

# THE OVERSEAS DIMENSION: WHAT CAN CANADA AND THE UNITED STATES LEARN FROM THE UNITED KINGDOM?<sup>©</sup>

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The United States and, to a slightly lesser extent, Canada have come to regard personal bankruptcy as a routine method of discharging debts, enabling the debtor to make a fresh start. By contrast, in the United Kingdom, bankruptcy is still seen as a remedy of last resort, and creditors may retain the right to enforce debts. The difference in approach is due to the fact that the United States and Canada have traditionally given priority to risk taking over security, while the United Kingdom has continued to give priority to security over risk taking. However, the British government's enthusiasm for flexible labour markets and entrepreneurship suggests that this may be about to change. While many people in the United States are having second thoughts about their liberal approach to bankruptcy, and the American government is coming under intense pressure from the credit industry to make it harder for people to protect their assets, the British government has recently set in train a review of the legal and social framework of bankruptcy to see whether Britain can learn from the American experience.

Les États-Unis et, dans une moindre mesure, le Canada sont arrivés à considérer la faillite personnelle comme une méthode routinière pour décharger des dettes, rendant possible au débiteur de faire un nouveau départ. Par contre, dans le Royaume-Uni, la faillite est toujours considérée comme un remède de dernier recours, et les créanciers pourraient garder le droit d'enforcer les dettes. La différence dans l'approche est due au fait que les États-Unis et le Canada ont traditionnellement donné la priorité à la prise de risques plutôt qu'à la sécurité, tandis que le Royaume-Uni a continué à donner la priorité à la sécurité plutôt qu'à la prise de risques. Pourtant, l'enthousiasme du gouvernement britannique pour les marchés de travail plus flexibles et l'entrepreneuriat, suggère que cela est sur le point de changer. Tandis que beaucoup de gens aux États-Unis commencent à réfléchir sur leur approche libérale à l'égard de la faillite, et le gouvernement américain se trouve sous une grande pression de la part de l'industrie des crédits afin de rendre plus difficile aux gens de protéger leur actifs, le gouvernement britannique a récemment mis en marche une révision du cadre légal et social de la faillite pour voir si la Grande Bretagne pourrait s'inspirer de l'expérience américaine.

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## I. INTRODUCTION

I want to say at the outset that I am an enthusiast for comparative socio-legal research, not least because (and this is particularly so when one of the countries which is being compared is your own) it forces you to question institutions and practices which you might otherwise take for granted. However, we need to be very wary about the prospects for legal and other institutional transplants—*i.e.*, about the prospects for successfully uprooting and transplanting legal rules and institutional arrangements from one socio-economic and legal environment to another, perhaps, very different one.

### A. *Insolvency in the United Kingdom*

Since there are two separate jurisdictions in the United Kingdom, I shall deal separately with England and Wales, and with Scotland.

#### 1. England and Wales

The government of the day described the *Insolvency Act 1986* as a reforming *Act* that was designed to address and ease the growing problem of personal indebtedness by tipping the balance, ever-so-slightly, in favour of the relief and rehabilitation of the debtor. The *Act* introduced a number of changes, perhaps the most important of which was the automatic discharge of most bankrupts after three years<sup>2</sup>—the exceptions being where the debtor has been bankrupt before (during the previous fifteen years),<sup>3</sup> or has not cooperated with the Official Receiver or trustee who has supervised the bankruptcy.<sup>4</sup>

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<sup>1</sup> (U.K.), 1986, c. 45.

<sup>2</sup> *Ibid.* s. 279.

<sup>3</sup> *Ibid.* s. 279(1)(a).

<sup>4</sup> *Ibid.* s. 279(3).

The passage of the *Act* resulted in a substantial increase in the number of individual bankruptcies—bankruptcy orders increased from 7,093 in 1986<sup>5</sup> (the year before the *Act* came into effect) to 32,106 in 1992—*i.e.*, by 353 per cent over six years. However, for reasons that are far from clear, the number of bankruptcy orders has fallen each year since then—the number fell to 19,892 in 1997, a decrease of 36 per cent in five years. The introduction of individual voluntary arrangements<sup>6</sup> does not explain the fall in the number of bankruptcy orders—they rose to a peak of 5,679 in 1993, but have fallen off somewhat since then, numbering 4,545 in 1997.<sup>7</sup>

In light of trends in the number of consumer bankruptcies in other jurisdictions, and other contextual developments—for example, the growth of consumer credit—it is unlikely that the (slight) liberalization in bankruptcy law brought about by the *Insolvency Act 1986* can account for more than part of the early increase in the number of bankruptcy orders. Thus, most of the early increase and all of the subsequent decrease remain to be accounted for.

## 2. Scotland

Prior to the passage of the *Bankruptcy (Scotland) Act 1985*<sup>8</sup> there were very few personal bankruptcies in Scotland. This was mainly because a trustee had to be paid out of the debtor's assets, and where there were insufficient assets to pay the trustee in full, it was difficult to persuade a trustee to act. In order to deal with this problem, the 1985 *Act* introduced public funding of "small assets cases"<sup>9</sup>—to the extent that the debtor's assets were insufficient, the trustee was reimbursed by taxpayers.

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<sup>5</sup> See Lord Chancellor's Department, *Judicial Statistics: England and Wales* (London: Her Majesty's Stationery Office, 1986).

<sup>6</sup> See *Insolvency Act 1986* *supra* note 1, s. 252.

<sup>7</sup> See Appendix, Table 1, below, for the annual numbers of bankruptcy orders and individual arrangements from 1988-1997.

<sup>8</sup> (U.K.), 1985, c. 66.

<sup>9</sup> See *ibid.* Schedule 2. Note that Schedule 2 does not actually use the term "small assets," but the procedures outlined in it come into play where the debtor's assets are insufficient to pay for the remuneration of trustees, and the court determines that these costs should be met by taxpayers out of a public fund.

After the passage of the *Act*, there was a huge increase in the number of awards of sequestration.<sup>10</sup> In 1985-1986 (the year before the *Act* came into effect) there were 298 sequestrations;<sup>11</sup> three years later, in 1988-1989, there were 1,612; and by 1992-1993 the number had risen to 11,970—a 4,000 per cent increase over seven years.<sup>12</sup>

The increase was due to an unintended anomaly in the *Act*, known as the “trust deed route.” Under the *Act*, sequestration could be granted on the petition of the creditor or creditors.<sup>13</sup> However, a trustee under a trust deed had title to petition for sequestration without consent<sup>14</sup> and, encouraged by the Citizens Advice Bureaux, Money Advice Centres, and other debt counselling agencies, debtors increasingly took advantage of this loophole.

Insolvency practitioners who acted as trustees were clearly on to a good thing—prior to the introduction of block payments in 1990,<sup>15</sup> the average payment to trustees was almost £3,000 (C\$7,500) per case. Subsequently, they received a block payment of £1,800 (C\$4,500) plus a second payment of £250 (C\$625), and further small payments in lengthy cases. However, debtors were clearly prepared to go along with this, presumably because they regarded sequestration as being in their best interests. Although a stigma still attaches to bankruptcy in the United Kingdom, it is undoubtedly less than it was; debtors are protected from attempts by creditors to enforce court decisions, or to pressure them into paying in other ways and, after three years, they receive an automatic discharge.<sup>16</sup> However, the cost to the taxpayer was quite considerable. Prior to the 1985 *Act*, the Scottish system of sequestration was effectively self-financing and, in proposing the legislation, the Scottish Law Commission made a serious miscalculation: they anticipated an additional annual expenditure of about £30,000–40,000 (C\$75,000–100,000) but, by 1990-1991, the cost had risen to £10 million (C\$25

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<sup>10</sup> “Sequestration” is the name usually given to the court procedure which follows on a petition by the debtor or a creditor for the appointment of a trustee. The strict meaning of the term is a judicial order that transfers property from the control of its possessor.

<sup>11</sup> See B. McBryde, “The Scottish Experience of Bankruptcy” in H. Rajak, ed., *Insolvency Law: Theory and Practice* (London: Sweet & Maxwell, 1993) 117 at 117.

<sup>12</sup> See Appendix, Table 2, below.

<sup>13</sup> See *Bankruptcy (Scotland) Act 1985* *supra* note 8, s. 59.

<sup>14</sup> *Ibid.* s. 5(2)(c).

<sup>15</sup> Circular letter from the Accountant in Bankruptcy to trustees (14 September 1990).

<sup>16</sup> See *Bankruptcy (Scotland) Act 1985* *supra* note 8, s. 54.

million) and, by 1993-1994, to £26 million (C\$65 million).<sup>17</sup> Although some people continued to agree that “wiping the slate clean” was in the public interest, the “trust deed route” to sequestration provided a massive subsidy to private insolvency practitioners, and the escalating cost of the scheme appeared to have no end. Inevitably, perhaps, the government determined to put a stop to it.

The loophole was plugged by the *Bankruptcy (Scotland) Act 1993*,<sup>18</sup> which ended a trustee’s power to petition for sequestration without the creditors’ consent. Under the *Act*, trustees can still petition for sequestration, but this will only be granted if the court decides that it is in the best interests of the creditors, or if the debtor has failed to honour the terms of the trust deed.<sup>19</sup> The Accountant in Bankruptcy, a public official whose role is analogous to that of the Official Receiver in England and Wales, now acts as trustee in all sequestrations—except those where an insolvency practitioner is elected or appointed by the creditors—and may either administer the sequestration using his or her own staff, or appoint agents to do so under contract. In addition, the *Act* empowers the court to award sequestration without the concurrence of the creditors if they have taken legal steps to enforce the debt, or have objected to the registration of a protected trust deed.

As a result of the 1993 *Act*, the “trust deed route” to sequestration came to an abrupt end. At the same time, there was an increase in the number of sequestrations initiated by the debtor but without the agreement of the creditors,<sup>20</sup> and an increase in the number of registered protected trust deeds. After a rapid fall (which, unlike the smaller decrease in England and Wales, *can* be attributed to legislative changes), the number of sequestrations appears to have settled down at around 2,500 per year, and the number of insolvencies at around 3,500 per year, both totals growing at between 5–10 per cent per year.<sup>21</sup> The cost to the taxpayer has likewise settled down at around £2.8 million (C\$7 million) per year<sup>22</sup>—*i.e.*, about 10 per cent of what it had been a few years before.

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<sup>17</sup> Accountant in Bankruptcy, *Annual Report for 1997/98* (Edinburgh: Accountant in Bankruptcy, 1998) at 3 [hereinafter *Annual Report*].

<sup>18</sup> (U.K.), 1993, c. 6.

<sup>19</sup> *Ibid.* s. 3, amending *Bankruptcy (Scotland) Act 1985* *supra* note 8, s. 5.

<sup>20</sup> See Appendix, Table 3, below.

<sup>21</sup> See Appendix, Table 2, below.

<sup>22</sup> See *Annual Report* *supra* note 17 at 3.

B. *What Can Canada and the United States Learn From the United Kingdom?*

My answer to the question that I was asked to address is pretty clear—very little. First of all, the contexts are very different. Some rough-and-ready calculations based on the data compiled by Trent Craddock indicate that the amount of consumer credit per head of population is approximately US\$5,000 in the United States; C\$3,000 in Canada; and £2,000 in the United Kingdom.<sup>23</sup> The credit economy in the United Kingdom resembles that in North America some years ago.

Second, the legal responses to debt or default are completely different. The data in Craddock's study illustrates this very clearly. The insolvency rates in the three countries are approximately 5.0 per 1,000 population in the United States; 3.0 per 1,000 population in Canada; and 0.5 per 1,000 population in the United Kingdom. Moreover, since about 40 per cent of personal bankruptcies in the United Kingdom are instigated by creditors, the United Kingdom figure inflates the extent to which personal bankruptcy is used as a remedy by debtors.

Consumer credit plays a very important, and growing, role in stimulating consumption and fostering growth in most capitalist societies. Inevitably there will be casualties, people who take on commitments that they are subsequently unable to meet, but societal responses to this situation vary a great deal. The United States and, to a slightly lesser extent, Canada, have come to regard personal bankruptcy as a routine method of discharging debts, enabling the debtor to make a fresh start. By contrast, the United Kingdom has not: although creditors may, at some point, choose to write off their debts, they retain the right to enforce them, and bankruptcy in the United Kingdom is still seen as a remedy of last resort.

Where does this leave us? In the United Kingdom, we continue to rely heavily on debt enforcement through the courts, although judgments entered, and the number of warrants of execution granted, have not increased much over time. This is largely due to what has been termed "systemic rationalization"—developments in consumer credit that have increased the attractiveness of settlement without resort to the

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<sup>23</sup> See T. Craddock, "International Consumer Insolvency Statistics" (Conference on the Contemporary Challenges of Consumer Bankruptcies in a Comparative Context, Faculty of Law, University of Toronto, 21-22 August 1998) [unpublished].

courts.<sup>24</sup> These developments, which have been many and varied, include: (1) changes in the range of available credit facilities to allow for more flexible payment of debts, such as the increased use of credit cards; (2) the increased dominance in the credit market of larger companies that can afford to finance the rescheduling of repayments without suffering undue financial hardship; (3) the increased use of direct debit, standing order and overdraft facilities to ease the repayment of debts, and the similar effect of more direct deductions from wages and social security payments; and (4) the increased use of pre-payment arrangements, especially in the utilities industries.

These changes notwithstanding, I certainly do not wish to give the impression that everything in the garden is rosy. Far from it—the benchmark survey of credit and debt by Richard Berthoud and Elaine Kempson<sup>25</sup> drew a grim picture of the extent of debt and its insidious effects on those concerned, especially on those with low incomes, most of whom are dependent on social security. The Blair government is seriously committed to an ambitious set of programs, collectively known as the “New Deal,” which attempt to get people off welfare and into work, but, to the extent that people do move into employment, any debts they may have will again become targets for creditors. The New Deal would be much more attractive to those receiving benefits if, by making themselves insolvent or by some other means, they were able to make a fresh start.

## II. CONCLUSION

Although I believe that North Americans have rather little to learn from the United Kingdom as regards bankruptcy, I also believe (in spite of the “health warning” I gave at the outset) that the United Kingdom has a good deal to learn from the general approach to insolvency adopted in the United States and Canada. The United States and (to a slightly lesser degree) Canada’s enthusiasm for market capitalism has reflected a preference for risk over security. However, the United States and Canada have also recognized that this will inevitably

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<sup>24</sup> See R.A. Kagan, “The Routinization of Debt Collection: An Essay on Social Change and Conflict in the Courts” (1984) 18 L. & Soc. Rev. 323; and M. Adler & D. McMillan, “Credit and Debt” in G. Fyfe, ed., *Poor and Paying for It: The Price of Living on a Low Income* (Edinburgh: Her Majesty’s Stationery Office, 1994).

<sup>25</sup> See R. Berthoud & E. Kempson, *Credit and Debt: The PSI Study* (London: Policy Studies Institute, 1992).

produce some casualties, that success for some will be achieved along with failure for others, but that these casualties can be rehabilitated through bankruptcy by giving those who fail the opportunity to try again. In the United Kingdom, we have traditionally given priority to security over risk but, in recent years, we have begun to embrace flexible labour markets and entrepreneurship—in short, to promote uncertainty and risk. However, with one or two notable exceptions,<sup>26</sup> little attention has been given to the problem of how best to deal with the adverse consequences of this strategy.

This situation may be about to change. According to a report in *The Guardian*,<sup>27</sup> the British government has recently set in train a review of the legal and social framework of bankruptcy to see if Britain can learn from the American experience. Somewhat perversely, we are doing so just at the time when many people in the United States are having second thoughts about their liberal approach to bankruptcy, and the American government is coming under intense pressure from the credit industry to make it harder for people to protect their assets. However, I hope that the review set up by the British government will come to recognize the merits of what, in spite of the many differences between the United States and Canadian approaches, we can nevertheless refer to as the North American approach to insolvency. I do not favour a residual welfare state in which the role of government is restricted to the provision of a safety net for society's casualties. On the contrary, I favour a more institutional welfare state in which the government plays a leading role in promoting the welfare of all its citizens. However, it is a mistake to think that an institutional welfare state does not need a social safety net.

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<sup>26</sup> See, for example, W. Hutton, "High Risk Strategy" *The [Manchester] Guardian* (30 October 1995) 2-2.

<sup>27</sup> See W. Lightfoot, "Labour Takes Gamble With Bankruptcy" *The [Manchester] Guardian* (22 March 1999) 19.

## APPENDIX

**TABLE 1**  
**INSOLVENCY IN ENGLAND AND WALES**  
**1988–1997**

<i>Year</i>	<i>Bankruptcy Orders</i>	<i>Deeds of Arrangement</i>	<i>Individual Voluntary Arrangements</i>	<i>Total</i>
1988	7,717	11	779	8,507
1989	8,138	3	1,224	9,365
1990	12,058	2	1,927	13,987
1991	22,632	6	3,002	25,640
1992	32,106	2	4,686	36,794
1993	31,016	8	5,679	36,703
1994	25,634	2	5,103	30,739
1995	21,933	2	4,384	26,319
1996	21,803	2	4,466	26,271
1997	19,892	4	4,545	24,441

Source: For data from 1988-1991, see Lord Chancellor's Department, *Judicial Statistics: England and Wales* (London: Her Majesty's Stationery Office, 1988), and similarly titled reports for each successive year. A compilation of the data from 1992-1997 is available through the Department of Trade and Industry Statistical Directorate: see online: The Insolvency Service <[www.dti.gov.uk/insolv\\_s/insolvhm.htm](http://www.dti.gov.uk/insolv_s/insolvhm.htm)> (date accessed: 22 June 1999).

**TABLE 2**  
**INSOLVENCY IN SCOTLAND**  
 1988/89–1997/98

<i>Year*</i>	<i>Sequestrations</i>	<i>Registered Protected Trust Deeds</i>	<i>Total</i>
1988/89	1,612	10	1,622
1989/90	2,618	12	2,630
1990/91	5,451	3	5,454
1991/92	8,587	1	8,588
1992/93	11,970	2	11,972
1993/94	4,022	282	4,304
1994/95	2,340	424	2,764
1995/96	2,380	525	2,905
1996/97	2,534	532	3,066
1997/98	2,701	890	3,591

Source: Accountant in Bankruptcy, *Annual Report for 1997/98* (Edinburgh: Accountant in Bankruptcy, 1998) at Tables (i), (iv).

\* Year beginning 1 April and ending 31 March.

**TABLE 3**  
**SEQUESTRATIONS IN SCOTLAND**  
 1988/89–1997/98

<i>Year*</i>	<i>Initiated by Debtor With Creditor Concurring</i>	<i>Initiated by Debtor Without Creditor Concurring</i>	<i>Initiated by Trustee</i>	<i>Initiated by Creditor</i>	<i>Total</i>
1988/89	44		748	820	1,612
1989/90	41		1,800	777	2,618
1990/91	30		4,340	1,081	5,451
1991/92	3		7,471	1,113	8,587
1992/93	52		10,380	1,538	11,970
1993/94	80	630	2,555	757	4,022
1994/95	101	1,073	2	1,164	2,340
1995/96	85	1,163	2	1,130	2,380
1996/97	97	1,350	7	1,080	2,534
1997/98	85	1,532	12	1,072	2,701

Source: Accountant in Bankruptcy, *Annual Report For 1997/98* (Edinburgh: Accountant in Bankruptcy, 1998) at Table (iv).

\* Year beginning 1 April and ending 31 March.