

Is Canadian Bankruptcy Law in Accord with Present Economic Reality?

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Abstract

In the light of several revisions in Canadian Bankruptcy Law, it appears that bankruptcy law more adequately meets the needs of consumers. However, changes in the law, coupled with poor economic times have resulted in increased filings, which has led to high dollar losses for creditors as well as for the nation.

The law does appear to be a general solution for debt situations. High rates and costs of bankruptcy could be reduced by attorneys (or courts) and creditors offering alternative solutions to bankruptcy, and by considering future income as a basis for repayment of debts in cases where adequate future income is available. In order for the law to fulfil its objectives of rehabilitating the debtors, professional financial counselling must be made available because help is needed by those who are contemplating bankruptcy.

Résumé

À la suite des quelques révisions apportées à la Loi Canadienne sur la Faillite, il semble que la loi sur la faillite réponde plus justement aux besoins des consommateurs. Néanmoins, ces changements dans la loi, venant s'ajouter à une période économique instable, ont contribué à une augmentation des déclarations de faillite, entraînant de fortes pertes en dollars pour les créanciers autant que pour la nation.

La loi ne semble pas apporter une solution générale à l'état de dette. Les taux élevés et le coût d'une faillite pourraient être réduits par les avoués (ou les tribunaux) et les créanciers proposant d'autres solutions à la faillite, et si on prenait les revenus futurs comme base de remboursement des dettes dans les cas où ces revenus sont suffisants. Afin que la loi puisse atteindre ses objectifs de réhabilitation des débiteurs, un service professionnel de consultation en matière financière s'impose pour venir en aide à ceux qui envisagent une faillite.

The purpose of this article is to draw attention to the social and economic rehabilitative functions of the bankruptcy process, and to examine the extent to which those functions are being performed by existing bankruptcy law. Three areas of concern will be examined in terms of current procedures and effectiveness of the law as a consumer solution for severe debt situations. These areas of concern are: (1) The impact of consumer bankruptcy law on the availability and cost of consumer credit. (2) The rationale of using present assets rather than

future income as a basis for discharge under bankruptcy. (3) The extent to which rehabilitative counselling is provided during the process of bankruptcy.

Records from the Office of the Superintendent of Bankruptcy, Consumer and Corporate Affairs Canada, show that over the past 12 years bankruptcy figures soared from 2,732 in 1970 to 30,643 in 1982.

A number of factors are associated with this increase in consumer bankruptcies. These include the great increase in consumer credit outstanding in Canada and the greater access to consumer bankruptcy through initiatives of the Bankruptcy Branch of Consumer and Corporate Affairs and the Federal Insolvency Trustee Agency. Bankruptcy is a legal process by which most insolvent consumer

debtors are able to obtain relief from their debt burden. In Canada, the bankruptcy system is governed by the *Bankruptcy Act* (R.C.S. 1970, C.B.-3) which is administered by the Bankruptcy Branch of Consumer and Corporate Affairs Canada.

The history of bankruptcy is, indeed, a long and colorful one stretching from harsh and merciless treatment of a debtor who failed to meet commitments, to the present day enlightened concepts of rehabilitation of such a debtor. The Canadian bankruptcy law is based on the laws of England and the first insolvency statute dates back to the year 1351.

An exhaustive review of the Canadian bankruptcy system was begun in 1908 by the *Study Committee on Bankruptcy and Insolvency Legislation* appointed by the Minister of Justice. The committee

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extension) to ability to pay based upon future income.

Bankruptcy courts in Canada recognize the concept of affordable debt by providing a Part X, *Orderly Payment of Debt* option, which permits wage earners to repay some or all of their debts out of future income. However, this plan is narrow in scope and from the creditor's perspective contains several problems.

It may be reasonable for the court to consider future income when determining what debts would be discharged because all debt is incurred in expectation of repayment; no credit market can be viable without this expectation. Most debt is repaid. That which is not, or cannot be repaid, results in a transfer of wealth. In the first instance, this transfer is from creditor to borrower. The ultimate incidence of the burden of this transfer is on the economy as a whole. The burden shows up in the form of higher interest rates and a cutback in the availability of credit.

Provisions of Rehabilitative Counselling during the Process of Bankruptcy

The process of bankruptcy is intended to provide financial rehabilitation for the debtor and a new start in life. However, little progress has been made toward this goal. In straight bankruptcy, no effort is made to educate or counsel the debtor during or after bankruptcy. Other than setting up a budget or plan as required by law, attorneys rarely give rehabilitative counselling beyond the immediate legal concerns.

Several studies (Brimmer, 1981; Hira, 1980, 1982; Stanley & Girth, 1971; Allen, 1977) stressed that a major cause of bankruptcy in a large number of cases, is the inability of consumers to manage debts. A *Training Manual* from the Office of the Superintendent of Bankruptcy, Consumer and Corporate Affairs Canada (1980), also cites misuse of credit and poor budgeting as two common causes for bankruptcies. The remedies for an insolvent individual debtor described in the *Training Manual* include the recommendations that the debtor must: (1) assess financial circumstance, (2) work out a budget taking a realistic look at income, expenses, assets, indebtedness and ability to pay, (3) determine

what remedy (legislative or non-legislative) is available, and (4) communicate the circumstances to the creditor. It is evident that the debtor has important responsibilities and tasks to perform when overextended. Debtors need assistance in performing these tasks and assessing their financial circumstances.

During personal interviews with those that were bankrupt, Hira (1980) found that many bankrupts had no idea of the cost of revolving charge accounts. They had very limited knowledge about the existing credit system although they were eager to learn about it. It also was apparent that those who were bankrupt and who appeared to have made the most progress in rehabilitation were persons with whom the administrators of the bankruptcy program established good working relationships. Furthermore, in these people's cases, efforts were made to gain their confidence to the extent that all or most problems relevant to the bankruptcy were discussed and specific steps to solve these problems were taken.

Whether tied to a community credit counselling service or attached to the bankruptcy process itself, money management education and rehabilitation appear to be desirable components of a liberalized bankruptcy law. Without them, a cyclical pattern of bankruptcy may be inevitable. Further, tighter bankruptcy laws may reduce the incidence of bankruptcy but will not solve the problem. Professional financial counselling coupled with debt liquidation provides a realistic alternative to personal bankruptcy as well as providing an opportunity to rehabilitate persons who have to choose bankruptcy as a solution to their financial situation. ●

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Errata

Fieldhouse, P. *Food and Development: What can YOU do?* *Canadian Home Economics Journal*, 1983, 33, (3).

Misplaced section in first column on page 161 should be moved to end of first paragraph on page 160. Section to be moved is as follows:

- If we can prevent something bad from happening without sacrificing something of equal moral significance, we ought to do it.
- Absolute poverty is bad.
- There is some absolute poverty we can prevent without sacrificing anything of comparable moral significance.
- Therefore we ought to prevent some absolute poverty. (Singer 1979, pp. 169-170).

The editors regret this error and apologize to the author and readers.