IN FACT AND IN LAW

Bankruptcy and Insolvency Law

November 1999

Bankruptcy: RRSPs and Life Insurance Policies — The Supreme Court Rules on the Trustee's Rights

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Do the amounts deposited in an unseizable pension plan remain unseizable when transferred to a seizable RRSP?

In an important decision, *Poulin* v. *Serge Morency et Associés Inc.*, rendered on September 17, 1999, the Supreme Court of Canada answered no to this question.

Serge Poulin was a physician employed by the government of Quebec from 1981 to 1990, during which time he contributed to the Government and Public Employees Retirement Plan (the "GPERP") and to a self-directed RRSP of which he had designated his sister as the revocable beneficiary. In 1991, Dr. Poulin asked the Commission administrative des régimes de retraite et d'assurance ("CARRA") to transfer the amounts which stood to his credit in the GPERP into his RRSP. In April 1993, Dr. Poulin went bankrupt and the trustee asked him to remit the amounts he held in his RRSP. Dr. Poulin refused and filed a motion for a declaratory judgment in which he requested that the amounts held in his RRSP be declared unseizable.

Dr. Poulin was successful before the Superior Court which concluded that an amount equal to that originally held in the GPERP, as transferred by the CARRA, together with an amount for appreciation in proportion to the total increase in the value of the plan, was unseizable in nature because the statute declares the amounts held in the original plan to be unseizable. This decision of the Superior Court was overturned by the Quebec Court of Appeal which, by a majority decision, declared that all sums constituting Dr. Poulin's RRSP were seizable because the protected amounts lost their unseizable status when they were transferred into the RRSP.

Dr. Poulin appealed to the Supreme Court of Canada.

In the Supreme Court of Canada, the doctor waived the argument that the amounts deposited in his RRSP, other than those derived from the GPERP, were unseizable because Dr. Poulin's sister was designated as the revocable beneficiary of the RRSP, and she did not fall into one of the classes of "protected" beneficiaries contemplated in the *Civil Code of Lower Canada* (the consort, ascendants and descendants, or a person irrevocably designated as a beneficiary).

The Supreme Court recalled that section 67 of the *Bankruptcy and Insolvency Act* sets out the trustee's rights over the bankrupt's property, and this section refers to the applicable laws in the province where the bankrupt resides, and where his or her property is located, in order to determine the property which is exempt from seizure and execution. The Supreme Court also recalled that in matters such as these, seizability is the rule and unseizability the exception, and any provisions that depart from this principle must therefore be narrowly interpreted.

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The Supreme Court confirmed the Court of Appeal's decision and declared that the amounts originally deposited in the GPERP, as transferred into Dr. Poulin's RRSP at his request, lost their unseizable nature. As of that moment, Dr. Poulin's rights and the amount invested were thereafter governed by the terms of the RRSP contract.

Dr. Poulin pleaded, in particular, that his RRSP was unseizable by virtue of the source of the funds used to create the RRSP, namely, the amounts deposited in the GPERP, which are declared unseizable under the *Act respecting the Government and Public Employees Retirement Plan*. The Supreme Court rejected this argument because, in the Court's view, the wording of the legislative provision which makes the amounts unseizable while they are held in the GPERP is not sufficiently clear to create a new case of investment, reinvestment or real subrogation when these amounts are withdrawn or transferred.

Although there is a general rule of personal subrogation in civil law, the Supreme Court noted that our law contains no principle of real subrogation and only makes fragmented applications thereof. As for the cases of investment and reinvestment, they are exceptional and are expressly provided for in the law. Where the Quebec legislature intended to extend the unseizability of certain sums derived from a retirement plan to the RRSP into which they had been transferred, it did so expressly and clearly. For the Supreme Court of Canada, the legislature did not express a clear intention that the amounts deposited in the GPERP should remain exempt from seizure once transferred into a seizable investment vehicle such as Dr. Poulin's RRSP. Circumstances would have been different if Dr. Poulin's RRSP had itself been unseizable under the rules governing the unseizability of RRSP's, and not by virtue of the sole source of the funds.

The Supreme Court of Canada therefore recognized the trustee's right to receive all the amounts held by Dr. Poulin in his RRSP.

Can a trustee in bankruptcy require an insurer to pay the trustee the cash surrender value of a life insurance policy taken out by the bankrupt?

In a case rendered on the same day (September 17, 1999), *Perron-Malenfant* v. *Malenfant (Trustee of)*, the Supreme Court of Canada answered yes to this question.

The decision was rendered in connection with the bankruptcy of the well-known businessman, Raymond Malenfant, his wife, Colette Perron-Malenfant and their children. Colette Perron had taken out an insurance policy on the life of her husband and designated herself as revocable beneficiary. According to the terms and conditions of the insurance policy, Ms. Perron was entitled to receive the cash surrender value of the policy. Following the bankruptcy of Mr. Malenfant, his wife and their children, the trustee in bankruptcy notified the insurer that he was exercising the right to surrender the policy in the name of Colette Perron and that the insurer therefore had to resiliate the policy and pay its cash surrender value to the trustee. The insurer complied with the trustee's request and paid the amount representing the said cash surrender value to the trustee.

Ms. Perron applied to the Superior Court for an order enjoining the trustee to pay back the cash surrender value to the insurer, and for an order enjoining the insurer to reinstate the policy. The Superior Court dismissed the application of Ms. Perron, who then appealed to the Quebec Court of Appeal. In a unanimous judgment written by Justice Jean-Louis Baudouin, the Court of Appeal overturned the Superior Court's decision and ordered the trustee to return the cash surrender value to the insurer.

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The Court of Appeal based its conclusion on two principles that it characterized as determinative. Firstly, the Court of Appeal stated that the right to surrender a life insurance policy in civil matters has always been considered a "purely personal" right, or a right "exclusively attached to the person". Quebec case law has consistently held that creditors cannot exercise the extrapatrimonial or "purely personal" rights of their debtors for their own benefit. For the Court of Appeal, this principle was determinative in this case.

Secondly, the Court of Appeal extended this principle to matters of bankruptcy by adding that the bankruptcy cannot confer greater rights on the creditors than they would have had if the bankruptcy had not occurred. Therefore, since the bankruptcy cannot place the creditors in a better position vis-à-vis their debtor, and the right to the cash surrender value of the policy cannot be exercised by the creditors in an oblique action, the trustee cannot force payment of the cash surrender value. The Court of Appeal therefore found for Colette Perron.

The trustee brought the matter before the Supreme Court of Canada. The question which the Supreme Court asked itself was whether the right to surrender a bankrupt's life insurance policy is exempt from seizure, even though the rights under the policy are not exempt, and, consequently, whether a trustee in bankruptcy is thereby prevented from exercising this right and distributing the policy's cash surrender value among the bankrupt's creditors.

First of all, the Supreme Court noted that Colette Perron's life insurance policy was not exempt from seizure under the applicable law of Quebec at the time of bankruptcy. Under her contract with the insurer, Colette Perron was both beneficiary and policyholder. This dual status meant that no privileged relationship could exist between the policyholder and the beneficiary which would trigger the protection afforded by the *Civil Code of Lower Canada* (the "*Civil Code*"). Colette Perron sought to impress upon the Supreme Court the relevance of the fact that she was the beneficiary of a policy insuring the life of her husband. Accordingly, even if, as beneficiary, she was not the consort of the policyholder and did not at first blush satisfy the requirements of the *Civil Code*, she was the consort of the insured and her policy was therefore of the same familial nature as that described in the *Civil Code* and merited similar protection from seizure.

The Supreme Court did not accept this argument for the reason that the Quebec legislature defines the types of familial life insurance policies that are unseizable according to the relationship of the beneficiary to the policyholder, and not to the insured. The exemption provisions of the *Civil Code* governing life insurance contracts are exhaustive and are express rules; consequently, they alone govern seizability.

In accordance with the decision rendered in 1996 in the case of *Royal Bank of Canada* v. *North American Life Assurance Co.* (the Ramgotra case),[1] and its interpretation of section 67(1)(b) of the *Bankruptcy and Insolvency Act*, the Supreme Court stated that provincial law alone is determinative in matters of exemption from seizure regarding the rights which the trustee can seize and exercise for the benefit of the creditors. This being the case, it was not necessary to consider the theory of personal rights under the *Bankruptcy and Insolvency Act* and the general law of Quebec, since, in this case, the exemption provisions relating to life insurance policies applied. Accordingly, all the rights conferred by a seizable policy are seizable, including the right to the cash surrender value of the policy.

Having found that Colette Perron's life insurance policy and all the rights attached to the policy, including the right to surrender it, were seizable, the Supreme Court therefore concluded that the trustee was entitled to receive the cash surrender value of the policy.

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[1] [1996] 1 S.C.R. 325

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