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BANKRUPTCY FOR THE MATRIMONIAL COURT JUDGE

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I. INTRODUCTION

This paper will review the important provisions of the Bankruptcy and Insolvency Act (BIA) that interact with a matrimonial dispute. The paper utilizes the key sections of the BIA as a guide to understanding the interaction between these two fields and their points of tension. I have done my best to fight the (for me) almost irresistible urge to digress into technical issues and the fine nuances of the case law. For further discussion, the reader is directed to my book, *Bankruptcy, Insolvency and Family Law*.[1]

In the title to this paper, and throughout, I refer to the "matrimonial court". Technically there is no such thing. This is a term that I employ in this paper, and elsewhere, as a simplification and convenience to distinguish the bankruptcy court

[1] 2nd Ed., Carswell, 2001, supplemented. Hereinafter "*BIFL*".

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from any other court (a "matrimonial court") that might entertain a matrimonial proceeding. It means any court that hears family matters in the course of its ordinary jurisdiction, as distinguished from the bankruptcy court. It includes specialized superior and provincial courts hearing only family law matters, and superior courts hearing all matters including family law proceedings.

II. POLICIES UNDERLYING BANKRUPTCY LAW

1. Traditional Bankruptcy Policies

Just as family law is based on certain key policies (equitable distribution of property, best interests of the children, etc.), bankruptcy law has an underlying set of policies on which its legislation and jurisprudence are based. These include the following:

- *Rehabilitation* of the honest but unfortunate debtor, free of his or her debts (subject to reasonable conditions), so as to be able to provide for self and family and contribute economically to society. This policy is expressed through the bankruptcy stay of proceedings, mandatory credit counselling, and ultimately through the bankrupt's discharge.

- *Orderly and fair distribution*: subject to limited exceptions, all of the debtors assets should be distributed pro rata to unsecured creditors: "Equality is Equity". When the debtor is insolvent, no creditor should be able to get an advantage over other creditors through private dealings with the bankrupt. This is expressed through the stay of proceedings, the vesting of assets in the trustee, and the various provisions that allow the trustee to reverse "preferences".

- *Realization:* to provide an expeditious and inexpensive method of gathering in, liquidating and ultimately distributing the debtor's assets, while minimizing the complexities and legal costs that often accompany or contribute to the insolvency.[2] This is expressed through the stay of proceedings, the role of the bankruptcy court in supervising litigation in other courts, the summary procedure for establishing and quantifying creditors' claims, and the role of the trustee in bankruptcy.

- *Investigation:* to afford the creditors and the public a mechanism by which the debtors assets and affairs may be investigated, and assets recovered by reversing any improper pre-bankruptcy transactions. This purpose can be seen

[2] In *Skytal Ltd. v. Schiber* (1997), 46 C.B.R. (3d) 275 (Ont. Gen. Div.), aff'd (1999), 9 C.B.R. (4th) 129 (Ont. C.A.), a non-matrimonial case, Justice Walters referred to "the overriding goal of the BIA to provide for the orderly winding up of a bankrupt's affairs with a minimum of litigation ... " (p. 278)

in the bankrupt's disclosure obligations, the various procedures for examining the debtor and others under oath, and the various provisions allowing the trustee to reverse fraudulent conveyances, "settlements" and "reviewable transactions".

⇨ *Reorganization:* to provide a framework for resolving overwhelming financial difficulties through negotiation with creditors in a judicially (commercial proposals) or administratively (consumer proposals) supervised process.

These policies conflict on many levels with matrimonial policy. For example, should rehabilitation under bankruptcy law trump equitable division of matrimonial property? In other words, to what extent should bankruptcy rehabilitation take place at the expense of a former spouse? To what extent should litigation be permitted to continue outside bankruptcy court if doing so will drain the bankrupt estate of funds and frustrate the policy of minimizing costs? Should an insolvent person be permitted to "prefer" his or her spouse through property transfers under a pre-bankruptcy separation agreement.

2. Defeating the Feminization of Poverty

In some areas bankruptcy and matrimonial policies coincide to some extent. The Supreme Court of Canada indicated in *Marzetti v. Marzetti*,[3] a bankruptcy case involving a priority dispute between a bankruptcy trustee and a support claimant, that the court should err on the side of caution where family needs are at issue. In addition, the importance of family welfare has a public policy aspect that is to be utilized as a factor in statutory interpretation: when statutory or contractual ambiguity permits, the court should adopt an interpretation which helps defeat the role that divorce plays in the feminization of poverty. *Marzetti* brought the concept of feminization of poverty into debtor-creditor law.

The concept of feminization of poverty has been applied in at least 14 debtor-creditor cases since 1994. Judicial attitudes toward public policy arguments reflect the personality, and the underlying belief systems, of the judge hearing the case. The two countervailing attitudes are illustrated, firstly, by the traditional aphorism discouraging resort to public policy:[4]

> "Public policy .. is very unruly horse, and when once you get astride it you never know where it will carry you."

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[3] [1994] 2 S.C.R. 765, 5 R.F.L. (4th) 1, 26 C.B.R. (3d) 161, 169 N.R. 161, 20 Alta. L.R. (3d) 1, [1994] 7 W.W.R. 623 (S.C.C.)

[4] *Richardson v. Mellish* (1824), 2 Bing. 229 at p. 252, 130 E.R. 294, per Burrough J.

and the second by Lord Denning's retort:[5]

> "I disagree. With a good man in the saddle, the unruly horse can be kept in control. It can jump over obstacles. It can leap the fences put up by fictions and come down on the side of justice."

Of the 14 cases that have considered the *Marzetti* public policy, four of them reject the relief requested by the support claimant. Two of those, *Hogan*[6] and *Renda*,[7] refuse to allow public policy arguments to bend what appears to be clear statutory language. The other two, *Cherkewich*[8] and *Cameron*,[9] both of them Alberta decisions, appear to be more inhospitable to the new policy ground. *Cherkewich* would limit the applicability of the *Marzetti* doctrine to priority disputes only. *Cameron* refuses to recognize an obvious ambiguity in the BIA, and rejects the idea that support claimants should be treated, in bankruptcy, with any special degree of judicial consideration.

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[5] *Enderby Town Football Club Ltd. v. The Football Association Ltd.*, [1971] Ch. 591 at p. 606 per Lord Denning, M.R.

[6] *Hogan, Re*, [1994] B.C.J. No. 2449 (B.C.S.C.)

[7] *Renda (Syndic de)*, J.E. 98-37, *sub nom. T.R. (Syndic de) c. L.H.*, [1997] J.Q. 5360 (C.S.Qué., 27 novembre 1997)

[8] *Cherkewich v. Cherkewich*, [2001] A.J. No. 846 (Alta. Q.B., June 25 2001)

[9] *Cameron, Re*, [2003] 6 W.W.R. 211, 42 C.B.R. (4th) 1, 38 R.F.L. (5th) 261, 12 Alta. L.R. (4th) 203, 327 A.R. 278 (Alta C.A., May 8 2003)

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Ten of the 14 cases, however, apply the *Marzetti* public policy approach. Three of these, *Jenanji*,[10] *Rathbone*[11] and *Watson v. Schellenberg*,[12] utilize public policy to override fairly clear statutory language. *Jenanji* uses public policy to overcome the clear meaning of BIA s. 70(1) without any demonstration of ambiguity; *Rathbone* allows the support claimant to assert priority despite not having complied with a statutory condition; *Watson v. Schellenberg* enforces an oral separation agreement where the applicable matrimonial statute appeared to require a written agreement. However, one would be hard pressed to consider the last two of these cases wrong; both of them present facts that justify a compelling application of public policy. In *Rathbone*, the support enforcement authorities had prejudiced the needy wife's support entitlement through appallingly dilatory conduct; in *Watson v. Schellenberg*, a father took advantage of his child's benefactor who had acted in loco parentis. All of these cases might well have been decided differently without the new policy grounds that were explicitly commended in *Marzetti.*

Another three of these ten cases apply *Marzetti* in an appropriate and unexceptional manner. In *Burrows*[13] the BIA was silent on the provability of support (before 1997), and the court used the *Marzetti* analysis to confirm a result reached

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[10] *Jenanji (Syndic de)*, [1997] R.D.F. 748, J.E. 97-1916 (29 avril 1997, C.S. Qué.)

[11] *Rathbone Herman v. Rathbone* (2000), 46 O.R. (3d) 678 (S.C.J.), also cited as *Herman v. Rathbone*

[12] (2002), 38 C.B.R. (4th) 130, [2003] 3 W.W.R. 75, 9 Alta. L.R. (4th) 192, 321 A.R. 371 (Q.B.)

[13] *Burrows, Re* (1996), 42 C.B.R. (3d) 89 (Ont. Gen. Div.)

on practical and purposive grounds. Likewise *Beattie v. Ladouceur*[14] was decided through the application of decided precedents, with *Marzetti* being utilized as a judicial safety check to confirm that this result was consonant with public policy. *Mattes*[15] applied *Marzetti* to the interpretation of an ambiguous court order. These cases might well have reached the same result without the assistance of *Marzetti.*

The last four of these ten cases use *Marzetti* to inform the exercise of judicial discretion, outside the context of any ambiguity. This is eminently appropriate, although one may argue in some of these cases that the court has gone too far. *Backman*[16] resorted to public policy in determining what conditions to impose upon a malicious bankrupt who was in serious arrears of support. *Kingston v. Ackerson*[17] applied public policy to deny a discretionary solicitor's lien where this would oust the payment of child support. In *Taylor*,[18] feminization of poverty was utilized to justify the court's refusal to grant a solicitor's lien over any part of the wife's $69,000 lump sum spousal support recovered through the solicitor's efforts – arguably the

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[14] (2001), 23 R.F.L. (5th) 33 (Ont. S.C.J., October 22 2001)

[15] *Mattes, Re* (1998), 5 C.B.R. (4th) 212 (N.S.S.C., Bkcy. Registrar)

[16] *Backman v. Backman* (1998), 7 C.B.R. (4th) 55 (Ont. Gen. Div.): "Together, the Bill C-5 amendments and the Marzetti case evidence the court's growing concern with bankruptcy issues in the area of family law. This concern must be factored into the court's assessment of justice particularly in the case at bar." (¶14) ... "Any order for security for costs or immediate payment of arrears could be construed as being unfair or unjust. However, equally, if not more, important is making certain that children are supported after divorce, irrespective of bankruptcy." [¶39]

[17] (2002), 22 C.P.C. (5th) 31, 252 N.B.R. (2d) 209 (Q.B.)

[18] *Taylor v. Taylor* (2002), 60 O.R. (3d) 138, 26 R.F.L. (5th) 208, 21 C.P.C. (5th) 205 (Ont. C.A.)

court ignored other persuasive policy arguments in so doing. *Cowger*[19] used public policy to justify granting the wife a modest constructive trust under extraordinarily weak facts where no-one else (i.e. the trustee) was actively pursuing the asset in question. Of these four cases, *Taylor* is the only one that would likely have been decided differently had the case been adjudicated before *Marzetti*; one might well argue that public policy was an unruly horse in this case.

The trend in a number of these cases is to re-evaluate, or re-balance, the tension between social policy favouring payment of support and bankruptcy policy favouring debtor rehabilitation. Historically, the exceptions to the bankruptcy discharge in BIA s. 178 have been narrowly construed, in favour of rehabilitation and to the prejudice of support claims and the other listed "exceptions", such as fraud, to the discharge. But several of these cases - *Backman* and *Watson v. Schellenberg* in connection with child support, *Burrows* and *Taylor* in connection with support generally - suggest the reverse, namely that support enforcement should trump debtor rehabilitation. At very least, these decisions compel us to weigh older precedents in this area against contemporary public policy favouring support enforcement, to determine whether the precedents still reflect the appropriate balance between the competing policies. The following considerations come to mind in this connection:

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[19] *Cowger v. Cowger*, [1998] N.W.T.R. 275, [1998] N.W.T.J. 20 (N.W.T. S.C., April 3 1998)

❑ Can the decision that is being advocated also be justified on conventional jurisprudential grounds, or solely on this new public policy ground?

❑ Should a general insolvency rule be applied to support claims, or are such claims, by their nature and special function, "different"?

❑ How far does this new policy ground apply?

❑ Has this public policy ground been 'spent' through the 1997 support amendments to the BIA, or the 2000 support enforcement amendments to family law legislation? How will we know when a sufficient degree of equality has been reached?

❑ Is this policy ground driven by sympathy, or by entitlement?

❑ Do women's comparative lack of commercial familiarity bias the system against them in bankruptcy?

III. SOME DEFINITIONS

1. Bankruptcy Court: The BIA creates a national system of bankruptcy courts by vesting bankruptcy jurisdiction in the superior court of each province. The Chief Justice in each province has the power to assign certain judges to exercise bankruptcy jurisdiction. These judges are referred to as bankruptcy judges, and the specialized sittings over which they preside are commonly referred to as the Bankruptcy Court. However, every judge of the superior court in the province is entitled to exercise bankruptcy jurisdiction[20] - although most would very much rather not do so. Procedure in Bankruptcy Court is governed by the Rules and Forms prescribed by the BIA or, where these are silent, by the rules of procedure applicable in the ordinary courts. Reference to the word "court" in the BIA is defined to mean the Bankruptcy Court.

2. Bankruptcy Registrar:[21] Other judicial functions are performed by the Registrar in Bankruptcy. In most provinces this role is fulfilled by a Master of the superior court. The Registrar exercises many of the judicial powers of a bankruptcy

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[20] BIA s. 186. Superior court judges who have not been designated with specialized bankruptcy jurisdiction should exercise such jurisdiction only in situations of urgency, because the Chief Justice has appointed specific bankruptcy judges under BIA s. 185: *548437 Ontario Inc., Re* (1985), 58 C.B.R. (N.S.) 195 (Ont. S.C.); *John Hobbs & Co. v. Sonntag*, [1992] O.J. No. 111 (Ont. Gen. Div.). A more relaxed approach may be taking hold on this question: *Carleton University v. Mercier* (2001), 21 C.B.R. (4th) 227 (Ont. S.C.J.) (non-matrimonial); *Retail Merchants Association v. Melissa Derek Inc.*, [2002] O.J. No. 3237 (S.C.J., July 18 2002) (non-matrimonial case)

[21] BIA s. 192

judge, although her decisions may be appealed to a bankruptcy judge. These powers include hearing bankrupts' discharges, dealing with unopposed or ex parte matters, making interim orders in cases of urgency, and disposing of practice or procedural matters.

3. **Superintendent of Bankruptcy:** The Superintendent of Bankruptcy is appointed by the federal Cabinet. The Superintendent, currently Marc Mayrand, is responsible for supervising the administration of all bankruptcies and proposals and the conduct of bankruptcy trustees. Where complaints arise over the administration of a bankruptcy, he is entitled to investigate or intervene in any court proceeding as a party. The Superintendent also issues periodic information statements, policy statements and directives to govern the administration of estates. To finance the administration of the bankruptcy system, the Superintendent receives a levy in each bankruptcy representing a percentage of every dividend to creditors. At present, this levy constitutes about five percent of every payment made by the trustee to creditors.

4. **Official Receiver (O.R):** Each province is divided into bankruptcy divisions; for example, Ontario has 16 divisions. For each division, an official receiver (O.R.) is appointed by the Superintendent to administer the BIA. All assignments in bankruptcy and bankruptcy proposals are filed with the O.R. in the bankruptcy

division where the debtor resides, carries on business or has most of his or her assets. After an assignment in bankruptcy is filed, and normally before the first meeting of creditors, the O.R. may conduct a written examination under oath of the bankrupt, known as the "O.R.'s Questionnaire".[22] The examination provides information to the creditors so that they may instruct the trustee to take any action that is appropriate. At the first meeting of creditors, the O.R. acts as the Chairman and decides any questions or disputes arising at the meeting (subject to appeal to the bankruptcy court). Like the Superintendent, the O.R. is an officer of the court.

5. Trustee in Bankruptcy ("the Trustee"): The trustee in bankruptcy is the official with whom creditors and debtors come into most contact in a bankruptcy proceeding. The trustee acquires title to the bankrupt's property, administers the estate, communicates with creditors, reports to the Superintendent and to the Court, and pays out dividends. Trustees are normally accountants by training, licensed by the federal government upon the recommendation of the Superintendent of Bankruptcy. The licensing process is rigorous, involving lengthy study and both written and oral examinations. Each trustee is an officer of the court and his or her administration of the estate is done under regulatory and court supervision. A trustee may be a corporation managed by an individual trustee.

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[22] BIA s. 161; Forms 26, 27. In some centres, the Official Receiver's Examination is conducted only if the trustee or a creditor specifically so requests.

As a general rule, the trustee stands in the shoes of the bankrupt except where statutory provisions otherwise decree. As an officer of the court, the trustee has an duty to be honest and fair. The case law requires that the trustee adhere to the norms of equity, fairness and honesty: The trustee ought not to take advantage of strict legal rights if doing so would be inconsistent with natural justice and that which an honest person would do.[23] While the trustee represents the interests of unsecured creditors, he or she must also be even-handed to the bankrupt and other interested parties. These duties are set out in the Code of Ethics for Trustees that is incorporated into the BIA under Rules 34 through 52. Even-handedness becomes difficult when the trustee's role places him or her in the middle of an acrimonious matrimonial dispute. This may occur when one spouse is a significant creditor in the bankruptcy.[24] The trustee will normally assist creditors (or their family lawyers) in filling out proofs of claim and guiding them through the process.

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[23] *Re Condon; Ex parte James*, 9 Ch. App. 609, [1874-80] All E.R. 388 (C.A.); *Re Tyler*, [1907] 1 K.B. 865; *Re McDonald* (1971), [1972] 1 O.R. 363, 16 C.B.R. (N.S.) 244 (S.C.); *Re Hardy* (1984), 51 C.B.R. (N.S.) 21 (N.S.T.D.). See *BIFL*, §4.3(b)(6).

[24] See *Balnaves, Re* (Dec. 13 1990, Fed. Ct. of Australia, O'Loughlin J., No. 680/87 Fed. #767): Malicious husband filed bankruptcy to defeat wife's matrimonial claims. He placed his assets in name of his girlfriend's parents. Wife warned trustee that husband about to sell certain shares (referred to in matrimonial judgment as belonging to husband) for $200,000; trustee turned a blind eye due to 'lack of funds', released any claim to the shares for $5000. Australian legislation provided that the court may order an enquiry into a trustee's conduct. Acrimony had arisen between wife and trustee in contested litigation between them. Held: trustee should have approached creditors for an indemnity. But while the facts were unsatisfactory, court not sufficiently uneasy or concerned to order an enquiry into the trustee's conduct. This case is an example of the court permitting a trustee to act as husband's dupe and, considering the damage done to wife, condoning an overly low standard of conduct on trustees caught in a matrimonial dispute.

6. Difference between "bankruptcy" and "insolvency": Bankruptcy is the formal legal status of a person who has become bankrupt under the BIA. Insolvency is a condition, short of bankruptcy, in which a person is unable to meet his or her liabilities or has an excess of liabilities over assets. Determining whether someone is, or was, bankrupt can be easily accomplished with certainty by performing a bankruptcy search; determining whether a person is insolvent is always a fact-driven exercise in business judgment or judicial analysis. Some insolvent people become bankrupt; others do not; some work through their problems to become solvent again; others may remain forever in an insolvent state known as "judgment proof". While bankruptcy often has a profound legal effect on matrimonial proceedings, insolvency may impose financial and practical problems (such as collecting the money) but normally has little formal effect.

7. Common Law Partner: In bankruptcy, a common law partner is defined to mean a person who is cohabiting with the individual in a conjugal relationship, having so cohabited for a period of at least one year.[25]

8. Discharge: In a personal bankruptcy, the debtor is discharged from bankruptcy automatically after 9 months in the case of a first-time bankrupt. If a creditor opposes the discharge (by delivering a notice of opposition within this time to the

[25] BIA s. 2(1).

bankrupt, the trustee and the O.R.), a discharge hearing is held before the Registrar to determine whether the discharge should be granted, or whether conditions should be imposed. All provable debts are released by the discharge, except those set out in s. 178. The notable exceptions in s. 178, for the purposes of this topic, are debts for support under court orders or agreements in favour of a support claimant living separate and apart from the bankrupt.

The trustee in bankruptcy also receives its discharge when his or her duties have been completed in the bankruptcy and all funds have been distributed. This usually takes place about two years from the date of bankruptcy, or longer. The trustee's discharge usually has no effect on the creditors or the bankrupt. When one speaks of the discharge, it is normally the bankrupt's discharge that is being referred to.

9. Dividend: Money collected by the trustee is distributed to creditors by paying each of them a dividend. "Dividend" is the formal term for any distribution from the bankrupt estate. It means a distribution or payout to creditors.

10. Exempt asset: This means any asset owned by the bankrupt that, under federal or provincial law, is exempt from execution, garnishment or seizure, and thus does not accrue to or vest in the trustee in bankruptcy for distribution among

creditors. Examples include tools of the trade, motor vehicles up to $5,000 in value, pensions, welfare benefits, and certain kinds of RRSP's. This meaning of "exempt" is quite different from the ordinary use in family law, namely an asset that does not fall within a person's net family property. This can cause problems when a spouse declares bankruptcy while holding an asset, such as a pension, that is divisible in family law, but exempt in bankruptcy.

11. "Settlement": This word has two completely different meanings. A settlement of property is a technical bankruptcy term, meaning a pre-bankruptcy gift or gratuitous property transfer by a "settlor" that can be challenged as a kind of fraudulent conveyance if the settlor becomes bankrupt. For example, "The property transfer was set aside as a settlement". Usage of the word "settlement" in this sense derives from trust law and has nothing whatever to do with the word's usual meaning in family law, namely the resolution or compromise of a dispute.

12. "Preference": Preferences, in bankruptcy law, can be either good or bad. A preference occurs when money is paid to a particular unsecured creditor rather than spread among all unsecured creditors. That is good if the payment is done by the trustee pursuant to a statutory ordering of specific favoured creditors set out in the BIA (a "preferred creditor") under s. 136. But it is bad if it is done before bankruptcy to a creditor not on this list (a "fraudulent preference").

13. "Provable claim": Only provable claims are stayed by bankruptcy and, in most cases, extinguished by the discharge. A provable claim is one that arises before the date of bankruptcy, although it may be unliquidated, contingent or contested.[26] Provable claims are proven by filing a proof of claim form that is accepted, or whose value is quantified, by the trustee or the bankruptcy court. As discussed below, some support is provable; in many cases equalization claims are provable.

14. Assignment in Bankruptcy: An Assignment in Bankruptcy is the formal term for declaring bankruptcy. It is usually made without legal involvement, as the documentation is fairly standardized and is drawn up directly by the trustee. The trustee is chosen by the debtor. The trustee's fees are either paid in advance by the debtor, guaranteed by a third party, or funded through voluntary surplus income payments made during the bankruptcy. The bankruptcy takes effect immediately on the date that the executed Assignment, and a sworn list of assets and liabilities (the "Statement of Affairs"), is filed by the trustee with the O.R. The vast majority of personal bankruptcies - more than 95% - are filed as "summary administration" bankruptcies where, at the time of filing, it appears that the unsecured assets will realize less than $10,000.[27] The trustee's basic fees in these

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[26] BIA s. 121

[27] BIA ss. 49(6)-(8), 155

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estates are capped by tariff at about $1,250, and the procedure is more stream-lined.

Upon the filing of an Assignment, the debtor becomes bankrupt. This has multiple consequences: All of the debtor's unsecured property vests in the trustee for distribution to creditors, subject to provincial or federal exemptions. The trustee proceeds to liquidate all of the non-exempt assets. Those assets that vest in the trustee for distribution to creditors are referred to as the "bankrupt estate". The bankrupt has no further rights over these assets.

Bankruptcy severs jointly held real estate. Bankruptcy does not affect the rights of secured creditors or of the beneficial owners of property held in trust by the bankrupt. The trustee is entitled to any property the debtor accrues between the date of bankruptcy and the date of the debtor's discharge (referred to as "after-acquired property").

Immediately upon the bankruptcy filing, all proceedings by unsecured creditors against the debtor are halted. This prevents any creditor from obtaining an advantage or preference against the general body of creditors as represented by the trustee, and avoids the trustee having to dissipate the assets of the estate through defence of multitudinous legal proceedings in different forums. Except

with permission of the bankruptcy court, no creditor may commence or continue any law suit, execution, garnishment or other proceeding against the debtor. This includes uncompleted execution proceedings under a writ of seizure and sale. Garnishment proceedings against the debtor's wages are also stayed, with the exception of garnishment for support claims. Creditors who have received money judgments before the bankruptcy have no greater rights than any other unsecured creditor. The stay of proceedings applies only to "provable" claims that arose before the date of bankruptcy. The stay does not apply to claims for support, although such claims may proceed only against assets that have not vested in the trustee.

15. Bankruptcy Proposal: A bankruptcy proposal is designed to provide a framework under which the debtor's financial obligations may be compromised or restructured outside of bankruptcy with the consent of a majority of creditors. There are two kinds of proposals. A "consumer proposal" is a cheap, streamlined procedure applicable to small dollar, individual debtors.[28] Individuals whose debts, excluding mortgages on their home, exceed $75,000, must utilize the "commercial proposal" procedure that is more technical and expensive, and requires court approval.[29] In either case, the proposal is a compromise offered to creditors,

[28] BIA ss. 66.11 - 66.4.

[29] BIA ss. 50 - 66.

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usually to reduce the size of the debts or to extend the time for payment. Until the proposal is voted upon or rejected, all proceedings by unsecured creditors are stayed (except for support claims). An accepted proposal is binding on all unsecured creditors, provided the debtor fulfils its terms. An accepted proposal has no effect on support claims unless the support claimant assents. Commercial proposals automatically result in bankruptcy if they are voted down; consumer proposals do not have this result.

IV. INTERACTION BETWEEN THE BIA AND MATRIMONIAL DISPUTES

The first four sections of this Part address the special bankruptcy treatment of support.

1. Support survives the bankruptcy discharge: BIA s. 178

> 178(1) *Debts not released by order of discharge.* — An order of discharge does not release the bankrupt from ...
> (b) any debt or liability for alimony;
> (c) any debt or liability under a support, maintenance or affiliation order, or under an agreement for maintenance and support of a spouse, former spouse, former common-law partner or child living apart from the bankrupt;
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> ...
> (2) *Claims released.* — Subject to subsection (1), an order of discharge releases the bankrupt from all claims provable in bankruptcy.

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Support debts are not extinguished by the bankruptcy discharge. This includes cost orders that were awarded in connection with obtaining or enforcing a cost order, or the portion of a cost order that relates to such support issues.

Issue (a): *How to determine what portion of a cost order survives bankruptcy as support*: Have the trial judge so specify at the time the order is made; or bring a motion, after bankruptcy, for an allocation of the cost award as between support issues and all other matters.[30] Since cost orders pertaining to support awards are themselves considered as part of the support award, it is necessary to determine what portion of the cost order relates to support. This may be established through affidavit evidence or viva voce testimony, or the trial judge may consult his or her notes. The support portion constitutes a support order; the remainder is an ordinary provable claim.

The governing precedents were all overlooked in a very unfortunate B.C. decision, *Lees, Re*.[31] After the wife died, her parents were appointed guardians of the two children. They brought a successful motion against the husband for monies to be paid into court to secure child support. When the husband then declared bankruptcy, the bankruptcy court confirmed (correctly) that costs incurred in

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[30] See *BIFL* §2.11

[31] (2002), 35 C.B.R. (4th) 150 (B.C.S.C.)

creating and enhancing a fund for the security for payment of support are non-dischargeable. However, the court decided that it had no jurisdiction to determine what portion of a mixed cost order was attributable to support so as to survive discharge and obtain priority in the bankruptcy. It is unclear whether any court could do so, because the decision is based on the grounds that the cost order had been entered and there is no jurisdiction to "amend" it in these circumstances after entry. The court paid lip service to the overriding social policy favouring payment of support, but adopted a procedural rule that guaranteed the frustration of that policy. The court did not advert to the numerous cases, discussed in my book,[32] that perform this allocation after the order is entered. Nonetheless, this case was followed in *Manolescu v. Manolescu*,[33] holding that where bankruptcy occurs after the matrimonial judgment is entered, the court has no jurisdiction to apportion a mixed cost order as between support and property. Once again, this decision ensures that procedural rules will defeat a fundamental public policy.

With respect, procedural rules of onus and *functus officio* should not be employed to frustrate the importance of family welfare and to unfairly prejudice the support claimant. Such procedural rules can be criticized under the epithet of 'systemic bias'. They have been built into the system. It is only when the effect of

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[32] *BIFL* §2.11

[33] [2003] B.C.J. No. 1687 (S.C., July 15 2003, wife unrepresented)

these rules on support claimants - primarily women - is examined, in view of the reality of matrimonial negotiation and litigation, that their inappropriateness in this context is revealed. This is, perhaps, classic feminization of poverty that should be 'defeated'.

Issue (b): *How to characterize a payment obligation in a court order or separation agreement* that does not explicitly indicate whether it is a support-type obligation or non-support.[34] For example, how does bankruptcy law treat a payment of $60,000 over five years that is based on the value of a spouse's professional degree? This can be seen as equalization of an asset (extinguished by the discharge), or as compensatory support (survives the discharge). The issue often arises in the case of an obligation to pay off a credit card or bank debt, or to maintain the payments on a mortgage or car lease in good standing. The general approach of the court is set out in *Moore v. Moore*.[35]

> It must be a question of fact in each case whether the debt or liability arises under an agreement for maintenance and support. The nature of the liability, the words of the agreement, and the circumstances surrounding the negotiation of the agreement may all be looked to in order to make a finding of fact about the nature of the debt or liability. The task in these cases is to determine as a question of fact whether the money owing under the agreement is really in the circumstances a *form* of maintenance and support, or is basically *intended* as maintenance and support, or is in effect maintenance and support or a *substitute* for it. [emphasis added]

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[34] See *BIFL* §3.2

[35] (1988), 67 O.R. (2d) 29, 72 C.B.R. (N.S.) 50, 17 R.F.L. (3d) 344 (S.C.) at p. 55-56 C.B.R.

The application of this test can be seen in *Maule-Ffinch v. Maule-Ffinch*,[36] where the amount owing to the wife under the separation agreement was based on the value of the equity in the matrimonial home. However the agreement, which the spouses had drafted themselves with input from a lawyer, specified that "The parties agree that the property divisions as set out above are to be construed as a lump sum payment in lieu of ongoing spousal or child support". Both the lower court and the Ontario Court of Appeal concluded that the obligation therefore survived the husband's bankruptcy as a substitute for support:

> "The plain and simple meaning of the words in the separation agreement is that the property division and the payments calculated in reference to the value of the wife's interest in the property, were in lieu of ongoing spousal and child support. We see no ambiguity in the agreement."

Factors in the characterization analysis

- Would the claimant have been entitled to support had the debt not been granted? If so, the obligation may be a substitute for support.

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[36] [1996] O.J. 1580 (Ont. C.A., May 7 1996), at ¶2. The Court of Appeal affirmed a brief decision which, being unreported, is set out here in full: "Judgment to go: The Separation Agreement is clear that the Financial payment was *in lieu of* child and spousal support. I find this to be a Fact. Put differently, the financial obligations are in effect a *substitute* for maintenance and support. Therefore, I find the personal bankruptcy in 1993 did not eliminate the Financial obligations set out in the Minutes of Settlement. Section 178(1)(c) applies." The wife's counsel, Patrick Muise of Bolton, advises that the lump sum payment was apparently calculated by reference to the value of the equity in the matrimonial home, evidenced by Minutes of Settlement referring to the amounts as being "in respect to the house".

- Does the debt reflect a specific valuation of an asset, or can it be traced in amount or nature to a property interest claimed in the proceeding? If so, the quantum may reflect a property division rather than a support entitlement; or alternatively, it may be a pure or partial substitute for support.

- The court will examine the wording of the agreement or order to attempt to glean an intention from the descriptive language used and the degree of integration with or differentiation of the debt from other parts of the document.[37]

- The labels used in the document are not determinative[38]

- Attributes of the obligation: does the obligation bear interest; is there an acceleration clause; is it affected by remarriage or death?

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[37] The separation agreement in *Miller, Re*, (1981), 37 C.B.R. (3d) 316 (Alta. C.A.), reversing 34 C.B.R. (N.S.) 172, 11 Alta. L.R. (2d) 376 (Q.B.) required the husband to assume and indemnify the wife against the second mortgage on the matrimonial home, that had been taken out to purchase chattels which he received on separation. The agreement was incorporated into a decree nisi. When he later failed to pay off the second mortgage, she was obliged to do so. After she successfully sued him for this amount, he filed for bankruptcy. The wife opposed his discharge. The lower court adopted a wide construction of the word "maintenance" as including amounts "necessary to put a person in a particular position", namely to provide the wife with lodging for herself and the two children. As the proceeds of the second mortgage were needed to purchase a mobile home for them, the indemnity obligation was "maintenance" and was not released by his discharge. This decision was reversed on appeal based on the circumstances of the negotiations and the language of the agreement. The spouses, after a nine-month marriage without children, had negotiated the division of their property and attended before a solicitor to memorialize their agreement. The agreement as drafted did not mention the word "maintenance", and spoke only of property issues. As such, it was unlikely that they intended the indemnity obligation to be subject to the laws relating to support.

[38] In *Ontario (Director of the Family Support Plan) v. Zuker* (1993), 47 R.F.L. (3d) 98 (Ont. Prov. Ct.), the payment obligation was described as a "lump sum" in the Minutes of Settlement; the word "support" had visibly been deleted from that phrase, out of concern that the amount might otherwise become taxable in the wife's hands. The obligation was characterized as support notwithstanding this evidence. In *Huntington v. Huntington* (1990), 101 N.S.R. (2d) 271 (S.C.), involving a 14 year marriage with two children, a $10,000 "lump sum settlement for spousal support and matrimonial property" was held to be entirely nondischargeable based on evidence that the words "matrimonial property" had been added solely to avoid problems with the welfare authorities.

- Tax treatment of the debt is not determinative.

- The court may consider the subsequent conduct of both spouses, although this may be insignificant if done without legal advice.[39]

- Compensatory or restitutionary support can be characterized either as support or property depending on the circumstances: Where one spouse (traditionally the wife) works, either to earn income or in the home, while the husband advances his career opportunities through education, the wife is entitled under family law principles to some form of compensation for the husband's increased earning potential. Normally it is a matter of theoretical interest only whether this compensation is described as a division of the value of the professional degrees obtained, or as compensatory support. In bankruptcy however, the characterization is critical. Unlike traditional support provision, compensatory support is based not on need, but on unjust enrichment. Since the long-term "asset" — the enhanced future earning stream — on which such compensation is based, does not fall into the bankruptcy as an asset of the estate, the court ought to be easily convinced that

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[39] *Eagar v. Eagar*, [1994] A.J. No. 197 (Alta. C.A.): "If it can be said that in other proceedings [the wife] had accepted that the debt was in fact and in law not maintenance, then she should not be heard to argue the contrary before the Bankruptcy Court." The Court held that this issue of estoppel should be decided before the characterization issue. [Comment: the procedural aspect of this decision is unfair and wrong. Surely the issue is an evidentiary one, to be balanced against all the other factors.] Compare *Ng, Re* (1994), 30 C.B.R. (3d) 126 (B.C.S.C.), where a mortgage indemnity obligation was characterized as non-support despite the husband's subsequent affidavit material, on two occasions, referring to the obligation as support. The necessary balancing cannot be accomplished if the hearing is bifurcated.

the entitlement should survive bankruptcy. Otherwise, the husband retains the asset while the wife receives no compensation for her efforts. Thus in *Bronson v. Bronson*,[40] the court acknowledged that a true compensatory support claim was properly characterized as support.[41] However in *Barnacle v. Barnacle*,[42] the wife's determination to ensure non-taxability, by designating the compensation as a property division, was held to preclude characterization as support.

A court should be much more leery of characterizing such compensation as support in connection with the priority afforded to support arrears in bankruptcy. Given that such compensation is based on long-term future earnings that do not form part of the bankrupt estate, the function of a restitutionary remedy would be soundly distorted. The husband would keep his long-term asset; the wife would receive priority compensation for amounts that have been fixed without reference to her needs; and all this would be done at the expense of the general creditors who do not benefit from the husband's enrichment. Disgorgement would be effected

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[40] (1997), 47 C.B.R. (3d) 142 (Ont. Gen. Div.)

[41] See also *Raff, In re*, 93 B.R. 41 (Bankr. S.D.N.Y. 1988), discussed in Green, *Bankruptcy's Effects on Divorce Settlements* (1991), 35 Boston B.J. 25 at p. 28. Wife supported husband through medical school. One month after graduation he commenced a divorce action. After four years of litigation, wife obtained order awarding her 25% of the present value of his medical degree. Husband became bankrupt one month later. Held: the award was in the nature of compensatory support that survived his discharge. Wife was entitled to the improved standard of living that she had expected would flow from his degree.

[42] [1993] O.J. No. 1273 (Ont. Gen. Div.). This case involved a 15 year marriage, two children.

against parties who do not receive any benefit. The more the husband had profited from the wife's efforts, the more the creditors would be prejudiced.[43]

- Obligations relating to division of a pension or pension stream, are more easily characterized as support.

- A payment obligation "in lieu of" or in reduction of support is a substitute for support. One of the three formulations in the leading decision of *Moore v. Moore* is whether the debt obligation is a *substitute* for support. Several courts have taken this literally, so as to characterize as support an obligation that utilizes the words "in lieu of support" or similar phraseology, to exempt from discharge a division of the equity in the matrimonial home that was designated "in lieu of ongoing spousal or child support". A payment obligation undertaken in consideration of a specific reduction of support will normally be characterized as a support debt, notwithstanding the designation utilized to describe the obligation.

- Indemnity, assumption and hold-harmless obligations: A debt or indemnity obligation will survive bankruptcy if payment of the underlying debt is necessary for the non-bankrupt spouse's support. The nature of the underlying debt itself is a

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[43] This argument applies whenever the court must characterize, in connection with s. 136(1)(d.1), a support obligation associated with an asset that does not fall into the bankrupt estate, such as a future income stream or a pension. These hybrid objects are referred to as "support assets" in McLeod & Mamo, *Matrimonial Property Law in Canada* (1993, supplemented, Carswell) at p. I-110.

secondary consideration. Where a wife, say, is solely or jointly liable on a debt owing to a third party — whether it be a mortgage, a bank loan, a credit card, a lien on a car, a tax debt or some other debt — a court order or separation agreement may require the husband to assume responsibility for the debt. This may be done in at least three ways:

- an express payment obligation imposed on the husband, for example requiring him to pay the mortgage;
- an express indemnity obligation requiring him to indemnify and hold her harmless against any monies she may be forced to pay on the debt; or
- an increased support obligation that affords her sufficient funds to pay the debt herself.

If the wife — or the court — requires the debt to be paid for the purposes of her support, these three modalities are simply different forms of the same remedy, and all three should survive the husband's bankruptcy. If the wife does not require the debt to be paid in order to provide for her (or, perhaps, the children's) support, the first two modalities ought not to result in characterization as support; and even the third modality might not truly serve a support function if the form were employed solely for tax savings. As in the case of other obligations, the court must look behind the formalities and examine the context and the circumstances. As suggested by the test in *Moore v. Moore*, the issue is whether the debt or liability

— in this context, the imposition of the indemnity obligation to the wife, not the underlying debt obligation to a third party — is in the nature of support.

If the debt is associated with the wife's continuing use or enjoyment of an asset necessary for her support, such as a mortgage on the home or a car loan, it is more likely that the indemnity obligation serves a support function.

The distinction is best illustrated through example from the case law:

Mills v. Martin (1990), 75 D.L.R. (4th) 556 (Ont. U.F.C.): The husband breached a family court order requiring him to make monthly payments on a joint bank loan. The wife moved for contempt before the same judge who had granted the order. Steinberg, U.F.C.J., held that he had intended by his order that the husband would discharge the joint bank loan by means of monthly payments, so as to confer a maintenance benefit upon the wife in the sense of enabling her to work and provide for herself and the children, free of the bank obligation. Thus the order could be enforced as a maintenance order:

> Much, in any case, depends upon the intent of the parties (where there has been an agreement for payment to a creditor), or the court which made the payment order, as to what its effect was to be. There may be some cases where the purpose of debt payment orders might be to effect proprietary transfers between the parties. That, however, was not the intent in this case. It is the nature of the provision and not the nature of the order that is critical.

Ness v. Ness (1998), 133 Man. R. (2d) 7 (Q.B.): Length of marriage unspecified; at least one child. Wife had not sought spousal support previously on the understanding that husband pay off a joint family debt. Husband went bankrupt, stopped payments, wife sought interim support to cover her increased debt. Not viable for her to file bankruptcy because, per evidence, might affect her employment. Wife awarded interim support to cover debt burden. ¶9: "The objectives of a spousal support order include, in subsections (a) and (c) [of the Divorce Act, s. 15], a recognition of economic disadvantages arising from the marriage or its breakdown, and relief from economic hardship arising from the breakdown. I am of the view that the joint debt is a direct consequence of the marriage and became an economic hardship to the wife

following the breakdown, the very circumstance which spousal support is intended to recognize."

Gilchrist v. Dasko, [2003] A.J. No. 1336 (Alta. Prov. Ct.): Wife sues in Small Claims Court on an indemnity in a separation agreement for a joint credit card used solely by the husband. It was paid off on separation, but run up after separation; bank got judgment, filed a writ against wife's new property, garnished her wages. Husband declared bankruptcy, now discharged. "I fail to appreciate how an agreement to indemnify could, under any circumstances, ever be considered as an agreement for alimony, maintenance or support. An indemnification is a contractual obligation to make good or reimburse for the loss, damage or liability of another". But since wife could not file a proof in the husband's bankruptcy (rule against double proof), her claim survives discharge. But since no evidence of what she has paid to bank, no right to damages, and Small Claims Court cannot grant declaratory relief.

C.H. v. M.S., Que. S.C., Fournier J., June 28 2004, #500-12-232564-967, Montreal): 12 year marriage, 4 children. Husband declared bankruptcy four years after separation agreement required him to guarantee payment to wife of $6,900 annually through the family tax credit program; $25,000 compensatory allowance payable in $2,500 annual instalments ($20,000 still due); and to pay off the mortgage on the home pursuant to a $100,000 obligation in their original marriage contract. After his discharge the wife garnisheed his salary, he moved to declare the debts were extinguished. Held: Strictly construe any provision of the BIA that acts as an impediment to the rehabilitation of the bankrupt, which is the foremost purpose of the BIA. [Comment: What about the other purposes such as providing for one's family, and the feminization of poverty?] The compensatory sum was contained in the section of the agreement entitled "alimentary support". But "compensatory allowance" is not alimentary in nature, but is the value of a spouse's contribution to the other's patrimony. So consider the pre-draft agreement, in which this obligation was contained in the property division section under the description, "in order to equalize the value of each spouse in a retirement plan", the husband agrees to pay her $25,000 [sic, probably means $2,500] annually for investment in an RRSP. Court therefore concludes that the $25,000 was not intended as alimentary in nature. Resolve any ambiguity in favour of the debtor. As to the mortgage, their original marriage contract contained a gift clause of $100,000; the mortgage provision simply expressed the means of discharging the obligation, so not a support obligation. The $6,900 was a support obligation. [Comment: The $100,000 and the $6,900 portions of the decision are appropriate. But the $25,000 aspect is highly suspect. It is regrettable, but common in such cases, that the court pays attention only to the policy goals involved in bankruptcy, and none whatsoever to the policy goals applicable to family law. There is no reason why this should be so. The effect of the decision, of course, is that the husband retains all of his pension (support in his old age) while the wife gets no share of the pension. The Supreme Court of Canada described this result as "intolerable" in *Clarke v. Clarke*, [1990] 2 S.C.R. 795. There were strong policy reasons to not extinguish this obligation, and the obligation was contained in the section of the agreement described as alimentary support. This aspect of the decision is similar to *Lees*, in that they both use bankruptcy policy (rehabilitation) to

frustrate matrimonial policy (support of the family, equitable division of assets between spouses, feminization of poverty), where there is no need to do so since the two can be reconciled.]

2. Support is provable in bankruptcy: BIA s. 121(4)

> 121(4) *Family support claims* — A claim in respect of a debt or liability referred to in paragraph 178(1)(b) or (c) payable under an order or agreement made before the date of the initial bankruptcy event in respect of the bankrupt and at a time when the spouse, former spouse, former common-law partner or child was living apart from the bankrupt, whether the order or agreement provides for periodic amounts or lump sum amounts, is a claim provable in proceedings under this Act.

Provable support arrears allow the support claimant to participate in the benefits of the bankruptcy. The holder of a provable support claim falls within the definition of "creditor" under the BIA, and is entitled to oppose the discharge, issue a bankruptcy petition, take proceedings under BIA s. 38 where the trustee refuses to act, and receive dividends. A support claimant with only non-provable claims is not a "creditor" within the bankruptcy proceedings and can do none of these things.

Support has been provable only since the 1997 amendments to the BIA. Jurisprudence before that date refers to support claims as being non-provable, which is no longer the case.

Support arrears, to be provable, must be based on an order or separation agreement made before the date of bankruptcy. *A post-bankruptcy retroactive*

order will not comply with this requirement. The parties must have been separated at the time the order or agreement was made; separation "under the same roof" falls within this requirement, if established on the facts.

3. Priority within bankruptcy for certain pre-bankruptcy support arrears: BIA s. 136

> 136(1) *Priority of claims* — Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows:
>
> ... {(a)-(d): funeral expenses; trustee's fees and legal costs; Superintendent of Bankruptcy's 5% levy; unpaid wages of employees up to $2,000 each} ...
>
> (d.1) claims in respect of debts or liabilities referred to in paragraph 178(1)(b) or (c), if provable by virtue of ss 121(4), for periodic amounts accrued in the year before the date of the bankruptcy that are payable, plus any lump sum amount that is payable; ...

Section 136 grants preferred status within the administration of the bankruptcy, in fifth position, to a portion of the provable support arrears. That portion consists of any *periodic* arrears accrued in the year before the bankruptcy, plus any *lump sum* that is payable. While s. 136 is sometimes referred to as granting "priority", this term is somewhat loose and must be used with care. It is indeed true that the specified support arrears will have priority over all other unsecured creditors and over those other claims specified in s. 136 that are listed after subsection (d.1). However, the section does not grant priority over the trustee in bankruptcy, which is the usual meaning of this term, nor over secured creditors. It gives no advantage or priority over any asset as against the trustee's entitlement to gather in the asset and administer it. Before the support claimant receives any preferred dividend from the estate, the trustee's administrative and legal costs will be paid in full, and the Superintendent's levy (currently about

5%) will be remitted. In this sense, the remedy grants a limited degree of priority over a limited portion of the support arrears.

Once again, the arrears must have accrued under a court order or agreement made before the date of bankruptcy, while the spouses were separated. A retroactive support award, made after bankruptcy, grants no priority whatever as against the trustee.

Note that by virtue of federal paramountcy, any priority granted to support arrears under provincial legislation is superseded by s. 136 of the BIA.

Issue (a): *How to differentiate between lump sum arrears*, which attain priority no matter how long before the bankruptcy they came due, and periodic arrears, which only qualify for priority if they accrued within one year before bankruptcy?

Outside the one year period before bankruptcy, only lump sum arrears, but not periodic arrears, acquire the benefits of preferred status. This juridical distinction also arises, in reverse, under the Income Tax Act, where beneficial tax treatment is afforded only to periodic arrears but not lump sums.[44] Confusion can arise because, in family law, lump sum support may be paid by instalments. The distinction between the two can be stated as follows: periodic support is made for the current support of the recipient; lump sum support is made to extinguish all future, or perhaps past, rights. For example, in *Cohen v. R.*,[45] the separation agreement provided for a $25,000 support obligation payable in three equal annual instalments. In the absence of any

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[44] See Income Tax Act Interpretation Bulletin IT-118R3 December 21 1990: "An amount paid as a single lump sum will generally not qualify as being payable on a periodic basis ... For example, (a) a lump sum payment made in place of several periodic payments not yet due but imposed under a court order or agreement; and (b) an amount paid pursuant to an order or agreement requiring that a payment be made in respect of a period prior to the date of that order or agreement, do not qualify as periodic payments ..."

[45] (1991), 91 D.T.C. 5239 (Fed. T.D.)

evidence connecting this amount to the wife's financial needs in re-establishing herself, the court characterized the obligation as a lump sum, not in the nature of periodic support, that was therefore non-deductible. In the bankruptcy context, this means that the entire obligation would qualify for preferred status even if it fell due more than one year before the bankruptcy.[46]

Lump sum indemnity obligations can likewise acquire preferred status if validly defined as support and serving that function. The preference will also extend to any cost obligation undertaken or ordered in reference to a support claim, whether or not the cost amount has been formally assessed before the bankruptcy.

Issue (b): *Can the spouses, the day before the husband's bankruptcy, enter into a separation agreement that creates, say, a $100,000 lump sum support obligation*, payable immediately? This would have the effect of creating a $100,000 priority for the wife in the husband's bankruptcy. Protection against abuse is contained in BIA s. 137, which provides that no dividend is payable on such a transaction unless the trustee, or the court, determines that the transaction was "proper". There is no judicial gloss on this section. As will be seen, matrimonial courts have granted such orders in appropriate circumstances,[47] and bankruptcy courts have

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[46] There is a wealth of jurisprudence on this issue. See M.L. Benotto, *An Income Tax Checklist*, [1993] Law Society of Upper Canada Special Lectures 297 at 305-308; *McKimmon, R. v.*, (1989), 25 R.F.L. (3d) 120, 104 N.R. 195, [1990] 1 F.C. 600, [1990] C.T.C. 109, 90 D.T.C. 6088 (Fed. C.A.); *Leclair v. M.N.R.* (1982), 82 D.T.C. 1755 (T.C.); *Urichuk v. R.* (1991), 33 R.F.L. (3d) 11, 91 D.T.C. 5375 (T.D.), aff'd (1993), 45 R.F.L. (3d) 195, 93 D.T.C. 5120 (Fed. C.A.); *Champagne v. M.N.R.* (1992), 93 D.T.C. 479 (T.C.C.); *Dubreuil v. M.N.R.* (1992), 93 D.T.C. 542 (T.C.C.). Another factor, not mentioned in these cases, is whether the support recipient had previously declared in her income, as periodic support, monies received on account of what are now sought to be characterized as lump sum instalment obligations. This can be ascertained by reviewing both spouses' prior tax returns.

[47] *Bottan v. Bottan* (Unreported, Ont. S.C.J. Newmarket No. 14284/02, Perkins J., December 10 2002), the author advised the wife's counsel: Court grants wife 2½ years retroactive child support of $31,000, compensatory lump sum spousal support of $37,500, 3 years future lump sum child support, calculated at $900/mo., of $32,400, all payable now, with $1,500 costs "all related to support". Father, on verge of insolvency, held half interest in home fully encumbered by a writ of execution in favour of a creditor; effect of order was to give wife priority in distribution of proceeds. Father attended; court was specifically advised about the execution, did not require notice to be given.

upheld property transfers, on the eve of insolvency, to satisfy future support claims.[48] In addition, the Supreme Court of Canada has laid down, in *Marzetti v. Marzetti*, discussed above, generous rules of interpretation where support issues, and family need, collide with creditors' interests. So there appears to be fairly wide latitude, despite the dramatic consequences of such an agreement.

Issue (c): *What about tax debts? Do they take priority over support arrears?* Tax arrears under federal legislation (i.e. income tax, GST, withholding taxes), fall within the scope of Crown paramountcy, and are not bound by provincial exemption legislation, nor by provincial legislation granting priority to support arrears. Outside of bankruptcy, therefore, tax arrears have priority over support arrears, and over the payor's residence exemptions, RRSP exemptions, etc..

But the BIA is federal legislation. The BIA treats most tax debts as ordinary unsecured claims. Therefore money collected by the trustee will be paid to the priority arrears claimant before the tax creditor, or other ordinary creditors, receives anything at all. The support claimant has a statutory preference for her priority support arrears, over all ordinary creditors. Furthermore, the tax debtor retains his exempt property under provincial legislation, which is therefore preserved for the purpose of support enforcement. Only a support claimant can assert remedies against the debtor's exempt assets once he becomes bankrupt.

There are two exceptions. First, the Canada Revenue Agency (CRA) can register security for tax arrears, by obtaining a Certificate from the Federal Court. While the certificate looks like

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[48] See, for example, *C.I.B.C. v. Shapiro and Shapiro* (1985), 49 O.R. (2d) 333, 44 R.F.L. (2d) 47, 54 C.B.R. (N.S.) 134 (Ont. S.C. in Bkcy), the matrimonial home was jointly owned. The wife had obtained an interim order in her divorce action that the husband pay her $3,000 monthly for support. Just three weeks before the husband's bankruptcy, they agreed to resolve their dispute whereby she acquired his titled interest in the home in consideration of a release of her claims for support. The agreement was enshrined in a decree nisi. The husband's trustee attacked the transaction as a property settlement and fraudulent conveyance, but was unsuccessful. The agreement was made in good faith in the resolution of valid claims against the husband and for valuable consideration. Neither the wife nor her lawyer knew of his desperate financial straits. The agreement represented a reasonable resolution of the wife's claims, was fully justified by her circumstances and was recommended by her lawyer.

a writ of execution, its effect, once registered, is to grant security for the amount set out in the Certificate. Once registered against land, it acts like a mortgage, and has priority over all subsequent claims against that land, including the interest of a trustee in bankruptcy, as if it were a registered mortgage for that amount. If the Certificate is registered under the applicable Personal Property Security Act (PPSA), it acquires the status of a perfected security interest against all the debtor's personal property. Effectively, a tax Certificate has priority over the trustee, and over the support claimant, once it is registered.

The second exception is more technical, namely for unpaid withholding taxes that a debtor may owe as an employer, or as the director of a corporate employer. Federal deemed trust legislation may grant priority for such claims over the bankrupt's income, as against a support claimant or the bankruptcy trustee, until the bankrupt has been discharged.

4. Limited Stay of Proceedings re Support: BIA s. 69.41

> 69.41(1) *Non-application of certain provisions.* — Sections 69 to 69.31 [the automatic bankruptcy stay of proceedings] do not apply in respect of a claim referred to in subsection 121(4).
>
> (2) *No remedy, etc.* — Notwithstanding ss (1), no creditor with a claim referred to in ss 121(4) has any remedy, or shall commence or continue any action, execution or other proceeding, against
> (a) property of a bankrupt that has vested in the trustee; or
> (b) amounts that are payable to the estate of the bankrupt under s 68 [surplus income payments].

The bankruptcy of a support payor does not stay or impede the enforcement of support claims. However, it does have the immediate effect of putting an end to any enforcement proceedings against the bankrupt's property which vests in the trustee in bankruptcy for distribution to creditors. Other sections of the BIA[49] operate to divest the debtor of such assets,

[49] BIA ss. 70(1), 71(2)

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vest them in the trustee, and give the trustee priority over all judicial proceedings then underway in respect of those assets. So support enforcement measures against the bankrupt's assets that vest in the trustee, are stopped in their tracks.

Issue (a): *Against which assets may support be enforced during the payor's bankruptcy?* Property that is still available for support enforcement during the bankruptcy includes the following: exempt assets; wages or self-employed earnings; income tax refunds; wrongful dismissal awards and severance pay. Unless and until the trustee obtains a court order giving him or her priority over these items,[50] a support claim can be pursued against them during and after the bankruptcy.

The remainder of this paper deals primarily with matrimonial property claims.

5. Provable Claims: BIA s. 121

> 121. (1) *Claims provable.* — All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

The provability of support claims has been discussed above. What about matrimonial property claims - are they provable?

Issue (a): *If a spouse declares bankruptcy before a separation agreement has been signed or an equalization judgment has been granted, is the equalization claim provable?* Case law suggests that so long as a triggering event — in Ontario, normally separation without reasonable

[50] BIA s. 68 allows the trustee to obtain a surplus income order during the bankruptcy. Since the section requires the bankruptcy court to defer to family needs, it is unlikely that a s. 68 order would be granted that will prevent the bankrupt from paying ongoing spousal and child support.

prospect of reconciliation — has occurred before the date of bankruptcy, the equalization claim is provable. This means that the claim is stayed by the bankruptcy and will be released by the discharge. This result applies in the "equalization" provinces: Ontario, P.E.I., Manitoba and probably Québec's *partition de patrimoine familiale* (division of family property).

This conclusion does not apply to all the provinces. In those provinces having division of property remedies – B.C., Alberta, Saskatchewan, New Brunswick, Nova Scotia and Newfoundland – the matrimonial property remedy is not, in structure, a debt-type remedy. As a result, while a debt claim for property division may be provable (and hence stayed and extinguished by discharge), a division claim, in specie, against an exempt asset is neither stayed nor extinguished by discharge.

In a few provinces, the matrimonial property remedy is so highly discretionary that the claim becomes provable only at the moment it is quantified and awarded. This applies to Québec's *prestation compensatoire* (compensatory allowance), and perhaps to Alberta's property division claim..

In *Lacroix v. Valois*,[51] the wife became destitute after her eight year marriage ended in separation. The following year, the husband made an assignment in bankruptcy, and was discharged one year later. Then he prospered. Four years after the separation, the wife petitioned for divorce and sought a compensatory allowance which, under arts. 427-430 of the Québec Civil Code, is a wholly discretionary remedy, akin to unjust enrichment, based on showing: (a) her contribution; (b) the enrichment of the husband's patrimony; (c) a causal link between the two; and (d) the proportion in which her contribution made possible the enrichment. The Court concluded that the wife's claim for a compensatory allowance would not arise until the judgment was awarded. As such, she had no provable claim at the time of bankruptcy:

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[51] (1990), 4 C.B.R. (3d) 113 (S.C.C.)

> First, I do not think that a "claim" arising out of art. 559 C.C.Q. can be provable in a proceeding brought pursuant to the [BIA]. Under art. 559 C.C.Q., the compensatory allowance is awarded at the time of the divorce, which probably excludes the possibility of claiming it in a bankruptcy proceeding. Second, because of the important part played by discretion in the judicial exercise leading to the award of a compensatory allowance, I do not think that considered in the abstract the existence of a contribution by a spouse which caused enrichment of the other spouse confers any right that could be described as a "claim" within the meaning of the [BIA]. *The judgment awarding a compensatory allowance creates the right.* [emphasis added]

According to the cases, the Alberta MPA does not grant to a spouse any "right" to matrimonial property, but only vests discretion in the court to distribute such property in accordance with the principles of justice and equity. A spouse's application grants "no entitlement, no right, but merely a hope that the court will exercise its discretion in favour of the applicant spouse."[52] "In Alberta, the Legislature has provided a remarkably flexible statute dealing with the division of matrimonial property. When in some statutes on this subject in other jurisdictions, the Legislature chose to specify firm rules to be followed, the Alberta Statute specifies only 'the matters to be taken into consideration' (s. 8) leaving the interplay of those matters to judicial discretion ... The Court must not replace this approach of judicial discretion with the rigid rules which the Legislature saw fit to reject."[53] Under existing case law, property division claims under the Alberta MPA are not provable until they have been liquidated.[54]

Issue (b): *What about a claim for equalization against a pension or other exempt asset where the pension-holder declares bankruptcy after the date of separation?* This is a problem only in equalization jurisdictions -- Ontario, Manitoba and P.E.I. Such assets do not fall into the bankruptcy, but the bankruptcy extinguishes the right to claim against them. If the equalization

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[52] *Deloitte Haskins & Sells v. Graham and Graham* (1983), 144 D.L.R. (3d) 539, [1983] W.W.R. 687, 47 C.B.R. (N.S.) 172 (Alta. Q.B.)

[53] *Dwelle v. Dwelle* (1982), 31 R.F.L. (2d) 113, 46 A.R. 1 (Alta. C.A.)

[54] *Dinapoli v. Yeung* (2002), 34 R.F.L. (5th) 19, [2003] 3 W.W.R. 714, 10 Alta. L.R. (4th) 123, 323 A.R. 113 (Q.B.)

claimant waits until the debtor is discharged, the right to claim against the pension will have been lost. The solution to this problem is to seek and obtain an order from the Bankruptcy Registrar, granting leave to commence or continue the equalization claim against the pension, notwithstanding the bankruptcy or the subsequent discharge. The bankruptcy courts routinely grant such orders now.[55] The order must be obtained before the bankrupt's discharge - this ordinarily means a **nine month limitation period** from the date of bankruptcy.[56] In the case of a bankruptcy proposal, the order should be obtained before the proposal is approved by the court (commercial proposal) or before deemed approved by the passage of time (60 days after filing, consumer proposal). This is an even shorter possible **limitation period**.

In my experience, a significant proportion of matrimonial lawyers in these three provinces are unaware of this limitation problem, as of course are their clients. To remedy the prejudice that this can cause, the Senate endorsed my proposal to amend the BIA so as to provide that a bankruptcy would neither the stay, nor extinguish, matrimonial property claims against exempt assets.[57] No-one opposes this, but the amendment did not make its way into the bankruptcy amendment bill, Bill C-55, now S.C. 2005 c. 47. Lobbying will continue when Mr. Harper takes office.

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[55] See, for example, *Hughes, Re* (October 23, 1997, Greer J., Ont. Gen. Div. #32-071120): The wife's equalization claim, commenced before husband's bankruptcy, comprised 77% of his debts, the other debts having been improperly incurred. The court granted leave to pursue the equalization claim against the husband's pension: "Bankruptcy proceedings were not, in my view, intended to wipe out property equalization claims against persons under the *Divorce Act* and *Family Law Act*, which were instituted prior to the Bankruptcy. The wife's claim for equalization against the Bankrupt's pension has no effect on any of the rights of the other creditors in bankruptcy, as the pension does not form one of the assets under the control of the Trustee .. The lifting of the stay does not affect the assets controlled by the Trustee nor does it prevent the Bankrupt from making a "fresh start", if he is discharged in November. Such a declaratory order is a special remedy against exempt assets, and in my view this takes the case at bar out of the line of cases which hold that leave will not be granted to continue an action against the Bankrupt where the creditors claim is provable in bankruptcy."

[56] Further discussion, and the precedents for granting such orders, can be found in *BIFL* §10.3, and in R. Klotz, *What's Happening in Bankruptcy/Family Law*, 10 C.B.R. (4th) 164 (1999).

[57] *Debtors and Creditors - Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*, Standing Senate Committee on Banking, Trade and Commerce, November 2003.

With such an order, the claimant can seek a division of the pension or exempt RRSP, either through an outright rollover, an "if and when" division, or through the imposition of a trust on the pension administrator.

6. Stay of Proceedings: BIA s. 69.3

> 69.3(1) *Stay of proceedings - bankruptcies.* — [Subject to the rights of secured creditors and any order the bankruptcy court may make to declare inoperable the stay of proceedings], on the bankruptcy of any debtor, no creditor has any remedy against the debtor or the debtor's property, or shall commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged.

The stay of proceedings in regard to support claims has been discussed above. Matrimonial property claims are stayed if the right to claim equalization — the cause of action — arose before the date of bankruptcy. In other words, in most provinces, if permanent separation occurred before the date of bankruptcy. The purpose of the stay is to avoid a multiplicity of actions against the bankrupt and the trustee during the administration of the estate. Vis-à-vis the trustee, this prevents the assets of the estate from being dissipated in legal costs,[58] and serves to channel disputes into the bankruptcy court which can then rationally determine whether there is a threshold claim and, if so, the most appropriate forum in which the claim is to be resolved.[59] Vis-à-vis the bankrupt spouse, this assures that the resources of the bankrupt are not dissipated, without good reason, in the defence of litigation against him or her, thereby exhausting income that might otherwise go to the creditors and also frustrating the rehabilitative goals of the BIA.

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[58] In *Skytal Ltd. v. Schiber* (1997), 46 C.B.R. (3d) 275 (Ont. Gen. Div.), aff'd (1999), 9 C.B.R. (4th) 129 (Ont. C.A.), a non-matrimonial case, Justice Walters referred to "the overriding goal of the BIA to provide for the orderly winding up of a bankrupt's affairs with a minimum of litigation ... " (p. 278)

[59] *Walters v. Walters* (1985), 56 C.B.R. (N.S.) 104, 62 B.C.L.R. 334 (B.C.S.C.)

Often there is no need to litigate the matrimonial property claim. A proof of claim can be filed in the bankruptcy, attaching the Net Family Property (NFP) calculations, that the trustee can evaluate. Alternatively, if there is good reason, leave can be granted to have the matrimonial property claim valued in matrimonial court.

Issue (a): *What claims can be pursued despite the bankruptcy, without leave of the court?* The following kinds of claims can proceed without leave. Note, however, that except for secured creditors, none of these claims can be enforced against assets that vest in the trustee for distribution among creditors.

- Claims for custody, access, divorce, paternity or similar matters, are purely personal and are neither provable nor stayed by the bankruptcy.

- Claims for arrears of support, whether provable or non-provable, and claims for on-going support, are not stayed by the bankruptcy. The same applies to cost orders granted in favour of a support recipient, to the extent that they relate to a support claim. In other words, support enforcement can continue outside bankruptcy despite the fact that the support claims being enforced are provable, or even priority, claims in the bankruptcy.

- Equalization and division of property claims that arise after the date of bankruptcy, namely where the triggering event, such as permanent separation, has occurred after the date of bankruptcy, are not provable and therefore are not stayed by the bankruptcy.

- A claim for *prestation compensatoire* (compensatory allowance) is not provable, hence not stayed, unless it has been liquidated (created) before bankruptcy. The same may apply to a matrimonial property claim in Alberta.

- Secured claims are not stayed.[60] Thus, where the claimant spouse holds a mortgage, or a charging order that constitutes valid security,[61] the bankruptcy does not stay or defer enforcement. No leave of the bankruptcy court is required to enforce such security.

- Bankruptcy does not stay proceedings for contempt.[62]

- Claims for division *in specie* of exempt assets, that is, direct proprietary claims against such assets, are not stayed.[63] This exception does not refer to equalization claims against such assets, but rather division of them, such as division of jointly owned household chattels.

- Bankruptcy does not stay the fulfillment by the bankrupt of a condition, such as an obligation to pay support arrears or post security in court, that may have been imposed by the court as a precondition to the bankrupt maintaining further proceedings in matrimonial litigation.[64]

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[60] BIA s. 69.3(2)

[61] Note that charging orders that constitute merely an aid to execution, do not grant secured creditor status in bankruptcy: BIA s. 70(1).

[62] *Pankhurst v. Kwan*, [1999] O.J. No. 41 (Jan. 11 1999, Gen. Div.): Creditor seeks costs re debtor's non-attendance at judgment debtor examination; defaulting debtor then goes bankrupt; judge has jurisdiction to fix costs despite stay: "I cannot imagine that the act of making an assignment in bankruptcy would stay the hand of a judge of this court in proceedings which were based upon contempt of court any more than an assignment in bankruptcy could bring a criminal prosecution to a halt." (¶9). The contempt power must not be used, however, to coerce payment of a debt that has been extinguished by the bankruptcy.

[63] *Suppes (Re)*, [1997] M.J. No. 152 (Man. Q.B., Sr. Registrar Goldberg): Husband files proof of claim in wife's bankruptcy for personal items in possession of wife, and equalization under MPA. "These claims relate to property which is listed in the trustee's Report as exempt. The stay of proceedings does not apply to exempt assets. These aspects of the claim are not provable in bankruptcy." *Cf. Johnson v. Johnson* (2005), 7 C.B.R. (5th) 226, 191 Man. R. (2d) 41, [2005] 7 W.W.R. 584 (Master, January 7 2005) (*Quaere*).

[64] Pre-bankruptcy order required husband to pay outstanding cost orders as a precondition of any further motions within the matrimonial proceeding. Husband then became bankrupt, brought motion regarding access and requested the deletion of this term due to the bankruptcy. No: bankruptcy does not preclude the satisfaction of the court order, nor the requirement to post security for costs, nor extinguish the requirements of a court order. Court not prepared to vary or amend the order: *May v. Stanley*, [1996] B.C.J. No. 1595 (B.C.S.C., May 9 1996)

- Bankruptcy does not preclude the trial judge from issuing a reserved decision in matrimonial property litigation where argument has been completed before the date of bankruptcy.[65]

It has been said that claims arising out of express or resulting trust are not stayed. However, the mandatory BIA s. 81 procedure normally applies. This section specifies a summary procedure for asserting claims against property in the possession of the trustee, including property to which the bankrupt holds legal title. The Québec Court of Appeal has concluded that a trust claim over the matrimonial home may be asserted against the trustee *only* through this procedure,[66] as has the B.C. Court of Appeal in connection with a wife's trust claim over an RRSP account held in the bankrupt husband's name.[67] Some older cases have concluded that express and resulting trust claims, not being stayed by the bankruptcy, may be advanced as of right in the civil courts.[68] In view of the wide definition to "possession" given by

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[65] *Rea v. Patmore* (1999), 13 C.B.R. (4th) 243, 253 A.R. 363 (Alta. Q.B.) (non-matrimonial case); *Trépanier (Syndic de), Re*, [1993] R.J.Q. 485 (C.S. Qué., Dec. 21 1992): Where bankruptcy occurs while a family court decision is under reserve, the court may proceed to render judgment (p. 492); *Little Tree Farm Ltd., Re* (1997), 45 C.B.R. (3d) 149 (Ont. Gen. Div.): Proposal filed after decision reserved; Judgment can be made effective from date hearing ended so as to predate proposal (non-matrimonial case); *Willard, In re*, 15 B.R. 898 (9th Cir., B.A.P., 1981)

[66] *Brazeau v. Cardinal*, *ibid.*: The wife's claim that jointly owned property was hers alone, through resulting trust, must proceed via BIA s. 81; the matrimonial courts have no jurisdiction to adjudicate this issue: "If the Respondent had followed the procedure prescribed by s. 59 of the Bankruptcy Act [now BIA s. 81] and had filed a sworn proof of claim respecting the property with the trustee giving the grounds on which the claim was based, the trustee would unquestionably have given her notice in writing that her claim was disputed with his reasons therefor. This would have compelled her to appeal to the court from his decision within the following 15 days. That appeal would have been decided by the Superior Court sitting in bankruptcy which would have had before it the claims of contending creditors ... In view of the facts mentioned above I am of the opinion that the trial judge of the Superior Court, sitting in divorce matters, lacked jurisdiction to decide Respondent's claim to be half-owner of the property in question and should have referred that aspect of the case to the Bankruptcy Division of the Superior Court." (Nolan J.) [author's translation]

[67] *Sykes, Re; Robson v. Robson* (1998), 2 C.B.R. (4th) 79, 156 D.L.R. (4th) 105 (B.C.C.A.) (no separation): The wife's trust claim against the trustee over the husband's RRSP was rejected on the evidence and also on procedural grounds. She did not file a s. 81 proof of claim despite being invited to do so by the Trustee. "We have not been provided with any authority which would permit her to pursue this claim other than in accordance with the [BIA]"

[68] *Bedard v. Schell*, [1987] 4 W.W.R. 699 (Sask. Q.B.). Note that in this case, the court concluded only that the resulting trust claim was not stayed by what is now BIA s. 69.3; the court's attention was, perhaps, not drawn to the applicability of BIA s. 81. Similarly, *Wormald Fire Systems Inc. v. Coopers & Lybrand Ltd.* (1985), 54 C.B.R. (N.S.) 296, 49 O.R. (2d) 222 (Ont. Dist. Ct.) held that no leave was required under what is now BIA s. 69.3 to advance a construction lien trust claim. As in *Bedard v. Schell*, the court did not address the mandatory language of BIA s. 81.

the Supreme Court in *Ramgotra*, the preclusive effect given to s. 81 by that court in *Giffen, Re*,[69] and the failure of these older precedents to consider s. 81, one is drawn to conclude that s. 81 cannot simply be ignored by advancing a trust claim in the ordinary courts without leave.[70]

A constructive trust is, at least in part, a remedy for unjust enrichment rather than a substantive proprietary right. Since the interests of creditors must be taken into account in imposing the remedy, a constructive trust claim requires leave of the court.[71] Furthermore, the comments in the previous paragraph also apply to constructive trusts: the s. 81 procedure applies.

7. Priority: BIA s. 70(1) and 71(2)

> 70(1) *Precedence of receiving orders and assignments.* — Every receiving order and every assignment made in pursuance of this Act takes precedence over all judicial or other attachments, garnishments, certificates having the effect of judgments, judgments, certificates of judgment, judgments operating as hypothecs, executions or other process against the property of a bankrupt, except those that have been completely executed by payment to the creditor or his agent, and except the rights of a secured creditor.
>
> 71(2) *Vesting of property in trustee.* — On a receiving order being made or an assignment being filed with an official receiver, a bankrupt ceases to have any capacity to dispose of or otherwise deal with his property, which shall, subject to this Act and to the rights of secured creditors, forthwith pass to and vest in the trustee ...

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[69] (1998), 1 C.B.R. (4th) 115 (S.C.C.)

[70] *Menzies v. Menzies* (2002), 37 C.B.R. (4th) 98 (Sask. Q.B.): Matrimonial court lifts stay of proceedings on consent of all parties. Court has no jurisdiction to divest property vesting in husband's trustee in satisfaction of wife's matrimonial claims under FPA, even if the property is "family property". Matrimonial court has no jurisdiction to order that an asset is jointly owned, not solely by bankrupt husband. Proper remedy is BIA s. 81. Matrimonial property legislation cannot be used to achieve indirectly what the wife failed to do directly through s. 81. *Miller v. Miller* (2000), 29 C.B.R. (4th) 98, 257 A.R. 380 (Alta. Q.B.): BIA is complete code, all claims for an interest in property seized by the trustee must be dealt with in bankruptcy court ie s. 81. *Toupin, Re* (Ont. S.C.J., #33-134002, Aitken J., July 2 2003): S. 81 is a mandatory procedure for husband's trust claim against matrimonial home in bankrupt wife's sole name. Husband's matrimonial action, joining trustee with claim for resulting and express trust, is stayed.

[71] *Bedard v. Schell*, [1987] 4 W.W.R. 699, 8 R.F.L. (3d) 180, 26 E.T.R. 225, 55 Sask. R. 71 (Q.B.)

BIA s. 70(1) provides that the trustee's property rights take precedence over all judicial proceedings, including judgments, garnishments and executions. This priority is absolute unless the judicial proceedings have been completed, by payment to the creditor; or if the creditor holds valid security; or if the property is held under a valid trust. BIA s. 71(2) provides that upon bankruptcy, the bankrupt loses all capacity to dispose of or deal with his or her property, which, subject to the rights of secured creditors, immediately vests in the trustee. This operates to divest the bankrupt of his or her property so as to place that property beyond the jurisdictional bounds of the matrimonial court in adjusting property and support issues between the spouses.

Once bankruptcy occurs, a claimant spouse loses any right to obtain priority through the Family Law Act, whether for support or equalization, over the bankrupt spouse's interest in the matrimonial home, or over any of the bankrupt spouse's other non-exempt assets. This problem is best exemplified by *Burson v. Burson*,[72] where the spouses jointly owned their matrimonial home. After their separation, the property was sold and the net proceeds were held in trust by the wife's solicitors pending agreement between the spouses or the judicial disposition of the equalization claim. As it transpired, the wife's entitlement exceeded the value of the husband's half interest. Had his bankruptcy not intervened, she would have recovered the entire proceeds. However, his assignment into bankruptcy had the effect of vesting in the trustee his half interest in the home (and hence his half of the funds):[73]

> [N]one of the provisions of the Family Law Act grant to one spouse a legal or beneficial interest in any property of the other spouse at any stage. At the highest, the Family Law Act statutorily created a creditor debtor relationship between the spouses upon permanent separation, with the calculation of the amount of the debt to be made by a formula that requires the valuation of their respective properties. There are of course provisions that empower the Court to order the transfer of the property of one spouse to the other, either for the satisfaction of the debt or as security for the debt, but these provisions are remedial only, and discretionary at that. Absent the actual making of such an order pursuant to them, those sections cannot possibly be

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[72] (1990), 29 R.F.L. (3d) 454, 4 C.B.R. (3d) 1 (Ont. Gen. Div.)

[73] *Ibid*, at pp. 459 - 460 R.F.L., pp. 7 - 8 C.B.R. See also *Starko v. Starko* (1993), 16 C.B.R. (3d) 236, 6 Alta. L.R. (3d) 64 (Q.B.), which reached the same result on analogous facts (save that the proceeds of sale had been paid into court) under Alberta's distribution of property scheme.

> construed so as to grant, on their face, property rights ... Unless and until Mr. and Mrs. Burson themselves actually agree upon a different division of the money, or unless and until a court directs a different division, Mr. and Mrs. Burson each retain the beneficial ownership of an undivided one-half interest. It is Mr. Burson's retained undivided one-half interest that vests in the bankruptcy trustee ...

Unless the bankrupt spouse's property has been conveyed or divided prior to bankruptcy by an actual conveyance - normally via a separation agreement - or court order, the trustee acquires the bankrupt's property interests and the wife has only a debt claim in the bankruptcy.

Note that the same applies to writs of execution registered against title: the Ontario FLA grants no jurisdiction to afford priority to a spouse's equalization claim over a writ of execution.[74]

Issue (a): *Are there any provincial nuances to this rule?*

- Homestead and residence exemptions, and other provincial exemptions, are recognized in bankruptcy law, and therefore escape the trustee's priority. They remain available for enforcement of equalization and property division claims, as well as support claims.

- In Newfoundland and Labrador: The FLA imposes a mandatory equal ownership of the matrimonial home between the spouses, regardless of title between them. This may be displaced only through a domestic contract executed before bankruptcy (or before a writ of execution has been registered).

- In New Brunswick, s. 20 of the MPA creates a vested trust entitlement in each spouse, without court order, to one half of the net proceeds of disposition of the matrimonial home. The statutory language appears to be sufficiently clear to vest a one-half interest in both

[74] *Maroukis v. Maroukis* (1984), 12 D.L.R. (4th) 321, 41 R.F.L. (2d) 113 (S.C.C.)

the non-bankrupt spouse and the trustee, regardless of the state of title between the spouses. Perhaps this applies only if the proceeds exist in undistributed money form on the date of bankruptcy.

- British Columbia's priority rules, under the developing jurisprudence, are quite confused. Priority depends on whether a triggering event (usually a judicial declaration of irreconcilability under s. 57 FRA) has occurred before bankruptcy, and whether a lis pendens has been registered. To summarize the confusing jurisprudence: A one-half entitlement in the family assets may vest in each spouse, provided a triggering event occurred before bankruptcy. If, in addition, a lis pendens was registered before bankruptcy, or - more questionably - a restraining or non-dissipation order was granted before bankruptcy, the non-bankrupt spouse may resort to unequal apportionment over the trustee's interest, provided this is justified on the facts. I believe that there is a better, more consistent analysis that is synthesized in my text and outlined in the note below.[75]
- In Alberta, under case law that has not been tested in the bankruptcy setting, the registration of a *lis pendens* has been used to grant priority to the matrimonial property claimant over the interest of a subsequently registered mortgage and over a subsequent writ of execution. It is questionable whether this result would overcome the federal paramountcy of BIA s. 70(1), although the confusing thicket of cases in B.C. should help.

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[75] (a) If the non-bankrupt spouse (say the wife) owned the property solely on the date of bankruptcy, the trustee acquires an interest only if, before the date of the husband's discharge, a triggering event has occurred such as the granting of an irreconcilability order. The trustee's half interest thereby acquired under s. 56 is subject to any s. 65 reapportionment that is required to prevent unfairness. No restraining order or *lis pendens* is necessary for this purpose. (b) If the spouses jointly owned the home, the trustee acquires a half interest on the date of bankruptcy unless the wife had obtained, prior to bankruptcy, a different division by way of vesting or securing order under the FRA or any other legislation. Upon bankruptcy, the trustee's interest vests and cannot be displaced under s. 65. A restraining order or *lis pendens* should make no difference. (c) If the bankrupt husband owned the home solely, the wife can acquire it all only through a pre-bankruptcy vesting or securing order under FRA s. 65 or any other legislation. She is entitled to a half-interest provided that a triggering event, such as a s. 57 irreconcilability order, occurred before bankruptcy; however she cannot exercise a s. 65 reapportionment remedy against the trustee's interest which vested independently of the FRA. A triggering event after the date of bankruptcy does not affect the trustee's rights. A restraining order or *lis pendens* makes no difference. See BIFL, §4.2(c)(4).

Issue (b): *How to preserve the opposing spouse's assets against the likelihood of a future bankruptcy (or execution claim)?* There are a number of procedural steps that can be taken to prevent the assets from falling into the creditors' hands until the Family Division has had an opportunity to grant a judgment dividing the assets:

- a suitably worded charging order, granting security over specified assets for the claimant spouse's equalization and support claims. In some provinces, this order must be registered against land.[76]

- establishing an express trust, through a formal trust agreement or suitably worded order imposing a trust, over the funds or assets in question, whereby the trust property is to be distributed in accordance with the court's final judgment in the matrimonial proceedings;

- both spouses can grant each other security over their individual assets, properly registered, to stand as security for the other's equalization, support and costs entitlements in the matrimonial proceedings;

- an injunction can be granted restraining the other spouse from declaring bankruptcy, allowing the claimant to obtain a judicial vesting remedy first.[77]

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[76] The wording of such an order is critical in view of BIA s. 70(1). To grant priority, the order should expressly indicate that it is intended to grant secured creditor status, effective in bankruptcy, pursuant to the court's inherent jurisdiction as well as under s. 9(1)(b) of the FLA or similar statutory provisions. This topic is discussed in *BIFL* Chapter 11.

[77] In *Uttley v. Uttley*, Order dated April 20 1995, Ont. Gen. Div. #18109/95, Barrie, in connection with a pending support motion, Eberhard J. ordered that "the Respondent husband shall not take any steps to file for bankruptcy if he is considering that step." In *Zoltak v. Zoltak*, Order dated May 2, 2000, Ont. S.C.J. #99-FP-248462FIS, Toronto, in connection with a pending support motion with convincing facts in a divorce proceeding, Potts J. ordered *ex parte* that the husband be "prohibited from assigning any of his property to any third party including a trustee in bankruptcy or filing an assignment in bankruptcy" pending the hearing of the balance of the motion and the delivery of certain security specified by the order. In *McDonald v. McDonald*, [2001] B.C.J. No. 2570 (B.C.C.A., December 6 2001), the B.C. Court of Appeal adopted, and continued pending appeal, a restraining order that the husband not declare bankruptcy until the orders of the Court of Appeal and of the trial judge were carried out.

- a motion for summary judgment vesting the matrimonial home in the moving party as partial or full satisfaction of an equalization entitlement,[78] or a cost award;[79] or a motion for security.

- a separation agreement, and consequent property transfer, or a court order doing so, will grant priority so long as it is completed before bankruptcy - although the transaction may be vulnerable as an attack as a fraudulent conveyance. In some provinces the order, or agreement, has priority only if it is registered against land.

- a lump sum support order or agreement, made before bankruptcy, will not grant priority, but will grant a preference in the distribution of monies out of the bankruptcy.

- In B.C., a pre-bankruptcy triggering event under FRA s. 57 (a judicial declaration of irreconcilability, or a separation agreement or divorce order) will presumptively vest the matrimonial assets equally as between the spouses. This may have positive or negative effects vis-a-vis the creditors or the trustee.

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[78] *Zagdanski v. Zagdanski* (2001), 55 O.R. (3d) 6 (S.C.J.) (non-bankruptcy case): The court may grant an interim advance on account of the equalization payment in an appropriate case. *McTeague v. McTeague* (Ont. S.C.J., Donahue J., Stratford #R01-124, May 17 2001, unreported, thanks to Keith Millikin of Guelph): Court grants summary judgment to wife vesting the matrimonial home in her as partial or full satisfaction of her equalization entitlement, where the net family property calculations showed that her claim exceeded the husband's interest in the home and he had threatened to declare bankruptcy. Wife suffered from onset of a debilitating disease. Husband attended, was represented but did not oppose except for costs. "Ordered that all right, title and interest of the husband in the matrimonial home is hereby immediately vested in the wife. This is in satisfaction of all or part of her entitlement to equalization of net family property. She is ordered to indemnify him for any liability for charges against the said property. It is clear that the wife's entitlement to a share in his pension is worth at least as much as the value of his interest in the home. The husband has expressed an intention to declare bankruptcy which would reduce the wife's claim to his share in the home to that of an unsecured creditor. She requires protection now against the consequences of his declared intention. This can only be accomplished by this order in advance of bankruptcy - which would not affect the only other asset - the pension - in the same way. A combined reading of *Fraser*, *Coathup* and *Jeffries* in Applicant's brief satisfy me that the Court has this authority on motion. It is to be noted that no argument was offered *contra* - the husband arguably being indifferent to whether he loses his interest in the home through this order or through bankruptcy."

[79] *T.L.F. v. S.L.F.* (1999), 254 A.R. 383 (Alta. Q.B.): Wife applies for order that husband transfer his interest in matrimonial home to her to pay the costs awarded against him after custody trial. Concerned that he will file bankruptcy to defeat cost order. While court acknowledges that her concerns are legitimate and real, adjourns hearing for one month pending cross-examinations to be done within 2 weeks. Court does not make any other order to protect wife against pre-emptive bankruptcy filing in the meantime.

- In B.C. or Alberta, the pre-bankruptcy registration of a lis pendens against title may afford priority against the trustee, and will certainly grant priority against subsequent execution claims.

- In Newfoundland and Labrador, a pre-bankruptcy domestic contract excluding the operation of s. 8 FLA will ensure that a non-titled spouse does not acquire a half interest in the matrimonial home that can accrue to his or her creditors or trustee.

Issue (c): *How to establish priority after bankruptcy over the bankrupt spouse's assets*, such as his or her half interest in the matrimonial home? A variety of equitable arguments are available in the common-law jurisdictions:

- *Express trust:* An express agreement as to how the property was to be owned or divided as between the spouses. In respect of land, it may have to be written. In Québec, the trust may have to be registered.

- *Resulting trust:* The claimant must show that his or her money or property was used to acquire the home to a greater extent than is reflected in the legal title. If so, this priority argument is aided by the presumption of resulting trust applicable in most family property statutes. Resulting trust fails if the contribution was intended as a gift at the time. For example, courts normally interpret as a gift, not a resulting trust, the scenario where one married spouse buys the matrimonial home and has title placed in joint names. Resulting trust is unavailable in Québec.

- *Constructive trust:* The claimant must establish unjust enrichment, namely a deprivation, a corresponding enrichment, and the absence of any juristic reason for the enrichment.

Constructive trust is extremely problematic after bankruptcy, because the debtor spouse, being bankrupt, likely has no "value survived"; and it is the creditors, not the debtor, who will suffer the consequences if a proprietary remedy is granted for the enrichment. The bankruptcy itself may be a juristic reason for the enrichment: all creditors lose in a bankruptcy, and the court should not be making things fairer for one claimant, through a constructive trust, at the expense of the others.[80] While Québec recognizes the unjust enrichment remedy, it cannot apparently be utilized to grant a property entitlement with priority over the trustee.

- *Equity of exoneration:* Where a mortgage has been placed against the matrimonial home for the sole or principal benefit of the bankrupt spouse, the other spouse may require that the bankrupt's half share of the property account for the full amount of the mortgage. This doctrine is known as the equity of exoneration.[81] It also applies to writs of execution against the home. The court must determine whether the debt or mortgage was purely for the bankrupt's benefit. If the other spouse benefitted in some way, the doctrine is arguably inapplicable. Recent Canadian cases addressing this doctrine are noted below.[82] It is unclear whether this doctrine applies in Québec.

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[80] See *Tierney v. Thibault*, [1997] A.J. No. 1246 (Alta. Q.B., Nash J., December 16 1997): Constructive trust claim by separated common law wife, 11 years cohabitation. Four years before they separated, he purchased a general store that they renovated and where she worked all day, seven days a week, for no remuneration. He closed the store one year after separation and declared bankruptcy one year later before her constructive trust claim reached trial. She obtained leave to proceed with her claim. The Court concluded unjust enrichment and granted a constructive trust declaration over half, but declared that this does not give priority in the bankruptcy or exclude the trust property from distribution among creditors because: a remedial constructive trust is not a "true" trust under BIA s. 67(1)(a); the priority of creditors must be known at the time of the assignment in bankruptcy; and allowing priority is tantamount to allowing the constructive trust beneficiary to trump other creditors.

[81] See *BIFL*, § 4.3(b)(2)

[82] *Slan v. Blumenfeld* (1997), 34 O.R. (3d) 713 (Gen. Div.) - applying the doctrine, although unduly restricting its ambit; *A.R. Thomson Ltd. v. Stock*, [1995] B.C.J. No. 1063 (S.C., Huddart J.), reversed on procedural grounds [1997] B.C.J. No. 596 (C.A.) - applying the doctrine without naming it; *317363 Canada Inc. v. Doctor* (1997), 50 C.B.R. (3d) 264 (Ont. Gen. Div.) - doctrine inapplicable as wife received indirect benefit; *Whitelaw v. Whitelaw*, [1996] O.J. No. 1245 (Ont. C.A.), varying [1991] O.J. No. 2402 (Gen. Div., MacLeod J.) - same.

- *Equitable charge or lien*: This category of equitable charge or lien, is flexible and ill-defined,[83] although it has been applied in Ontario.[84] Two formulations are:

> "It is a well-established principle that a husband who pays off or reduces encumbrances upon his wife's property is entitled, in the absence of proof of an intention to the contrary, to a lien on the property for the sums so paid."[85]
>
> "There can be no doubt upon the authorities that where an owner of land invited or expressly encouraged another to expend money upon part of his land upon the face of an assurance or promise that that part of the land will be made over to the person so expending his money, a court of equity will prima facie require the owner by appropriate conveyance to fulfil his obligation; and when, for example, for reasons of title, no such conveyance can effectively be made, a court of equity may declare that the person who has expended the money is entitled to an equitable charge or lien for the amount so expended ... It was said in *Plimmer v. Wellington Corporation* (1914), 9 App. Cas. 699, at p. 714 P.C. that the court must look at the circumstances in each case to decide in what way the equity can be satisfied."[86]

- *Equitable assignment:* Under this doctrine, an agreement between the spouses that a debt owing to one of them — perhaps based on a larger contribution to the property or on some other ground — would be paid out of the proceeds of sale of the matrimonial home, operates as an equitable assignment of the proceeds and creates a valid equitable charge on the monies.[87] This doctrine is likely unavailable in Québec unless the agreement is registered.

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[83] See *BIFL*, § 4.3(b)(3)

[84] *Canada Life Assurance Co. v. Kennedy* (1978), 21 O.R. (2d) 83 (Ont. C.A.)

[85] *Hendry v. Hendry*, [1960] N.Z.L.R. 48 (S.C.)

[86] *Chalmers v. Pardoe*, [1963] 1 W.L.R. 677 (Fiji P.C.) at pp. 681-82

[87] *Gilmour, Re* (1997), 9 C.B.R. (4th) 191 (Ont. Gen. Div.), reversing (1997), 47 C.B.R. (3d) 256 (Registrar), the author acted for the husband. A separation agreement and court order provided that the jointly owned matrimonial home be sold, the proceeds be divided equally, and from wife's share "[S]he shall direct that the husband be paid the sum of $50,000 .. in full satisfaction of his claim for an equalization of net family property". When the wife became bankrupt before the sale, the court held that the husband's claim to $50,000 against her share was enforceable in priority to the trustee under the equitable assignment doctrine. See R. Klotz, *When has the property been divided? Case Comment: Re Gilmour and Re Mikolajczuk*, 9 C.B.R. (4th) 195 (1999)

- *Equitable accounting:* Where joint property has been sold, and one party (the non-bankrupt spouse) has contributed more than a half share to the purchase or upkeep, the court may grant an allowance out of the proceeds.[88] It is unclear whether Québec courts would recognize this doctrine.

- *Equitable right of set-off:* Where the trustee's claim against the non-bankrupt spouse is for a money payment rather than a proprietary claim, the ordinary rules of set-off apply.[89] Both legal and equitable set-off are available in bankruptcy. Legal set-off requires the existence of mutual debts between the same parties and in the same capacity; the debts must exist at the date of bankruptcy. Equitable set-off is more discretionary, and arises where the relationship between the parties' claims is such that it would be unconscionable or inequitable not to permit set-off.[90] The claims need not be liquidated, but should be so clearly connected with each other that it would be "manifestly unjust" to enforce one claim without taking into account the other. Equitable set-off is available whether or not the cross-obligations are mutual debts, or perhaps even debts at all, provided that there is a relationship between the cross-obligations such that it would be inequitable to permit one to proceed without taking the other into account. It is enough that the opposing claims flow from the same transaction or relationship between the parties. In Québec, by virtue of recent Supreme Court of Canada jurisprudence, the set-off doctrine is largely unavailable as against the trustee.[91]

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[88] *Goertz (Trustee of) v. Goertz* (1994), 26 C.B.R. (3d) 222 @ 247-48 (Sask. Q.B.). See Courts of Justice Act, s. 122(2): An action for an accounting may be brought by a joint tenant or tenant in common, or his or her personal representative, against a co-tenant for receiving more than the co-tenant's just share... . See *Griffiths v. Zambosco* (2001), 54 O.R. (3d) 397 (C.A.); Bruce Ziff, *Principles of Property Law* (3rd ed., Carswell, 2000), p. 319.

[89] BIA s. 97(3). See, generally, Kelly Palmer, *The Law of Set-Off in Canada* (1993, Canada Law Book, Aurora)

[90] *Telford v. Holt*, [1987] 2 S.C.R. 193, 21 C.P.C. (2d) 1, [1987] 6 W.W.R. 385, 41 D.L.R. (4th) 385 (S.C.C.)

[91] *D.I.M.S. Construction inc (Syndic de)*, [2003] R.J.Q. 1104, 227 D.L.R. (4th) 629 (C.A. Qué., April 10 2003), affirmed on other grounds [2005] S.C.J. No. 52 (October 6 2005) (non-matrimonial case). No equitable set-off in Québec; no legal set-off for payments made after the date of bankruptcy. See Bernard Boucher, *The Supreme Court Rules — The End of Equitable Set-Off in Québec*, 18 Commercial Insolv. Rptr. 33 (2005)

- *Trustee's duty of fairness*.[92] The seminal case of *Ex parte James; Re Condon*[93] stands for the rule that the trustee must apply the principles of honesty and fair dealing in the administration of the bankruptcy estate. While the trustee is obliged to carry out his statutory duties, and to do so in reliance upon technical statutory rules, the court may in some circumstances direct that he not take full advantage of his legal rights. The trustee should not retain money that morally belongs to someone else. As an officer of the court, the trustee must set an example of commercial morality. This priority theory is, at best, a long shot. It has, however, recently been utilized in Québec to overcome the unavailability of trust and equitable doctrines in that province.[94]

- *Estoppel:* In some cases the courts have applied estoppel principles to defeat the priority otherwise afforded by the statutory scheme. These cases do not easily apply in the bankruptcy setting, where there can rarely be the delicate adjustment of equities between the two affected parties which estoppel requires without affecting both the statutory distribution scheme and the other innocent creditors.[95]

Issue (d): *If the trustee becomes the half-owner of the matrimonial home, can the trustee force a sale of the property?* Under the case law, a half-owner can indeed force partition and sale

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[92] *BIFL* §4.3(b)(6)

[93] (1874), 9 Ch. App. 609, [1874-80] All E.R. 388 (C.A.)

[94] *Bédard (Faillite de)*, [2005] R.J.Q. 1732, [2005] J.Q. no 7779 (C.S.Q., 8 juin 2005): Common law spouses purchased their home in joint names, subject to an unregistered trust declaration in favour of the wife, who funded the purchase and made all mortgage payments. Husband declared bankruptcy 2½ years after leaving the home. The trust declaration was registered 6 days after the bankruptcy but shortly before the notice of assignment was registered. Quebec law gives good faith third parties priority over unregistered interests. The trustee knew of the trust declaration before the assignment. Held: the trustee was not a third party as against the bankrupt for purposes of priority. The bankrupt should not be allowed to profit from the surplus that would accrue to him after his debts were paid off. The trustee should not receive an unjust enrichment. The trustee's claim was not in good faith, it would be incompatible with natural justice, applying the *Ex parte James* concept to recognize the express trust. [Comment: Unclear if same result would apply if notice of the assignment had been registered first.]

[95] See *Goldin (Trustee of) v. Bennett & Co.* (2003), 65 O.R. (3d) 691, 229 D.L.R. (4th) 736 (Ont. C.A.)

unless this would result in "undue hardship" or “oppression”) to the other half-owner. If alternative accommodation is available that will not cause undue disruption to the children, sale will be compelled. If undue hardship can be established, the court may defer sale proceedings until the youngest child turns 18, or other comparable terms.[96]

8. Property of the bankrupt: BIA s. 67

> 67(1) *Property of bankrupt*. — The property of a bankrupt divisible among his creditors shall not comprise
> (a) property held by the bankrupt in trust for any other person
> (b) any property that as against the bankrupt is exempt from execution or seizure ...
>
> but it shall comprise
> (c) all property wherever situated of the bankrupt at the date of his bankruptcy or that may be acquired by or devolve on him before his discharge ...

The definition of "property of the bankrupt", in s. 67, is intended to be extremely wide. Two issues arise here.

Issue (a): *Does the bankrupt spouse's trustee acquire the bankrupt's right to claim equalization against the non-bankrupt spouse?* If the bankrupt spouse engaged in protective business planning (also known as creditor-proofing), the assets will be mostly in the name of the solvent spouse, giving rise to a large equalization or division claim in favour of the bankrupt spouse. Can the trustee pursue and settle this cause of action? Matrimonial property statutes in Ontario and P.E.I. both provide that the right to claim equalization is “personal as between the spouses”. Yet case law in Ontario is fairly clear that so long as an equalization claim had been commenced before the date of bankruptcy, and is ongoing at the time of bankruptcy, the cause

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[96] *Yale v. MacMaster* (1974), 3 O.R. (2d) 547, 18 C.B.R. (N.S.) 225, 18 R.F.L. 27, 46 D.L.R. (3d) 167 (S.C.); *Kutschenreiter v. Kutschenreiter* (1983), 46 C.B.R. (N.S.) 1 (Ont. S.C.); *Slan v. Blumenfeld* (1997), 34 O.R. (3d) 713 (Gen. Div.)

of action vests in the trustee.[97] The trustee alone has the right to litigate and to settle the equalization claim. The same result has been confirmed in Manitoba, Saskatchewan[98] and British Columbia.[99] Even Alberta, whose legislation had been construed to lead to the opposite result due to its highly discretionary content (the "Alberta rule"), has recently adopted this approach, namely that the right to settle or litigate the bankrupt's matrimonial property claim vests in his or her trustee in bankruptcy.[100] Case law in Québec adopts this approach in relation to the *partition de patrimoine familiale* (though not without dissension), but not the highly discretionary *prestation compensatoire*.[101]

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[97] *Re Bosveld* (Unreported, January 10, 1986, Ont. S.C., London No. 35-023467, Sutherland J.); *Blowes v. Blowes* (1993), 49 R.F.L. (3d) 27, 21 C.B.R. (3d) 276, 16 O.R. (3d) 318 (C.A.); *Sluis v. Roche* (1997), 124 Man. R. (2d) 191 (Q.B.); *Tinant v. Tinant* (2003), 46 C.B.R. (4th) 150, 15 Alta. L.R. (4th) 225, 330 A.R. 148 (C.A., in Chambers); *Cochard v. Cochard*, [2004] A.J. No. 669 (Alta. Q.B., June 14 2004)

[98] *Huber v. Huber* (2003), 45 C.B.R. (4th) 85, *sub nom. K.D.H. v. P.A.H.* (2003), 236 Sask. R. 87 (Q.B., July 18 2003)

[99] *Hamilton v. Hamilton*, [2005] B.C.J. No. 2667 (S.C., Smith J., December 6 2005)

[100] *Tinant v. Tinant* (2003), 46 C.B.R. (4th) 150, 15 Alta. L.R. (4th) 225, 330 A.R. 148 (C.A., Chambers, July 2 2003, bankrupt self-represented); *Lecerf v. Lecerf* [2004] A.J. No. 887 (Alta. Q.B., June 24 2004, both parties unrepresented); *Cochard v. Cochard* (2004), 7 C.B.R. (5th) 73 (Alta. Q.B., June 14 2004). All of these cases are arguably incorrectly reasoned, and have been strongly criticized elsewhere by the author: see R. Klotz, *Restructuring the Insolvent Family Unit: Recent Unfortunate Cases*, Pan-Canadian Insolvency Conference, Canadian Bar Association, Québec City, September 16, 2005.

[101] *Droit de la famille - 871*, [1990] R.J.Q. 2107 (C.A.): The right to claim a compensatory allowance is a right of equity, based on unjust enrichment. It is a personal right that does not accrue to the trustee, and may be granted by the court in favour of an entitled spouse, despite bankruptcy, at the time the divorce is pronounced. It is intimately bound to the personal status of the spouses, and may be exercised only by them or by persons who may be specifically authorized to do so by legislation — not the trustee. *Droit de la famille - 1809*, [1993] R.J.Q. 1522 (C.S.): The husband's bankruptcy followed the commencement of a divorce proceeding. While the court ruled that his claim for division of the family patrimony accrued to his trustee, he was permitted to advance a claim for compensatory allowance. *Droit de la famille - 2126*, [1995] R.J.Q. 546 (C.S., 1 janvier 1995): Compensatory allowance cannot be claimed by deceased spouse's personal representative because the claim is personal and incapable of assignment unless and until quantified by judgment or separation agreement. *Fine (Succession de) c. Bordo*, [1998] R.J.Q. 1823 (C.S., Senécal J., 21 mai 1998): The right to claim division of family property is personal, cannot be exercised by heirs: "Les règles du patrimoine familial n'ont donc jamais eu pour objet de procurer des bénéfices à des tiers, de les protéger ou de sauvegarder leurs 'droits', qu'il s'agisse des héritiers ou des créanciers, pas même des enfants. (¶69) ... Pire, le partage du patrimoine en faveur des héritiers irait à l'encontre même des buts de la législation relative au patrimoine familial. Alors que celle-ci veut protéger les époux, ce serait en effet reconnaître que la loi pourrait avoir pour effet que des étrangers puissent, en cas de décès de l'un des conjoints, venir dépouiller l'autre à seule fin de les avantager eux, qui ne sont pourtant pas parmi les personnes que la loi voulait protéger. Ce serait reconnaître en somme que l'une des personnes que l'on voulait protéger puisse être dépouillée au profit de quelqu'un que l'on ne voulait pas protéger! Cela conduit à des résultats injustes, absurdes et 'socialement inacceptables' (¶72) ... Pareille interprétation serait antinomique des buts mêmes du patrimoine familial et de sa nature. (¶74) ... Comme les autres effets du mariage telle l'obligation de faire vie commune, l'obligation de fidélité, l'obligation alimentaire, la protection accordée à la résidence familiale, : etc.,le patrimoine familial est rattaché à la personne des époux en tant qu'époux, porte sur des matières purement personnelles aux époux et ne peut impliquer que les époux. C'est une mesure de protection propre aux époux et qui leur est personnelle." (¶83) {"The rules of family property were never intended to benefit third parties, to protect them or to safeguard their 'rights', whether heirs, creditors or even infants. (¶69) ... Worse, the division of family property in favour of heirs would even contradict

I have strongly criticized this rule in my book.[102] The Senate has recommended my proposal to legislatively adopt the now anachronistically named "Alberta Rule" in the BIA, namely that the trustee should never acquire the right to litigate or settle the matrimonial property claim..[103] This recommendation did not find its way into the recent bankruptcy amendment bill.[104] For the reasons set out in my submission to the Senate, substantially greater justice would result from a clear rule that the bankrupt alone, and not his or her trustee, retains the right to litigate or settle his or her matrimonial property claim against the other spouse. Creditors and bankruptcy trustees should not have the right to initiate, or to intervene in this way in matrimonial disputes. Their remedy ought to be limited to seizing the non-exempt proceeds of the dispute accruing to the bankrupt spouse, once they are determined, or to oppose the bankrupt's discharge.

Issue (b): *Does lump sum support money owing to or received by the bankrupt spouse, accrue to the trustee as property of the bankrupt?* The cases are fairly clear that periodic support does not accrue to the trustee as an asset. However some cases permit the amount of spousal and child support received by the debtor to be factored into the surplus income provisions, resulting in a obligation to pay a higher portion of total income to the trustee during the bankruptcy. If the

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the objects of the family property legislation. Given that the legislation is for the protection of spouses, this would in effect recognize that the law could have the effect that, in the event of a spouse's death, strangers could impoverish the other spouse solely to benefit themselves, even though they are not even among the persons that the law would like to protect. This would recognize, therefore, that a person that the law wishes to protect could be impoverished to the profit of someone that one does not want to protect! That leads to results which are unjust, absurd and 'socially unacceptable' (¶72) ... Such an interpretation would be contrary to the purposes of family property and to its nature. (¶74) ... Like the other incidents of marriage, such as the duty to lead life together, the duty of faithfulness, the duty of support, the protection given to the family home, etc., the family property is attached to the person of the spouses as spouses, governs subjects purely personal to the spouses and can only involve the spouses. It is a protective measure for the spouses themselves and is personal to them. (¶83)} [author's translation]. *Bolduc c. Moffatt*, [2000] R.D.F. 526 (C.S. Qué., 6 juin 2000): The division remedy is transmissible to third parties (here, the testamentary estate). Draws a distinction between the discretionary nature of the prestation compensatoire that comes into being only upon the judgment being granted, and the division of family patrimony that comes into being when the action is commenced.

[102] See *BIFL* §6.1(g)

[103] *Debtors and Creditors - Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*, Standing Senate Committee on Banking, Trade and Commerce, November 2003.

[104] Bill C-55, now S.C. 2005 c. 47, Royal Assent November 25, 2005, not yet in force.

amount of lump sum support exceeds the bankrupt's needs for the duration of the bankruptcy, it might be treated as surplus income that accrues to the trustee, much in the same way as severance pay is treated in bankruptcy: the portion justly needed by the bankrupt as income is retained, the balance is paid to the trustee. However, recent authority from the Court of Appeal, in *Taylor v. Taylor*,[105] suggests that, for public policy reasons, even a substantial lump sum support entitlement may be treated as exempt.

9. Annulment: BIA s. 181

> 181. (1) *Power of court to annul bankruptcy.* — Where, in the opinion of the court ... an assignment ought not to have been filed, the court may by order annul the bankruptcy.

The prioritizing effects of bankruptcy may be reversed if the claimant spouse succeeds on a motion to annul the bankruptcy under BIA s. 181.[106] Such a motion must be made promptly to the bankruptcy court. Pending the hearing, the Bankruptcy Court may direct the trustee to keep administrative costs to a minimum.[107] If the debtor spouse is not truly insolvent, and there has been an abuse of process, the bankruptcy may be annulled. While some courts have held that

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[105] (2002), 60 O.R. (3d) 138, 26 R.F.L. (5th) 208, 21 C.P.C. (5th) 205 (Ont. C.A.). The court cannot grant a solicitor's charging order against the wife's lump sum spousal support arrears ($69,000) collected by her lawyer through his superb efforts. The wife is entitled to the money from his trust account even though he was owed $112,000. Spousal support is not "property" recovered or preserved within the meaning of the Solicitors Act. Moreover, by virtue of *Marzetti* and public policy, spousal support occupies a unique perch in our legal system. The court ought not to grant a charging order against support. See James McLeod's Annotation at 26 R.F.L. (5th) 208.

[106] The husband in *Wale, Re* (1996), 45 C.B.R. (3d) 15 (Ont. Gen. Div.), declared bankruptcy 1½ hours before the matrimonial trial was set to begin. The trial was adjourned to permit an annulment motion to be made before the same judge, sitting in bankruptcy. All creditors were served, but none attended. The husband was clearly maliciously motivated, having removed and hidden the contents of the matrimonial home and having sold off assets in violation of a non-dissipation order. He was barely insolvent. He had been over-paying his mortgage, hiding his assets and income, and had voluntarily ceased paying his trade debts. The court indicated that motive was the primary consideration in determining abuse of process. In this case the husband's motive was quite clear: to destroy the wife, frustrate her claims and remove his assets from the reach of the matrimonial court. As such, the assignment was an abuse of process. In addition to annulling the assignment, the bankruptcy court vested title to the matrimonial home in the wife, ordered the trustee to return all other assets to the husband, ordered costs to be paid by the husband, and deprived the trustee of its costs.

[107] *Schroeder (Bankrupt), Re* (2000), 17 C.B.R. (4th) 135, 144 Man. R. (2d) 101 (Registrar Lee)

the debtor's motive is of central importance in this determination, the better view is that motive is merely a factor. In a 1994 case, the Manitoba Court of Appeal noted that it was entirely appropriate for a spouse (the wife) to file a bankruptcy proposal whose sole purpose was to avoid garnishment under a divorce cost order.[108] An Ontario decision confirms that even a spouse whose evidence and conduct have been soundly repudiated by the matrimonial court, is entitled to the protections of bankruptcy legislation, at least absent a finding of fraud.[109] Another more recent decision concluded that even where the bankrupt's motive was improper, and he had concealed assets, his bankruptcy ought not to be annulled if the purpose of doing so was to grant a preference over his assets to the spouse who sought the annulment.

10. Setting aside improper pre-bankruptcy transactions: BIA ss. 91, 95-96, 100

There are several different ways to challenge property transfers or conveyances made before bankruptcy.

- **Fraudulent Conveyance**: The theory behind fraudulent conveyance legislation is to require a debtor to pay his or her creditors before making any gratuitous disposition of property that would deprive them of assets that should be available to them: "Debts must be paid before gifts can be made". Ontario's Fraudulent Conveyances Act renders voidable every gratuitous disposition of property that is made with the intent to defeat or defraud creditors or others. The

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[108] *Plesh, Re* (1994), 100 Man. R. (2d) 168 (C.A.), reversing (1994), 93 Man. R. (2d) 66 (Q.B.)

[109] *Manis v. Manis* (May 7 2001, Cameron J., Ont. S.C.J. #31-OR-385981, thanks to Avra Rosen of Toronto) Refusal to annul husband's bankruptcy despite matrimonial court finding that he was a rat. Consider interests of other creditors who would bear the burden of any preference given to the wife by reason of an annulment. ¶38: "The BIA constitutes a declaration by parliament of the social policies which should be addressed and which should prevail if a person is insolvent." The husband gets protection from creditors and a fresh start; the wife gets support priority and survivability, and provability for her equalization claim. The wife created the risk of loss when she consented to the husband's mortgage on the home and agreed to be jointly liable for his bank debt. A finding by the matrimonial court that the husband's evidence was "unreliable and less than candid" is not a finding of fraud, even on a civil standard. Annulment refused without prejudice to renew the motion on evidence of fraud.

prohibition does not apply to dispositions made for *good consideration*, in *good faith*, to a person *without knowledge* of the transferor's fraudulent intent.

- **Settlement:** A settlement of property is a technical term under the BIA that is related to a fraudulent conveyance. Basically a settlement of property, at common law, is a gift or gratuitous disposition of property by a transferor (the "settlor") that is intended to be retained by the recipient either in its original form or in a form that can be traced. If the gift was intended to be spent, dissipated, consumed or used as the recipient sees fit, it is not a settlement.[110] A settlement may be a nominal conveyance where the benefit and control of the property remains with the transferor, or an outright transfer where the transferor has no intention of retaining control.[111] BIA s. 91 renders void any settlement made within one year of the bankruptcy, unless the settlement was made in favour of a good faith purchaser for valuable consideration. If the settlement occurred more than one but less than five years before bankruptcy, the trustee must also prove that at the time of the disposition, the transferor was unable to pay his or her debts without the property in question.

- **Reviewable Transaction:** BIA s. 100 permits the trustee to attack non-arms length transactions effected within one year before bankruptcy where the consideration received by the bankrupt for the transaction was conspicuously inadequate. BIA ss. 3 and 4 deem the spouse or common law partner of the bankrupt to be a related person not dealing at arm's length. If a transfer was made within the year before bankruptcy to a related person, questions of intent and good faith are irrelevant under this provision — the only question is the adequacy of the consideration.

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[110] Rationale: the donor's family members might otherwise be required to refund money already spent on their maintenance or advancement: *Royal Bank of Canada v. Whalley* (2002), 59 O.R. (3d) 529, 34 C.B.R. (4th) 277, 213 D.L.R. (4th) 106 (Ont. C.A.).

[111] To prove a settlement, one only need to establish the transferor's intention that the property be retained by the *recipient*; it is unnecessary to establish that the recipient was to have been subject to any enforceable restraints on what he or she could do with the property: *Kostiuk (Re)* (1998), 6 C.B.R. (4th) 46 at ¶52, supp. reasons (1999), 10 C.B.R. (4th) 303 (B.C.S.C.)

• **Fraudulent or Unjust Preference:** An unjust preference arises when a debtor who is close to insolvency chooses to pay or benefit one of his or her creditors at the expense of the others. Unjust preference legislation is designed to ensure that in such circumstances, all creditors are treated fairly and equally pro rata. The difference between an unjust preference and a fraudulent conveyance lies in the fact that a preference involves giving a benefit to a *creditor*, in reduction or extinction of an existing debt; thus, it is not a gift because good consideration is received, namely the reduction or extinction of the debt. Preferences are improper not because they are gifts, but because they violate the cardinal equitable principle of equal sharing that applies among creditors of an insolvent person. The Ontario Assignments and Preferences Act renders void any non-cash disposition of property to a creditor by a person who is insolvent or on the eve of insolvency, with the intention of giving that person an unjust preference over other creditors. In the event of bankruptcy, BIA s. 95 renders fraudulent and void any conveyance or disposition of property to a creditor by an insolvent person with a view to preferring that creditor over others, if made within three months of bankruptcy. If the recipient was a "related person" such as a spouse or common-law partner, the preferential period is extended to one year. The preferential intent can be rebutted by showing that the conveyance or payment was not rendered voluntarily, but was a bona fide response to pressure applied by the creditor.

Issue(a): *What recourse does a wife, say, have if the husband declares bankruptcy but the trustee does nothing to set aside his improper pre-bankruptcy transactions?* This occurs quite often, because normally the trustee does not have sufficient funds to investigate or litigate these issues unless creditors fund him. BIA s. 38 allows the creditor, say the wife, to obtain a court order from the Registrar authorizing her to pursue these proceedings that the trustee has refused to take. On receiving the order, which is usually granted on consent, the wife must serve it on all other proven creditors, to afford them a 15 day opportunity to elect to participate

pro rata in the cost and ultimate benefit of the proceeding. If none do so, the wife can proceed, alone, to enforce all the rights of the trustee that the Order authorizes her to advance.

Issue(b): *Can a property transfer, made pursuant to a separation agreement shortly before bankruptcy, be set aside as an improper pre-bankruptcy transaction?* Technically this is possible, and a number of instances have occurred. However, it appears that if the separation agreement was negotiated by counsel at arms length, and resulted in relief that falls within the range of what a court might have ordered, it will likely withstand attack.

As of September 1, 2005, there is no Canadian case setting aside the transfer of a matrimonial home pursuant to a separation agreement negotiated between counsel.[112] Instead, we have numerous instances of courts upholding such agreements, even those done in

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[112] I am eagerly awaiting the first such case, or alternatively an existing example that I have overlooked and which may disprove my hypothesis. As such, I reviewed with some excitement the Québec decision in *Bisson c. François Huot Syndic Ltée*, J.E. 2005-1624, 2005 IIJCan 27646 (C.S.Q., 8 août 2005), where the court set aside, as a preference, a payment made under a separation agreement that was negotiated shortly before bankruptcy with the involvement of counsel for both spouses. As this appeared to break new ground, it is useful to review the case in some detail. The spouses separated in autumn 2002. The husband retained their joint credit card, which the wife stopped using after separation. Two years later, when the husband had increased the balance to its $25,000 limit, the bank made a demand on both spouses. They were then in the course of negotiating their separation agreement, in particular the husband's entitlement to property division from the matrimonial home in the wife's name. The wife insisted that, from the sale proceeds of the home, the notary must pay off the bank from the husband's $49,000 entitlement before he receive any money. She was concerned about her liability on the joint card, notwithstanding the husband's assertion that he had informed the bank one year previously that she was no longer to be liable. The home was sold, with the husband's consent, on October 18 2004 (slightly more than 3 months before his bankruptcy on February 25, 2005), and they agreed that his entitlement, $49,000, would remain with the notary. The separation agreement was executed on January 21 2005, and a divorce was obtained on February 3 2005. On the next day, pursuant to their separation agreement, the notary paid off the bank (now $27,000) and the husband received the remainder of $22,000. He was insolvent at the time ($245,000 tax debt), and declared bankruptcy three weeks later, by which time he had already spent his $22,000. The trustee sought to set aside as a preference, the $27,000 payment to the bank. The court held that, notwithstanding the separation agreement, the bank payment was made by the husband, despite the intervention of the notary who acted as his agent. The payment was made on February 4, not the earlier date when the money was deposited with the notary. Thus the payment was made within 3 months, and was an 'obvious' preference: the bank must refund the money to the trustee. Unfortunately, the precedential value of this case can, with respect, be challenged on several grounds. There was no discussion of the husband's 'view' to prefer (a key statutory element in the s. 95 test), nor of the fact that he had no claim to the money paid to the bank, nor any reference to the doctrine of equitable assignment (to be fair, this doctrine is arguably unavailable in Québec). Surely if the payment was to be set aside, the money should be returned to the wife, whose money it was. She was not apparently a party to the motion, nor is there any mention of her counsel. Counsel in this case have advised me that the wife was not a party to the application, nor an object of the trustee's recovery. The bank's counsel has advised that there is no intention of seeking reimbursement from her. In other words, the result in this case did not affect or disturb the resolution of the matrimonial dispute. *Quaere*.

questionable circumstances where the transferor spouse's insolvency looms and both spouses are aware of (usually) his pending credit crisis.

I have argued in my text that this consistent refusal to set aside property transfers effected through separation agreements negotiated between counsel, is reflective of the unique policy concerns at play in these matrimonial disputes.[113] Some of the applicable considerations, that do not apply to other transactions, include:

- The judicially favoured public policy of defeating the feminization of poverty consequent upon divorce. The court is to err on the side of caution where family needs are at issue, and when statutory or contractual ambiguity permits, to adopt an interpretation which favours family need: *Marzetti*.
- The *Divorce Act* requires, in many different respects, that both counsel and the court steer the spouses toward a negotiated resolution of their conflict, e.g. s. 9(2).[114] The Supreme Court of Canada has emphasized that this section clearly indicates Parliament's intention to promote negotiated resolution of all matters corollary to a divorce.[115]
- The practice of "collaborative family law" is now in vogue across the country. Every family court has devoted massive resources to promote the resolution of matrimonial disputes, that otherwise clog the court system, ruin families through the cost of endless litigation, and prevent spouses and their children from moving on with their lives. Countless hours have been devoted by practitioners across the country to design procedural and administrative mechanisms associated with court process that will maximize the likelihood of such resolution and drive the spouses toward agreement.

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[113] See *BIFL*, §9(6)(a)

[114] Divorce Act, s. 9(2): It is the duty of every barrister, solicitor, lawyer or advocate who undertakes to act on behalf of a spouse in a divorce proceeding to discuss with the spouse the advisability of negotiating the matters that may be the subject of a support order or a custody order and to inform the spouse of the mediation facilities known to him or her that might be able to assist the spouses in negotiating those matters.

[115] *Miglin v. Miglin*, [2003] 1 S.C.R. 303, 34 R.F.L. (5th) 255, 224 D.L.R. (4th) 193, 302 N.R. 201 (S.C.C.), at ¶54

- The *Divorce Act* also requires that support orders should relieve any economic hardship of the spouses arising from the breakdown of the marriage, and insofar as practicable, promote the economic self-sufficiency of each spouse within a reasonable period of time.[116] Some matrimonial courts are quite prepared, where they can do so, to make "stripping orders" that have the effect of transferring to the solvent spouse all of the realizable assets of the insolvent spouse, leaving the insolvent spouse with no exigible assets and hence the creditors with nothing. It is often only the trustee and his or her counsel who, after the fact, think that this is a bad thing. Most other actors in the family law system believe that it is just, fitting and appropriate. It seems incongruous to set aside, and label as fraudulent, the same kind of transaction that family court judges themselves effect.
- These cases are usually brokered by family lawyers who are paid, trained and educated to negotiate the resolution of matrimonial disputes. Setting aside a separation agreement may therefore implicate the integrity and professionalism of two lawyers along with the spouses. Where a court order effects or approves the transfer, the judge's integrity is also challenged, if only tangentially. The involvement of these professionals may also be seen to reduce the likelihood of fraud
- Separation agreements cannot be set aside antiseptically. While commercial contracts, if they are voided, normally result merely in a money transfer, separation agreements can be set aside only at the cost of plunging a family back into crisis, even perhaps a fresh custody dispute. Poverty can loom in the backdrop of this remedy. Thus the clear intent of matrimonial policy, on many levels, will be violated if a matrimonial resolution is overturned. This has an important public policy aspect:[117]

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[116] Divorce Act, s. 15.2(6)(c), (d).

[117] *Mitchell v. Mitchell* (1982), 35 B.C.L.R. 392 (S.C.) at p. 399, cited in *Schlenker v. Schlenker* (1999), 1 R.F.L. (5th) 436 (B.C. S.C.) at ¶16:

> "It is of great importance not only to the parties but to the community as a whole that contracts of this kind should not be lightly disturbed. Lawyers must be able to advise their clients in respect of their future rights and obligations with some degree of certainty. Clients must be able to rely on these agreements and know with some degree of assurance that once a separation agreement is executed their affairs have been settled on a permanent basis. The courts must encourage parties to settle their differences without recourse to litigation. The modern approach in family law is to mediate and

- Property transfers are a normal component of negotiated agreements in matrimonial disputes. Conveyances are often necessary to satisfy or protect support entitlements and property or equalization claims. The fact that litigation looms in the background, along with potentially ruinous legal fees and a possible cost sanction, suggests that the resolution of these disputes does not always correspond to the value of the parties' underlying rights.

Exelby & Partners LLP v. Gibson[118] is a recent example of the very high threshold at play in these cases. The spouses jointly owned their home and had been married 8 years with at least one child. One month after their separation, they agreed that the husband would transfer his half interest in the home to the wife in lieu of spousal support and equalization against his pension. She took over making mortgage payments based on the agreement. The transfer was effected eight months later for $1 stated consideration. Three weeks later the husband declared bankruptcy. Both spouses had lawyers during this period, and draft agreements had been exchanged but not finalized. There was no executed separation agreement at the time of the transfer, the date of the bankruptcy, nor as late as 1½ years after the separation, while the spouses haggled over custody. The trustee moved to set aside the transfer as a settlement, fraudulent preference or reviewable transaction. The registrar rejected the trustee's motion, without detailed reasons. On appeal, the wife's undertaking not to sue for support or equalization, was valuable consideration which was not grossly inadequate. The agreement need not be in writing. The evidence demonstrated a lack of intent to defraud and the wife's lack of knowledge of his insolvency, and overcame the presumption raised by the relationship between the spouses.

The case is disturbing in that there was no enforceable consideration given for the transfer. The Alberta Matrimonial Property Act requires separation agreements to be written. The

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conciliate so as to enable the parties to make a fresh start in life on a secure basis."

[118] (2005), 7 C.B.R. (5th) 196, *sub nom. Gibson (Trustee of) v. Gibson*, [2005] A.J. No. 18 (Alta. Q.B., January 12 2005)

agreement must be accompanied by a detailed written acknowledgment regarding voluntariness, full disclosure and knowledge of the rights being compromised in the agreement. The acknowledgment must be signed before a lawyer, outside the presence of the other spouse. Surely an unenforceable oral understanding is not enough, particularly one that never comes to fruition either before the transfer, before the bankruptcy, or within a reasonable time thereafter. This is not an issue of fraud or knowledge, but simply the adequacy of the consideration. By focusing solely on good faith, the court ignored the statutory requirement of good consideration.

This decision is reflective of the policy grounds discussed above. Clearly the judge does not wish to apply the statutory tests that may invalidate this transaction, because the spouses and their lawyers have acted honourably, from a matrimonial law perspective. Suffering, confusion and additional legal fees will be inflicted upon this family if the transaction is unravelled.

I have set out in the note below some examples of recent agreements that are essentially stripping orders, which have nonetheless been upheld against attack by creditors or a trustee. They demonstrate the wide latitude given to divorce settlements.[119] As noted in a recent

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[119] *Banque Nationale du Canada c. S. (S.)*, [2000] R.J.Q. 658, *sub nom. Banque Nationale du Canada c. Bitar*, [2000] J.Q. no 471 (C.A. Qué., February 28 2000) (non-bankruptcy case): Husband gets credit line in 1992, goes to Kuwait in 1993 permanently. In 1995 he commences divorce proceedings in Montreal, wife claims the usual spectrum of relief including unequal division and child support. She seizes his RRSP and their joint investment funds in his brokerage account. Bank gets default judgment in November 1997 for $25,000 on credit line. Fixed trial date of January 19 1998 for the divorce hearing. One day before trial, spouses settle their affairs whereby she gets $54,000 transferred to her name from the remaining $70,000 in the investment account, he gets $16,500; she gets the RRSP, his lot of land and his car, and he agrees to accompany her within the next two days to effect the transfers. The agreement is incorporated into a divorce judgment on the following day. The transfers were done. Husband cashes out his $16,500. On January 26, bank effects seizure on the brokerage account ie on her $54,000; brokerage agrees to hold funds pending adjudication. Husband has no other assets in Canada. Wife opposes the seizure, bank brings action for the remedy of inopposability. Held on appeal: Husband was insolvent, wife knew it. But wife acted in absolute good faith, since the divorce proceedings had been started one year before bank's lawsuit; the trial date had been fixed by the court without reference to the bank's action; wife received only what she was entitled to; the agreement set out the complete financial situation of the spouses and did not attempt to conceal anything. The deemed presumption of fraudulent intent in Civil Code Art. 1632 is rebuttable, and was rebutted her because the wife acted in good faith. Dissent of Chamberland J.A.: the presumption is absolute and non-rebuttable, despite the wife's good faith; the agreement is be unenforceable as against the bank. *Mateo v. Official Trustee in Bankruptcy* (2002), 188 A.L.R. 667, [2002] FCA 344 (Australia Fed. Ct., Tamberlin J., March 27 2002, Sydney): Trustee applies in bankruptcy court to set aside as a fraudulent preference a transfer made pursuant to

Newfoundland appellate decision,[120] "Trying to get the best for oneself (on one's children) per se cannot be equated with intent to defraud other creditors."

My rule of thumb for separation agreements made on the eve of one spouse's insolvency, is whether a judge would have approved the agreement if the circumstances had been fully disclosed in matrimonial court. If the family lawyers can certify that in their view, the compromise reached by the spouses would have received court approval by a judge in that jurisdiction, who was apprised of all the relevant facts (such as the looming debt crisis of one spouse), then the agreement is likely to stand up to subsequent challenge. This standard allows one to compare the impugned transfer, and the circumstances in which it was effected, with matrimonial cases where similar transfers were approved or specifically ordered by the matrimonial court. It allows one to base an assessment of the propriety of these transfers, on empirical evidence from matrimonial litigation.

If a matrimonial judge would have ordered the transfer, how can a bankruptcy judge determine that the transfer was a fraud? This also has the effect of focusing attention on process issues: Were the parties separately represented? Was the agreement effected through arms' length negotiations, evidenced by documentation? Was the recipient spouse

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a pre-bankruptcy consent family court order requiring the husband to convey the $107,000 home to the wife on payment of $10,000 now, $10,000 within one year, and $80,000 to the three children on sale of the home. Husband was insolvent at the time. Held: the transfer was effective in equity when the order was made. Good consideration: compliance with Family Court order, which had not been directly attacked in this application, and which was based (per statute) on a "broad range of considerations". Also good consideration was "final resolution of all claims" between the spouses in the matrimonial proceedings. The work that she said she had put into the marriage and bringing up the family over 27 years (at 35 hours weekly) had a value that exceeded $107,000. So consideration was sufficient. Husband's main purpose was not to defeat creditors, but to resolve outstanding matrimonial issues. Wife did not know he was insolvent. *MGM Grand Hotel Inc. v. Liu*, [1997] B.C.J. No. 2528 (S.C., Levine J., November 10 1997): Husband transferred all his assets to wife in consideration of release of support in conjunction with divorce, one month after incurring huge gambling debt in Las Vegas. While husband may have intended to defraud creditor, wife not privy to the fraud because her intention was "to end a bad marriage and have financial security in Canada for herself and her children". Independent evidence of husband's infidelity, problems in the marriage, physical abuse. No evidence of negotiations between the spouses. No consideration given to value of the assets transferred or quantification of support claims released. Settlements made as part of matrimonial disputes are considered to have been made for good consideration.

[120] *Hawco v. Myers*, [2005] N.J. No. 378 (Nfld. C.A., December 7 2005)

merely following legal advice? Was she merely aggressively attempting to advance her own interests? These are process factors that the courts utilize as markers of good faith.

This result, which is not out of keeping with the thrust of the jurisprudence, highlights the changes that are threatened by Bill C-55, now S.C. 2005, c. 47, the bankruptcy amending legislation that received Royal Assent on November 25, 2005 but has not yet been proclaimed (and may never be). That Bill will replace s. 91 (settlements) and s. 100 (reviewable transactions) with new s. 96.1 (undervalued transactions). To paraphrase, the Trustee may apply to court to inquire whether a transaction with the debtor was a "transfer at an undervalue", defined in s. 2(1) as a transaction where the consideration received is conspicuously less than the Fair Market Value of the property or services sold or disposed of. In the case of non-arms length transactions, the court may give judgment for the difference if:

(i) the transaction was within one year before bankruptcy, or

(ii) within 5 years and debtor was insolvent or rendered insolvent, or

(iii) within 5 years and the debtor intended to defeat the interests of creditors.

Consider the application of this standard to separation agreements. Section 160 of the Income Tax Act, the statutory fraudulent conveyance remedy applicable to non-arms length transfers by tax debtors, specifically exempts from its scope transfers effected pursuant to separation agreements, suggesting that Parliament does not wish to subject such transfers to a 'fair market value' approach. As reflected in the case discussed above, the courts do not use a 'fair market value' approach in assessing whether separation agreements ought to be impugned. Rather, the courts look to the good faith and bona fides of the parties, particularly those of the recipient spouse, and sometimes the degree of knowledge by the transferee of the debtor spouse's insolvency and intent. Many separating spouses are insolvent, and must nonetheless pay support and address their matrimonial property obligations. Their spouses may simply be attempting to obtain the best possible deal for themselves and their children in difficult, fluid and

emotionally charged circumstances, under the spectre of matrimonial litigation or trial. The proposed remedy will make such transfers vulnerable despite good faith and lack of knowledge. It will risk overturning numerous matrimonial resolutions despite a clear policy trend toward encouraging mediated resolution of family disputes. It will force such cases to proceed to trial, with the enormous costs and risks that entails. The proposed standard of review - fair market value of the consideration - is highly subjective in matrimonial cases, and does not facilitate or advance the process of determining whether an agreement ought to pass muster. The absence of any reference to the recipient's knowledge, intent, good faith or bona fides, shows that the proposed test is deeply flawed in this respect.

In my view, transfers pursuant to separation agreements ought to be excluded from the proposed s. 96.1. A separate standard can be defined for such transfers, or the existing fraudulent conveyance and fraudulent preference remedies should continue to govern.

While we are on the subject of Bill C-55, the proposed undervalued transaction test is also flawed in connection with non-separated spouses, i.e. intact families, where the bankrupt spouse is responsible for supporting the family. Note that s. 91, scheduled for repeal, did not require an intention to defraud, but contained within the definition of 'settlement' a safe harbour for gifts made for the purpose of *consumption* by the donee. The proposed s. 96.1 will jeopardize payments made to support one's family in the five years before bankruptcy.

- For example: The debtor enters into cohabitation with an unemployed person one year before bankruptcy, and pays for that person's food and expenses during that year. Since the law imposes no obligation to support that person until, normally, the two- or three-year mark, there is no possible legal consideration for such payments. Since the only consideration was affection (which has no fair market value), all such payments give rise to liability upon the transferee: the unemployed boyfriend or girlfriend.

- Payments by a married or common-law debtor to his or her spouse while insolvent before bankruptcy will give rise to liability upon the transferee spouse without documented consideration, regardless of good faith or the transferee spouse's good intentions. Jurisprudence under similar wording of s. 160 of the Income Tax Act suggests that liability will follow even if the transferee spouse utilized the funds for family purposes. Under s. 160 jurisprudence, a payment made to support one's family is a payment made without consideration.[121]

In short, there is no safe harbour or defined standard for reasonable payments intended for the recipient's consumption. In regard to family support, an exclusion should provide that such transfers are protected if they are payments to support one's family either under a separation agreement, or in amounts that are reasonable in the circumstances.

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[121] *Raphael v. Canada*, [2000] 4 C.T.C. 2620, [2000] T.C.J. No. 688 (T.C.C.): Domestic support obligations cannot be consideration under s. 160 because even though they may be quantified for enforcement purposes, the obligation has no fair market value: "Domestic obligations arising out of a family relationship are intensely personal and should not be used as "consideration" to camouflage transfers of property." ¶28. Affirmed on appeal *sub nom. Raphael v. R.* (2002), 33 C.B.R. (4th) 288 (Fed. C.A.), thought the court noted that it did not wish to be taken to agree with the lower court's comments regarding consideration between husband and wife. *Tétrault v. Canada*, [2004] T.C.J. No. 265, 2004 CarswellNat 1370 (T.C.C., May 11 2004): Support legislation does not require either spouse to transfer property to the other. Providing the use of such assets is sufficient. Support is an entitlement that does not require the recipient to provide consideration in exchange. The obligation may be asymmetrical, since it is in proportion to their respective means: a husband must support his wife even if she is in a coma. It is a unilateral obligation. Contribution to family expenses, indeed any property transfer made under a legal obligation, is a donation given without consideration. The mere right to be the beneficiary does not constitute consideration. *Mathieu c. Canada*, 2004 CarswellNat 1935, 2004 CCI 135, [2004] T.C.J. No. 338 (T.C.C., 28 juin 2004): Tax-indebted husband paid $560 monthly to wife, who deposited it in a bank account used to pay the mortgage on wife's cottage purchased after they began living together. Total was $12,880 over the 2 years in question. 3 kids, 20 year marriage, she earned $20,000/yr., he earned $40,000/yr. Family expenses $60,000/yr. He says he was simply providing for family needs. Held: It makes no difference if he paid the money to her, or paid the mortgage directly. ¶18: ".. la contribution aux charges du mariage est de la nature d'une donation par laquelle un bien est donné sans aucune contrepartie. Autrement det, les obligations familiales ne peuvent constituer une contrepartie au sens de l'article 160" [".. the contribution to the expenses of the marriage is in the nature of a donation by which property is given without any consideration. In other words, domestic obligations cannot be consideration within the meaning of s. 160."]. ¶19: "The mere right to be the beneficiary of an obligation does not necessarily constitute a consideration. In other words, in performing a domestic obligation, the transfer of property to the other spouse constitutes a transfer for which no consideration was given .." *Cf. Laframboise v. Canada*, [2002] T.C.J. No. 628, [2003] 1 C.T.C. 2672, [2003] D.T.C. 781 (T.C.C., November 29 2002): No s. 160 liability for paying money to wife for living expenses or expenses of the marriage (conceded by Crown and so held by the court).

11. Contempt

Issue (a): *Does bankruptcy affect the court's exercise of its contempt powers against the bankrupt?* As noted by the leading English case on this point, *Woodley v. Woodley (No. 2)*,[122] the court's contempt power is ordinarily both coercive - to compel compliance with the court's order - and punitive.. When bankruptcy occurs, it is improper to utilize the contempt power to coerce compliance with an obligation that is stayed by the bankruptcy, such as an obligation to pay equalization; or to perform an obligation that has become impossible or illegal to compel, such as the transfer of property or money that has, by operation of law, vested in the bankruptcy trustee. However, bankruptcy does not preclude the court, in theory or in practice, from punishing the bankrupt for having failed to comply with the order when he had the means to do so, before bankruptcy.[123]

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[122] [1993] 2 F.L.R. 477 (Eng. C.A.). The husband was ordered to pay a £60,000 lump sum to the wife, but instead hid his assets and did everything possible to defeat her claims. He appealed the order and, when the appeal was unsuccessful, filed for bankruptcy. The wife sought a committal order against him for failing to pay the lump sum, which had not been stayed by the appeal and which was non-provable in the bankruptcy. The court concluded that while the husband's bankruptcy now precluded him from legally satisfying the order, he was in contempt for having failed to pay prior to bankruptcy when he had the funds. However, his committal to prison was overturned as the court gave him the benefit of the doubt that, as a layman, he may have believed that his appeal stayed the payment obligation.

[123] *Brit Corp. v. Triumbari Containers Ltd.*, [2005] O.J. No. 2973 (S.C.J., July 8 2005), a non-matrimonial case: After a civil judgment was granted against him, the debtor had numerous non-attendances, refusals, non-production of documents and unanswered undertakings regarding the creditor's examination in aid of execution. He declared bankruptcy before the return date of a contempt motion. The court held that his bankruptcy stayed the contempt motion, which was an integral part of the civil action. [Comment: The court did not consider the wealthy case law establishing that contempt proceedings are not stayed unless they are brought to enforce a debt rather than to punish the bankrupt for his or her pre-bankruptcy conduct]. The decision refers to an unreported endorsement of the Registrar (June 30, 2005) in same case: "To the extent, if any, that the contempt motion is the motion of Brit Corporation [the plaintiff] and not a proceeding of the Brampton court to exercise its inherent jurisdiction over parties before it, the said motion is stayed pending further order of the bankruptcy court." [Comment: This is an impractical and wrong test]. Compare this decision to *Turkawski v. 738675 Alberta Ltd.*,[2005] A.J. No. 525 (Alta. Q.B., May 6 2005), a non-matrimonial case: The debtor declared bankruptcy after the court committed him to jail for contempt for non-disclosure in judgment debtor examination proceedings arising from a fraud judgment. Held: while the bankruptcy affects his right to dispose of any of his property, it does not affect the application to him of any laws of general application, including contempt. The bankruptcy is irrelevant to the committal proceedings.

IV. CONCLUSION

I hope that this brief tour of bankruptcy law, insofar as it relates to a matrimonial dispute, has been useful and comprehensible. There is much more to tell. It is much easier to detail the technicalities than it is to present a comprehensible overview that does not sacrifice accuracy. This paper, while appearing in places to resemble the former, was intended to emulate the latter. For further discussion, the reader is directed to the leading Canadian bankruptcy text by Houlden & Morawetz, *Bankruptcy and Insolvency Law of Canada*, and to my book.

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V. APPENDIX

1. Proof of Claim
2. Order Charging Property and Requiring the Execution of Security

1. Proof of Claim

In the matter of the bankruptcy of Jeremy Roberts of Troutling Bay, Ontario
and the claim of Alexandra Roberts, creditor.

All notices or correspondence regarding this claim to be forwarded to the following address:
_____ *(detailed mailing address of creditor, including postal code and fax if applicable)*

I, Rachel E. Cox *(creditor or representative)*, residing in the Town *(city, town, village, etc.)* of Havelock *(name of municipality)* in the Province of Ontario, do hereby certify that:

1. I am the solicitor for Alexandra Roberts *(name of creditor)*.

2. I have knowledge of all the circumstances connected with the claim referred to in this form.

3. The said debtor was at the date of the bankruptcy namely the 12th day of January, 2006 and still is justly and truly indebted to the above-named creditor (hereinafter referred to as "the creditor") in the sum of $232,500 as shown by the statement of account hereto attached and marked "A" after deducting any counter claim to which the debtor is entitled. *(The attached statement or account or affidavit must specify the vouchers or other evidence in support of the claim).*

4. *(Check and complete appropriate category)*

(X) A. UNSECURED CLAIM of $232,500
In respect of this debt, I do not hold any assets of the debtor as security and
(Check appropriate description.)
( ) Regarding the amount of $215,300 , I do not claim a right to priority.
(X) Regarding the amount of $17,200 , I claim a right to a priority under s. 136 of the Act.
(Set out on an attached sheet details to support priority claim.)

( ) B. SECURED CLAIM of $.....
In respect of this debt, I hold assets of the debtor valued at $..... as security, particulars of which are as follows:
(Give full particulars of the security, including the date on which the security was given and the value at which you assess the security, and attach a copy of the security documents.)

5. To the best of my knowledge and belief, I AM (~~AM NOT~~) related to the debtor within the meaning of section 4 of the *Bankruptcy and Insolvency Act*.

6. The following are the payments that I have received from, and the credit that I have allowed to, the debtor within the three months (*or, if the creditor and the debtor are related within the meaning of s. 4 of the Act, within the 12 months)* immediately before the date of the initial bankruptcy event within the meaning of s. 2 of the Act: *(Provide details of payments and credits.)*

7. *(Applicable only in the case of the bankruptcy of an individual.*)
(X) I request to be advised of any material change in the financial situation of the bankrupt, pursuant to s. 102(3)(b)(i) of the Act.

(X) I request to be advised of any amendment made regarding the amount that the bankrupt is required to pay, pursuant to s. 68(4) of the Act.

(X) I request that a copy of the report filed by the trustee regarding the bankrupt's application for discharge pursuant to s. 170(1) of the Act be sent to the above address.

Date:

_____ _____

Witness Rachel E. Cox

Phone number: _____

Fax number: _____

Email address: _____

PROXY [optional]

In the matter of the bankruptcy of Jeremy Roberts, a bankrupt, I, Alexandra Roberts, of Troutling Bay, Ontario, a creditor in the above matter, hereby appoint Rachel E. Cox of Havelock, Ontario, to be my proxy in the above matter except as to the receipt of dividends, WITH (~~WITHOUT~~) power to appoint another proxy in his or her place.

Date:

_____ _____

Witness Alexandra Roberts *(Individual Creditor)*

SCHEDULE A

Judgment dated January 23, 2000, copy attached, showing equalization debt of $184,000	$184,000
Interest to date of bankruptcy per judgment	$ 11,000
Pre-bankruptcy arrears of support per attached calculations	$ 28,500
Taxed costs	$ 9,000
Total unsecured claim:	**$232,500**

Priority for the taxed costs of $9,000 is claimed under s. 136(1)(g) as first execution creditor. If that claim is rejected, then priority for 50% of the taxed costs is claimed under s. 136(1)(d.1) as lump sum pre-bankruptcy support, in that 50% of the costs related to support issues. [Plus interest to date of bankruptcy]

Priority for pre-bankruptcy support arrears of $8,200 is claimed under s. 136(1)(d.1) as follows:

Total pre-bankruptcy support arrears per attached schedule: $28,500

Periodic support arrears accruing due more than one year before the date of bankruptcy: $20,300, per attached schedule.

Priority support arrears: $8,200 [Plus interest to date of bankruptcy]

Total priority claim: $17,200 plus interest

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2. Order Charging Property and Requiring the Execution of Security

(preamble)

1. THIS COURT ORDERS that the husband grant, execute and deliver the following security documentation in favour of the wife to stand as security for all indebtedness now or in the future owing to her under any court order granted in this proceeding, and in particular for existing and future spousal and child support, any future equalization payment, interest, legal costs and the costs pertaining to enforcement of the security:

(a) a collateral mortgage over the husband's interest in the matrimonial home municipally known as 35 Feldman Blvd., Hamilton, Ontario, in the form annexed hereto as Schedule "A" or such other form as may be approved by the court; and

(b) a general security agreement in the form annexed hereto as Schedule "B" or such other form as may be approved by the court, over the husband's existing and future personal property and in particular over any bank account or account receivable now or in the future held by the husband or to his credit in Canada or elsewhere.

2. THIS COURT ORDERS that the husband execute and deliver such security documentation to the wife within five days of the date hereof, failing which the Sheriff of the Judicial District of Hamilton Wentworth is hereby vested with authority and appointed as trustee for the husband, to execute and deliver such security documentation forthwith on behalf of the husband.

3. THIS COURT ORDERS that until such security documentation has been validly executed, delivered and registered in accordance with all applicable statutory requirements,

(a) the husband's interest in the said matrimonial home; and

(b) the husband's existing personal property, and in particular any bank account or account receivable now held by the husband or to his credit in Canada or elsewhere,

be and the same are hereby charged and secured in favour of the wife as security for all indebtedness now or in the future owing to her under any court order granted in this proceeding, and in particular for existing and future spousal and child support and any future equalization payment, interest, legal costs and the costs pertaining to enforcement of the security; and a mortgage and charge for that purpose is hereby vested in the wife.

4. THIS COURT ORDERS that a copy of this Order be registered on title to the said matrimonial home in the applicable Land Registry Office.

5. THIS COURT ORDERS, in the exercise of this Court's inherent jurisdiction, that until the aforesaid security documentation has been validly executed, delivered and registered in accordance with all applicable statutory requirements, the husband be restrained and enjoined from performing any act or executing any document having the effect of disposing, mortgaging, assigning, alienating or otherwise parting with his property or with the legal or equitable title thereto, including declaring bankruptcy or filing a bankruptcy proposal under the Bankruptcy and Insolvency Act.