Consumer Council

REPORT

ON PERSONAL BANKRUPTCY

CANADIAN CONSUMER COUNCIL

CONSEIL CANADIEN DE LA CONSOMMATION

BOX C.P. 94
OTTAWA CANADA

RECOMMENDATIONS TO THE MINISTER OF CONSUMER AND CORPORATE AFFAIRS ON THE CONSUMER BANKRUPTCY ASPECTS OF THE REPORT OF THE STUDY COMMITTEE ON BANKRUPTCY AND INSOLVENCY LEGISLATION

June, 1972

CANADIAN CONSUMER COUNCIL

CONSEIL CANADIEN DE LA CONSOMMATION

BOX C.P. 94
OTTAWA CANADA

June 7, 1972

The Honourable Robert K. Andras
Minister of Consumer and
Corporate Affairs
Room 1403, Canadian Building
219 Laurier Avenue West
OTTAWA
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Dear Mr. Minister:

I am pleased to transmit herewith the Recommendations of the Canadian Consumer Council on those aspects of the Report of the Study Committee on Bankruptcy and Insolvency Legislation, 1970 that deal with the problems of personal consumer bankruptcies.

As you are aware, these Recommendations and reactions were requested of the Council by your predecessor, the Honourable Ron Basford, in April, 1971. They have been arrived at as a result of the Council conducting a public Seminar on personal bankruptcy in Vancouver in September, 1971, research and study conducted or commissioned by the Council, and by the efforts of a special subcommittee of the Council headed by Mr. George May of Vancouver.

Our analysis of the problem of consumer bankruptcies has not been confined to the Report of the Study Committee. It also includes the Council's reactions to the Small Debtors Program you announced on March 20th of this year. As well, it addresses itself to the need for further action if the root causes of personal insolvencies are to be dealt with. This is of equal importance to the introduction of improved legal mechanisms in order to alleviate the lot of the over-committed consumer in our credit pervasive life style and living patterns.

The Recommendations have as their prime thrust the predicament of the overcommitted consumer and his rehabilitation from what appears to the Council at present to be an alien system from the purview of the personal bankrupt. Initiated as it has been for business situations, the existing approach suffers from its social and commercial inappropriateness for individuals who become indebted in the acquisition of goods for their own personal use and consumption. Personal Bankruptcy legislation should at all times be a vehicle for relief and rehabilitation for the consumer insolvent and not a servitude without the prospect of release and renewal. They are the product of a major effort on the part of the Council members involved. I would sincerely hope they will receive your favourable consideration.

Yours truly,

Harold Buchwald

HAROLD BUCHWALD
Chairman

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FOREWORD

Personal bankruptcy as a mechanism for dealing with debt over-commitment by individual citizens has been part of the fabric of Canadian mercantile law for over half a century. However, while the social, commercial and credit purchasing patterns of our society have changed considerably, there has been little alteration to the underlying legal approach to consumer insolvency.

The federal and provincial consumer protection legislation of the last half dozen years has rightly removed consumer transactions from the traditional rules of orthodox commercial law. The special relationship between the buyers of goods and services for their own personal use and consumption, on the one hand, and those who manufacture, sell and finance those purchases, on the other hand, has finally been recognized as quite distinct and different from the legal relationship when business concerns deal with each other. By reversing the doctrine of caveat emptor in consumer purchasing and by requiring credit grantors to exercise intelligent restraint in the wide-spread extension of consumer borrowing or suffer the financial consequences, Canadian society has moved considerably toward redressing the legal imbalance.

But the critical area of alleviating the dilemna of the over-committed consumer still awaits enunciation and implementation. The special Federal Study Committee on Bankruptcy and Insolvency Legislation deserves the highest commendation for addressing itself to this important concern (within the context of its much larger review of the general subject), and for proposing in the main, enlightened approaches to corrective action. However, while many of the Study Committee's recommendations are attractive, some do not appear to provide the complete answers that are called for. And there are some other aspects not dealt with in the Study Committee's Report which require consideration and solution.

It has become trite to say that we are living in a consumer credit society. But a society which has created and nurtured credit purchasing as the way of life of the vast mass of its citizens has a concurrent obligation to provide the avenue for respectable and meaningful recovery from the consequences of the inability to

manage credit, its too-easy extension, and the apparent hopelessness of over-commitment. Relief and rehabilitation of the insolvent consumer as a matter of right should become the underlying philosophy. Debt collection and enforcement of creditors' rights must take a secondary position to maintaining the personal debtor as a useful and productive citizen. Credit grantors and debt adjustment administrators must recognize this new thrust and adopt it in their future activities.

At the same time, and with equal vigor, the causes of and contributors to consumer insolvency must be ascertained and apprehended. Here, also, there is a vital and dynamic role to be performed by the state and its instrumentalities in concert with agencies in the private sector. That role is of equal importance and priority to effecting appropriate legislative solutions for those who must already bear the burden of personal debt over-commitment.

I. INTRODUCTION

The Canadian Consumer Council respectfully submits the present recommendations on the consumer aspects of the Report of the Study Committee on Bankruptcy and Insolvency Legislation (Canada, 1970, Submitted to the Minister of Consumer and Corporate Affairs; Information Canada). We have deliberately refrained from concentrating on any other aspects of the Report.

These recommendations are the result of the work of a sub-committee of the Council and are based on the findings of the Study Committee and on the proceedings of a special seminar conducted by the Council and held in Vancouver in September 1971. A transcript of those proceedings is available from the Council offices.

The Council was favourably impressed by the quality of the report of the Study Committee and by the careful attention it devoted to the individual or consumer, in the treatment of both pre-bankruptcy arrangements and bankruptcy proper. The Council strongly supports many of its recommendations and looks forward to their early implementation. However, there are a number of specific points with which the Council finds itself in disagreement with the Study Committee and which are the subject of these recommendations.

II. HISTORICAL AND PHILOSOPHICAL BACKGROUND TO CONSUMER BANKRUPTCY

The very idea of "consumer bankruptcy" though not new to Canada, is sometimes looked upon with suspicion by those who have been accustomed to our mercantile tradition. The Study Committee rightly points out the introduction, in 1919, of federal bankruptcy and insolvency legislation relating to individuals (parag. 1.2.06.). It does not, however, underline the fundamental difficulty which has always impaired the application of the bankruptcy legislation with respect to consumer debtors, namely the nature of the total framework of the Act; an act designed for merchants and traders which assumes a strong mercantile tradition and a strict observance of contractual and customary rules. The Bankruptcy Act was structured to provide solutions to problems arising between merchants and later involving corporations, but though it has for many years now included

the non-merchant individual, few adjustments have been made to accommodate his particular problems.

The process of determining the actual causes and roots of consumer bankruptcy and insolvency is by definition a complex one. Indeed, one may never be able to determine a common profile of such situations, which vary according to the many facets of the individual's life.

There seems to be little doubt that the rising figures of total consumer indebtedness, credit operations, consumer spending and personal insolvency indicate that there is a malaise in the consumer society. Whether these problems can be said to have their source in the type of economy of our country, in the basic deficiencies of the human beings involved, or in the local circumstances of person, town and region is a question of much importance and complexity which the Council finds itself unable to tackle. On the other hand, while the reform of the Bankruptcy Act affords a substantial remedy to unfortunate situations, it would seem equally important to devote some time and energy to preventing such situations by attacking the very causes of consumer difficulties.

The consequences, personal, social, and economic, of a personal bankruptcy have a magnitude that cannot be ignored in the planning of budget and legislation. They should provide a sufficient example of the need for remedies that reach the human element of situations as opposed to their purely legal aspects.

Should the economic devices fail or should the weakness of the individual prevail and lead him to insolvency, then the Bankruptcy Act should bring relief in such circumstances as to impose as light a burden as possible on all concerned (including the bankrupt).

As a starting point, the causes of bankruptcy should be of interest to the legislator. Many personal bankruptcies result from over-indebtedness accompanied by an unusual event that was unforeseen or by a chronic situation which can hardly find an easy remedy; one may cite sickness, accident, unemployment, lack of knowledge or of education and family difficulties. The individual who reaches a state of advanced insolvency needs help from the state to enter into a program of rehabilitation that will enable him to programme his payments through extension or composition or to start afresh by a total

liberation of previous indebtedness or bankruptcy.

These two methods - orderly payment of debts and bankruptcy - should be available to whoever needs them, and the choice between the two should be made to the benefit of the debtor as well as that of his creditors. The Study Committee rightly recommends that bankruptcy should be available to all (parag. 3.2.006).

The need for further relief to be afforded the consumer bankrupt is enhanced by the inequitable treatment of individuals and corporations under the present Act. The corporation that is dissolved through bankruptcy ceases ipso facto to carry the inconvenience of that experience, and as a result of the limited liability rule or of the corporate shell principle, shareholders and directors escape the disaster with limited damages to their solvency and reputation. The burden may be heavier where the personal name and reputation has a reasonable chance of remaining untouched. The persons behind the corporation are free to start business anew without significant impediments, though certain restrictions may now be introduced in that respect through the Corporations Act.

The individual who is not in business carries the personal hardship, stigma and embarrassment associated with bankruptcy. He is always regarded as being responsible for his over-indebtedness. Unexpected circumstances or market situations provide him with no excuse for his failure to pay. In the Report of the Study Committee it has now been suggested that cases of real hardship be covered and that a moratorium be declared in cases of earthquake, fire, crop failure or other acts of God (parag. 3.1.41.). Nevertheless, it would appear necessary to lay down the principle that where a consumer debtor has reached a point where he/she qualifies for bankruptcy under the Act, then it is a question of right for him to "enjoy" all the privileges and recourses of the Act, and to be able to enjoy them as often as he needs to.

The rationale here is that one of the responses of the consumer society to itself is that the easier it is to become over-indebted through easy credit, the higher the cost of credit and the quicker property depreciates; the more it becomes necessary to give quick and easy relief to those who have reached the point of no return.

Beyond the pure laissez-faire of the contractural rule, this requires an effort in communal self-criticism to determine that where the system has caused the loss suffered by a consumer, the system should also provide ways of relief.

The Study Committee has provided a number of solutions of considerable value in an effort to bring more equity to the bankruptcy procedures and the treatment of the overcommitted consumer. The Consumer Council fully supports these proposals, but expresses its desire for even more equitable solutions. The following paragraphs contain specific recommendations concerning the Report of the Study Committee and the recently introduced small debtors programme as they relate to individuals as consumers and not as traders (corporations are not considered).

III. SPECIFIC RECOMMENDATIONS RELATING TO THE REPORT OF THE STUDY COMMITTEE

1. National Profile of Consumer Bankruptcies

The Council has found it difficult to appreciate the suggestions of the Study Committee and to formulate its own recommendations without a set of detailed statistics on the profile and circumstances of consumer bankrupts. Consumer bankruptcies are a constant reality, and in many cases it is reasonably easy to find the broad and immediate causes of a given bankruptcy. However, a more detailed analysis of a great number of situations might help determine more profound bases and establish a cause-to-effect relationship in an overall picture of personal bankruptcies.

On the other hand, the Council wishes to express approval of the general approach adopted by the Study Committee and, in particular, its emphasis on the concepts of equity, universality and social relevance.

2. The Personal Bankruptcy: The Last Resort Solution

The Study Committee correctly envisages personal bankruptcy as a last resort for the hopelessly overcommitted debtor.

The Council anticipates an increase in the number of personal bankruptcies if the recommendations of the Study Committee are imple-

mented. By the same token, the number of insolvent persons who will avail themselves of the rehabilitation procedures will also increase, and it may well be that a good proportion of these will fail in their effort and will have to use the last resort, that is, bankruptcy. In view of the inter-action of rehabilitation and bankruptcy procedures and the importance of the latter should the former fail, it seems necessary to offer a few comments on bankruptcy proper in the first place, especially with respect to the treatment of secured creditors.

(i) Financial criteria for bankruptcy

The Council agrees with the recommendation of the Study Committee concerning the minimum income of the potential bankrupt or financial constraints on bankruptcy,and more particularly with the recommendation that there should be no minimum amount of debts necessary to enable a person to enter into a voluntary bankruptcy (parag. 3.2.008.) and with the recommendation that in the case of an involuntary bankruptcy, the amount of debt that must be owed to the petitioning creditor (or creditors) should remain at one thousand dollars (parag. 3.2.008.).

(ii) Exemptions

The Council expresses reservations on the finding of the Study Committee that the nature of the property to be exempted from seizure on the bankruptcy of a debtor should continue to be established by the provinces (parag. 3.2.031. to 3.2.034.). It would seem that the federal jurisdiction over bankruptcy justifies the determination of properties and assets that would be exempt from seizure in bankruptcy procedures, over and above the exemptions established by the provinces. Uniformity of entitlement and treatment in all parts of Canada and equity would appear to be sufficient motives for this recommendation.

More specifically, the Council recommends that serious consideration be given to the possibility of exempting from seizure in bankruptcy proceedings all personal and household effects and belongings, the basic tools of the trade of the bankrupt and his homestead or principal residence, subject to the possible exception of the unpaid vendor's lien or privilege in this last instance (see infra).

Experience has shown that the seizure and judicial sale of such properties (homestead excluded) bring little by way of proceeds which in most cases are barely sufficient to pay for the seizure and other legal fees and costs. The principle should be established that there is a greater social advantage in having him retain these personal assets notwithstanding his state of insolvency. This rule would prevail irrespective of the source or cause of debts. What is now known in tax law as "personal listed property" could conveniently be excluded from this rule.

(iii) Secured and preferred creditors

The treatment of secured creditors raises many questions of policy in determining the general philosophy of bankruptcy. The right of a secured creditor in a specific asset of the bankrupt has traditionally been acknowledged, and the secured creditor has the choice of either abandoning his security and filing his claim with the trustee in bankruptcy or realizing his security outside of the bankruptcy proceedings. In many instances, the removal of assets that are affected by security means that little is left in the bankrupt estate for the mass of ordinary (unsecured) creditors.

The Council therefore approves of the recommendations of the Study Committee concerning the treatment of secured creditors and the equitable principles that are introduced in order to protect the "equity" of the bankrupt in assets that are pledged, mortgaged or hypothecated in favour of secured creditors (parag. 3.2.038. et seq.). More specifically, the Council welcomes (a) the prohibition imposed on a secured creditor to treat a petition in bankruptcy against his debtor as a deemed or technical default of payment in the absence of an actual default; (b) the obligation imposed on the secured creditor to prove both the value and the validity of the security before he can claim possession and realize his security, and (c) the outlined procedures for establishing the value of a deficiency between the claim of a secured creditor and the proceeds obtained from the fact of taking possession or from the realization of the security (parag. 3.2.039. - 3.2.040.).

The Study Committee has put forward forceful arguments concerning the potential course of events whereby, owing to the wider use of secured claims, the majority of liquidations or realizations of assets would take place outside the Bankruptcy Act. The increasing proportion of secured transactions, both moveable and immoveable is being stressed and the need for more powerful remedies is advocated, though not, in the respectful view of the Council, with sufficient force to provide an integrated solution of all insolvency problems.

(a) Exemptions and secured creditors

As it has been pointed out with respect to unsecured creditors and bankruptcies generally, the Council believes that the exemption from seizure of certain properties should also be applicable to secured creditors. Certain provincial legislations (e.g., Alberta, Exemptions Act, 1955, s. 4; Saskatchewan, Exemptions Act, 1965, s. 3; Quebec, art. 522-553 Code of Civil Procedure) exempt defined property from both seizure and realization under security interests or other charges. The same principles that justify exemption from seizure and sale with respect to unsecured creditors are, in the Council's view, equally applicable with respect to secured creditors. Where property is necessary to the subsistence and basic activity of a debtor, it should remain immune from all remedies, whatever the nature, source or cause of the creditor's claim against, or right in, them. This should apply to property both moveable and immoveable, the latter being a reference to the principle residence or homestead. Only in very exceptional circumstances would a creditor be allowed to realize his security on such property. The only foreseeable exception might be the unpaid personal (as opposed to commercial) vendor or purchase money security interest creditor, and even then, the exemption should be lifted only where real hardship would result to the creditor.

This proposal may incidentally raise a number of difficulties where the vendor of an immoveable is concerned. In many instances, the owner of a house who sells it remains a secured creditor with respect to the balance of the sale price (often ranking as second secured creditor). Should the new owner of the property enter into a bankruptcy, his claim may seriously be endangered if the exemption from seizure

applied against him. The Council recommends, therefore, that serious consideration be given to the possibility of having the Central Mortgage and Housing Corporation (or other similar body) intervene in such circumstances to guarantee the reimbursement of the claim of the vendor, just as it guarantees the reimbursement of first secured loans by institutions. Such a solution could be even broadened in order to cover all cases of hardship in keeping with payments on a principal residence. It would also provide incentives for the individual to become a house-owner. There would, of course, be situations where a particular consumer can simply not hope to keep a house which is too expensive for his means, present or future, in which case he would have to surrender or otherwise dispose of it. This difficulty could easily be handled by having a form of counselling whereby decisions benefiting the consumer as well as his creditors could be taken with reasonable speed and efficiency.

(b) Alimony and pension creditors

The Council recommends that a new category of preferred creditors be added to the list: alimony and pension creditors. This preference would be applicable in both bankruptcy and rehabilitation procedures. In the present situation when a spouse or children have obtained a judgement for alimony, their claim is completely set aside upon procedures in bankruptcy. This appears totally unsatisfactory to the Council. The creation of a high ranking preferential claim for such creditors is amply justified in fact and in law. There are also indications that some of the provinces are considering the adoption of a similar rule. (In the province of Quebec, a good portion of the insolvent's earnings are exempt from seizure, but a proportion of the amount so exempted may be seized in the case of an "alimentary debt": art. 553, Code of Civil Procedure).

(c) Floating charges and general security

The Report of the Study Committee contains valuable observations on the treatment of secured creditors involved in a personal bankruptcy (parag. 3.2.035.-3.2.040.). The Council feels, however, that the question of floating charges and general security would have benefited from a more specific treatment. Whereas the floating charge was up to quite recently restricted to the financing of corporations,

the advent of modern Personal Property Security Acts has brought a wide-spread use of the floating or general charge even in the case of consumers. It is questionable whether a creditor should be allowed to acquire security over all the assets of his consumer-debtor, or over a substantial portion of them for the securing of his claim. For example, the vendor of a television set does not need security on a piano to guarantee payment of the sale price of the TV set; consumer lenders do not need a general or blanket security on all the assets of their debtor. The temptation of using the floating charge or the general security will be great in the future, but the Council feels that the insolvent's other assets should never be available to a trustee in bankruptcy or enforceable in insolvency proceedings.

Moreover, should a floating charge or general security be accepted in principle, it could mean that the largest portion of the execution would take place outside of the bankruptcy proper.

A consumer who would be subject to this form of security commitment would be under extreme pressure since default would mean losing all his assets. This may even encourage him to borrow more and more in order to avoid this possibility, and he may thus find himself desperately over-committed. His other creditors would be the first to lose from secured situations of this type. One might imagine the situation where competing creditors would try to be the first to obtain floating or general charges over the property of consumers and, therefore, keep them under control for unduly long periods of time. The result might not be unlike a form of lending feudalism.

A floating charge or general security is also basically unfair to the unsecured creditor, who may, up to a certain point, have extended credit on a gentlemanly basis: the arrival of a secured party whose position literally wipes out the availability of every asset would be most frustrating and may just prevent the establishment of good business relations.

The creditor who finds his debtor in a state of quasi-insolvency might also be more inclined to extend credit to him if he can obtain a floating or general security on his assets, knowing that he will be able to realize the security outside the bankruptcy. This

may even precipitate bankruptcy, and it certainly does deprive unsecured creditors of many recourses which would otherwise be available.

These considerations apply as well in consolidation loans as in other circumstances, since conflicts between secured creditors or between secured and unsecured creditors are real no matter what the cause of the credit extension may be. (The Consumer Protection Act, Quebec, 1971, prohibits the floating or general charge where terms of sale are concerned (s.29 et seq.); regulations under that Act prohibit them where consolidations are concerned; the Ontario Personal Property Security Act (s. 13 and 19); the Manitoba Consumer Protection Act, 1970; the proposed Uniform Personal Property Security (s.13), the Crowther Committee Report on Consumer Credit (U.K., 1971, vol. I, p. 201);and the Australian Law Council Report on Consumer Credit (1971, p.87) prevent the taking of after-acquired property as security in consumer transactions).

The restriction on floating and general security should therefore cover both after-acquired and present property, as only purchase-money security interests in assets bought by the consumer with new credit would be valid against the trustee in bankruptcy, subject to the exemption provision stated above.

The Council is not reassured about the extent of the proposed restrictions on the effectiveness of the floating or general security in the Report of the Study Committee (cf. parag. 3.2.056 et seq.).

With respect to consolidation by means of extensions or compositions, the Council recommends that any security taken by a creditor to secure new advances or to secure credit to a small debtor (other than property purchased with that new credit) should be void against creditors under such extension or composition.

The operation of this provision, as well as others concerning secured creditors should not be subject to any retrospective time limit.

(d) Security over immoveable property

In relation to the recommendation of the Study Committee on creditors having security over immoveable property in a bankruptcy (parag. 3.2.038. et seq.), the Council suggests that apart from the

above recommendations dealing with personal residences, it should be established that creditors who have a security over the immoveable property (i.e., real estate) of a small debtor should not be able to realize their security where two-thirds of the principal amount has been paid.

Another solution could be applied to most situations where debtors own immoveable property (including personal residences). Instead of applying an acceleration clause (loss of term) or of declaring the debt to be totally in default, the creditor should be able to file a claim for the amount of debt owing that is not the capital amount and prove his claim to the property for the balance of capital remaining due. The trustee in bankruptcy would then have a choice (under guidance of the creditors and of the court) either to realize the security, if the equity of the bankrupt in the property is sufficient to bring worthwhile proceeds, or of leaving the immoveable untouched. The balance of non-capital debt would be absorbed in the bankruptcy and be available for a dividend out of the estate, while the balance of capital remaining due would not be realized upon discharge of the bankrupt, as both security and debt would revive after the discharge and be carried for the rest of the term. Where a principal residence is involved, in order to keep the property available to the debtor, the trustee's choice of realizing the immoveable should be exercised only in very special cases. It could then be arranged that the unpaid creditors would be given security in the property for the portion of their claim that is left. In order to prevent a debtor avoiding discharge so as to avoid resuming his mortgage or hypothecary payments, the creditor should then have the right to petition the court for his discharge. As of that time, pre-bankruptcy or pre-discharge interest would not be recovered from the debtor,who would not end up owing more than when he started.

(iv) Property acquired after bankruptcy and annulment of releases

The Council agrees with the Study Committee's comment that "perhaps the real purpose of the after-acquired property provisions is to punish" (parag. 3.2.047.), and that this provision should be repealed. This concerns property that is acquired by the debtor after his bankruptcy, but before his discharge (sec. 67 of the Bankruptcy Act.)

The Council approves of the recommendation that the bankrupt's wages be exempt from the trustee's and creditor's reach if the debtor is to have any incentive to rehabilitate himself. Unlike the Study Committee, however, the Council believes that sudden and unexpected wealth arising after the bankruptcy (such as inheritance, or earnings at a lottery) should also be exempt. Bankruptcy should be regarded as the termination of an unfortunate situation which should not be perpetuated unduly, unless it is in the interest of the debtor. Barring fraud or deceitful transactions, property and assets earned after bankruptcy should, therefore, be exempt from earlier claims (cf.parag. 3.2.054.).

Similarly, the Council is troubled by the recommendation that the Court be given the power to annul a release of debts arising from a bankruptcy that follows within five years of a previous bankruptcy (parag. 3.2.090.). Whereas this recommendation is presumably designed to prevent abuse of the system, the Council disagrees with the aim and result for two reasons: firstly, the purpose of rehabilitating the debtor should be paramount and every step should be taken in that direction; and secondly, once bankruptcy has taken place, the whole past should be wiped out with as few exceptions as possible. The philosophy behind the new bankruptcy procedure should be to regard bankruptcy as a matter of protection for the debtor that he can avail himself of as a matter of right, not as a form of legalized fiscal servitude. Potential abuses should be corrected not by civil measures that revive the pre-bankruptcy situation, but by penal or criminal procedures designed to prevent abuses and fraud. Being a matter of right, bankruptcy should be made available to debtors as often as it is needed, without punitive measures of a civil nature. Our society should strive to bring remedies to those in need as much as it purports to offer credit and favour indebtedness on a large scale.

The creditor who extends credit assumes the implicit risk of his actions, which results either in payment or in loss as the case may be. It behoves the creditor to inform himself of the credit worthiness of his debtor and to assume the general risks of his business. What must become the rule is that credit grantors must police themselves and not have the legal machinery to continually hold the debtor responsible for the easy extension of credit granted or accepted under the pressure of advertising or salesmanship - especially when the person borrowed well beyond his means, and with the knowledge of his creditors. Where a debtor

obtains credit as a result of fraud, remedies should be found primarily in criminal or penal laws, rather than in property or personal liability recourses, which then become applicable to the honest, but overcommitted consumer purchaser.

3. Extension of Term and Consolidation of Debt (The Alternative To Personal Bankruptcy

Part X

Until 1966, arrangements for the orderly repayment of debts as an alternative to personal bankruptcy were possible in only two provinces, Alberta and Manitoba which had enacted provincial legislation to facilitate such a procedure. Although it was possible under Part III of the Bankruptcy Act to make a proposal to creditors, the costs (usually several hundred dollars) of making this type of arrangement generally negated its usefulness for the consumer debtor. In 1966, the provincial legislation was declared ultra vires as it was said to infringe upon the federal right to legislate in matters of bankruptcy and insolvency. To fill the gap left by this decision, the federal government added Part X to the Bankruptcy Act. This Part in effect incorporated the main features of the provincial legislation. The consumer was thus provided with a simple, inexpensive and informal scheme for the orderly payment of debts. However, due to federal-provincial jurisdictional conflict, Part X comes into force only in those provinces (to date only British Columbia, Alberta, Saskatchewan, Manitoba, Nova Scotia and Prince Edward Island, though it is not yet in operation in P.E.I.) which request its application. Although a much needed piece of legislation, Part X is not without significant shortcomings. The Study Committee clearly recognized the limitations of the Part and the Council is in support of their main recommendations for the improvement of this Part. In this respect, the Council would like to submit the following comments on Part X.

Among the advantages of consolidation under Part X, one may note:

(a) the avoidance of the stigma which many believe is attached to personal bankruptcy or, at any rate, the avoidance of the fact and status of being bankrupt;

(b) the opportunity for the debtor to retain his existing property and eventually a total discharge of past debts;

(c) the protection of the debtor's credit-rating in the future;

(d) the possibility for the debtor to remain in business and the protection of future business activities.

Those are not unimportant features of Part X and they warrant its retention.

(i) General comments on Part X

(a) Universality of application

The Council strongly recommends the universal application of Part X. The present situation leads to discrimination in the treatment of various Canadians in those provinces where Part X has not been proclaimed.

(b) Limitation as to the quantity of debt

In its present form, Part X can only be applied to individual debts not exceeding $1,000 unless the creditor agrees otherwise, and unless otherwise provided by Order-in-Council. Two provinces, British Columbia and Nova Scotia, have put the limit at $2,000 while the four others have removed the ceiling altogether. There seems no reason for imposing a ceiling which has become obsolete and restrictive and denies the peculiarity of individual cases. The Council thus recommends that the ceiling be removed.

(c) Exclusion of business debts

While there is at present some ambiguity as to the possibility of including business and self-employment debts in an arrangement under Part X, the Council sees no reason for such a restriction. Indeed, the debtor should be able to include all his debts in the arrangement in order to benefit fully from the rehabilitation procedure, there is no justification for discriminating about the source of the debt. As an alternative, the matter of including business debts in an arrangement could be regarded as a discretionary matter on the part of the administrator, in appropriate cases.

(d) Exclusion of debts owing to public bodies

The Council feels that public debts should be included in Part X extensions. The general goal of rehabilitation provides a sufficient reason for doing so. Therefore all debts in the nature of taxes, whether federal, provincial, municipal or school, as well as debts to other public bodies (federal or provincial) should cease to be exempt from an arrangement under Part X and be treated as part of the debtor's liabilities for that purpose (cf. parag. 3.2.075 et seq.)

(e) Stay of proceedings

The Council strongly supports the recommendation of the Study Committee concerning a stay of all proceedings against the debtor as soon as he proposes an arrangement (parag. 3.1.24.); otherwise, a creditor could commence such procedures bofore the consolidation order has come into effect. All proceedings should be stayed until such time as the petition is withdrawn or dismissed, or, if a consolidation order is made, until such time as it is set aside by the court.

(f) Unconscionable transactions; disclaimer of contracts

The Council also fully supports the recommendations of the Study Committee relating to harsh, onerous and unconscionable transactions and to the disclaimer of executory contracts or leases (parag. 3.1.29 et seq.). The Council further suggests that a court official be given discretionary power to allow relief from such transactions or contracts. Such decisions could be subject to appeal to the Court.

(g) Temporary suspension of arrangements

The Council supports the recommendation of the Study Committee that while the term allowed for an arrangement (extension or consolidation) may not exceed three years (parag. 3.1.26.), it is necessary to provide conditions under which the debtor could be allowed to suspend his payments and to make up, at the end of the arrangement, the payments he has missed. Such conditions should include illness, unemployment, accidents or strikes. A temporary

suspension should not make the debtor subject to the consequences of default.

(h) Automatic bankruptcy

The Study Committee recommends the annulment of an order providing for an arrangement where a creditor can prove that the proposed consolidation is not in the best interest of the creditors or was fraudulently established (parag. 3.1.26.). Such an annulment would result in the automatic bankruptcy of the debtor.

The Council feels that the automatic bankruptcy in such a case may not be the best solution for all concerned. Indeed, where the creditor proved fraud on the grounds that the debtor actually had the ability to pay, then bankruptcy would not seem the best remedy. A more flexible solution would be one which allowed the creditors to take whatever course of action they considered appropriate upon the annulment of the order. While they might opt to petition the debtor in bankruptcy, they would also have other options.

(i) Default

One of the essential features of the present Part X is that application to make an arrangement under this Part X is completely volontary. Once under the Part X, however, upon a single default, the creditors may petition for bankruptcy or pursue any other remedy. In view of the heavy burden placed upon a debtor by an arrangement, the Council recommends that:

(1) the use of Part X be entirely voluntary;

(2) the debtor be given the right to apply for bankruptcy at any time;

(3) one default should not result in the loss of the protection afforded by Part X; and

(4) the court should, in the event of default of one payment, have the power to arrange for Part X payments to be deducted at the source of income of the debtor.

The purpose of Part X is to provide a method whereby debts can be discharged without the debtor being subjected to the usual

creditor remedies. If the debtor defaults under such an arrangement, this protection is lost. By making the deduction at the source after only one default, the debtor will be afforded the full protection of the Part. However, should the debtor find the burden of a Part X arrangement intolerable, he should have the option of declaring personal bankruptcy.

Creditors would also find value in this procedure; if one default were not considered to constitute sufficient grounds to permit a petition of bankruptcy, the attachment of wages at the source, would, as long as the arrangement was in effect, provide for a greater potential repayment than might be expected should the individual be forced to petition for bankruptcy.

(ii) Secured Creditors under Part X

One of the attractions for a debtor to enter into an arrangement rather than to go bankrupt is that he will be able to keep his property in return for undertaking to pay off his debts in full over three years (an extension) or in part over that time (a composition) out of current earnings. The Study Committee has stressed the importance of the rehabilitative aspect of schemes of arrangement in contrast with the trauma of bankruptcy where everything is lost (parag. 3.1.02). The option presented to a debtor is either (a) to go into bankruptcy, lose all his assets but retain his future earnings (with the proposed abolition of the doctrine of after-acquired property); or (b) to enter into an arrangement, keep all of his assets, but surrender a proportion of his future earnings over three years.

However, a scheme of arrangement will not be an attractive option for an insolvent debtor unless he can actually hope to retain his assets. If he is to lose all or most of them, anyway, he may as well go into bankruptcy now and save himself the effort of having to struggle for three years to pay his creditors out of his wages. Yet, if security becomes as widely used as the Committee foresees (parag. 2.1.24 et seq., 3.1.32.), then to allow secured creditors to enforce their security whenever an arrangement is entered into

will remove most of the attractions of such a course of action for a debtor. On the other hand, simply to provide that the security is not enforceable during a scheme of arrangement, provided payments to the secured creditor are made in full as they fall due, may well mean that a debtor will be faced with an impossible obligation during this period of financial "resurrection" or that he will have little or nothing left to pay the unsecured creditors. This may mean that an extension over three years will not be possible, or a composition, though possible, will not be attractive to unsecured creditors who may prefer an immediate bankruptcy.

It is important to stress again here that any attack on a creditor's remedies, while at one level necessary in order to make arrangements a viable alternative to bankruptcy, necessarily must have an effect on the terms on which a creditor will be prepared to do business: either he will raise the price of his credit, which may price some debtors out of the market, or he will be more selective in determining which credit risks he is prepared to do business with. Either way, persons who are getting credit today may no longer qualify for credit if creditors' remedies are restricted. This is basically a question of policy. It is, however, difficult to assume that creditors will, with less effective remedies, continue to extend credit to the same debtors on the same terms, but with fewer prospects of collection. As creditors (i.e. vendors and lenders) will be tempted generally to increase their prices, the slightly better credit risks will end up subsidizing the worse credit risks.

Assuming that the policy objective in the present context is to make arrangements a viable alternative to bankruptcy, then the secured creditors' rights must be restricted, with the consequence that credit will be rationed more restrictively, and the Council thus makes the following proposals for achieving that objective:

(a) Extensions

The Study Committee recommends that under an extension arrangement a creditor should not be entitled to enforce his security unless it was given during the 60 days prior to the filing of the petition

for an arrangement and less than two-thirds of the amount owing has been paid (parag. 3.1.35). These restrictions do not apply to security over immoveables.

The Council wishes to offer a few amendments to this recommendation. In the first place, it would seem that the 60 day reservation is unjustified: indeed it would encourage precisely the situation described earlier where a creditor, knowing that a debtor is in difficulties, nevertheless advances credit only because he is able to fully secure himself. Secured creditors who advanced their credit at an earlier point of time when perhaps the debtor's state of distress was not as far advanced or as visible would be at a disadvantage, without justification. The Council believes that in an arrangement by way of extension, the enforcement of all security over moveables should be suspended and debts due to secured creditors be rescheduled over the three year period as with other creditors. On the other hand, should default occur during this period, the normal remedies of creditors will revive, including the secured creditor's right to enforce his security. It is appreciated that in cases where the security is of a kind that rapidly deteriorates in value, a rescheduling of payments over a three year period may mean that if default occurs late in this period, a creditor's security could have depreciated so much that his prospects of enforcement of his debt is to that extent prejudiced by the extension. The obvious response to this is that secured creditors will have to cost out this factor and adjust the terms of their credit accordingly. This revision of the terms on which they will grant credit may have an exclusionary effect on some debtors.

The Council has come to the conclusion that there is an even stronger case for adopting a similar approach with security over immoveables. Nothing could be more serious for a debtor or more discouraging to attempts on his part to eventual financial rehabilitation than for him to lose his home, particularly in a situation where he is able, if given the opportunity, to clear his debts completely within three years. Most hypothecs or mortgages will involve payments extending beyond the proposed three year period.

Therefore the regulations applied to all creditors will have to be modified in the case of mortgage debt. It would seem that the formula suggested for dealing with mortgages in a bankruptcy where the two-thirds of the mortgage has been paid would be entirely apt in the case of all hypothecs or mortgages in an extension situation. This would involve (a) a suspension of the enforcement of the secured debt during the three year period, (b) a rescheduling of payments that would otherwise have fallen due in this period, (in the discretion of the court), so that a hypothec or mortgage would be subject to the same scale of deferment as other creditors, (c) the revival of the right to enforce the security should the debtor default during the extension, and (d) the addition of the deferred sum to the end of the term of the secured debt, which would revive in full force once the period of extension was over and the other creditors had been paid off.

A secured creditor upon an immoveable would stand to be little prejudiced by a deferment of this kind, as in most cases, unlike creditors with security over moveables (chattels and personal property), his security will not be rapidly depreciating in value. However, to safeguard against cases where his security is being placed in jeopardy by actions of the debtor, the creditor should be given the right to apply to the court at any time for an order reinstating the hypothec or mortgage in full effect immediately. The question of the treatment of a hypothecary creditor or mortgagee in an extension should be dealt with in the original petition for an extension and not be a matter for separate or subsequent application (see parag. 3.1.40).

(b) Compositions

In relation to arrangements by way of composition, the Study Committee recommends that a secured creditor should be given the right to chose between filing under the plan or enforcing his contract, except where two-thirds or more of the debt has been paid, in which case the creditor must file under the plan (parag. 3.1.36.).

The Council considers that, as with an extension, a secured creditor's rights should be "frozen" in a composition, and he

should file in the composition and receive a dividend in the composition like other creditors. However, should default occur during the period of the composition, his rights over the security revive. Because in this case, unlike an extension, he will not be paid off in full during the period of the composition, it is suggested that his debt not be released at the termination of the composition, but that both the security and the contract terms be reinstated at this time, with the deferred payments and interest being added to the end of the contract.

The hypothecary creditor or mortgagee (upon an immoveable) should also be treated in the same manner, following the suggestion made in this respect in the case of extensions. However, because a composition is consensual and not a result of a court order, the question arises whether a hypothecary creditor or mortgagee should vote on the question of whether there is to be a composition. If the approval required of creditors is related to the value of their debts, a hypothecary creditor or a mortgagee, who will always find it in his interests to resort to his security and avoid a composition, will almost always succeed in blocking a composition. On the other hand, to allow a simple majority in number of the creditors to bind him ignores the fact that his financial stake in the situation may be much greater than theirs, and if he is an individual (e.g. not an institutional creditor), he may sustain considerable hardship if his major source of income is suspended or reduced. The Council recommends therefore, that in the case of a composition a debtor may apply to the court for an order preventing enforcement of an immoveable security while he adheres to the terms of the composition. The deferred payments would be added to the end of the term of the secured debt which would fully revive once the composition terminates.

(c) <u>The Problem of After-Acquired debts in a Part X Arrangement</u>

The situation where a debtor in an extension or composition, incurs further debts while meeting his payment obligations under the arrangement does not seem to have received the attention of the Study Committee. Obviously, in the light of the Study Committee's premise that a debtor cannot reasonably be expected to maintain a

high degree of self-discipline for more than three years, it would not be appropriate to bring these new debts into the arrangement. Addition of new creditors would mean that the period of the arrangement would have to be extended beyond the three year limit and that the scale of payments would have to be reduced for all creditors. This is the experience at present under the Quebec Lacombe Law (art. 652 et seq., Code of Civil Procedure), where a majority of debtors under the regime continue incurring new debts throughout the period they are under Lacombe Law. It is also worth noting here the findings of Professor J.S. Ziegel in a recent study of the Lacombe Law to the effect that if all debtors under the voluntary payment scheme had maintained their scheduled payments, only 39% would have paid off their debts in five years. If one then takes into account the factors of periodic defaults in payments and the creation of new debts while under the scheme, one would appreciate that only a tiny percentage of present Lacombe law debtors will ever meet the objectives of an arrangement by way of extension under the Study Committee's recommendation. Even with a three year arrangement by way of composition, a debtor who incurs additional debts during the period of the composition is unlikely to be able to adhere to the terms of the composition, or if he does, he will not be rehabilitated at the end of the composition because he is likely to have new creditors to pay. In the case of a low-income debtor, it must be recognized that the temptation (or, frequently, the necessity) to keep incurring debts despite an extension, composition or even a bankruptcy is very high. His needs are pressing. No matter how many debts he incurs, he will have available to deposit only the seizable portion of his wages. While there is a potential rehabilitative role for Part X-style arrangements with a middle or upper income debtor who has suffered a temporary financial reverse, one remains sceptical that the Study Committee's recommendation in this regard will have a major application to low income debtors whose lack of resources is permanent, expenditures largely fixed, and over-commitment often chronic.

It would appear that whatever measures are available should be taken to discourage a debtor from adopting this practice of acqui-

ring new creditors if he is to benefit from the rehabilitation procedure. Perhaps penal or quasi criminal offences should be introduced as a deterrent; even then, this is unlikely to provide a total answer to this problem because of the difficulties involved in penalizing a large number of poor debtors in such circumstances. Debt counselling services should play an important role in trying to discourage debtors from creating further debts during the arrangement period. However, the Council considers that once a debtor has created after-acquired debts which he is unable to pay out of the non-seizable portion of his income, then the objective of an arrangement either of extension or composition has failed, and there is no alternative but to treat it as at an end. In this event, both creditors in the arrangement and after-acquired creditors would have their normal remedies, including bankruptcy. The debtor in turn would be able to consider the alternative of filing for personal bankruptcy. The Council frankly recognizes that by preventing a debtor from bringing into an arrangement after-acquired debts, a premium is thus placed on personal bankruptcy. However, it does not believe that making an arrangement a permanent state for a debtor serves a valid purpose. The law must encourage a debtor to move to a more positive financial situation. Bankruptcy in many cases may be the only means of providing a debtor with the possibility of a fresh start and financial rehabilitation.

It may be, of course, that these problems will transfer themselves to any bankruptcy where the debtor will incur new debts while an undischarged bankrupt. These debts are not discharged in the first bankruptcy and can be executed at the moment the bankrupt obtains his discharge. If a debtor goes bankrupt a second time to avoid this, his creditors will get nothing, as the debtor will have few or no assets, and under the Study Committee's recommendation, they have no access to after-acquired property of the debtor in the form of future earnings. Presumably, this is the only form that "rehabilitation" can take within the present terms of reference. However, it can still be legitimately questioned whether even this would break the cycle of over-commitment in the case of the low-income debtor.

(iii) A Final Comment on Part X and Bankruptcy Act Revisions In General

The Council recognizes the need for major revisions in the Bankruptcy Act and the extension of all of its provisions to every region of Canada. But such revisions, no matter how extensive, will only provide one method for dealing with a given situation. The root cause of the dilemma will still remain. It is therefore essential that this fact be recognized and that steps be taken to remove or at least substantially reduce in impact the factors that are the cause of individuals becoming over-indebted. The last portion of this report contains recommendations to that effect.

IV. THE SMALL DEBTORS PROGRAMME

The inauguration of a programme aimed at providing needed assistance for the over-committed small debtor was announced by the Minister of Consumer and Corporate Affairs on 20 March, 1972, in partial response to the recommendations of the Study Committee (parag. 3.1.09 et seq.).

The Council of course, supports this action, which meets the Council's own recommendations contained in its Report on Consumer Credit (November, 1969). There are, however, a number of points on which the Council would like to comment.

1. The Existence of an Entrance Fee

The Council cannot see the justification for an entrance fee. In effect, the proposed $50 filing fee is equivalent to an entry fine and it appears to be repugnant to the principal goal of rehabilitation and education for the debtor. Moreover, a debtor in need can hardly obtain the money to pay such fee. Such a program should be publicly funded since the consumer is so helplessly in debt that he is virtually in a state of economic bondage. In the aggregate, the fees collected will barely make an impression on the administrative costs to be incurred by this reform. The Council, therefore, recommends that the fee of $50 be removed.

2. Income Restraints on Potential Users

The announcement of the small debtors program contained a reference to income restraints to be used in determining who can apply under the programme. The Council feels that it is not in accordance with the policy of the government to insist on a means test, especially when federally-supported pro-rating services such as the Metro Credit Counselling Services of Toronto have never applied such a criterion. While there may be some justification for applying an earnings yardstick as a prima facie guide, it is difficult to see such a yardstick as a normative rule. The debtor's need for assistance should be the over-riding consideration in each case.

3. Exclusion of Debts Incurred While Self-Employed

The Council has already expressed views on the question of exempting debts incurred while self-employed from an arrangement by way of extension or composition. It believes that the same reasons are valid here and that any programme of rehabilitation should include all debts.

4. Geographic Limitation of the Programme

The Council notes that through the three offices planned for June 1972 for the small debtors program, as much as 35% of the population will be covered. It further notes that the program will gradually be extended to all Canadians. The Council strongly recommends that the programme be extended to cover the whole of the population as soon as administratively feasible for fear that discrimination might result from this unequal situation.

One possible interim solution would be to allow provincial governments to put forward names of their own civil servants who could be appointed as public trustees in bankruptcies pending full scale federal implementation of the programme. The legal and organizational demands of the job are hardly overwhelming and such a stop-gap measure would appear eminently sensible in a situation of this kind.

A further alternative would have the federal government itself appoint trustees in bankruptcy from a pool of civil servants in the Department of Consumer and Corporate Affairs, or indeed from other

departments such as National Revenue. The appointments would be for centres other than the three mentioned in the announcement of 20 March 1972. During the interim period and until staff can be recruited, co-ordinating and supervisory officers at the three named centres could be appointed to oversee the implementation of the scheme in the smaller centres.

V. THE NEED FOR FURTHER ACTION

1. A Change in the Bankruptcy Act is Not Enough

The Council is of the opinion that the rising number of personal bankruptcies and the acute need for reform of bankruptcy legislation are symptomatic of major problems facing a large number of Canadians. On the whole, one can safely state that the reform of the Bankruptcy Act, while of benefit to the nation, cannot be considered as the sum total of needed efforts in dealing with the problem of personal indebtedness.

The following paragraphs contain a few suggestions as to further study and action in this respect.

(i) The Magnitude of the Problem of Personal Insolvency

Information on the total perspective of personal bankruptcies is not easily obtained. The appendices reveal some of the Council's estimates and show perhaps the need for more study of the individual's position.

a) The number of people involved:

Assuming that the recommendations of the Study Committee are adopted and implemented, the Council foresees (See Appendix A) that the total number of personal bankruptcies in Canada would be anywhere between 8,300 and 17,000 per year. The variation in the estimate is a function of the basic assumptions used and the methods of calculation. In addition to personal bankruptcies it is estimated that an additional 3,400 to 8,400 persons would avail themselves of the provisions of Part X or its equivalent. In total, the number of people that would come under some provi-

sion of the revised Bankruptcy Act is estimated as between 16,700 and 20,400 per year. There may be a substantial number of additional Canadians who are on or very close to the border line with respect to insolvency and these individuals along with those brought in under the provisions of the revised Bankruptcy Act are in need of assistance.

When one considers that each personal insolvency directly affects the family of the over-extended debtor, the number of Canadians involved by this problem would reach a total of 80,000. This, of course, only refers to the debtors and not the creditors.

b) The magnitude of the debts involved:

Should the Bankruptcy Act be revised, it is estimated that the costs directly attributable to personal bankruptcy will range between $52.8 and $88.8 million per year (See Appendix B); to this must be added the estimate of losses involved with arrangements expected to be effected under Part X ($2.9 - $7.3 million), thus bringing the total estimate of the cost of insolvency under the revised Bankruptcy Act to an amount between $60.1 and $91.7 million per year. The average cost per insolvency, be it bankruptcy or an arrangement under Part X, would range between $3,600 and $4,500.

It is important to bear in mind that these are estimates of annual rates of bankruptcy or insolvency and annual rates of losses.

(ii) The Role of Government With Respect to Large-Scale Insolvency

The Act which established the Department of Consumer and Corporate Affairs charged the Minister with the powers and function to:

> "initiate, recommend or undertake programs designed to promote the interests of the Canadian consumer."

It is the opinion of the Council that the increasingly acute problem of the insolvent consumer is one area where the Department can and should play an important role in promoting the interests of Canadian consumers.

A reference here may be made to the need to reconsider

the general framework of our economy and the aims and ambitions of the citizens in the appreciation of their way of living. It would in fact seem very proper to act upon the fundamental causes of personal insolvency, whatever the ultimate economic policy of our society. In a direct economic sense any reduction in the large magnitude of losses involved would be a substantial gain.

The important social consequences that stem from personal insolvency deserve attention on the part of the state. The stresses on the families directly involved in insolvency and on society as a whole cannot be ignored. An attack on such a universal and important source of social stress would substantially help the improvement of the quality of life for all Canadians.

(iii) Policy Options Available

Given the nature of the problem and the need for action, just what can be done? In part, the response to that question depends upon the basic policy adopted for reform.

It would be most useful to gather more information about individuals and groups of individuals who have suffered from insolvency. More research should be devoted in the determination of the actual causes of insolvency. Much of the basic material needed for that purpose is already available in the form of the reports filed with the Department of Consumer and Corporate Affairs in conjunction with personal bankruptcies and arrangements under Part X. Additional information could be easily obtained from people who are now directly involved in the granting of credit, credit counselling, and other activities.

Reports and other information that the Council has on hand indicate that most cases of personal insolvency can on the whole be attributed to three basic causes:

(a) the changed circumstances of the individual, sickness, unemployment, death of the principal wage earner

(b) limited income

(c) lack of knowledge on the use of credit, on family budgeting and personal financial management.

It is not, however, known how important each of those factors is as a cause of personal insolvency. The importance varies depending upon who is asked the question. Yet the virtual unanimity of all those involved in citing these three broad areas indicates at least, where possible action might be taken by the government.

a) Changed circumstances

The Study Committee has well perceived this aspect of the insolvent debtor's problems. Indeed, the facts speak for themselves: where a person has to carry the burden of unsuspected changes in his personal circumstances, all previous planning becomes obsolete. Our laws should afford him relief on that ground.

b) Low Income

It may seem obvious and redundant now to state that the lack of adequate income is a primary cause of insolvency. Until this basic problem of insufficient income can be resolved one can expect that the problem of the over-committed personal debtor will become an increasingly substantial issue. Whether the government opts to tackle this problem through economic stimulation, negative income tax or other forms of wide scale welfare programmes is a question of basic policy. It is clear, however, that this issue cannot be much longer ignored in the present circumstances.

There is a wealth of information on the extent and causes of the problems relating to low personal income in Canada, including the recent report of the Senate Committee and other materials from both government and other agencies. The Council would urge the government to support and implement programmes that will serve to eliminate this problem in Canada, for its solution will not only affect bankruptcies, but many other aspects of the nation's social and economic life.

c) Lack of Knowledge on the Use of Credit and Financial Management

The question of the lack of knowledge about the use of credit and financial management can be solved more easily through the services of both private agencies and the Department of Consumer and Corporate Affairs. In agreement with the Study Committee, the Council urges the Department to contribute help and financial support in order to improve and strengthen the existing credit counselling facilities and to initiate more such programs.

Such counselling should be easily accessible (not unlike the service that the Council has recommended in its Report on Consumer Education urging the establishment of nation-wide consumer information centres) and be located where the people with debt problems are most likely to be found. The emphasis of the counselling units should be on service, on helping the individual with his problems and on providing advice on the use of credit, the consequences following from such use, the family or personal budget, and information on where, if needed, legal help might be obtained. Such an operation could, in part at least, be combined with the announced program of public trustees with regard to personal bankruptcies.

The Province of Alberta has, for a number of years, been engaged in providing its residents with such counselling: such a service should be made available to all Canadians, regardless of their location. Appendix "C" of this report contains an estimate of the cost of providing such a service on a nation-wide scale. The estimate has been made on two different assumptions: first, the cost of providing counselling for those persons previously estimated as potential users of the reformed Bankruptcy Act; the cost for such persons would be approximately $600,000 to $735,000 per year. Alternatively, it has been assumed taht the number of persons that might seek such counselling would correspond on a per capita basis to the numbers that have asked for such assistance in Alberta under the Debtor's Assistance Program. In this case the cost of such a

program would be approximately $3.3 million per year. Given the figures arrived at concerning the average loss involved as a result of personal insolvency, the counselling service would show benefits equal to its costs should 167 bankruptcies be avoided under the first assumption or should 930 bankruptcies be avoided under the alternative assumption. The Council therefore believes that expectations of success in the order of 167 or 930 cases (depending on the above choice) are not too unreasonable. In fact, if the counselling was done in the proper fashion, and if it was supplemented by increased "debt and budgeting education" in the school system, the benefits to Canada as a whole would greatly exceed the projected costs.

(iv) Provincial Initiative and Co-Operation

The Report of the Study Committee unfortunately does not deal with the impact of provincial laws in the garnishment and execution areas affecting the over-committed consumer debtor. A recent study involving 250 debtors who consulted the Small Claims Court Referee in Toronto indicated that over 75% of the sample had had their wages garnisheed or threatened with garnishment; one-third had actually lost their employment because of a garnishment and over 10% had had some of their property seized. Several provinces have moved to review and, in some cases, change the laws of garnishment and execution. For example, in 1971, New Brunswick acted to exempt personal wages from garnishment and in 1970, Ontario amended its Employment Standards Act to prohibit the dismissal or suspension of an employee "upon the ground that garnishment proceedings are or may be taken against that employee". Other provinces have acted to increase or render more flexible the level of earnings to be protected from garnishment.

These actions emphasise two points. First, that the provinces exercise jurisdiction in garnishment and execution proceedings of crucial importance to the development of any national reform of bankruptcy and insolvency legislation. Secondly, that there is an

urgent need to enlist provincial initiative and co-operation towards the attainment of a uniform set of enlightened execution and garnishment laws which should be closely integrated with the federal provisions and run in tandem with them.

The Council wishes to underline the significance of the partnership of purpose and application between federal and provincial legislation as they affect the over-committed individual debtor; and in particular strongly recommends that:

(1) every effort be made to accelerate the preparation and adoption of a uniform set of provincial execution and garnishment laws that will properly compliment the federal laws;

(2) provincial governments be urged to consider favourably (failing abolition of wage garnishments) a system of debts review whereby a judge or court official such as a Registrar be empowered to examine the debtor's circumstances before any garnishment proceedings may be taken. He would have to be satisfied before an order is granted that the debtor is able to make a payment from his earnings. Such a system is presently in operation in the United Kingdom under the Attachment of Earnings Act, 1971, and deserves serious study in Canada;

(3) any revised Bankruptcy Act clearly provide that where an application has been made by a debtor for relief under one of the three schemes, all further execution and garnishment proceedings under provincial law should be stayed pending the disposition of the federal proceedings.

(v) The Need for Information

The implementation of the recommendations of the Study Committee and of the Council, especially where debt counselling and rehabilitation procedures are concerned, calls for a programme of information to the public on the type and location of services available.

Bringing the consumer to the service is often more difficult than organizing the service itself and all due care should be used to reach that goal.

VI. CONCLUSION

The Council believes that adoption of the recommendations submitted by the Study Committee, together with our additional comments and recommendations would result in an effective and useful reform of bankruptcy legislation affecting consumers in Canada, and that the adoption of our recommended program of financial counselling would make substantial strides towards reducing the occurrence of personal insolvency in Canada. The Council feels that such a program is needed and that, on the basis of its estimates it can easily be justified both in economic and social terms.

We look forward to receiving the response of the Department of Consumer and Corporate Affairs to our suggestions.

APPENDIX A

Number of Personal Bankruptcies and Part X Applications

I. Personal Bankruptcies

The Council has estimated the number of personal bankruptcies, given the acceptance of the recommendations of this report, as between a lower bound of 8,300 and an upper bound of 17,000. These estimates were derived as follows:

A. Lower Bound

In 1971, some 1,700 consolidation orders were made under Part X in the six provinces which have accepted this Part.[1] The provinces are British Columbia, Alberta, Saskatchewan, Manitoba, Prince Edward Island and Nova Scotia.

In 1970, these provinces accounted for 12% of all personal bankruptcies.[2] It is assumed on this basis that actual Part X applicants represent 12% of potential applicants could in effect have applied under Part X in all provinces if it had been available to them. Thus, we estimate potential Part X applicants as approximately 14,000 (1,700 ÷ .12).

It is then assumed that, were personal bankruptcy available, 40% of these potential applicants would opt for bankruptcy over Part X. At present, many individuals under Part X are not capable, nor do they wish to make an arrangement, but they cannot afford personal bankruptcy. Given access to inexpensive facilities, it is assumed that they would opt for relief through bankruptcy. To support our 40% assumption we refer to the 3 sources of data: (1) a study of a sample of debtors under the Lacombe law (art. 652, Code of Civil Procedure, Quebec's counterpart of Part X) showed that 20.4% made no payments at all in the nine months following their application and 48% were delinquent in their payments.[3]

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1. Summary of the Annual Reports of the Provinces. Bankruptcy Branch, Department of Consumer and Corporate Affairs.
2. Report of the Superintendent of Bankruptcy.
3. J.S. Ziegel, "Consumer Credit and the Lower Income Family". Canadian Welfare Council, 1970, p.45.

(2) The same study showed that if payments that were made were maintained at the same rate over a five-year period, only 39.6% of the debtors would have discharged their debts in full at the end of this period.[4] (3) Finally, statistics on consolidation under Part X administered by the Debtors' Assistance Board in Alberta show that of 596 orders in effect, 45% were over 90 days in arrears. In addition, of 1,018 orders taken up to December 30/71, 27% had either defaulted, been discontinued by the debtor or had gone into bankruptcy.[5]

On the basis of the assumption that 40% of potential Part X applicants would choose personal bankruptcy if available, it is estimated that 5,600 personal bankruptcies would take place (14,000 X .40). Actual non-business bankruptcies filed in 1970 were 2,700.[6] Assuming 1971 bankruptcies to at least match this figure, we arrive at a total estimate of personal bankruptcies as 2,700 + 5,600 = 8,300. This is considered to be a minimum estimate. No account has been made for individuals who could not afford bankruptcy nor had the financial resources to make an arrangement. Addition of this unknown quantity would obviously increase the estimate.

B. Upper Bound

Alternatively, an estimate has been made of potential personal bankruptcies by extrapolating from experience in the United States. In 1970, there were 178,202 personal bankruptcies filed in the U.S.[7] As the American legislation closely approximates the type of system that would evolve were the recommended changes instituted in Canada,

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4. J.S. Ziegel, "Consumer Bankruptcies and the Report of the Bankruptcy Committee", Bankruptcy Seminar, Canadian Consumer Council, p. 12.
5. Data from Alberta Debtors' Assistance Board.
6. Report of the Superintendent of Bankruptcy, 1971.
7. "Bankruptcy", Brookings Institution. Washington, p. 25.

one might assume the same number of personal bankruptcies in Canada as in the U.S. Using a scale factor of 10, this would produce an estimate of 17,820 personal bankruptcies in Canada.

It has in addition been assumed that there would be a lag of seven years in credit facilities and use in Canada.[8] By applying the 1964 personal bankruptcy rate in the U.S. (135.0 per 100,000 population over 20) there results an estimate of 17,000 personal bankruptcies in Canada for 1971. This is a maximum of potential personal bankruptcies.

II. Part X Applications

A. Lower Bound

In the United States, experience with Chapter XIII (a section of the U.S. bankruptcy legislation similar to the recommended Part X) has shown that 1 out of 5 over-committed debtors choose Chapter XIII over personal bankruptcy.[9] Assuming 17,000 personal bankruptcies, and equivalent behaviour in Canada, this would imply 3,400 Part X applications.

B. Upper Bound

On the other hand, from the previous estimates of 14,000 potential Part X applicants, 40% of whom choose bankruptcy there results an estimate of 8,400 Part X applicants. This is considered as a maximum figure.

To calculate the lower and upper bounds of cases of insolvency (bankruptcy and Part X) the lower bound of bankruptcies has been added to the upper bound of Part X and, conversly, the upper bound of Part X has been added to the lower bound of bankruptcies. This has been done in view of the fact that Part X and bankruptcy are mutually exclusive. Fewer Part X cases imply more personal

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8. "Our forms of credit follow closely those developed in the United States, although there is usually a five to ten year time lag.", J.S. Ziegel, Aspects of Comparative Commercial Law.

9. Bankruptcy, Brookings Institution, Washington, p. 74.

bankruptcies. Consequently, the lower bound of the number of insolvencies is 8,300 + 8,400 = 16,700; and the upper bound 3,400 + 17,000 = 20,400.

APPENDIX B

Costs of Insolvency

The costs of insolvency are divided into two categories: (1) deficiency, and (2) administrative. The deficiency is the loss to the creditors.

A. Bankruptcy

The deficiency on the 2,700 non-business bankruptcies filed in 1970 was $33 million.[1]

The average debt on Part X applications in 1971 was $4,100.[2] This is assumed to be the average debt of potential personal bankrupts. A maximum dividend of 6¢ on the dollar is also assumed.[3] On this basis, the deficiency per case is $3,854. Deficiency on 5,600 cases (Part X potentials) is 5,600 X $3,854 = $21,582.

On 14,300 bankruptcies (17,000 possible - 2,700 actual) the deficiency would be $55,116. Therefore, upper and lower bounds on deficiency costs of bankruptcy are $21.6 + $33.0 = $54.6 million and $55.1 + $33.0 = $88.1 million.

In addition a minimum administration cost of $50 is assumed which is the equivalent of the proposed trustee fee.

Lower limit of administration costs thus totals $50 X 5600 = $280,000; and upper = $715,000.

Total costs of personal bankruptcy are thus calculated as: lower bound is $54.6 + .3 = $54.9 million; and upper is $88.1 + .7 = $88.8 million.

B. Part X

The average debt for 1971 Part X applicants was $4,100. A deficiency of 20% is assumed, i.e., an average of $820 per case. This deficiency is to take into account defaults and arrangements of composition.

Deficiency costs are thus calculated as: lower bound - 3,400 X $820. = $2,788 thousand; upper bound - 8,400 X $820. = $6,888 thousand.

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1. Report of the Superintendent of Bankruptcy.
2. Summary of the Annual Reports of the Provinces, 1971.
3. The Study Committee Report, p. 89 stated, "almost all consumer bankruptcies are no asset or nominal asset cases in which the creditors get nothing". We use 6¢ as a maximum dividend to allow for some return on asset cases.

For administration costs a very conservative estimate of $50 has been used. This only covers the court costs. On this basis costs are estimated as $170 thousand and $420 thousand respectively. Costs of Part X are therefore a minimum of $2.9 million and a maximum of $7.3 million.

To determine the total costs of insolvencies, as for the number of insolvencies, the lower cost of bankruptcy and the upper of Part X are added, and vice versa. The result is:

minimum cost of insolvency = $62.2 million

maximum cost of insolvency = $91.8 million

The average costs of insolvency are derived by dividing the costs by the estimated number of cases. This produces average costs of $3,725 and $4,499 for a minimum and maximum respectively.

APPENDIX C

Costs of Debt Counselling

Costs of debt counselling were derived in two ways. One assumed counselling only for the estimated cases of insolvency, the other, considered a more generalized system cross-country counselling.

Both methods assumed an average cost per case as $36. This cost was arrived at as a compromise between the cost estimated from experience of the Credit Counselling Service of Metropolitan Toronto, which averaged $48[1] per case and that of the Alberta Debtors' Assistance Board which averaged $16[2] per case.

(1) Counselling only individuals who have been estimated as potential Part X or bankruptcy cases. The minimum and maximum number of cases of insolvency were estimated as 16,700 and 20,400 respectively. These persons are considered to constitute the minimum number requiring debt counselling. To counsel only this group would thus cost between $601 and $734 thousand. Consequently, if counselling of this group of overcommitted debtors reduced the incidence of Part X or personal bankruptcy by 1% (i.e., 161 cases out of 16,700), using minimum estimates or by .8% (163 cases out of 20,400), then the costs of providing the counselling would equal the saving realized by the reduction of casualties.[3]

(2) General Counselling

Alternatively, the cost of a more universal scheme of counselling has been considered. As a basis for estimates, data from the experience of the Alberta Debtors' Assistance Board which provides counselling services for the whole province has been used. In 1971, 7,000 individuals turned to the Board for some type of counselling. If the same number of persons per 10,000 population requested counselling in all of Canada, this would imply 92,790 cases. Again, a cost of $36 per person

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1. The 1971 budget of $90,000 divided by 1,875 cases counselled.
2. A budget of $115,000 and 7,000 cases. The Alberta Debtors' Assistance Board is partially subsidized by the government in that it has rent free office space in the court houses, etc. This accounts for much of the difference in the average cost between Alberta and Metro Toronto. On the other hand, given high wage rates and rents in Toronto, we consider the $48 figure an above average one.
3. These numbers were calculated by dividing the minimum/maximum cost of counselling by the minimum/maximum average cost of insolvency, i.e., $601,000 ÷ $3,725 and $734,000 ÷ $4,499 ≅ 163.

is assured to provide counselling. Thus, as a very rough estimate of the cost of counselling were it provided across the country, would represent an expenditure of $3,34 million.

In cost/benefit terms, to support such an expenditure, the break-even point would be a reduction of the cases of insolvency by 3.6% to 5.4%.[4]

4. As in the other estimates, we divided the cost of counselling by the minimum/maximum average cost of insolvency. The result was divided by the minimum/maximum number of cases.

SUMMARY OF RECOMMENDATIONS OF THE CONSUMER COUNCIL IN SUPPORT OF THE RECOMMENDATIONS OF THE STUDY COMMITTEE

Bankruptcy Legislation

1. The Council supports the emphasis of the Study Committee on the concepts of equity, universality and social relevance. (p.4)*

2. The Council agrees with the recommendation that there should be no minimum amount of debts necessary to enable a person to enter into a voluntary bankruptcy. (p.5)

3. The Council also agrees that in the case of an involuntary bankruptcy, the amount of debt that must be owed to the petitioning creditor (or creditors) should remain at one thousand dollars. (p.5)

4. The Council welcomes (a) the prohibition imposed on a secured creditor to treat a petition in bankruptcy against his debtor as a deemed or technical default of payment in the absence of an actual default; (b) the obligation imposed on the secured creditor to prove both the value and validity of the security before he can claim possession and realize his security and, (c) the outlined procedures for establishing the value of a deficiency between the claim of a secured creditor and the proceeds obtained from the fact of taking possession or from the realization of the security. (p.6)

5. The Council agrees with the Study Committee recommendation that the present after-acquired property provisions should be repealed. (p.11)

6. The Council strongly supports the recommendation of the Study Committee concerning a stay of all proceedings against the debtor as soon as he proposes an arrangement. (p.15)

7. The Council also fully supports the recommendations of the Study Committee relating to harsh, onerous and unconscionable transactions and to the disclaimer of executory contracts or leases. (p.15)

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* Page numbers refer to body of Council's Recommendations

8. The Council supports the recommendation of the Study Committee that while the term allowed for an arrangement (extension or consolidation) may not exceed three years it is necessary to provide conditions under which the debtor could be allowed to suspend his payments and to make up, at the end of the arrangement, the payments he has missed. (p.15)

Credit Counselling

9. In agreement with the Study Committee, the Council urges the Department to contribute help and financial support in order to improve and strengthen the existing credit counselling facilities and to initiate more such programs.

SUMMARY OF ADDITIONAL RECOMMENDATIONS OF THE CONSUMER COUNCIL ON THE PROBLEM OF CONSUMER INSOLVENCIES AND BANKRUPTCY

Bankruptcy Legislation

1. The Council recommends more detailed analysis of consumer insolvency and bankruptcy situations in order to determine cause and effect relationships. (p.4)

2. The Council considers that the federal jurisdiction over bankruptcy justifies the determination of properties and assets that would be exempt from seizure in bankruptcy procedures over and above the exemptions established by the provinces. (p.5)

3. The Council recommends that serious consideration be given to the possibility of exempting from seizure in bankruptcy proceedings all personal and household effects and belongings, the basic tools of trade of the bankrupt and his homestead or principal residence, subject to the possible exception of the vendor's lien or privilege in this last instance. (p.5)

4. The same principles that justify exemption from seizure and sale with respect to unsecured creditors are, in the Council's view, equally applicable with respect to secured creditors. (p.7)

5. The vendor of a house who remains a secured creditor with respect to the sale price should be protected from suffering the consequences if the purchaser petitions for bankruptcy. The Council recommends that serious consideration be given to the possibility of having the Central Mortgage and Housing Corporation (or other similar body) intervene in such circumstances to guarantee the reimbursement of the claim of the vendor just as it guarantees the reimbursement of first secured loans by institutions. (p.8)

6. The Council recommends that in bankruptcy and rehabilitation procedures a new category of preferred creditors be added to the list: alimony pension creditors. (p.8)

7. The Council recommends that security obtained through a floating charge or general security should not be available to a trustee in bankruptcy or enforceable in insolvency proceedings. (p.9)

8. Where consolidation, extension or composition is concerned, the Council recommends that any security taken by a creditor to secure new advances or credit to a small debt, other than property purchased with that credit, should be void against creditors remedies. (p.10)

9. The Council suggests that creditors who have a security over the immoveable property of a small debtor should not be able to realize their security where two-thirds of the principal amount has been paid. (p.11)

10. Unlike the Study Committee, the Council believes that sudden and unexpected wealth arising after a bankruptcy (such as inheritance, or earnings at a lottery) should be exempt from the trustee's and creditor's reach. (p.12)

11. The Council disagrees with the Study Committee recommendation that the Court be given the power to annul a release of debts arising from a bankruptcy that follows within five years of a previous bankruptcy. The Council considers that potential abuses should be corrected not by civil measures that revive the pre-bankruptcy situation, but by penal or criminal procedures designed to prevent abuses and fraud. Being a matter of right, bankruptcy should be made available to debtors as often as it is needed, without punitive measures of a civil nature. (p.12)

12. The Council strongly recommends the universal application of Part X. (p.14)

13. The Council recommends that the ceiling on debts allowed under Part X without the creditors consent should be removed. (p.14)

14. The Council does not see any reason for the exclusion of business and self-employed debts in an arrangement under Part X. The Council thus recommends that the debtor be able to include all his debts in the arrangement in order to benefit fully from the rehabilitation procedure. (p.14)

15. The Council feels that public debts should be included in Part X extensions. (p.15)

16. With respect to unconscionable transactions and contracts, the Council suggests that a court official be given discretionary power to allow relief from such transactions or contracts. (p.15)

17. Where a creditor can prove that a proposed consolidation is not in the best interest of the creditors, the Council feels that automatic bankruptcy suggested by the Study Committee may not be the best solution. The Council recommends that in such a case, creditors be allowed to take whatever course of action they consider appropriate. (p.16)

18. In view of the heavy burden placed upon a debtor by an arrangement, the Council recommends that:

    (1) the use of Part X be entirely voluntary;

    (2) the debtor be given the right to apply for bankruptcy at any time;

    (3) one default should not result in the loss of the protection afforded by Part X, and

    (4) the court should, in the event of default of one payment, have the power to arrange for Part X payments to be deducted at the source of income of the debtor.

19. The Council does not agree with the Study Committee recommendation that creditors who extend credit less than 60 days prior to the debtors petition for an arrangement should be able to enforce their security. The Council recommends that the 60 day reservation be dropped.

20. The Council believes that in an arrangement by way of extension, the enforcement of all security over moveables should be suspended and debts due to secured creditors be rescheduled over the three year period as with other creditors. On the other hand, should default occur during this period, the normal remedies of creditors will revive, including the secured creditor's right to enforce his security. (p.19)

21. The Council has come to the conclusion that there is an even stronger case for adopting a similar approach with security over immoveables.(p.

22. The Council considers that, as with an extension, a secured creditor's rights should be "frozen" in a composition, and he should file in

the composition and receive a dividend in the composition like other creditors. (p. 20)

23. The Council recommends that in the case of a composition a debtor may apply to the court for an order preventing enforcement of an immoveable security while he adheres to the terms of the composition. The deferred payments would be added to the end of the term of the secured debt which would fully revive once the composition terminated. (p.21)

24. It would appear to the Council that whatever measures are available should be taken to discourage a debtor from adopting the practice of acquiring new creditors if he is to benefit from the rehabilitation procedure. Perhaps penal or quasi criminal offences should be introduced as a deterrent. (p.22)

25. The Council considers that once a debtor has created after-acquired debts which he is unable to pay out of the non-seizable portion of his income, then the objective of an arrangement either of extension or composition has failed, and there is no alternative but to treat it as at an end. (p.23)

Small Debtors Programme

26. The Council recommends that the proposed filing fee of $50 be removed. (p.24)

27. The Council feels that the use of income criterion in the small debtors programme is unduly restrictive. The debtor's need for assistance should be the over-riding consideration in each case. (p.25)

28. The Council believes that a debtor should be able to include debts incurred while self-employed in bankruptcy proceedings under the small debtors programme. (p.25)

29. The Council strongly recommends that the small debtors programme be extended to cover the whole population as soon as administratively feasible. (p. 25)

Provincial Initiative and Co-operation

30. The Council strongly recommends that every effort be made to accelerate the preparation and adoption of a uniform set of provincial execution and garnishment laws that will properly complement the federal laws. (p.32)

31. The Council strongly recommends that provincial governments be urged to consider favourably (failing abolition of wage garnishments) a system of debts review whereby a judge or court official such as a Registrar be empowered to examine the debtor's circumstances before any garnishement proceedings may be taken. He would have to be satisfied before an order is granted that the debtor is able to make a payment from his earnings. Such a system is presently in operation in the United Kingdom under the Attachment of Earnings Act 1971 and deserves serious study in Canada. (p.32)

32. The Council strongly recommends that any revised Bankruptcy Act clearly provide that where an application has been made by a debtor for relief under one of the three schemes, all further execution and garnishment proceedings under provincial law should be stayed pending the disposition of the federal proceedings. (p.32)