

BANKRUPTCY: EFFECTS ON JUDGMENTS AND PRIORITIES IN A TITLE SEARCH

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Introduction

This paper is intended to be a practical discussion of common issues arising where bankruptcy appears in the chain of title to real property. The first part will summarize the most relevant sections in the Bankruptcy and Insolvency Act ("BIA"). Subsequently, it will discuss several issues in greater detail. I acknowledge previous papers done on this topic by W. Mark Penfound and J. Craig McCrea.¹

Relevant Sections of the Bankruptcy and Insolvency Act

Section 70(1)

A Receiving Order or Assignment in Bankruptcy "takes precedence" over judgments and all judicial or other attachments, garnishments or certificates having the effect of judgments and executions. This means that the charge on realty a judgment creditor has obtained in the Court process is lost and the judgment creditor is reduced to the same rights of any unsecured creditor who files a Proof of Claim with the judgment debtor's Trustee in Bankruptcy.

Section 71(2)

Upon bankruptcy (ie., a Receiving Order being made, an Assignment in Bankruptcy filed with the Official Receiver, or a Division I proposal being refused by creditors or not approved by

registration of the Receiving Order or Assignment in Bankruptcy obtains title as validly and effectually as if no Receiving Order or Assignment in Bankruptcy had been made.

Section 99

A transaction by a bankrupt with any person dealing in good faith and for value in respect of property acquired by the bankrupt after his bankruptcy is valid if completed before any intervention by the Trustee.

**Section 30(1)(a),
20(1) & 40**

The approval of the inspectors is normally required for the Trustee to sell property of the bankrupt, or disclaim or quit claim any interest (normally to a mortgagee) or where such a property cannot be realized, returning it to the bankrupt. Approval is not required where the bankruptcy is a summary administration, ie. where the value of assets is less than \$5,000.00 - see Sections 49(6) and Section 155.

Section 61(1)

A bankrupt can make a proposal, and if approved, the proposal unless otherwise stated, reverts the property of the bankrupt in the debtor.

**Section 180(1)(2)
& 181(1)**

Where a bankrupt has failed to perform the duties imposed on him, obtained his discharge by fraud, or the Court determines that a Receiving Order ought not to have been made or an assignment not filed, the Court may annul the bankruptcy. This vests in the bankrupt or other person as may be appointed in the Order the property of the bankrupt, subject to prior transactions done by the Trustee acting under his authority.

the Court), a bankrupt ceases to have any capacity to dispose of or otherwise deal with his property which, subject to the rights of secured creditors, vests in the Trustee.

Section 71(1)

The date of bankruptcy relates back to and commences at the time of the filing of a Petition for a Receiving Order or the date of filing an Assignment in Bankruptcy with the Official Receiver.

Section 57, 61(2)

Where a proposal is refused by the creditors or not approved by the Court, the date of bankruptcy "relates back" or is effective on the earliest of the filing of the Notice of Intention to File the Proposal, the filing of the proposal with the Official Receiver, or the date the first Petition for a Receiving Order was filed.

Section 67(c)

"Property of the bankrupt" which vests under 71(2) in a Trustee in bankruptcy includes all property of the bankrupt at the date of his bankruptcy and property acquired by or devolving on him after his bankruptcy but before his discharge.

Section 74

A certified true copy of a Receiving Order or Assignment in Bankruptcy may be registered by the Trustee in the Registry of Deeds for the district in which the bankrupt owns real property, and pursuant to 72(2), the Registrar of Deeds must accept it for registration regardless of whether it otherwise complies with Registry Act requirements.

Section 75

Notwithstanding the bankrupt's lack of capacity to deal with the property under 71(2) a bona fide purchaser or mortgagee for value who records his instrument in the Registry of Deeds prior to the

Release of Judgments on Bankruptcy of Judgment Debtor

The release of Judgments against a debtor on the debtor's bankruptcy occurs by virtue of Section 70(1) of the BIA, but it is subject to the following exceptions:

- (a) Where the debtor has conveyed property after registration of a judgment and before his bankruptcy, then that real property is no longer considered property of the bankrupt and that judgment is not released.²

- (b) Where the judgment is in favour of Workers' Compensation Board and the bankruptcy occurred on or after November 30, 1992, the effective date of amendments to the BIA, the Workers' Compensation judgment will not be released because it is considered a secured claim.³ Workers' Compensation judgments will be returned to unsecured status for bankruptcies occurring after a prescribed date if proposed amendments to Section 86 of the BIA are enacted.⁴

Judgments will be released if a mortgage has been registered against lands of the debtor after registration of the judgment although the mortgage will remain as a secured claim in bankruptcy!⁵

All Provincial Crown statutory liens which would outside of bankruptcy constitute a charge on real estate become unsecured claims in bankruptcy by virtue of the Federal power over bankruptcy and insolvency and Section 86 and 87 of the BIA. The Courts have consistently held that Provincial statutes cannot create statutory liens in favour of the Crown or agents of the Crown as this would destroy the integrity of the Federal bankruptcy power. Only true "secured creditors" claims will survive bankruptcy. Claims of Mechanics' Liens have been always held to be true secured claims.

Where a debtor has judgments registered against him and makes a proposal under the BIA, a question arises as to whether Section 70(1) applies to release the judgments as encumbrances against the debtor's real property. Section 66 of the BIA states that all provisions of the BIA apply to Division II Proposals "in so far as they are applicable...with such modifications as the circumstances require...". Proposals can vary considerably in their terms and conditions, and it depends on the intent of the proposal as to whether judgments against the debtor are released upon acceptance by the creditors and approval by the Court. If the proposal vests all of the property of the bankrupt in the Trustee, then there is clear authority that the judgments are released.⁶ In my opinion, proposals which do not vest all assets in the Trustee but which specifically state that judgments shall be released and are so approved invoke the provisions of 70(1) of BIA, because a proposal once accepted and approved in accordance with the procedures of the BIA is a contract binding on all creditors⁷ (other than those listed in Section 178⁸).

Joint Tenancy

Bankruptcy of a joint tenant of real property acts to sever the joint tenancy and convert it to a tenancy-in-common.⁹

Sales by Trustee

As stated at the beginning of this paper, Sections 20, 30 and 40 provide the basis on which Trustees can sell property of the bankrupt. A sample form of Deed is attached to Craig McCrea's article, and he notes that it is a requirement that the Trustee obtain the permission of the inspector to such a sale. As stated in the In Standard 26 of the Practice Standards for Real Property Transactions in Nova Scotia adopted by the Barristers' Society on February 16, 1996, the approval may be indicated by the inspector signing the Deed, by a Statutory Declaration of the Trustee, or by a copy of an inspector's Resolution certified by the Trustee. Clearly, having

the inspector sign the Deed is the preferred method where there is a single inspector, but when there are a number of inspectors, it is more usual to have a copy of the Resolution signed by each of them and appended as a schedule to the Deed and referred to in the recitals of the Deed.

Discharge from Bankruptcy

Section 178(2) states that all debts, other than those described in Section 178(1), which constitute "claims provable in bankruptcy" are released on the bankrupt's discharge from bankruptcy. The Discharge Order would rarely be filed at the Registry of Deeds, so something must be recorded for a chain of title for real property out of a Trustee following registration of the Assignment of Bankruptcy or Receiving Order in the Registry of Deeds. This should be accomplished by a Trustee's Deed under Section 30(1) or a disclaimer or quit claim under 20(1) to a third party or to the bankrupt pursuant to Section 40.

In an unreported decision of the Registrar in Bankruptcy¹⁰, it was held that a Trustee may not claim any equity in real property which has accrued after the bankrupt's discharge from bankruptcy. The Trustee has an obligation to realize the equity prior to the discharge or to divest it to the bankrupt under Section 40.

After the Trustee in Bankruptcy has completed the administration of the bankruptcy, the Trustee applies for a discharge as Trustee, confirming that its duties have been completed. However, should assets not disclosed to the Trustee surface after the Trustee's discharge, any interested person may apply to Court for re-appointment of a Trustee under Section 41(11). The original Trustee, although discharged, remains "de facto Trustee" of the estate for administration purposes under Section 41(10). Accordingly, where a purchaser's solicitor identifies property owned by a bankrupt which has not been conveyed by the Trustee and is subsequently found to be property not disclosed by the bankrupt to the Trustee, then the original Trustee should be contacted to be re-appointed as Trustee to complete the administration of the bankruptcy.

After Acquired Property

In some circumstances it is important to confirm a bankrupt has been discharged, because property acquired by the bankrupt after his bankruptcy, but before his discharge vests in the Trustee pursuant to Section 67(c). In Re Janetta¹¹ a bankrupt who had not received his discharge nine years after his bankruptcy acquired land with a loan from his parents. His Trustee in Bankruptcy applied to have the land sold and the proceeds paid to the Trustee for distribution to his creditors pursuant to Section 67(c). The Court acknowledged that the property devolved to the Trustee, but in the circumstances, determined that his parents had a subrogated claim to a vendor's unpaid lien, at the same time expressing some sympathy that the bankrupt's parents could not have imagined that he would not be discharged nine years after his bankruptcy.

Matrimonial Issues

Under Section 172, the Court can discharge a bankrupt absolutely, suspend a discharge or make a Conditional Order of Discharge. In the case of a Conditional Order, the Conditional Order may immediately discharge the bankrupt if the bankrupt consents to a judgment in the amount and on the terms provided in the Conditional Order, or the Court may order that the bankrupt remain undischarged until all the conditions are satisfied. In Re Gray¹² the bankrupt received a Conditional Order requiring him to pay \$10,000.00 in a lump sum to the Trustee. Subsequent to his bankruptcy and before his discharge he separated from his wife and commenced proceedings for a division of matrimonial assets. Several months later the bankrupt paid \$10,000.00 to the Trustee and obtained his discharge from bankruptcy. The Court held that his share of the matrimonial assets vested in the Trustee as after acquired property because his discharge was not obtained until after Court proceedings giving rise to his claim were commenced.

The right of a spouse to apply for division of matrimonial assets is not considered "property of the bankrupt" but a mere personal right. Therefore, should a similar situation to the Gray case arise in Nova Scotia, where the application for division of assets is made after the bankrupt's discharge, the debtor's share in the matrimonial assets would not accrue to the Trustee, even though the parties may have separated prior to the discharge being obtained.

Where a matrimonial home is owned jointly by husband and wife and one becomes bankrupt, the Trustee may have difficulty realizing on the half interest of the bankrupt spouse, as Courts generally have a discretion as to whether to order partition and generally do not do so where it causes undue hardship to one party.¹³

Property Held in Trust

Interesting situations arise where a bankrupt claims to hold property in trust for another, and if such a trust claim is valid, that property does not vest in the bankrupt's Trustee. However, particular scrutiny would be paid to such a declaration and to whether the declaration was executed on a timely basis.

Innocent Third Parties

Sections 75 and 99 protect innocent third party purchasers or mortgages for value where the Trustee has not intervened by filing the Assignment in Bankruptcy or Receiving Order in the Registry of Deeds or otherwise notifying the third party of the bankrupt's status. This puts an onus on Trustees to immediately file these documents in the Registry of Deeds where it believes the bankrupt has property.

1. Bankruptcy in the Chain of Title, W. Mark Penfound, Practical Property II, CLE Materials, October 12 & 13, 1984;

Buying a Commercial Property from a Receiver or Trustee, McCrea, J. Craig; Real Estate; CLE Materials, October 11, 1992 and October 9, 1992;
2. Starratt v. Turner (1989) 78 CBR (N.S.) 83 (N.S.C.A.);
3. Workers' Compensation Board of Nova Scotia v. Coopers & Lybrand Limited, unreported June 5, 1995, Edwards, J., (N.S.S.C.);
4. Bill C-109 1st Session 35th Parliament 42-43-44 Elizabeth II, 1994-5, an Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act and the Income Tax Act which will be likely re-introduced in the current session of Parliament.
5. Parker & Eakins Co. v. Royal Bank of Canada (1922) 3 CBR 211 (N.S.C.A.);
6. Bruce v. Silver (1978) 29 N.S.R. (2d) 590 (N.S.C.T.D.);
7. Re Zutphen Bros. Construction Ltd. (1994) 132 N.S.R. (2d) 337 (N.S.C.A.); Re Relcor (1977) 18 N.S.R. (2d) 370 (N.S.S.C.A.D.);
8. Flint v. Barnard (1888), 22 Q.B.D. 90 (C.A.);
9. Re White (1928) 8 CBR 544, [1928] 1 DLR 846 (Ont. S.C.);
10. Unreported decision of Registrar Smith dated October 17, 1994 in Court Nos. SPB2049, SPB2048, 8509, SY1956, 9802;
11. Re Janetta (1990) CBR (N.S.) 139 (Ont. S.C. Master);
12. Re Gray (1988) 67 CBR (N.S.) 161;
13. Yale v. MacMaster (1974) 18 C.B.R. (N.S.) 225, 46 DLR (3d) 167 (Ont. H.C.).