BANKRUPTCY AND THE MATRIMONIAL DISPUTE

INTRODUCTION

Various studies have documented a link between poverty and marriage breakdown. With poverty, we see high unemployment, inadequate living conditions, derelict neighbourhoods, ill health and a lack of community resources. Each of these factors can undermine the stability of a family.[1] For those families that are not poor, the economy exerts an impact on the stability of the family. The National Council of Welfare reports that the relationship between poverty and marital breakdown is a complex one. For women, separation and divorce cause them to become poor, and living in a relationship under conditions of poverty increases the risk of separation and divorce.[2]

The economic effect of divorce on women and children has been documented in the Department of Justice's five year study of the Divorce Act.[3] After making support payments, approximately eleven percent of the men in the study were found to be below the poverty line, though the average income was still $13,500 above

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[1] Boyd, Monica, "The Social Demography of Divorce in Canada", in Marriage and Divorce in Canada ed. K Ishwaran (Toronto: Methuen, 1983), p.255.

[2] National Council of Welfare, Women and Poverty Revisited, 1990, (Minister of Supply and Services Canada, Catalogue Number H68-25/1990E) p.60.

[3] R.S.C. 1985, (2nd Supp.), c. 3.

the poverty line for their one-person household. In contrast, approximately fifty-eight percent of the women with custody reported total incomes, including support and employment income, below the poverty line. If the women studied were to depend solely on support payments for their income, ninety-seven percent with custody would be below the poverty line while, without support, approximately seventy-three percent would be living in poverty. Forty-two percent of men with sole custody were found to have family incomes below the poverty line.

The financial impact of separation and divorce is significant. While bankruptcy may have threatened a united family, the protection against this threat is reduced when the family separates. While the general approach of the courts to the Bankruptcy Act[4] is that this is a commerical statute working in a business context, the Bankruptcy Act is legislation that can have considerable impact in the non-business world of the family.

This paper is intended to provide a general overview of areas of bankruptcy law which have a particular relevance for family law practitioners. References are to the current Bankruptcy Act and comment is not offered on the proposed legislation. Sections cited from the Act are appended at the conclusion of the paper.

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[4] R.S.C. 1985, c. B-3 (as amended).

THE BANKRUPTCY ACT - GENERAL

According to section 91(21) of the Constitution Act, 1867, Parliament has exclusive jurisdiction to enact laws in relation to bankruptcy and insolvency. Each province has the exclusive right to enact laws with regard to property and civil rights within their boundaries.

The purposes of our present bankruptcy legislation are fourfold:

1. to permit the debtor to be discharged from debts, subject to reasonable conditions, so the debtor can be re-integrated into the community's economic life as a useful participant;

2. to promote the orderly and fair distribution of the bankrupt's property among creditors without preference;

3. to allow the investigation of a bankrupt's affairs; and

4. to permit the rehabilitation of the bankrupt, starting with providing for the bankrupt's financial needs.

THE BANKRUPT'S PROPERTY

Under s. 2 of the Bankruptcy Act, property is defined in very broad terms. It includes money, goods, things in action, land and every description of property, whether real or personal,

legal or equitable, and whether situated in Canada or elsewhere, and includes obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, in, arising out of or incident to property. Aside from property which the debtor holds in trust, or property which is exempt from execution or seizure, **ALL** property of the bankrupt is available for creditors. This includes property at any location at the time of the bankruptcy and property that is acquired by the bankrupt or devolved on the bankrupt before discharge.

THE STAY OF PROCEEDINGS

Section 69(1) of the Bankruptcy Act provides that upon filing a proposal or upon bankruptcy, no creditor with a claim provable in bankruptcy has any remedy against the debtor or the debtor's property, or shall start or continue any proceeding for the recovery of a claim provable in bankruptcy until the trustee has been discharged or the proposal has been refused, unless the leave of the court is obtained and then, action is taken on the terms dictated by the court. The exception to the stay is claims which are not provable in bankruptcy. Claims for payment of arrears of support and claims for ongoing support are not claims provable in bankruptcy, so they are not stayed by s. 69(1). Further, costs attributable to a support action are not claims

provable in bankruptcy and may be pursued.

Because support claims are not provable in bankruptcy, it is not necessary to obtain an order from the bankruptcy court to proceed with such a claim. Despite the bankruptcy, the support creditor is able to pursue other enforcement remedies, as well.

Section 178 of the Act is intended to protect a spouse from losing support when the other spouse becomes bankrupt. In each case the question arises whether the money owed by the bankrupt is support. In Craig v. Bassett (1988), 15 R.F.L. (3d) 461 (T.D.), aff'd at (1988) 17 R.F.L. (3d) 225 (A.D.) the former wife was owed money to assist her in re-establishing herself. These amounts were protected by s. 178 of the Act and were not released or discharged by the bankruptcy. In this case, there was no support order under the Divorce Act and our Appeal Division held that the disposition of property which had been ordered and which was intended to be maintenance or a substitute for it could fall within s. 178 of the Act. Consequently, the fact that in earlier proceedings the court had ruled that the obligations in the separation agreement constituted a debt or liability in the nature of support, did not render res judicata the issue of whether those obligations were a support order.

MATRIMONIAL PROPERTY

Under The Matrimonial Property Act[5] the untitled spouse of a bankrupt has no inchoate right to any interest in the matrimonial home. Before a spouse has an interest in this or other property, a triggering event must occur. Until a triggering event occurs, a spouse's equitable interest is dormant. Under s. 12 of our Matrimonial Property Act the triggering events are: the filing of a Petition for Divorce, the filing of an application for a declaration of nullity, the separation of the spouses without reasonable prospect of the resumption of cohabitation or the death of a spouse.

According to Glube C.J.T.D. in Sagar v. Bradley Estate (1984), 62 N.S.R. (2d) 120 at 125, a non-titled spouse has two entitlements to the matrimonial home: first, there is a right of occupation or possession; and second, there is a right to apply for a division of the matrimonial home and other matrimonial assets. The leading case canvassing the remedies of a judgment creditor against such matrimonial assets is Maroukis (1984), 5 O.A.C. 182 (S.C.C.).

In Maroukis the couple acquired the matrimonial home in joint tenancy. In November, 1978, Mrs. Maroukis commenced an

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[5] R.S.N.S. 1989, c. 275.

application for a division of assets under the then-existing Family Law Reform Act. In July, 1979, the bank entered default judgments against Mr. Maroukis. Three months later, in October, 1979, Luchak Co. Ct J. ordered that the matrimonial home vested in the wife. This decision was later revised to be retroactive to the time the wife commenced the application. By back-dating the order, the court was able to deny the interest of the bank.

Mr. Justice McIntyre upheld the judgment of the Ontario Court of Appeal that the matrimonial home vested in the wife only at the time the order was made. The Family Law Reform Act provided, in s. 4(1), that "each spouse is entitled to have the family assets divided in equal shares notwithstanding the ownership of the assets by the spouses as determinable for other purposes". According to McIntyre J., the Ontario Act did not automatically confer any property interest in family assets. The mechanism for the division of property provided by s. 4 of the Act might only be set in motion by an application for distribution. It was the application for distribution that gave the court the power to determine the division of matrimonial property between the spouses. Prior to the conclusion of the application and an order for distribution, the property regime created by the Act was not in effect. McIntyre J. wrote, at 186-7: "The vesting in a spouse of the specific property making up his or her respective share takes place upon the date the court order is made."

In Maroukis the appellant argued that because the husband had encumbered the interest in the family home contrary to the provisions of s. 42(1), the court had jurisdiction to set aside the writs of execution. Section 42(1) of the Family Law Reform Act was the companion section to s. 8(1) of our Matrimonial Property Act, with minor variations in wording. In the opinion of Mr. Justice McIntyre, this argument was without merit, primarily because the power of the court to set aside the writs of execution required that such an application be brought, and none had. Aside from this "technical point", McIntyre J. referred to the language of s. 42 and wrote, at 189-190: ". . . it is my opinion that they [the words of s.42] cannot be extended to include an execution taken by creditors of one of the parties to the marriage."

SETTLEMENTS

A settlement includes a conveyance or transfer of property: Re Bishop (1982), 55 N.S.R. (2d) 256 (T.D.). It has also been defined as a disposition of property for the benefit of the person on whose behalf the settlement is made that is subject to such restrictions and conditions on the retention of the settled property in its settled form as are imposed by the settlor. In the case of money, the restrictions imposed would relate to investment. Given the Act's broad definition of property, a

settlement can include the transfer of a contingent interest in property or a designation of a beneficiary in an insurance policy. The law relating to settlements is of particular relevance in the context of separation agreements and marriage contracts.

Section 91(1) provides that all settlements are void if a bankruptcy occurs within one year of the date of the settlement. Under s. 91(2), a settlement made more than one year, but less than five years, before the date of bankruptcy is void where the bankrupt required the property included in the settlement for the payment of debts at the time the settlement was made or if the interest of the settlor did not pass on the execution of the settlement. Such settlements are only voidable. The settlement becomes void when the bankrupty occurs.

The onus in s. 91(2) is on the trustee. With regard to the question of whether the settlor's interest passed, the presumption of a resulting trust may arise if, for example, a husband transfers property to a wife without consideration. If that presumption is rebutted, then the second branch of s. 91(2) has no application because the property did not pass on the execution of the settlement document.

In Wright (1986), 74 N.S.R. (2d) 399 (T.D.), the trustee applied to set aside a transfer of Mr. Wright's joint interest in the

matrimonial home and the transfer of three motor vehicles to his wife. The trustee relied on both the Assignments and Preferences Act and the Statute of Elizabeth, though Hallett J. did not rely on the first statute in rendering his decision. Mr. Wright's conveyance of his half interest in the matrimonial home to his wife was without consideration. The application pursuant to the Bankruptcy Act failed as the trustee did not prove that, at the time of the settlement, Mr. Wright was unable to pay all his debts without the aid of the settled property.

The second branch of s. 91(2) was also discussed by Mr. Justice Hallett in this case. The trustee had argued that, pursuant to s. 21 of the Matrimonial Property Act, there is a resulting trust where conveyances are made without consideration by one spouse to another. Hallett J. was satisfied that the presumption created by s. 21 was rebutted, because it was clearly the intention of the husband to convey his interest in the home and vehicles to his spouse and his desire to do so came from his wish to keep that property from falling into the hands of his creditors.

Mr. Justice Hallett held that these conveyances must be set aside under the Statute of Elizabeth. He was satisfied that the transfers were without consideration, that Mr. Wright had the intention to delay or defeat his creditors (the intention was imputed because the conveyance denuded him of substantially all of his property) and that the conveyances had the effect of delaying or defeating his creditors.

Upon the finding that a transaction is a settlement within the meaning of s. 91, the property transferred is deemed to be the property of the bankrupt. Once a transfer of property is found to be a settlement and void against the trustee, s. 67 will not exempt the property from the operation of the Act.

It is important to distinguish between the settlement and a gift. Each is a gratuitous disposition of property and they are differentiated by the intent with which they are made. If the donee has a free hand to use property and there is no intent that it be maintained or traceable, then the disposition is gift. As a gift, it falls under the protective umbrella provided by s. 91(3) of the Act.

A distinction can also be drawn between a settlement and a fraudulent preference. A settlement involves a gift to a stranger to the bankruptcy. A preference involves a transaction with a creditor where the creditor is preferred over other creditors. Settlements do not include business transactions. If a third party has given consideration for property received from the bankrupt, the transaction cannot be attacked as a settlement. This is because a settlement has reference only to a gratuitous disposition.

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[6] R.S.N.S. 1989, c. 25.

The provisions of s. 91 of the Act do not apply to any settlement made in specific circumstances set forth in s. 91(3): settlements made before and in consideration of marriage; settlements in favour of a purchaser or encumbrancer in good faith and for valuable consideration; and settlements on or for the spouse or children of the settlor of property that has accrued to the settlor after marriage in right of the spouse or children. The burden is on the defendant to prove that the settlement was made in one of these circumstances. If a marriage was a collusive one intended to protect the settled property from creditors, the settlement will not be saved by s. 91(3)(a). To come within the ambit of s. 91(3)(c), the property must accrue to the settlor because the person from whom it has accrued was the settlor's spouse or child and it must be for the benefit of the spouse or child.

Halibutron L.J.S.C. gave some consideration to s. 91(3)(b) in Wilson's Shopping Centre Ltd. v. Kenney (1991), 102 N.S.R. (2d) 247 (T.D.). The Kenneys separated pursuant to a separation agreement. The following year, the husband re-organized his finances by conveying his interest in the matrimonial home to his wife so she was responsible for the mortgage and other payments. At the time of the conveyance, Mrs. Kenney had no particular knowledge of her husband's poor financial situation. Shortly thereafter, Mrs. Kenney was assigned into bankruptcy and a creditor applied to set aside the transfer.

It was the opinion of Haliburton L.J.S.C. that this transfer was not a settlement, as defined by s. 91(1) because Mr. Kenney did not retain any further interest in the home, nor did he have any right to trace its proceeds. He went on further to say that Mrs. Kenney had given good consideration for the home by her surrender of her right to receive maintenance by way of mortgage, property tax and property insurance payments.

Section 92 of the Bankruptcy Act addresses covenants or contracts in consideration of marriage to pay money or settle property in which the settlor, at the date of the marriage, had no interest. If the settlement document was not executed at the date of bankruptcy, the beneficiary may prove against the estate, but can only rank for dividend after the claims of the other creditors have been paid. Section 92 applies to any marriage contract which provides for future payment of money or a transfer of property for the benefit of the settlor's spouse or children if the settlor is bankrupt before meeting the obligation. A spouse whose claim comes within s. 92 can only claim in the bankruptcy as a deferred creditor.

Section 93 complements s. 92, addressing payments or transfers which are actually made, rather than those which are simply the subject of a contract. Section 93 makes void any payment or transfer pursuant to a s. 92 contract unless the beneficiary

establishes one of the exceptions in that section or unless it is payment of a premium on a life insurance policy in favour of the settlor's spouse or child. If a payment or transfer is set aside under s. 91(3), the recipient can claim for a dividend as an ordinary creditor. If a court finds a transaction to be a settlement, the transferred property is deemed to be the bankrupt's property regardless of the transfer.

Section 95(1) makes every conveyance, transfer, security or payment given within three months prior to the bankruptcy by an insolvent person with a view to prefer fraudulent and void. According to subsection 95(2) the intent to prefer is prima facie presumed if the effect of the payment, transfer, security or conveyance does prefer. Transactions within three months of the bankruptcy which are protected by the Bankruptcy Act appear only to be those transactions which occur in the normal course of business.

According to s. 95 of the Act only a fraudulent preference which occured within three months of the bankruptcy could be attacked. When section 96 was enacted it provided that transactions occuring within twelve months of bankruptcy could be attacked if the conveyance was in favour of a person related to the bankrupt. Section 4(2)(a) provides that related persons are, inter alia "individuals connected by blood relationship, marriage or adoption".

PROVINCIAL LEGISLATION

Provincial fraudulent conveyance acts do not conflict with the Bankruptcy Act and, generally, a trustee in bankruptcy will employ these Acts to supplement the remedies and procedures of the Bankruptcy Act. Most provinces have a Fraudulent Conveyances Act which is based on the Statute of Elizabeth 1571, 13 Eliz. I, c.5. In Nova Scotia, no such statute exists. We continue to employ the Statute of Elizabeth and it has been held that, though the statute has been repealed in England, it is still in force in Nova Scotia: Bank of Montreal v. Crowell (1980), 37 N.S.R. (2d) 292 (N.S.S.C.T.D.).

Legislation such as the Assignments and Preferences Act, give operation to the principle of s. 141 of the Bankruptcy Act that all ordinary creditors rank equally in a bankruptcy. Under this legislation, it is necessary to prove: (a) there has been a gift by way of a conveyance; (b) there is an intention to defeat, hinder, delay or prejudice creditors; and (c) at the time of the transfer, the transferor was insolvent or unable to pay debts in full or knew that insolvency pending. Under the Statute of Elizabeth, it is necessary to establish a gift by way of conveyance and knowledge of impending insolvency, only.