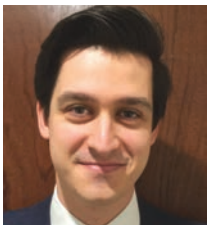
WHEN IS A CONTRACT CLAIM A BANKRUPT'S CLAIM?



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Snapshot

- Contract claims of a personal nature, such as a personal injury or wrong, will not be stayed by virtue of a claimant's bankruptcy.
- Any benefits or damages awarded from such actions will not be divisible amongst a bankrupt's creditors if the claim and estimation of damages is centrally focused on the personal injury or wrong to the bankrupt.
- The intention of ss 116(2)(g) and 60(4) of the *Bankruptcy Act 1966* is to protect a bankrupt's right to compensation for personal injury or wrong from his or her creditors.

The recent Western Australian decision of *Berryman v Zurich Australia Ltd* [2016] WASC 196 (***Berryman***') is the first time an Australian court has considered whether a benefit payable pursuant to a bankrupt's disability insurance policy falls outside the scope of property divisible amongst creditors and, if so, whether the bankrupt may continue court action in his or her own name to recover that benefit.

Background

Mr Berryman was a self-employed carpenter who had held a life insurance policy with Zurich Australia Ltd ('**Zurich**') since 17 June 2009. It was a term of the policy that, upon Mr Berryman becoming totally and permanently disabled within the meaning of the policy, Zurich would pay Mr Berryman a total and permanent disability ('**TPD**') benefit of $2 million.

On 7 July 2009, Mr Berryman suffered an injury whilst at work when a large granite rock crushed his foot. Mr Berryman subsequently made a claim on his policy with Zurich for payment of the TPD benefit, however, his claim was declined.

On 29 August 2014, Mr Berryman commenced proceedings in the Supreme Court of Western Australia seeking damages for breach of contract in the sum of $2 million. On 10 August 2015, Mr Berryman was declared bankrupt. As a result, Zurich sought to have the action dismissed on the basis that Mr Berryman's bankruptcy trustee was deemed to have abandoned the proceedings by operation of section 60(3) of the *Bankruptcy Act 1966* (Cth) ('**the Act**').

Preliminary questions

The issues raised in Zurich's dismissal application were tried separately and focused on two discrete questions. The first and primary question was whether Mr Berryman, having been declared bankrupt, was entitled to continue the action against Zurich in his own name by operation of s 60(4) of the Act. If the answer to that question was 'no', the subsequent issue turned on whether the proceedings should be dismissed in light of the trustee having made no election to prosecute the proceedings. Ultimately, the Court's answer to the first question was 'yes' which meant that the second question did not arise.

Section 116 of the *Bankruptcy Act*

Section 116 of the Act deals with property that is divisible amongst the creditors of a bankrupt. Pursuant to that section, all property that belonged to the bankrupt at the commencement of the bankruptcy, and the capacity to bring proceedings for exercising all powers over the bankrupt's property, is considered to be property that is divisible amongst the bankrupt's creditors (s 116(1)(a)-(b)). The categories of property that are not divisible amongst creditors include, but are not limited to, any right of the bankrupt to recover damages or compensation for personal injury or a wrong done to the bankrupt and any damages or compensation recovered by the bankrupt in respect of such an injury or wrong (s 116(2)(g)).

Section 60 of the *Bankruptcy Act*

Section 60(2) of the Act provides that an action commenced by a person who subsequently becomes bankrupt is, upon his or her becoming bankrupt, stayed until the trustee makes an election, in writing, to prosecute or discontinue the action. If the trustee does not make an election within 28 days after notice of the action is served, then the trustee shall be deemed as having abandoned the action (s 60(3)).

However, by virtue of s 60(4), a bankrupt may continue an action in his or her own name in respect of any personal injury or wrong done to the bankrupt, being the rights specified by s 116(2)(g). Both ss 116(2)(g) and 60(4) were the primary focus of *Berryman*.

Authorities considered

The Court considered, and Zurich relied upon, the case of *Cox v Journeaux (No 2)* [1935] HCA 48; (1935) 52 CLR 713 in which it was established that the test for determining what constitutes a 'personal injury or wrong' within ss 60(4) and 116(2)(g) is whether the damages are to be determined by immediate reference to pain felt by the bankrupt in respect of mind, body or character without reference to the bankrupt's property rights.

The Court also had regard to, and ultimately agreed with, the approach in the case of *Moss v Eaglestone* [2011] NSWCA 404; (2011) 83 NSWLR 476 which concerned a bankrupt's claim against his former solicitor for damages for loss of chance to pursue a defamation claim. In those proceedings, Allsop P (as the Chief Justice then was) determined that the bankrupt was entitled to continue his action for reputational harm. His Honour's reasoning made clear that the distinction between personal and proprietary rights is one of substance and that a bankrupt's creditors should not benefit from a personal wrong to the bankrupt.

This outcome assumes that damages will be referrable to the substance of the matter, not the form of the action. So whilst Mr Berryman's claim was made pursuant to a policy of insurance (ie

underpinned by contract), the substance and nature of his claim (i.e. for personal injury) was not altered by the imposition of the policy between the injury and his action, as was in the case of *Moss v Eaglestone*.

Analysis of sections 60(4) and 116(2)(g)

In concluding that Mr Berryman's claim fell within the exception of ss 60(4) and 116(2)(g), Mr Berryman was permitted to continue the action in his own name. Although the resolution of the prevailing issue in *Berryman* was based on statutory construction and purposive readings of those sections, the following points can be gleaned from the judgment:

- **Protective provisions**: the intention of the sections is to protect a bankrupt's right to compensation for personal injury or wrong from his or her creditors (at [62]). It would be unjust to give that relief to the bankrupt's general creditors.
- **Complementary provisions:** s 116(2)(g) concerns the damages or compensation being the nature of the loss and s 60(4) the action to which that loss relates (at [60]-[61]).
- **Substance over form**: the real enquiry for monies payable by way of contract or tort in the context of personal injury is the relationship between the amount of compensation and the nature of injury. Provided that the relation exists, the essential character of the payment will be compensation for injury (at [68]).
- **Proprietary rights and personal injury:** a distinction is drawn between the bankrupt's property rights and personal injury. Assessment of the former concerns matters outside the personal injury of the bankrupt. With respect to the latter, personal injury is centrally important to the examination of a policy of insurance and the application of s 60(4) to a bankrupt's claim (at [67]-[72]).
- **Damages referrable to chance of success and personal injury:** a claim will still fall within s 60(4) if the damages claimed are not estimated by immediate reference to pain and suffering. That assumes there is still a substantial reliance on the issue of personal injury. The nature of the bankrupt's injury and substance of the claim will not be altered by the chosen formulation of the case (at [73]-[78]).
- **Personal injury or wrong need not be by a third party:** there is no policy reason why the personal injury or wrong should be confined to conduct caused by a third party where accidents may occur without the presence of a third party (at [86]). To suggest otherwise sits contrary to the protective intent of the sections.
- ***Cork v Rawlins* point**: the Court made reference to the decision of *Cork v Rawlins* [2001] Ch 792. The facts were very similar to *Berryman* and concerned the issue of whether benefits payable under an insurance policy as a result of a permanent disability were divisible amongst the bankrupt's creditors. In that case, Mr Rawlins was a self-employed landscape gardener who became permanently disabled following an accident. After making a claim with his insurer, Mr Rawlins became bankrupt and was subsequently paid his benefit under his insurance policy.

  Although not dealing with equivalent provisions such as ss 60(4) and 116(2)(g), the Court of Appeal of England and Wales accepted that the trustee was entitled to the policy monies, the reasoning of which was based on the following (*Berryman,* at [49]):

  a. lack of authority to support the point;

  b. the policy was purchased by the payment of a premium;

  c. the contractual nature of the right to receive the sum of money under the policy;

  d. the benefits under the policy becoming payable upon satisfaction of a test of pain and suffering being a contractual test of 'employability'; and

  e. the patent extension of the common law exception of the bankrupt's pain and suffering was a matter for Parliament and not the courts.

  The Court in *Berryman* eschewed reliance on *Cork v Rawlins* for the following reasons:

  a. it was of little precedential value and not based on ss 60(4) and 116(2)(g) (at [91]);

  b. unlike *Cork v Rawlins, Berryman* was supported by intermediate appellant authority of a coordinate jurisdiction and, unless plainly wrong, should be followed (ie *Moss v Eaglestone*) (at [92]);

  c. the substance of the claim will trump the form of the claim if made in contract (at [93]);

  d. no such extension of the common law exists in light of the provisions of ss 60(4) and 116(2)(g) (at [94]); and

  e. it is speculative to suggest that premiums paid to maintain policies of insurance would have been available to creditors if the policy were not acquired (at [95]).

Berryman's right to continue

From the analysis above, the Court determined that Mr Berryman's action was in respect of personal injury and not a property right. Mr Berryman's right to sue in contract did not mean the action was outside of s 60(4).

In the context of estimating the value/damages of Mr Berryman's claim, his personal injury was of central importance thereby reiterating the substance of his claim over its form. Further, injury 'done to' Mr Berryman was not contingent on the injury being caused by a third party, given that the facts suggest that Mr Berryman was the sole cause of his personal injury.

Takeaway points

Berryman provides significant clarity on the relationship between ss 116(2)(g) and 60(4) in the context of personal injury/damages claims whilst addressing when and how proceedings will be stayed in the context of a party's bankruptcy under s 60(4).

For proceedings concerning personal injury and other claims for damages of a personal nature such as defamation, proceedings will not be stayed by virtue of a party's bankruptcy and any benefits or damages awarded from those actions will also not be divisible amongst creditors so long as the following elements are present:

- the claim of personal injury or wrong is of central importance to the proceedings;
- despite a claim being made in contract or tort, the substance of the proceedings concerns a personal injury or wrong; and
- the calculation of damages or value is centrally focused on the personal injury or wrong to the bankrupt.

The *Berryman* decision will be of particular importance to those acting for bankruptcy trustees and for those practitioners involved in litigation concerning a personal injury or wrong to a party who subsequently becomes bankrupt during the course of proceedings. **LSJ**