

October 2005

OBSTRUCTIONIST

The purpose of the Bankruptcy Act is to allow unfortunate debtors to start their financial lives afresh. Conversely, it is not meant to be a fiscal car wash. The court must keep these two themes in mind when determining whether to grant a discharge after bankruptcy. These themes were readily apparent in the 2005 Ontario Superior Court of Justice decision of Re Zolnierowicz.

Nasty Business

The bankrupt was not a model unfortunate debtor. When he made his assignment into bankruptcy, he "forgot" to disclose to his trustee in bankruptcy the fact that he had transferred title to his residence to his son one month before the assignment. He "remembered" and told his trustee before the closing of the sale of his residence. Ultimately, the trustee obtained an order setting aside the conveyance as fraudulent.

Then the bankrupt refused to vacate the premises, forcing the trustee to obtain and execute a writ of possession. Finally, when the bankrupt left the residence, he took some of the fixtures with him.

All of these shenanigans cost the estate \$20,000 and, when the bankrupt applied for his discharge from bankruptcy, the trustee demanded payment of the \$20,000 as a condition of the

discharge.

Conversely

The bankrupt was 77 years of age and survived on \$1,000 per month from his CPP and OAS pensions. He clearly had no financial means to pay \$20,000.

However, for some period during his bankruptcy, the bankrupt had been paying \$150 per month to the trustee.

Balancing

The Bankruptcy Registrar, who was the hearings officer, held that the bankrupt failed to cooperate with his trustee, failed to disclose his assets, and put the creditors to unnecessary expense with frivolous and vexatious responses to motions to deal with his residence. Accordingly, the Registrar could not, under section 172 of the Act, grant an absolute discharge.

To show his displeasure with the bankrupt's conduct, the Registrar suspended the discharge for one year. Accordingly, the bankrupt remained an undischarged bankrupt for that additional year. Further, but running concurrently, the Registrar made the discharge conditional on the bankrupt paying his creditors, via the trustee, \$150 per month for five years. The Registrar reasoned that if the bankrupt had been able to pay \$150 per month during the period of his bankruptcy, then he should be able to make the payments af-

ter the conditional discharge. Accordingly, if the bankrupt made all of the payments, the estate would receive \$9,000 of the \$20,000 that the trustee had requested. In this manner, the Registrar attempted to balance the two underlying themes of the Act.

Upshot

Given the impecuniosity and age of the bankrupt, this order may well preclude him from ever being discharged from his bankruptcy. However, in light of his actions that showed a complete disregard for the bankruptcy process and his creditors, we suggest that this is not so bad; indeed, it may even be seen to be good.

FIRE GONE

In our April 2004 newsletter, we wrote about the Ontario Court of Appeal decision in Royal Bank of Canada v. State Farm Fire and Casualty Company. The Supreme Court of Canada, which does not often grant leave to appeal a commercial decision, much less reverse the Ontario Court of Appeal, dealt with the appeal in a 2005 decision.

Quick Summary

Mortgagors insured a property with a homeowners' policy through State Farm. The interest of the first mortgagee was noted on the policy. The mortgagors then defaulted on their mortgage to the Bank and

the Bank initiated foreclosure proceedings, including taking possession of the property.

During the enforcement proceedings, a fire destroyed the property. State Farm refused to pay the Bank the insurance proceeds because the Bank had not notified it that the property was vacant, contrary, it alleged, to the insurance policy.

The insurance contract had three important clauses:

1. The vacancy exclusion. This clause excluded State Farm's liability to pay if the property was vacant for more than 30 days.

2. Statutory Condition No 4 ("Stat 4"), which under the Insurance Act is deemed part of every fire insurance contract. It states, *"any change material to the risk and within the control and knowledge of the insured voids the contract ... unless the change is properly notified in writing to the insurer."* Once notified, the insurer may then cancel the policy or increase the premium.

3. The mortgage clause, which insulates the mortgagee from improper actions of the mortgagor. It states that the mortgagee is covered regardless of any act or neglect of the insured that would otherwise void coverage, including any vacancy of the premises. However, it also stated that *"The mortgagee shall notify forthwith the insurer (if known) ... of any vacancy ... extending beyond 30 consecutive days ... that shall come to his knowledge."* Unlike Stat 4, there is nothing in the mortgage clause giving the insurer a right to cancel the policy for failure to give that notice.

The Court of Appeal held that *"the mortgage clause is concerned with the conduct of the mortgagor and the mortgagee's obligations if and when that conduct comes to the attention of the mortgagee. Statutory Condition No. 4 is concerned with the conduct of insured, including insured who are mortgagees. It addresses the consequences of the mortgagee's actions which materially affect the insured risk."* Accordingly, the Court of Appeal determined that the two clauses were consistent with each other. It then went on to determine that the mortgagee ought to have given notice after it took possession of the premises and held that failure to do so resulted in a denial of coverage.

Inconsistent

The Supreme Court of

Canada disagreed that Stat 4 and the mortgage clause were consistent. As far as it was concerned, Stat 4 allowed the insurer to deny coverage if there was a vacancy greater than 30 days, but the mortgage clause applied regardless of the vacancy and lack of notice. Accordingly, Stat 4 did not apply.

As to the proviso that a mortgagee had to notify the insurer (if known) of a 30-day vacancy, the court held that the mortgage clause did not go far enough. If the insurer expected to be able to void the contract for breach of the notice provision in the mortgage clause, it should have said so.

The court allowed the appeal; State Farm had to pay the Bank for the fire loss; and mortgagees can breathe easier.

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