**The Intersection of Bankruptcy and Family Law**

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## I. Introduction

The Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 ("BIA") is a Federal legislative framework which governs both consumer and commercial insolvency situations. Its principle objective is to enable 'an honest but unfortunate debtor'[1] and to obtain relief from his or her debts in order to receive a "fresh start"[2] principle, and emerge as a brand new, rehabilitated member of society. The Ontario *Family Law Act,* R.S.O. 1990, c. F. 3 ("FLA") provides a Provincial legislative framework which is described in its preamble, namely, "to provide in law for the orderly and equitable settlement of the affairs of spouses upon the breakdown of their partnership and to provide for other mutual obligations in family relationships"[3] It is becoming more and more common for Bankruptcy and Family law practitioners to find their worlds intertwined, and facing the affect of their respective legislation on their cases. It is imperative for these practitioners to have an understanding of each piece of legislation, and the effect that it can and will have on the other. Often Family practitioners, lawyers, and Judges especially do not have an intricate enough understanding of the effect and impact that the rights and remedies of the BIA, which may have an effect on spouses in both bankruptcy and family files.

Both the BIA and FLA have at their core the same end goal: to aim to achieve an equitable distribution of assets between its parties. In the FLA, this aim is restricted to the parties invoked in the family context (spouses, children etc.) and their respective assets,

[1] Re Rosenfeld [2004] O.J. No. 2459
[2] LW, Houlden, Morawetz GB, and Sarra JP. *The 2015-2016 Annotated Bankruptcy and Insolvency Act*. Carswell, 2015, pg 2,A§2; *Re Irwin* (1994), 24 C.B.R. (3d) 211.
[3] FLA, preamble.

while in the BIA the distribution is intended to maximize the distribution of the debtor's assets among the debtor's unsecured creditor. The biggest problem for practisioners, and judges, is the intersection between the two statutes. In effect, what happens when a debtor is also a spouse as defined in the two statutes.

## II. Jurisdiction

Every Judge of the Superior Court of Justice has jurisdiction in Bankruptcy matters.[4] Therefore, any Family Court Judge presiding over any matter has jurisdiction over Bankruptcy law matters as well which are incidental to family matters. This may reduce some duplicity and inefficiency, as well costs. This can also lead to Judges whom are unfamiliar with Bankruptcy matters makings decisions which are flawed and inconsistent with previous jurisprudence.

However, Bankruptcy matters which occur in the Toronto Region must be heard at the Commercial List.[5] This region is categorized by the Divisions which are divided by the Office of Superintendent of Bankruptcy Canada ("OSB")[6] . The Toronto Court Region extends from Toronto to Kitchener in the west, and to Kingston in the east. Some family matters which intersect with Bankruptcy can be heard here as well. This Court is designed to expedite matters and has certain procedures and policies which do so. This court has access to all bankruptcy documents, and has a Registrar (Master) court which only deals

[4] BIA, s.183(1)
[5] http://www.ontariocourts.ca/scj/practice/practice-directions/toronto/commercial/#Part_I_Introduction
[6] Supra Note 2, C§3, SS 5-9

with Bankruptcy. Other jurisdictions, such as London and Windsor, may have similar procedures.

## III. Invoking the BIA

A Bankruptcy proceeding can be commenced by three (3) different ways:

*(a) Voluntary assignment*

The majority of bankruptcies are initiated through a voluntary proceeding in which the Debtor attends at an office of Licensed Insolvency Trustee (“LIT or Trustee”) (formerly known as a Trustee in Bankruptcy). At the office of the LIT, the Debtor will complete a package of prescribed forms, including a sworn statement of affairs and an assignment for the general benefit of their creditors. This document details all the Debtors assets and liabilities, and includes information regarding businesses the Debtor may have operated in the last five (5) years, assets which may have been disposed of, and any monies which were invested in the past twelve (12) months. This is a sworn document which the Debtor must fill out to the best of their ability. It is also at this time period that the Debtor is informed of their respective duties under the BIA, and what is required of them in order for them to receive their discharge from Bankruptcy.

*(b) Involuntary Assignment*

The next manner in which a bankruptcy can be initiated is an involuntary bankruptcy. For this to happen, a creditor must bring an application (either unopposed, in front a Registrar[7], or if opposed, it is adjudged by a Judge) to have the debtor assigned into Bankruptcy. The creditor must prove that the Debtor owes more than $1,000.00, and that an, "act of bankruptcy"[8] has occurred. Typically, a court prefers to see that the Debtor has more then one (1) creditor who is unpaid, although, if the debt is large enough, a single creditor can petition a debtor into bankruptcy. In this manner, the creditor is seeking the benefit of bankrupting the Debtor. This Application was previously known as a Petition for a Receiving Order before amendments in the 1990's to the BIA.

*(c) Rejected Division I Proposal*

The last and final method that a party can become Bankrupt occurs when a debtor filed a Division I Proposal, and the proposal fails on account of not receiving the necessary votes from the creditors, or when the court deems the proposal unjust[9] and will not approve it. If either of the aforementioned occurs, then the Debtor is deemed bankrupt by the court. Proposals will be discussed in detail in the next section.

[7] A Registrar is an officer created by the BIA, and given certain powers under Section 192 BIA
[8] Section 4 BIA
[9] Section 59(2) BIA

## IV. **Proposals**

A proposal is another means which is prescribed by the BIA, which allows the debtor to be released from their unsecured debts, without having the stigma and long terms credit issues that a Bankruptcy results in. A Proposal is an offer to creditors to pay off some of the debt, which requires the majority of one's creditors to approve a payment plan for repayment of unsecured debts, based on a voluntary scheme which allows the creditors to receive some type of dividend. In order for a proposal to be recommended by the LIT, the proposal must yield a higher dividend then the result of a Bankruptcy.

*(a) Consumer Proposals ("CP")*

There are two (2) types of proposals which are available under the legislative scheme in the BIA: Division I Proposals, and Division II Proposals, which are generally known as Consumer Proposals. Consumer Proposals were formally enacted in the 1992 amendments to the BIA, and have become more and more popular over the last number of years. A CP is filed under section 66.12 of the BIA, and is only available to individuals who are insolvent. In 2009, the Federal government amended the BIA to allow for CPs to be filed whose aggregate debts does not exceed $250,000.00 from the previous $75,000.00. A CP is filed, and during the first 45 days' creditors can ask for a creditor's meeting to discuss the proposal. After the 45-day window has elapsed, there is a 15 day period during which a creditor can request Court review of the proposal. If none of this occurs, then the proposal is deemed accepted by the creditors and the Court. In most cases, if the creditors do not object to the proposal or ask to call a meeting, then there is

no cause for court review[10]. A Consumer Proposal has the added benefit of not resulting in an automatic bankruptcy in the event that the proposal is rejected. Once a CP is accepted, if the proposal is annulled for lack of payment or for any other reasons, the debtor cannot file another CP without Court approval. It is important for creditors to realize that once the Proposal has been approved, unless the Debtor makes a mistake (lack of payment etc.) that the debts will be extinguished by completion. However, if the proposal is annulled, then the rights of the creditors are revived, and the creditors can take all enforcement steps as if there was never a proposal[11]. A CP is limited in that it must be completed in a five (5) year period, and cannot last longer then five (5) years total.

*(b) Division I Proposals*

Division I Proposals are the catch all, no rules proposals. They have no minimum or maximum amount of debt, and they are not restricted in time period. They are available to all debtors, as long as they are insolvent. There are two critical differences from CP's and Division I proposals. The first is that a Division I proposal requires both a majority vote[12] of the creditors and an approval of the court. If either of these do not happen, the debtor is automatically assigned into bankruptcy. The second is that Division I proposals do not have a revival provision: meaning that if a debtor makes a mistake in a Division I proposal, it is much more difficult for them to revive the proposal[13].

[10] s. 66.18(1); see BIA pg 313, E§98.
[11] There are special rules for distribution following annulment, see 63(6) BIA
[12] Majority is 2/3 of the creditors in dollars, and ½ in number
[13] In the matter of the Proposal of James Bond, Madam Justice Mesbur, Toronto Commercial List, 31-301128, January 5, 2016

## V. Division of Liabilities

During the initial phases of separation in a matrimonial proceeding, the parties will provide the details of their 'net family property'[14] ('NFP'), as of the valuation date which is usually done as of the date of separation. This is usually done through filling out a financial statement (or income and expense statements) and these are used to calculate the NFP. Spouses will usually then take the value of the debts that they have accrued, and deduct them from the debts of the assets which are in their name. The difference between the two is roughly the NFP. Spouses will often use this as a starting point to create the separation agreement, and assign debts to the party that needs to pay them. However, this is only a contract between the parties. The two parties are the only parties which are bound by this contract. Therefore, if one spouse cannot make the payments on their liabilities, or files for bankruptcy, then the creditors will seek to recover from the other spouse. The decisions made in the separation agreement do not bind the creditors or stop them from choosing who to enforce against.

## VI. Protection by One Party Spouse against other spouses assets when there is suspicion or likelihood of bankruptcy

As will be discussed in the following sections, bankruptcy of one spouse after the separation agreement or divorce proceeding occurs can affect the ability and ultimately

[14] Section 4, FLA

cause a non-ability of the other spouse to be able to collect on their matrimonial claims. But an issue which arises before this is what if the spouse suspects that the other spouse intends on making an assignment in bankruptcy while they are in the process of completing the arrangements.

There are different legal instruments that have been allowed in different jurisdictions across Canada to preserve spousal rights, and prevent the eroding of spousal benefits (especially important for equalization payments, which will be discussed later in the paper). A charging order, specifically worded, which grants security over a spouse's equalization and support claim may be beneficial. Of course this carries with it the challenges of all other forms of security: namely, registration, perfection etc. As discussed later in this paper, an express trust may be beneficial in establishing security over funds in the same type of proceeding (challenges discussed later on paper).

Both spouses can grant each other security over each others assets, and the payments would consist of equalization payments. While this type of security has been used before, its questionable as to the validity of such security. A trustee or creditor who is particularly investigative, may question this as being specifically designed to defeat creditors. As discussed later in this paper, if the intent is defrauding creditors on both parties, then this is particularly questionable and could be reversed.

One that is particularly interesting which some judges have recognized as valid, and seems to have been used in multiple jurisdictions, is an injunction to the debtor not to file for bankruptcy. Bob Klotz describes the unreported cases of *Uttley v. Uttley*[15], and *Zoltak*

[15] Bob Klotz, Bankruptcy for the Matrimonial Court Judge, February 2006, cited, Uttley v. Uttley, Order dated April 20 1995, Ont. Gen. Div. #18109/95, Barrie and Zoltak v. Zoltak, Order dated May 2, 2000, Ont. S.C.J. #99-FP-248462FIS

*v. Zoltak,* in Ontario, both cases in which an Order was made that prohibited the spouse from filing for bankruptcy. He goes on to describe a British Columbia case, *McDonald v. McDonald*[16]*,* in the which the BC Court of Appeal allowed a restraining Order prohibiting a spouse from filing for bankruptcy. The Ontario Court of Appeal, in a recent judgment of *Walchuk v. Houghton*[17] found that a stay of proceeding caused by a bankruptcy would discharge a contempt proceeding in certain circumstances. It remains undetermined, but certainly interesting, to note whether a motions judge making an Order for a debtor to comply with injunctive relief, from a Provincial Court Order and the inherent jurisdiction of a Superior Court Judge's Order of contempt for violating the injunctive relief, would be vacated by the filing of a bankruptcy. In practical theory, can a judge make an order prohibiting a filing of a bankruptcy until satisfied that the family court proceeding has been satisfied.

## VII. Intersection of FLA and BIA for CPs and Division I Proposals

### *(a) Voting Rights*

Related persons are defined in the BIA, among other things, as, "individuals connected by blood relationships, marriage, common-law partnership or adoption."[18] The

[16] [2001] B.C.J. No. 2570 (B.C.C.A., December 6, 2001)
[17] 2016 ONCA 643
[18] S 4(2) BIA

BIA specifically states that a vote cannot be recorded in favour of a proposal, by a related person, but it can be recorded against by a related person[19]. Therefore, to the extent that a person files a CP or Division I proposal, and their spouse is a creditor, they cannot vote in favour of the proposal. Separated parties who are not yet divorced are considered related, while common-law partners are not.

Mr. Robert Klotz in his text *Bankruptcy, Insolvency & Family Law, 2nd ed* ("BIFL") provides the following summary on point:

"*While married persons remain related to one another until they are divorced – normally at least one year after separation – common-law partners lose their relatedness as soon as cohabitation ends. This follows from the utilization of the present tense in the BIA definitions of common-law partner and related party, and from the applicability of ss. 121 and 178 only to "former", not present, common-law partners. Likewise, a common-law partner can vote in the bankruptcy so long as separation occurred more than one year before the date of the bankruptcy, whereas married spouses cannot normally do so, on a strict reading, unless a final divorce decree has been granted at least a year before bankruptcy.*
*This has significant consequences in connection with the anti-collusion provisions of the BIA…former common-law partners who negotiate a separation agreement normally do so at a time when they are no longer cohabiting, and thus are no longer related parties. Their transactions do not meet the same scrutiny; for example, the look-back period for fraudulent preference attack is three months for such agreements, rather than the 12-month period applicable to married spouses. This seems inequitable: married spouses receive harsher treatment. The Canadian Bar Association's Submission to the Federal Government challenged this inequity, without effect*."[20]

*(b) Inadvertent Discharge of Support Arrears*

Section 178 of the BIA provides for certain debts which are not released by a Bankruptcy Order of Discharge, and by association, a Certificate of Completion of a proposal. These specific debts are debts which over time were identified by Parliament

[19] 54(3)
[20] Bankruptcy, Insolvency, and Family Law, 2nd Ed., (Toronto: Carswell, 2001, supplemented) ("BIFL")

as unsecured debts which needed to be protected by the Bankruptcy legislative scheme based on social policy[21].

Section 178 specifically states:

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;

However, Section 62 (2.1) specifically states that, "A proposal accepted by the creditors and approved by the court does not release the insolvent person from any particular debt or liability referred to in subsection 178(1) *unless the proposal explicitly provides for the compromise of that debt or liability and the creditor in relation to that debt or liability voted for the acceptance of the proposal.("emphasis added")*

Therefore, if the debtor puts in his proposal that the proposal relieves the debtor from support arrears, and the Creditor votes in favour of the proposal, then the Creditor cannot later on try to have their debt survive the proposal.

(c) Pre-proposal "transfers at undervalue" or "preferences"

Similar to the Section 178 remedy provision previously discussed, a spouse who files a proposal and is accepted by the court, can be challenged by the Trustee or an assignee

[21] *Martin v. Martin* (2005), 2005 CarswellNB 145, 2005 CarswellNB 146, 2005 NBCA 32, 9 C.B.R. (5th) 235, 251 D.L.R. (4th) 304 (N.B. C.A.).

if they believe that there has been a transfer under value, or a preferential payment. This remedy can only be excluded if the provision is exclusively listed in the proposal and the creditors have accepted it. [22] This is similar to the remedy further discussed for a Bankruptcy in the next section of this paper.

## VIII. Traditional Bankruptcy (separation pre-bankruptcy)

When a person is either assigned into bankruptcy, or voluntarily assigns into bankruptcy, creditors are given an opportunity to prove there claims to distribution within the bankruptcy. A typical creditor who is making a claim for an unpaid liability, must line up with all other creditors for payment of a dividend (if there is any). However, in certain circumstances, the BIA recognizes certain claims which are preferential and therefore result in a claim which supersedes other unsecured creditors. The distribution scheme which is listed in Section 136 of the BIA, categorizes unpaid child support, alimony and maintenance, within twelve (12) months or as a lump sum[23], as a preferred status and therefore it is paid in priority to all other creditors after the Office of the Superintendent in Bankruptcy's ("OSB") levy, and Trustee fees.

*(a) Preferred and Preferential Claims*

As mentioned previously, preferred claims in bankruptcy result in a payment by the estate to the claimant over and above the other unsecured claimants. Until the mid-1990's, Canada Revenue Agency had a preferred status in all bankruptcy claims. In some

[22] *Re Sefel* (1989), 76 C.B.R. (N.S.) 48, 69 Alta. L.R. (2d) 273 (Q.B.),
[23] R. Klotz, Bankruptcy and Support, Ontario Bar Association, September 2010

certain circumstances, they still will have such a claim. However, for the purposes of this paper we will only discuss familiar claims.

A preference, as defined in the BIA, is a payment made by an insolvent person within a certain time period which can be challenged by the Trustee, under Section 95 and 96 of the BIA, because it gives an unfair preference to the creditor who received it. However, Section 136(1)(d.1) specifically gives a preferential claim to a familiar claimant, who qualifies under Section 178(1)(b) and (c) for:

- **(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;

Therefore, any amounts that the estate has are paid in priority to the spouse of the Debtor in priority to all the other creditors after the deductions listed in 136(1) are effected. As many bankruptcies have very limited assets and in fact may have no distribution whatsoever, it is important that spouses understand the importance filing a proper proof of claims[24] in a bankruptcy which notes the preferred status of their claim. Without doing so, they may end up with nothing.

*(b) Equalization Payments*

Another area that is often misunderstood and creates havoc for insolvency and family practitioners are claims to equalization. In Ontario, when a marriage ends, the

[24] Form 31 – G§7 Supra Note 2

equal contribution of each person to the marriage is recognized. The law provides that the value of any kind of property acquired by the spouse during the marriage and still exists at separation must be divided equally between the spouses. Also, any increase in the value of the property owned by a spouse at the date of marriage must be shared. The payment that may be owed to one of the spouses in order to effect this sharing is called an equalization payment. Equalization payments are unsecured debts which are not given special status under the BIA, and are therefore discharged by an Order of Discharge[25]. While there is confusion among Family law practitioners as to whether an equalization payment which is incurred through a separation agreement, would be discharged, the BIA provides no special protection for any type of equalization payments. There is jurisprudence in this area which suggests that a debtor who files for bankruptcy specifically to avoid his Family Law equalization payment, would have a higher standard to bear in order to obtain their discharge.

A spouse who objects to a discharge from bankruptcy for their ex-spouse, on the basis of the equalization payment, and can prove the reason behind the accrual of the high equalization payment in arrears is due to the Bankrupt's fault, will have a harder time obtaining their discharge. The court will consider this in handing down a conditional discharge order which requires the bankrupt to pay the amount to the Trustee in order for him to obtain a discharge from bankruptcy. A bankrupt of this sort will be adjudged on the criterion established in the case of *Kozack v. Richter*[26], which established a criterion that highly attributes fault as the prevailing issue. In the case of *Re Matthews*[27], the bankrupt

[25] *Thibodeau v. Thibodeau*, 2011 ONCA 110, 104 O.R. (3d) 161
[26] *Kozack v. Richter* (1973), [1974] S.C.R. 832, 20 C.B.R. (N.S.) 223, [1973] 5 W.W.R. 470, 36 D.L.R. (3d) 61
[27] Supra Note 1, H§63; *Re Matthews,* 1993 CarswellOnt 188, 17 C.B.R. (3d) 103

owed $614,141.30 in unpaid equalization payments. The bankrupt was seeking an absolute discharge from bankruptcy, but was opposed by his spouse. While the BIA provides no specific protection for equalization claims, it was unquestionable that the bankrupt had filed for bankruptcy to avoid this debt. Justice O'Driscoll, in his decision, cited *Kozack v. Richter,* and Court of Appeal Justice Houlden stating: "The court does not regard with favour the filing of an assignment in bankruptcy for the purposes of getting rid of a judgment such as that held by the appellant"[28]

There is often confusion by the Family Court bar due to the previously mentioned cases, as to what will survive bankruptcy, and what will not. Attempts have been made by Family law counsel to attempt to shroud equalization payments into lump sum support and maintenance, and therefore escap3 the discharge of the debt through the bankruptcy process[29]. Family counsel have also argued that the character of the equalization was actually a support payment.[30] There is jurisprudence which addresses the character of clauses in separation agreements. In the case of *Maule-Ffinch v. Maule Ffinch*[31]*,* the Ontario Court of Appeal confirmed a ruling that stated that a separation agreement which stated 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," would be child support or alimony, and therefore fall under the survival clauses in the BIA. Unfortunately for most spouses involved in these type of ordeals, clauses which purport to change the status of the payments simply on the basis of filing for bankruptcy are void according to Section 84.2(1) of the BIA. Therefore, Family counsel seeking to preserve their client's rights cannot do

[28] Re Gigault, 1981 CarswellOnt 150, at para 6, citing with approval *Kozack v. Richter, Supra.*
[29] Re Legallais (2015), 30 C.B.R. (6th) 323
[30] Eveleigh v Eveleigh [2005] O.J. No. 945
[31] [1996] O.J. 1580 (Ont. C.A., May 7 1996), the leading case in this area is *Shea v. Fraser*, [2007] O.J. No. 1142 (Ont. C.A., Mar 29, 2007)

so simply on the basis of the assignment into bankruptcy. The distinction between surviving bankruptcy, and having to prove it at a discharge hearing is important.

Parties in Family law proceedings have sought to modify court orders in the Family law context following an assignment in bankruptcy, if the Debtor has any exempt assets[32]. In Ontario, Pensions are exempt assets under the Section 67(1)(b) of the BIA and Section 66(1)(b) of the *Pensions Benefits Act* R.S.O. 1990, c. P.8. Therefore, if the Debtor is receiving a pension, then the creditor spouse can seek to have the Family court modify the Order to pay from the pension to the creditor for the equalization payment on the basis of fairness.[33] It is important for the non-bankrupt spouse to seek this Order as soon as possible, within the time period of the bankruptcy and proposal. The Stay of proceedings will stay the non-bankrupt spouse's ability to make a claim in the divorce proceeding, and if an equalization occurs which removes the ability to make such a claim, then the non-bankrupt spouse will have no claim against the pension.

Some other remedies include making a trust claim over property which under Section 67 of the BIA, do not become the property of the Trustee. This is a particularly tough remedy as not all bankrupt's will have property which is eligible to survive. As previously mentioned, a pension and a Registered Retirement Savings Plan ('RRSP') qualify under this exemption. Pensions have blanket survival as previously discussed, while RRSP contributions from before the 12-month's which pre-date the date of assignment in bankruptcy will survive bankruptcy. Usually an RRSP or pension, if they exist, will be of substantial value as they represent income which the contributor is relying

[32] See Execution Act, R.S.O. 1990, c. E. 24
[33] Sim v. Sim, [2009] W.D.F.L. 1339, [2009] O.J. No. 678

upon in later years. A trust claim over one or both of these assets can be very successful, because the assets themselves survive bankruptcy. As well, a trust over an asset will render the ownership of the assets that of the non-bankrupt spouse, and therefore would have no draw to the Trustee[34]. Trust claims need to be carefully approached, and written properly and legally, as often the slightest problem with the documentary evidence can be challenged and therefore be set-aside.

*(c) Family Claims and OSB Levy*

The distribution scheme which was earlier discussed in Section 136 of the BIA, is intended to temper the costs of the operations of the OSB. Debts under Section 178(b) and (c) of the BIA, which survive bankruptcy, and are collected directly by the principal creditor against assets that are no longer part of the bankruptcy are not subject to the levy. However, debts which are preferred payments and are collected by the Trustee and then paid as preferred, are subject to the levy.

The judgment of the Court of Appeal in *Re Cameron* held that the OSB levy is to be shared by all creditors who benefit from the proceedings. The impact of this is that family support creditors must give the bankrupt credit for amounts paid in respect of the levy. This arguably results in an inequitable situation where some section 178 family creditors obtain full payment and others do not. For example, if a bankruptcy results in a $10,000.00 dividend to a preferred spouse claimant, the net payment to him would be $9,500.00. Notwithstanding the spouse only receiving $9,500.00 the bankrupt is credited

[34] See Section 68 BIA

for the full $10,000.00 in circumstances where the debt survives bankruptcy. On the other hand, if a spouse claimant received the same $10,000.00 payment outside of a bankruptcy, he would receive the full $10,000.00 and the debtor spouse would also receive full credit of the said amount.

Spousal creditors often seek to get around these type of losses due to their non-understanding of the bankruptcy system. In the case of *Re Williams*[35], a husband and wife had sold their matrimonial home and the equity was paid into the Accountant of the Superior Court of Justice. The husband then went bankrupt sometime after, but before the funds were withdrawn. There was an Order of Family Court ordering that the wife was entitled to receive her share of the funds, and a portion of the husbands as well. The husband was also behind on support payments for the teenage son. The Trustee sought to have the monies paid into court which belonged to the bankrupt, paid to the Trustee. The wife objected. She claimed that due to her preferential status as a creditor, she should be able to obtain all these funds, and not have to wait or lose further funds. The Court ruled that these funds were subject to scheme of distribution from the BIA, the levy, and anything else that was required. She would have to file a claim in the bankruptcy, and wait.

[35] Re Williams (7 June 2016), Toronto, 31-1983022 (ON SC: Registrar's Court)

## IX. Traditional Bankruptcy (separation post-bankruptcy)

*(a) Distribution*

If a bankruptcy occurs before the 'triggering'[36] effect of a separation under the FLA, then the Trustee acquires all of the rights that the spouse is entitled to under Section 71 of the BIA, and under the FLA regime. That is, the Trustee would acquire one-half interest in the matrimonial assets etc. If the property is exclusively in the name of the non-bankrupt spouse, the Trustee may elect to become party to the FLA proceedings to ensure that there is no unequal distribution of assets which would lessen the amount of equity that the creditors would receive. The Trustee is not concerned with non-pecuniary rights under the separation, and will leave these issues to the parties. As discussed later, these are not required.

If the Bankrupt party is the only one named on the asset, namely the matrimonial home, then the FLA proceeding will not have an effect on the Trustee. The Trustee can take steps to realize on the home, and the other spouse will have to prove a beneficial ownership in the home. Although most Trustee's will afford some type of spousal interest and work towards resolution.

*(b) Leave of the Court*

[36] FLA Section 4(1) aka 'valuation date'

Once a bankruptcy occurs, generally a Family proceeding cannot be initiated or continued without leave of the Bankruptcy Court. Since a Bankruptcy results in an automatic stay, that is a moratorium against any and all actions from commencing or continuing against the bankrupt without leave of the court, the non-bankrupt spouse must apply to the Bankruptcy court under Section 69.4 of the BIA, to receive leave to continue with the family action. While there are certain elements of a Family action, such as claims for custody, access, divorce, paternity and others that are not provable in bankruptcy and therefore do not require leave, items such as equalization claims from the before the bankruptcy filing are. As the Family action will typically not address assets which are bound up in the bankruptcy, the court will give leave most of the time. This is done with the caveat that if there are any assets which are subject to the bankruptcy, the Trustee's interest remains and must be dealt with. Of course, a filing in bankruptcy does not preclude a Judge issuing a reserved decision in family property litigation where arguments have been completed before the date of bankruptcy; as mentioned earlier, Superior Court Judges can make decisions which have an effect on the bankruptcy by right.

*(c) Separation Agreement*

A separation agreement cannot be entered into while a spouse is bankrupt. Since Section 71 of the BIA renders all property of the bankrupt that of the Trustee, and a separation agreement is a contract between two parties, a bankrupt would lack the capacity to do

so. However, as earlier addressed, in practicality, a Trustee will often become party to a family proceeding. If a separation agreement only addresses specific issues, such as spousal support, child support, child access, then a Trustee may allow it to be entered into. The Trustee will become party to the matrimonial proceeding and will make decisions in the role of the husband.

*(d) Separation post-discharge*

When a bankrupt receives their discharge, they are usually left with little to no assets; depending on the assets that may survive, or items that they may have recovered immediately after discharge. But a problem that occurs on rare occasions are post-discharge separations: that are separations which occur slightly after the bankrupt has received their discharge, so their Net Family Property is low, and their income is likely low as well; which is reflective of the bankruptcy. If there is ongoing income, then a Family court judge can use this income to impute what the party may be able to make in the future. If not, the same can be done, but it is much more difficult. For the purposes of this paper, this issue will not be delved into. This section is only informative in nature.

## X. Can a Separation Agreement be deemed to be a Conveyance or Preference

Section 137 of the BIA states that no dividend is payable on a transaction between parties who were not at “non-arm’s length” at the time, unless upon application a Court

or Trustee deemed the transaction as proper. This type of determination is a matter of fact, and becomes difficult to predict. But, Section 4 of the BIA defines persons who are married to each other to be not at arm's length, which was previously discussed in this paper. Similar to many other sections of the BIA.

It is quite difficult to assess the validity of a separation agreement in the context of bankruptcy. What may often be the case, is that a separation agreement occurs on the eve of a bankruptcy, and it is left to the Trustee or the Court to assess the validity of the Separation Agreement. While many Trustee's accept separation agreements as *prima facie* valid and do not challenge them, there is some very limited jurisprudence in this area.

In *Marzetti v. Marzetti*[37]*,* the Supreme Court of Canada granted generous interpretation where support issues and family need, intersect with creditors' interests. The Court stated: "When family needs are at issue, I prefer to err on the side of caution. In s. 68 of the *Bankruptcy Act*, Parliament has indicated that, before wages become divisible among creditors, it is appropriate to have "regard to the family responsibilities and personal situation of the bankrupt". This demonstrates, to my mind, an overriding concern for the support of families…," and, "Moreover, there are related public policy goals to consider. As recently recognized by L'Heureux-Dubé J. in *Moge v. Moge*, [1992] 3 S.C.R. 813, "there is no doubt that divorce and its economic effects" (p. 854) are playing a role in the "feminization of poverty" (p. 853). A statutory interpretation which might help defeat this role is to be preferred over one which does not."

[37] [1994] 2 SCR 765 ('Marzetti')

However, Section 95 and 96 of the BIA which created the ability for the Trustee to challenge the conveyance or unjust preference were structured different, and not addressed, at the time of this decision. The jurisprudence which specifically addresses this area of law is incredibly limited. In the case of *Royal Bank v. Morrison*[38], Justice Conant refused to grant an order to set aside a separation agreement as a preference and conveyance. Even though under the Provincial fraudulent preference and conveyance legislation[39] and the BIA provisions, his honour found that both parties did not have the intent to defeat the creditor. While it was evident that it was between two non-arm's length parties, his Honour found that due to the fact that the separation agreement was negotiated over time, by two arm's length party counsel, and the fact the non-bankrupt spouse did not intend for the creditors' interests to be defeated, his honour refused to set it aside. There must be intent to show that the actual transaction was not done to defeat creditors, and that valuable consideration actually passed. There is case law to show that intent can be inferred, and that intent to defraud creditors from payments should be inferred if a solvent person directs payment to another person causing them to be insolvent as a result: even in a matrimonial proceeding. [40] However, this is all fact based. If the separation agreement was on the eve of the proceeding with nothing behind it, then a Court can infer intent to defraud. But if it is years old, and the insolvency is recent, a Court will be more lenient.

Separation agreements, and marital proceedings in general, enjoy special status by parliament. Mainly, when items are negotiated by two parties seeking to resolve their

[38] 1992 CarswellOnt 195, 15 C.B.R. (3d) 273, 36 A.C.W.S. (3d) 902, 43 R.F.L. (3d) 278
[39] s. 2 of the *Fraudulent Conveyances Act*, R.S.O. 1990, c. F.2; and (3) whether it was in violation of s. 4 of the *Assignments and Preferences Act*, R.S.O. 1990, c. A. 33.
[40]Sun Life Assurance Co. of Canada v. Elliot, 1900 CarswellBC 17, [1900] S.C.J. No. 65

familiar lives, parliament has seen fit to recognize that there should be special consideration. Often there are other considerations other then just the two parties. For instance, children, who's future's will be greatly affected. The ability of a court to set aside a separation agreement may cause a family to fall into turmoil, poverty, or worse. In *Schlenker v. Schlenker*[41], the British Columbia Supreme Court stated:

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

In a recent paper[42], Robert Klotz, cited a recent case of *Exelby & Parters LLP v. Gibson*[43]. This case involved a Trustee seeking to set aside a transaction which had occurred between a husband and wife. The transaction between the two occurred a couple months before the husband declared bankruptcy, and the transaction was made for $1.00. The wife responded that the consideration that she had given was the non-written undertaking not sue for child support and equalization was considered good consideration, and on appeal this was upheld. While this wasn't written, it shows the

[41] Schlenker v. Schlenker (1999), 1 R.F.L. (5th) 416 (BCSC) at 16
[42] R. Klotz, *Bankruptcy for the Matrimonial Court Judge,* February 2006
[43] (2005), 7 C.B.R. (5th) 196, sub nom *Gibson (Trustee of) v. Gibson* [2005] A.J. No. 18 (Alta. Q.B., January 12 2005)

length that the court will go to uphold family provisions and the value that it has in the courts eye.

The fact that family provisions are to be looked at with caution, does not automatically give rise to protection to the debtor. For instance, an action being brought by the Trustee to challenge the conveyance cannot be challenged by the non-bankrupt spouse claiming initiating a divorce proceeding in the middle of the action. If the court can see through the application as a last ditch effort to attempt to preserve the rights, then the court will ignore this application and hear the Trustee. In the case of *Re Rehman*[44], Justice Pattillo refused to adjourn an application by a Trustee to set aside a trust agreement which purportedly was held on behalf of children by the bankrupt's spouse, on the basis that the spouse had initiated a divorce proceeding in a neighboring jurisdiction. The question of the protection of the family rights at the expense of the creditors is an ongoing battle which falls on either party and is often unclear. Judges often struggle with this issue as the jurisprudence remains unclear.

*(A) What solution would a wife have if a husband declares bankruptcy (or is assigned), but the Trustee does nothing to set aside an improper transaction*

This is not uncommon as a Trustee may have little to no money in realizable assets, and therefore, they do not want to take any other action (more commonly known as no money in the file). Therefore, the wife, like any other creditor, has a remedy under Section 38 of the BIA. Section 38 allows a creditor to obtain a court order to 'step into the

[44] Rehman, Re, 2015 ONSC 188, [2015] O.J. No. 1748

shoes of the Trustee'[45], and to pursue any proceeding that the Trustee has not undertaken. The wife, in this case, would take all the risk and absorb any of the costs associated with the action. The wife would have to serve all known creditors, and allow them the opportunity to participate if they wish. If none chooses to participate then the benefit and risk will exclusively lie on the wife.

## XI. Annulment

One last remedy of a spouse seeking to address the issue of a spouse who has attempted to declare bankruptcy as a way of only getting around their debts to the other spouse, is to attempt to annul the bankruptcy. This is a remedy that should be attempted quickly, but is also a very rash and overreaching remedy which the court is very hazardous to use. Under Section 181 of the BIA, a motion can be made to a Bankruptcy Court seeking to annul a bankruptcy. The Court is loathed to grant this type of relief, and does not do so lightly. In *Re Wale*, the Court ordered an annulment of a bankruptcy because a husband had declared bankruptcy 1.5 hours before the trial was set to begin. It was clear that this was an abuse of process, and the court on notice to the creditors believed that the only motive was to hurt the wife[46]. In *Plesh v. Plesh*[47], the Manitoba Court of Appeal overturned a judgment of a creditor seeking to annul a proposal on the basis that the proposal was only to avoid the garnishment which the husband had

[45] Indocondo Building Corporation v. Sloan 2010 ONCA 890 (CanLii)
[46] (1996), 45 CBR (3d) 15 (Ont. Gen. Div)
[47] Plesh, Re (1994), 100 Man. R. (2d) 168 (C.A.), reversing (1994), 93 Man. R. (2d) 66 (Q.B.)

obtained against his wife, in a matrimonial proceeding. Once a proceeding has been initiated the court doesn't typically allow for the vacating without good reasoning.

## XII. Costs Awards

Costs awards in Family Law often flow from each motion and certainly from a long trial. These awards can have a large impact on the parties, and their abilities to live post-trial. When a spouse goes bankrupt, and has a costs award against them, the costs award is usually factored into the claim that they make in the bankruptcy. The court has in the past recognized that costs in alimony or maintenance proceedings receive similar protection and are not discharged in bankruptcy.[48] However, Section 173 and 178 have no such protections written into them. In fact, Section 178(h) protects interest associated with 178(a) to (g.1) non-released damages, but does not address costs associated with them. Typically, when a proof of claim is filed, creditors file it with all the costs and interest associated with it. It is then left to the Trustee to disallow the claim if they do not believe that it is correct: however, Court Order containing costs are normally *prima facie* accepted.

## XIII. Trustee remedies

If a Trustee becomes the owner of a matrimonial property, due to the fact that the asset is in the name of the bankrupt, joint name of the bankrupt and his spouse, or through

[48] Lang v. Soyatt (1988), 68 C.B.R. (N.S.) 201 (Ont. Bkty. Ct.)

any other means discussed in this paper (and not discussed), then the Trustee has general remedies available at law to deal with the property and realize on the asset.

*(a) Sale to Wife (or other family or friend)*

Typically, most Trustee's would rather take the path of least resistance when it comes to realization. Additionally, selling the property interest back to a spouse or a family member is an easy way to minimize the actual damage to the family and to still ensure that the creditors maximize on the asset. Usually, selling the asset back in this manner will minimize selling fees and legal fees as well. Therefore, the Trustee can negotiate with the spouse or family member. However, the Trustee is required under Section 30(4) of the BIA, to receive approval from the Court before selling an asset back to a non-arm's length party. Typically, the court is looking for the maximum amount of realization for the Trustee in the shortest amount of time, and will not cause added aggravation to all parties. The Court will only allow deductions to the sale price, if they are legitimate[49]. Unless there is a creditor opposing the sale, and with good reason, the court will approve the sale[50].

*(b) Non-Agreement*

If there is no agreement between the parties, then it can make for a particularly tough set of circumstances. The Trustee has by virtue of case law and statute, the right to

[49] Brisco [2006] O.J. No. 2827, 21 C.B.R. (5th) 207
[50] Re Vittoria Yousuf Mantenuto, Court File No. 32-999910, ONT SC: Registrar, Master Jean, July 27, 2015

partition property and sell it. When a filing in bankruptcy occur, a property which is held in Joint-Tenancy automatically becomes severed and becomes Tenancy In Common (similar to a divorce).

Therefore, a Trustee can initiate an action to sell the property. There is case law that says that if "undue hardship" or "oppression" [51]to the other owner would be caused, that the partition cannot happen. This type of standard defense is not as applicable in a bankruptcy context. The interests of the creditors will force the property to be sold. However, if there are children living in the home, under 18, then the court may take this into account and not allow for the sale of the home until the children come of age[52]. This is a factual and circumstantial based case and it will tough for the offending spouse to show that they should be able to stay in the property if they have not taken steps to attempt to sell or buy out the Trustee's interest. Most Trustee's will be as accommodating as possible, and not force children to leave their homes: as the partition action can be difficult and cause many issues[53].

The Trustee also has remedies available to it through the bankruptcy discharge process against the actual bankrupt. The scope of these remedies, and how the Trustee would enforce them, are beyond the scope of this paper and are only mentioned here for the completeness.

[51] Re Ali [1987] O.J. No. 2
[52] Slan v. Blumenfeld (1997), 34 O.R. (3d) 713 (Gen. Div.)
[53] Ezard (Trustee of) v. Zgraggen 2011 ONSC 4474

## XIV. Solicitor Liens (and Charging Orders)

A Solicitor Lien or a charging order is a remedy created by the common-law and the Ontario Solicitor's Act[54], which allows a solicitor to create a secured interest over property which they have helped to obtain or retain. However, depending on the type of property, a secured interest may need to be registered or further steps may need to be taken to perfect the actual security.

By way of example, a Family lawyer who helps to recover a condominium for a spouse may exert a solicitor's lien over that condominium. However, an issue occurs when that spouse files for bankruptcy or a proposal. Since the lien can only be registered by way of an application to the court, and then through a registration on land title, when does that lien become valid. In *Taylor v. Taylor*[55], the court refused to grant a solicitor's lien over any part of a wife's $69,000.00 lump sum spousal support received through solicitor's effort on the basis of public policy. However, it is likely that the case that was referred to earlier, *Marzetti,* may have a different effect on the decision.

Justice Cumming, in the case *King Insurance Finance (Wines) Inc. v. 1557359 Ontario Inc. (c.o.b. Willowdale Autobody Inc.)*[56] held that a solicitor is a secured creditor within the BIA due to the legal right to solicitor's lien in conjunction with subsection 136(1) of the BIA, in which secured creditors rights take precedents over the rights of the unsecured creditors. However, this case is distinguishable from a case in which the rights asserted by a solicitor are asserted after a proposal or bankruptcy is filed, but before the

[54] R.S.O. 1990, c. S.15
[55] (2002), 60 O.R. (3d) 138, 26 R.F.L. (5th) 208, 21 C.P.C. (5th) 205 (Ont. C.A.)
[56] [2012] O.J. No. 3544

actual security has been registered. The jurisprudence on this issue is questionable since it is not actively reviewed. However, it is the writer's opinion that a solicitor's lien has special character in that it has been recognized in the past to be valid over recovered property, but not always prima facie[57]. If the solicitor debt has been asserted before the filing, but the insolvency filing has been done before registration can occur/affected, then the lien wouldn't be valid and the unsecured debt would be assumed by the filing. Justice Cumming's judgement also was not in a F amily law context, and it also did not address real estate which was a non-liquid asset. Courts can also exercise judgment in recognizing the legitimacy of a lien. In *Foley v. David*[58], the Ontario Court of Appeal refused to recognize a solicitors charging order over funds which consisted of court ordered child support and arrears. The concept of the lien is that it exists on its own, and is given rise by a set of action. But it becomes very difficult to assess the validity of the lien when the court says it exists, and then may choose not to recognize it.

## XV. Conclusion

This paper has reviewed the general issue concerning Family Law and Insolvency Law. It has delved into the general law of Bankruptcy and Insolvency, and has also touched on the cross-roads between the Family and Insolvency Law. As is typical with any paper, it did not delve into every single issue that can particularly intersect, but it has

[57] See Supra note 23.
[58] (1996), 93 O.A.C. 114

touched on many of the issues that affect practitioner of Family and Insolvency Law, and the jurisprudence surrounding them.

As Family Law rules are dictated by the Ontario FLA, and the Bankruptcy Law stems from the Federal BIA, any absolute conflicts between the two would be governed by the doctrine of Federal Paramountcy. Most conflicts can be dealt with by addressing both statues, and therefore, this is only called into play on the highest of conflicts. The Federal Divorce Act[59], which was not addressed in detail in this paper, may have some impact as well. It is typical that Judges will try to evaluate the nature of the problem, before conceding to one statute or the other.

Creditor law, and by extent, Bankruptcy Law addresses the world as a whole. It deals with any person, on any day, making average contracts. Family Law is more intimate. It is at the core of the home, and the results are always more emotional. Yet, both areas of law are similar in that they seek a distribution scheme which is fair and equitable. It is important for any practitioner of one of these type of law, to be aware of both of these statute, and to apply equally. Ultimately, it is the writer's opinion that creditor law is principal, as it always between one party and another party which has notice from all the other protections to which it is entitled. Family law is important, but will always be subject to creditor rights and procedures.

[59] RSC 1985, c.3 (2nd sup)