *Aircell Communications* suggests that the anti-deprivation principle could apply to invalidate *ipso facto* clauses.

2. The Affected Parties

What kind of parties might be affected by the statutory provisions or the anti-deprivation rule? The English jurisprudence only extends protection to the insolvent party with whom the non-defaulting party has entered into a contract.²²⁰ That is, where another party's insolvency triggers an *ipso facto* clause in an agreement between the debtor and the non-defaulting party, the anti-deprivation rule would not apply.²²¹ The Canadian statutory provisions follow a similar approach.

As seen in Part II.B., Goode distinguished the *pari passu* principle from the anti-deprivation rule on the basis that the latter did not apply to creditors. Conceptually, this is difficult to understand once executory contracts are considered. As explained in Part I.C., executory contracts arise where both parties have outstanding obligations and the failure to perform would be a material breach.²²² In *Aircell Communications*, for instance, both Bell and Aircell had substantial outstanding obligations under their contract—that is, to pay commissions and to pay for the inventory respectively. Bell, though, qualified as a creditor under the *BIA*. A creditor is defined as a person who has a claim, either liquidated or unliquidated, that is provable in bankruptcy.²²³

Unfortunately, Lord Collins deliberately stayed silent on whether the anti-deprivation rule was applicable to executory contracts.²²⁴ In a later case, *Lomas v. JFB Firth Rixson Inc.*,²²⁵ the English Court of Appeal seemed to suggest, though refraining from using the term “executory contracts”, that situations where parties have outstanding obligations could

²¹⁸ See *ibid* at para 8.

²¹⁹ See *ibid* at para 13.

²²⁰ See Edward Murray, “*Lomas v Firth Rixson: ‘As You Were!’*” (2013) 8:4 Capital Markets LJ 395 at 413 [Murray, “As You Were!”].

²²¹ See *ibid*.

²²² See Pickerill, *supra* note 39 at 64.

²²³ See Wood, *Bankruptcy*, *supra* note 27 at 55; *BIA*, *supra* note 1, ss 2, 121.

²²⁴ See *Belmont*, *supra* note 4 at paras 100–101.

²²⁵ [2012] EWCA Civ 419, [2012] 1 CLC 713.

be considered under Lord Collins' approach outlined in *Belmont*.²²⁶ The Canadian statutory provisions being examined, however, sidestep this difficulty by stating that "no person" can rely on *ipso facto* clauses, without specifying the nature of that person's relationship with the debtor. That is, the statutory provisions could apply to, for instance, a creditor party to an executory contract or a partner as in the case of *Borland's Trustee*. Thus, the statutory provisions not only codified the principle but expanded its scope.

What about cases involving corporate bankrupts and receiverships where the statutory provisions are inapplicable? Unfortunately, the dearth of case law means that it is difficult to answer this question with any confidence. The language used by the courts likely adds to the confusion. In *PIA Investments Inc. v. Deerhurst Ltd. Partnership*,²²⁷ the debtor's receiver challenged the validity of a provision that required the debtor to pay outstanding fees to Canadian Pacific Hotels Corporation, which operated the debtor's hotel.²²⁸ The Ontario Court of Appeal, however, held that the anti-deprivation rule only operates to strike down provisions that affect the debtor's creditors.²²⁹ This reference to creditors likely stemmed from the language used in *Bramalea* (see Part III.B.), which was cited by the Ontario Court of Appeal in *PIA Investments*.²³⁰ Whether the anti-deprivation rule applies to creditors remains unresolved since this particular issue was not discussed by the Ontario Court of Appeal in *Aircell Communications*.

3. Timing Requirements

Lord Collins' decision in *Belmont* was also unclear on whether the anti-deprivation rule applied if the deprivation occurred after the debtor's bankruptcy.²³¹ In this respect, the Canadian statutory provisions have largely displaced the common law by omitting the timing requirements seen in the provisions relating to preferences and transactions at an undervalue. If the debtor's insolvency or its filing of bankruptcy, notice of in-

²²⁶ See *ibid* at paras 88–92 where Lord Justice Longmore of the Court of Appeal refers to a quid pro quo test, which was formulated by the lower court in the same case, as being subsumed within the wider approach laid out in *Belmont*. For a discussion of the quid pro quo test, see Edward Murray, "Lomas v Firth Rixson: A Curate's Egg?" (2012) 7:1 Capital Markets LJ 5; Murray, "As You Were!", *supra* note 220 at 412.

²²⁷ 20 CBR (4th) 116, 2000 CanLII 16819 (Ont CA) [*PIA Investments* cited to CBR].

²²⁸ *Ibid* at paras 5, 51–54.

²²⁹ See *ibid* at para 51.

²³⁰ *Ibid*. See also *Bramalea*, *supra* note 150 at 694.

²³¹ See Goode, "Flip Clauses", *supra* note 110 at 174.

tent, proposal, or proceeding (depending on the applicable provision) triggered the *ipso facto* clause, the statutory provisions would apply.²³² The provisions in the *BIA* and the *CCAA*, in turn, suggest that deprivations occurring after an act of bankruptcy or insolvency would be prohibited. Again, what would the situation be like for corporate bankrupts and in receiverships where such statutory protection is unavailable? Unfortunately, the issue has yet to arise in Canadian jurisprudence.

4. Deprivation Took Place for Reasons Other than Bankruptcy

As explained in Part II.E.2., the anti-deprivation rule does not apply in England where the deprivation took place for reasons other than bankruptcy.²³³ As discussed in Part III.C.1., each of the Canadian statutory provisions lists situations where they apply, such as in the case of a bankruptcy order or the filing of a proposal. Their specificity suggests that non-defaulting parties can rely on *ipso facto* clauses triggered on other grounds, such as a general contractual breach as in the English case of *Ex parte Newitt* that was discussed above. Thus, the question is whether the anti-deprivation rule could be used to invalidate an *ipso facto* clause triggered by reasons other than the debtor's bankruptcy.

The jurisprudence on this issue is unclear. The Ontario Court of Appeal's holding in *Aircell Communications* suggests that where the contractual breach is a consequence of the party's insolvency, the court would consider the application of the anti-deprivation principle. Bell's reliance on the impugned clause was based on Aircell's failure to remedy a default in payment within thirty days of notice.²³⁴ It was not because Aircell had filed a notice of intention or that it had been deemed a bankrupt. The court held that Bell had terminated the agreement due to a reason that was a consequence of Aircell's insolvency, and it applied the anti-deprivation rule to hold the provision to be void.²³⁵

An Alberta Court of Appeal case, however, suggests an alternative approach. In *Valin Industrial*, a lease provided that Sok, the lessee, could not exercise an option to purchase the property if he were considered to be in default under the lease.²³⁶ When Sok purported to exercise the option, the landlord argued that Sok was "in default" for two reasons. First, Sok failed to pay "last month's rent", which was attributable to the month of

²³² See *BIA*, *supra* note 1, ss 65.1(1), 66.34(1), 84.2(1); *CCAA*, *supra* note 2, s 34(1).

²³³ See *Belmont*, *supra* note 4 at para 80.

²³⁴ See *Aircell Communications*, *supra* note 155 at paras 8, 11–13.

²³⁵ See *ibid* at para 12.

²³⁶ *Valin Industrial*, *supra* note 62 at paras 1–3.

April 2011 after the lease was extended. Sok only paid “last month’s rent” seven months after the landlord sent him a letter, dated October 13, 2010, demanding him to do so. Second, Sok filed a notice of intention to make a proposal under the *BIA*.²³⁷ The Court of Appeal agreed with the trial judge that the letter dated October 13, 2010 was an effective notice of default and that the landlord was alleging breaches in the lease. Having determined that there was a contractual breach for the late payment of rent, the majority of the Court of Appeal found that it was unnecessary to address whether the clause concerning Sok’s option to purchase the property “was contrary to public policy.”²³⁸ Although the majority did not explicitly mention the anti-deprivation rule, the dissenting justice did find the clause to contravene both the anti-deprivation rule and section 65.1(1) of the *BIA*.²³⁹ Regardless of the dissenting judgment, the decision in *Valin Industrial* suggests that in contrast to *Aircell Communications*, a non-defaulting party could rely on an *ipso facto* clause if it were triggered by grounds unrelated to insolvency, such as a contractual breach.

5. Limited Protection for Flawed Assets

In *Belmont*, Lord Collins struggled with the long-standing distinction between limited and absolute interests as well as flawed assets (see Part II.E.1.). In England, a lease, being a limited interest, could be validly terminated upon a debtor’s insolvency.²⁴⁰ In this respect, the Canadian statutory provisions have displaced the common law. Under section 34(2) of the *CCAA*, lessors cannot terminate or amend a lease by reason only that proceedings have been commenced under the *CCAA*, the company is insolvent, or the company has not paid rent before the commencement of the proceedings.²⁴¹ Similar provisions can be found in the *BIA* with respect to parties filing Division I proposals, consumer proposals, as well as bankrupt individuals.²⁴²

Section 65.1(2) of the *BIA*, however, is the only one of the four sections being examined that also extends this protection to licensing agreements. That is, in the case of a licensing agreement, a party cannot rely on *ipso facto* clauses on the basis that the insolvent person has not paid royalties in the period preceding the filing of the notice of intention or the pro-

²³⁷ *Ibid* at para 3.

²³⁸ *Ibid* at para 8.

²³⁹ *Ibid* at paras 33–36.

²⁴⁰ See Worthington, *supra* note 102 at 118.

²⁴¹ See *CCAA*, *supra* note 1, s 34(2).

²⁴² See *BIA*, *supra* note 1, ss 65.1(2), 66.34(2), 84.2(2).

posal.²⁴³ Although it is only section 65.1(2) of the *BIA* that mentions licenses, it is unlikely that *ipso facto* provisions would be enforceable under the other three sections examined as all use the term “agreement” in the respective language that generally prohibits such *ipso facto* clauses. Licenses might fall under the term “agreement”. Section 65.1 was enacted first, as part of the 1992 amendments, and so it may have been overly careful drafting.

For cases involving corporate bankrupts and receiverships, it is unclear how licensing agreements will be treated as there is little case law on the matter.²⁴⁴ At least in the case of bankruptcy, the trustee must return copyright interests in works that have not been put onto the market.²⁴⁵ As for leases, provincial legislation requires that leases must remain in force during bankruptcy, even if the parties had contracted otherwise.²⁴⁶ The *Commercial Tenancies Act* (Ontario), for example, only requires that the lease remain in force if the lease is assigned or a bankruptcy order has been made.²⁴⁷ Thus, a court could uphold an *ipso facto* clause during a receivership proceeding.

6. Distinctions Between Consumers, Insolvent Persons, and Eligible Financial Contracts

Unlike the common law, legislation can treat unlike debtors differently. As seen in Part II, Lord Collins in *Belmont* was perhaps concerned that if the flip clause was held to be invalid, it might impinge on the ability of financial market participants to manage their risk in international swap transactions. In this respect, Canada’s statutory developments are preferable to the English common law approach. All of the sections examined have carve-out provisions where they are deemed not to apply to eligible financial contracts. The provisions also provide for the netting or setting off of obligations.²⁴⁸

Bélanger and Rigaud suggest that Parliament deliberately decided to exempt corporate bankrupts and those petitioned into receivership from

²⁴³ See *ibid.*, s 65.1(2).

²⁴⁴ For one example, see *Song Corp.*, *supra* note 181 at paras 51–61, 71–74. The trustee argued that certain contractual provisions in a licensing agreement were void. However, the court ultimately decided the case on the *BIA*, *supra* note 1, s 83.

²⁴⁵ See *BIA*, *supra* note 1, s 83(1).

²⁴⁶ Note that in Quebec, *ipso facto* clauses are opposable to trustees (see Halsbury’s Laws of Canada (online), *Bankruptcy and Insolvency* at HBI-70 “General Principles”, n 3).

²⁴⁷ *Commercial Tenancies Act*, RSO 1990, c L7, s 38(2).

²⁴⁸ See *BIA*, *supra* note 1, ss 65.1(7)–(10), 66.34(7)–(9), 84.2(7)–(9); *CCAA*, *supra* note 2, ss 34(7)–(10).

the prohibition on *ipso facto* clauses.²⁴⁹ Grottenthaler and Pillon believe the exclusion is “a clear indication that the purpose of the Canadian *ipso facto* provision and stay provisions is not to prevent the debtor’s estate from being unfairly deprived of an asset, but to maintain the *status quo* during the restructuring process.”²⁵⁰ That may be the case, but such a view is an inadequate explanation of the rationales underlying the provisions. If the purpose were only to maintain the *status quo* during the restructuring process, it does not explain why consumer bankrupts are afforded protection from *ipso facto* clauses.

A better explanation may be that Parliament was concerned about the vulnerability of individual consumers during bankruptcy. Industry Canada has stated that the nullification of *ipso facto* clauses ensures that “the individual bankrupt, who is attempting to obtain his or her ‘fresh start,’ will not be unreasonably evicted from their home, denied basic and essential services or denied other benefits to which they would otherwise be entitled.”²⁵¹ Industry Canada offers similar reasons as to why *ipso facto* clauses should also be nullified in the case of debtor companies under the CCAA.²⁵² The debtor-friendly nature of Canada’s insolvency legislation is also reflected in the fact that all four provisions discussed prevent public utilities from terminating services on the basis that, depending on the provisions, a debtor became insolvent; filed a proposal, CCAA proceeding, or notice of intention; or has become bankrupt.²⁵³ Furthermore, public utilities cannot rely on *ipso facto* clauses triggered by the debtor’s failure

²⁴⁹ Philippe H Bélanger & Sylvain Rigaud, *La réforme en matière d’insolvabilité: nouveautés et codification de pratiques existantes* (Cowansville, Que: Yvon Blais, 2009) at 70–71.

²⁵⁰ Grottenthaler & Pillon, *supra* note 145.

²⁵¹ Corporate, Insolvency and Competition Law Policy Directorate, “Bill C-55: Clause by Clause Analysis”, s 84.2(2), online: Industry Canada <www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/h_cl00790.html> [Industry Canada, “Clause by Clause”]. See also Senate, Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies Creditors Arrangement Act* (November 2003) at 74–75, online: Parliament of Canada <www.parl.gc.ca/Content/SEN/Committee/372/bank/rep/bankruptcy-e.pdf> where the Senate Committee expressed its concern that consumer bankrupts would be cut off from essential services like banking and utilities in the event of bankruptcy. See also *Re Abattoir Coquelicot Inc*, 23 CBR (3d) 267 at paras 20–22, 29, 1993 CarswellQue 40 (QC CS (en matière de faillite)) where the court held that a bank guarantee or deposit for a sum equivalent to two of the most costly months of the year was not required as a condition of continuing service, despite what Hydro-Québec’s bylaws state. Hydro-Québec, being a public utility, was prohibited from discontinuing its services under section 65.1 of the BIA, *supra* note 1. The court has expanded the scope of the section to apply not only where the debtor has failed to pay for utility services but where the debtor had not made a deposit.

²⁵² See Industry Canada, “Clause by Clause”, *supra* note 251.

²⁵³ See BIA, *supra* note 1, ss 65.1(3), 66.34(3), 84.2(3); CCAA, *supra* note 2, s 34(3).

to pay for services rendered or materials provided before the commencement of the applicable bankruptcy or insolvency proceeding.²⁵⁴

The exemption of corporate bankrupts and receiverships from the statutory provisions discussed might partially stem from the fact that in those instances, as seen in Part I.B., the debtor is not expected to continue as a going concern and its assets are simply awaiting liquidation. In contrast, in a proceeding under the *CCAA*, the objective is for the debtor company to successfully restructure, so there is greater concern to maintain the status quo. That said, the provisions discussed, by explicitly prohibiting the denial of essential services, are much more debtor-friendly than what would have been available at common law.

D. Where the Statutory Provisions and the Anti-Deprivation Rule May Not Apply

As seen from Part II.E., the anti-deprivation rule has historically not been applied where there has not been a deprivation and where the deprivation was triggered by a cause other than insolvency. Most recently, Lord Collins in *Belmont* has effectively created another exemption—that is, where the arrangement was made in good faith and without the deliberate intention to deprive the debtor of its assets upon its insolvency. In this respect, the provisions in the *BIA* and the *CCAA* have displaced the common law by creating additional exceptions where *ipso facto* clauses may be upheld. Nevertheless, given that the anti-deprivation rule is still a valid part of Canadian law, it remains to be seen whether Lord Collins' newly created exception will be adopted by Canadian courts.

1. Statutory Exceptions to the General Prohibition in the *BIA* and the *CCAA*

First, both the *BIA* and the *CCAA* contain carve-outs for eligible financial contracts; thus, if a situation akin to *Belmont* were to arise in Canada, the flip clause would have been upheld. Second, both statutes provide mechanisms by which non-defaulting parties can evade the application of the sections. With respect to all four of the sections discussed, the non-defaulting party can demand payment for any goods, services, or use of leased property that was provided after the insolvency event.²⁵⁵ The non-defaulting party is also not obligated to further advance money or

²⁵⁴ See *BIA*, *supra* note 1, ss 65.1(3), 66.34(3), 84.2(3); *CCAA*, *supra* note 2, s 34(3).

²⁵⁵ See *ibid*, ss 65.1(4)(a), 66.34(4)(a), 84.2(4)(a) (in the case of section 65, this right extends to the use of licensed property as well); *CCAA*, *supra* note 2, s 34(4)(a).

credit to the debtor.²⁵⁶ Furthermore, the non-defaulting party, including utilities, can apply for a court order that the section does not apply, or only applies to an extent determined by the court, if the applicant can demonstrate that the operation of the section will cause it significant hardship.²⁵⁷ These mechanisms introduce concepts that have not been seen in the English application of the anti-deprivation rule.

The reason for these provisions may be found in Industry Canada's commentary to Bill C-55, which states that section 84.2 of the *BIA* struck a balance between the bankrupt and the non-defaulting party.²⁵⁸ For instance, the bankrupt, with the exception of payments with respect to leases and utilities, is still expected to pay for goods and services; the non-defaulting parties also reserve the right to demand payment.²⁵⁹ Although these comments were made with respect to individual debtors, the idea that the non-defaulting party and the debtor's rights must be balanced can be applied to all four of the sections discussed.

Unfortunately, there is little case law that interprets these sections. The provision that allows non-defaulting parties to demand payment for goods and services provided after the initial insolvency event may not create new substantive rights. That is, the non-defaulting party might not be able to rely on the section if the right to insist on cash payment, for instance, did not already exist in the contract.²⁶⁰ Hayes offers an alternative perspective. She believes that the subsection effectively allows non-defaulting parties to override the general prohibition on *ipso facto* clauses.²⁶¹ Hayes justifies her viewpoint on the basis that otherwise, parties could be obligated to extend further credit to the insolvent party.²⁶²

The case law has largely focused on section 65.1 of the *BIA*, which was enacted nearly a decade after the other provisions examined. Nevertheless, the concepts discussed could be extended to the other provisions as all of them are similarly worded. The purpose of section 65.1 of the *BIA* has been recognized as trying to balance the competing interests of the in-

²⁵⁶ See *BIA*, *supra* note 1, ss 65.1(4)(b), 66.34(4)(b), 84.2(4)(b); *CCAA*, *supra* note 2, s 34(4)(b).

²⁵⁷ See *BIA*, *supra* note 1, ss 65.1(6), 66.34(6), 84.2(6); *CCAA*, *supra* note 2, s 34(6).

²⁵⁸ Industry Canada, "Clause by Clause", *supra* note 251.

²⁵⁹ See *ibid*; *BIA*, *supra* note 1, ss 84.2(2)–(4).

²⁶⁰ See KP McElchern, "Suppliers and the Restructuring and Realization Process" (Paper delivered at the Canadian Institute Conference, "Trade Creditors' Rights", 23 February 1993), cited in Hayes, *supra* note 193 at 57.

²⁶¹ Hayes, *supra* note 193 at 57.

²⁶² *Ibid*.

solvent party and its suppliers.²⁶³ Where parties are unsure if something falls within the scope of section 65.1 of the *BIA*, which allows parties to demand immediate cash payments, the party can apply to the court for clarification.²⁶⁴ Courts have held that suppliers cannot be ordered to continue supplying goods on credit if the debtor could only provide security rather than cash payments²⁶⁵ and ad hoc financing arrangements will not be enforced when the non-defaulting party could have proceeded under section 65.1(4) to require that the debtor pay immediately for goods and services provided.²⁶⁶ The court in *Re Cosgrove-Moore Bindery Services Ltd.*²⁶⁷ also observed that it would be contrary to the section's purpose if expensive, lengthy litigation was required for payments to be obtained under section 65.1(4).²⁶⁸

It seems that a non-defaulting party has a high threshold to meet to succeed on an application asking to be exempted from the section's operation. The Ontario Superior Court in *Toronto-Dominion Bank v. Ty (Canada) Inc.*²⁶⁹ agreed with the receiver that section 65.1(6) of the *BIA* requires that the applicant demonstrate "quantitatively the prejudice that it will suffer if the stay is not removed."²⁷⁰ The court denied the application on the basis that the applicant would not suffer prejudice due to the stay, it would be not equitable to do so, and that granting the order would be detrimental to all of the debtor's stakeholders.²⁷¹

A similar approach was applied by the British Columbia Court of Appeal in *Re Galaxy Sports*.²⁷² In that case, the court held that section 65.1

²⁶³ See *HSBC Bank Canada v Tri-Tec Industries Ltd*, 22 CBR (5th) 120 at para 2, 2006 CanLII 17334 (Ont Sup Ct J) [*Tri-Tec Industries*].

²⁶⁴ See *Re Plancher Heritage Ltée/Heritage Flooring Ltd*, 2004 NBQB 168 at paras 72–75, 3 CBR (5th) 60. The court clarified that the bank was not authorized under section 65.1(4)(b) of the *BIA* to take funds from the insolvent party's accounts since credit supplied under a revolving line of credit is not considered to be a further supply of credit under section 65.1(4).

²⁶⁵ See *Re 728835 Ontario Ltd*, 3 CBR (4th) 211 at paras 7–8, 1998 CarswellOnt 2025 (Ont Ct J (Gen Div) (Commercial List)).

²⁶⁶ See *Tri-Tec Industries*, *supra* note 263 at paras 1–4.

²⁶⁷ 17 CBR (4th) 205, 48 OR (3d) 540 (Ont Sup Ct J (Commercial List)) [cited to CBR].

²⁶⁸ *Ibid* at para 11.

²⁶⁹ 42 CBR (4th) 142, 2003 CanLII 43355 (Ont Sup Ct J) [cited to CBR].

²⁷⁰ *Ibid* at para 22.

²⁷¹ See *ibid* at paras 22–23. See also *Nautical Data*, *supra* note 212 at para 22 where the court denied an application to terminate the section 65.1 order, taking into account the purpose of the *BIA*, which is to give the insolvent person time to restructure and to make a proposal to its creditors; *Re Engineered Fibres Inc*, 47 CBR (4th) 233 at para 39, 2003 CarswellQue 1387 (Qc CS).

²⁷² 2004 BCCA 284, 240 DLR (4th) 301.

prevents applicants “from presenting burdensome proofs of claim that inhibit insolvents from regaining viability, but also to avoid prejudice to unsecured creditors whose ability to recover is dependent on the continued operation of the debtor.”²⁷³ The court also held that the section prohibits the termination of agreements, even if the debtor had encouraged it, on the basis that it would prejudice its other unsecured creditors.²⁷⁴ Thus, despite section 65.1(6) and its mirror provisions in the sections of the *BIA* and the *CCAA*, it seems that non-defaulting parties will have trouble evading the statutory nullification of *ipso facto* clauses.

2. Good Faith and the Canadian Anti-Deprivation Rule

As seen in Part II.E.3., the most notable aspect of Lord Collins’ decision in *Belmont* is the introduction of a test that considers the parties’ intentions and whether they acted in good faith. Would the Canadian jurisprudence follow this development in the English law? Wood strongly believes that Canada should not adopt this good faith element.²⁷⁵ Given the existing case law, it is unlikely that they will do so.

First, the Supreme Court of Canada’s ruling in *Coopérants* suggests that contracts signed in good faith should be respected unless they contain provisions that would prejudice other creditors.²⁷⁶ The Supreme Court of Canada’s view seems to echo Lord Collins’ notion that unless the commercial arrangements were designed to deprive the debtor of its property, which would by implication prejudice its other creditors, the agreement must stand. The Supreme Court of Canada, however, did not explicitly find this to be another categorical exemption to the anti-deprivation principle.

Second, the Canadian jurisprudence has already applied a version of Lord Collins’ formulation of the anti-deprivation rule, albeit three years earlier than *Belmont*. The Quebec Court of Appeal, for instance, held that a so-called resolutive clause in a lease was valid, but its exercise by the landlord was not as it was abusive and was detrimental to creditors.²⁷⁷ In

²⁷³ *Ibid* at para 53.

²⁷⁴ See *ibid*.

²⁷⁵ Wood, “Direct Payment Clauses”, *supra* note 148 at 184.

²⁷⁶ *Coopérants*, *supra* note 154 at para 41.

²⁷⁷ The resolutive clause, or “la clause résolutoire”, allowed the landlord to assign the lease to a new lessee, who in exchange for not having to pay for goodwill, conferred benefits to the landlord and the bankrupt’s shareholder (see *Re 91133 Canada ltée*, [2003] RJQ 753 at paras 56–61, 2003 CanLII 46804 (CA)). See also Martin Desrosiers & David Tardif-Latourelle, “Insolvency and Restructuring in Québec: A Common Law Practitioner’s Guide” (2005) *Ann Rev Insolv L* 319 at 348–49.

another case, *Funtig*, the city of Windsor gave Capital Theatre a grant, with the condition that the theatre grant the City a mortgage and that the property be conveyed to the City should the theatre become insolvent.²⁷⁸ When it finally did become bankrupt, the City sued for an amount equivalent to the principal amount of the mortgage, arguing that it was a loan.²⁷⁹ The City argued that *Bramalea* did not apply as it had given valuable consideration for the mortgage and these arrangements were validly entered into when the grant was made.²⁸⁰ The court agreed, holding that the anti-deprivation rule was inapplicable because the arrangements in question were “bona fide contractual arrangements” and there was not any “fraud or design to create any preference ... and all the parties had acted in good faith.”²⁸¹ All the parties who dealt with the theatre were also aware of these arrangements with the City.²⁸²

In coming to its conclusion, the court in *Funtig* relied on two cases. The first is *Re Olympia & York Developments Ltd.*,²⁸³ which in turn distinguished *Knechtel*, a case where the anti-deprivation rule was applied in the context of pension plan surpluses.²⁸⁴ In doing so, the court in *Olympia* held that, unlike the agreements in *Knechtel*, the arrangements in question were not “designed to keep certain assets out of the hands of creditors (with no quid pro quo).”²⁸⁵ Although the language is similar to that used by both Lord Collins and Lord Mance in *Belmont*, the holding in *Olympia* should be treated cautiously as the arrangements in question included a receivership order,²⁸⁶ rather than solely contractual arrangements that were made ex ante to the debtor’s insolvency. The second case cited in *Funtig* is *Re Atlantic Cultural Constructing Ltd.*,²⁸⁷ which concerned an agreement whereby the publisher, ACCL, in the event of its insolvency, must pay its investors any sale proceeds due from the sale of prints and give the investors unsold prints.²⁸⁸ The Nova Scotia Supreme Court held that the arrangement was valid on the basis that it created a trust ar-

²⁷⁸ *Funtig*, *supra* note 183 at paras 11, 13–15.

²⁷⁹ See *ibid* at paras 5, 38.

²⁸⁰ See *ibid* at paras 38–41.

²⁸¹ *Ibid* at para 63.

²⁸² See *ibid*.

²⁸³ 34 CBR (3d) 93, 1995 CanLII 7380 (Ont Ct J (Gen Div) (Commercial List)) [*Olympia* cited to CBR].

²⁸⁴ *Supra* note 153.

²⁸⁵ *Olympia*, *supra* note 283 at para 19.

²⁸⁶ *Ibid* at para 2; *Belmont*, *supra* note 4 at paras 100, 130–32.

²⁸⁷ *Supra* note 184.

²⁸⁸ See *ibid* at 266.

rangement entered into in good faith,²⁸⁹ but it did not mention the anti-deprivation rule.

Neither *Olympia* nor *Atlantic* nor *Funtig* has been applied in other cases to resolve an issue that might attract the application of an anti-deprivation rule. The other Canadian anti-deprivation cases examined, including *Aircell Communications*, do not discuss the role of good faith. Thus, it seems unlikely, at the moment, that Canadian courts will follow Lord Collins' approach.

Conclusion

Canada has taken the unique approach of drawing from both English and American law in its treatment of the issue of a non-defaulting party's rights in relation to the debtor's contract when the latter becomes insolvent. Canada has preserved the common law anti-deprivation rule although it has enacted a general statutory prohibition on *ipso facto* clauses in the *BIA* and the *CCAA*. The way in which the statutory provisions came into effect, however, could be a cause for concern as they were not thoroughly scrutinized by the Senate or the House of Commons.

By examining various aspects of the Canadian statutory legislation, this article has highlighted some areas where the provisions in the *BIA* and the *CCAA* provide some much needed clarity and also situations where reform may be needed. By using the development of the English application of the anti-deprivation rule as a framework of analysis, it is clear that the statutory provisions in the *BIA* and the *CCAA* have codified, and to a degree, displaced the common law approach. For example, whereas it was unclear in the English context if reorganizations and administrations were sufficient to trigger the application of the principle, the *BIA* and the *CCAA* provide clearer guidelines. Each of the statutory provisions lays out specific tests, which include both formal acts of insolvency such as a filing of a proposal and mere factual insolvencies, the latter being where the debtor has failed a cash flow or balance sheet test. Furthermore, unlike the English context, it is clear that the statutory provisions operate against all types of parties, both creditors and non-creditors alike.

Despite the fact that the bulk of statutory amendments were enacted with little scrutiny from Parliament, they seem to have solved some of the problems that arose in the common law application of the anti-deprivation rule. The statutory provisions do not apply in cases involving eligible financial contracts where concerns about essential services being cut off, in

²⁸⁹ See *ibid* at 269–70.

turn making a debtor vulnerable, are irrelevant. A legislative approach also better balances the rights between debtors and non-defaulting parties. The latter cannot utilize *ipso facto* clauses but is able to demand immediate repayment for goods and services supplied to the debtor after the insolvency event. Canada has also avoided the problem of distinguishing between absolute and limited interests; rather, leases are largely subject to provincial legislation and in cases involving Division I proposals, the *BIA* nullifies *ipso facto* clauses in licensing agreements.

An area that needs reform is the nature of the relationship between the statutory provisions in the *BIA* and the *CCAA* and the anti-deprivation rule. Given the Ontario Court of Appeal's decision in *Aircell Communications*, it is clear that the anti-deprivation rule is still valid, even if its application has been limited since *Bramalea*. Drawing upon both the wording of the legislation and the limited jurisprudence available, this article has speculated how the two regimes might interact. There needs to be, however, greater clarity from the courts in this area. Furthermore, some of the problems seen in the English application of the anti-deprivation rule could arise in Canada as well. For example, statutory protection is unavailable in cases of corporate bankruptcies and receiverships, so the common law, and the problems associated with it, would be applied. The anti-deprivation rule would also apply where the statutory provisions have not been triggered, as seen in *Aircell Communications*.

The fact that the anti-deprivation rule is still a valid principle means that there is a greater risk of uncertainty over whether an *ipso facto* clause will be upheld. As seen in the discussion on the English application of the anti-deprivation rule, there are still many unresolved issues. For example, it is unclear if the anti-deprivation rule could operate against creditors and whether it would apply to invalidate deprivations that occurred after the initial insolvency event.

Unfortunately, the Canadian jurisprudence on the anti-deprivation rule is limited and is not as well developed as its English counterpart. The absence of explicit legislation on the role of *ipso facto* clauses in corporate bankruptcies and receiverships would only result in increased uncertainty and litigation as parties turn to the courts to resolve their issues. Canadian courts could follow the recent *Belmont* decision by adapting a test that considers whether the contract was made in good faith and without the deliberate intention to evade the application of insolvency law. As highlighted in this article, though, the Canadian jurisprudence has so far not followed the trend of considering the role of good faith and whether the parties had the deliberate intention of trying to evade the application of insolvency law. Lord Collins' approach also has its own problems, particularly with the fact that it is difficult to determine *ex post* if the parties were acting in bad faith when they entered into their contract. That said,

this approach would increase certainty by providing parties with the confidence that contractual agreements will generally be upheld.

The *BIA* and the *CCAA*'s treatment of a debtor's contract in cases of Division I proposals, consumer proposals, proceedings under the *CCAA*, and individual bankruptcies are relatively comprehensive and are a careful balance between the rights of the counterparty and the debtor. Nevertheless, Parliament's failure to either expressly prohibit *ipso facto* clauses in cases of corporate bankrupts and receiverships, or displace the common law by explicitly stating that such *ipso facto* clauses are valid, has left much uncertainty. Hopefully, the next batch of reforms to the *BIA* and the *CCAA* will bring some much-needed clarity to this area.
