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Clarion Call for Consistent Statute Interpretation

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Case commented on: *Piikani Energy Corporation (Re)*, 2013 ABCA 293, rev'g 2012 ABQB 187

Introduction

This Alberta Court of Appeal decision (per Justices Frans Slatter, Patricia Rowbotham, and Barbara Lea Veldhuis) came to my attention as a preferences case under section 95 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 ("*BIA*"). The weightiness of the analysis reversing Justice R.A. Graesser's conclusion of a "non-arm's length" relationship between the debtor corporation Piikani Energy Corporation and the two payees 607385 Alberta Ltd. ("607") and Dale McMullen made the insolvency and preferences issues irrelevant.

The distinction between dealing at arm's length and not dealing at arm's length in *BIA* section 95(1) is significant. Whether a transaction is at arm's length determines the applicable review period. Under section 95(1)(a) an arm's length transaction is reviewable if it occurred within the three months before the bankruptcy. Under section 95(1)(b) for a non-arm's length transaction the review period is 12 months before the bankruptcy. The *BIA* doesn't define "arm's length".

The Court of Appeal explained the proper statutory interpretation of "arm's length" in *BIA* section 95(1) in *Piikani Energy Corporation*, 2013 ABCA 293, rev'g 2012 ABQB 187 as this comment will elaborate.

Facts

607 is a consulting business owned and operated by Stephanie Ho Lem. It received "early" payment of an annual retainer under a consulting agreement with Piikani Energy. McMullen received a severance payment under an employment contract with Piikani Energy. When those payments were made Ho Lem and McMullen were directors and officers of Piikani Energy. Neither 607, Ho Lem, nor McMullen were ever Piikani Energy shareholders.

The Court of Appeal pointed out (at para 38) that Ho Lem and McMullen were only two of the five directors of Piikani Energy and not 50% of Piikani Energy's Board of Directors as erroneously found (at para 138) by Justice Graesser.

The two impugned payments ("payments") were made more than three months, but less than 12 months before the bankruptcy of Piikani Energy. The trustee of Piikani Energy attacked the payments as preferences under BIA section 95(1)(b) for being made to a creditor who was not dealing at arm's length with the insolvent debtor during the 12 months review period.

Interaction Between *BIA* Section 4 and *BIA* Section 95(1) Preferences

BIA section 4 defining "related persons" includes the following:

> (2) For the purposes of this Act, persons are related to each other and are "related persons" if they are
> …
> (b) an entity and
> (i) a person who controls the entity, if it is controlled by one person,
> (ii) a person who is a member of a related group that controls the entity, …

The *BIA* section 4(2) definition of "related persons" came from the *Income Tax Act*, RSC 1985, c 1 (5th Supp) ("*ITA*") concerning persons who are closely connected with each other (see *ITA* section 251, "Definition of related persons", and Frank Bennett, *Bennett on Bankruptcy*, 13th ed (Toronto: CCH Canadian Limited, 2010) at 403).

BIA section 4(4) reads as follows:

> 4(4) It is a question of fact whether persons not related to one another were are at a particular time dealing with each other at arm's length. (Emphasis added)

BIA section 4(5) provides the following presumption:

> 4(5) Persons who are related to each other are deemed not to deal with each other at arm's length while so related. For the purpose of paragraph 95(1)(b) …, the persons are, in the absence of evidence to the contrary, deemed not to deal with each other at arm's length.

In other words, whether persons not related to each other were dealing at arm's length is a question of fact, but related persons are, in the absence of evidence to the contrary, deemed not to deal with each other at arm's length.

BIA section 95, which deals with preferences, reads in part as follows:

> 95(1) … a payment made … by an insolvent person
> …
> (b) in favour of a creditor who is not dealing at arm's length with the insolvent person ... that has the effect of giving that creditor a preference over another creditor is void as against – or, in Quebec, may not be set up against – the trustee if it is made … during the period beginning on the day that is 12 months before the date of the initial bankruptcy event and ending on the date of the bankruptcy.

Given *BIA* sections 4(4) and (5), *BIA* section 95(1)(b) requires an individualized analysis, meaning each case turns on its own facts.

The Court of Appeal mentioned (at paras 14-16) the recent amendments to *BIA* section 95(1) creating a distinction between arm's length and non-arm's length creditors and removing intent as a legal requirement for a preference between non-arm's length parties. If the facts prove a

preference occurred between non-arm's length parties, the transaction is void as against the trustee in bankruptcy. Determining whether the parties were not dealing at arm's length was crucial to the outcome in this case.

Justice Graesser correctly concluded (at para 128) that Lo Hem and McMullen were not related to Piikani Energy under the *BIA*.

Justice Graesser and the Court of Appeal conducted an individualized analysis of the facts, examined the same statutes, considered the same case law, and achieved opposite conclusions on the "arm's length" issue.

Justice Grasser's Analysis of the "Arm's Length" Issue

Justice Graesser in an application hearing decided that Ho Lem and McMullen were not dealing at arm's length to Piikani Energy because they were among its key employees and directors at the time of the payments. He declined to use case law defining "arm's length transactions" in the *ITA*. Justice Graesser reasoned that arm's length transactions in the *ITA* had a different purpose from the *BIA* preferences provisions. He relied on three concepts to conclude that directors are not at arm's length from their corporation

> 1. "arm's length" for *BIA* purposes is more closely connected with the concept of "insiders" under the *Securities Act*, RSA 2000, c S-4 (at para 120);
>
> 2. a corporate director's fiduciary duties make it difficult for a director to be at arm's length to the corporation (at para 123);
>
> 3. decision makers can't be at arm's length when they make decisions to pay themselves (at para 129).

Justice Grasser focused on the absence of evidence to create suspicious circumstances surrounding the payments, including the following:

> 1. "There is no evidence of board meetings, resolutions or corporate actions in the making of the payments to Mr. McMullen and Ms. Ho Lem" (at para 132);
>
> 2. "There is no evidence that Ms. Ho Lem played a role in the decision to pre-pay the retainer … but it was paid some two weeks early" (at para 133);
>
> 3. "There is no evidence that she was involved as a decision-maker relating to the payments … it is hard to see how decisions on the payments were made, without Ms. Lo Hem being involved …" (at para 136);
>
> 4. "In the absence of evidence of a directors' meeting, … it is difficult to piece together how the decisions to pay Mr. McMullen and pre-pay Ms. Ho Lem's company were made and it is inconceivable that Mr. McMullen was not directly and intimately involved in all aspects of the decisions as they related to himself, Ho Lem and 607385" (at para 137);

> 5. "Significant decisions could have been made only by the board of directors (of which Mr. McMullen and Ms. Ho Lem comprised 50%) or by senior officers or employees (which Ms. Ho Lem was and Mr. McMullen was at least to … when his employment was terminated)" (at para 138).

Justice Graesser decided the two payees 607 and McMullen were not dealing at arm's length because Ho Lem and McMullen were among Piikani Energy's key employees and directors at the relevant time.

Court of Appeal's Analysis of the "Arm's Length" Issue

The standard of review (at para 17) was palpable and overriding error on whether persons not related to one another were dealing at arm's length and errors of law were to be reviewed for correctness on the meaning of "arm's length" in the *BIA*.

The Court of Appeal determined Justice Graesser made a reviewable error by failing to appreciate that being a director does not necessarily mean a non-arm's length relationship with the corporation. The Court of Appeal noted that the *BIA* definition of "related persons" does not specify a "director". The Court of Appeal reasoned that had Parliament intended to create a presumption that a director is not dealing at arm's length with the insolvent person, it would have included director in the definition of "related parties" [*sic*] in the *BIA* (at para 36).

The Court of Appeal also determined that Justice Graesser erred in law by not using case law defining "arm's length transactions" in the *ITA*. The Court of Appeal strongly disagreed with Justice Graesser rejecting the *ITA* in favour of the concept of "insiders" under Alberta's *Securities Act* as the source for defining "arm's length" in the *BIA*. The Court of Appeal relied on compelling case law where the *ITA* was used for interpretative guidance to define "arm's length" in the *BIA*, including *McClarty v R*, 2008 SCC 26 where Rothstein J discussed the term "not dealing at arm's length" in *ITA* section 69. The Court of Appeal summarized (from the judgment of Rothstein J in *McClarty* as follows:

> [29]… the Canada Revenue Agency Income Tax Interpretation Bulletin IT-419R2 "Meaning of Arm's Length" (June 8, 2004) contains the following "useful criteria that have been developed and accepted by the courts": (i) was there a common mind which directs the bargaining for both parties to a transaction; (ii) were the parties to the transaction acting in concert without separate interests; and (iii) was there *de facto* control…

The Court of Appeal directed (at para 30) that these three factors are to be used by courts in determining whether, as a question of fact, two parties dealt with each other at arm's length in the *BIA* context.

The Court of Appeal explained the importance of the principle of the legislature's "statute book" in defining a term in an enactment by stating (at para 26):

This approach relies on the logical assumption that Parliament knows what other statutes say when it passes an enactment, and perhaps even more so when it amends a statute (i.e. the ***BIA***) to incorporate a term that has been defined in the courts in another context (i.e. the *ITA*). This approach also minimizes the potential for unnecessary conflicts in interpretation.

The Court of Appeal cited (at para 27) the Supreme Court of Canada decision in *R v Ulybel Enterprises Ltd.*, [2001] SCR 867 quoting from Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed (Markham: LexisNexis, 2008) as follows:

> [30] The meaning of words in legislation depends not only on their immediate context but also on a larger context which includes the Act as a whole and the statute book as a whole. The presumptions of coherence and consistency apply not only to Acts dealing with the same subject but also, albeit with lesser force, to the entire body of statute law produced by a legislature. ... Therefore, other things being equal, interpretations that minimize the possibility of conflict or incoherence among different enactments are preferred.

In reversing Justice Graesser's conclusion of a non-arm's length relationship between the parties to the payments, the Court of Appeal's analysis defining "arm's length" focused on the legislative history of the terms "control" in *BIA* section 4(2)(b)(i)-(ii) defining "related persons", and undefined "arm's length" in *BIA* section 95(1) concerning preferences. The Court of Appeal emphasized (at paras 21-23) the significance of the terms "control" and "arm's length" already existing in the *ITA* before being brought into the *BIA* for what became section 100 "Reviewable transactions" recently merged into a new remedy in *BIA* section 96, "Transfer at undervalue".

The evidence before Justice Graesser about the circumstances surrounding the payments was affidavit evidence from Ho Lem and McMullen. There was no evidence that Ho Lem or McMullen directed or controlled the payments to 607 and McMullen. The evidence of 607 and McMullen was entirely contrary to them directing or controlling the payments. In the Court of Appeal's view (at para 39) Justice Graesser disregarding that evidence was a reviewable error. The Court of Appeal concluded (at paras 40, 41) that Ho Lem and McMullen were each acting at arm's length to Piikani Energy at the time of the payments.

The Alberta Court of Appeal in this case explained why "arm's length" in *BIA* section 95(1) and "control" in *BIA* section 4(2)(b)(i)-(ii) have the same meaning as in *ITA* section 69(1), "Inadequate considerations" and *ITA* section 251, "Definition of "related persons"", respectively.

Conclusion

For the application judge ordinary perception trumped legal reality. In contrast, the Court of Appeal's interpretation of "arm's length" differs from ordinary definitions of that term. For example, *Osborn's* defines the term "arm's length" as "[t]he relationship which exists between parties who are strangers to each other and who bear no special duty, obligations, or relation to each other; e.g. vendor and purchaser" (see *Osborne's Concise Law Dictionary*, 11th ed, s.v. "arm's length, at"). At the Alberta Court of Appeal, consistent statutory interpretation among statutes is a top priority, more so than the plain meaning approach.