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Contempt and Bankruptcy: Striking the Right Balance

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In its recent decision in *Walchuk v Houghton*, 2016 ONCA 643, the Court of Appeal for Ontario clarified the interaction between the stay provisions of the *Bankruptcy and Insolvency Act* (BIA) and motions for contempt of court orders.

The Automatic Stay Provision of the BIA

The BIA stays proceedings against a debtor when the debtor files a notice of intention to file a proposal (s. 69) or upon the debtor's bankruptcy (s. 69.3).

A main goal of the BIA is to provide for the orderly and fair distribution of the bankrupt's property among its creditors. The stay provisions of the BIA further this goal by preventing a creditor from instituting proceedings that could give it an advantage over other creditors[1].

The language of the stay provisions is very broad. It prevents the commencement or continuance of "any action, execution or other proceedings", but only those proceedings that are "for the recovery of a claim provable in bankruptcy".

The Motion Judge's Decision in *Walchuk Estate v Houghton*

The facts in *Walchuk* were straightforward. The defendant, Wilfred Houghton, was indebted to the plaintiff for $120,500 pursuant to a judgment dated February 23, 2011.

The plaintiff arranged for a judgment debtor examination on December 5, 2013, but Mr. Houghton failed to attend. The plaintiff brought a motion seeking an order requiring Mr. Houghton to attend an examination.

The motion was heard on September 5, 2014. Mr. Houghton appeared without counsel. He admitted that he had not attended the examination scheduled for December 5, 2013, but argued that he had not been properly served with the Notice of Examination.

The motion judge ordered Mr. Houghton to attend an examination on September 17, 2014 and produce a number of relevant documents. On the day before that scheduled examination, Mr. Houghton filed for bankruptcy. He attended his examination, but without the documents he had been ordered to produce. The plaintiff moved for a finding that Mr. Houghton was in contempt of the September 5, 2014 order.

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1. Lloyd W. Houlden, Geoffrey B. Morawetz & Janis P. Sarra, The 2016 Annotated Bankruptcy and Insolvency Act (Toronto: Thomson Reuters, 2016) at p 469.

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As a preliminary issue on the contempt motion, Mr. Houghton argued that the motion could not proceed in the face of the BIA's stay provisions. The motion judge rejected this argument and found that the contempt motion could proceed: *Walchuk Estate v Houghton*, 2015 ONSC 1291.

Precedents relied upon were distinguishable

The motion judge relied heavily in his reasons on the decisions in *822878 Ontario Ltd* (*cob Wilson Air*) *v Firth*, 2013 ONSC 2422 and 2013 ONSC 4248. In overturning his decision, the Court of Appeal noted that the *Firth* cases and the cases cited therein all contained a key distinction from the instant case: in those cases, the contemptuous act had already taken place before the filing for bankruptcy.

822878 Ontario Ltd (cob Wilson Air) v Firth, 2013 ONSC 2422 and 2013 ONSC 4248

In *Firth*, as in the motion decision in *Walchuk*, the defendant was self-represented. He had been ordered to attend an examination in aid of execution but failed to do so. The plaintiff brought a motion for contempt. On the day prior to the return of the contempt motion, the defendant filed a petition in bankruptcy. At issue was whether the contempt proceeding was stayed by s. 69 of the BIA.

Justice Turnbull found that the contempt proceeding was not stayed. He reasoned that the remedy sought by the plaintiffs was not one which was recoverable in bankruptcy (the plaintiffs were seeking a prison sentence against the defendant). The purpose of the contempt order, according to Turnbull J., would be to uphold respect for the court's orders and processes.

At the contempt hearing itself the defendant, now represented by counsel, argued again that the proceedings were stayed by s. 69 of the BIA. Justice Ramsey found that this issue had already been decided by Turnbull J., but also explicitly agreed with the plaintiff that "the bankruptcy legislation does not prevent punishment of acts of contempt committed before the bankruptcy." The defendant was found in contempt.

In coming to its conclusion, the court in *Firth* referred to several previous decisions wherein courts allowed contempt proceedings to continue post-bankruptcy: *Neufeld v Wilson, Long Shong Pictures (H.K.) Ltd v NTC Entertainment Ltd*, and *Manis v Manis*. In addition, the more recent decision of the Alberta Court of Appeal in *Walker v Walker* also reached the same conclusion.

Neufeld v Wilson (1997), 45 CBR (3d) 180 (BCCA)

In *Neufeld*, Ms. Neufeld obtained judgment against Mr. Wilson in March 1992 for just over $100,000. On November 3, 1994, a master ordered Mr. Wilson to make monthly payments to Ms. Neufeld on account of the amount owing. Mr. Wilson made one payment pursuant to that order, but then assigned himself into bankruptcy on April 21, 1995.

On June 12, 1995, Ms. Neufeld applied for an order that Mr. Wilson be held in contempt of court. The chambers judge found Mr. Wilson in contempt, stayed his bankruptcy proceeding and ordered him to make all payments to Ms. Neufeld pursuant to the master's order.

On appeal, the British Columbia Court of Appeal allowed the appeal in part. It found that the chambers judge lacked jurisdiction to order Mr. Wilson to pay Ms. Neufeld because of the stay of proceedings under s. 69.3 of the BIA. It did not overturn, however, the finding that Mr. Wilson was in contempt of court for not complying with the master's order before he filed for bankruptcy.

The decision, like in *Firth*, supports the proposition that a person who does not comply with an order pre bankruptcy can be found in contempt of that order post bankruptcy.

Long Shong Pictures (H.K.) Ltd. v NTC Entertainment Ltd (2000), 18 CBR (4th) 223 (FCTD)

The issue was similar in *Long Shong* where the defendant was accused of violating two injunction orders dated June 21, 1999 and July 5, 1999 and a contempt hearing was scheduled for September 28, 1999. On the eve of the hearing, the defendant filed an assignment in bankruptcy. The court found that the contempt proceedings were not stayed by s. 69.3 of the BIA, citing *Neufeld*, reasoning that the court must have the power to enforce its orders.

Manis v Manis (2001), 148 OAC 127 (CA)

In *Manis*, the appellant had been ordered to, among other things, discharge a mortgage on title to the matrimonial home. He failed to do so. Instead, he made an assignment into bankruptcy. The motion judge found the appellant in contempt of court for not discharging the mortgage and sentenced him to jail.

On appeal, the appellant argued that he could not be in contempt because his property vested with his bankruptcy trustee and therefore he could not deal with the property and comply with the order. The appellant brought a motion to stay the warrant of committal.

Justice Simmons heard and dismissed the motion. She found that the appellant could not explain why he had not complied with the order before he made the assignment into bankruptcy, and therefore found that the appellant had not raised a serious issue to be tried regarding the contempt order.

Again, this case is supportive of the principle that non-compliance with orders before bankruptcy can be punishable by contempt after bankruptcy, but does not address the question of whether non-compliance with an order *after* bankruptcy can be punishable by contempt.

Walker v Walker, 2013 ABCA 213

Finally, the Alberta Court of Appeal came to the same conclusion in *Walker* where, again, the appellant disobeyed court orders and then declared bankruptcy on the eve of the return of a contempt motion, arguing that this stayed the contempt proceedings.

The Court disagreed, finding that:

> If a court orders a person to take certain steps, and he knows it but he does not do so, that is contempt of court. That four months later he invoked the bankruptcy laws, does not bar the contempt proceedings, even if the order disobeyed was largely about property, and even if he was insolvent at the time of his disobedience.

This finding is in line with the B.C. Court of Appeal's conclusion in *Neufeld*, the Ontario Court of Appeal's decision in *Manis*, and the Federal Court's decision in *Long Shong*.

Court of Appeal Overturns the Motion Judge's Decision

The Court of Appeal for Ontario noted that the cases relied upon by the motion judge all contained acts of contempt that occurred before the bankruptcy, whereas Mr. Houghton's allegedly contemptuous act (not producing documents) did not occur until after he had sought protection pursuant to the BIA. He was not in contempt of the order to attend the examination because that order was stayed by s. 69.3 of the BIA.

This argument had been made to the motion judge, but he rejected it, finding:

> The order I made was an order that called for the defendant to do certain things. Whether he did them or not cannot be

caught up in his choice of the timing of his filing for bankruptcy.

Assuming that the motion judge meant "whether he had an obligation to do them or not" rather than "whether he did them or not", the answer to that question is *precisely* caught up in the timing of the bankruptcy. As reasoned by the Court of Appeal, while contempt proceedings for acts of contempt that are complete before bankruptcy may proceed, one cannot be in contempt of court orders that are already stayed by the BIA. Because the timing of Mr. Houghton's BIA occurred before he was in violation of any court order, there could be no contempt.

Policy Considerations Support the Reversal

The Court of Appeal's decision makes good policy sense. If a bankrupt is forced to continue to comply with court orders post-bankruptcy, especially debt collection efforts such as judgment debtor examinations, this would create serious negative consequences for the bankruptcy process which s. 69.3 is meant to protect against, such as:

1. It could give some creditors an advantage over the rest. For example, in *Walchuk* the plaintiff would have gained access and been privy to the bankrupt and had the right to examine him, which all other creditors would not have.

2. A bankrupt would have to spend time and effort complying with pre bankruptcy orders, to the potential detriment of the bankruptcy process.

3. A multiplicity of proceedings could develop, with the bankrupt fighting litigation in both his bankruptcy proceeding and in other, ongoing proceedings.

It should also be noted that judgment creditors are not without recourse simply because the BIA governs. A bankrupt can be examined pursuant to the provisions of the BIA and if a bankrupt fails to comply with orders within the bankruptcy, contempt proceedings may be brought within the bankruptcy proceeding. In some situations, a creditor may choose to bring a motion to lift the stay of proceedings pursuant to s. 69.4 of the BIA.

The Court of Appeal's decision has restored a balance in this area of the law. While bankrupts and trustees should keep in mind that filing for bankruptcy is not a "get out of jail free card" for any past violations of court orders, they can rest assured that any outstanding obligations pursuant to court orders are stayed, and they may focus their attention on the bankruptcy process moving forward.