Supreme Court of Canada: Landmark decision on corporate attribution and transfers at undervalue

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On Oct. 11, 2024, the Supreme Court of Canada (the SCC) released its decision in *Aquino v. Bondfield Construction Co.* – the first case in which it has addressed the doctrine of corporate attribution in the context of insolvency proceedings. In particular, the SCC considered the way in which the doctrine interacts with section 96 of the *Bankruptcy and Insolvency Act* (the BIA), also known as the "transfer at undervalue" provisions.

The SCC upheld the lower courts' finding that certain payments made by two construction companies prior to the commencement of proceedings under the *Companies' Creditors Arrangement Act* (the CCAA) and the BIA were transactions undertaken as a part of a false invoicing scheme, and therefore constituted "transfers at undervalue". The directing mind of the two debtor companies and his associates who participated in the scheme were required to repay the tens of millions of dollars that they had taken from the two debtor companies. The appeal from this ruling was ultimately dismissed by the SCC.

The SCC's decision clarifies the way in which courts ought to apply the corporate attribution doctrine purposively, contextually and pragmatically. In the context of insolvency proceedings, certain exceptions to corporate attribution should not apply to "transfer at undervalue" claims under s. 96 of the BIA, as these exceptions would undermine the purpose of the provision. The decision also sheds light on the legal test that must be met in order for courts to attribute the actions, intent and knowledge of a company's directing mind to the company itself, for the purposes of s. 96.

Background

Bondfield Construction Co Ltd. (Bondfield) and its affiliate, Forma-Con Construction (Forma-Con together, the Debtor Companies) were a part of the Bondfield Group, a full-service group of construction companies operating in the GTA and elsewhere in Ontario. Bondfield commenced proceedings under the CCAA in April 2019, and a trustee in bankruptcy was appointed over Forma-Con in December 2019.

The CCAA monitor of Bondfield and the bankruptcy trustee of Forma-Con (together, the Respondent**s**) discovered that the directing mind of the Debtor Companies, John Aquino, and his associates had siphoned off tens of millions of dollars from both companies using a "false invoicing scheme" by which the Debtor Companies paid suppliers who had issued false invoices and provided no goods or services in return.

The Respondents brought an application to recover the funds that were improperly paid, arguing that those fraudulent payments were "transfers at undervalue" within the meaning of s. 96 of the BIA. The provision allows the court to reverse a transfer at undervalue by ordering a party to the transfer to return any property that it had improperly received under certain conditions. In particular, s. 96 targets three types of transactions that may raise suspicion:

1. **Arm's length transaction**. The bankruptcy trustee must show that:
    a. the transaction occurred within one year of the bankruptcy;
    b. the debtor was insolvent at the time of the transfer (or rendered insolvent by it); ***and***
    c. the debtor intended to defraud, defeat or delay a creditor.
2. **Non-arm's length transaction within one year of bankruptcy**. If the transaction occurred within one year of the bankruptcy, the bankruptcy trustee need not show that the debtor was insolvent at the time of the transfer or that the debtor intended to defraud, defeat or delay a creditor.
3. **Non-arm's length transaction within five years of bankruptcy**. If the transaction occurred more than one year but within five years of the bankruptcy, the bankruptcy trustee must show that:
    a. the debtor was insolvent at the time of the transfer (or rendered insolvent by it); ***or***
    b. the debtor intended to defraud, defeat or delay a creditor.

Since *Aquino* involved the third type of transaction, the SCC focused on the issue of whether the debtor had intended to defraud, defeat or delay a creditor.

Lower Court decisions

The Ontario Superior Court of Justice and the Ontario Court of Appeal accepted that there were indicators of suspicious activity (referred to as "badges of fraud") that sufficiently established John Aquino's intent to defraud, defeat or delay creditors. Specifically, there was an absence of value received by the Debtor Companies, the payments were made to non-arm's length persons, the payments were conducted with secrecy and unusual haste, and the transferors were facing actual or potential liabilities, or were about to enter into a risky undertaking.

The courts accepted that while John Aquino and the other participants of the false invoicing scheme (collectively, the Appellants) had intended to defraud the Debtor Companies, this did not immediately lead to the conclusion that there was an intention to defraud creditors. The courts bridged this gap by attributing John Aquino's fraudulent intention to the Debtor Companies, thus finding that "the debtor intended to defraud, defeat or delay a creditor" as required under s. 96. The courts applied the doctrine of corporate attribution, which provides a framework for attributing the actions, intent and knowledge of a company's directing mind to the company itself.

The test for corporate attribution was established in the criminal law case of *Canadian Dredge & Dock Co. v. The Queen*. To attribute the fraudulent acts of a company's employee to the company itself, two conditions must be met: (1) the wrongdoer must be the directing mind of the corporation, and (2) the wrongful actions of the directing mind must have been done within the scope of such person's authority. *Canadian Dredge* also provided for two exceptions: the directing mind's intent cannot be attributed to the company itself if the directing mind was acting in fraud of the company (the Fraud Exception) and if their acts did not benefit the company (the No Benefit Exception).

Both courts held that the exceptions set out in *Canadian Dredge* should not apply to applications under s. 96 with respect to transfers at undervalue. The Ontario Court of Appeal held that it would be perverse and counter to the purpose of s. 96 to adopt an approach that would allow the fraudsters to benefit at the expense of creditors. Given that the purpose of the BIA is to provide proper redress to creditors, the "intention of the debtor" in s. 96 should be interpreted to include the intention of the individuals in control of the corporation, regardless of whether those individuals had any intent to defraud the corporation itself.

The SCC's analysis and decision

The SCC upheld the decisions of the lower courts, finding that John Aquino's fraudulent intent should be attributed to the Debtor Companies.

Corporate attribution in the insolvency context

The SCC rejected the Appellants' argument that the Fraud Exception and No Benefit Exception applied in this case given that John Aquino acted in fraud of the Debtor Companies and his actions did not benefit the Debtor Companies. The SCC reiterated that the corporate attribution doctrine is not a "standalone" principle and that there was no "one-size-fits-all" approach. Rather, the corporate attribution doctrine must be applied purposively, contextually and pragmatically to give effect to the policy goals of the relevant law. This may require courts to tailor the general rule of attribution or its exceptions to the legal context at hand.

In the case of a transfer at undervalue under s. 96 of the BIA, the Fraud Exception and No Benefit Exception should not apply as they would undermine the purpose of the provision, which is to protect creditors from harmful actions by a debtor that would diminish assets available for recovery. This purpose is served by attributing the actions, knowledge, state of mind or intent of the corporation's directing mind to the corporation itself, even if the directing mind acted in fraud of the corporation and even if the corporation did not benefit from such actions.

On the other hand, applying the Fraud Exception and the No Benefit Exception under s. 96 would deny creditors the benefit of a statutory remedy that was intended to protect them from asset stripping. This would undermine the purpose of s. 96 and render the transfer at undervalue remedy meaningless.

Accordingly, the SCC affirmed that the test for corporate attribution under s. 96 of the BIA is simply (i) whether the wrongdoer was the directing mind of the debtor company, and (ii) whether the wrongdoer's actions were performed within the sector of corporate

responsibility assigned to them. If these criteria are met, the directing mind's actions, knowledge, state of mind or intent should be attributed to the corporation.

Transfer at undervalue analysis

The SCC's decision also sheds light on the transfer at undervalue provisions of the BIA. *Aquino* provides an analysis that strengthens the ability of insolvency officials to leverage these provisions in their efforts to preserve the debtor's assets and remedy improper transactions that diminish the value of the estate. The SCC made the following key observations:

- The two main purposes of the BIA are the equitable distribution of the bankrupt's assets among creditors and the bankrupt's financial rehabilitation. Transfers at undervalue frustrate the purposes of the BIA and undermine the integrity of the bankruptcy process by diminishing the value of a debtor's estate and reducing the funds available for distribution.
- In determining that the transactions undertaken by the Debtor Companies as part of the false invoicing scheme were transfers at undervalue, the SCC focused on whether the debtor had the intent to defraud, defeat or delay a creditor. The SCC stated that such intent can be inferred from the existence of suspicious circumstances, or "badges of fraud". The SCC rejected the Appellant's argument that there could be no fraudulent intent if the transfers were made at a time when the companies were able to pay their debts when due, stating that the debtor's financial condition is not determinative.
- When the debtor is a corporation, the court must determine whether the corporation's directing mind intended to defraud, defeat or delay a creditor, and then consider whether the directing mind's intent can be attributed to the corporation itself, having regard to the principles discussed above.

Key takeaways

Aquino provides important guidance on the doctrine of corporate attribution by affirming that the doctrine must be applied purposively, contextually and pragmatically. The general rule of attribution, and its exceptions, must be tailored to the legal context of each particular case.

Importantly, *Aquino* is the first case in which the SCC has considered the application of the corporate attribution doctrine in the context of transfer at undervalue claims under s. 96 of the BIA. By employing a purposive and contextual approach that takes the purpose of s. 96 into consideration, the SCC set out an analytical framework that allows courts to attribute the intent of a corporate debtor's directing mind to the corporation itself when determining whether there was an intent to defraud, defeat or delay a creditor. In turn, such fraudulent intent can be used to show that a transfer of assets out of a debtor company was a transfer at undervalue and can be "clawed back" into the estate.

Aquino enhances the transfer at undervalue provisions of the BIA, strengthening the ability of insolvency officials to preserve the estate and maximize recovery for the benefit of the creditors.

By

Roger Jaipargas

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BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

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