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It was the worst of times. And then it got worse.
Divorce and bankruptcy: when two negatives can not make a positive

The unanimous July 14, 2011 Supreme Court of Canada decision in Schreyer v. Schreyer (2011) SCC 35 is the latest case to show the even more difficult circumstances in which parties to a marital breakdown can find themselves when one of them becomes bankrupt. It also highlights the challenges which arise from the constitutional division of powers in Canada, and hence the differing outcomes which can arise from things such as where the parties reside at the time of their divorce.

Schreyer is of interest, not only because it establishes what a non-bankrupt spouse can expect in an "equalization jurisdiction" such as Manitoba and Ontario, but also because of the implications which flow from it, not the least of which is the prospect of Provincial family law Courts pronouncing maintenance Orders which in fact have nothing to do with maintenance at all, but rather which are imposed as nothing more or less than compensation for the Court's inability, in view of the bankruptcy of one of the parties, to make a more traditional form of Order regarding family assets.

I. Background and Case Summary.

Under s. 91(21) the Constitution Act, the federal government's exclusive legislative powers include matters regarding bankruptcy and insolvency. Under s. 92(13), a Province's legislative sphere includes property and civil rights in the Province. In a domestic relations context, that includes things such as property and maintenance issues which arise in the course of a divorce. As Schreyer demonstrates, that means that the property entitlements of someone whose spouse becomes bankrupt can be different according the Province in which he or she lives.

The potential for differing provincial legislative regimes to affect the outcome of bankruptcy matters was recognized by the Supreme Court of Canada in Husky Oil Operations v. Minister of National Revenue [1995] 3 S.C.R. 453, in which Gonthier, J., for the majority commented as follows, at Paragraph 30:

> It is trite to observe that the Bankruptcy Act is contingent on the provincial law of property for its operation. The Act is superimposed on those provincial schemes when a debtor declares bankruptcy. As a result, provincial law necessarily affects

> the "bottom line", but this is contemplated by the Bankruptcy Act itself. Indeed, it is no exaggeration to say that there is no "bottom line" without provincial law.

The difficulty that can cause, and the Court's policy of resisting it where possible, was acknowledged at Paragraph 37 of Husky Oil, in which the Court noted that, desirable as it might be for creditors' property entitlements in a bankruptcy to be consistent across the country, that ambition can only be realized imperfectly in view of the constitutional division of powers between the federal government and the Provinces:

> I also think it is important to emphasize the importance of Roman and Sweatman's proposition 3. While I agree with my colleague Iacobucci J. that complete standardization of the distribution of property in bankruptcies is not possible across Canada having regard to the diversity of provincial laws relating to property and civil rights, yet the value of a national bankruptcy system is confirmed by the placing of bankruptcy under exclusive federal jurisdiction. As Professor Hogg has explained (supra, at pp. 25-1 and 25-2):
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> > ... debtors may move from one province to another, and may have property and creditors in more than one province. A national body of law is required to ensure that all of a debtor's property is available to satisfy his debts, that all creditors are fairly treated, and that all are bound by any arrangements for the settlement of the debtor's debts. Indeed, without these assurances, lenders would be reluctant to extend credit to persons who could evade their obligations simply by removing themselves or their assets across a provincial boundary.
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> Furthermore, as my overview of the quartet hopefully indicated, the goal of maintaining a nationally homogeneous system of bankruptcy priorities has properly been a constant concern of this Court. Were the situation otherwise, "Canada [would] have a balkanized bankruptcy regime which [would] diminish the significance of the exclusivity of federal jurisdiction over bankruptcy and insolvency.... Otherwise there could be a different scheme in every jurisdiction; ten different bankruptcy regimes would make ordinary commercial affairs extremely complex, unwieldy and costly, not only for Canadians but also for our international trading partners" (Roman and Sweatman, supra, at pp. 80 and 104). This is a prospect which this Court has been acutely mindful of in the past, and its vigilance has ensured the continuing vitality of our nation's bankruptcy legislation. In my view, its past vigilance commends itself to the present and, barring an amendment to s. 91(21) of the Constitution Act, 1867, also to the future.

The Schreyers lived in Manitoba, which like Ontario, is a "equalization jurisdiction" for family law purposes. Under the provincial Marital Property Act and its successor Family Property Act, (the "**FPA**") it is anticipated that, on the termination of a marriage-like relationship, there will be an accounting between the spouses regarding their respective property holdings, with one spouse

ultimately being found to be indebted to the other for whatever amount is required to equalize the difference between their respective family property holdings. Such jurisdictions are in contrast to "division of property jurisdictions" such as British Columbia, where the provincial legislation begins with an assumption of equal ownership of "family assets" which are to be equally divided between the parties, subject to possible judicial reallocation.

During their marriage, the Schreyers operated a farm. Perhaps because the farm had formerly been owned by the husband's parents, title to the property was in the husband's name alone. As part of the matrimonial proceedings, the wife sought an Equalization Order from the Court to address the fact that her husband alone held title to the family farm. Before that facet of the proceedings was completed, however, the husband made an Assignment in Bankruptcy. He did so without advising his wife, and he did not include her among the creditors enumerated on his Statement of Affairs. The wife did not become aware of the bankruptcy until after her husband had already been discharged. (The Court made no adverse comment regarding those circumstances. There was no suggestion that the bankruptcy was motivated by a desire to thwart the wife's recovery efforts, as seen in cases such as Henfrey Samson Belair Ltd. v. Manolescu (1985) 58 C.B.R. (N.S.) 181, 69 B.C.L.R. 216 (British Columbia Court of Appeal) and Mahood v. High Country Holdings Inc. 43 C.B.R. (3d) 267, so as provide some basis for annulling the bankruptcy and subsequent discharge and therefore permitting a different outcome.)

Complicating the wife's efforts, the farm was an asset which was exempt from execution under the Manitoba Judgments Act, and therefore did not form part of Mr. Schreyer's bankruptcy estate for division amongst his creditors. In the result, when the husband was discharged from bankruptcy, he retained ownership of the farm, despite the fact no dividend was paid to any of the creditors in his bankruptcy.

The issue which arose from the foregoing circumstances was what effect of the husband's bankruptcy and subsequent discharge was on the wife's equalization claim, which was ultimately valued at approximately $41,000.00.

The Supreme Court of Canada sent Mrs. Schreyer away empty-handed, finding that because the couple lived in an "equalization jurisdiction," she had no property claim to the farm, as she might well have had in a "division of assets" jurisdiction (Paragraphs 15 - 18); that she was therefore simply a creditor in her husband's bankruptcy estate; and that her husband's discharge from bankruptcy, obtained before she even became aware of the bankruptcy, operated to release him from the equalization claim which she had against him. It concluded that a "hybrid" approach proposed by the wife, which might allowed her a remedy akin to that which might have been had in a "division of property jurisdiction," was inappropriate since, it would confuse two distinct legislative options (Paragraph 24).

The Court took pains to note its sympathy for Mrs. Shreyer regarding the conclusion which it considered itself bound to reach, noting in Paragraph 9 that "despite the apparent injustice of the outcome, it is impossible to wish away the fact and problem of the [husband's] bankruptcy".

II. The Decision in Detail.

The Court began by reviewing the general operation of the Bankruptcy and Insolvency Act (the "**BIA**") regarding all claims, regardless of their nature. The fact the wife's claim arose from a matrimonial proceeding was considered to be of significance only to the extent it might constitute some express exception to the general, clearly-expressed governing rules, something which the Court ultimately concluded it did not.

The essence of the decision is found in Paragraphs 19 – 21, 25 - 26, 29, 32, 37, 38, and 41, as follows:

> [19] The very design of insolvency legislation raises difficult policy issues for Parliament. Legislation that establishes an orderly liquidation process for situations in which reorganization is not possible, that averts races to execution and that gives debtors a chance for a new start is generally viewed as a wise policy choice. Such legislation has become part of the legal and economic landscape in modern societies. But it entails a price, and those who might have to pay that price sometimes strive mightily to avoid it. Despite the proven wisdom of the policies underpinning the insolvency legislation, it is understandable that few appreciate the "haircuts" or even outright losses that bankruptcies trigger. So creditors seek to obtain security or third-party guarantees. In other cases, statutory exemptions from the application of the BIA may apply. For a long time, governments took care to protect their own interests, but they now generally accept, albeit with some reluctance, that they should share the fate of ordinary creditors (Century Services Inc. v. Canada (Attorney General), 2010 SCC 60, [2010] 3 S.C.R. 379). Other types of exemptions that seem fair or even necessary are set out in the BIA. However, the more exemptions there are, the less likely it is that the basic policy objectives of insolvency legislation can be achieved.
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> [20] As a consequence, the interpretation of the BIA requires the acceptance of the principle that every claim is swept into the bankruptcy and that the bankrupt is released from all of them upon being discharged unless the law sets out a clear exclusion or exemption. As I will explain below in greater detail, the [wife's] equalization claim was provable in the [husband's] bankruptcy. In light of the provisions of the BIA, it is therefore difficult, subject to one minor reservation concerning the terminology used, to find fault with the Court of Appeal's holding that the equalization claim had been "extinguished" by the [husband's] discharge. That holding appears to be faithful both to the words of the FPA and to the provisions of the BIA. In this respect, given that Ontario is also an equalization province, it is worth mentioning that the Ontario Court of Appeal recently espoused this reasoning in Thibodeau v. Thibodeau, 2011 ONCA 110, 104 O.R. (3d) 161. I agree with the following comments by Blair J.A.:
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> > Separating spouses [in an "equalization jurisdiction"] are not entitled to receive a division of property. Rather, they are entitled (generally speaking) to receive one-half of the *value* of the property accumulated during the marriage. An equalization *payment* is the chosen legislative

> default position. On the bankruptcy side, unsecured creditors are to be treated equally and the bankrupt's assets to be distributed amongst them equally subject to the scheme provided in s. 136 of the BIA. Parliament has not accorded any preferred or secured position to a claim for an equalization payment. While it has recently chosen to amend the BIA to give certain debts or liabilities arising in relation to claims for support and/or alimony a preferred status, Parliament has made no such provision for equalization claims in relation to family property. [Underlining added; para. 37.]

[21] The only reservation I have with the decision of the Court of Appeal in the case at bar relates to its numerous statements that the operation of s. 178(2) BIA has the effect of "extinguishing" the equalization claim. With respect, this provision does not purport to extinguish claims that are provable in bankruptcy pursuant to s. 121 BIA, but "releases" the debtor from such claims: see, on this point, Re Kryspin (1983), 40 O.R. (2d) 424 (Ont. H.C.), at pp. 438-39; and Ross, Re (2003), 50 C.B.R. (4th) 274, at para. 15. As is clear from the words of s. 178(2) BIA, the discharge operates to release the bankrupt from all claims provable in bankruptcy. For creditors, the discharge means that they "cease to be able to enforce claims against the bankrupt that are provable in bankruptcy" (L. W. Houlden, G. B. Morawetz and J. Sarra, Bankruptcy and Insolvency Law of Canada (4th ed. (loose-leaf)) vol. 3, at p. 6-283). ...

[25] I do not doubt that an outcome like the one in this appeal looks unfair, given that the [wife's] equalization claim was based primarily on the value of an asset — the farm property — which was exempt from bankruptcy and therefore not accessible to other creditors. None of the policies underlying the BIA require that the [wife] emerge from the marriage with no substantial assets. Parliament could amend the BIA in respect of the effect of a bankrupt's discharge on equalization claims and exempt assets. But the absence of such an amendment makes the outcome of this case unavoidable. The only way Ms. Schreyer could have avoided it would have been to obtain an order from the bankruptcy court lifting the stay of proceedings imposed by operation of s. 69.3 BIA so that she could seek a proprietary remedy under s. 17 FPA. As will be discussed below, however, the circumstances were such that Ms. Schreyer did not pursue these recourses.

[26] Section 121 BIA contains a broad definition of a provable claim, which includes all debts and liabilities that exist at the time of the bankruptcy or that arise out of obligations incurred before the day the debtor went into bankruptcy. Thus, s. 121 provides that"[a]ll debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt" are deemed to be provable claims. According to s. 121(2), the trustee

must apply s. 135 BIA to determine whether contingent or unliquidated claims are provable. If the debt exists and can be liquidated, if the underlying obligation exists as of the date of bankruptcy and if no exemption applies, the claim will be deemed to be provable. ...

[29] In the instant case, the [wife's] claim is not a proprietary claim. It was provable under ss. 121 and 135 BIA. It was not exempt from the effect of a discharge as a claim for support or maintenance under s. 178(1)(b) and (c). The bankruptcy and discharge had the effect of releasing the husband from it. The BIA and the possible remedies create an exception that applies solely to alimony or support. Although it is of equal importance, a claim under an equalization of property scheme cannot be considered to constitute support (R. J. Wood, Bankruptcy and Insolvency Law (2009), at pp. 291-92). ...

[32] In such circumstances, the appropriate remedy for a creditor like [Mrs. Schreyer] would be to apply to the bankruptcy judge under s. 69.4 BIA for leave to pursue a claim against the exempt property. Since this property is beyond the reach of the ordinary creditors, lifting the stay of proceedings cannot prejudice the estate assets available for distribution. In keeping with the wording of s. 69.4(b) BIA, this is why it would be "equitable on other grounds" to make such an order. This procedure would also accord with the policy objective of bankruptcy law of maximizing, under the BIA, returns to the family unit as a whole rather than focussing on the needs of the bankrupt: see, on this point, Hildebrand v. Hildebrand (1999), 13 C.B.R. (4th) 226 (M.B.Q.B.), at para. 16; and, generally, on Parliament's concern for the support of families, Marzetti v. Marzetti, [1994] 2 S.C.R. 765, at pp. 800-01. ...

[37] In its current form, therefore, the BIA offers limited remedies to spouses in [Mrs. Schreyer's] position. In this regard, family law may provide them with a safer harbour after the bankrupt has been discharged, more particularly through spousal support. The record in this case does not disclose whether a support order has been made, and the issue of whether support should be granted or varied is not before this Court. The appropriateness of awarding or varying spousal support and the quantum of support are matters that fall within the discretion of the family court. If a support order were made in a case like this one, the court might well aim to mitigate the inequities arising from the bankruptcy, such as the release of the debtor spouse from an equalization claim or the retention by the debtor spouse of an exempt asset (see Turgeon v. Turgeon, [1997] O.J. No. 4269 (Gen. Div.); and Sim v. Sim (2009), 50 C.B.R. (5th) 295 (Ont. S.C.J.)). Such determinations must be made on a case-by-case basis.

> [38] However, the possibility of mitigating the consequences of this litigation by means of a decision with respect to spousal support should not overshadow the problems created by the failure in the BIA to differentiate between equalization schemes and division of property schemes. The best way to address the potentially inequitable impact of bankruptcy law on the division of family assets would be to amend the BIA: see, on this point, Shea v. Fraser, 2007 ONCA 224, 85 O.R. (3d) 28, at para. 48. Over the last two decades, Parliament has made positive steps in amending the BIA to address the economic effects of divorce when those effects are compounded by insolvency, and the role of such situations in the "feminization of poverty"(M. J. Bray, "To Whom the Swords, for Whom the Shields? The Feminization of Poverty in Canadian Insolvency Practice", in J. P. Sarra, ed., Annual Review of Insolvency Law *2008* (2009), 455). ...
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> [41] However, until such legislative changes are made, creditor spouses should be alive not only to the pitfalls of the BIA, but also to the importance of the remedies available under it in such situations. In the case at bar, however, given the nature and the state of the proceedings now before this Court, I am of the view that the Court of Appeal made no errors and that the specific remedies sought by [Mrs. Schreyer] may not be granted.

As the last pair of excerpts indicate, the Court ultimately salved its conscience by laying the proverbial blame for Mrs. Schreyer's predicament at the feet of Parliament, noting in Paragraph 39 that the Senate Committee on Banking, Trade, and Commerce had recommended amendments to the Bankruptcy and Insolvency Act to address circumstances such as those arising in this case as long ago as November 2003, but that Parliament had so far chosen not to enact any. Interestingly, there was no mention of the Province's involvement in the outcome of the case because of its own policy decision to be an "equalization jurisdiction" for family law property purposes, rather than a "division of assets" jurisdiction. In any event, it would seem that what the Court perceived to be a legislative failure on Parliament's part was sufficient in the Court's view to make it appropriate for Provincial family law Courts to at least consider doing what Parliament has so far chosen not to do, by pronouncing spousal maintenance Orders, the terms of which compensate for the inadequacies the Court identified in the current bankruptcy legislation.

III. Lessons, Implications, and Trouble Brewing.

Schreyer is worthy of note for several reasons. First and most obviously, there is now clear, indeed unanimous, Supreme Court of Canada-level authority for the proposition that those non-bankrupt spouses who happen to reside in an "equalization jurisdiction" at the time of their

divorce, and who would generally be entitled to some form of Equalization Order relief, are at a distinct disadvantage in comparison to those who reside in "division of assets jurisdictions".

Second, the Court's suggested response for those in Mrs. Schreyer's position of seeking an Order lifting the automatic stay of proceedings which accompanies every bankruptcy is only of assistance in those jurisdictions where the entirety of the asset in issue is exempt. In jurisdictions such as British Columbia, where only a portion of the equity in the property is exempt, the benefit to be obtained by that means is reduced accordingly. In that regard, s. 3 of the Court Order Enforcement Act Exemption Regulation 28/98 restricts the exemption to $12,000.00-worth of equity in a residence if it is located in the Greater Vancouver Regional District or the Capital Regional District and $9,000.00 elsewhere. Indeed, as noted in our last case commentary, to the extent the law of British Columbia is accurately reflected by Re Thow 2010 BCSC 1561, 73 C.B.R. (5th) 88, now followed in Re Atwal 2011 BCSC 687 (which is currently under appeal), there would be no remedy forthcoming through that route at all if the value of the equity in the residence exceeded the amount protected by the Regulation because, according to Thow and Atwal, the equity would no longer be an exempt asset in those circumstances. If the upshot of the appeal in Atwal confirms that to be so, then the final aspect of Schreyer discussed below, i.e., the pronouncement of "compensation maintenance" Orders, might well be as much a factor in British Columbia, despite its being a "division of property" jurisdiction, as it may now become in "equalization jurisdictions".

Finally, there is the Court's surprising de facto invitation to Provincial family law Courts to do what Parliament has not, by making support Orders which effectively over-ride the outcome arising from the combination of the BIA as currently drafted and the fact of a equalization approach to family assets. The notion is remarkable on two levels.

First, the suggestion flies in the face of the reasoning in Thibodeau which the Court expressly approved, and with the Court's own observation in Paragraph 29, amplified in Paragraphs 38 and 41, that "although it is of equal importance, a claim under an equalization of property scheme cannot be considered to constitute support". If there is any real point to the distinction between claims for equalization on one hand and claims for support on the other for the purpose of explaining the basic concepts at play, surely the distinction is not less important when the time comes to apply those concepts. The two are either substitutes for each other or they or not. Simple logical consistency requires that the Court have it one way or the other, but not both.

Second, any "back door remedy" approach of the kind suggested by the Court is entirely at odds with two fundamental principles regarding the interpretation and application of statutory provisions. The first is that statutes are presumed to be well-drafted and that the Court should neither add terms which the legislator chose to omit or ignore those which the legislator chose to include. Similarly, the Court ought not to ignore distinctions which the statute makes, or impose distinctions which the statutory provision in issue does not provide: see Vachon v. Canada (Employment and Immigration Commission) [1985] 2 S.C.R. 417, 57 C.B.R. (N.S.) 113, (Supreme Court of Canada).

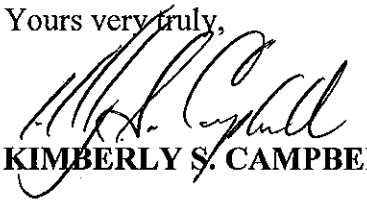
In this case, one of the fundamental bases of the Court's decision was that the wife's equalization claim, as one which ultimately reduced itself to a debt claim provable in the husband's bankruptcy, was one which was released by the husband's discharge; as opposed to one for

maintenance which expressly survived discharge pursuant to s. 178(1)(b) or (c) of the BIA. In our (always respectful) view, to invite the Provincial family law Court to ignore a distinction which is made, not only by the terms of the BIA, but even by the Court's own decision, is "a head-scratcher," if nothing else. That said, a suggestion from the Supreme Court of Canada, even if in obiter as here, is one which we would anticipate family Court Judges will find difficult to resist, particularly in highly sympathetic cases.

The second principle engaged by the Court's suggestion is that, while the Court is free to exercise its inherent discretion in supplement to a statutory provision, it can not exercise it contrary to "the clear expression of the legislative will": see, e.g., Baxter Student Housing Ltd. v. College Housing Co-operative Ltd. [1976] S.C.R. 475, 20 C.B.R. (N.S.) 240 (Supreme Court of Canada); Re United Used Auto & Truck Parts Ltd. (2000), BCCA 146, 73 B.C.L.R. (3d) 236, 16 C.B.R. (4th) 141 (British Columbia Court of Appeal). It is difficult to imagine how the Provincial family law Court could take the Supreme Court of Canada's suggestion without doing precisely that. The problem becomes all the greater, of course, if the discretion being exercised is one which is itself given by statute, and which of necessity therefore has its operation confined to the objects of the statutory provision in issue, as opposed to a more general, free-ranging inherent jurisdiction.

We trust that the foregoing has been of some interest to you. Should you have any questions arising from any of the foregoing, or if we can be of assistance in any other way, please do not hesitate to contact us at your convenience.

Yours very truly,



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