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SUPPORT AND BANKRUPTCY

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I. INTRODUCTION

Until 1997, the Bankruptcy and Insolvency Act (BIA) contained only one section, s. 178, that dealt with family support obligations. It provided that debts for support or alimony were not extinguished by the bankrupt's discharge.

In 1997, the BIA was amended to give more special treatment for support obligations. As a result, and simplifying somewhat, support is now treated as follows:

a. Support obligations are not extinguished by the bankrupt's discharge: s. 178.

b. Some support arrears (under a pre-bankruptcy support order or separation agreement) are provable in bankruptcy, just like ordinary unsecured creditors, entitling the support creditor to a dividend, if any: s. 121(4).

c. Support enforcement is not stayed by the bankruptcy, except against any property that vests in the trustee in bankruptcy: s. 69.41.

d. Some support arrears (any lump sum, and any periodic arrears in the 12 month period before bankruptcy, owing under a pre-bankruptcy support order or separation agreement) are entitled to a preference, paid out of any money collected by the trustee, ahead of all other unsecured creditors but behind certain other claims: s. 136(d.1).

In this paper, I will first review the unique public policy perspective applicable to the bankruptcy treatment of support. I will then review the statutory provisions, and along the way discuss how they might interact with a family law dispute. The focus of the paper is on Ontario law. Further detail can be accessed in my book, *Bankruptcy, Insolvency and Family Law, 2nd ed.* ("*BIFL*"), or in the definitive bankruptcy text by Houlden, Morawetz and Sarra, *Bankruptcy and Insolvency Law of Canada, 4th ed.*

II. THE CONCEPTUAL FRAMEWORK: *MARZETTI V. MARZETTI*

In some areas bankruptcy and matrimonial policies coincide. The Supreme Court of Canada indicated in *Marzetti v. Marzetti*,[1] 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 Court stated that 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.

Of the cases that have considered the *Marzetti* public policy to date, several refuse to allow public policy arguments to bend what appears to be clear statutory language.[2] Others demonstrate an inhospitability to the new policy ground: one of them would limit the applicability of the *Marzetti* doctrine to priority disputes only[3], while another refused to recognize an obvious ambiguity in the BIA, and rejected the idea that

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[1] [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.)

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

[3] *Cherkewich v. Cherkewich* {(2001), 18 R.F.L. (5th) 17 (Alta. Q.B., Veit J.)

support claimants should be treated, in bankruptcy, with any special degree of judicial consideration.[4]

The majority of the cases that have considered *Marzetti*, however, apply its public policy approach.. Three of these utilize public policy to override fairly clear statutory language:[5] One uses public policy to overcome the clear meaning of BIA s. 70(1) without any demonstration of ambiguity; another allows the support claimant to assert priority despite not having complied with a statutory condition and a third enforces an oral separation agreement where the applicable matrimonial statute appears to require a written agreement.

Another strand of cases apply *Marzetti* as a form of judicial safety check, to confirm that a proposed result, reached under conventional reasoning, is consonant with the evolving norms of public policy.[6] These cases might well have reached the same result without the assistance of *Marzetti.*

A growing number of decisions utilize the *Marzetti* policy 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. One

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[4] *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 (C.A., May 8 2003)

[5] *Jenanji (Syndic de)*, [1997] R.D.F. 748, J.E. 97-1916 (29 avril 1997, C.S. Qué.); *Rathbone Herman v. Rathbone* (2000), 46 O.R. (3d) 678 (S.C.J.); *Watson v. Schellenberg*(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.)

[6] *Burrows, Re* (1996), 42 C.B.R. (3d) 89 (Ont. Gen. Div.); *Beattie v. Ladouceur* (2001), 23 R.F.L. (5th) 33 (Ont. S.C.J., October 22 2001); *Mattes, Re* (1998), 5 C.B.R. (4th) 212 (N.S.S.C., Bkcy. Registrar)

decision resorted to public policy in determining what conditions to impose upon a malicious bankrupt who was in serious arrears of support.[7] Another applied public policy to deny a discretionary solicitor's lien where this would oust the payment of child support .[8] In *Taylor v. Taylor*,[9] 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 court ignored other persuasive policy arguments in so doing. Of these cases, *Taylor v. Taylor* is the only one that would likely have been decided differently had it been adjudicated before *Marzetti*; one might well argue that public policy was an unruly horse in this case.

The trend in many of these cases is to re-evaluate, or re-balance, the tension between social policy favouring payment of support and bankruptcy policy favouring both debtor rehabilitation and distribution among creditors. 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

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[7] *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]

[8] *Kingston v. Ackerson* (2002), 22 C.P.C. (5th) 31, 252 N.B.R. (2d) 209 (Q.B.)

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

debtor rehabilitation.[10] 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:

❑ 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?[11] How will we know when a sufficient degree of equality has been reached?

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[10] One can see this re-calibration at work in cases such as *Wykes, Re* (2003), 40 C.B.R. (4th) 319 (Alta. Registrar Laycock, February 24 2003): ¶15 "I view the support of children as a primary obligation of any bankrupt and require all child support payments payable during bankruptcy to be current before a discharge order is granted." The court imposed, as a condition of the bankrupt's discharge -- i.e. his rehabilitation through bankruptcy -- that he make all child support payments due from the date of bankruptcy to the date of discharge.

[11] This appears to be the view of Justice Veit in her decision in *Cameron, Re*, [2002] 6 W.W.R. 687, 32 C.B.R. (4th) 176, 25 R.F.L. (5th) 252, 2 Alta. L.R. (4th) 86 (Q.B.), that was later affirmed by the Alta. C.A.

III. STATUTORY TREATMENT OF SUPPORT IN THE BIA

1. Support survives the bankrupt's discharge: BIA s. 178

> 178. **Debts not released by order of discharge** — (1) An order of discharge does not release the bankrupt from ...
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> (b) any debt or liability for alimony or alimentary pension;
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> (c) any debt or liability arising under a judicial decision establishing affiliation or respecting support or maintenance, 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) Subject to subsection (1), an order of discharge releases the bankrupt from all claims provable in bankruptcy.

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

(a) Issue: *How to determine what portion of a cost order survives bankruptcy as support*: The best course, in most cases, is to request, at the date of trial, that the trial judge specify what portion of the costs pertains to support. Otherwise, it is necessary to bring a motion, after bankruptcy, for an allocation of the costs award as between support issues and all other matters.[12] Ontario judges have not followed an

[12] *Beaumont v. Beaumont*, [2006] O.J. No. 2433 (S.C.J., Scott J., June 16 2006): Three years after divorce judgment, and 2½ years after the $85,000 cost award granted to the wife, the wife sought an order from the trial judge specifying that half the costs pertained to support. The husband had declared bankruptcy after the judgment and was undischarged. Ontario Family Law rule 15(14) provided for the

unfortunate line of British Columbia cases that appear to prohibit a support claimant from asking the court, after the payor's bankruptcy, to identify the support component of a cost order that has been issued and entered.[13]

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court to change any order that "needs to be changed to deal with the matter that was before the court but that it did not decide". The responsibility for costs was before the court at trial, which addressed costs on an issue-by-issue basis, but "inadvertently" failed to specify apportionment in the costs endorsement. So the court had jurisdiction to determine the issue. The wife's counsel's accounts, the trial transcript and the Judge's trial bench book notes, formed a sufficient evidentiary base to assist the judge's independent recollection. The support issue was wholly intertwined with the valuation of the husband's business (hence his income), the wife's illness, and the husband's non-compliance with interim orders and lack of financial disclosure. At least half of the spouses' testimony was relevant and material to support. Held: 50% was attributable to support. Costs of the motion fixed at $3,000, attributable to support. *D.P.L. v. M.E.I.*, [2007] P.E.I.J. No. 32 (P.E.I. S.C., Mitchell, C.J., June 27 2007): The husband declared bankruptcy shortly after the matrimonial trial, at which the wife had obtained a $34,000 costs order against him. She applied to the trial judge to amend the judgment to apportion the costs as to support. Held: At the hearing, apportionment of the costs among various issues was neither addressed nor considered. It had not been adjudicated upon. The court has jurisdiction, when the husband declares bankruptcy after the judgment is entered, to apportion the wife's cost order between support and non-support. The court applies Rule 59.05(1(b): "An order that .. (b) requires amendment in any particular on which the court did not adjudicate, may be amended in a motion in the proceeding." As to quantum, the cost order related to the entire proceedings including interlocutory motions and many filings. The Judge reviewed the previous interlocutory orders, the court file, the wife's affidavit, her solicitor's accounts, the parties' submissions and his own recollection of the proceeding: 65% of the costs related to support. The order was amended to reflect this. *Philip v. Philip*, 2008 CarswellOnt 4671 (Ont. S.C.J., Henderson J., August 7 2008): Almost two years after the matrimonial trial, the trial judge awarded the wife costs of $18,000. The husband declared bankruptcy two months later. The wife moved before the trial judge to amend the costs order by identifying the portion of the costs that related to support. Motion granted. The original costs order needed to be changed as provided under Family Law Rule 15(4)(c) ["The court may, on motion, change an order that ... (c) needs to be changed to deal with a matter that was before the court but that it did not decide; ..], because of the husband's intervening bankruptcy. The passage of time since the trial, while making reconstruction of the proceedings more difficult, did not preclude this apportionment the clarify matters. especially given the recency of the bankruptcy. This would also assist the trustee. The issue of costs in its entirety was before the court at the trial, even though there was no specific request for apportionment at that time, since it would have been a waste of time to do so before it became relevant due to the bankruptcy. Costs submissions were not subject to the same hard and fast evidentiary rules that applied to substantive legal issues, as the rules provided that costs were to be made in a summary manner. The judge reviewed his bench book and heard submissions: 60% of the award pertained to support. The wife was also awarded costs of this motion, which the court characterized as a support-related debt. See *BIFL* §2.11.

[13] *Lees, Re* (2002), 35 C.B.R. (4th) 150 (B.C.S.C., Wilson J.): Bankruptcy Court has no jurisdiction to determine what portion of a mixed cost order is attributable to support so as to survive discharge. *Manolescu v. Manolescu* (2003), 47 C.B.R. (4th) 77, 42 R.F.L. (5th) 407 (B.C.S.C., Groberman J., July 15 2003, wife unrepresented): The wife's motion in bankruptcy court to set aside the husband's discharge had been dismissed many years before for lack of standing on the basis that her cost award was not released by the discharge, evidently due to its characterization as support. But the court's formal order merely dismissed her motion. Ten years later, when she applied to renew her judgment, the court refused

(b) Issue: *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.[14] 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*.[15]

> 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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to accept this characterization as binding, holding that issue estoppel was inapplicable as there had been no true adversarial hearing on the characterization issue. The wife's motion had been brought hurriedly and both she and the husband had argued, on different grounds, that her motion should be dismissed. Since only the reasons, but not the formal order, characterized her claim as support, the husband had no right of appeal; the wife ought to have applied for a declaration. *B. (K.J.) v. B. (W.S.)* (2004), 2 C.B.R. (5th) 40 (B.C.S.C., Taylor J., June 24 2004, both parties unrepresented): Applying *Manolescu*, costs which cannot be distinguished as being solely in respect of support are extinguished by bankruptcy.

[14] See *BIFL* §3.2

[15] (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*,[16] 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."

In the leading Ontario case, *Shea v. Fraser*,[17] the Court of Appeal directed a trial on whether or not the following clause, contained in the section of a separation agreement headed "Settlement of Rights to Division of Net Family Properties", was in the nature of support:

> The husband shall pay $300 to the wife each and every month until such time as a total amount of $30,000 has been paid to the wife in full satisfaction of this equalization payment.

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[16] [1996] O.J. 1580 (Ont. C.A., May 7 1996), at ¶2. The Ontario 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".

[17] *Shea v. Fraser*, [2007] O.J. No. 1142 (Ont. C.A., Mar 29 2007)

The Court of Appeal adopted the following list of 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.

- 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.[18]

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[18] In *Bremner v. Thorne, Ernst & Whinney Inc.*, [1989] 3 W.W.R. 377, 74 Sask. R. 110, 73 C.B.R. (N.S.) 91 (Q.B.) (length of marriage unspecified), the wife's employment in the husband's corporations had been her sole source of income before separation. She had an interim order for maintenance until they concluded a separation agreement. The agreement provided that she receive $100,000 (of which $50,000 had been paid at the time of the agreement) for her share of the parties' interests in the corporations. The remaining $50,000 was payable over two years in two annual $25,000 instalments. The agreement provided that "neither of the parties hereto shall seek, nor be entitled to maintenance or alimony from the other for themselves." When the husband declared bankruptcy before paying either $25,000 instalment, the wife applied to enforce her entitlement. She argued that, in considering the agreement as a whole, she had granted the waiver of maintenance because there was sufficient matrimonial property to permit her to maintain herself from her share — otherwise maintenance would have been negotiated. However, the court was impressed with the specific categorization of the debt, in the agreement, as the value of her one half interest in the corporations' shares. This did not permit any reasonable inference that the debt represented maintenance. Otherwise, every debt arising from an agreed or designated share of matrimonial property could be converted into a debt for maintenance should the circumstances so require. This the court refused to countenance. The terms of the agreement specifically characterized the debt as a property settlement, and therefore precluded any characterization as payment in lieu of maintenance. [RAK: In view of the policy concerns at play here, this decision ought to be treated skeptically. The court considered, but did not determine, whether the wife would have been entitled to support but for the promise of receiving the stated payment. Indeed, the case contains a suggestion that the $50,000 debt obligation was undertaken in lieu of the continuation of support the wife was receiving before the agreement was executed.]

- 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.[19]

- The labels used in the document are not determinative[20]

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

- 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.[21]

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[19] In *Schmidt v. Schmidt* (1991), 36 R.F.L. (3d) 390, 95 Sask. R. 318 (Q.B.) (length of marriage unspecified), the husband was ordered to pay the wife $142,800 in four equal instalments, together with monthly payments of $500 which were specifically characterized in the order as advances on the division of property in reduction of the lump sum award. She was also granted nominal support under the Divorce Act. The husband declared bankruptcy after two payments. It was held that the lump sum could not be characterized as maintenance in view of the specificity of characterization of the $500 payments. Thus the debt was discharged. However, the default in payment was construed to be a material change in circumstances, entitling the wife to apply to vary the nominal support.

[20] 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.

[21] *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.

• 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 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*,[22] the court acknowledged that a true compensatory support claim was properly characterized as support.[23] However in *Barnacle v. Barnacle*,[24] the wife's determination to ensure non-taxability, by designating

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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.

[22] (1997), 47 C.B.R. (3d) 142 (Ont. Gen. Div.)

[23] 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.

[24] [1993] O.J. No. 1273 (Ont. Gen. Div.). This case involved a 15 year marriage, two children.

the compensation as a property division, was held to preclude characterization as support.

- 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. Some older cases examine this question in terms of the purpose for which the debt was originally incurred, but that is an unhelpful approach. The nature of the underlying debt itself is a secondary consideration. The real question is whether the imposition of responsibility for the debt was done for the purpose of support.

Look at it this way: 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 functionally 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 — required 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. Contrariwise, if the wife did 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 on the husband, 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.

Stokalko v. Stokalko, [1997] S.J. No. 299 (Sask. Q.B., Gunn J., April 30 1997): Eight year marriage, 2 kids. In the separation agreement, the wife had kept the family car, paid the husband $3,000 equalization, and waived spousal support. He concealed a $6,000 lien on the car, which caused her to lose the car when he declared bankruptcy. She promptly applied for $6,000 lump sum support. Held: no material change; this was in effect an application to vary the division of property. No lump sum spousal support was available in view of the release of support rights in the agreement. Indemnity obligations re debts are not support. But her monthly child support was varied upward by half the cost to lease a new car, because the kids' needs required a car.

(c) Issue: *Can the bankrupt's spouse obtain a support order that requires the bankrupt to pay, as support, a debt that is extinguished by the bankruptcy?* Clearly such relief is available, and is frequently granted by the matrimonial court in appropriate instances.[25] If the wife requires that the debt be paid in order for her to meet her family needs, the court may impose a new obligation on the husband, in the nature of support, that he make the payments or indemnify her. Such an obligation is more easily imposed where the husband's misconduct contributed to the family's debt load.[26]

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[25] *Freno-Link v Link*, [2001] B.C.J. #2710 (S.C., Grist J., December 7 2001): Wife obtains a support variation order requiring husband to pay lump sum spousal support equal to the husband's total indemnity obligation ($37,000) that was extinguished by his bankruptcy. *Johansen v. Martin*, [2001] B.C.J. No. 2898 (B.C.S.C., Wilson J., March 28 2001) (non-bkcy): Spousal support granted of $200/mo. to redress wife's forced assumption of sole responsibility for the spouses' joint debts: an economic disadvantage arising from the marriage breakdown, impairing her ability to remain economically independent and self-sufficient. See also *Pipitone v. Pipitone* (2009), 50 C.B.R. (5th) 85 (Ont. S.C.J., Graham J., January 16 2009): Wife enforces matrimonial court order requiring husband to indemnify her on a credit line debt, and costs. Husband had used the joint credit line to pay his interim support order, so the enforcing court notes that the indemnity obligation imposed by the trial judge (characterizing the indemnity obligation as lump sum support) was properly characterized as support.

[26] *MacDonald v. MacDonald*, [2002] N.B.J. No. 228 (Q.B., Robichaud J., June 25 2002): After separation, the husband convinced the wife to cash in $6,500 of her RRSP's under the pretext of reconciliation. He used the proceeds, then stopped paying any bills, declared bankruptcy after she commenced litigation, leaving her with huge bills and a $3,000 tax liability from the RRSP. The matrimonial trial proceeded before his discharge. The court ordered him to pay her $8,000 consisting of: (a) half of her tax debt

Likewise, the court may in an appropriate case grant support, or vary a support obligation upwards, to reflect the loss, due to the other spouse's bankruptcy, of an equalization payment or costs award.[27]

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incurred through his income-splitting during cohabitation, as it was not listed as a debt in his bankruptcy [*quaere*]; (b) the after-tax value of the RRSP she collapsed and paid to him; (c) the tax liability she incurred through collapsing the RRSP: his egregious conduct in engineering the collapse of the RRSP rendered unconscionable his avoidance of the liability; the liability was only made known in a tax reassessment shortly before trial, and was not listed in his bankruptcy; considering the surreptitious manner in which the liability was created, it was not a provable claim and he should pay it. The court also granted her spousal support since he had by his conduct, prolonged and aggravated her need for support "because of the enormous marital and non-marital debt load which he has foisted upon her." ¶178. [RAK: note that the judge's language, referring to debts that were not 'provable', is outdated; the trial judge probably meant to say 'nondischargeable'. Also, there is no distinction in law under s. 178 between debts that have been listed by the bankrupt, and those that have been not. The section applies even if the creditor never received notice of the bankruptcy, subject to exceptions not engaged on the facts in this case.]

[27] *Bertrim v. Bertrim* (2002), 29 R.F.L. (5th) 263 (Ont. S.C.J., Del Frate J., July 3 2002), aff'd (2004), 49 R.F.L. (5th) 1 (Ont. Div. Ct., January 5 2004): The husband declared bankruptcy five months after a trial judgment awarded the wife $15,000 equalization by virtue of his pension. The court increased her support by $700 monthly by virtue of the material change in circumstances, being his non-payment of the equalization. Five years later the husband retired, reducing his income, and sought to terminate support, saying that he had in effect overpaid, through increased support, the amount that she lost from his non-payment of equalization. Held: the increased support order did not specify that it reflected a payment of the foregone equalization; to take this approach would abuse the system. However, support was reduced back to the original trial level due to the husband's reduced income from retirement. *Catsoudas v. Catsoudas*, 2009 ONCA 706 (October 8 2009): Quantum in family court: The court refused to reduce the husband's support quantum, because his bankruptcy has had an adverse effect on the wife: her cost order at trial, to the extent that it relates to property claims, will not be paid, and she will have to assume responsibility for a joint debt that he had previously agreed to pay in their separation agreement. *Sim v. Sim* (2009), 50 C.B.R. (5th) 295, 66 R.F.L. (6th) 185, 2009 CanLII 6835 (Ont. S.C.J., Marshman J., February 19 2008, undefended): The husband secretly declared bankruptcy one month before the wife's $60,000 equalization judgment was granted. He was later discharged, retaining his $100,000 pension. Held: The court cannot grant an equalization against a bankrupt spouse's pension after the bankruptcy discharge, because discharge releases the equalization debt. But regarding support, there was a material change in circumstances because the wife had counted on her equalization payment to fund her retirement, but his bankrupt left her without the equalization but left him with full entitlement to his pension. This entitled her to lump sum support of $60,000, secured against his pension. *Yetman v. Yetman*, [2006] O.J. No. 926 (S.C.J., Henderson J., Mar 2006): As one of the factors relied upon by the court for increasing interim spousal support, the court noted that the wife did not receive her equalization of the husband's pension because of his bankruptcy.

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.

Here is the section again, parsed for better understanding:

- A claim in respect of a debt or liability
  - (a) for alimony, or
  - (b) 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,

- payable under an order or agreement made

    (c) before the date of the initial bankruptcy event in respect of the bankrupt [normally the date of bankruptcy], *and*

    (d) 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.

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.

An Ontario case, *Bukvic v. Bukvic*,[28] has decided that it is not only support arrears owing on the date of bankruptcy that are provable, but also any arrears that accumulate up to the date of the bankrupt's discharge. This is a questionable result that may perhaps be restricted to the egregious facts in the case. If applied generally, this

[28] *Bukvic v. Bukvic*, [2007] O.J. No. 1637 (Ont. S.C.J., Gordon J., March 29 2007, the author assisted the wife's counsel, Charles Morrison): All support arrears accumulating, under a pre-bankruptcy interim order, before the bankrupt's discharge are provable. When the bankrupt has permanently left the jurisdiction shortly after declaring bankruptcy, and abandoned his family, there is no reasonable likelihood of the wife receiving future support, so she must be allowed to prove her claim in the estate. Here, the husband would not likely be seeking a discharge, and would be ineligible for such relief [*quaere*]. So the wife's claim includes the whole of his future support obligation, which is capable of valuation, and indeed was calculated and converted into a lump sum amount at an uncontested trial, namely $390,000, which was therefore her provable claim under s. 121(1).

decision would hinder the proper administration of many bankruptcy estates. A similar result was reached, on flawed reasoning, in a Quebec decision.[29]

3. Limited Stay of Proceedings: 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
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> (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 [i.e. surplus income payments payable by the bankrupt until his or her discharge].

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 operate to divest the debtor of such assets, vest them in the trustee, and give the trustee priority over all judicial proceedings then underway in respect of those assets.[30] So support enforcement measures against the bankrupt's assets that vest in the trustee - such as

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[29] *G.R. (syndic de)*, [2001] J.Q. no 3803, J.E. 2001-1607, [2001] R.D.F. 642 (rés.) (C.S. Qué., Dubois J., 31 juillet 2001)

[30] BIA ss. 70(1), 71

bank accounts, or the bankrupt's non-exempt interest in the matrimonial home - are stopped in their tracks.

(a) Issue: *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; RRSP's, wrongful dismissal awards and severance pay. Unless the trustee has already obtained a court order giving him or her priority over these items,[31] a support claim can be pursued against them during and after the bankruptcy.

[31] 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 would prevent the bankrupt from paying ongoing spousal and child support. See *Mattes, Re* (1998), 5 C.B.R. (4th) 212 (N.S Registrar Hill, March 23 1998): A conditional discharge order requiring the bankrupt to make monthly payments to his trustee should not be granted if it would jeopardize his ability to pay child support. *B. (G.) v. K. (M.)*, 2008 NUCJ 23 (Nunavut C.J., Johnson J., October 1 2008): The matrimonial court fixed the father's child support obligation. ¶51 "The father is an undischarged bankrupt who will become eligible for discharge next April. He did not file his monthly statement of income and expenses. He is paying a monthly surplus to the Trustee that did not take into account this maintenance obligation. The Trustee will have to recalculate that payment to consider this new maintenance obligation that will survive the discharge."

- Bankruptcy does not stay proceedings for contempt,[32] provided that the purpose of the contempt proceeding must not be to collect a debt that is stayed by the bankruptcy.

- Bankruptcy does not stay the fulfillment by the bankrupt of a condition, such as an obligation to pay support arrears or to post security in court, that may have been imposed by the court as a precondition to the bankrupt maintaining further proceedings in matrimonial litigation.[33]

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[32] *Pankhurst v. Kwan*, [1999] O.J. No. 41 (Jan. 11 1999, Gen. Div., Hawkins J.): 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 which has been extinguished by the bankruptcy. *Beattie v. Ladouceur* (2001), 23 R.F.L. (5th) 33 (Ont. S.C.J., Polowin J., October 22 2001): Malicious husband refuses to pay support despite contempt, jail, 20 years of litigation. He declares bankruptcy and moves to stay contempt proceedings, collection proceedings for costs or interest, and a general stay until his discharge and surplus income obligations are determined. Held: Bankruptcy does not stay contempt proceedings. Support claims are not stayed by bankruptcy. Costs and interest on support claims are part of support, not stayed or discharged. Court should not stay enforcement of child support pending the Trustee's determination of surplus income under s. 68. Court makes a vexatious litigant ruling against husband, in part because of his bankruptcy, brought for an improper purpose since no creditor was pushing him into bankruptcy, support debt was 95% of total debts, probably attempting to use bankruptcy to avoid his obligations to wife and delay the enforcement proceedings.

[33] A pre-bankruptcy order required the husband to pay outstanding cost orders as a precondition of any further motions within the matrimonial proceeding. He then became bankrupt, and brought a motion regarding access, requesting 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. In the circumstances, the court was not prepared to vary or amend the order: *May v. Stanley*, [1996] B.C.J. No. 1595 (B.C.S.C., Stromberg-Stein J., May 9 1996). *Kordic v. Bernachi*, [2006] O.J. No. 4611 (S.C.J., Clark J., November 20 2006): Where cost orders, made against the husband before his bankruptcy in a support variation proceeding, remain outstanding, the orders for costs survive his bankruptcy. The court may (and here, did) order that he post security for costs in respect of the ongoing proceeding.

- A bankruptcy proposal does not stay any support enforcement measures. In most proposals, unlike in a bankruptcy, no assets vest in the proposal trustee,[34] unless and until the proposal is defeated and results in a bankruptcy. Likewise, in a proposal there are normally no surplus income payments made under s. 68. Hence s. 69.41 permits support enforcement against all the payor's assets in the hiatus between the filing of the proposal, and its acceptance by creditors and the court. Conceivably a vesting or securing order for support could be obtained in this hiatus, although not for equalization which, under s. 69.3, is stayed by the commencement of the proposal.

4. 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.02): funeral expenses; trustee's fees and legal costs; Superintendent of Bankruptcy's 5% levy; unpaid wages of employees} ...
>
> (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; ...

[34] Unless the proposal specifically provides for such vesting.

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 which 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 for a limited portion of the support arrears.

Subsection (d.1), which cross-references two other sections of the BIA, can be parsed as follows:

- A claim in respect of a debt or liability
  - (a) for alimony, or
  - (b) 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,
- payable under an order or agreement made

(c) before the date of the initial bankruptcy event in respect of the bankrupt [normally the date of bankruptcy], and

(d) at a time when the spouse, former spouse, former common-law partner or child was living apart from the bankrupt,

- for

(e) periodic amounts accrued in the year before the date of the bankruptcy that are payable,

(f) plus any lump sum that is payable.

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 order, made after bankruptcy but applicable to the period before bankruptcy, does not entitle the support claim to preferential treatment under s. 136.[35]

Support priority is also available outside the bankruptcy setting by virtue of s. 4 of the Ontario Creditors' Relief Act (CRA).[36] Unlike in bankruptcy, that priority is not limited to one year's arrears: all arrears fall within the section. But since the CRA is provincial legislation that does not bind the federal Crown, the debtor's income tax arrears will take priority over support arrears by virtue of the paramountcy doctrine. The support creditor in these circumstances should consider putting the debtor into bankruptcy to reverse the priorities: the federal Crown becomes unsecured, while the support debt retains its priority, albeit more limited in respect of periodic payments.

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[35] *Bukvic v. Bukvic*, [2007] O.J. No. 1637 (Ont. S.C.J., Gordon J., March 29 2007)

[36] Ontario Creditors' Relief Act, s. 4(1): A support or maintenance order has priority over other judgment debts regardless of when an enforcement process is issued or served,

(a) if the order is for periodic payments, in the amount of the arrears owing under the order at the time of seizure or attachment;

(b) if the order is for a lump sum payment, in the amount of the lump sum.

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

The tax cases give some guidance on this question, as only periodic support payments are eligible for deductibility under the *Income Tax Act*. Under the tax jurisprudence, it would appear that an obligation to pay an amount on a periodic basis maintains that character even if several such amounts are paid late in a single lump sum. But a fresh obligation creating a retroactive support obligation for a given period where no clear obligation already existed, is not periodic.[37]

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[37] *Groleau v. R.* (2002), 24 R.F.L. (5th) 377, [2002] 2 C.T.C. 2368, 2002 D.T.C. 1725 (T.C.C., Rip J.): Lump sum settlement for periodic support arrears claim against husband, is in the circumstances not taxable in wife's hands (not periodic any more). *Ostrowski v. R.* (2002), 31 R.F.L. (5th) 360, 292 N.R. 161, [2002] 4 C.T.C. 196, 2002 D.T.C. 7209 (Fed. C.A.) (non-bkcy case): "secured" does not necessarily mean security; it can be used colloquially in a court order to mean assurance of payment. Tax case re deductibility. Previous consent decree established quantum of spousal and child support. When joint home sold, court ordered that from husband's share, "$88,800 be secured as a lump sum payment" for support for a two year period. This amount was ordered to be paid to wife. Tax dept. ruled that it was not deductible because not periodic. Held: The order did not "secure" periodic support. But the order did not extinguish the periodicity of the support obligation. The foundation of the payment obligation was the consent decree, which remained in force. This was not a commutation or replacement of all future maintenance payments as in *MNR v. Armstrong* (1956), 3 D.L.R. (2d) 140 (S.C.C.) or *Trottier v. MNR* (1968), 69 D.L.R. (2d) 132 (S.C.C.). Even using the words "lump sum" does not necessarily extinguish periodicity: *Sanders v. Canada* (2001), 22 R.F.L. (5th) 207, [2002] 1 C.T.C. 2065 (T.C.C., Bonner J.). So periodic, hence deductible. *Peterson v. Canada* (2005), 257 D.L.R. (4th) 240 (Fed. C.A., June 17 2005): Minutes of Settlement of the wife's support enforcement proceeding that was defended by the husband, who alleged he was current. "Defendant will pay retroactive additional periodic child support to the Plaintiff for each of the aforementioned children in the amount of $36,000 for the twelve months from January 1st, 1996 to and including December 1st, 1996. Payments are taxable in hands of Plaintiff and deductible by Defendant." The wife (Plaintiff) did not declare this amount in her income on the basis that it was not periodic. Held: An obligation to pay an amount on a periodic basis maintains that character even if several such amounts are paid late in a single lump sum. But a fresh obligation creating a retroactive support obligation for a given period where no clear obligation already existed, is not periodic. The parties can settle unpaid support issues in a way that formally recognizes the arrears and provides for their payment or partial payment; or they may put aside the issue

(b) Issue: *Can the wife recover the 5% bankruptcy tax from the husband?*

Every payment made by the trustee in bankruptcy to a creditor is expressly made subject to the Superintendent's levy, which is a form of bankruptcy tax used to fund administrative oversight of the insolvency system. The levy is calculated through a formula set by regulation. It amounts to 5% of each distribution made by the trustee, except in modest estates. Let us imagine a support creditor, say a wife, who proves a claim in the husband's bankruptcy for a $20,000 lump sum support obligation owing under a pre-bankruptcy court order. Under s. 136, this claim is entitled to priority (technically, a preference) in 5th position, after payment of trustee's fees and the Superintendent's levy. So the wife is entitled to receive a dividend of $20,000 from the trustee on account of her support claim. However, 5% of that, or $1,000, must be deducted and paid to the government. So she -- or the Family Responsibility Office (FRO) on her behalf -- receives only $19,000. Presumably she should credit this amount, and in due course recover the remaining $1,000 owing on the lump sum.

However, wretched case law has arisen under this section. In *Cameron, Re,*[38] the Alberta Court of Appeal concluded that although the wife has only received $19,000, i.e.

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of arrears and create an entirely new obligation. In this case, there was no express recognition in the agreement of a pre-existing support obligation or the existence of arrears, nor evidence of implicit recognition of the husband's obligation; the spouses maintained their disagreement over this until the Minutes of Settlement were signed. The sentence immediately following, "The payments are taxable in the hands of the wife and not deductible by the husband", is irrelevant. The tax treatment depends on the construction of the obligation. The judge should ignore this sentence.

[38] *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)

95% of her claim, she must give the bankrupt husband credit for the full $20,000. She is not entitled to collect the remaining balance from him. She alone must bear the full burden of the bankruptcy tax. Supposedly, this treatment is consistent with the treatment accorded to other s. 178 creditors whose claims survive the bankrupt's discharge.

This case is regressive and poorly reasoned. It is unclear whether it is being followed in Ontario; it should not be. Oddly enough, it is only support claimants who are treated this way in bankruptcy. Courts routinely permit every other kind of creditor whose claim survives the bankrupt's discharge, to credit the bankrupt only for the actual amount received from the trustee, not a grossed up amount that incorporates the bankruptcy tax.[39] The Canadian Senate, in its 1993 insolvency review, adopted my

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[39] Other than *Cameron*, I have never seen any case -- and I have looked hard -- that forces a s. 178 creditor to credit the bankrupt with more than the amount actually received from the trustee. Under the rationale of treating support creditors consistently with other s. 178 creditors, the Alta. C.A. has established a rule that treats them worse than any other creditor. Here are recent examples of cases that contradict the erroneous assumption made in *Cameron*: *Skytal Ltd. v. Schiber* (1997), 46 C.B.R. (3d) 275 (Ont. Gen. Div.), ap. dis. (1998), 9 C.B.R. (4th) 129 (Ont. C.A.) (judgment for breach of fiduciary duty granted against the bankrupt, less the sum the plaintiff already received as a distribution from the bankrupt's estate); *Garneau c. Developpement 4e Dimension inc.*, [2007] J.Q. no 2219 (C.Q., Dortélus J., 14 mars 2007) (guarantor's claim for a refund of $45,000 from a secured creditor that improperly seized the guarantor's deposit, reduced by the amount the guarantor had received from the debtor's trustee). *Amex Bank of Canada v. Johnson* (2007), 33 C.B.R. (5th) 290, 418 A.R. 320, 75 Alta. L.R. (4th) 387, [2007] 11 W.W.R. 732, 42 C.P.C. (6th) 284 (Prov. Ct., O'Ferrall J., May 11 2007): Action, after bankrupt's discharge, for taking a $4,000 cash advance from his credit card one month before declaring bankruptcy. After making a determination of fraud, the court ruled: "¶51 So there will be judgment in favour of Amex in the amount of $3,985.31, being the amount sued for, less the dividend received in the Defendant's bankruptcy." *Johnson v. Erdman* (2007), 34 C.B.R. (5th) 108, *sub nom. Erdman (Bankrupt), Re*, 297 Sask. R. 161 (Q.B., Ball J., June 26 2007) (non-mat): Court awards fraud plaintiff judgment for the quantum of its claim "less the dividend of $733.45 received by the plaintiff from the estate of the bankrupt .." (¶16). *Caliber Management Ltd. v. Hardt*, 2010 BCSC 1155 (S.C., Kloegman J., August 16 2010) (commercial case): The plaintiffs sued the bankrupt corporation's principal, personally, for breach of warranty. The plaintiffs had filed proofs of claim in the corporation's bankruptcy and received dividends: "[56] The plaintiffs .. are entitled to judgment for the full amount of their loan plus interest at the contractual rate of 12% per

recommendation to legislatively reverse *Cameron*,[40] although the bankruptcy reform legislation that came into force in 2009 did not enact this recommendation.[41] The FRO should be encouraged to challenge this decision.

(c) Issue: *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 a transaction between parties who were not at "non-arm's length" at the time, unless the trustee, or the court, determines that the transaction was "proper".

It is hard to know whether spouses who have entered into a separation agreement are at arm's length. The BIA definition section, s. 4, provides that this is a question of fact, with one key exception: persons who are married to each other are *deemed* not to deal with each other at arm's length. While this deemed status is reduced to a rebuttable presumption in respect of other anti-abuse provisions of the BIA, s. 137 is

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annum, less their recovery from the Trustee in Bankruptcy of [the corporation."]

[40] *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, Canada, November 2003.

[41] Nor did any of my other four proposals in the bankruptcy/family law area, all adopted by the Senate, find their way into the amending legislation. And so it goes.

not so qualified.[42] This results in discriminatory treatment of married spouses: they are deemed not to act at arm's length. Hence any transaction or agreement between married spouses who are not yet divorced, must pass the s. 137 test before a dividend may be paid. Common-law spouses, in contrast, only fall within s. 137 if a judicial determination is first made that they were not at arm's length at the time of the transaction or agreement. This provision is ripe for a constitutional challenge, as there is no conceivable legislative rationale, other than drafting error, to discriminate against married spouses in this fashion.

There is almost no judicial gloss on this section,[43] and none at all outside the commercial setting.[44] As will be seen, matrimonial courts have granted such orders in

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[42] BIA s. 4 (4). It is a question of fact whether persons not related to one another were at a particular time dealing with each other at arm's length. 4 (5). Persons who are related to each other are deemed not to deal with each other at arm's length while so related. For the purpose of paragraph 95(1)(b) or 96(1)(b), the persons are, in the absence of evidence to the contrary, deemed not to deal with each other at arm's length.

[43] See the following commercial cases: *Kronson v. Metro Drugs Manitoba Ltd. (Trustee of)* (1985), 61 C.B.R. (N.S.) 312 (Man. Q.B., Hanssen J.); *Provost Shoe Shops Ltd., Re* (1993), 21 C.B.R. (3d) 108, 123 N.S.R. (2d) 302 (S.C., MacLellan J.); *J.M. Chaput ltée c. Club de voyages aventure inc. (syndic de)*, [2000] J.Q. no 5180 (C.S.Q., Journet J., 10 novembre 2000)

[44] While s. 137 does not figure in the following case since there was no bankruptcy, it may be applicable to this discussion. In *Hawco v. Myers* (2005), 22 R.F.L. (6th) 17, 252 N. & P.E.I.R. 121 (Nfld. & Lab. C.A., December 7 2005), reversing in part *Myers v. Hawco* (2004), 243 D.L.R. (4th) 726, 11 R.F.L. (6th) 291, 240 N. & P.E.I.R. 248 (Nfld. S.C., Cook J., September 22 2004), the husband, a then non-practicing lawyer who was insolvent, prepared a separation agreement. He had paid no support in the four years since separation. The agreement provided for payment to the wife of $2,000 monthly child support and $1,000 monthly spousal support, both retroactive to the separation date; and $100,000 compensatory support with interest from date of separation: total instant arrears of $217,000. His intention was to create substantial child and spousal support arrears to establish priority against his other creditors over a substantial fee from litigation that was nearing completion. At the time he had been unemployed for 3 years. His plan boomeranged: the fee ended up going to his creditors, and the wife attempted to enforce the obligation against him. Held: The level of child support bore no relation to the guidelines, and had no realistic relationship to his ability to pay, nor did the retroactive arrears or the lump sum. The agreement was a sham drafted to create an artificial priority. Contrary to public policy to uphold such artificial priorities.

appropriate circumstances,[45] and bankruptcy courts have upheld property transfers, on the eve of insolvency, to satisfy future support claims.[46] In addition, the Supreme Court of Canada has laid down, in *Marzetti v. Marzetti*,[47] generous rules of interpretation where support issues, and family need, collide with creditors' interests: The importance

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Besides, the agreement did not reflect the factors and objectives of the *Divorce Act*. All arrears were extinguished. Reversed in part on appeal. As to whether it is improper for a separation agreement to put the wife and children ahead of other creditors: "Whether a separation agreement can be attacked by creditors of one of the parties to the agreement depends on a number of factors. Trying to get the best for oneself (on one's children) per se cannot be equated with intent to defraud other creditors." However, when the agreement created a $217,000 support debt, this exceeded the most optimistic view of the money he would be receiving or earning; it bore no relation to reality. The trial judge was correct to discount it. [RAK: Clearly, in a bankruptcy setting, this transaction would be improper under s. 137.]

[45] *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.

[46] See, for example, *Blumer v. Blumer* (2004), 1 R.F.L. (6th) 16 (B.C.S.C., Paris J., March 8 2004): Court effectively grants stripping order to wife (a stripper) for $10,000 lump sum spousal support. The husband's income was earned through drug trafficking; he owed a huge tax debt from trafficking. No assets of value aside from house owned by husband, worth $260,000, net proceeds of about $21,000. ¶24 "The plaintiff knowingly and willingly took the benefit of the defendant's illegal income over the years. There is therefore no basis for making any compensation order in favour of the plaintiff in this regard." But the judge divided the house proceeds in half, granted the wife $10,000 lump sum support for a clean break, and ordered that the husband's half be applied firstly to the lump sum. The order effectively left the husband's tax creditors with nothing. Consider *Goldberg, Re* (2002), 32 C.B.R. (4th) 26 (B.C.S.C., Vickers J.): Trustee objects to giving full credit to the bankrupt, in his surplus income calculation, where a matrimonial court had granted a whopping support order requiring him to pay for a full-time nanny and other expenses, totalling $12,800 monthly, for the children of whom he had obtained custody. The bankrupt had sought the support order against himself on behalf of the children. Most of the items were necessary to save the children from the disgraceful actions of the wife (a drug abuser, falsely accusing husband of sexual abuse resulting in criminal charges against him, nanny required by court order for custody to help children recover from the false abuse accusations, husband had had to 'rescue' the children from a dysfunctional setting and sustain their recovery). Held: The order was sought in extraordinary circumstances where the well-being and rehabilitation of his children was paramount, based on their extraordinary needs; it was proper in the circumstances. But the trustee was correct in not giving full credit for the order in the surplus income calculations; taken into account in setting discharge order. Apply *Wallace v. United Grain Growers* (1997), 3 C.B.R. (4th) 1 (S.C.C.): Parliament has chosen to put the needs of the family ahead of the interests of creditors.

[47] [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.)

of family welfare has a public policy aspect that is to be utilized as a factor in statutory interpretation. When family needs are at issue, the court should err on the side of caution. In addition, the courts should prefer an interpretation which helps defeat the role that divorce plays in the feminization of poverty. So there appears to be fairly wide latitude, despite the dramatic consequences of such an agreement. It remains to be seen whether the new BIA anti-abuse provisions, ss. 95 (preferences) and 96 (undervalued transactions) will materially alter the prevailing leniency with which such agreements have traditionally been received.

5. Priority over the Trustee: BIA ss. 70(1) and 71

70(1) *Precedence of bankruptcy orders and assignments.* — Every bankruptcy order and every assignment made under this Act takes precedence over all judicial or other attachments, garnishments, certificates having the effect of judgments, judgments, certificates of judgment, legal hypothecs of judgment creditors, executions or other process against the property of a bankrupt, except those that have been completely executed by payment to the creditor or the creditor's representative, and except the rights of a secured creditor.

71. *Vesting of property in trustee* — On a bankruptcy 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 their property, which shall, subject to this Act and to the rights of secured creditors, immediately pass to and vest in the trustee named in the bankruptcy order or assignment, and in any case of change of trustee the property shall pass from trustee to trustee without any assignment or transfer.

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 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 normally loses any right to obtain priority through the *Ontario Family Law Act*, whether for support or property division, 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*,[48] 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):[49]

> [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 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 ...

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[48] (1990), 29 R.F.L. (3d) 454, 4 C.B.R. (3d) 1 (Ont. Gen. Div.)

[49] *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.

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. This is known as the *Maroukis* rule, after a Supreme Court of Canada case, *Maroukis v. Maroukis*,[50] which established this point in relation to a writ of execution registered after separation but before matrimonial adjudication of a matrimonial property claim.

(a) Issue: *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 Court has had an opportunity to grant a lump sum support order or to impose a transfer or security for support against the insolvent spouse:

- a suitably worded charging order, granting security over specified assets for the claimant spouse's support claims.[51] These orders can and often should be sought *ex parte.*[52]

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[50] *Maroukis v. Maroukis*, [1984] 2 S.C.R. 137, 12 D.L.R. (4th) 321, 41 R.F.L. (2d) 113, 54 N.R. 268, 34 R.P.R. 228

[51] 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. This topic is discussed in *BIFL* Chapter 11. If the charging order is intended as an aid to execution, rather than as security, it will not acquire priority over the trustee: *Bascello v Bascello Estate* (1997), 48 C.B.R. (3d) 235 (Gen. Div.); *Wright v Canada (A-G)* (1987), 62 O.R. (2d) 737, 13 R.F.L. (3d) 343 (Did. ct.): the charge for support over the husband's RRSP was a mere form of execution, not security.

[52] *Raymond v. Raymond* (2008), 64 R.F.L. (6th) 160, 2008 CanLII 68138 (Ont. S.C.J., Hennessy J., December 23 2008): The court granted a vesting order for lump sum support and equalization, where the husband had not attended at case conferences and had ignored court orders to make disclosure and pay

- establishing an express trust, through a formal trust agreement, 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 matrimonial claims in the pending litigation;

- an injunction can be granted restraining the other spouse from declaring bankruptcy, allowing the claimant to obtain lump sum support, or a judicial vesting remedy, first.[53]

- a separation agreement, and consequent property transfer, or a court order or agreement directing that property be transferred, will usually be sufficient to

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monthly support. "¶31 On the basis of the Respondent's previous actions and reasonably anticipated future behaviour, I find that the Order granted will likely not be complied with without additional, more intrusive provisions .. There is no requirement under the FLA or CJA for notice to be given to anyone in particular when a Vesting Order is sought .. A Vesting Order is necessary to ensure both the satisfaction of judgment for net equalization and to secure the spousal support. ¶32 In *Lynch v Segal*, 82 O.R. (3d) 641 (C.A.) the court held that there must be a reasonable relationship between the values of the asset and the amount of the liability. The equalization payment of $74,066.45 and the lump sum support order of $98,585 total $172,651. ¶33 There will be an immediate Vesting Order in favour of the applicant in the right, title and interest in the post office property municipally known as .. to allow Mrs Raymond to preserve the value of this property through necessary repairs and on account of the ultimate Vesting Order which shall be made following further submissions.

[53] 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.

establish priority - although the transaction may be vulnerable to attack as a fraudulent conveyance or undervalued transaction;

- 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.

- A little known practice of the appeal courts may in some cases be utilized even if the motions court has rejected a pre-bankruptcy request for security or a vesting order. If the support claimant appeals the motion court's refusal to grant a securing or vesting order or a lump sum support order, a successful appeal will overcome the prioritizing effect of the payor's subsequent bankruptcy. The "usual rule" is that the appellate decision is substituted for the order or judgment appealed from, so its effective date is the date of the original order.[54] Hence the appeal court's decision to grant a vesting or securing order, will be effective as of the date of the original motion, thus pre-dating the bankruptcy.[55]

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[54] *Preweda v. Preweda* (1993), 48 R.F.L. (3d) 190, 88 Man. R. (2d) 2 (C.A.); *Metzner v. Metzner* (2000), 182 D.L.R. (4th) 583 (B.C.C.A.)

[55] *D.B. c. A.L.*, [2002] J.Q. no 3690, J.E. 2002-1653, [2002] R.J.Q. 2206, [2002] R.D.F. 830 (rés.) (C.A. Qué., 28 août 2002), also cited as *Boutin v. Lefebvre*. The wife lost her claim at the divorce trial seeking to vest the matrimonial home in her name on account of her support claims. She appealed. The husband later declared bankruptcy. On appeal: a successful appeal is retroactive to the date of the order appealed from, and ousts the intervening trustee's property rights. So the appeal court's decision to reverse the trial judge and grant the wife a lump sum payable through a stripping order (the transfer to her of the husband's half interest in the home, his car and trailer, essentially all of his assets) gives her priority over trustee.

(b) Issue: *What kinds of secured debts have priority over the matrimonial home or other assets?* This question does not only arise in bankruptcy, but also in ordinary matrimonial disputes. The answer does not change when bankruptcy occurs, because secured creditors' rights are generally not impaired by a bankruptcy.

It is well known that mortgages take priority over judgment creditors and bankruptcy trustees. What is not as well known is that there is no need for a mortgage against *land* to be registered in order to maintain that priority. An unregistered mortgage against land is fully valid against the property owner who granted it, his or her judgment creditors, and his or her subsequent bankruptcy trustee. Security agreements against *personal* property however, under the Personal Property Security Act ("PPSA"), lose their priority unless they are perfected (registered) before bankruptcy, or before a sheriff has taken possession of the goods through a writ of execution. In other words, an unregistered mortgage against land retains priority over the trustee. But a security agreement against, say, an investment, a bank account, a car or an art collection, loses priority to the trustee unless a financing statement has been registered before bankruptcy.

In Ontario, Legal Aid liens constitute enforceable security if properly registered. Case law has confirmed that their status is equivalent to a registered mortgage, even in the event of a subsequent bankruptcy.[56]

Normally income tax debts are unsecured. But a new remedy, the Tax Certificate, was enacted a few years ago to assist the Canada Revenue Agency ("CRA") in tax enforcement. If a Federal Court Tax Certificate is registered against land, or against personal property through the PPSA registry, it becomes a secured claim (like a mortgage or security agreement) for that amount, whether or not there is a subsequent bankruptcy. The Certificate may not, however, be registered after bankruptcy.

If there is no Tax Certificate, the priority of income tax arrears changes dramatically when bankruptcy occurs. Before the bankruptcy occurs, the tax arrears hold a crown priority that can be asserted over all provincial legislation. So support priority under provincial legislation is of no avail against a tax claim. Nor, outside of bankruptcy, do provincial exemptions apply (car, Insurance-type RRSP's, tools) against tax claims. The tax arrears are paid in full before any creditor, including a support claimant, receives one penny. But if bankruptcy occurs, most taxes[57] are unsecured

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[56] *Calla, Re* (1976), 9 O.R. (2d) 755 (S.C.); *Sikorski and Sikorski, Re* (1978), 21 O.R. (2d) 65 (Ont. H.C.J., Boland J.)

[57] If the bankrupt was an employer who has not remitted withholding taxes to the government, the withholding tax arrears have a special trust status that affords them priority. This priority is effective against any secured creditor over the bankrupt's personal property, against any assets vesting in the trustee (therefore beats support preference), and probably against the bankrupt's income and exempt assets until he or she is discharged from bankruptcy (thereby possibly defeating support enforcement).

claims that become stayed by bankruptcy. Tax claims are bound by the BIA. So support enforcement has priority against the trustee (and hence against the tax arrears) over non-bankruptcy assets such as income and exemptions. Some pre-bankruptcy support arrears have a preference, in the distribution of money collected by the trustee, against all other unsecured creditors (s. 136(1)(d.1)). The remaining pre-bankruptcy support arrears share pro rata with all other creditors, including the tax arrears.

(c) Issue: *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, although it may place the bankrupt's income at a sufficiently high level that surplus income payments must be made to the trustee. As to lump sum support, if it 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. However, authority from the Ontario Court of Appeal, in *Taylor v. Taylor*,[58] suggests that, for public policy reasons, even a substantial lump sum support entitlement may be inexigible.

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[58] (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 Ontario 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.

6. Setting aside pre-bankruptcy property transfers made in satisfaction of support: BIA ss. 95, 96

(a) Issue: *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 provide funding. 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 brief 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.

If the trustee decides to accept a paltry sum from the transferee to resolve the dispute, the wife may object; but the bankruptcy court usually upholds the trustee's right, when so instructed by the creditors, to settle for a lowball figure.[59] Great injustice can occur in this situation, especially when the trustee departs from its

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[59] *Braich, Re* (2003), 2 C.B.R. (5th) 75 (B.C.S.C., Koenigsberg J., November 27 2003) (non-matrimonial): Trustee's decision to settle a fraudulent preference claim, that it considered to be a risky claim, takes precedence over the objecting creditor's attempt to obtain a s. 38 order to pursue the litigation, despite the creditor's concern that the trustee was settling only because of its limited resources, not the strength of the claim.

disinterested role and becomes partial to the husband. Strong lawyering is necessary to protect the wife's access to justice.[60]

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[60] The cases demonstrate the problems when the trustee, under commercially sensible principles, settles litigation for a song instead of pursuing the claim to fruition. See *Beynon, Re* (2003), 45 C.B.R. (4th) 172 (Ont. S.C.J., September 19 2003), varied [2004] O.J. No. 457 (February 4 2004), varied on appeal (2004), 6 C.B.R. (5th) 4, 11 R.F.L. (6th) 1 (Ont. C.A.). In a complicated fact situation, the plaintiff (wife #1) won a fraudulent conveyance judgment at trial against the husband and his new wife (wife #2). The judgment declared that he was the sole owner of his new matrimonial home that he had placed in the name of wife #2 for the purpose of avoiding wife #1's support order arising out of matrimonial proceedings. The fraudulent conveyance judgment was made without prejudice to wife #2's claims against the husband, since they had separated before trial. Without informing wife #1, the newly separated wife #2 then brought proceedings against the husband, who acquiesced to a court order declaring that she held a constructive trust interest in half the home. In addition, the court order awarded her "damages" of $320,000. The husband then declared bankruptcy. His trustee entered into negotiations with wife #2 to challenge the transaction, and reached a settlement (for one-half the net value of the home) that wife #1 opposed. The amount of the settlement was barely enough to cover wife #1's priority claim for costs. Wife #1 sought a s. 38 order to challenge wife #2's unusual judgment. The lower court held that the trustee has first right to the cause of action, and his decision to settle should be respected. The settlement was approved, subject to certain reductions (unclear) in wife #2's entitlement under the settlement to ensure that wife #1's priority claim for costs was paid out in full. Wife #1 cannot attack the impugned order as this would be incompatible with the settlement. The court seemed to approve two western cases suggesting that the trustee had sharply limited rights to challenge wife #2's order. On reconsideration, the court varied its reasons to clarify that the settlement may proceed but only if wife#2's half share in the property were reduced, to the extent necessary for wife #1's priority claim in the bankruptcy to be paid in full. On appeal: the court cannot vary the settlement, but only approve it or not. The appeals court approved the settlement without the judge's variations: it was reasonable for the trustee to avoid litigation whose outcome was uncertain. His decision was "not unreasonable". *Stein v. Blake*, [1996] A.C. 243 (Eng. C.A., Hoffman J.A.) at 260: "It is a matter of common occurrence for an individual to become insolvent while attempting to pursue a claim against someone else. In some cases, the bankruptcy will itself have been caused by the failure of the other party to meet his obligations. In many more cases, this will be the view of the bankrupt. It is not unusual in such circumstances for there to be a difference of opinion between the trustee and the bankrupt over whether a claim should be pursued. The trustee may have nothing in his hands with which to fund litigation. Even if he has, he must act in the interests of creditors generally and the creditors will often prefer to receive an immediate distribution rather than see the bankrupt's assets ventured on the costs of litigation which may or may not yield a larger distribution at some future date. The bankrupt, with nothing more to lose, tends to take a more sanguine view of the prospects of success. In such a case the trustee may decide, as in this case, that the practical course in the interests of all concerned (apart from the defendant) is to assign the claim to the bankrupt and let him pursue it for himself, on terms that he accounts to the trustee for some proportion of the proceeds." *Beals, Re* (Unreported, February 17 1998, N.Z. High Court, Gendall J., Palmerston North #B121/95), discussed in Anthony Johnson, *The Official Assignee and Matrimonial Property*, [1999] N.Z.L.J. 82: The bankrupt husband's trustee settled the wife's matrimonial claims against the husband's wishes. No matrimonial litigation had been commenced. The Trustee and the wife agreed on the division of exempt chattels, the wife retained the minimal exempt proceeds of the family home. There was no prospect of any dividends to creditors, the trustee received nothing from the agreement but released the husband's claims to the chattels. The husband applied to court to review the trustee's decision. The trustee's purpose was to avoid litigation in family court. Held: the trustee's conduct was not unreasonable. The husband would not have

(b) Issue: *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.[61] However, it appears from the existing jurisprudence 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 almost certainly withstand attack.[62]

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benefitted had the trustee taken proceedings, nor if the agreement were set aside. The only effect would be a futile dispute in family court between husband and wife over a few exempt chattels, where the husband would be liable for costs. Since the result was reasonable, the agreement was upheld. The agreement precluded the husband's claim for division of exempt chattels.

[61] *Royal Bank of Canada v. Victor* (1986), 7 B.C.L.R. (2d) 151 (S.C.): fraudulent conveyance overturned. Company was indebted to bank, husband and son liable on guarantees. After bank demand, they transferred 4 properties to the wife, allegedly pursuant to a separation agreement re division of assets, as she had apparently decided to divorce. But 3 of the 4 properties belonged to the company, not the husband; the 4th belonged to the son. The agreement was a sham, the wife had colluded. Some of her assets were left out of the agreement - an omission showing the lack of bona fides. Assets she got were over-valued, her own assets were undervalued. The lack of bona fides must have been intended to defeat the bank, otherwise merely camouflage.

[62] Consider *Dion v. Dion* (2005), 23 R.F.L. (6th) 156, 25 C.P.C. (6th) 144 (B.C.S.C., Russell J., December 23 2005): The husband had guaranteed loans to his company. During the period in which the spouses' matrimonial proceedings were being tried, the lender obtained default judgment against him for 7 million dollars. While the matrimonial decision was under reserve after four days of trial, the spouses settled and sought a consent order incorporating their comprehensive settlement, under which the wife would retain almost all of the two significant parcels of real estate that were owned by her company. The settlement also resolved the issues of support, custody and access. At this point in the proceedings, the judgment creditor sought to be added, on the basis that the husband held a half interest in the parcels (that were allegedly family assets) and the creditor's judgment took priority over his half (a s. 57 declaration had been granted before trial). The creditor had obtained a charging order against the husband's interest in those parcels. The Court acknowledged that the judgment creditor shared a common issue with respect to the proceedings, namely the division of assets, and that if the consent order were granted, it would have difficulty enforcing its judgment against the husband. However, it would not be just and convenient to add the judgment creditor - for the purpose of determining the nature and priority of its interest - because (a) the late stage of the proceedings; (b) the result would be to 'hijack' the proceedings and complicate them; and (c) the cost of the matrimonial proceeding would increase and they would be delayed. The Court expressed reluctance in joining a judgment creditor to bona fide matrimonial proceedings, and observed that the terms of the proposed consent order were a bona fide attempt to resolve issues resulting from their marital dispute. ¶33 ".. [I]n bona fide matrimonial proceedings, the interest of the spouses in the equitable resolution of the issues arising from the breakdown of their marriage is paramount." The creditor can assert its interest, and alleged priority, in other proceedings; it is inappropriate to do so in this proceeding.

There are important policy issues at play that simply do not arise in respect of property transfers between cohabiting spouses. For example, the *Divorce Act* requires in many different respects that counsel and the court steer the spouses toward negotiated resolution of their conflict. The Supreme Court of Canada has emphasized that this section clearly indicates Parliament's intention to promote negotiated settlements of all matters corollary to a divorce.[63] The practice of "collaborative family law" is now in vogue across the country. Every family court has devoted massive resources to induce consensual resolution of these cases, which 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.

These cases are usually brokered by matrimonial lawyers who are paid, trained and educated to negotiate settlements. 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.

Separation agreements cannot be set aside antiseptically. While commercial contracts, if they are voided, normally result merely in a money transfer, matrimonial settlements can be set aside only at the cost of plunging a family back into crisis, even

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

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 settlement is overturned.

For all of these reasons, it appears that the threshold is extraordinarily high to overturn a final matrimonial resolution, even one that incorporates suspicious or aggressive property transfers. Where a release of support, and particularly child support, is put forward as consideration, courts are very accepting. When the separation agreement is negotiated at arms length by matrimonial lawyers, and duly approved by a matrimonial court judge, it is very difficult to challenge.

I have set out in the note below some examples of 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.[64]

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[64] *MGM Grand Hotel Inc. v. Liu*, [1997] B.C.J. No. 2528, 75 A.C.W.S. (3d) 284 (B.C.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. *Rakus, Re* (1991), 3 C.B.R. (3d) 25 (Ont. Gen. Div.): The husband transferred his half interest in the matrimonial home to his wife some four months before his assignment in bankruptcy. The transfer was incorporated into Minutes of Settlement in the family law proceedings which had been outstanding for several years. The transfer was stated to represent, in part, an $80,000 lump sum payment on account of future child support at the rate of $1,000 per month. The wife was fully aware of his financial difficulties, since the agreement contained a clause permitting either spouse to withdraw from the agreement if a bankruptcy lawyer advised that it was too risky. The trustee did not attack the transfer directly, but raised the issue at the husband's discharge hearing as grounds for imposing harsh conditions of discharge. Austin J. accepted that, in effecting the transfer, the husband had been acting

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

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in good faith on the advice of his solicitor and, in essence, held that the transaction was bona fide. *Bank of Montreal v. Ngo and Wong* (1985), 56 C.B.R. (N.S.) 66, 66 B.C.L.R. 171 (S.C.), where the court upheld a conveyance from a common law husband to the wife of his half interest in the home in satisfaction of his indebtedness to her. Part of the debt consisted of his obligation to reimburse her for half the cost of supporting the two of them for 21 months. *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 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 which 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. *Cf. Fleury, Re* (2005), 16 C.B.R. (5th) 38 (B.C. Registrar Baker): CCRA opposes 66 year old husband's discharge where he took $1.8 million from sale of his company's sole asset and sent the money to Mexico without paying the $900,000 tax debt thereby generated. He married his Mexican wife 4 years before, but only obtained permanent status there in the year of the sale. He gave his wife power of attorney and says that she deviously transferred all the money to her accounts. They later separated and she divorced him. He says that the divorce order left all his Mexican assets with her; but the order did not mention assets other than noting that they had contracted under a joint ownership of property regime. A form of separation agreement left all the assets with her. But he was lying about his lack of any bank account in his name. His ongoing "cordial" relationship with his ex-wife did not reconcile with her apparently absolute refusal to assist him in his ongoing bankruptcy problems. Discharge refused.

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 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.

***(d) Issue**: What is the impact of the new BIA amendments (effective for bankruptcies commenced after September 14, 2009)?* The first problem pertains to attacks against separation agreements. Under the new provisions, *married* spouses, even those who have separated, are rebuttably deemed to be non-arm's length for the purposes of preferences and undervalued transactions. This deeming will not, however, apply to *common law* partners who have separated, since they do not remain common law partners once they have separated. Separation agreements between common law partners will therefore be treated more favourably than those between married spouses,[65]

[65] No rational justification exists for this arbitrary discrimination. There is no rational reason for utilizing the date of divorce as the dividing line between arm's length and non-arm's length transactions. Separating spouses, whether they are married or common law partners, should be treated the same under

particularly in view of the renewed importance given to such presumptions by the Supreme Court of Canada in *Pecore v. Pecore,*[66] and the fact that a "deeming" would appear to carry a more weight than a mere presumption. I anticipate a successful Charter challenge against the new provisions in this respect.[67]

Further, the use of "arm's length" as the differentiating factor between the two sets of rules -- arm's length vs. non-arm's length -- is not suitable for separated spouses. Even spouses who despise one another and have separate lawyers, may nonetheless agree to keep the family's money within the family, at the expense of creditors. In other words, they may be at arm's length in some respects, and not in other respects. It is the content of the agreement, the good faith of the spouses and all of the circumstances that should govern the propriety of their separation agreement, not an arm's length test that obscures the subtle and multifarious nature of the spousal relationship. In other words, the criteria that will be applied to separation agreements, will be even more arbitrary than at present, and will not serve adequately as a standard to differentiate between proper agreements and collusive ones.

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these provisions.

[66] *Pecore v. Pecore* (2007), 279 D.L.R. (4th) 513, 32 E.T.R. (3d) 1, 37 R.F.L. (6th) 237, 361 N.R. 1 (S.C.C., May 3 2007): The trial judge should commence his or her inquiry with the applicable presumption and weigh all of the evidence in an attempt to ascertain, on a balance of probabilities, the transferor's actual intention. The presumption will determine the result unless there is sufficient evidence to rebut it on a balance of probabilities. The court explicitly rejected the concept that in some cases, only slight evidence will be required to rebut the presumptions. (¶42-44)

[67] The controlling precedent is *Hodge v. Canada (Minister of Human Resources Development)*, [2004] 3 S.C.R. 357, 244 D.L.R. (4th) 257 (S.C.C., October 28 2004), which superficially seems to endorse treating separated common law spouses differently than married spouses. But when that case is closely examined, it in fact supports the argument that the harsher treatment of married spouses in the BIA contravenes the Charter.

The undervalued transactions remedy will make these transfers vulnerable despite the good faith and lack of knowledge, by the recipient of property, of the possible insolvency of the transferor. Hence it will be essential to determine, perhaps long after the fact, whether the parties were or were not at arm's length. This imposes a significant risk on separated spouses who have decided to be reasonable with one another for the sake of the children, or to avoid incurring substantial legal fees. Hostile and warring spouses are much more likely to be adjudged as acting at arm's length.

Let us consider the impact of this provision on the practice of 'collaborative family law', which has developed in response to the overwhelmingly expensive and destructive effects of matrimonial litigation. The new provision will risk overturning negotiated family property resolutions despite a clear policy trend toward encouraging mediated resolution of family disputes. The proposed standard of review, fair market value of the consideration, is often highly subjective in family law cases, and does not assist in determining whether an agreement ought to pass muster. For example, what is the fair market value of a release of support claims? The new provision imposes the burden on the recipient spouse to establish this value. This represents a significant departure from existing case law -- which largely ignores arithmetical calculations of consideration -- but without any articulated purpose. In my view, the absence of any reference to the recipient's knowledge, intent, or good faith, is a deep flaw in the new test. Separation agreements, as in the case of s.160 of the *Income Tax Act*, should be excluded from the new BIA s. 96. A fraudulent conveyance test, or a test devised specifically for

separation agreements or court orders, is necessary to do justice and carry out the underlying policy goals.

The new preference provision is even worse. The arm's length test mirrors the existing BIA provision.[68] But the non-arm's length provision is highly problematic. It provides that a payment or property transfer between non-arm's length parties is *void* if the transferor declares bankruptcy or files a proposal within *one year* of the transaction, and the transaction has the *effect* of giving that creditor a preference over other creditors. Good faith and honesty will not matter under this test, nor will it matter whether the debtor was insolvent at the time the transaction occurred. The statutory test is remarkable in the way it detaches the preference remedy from any underlying morality. There is no contemplation of, much less a focus on, culpable intent. Nor is there any role for judicial discretion in differentiating between correct and collusive behaviour. All are struck down if they have a preferential effect. That effect will occur if the wife, say, receives satisfaction of her debt claim against the husband, while his other creditors' claims are not satisfied.

In my view, the new provision unacceptably detaches statute law from underlying public policy. We want people to act morally or ethically in our society. One of the ways

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[68] **Arm's length** transactions: The court may give judgment for the difference if:
(i) the transaction was within one year before bankruptcy, **and**
(ii) the debtor was insolvent or rendered insolvent, **and**
(iii) the debtor intended to defeat the interests of creditors.

we encourage this is by ensuring that our laws reflect and embody this underlying morality. However, good faith and honesty will not matter under the non-arm's length provision, nor will it matter if the debtor was solvent when the transaction occurred. If the parties are not at arm's length, it will be irrelevant whether the transferor/payor accurately discloses, or fraudulently conceals, his true financial situation. While economic and efficiency considerations may justify this approach in the corporate setting, it is inappropriate and ill-advised in the personal insolvency setting, where we want people to avoid making preferences because they are wrong.[69]

Indeed, one can even see, in the title of s. 95, the disappearance of the moral underpinning of the preference remedy. Formerly entitled "Fraudulent Preferences", the new title is merely "Preferences". A preference is no longer good, bad, unjust or fraudulent. It is set aside not because it is wrong or improper, but because it fails a rigid statutory test.

The preference remedy in s. 95 significantly exacerbates the problem identified above in relation to undervalued transactions and separation agreements. For non-arm's length parties — as married spouses are rebuttably deemed to be — any transaction that has the effect of giving a preference to the 'creditor' is void if the payor/transferor

[69] The new title of the remedy is bound to create significant confusion for those who are unfamiliar with bankruptcy law. The same word, 'preference', has now been designated for both the s. 95 remedy and the s. 136 list of preferences. Is a preferred creditor good - i.e. within the s. 136 list of policy-favoured creditors who get paid first before the general body of creditors, or bad - i.e. a creditor who has received a pre-bankruptcy preference? We no longer have a statutory adjective, 'fraudulent', that serves to differentiate the two.

subsequently declares bankruptcy within one year of the transaction. The "related creditor" test does not refer to any mental element: it is purely a matter of timing and effect, without reference to good faith, bona fides, or valuable consideration. This will have a significant impact on separation agreements, even those made under the spectre of an impending matrimonial trial. Any such agreement, and presumably even a consent or unopposed order, will be vulnerable if the opposing spouse declares bankruptcy within one year after the agreement. Neither good faith, nor legal advice, nor need, will be sufficient to defend the transaction. The impact of the new remedy will be to force matrimonial disputes to trial, and to undercut the crucial importance of finality in matrimonial litigation. Again, this effect conflicts with the clear judicial and legislative trend favouring consensual or mediated resolution of matrimonial disputes. Likewise, because it will often be unknowable whether an opposing spouse may declare bankruptcy after an agreement is signed, the critically important element of certainty will only be achievable once one year has passed and no bankruptcy has occurred.

IV. CONCLUSION

I hope that this discussion of the bankruptcy treatment of support has been useful. In my view, one of the keys to the successful resolution of these cases is to ensure that both the bankruptcy court, and the matrimonial court, are fully aware of the conflicting public policies underlying each are of the law. This is more easily accomplished in judicial

venues where judges of the superior court hear both family and bankruptcy cases in the course of their normal duties. In venues such as Toronto that have specialized divisions for family law and bankruptcy law, the gulf in understanding must be both identified and remedied by counsel. This can present a formidable litigation challenge. Fortunately the jurisprudence in the intersection of these two fields is becoming more sophisticated, with the result that the court can more easily be directed toward useful guidance. Would that it should.

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V. APPENDIX: LEGISLATIVE EXCERPTS

1. BANKRUPTCY AND INSOLVENCY ACT, R.S.C., Chapter B-3, as amended

{Effective for bankruptcies commenced after September 18, 2009}

Definitions ...

Definition of "related persons"

4. (2) For the purposes of this Act, persons are related to each other and are "related persons" if they are ...

(a) individuals connected by blood relationship, marriage, common-law partnership or adoption;

Relationships

(3) For the purposes of this section, ...

(e) persons are connected by blood relationship if one is the child or other descendant of the other or one is the brother or sister of the other;

(f) persons are connected by marriage if one is married to the other or to a person who is connected by blood relationship or adoption to the other;

(f.1) persons are connected by common-law partnership if one is in a common-law partnership with the other or with a person who is connected by blood relationship or adoption to the other; and

(g) persons are connected by adoption if one has been adopted, either legally or in fact, as the child of the other or as the child of a person who is connected by blood relationship, otherwise than as a brother or sister, to the other.

Question of fact

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

Presumptions

(5) Persons who are related to each other are deemed not to deal with each other at arm's length while so related. For the purpose of paragraph 95(1)(b) or 96(1)(b), the persons are, in the absence of evidence to the contrary, deemed not to deal with each other at arm's length.

Proceeding by creditor when trustee refuses to act

38. (1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other

creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.

Transfer to creditor

(2) On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.

Benefits belong to creditor

(3) Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.

Trustee may institute proceeding

(4) Where, before an order is made under subsection (1), the trustee, with the permission of the inspectors, signifies to the court his readiness to institute the proceeding for the benefit of the creditors, the order shall fix the time within which he shall do so, and in that case the benefit derived from the proceeding, if instituted within the time so fixed, belongs to the estate.

Stays of proceedings -- bankruptcies

69.3 (1) Subject to subsections (1.1) and (2) and sections 69.4 and 69.5, 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.

End of stay

(1.1) Subsection (1) ceases to apply in respect of a creditor on the day on which the trustee is discharged.

Court may declare that stays, etc., cease

69.4 A creditor who is affected by the operation of sections 69 to 69.31 or any other person affected by the operation of section 69.31 may apply to the court for a declaration that those sections no longer operate in respect of that creditor or person, and the court may make such a declaration, subject to any qualifications that the court considers proper, if it is satisfied

(a) that the creditor or person is likely to be materially prejudiced by the continued operation of those sections; or

(b) that it is equitable on other grounds to make such a declaration.

Non-application of certain provisions

69.41 (1) Sections 69 to 69.31 do not apply in respect of a claim referred to in subsection 121(4).

No remedy, etc.

(2) Notwithstanding subsection (1), no creditor with a claim referred to in subsection 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 section 68.

Precedence of receiving orders and assignments

70. (1) Every bankruptcy order and every assignment made under this Act takes precedence over all judicial or other attachments, garnishments, certificates having the effect of judgments, judgments, certificates of judgment, legal hypothecs of judgment creditors, executions or other process against the property of a bankrupt, except those that have been completely executed by payment to the creditor or the creditor's representative, and except the rights of a secured creditor.

Costs

(2) Despite subsection (1), one bill of costs of a barrister or solicitor or, in the Province of Quebec, an advocate, including the executing officer's fees and land registration fees, shall be payable to the creditor who has first attached by way of garnishment or filed with the executing officer an attachment, execution or other process against the property of the bankrupt.

Vesting of property in trustee

71. On a bankruptcy 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 their property, which shall, subject to this Act and to the rights of secured creditors, immediately pass to and vest in the trustee named in the bankruptcy order or assignment, and in any case of change of trustee the property shall pass from trustee to trustee without any assignment or transfer.

Preferences

95. (1) A transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person

(a) in favour of a creditor who is dealing at arm's length with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor is void as against — or, in Quebec, may not be set up against — the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy; and

(b) in favour of a creditor who is not dealing at arm's length with the insolvent person, or a person in trust for that creditor, that has the effect of giving that creditor a preference over another creditor is void as against — or, in Quebec, may not be set up against — the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is 12 months before the date of the initial bankruptcy event and ending on the date of the bankruptcy.

Preference presumed

(2) If the transfer, charge, payment, obligation or judicial proceeding referred to in paragraph (1)(a) has the effect of giving the creditor a preference, it is, in the absence of evidence to the contrary, presumed to have been made, incurred, taken or suffered with a view to giving the creditor the preference — even if it was made, incurred, taken or suffered, as the case may be, under pressure — and evidence of pressure is not admissible to support the transaction.

Transfer at undervalue

96. (1) On application by the trustee, a court may declare that a transfer at undervalue is void as against, or, in Quebec, may not be set up against, the trustee — or order that a party to the transfer or any other person who is privy to the transfer, or all of those persons, pay to the estate the difference between the value of the consideration received by the debtor and the value of the consideration given by the debtor — if

(a) the party was dealing at arm's length with the debtor and

(i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and that ends on the date of the bankruptcy,

(ii) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, and

(iii) the debtor intended to defraud, defeat or delay a creditor; or

(b) the party was not dealing at arm's length with the debtor and

(i) the transfer occurred during the period that begins on the day that is one year before the date of the initial bankruptcy event and ends on the date of the bankruptcy, or

(ii) the transfer occurred during the period that begins on the day that is five years before the date of the initial bankruptcy event and ends on the day before the day on which the period referred to in subparagraph (i) begins and

(A) the debtor was insolvent at the time of the transfer or was rendered insolvent by it, or

(B) the debtor intended to defraud, defeat or delay a creditor.

Establishing values

(2) In making the application referred to in this section, the trustee shall state what, in the trustee's opinion, was the fair market value of the property or services and what, in the trustee's opinion, was the value of the actual consideration given or received by the debtor, and the values on which the court makes any finding under this section are, in the absence of evidence to the contrary, the values stated by the trustee.

Meaning of "person who is privy"

(3) In this section, a "person who is privy" means a person who is not dealing at arm's length with a party to a transfer and, by reason of the transfer, directly or indirectly, receives a benefit or causes a benefit to be received by another person.

Family support claims

121. (4) 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 under this Act.

Priority of claims

136. (1) 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) in the case of a deceased bankrupt, the reasonable funeral and testamentary expenses incurred by the legal representative or, in the Province of Quebec, the successors or heirs of the deceased bankrupt;

(b) the costs of administration, in the following order, ...

(ii) the expenses and fees of the trustee, and (iii) legal costs;

(c) the levy payable under section 147;

(d) - (d.02) [arrears of wage]

(d.1) claims in respect of debts or liabilities referred to in paragraph 178(1)(b) or (c), if provable by virtue of subsection 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; ...

Payment as funds available

(2) Subject to the retention of such sums as may be necessary for the costs of administration or otherwise, payment in accordance with subsection (1) shall be made as soon as funds are available for the purpose.

Balance of claim

(3) A creditor whose rights are restricted by this section is entitled to rank as an unsecured creditor for any balance of claim due him.

Postponement of claims from reviewable transactions

137. (1) A creditor who, at any time before the bankruptcy of a debtor, entered into a transaction with the debtor and who was not at arm's length with the debtor at that time is not entitled to claim a dividend in respect of a claim arising out of that transaction until all claims of the other creditors have been satisfied, unless the transaction was in the opinion of the trustee or of the court a proper transaction.

Debts not released by order of discharge

178. (1) An order of discharge does not release the bankrupt from

...

(b) any debt or liability for alimony or alimentary pension;

(c) any debt or liability arising under a judicial decision establishing affiliation or respecting support or maintenance, or under an agreement for maintenance and support of a spouse, former spouse, former common-law partner or child living apart from the bankrupt;

...

Claims released

(2) Subject to subsection (1), an order of discharge releases the bankrupt from all claims provable in bankruptcy.

2. PROVINCIAL LEGISLATION

A. ONTARIO FRAUDULENT CONVEYANCES ACT

Definitions

1. In this Act, …

"conveyance" includes gift, grant, alienation, bargain, charge, encumbrance, limitation of use or uses of, in, to or out of real property or personal property by writing or otherwise;…

Where conveyances void as against creditors

2. Every conveyance of real property or personal property and every bond, suit, judgment and execution heretofore or hereafter made with intent to defeat, hinder, delay or defraud creditors or others of their just and lawful actions, suits, debts, accounts, damages, penalties or forfeitures are void as against such persons and their assigns.

Where s. 2 does not apply

3. Section 2 does not apply to an estate or interest in real property or personal property conveyed upon good consideration and in good faith to a person not having at the time of the conveyance to the person notice or knowledge of the intent set forth in that section.

Where s. 2 applies

4. Section 2 applies to every conveyance executed with the intent set forth in that section despite the fact that it was executed upon a valuable consideration and with the intention, as between the parties to it, of actually transferring to and for the benefit of the transferee the interest expressed to be thereby transferred, unless it is protected under section 3 by reason of good faith and want of notice or knowledge on the part of the purchaser.

B. ONTARIO ASSIGNMENTS AND PREFERENCES ACT

...

Nullity of certain confessions of judgment, etc.

3. Every confession of judgment, cognovit actionem or warrant of attorney to confess judgment given by a person, being at the time in insolvent circumstances or unable to pay his, her or its debts in full or knowing himself, herself or itself to be on the eve of insolvency, voluntarily or by collusion with a creditor with intent thereby to defeat, hinder, delay or prejudice creditors wholly or in part, or to give one or more creditors a preference over other creditors or over any one or more of them, is void as against the creditors of the person giving the same and is ineffectual to support any judgment or execution.

Nullity of gifts, transfers, etc., made with intent to defeat or prejudice creditors

4. (1) Subject to section 5, every gift, conveyance, assignment or transfer, delivery over or payment of goods, chattels or effects, or of bills, bonds, notes or securities, or of shares, dividends, premiums or bonus in any bank, company or corporation, or of any other property, real or personal, made by a person when insolvent or unable to pay the person's debts in full or when the person knows that he, she or it is on the eve of insolvency, with intent to defeat, hinder, delay or prejudice creditors, or any one or more of them, is void as against the creditor or creditors injured, delayed or prejudiced.

Unjust preferences

(2) Subject to section 5, every such gift, conveyance, assignment or transfer, delivery over or payment made by a person being at the time in insolvent circumstances, or unable to pay his, her or its debts in full, or knowing himself, herself or itself to be on the eve of insolvency, to or for a creditor with the intent to give such creditor an unjust preference over other creditors or over any one or more of them is void as against the creditor or creditors injured, delayed, prejudiced or postponed.

When there is presumption of intention if transaction has effect of unjust preference

(3) Subject to section 5, if such a transaction with or for a creditor has the effect of giving that creditor a preference over the other creditors of the debtor or over any one or more of them, it shall, in and with respect to any action or proceeding that, within sixty days thereafter, is brought, had or taken to impeach or set aside such transaction, be presumed, in the absence of evidence to the contrary, to have been made with the intent mentioned in subsection (2), and to be an unjust preference within the meaning of this Act whether it be made voluntarily or under pressure.

Good faith sales, etc., protected

5. (1) Nothing in section 4 applies to ... any sale or payment made in good faith in the ordinary course of trade or calling to an innocent purchaser or person, nor to any payment of money to a creditor, nor to any conveyance, assignment, transfer or delivery over of any goods or property of any kind, that is made in good faith in consideration of a present actual payment in money, or by way of security for a present actual advance of money, or that is made in consideration of a present actual sale or delivery of goods or other property where the money paid or the goods or other property sold or delivered bear a fair and reasonable relative value to the consideration therefor.

C. ONTARIO EXECUTIONS ACT

Exemptions

2. The following chattels are exempt from seizure under any writ issued out of any court:

1. Necessary and ordinary wearing apparel of the debtor and his or her family not exceeding the prescribed amount [$5,650] ...

2. The household furniture, utensils, equipment, food and fuel that are contained in and form part of the permanent home of the debtor not exceeding the prescribed amount [$11,300] ...

3. In the case of a debtor other than a person engaged solely in the tillage of the soil or farming, tools and instruments and other chattels ordinarily used by the debtor in the debtor's business, profession or calling not exceeding the prescribed amount [$11,300] ...

4. In the case of a person engaged solely in the tillage of the soil or farming, the livestock, fowl, bees, books, tools and implements and other chattels ordinarily used by the debtor in the debtor's business or calling not exceeding the prescribed amount [$28,300] ...

5. In the case of a person engaged solely in the tillage of the soil or farming, sufficient seed to seed all the person's land under cultivation, not exceeding 100 acres, as selected by the debtor, and fourteen bushels of potatoes, and, where seizure is made between the 1st day of October and the 30th day of April, such food and bedding as are necessary to

feed and bed the livestock and fowl that are exempt under this section until the 30th day of April next following.

6. A motor vehicle not exceeding the prescribed amount [$5,650] ...

Sale and refund of amount of exemption

3. (1) Where exemption is claimed for a chattel referred to in paragraph 3 of section 2 that has a sale value in excess of the amount referred to in that paragraph plus the costs of the sale, and other chattels are not available for seizure and sale, the chattel is subject to seizure and sale under a writ of execution and the amount referred to in that paragraph shall be paid to the debtor out of the proceeds of the sale.

Same

(2) The debtor may, in lieu of the chattels referred to in paragraph 4 of section 2, elect to receive the proceeds of the sale thereof up to the amount referred to in that paragraph, in which case the officer executing the writ shall pay the net proceeds of the sale if they do not exceed the amount referred to in that paragraph or, if they exceed that amount, shall pay that sum to the debtor in satisfaction of the debtor's right to exemption under that paragraph.

Same

(3) Where exemption is claimed for a motor vehicle that has a sale value in excess of the amount referred to in paragraph 6 of section 2 plus the costs of the sale, the motor vehicle is subject to seizure and sale under a writ of execution and the amount referred to in that paragraph shall be paid to the debtor out of the proceeds of the sale.

Money derived from sale of exempted goods

4. The sum to which a debtor is entitled under subsection 3 (1), (2) or (3) is exempt from attachment or seizure at the instance of a creditor.

Disposal of exempted goods after death of debtor

5. (1) After the death of the debtor, chattels exempt from seizure are exempt from the claims of creditors of the debtor.

Idem

(2) A surviving spouse is entitled to retain the chattels exempt from seizure for the benefit of the surviving spouse and the debtor's family.

Idem

(3) If there is no surviving spouse, the family of the debtor is entitled to the chattels exempt from seizure for its own benefit.

Right of selection

6. The debtor, the surviving spouse or the debtor's family, or, in the case of minors, their guardian, may select out of any larger number the chattels exempt from seizure.

Rules concerning exemptions

Articles for which debt contracted

7. (1) The exemptions prescribed in this Act do not apply to exempt any chattel from seizure to satisfy a debt contracted for the purchase of such chattel, except beds, bedding and bedsteads, including cradles in ordinary use by the debtor and his or her family and the necessary and ordinary wearing apparel of the debtor and his or her family.

Debt for maintenance

(2) The exemptions prescribed in this Act do not apply to exempt any article from seizure to satisfy a debt for maintenance of a spouse or former spouse or of a child, except tools, instruments and chattels ordinarily used by the debtor in the debtor's business, profession or calling.

Chattels purchased to defeat creditors

(3) The exemptions prescribed in this Act do not apply to chattels purchased for the purpose of defeating claims of creditors.

Regulations

35. (1) The Lieutenant Governor in Council may make regulations prescribing amounts for the purposes of paragraphs 1, 2, 3, 4 and 6 of section 2.

Five-year intervals

(2) Regulations under subsection (1) may be made once in the year 2005 and once in each year thereafter that is divisible by five.

D. ONTARIO CREDITORS' RELIEF ACT

Support Orders

Priority over other judgment debts

4. (1) A support or maintenance order has priority over other judgment debts regardless of when an enforcement process is issued or served,

(a) if the order is for periodic payments, in the amount of the arrears owing under the order at the time of seizure or attachment;

(b) if the order is for a lump sum payment, in the amount of the lump sum.

Support orders rank equally

(2) Support or maintenance orders rank equally with one another.

Enforcement process

(3) Process for the enforcement of a support or maintenance order shall be identified on its face as being for support or maintenance.

Crown bound

(4) Subsection (1) binds the Crown in right of Ontario.
