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Preservation of Human Dignity as the Justification for Excluding Personal Rights of Action in Bankruptcy

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Case Commented On: *Cooke (Re)*, 2018 ABQB 628

This case considers whether a contractual "critical illness" benefit forms part of the property of the bankrupt's estate. Personal rights of action arising out of tort claims have traditionally not formed part of the bankrupt's estate, meaning the bankrupt gets to keep the money from these claims. Prior to this case, however, courts do not appear to have addressed the bankrupt's entitlement to personal rights arising from contract. In this case, the court drew an analogy between the two types of claims. It found that both compensate for the pain and suffering of the bankrupt and consequently concluded that a contractual critical illness claim should also be excluded from the distribution to creditors.

The bigger question raised by this case is why these types of claims are not included in the distribution to creditors. This is not a statutory exemption, but courts have been excluding personal rights of action in bankruptcy distributions for more than a century. This blog explores one possible reason for the exemption. Rather than seeing the debtor as a financial problem that must be solved without requiring state assistance, which has been the pattern of bankruptcy law, this may be the courts seeing and treating the debtor as a human being.

Facts:

At the time of judgment, the bankrupt, Ms. Cooke, was 62 years old (at para 2). She was diagnosed with breast cancer in March 2016 (at para 4). Prior to her diagnoses, she had worked as a health care aide (at para 2). She ceased working that same month to undergo surgery and radiation (at para 5). In August 2016, she resumed casual employment with the same employer, also as a health care aide (at para 5).

When she was diagnosed, her employer advised her to apply for the critical illness benefit, which she did (at para 6). She declared bankruptcy in September 2016 and did not disclose her pending application to the trustee in bankruptcy (at para 7). When she received the benefit, in January 2017, she told the trustee about it (at para 8).

Ms. Cooke received $25,000 under the benefit. She spent the money, $5000 of which on a used car. In her bankruptcy, she had $13,000 of unsecured debt, $6,400 of which had been proven (at paras 11 and 12). The court found that if she had disclosed the application for the benefit to the trustee at the time she made an assignment in bankruptcy, the trustee would have likely advised her not to do so, as the amount of the benefit would have covered her debts (at para 12).

When Ms. Cooke applied for a discharge from bankruptcy, the trustee argued for the imposition of a condition, which was the issue before the court (at para 13).

Ms. Cooke was not well at the time of judgment. In addition to the cancer diagnosis and subsequent treatment, she had several other health ailments that affected her mobility and prevented her from being employed on a consistent basis (at para 15).

Arguments:

The trustee argued that the court should make the discharge conditional on Ms. Cooke paying $20,000 (at para 13). The trustee also argued that the $25,000 policy counts as "income" and should therefore be included as part of the bankrupt's estate (at para 9). The $20,000 condition would cover the cost of the administration of the estate, which was higher here to cover the trustee's time in which she spent researching the legal status of the critical illness benefit in a bankruptcy (at para 13).

Ms. Cooke argued that her benefit did not form part of the property of the estate. She also maintained she was not be able to pay $20,000, nor would she be able to, given the state of her employment, meaning that condition could potentially designate her to be a bankrupt for the rest of her life (at para 14).

The Law:

Upon becoming bankrupt, s.71 of the *Bankruptcy and Insolvency Act*, RSC 1985, (*BIA*) provides that the bankrupt ceases to deal with his property, and that the property passes to the trustee. Section 2 defines "property" and section 67 determines which of the property of the bankrupt vests in the trustee and becomes divisible among his creditors. This includes "after-acquired property", which is property that is acquired by the bankrupt after the date of bankruptcy but before the date of discharge (at para 24).

If the insurance benefit falls under the definition of "property" in section 2 of the *BIA* and does not fall within any of the exceptions listed in section 67, then it becomes property of the estate and vests in the trustee. If it does fall under one of the exceptions in section 67, then it does not vest in the trustee and it is therefore not divisible among the creditors of the bankrupt, meaning the bankrupt gets to keep it.

That is not the only way the trustee in bankruptcy can get at the property of the bankrupt. Under the *BIA*, if the bankrupt earns income after the date of bankruptcy, section 67 must be read in conjunction with section 68, the provision on surplus income. Income does not fall under section 67, meaning it is not property of the estate that immediately vests in the trustee. Rather, income vests in the bankrupt. Section 68 provides standards for determining how much of the bankrupt's income constitutes income surplus to that which the bankrupt needs to maintain a reasonable standard of living; it is only after following the section 68 requirements that the trustee has access to the portion of it that is determined to be "surplus income," which is then distributed to creditors.

Decision:

Is it income?

The court decided that the policy was not "income" under section 68 of the *BIA*. It noted that the benefit was "not payable in respect of loss of income," meaning it was not an income replacement policy but was "payable for the 'pain and suffering associated with the illness" (at para 31). Therefore, it found section 68 to be inapplicable.

Is it property? Is it property divisible by creditors?

The court then turned to whether the policy was "property" under the estate. It found that case law has drawn a distinction between claims that are personal to the bankrupt and other types of claims in relation to personal property. Those that are personal to the bankrupt, as in, those that arise from a personal injury claim, "do not form part of the property assigned to the trustee" (at para 26). The court quoted *Sibley v Mason*, 196 Mass 125 (1907), a case that articulated the prevailing view behind this exemption more than a century ago:

> It is not, and never has been, the policy of the law to coin into money for the profit of the creditors the bodily pain, mental anguish or outraged feelings of a bankrupt. None of the federal or English bankruptcy acts nor our own insolvency statutes, have gone to that length. (*Sibley v Mason*, 196 Mass 125 (1907) quoted in *Ritenburg v Crown Trust Company*, 1961 CanLII 351 (AB QB), 33 D.L.R.(2d) 498 (Alta. S.C., 1961), at para 32)

It noted that Alberta adopted this approach in 1961, and in *Gano v Alberta Motor Assn. Insurance Co*, 1997 CanLII 14775 (AB QB), 1997 CanLII 14775, the court more recently upheld the principle. At paragraph 34:

> The case law says that heads of damage that are 'personal to the bankrupt (i.e., relate to his person) are not available for distribution among his creditors. This would include physical injury, loss of expectation of life, pain and suffering, loss of amenities of life, mental suffering, emotional suffering, injury to reputation (defamation) and so on.

The court concluded that the policy was a claim "based in an insurance contract taken out by the employer to provide a benefit to its employees" (at para 27). Given that this contract-based insurance claim was for pain and suffering, it applied the rationale underlying tort-based claims. At paragraph 35, the court maintained:

> In one case there is someone who caused the pain and suffering, so a claim is made in tort against that person. In the other, the illness might be described as an "act of God", and there is insurance to provide compensation, with no need to prove that anyone was at fault. In both cases the approach is the same, expressed in simple terms: as long as the pain and suffering remain with the bankrupt, so does the compensation for it. That pain and suffering are not to be "coined into money for the profit of creditors."

Interesting Question

In my opinion, this was a correct decision. Excluding personal rights of action from the bankrupt's estate is a principle that has prevailed for over a century, and if a contractual claim serves the same purpose for the bankrupt, it should be decided in the same way. In the case of *Re Hollister*, [1926] 3 D.L.R. 707, 30 O.W.N. 328, 7 C.B.R. 629, the court discussed the purpose of the monies that were awarded to the debtor, an undischarged bankrupt, for personal injuries sustained in a car accident. The court maintained, "these monies are awarded as damages to the debtor for his pain, suffering and loss of comfort of life, to pay his physician, nurses and hospital expenses, and to compensate him whilst he is incapacitated from earning a living for himself and his family" (pp. 708-09 D.L.R.). I do not see a substantial difference between the purpose of the monies at issue in *Re Hollister* and those paid out under a critical health policy.

However, this case raises an interesting question. The line of cases that have articulated and upheld the principle that creditors in a bankruptcy should not profit from the pain and suffering of the bankrupt, are not relying on a legislative provision; there is no statutory authority for this principle in the *BIA*. Rather, this principle could be seen as coinciding with one of the objectives of insolvency law: giving the debtor a "fresh start." Consideration for the debtor's plight has not always been one of the tenants of bankruptcy law. It is only under a more modern approach that the debtor is seen as a person who is deserving of the opportunity for an economic start fresh and is provided with the means to do it.

There are several provisions in the *BIA* to support the debtor's rehabilitation. For example, the debtor can obtain a discharge, which allows the debtor to discharge her old debts, with certain exceptions, and start fresh. The discharge recognizes that bankrupts will never be able to repay their creditors in full, and that individuals cannot live under the weight of their old debt for the rest of their lives. Exempt property is another example: the debtor is entitled to keep certain property that will aid in her rehabilitation efforts. A debtor cannot start fresh if she and her family are stripped of the necessaries of life, such as food, clothing, shelter and medical and dental aids.

The fresh start doctrine appears to have begun to take shape in 1904 in the United States, with *Wetmore v Markoe*, 196 U.S. 68 (1904). There, the court noted, ""[s]ystems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has become oppressive and to permit him to have a fresh start in business and commercial life, freed from the obligation and responsibilities which may have resulted from business misfortunes." Importantly, the primary concern with the debtor's fresh start, as shown in this passage, is the debtor's financial life. It was not about compassion for the debtor as a human being. Rather, inherent in the fresh start doctrine is the concern that, without the opportunity to re-establish herself financially, the debtor would need to rely on the state. It was these concerns that led to the concept of exempt property.

There is no clear line between the concept of fresh start to the idea that only a debtor is entitled to her personal rights of action. And yet it seems to me that there is an argument to be made here; a link can be found between exempting certain property from distribution to creditors and exempting these personal rights of action.

Creditors are entitled to the debtor's property, but not all the debtor's property; they are not entitled to the property the debtor needs for reintegration after bankruptcy. The reasons for these exemptions lie in public policy; the legislation leaves the debtor with the necessities in an attempt to lower a debtor's risk of requiring state assistance. It seems, however, that there is another aspect to this exemption. If we look closely, the thread underlying the concept of fresh start and personal rights of action is human dignity. Human dignity is simply the respect each person deserves by virtue of being human; it is "the moral status of a human person subject to law. Persons possess this status not because each has committed the relevant act to acquire it, but because this status inheres in each individual 'by virtue of his or her being a person'" (Jacob Weinrib, The Modern Constitutional State: A Defence, 40 Queen's L.J. 165 (2014) at 172). Acting in a way that deprives a person of dignity is to violate that person, it is to "degrade, humiliate or treat another person as unworthy of respect or consideration" (Alice Woolley, "Does Civility Matter?").

Exempting certain property from the distribution to creditors is the refusal to impose an additional cost on the debtor, the cost of depriving the debtor from every shred of property, even if exempting that property is detrimental to creditors. It is not the case, however, that this property is exempt to maintain the debtor's human dignity; rather, it is exempt to ensure the debtor's financial wellbeing. And yet, ensuring a person and her family are not deprived of food, clothing and shelter inherently acknowledges that person's dignity because it respects her basic needs. Most of the debtor's property will vest in the trustee, but enough will be left to the debtor to ensure the debtor is not degraded or humiliated. Similarly, damages that compensate the debtor's person allow her to maintain her dignity. These damages compensate the debtor for injuries done to her body, her reputation, her mental capabilities and her life expectancy. To take those from her is a violation of her person, and consequently, an affront to her dignity.

In a legislative structure where the preservation of debtor dignity is only a tangential consequence arising from provisions with other purposes, exempting damages arising from personal rights of action from the distribution to creditors may be the courts' overt acknowledgment that debtor dignity is, in and of itself, an end for which we must strive. The fresh start doctrine facilitates the treatment of the debtor as a human being with dignity, though the debtor's human dignity may be a secondary consideration to the economic justification driving rehabilitation, or not a consideration at all. It does nonetheless arise as a consequence of exempting property from the distribution to creditors. Allowing the debtor to keep damages resulting from her personal rights of action could be the direct affirmation of that goal.

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