

# TECHNICAL INSIGHTS

Issue 6 - 2016

## The bankrupt's right to recover and retain damages or compensation for personal injury or wrong done to the bankrupt

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- ▲ Dealing with actions giving rise to mixed claims.
- ▲ Dealing with collateral actions closely allied to primary claims for injury or wrongs suffered, where a company has failed to keep or retain financial records

### Statutory framework

Under s 60(2) Bankruptcy Act an action commenced by a person who subsequently becomes a bankrupt is, upon becoming a bankrupt, stayed until the trustee in bankruptcy makes an election, in writing, to proceed with or discontinue the action. Section 60(4), however, provides for certain exceptions to this provision. For present purposes, it provides that "a bankrupt may continue in his or her own name, an action commenced by him or her before he or she became a bankrupt in respect of any personal injury or wrong done to the bankrupt...."

Section 116(2)(g) Bankruptcy Act is also relevant. It excludes from property that is divisible among the creditors "any right of the bankrupt to recover damages or compensation for personal injury or wrong done to the bankrupt" as well as any damages or compensation recovered in respect of such injury or wrong.

The effect is that section 60(4) permits a bankrupt to proceed in his or her own name an action for personal injury or wrong done to the bankrupt, and section 116(2)(g) provides that the right to damages in such

an action and any damages recovered does not vest in the trustee for the benefit of creditors.

The intent of these provisions is clear. With respect to a bankrupt's right to compensation for personal injury or wrong suffered it is considered unjust to give such compensation for hurt suffered to general creditors; moreover, it is appropriate that any redress for wrongs suffered should vest in the very person who has suffered the injury or wrong, and not be assigned to a trustee to prosecute.

### Defining the nature and character of an action involving personal injury or wrong done

#### General

It is apparent that the distinction between an action involving property of the bankrupt as opposed to personal injury or wrong suffered by the bankrupt is the first step in matters of this kind.

The High Court in *Cox v Journeaux (No 2)* (1935) HCA 48 has provided a frequently cited account of what constitutes an action for personal injury or wrong done within the meaning of s 60(4), namely:

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"The test appears to be whether the damages or part of them are to be estimated by immediate reference to pain felt by the bankrupt in respect of his mind, body or character and without reference to his rights of property."

A useful application of the *Cox v Journeaux* principle can be found in *Faulkner v Bluett* (1981) FCA 3 where the court determined that property rights as opposed to compensation for personal injury or wrong done were involved.

In this case the plaintiff sued the Commonwealth of Australia alleging that the Commonwealth, through its agent, represented to the plaintiff that it would place an order with the plaintiff's company for a patented product (Trisal clips) for use by the armed forces. When the Commonwealth did not proceed with the order the plaintiff sought damages in respect of loans made to the company, share capital injected into the company, expected profits from the proposed contract, and the value of the patent which she had refrained from selling in expectation of the order. After commencing the proceedings, the plaintiff became bankrupt.

In finding that the plaintiff had no right to continue the action in her own name, the court observed:

"The right of action of the applicant is directly related to her property or her estate, namely, her shares in Trisal Engineering Pty Ltd and her interests in the patents or the Trisal clips. Any damages to which the applicant may be entitled would be estimated by immediate reference to her rights of property and not to pain felt by her in respect of her body, mind or character."

### The issue of the mixed claim

Cases have emerged involving mixed causes of action in the sense that the action as pleaded gives rise to claims some of which would vest in the trustee, being with respect to property rights, while others being more in the nature of personal harm suffered would be retained by the bankrupt.

For example, in *Holmes v Goodyear Tyre and Rubber Co*

(Aust) Ltd (1984) 55 ALR 594 the plaintiff bankrupt had claimed damages for loss suffered to his business as a result of passing off. Those claims were held to have vested in the trustee in bankruptcy. However, the plaintiff also claimed damages for injury to his reputation, credit and character. In this respect the court determined that the proceeding may be severed such that the bankrupt was entitled to continue in his own name that part of the action in which he claimed damages for injury to his reputation, credit and character.



More recently the courts have shown a reluctance to sever proceedings in this manner. For example, in *Mannigel v Hewlett Phelps* (1991) NSWCA 186 the plaintiffs had sued their former solicitors for professional negligence in connection with the purchase of land. They claimed damages for their economic loss and also for loss of their credit and reputation, inconvenience, and for mental distress and strain. After the action was commenced the plaintiffs became bankrupt.

In finding that the non-economic claims were consequences of the alleged economic loss the court concluded that the claims were not "without reference to rights of property" as required under the principle stated by the High Court in *Cox v Journeaux (No 2)* (see above).

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The unwillingness to sever proceedings into economic and non-economic claims was recognised in *Sands v State of South Australia* (2015) SASCFC 36 where the SA Full Court observed:

".... breaches of contract involving injuries or wrong done to the property or economic interests of a person might in special circumstances give rise to damages for distress. The mere fact that they give rise to such non-economic loss does not detract from their proper characterisation as not being wrongs to the person."

### The characterisation of secondary or collateral claims of the bankrupt

Cases may arise where a bankrupt is in the process of pursuing a claim which, although on its face would appear to have economic or property-related qualities, is so closely allied to injury or wrong suffered by the bankrupt that it may reasonably be characterised as a claim involving in substance injury or wrong suffered. In that event, notwithstanding the property or economic aspects of the claim, the bankrupt may continue with the proceedings and retain any compensation recovered.

Recently this issue was considered by the WA Supreme Court in *Berryman v Zurich Australia Ltd* (2016) WASC 196, 1/7/2016. The plaintiff was a self-employed carpenter. He had entered into a policy of life insurance with Zurich with it being a term of the policy that upon becoming totally and permanently disabled within the meaning of the policy, Zurich would pay him a total and permanent disability (TPD) benefit of \$2 million.

On 7/7/2009 the plaintiff suffered an accident at work resulting in a claim upon Zurich for payment of the TPD benefit which was declined by Zurich. In August 2014 the plaintiff commenced this action. After commencing the action, the plaintiff became bankrupt.

The issue for determination by the court was whether the plaintiff's contractual action against Zurich was an action involving property rights or one involving personal injury. Zurich's submissions were to the effect that the plaintiff was seeking to enforce a contractual

right (being a property interest) and that his claim was linked to the conditions of the policy and not to his physical injury.

In rejecting this reasoning the court found that the substance of the TPD claim under the policy was in respect of the plaintiff's personal injuries. The court concluded:

".....the rights under a policy of disability insurance are only valuable if the insured suffers an injury of the nature specified in the policy. The value is entirely dependent on the insured suffering a personal injury of sufficient seriousness to meet the policy conditions."



Essentially the court concluded that the substance of the claim was not altered by the interposition of the policy between the plaintiff's injury and his action under the policy. As a consequence the plaintiff was entitled to continue the action notwithstanding his bankruptcy.

### Concluding comments

The basic proposition in this area of bankruptcy law is that a bankrupt should not be deprived of a right to recover compensation for injury or wrong done

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to the bankrupt. However, as we have observed, this basic proposition quickly becomes contentious where, for example, the right of recovery involves a mixed claim, or a collateral action allied to the primary action. Notwithstanding the challenges generated by these issues, the courts have shown willingness to isolate the substantive nature of the claim under scrutiny, and to readily acknowledge the long-standing principle that it is unjust to bestow on general creditors compensation benefits derived by a bankrupt for personal injury or wrong done to the bankrupt.

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