Matthew R. Harris

Cross-Border Consumer Insolvency

Introduction

The consumer is a small but integral party to the insolvency and litigation systems of both Canada and the United States. The consumer is the entry level foundation of the economy, and is an integral party which supplies cash and liability to the economy. But what happens when a consumer incurs debt in more than one country, and seeks to get out of it. This is an area of law which is frequently not reviewed, and misunderstood. This essay will review the basis of cross-border litigation and insolvency for consumers, and will seek to understand how a consumer can proceed to use the insolvency system, in more than one country, to recover and rehabilitate.

Litigation and Enforcement

Canada

Both Canada and the United States of America have statutes and procedures in place which allow for reciprocal enforcement of debts in their various jurisdictions. Ontario courts will recognize and enforce American judgments against Canadian defendants with assets in Ontario if the judgment is final and *in personam*[1]. Finality is an important requirement. Judgments which can be challenged, varied, or on appeal, will not be enforceable, as they wouldn't be in Canada either. However, there must be a *real and substantial connection* between the Ontario defendant, and the American Plaintiff. This test was reviewed in a seminal case heard by the Supreme Court of Canada, *Beals v. Saldanha*[2], in which the SCC reviewed the basis for enforcement of foreign judgments in Canada. The majority applied the real and substantial connection test,

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1 OZ Optics Ltd. v. Dimensional Communications Inc., 2004 CanLII 35937 (ON SC), at para 27
[2] [2003] 3 S.C.R. 416, 2003 SCC 72, ('Beals')

but stated that if the enforcement of the judgment is contrary to public policy, natural justice, or obtained in fraud, then the judgment cannot be enforced in Canada. Therefore, the test from Beals will apply to all individual provinces and territories in Canada, unless they have a statute that states contrarily[3].

The *Beals* case involved Florida residents who were sold Florida properties by Ontario resident who did actually own the properties. They were sued, and a defence was filed, but nothing else was done and the defence was stricken leading to a judgment by a Florida jury of $260,000.00. The Defendant was informed that the judgment could be enforced against them in Ontario, but they did nothing. Beals then brought an action in Ontario to enforce the judgment, with interest, for $800,000.00. The SCC found that it was enforceable.

Ontario, like most Canadian jurisdictions[4], has passed the *Reciprocal Enforcement of Judgments Act*[5]. This act allows for the enforcement of debts from other jurisdictions in Ontario. However, American states are not party to this act.

Canadian courts have generally attorned to the jurisdiction of American courts, if the judgment was based on the parties having enforceable claims. For instance, if both parties lived or worked in an American state, but one of the parties was Canadian, and the party fled to Ontario to escape judgment.

To enforce an American debt in Canada, particularly in Ontario, there are two ways to do so. Either, an Application[6] can be brought under *Rule 14.05 (3) (h)* of the *Rules of Civil Procedure* for a breach of contract debt. This particular rule deals with matters where there are no factual issues to be argued, and a court can simply hear the matter on affidavit, with typical cross-examinations available to each party.

[3] At time of writing, nothing to this effect.
[4] Quebec is not a party to this act
[5] RSO 1990, c R.5
[6] *Nuvex Ingredients Inc. v. Snack Crafters Inc.*, 2005 CanLII 1413 (ON SC)

A second, more complex option, is for a Plaintiff to bring an action via statement of claim. From here, a Plaintiff can then use *Rule 20* of the *Rules of Civil Procedure,* and bring a motion for summary judgment to enforce the debt[7].

Individual provinces and territories have their own Rules of Civil Procedure, or in lieu, other ways to initiate applications and actions which will apply. In Quebec, it has been held that a US judgment can be enforced under the provincial procedure in the Quebec Civil Code, and that a Trustee in Bankruptcy can use this same procedure to enforce on debts from the US[8].

United States of America

Canadian debts are much tougher to enforce in the United States ('US'). In most US states, enforcing judgments from foreign countries is governed by the *Uniform Foreign Money-Judgments Recognitions Act*[9]. Forty-Seven (47) states and the US territories have a version or recognize this act. The only exceptions are California, Massachusetts[10] and Vermont. This act provides for final judgments, monetary in nature, which are given by foreign courts are enforceable in these states, subject to certain exceptions, which may create problems.

Additionally, a fundamental component of US law is that a judgment taken against a defendant under circumstances where the defendant's right to due process of law has been violated cannot be enforced in the US. In the US, a court's right to take jurisdiction over a defendant is granted by the defendant's right to due process. The right to due process in the US requires that a defendant can only be sued in a jurisdiction where the defendant has established certain "minimum

[7] *Mill Valley Bamboo Associates, LLC v. D.T.I. Diversified Transportation Inc.* 2006 CarswellOnt 7424
[8] *Re Kevco Inc.* (2005), 2005 Carswell-Que 840
[9] 13 U.L.A. 261 (1986)
[10] Massachusetts is currently in the process of passing legislation to this effect.

contacts."[11] Conversely, a defendant in the US cannot be sued in a jurisdiction where the defendant has not established such minimum contacts and any attempt to do so would be in violation of the defendant's right to due process of law and could lead to a US court not recognizing the jurisdiction of the judgment.

In Canada, a Canadian court may take jurisdiction over a defendant regardless of whether the defendant has established "minimum contacts" in Canada. Canadian courts base their jurisdictional powers on subject matter granted under the constitution, and other rules[12]. Therefore, while it would be proper under Canadian law to sue a US defendant in Canada even though the US defendant has not established "minimum contacts" within the Canadian jurisdiction, a judgment given by a Canadian court might not be enforceable in the US on the basis that the judgment was taken in violation of the defendant's due process rights under US law. In that case, even though it would be valid in Canada, the judgment would not be enforceable in the United States.

Further, similar to the SCC previous decision, a judgment based on a cause of action that the US court would find contrary to its public policy would not be enforceable. Given that both systems originated in English Common Law (except for Quebec), it is not particularly likely that a US court would declare a judgment based on a common law cause of action contrary to its public policy. However, a statutory claim or a distinctive kink on a Common Law claim has at least some potential to be contrary to the public policy of a US state.

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[11] *International Shoe Co. v. Washington*, 326 U.S. 310 (1945)
[12] For instance, See *Rule 13 and 17 of the Rules of Civil Procedure*, RRO 1990, Reg 194

Bankruptcy Systems

When a consumer files, or is assigned, into bankruptcy in Canada, he is required by the *Bankruptcy and Insolvency Act ('BIA')*[13], Section 158(d) to inform the Trustee in Bankruptcy ('Trustee') of any and all debts, liabilities, and assets that he currently has or owes. Additionally, he is required to inform the Trustee of any contingent debts that may arise during the bankruptcy. The Trustee will then prepare a statement of affairs, and the bankrupt must sign this document. The document is then commissioned and has the effect of a sworn legal document. In filing for bankruptcy in the United States, there is a similar form called Form 7, which is required under Chapter 7 filing for bankruptcy.

In Canada, on a first-time bankrupt, subject to certain exceptions, an injunctive discharge which permanently stays all debts is granted after nine-months. In the USA, the court generally grant a similar injunctive discharge after sixty (60) to ninety (90) days.

In both the United States and Canada, a creditor can object to the discharge being granted by the court. The creditor would then have to show evidence as to why the bankrupt's discharge should not be granted.

Both Canada and the United States have separate provisions in their respective bankruptcy acts which allow for repayment plans. In Canada, a Consumer or Division I Proposal, and in the United States a Chapter 11 or Chapter 13 filing. While creditors in these respective actions have

[13] RSC 1985, c B-3, ('BIA')

similar rights to bankruptcy, ultimately, they are given the final say as they can assign the consumer into bankruptcy if the repayment plan is not to their liking.

Foreign Debts in Bankruptcy

A debt does not necessarily have to be registered or recognized as a judgment for it to be heard as part of a bankruptcy discharge. Debts may be submitted to the Trustee for a claim, and if in the Trustee's judgement the claim is valid after examining it, the Trustee may admit the claim for the purposes of disbursement and voting in the estate. In order to avoid extensive costs, creditors have skipped the process of having a judgment executed, or bringing a claim in either Canada or the USA, and simply supplied claims to the Trustee for enforcement of a debt.

A Chapter 7 Discharge Order protects the bankrupt from any and all collection of debts in the United States. This would include any foreign judgments that are registered for collection in the United States, subject to exceptions which survive bankruptcy. A discharge Order from a Canadian Bankruptcy Court would grant the same type of Order; subject to certain exceptions.

As previously described, a Creditor can object to a discharge. In *Re O'Shaughnessy*[14], a husband in Alabama, was granted an Order for matrimonial disposition against his former spouse in absentee, as his wife had fled for Ontario. The husband, and opposing creditor, opposed her discharge as his debt was the largest and main debt declared by the wife. Registrar Neddie found that even though the debt was from another country, and there was no evidence that the debt had been registered in Canada, that the wife had to repay one-third of the debt that she had fled from.

[14] 2009 CarswellOnt 2874, 177 A.C.W.S. (3d) 302

One of these exceptions is for government and non-governmental student loans[15]. A student seeking a discharge of an American student loan, residing in Canada, would need to apply to a Canadian court to have declaration that the debt does not survive under the exception[16] in the BIA. However, the Canadian Court could only make such an Order discharge the debt in Canada. The creditor could still enforce the debt in the US, and same vice-versa. In the past, consents to judgments have been used to avoid this type of situation, if the bankrupt has agreed to pay off the debt. [17]

Another of these exceptions is fraud, or breach of trust. This exception is listed twice in the BIA: once in Section 173, a factor on a discharge, and once in Section 178, a debt that survives discharge. In *Re Aby*[18], a judgment was given by an English Court against a debtor. The debtor then went bankrupt, and claimed that she had additional evidence that would placate the claim by the creditor as to fraud. She adduced this evidence at her hearing, and Justice MacLeod ruled that there was not enough proof that this was fraud, and that since fraud could be abrogated by a Canadian Court if it found new and fresh evidence following a judgment, the same should be a factor for an English Court. Therefore, he ruled that the debtor was to repay $10,000.00 of a possible $75,000.00.

[15] 11 U.S.C. sec. 523 (a)(8)
[16] Section 178 (1) and 178(1.1)
[17] *Skal, Re* (12 May 2004), Toronto, 32-132159 (ONT SC)
[18] 1995 CarswellSask 585, [1995] S.J. No. 677, [1996] 2 W.W.R. 488

Discharges of Debt – Conflicts of Laws

While debts can be enforced from other jurisdictions based on their validity, discharges of debts remain a problem if they can be linked to another jurisdiction. They are not typically recognized outside of the jurisdiction that they were granted in.

In *Harvester Company of Canada v. Zarbok*[19], a Defendant obtained a discharge in bankruptcy in the US before the Canadian Bankruptcy Act was enacted. The Defendant resided in North Dakota but had travelled between there and Saskatchewan. He had purchased bank notes in Saskatchewan, and was sued for them in Canada. However, he had used another bank notes from the US to purchase the Canadian notes, and these US bank notes were part of the discharge. The Court in Saskatchewan granted judgment on the precipice that the new notes constituted a new promise to pay, and were therefore not part of the original discharge.

An earlier case[20] then this involved a Plaintiff who sued a Defendant in Canada, on a US based judgment. During the course of the judgment, the Defendant obtained a discharge from bankruptcy from a US district court. He subsequently sought to use this discharge as a defense from the enforcement of the judgment in Canada.

US Courts as a whole typically grant discharges on a quicker and easier basis. However, US Courts have not recognized Canadian discharges *prima facie* as it would prejudice the rights of US based creditors[21]. Bankrupts claiming that they are discharged by Canadian discharge Orders would always be able to file a claim in *res judicata,* or make the argument that the US forum was

[19] [1918] 3 WWR 38,11 Sask LR 354 (KB).
[20] *Ohlemacher v. Brown,* (1879) 44 UC QB 366.
[21] *Bank of Buffalo v. Vesterfeldt,* 36 Misc 2d 381; 232 NYS2d 7~3 (County Ct Erie Co 1962)

inappropriate under *forum non conveniens.* US Courts have lastly accepted discharged contracts from jurisdictions if the contract fell in the jurisdiction of the decision maker.[22]

Other Issues Stemming from Lack of Discharge

US creditors (and Canadian) will not simply let a debt go by the wayside if there is no legal process forcing it. A Canadian living in California, working and spending money, whom moves back to Ontario and then seeks to return to the US, will find that US creditors will track him down and may seek to enforce or garnish wages if he ever attempts to work again in the US. Credit checks are often done by employers in an effort to evaluate applicants. Of course, as previously discussed, a bankruptcy in one country may not discharge debts in another. With the increase of Canadians opening bank accounts in the US, creditors seeking to recoup losses will garnish and seize property and accounts which are available to them.

Solutions

In 1979, Canada and the US were negotiating a bi-lateral treaty which was specifically linked to insolvency. The treaty proposed a single, transnational administration of insolvency proceedings under the law of the nation in which the bankrupt retained the greater value of its assets at the time of its filing. The Courts of the administering country would apply national law

[22] *Green v. Sarmiento* 10 F Cas 1117; 3 Wash CC 17; Pet CC 74 (Cir Ct D Pa 1810).

to all aspects of the proceeding, including matters over which the courts of the opposite nation would normally exercise jurisdiction. National courts in the other country would have jurisdiction ancillary to the main proceeding in order to aid the court in the administering country.

The draft treaty instituted an automatic stay of proceedings in both countries upon the bankruptcy filing in either jurisdiction and the powers of trustees in both the main and ancillary proceedings were to be determined by the laws of the nation of main forum[23]. Criticisms toward the adoption of the bilateral treaty and its prohibitions on the application of local law in ancillary proceedings and on its inability to ensure the stability of the proceedings generally, caused the breakdown of the negotiations. Other issues addressed restrictions preventing courts from applying national law and the flexibility of the "location of assets" test that forces creditors to gamble on which country has jurisdiction over bankruptcy proceedings. Neither Canada nor the United States have ratified the Canada-U.S. treaty; the treaty was concluded prior to Canada's most recent reformation of its bankruptcy laws and was dismissed by the U.S. courts without explanation in its first instance of judicial consideration. As a result, the draft Canada-U.S. treaty has been regards as a negative model for future agreements. Despite its downfalls, the common ground found in the formation of the Canada-U.S. treaty may be emphasized to push for renewing a cross-border insolvency system this century.

Unfortunately, for consumers, the focus today for insolvency regimes is on corporations. The need to individuals with assets or liabilities in a cross-border setting, should be considered on any further drafting. As the world is a much more globalized place now, much more than in 1979,

[23] Mike Perry, *Lining-Up at the Border: Renewing the Call for Canada-US Insolvency Convention in the 21st Century*, 2000, Duke Law Journal.

consumers are more than likely to be involved with debt, and liabilities on a global sphere in the coming years.

Credit Reporting

Canada and the US operate credit reporting systems which supply information to companies when a person applies for credit[24]. Generally, a rating is given which a person is then granted credit upon. In Canada, there are two credit reporting companies: Equifax, and Transunion. In the US, there are three: Equifax, Experian and Transunion. Bankruptcy will cause a very low rating in both countries, and will require seven (7) years to recover in Canada, and up to ten (10) years in the United States.

Generally, credit reporting agencies don't share information for cross-border clients. If a Canadian or American get a credit card in the other's country, then that information will not be reported to the agency in the other respective country. Each country's reporting agency maintain separate databases. However, if an American company seeks and is able to use their judgment in Canada to enforce against a Canadian, then that will be reported to the agency as a debt. Also, respective agencies can obtain reporting information, if they chose to from the other agency. This tends to only happen for Americans or Canadian with very limited credit reporting history, who are seeking new credit facilities. As discussed earlier, bankruptcy discharges will not help a debtor

[24] http://www.cbc.ca/news/canada/how-to-check-your-credit-report-1.1185975

seeking to be free and clear in one country and not the other. This consumer will need to pay off debts individually.

Conclusion

At current, consumers have systems which currently work against them. The Bankruptcy and Insolvency systems in Canada and the United States, are individually suited to help consumers rehabilitate and recuperate in their individual jurisdictions. However, consumers with debts which are cross-border, or whom are seeking to escape debts as a whole within both countries will find that individual courts are generally not willing to cause any potential harm to creditors by imputing stays and discharges from other jurisdictions within their own. In the increasingly more globalized world that exists today, it is imperative that the United States and Canada, which has so many cross-border agreements, find a way to address the backbone of the economy: the consumer.