IN FACT AND IN LAW

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A Trustee's Right to the Cash Surrender Value: The Supreme Court Rules on the Matter

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In a recent judgement (rendered on September 17, 1999)[1], the Supreme Court ruled on the right of a trustee to seize an insurance policy taken out by the bankrupt policyholder on her husband's life and to exercise the right to surrender in order to obtain the cash surrender value of the policy.

The Supreme Court overruled the unanimous decision of the Québec Court of Appeal rendered on November 25, 1997[2] and confirmed the Superior Court judgment rendered on November 5, 1993[3].

The Supreme Court put an end to the uncertainty which had existed in Québec as to whether or not a trustee in bankruptcy of a policyholder or participant under a policy could act in the place and stead of the bankrupt in order to exercise the right to surrender and request that the insurer resiliate the policy. A trustee will be entitled to do so only under specific circumstances, depending upon the type of policy in question.

The Facts

On March 30, 1978, Mrs. Perron-Malenfant insured her husband Raymond Malenfant's life for $300,000 in a life insurance policy taken out with La Laurentienne Vie Inc. (hereinafter referred to as "La Laurentienne"). This was a typical life insurance policy with a cash surrender value, in which Mrs. Malenfant designated herself as a revocable beneficiary.

In December of 1992, Mrs. Malenfant, her husband and her children were in the business of operating hotels and office buildings. At that time, they were petitioned into receivership and the trustee in bankruptcy contacted La Laurentienne on April 16, 1993 in order to obtain payment of the cash surrender value of the policy and request the resiliation thereof.

At the end of 1992, the cash surrender value was approximately $85,000. La Laurentienne sent a cheque in this amount to the trustee and resiliated the policy on May 4, 1993, without first having contacted Mrs. Malenfant.

Mrs. Malenfant was informed of the payment and resiliation in July of 1993 and immediately took measures to bring a motion to the Superior Court to have the trustee's decision reviewed and to obtain orders enjoining the trustee to return the cash surrender value to La Laurentienne and enjoining the insurer to reinstate the policy.

The Judgment of the Superior Court

The Superior Court was seized of the following question: can a trustee in bankruptcy act in the place and stead of a bankrupt in order to exercise the right to surrender in a life insurance policy?

The Superior Court answered in the affirmative and dismissed Mrs. Malenfant's motion. The Court concluded that Mrs. Malenfant, in her capacity as policyholder and beneficiary of the insurance policy, possessed in her patrimony the right to surrender the policy for its cash surrender value, and this right formed part of the class of property of the bankrupt which vested in the trustee.

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[1] *Perron-Malenfant* v. *Malenfant (Trustee of)*, S.C.C., 26451, September 17, 1999, Justices L'Heureux-Dubé, Gonthier, Cory, McLachlin, Iacobucci, Bastarache and Binnie.

[2] *Perron-Malenfant* v. *Samson-Bélair/Deloitte & Touche Inc. et La Laurentinne Vie*, C.A., November 25, 1997, Justices Lebel, Baudouin and Chamberland.

[3] *Perron-Malenfant* v. *Samson-Bélair/Deloitte & Touche Inc. et La Laurentinne Vie*, C.S., November 5, 1993, Justice Letarte.

In essence, the Superior Court relied on the definition of "property" set forth in section 2 of the *Bankruptcy and Insolvency Act*[4] as well as on the provisions of subsection 67(1) of the said *Act*. It also referred to a line of jurisprudence and doctrine to the same effect.

The Judgment of the Court of Appeal

The Court of Appeal reversed the Superior Court's ruling and answered the aforementioned question in the negative. Justice Baudouin wrote the unanimous opinion of the Court and based his conclusion on two controlling principles, which are set forth as follows:

1. a bankruptcy cannot confer greater rights upon creditors than they would have had if the bankruptcy had not occurred[5];
2. in civil law, as in common law, creditors can never exercise, on their own behalf, those of their debtor's rights that are extrapatrimonial rights[6].

In other words, according to the first principle, a trustee in bankruptcy cannot, solely by virtue of a bankruptcy, have conferred upon it a right to the cash surrender value which the creditors could not have previously claimed for themselves.

According to the second principle, neither creditors nor a trustee can exercise a right to surrender in the place and stead of the bankrupt, because this is a right strictly attached to a person.

For these reasons, the Court of Appeal allowed the appeal, ordered the trustee to return the cash surrender value to La Laurentienne and ordered La Laurentienne to reinstate the insurance policy upon payment of the cash surrender value and the premiums payable since the date of resiliation.

The Judgment of the Supreme Court

The Supreme Court reversed the Court of Appeal's decision and ruled that the trustee was entitled to seize the life insurance policy and exercise the surrender right in order to obtain its cash surrender value.

The Supreme Court phrased the issue in dispute differently: *if a life insurance policy **is not** exempt from seizure under the law of Quebec, should its cash surrender value nevertheless be excluded from the property divisible among creditors in a bankruptcy?*

The Criteria Exempting an Insurance Policy From Seizure

The question raised by the Supreme Court referred specifically to the provisions of articles 2552 and 2554 of the former *Civil Code of Lower Canada*, which are similar to articles 2457 and 2458 of the new *Civil Code of Québec*:

> **"Art. 2552 C.C.L.C.**
>
> When the beneficiary of the insurance is the consort, descendant or ascendant of the policyholder or of the participant, the rights under the contract are exempt from seizure as long as the beneficiary has not received the sum insured.
>
> **Art. 2457 C.C.Q.**
>
> Where the designated beneficiary of the insurance is the spouse, descendant or ascendant of the policyholder or of the participant, the rights under the contract are exempt from seizure until the beneficiary receives the sum insured.
>
> **Art. 2554 C.C.L.C.**
>
> The stipulation of irrevocable designation binds the owner even if the beneficiary has no knowledge of it.
>
> As long as the designation of a beneficiary as irrevocable subsists, the rights of the policyholder, the participant and the beneficiary are unseizable.
>
> **Art. 2458 C.C.Q.**
>
> A stipulation or irrevocable designation binds the policyholder even if the designated beneficiary has no knowledge of it. As long as the designation remains irrevocable, the rights conferred by the contract on the policyholder, participant or beneficiary are exempt from seizure."
>
> (Emphasis added)

Since these are the only provisions in the *Civil Code* relating to exemption from seizure as regards life insurance, the wording of these articles must be adhered to strictly.

Two important conclusions can be drawn from the interpretation of these provisions:

1. the Québec legislature intended these provisions to protect from seizure all rights under the contract, especially the right to surrender;

[4] *Bankruptcy and Insolvency Act*, R.S.C. (1985), c. B-3.
[5] *Royal Bank of Canada* v. *North American Life Assurance Co.*, [1996] 1 S.C.R. 325.
[6] *Banque canadienne nationale* v. *Carrette-Poulin*, (1934), 56 B.R. 143, *Zenith Tire & Repair* v. *Angle & Lemessurier Reg'd*, Sup. Ct. Mtl. E-106243, February 13, 1934, *Jarry Automobile Ltée* v. *Mendicoff*, [1947] C.S. 465, *Gagnon* v. *City of Montreal*, [1956] R.P. 385 (C.S.), *Lauwers* v. *Tardiff*, [1966] C.S. 79.

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2. the Québec legislature specifically chose to exempt from seizure only rights under certain types of policies. Conversely, one must conclude that all rights under other classes of policies are seizable.

The Application of Paragraph 67(1)(b) of the *Bankruptcy and Insolvency Act*[7]

Articles 2552 and 2554 of the *Civil Code of Lower Canada* were determinative in the application of paragraph 67(1)(b) of the *Bankruptcy and Insolvency Act*:

> "**67.** (1)The property of a bankrupt divisible among his creditors shall not comprise
>
> (…)
>
> (b) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides,"

One must refer to the definition of the word "property" set forth in section 2 of the *Act*, which reads as follows:

> "property" includes money, goods, things in action, land and every description of property, whether real or personal, legal or equitable, and whether situated in Canada or elsewhere, and includes obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, in, arising out of or incident to property;

As regards rights under a life insurance policy, the Supreme Court concluded that the only rights *"exempt from seizure under any laws applicable in the province"* are those declared to be exempt from seizure pursuant to articles 2552 and 2554 C.C.L.C.

Thus, when it comes to determining whether or not the rights of a bankrupt form part of the property divisible among the bankrupt's creditors, it does not seem necessary to consider the personal rights doctrine raised by the Court of Appeal; one must rely strictly upon the rule set forth in the *Bankruptcy and Insolvency Act* and upon the general law of Québec.

In summary, in matters of life insurance, only the rights under the two classes of policies set forth in articles 2552 and 2554 of the *Civil Code of Lower Canada* are exempt from seizure. Consequently, only those rights give rise to the restriction set forth in paragraph 67(1)(b) of the *Bankruptcy and Insolvency Act*.

Was the Life Insurance Policy Taken Out by Mrs. Malenfant Exempt From Seizure?

The life insurance policy taken out by Mrs. Malenfant did not meet the criteria of either of the two classes of policies affected by the exemption from seizure rules. Indeed, Mrs. Malenfant was both the beneficiary and policyholder of the policy taken out with La Laurentienne.

Moreover, Mrs. Malenfant specifically designated herself as a revocable beneficiary and, therefore, she could not benefit from the presumption of irrevocability set forth in article 2547 of the *Civil Code of Lower Canada* (article 2449 C.C.Q.), given that she was not the "consort of the policyholder":

> **"Art. 2547 C.C.L.C.**
>
> The irrevocable designation of a beneficiary cannot be made except in the policy or in a separate writing other than a will.
>
> The designation, by the policyholder or participant, of his consort as beneficiary is irrevocable unless otherwise stipulated.

> **Art. 2449 C.C.Q.**
>
> The designation in a writing other than a will, by the policyholder or participant, of his spouse as beneficiary is irrevocable unless otherwise stipulated. The designation of any other person as beneficiary is revocable unless otherwise stipulated in the policy or in a separate writing other than a will. The designation of a person as subrogated policyholder is always revocable.
>
> Where revocation is permitted, it may only result from a writing but it need not be express."

Consequently, when the beneficiary of the insurance and the policyholder are one and the same person and the designation of beneficiary is revocable, the rights under the policy are seizable and constitute property divisible among creditors within the meaning of paragraph 67(1)(b) of the *Bankruptcy and Insolvency Act*.

What is the Current Situation?

The Québec legislature has defined the classes of policies exempt from seizure based upon the privileged relationship between the beneficiary and the policyholder or participant.

Thus, when a policyholder or participant is petitioned into receivership, the trustee will not be able to avail itself of the surrender right in the following circumstances:

1. when the designated beneficiary of the insurance is the spouse of the policyholder or participant, regardless of whether the designation is stipulated as being revocable or is presumed to be irrevocable;

[7] *Bankruptcy and Insolvency Act*, R.S.C. (1985), c. B-3.

2. when the designated beneficiary of the insurance is the descendant or ascendant of the policyholder or participant;
3. when the designation of beneficiary is irrevocable.

In the past, the courts have already had to interpret, several times, the term "**spouse**" (or "**consort**") within the meaning of insurance policies and the provisions of the *Civil Code*.

The expression "spouse" (or "consort"), as used in the *Code*, was used for the benefit of legitimate spouses and does not include the notion of common law spouses. This notion has always been foreign to the Civil Code; moreover, the English text, which uses the word "spouse", does not make any distinction[8]. The designation of a common law spouse will exempt the policy from seizure only if the designation is made irrevocably.

Conclusion

This Supreme Court ruling provides all the clarification life insurance companies need in order to guide them with respect to the numerous requests made to them by trustees.

The protection of family in the life insurance context as well as the specific protection afforded to a beneficiary who does not form part of the traditional family circle have been confirmed.

The essential point is that the rules of the *Civil Code of Québec* constitute a complete and exclusive code governing the exemption from seizure of the rights under life insurance contracts governed by the laws of Québec as regards the rights of a trustee pursuant to paragraph 67(1)(b) of the *Bankruptcy and Insolvency Act*.

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[8] *Syndic de Di Paolo*, [1998] R.J.Q. 174 (C.S.), *Memmi* v. *Compagnie d'assurances générales Héritage*, [1997] R.R.A. 836 (C.S.), *Miron* v. *Trudel*, [1995] 2 S.C.R. 418, *Doré-Marcoux* v. *Arteau*, (1987) 2 Q.A.C. 201 (C.A.).

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