Revd mss Nov 14 pm CFM 10:30PM; jsz Nov 15

FACTS ON THE GROUND AND RECONCILIATION

OF DIVERGENT

CONSUMER INSOLVENCY PHILOSOPHIES

Jacob Ziegel

Professor of Law emeritus

University of Toronto

Presentation at University of Texas Law School Seminar, November 28, 2005

This is the revised version of a paper, in course of publication, and delivered by the author at a conference on comparative consumer insolvency issues held at the University of Tel-Aviv Faculty of Law on June 5-8, 2005. The paper has been expanded in several sections to make it more intelligible to American readers; more additions would have been desirable but there was no time for it. Please do not cite or quote from this version without the author's permission. Comments and suggestions will be warmly welcomed and should be emailed to j.ziegel@utoronto.ca.

Contents

I INTRODUCTION

Comparative consumer insolvency law is the newest branch of insolvency law and is only 25 years old.[1] Its newness is due to the fact that until the mid-1980s there was little to compare with outside the common law jurisdictions. This was because the civil law countries in continental Europe and the Scandinavian countries either did not recognize the availability of consumer bankruptcies or, if they did, did not recognize the possibility of a discharge of the consumer's debts at the end of the proceedings[2] – a critical component of meaningful relief for seriously overcommitted debtors.

The leading common law jurisdictions – the US, England, Canada, Australia – were significantly more accommodating that their civilian cousins. Even here, however, there were still major hurdles to overcome. Only the US had a firmly entrenched and near-century old fresh start policy and gave debtors easy access to the bankruptcy system as well as an optional chapter 13 compositional alternative. In the other enumerated common law countries, access to the system was expensive, a powerful stigma still attached to bankruptcy, and discharge of debts was at the court's discretion and was generally only available a substantial number of years after the initial filing.

The legal scene has changed dramatically since the mid-1980s. The Scandinavian countries and most of the leading civil law jurisdictions on the continent – Germany, France,

---

[1] See J. Ziegel, *The Challenges of Comparative Consumer Insolvencies*, 23 PENN STATE INTERNATIONAL L. REV. 839 (2005), E. Franken, Book Review of J. Niemi-Kiesilainen et al., *Consumer Bankruptcy in Global Perspective* and J. Ziegel, *Comparative Consumer Insolvency Regimes: A Canadian Perspective*, 68 MODERN L. REV.169 (2005), and K Anderson, *The Explosive Global Growth of Personal Insolvency and the Concomitant Birth of the Study of Comparative Consumer Bankruptcy*, 42 OSGOODE HALL L. J. 661 (2004).

[2] J. ZIEGEL, COMPARATIVE CONSUMER INSOLVENCY REGIMES: A CANADIAN PERSPECTIVE, ch. 7(1) (Hart Publishing 2003) ('ZIEGEL, CONSUMER INSOLVENCY REGIMES'), and cf. Nick Huls, *American Influences on European Consumer Bankruptcy Law* 15 JOURNAL OF CONSUMER POLICY 125 (1992).

Austria, the Netherlands, Belgium and Luxembourg – have adopted consumer insolvency or debt adjustment legislation.[3] The legislation recognizes at least the possibility of a partial or complete discharge of the debtor's outstanding debts albeit only at the end of a very substantial and, in some cases, onerously long period of mandatory repayments and close supervision of the debtor's conduct. Civil law jurisdictions in Latin America and Southeast Asia have followed suit with comparable legislation or are showing interest in doing so. In Southeast Asia, Japan is a particularly arresting example of a powerful industrial state with a combined indigenous and civilian insolvency tradition whose consumer insolvency law moved perceptibly closer to the common law models in the 1990s and early 2000s.[4]

The common law jurisdictions have not stood still either. Over the past 20 years, Canada, England and Australia have all made their consumer insolvency legislation and procedures much more user friendly.[5] The bankruptcy stigma has been substantially eliminated and discharge of unpaid debts is near automatic or completely automatic in a broad run of cases, although not along the US fresh start lines as I explain later. The critical distinction between the US fresh start policy, as it existed until very recently, and the Commonwealth jurisdictions' approach lay in the

---

[3] For the details see Ziegel, *supra* note 2, ch 7(2) and (3).

[4] See Mark D West, *Dying to Get Out of Debt: Consumer Insolvency Law and Suicide in Japan*, University of Michigan Law School, Public Law & Legal Theory Res. Paper Series, Res. Paper No. 37, *at* http://ssrn.com/abstract=479844, esp at 3, 17, and K. Anderson, *Insolvency*, *in* JAPAN BUSINESS LAW GUIDE (Veronica Taylor, ed., CCH-Singapore 2003) (with Stacey Steele) and *Insolvency Law for a New Century: Japan's New Framework for Economic Failures*, *in* LAW IN JAPAN: INTO THE 21ST CENTURY (Dan Foote, ed, U. Wash. & U. Tokyo Presses 2003) (with Makoto Ito).

[5] For the details see Ziegel, *supra* note 2, ch 2(2) (Canada), ch 4 (Australia), and ch 5 (England and Wales). With respect to England, see also the important recent report, THE INSOLVENCY SERVICE, RELIEF FOR THE INDEBTED – AN ALTERNATIVE TO BANKRUPTCY? (March 2005) advancing a proposal for a fast track non-judicial debt relief procedure for low income no-asset debtors to replace the existing administration order debt relief regime under the County Courts Act. On the latter, see Ziegel, *supra* note 2, ch 5(4)(c).

treatment of the debtor's post bankruptcy income and the timing and conditions of the debtor's discharge. Contrary to a widely held belief among civilians, until April 20, 2005 a wide gulf separated the Commonwealth countries from the US Bankruptcy Code on these basic features.

The ideological gap has narrowed perceptibly with President Bush's signature on April 20, 2005 of the 500 page Bankruptcy Abuse Prevention and Consumer Protection Act 2005 (BAPCPA), which was approved by large majorities by both branches of Congress earlier in the year. Easily the most important conceptual change wrought by BAPCPA is the introduction of a mandatory means test for all new personal bankruptcy filers.[6] In turn, this will trigger denial of access to chapter 7 of the Code to those filers with median incomes or better whose net disposable income after deduction of recognized expenses is deemed sufficient to enable them to enter into a chapter 13 adjustment of debts plan with their creditors. Prior to BAPCPA, the US was rightly regarded as the jurisdiction with the most generous fresh start policy in the Western hemisphere for first time consumer bankrupts. BAPCPA has fundamentally changed the direction and mood of US consumer bankruptcy philosophy and has brought it much closer in concept, though surely not in execution and detail, to the qualified fresh start policy and means test model practiced in the other common law jurisdictions.

These dramatic changes did not occur in an economic and social vacuum. They were inspired by the dismantling of usury barriers and other credit restrictions in North America and Western Europe, by the rapid growth of consumer credit of all types but especially (in North

[6]BAPCPA, §102. For a summary of the principal consumer provisions, see American Bankruptcy Institute, *25 Changes to Personal Bankruptcy Law, at* http://abiworld.net/bankbill/changes.html.

America) by the expansion of credit cards, and by an equally rapid and disturbing increase in the number of overindebted consumers.[7]

Given that the basic social and economic phenomena appear to be similar in advanced economies, it is relevant to ask whether we are witnessing a meaningful convergence in the remedial laws adopted to address the problems of overcommitted consumers – whether, in short, pragmatism and facts on the ground have inspired the crop of *fin de siècle* 20th century legislation – or whether basic ideological differences still distinguish the civil law from the common law approach. If we conclude that there is still such a distinction (as many would argue there is), then we must ask which of the two approaches we find more compelling. It is important to stress however that the ideological divide is not peculiar to the civil and common law approaches. Prior to the enactment of BAPCPA, non-US common law observers often perceived the US fresh start doctrine as enshrined in the 1978 US Bankruptcy Code to be as ideologically driven in its own way as was the civil law commitment to the sanctity of contractual obligations,[8] and that this distinguished the US approach fundamentally from the heavily qualified discharge doctrine

---

[7] Here are some random figures. Between 1985 and 1997 the number of Canadian personal insolvencies increased from 19,752 to 90,034, and increased further to 102,539 in 2001. ('Personal insolvencies" include business related insolvencies). In the US, the number of consumer insolvencies reached 1.596 million in 2004. The number of insolvencies in England and Wales grew from 6,776 in 1985 to 24,441 in 1997 and reached 46,650 in 2004. The number of Australian personal insolvencies grew from 8,761 in 1986/87 to 24,109 in 2001-2002. In Germany, where bankruptcy relief for consumers only became available as of 1999, 20,000 personal bankruptcy and small business petitions were filed in the first full year of operation of the 1994 law; 44,000 petitions were filed in 2002 after the 2001 amendments to the InsO. In 2004, the figure reached 48,000. Ziegel, 'Comparative Challenges', above n1, text accompanying n 16. In Japan, the number of individual bankruptcies increased from 160,457 in 2001 to 214,633 in 2002. Cf. *Japan Information Centre* (2005), *at* http://www.jicc.co.jp/f/index.html. According to a New York Times report, as many as 2 million Japanese were effectively bankrupt in 2002. Mark West, *supra* note 4, at 3 compares a similar estimate by a Japanese bankruptcy attorney.

[8] This author was among those who reached this conclusion.

applied in the other common law insolvency systems. This paper therefore attempts to address the ideological component at both ends of the insolvency spectrum.

II THE ETHOS OF THE CIVIL LAW REFORMS 1989-2005

Jason Kilborn has given us three meticulously detailed and documented accounts of the evolution and current status of the German, French, Belgian and Luxembourg consumer insolvency and debt adjustment laws between 1989 and 2004.[9] Johanna Niemi-Kiesilainen, a distinguished Finnish scholar, previously told us in two powerful critiques[10] that what the continental laws and the Scandinavian insolvency regimes share is a common socializing philosophy based on the sanctity of contractual obligations that sharply distinguishes the European approach from the market oriented Anglo-Saxon fresh start policy. According to her, the object of the Anglo-Saxon fresh start philosophy is to relieve the consumer of the burden of accumulated debts at the earliest possible opportunity and to restore the consumer as an active participant in the market place. The civil law programmes, on the other hand, have different goals. They are designed to impress on the consumer the importance of observing her debt obligations, and to impose on her a period of rehabilitation and repayment of debts which may

---

[9] J. Kilborn, *La Responsabilisation de l'Economie: What the U.S. Can Learn from the New French Law on Consumer Indebtedness*, MICHIGAN J. OF INTERN. L. (forthcoming 2005), J. Kilborn, *Continuity, Change, and Innovation in Emerging Consumer Bankruptcy Systems: Belgium and Luxembourg* (unpublished manuscript), and J. Kilborn, *The Innovative German Approach to Consumer Debt Relief: Revolutionary Changes in German Law, and Surprising Lessons for the United States* 24 NW J. INT. L. & BUS. 257 (2004). Shorter descriptions of the German and French positions also appear in Ziegel, supra n.2, ch. 7.3.

[10] J. Niemi-Kiesilainen, *Consumer Bankruptcy in Comparison: Do We Cure a Market Failure or a Social Problem?* 37 OSGOODE HALL L. J. 473 (1999) and Collective or Individual? Construction of Debtors and Creditors in Consumer Bankruptcy, in CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE (J. Niemi-Kiesilainen et al. eds., 2003), ch. 2.

run for as long as ten years, and which (in France's case) only grudgingly hold out the prospect of a partial or complete discharge at the end of the period.

A. Critique of the European Civil Law Approach

As consumer insolvency comparativists, we have both the opportunity and obligation, to evaluate the theoretical underpinnings and assumptions of the different approaches to consumer insolvencies and to test them against the available data. I claim no first hand knowledge of the Western European and Scandinavian laws and their practical operation. Instead, I have had to rely on secondary sources I believe to be reliable to educate me on these points. That study has led me to believe that the civilian approach is vulnerable to challenge on the following grounds.

1. There is no obvious justification for the stigma attached to the overcommitted debtor in civilian insolvency systems and no convincing correlation between the debtor's conduct and the rehabilitative requirements. The civilian philosophy appears to be that an overindebted debtor who has not met her contractual obligations has breached a basic moral and legal code, a breach that may, if a sufficient number of debtors follow suit, jeopardize the whole basis of the modern credit system. This view is redolent of the philosophy that permeated the common law treatment of insolvent debtors for much of the 19th century and before.[11] The 19th century common law reaction was largely unsuccessful in correctly diagnosing and addressing the root problems of personal bankruptcies and, it seems, their 20th century civilian successors may have succumbed to the same mistaken dogma.

---

[11] Cf. V. M. LESTER, VICTORIAN INSOLVENCY: BANKRUPTCY, IMPRISONMENT FOR DEBT, AND COMPANY WINDING-UP IN NINETEENTH-CENTURY ENGLAND (Clarendon Press 1995), esp. ch 3.

We are told that the European debt adjustment laws are only accessible to those debtors who have acted honestly and have not abused the credit system.[12] This being the case, it is difficult to see how one can reproach a debtor who, through no fault of his own, has lost his job because of plant closing or general recession, who has fallen ill, or whose marriage has fallen apart. The same observation applies to a working family that relied on two incomes to meet heavy financial commitments and now finds itself unable to keep up the payments because one of the partners has lost her job or is no longer able to work.[13] Such misfortunes deserve our sympathy, not moral condemnation, and it is difficult to see what a long rehabilitation period and exacting payment requirements can accomplish to remedy the debtor's plight. There is also another aspect that appears to be overlooked in the civilian calculus. Even if one assumes the debtor(s) acted unwisely in assuming so much debt to begin with, behavioral economists and psychologists have shown that impulsive behaviour in making credit purchases is common among consumers, and is not evidence of a character defect.[14] Indeed, impulsive behaviour is relied on heavily by the credit industry to promote the use of its products.[15]

---

[12] Cf. NIEMI-KIESILAINEN ET AL. EDS., GLOBAL PERSPECTIVE, *supra* note 10 at 43.

[13] Cf. E. WARREN AND A. TYAGI, THE TWO-INCOME TRAP: WHY MIDDLE-CLASS MOTHERS AND FATHERS ARE GOING BROKE (Basic Books 2003).

[14] Prof Jackson was the first insolvency scholar to apply the behaviorists' findings to rationalize the US fresh start doctrine. See T. H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW ch. 10 (Harvard University Press 1986). His example has since been followed by others. See e.g., S Schwartz, *Personal Bankruptcy Law: A Behavioural Perspectiv*e, *in* GLOBAL PERSPECTIVE ch. 3*, supra* note 10, and J. Kilborn, *Behavioral Economics, Overindebtedness and Comparative Consumer Bankruptcy: Searching for Causes and Evaluating Solutions*, CEGLA CONFERENCE PAPER*,* Jun. 2005 (in course of publication). *See also* R. Harris and E Albin, *Bankruptcy Policy in Light of Manipulation in Credit Advertising,* Paper presented at the Cegla Conference and in course of publication.

[15] Two simple examples must suffice. The first is the familiar 'come on' used by North American credit card companies to attract new card subscribers by offering low interest rates during the first three or six months' life of the credit card, only to be followed at the end of the introductory period by much higher rates. The second example is the common form of credit

2. The moralistic approach ignores the singular nature of consumer credit and the credit industry's superior capacity for policing debtor behaviour. A distinctive feature of much consumer credit is that it encourages present consumption and defers the obligation to pay into the future. Here too behaviorist researchers have done much to illuminate this phenomenon and have shown that when assuming credit obligations consumers often discount the risk of not being able to meet future installment payments (cognitive dissonance). A third important ingredient is the high cost of consumer credit and its ballooning effect, especially with respect to credit cards, where the debtor fails to make a timely payment, exceeds her credit limits, or is guilty of some other infraction of the credit card agreement.[16] All of this suggests that governments should place a much heavier burden on the credit industry to prevent consumers from overextending themselves and sanctioning those creditors who exploit consumer weaknesses for their own gains. Some modest efforts have been initiated along this line in Western European countries

---

advertising used by merchants informing the consumer that the first payment will only become due twelve months or some other long period after the purchase (and incidentally without alerting the consumer to the fact that interest liability may still accrue during this period or is incorporated in the price; it is only the obligation to start paying that is postponed.) Another common form of impulsive behaviour (to which this author has also frequently fallen victim) is to visit a store to make one credit card purchase and to end up making more purchases because the merchandise looked attractive and the purchases seemed so "convenient". I do not mean to suggest the card companies are responsible for this infectious type of behaviour though they must surely know of and rely on it in making their calculations of prospective credit card use.

[16] Credit card rates in Canada currently run from 18-20% per annum, though lower rates may obtain in special cases. The cost of department store revolving credit may be as high as 30%. The cost of 'pay day' loans may be over 500% depending on how one calculates the various items and on whether the debtor has missed one or more payments. Credit card advertising often also underplays the impact of high interest charges and delinquency penalties and the danger of putting the consumer on a treadmill from which he cannot extricate himself. See further National Consumer Credit Centre, *Hearings on improved credit card disclosure before the U.S. Senate Subcommittee*, AMERICAN BANKRUPTCY INSTITUTE UPDATE, May 19, 2005 and compare Ronald J. Mann, *Optimizing Consumer Credit Markets and Bankruptcy Policy*, Paper presented at the CEGLA Conference, esp. Part II of Paper (in course of publication).

(but almost none in North America),[17] but seem too fall short of what is needed if creditor policing of debtor behaviour is to be taken seriously. An economist might contend that the threat of the debtor declaring bankruptcy and the creditor not being able to recover the balance of its debt is the most effective sanction.[18] However, this reasoning overlooks the fact that the sanction can be heavy handed and penalizes the careful as well as the risk prone creditor. It can also hurt involuntary creditors, which is a widely adopted reason in common law jurisdiction for excluding a variety of debts from the catalogue of dischargeable debts in bankruptcy.

3. The Rocky Road of Credit Counselling and Financial Education. Many regulators in the Western hemisphere have warmly embraced the virtues of credit counselling and financial education for overcommitted debtors. Such programmes also occupy a high profile in BAPCPA.[19] Credit counseling was made mandatory under the 1992 amendments to the Canadian Bankruptcy and Insolvency Act (BIA).[20] Together with financial education, it likewise appears to

---

[17] The German and French laws and the recently adopted Swiss Federal Law on Consumer Credit of March 2001 require creditors to exercise prudence in extending credit and to report defaults to a central credit bureau. However, there is no available data on the impact these requirements have had on actual credit practices. The British government also introduced extensive amendments in a December 2004 bill to the Consumer Credit Act 1974. *See Consumer Credit Bill, H.L. Bill 18*. These too were mainly designed to improve disclosure of the cost of consumer credit and amounts owing by consumers under existing agreements, and to improve policing of usurious interest rates. Additional steps for improving responsible credit extension practices are considered in THE GRIFFITHS COMMISSION ON PERSONAL DEBT, WHAT PRICE CREDIT? Chs. 10 and12, Recomm. 28. In the US, BAPCPA contains no restrictions on credit agreements and imposes no sanctions for credit grantors' abusive practices; nor does the Canadian insolvency legislation. See further Ziegel, *supra* note 2, ch 8(2)(c).

[18] Prof Jackson gives this as a reason in support of the US style fresh start rule. See Jackson, *supra* note 14.

[19] See ABI, *supra* note 6, items 2 and 4.

[20] Ziegel, *supra* note 2, 50-52.

play a foundational role in much of the continental European and Scandinavian debt relief legislation.[21]

However, there are substantial grounds for caution if not outright skepticism. Canadian and American investigations have shown that there may be no difference in the payment performance and post bankruptcy conduct of debtors who have been exposed to credit counselling and financial education programmes and those who have not.[22] The financial education may also be tendentious and interest driven (as where it is financially supported by the credit industry).[23] Just as important, its value may be quickly dissipated by seductive credit advertising ('no down payment' or 'no payments for the first 12 months') of the kind all too familiar in North America.

4. The Questionable Effectiveness of Long Probationary Periods and Harsh Repayment Requirements. As previously noted, a distinctive feature of the continental European debt relief programmes is the long probationary period the debtor must serve and the harsh repayment requirements to which he is often subjected before becoming eligible for partial or complete discharge if discharge is available at all.[24] Professor Kilborn notes that reliable completion

---

[21] See J. Niemi-Kiesilainen, *The Role of Consumer Counselling as Part of the Bankruptcy Process in Europe* 37 OSGOODE HALL L. J. 409 (1999)

[22] See J. Braucher, *An Empirical Study of Debtor Education in Bankruptcy: Impact on Chapter 13 Completion Not Shown,* 9 AMERICAN BANKRUPTCY INSTITUTE L. REV. 557 (2001), and compare Saul Schwartz, *Effect of Bankruptcy Counseling on Future Creditworthiness: Evidence from a Natural Experiment,* 77 A. B. L. J. 257 (2003) (comparison of Canadian consumer bankrupts pre-1993 who had not received counselling with post-1993 bankrupts who had received counselling showed no statistically significant differences in their credit ratings.)

[23] J. Braucher, *Debtor Education in Bankruptcy: The Perspectives of Interest Analysis*, *in* GLOBAL PERSPECTIVE*, supra* note 10, ch 16.

[24] Professor Kilborn commends the German 2001 amendments allowing the debtor to retain a progressively higher percentage of his income in the later years of the repayment period. One

figures are scarce.[25] However, there appears to be much evidence of high failure rates and recidivism among debtors under the *loi Neiertz* in France. We know too that the *loi Neiertz* has been amended three times over a fifteen-year period because the regulators' expectations from debtors enrolled in the programme were much too high.

III SURPLUS INCOME PAYMENT PROGRAMMES: THE CANADIAN EXPERIENCE

Until very recently most comparative insolvency literature ignored Commonwealth experience with means testing and income payment programmes as preconditions to debtors' discharge from bankruptcy and focused instead on the contrasting continental European and American philosophies in providing debt relief. However, the Commonwealth approaches offer an alternative model. England, Australia and Canada have long had income payment requirements of some description. Of the three approaches, the current Canadian programme is probably the most sophisticated and best documented and is therefore the object of the present section.

A. Evolution of Canadian Insolvency Law

---

may question however whether this is enough of an incentive and whether a shorter repayment period – say, of 3 years – would not be a better trade off. Presumably, economists and social workers have much to contribute to the design of efficient and realistic oriented repayment plans though there is not much evidence of their expertise being used for this purpose. (Debt adjustment arrangements in France under the *loi Neiertz* may be an exception to this observation.)

[25] Kilborn, *supra* note 9, text accompanying fn 151-152.

In the Canadian constitution, bankruptcy and insolvency fall under the exclusive jurisdiction of the federal government.[26] Between 1880 and 1919, Canada had no personal insolvency legislation of any kind.[27] In the latter year, the federal Parliament adopted the Bankruptcy Act of 1919, which was heavily influenced by the English Bankruptcy Act of 1914. The Canadian Act permitted voluntary and involuntary bankruptcies by and against individuals but rejected the American fresh start concept. Instead, debtors had to apply for a discharge. Creditors could oppose the discharge and the courts enjoyed a wide discretion in determining whether to grant a discharge and on what terms. A discharge was often granted conditioned on the debtor paying off a required percentage of the outstanding unsecured debts. Prior to discharge, the debtor's non-exempt present and after-acquired property, *including* the debtor's post bankruptcy earnings,[28] were treated as part of the estate and therefore available for distribution among the debtor's creditors. In all these respects, Canadian law differed fundamentally from US law as reflected in the 1898 US Bankruptcy Act.

In another respect, however, the Canadian Act was actually more accommodating, and remains so, than the US legislation. It is very easy for a Canadian consumer to file for bankruptcy, a procedure that almost invariably is completed with the assistance of a privately appointed trustee in bankruptcy.[29] All that is required is the completion of a simple prescribed

---

[26] Canada, Constitution Act 1867-1982, s 91(17).

[27] Several of the provinces bridged the gap by adopting legislation providing for assignment of assets by debtors for the benefit of their creditors. Facially, the legislation was not conditioned on the debtor's insolvency although in practice this would almost certainly have been the case. The Judicial Committee of the Privy Council seized on this distinction to uphold the validity of the legislation. See *Ontario (AG) v. Canada* [1894] A.C. 189 (P.C.).

[28] The issue was unsettled for a number of years but was finally resolved by the Supreme Court of Canada in *Industrial Acceptance Corp. Lalonde* [1952] 2 S.C. R. 209.

[29] In Canada, bankruptcy attorneys are seldom involved in the filing of voluntary bankruptcy assignments because it can be done much more cheaply by trustees. The trustees advertise

document together with a summary statement of the debtor's affairs, both of which are filed in the regional office of the Superintendent of Bankruptcy (SOB) together with a modest filing fee of Can$100. The debtor is not required to show that she has consulted a debt counsellor before filing for bankruptcy nor is the trustee held responsible for the accuracy of the debtor's statement of affairs.

As in the US, the popularity and massive marketing of consumer credit in the post-WW II era, followed by the deep penetration of credit cards in the 1970s, led to a commensurate increase in the number of personal insolvencies in Canada: the number quintupled from 21,025 in 1980 to 104,000 in 2004. It also forced the Canadian government to review the adequacy of Canada's insolvency legislation in the light of these and other economic and social changes. Between 1975 and 1984, five abortive attempts were made to introduce a revised Bankruptcy Act but all failed. Instead, starting in 1992, Parliament embarked on an incremental programme of bankruptcy reform. The 1992 amendments to the (restyled) Bankruptcy and Insolvency Act (BIA) introduced the following important amendments in the consumer area: (a) it entitled first time bankrupts to an automatic discharge nine months after the bankruptcy declaration unless the discharge was opposed; (b) it introduced an optional chapter 13 type procedure, known as a consumer proposal (CP)[30] for the benefit of debtors who wanted to avoid the stigma of bankruptcy and to be able to retain all of the debtor's assets; and (c) it required all bankrupt

---

heavily and the larger firms generally have branch offices, often in more than one city. Legally, the trustees are not permitted to tout for bankruptcy business and they overcome this hurdle by encouraging consumers to consult them about their debt problems. Much of the time, the debtor will end up retaining the trustee's services both to prepare the bankruptcy assignment and to serve as trustee of the estate once the assignment has been filed. Some may think (as this writer does) that this practice involves trustees in a conflict of interest. However, trustees deny the allegation and also argue that the standard procedure saves the debtor having to pay two sets of fees, one to the person preparing the bankruptcy assignment and the other for the administration of the estate. Canadian trustees' fees are regulated under the BIA Bankruptcy Rules.

[30] See BIA, Part III, Division 2.

debtors, as a precondition to their discharge, to receive debt counseling from the trustee or the trustee's accredited agent.

The 1992 amendments did not change the system for determining what portion of their income a debtor was obliged to pay over to the trustee prior to the debtor's discharge. This feature continued to be governed by section 68 of the BIA and the Superintendent's guidelines.[31] Basically, it was left up to the trustee to determine the debtor's surplus income in light of the Superintendent's guidelines and the debtor's family responsibilities and personal situation. The trustee was also free to apply to the court for a payment order if the trustee and the debtor were unable to reach agreement. Creditors complained that trustees were too lax in exercising their powers and that they tended to ignore the guidelines in favour of a more generous cost of living allowances to debtors. In response to the complaints, section 68 was extensively revised in 1997 and it was made clear that the trustee was legally obliged to calculate the debtor's surplus income in accordance with the Superintendent's directive.[32]

The following are the key features of s 68 and of the directive. The trustee is initially responsible for determining the debtor's monthly income and the income of the members of his family, if living with the debtor, after deducting expenses reflecting the debtor's personal and family situation as well as the expenses of the family members.[33] The recognised expenses cover

---

[31] See Directive No. 17R2, January 10, 1991, and SOB, Insolvency circular, April 2, 1993.

[32] The BIA confers explicit power on the Superintendent to issue directives for implementation of the Act. Although intended to be purely procedural and administrative in character and not subject to Parliamentary scrutiny before they become effective, in practice the surplus income directives carry a lot of punch, more so than some of the Bankruptcy Rules which are subject to Parliamentary review..

[33] OSB Directive No 11R, s 4(1).

statutory payments for income taxes and such like, and include non-discretionary expenses such as child support and spousal maintenance payments.[34]

The trustee must next determine the debtor's available surplus income by consulting the Superintendent's Standards showing the allowable living expenses for a person in the debtor's personal or family situation. These standards are based on Statistics Canada annual tables of low-income family units (LICO), a family unit being considered as falling into a low-income category when its income is substantially below other family units.[35] As of January 2004, the cost of living allowance was CAN$1,674 for a single person, CAN$2,093 for a couple, and CAN$2,602 for a family of three.[36] The directive also provides that where the total monthly surplus income of the debtor is equal to or greater than CAN$100 and less than CAN$1,000, the debtor is required to pay 50 per cent of the surplus income as calculated under the directive. If the surplus income is CAN$1,000 or greater, the trustee must require the debtor to pay over at

---

[34] *Ibid*, ss 6(2) and 6(3).

[35] LICOs are set according to the proportion of annual family income spent on food, shelter and clothing. A Canadian family with average income currently spends 44% of its after-tax income on food, clothing, shelter and other basic necessities. A low-income family is deemed one that spends 64% of its income this way. See further Bernard Paquet, *Low Income Cutoffs from 1992 to 2001 and Low Income Measures from 1991 to 2000*, Statistics Canada, November 2002, Cat. No. 75F0002MIE2002005. Statscan insists that LICO does not measure poverty in Canada since there is no objective way to measure poverty, nationally or internationally. In addition to the LICO tables, Statscan also publishes 'Low Income Measures' tables identifying Canadian family units whose income is 50% of the median Canadian family unit income. Another low-income benchmark, 'market-basket measure', related to families unable to afford a shopping basket of basic life necessities, is currently being contemplated for adoption by the Canadian government. See Margaret Philp, 'New poverty gauge based on survival' *The Globe and Mail*, January 2002, A3.

[36] These amounts are much higher than the welfare payments made to indigent individuals and families under Canadian provincial welfare law.

least CAN$500 and may require the debtor to pay up to 75% of the surplus income.[37] The surplus income amount may be amended by the trustee from time to time to take into account material changes that have occurred in the bankrupt's personal or family situation.[38] The official receiver may also 'recommend' to the trustee and the bankrupt changes in the amount to be paid by the bankrupt where the OR is of the view that the amount is substantially not in accordance with the applicable standard.

The directive applies a uniform standard of cost of living allowances for all debtors in the same family situation regardless of their social, economic or geographic background and location.[39] Seemingly, the trustee has no discretion in varying the debtor's living needs unless somehow it can be brought under the rubric of non-discretionary expenses. If the debtor and the trustee cannot agree on the amount required to be paid by the debtor, the trustee must request

---

[37] *Ibid*, s 7(2)(a)(b). In case of a family unit with more than one income, the debtor's surplus income is prorated as a percentage of the total family income. *Ibid*, s 8, and Example (Family unit of 1).

[38] BIA s 68(4). There has been uncertainty with respect to the status of income earned by the bankrupt prior to bankruptcy but received by him after bankruptcy, and with respect to the treatment of non-periodic lump sum payments. The Supreme Court of Canada held in *Marzetti v Marzetti* [1994] 2 SCR 765 and in *Wallace v United Grain Growers* [1997] 3 SCR 701 that it is the characterisation of the entitlement, and not solely the date of accrual, that is material for ss. 67 and 68 purposes, and these holdings have been applied by lower courts in a wider range of cases. See, e.g. *Re Landry* (2000) 21 CBR (4th) 58 (Ont CA); and further, R Klotz, 'Who Gets the Bankrupt's Pre-bankruptcy Earnings?' (2000) 15 CBR (4th) 153. So far as the treatment of lump sum payments is concerned, lower courts have generally held that it is a question for the court's discretion. See *Re Laybolt* (2001) 27 CBR (4th) 97 (Nova Scotia).

[39] During the discussions preceding the adoption of the directive, CIPA (since renamed as the Canadian Association of Insolvency and Restructuring Professionals (CAIRP)) urged the adoption of differential scales depending on the debtor's province of residence and the size of the community of the debtor's residence, but its efforts were unsuccessful. The pre-1998 Guidelines also drew no geographical distinctions with respect to differences in the cost of living within a province and between the provinces. This silence influenced the court's decision in *Re Demyen* (1999) 4 CBR (4th) 67 (Sask QB) in rejecting the trustee's argument that the debtor should be required to hand over a larger share of his income because the cost of living in Regina, Saskatchewan, was lower than elsewhere in Canada.

mediation of the parties' dispute.[40] If mediation has not resolved the issue, the trustee may apply for a court hearing.[41] Mediation has so far been invoked very sparingly.[42] If there is a court hearing, it is not clear however how much discretion the bankruptcy court has in determining the amount of the debtor's surplus income. Section 68(10) of the BIA requires the court to act in accordance with the standards established in subsection 68(1) (i.e., the standards set by the Superintendent) and 'having regard to the personal and family situation of the debtor'. These criteria seem to be the same as those incumbent on trustees. However, they have not so far been tested in judicial proceedings and it is possible that a court may be willing to give them a more elastic meaning. Though the process for determining the debtor's surplus income liability looks complex on paper it is not so in practice, and it usually takes the trustee very little time to make the calculations. The fact that the LICO standards are well above what most Canadians would regard as the poverty line, that 80 per cent of the debtors fall below the LICO cut off point, that those who are shown to have surplus income are only required to surrender one half of it and then ordinarily only for a nine months' period -- all these factors make the payment requirements much more palatable than they might otherwise be.

B. Results of Surplus Income Payment Requirements

A substantial body of data is now available on the operation of the Canadian surplus income requirements and is partly reproduced below. The data are important because Canada is

---

[40] BIA s 68(6).

[41] BIA s 68(10)(b) The subsection does not confer a similar right of appeal on the bankrupt but this must be an oversight in the drafting. The subsection also does not explain when mediation is deemed not to have resolved an issue.

[42] Between 1 October 1999 and 17 July 2002, there were 130 mediations across Canada involving surplus income disputes and 125 involving bankruptcy discharge issues. (I have not so far been able to lay my hands on more recent figures.)

apparently the only jurisdiction in the three Commonwealth countries with income contribution requirements that has developed this much detail. Table 1 shows the overall results from the 257,116 consumer bankruptcies filed between August 1, 1998 and December 31, 2001[43] and indicates that 19.06% of the consumer bankrupts had surplus incomes calculated in accordance with the Superintendent's directive. Further, 90.71% of the consumer bankrupts made section 68 payments to their trustees at or above the prescribed levels; only 9.29% of them failed to do so. Canadian debtors have a strong incentive to meet their statutory obligations because the debtor's entitlement to a discharge at the end of the nine months' period is contingent on compliance with the surplus income requirements.

Table 1
Total Consumer Bankruptcy Population and Surplus Income Estates for Canada and the Provinces from 1 August 1998 to 31 December 2001: Overall Results

		Total Population	Total SI Estates	At or Above Standard	% At or Above	Below Standard	% Below	% with SI
Canada	*1998	29375	4975	4310	86.63%	665	13.37%	16.94%
	1999	73124	14015	12636	90.16%	1379	9.84%	19.17%
	2000	75142	14228	13015	91.47%	1213	8.53%	18.93%
	2001	79475	15796	14502	91.81%	1294	8.19%	19.88%
	Total	257116	49014	44463	90.71%	4551	9.29%	19.06%

* The 1998 numbers represent 1 August 1998 to 31 December 1998 estates only.
Source: OSB, Ottawa (January 2003)

The successful completion rates have led Canadian regulators to believe that the right formula has been struck. The great majority of Canadian bankrupts are exempt from making payments because their incomes fall below the LICO level; those who are required to make payments are not left destitute but are left with a generous margin for discretionary expenditures,

[43] The author has sought to obtain more recent statistics but they are not yet available.

though I do not want to suggest it is always adequate. Just as important, the belt tightening is for a relatively short period, 9 months. At the end of this period, paying debtors have the psychic satisfaction of knowing that they have met the statutory requirements. They also have the presumptive entitlement to a new financial start free of all remaining non-exempt debts except for the small number of cases where the trustee or a creditor raises objections.[44]

C. Experience under Consumer Proposals

Canada's experience with surplus income payment requirements in straight bankruptcies should be compared with Canada's performance experience under the BIA's consumer proposal (CP) regime,[45] Canada's counterpart to the US Bankruptcy Code's chapter 13. The CP regime, like chapter 13, is optional but unlike chapter 13 is conditioned on creditors' as well as the

---

[44] For the small minority of cases, see Ziegel, *supra* note 2, 38-39. The position will change significantly, if Bill C-55, 53-54 Eliz. II, 2004-2005, First Reading, June 3, 2005, a major bankruptcy and insolvency legislation amending bill currently before the Canadian House of Commons, is adopted by the Canadian Parliament. Section 100 of the bill replaces s.168.1(1) of the BIA and will postpone the automatic discharge of first time bankrupts from 9 months to 21 months where the debtor has been required to make surplus income payments under s.68. The change was requested by Canadian trustees for the following reasons. Section 170-170.1 of the BIA requires the trustee of a bankrupt to file a report with the court and the Superintendent of Bankruptcy indicating, among other things, whether in the trustee's opinion, the bankrupt could have made a viable proposal to creditors under Part III Division 2 of the Act but chose instead to file for bankruptcy. Trustees complained that debtors would often want to know in advance, before engaging the services of a trustee, what the trustee's practice was with respect to the s.170 report and that this set up unfair competition among trustees. See Personal Insolvency Task Force, *Final Report,* ch.3(IV), 44-45. The writer, who was a member of the Task Force, opposed the amendment and continues to do so. Trustees were strongly represented on the Task Force and consumers very poorly so. The Task Force gave no consideration to the impact of an automatic extension of the 9 months' discharge period. The majority of its members assumed that debtors with surplus income would have no difficulties maintaining their surplus income payments for an extra 12 months even though experience with consumer proposals showed that as many as 38.2 per cent of debtors failed to maintain their payments resulting in cancellation of the proposal. See further below text accompanying note 68 and J. Ziegel, *A Rough Deal for Bankrupt Consumers*, (Toronto) GLOBE AND MAIL, August 29, 2005, A21.

[45] Bankruptcy and Insolvency Act, Part III, Division 2 (Can.).

court's approval of the debtor's proposal. There are other important differences as well. One is that secured creditors cannot be included in a proposal without their consent nor can the value of their security be reduced to its current market value. Another critical difference is that it is the debtor, not the court, who determines the terms of the proposal and the frequency and size of the payments to be made by the debtor. The size of the payments will be influenced by what the debtor would be obliged to pay under the LICO standards in a straight bankruptcy, but there is no legal rule obliging the debtor to follow this route.[46] The proposal usually involves payments over a three to five year period. On successful completion of the payments, the balance of the debts are discharged as under a straight bankruptcy unless non-dischargeable..

The ratio of CPs to straight individual bankruptcies has grown significantly since consumer proposals were introduced in 1992 and amounted in 2004 to 16.04% of the total number of individual filings. Just as important is the fact that the non-completion rate for consumer proposals is much higher than non-payment of surplus income in straight bankruptcies. It amounted in 2004 to 38.21% of the number of proposals approved by the debtor's creditors in 2000.[47] Admittedly, the Canadian failure rate is much less than the 70 per cent failure rate under chapter 13 in the US, but this is small consolation. It raises the question why there is such a marked difference between performance ratios under the surplus income payment requirements and performance under consumer proposals. There is no empirically verified answer, but Canadian observers believe the following factors are important. The statutory period for surplus

---

[46] In practice, the trustee will be able to advise the debtor on whether creditors' are likely to accept the proposal and there may also be informal discussions between the trustee and the largest creditors before a formal proposal is put to the creditors.

[47] Tabular information provided to the author by the OSB in April 2005. Precise figures for non-completion rates under Part IX of the Australian Bankruptcy Act were not available to the author but appear to be similar to the Canadian rate for consumer proposals. See Ziegel, *supra* note 2 , p 106, Table 4.2.

income payments is much shorter – nine months versus three to five years for consumer proposals – and therefore involves much less belt tightening for debtors. Second, local culture may be at work in debtors being persuaded by trustees to opt for a consumer proposal when realistically their current earnings and future prospects do not justify the heavier commitments under a CP. In the third place, the debtor's financial condition may have deteriorated subsequent to creditors' approval of the proposal and the debtor may have lacked the resources or initiative to seek creditor approval of a modified CP. In any event, the Canadian experience strongly suggests that a short repayment period leaving the debtor with a relatively generous margin for above welfare-level expenditures stands a much higher chance of success than multi-year plans involving significant economic sacrifices.

IV REVISITING THE US PRE-*BAPCPA* FRESH START POLICY

Revisiting the pre-2005 US fresh start policy may seem an academic exercise given the fact that it has now received a lethal blow[48] at the hands of a Republican Congress and Republican president. Yet there are good reasons for conducting a postmortem for the purposes of this paper. One is that there is no guarantee that the burdensome, complex, and widely criticized means test in BAPCPA and the many other creditor oriented features in the Act will survive long without extensive amendments.[49] A second reason is that even a cursory review of

---

[48] Cf. C. J. Tabb, *The Death of Consumer Bankruptcy in the United States?* 18 BANKRUPTCY DEVELOPMENT JOURNAL 1 (2001), commenting on Bill S256's substantially identical predecessors.

[49] In fact, an amending bill, H.R. 1860,was introduced in Congress on April 26, 2005 by Congress persons Dana Rohrabacher and Walter Jones. A larger number of members of Congress also gave notice on September 2, 2005, of their intention to present an amending bill in the light of the disruption of their personal and economic lives caused by tropical storm Katrina. In the US Congressional system, where the members are not bound by party discipline, it is much easier for a Senator or Congress member to introduce legislation and garner support for it

the history and rationales of the fresh start doctrine will illuminate the ideology that sustained the doctrine for more than 100 years in contrast to the sanctity of contract doctrine that provided the mainstay for continental European opposition to the adoption of any kind of fresh start principle. Finally, acceptance of the argument that there were significant flaws in the justification for an all or nothing fresh start doctrine may persuade us that a qualified fresh start rule as currently mandated in the British, Canadian and Australian insolvency legislation has much to commend it.

A. Historical Overview

A fresh start rule entitling a debtor to be discharged from his remaining debts already appeared in the insolvency legislation of some of the colonial American states before 1789.[50] It was therefore a familiar issue to 19th century federal politicians as they grappled with the recurring question of what type of bankruptcy legislation should be adopted by Congress, usually in response to one of the many economic recessions that plagued the United States during the century. A fresh start rule was included in the 1841 Bankruptcy Act, and was much invoked by debtors. However, the Act was repealed three years later and the fresh start rule did not make its reappearance until the Bankruptcy Act of 1898. That Act itself was a compromise between Northern mercantile interests, who badly wanted a national bankruptcy act, and Southern and Midwestern agricultural interests who saw little need for it.[51] Inclusion of the fresh start rule was the price the latter group exacted for its support. Other options, such as the qualified discharge

---

from other Congressional members than is true of members of Parliament in the British style Parliamentary system. Much US legislation is initiated this way and is often enacted into law.

[50] P. J. COLEMAN, DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900, 270 *et seq* (State Historical Society of Wisconsin 1974).

[51] For a more nuanced explanation of the various factors influencing the final outcome, see D. A. Skeel Jr, 15 BANKRUPTCY DEVELOPMENT J. 321 (1998/99).

rule adopted in the 1882 British Bankruptcy Act, do not appear to have been seriously considered by the members of Congress, and no doubt for good reason.

The fresh start rule appears to have caused no serious reverberations among creditors in the interwar period 1914-1939. Presumably, this was because consumer credit was still in its early stages and because the number of personal bankruptcies was modest judged by current standards.[52] Another explanation may be that few insolvent debtors would have been in a position to make surplus income payments after the start of Great Depression even if the US Bankruptcy Act had contained such a requirement.[53] The fresh **st**art rule received official imprimatur at the highest judicial level in the US Supreme Court's judgment in *Local Loan Co v. Hunt*[54] and therefore would have been seen as an intrinsic part of American values and not lightly to be tampered with.

That positive perception of the rule continued into the post-World War II period until at least the 1970s. The National Bankruptcy Commission had no hesitation reaffirming the soundness of the fresh start principle in its 1973 report to Congress[55] and the revised Bankruptcy

---

[52] The total number of bankruptcy cases filed in the US was 45,641 in 1925, 62,845 in 1930, and 50, 997 in 1939. In 1952, the number was 34,873 and grew to 62, 086 in 1956. The numbers continued to grow rapidly during the balance of the 1950s. See UNITED STATES STATISTICAL ABSTRACTS, Tables Nos 642 and 643 and *compare* REPORT OF THE COMMISSION OF THE BANKRUPTCY LAWS OF THE UNITED STATES, Part I, ch. 2 (July 1973) with respect to the postwar consumer bankruptcy figures. (I am very grateful to Prof. Robert Lawless of the University of Utah Law School for assisting me to track down the above source of prewar US bankruptcy statistics.)

[53] However, Leo Calder offers a different explanation. He points out that householders were very committed during the Depression to maintain installment payments on durable goods and this may explain why the bankruptcy figures remained remarkably stable throughout the 1930s. See L. CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT (Princeton U.P., New Jersey 1999), pp. [INSERT], and *compare* the number of bankruptcies cited *supra* in n.52.

[54] Local Loan Co v. Hunt, 292 US 234, 244 (1934).

[55] *Supra,* note 52, Part I, ch. 3.

Act adopted by Congress in 1978 reflected the same sentiment. Surprisingly, the US credit industry does not appear to have mounted a serious effort while Congress was debating the Act to modify the fresh start rule[56] although the number of consumer bankruptcies was beginning to grow substantially. Nevertheless, the credit industry was successful in persuading Congress to adopt s.707(b) of the Code as part of a package of amendments in 1984. Section 707(b) empowers the bankruptcy judge or the United States Trustee to initiate proceedings to deny the petitioner bankruptcy relief if one or the other was satisfied that granting the relief would lead to a substantial abuse of the system. Until recently, the abuse provision does not appear to have been invoked often. Moreover, the bankruptcy judges were not agreed on how the abuse standard should be applied in practice.[57]

The number of US consumer bankruptcies quadrupled between 1985 and 1997.[58] Not surprisingly, the credit industry became alarmed and started to mount a well-financed campaign to curb what its representatives described as consumer abuses in the use of chapter 7. The industry also pushed hard to persuade the newly appointed National Bankruptcy Review Commission (NBRC) that the time had come to impose meaningful restrictions on the use of chapter 7 and to endorse the industry's strong partiality for a means test. The efforts were not successful. On the contrary, a majority of the Commission strongly reaffirmed its support for the fresh start rule and rejected the industry's contention that there were large scale abuses.

---

[56] Note however Prof Tabb's statement that the US consumer credit industry began its reform efforts to qualify the fresh start rule from the mid-1960s onwards. Tabb, *supra* note 48, at 9. However, the earlier efforts do not appear to have left much of an impact since they are not referred to in the NBC Report.

[57] *See* C.J. TABB, THE LAW OF BANKRUPTCY, §2.14 (Foundation Press 1997).

[58] It escalated from 341,233 in 1985 to 1,350,118 in 1997. OSB, INTERNATIONAL STATISTICS 7 (June 1999).

Nevertheless, the credit industry persisted in its lobbying efforts and is said to have spent many millions of dollars winning the support of Congressessional members. After several unsuccessful efforts during the Clinton administration, the credit industry finally achieved its goal with the enactment of Bill S 256. As previously explained, the BAPCPA 2005 imposes a means test on all new bankruptcy filers and forces those deemed capable of paying off a substantial part of their debts into a chapter 13 arrangement or to forgo bankruptcy relief altogether. The means test constitutes only a small –but, from the industry's point of view, critically important - part of the heavily creditor oriented provisions in Bill S-256.

Although not necessarily opposed to some restrictions on the availability of easy discharges from bankruptcy, most US insolvency academics and many bankruptcy judges and trustees have opposed the means test provisions as being unwieldy, bureaucratic and expensive to implement and as likely to do more harm than good. Regrettably, in the long debate on the BAPCPA and its predecessors, there was little discussion, even in the academic community, of the qualified discharge provisions appearing in the English and Canadian legislation and what the US could learn from the Commonwealth experience.[59]

B. Rationales of the Fresh Start Principle

A century's familiarity with the fresh start doctrine has led many US scholars to endorse its virtues as energetically as their European civilian colleagues embrace the sanctity of contract

[59] An early exception of a US scholar taking a close look at British bankruptcy and discharge law and practice is Prof Boshkoff's article, *Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings,* 131 UNIVERSITY PENNSYLVANIA L. REV. 69 (1982). The article is frequently referred to by subsequent US commentators on the fresh start policy as a cautionary tale of the British hostility to individual bankruptcies. Prof Boshkoff's article was written long before the major changes adopted in the English legislation of 1986 and 2002 and no longer reflects current English law and practice.

principle. The question for discussion is whether the rationalizations in favour of the US rule are convincing and whether a persuasive case cannot be made, even in the US context, in support of a qualified discharge policy along the lines adopted in the Commonwealth legislation.

I have summarized elsewhere, and given my reactions to,[60] eight principal reasons advanced by US authors over the years who oppose the introduction of any type of means test, whether in order to deny debtors access to chapter 7 bankruptcy (as mandated in BAPCPA) or to require debtors to pay over surplus income for a prescribed period as a condition of the discharge of the remaining debts. I was not then wholly persuaded by the reasoning in favour of the retention of the status quo and still remain unconvinced. Four of the reasons that have surfaced regularly in discussions of the US discharge policy, and in debates on the defects of the credit industry's driven Congressional bills introducing a means test, deserve some attention here.

The first is that that it is much better to secure the debtor's consent to a voluntary payment system by giving the debtor incentives that are not available in a straight bankruptcy than to coerce him to make involuntary payments. Unhappily, the weakness with this reasoning is that US experience with chapter 13 plans (and, one might add, speaking comparatively, Canadian and Australian experience with their Commonwealth counterparts) challenges the assumption that voluntary repayment programmes work best. Economists have also argued that the option of a chapter 7 discharge without a payment requirement encourages debtors to behave opportunistically and to choose the chapter of the Code (ch 7 or ch13 or, occasionally, ch 11) that will best shelter their assets and income from the creditors' grasp. Given this option, it is argued, why would a debtor with surplus income opt for a chapter 13 plan (other than for moral or professional reasons) when he can shelter all of his post bankruptcy income and obtain a

[60] Ziegel, *supra* note 2, ch 3.5.

prompt discharge under chapter 7? In the light of this encouragement for debtors to engage in strategic planning, it may be thought the British and Canadian approaches strike a better balance between a straight bankruptcy and a compositional scheme. This is particularly so given the need for creditor approval of a compositional scheme under the Canadian and British legislation and the court's power to deny a discharge from straight bankruptcy if the debtor has substantial income and the court is of the view (in the Canadian context) that the debtor ought to make payments for a longer period than the minimum nine months prescribed by Parliament.

A second reason given in support of the US fresh start position is that a British-style income payment and discretionary discharge system is intrusive, paternalistic, and subjective since no two debtors and their families have the same needs and face the same circumstances.[61] The short answer to this objection, it is suggested, is that there is much less paternalism and subjectivity in the Canadian and Australian surplus payment models than there is in the British provisions and that even in England the Insolvency Service has adopted a standard payment scale in bankruptcies administered by the Service which eliminates the earlier defects. As previously mentioned, the Canadian model, introduced in 1997, appears to be working well and, so far as one can tell, has provoked little resistance and few complaints from debtors. In England, too, most income payments are negotiated with the Insolvency Service and there is only intermittent judicial involvement.[62] It seems, in any event, inconsistent for US critics to accuse the British system of paternalism and to argue in the same breath, in opposing a means test, that no two debtors and their families have the same needs and face the same circumstances.

---

[61] *Ibid* at 120-123; and J. Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures,* 67 AMERICAN BANKRUPTCY L. J. 501 (1993), 583 (eloquently expressing similar sentiments without allusion to the British style provisions), cited in E. Warren, *A Principled Approach to Consumer Bankruptcy,* 71 AMERICAN BANKRUPTCY L. J. 483, 505 (1997).

[62] See Ziegel, *supra* note 2, 117-118.

The third oft repeated reason in support of the US style fresh start rule (one that I have invoked myself in criticizing the civilian 'must pay' morality) is this. It is argued that since the bulk of consumer bankruptcy debts today consist of consumer credit liabilities, it is more efficient to oblige the credit industry to internalise its losses or to tighten its credit granting standards if creditors believe their losses are too high than it is to expect consumers to resist the impulse for instant gratification encouraged by the ready availability of consumer credit.[63] In my view, this reasoning commends itself when the debtor has no surplus income but provides no answer in respect of the debtor who *is* in a position to make payments but opportunistically seeks bankruptcy shelter to avoid having to do so. The insurance analogy implicit in the US critics' reasoning breaks down in this scenario, just as it does where the debtor has incurred involuntary liabilities or seeks a discharge from non-commercial liabilities such as repayment of a student loan or taxes owing to various levels of government.

A fourth, and most commonly given, reason by critics of BAPCPA and its predecessors will strike many as the most compelling. This is that there is no evidence of large scale abuses in the existing bankruptcy system and that the overwhelming percentage of those seeking chapter 7 bankruptcy protection are hopelessly insolvent and would not be able to pay off their indebtedness in any reasonable time frame even if means testing and a mandatory chapter 13 regime were to be introduced.[64] There are really three parts to this criticism of the means testing ideology. The first is that it is inefficient and oppressive to apply a means test to ferret out the small percentage of debtors in a position to make some payments. The criticism may well be

---

[63] T. H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 234-236 (Harvard University Press 1986).

[64] T. A. Sullivan, E. Warren and J. L. Westbrook, *Consumer Bankruptcy in the United States: A Study of Alleged Abuse and of Local Legal Cultures,* 20 JOURNAL OF CONSUMER POLICY 223 (1997).

justified for the complex means testing provisions in BAPCPA and its ilk, but it does not demolish the case for a simpler and much less intrusive means testing such as is applied under the Canadian regime. As previously indicated, the section 68 surplus income provisions in the Canadian Act appear to be working well and have generated few complaints. [65]

The second proposition implied in the means testing criticism is that means testing may also jeopardize the debtor's entitlement to a prompt discharge where there is *no* surplus income. Obviously this is a danger that must be guarded against. However, I am not aware of any evidence that the Commonwealth surplus payment requirements have had this spillover effect. On the contrary, the March 2005 proposals of the English Insolvency Service[66] signals considerable enthusiasm for creating a fast track discharge procedure for no-asset and bottom income indigent debtors.

The third and more questionable proposition implicit in the opposition to means testing is that means testing should not be used to extract nominal payments from debtors. It is true that the Canadian experience, and even more so the continental European experience, is that the payments are in many cases too small to make a dent in the outstanding debts and are in any event mostly swallowed up in trustees' fees and administrative expenses.[67] I believe, these are questions of detail[68] and do not address the question of principle. This question is whether

---

[65] I do not mean to suggest the system has no flaws; it clearly has. For an early critique see J. Ziegel, *The Philosophy and Design of Contemporary Consumer Bankruptcy Systems: A Canada-United States Comparison,* 37 OSGOODE HALL L.J. 205, 227-228 (1999).

[66] *Supra* note 5.

[67] See Ziegel, *supra* note 2, ch 7(b), and compare J. Kilborn, *supra* note 9 at 258, 290.

[68] The problem could be addressed by providing that payments below a threshold amount be paid into a public fund for consumer education or other worthy purpose. Cf. the Belgian provision requiring lenders to pay a percentage of their defaulted loans into a public fund to help defray the fees of the debt mediators. See J. Kilborn, *supra* note 9, at 30. In Canada, the Superintendent of Bankruptcy has proposed a legislative amendments to allow uncashed dividend remittances to

requiring debtors with surplus income to make *some* payments as a condition of their discharge is morally justifiable and protects the integrity of the bankruptcy system.

Another objection that is increasingly raised against means testing in the US and that is of more recent origin is this. Western European countries and Commonwealth jurisdictions such as England, Canada and Australia have a state financed medicare system and so consumer debtors, when they or a family member falls sick, are not burdened by crushing medical expenses as is true of millions of Americans. The inference we are asked to draw from this distinction is that insolvent debtors in countries with a strong social safety net are in a much better position to make payments on their debts than is true of their US cousins and therefore have less need of a fresh start policy than do American debtors. In my view, the Canadian and European statistics do not support the conclusion sought to be drawn from this distinction. As we have seen, about 80 per cent of Canadian bankruptcy filers are exempt from making income payments because they fall below the LICO cut off line; similar percentages can be adduced in respect of the English and European insolvents. In any event, the argument misses its mark. If a consumer goes bankrupt because she or her family have incurred heavy medical debts or are too sick to work, her plight deservedly attracts greater sympathy than the consumer who went on a spending binge and now finds he can't repay a mountain of debt. However, it doesn't prove that the latter is in a better position to make payments than the consumer with heavy medical debts; on a balance sheet basis both may be hopelessly insolvent and neither may have any surplus income. And conversely, the fact that a debtor has medical debts ought surely not to excuse him from being required to make some payments even after bankruptcy if his income is sufficiently large to enable him to pay off his medical debts *and* to make some payments towards his other debts.

---

estate creditors to be credited to a bankruptcy research fund. However, the proposal did not find its way into Bill C-55, *supra* note 44.

V WHAT LIES AHEAD? PARALLEL PATHS, CONVERGENCE, OR RECONCILIATION OF PHILOSOPHIES?

It is appropriate now to answer, albeit briefly, the question implicit in the title of this paper. What are the important factors that determine the structure and contents of a country's insolvency system? Are they ideology, past history and experience or the pressures exerted by the mounting number of overindebted debtors and the need to find practical solutions? Do ideologies remain constant or do they bend under the pressure of events?

So far as legislative and operational developments in continental Europe and the common law jurisdictions are concerned, this paper has attempted to show that all these factors have played a role over the past twenty years. If one had to single out one factor as playing a dominant role it would be facts on the ground – the hard reality of the insolvency systems having to adjust to the new social and economic environments. This is surely true of the legislative and operational changes adopted in England and Canada, and particularly so in England , where until very recently the English Insolvency Service did not even deem it necessary to publish separate statistics on the number of consumer bankruptcies. Similarly, the truncated periods[69] under the recent amendments to the English and Canadian Acts for the discharge of first time no-asset and low income debtors is a realistic response to the mounting number of consumer insolvencies.

Acceptance, even if reluctant acceptance, of social and economic realities surely also explains German willingness to grant debtors a discharge from their remaining debts, although

[69] Viz. 9 months under the 1992 amendments to the BIA and 1 year under the 2002 amendments to the English Insolvency Act with the possibility of a reduction of the period in the English Act to 6 months.

admittedly only after a six year probationary period and only after the ritual offerings and lamentations at the shrine of sanctity of contracts. That willingness represents a major sea change from the outright rejection of the 'Anglo-Saxon' solution in a German experts' report as recently as 1986.[70] Admittedly, too, the French willingness to wipe the slate clean and to allow debtors to make a fresh start has been much slower and more hesitant. The fact remains however that the *loi Neiertz* would not have been changed several times between 1989 and 2004 if the French authorities had resolutely preferred ideology over hard realities.

So far as continuing continental European adherence to the sanctity of promises in the consumer insolvency context is concerned, I have argued that it is based on doubtful premises and fails to take into account the realities of the modern market place and the special character of consumer credit. Whether this means that the ideology will quickly disappear (or ought to disappear) is more debatable.[71] The common law history of the acceptance of easy discharge facilities shows that it may take half a century or more,[72] depending on the pressure of events, but that it is bound to occur sooner or later.

With respect to American developments, the historical evidence shows that adoption of the fresh start principles in the 1898 Bankruptcy Act was coloured by early exposure to the iniquities of indentured labour, distrust of judicial discretion involving the discharge of debts, and a strong preference for a simple and clean discharge rule. No doubt, the fresh start principle

---

[70] J. Kilborn, *supra* note 9, at 269.

[71] I hope this paper has made it clear that I am not opposed to enforcing promises if the debtor has a realistic capacity to pay. My concern over the continental philosophy is that it insists on continuing to squeeze the lemon even after it is clear that there is no juice left and that it too often ignores the reasons why the lemon was so small to begin with.

[72] In England, the interval was 72 years between the 1914 Bankruptcy Act and the 1986 Insolvency Act, although there were some ameliorating amendments in between. In Canada, the interval between the 1919 Bankruptcy Act and the major 1992 amendments was 73 years, but again there were intervening amendments.

was also influenced by ideology – the need to allow insolvent debtors to make a new economic start free of the burden of debt – but the ideology had a strong pragmatic bent and was grounded in experience. The attitude changed in the late 1970s when creditors claimed to have discovered the true cost of easy discharges and began to agitate for stricter rules. It remains to be seen how well or badly BAPCPA translates into practice and whether it will create the bureaucratic nightmares predicted by its critics. Whatever the future holds in store, it cannot be denied that adoption of a means test for chapter 7 filers represents a seismic shift in American insolvency philosophy and brings it much closer to the Commonwealth models, though there are large differences between the techniques adopted in BAPCPA and the Commonwealth provisions. I have suggested that those who oppose *any* type of means test to determine whether debtors should be required to make payments in the post bankruptcy period may have overshot their mark and that Commonwealth experience shows that it can be made to work without extravagant costs and without discouraging overburdened debtors from seeking relief.[73]

My overall conclusion, then, is that, yes, there is increasing convergence in solutions adopted to address consumer indebtedness, that facts on the ground are very important but that they will not on their own lead to a change in official attitudes or national cultures without very persuasive research to show the flawed premises on which the early attitudes were based. It is open for consideration whether the adoption of BAPCPA in the US represents an authentic change in US public opinion on the need for a means test of some description to curb alleged widespread consumer bankruptcy abuses or whether the Act reflects the successful lobbying

[73] A cynic may suggest that opponents of BAPCPA adopted the wrong strategy. Instead of criticizing it they should have embraced the legislation enthusiastically and urged the adoption of still stiffer means tests and burdensome obligations for attorneys in the unarticulated hope that the American public would rebel against the draconian provisions in the light of their practical impact and force Congress to repeal the Act!

efforts of a very powerful industry and a responsive US president and Republican dominated Congress.[74] A means test has been an integral part of Commonwealth insolvency legislation for many years, so its retention in the most recent reforms has caused little controversy. What does require much closer examination for comparative purposes is the structure of the Commonwealth means tests, the duration of the means test, and the relationship between surplus income payment requirements in straight bankruptcies and optional consumer proposals to creditors in chapter 13 type arrangements.

[74] Note however that a very substantial number of democratic Congress persons and senators also supported the legislation. A foreign observer is also puzzled to know why, given the heavy stake many American debtors had in the retention of the fresh start doctrine or at least in opposing the draconian provisions in BAPCA, more of them did not speak out in opposition to the legislation or why a latter day Ralph Nader did not emerge to lead the troops on an anti-BAPCPA crusade.