

# DEBTORS AND CREDITORS SHARING THE BURDEN:

## A Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*

Report of the Standing Senate  
Committee on Banking, Trade and Commerce

November 2003

*[Excerpt]*

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### **Chapter Four: Consumer Insolvency Issues**

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#### **R. Bankruptcy and Family Law**

In 1997, the BIA was amended to provide for the provability and limited priority for child and spousal support arrears, thereby resulting - in some cases - in the payment of a dividend to the claimant spouse for the arrears where no payment had before existed in the event of the non-claimant spouse's bankruptcy. Unpaid remaining claims for support arrears, however, survive discharge from bankruptcy. The Office of the Superintendent of Bankruptcy receives a 5% levy on these dividends, as it does in all cases where dividends are paid by trustees to creditors. A Court decision has confirmed that the claimant spouse cannot recover the amount of the levy.

Recognizing the "special vulnerability of support claimants" and "public policy favouring the collection and payment of spousal and especially child support," Mr. Robert Klotz, of Klotz Associates, recommended that the BIA be amended to ensure that bankruptcy does not prevent support claimants from recovering the total amount of their support arrears from the bankrupt spouse. In his view, the burden of the levy should be borne by the individual paying support, rather than by the recipient of the support payments; otherwise, the support claimant "would suffer from the bankrupt's choice to declare bankruptcy." He believed that this provision should apply with respect to all Section 178 creditors, but particularly those with claims for support arrears.

In theory, the bankrupt should make surplus income payments to his or her trustee, for disbursement to creditors, only if there are sufficient moneys available after meeting the reasonable financial needs of his or her family; for a separated family, this should include support obligations.

Under Section 68 of the Act, the trustee and the Court are required to have regard to the personal and family situation of the bankrupt, and the Superintendent of Bankruptcy's surplus income standards require that the trustee permit the bankrupt to deduct both child and spousal support payments in the calculation of surplus income. Section 69.41(2)(b) of the Act, however, provides that the enforcement of support claims is stayed against "amounts that are payable to the estate of the bankrupt under s. 68." In some cases, this provision has been interpreted as allowing the trustee to enforce this obligation in priority over the support claimant's wage garnishment once a surplus payment agreement has been made.

Mr. Klotz informed the Committee that, because of the interaction among Section 68 and Section 69.41 of the BIA and the Superintendent's surplus income standards, difficulty is being created for spouses who attempt to collect support from the wages of a bankrupt spouse when that spouse has entered into a surplus income agreement with his or her trustee. To correct the ambiguity that has been created, he recommended that the BIA be amended to clarify that only Court orders made under Section 68 of the Act have priority over the enforcement of spousal and child support against the bankrupt's income during bankruptcy. He believed that agreements made between the bankrupt and the trustee should not have priority over support obligations.

A third issue to be considered with respect to family law and insolvency is the extent to which bankruptcy may be used to frustrate division of the bankrupt's pension and such other exempt assets as life insurance Registered Retirement Savings Plans (RRSPs).

The Committee was told by Mr. Klotz that "[t]here is no policy reason for permitting bankruptcy, which does not distribute [pension and life insurance RRSPs] among creditors, to frustrate the principles of matrimonial property division against these assets. [Allowing this to occur] would amount to rehabilitating the bankrupt at the expense of his or her spouse."

In Mr. Klotz's view, an amended is needed to the BIA in order to provide that bankruptcy does not stay or release any claim for equalization or division against exempt assets under provincial/territorial legislation in the areas of equalization and/or division of matrimonial property.

In some provinces/territories and in certain circumstances, the trustee acquires the right of the bankrupt to sue the non-bankrupt spouse for matrimonial property division or equalization. This right is treated as an asset that vest with the trustee, although the matrimonial property claim is generally not a valuable right in the hands of the trustee.

Mr. Klotz believed that "one cannot reliably bring this kind of claim to fruition when it has been detached from the spouse for whose benefit the remedy was designed... [E]ven if the right to sue for equalization or division accrues to the trustee, the sad fact is that the trustee is rarely in a position to realize upon this asset in any meaningful way. It must usually be settled for a steep discount, or surrendered for nothing." Confidence in the system is thereby undermined, since: the bankrupt spouse is denied the opportunity to obtain matrimonial justice; the non-bankrupt spouse retains most of the bankrupt spouse's share of the family assets; the creditors receive very little; and the bankrupt spouse cannot trade his or her equalization claim for reduced spousal or child support. He supported an amendment to the BIA that would exclude, from the assets vesting in the trustee, the right to sue the bankrupt's spouse for equalization or division of property under provincial/territorial matrimonial property law.

A final issue to be considered is malicious or fraudulent dissipation or concealment of property. In some cases of marital discord, bankruptcy is used by a spouse as a means to ensure that the other spouse receives nothing when the marital assets are divided. Other means that might be used by the spouse include: deception; dissipation; concealment; destruction of property; phoney creditors; fraudulent transfers; and corporate machinations. A problem arises, however, in proving the allegation that the spouse acted in this way. While there are mechanisms for addressing this problem in cases of bankruptcy, opposition to the bankruptcy discharge hearing is useful only if the other creditors are limited.

The Committee was also told by Mr. Klotz that "[i]f we are to take seriously the injustice created by such conduct, we ought to provide a simple remedy to the victim, if we can that does not embroil him or her in a fresh round of litigation once bankruptcy ensues. At the same time, we must be concerned that this remedy is appropriately designed so as not to prejudice an honest but unfortunate debtor."

Mr. Klotz suggested to the Committee that the BIA be amended to exclude, from a discharge from bankruptcy, any provable claim for matrimonial property division that arises from the bankrupt's malicious or fraudulent dissipation or concealment of property. This exclusion should be limited to the amount of the dividend that the creditor would have received had the conduct not occurred. In particular, he believed that Section 178 of the BIA should be amended to add, to the debts that survive bankruptcy, a debt for equalization or division of property under provincial/territorial matrimonial property law, to the extent that the debt arises from malicious or fraudulent dissipation or concealment of property by the bankrupt.

The Committee endorses the recommendations and reasoning provided by Mr. Klotz. We are concerned about the manner in which a law - and interaction between laws - can have unintended consequences that negatively affect innocent individuals. The issues raised by him require prompt resolution. We must ensure that the devastating effects of marital breakdown and its aftermath are, to the extent possible, minimized - financially and otherwise - for all parties concerned, but

particularly for those who are blameless. We are concerned, as well, about the fact that the Crown may receive any moneys owed in priority to child support and alimony payments. Clearly, the changes that Mr. Klotz proposed support our fundamental principles of fairness and responsibility. From this perspective, the Committee recommends that:

**The *Bankruptcy and Insolvency Act* be amended to:**

- **ensure that bankruptcy does not prevent a claimant from recovering the total amount of support arrears from a bankrupt spouse;**
- **clarify that only Court orders made under Section 68 of the Act have priority over enforcement of spousal and child support against the bankrupt's income during the period of bankruptcy;**
- **provide that bankruptcy does not stay or release any claim for equalization or division against exempt assets under provincial/territorial legislation regarding equalization and/or the division of marital property;**
- **exclude, from assets vesting in the trustee, the right to sue the bankrupt's spouse for equalization or division of property under provincial/territorial matrimonial property law; and**
- **add, to the debts that survive bankruptcy, a debt for equalization or division of property under provincial/territorial matrimonial property law, to the extent that the debt arises from malicious or fraudulent dissipation or concealment of property by the bankrupt.**