The Effect of Bankruptcy on Legal Interests in Land
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What effect does a discharge from bankruptcy have upon a judgment debt that was registered against the land of the bankrupt prior to his or her assignment? Does it matter whether the land in question was transferred to a third party after the debt was registered but before the assignment was made? In what follows I suggest two points that lawyers and conveyancers ought to keep in mind when dealing with this type of case.

First, as a general rule a discharge from bankruptcy will extinguish the debt that underlies the registered judgment and so render the registration nugatory.

Second, there is a caveat to the general rule. Certain types of judgment debts are *not* extinguished by a discharge from bankruptcy. These 'exception' judgment debts (s. 178(1) debts described below) registered against the land of such bankrupts are *not* extinguished and continue to bind the land. And the only safe way to determine which case applies is to search the pleadings and the decision of the lawsuit that underlay the judgment debt.

We take as our starting point an owner of land. He or she is sued for damages. They lose. Judgment is entered against them, and the judgment is registered against their land. The judgment binds the land.

Now assume that the judgment debtor transfers the land to someone (often a relative), and then makes an *assignment* in bankruptcy. What happens if the transferee then in turn sells or transfers the land? Can the purchaser or the new owner take the land free of the judgment debt?

The qualified answer is "no." The assignment alone does not affect the registration of the judgment. The registration of the judgment is not affected because the land is no longer part of the estate of the bankrupt. Hence the judgment continues to bind the land: see *Starratt v. Turner* (1989) 78 CBR (NS) 83 (NSCA). Anyone who then purchases or accepts a transfer of the land in question will receive land that is still subject to the judgment debt.

Discharge of Bankrupt

The question that *Starratt v. Turner* did not answer is this: what happens to the judgment debt (and hence the registration) in such a case once the judgment debtor is *discharged* from bankruptcy? A review of the issue and of the original court file in the *Starratt v. Turner* case indicates that the decision in *Starratt v. Turner*

i) stands only for the very limited proposition that an *assignment* in bankruptcy does not *in and of itself* affect the registration (or the enforceability) of any executions which had been registered against land formerly owned by the person who has made the assignment, but

ii) said and says nothing about the effect *of the discharge* of that person upon the enforceability of those executions.

As a general rule, the discharge will release the judgment debt, regardless of whether the debt was for tort or contract breach: s.178(2), *Bankruptcy and Insolvency Act*, RSC 1985, C.B-3 (the "Act"). Once the judgment debt is released the security that was registered in respect of that debt (that is, the

judgment) is rendered null and void; there is nothing left for it to secure: see *Franklin v. Schultz* (1967) 62 DLR (2d) 643 (Ont. CA). The judgment may still show in the chain of title, but it no longer has any practical effect.

Section 178(1) Exceptions

One must recall however that s.178(2) does not release *all* judgment debts. It does not release the types of debt which are specified in s.178(1) of the Act. It does not, for example, release debts or liability "arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity:" s.178(1)(d). Examples of these types of debts or liability are given in Holden and Morawetz, *Bankruptcy and Insolvency Law of Canada* (Toronto, 3rd ed.) at chapter H§22(4)(b) and include the following: money advanced by the creditor to the debtor for a specific purpose, but used for something else (though *semble*, it may also require a position of vulnerability on the part of the creditor and influence on the part of the debtor); a solicitor in relation to a client; an employee who handles his employer's money in whatever form; an officer in relation to his or her company; in some cases, a partner who fails to account to his or her partners.

The law also appears clear that judgment creditors in respect of *these types* of debt are not affected by the discharge order. Such a creditor can apply to the court for an order that the discharge does not affect him or her: see, for e.g., *Berthold v. McLelland* (1994) 25 CBR (3d) 45 (Alta CA); *Blakley v. Horsman* (2001) 25 CBR (4th) 12 (Sask QB). If such a creditor can so apply, then it follows that if he or she does, and if a court rules that the debt falls within s.178(1), then:

i) the debt remains in play (was not released) despite the discharge order; and accordingly,

ii) the registered judgment continues to have substance and legal effect, since the debt that feeds it remains in place.

In other words, the land subject to the registered judgment with respect to a s.178(1) debt or liability remains subject to seizure and sale by the Sheriff, even though the bankrupt no longer owns the land, did not own it at the time of the original assignment in bankruptcy, and has since been discharged from bankruptcy. However, if the judgment is not based on a s. 178(1) debt, but is rather a typical trade debt, the *discharge* of the bankrupt judgment debtor will extinguish the underlying debt–hence rendering the judgment of no force or effect.

The decision in *Starratt v. Turner* does not affect this conclusion. A review of the facts of the case, and in particular of the court file, reveals that the case dealt only with an *assignment*. The judgment debtor in that case (who had transferred land that was subject to the registered judgment) had made an assignment in bankruptcy, but he had not been granted a discharge as of the hearing.

From this it would appear that one cannot determine for certain whether or not a particular debt or liability has been discharged unless one knows how the debt or liability arose. One needs to know first whether the judgment arose out of a "normal" trade debt (in which case it would be released upon the discharge of the bankrupt), or whether it arose out of a s.178(1) situation, in which case it would not be released. While a lawyer may be able to determine that it is obviously a trade debt by the name of the judgment creditor (e.g. *Sears.* v. John Doe) or from his/her other knowledge of the circumstances of the underlying debt, in other cases it may be necessary to search the underlying pleadings/decision in order to determine the nature of the debt.

The problem is compounded by the fact that the judgment itself does not need to refer to any of the s.178(1) *indicia* to be effective for s.178(1) purposes. It is enough that the underlying facts and causes of action did fall within s.178(1): *Re Hayton* (2005) CarswellOnt 6394 (Ont SCJ). This means that one cannot simply rely on a judgment being listed in a Statement of Affairs. One would have to look at the underlying pleadings and, if there was one, the decision to determine whether or not the judgment debt was one that was released by the discharge.

Conclusion

A title searcher who comes across a judgment that was registered against a prior title holder cannot rely entirely upon the subsequent discharge of bankruptcy of the prior title holder as releasing (or negating) the binding effect of the registered judgment debt. The judgment may still bind the land. Unless it is obvious from the name of the creditor that it is a normal 'trade' type debt, one can know for certain whether the judgment still binds only if one checks the pleadings or the decision that underlay the judgment, so as to determine whether the debt in question was or was not a s.178(1) type debt.