Bankruptcy and Family Law: What a Solvent Spouse Should Know

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INTRODUCTION AND SCOPE

Unfortunately, the breakdown of a marriage is far too often accompanied by financial problems of one or both spouses. Sometimes these financial problems cause or contribute to the breakdown of the marriage, while in other cases the marriage breakdown causes or contributes to the eventual bankruptcy.

This paper explores some of the general principles that family practitioners (and insolvency practitioners as well) should be aware of with respect to the intersection between family law proceedings and bankruptcy, with a focus on strategies to protect the solvent spouse. It will start out with some relevant bankruptcy basics, then proceed to address some issues surrounding timing and priority, contents of matrimonial property agreements and Orders, Certificates of Lis Pendens ("CLPs"), and other strategies to assist the solvent spouse.

While the basics are covered and some commentary is provided on some issues of interest, this paper is not intended to be an exhaustive review of this area of law. Therefore, readers are encouraged to take note of the "References and Further Reading" section at the end of this paper.

Furthermore, this paper focuses solely on the effect of bankruptcy. It does discuss the effect that a Division 1 Proposal or Consumer Proposal may have on matrimonial proceedings.

In addition, this paper is not intended to be relied upon as legal advice. Readers are advised to obtain legal counsel to explore their full range of options in light of their particular circumstances.

The reader should also be cautioned that matrimonial property regimes may differ significantly from province to province. This paper focuses solely on the law that is relevant in Alberta.

Throughout the paper, there is discussion about the solvent spouse, the insolvent spouse, and the trustee. For convenience, this paper presumes at times that the insolvent spouse is the husband, and reference is made to "him" or "he", and likewise for the gender of the Bankruptcy Trustee (most Trustees are actually corporate entities). Nothing is implied by this and it is not intended to give credence to any stereotypes; rather the aim is to assist with ease of phrasing and to avoid the reader having to put straight in his or her mind which spouse is the solvent one and which is the insolvent one.

BANKRUPTCY BASICS

For those who practice primarily in the area of insolvency, this section of the paper may be elementary. However, it is common that some of the basic bankruptcy principles are quite foreign to those without significant practice in the insolvency area. This section will highlight a few of the basic principles to keep in mind as we explore more specific issues.

The following are some of the fundamental principles that will be most germane to the topics covered in this paper:

- The *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (hereinafter the "BIA" or the "Act") is federal legislation. Where there is an operational conflict between the BIA and provincial statues, the BIA trumps provincial law.
- Bankruptcy triggers an automatic stay of proceedings against the bankrupt. There are a few exceptions here, with the ones relevant to the topics at hand discussed later.
- The bankrupt's "property" (which is broadly defined under the BIA – see section 2) vests in the Trustee upon bankruptcy (s.71). Accordingly, the Trustee does not simply distribute the bankrupt's property – he becomes the owner of it. The Trustee will generally proceed to liquidate the bankrupt's assets, and where sufficient funds are realized (net of secured creditor claims), pay a dividend to unsecured creditors (generally on a *pro rata* basis, although certain classes of unsecured creditors may have some priority over the general body – see s.136 of the BIA for the scheme of distribution)[1].
- Upon the bankrupt's discharge, he is released from all debts and claims that are "provable" in the bankruptcy (with a few exceptions – see s.178), regardless of whether the creditor filed a proof of claim in the bankruptcy proceedings or even had notice of the proceedings (although there may be some remedies available for this latter situation). Provable claims are defined generally at s.121(1) of the Act as follows:

  > All 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 shall be deemed to be provable in proceedings under this Act.

[1] As noted, a discussion of Proposals, which is another common insolvency option under the BIA, is beyond the scope of this paper. However, a crucial distinction between a bankruptcy and a BIA proposal is that there is no vesting of property in the latter.