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# AN INTERNATIONAL LOOK AT BANKRUPTCY AND FAMILY LAW

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## 1. INTRODUCTION

Bankruptcy and family law collide in every modern legal culture in which they coexist. Bankruptcy law represents the economic world of commercial credit and dispassionate legal certainty, where, as the U.S. Supreme Court once said of bankruptcy matters, "it is more important that the law be settled than that it be settled right."[1] Family law governs the private sphere, of interest primarily only to the two spouses of the marriage, where fairness and equity predominate and legal certainty is one of the faintest arguments that can be raised. To stereotype the difference, bankruptcy is "male"; family law is "female". Until fairly recently, the two genders understood this difference; most bankruptcy lawyers were historically male, family lawyers tended to be female.

However these two subject areas also share many attributes. Both areas of law came into prominence in the 20th century, before which the idea of a bankruptcy discharge of consumer debt was as unlikely and unnatural as the notion that divorce could be granted without "fault" or that women could leave their husbands and still claim support from them. Both fields exist in an ethical landscape where the stigma, of both bankruptcy and divorce, was once powerful but is now significantly abated. Both fields address poverty and subsistence issues in the context of a "fresh start". Both fields

[1] *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406; 52 S.Ct. 443, 447 (1932)

impact upon the personal or private spheres of life, where court decisions and legal nuances affect the enjoyment of life and access to life's rewards. Finally, both bankruptcy and family law operate on individuals who, by virtue of marriage breakdown or their financial predicament, are in circumstances of extremely high stress.

There is also an increasing tendency for both of these events, bankruptcy and marriage breakdown, to occur together. It is easy to see why. The social developments of the past few decades, and the economic realities of our era, have brought about a change in the complexion of bankruptcy filings. Whereas in the early 1970's fewer than 13% of bankruptcy filings were done by women, this percentage swelled to 45% by 1994.[2] As one seminal U.S. study parenthetically notes, women have now achieved parity with men in their rate of bankruptcy filing.[3] Thus women form an increasing number of bankrupts. The same 1994 figures showed that 10.1% of bankrupts were divorced, compared to a 5.3% divorce rate in the general population; and a further 15.2% were separated.[4] One study noted that about 10% of bankrupts named marital breakdown as a significant cause of their bankruptcy, usually in combination with other factors;[5] another found that 17% of personal bankruptcies were triggered by marital strife.[6]

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[2] Iain Ramsay, *Individual Bankruptcy: Preliminary Findings of a Socio-Legal Analysis*, 37 Osgoode Hall L.J. 15 (1999)

[3] Teresa Sullivan, Elizabeth Warren & Jay Westbrook, *The Fragile Middle Class* (Yale University Press, 2000), Ch. 6, p. 181

[4] Another study found that 29% of Canadian bankrupts were "formerly married": Saul Schwartz and Leigh Anderson, *An Empirical Study of Canadians Seeking Personal Bankruptcy Protection* (Carlton University, 1998). See S. Driscoll, *Consumer Bankruptcy and Gender*, [1994] Georgetown L.J. 525 at pp. 530-532, who notes that over 26% of debtors in a 1993 Washington D.C. sample were divorced or separated, compared to 15.1% for the general population. The author also refers to another study of 1991 debtors in which 22% reported themselves divorced, compared to 8.1% in the general population. See also the author's interesting hypothesis that a different "ethic of care" among women might lead to more bankruptcy proposals and post-bankruptcy debt reaffirmations.

[5] Ramsay, *supra*, note 2.

[6] *Why are Personal Bankruptcies Rising?*, Consumer Quarterly, October 1997, Vol. 2, No. 4 (Office of Consumer Affairs Canada). Another U.S. study determined that bankrupt debtors are much less likely to be remarried than other divorced people: *The Fragile Middle Class*, *supra*, note 3, p. 174. The authors note that in some sense remarriage is a safeguard against economic ruin, especially for women, and that debtors in bankruptcy are

Concomitant with the dramatic increase in the number of Canadian bankruptcy filings in recent decades, it is not insignificant that, as another study noted, the number of divorces in Canada rose more than 50% between 1975 and 1995.[7] As the social stigma of divorce has waned during this period, attitudes towards personal bankruptcy have likewise shifted. Both attitudes may reflect the weakening social stigma of promise-breaking generally.[8] 46% of respondents surveyed believe that bankruptcy is now more acceptable than it was ten years ago; a similar proportion viewed bankruptcy as being 'a financial decision like any other'.[9]

What accounts for the significant number of families who must face the double misfortune of both marital breakdown and the personal bankruptcy of a spouse? It seems that the seeds of financial ruin germinate in many matrimonial disputes. It is well known that ongoing financial stress is one of the major contributing factors toward marital breakdown. Separation of the spouses results in increased living expenses to finance a double-, rather than single-household family. Accumulated savings can be reduced through loss of employment income during the adjustment phase after separation and one-time costs such as moving, furnishing new premises and the like; not to mention the obligation to pay what may be an overwhelming equalization debt due to the fact of separation. A support recipient may be driven into bankruptcy through the inability to obtain a judicial support remedy in sufficient time or at a sustainable cost; failure to collect contractual or court-ordered support monies in time or at all; or the inability to quickly master the art of budget control on a reduced income. The enormous

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disproportionately those who "lose the remarriage sweepstakes". (p. 188)

[7] Saul Schwartz, *The Empirical Dimensions of Consumer Bankruptcy: Results from a Survey of Canadian Bankrupts*, 37 Osgoode Hall J.L. 83 (1999)

[8] F.H. Buckley and M.F. Brinig, *The Bankruptcy Puzzle*, 27 J. Legal Studies 187 (1998), at pp. 200-206, postulated that divorce rates might be positively correlated with bankruptcy rates in two ways. First, divorce and bankruptcy rates might both increase if the social stigma of promise-breaking is weakened across the board; second, higher divorce rates might directly affect bankruptcy rates because divorce results in financial distress. Their study showed significant correlation, consistent with the hypothesis that filing rates are higher when social sanctions for promise-breaking are weaker.

[9] *Why are Personal Bankruptcies Rising?*, *supra*, note 6

cost of matrimonial litigation alone can destroy a lifetime of savings. Finally there are the wild cards: malicious parties who wish to self-destruct in order to spite a former spouse; and those for whom the emotional and psychological aspects of separation trigger or accelerate a downward cycle of depression and financial collapse. As one judge commented,[10]

> "It was the not inconsiderable experience of the author of this opinion in his years on the trial bench that in domestic relations litigation more often than not he was dealing with a bankrupt family - a situation usually brought on because of our too easy credit culture. In most of these cases, the stresses resulting from the economic chaos in which the family existed was a factor in the separation. Thus rather than wrestling with a problem of dividing property, he usually found himself acting as an informal, inadequate and very frustrated referee in bankruptcy. Seldom was there a serious problem in the division of assets. The real crunch was in deciding just who was going to pay Seaboard Finance."

These comments apply to all western societies. In this paper, I will focus on four English-speaking countries who, roughly speaking, share similar social values and whose legal systems all derive from the English model. These countries are the United States,[11] the United Kingdom,[12] Australia and Canada.[13] Both the U.S. and the U.K. have enormously influenced Canadian law in both the family and bankruptcy fields. Australia mirrors Canada in size and political culture. All four have modern insolvency systems with an international outlook. The legal emancipation of women has had a significant impact in all four countries, as have the tides of feminist theory in family law, and social theory in bankruptcy law.

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[10] *Eastis, In re Marriage of*, 120 Cal. Rptr. 861, quoted in *Gardiner v. Gardiner* (1987), 54 Sask. R. 246 (Q.B.) at 253.

[11] The seminal U.S. text on this subject is, I believe, Sommer, McGarity & King, *Collier Family Law and the Bankruptcy Code* (Matthew Bender, 2004, supplemented).

[12] The leading U.K. text on this topic is Schofield & Middleton, Eds., *Debt and Insolvency on Family Breakdown* (2d Ed., 2003, Jordan Publishing, Bristol)

[13] See Robert Klotz, *Bankruptcy, Insolvency and Family Law* (2d Ed., 2001, supplemented, Carswell) ("*BIFL*")

In this paper I wish to examine the treatment in these different jurisdictions of some of the hot issues that arise in this confluence of subject areas. The approach that I take in this respect, in my own research and writing, is that in order to extrapolate Canadian law where there are few cases precisely on point, one should examine foreign precedents arising out of the same facts. Despite differences in legal nuance, the intellectual tools used by, say, an Australian judge grappling with a given problem, can inform the decision-making of a Canadian judge dealing with the same issues.

## 2. CONSTITUTIONAL STRUCTURE AND DUELLING COURTS

Except for the U.K., all of the states discussed in this paper are federal jurisdictions whose constitutions allocate the division of powers. In these states, bankruptcy falls within federal jurisdiction, and is adjudicated in a specialized bankruptcy court (Federal Court or, in Canada, Bankruptcy Court).

In the U.S., family law falls within states rights. The family courts are state courts. Matrimonial disputes are adjudicated in a different court system than bankruptcy cases, with different judges. The constitutional structure permits the Federal Court, exercising bankruptcy jurisdiction, to override or circumscribe the effect of state court orders. The Federal Court can, using its contempt powers under the bankruptcy stay, penalize matrimonial litigants who continue with matrimonial litigation in the face of a bankruptcy filing. In the judicial pecking order, the bankruptcy judge appears to be the big pecker, and the state court judge the little pecker.

The U.S. federal courts have historically been loathe to become involved in domestic relations matters of any kind. This reluctance has been characterized and invoked as the "domestic relations exception" to the federal court's acceptance of jurisdiction in cases otherwise properly brought before it.[14] However the bankruptcy

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[14] See Sommer, McGarity & King, *Collier Family Law and the Bankruptcy Code* (1993, Matthew Bender, New York) at §5.01[1][a]. *Wilson, In re*, 85 B.R. 722 (B.Ct., E.D. Pa. 1988): "It is appropriate for bankruptcy courts to avoid incursions into family law matters 'out of

courts normally choose to retain authority over 'core' issues such as the determination of whether property is property of the bankrupt estate,[15] and the power to distribute the property once a determination is made in family court.

This is very different in Australia, where an extensive jurisprudence has developed on how to determine which court (Federal Court vs. Family Court) should adjudicate a bankruptcy/family law dispute. Since family law also falls within federal jurisdiction in Australia, both courts are federal. This means that the same level of government can legislate over both fields. Australian legislation in this area is therefore perhaps more rational, and more amenable to responsive change, than those countries where family law falls within state or provincial jurisdiction. The Australia Family Law Council in its 1992 Report, *The Interaction of Bankruptcy and Family Law*,[16] recommended that where there are competing claims under the Bankruptcy and Family Law Acts, one court should determine those competing claims; the appropriate court should be the Family Court of Australia. The Australian Family Court has been fairly responsive to creditor concerns, especially in the last two decades where the jurisprudential principle has evolved that the Family Court must protect the interests of third parties by refraining from effecting or approving a property division which would prejudice the spouses' creditors.[17] Recent cases have tended to utilize Australian cross-vesting legislation[18] to consolidate

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consideration of court economy, judicial restraint, and deference to our state court brethren and their established expertise in such matters'" (p. 729). The bankruptcy court retained jurisdiction over the property in question for purposes of any distribution and implementation of the state court decree.

[15] *Duval County Ranch Co., In re*, 167 B.R. 848 (B.Ct., S.D. Tex. 1994): US Bankruptcy court refuses to remand to family court a proceeding re whether property was property of the estate. *Becker, In re*, 136 B.R. 113 (B.Ct., D.N.J. 1992): Bankruptcy court refuses to abstain because property division claim could not alter the estate's rights to debtor's property as of date of bankruptcy, and because the determination of the estate's interest involved bankruptcy law as well as family law. Court disinclined to abstain in similar cases because of past experience in which a family court had entered orders that had the effect of frustrating the administration of a bankruptcy case.

[16] AGPS, Canberra, June 1992, 7 Australia J.F.L. 3, §4.01 - §4.13.

[17] This Australian jurisprudence is reviewed in *BIFL*, Chapter 9.10(a).

[18] Australia Jurisdiction of Courts (Cross-Vesting) Act 1987.

overlapping bankruptcy and family law proceedings in Family Court for reasons of efficiency and economy of judicial administration.[19] The Family Court addresses all the issues, including what might be considered "core" issues such as priority. No conflict arises because the Family Court becomes vested with bankruptcy jurisdiction.

The Canadian position is much more complicated, in large part due to our constitutional structure. In Canada, divorce is federal while property division is provincial. The Canadian Bankruptcy Court, while holding an august name, is actually only an administrative branch of the Superior Court - the same Superior Court which hears family cases. The Family Court is another administrative branch. The judge who sits in Bankruptcy Court one day, may sit in Family Court the next.[20] This means that there is no judicial pecking order between the two courts: orders from each court hold the same weight, and must be accorded equivalent judicial respect. For example, if a spouse takes proceedings in Family Court which violate the automatic bankruptcy stay, it is up to the Family Court judge to enforce the stay. If that judge does not do so, and allows the case to continue, his or her decision cannot be challenged in Bankruptcy Court. There is no contempt power available under Canada's Bankruptcy and Insolvency Act ("BIA") to penalize this conduct. It is, to some extent, a free-for-all. This aids the spouses, of course, over the trustee in bankruptcy. Likewise, under current Canadian law a Bankruptcy Court is not permitted to set aside or subordinate, as a preference or fraudulent conveyance, a Family Court order — even one made on consent. The trustee's

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[19] *Sharpe, Re; ex p. Powell*, [1996] 896 F.C.A. 1 (Oct. 17 1996, Sydney, Lindgren J., Fed. Ct. of Australia): Husband bankrupt one month after $750,000 judgment for property settlement [i.e. Australian version of equalization]. Wife sought to annul bankruptcy and transfer to family court. Bankruptcy court transfers all proceedings to family court for reasons of efficiency and economy of judicial administration. *Maas, Re*, [1997] 625 FCA (July 17, 1997, Whitlam J., Sydney, Fed. Ct. of Australia): Cross-vesting order made to have bankruptcy and family proceedings in same action in family court where bankrupt's assets exceeded liabilities. Considerations of efficiency and economy of judicial administration; the advantage of having one court (or better still, one judge) control the use that may be made in one set of proceedings of information or documents that are required to be disclosed in another set of proceedings; substantial overlap with the issues in the Family Court proceedings, particularly in relation to the bankrupt's cash resources and liquidity when he declared bankruptcy.

[20] This is a simplification of the actual system, which varies among the provinces.

remedy is to return the matter to Family Court and ask that the order be set aside.[21] As noted in one recent Canadian case,[22]

> "I am aware that in some jurisdictions, particularly Australia, the courts have been open to allowing the High Court in bankruptcy matters to override Family Court decisions wherein the latter deal with transactions that, upon a Trustee's challenge, are found to be reviewable. This approach has not been widely followed in Canada and, with respect, I find that avoiding an otherwise unacceptable collateral attack on a court process to be the correct one .. It would be wrong on my part to presume that the court blindly rubber-stamped a decision of the parties and I decline to do so .. If sufficient grounds exist, the judgment may be reviewed by normal procedures such as an appeal, an action for setting aside based on fraud or by an application to the issuing court for variation."

As for the U.K., I have not seen any jurisprudence or academic commentary on the question of "which court". It is a non-issue.

## 3. SUPPORT

Until recently, the bankruptcy laws of each of the countries under study, excluded support, maintenance and alimony claims (collectively referred to as "support") from participation as a debt in the payor's bankruptcy.

In the U.S., this rule was based on public policy grounds.[23] In the three commonwealth countries, the rule was based on the now-antiquated view that support was not a real debt, since it was always within the court's discretion to vary and hence was never final.

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[21] *Bank of Montreal v. Coopers and Lybrand Inc. and Ostapowich* (1996), 40 C.B.R. (3d) 161 (Sask. C.A.)

[22] *Archibald, Re* (2003), 39 C.B.R. (4th) 18, 259 N.B.R. (2d) 256 (Registrar Bray) at ¶54-58

[23] In *Wetmore v. Markoe*, 196 U.S. 68, 25 S.Ct. 172 (1904), the U.S. Supreme Court held that the non-provability of support was based not on contingency of the debt, but on the public policy grounds favouring the obligations of familial support. The obligation arises "not because of any contractual obligation, but because of the policy of the law which imposes the obligation." (p. 74)

While the intent of this rule was to allow such claims to survive the bankruptcy discharge and to permit enforcement against the payor's income during bankruptcy, there was also an unfortunate collateral impact: support claimants did not share in any bankruptcy distribution, could not avail themselves of any bankruptcy remedies, and received no priority under bankruptcy law despite provincial or state rules granting such priority outside of bankruptcy.

This treatment has changed in recent years in all but the U.K. The U.S. Bankruptcy Code has, since 1978, included 'matured' support claims under a separation agreement or court order, as of the filing date, within the definition of provable claims.[24] Companion provisions permit enforcement of such claims to proceed, despite the automatic stay, against any property that is not property of the estate.[25] The Code also grants the support arrears a priority status in any distribution, in seventh position.[26] Under the proposed U.S. Bankruptcy Reform Act, this priority will rise to first position, ahead of the fees of the trustee; this is sure to create significant difficulties.

The problem was redressed in Australia in the 1980 amendments to its Bankruptcy Act. Support arrears under a pre-bankruptcy separation agreement or court order are now provable, limited to the arrears accruing in the one year period before bankruptcy, or any lump sum payable before bankruptcy.[27] There is no priority. The arrears survive the bankrupt's discharge except to the extent that the bankruptcy court orders the arrears released or reduced.

Canada was twenty years behind the U.S. and Australia. Its legislation, passed in 1997, provides that all pre-bankruptcy support arrears owing under a pre-bankruptcy order or separation agreement are provable; a limited portion of those arrears are

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[24] U.S. Bankruptcy Code, §502(5), §523(a)(5)

[25] U.S. Bankruptcy Code, §362(b)(2)

[26] U.S. Bankruptcy Code, §507(a)(7)

[27] Australia Bankruptcy Act, s. 82(1A). Section 58(5A) allows the support claimant to continue to enforce any remedy against the bankrupt, or against any property which had not vested in the trustee.

entitled to priority, in fifth position, in any distribution resulting from the bankruptcy; and the discharge does not extinguish any arrears, whether provable or not.[28] The Bankruptcy Court has no jurisdiction to reduce or extinguish the support arrears.

Another key development in Canada is the importation of a new public policy norm derived from feminist theory. In *Marzetti v. Marzetti*[29], a priority contest involving the husband's trustee in bankruptcy versus the wife's claim for support arrears, the Supreme Court of Canada declared that "there is no doubt" that divorce and its economic effects are playing a role in the *feminization of poverty*. "A statutory interpretation which might help defeat this role is to be preferred over one which does not." The support creditor is not to be treated as just another claimant, but is to receive the benefit of the doubt where statutory interpretation permits. Otherwise divorce will impoverish women more disproportionately than men. The social or moral value of mitigating such discriminatory consequences is such that, in certain circumstances, third party creditors should pay the social cost.

In the U.K., support arrears are not provable in the bankruptcy.[30] They obtain no priority. The arrears survive the bankrupt's discharge except to the extent that the bankruptcy court orders them released or reduced. There are no cases in which this jurisdiction has been exercised.

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[28] Canada BIA, ss. 121(4), 136(1)(d.1), 178(1)(b),(c). The priority amounts are identical to Australia: arrears accrued in the one year period before bankruptcy, plus any pre-bankruptcy lump sum support entitlement.

[29] *Marzetti v. Marzetti*, [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.)

[30] In autumn 2001 a sub-committee of the Insolvency Courts Users Committee proposed that lump sums, arrears of periodical payments and the costs of family proceedings all be provable in bankruptcy, and the bankrupt would not be released from such debts on discharge. At last report (May 2002), the proposals were said to be under "active consideration" by the Department of Trade and Industry. See Christopher Brougham, Q.C., *Personal Insolvency*, Ch. 18 of *Encyclopedia of Financial Provision in Family Matters*, S. Wildblood & D. Eaton, Eds., Sweet & Maxwell, London, 2003

To summarize this section, most of these jurisdictions are evolving toward provability and priority, to some degree, of support arrears. While this is arguably a benevolent approach, we can see the distortions this priority rule can cause in cases such as *Bottan v. Bottan*,[31] where the husband, on the verge of insolvency, held a half interest in the family home which was fully encumbered by a writ of execution against him in favour of his major creditor. Shortly before the husband's bankruptcy, the matrimonial court granted his wife a lump sum support order consisting of the following: 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; and $1,500 costs "all related to support". The effect of the order was to give the wife priority in the distribution of proceeds. The court was specifically advised about the execution, but did not require notice to be given to the major creditor. Under the support priority regime, the wife took all.

## 4. PROVABILITY AND EXIGIBILITY OF MATRIMONIAL PROPERTY CLAIMS

Every bankruptcy system defines which kinds of claims are caught by the bankruptcy. Such claims, in Canadian parlance, are "provable" claims: their nature and quality is such that they can be proven in the bankruptcy. A provable claim is normally stayed by the bankruptcy, and is extinguished by the discharge (or, in the case of reorganization, is replaced by the obligations spelled out in the plan of reorganization).

Each of our jurisdictions provides that upon marital breakdown, a separation agreement or court order may divide the spouses' property in a certain prescribed fashion, subject to various exceptions and deductions, and normally with a healthy dose of judicial discretion. This is variously known as equitable distribution, equalization, division of matrimonial property, or some similar term.

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[31] (Unreported, Ont. S.C.J. Newmarket No. 14284/02, Perkins J., December 10 2002). The author advised the wife's counsel.

Timing normally determines whether a claim for property division is caught by the bankruptcy. If the obligation has been reduced to judgment, or to a defined debt in a separation agreement, before the payor declares bankruptcy, each of our four jurisdictions treats the obligation as a provable debt that is caught, and extinguished, by the bankruptcy.[32] In effect, a claim for property division, once it has been *liquidated*, is treated as an ordinary debt for bankruptcy purposes.

What of an unliquidated claim? In other words, if the spouses separate, and the husband declares bankruptcy, is the wife's claim for property division a provable claim that is caught, and extinguished, by his bankruptcy? Is she merely a creditor?

There is a flip side to this question: Does the bankrupt husband's claim for property division constitute property of the estate such that his trustee can maintain his matrimonial action against the wife? In other words, is the right to sue for matrimonial property division, a property right that passes to the trustee?

Here is where our jurisdictions diverge, because the nature of the matrimonial remedy differs in a fundamental respect.

The matrimonial property remedy in Australia, the U.K. and, it appears, the U.S. states, is largely a discretionary one that is considered so closely tied to the individuality of the spouses that it cannot be quantified in the abstract. As such, if the claim has not been adjudicated before bankruptcy, it is normally not caught by the bankruptcy. Likewise, it is too discretionary to be considered a property right that accrues to the trustee.

However some Canadian provinces have moved in the direction of reducing the discretionary component of the matrimonial property remedy. Four Canadian provinces, Ontario, Quebec, Manitoba and Prince Edward Island, have adopted "equalization"

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[32] The question of discharge is, of course, subject to the characterization issues discussed below. If the property division award is in the nature of support, it survives discharge.

schemes which essentially transform the matrimonial property claim into a debt action, with defined rules and sharply curtailed discretion. Property must be divided according to the prescribed rules unless the result turns out to be "unconscionable". It does not matter if the result is unfair so long as it is not unconscionable. The intent of this change is to reduce litigation, to facilitate settlement, and to minimize the utilization of blame and fault as criteria for property distribution. However, in bankruptcy, there is a consequence that is startling.

The jurisprudence now recognizes the equalization claim as a kind of calculable debt. As such, it is now considered provable so long as the separation precedes the bankruptcy. The equalization claim is extinguished by discharge.

Likewise, if matrimonial property litigation is underway at the time of bankruptcy, our jurisprudence has declared that the trustee becomes the plaintiff who is entitled to litigate, and settle, the property claim.[33] Trustees are thus thrust into matrimonial court, a forum that they do not enjoy and which is often hostile to them. The trustee becomes an interested party in the miseries of the matrimonial dispute, since the matrimonial trial often involves such issues as custody, support and mobility issues. Although our courts have held that the matrimonial property claim is not personal to the spouses, trustees are usually not sympathetic litigants in these courts, and cannot generate a predictable return on the litigation. All of this suggests that this aspect of our law is flawed. Indeed, the Canadian Senate has recommended in its November 2003 *Review of the Bankruptcy and Insolvency Act* that the equalization claim ought never to vest in the trustee.

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[33] *Blowes v. Blowes* (1993), 49 R.F.L. (3d) 27, 21 C.B.R. (3d) 276, 16 O.R. (3d) 318 (C.A.); *Droit de la famille - 1809*, [1993] R.J.Q. 1522, [1993] R.D.F. 546 (C.S. Qué., Forget J.); *Sluis v. Roche* (1997), 124 Man. R. (2d) 191 (Q.B., Steel J.).

## 5. SUPPORT vs. PROPERTY

The spirit of bankruptcy legislation is to ensure that no debt or liability for support, alimony or maintenance is prejudiced by the bankruptcy. While rehabilitation of the debtor is a cornerstone of the public policy which informs bankruptcy law, there is no good policy reason why this should be at the expense of the economically dependent members of the family. As a result, claims for support receive a far more favourable treatment in bankruptcy than any other claims. Their enforcement is normally not stayed by the bankruptcy,[34] nor extinguished by the discharge; arrears are provable in the bankruptcy and they receive a degree of priority in the trustee's distribution; if the support recipient is bankrupt, the support entitlement does not normally constitute an asset of the estate. As a result, the characterization of a given debt as "support" has important ramifications.

Canadian and U.S. law are analogous on this issue, and both jurisdictions have been heavily influenced by feminist analysis of this point, which is extensive. Unlike many other arcane questions, this issue has a public profile.[35]

The Canadian BIA does not offer any guidance on how to determine whether a given debt is in the nature of support. This is often a difficult question. Matrimonial courts, and the parties themselves, often blur the distinction between support and property entitlements. Since courts adjust their support awards depending on the amount of

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[34] Although it may be caught, in the U.S., by a reorganization plan under Chapter 13.

[35] As the treatment of support claims has political and feminist aspects, danger lurks for the commentator who swims in these waters. One author of an insightful treatise referred to in this paper was unfairly excoriated in the U.S. Congress for addressing the issue: "We have previously heard complaints from some on the Senate floor about whether our bill does enough to protect child support and also to protect alimony during bankruptcy proceedings. I have already spoken to that topic on a previous occasion, but for now, I want to point out that some bankruptcy lawyers actually advertise that they can help deadbeat dads get out of their child support and other marital obligations. One bankruptcy lawyer has even written a book entitled, as you can see, `Discharging Marital Obligations in Bankruptcy ,' by James P. Caher, Esquire. ... I think it is outrageous, Mr. President, that bankruptcy lawyers are helping deadbeats to cheat to force spouses out of alimony and to cheat children out of child support." (Senator Grassley, September 21 1998, Congressional Record)

family assets available for division or equalization, property division often serves as an alternative to support. The matrimonial court judge, and the parties themselves, are usually more concerned with achieving an overall fair result than with precisely characterizing each obligation in the order or agreement as property or support. It is precisely the flexibility between the two remedies which allows the parties, or the court, to tailor the obligations with other factors in mind, such as business considerations or income tax consequences. The labels used in the order or agreement may also reflect mere drafting preferences, lack of forethought or, in some instances, covert pre-bankruptcy planning.[36]

Family law jurisprudence has in recent years departed from a strict conceptual distinction between the two "solitudes" of support and property division. These are now considered simply two tools to achieve an equitable distribution of family resources on marriage breakdown, which may be combined in flexible ways. A court engaged in the equalization or division of property can consider many of the same factors as would a divorce court in awarding support. The two notions are no longer distinct — they overlap. Matrimonial property law concepts have expanded to include support-related assets such as pensions and professional goodwill; and where these statutes provide for unequal division, they incorporate numerous factors traditionally associated with support. The fundamental rethinking of the nature and function of support now emphasizes the compensatory and restitutionary functions traditionally associated with division of property. As a result, some obligations have both support and property characteristics. An award of support no longer represents the only, or indeed the primary, means of alleviating financial need and achieving economic equality at the time of divorce or separation. This flexibility has a beneficial theoretical and practical effect in family law; but in bankruptcy it creates uncertainty and confusion. When bankruptcy occurs after a court or separation agreement has quantified or created a debt, profoundly different consequences follow depending on whether the debt is characterized as support or property division.

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[36] The payor spouse, perhaps with bankruptcy in mind, will be more inclined to emphasize the formal characterization of obligations as property division; the unsuspecting payee spouse will normally be more concerned with the substance of the agreement.

Where the debt is clearly denoted as support, and serves a support function, there is usually no ambiguity — the debt survives bankruptcy. Similarly, where the debt is explicitly described as an equalization payment or division of property, and it serves no support function, bankruptcy normally discharges it.[37] Sometimes however, the separation agreement or court order is ambiguous. In other cases the agreement may clearly provide for an property payment, but just as clearly the circumstances may show that the recipient requires that payment for support. How does the court determine whether a given debt is in the nature of support?

This issue has been heavily litigated and commentated in the U.S., where the Bankruptcy Code contains a definition of support that encompasses any obligation "in the nature of" support.[38] The American literature is extensive.[39]

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[37] James Caher, in his superb treatise, *Discharging Marital Obligations in Bankruptcy* (LRP Publications, 1997, Horsham Pennsylvania), puts this as follows: "A marital obligation is likely to be held to be a property division if *all* of the following are present: • The marital settlement agreement or divorce decree does not expressly identify the obligation as support. • The obligation does not relate to expenses of raising the parties' children. • The incomes of the parties at the time of the divorce were relatively equal, at least after taking into account other provisions of the agreement or decree. • The debtor spouse never treated the obligation as support in the past by, for example, deducting payments on his income tax return, or otherwise admitting that it represented support. If *any* one of these elements is missing, all bets are off."

[38] 11 U.S.C. §523(a)(5): A discharge ... does not discharge an individual debtor from any debt ... to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that ... (B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support.

[39] See Michaela White, *Strange Bedfellows: The Uneasy Alliance between Bankrupt and Family Law* (1987), 17 New Mex. L.R. 1; Judith Fitzgerald & Ramona Arena, *Wrestling with Bankruptcy and Divorce Laws in Property Division and Support Issues*, 6 Am. J. Fam. Law 109 (1992) at pp. 113-117; Sheryl Scheible, *Defining "Support" under Bankruptcy Law: Revitalization of the "Necessaries" Doctrine* (1988), 41 Vand. L.R. 1; Sheryl Scheible, *Bankruptcy and the Modification of Support: Fresh Start, Head Start, or False Start?* (1991), 69 North Carolina L.R. 577; Sommer, McGarity & King, *Collier Family Law and the Bankruptcy Code* (1999, Matthew Bender, New York), ¶6.04-.07; James Caher, *Discharging Marital Obligations in Bankruptcy* (LRP Publications, 1997, Horsham Pennsylvania); J. H. Gold, *The Dischargeability of Divorce Obligations Under the Bankruptcy Code: Five Faulty Premises in the Application of Section 523(a)(5)*, 39 Case W. Res. L. Rev. 455 (1988-89); Jana B.

The United States has experimented with statutory reform to mitigate the problems associated with the characterization issue. This reform largely stemmed from the all-to-frequent failure of the judiciary to appreciate that awards and agreements for property division, and particularly those providing for a debt indemnity, often performed a support function. The bankruptcy treatment of these obligations lagged behind the evolution of family law.[40] The cost and unpredictability of the characterization issue was also considered unacceptable. The substantial level of personal exemption legislation in many states, and the absence of surplus income payment obligations in bankruptcy, allowed many bankrupt debtors to retain significant wealth and income while defeating their ex-spouse's property entitlements. An impetus therefore developed to eliminate the characterization issue by rendering all matrimonial debt obligations non-dischargeable in bankruptcy, including those for property division or indemnity.[41]

The U.S. Bankruptcy Code was amended in 1994 to add s. 523(a)(15), which has the effect of making all divorce-related obligations subject to a presumption of

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Singer, *Divorce Obligations and Bankruptcy Discharge: Rethinking the Support/Property Distinction*, 30 Harv. J. on Legis. 43 (1993); P. Alexander, *Divorce and the Dischargeability of Debts: Focusing on Women as Creditors in Bankruptcy*, 43 Cath. U. L. Rev. 351 (1994); Brian Rothenberg, *The Dischargeability of Marital Obligations: Three Justifications for the Repeal of §523(a)15*, 13 Bkcy. Dvpts. Jo. 135 (1996) at pp. 154-59; Peter Alexander, *Building "A Doll's House": A Feminist Analysis of Marital Debt Dischargeability in Bankruptcy*, 48 Villanova L. Rev. 381 (2003)

[40] See Jana B. Singer, *Divorce Obligations and Bankruptcy Discharge: Rethinking the Support/Property Distinction*, 30 Harv. J. on Legis. 43 (1993): "[T]he Bankruptcy Code's purported distinction between nondischargeable marital support obligations and dischargeable property debts arguably represented an acceptable compromise as long as two critical assumptions held true. First, that obligations described as property divisions differed substantively from those described as support. Second, that awards of spousal support — rather than distributions of marital property — represented the primary means of alleviating financial need and achieving economic equity at the time of divorce. Recent developments in family law have vitiated both of these assumptions." (pp. 44-45)

[41] See, for example, Patricia Cullen, *Does Anybody Know the Rules in Federal Divorce Court?: A Case for Revision of Bankruptcy Code §523* (1993) Rutgers L.R. 427; Jana B. Singer, *Divorce Obligations and Bankruptcy Discharge: Rethinking the Support/Property Distinction*, 30 Harv. J. on Legis. 43 (1993)

nondischargeability. This provision exempts from the discharge any non-support debt arising out of a separation agreement or matrimonial court order, unless -

> (A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in a business, for the payments of expenditures necessary for the continuation, preservation, and operation of such business; or
> (B) discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor[.]

As a result of this amendment, matrimonial debt obligations under an order or agreement survive the bankruptcy in broader circumstances. To summarize, such a debt survives the bankruptcy if it satisfies either of the following:

- it can be characterized as support; or
- the payor has the current or future ability to pay it, and the hardship that non-payment would cause is equal to or outweighs the benefit to the payor of discharging the debt.

The new provision has received extraordinary criticism from the bench,[42] and has inspired considerable academic apprehension and comment.[43] Commentators have noted

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[42] See James Caher, *Discharging Marital Obligations in Bankruptcy* (LRP Publications, 1997, Horsham Pennsylvania), pp. vi-viii, compending the various judicial reactions to the new provision, including: "A 'pernicious creature' consisting of incomprehensible 'sausage' ... [A proceeding under this section is] "equivalent to applying acupuncture without a license because it does not heal the emotional wounds from a divorce. Indeed, s. (a)(15) is an intrusive invasion into the private lives of a former couple who had agreed in their divorce to separate forever. Section (a)(15) can be described as an impediment to the emotional fresh start in life that divorce may bring. It also can impede the fresh start of bankruptcy.": *Butler, In re*, 186 B.R. 371 (Bankr. D. Vt. 1995) at 372-73; "... a paving stone on the road to the region of Hades reserved for litigation nightmares.": *Smither, In re*, 194 B.R. 102 (Bankr. W.D. Ky., 1996) at 106; Draftsmanship so "disgraceful" that a court "ventures onto thin ice in arguing that Congress said what it meant and meant what it said in this clumsy statute ...": *Jodoin, In re*, 196 B.R. 845 (Bankr. E.D. Cal. 1996) at 853; "The problem with [s. 523(a)(15)] is that it requires bankruptcy courts to revisit, in excruciating detail, the anger, the bitterness and the pain which the Debtor and the Debtor's former spouse have felt and now feel ... One could almost see the old wounds being reopened and new and more expensive scars being inflicted upon both parties.": *Silvers, In re*, 187 B.R. 648 (Bankr. W.D. Mo. 1995).

[43] See Brian Rothenberg, *The Dischargeability of Marital Obligations: Three Justifications for the Repeal of §523(a)15*, 13 Bkcy. Dvpts. Jo. 135 (1996); Maloy, *Using Bankruptcy Court*

that the effect of the new provision has been to reduce, rather than enlarge, the recipient spouse's chances of exempting marital obligations from bankruptcy, since the courts are more likely than before to characterize an uncertain obligation as a property settlement subject to the new hardship analysis.[44] The provision has resulted in substantial additional matrimonial litigation in the bankruptcy courts.

## 6. DISCHARGE HEARING AS A REMEDY FOR THE MATRIMONIAL PROPERTY CLAIM

The bankruptcy discharge hearing offers a remedy in some jurisdictions to a spousal claimant. In Canada creditors, and particularly spousal creditors, have a real opportunity to recoup a portion of the discharged property debt by seeking judicially imposed conditions on a bankrupt who wishes to exit from bankruptcy. If the bankrupt spouse is not an "honest but unfortunate" debtor, in other words if there has been some misconduct or other sufficient reason, the bankruptcy court may, after a hearing, require the bankrupt to pay a certain portion of the debts over a number of years out of his or her post-bankruptcy income. The percentage of debt imposed, varies from zero to 100% depending on the facts. I have not seen similar jurisprudence in any of the other jurisdictions. Here are some examples.

The husband in *Re Matthews*[45] filed his assignment immediately after the wife obtained a judgment for equalization in the amount of $767,000. There were no other

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*to Modify Domestic Relations Decrees: Problems Created by 523(a)(15)*, 31 Fam. L.Q. 433 (1997); Johnson, *At the Intersection of Bankruptcy and Divorce: Property Division Debts under the Bankruptcy Reform Act*, 91 Columbia L. Rev. 91 (1997); Miles, *The Nondischargeability of Divorce-Based Debts in Bankruptcy*, 60 Albany L.Rev. 1171 (1997); Donald and Latta, *The Dischargeability of Property Settlement and Hold Harmless Agreements in Bankruptcy: An Overview of 523(a)(15)*, 31 Fam. L.Q. 409 (1997).

[44] Rothenberg, *supra*; U.S. National Bankruptcy Review Commission Report, *Bankruptcy: The Next Twenty Years*, October 1997, §1.4.4, Family Support Obligations, pp. 199 - 207

[45] (1993), 17 C.B.R. (3d) 64, 44 R.F.L. (3d) 243 (Ont. Gen. Div.). The author acted for the wife.

significant creditors. He had been a wealthy businessman whose income, at the time of the discharge hearing, was only $25,000 per year. He was ordered as a condition of discharge to pay $307,000 to the trustee, at the rate of $24,000 per year, in addition to his ongoing support obligations to the wife and the children. The wife had never received a penny from him, and despite being mentally and physically disabled and in constant pain and frequent agony, she was attempting heroically to raise their two children in abject poverty. The husband had contributed, through an assault on the wife during the marriage, to her disastrous state of health and inability to work; he had concealed his assets and covertly disposed of them, and had himself caused his financial difficulties in order to flout his family obligations.

In *Re Hederich*,[46] the wife's equalization claim of $203,000 constituted 98% of proven claims. The husband, while unemployed, had significant income-earning potential. Prior to bankruptcy, he had placed three mortgages on his real estate in the face of a matrimonial non-dissipation order. The judge concluded that the husband had used the bankruptcy process to avoid so far as possible the wife's proper claims. He was ordered as a condition of discharge to pay $108,000 in monthly installments over six years. This amounted to roughly 60% of the wife's entitlement, since she had already received $25,000 on account of her claim.

I have seen no jurisprudence or academic commentary from Australia or the U.K. on this subject, nor is it addressed in any specific legislative provisions. The issue is not mentioned in the leading U.K. text. I do not understand this gap.

## 7. POSSESSION OF THE JOINTLY OWNED MATRIMONIAL HOME

One of the common paradigms in this subject area is the jointly owned matrimonial home, where one of the spouses, say the husband, has declared bankruptcy. In effect,

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[46] (January 4 1994, supp. endorsement January 13, 1994, Ont. Gen. Div. in Bkcy, Toronto #31-260671, Spence J.)

his trustee becomes a co-owner of the home. The trustee would like to sell the home; the wife and children wish to stay. Can the trustee force a sale?

Here is the U.S. position, as I perceive it. A jointly owned property may be sold only if

> the benefit to the estate of a sale of such property free and clear of the interest of co-owners outweighs the detriment, if any, to such co-owners ...[47]

There is surprisingly little jurisprudence on this point.

The Canadian position is judge-driven rather than legislative. The test is "undue hardship": the home must be sold, and the proceeds divided, unless this would cause undue hardship to the wife and children. The case law defines undue hardship relatively leniently. Where there are several children under ten years old who were born in the matrimonial home, have made their friends in the area and are attending school there and have a degree of security in the present home and environment, exclusive possession will be ordered as against the trustee. As appears from recent cases, the court may order that the sale be deferred until the youngest child reaches majority; until there are no longer any "children of the marriage" as defined by the Divorce Act; or for so long as child support is payable by the bankrupt spouse.

Interestingly, the judicial attitude in the U.K. toward possession and sale of the matrimonial home has evolved with more sympathy to the interests of creditors.[48] Under the common law, a jointly owned house will be partitioned and sold promptly (within six months) unless the non-bankrupt spouse's circumstances are exceptional, not merely sympathetic. The inability to purchase alternative housing, and the consequent schooling problems caused by forced relocation, are merely "the melancholy consequences of debt and improvidence with which every civilised society has been familiar", and, while evoking

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[47] 11 U.S.C. §363(h). See *In re McCoy*, 92 B.R. 750 (Bkcy Ct., N.D. Ohio 1988): the financial hardship of the cost of alternative accommodation outweighed the estate's benefit.

[48] For a further discussion of the U.K. approach and jurisprudence, see C. Wagstaffe, *Possession Proceedings and Bankrupt Home-Owners*, [1998] Fam. Law. 99 (Eng.); Ian F. Fletcher, *The Law of Insolvency* (2nd Ed., 1996, Sweet & Maxwell, London); S. Shaw, *The Wife's Last Stand*, 140 Sol. Jo. 8 (1996)

the sympathy of the court, will not prevail over the interests of creditors and the bankruptcy trustee's rights.[49]

The U.K. Insolvency Act 1986 now deals specifically with priority disputes involving possession of the matrimonial home.[50] Section 336 and 337 require the trustee in bankruptcy to bring application before the bankruptcy court in any case in which the bankruptcy affects occupation rights of the non-bankrupt spouse or of a child who resides with the bankrupt in the matrimonial home. The court must make such order as it thinks just and reasonable:[51]

> ... having regard to the interests of the creditors, to the conduct of the spouse or former spouse so far as contribution to the bankruptcy, to the needs and financial resources of [that person], to the needs of any children and to all the circumstances of the case other than the needs of the bankrupt.

If the application is made more than a year after the bankruptcy, the court:[52]

> ... shall assume, unless the circumstances of the case are exceptional, that the interests of the bankrupt's creditors outweigh all other circumstances.

## 8. FAMILY ISSUES DRIVE BANKRUPTCY REFORM

I will close this discussion with a glance at legislative change. Although matrimonial issues form only a small subset of the vast field of insolvency, these issues have a remarkable vitality in driving insolvency reform. A few examples are notable.

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[49] *Re Citro (a bankrupt)*, [1990] 3 All E.R. 952 (C.A.); *Re Lowrie*, [1981] 3 All E.R. 353 (Ch.D.); *Bailey (A Bankrupt) (No. 25 of 1975), In re*, [1977] 1 W.L.R. 278, [1977] 2 All E.R. 26 (Ch.D.); *Turner, A Bankrupt, In re*, [1974] 1 W.L.R. 1556, [1975] 1 All E.R. 5 (Ch. D.)

[50] For further discussion, see S. Wheeler, *Protection for the Matrimonial Home*, [1989] Jo. Social Welfare Law 101; P.M. Bromley & N.V. Lowe, *Family Law* (8th Ed., 1992, Butterworths, London) at pp. 626-628.

[51] *Insolvency Act* (U.K.), s. 336(4)

[52] *Ibid.*, ss. 336(5), 337(6)

In Canada, the proposed amendment providing for provability and priority of support claims in bankruptcy was one of roughly 75 proposed changes before Parliament in 1996. Yet it drew more correspondence to the government than any other proposal. This amendment was mentioned by government representatives whenever the bankruptcy amendments were discussed in Parliament. The politicians realized that this amendment would, more than others, translate into votes.

U.S. Bankruptcy reform in 2002 was stalled by the "Schumer amendment" to H.R. 975. The abortion debate, which really had no place in bankruptcy reform, derailed this legislative initiative. To simplify the matter, Mr. Schumer added an amendment to the Bill that would exempt from discharge, any civil damage awards (including under RICO) granted against anti-abortion protesters who wrongfully shut down or harrassed abortion clinics. The pro-life movement, and politicians sympathetic to it, refused to move the Bill along. A fascinating alliance of convenience developed between consumer groups — typically of the left — who opposed the creditor-friendly thrust of the Bill, and the pro-life forces — typically of the right — who opposed the Schumer amendment. The latest version of the Bill, without the Schumer amendment, is currently pending.

In spring and summer of 2003, the Canadian Senate Standing Committee on Banking, Trade and Commerce heard testimony and submissions on bankruptcy reform. After most of the testimony was heard, the Committee requested that this author advance proposals for reform in the bankruptcy/family law area. Five proposals were advanced, each of which was adopted by the Senate. It is likely that the Senators, all politically attuned, recognized that the reform package would be more politically palatable with the inclusion of amendments that visibly helped women and families who are confronted by a bankruptcy. Since voters can understand and empathize with these issues, such proposals may significantly aid passage of the whole package of insolvency reform.

Finally, in Australia, a number of high profile personal bankruptcies have led to public dismay. A significant number of these filings were done by high income professionals, often lawyers, who lived a high lifestyle while flouting their tax debts.

When they declared bankruptcy, their assets were fully creditor-proofed, placed safely, years before, in the names of their spouse or children or a family trust. The public outcry, along with the zeal of the tax collectors, has led to a current legislative proposal that will permit the trustee to claw back into the bankrupt estate, any assets owned by the bankrupt's spouse or child that was originally funded by the bankrupt and is still utilized by the bankrupt. The matrimonial home owned solely by the wife; the wife's yacht; her investments; but not her mink stole, will be discretionarily recoverable by the trustee if their acquisition was funded by the bankrupt. One must wonder, and we will soon learn, whether the public disgust is sufficiently robust to overcome the power of the feminist lobby which is sure to object to any law which so resolutely prefers creditor interests over the welfare of the family.

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