Discharged but not disconnected: litigation for personal injury lawyers after *Thistle v. Schumilas*

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KEY BANKRUPTCY AND INSOLVENCY ISSUES IN PERSONAL INJURY LAW
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Bankruptcy is not only a financial status; it is a legal status. This legal status is terminated when a bankrupt is discharged. This involves a discharge hearing at which a Registrar in Bankruptcy orders either an absolute discharge, conditional discharge or suspended discharge. An "*undischarged bankrupt*" therefore is a person that either filed an assignment in bankruptcy or against whom a bankruptcy order was issued and who has not yet been discharged.

The *Bankruptcy and Insolvency Act* ("**BIA**") sets out the duties, responsibilities, and restrictions for undischarged bankrupts, including but not limited to:

> ***Section 71***
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> On a bankruptcy order being made or an assignment being filed with an official receiver, **a bankrupt ceases to have any capacity to dispose of or otherwise deal with their property, which shall, subject to this Act and to the rights of secured creditors, immediately pass to and vest in the trustee** named in the bankruptcy order or assignment, and in any case of change of trustee the property shall pass from trustee to trustee without any assignment or transfer.
>
> ***Section 158(a)***[1]
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> **A bankrupt shall make discovery of and deliver all his property that is under his possession or control to the trustee** or to any person authorized by the trustee to take possession of it or any part thereof.

[1] See s.158 of the BIA for a full list of the duties of a bankrupt.

Property is defined in s.2 of the BIA as

> any type of property, whether situated in Canada or elsewhere, and includes money, goods, **things in action**, land and every description of property, whether real or personal, legal or equitable, as well as obligations, easements and every description of estate, interest and profit, present or future, vested or contingent, in, arising out of or incident to property. [emphasis added]

'Things in action' are choses in action. The property of a bankrupt divisible among their creditors also includes all property wherever situated of the bankrupt at the date of the bankruptcy or that may be acquired by or devolve on the bankrupt before their discharge; in other words, **after-acquired property**.[2]

So what happens if the bankrupt is discharged and they come to you seeking to commence a personal injury action for a cause of action they discovered after their discharge? Should you proceed? Assuming that your client's personal injury claim involves the type of property that vests with a trustee (e.g., an insurance claim), the Ontario Court of Appeal says "NO". This action belongs to the discharged bankrupt's Trustee. The seminal case addressing this issue is *Thistle v. Schumilas*, 2020 ONCA 88.

THISTLE V. SCHUMILAS

This appeal was brought by a discharged bankrupt seeking an Order granting him standing to continue his litigation against an insurance agent.

The respondent made an assignment in bankruptcy on June 25, 2009. The respondent's wife died in 2010, so the respondent made a claim under the policy for $600,000 as the sole beneficiary. In

[2] BIA s.67(1)(c)

February 2011, Equitable Life denied the claim on the basis that the respondent's wife had misrepresented or failed to disclose material facts on her application for insurance.

The respondent was discharged from bankruptcy on June 13, 2011.

Around December 2012, the respondent became aware of a potential claim in professional negligence against the appellant, who had acted as his wife's insurance agent when she purchased the policy. The respondent commenced a claim against the appellant on February 11, 2013, seeking damages equivalent to the policy's value. The respondent commenced this action almost two years after his discharge from bankruptcy.

In or about September 2018, the appellant brought a motion for summary judgment to dismiss the action on the basis that any right to assert a claim against him arose when the respondent was an undischarged bankrupt and, therefore, the cause of action vested with his trustee in bankruptcy. The respondent brought a cross-motion seeking an order *nunc pro tunc* granting him "standing to bring this action issued February 11, 2013 in his own name and at his own risk and expense, notwithstanding his assignment in bankruptcy and subsequent discharge". The Trustee consented to the respondent’s cross-motion.

The motion judge found that she had a discretion under the BIA and/or the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, to validate the claim and regularize the proceedings. She relied on s. 187(9) of the BIA, which provides that no bankruptcy proceeding shall be invalidated by a formal defect or irregularity. According to the motion judge, the order the respondent sought was consistent with the interests of justice and would help protect innocent third-party creditors and the respondent. To do otherwise, she reasoned, would result in a potential windfall for the appellant and a corresponding loss to the creditors.

Issue:

The parties agreed that the cause of action arose during the respondent's bankruptcy and therefore constituted property vested in the Trustee. The Court of Appeal, however, raised the issue of discoverability and its application to these facts. Specifically, *does the cause of action vest with the Trustee given that the respondent only discovered the cause of action after his discharge from bankruptcy?*

Argument & Conclusion[3]:

The respondent argued for the import of the discoverability rule as an exemption to the automatic vesting of a cause of action under s.71 of the BIA. The reasoning advanced by the respondent is that until a bankrupt or a trustee has discovered a claim, there is nothing that can be practically done to prosecute a cause of action. Finding that a cause of action vests with the trustee regardless of discoverability would allow defendants like the appellant to wrongfully avoid liability.

The Court of Appeal disagreed for the following reasons:

(a) Sections 2 and 67(1)(c) define property broadly and without the caveat of discoverability, this being an intention of Parliament to "sweep up a variety of assets… not normally considered 'property' at common law";
(b) Importing the discoverability rule into the vesting procedure under s. 71 would not only create uncertainty, it could incentivize bankrupts to avoid learning of and disclosing all assets to their trustee; and

[3] For further discussion on the respondent's request for a *nunc pro tunc* order, please see paragraphs 22-31 of the Court of Appeal's decision.

(c) The exemptions to the vesting of property procedure under s.71 are limited and not analogous to the proposed exemption based on discoverability.

The Court of Appeal held that the BIA does not prevent a claim from being asserted or prevent discoverability from operating; all it does is direct that a cause of action vests in the trustee. In fact, the *nunc pro tunc* order of the motion judge was set aside by the Court of Appeal on the grounds that the respondent was out of time. The respondent brought his motion to regularize the proceeding more than two (2) years after discovering his cause of action against the appellant.

Had the respondent re-appointed the Trustee under to s. 41(11)[4] of the BIA, the Trustee could have prosecuted the respondent's claim against the appellant. If the Trustee determined that it did not want to prosecute the claim against the appellant, the respondent could have arranged to have the cause of action assigned to him under s.40[5] of the BIA. Whether the action is pursued by the Trustee or the respondent after following the above procedure, the Court of Appeal affirmed that the doctrine of discoverability could still be relied on to argue that the claim was not statute barred.

The appeal was allowed and the respondent's action dismissed.

[4] **Section 41(11)**: The court, on being satisfied that there are assets that have not been realized or distributed, may, on the application of any interested person, appoint a trustee to complete the administration of the estate of the bankrupt, and the trustee shall be governed by the provisions of this Act, in so far as they are applicable.

[5] **Section 40(1)**: Any property of a bankrupt that is listed in the statement of affairs referred to in paragraph 158(d) or otherwise disclosed to the trustee before the bankrupt's discharge and that is found incapable of realization must be returned to the bankrupt before the trustee's application for discharge, but if inspectors have been appointed, the trustee may do so only with their permission.
(2) Where a trustee is unable to dispose of any property as provided in this section, the court may make such order as it may consider necessary.

PRACTICAL CONSIDERATIONS

The Court of Appeal's decision in *Thistle* has the following practical implications for your personal injury practice:

A. Client intake

It is critical that you gather the relevant information at client intake by asking the right questions. Assuming your client's cause of action was discovered within the last two years, you will need to consider whether your client's claim involves property that vests with a Trustee in bankruptcy, ask about any potential bankruptcy history, including date of bankruptcy and date of discharge, ask whether their Trustee has taken any steps with regards to the cause of action, and request a copy of a s.40 BIA Order before proceeding with any litigation.

B. Bankruptcy searches

In addition to asking your client about their bankruptcy history, best practice is to conduct your own bankruptcy search as well. Due to the stigma of personal bankruptcy or simply a lack of knowledge, clients may not disclose this information to you or conclude that it is not relevant for you to know. The Office of the Superintendent of Bankruptcy can confirm whether your client was (or perhaps still is) an undischarged bankrupt. To obtain a bankruptcy search, visit *https://www.ic.gc.ca/app/scr/bsf-osb/ins/login.html.* You will be required to set up an account with ISED[6] in order to start your search. See Schedule 'A' attached hereto for an example of a bankruptcy search result.

[6] Innovation, Science and Economic Development Canada; Note: there is a charge of $8.00 for each set of 10 results you view.

C. Spotting a *Thistle* situation

Determining whether your client's action may be subject to the Court of Appeal's decision in *Thistle* boils down to whether your client was an undischarged bankrupt at the time their cause of action arose. The below chart summarizes the next steps your client will need to take to advance their claim.[7]

	Before Discharge	After Discharge
Before Commencement of Action	▪ Contact Trustee and request a s.40 assignment of the cause of action	▪ Re-appoint Trustee under s.41(11) to pursue cause of action; if Trustee refuses, request a s.40 assignment
After Commencement of Action	▪ Contact Trustee and bring a *nunc pro tunc* motion for a s.40 assignment of the cause of action	▪ Re-appoint Trustee under s.41(11) to pursue cause of action; if Trustee refuses, bring a *nunc pro tunc* motion for a s.40 assignment of the cause of action -or- ▪ Bring motion within 2-year limitation period for a *nunc pro tunc* order to regularize the action

[7] If you are unsure whether a previous bankruptcy affects your client's ability to prosecute their cause of action, we recommend you speak with an insolvency lawyer for further directions.