Torkin Manes
Barristers & Solicitors

Novel Coronavirus (COVID-19)

Family Law

August 2020

How much is 'unconscionable'? Why a 2009 decision is suddenly relevant again in high-stakes Ontario separation cases

The case provides a path for some spouses to reduce equalization payment owing, but much is unclear

By Laurie H. Pawlitza

The financial fallout from COVID-19 is being felt far and wide, but for some Ontario couples who separated before the pandemic hit, the consequences could be particularly significant.

That's because while other provinces determine the value of property to be equalized or divided during a separation based on the date of trial, Ontario uses the date of separation itself, which can be months or years earlier. A spouse must, in other words, pay based on the value of his/her assets at separation, even if those assets have since plummeted in value.

Ontario's *Family Law Act* was introduced in 1986, and the pandemic is thus not the first instance of financial turmoil that have tested this requirement.

The 1990 recession, with its bursting Freal estate bubble, and the 2008 meltdown of the stock market, created many instances of inequity for separating spouses. During and after each of these recessions, creative family lawyers tried to find ways to ease the pain for clients whose assets had dropped in value, but the restrictive language in the Act meant that most remained without relief.

But since the pandemic hit, family lawyers have been dusting off one case in particular from the previous financial crisis to see whether it can help those spouses whose assets have significantly declined in value.

In the 2009 Court of Appeal case of *Serra v Serra,* an appeal written by Justice Robert Blair, interprets a section of the *Family Law Act,* which has rarely been used successfully. Nevertheless, it does offer a glimmer of hope for spouses with a significant market-based post-separation decline in their assets. For

spouses in industries such as retail, transportation, hospitality and travel which have been hardest hit by the pandemic, it may be their only hope.

The *Family Law Act* provides discretion for a payor to reduce the property payment otherwise owing to their spouse if the court finds that "equalizing" the parties' property is "unconscionable." The Act then lists a number of circumstances that the court can take into account, which include a spouse incurring debt recklessly or in bad faith, failure to disclose debts at the date of marriage and "any other circumstance relating to the acquisition, disposition, preservation, maintenance or improvement of property." Serra provided the Court of Appeal the opportunity to interpret this section in detail.

In *Serra,* the parties separated in 2000, after a 24-year marriage. Mr. Serra owned and operated a textile business. By the time the trial rolled around in 2006, Canada's domestic textile industry was in deep decline. The industry's decline was mainly related to the removal of quotas and China's admission into the World Trade Organization. The trial judge found that Mr. Serra's company had lost as much as $9 million in value between the date of separation and the date of trial six years later. At trial, Mr. Serra's business was worth somewhere between about $1.9-$2.6 million.

The trial judge, Justice Thea Herman found that she could not take into account a market-driven post-separation date decline in value, given the language of the Act and the existing case law. She ordered that Mr. Serra pay about $3.3 million as an equalization payment – more than his then current net worth.

Inevitably, the decision was appealed to the Ontario Court of Appeal. On appeal, Justice Blair had to first decide the amount of the equalization payment owing by Mr. Serra, using the value of his corporation at the date of separation. Only after determining the equalization payment owing, could the judge determine whether the unconscionability test was met.

In Mr. Serra's case, the court considered the circumstances surrounding the acquisition, disposition, preservation, maintenance or improvement of Mr. Serra's business. His counsel argued that the court had to consider, not only the decline in the value of the business, but also the circumstances that occurred in the litigation.

Mrs. Serra had, among other things, made a claim for an ownership interest in Mr. Serra's shares, obtained an order that he preserve his property and received a significant interim support order. In addition, Mr. Serra had paid advances to Mrs. Serra before trial on the property payment owing.

For an equalization payment to be "unconscionable," it must "shock the conscience of the court."

The result has to be more than "unfair," "harsh" or "unjust" to the payor spouse. Justice Blair described the threshold as "exceptionally high."

Ultimately, the Court of Appeal found that the post-separation, market-driven decline in value of Mr. Serra's textile business was indeed "unconscionable." In deciding this, the court was careful to note that the circumstances Mr. Serra found himself in were not ones that he could rectify by "cutting his losses" or selling his business because Mrs. Serra's claims and interim orders to preserve his property precluded him from doing so. The court also observed that she had received the benefit of significant interim support, which Mr. Serra could continue to pay only if his business continued to operate.

Most importantly, the court accepted evidence that the decline in the fortunes of Mr. Serra's business was not temporary, and that there was nothing more he could have done to maintain the value of the business at its date of separation value.

The Court of Appeal, however, gave fair warning to those who had most recently suffered in the 2008 market crash, saying "This case is not about whether a significant post-separation drop in the value of an individual's stock portfolio, precipitated by a deep but temporary recession will amount to unconscionability. Such an occurrence may well be a factor for consideration … but whether it would be sufficient by itself to constitute 'unconscionability' is quite another matter. Each case must be determine on its own facts."

The question for the Court of Appeal then became what Mr. Serra should pay instead of the equalization payment based on the date of separation value of the business. While many expected the Court of Appeal would simply substitute the current value of the business for the date of separation value, the court chose not to do so. Mrs. Serra's lawyers argued that once the Court of Appeal found the equalization payment was unconscionable, the court should determine an amount that was "just short of being unconscionable."

Justice Blair rejected that argument, saying that the court's obligation was ultimately to do what was "just and fair," once the threshold of unconscionability has been met.

If the value of the business at trial had been used, the payment owing to Mrs. Serra would have been about $1.5 million, less the advances made by him before trial, for a payment of about $650,000.

Justice Blair rejected this simplistic calculation and found that what was "just and fair" was a payment of $900,000. The addition of another $250,000, Justice Blair reasoned, was to take into account the remote possibility of a recovery in the business, the length of the parties' marriage and the principle of equalization, which recognizes both spouses' contribution to the accumulation of wealth.

The final reason provided, however, seemed to be the one given the most weight: Justice Blair said that the court had a desire "not simply to substitute a trial date valuation for the separation date valuation in the circumstances of this case." While he acknowledged that there might be cases where it would be appropriate to apply the trial date values, this was not one of them.

If a payor spouse is able to take advantage of *Serra*, that spouse will have little cause for joy: not only does the value of a significant asset have to plummet, there must be little hope that the asset value will recover. If the non-asset holding spouse has obtained court orders pending trial that limit the owners' ability to 'cut their losses', that, too, will make a difference. In short, both prior to and at the time of trial, the owner spouse will have to be in very dire financial straits.

While *Serra* provides a path for some spouses to reduce the equalization payment owing, it remains unclear exactly what circumstances may warrant the exercise of discretion by the court and if "unconsionability" is found, how the amount of the reduced payment will be determined.

It will likely be some years before there are clear answers to these questions.

Author

Laurie H. Pawlitza
Partner

Tel: 416 777 5192
lpawlitza@torkinmanes.com