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SCHREYER v SCHREYER: SHOULD BRITISH COLUMBIA CARE?

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Many families in British Columbia and throughout Canada are currently faced with the prospect of not being able to meet their financial obligations. Not surprisingly, many find themselves facing the prospect of bankruptcy. The *Bankruptcy and Insolvency Act*[1] (the "BIA") supposedly provides the opportunity for an orderly liquidation process, a degree of protection for creditors, and an opportunity to give debtors a fresh start. However, add marital property claims into the mix with a bankruptcy and the supposed protection offered by the BIA may have the effect of creating uncertainty as to what property can be pursued upon a separation.

In a timely decision last year, the Supreme Court of Canada had the opportunity to weigh in on the interplay of insolvency legislation and family property division schemes across the country. In *Schreyer v. Schreyer*,[2] the Court had to consider the perceived clash between family law and bankruptcy law in seeking to resolve the claim by a wife denied entitlement to her previously agreed-upon equalization payment. In reaching the result, the Court offered significant comment for legislative reform so as to avoid bankruptcy and family law operating at cross purposes.

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1 *Bankrupty and Insolvency Act*, RSC 1985, c B-3 [*BIA*].

2 2011 SCC 35, [2011] 2 SCR 605 [*Schreyer*].

BACKGROUND

The Schreyers resided in Manitoba. They had a long-term marriage of nineteen years prior to their separation. In 1997, two years before their separation, the husband purchased a farm from his parents. Title was registered solely in his name. He financed the purchase by way of a mortgage.[3] The parties lived together on the farm.

Upon separation, a divorce action was brought in 2000. Later in the same year, a consent order was entered into for a valuation of their family assets. It would appear that the farm was the most significant asset that either of them owned. The valuation was to occur pursuant to the Manitoba *Family Property Act*[4] (the "FPA").

However, before the valuation had been completed, the husband made an assignment in bankruptcy. The wife was not listed as a creditor and did not receive notice of the bankruptcy. The husband was discharged from bankruptcy in November, 2002. Nonetheless, the valuation proceeded under the FPA. The trial court confirmed an amount due to the wife of $41,063.48 in 2007.

Of note, under the Manitoba *Judgments Act*,[5] the family farm was exempt from execution by creditors under the husband's bankruptcy. As such, the farm did not form part of

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3 Interestingly, there is no mention in the decision as to whether the wife guaranteed the mortgage. If she had, this may have amounted to what Belinda Fehlberg, an Australian legal scholar, has identified as "sexually transmitted debt" or "STD": Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Oxford: Oxford University Press, 1997).

4 SM 2002, c 48, CCSM c F25

5 CCSM c J10.

the bankrupt estate and the husband was thus able to continue to own and live on the farm, both throughout and subsequent to his discharge from bankruptcy. The husband was thus able to benefit from the insolvency legislation. As it transpired, the wife was not.

Upon appeal to the Manitoba Court of Appeal,[6] it was held that the model for the distribution of family assets in that province was based on an equalization theory, as opposed to the actual division of property. As such, the wife's claim only gave rise to a personal claim against the husband. It was a claim "provable" in bankruptcy and, in the result, extinguished by the husband's discharge from bankruptcy. The Court rejected the wife's argument that her claim should survive the bankruptcy on the basis that the farm was exempt property.

The wife appealed to the Supreme Court of Canada.

EQUALIZATION VS. PROPERTY DIVISION

Mr. Justice LeBel delivered the reasons for the Supreme Court. The panel of seven justices was unanimous in dismissing the wife's appeal. The reasoning from the court below was upheld. However, the Court embarked upon a considered analysis of the effect of the bankruptcy upon defeating the wife's valid claim under the family law legislation. Mr. Justice LeBel was quick to note:

> Despite the apparent injustice of the outcome, it is impossible to wash away the fact and problem of the respondent's bankruptcy.[7]

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6 2009 MBCA 84.

7 *Schreyer*, *supra* note 2 at para 9.

In the analysis of the Court, the problem lay with the fact that Manitoba has adopted an equalization model of property division. The equalization model requires one spouse to pay to the other an amount in money or otherwise receive a transfer of assets in lieu of that amount.

In contrast, the division of property model, which has been adopted in British Columbia, gives rise to a proprietary or beneficial interest in the assets themselves. The court found that the equalization model created a relationship that was more in the nature of debtor-creditor in that the creditor spouse obtains a monetary claim against the debtor spouse.

The court also added:

> 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.[8]

The court analyzed the structure and policy of the BIA, noting that creditors will seek, where possible, to avoid its application by seeking security on third-party guarantees. Statutory exemptions may also apply; however, the court recognized that the more exemptions there are, the less likely it would be that the basic policy objectives of insolvency legislation could be obtained.[9]

Mr. Justice LeBel was clear that:

> ... the interpretation of the BIA requires the acceptance of the principle that every claim is swept into the bankruptcy and that

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8 *Ibid* at para 19.

9 *Ibid* at para 19.

> the bankrupt is released from all of them upon being discharged unless the law sets out a clear exclusion or exemption.[10]

Counsel for the appellant, no doubt getting a sense of the way the judicial wind was blowing, argued that in fact the Manitoba legislation created a 'hybrid claim', giving rise to proprietary rights. However, the court rejected this on both legal and policy grounds. First, it held that any proprietary interest arose only at the remedial stage and only upon the parties' agreement or court order. Secondly, the court said that to accept such an interpretation would be to interfere with the clear policy choice that the Manitoba legislature made in adopting the equalization model.

The court, after undertaking an analysis of what a provable claim is, confirmed that the wife's claim was one that was provable in the bankruptcy. Even though the amount of the claim had not been identified at the date of the bankruptcy, or for that matter by the date of the husband's discharge, it was not so uncertain as to avoid the scope of the BIA. The court affirmed:

> A right to payment existed in this case from the time of separation of the spouses, and hence existed at the time of the bankruptcy.[11]

Only the quantum remained to be determined. As the claim of the wife was not proprietary in nature, the husband's bankruptcy and discharge had the effect of releasing him from further liability.

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10 *Ibid* at para 20.

11 *Ibid* at para 27.

APPLICATION OF *SCHREYER* IN BRITISH COLUMBIA

As British Columbia is a property division jurisdiction, the immediate dilemma faced by Mrs. Schreyer does not necessarily arise. However, the issues arising within the case do give rise to concerns here.

The division of matrimonial property in British Columbia is governed by the *Family Relations Act*[12] (the "FRA"). Section 56(1) sets out as follows:

> Subject to this Part and Part 6, each spouse is entitled to an interest in each family asset on or after March 31, 1979 when
> (a) a separation agreement,
> (b) a declaratory judgment under section 57,
> (c) an order for dissolution of marriage or judicial separation, or
> (d) an order declaring the marriage null and void respecting the marriage is first made.

The happening of any of the events referred to in section 56(1) of the FRA is referred to as a 'triggering event'. Upon the occurrence of a triggering event, each spouse has an undivided one-half interest in all of the family assets as tenants in common. The interest each spouse is entitled to is vested at that time. Further, the interest is not limited to an undivided one-half interest in its value, but in the asset itself.[13]

Given the underlying nature of the property regime in B.C., the immediate problem presented by *Schreyer* does not necessarily arise. Nonetheless, there is still cause for concern

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12 *Family Relations Act*, RSBC 1996, c 128.

13 *Blackett v Blackett* (1989), 22 RFL (3d) 337 (BCCA).

with respect to the intersection of family law property rights and bankruptcy legislation in B.C. These relate primarily to the timing of the bankruptcy in relation to the occurrence of the triggering event under the FRA.

Three areas of concern currently exist in this regard:

Bankruptcy Before a Triggering Event

B.C. courts have determined that, as the vesting of the spouses' interests in family assets only arises upon a triggering event, a prior declaration of bankruptcy will defeat any claim by a spouse against family assets in the possession of the bankrupt spouse.[14]

As in most bankruptcies, those assets will vest free and clear in the trustee, subject to the claims of the secured creditors and subject to any exemptions recognized under the BIA.[15]

Bankruptcy After a Triggering Event

Before Division of Assets

An assignment in bankruptcy subsequent to a triggering event does not adversely affect the vesting of an undivided one-half interest as tenant in common in any family assets.[16] The trustee will still take the other half interest in the property pursuant to section 71 of the BIA.

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14 *Biedler v Biedler* (1983), 33 RFL (2d) 366, [1983] 5 WWR 129 [*Biedler*].

15 *Walters v Walters* (1985), 62 BCLR 334, 56 CBR (NS) 104 (BCSC).

16 *Biedler, supra* note 14.

After Division of Assets

If assets have already been divided by either agreement or court order, the trustee will be limited to only pursuing property not otherwise dealt with.[17]

However, it should be noted that if the agreement or order has given rise to a monetary obligation which has not been perfected at the time of the bankruptcy, the claim will be treated similarly to those of other unsecured creditors. This was the precise problem faced by Mrs. Schreyer. It is not uncommon in property agreements for one party to accept a lump sum settlement in return for surrendering any claims against family assets held by the other party. In such an instance, reference must be made to section 67 of the BIA to determine if property vested in the trustee is property which is subject to a trust claim.

Exempt Property

Under the BC *Court Order Enforcement Act*[18] ("COEA"), provision is made for the allowance of exempt assets. Personal property is dealt with under section 71 and real property is dealt with under section 71.1. However, under both sections, the exemptions are very small. The debtor is only allowed an exemption of between $9,000 and $12,000, depending on area of residence, in the proceeds of sale of their principal residence (COEA Exemption Regulation 28/98).

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17 *Re Speklie* (1996), 18 BCLR (3d) 229, 39 CBR (3d) 7 (BCSC).

18 *Family Relations Act*, *supra* note 12.

BC FAMILY LAW ACT

After many years of discussion, albeit mostly not in the legislature, the B.C. *Family Law Act* (the "FLA") (Bill 16-2011) was given assent on November 23, 2011.[19] However, it has yet to be proclaimed. Coincidentally, as with the FRA, property division is dealt with in Part 5 of the Act. Section 81 sets out as follows:

> Subject to an agreement or order that provides otherwise and except as set out in this Part and Part 6 [*Pension Division*],
> (a) spouses are both entitled to family property and responsible for family debt, regardless of their respective use or contribution, and
>
> (b) on separation, each spouse has a right to an undivided half interest in all family property as a tenant in common, and is equally responsible for family debt.

The obvious significant difference between the existing language of the FRA and that of the FLA is when the entitlement to an undivided interest in family property arises. The FLA contemplates that this interest will arise "on separation". There no longer appears to be the need for a more proactive triggering event such as an order for dissolution of a marriage.

"Separation" is not defined in the new Act. However, the FLA does provide, in section 3(4):

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[19] Bill 16, *Family Law Act*, 4th Sess, 39th Parl, British Columbia, 2011 (assented to 24 November 2011), SBC 2011, c 25, online: <www.leg.bc.ca/39th4th/3rd_read/gov16-3.htm#part3div2>.

> For the purposes of this Act,
> (a) spouses may be separated despite continuing to live in the same residence, and
> (b) the court may consider, as evidence of separation,
> (i) communication, by one spouse to the other spouse, of an intention to separate permanently, and
> (ii) an action, taken by a spouse, that demonstrates the spouse's intention to separate permanently.

Therefore, for the purpose of property division, parties are not considered to have separated if, within one year after separation, they have lived together for the primary purpose of reconciliation. Such a period of reconciliation must total 90 days. However, the 90 days are not required to be consecutive, as long as the period of reconciliation occurs within one year of separation.

PRACTICAL CONCERNS

Trustees dealing with property in B.C. currently have to consider if there are any outstanding or pending claims against matrimonial property. Firstly, they need to determine the status of any family proceedings including claims against property. They will have to determine whether any orders or agreements have been made or entered into.

Even if an order or agreement has been made, the trustee should determine if it has been perfected, as it may determine what property may yet vest in the trustee. The issue of trust property will also have to be considered.

The trustee's inquiries will become more broad once the FLA is proclaimed. The trustee will have to determine if the parties were separated at the time of the assignment into

bankruptcy. Also, the trustee may have to monitor the marital status of the parties for one year after the alleged separation. Any reconciliation attempt in excess of 90 days during that year may give rise to additional property vesting in the trustee. This may affect the date on which a discharge can be granted in British Columbia.

Spouses in B.C. must act expeditiously if they anticipate that their partner is considering bankruptcy. Obtaining a triggering event as soon as possible will make it much easier to protect their claims against matrimonial property. Once the FLA is proclaimed, it will be easier to pursue claims as only a "separation" is needed. However, clear and cogent evidence of that separation will likely be needed if the spouse hopes to stave off claims by the trustee against disputed property.

Certainly the pending FLA is likely to expand the incidents of conflict between competing claims for marital property under both family law and bankruptcy law provisions.

CONCLUSION

In *Schreyer*, the Supreme Court of Canada urged Parliament to act quickly to clear up the likes of the loophole that gave rise to the dilemma with which the Court was faced, noting that the remedies under the BIA for claims against marital property are limited. The court did hold out the prospect of pursuing a spouse after a discharge from bankruptcy through spousal support, as section 178(1)(c) of the BIA accords special treatment for obligations arising for maintenance or support of a spouse or children.[20] However, the court recognizes that this option may not always exist and it is a poor fallback position when considering that it is a failing in the BIA to give effect to the wife's claim to her share of family assets.

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20 *BIA*, *supra* note 2 at para 37.

As family law practitioners know, these claims are inherently difficult to pursue and even if successful may prove empty if the bankrupt has no means to pay.

In a not so subtle prompt, the court noted that it has been almost eight years since the Senate Standing Committee on Banking, Trade and Commerce report on the BIA recommended "prompt resolution" for such inequities. Specifically, it was recommended that bankruptcy should not stay or release a claim against exempt assets under either model for dividing family property. Mr. Justice LeBel said:

> More than seven years have elapsed since the Committee issued its report. It seems to me that this matter is ripe for legislative attention so as to ensure that the principles of bankruptcy law and family law are compatible rather than being at cross purposes.[21]

In reaching the conclusion that it did, the Supreme Court went to great lengths to point out that this is a case where the law appears to trump common sense:

> I do not doubt that an outcome like this one in this appeal looks unfair, given that the appellant's equalization claim was primarily based on the value of an asset – the farm property – which was exempt from bankruptcy and therefore not accessible to other creditors. None of the underlying policies of the BIA require that the appellant 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

21 *Ibid* at para 40.

> exempt assets. But the absence of such an amendment makes the outcome of this case unavoidable.[22]

One cannot help but agree with the Supreme Court that until the necessary legislative changes are made, creditor spouses must be wary of the BIA. Even in a province with a division of property regime, like British Columbia, there is a clear need for a review of the BIA to ensure that it does not interfere with the *prima facie* property rights of spouses upon separation. Given the continuing uncertain economic future in Canada, Mrs. Schreyer is likely to have more company before any review of or protection is offered her under the BIA.

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22 *Ibid* at para 25.