

CONSUMER BANKRUPTCIES: A NEW ZEALAND PERSPECTIVE[©]

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In this article, the author considers the need for reform of New Zealand bankruptcy law to reflect recent socio-economic developments in New Zealand. The author addresses several consumer bankruptcy issues, and considers them in the context of a number of competing public interest factors, such as the purpose of insolvency law, the role of the state in insolvency law, and the necessary balance to be struck between competing macroeconomic and microeconomic factors. The author suggests varying solutions—some educational, and some legal.

Dans cet article, l'auteur examine les besoins de réforme de la loi de la Nouvelle Zélande sur la faillite, afin de refléter les développements socio-économiques récents en Nouvelle Zélande. L'auteur aborde plusieurs questions de la faillite des consommateurs, et les examine dans le contexte d'un concours de plusieurs facteurs d'intérêt public, tel que le but de la loi sur l'insolvabilité, le rôle de l'état dans cette loi, et l'équilibre nécessaire à trouver entre les facteurs macro-économiques et micro-économiques concurrents. L'auteur suggère des solutions variables—certaines sont éducationnelles, d'autres juridiques.

I. INTRODUCTION	428
II. A LITTLE BIT OF HISTORY	431
III. THE 1967 BANKRUPTCY LAW REFORMS	434
IV. CONSUMER BANKRUPTCY IN NEW ZEALAND: FACTS AND PRACTICE	438
V. INSOLVENCY LAW REVIEW	440
VI. SOME THOUGHTS ON LAW REFORM	441
A. <i>Purpose of Insolvency Law</i>	441
B. <i>Role of the State</i>	441
C. <i>Definitional Problems: What is a "Consumer Bankrupt"?</i>	443
VII. CONCLUSION	446

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I. INTRODUCTION

The law governing personal insolvency in New Zealand is the *Insolvency Act 1967*.¹ That *Act* repealed and replaced the *Bankruptcy Act 1908*,² which had been modelled on nineteenth century English legislation.³ Although enacted in 1967, the *Insolvency Act 1967* did not come into force until 1 January 1971, after subordinate legislation had been passed.⁴ Credit cards were not introduced into New Zealand until 1981.⁵ In the last ten years, the total value of credit card sales has increased from about \$2.6 billion in 1988 to about \$6.9 billion in 1997.⁶

Although New Zealand was late in joining the “cashless society,” it has rapidly embraced the concept. Credit cards, Electronic Funds Transfer at Point of Sale (EFTPOS),⁷ and telephone banking have become important features of contemporary New Zealand society. There were 1,447 operating bank branches in New Zealand in 1995, compared with 1,094 branches in 1997. Because of the reduction in the number of branches, many redundancies have occurred. In contrast, the number of automatic teller machines rose from 1,419 in 1995 to 1,513 in 1997.⁸

New Zealand now has one EFTPOS terminal for every 63 people.⁹ Approximately 340 million EFTPOS transactions took place in the year to

¹ [1967] 1 N.Z. Stat. 462, No. 54. For commentaries, see P.D. McKenzie, ed., *Spratt and McKenzie's Law of Insolvency* 2d ed. (Wellington, N.Z.: Butterworths, 1972) [hereinafter *Spratt and McKenzie's Law of Insolvency*]; and *The Laws of New Zealand* (Wellington, N.Z.: Butterworths, 1994) “Insolvency” [hereinafter *Laws NZ*]. Company liquidations are governed by the *Companies Act 1993*, [1993] 3 N.Z. Stat. 2256, No. 105.

² [1957] 1 N.Z. Stat. Rep. 427, No. 12.

³ See generally F.C. Spratt, *The Law and Practice of Bankruptcy in New Zealand* (Wellington, N.Z.: Butterworths, 1930).

⁴ See *Insolvency Act Commencement Order 1970* (S.R. 1970/244/2). See also *Insolvency Rules 1970* S.R. 1970/245; *Insolvency Regulations 1970* S.R. 1970/260; and *Summary Instalment Orders (District Courts) Rules 1970* (RPT 1981/182).

⁵ See Statistics New Zealand, *New Zealand Official Yearbook 1998* (Wellington, N.Z.: Government Printer, 1998) at 507 [hereinafter *Yearbook*].

⁶ *Ibid.*

⁷ EFTPOS was introduced in New Zealand in 1984 as a means of payment for retail goods and services. All banks agreed in 1990 to integrate their EFTPOS services, and growth since then has been rapid. By December 1997, there were 59,952 EFTPOS terminals in use in New Zealand at supermarkets, service stations, liquor merchants, and other retail outlets: see *Yearbook, supra* note 5 at 560.

⁸ *Ibid.* at 559.

⁹ See *ibid.*

31 December 1997, representing an increase of about 30 per cent over the approximately 260 million transactions in 1996. These figures include the majority of credit card transactions, the balance of which were by paper or telephone.¹⁰

Furthermore, the investment, finance, and banking industries accounted for approximately \$66 million worth of advertising expenditures in 1997.¹¹ The credit industry generally is regulated by the *Credit Contracts Act 1981*¹² which is self-policing in nature. Unless appropriate disclosure is made (whether initial, modification, or on request), interest will be irrecoverable.¹³

Many behavioural changes have occurred as a result of the deregulation of the New Zealand financial sector, which started after the general election of June 1984. Deregulation of the banking sector came about in 1986 through legislation that established a framework for the registration and prudential supervision of banks.¹⁴ Deregulation of other aspects of the financial sector followed.¹⁵ The *Insolvency Act 1967* was, quite simply, never drafted for use in contemporary New Zealand society.

In the year ending 31 March 1980, 530 persons were adjudged bankrupt in New Zealand; by 30 June 1997, the annual number of

¹⁰ *Ibid.*

¹¹ *Ibid.* at 259.

¹² [1981] 1 N.Z. Stat. 263, No. 27.

¹³ See generally *Laws NZ*, *supra* note 1, "Consumer Credit and Hire Purchase," which discusses the relevant provisions of the *Credit Contracts Act 1981* *supra* note 12.

¹⁴ See *Reserve Bank of New Zealand Amendment Act 1986* [1986] 3 N.Z. Stat. 1427, No. 131, as am. by *Reserve Bank of New Zealand Act 1989* [1989] 4 N.Z. Stat. 2544, No. 157. There are now twenty registered banks in New Zealand, only four of which were former trading banks: see *Yearbook* *supra* note 5 at 557. Unlike in other countries, the new New Zealand banking legislation provides no explicit protection of bank deposits. Under section 68 of the *Reserve Bank of New Zealand Act 1989*, the Reserve Bank is required to carry out its registration and prudential supervision functions for the purposes of (1) "promoting the maintenance of a sound and efficient financial system," or (2) "avoiding significant damage to the financial system that could result from the failure of a registered bank." Similarly, there is no licensing of deposit-taking as an activity within New Zealand. Neither is there any official deposit insurance by which losses of bank depositors are borne by an insurance fund, and no priority is given to bank depositors on insolvency. The approach to banking supervision also differs in New Zealand, which has a less prescriptive regime than many other countries. The banking supervisory regime in New Zealand relies heavily on market discipline, on the publication of disclosure documents, and on the requirement that directors attest to the accuracy of information contained in such documents, to hold directors and managing personnel accountable for the prudent and responsible management of a bank's fiscal affairs. I am indebted to Sachin Zodgekar of Chapman Tripp Sheffield Young, Barristers & Solicitors, for this summary.

¹⁵ See Part II and Part VI(B), below, for a discussion of these features.

personal bankruptcies had reached 2,464.¹⁶ Between 1960 and 1980, the number of bankruptcies remained reasonably stable, averaging 15 to 20 per 100,000 of population.¹⁷ By 1997, that figure had reached 70 per 100,000 of population.¹⁸

The New Zealand Income Support system provided support for 843,825 persons in the year ending 30 June 1997.¹⁹ The recipients received benefits worth roughly NZ\$10.6 billion, approximately 11.2 per cent of New Zealand's gross domestic product.²⁰ The recipients represented approximately one in four of New Zealand's resident population,²¹ meaning that roughly one-quarter of New Zealand's adult population contributes little to the tax base for the provision of services to New Zealanders.

Until 1983, the number of registered unemployed persons in New Zealand remained below 50,000. In the early 1990s that figure, at times, exceeded 200,000.²²

All of this information needs to be considered in the context of a country that consists of two main islands (the North Island and the South Island) and a number of smaller islands (the largest of which are Stewart Island and the Chatham Islands), and occupies an area that is about 10,000 square miles more than the area of the United Kingdom and Northern Ireland.²³ The resident population of New Zealand at the last census, conducted in 1996, was 3,681,546, of which approximately 1 million live in Auckland.²⁴

Before I endeavour to draw together these statistics, I need to provide some historical material of significance for assessing the issue of consumer bankruptcy in New Zealand.

¹⁶ See *Yearbook supra* note 5 at 497.

¹⁷ *Ibid.* at 498.

¹⁸ *Ibid.*

¹⁹ *Ibid.* at 142. The benefits payable to citizens include the unemployment benefit, sickness benefit, domestic purposes benefit, family support, and the New Zealand superannuation and veterans' pension.

²⁰ *Ibid.* at 141.

²¹ *Ibid.* at 142.

²² *Ibid.* at 311.

²³ The land area of New Zealand is 103,736 square miles; that of the United Kingdom is 94,227 square miles.

²⁴ See *Yearbook supra* note 5 at 85, 89.

II. A LITTLE BIT OF HISTORY²⁵

In June 1984, the National Party was in power in New Zealand under the leadership of Sir Robert Muldoon. Historically, the National Party has been a conservative party with values similar to the Conservative Party in the United Kingdom and the Liberal/National Coalition in Australia. However, in the years leading up to 1984, protectionist policies were implemented that stifled economic growth. By early 1984, interest, rents, prices, and wages had all been frozen by regulations passed by the government through executive orders in council made under the *Economic Stabilisation Act 1948*²⁶

The *Economic Stabilisation Act 1948* had been used for many years to regulate most sectors of the New Zealand economy by executive order. The regulation-making powers contained in section 11 of the *Act* were widely framed. The wording of the section allowed the governor general to make such regulations as appeared to him necessary for the economic stability of the country. In order to hold that a regulation adopted under the *Act* was *ultra vires*, a court was required to find that the regulation could not reasonably be considered necessary or expedient for the economic stability of New Zealand, or that it was unrelated to the purposes of the *Economic Stabilisation Act 1948*²⁷

By 1984, New Zealand probably had one of the most regulated economies in the democratic western world. Its economy had also deteriorated to such an extent that, on 31 March 1984, its total public debt was approximately \$21.9 billion, a sum equal to 64.7 per cent of the gross domestic product.²⁸

In the 1981 election, the National Party was returned with only a one seat majority. For various reasons (mostly unconnected with economic policy), there was so much dissension within the party that Sir

²⁵ What follows is substantially based on an unpublished article by the author: see P. Heath, "Entry and Exit: Investment Credit and Insolvency Issues in the Asia/Pacific Region: New Zealand" (International Bar Association Conference, Melbourne, Australia, October 1994) [unpublished].

²⁶ [1948] 1 N.Z. Stat. 347, No. 38.

²⁷ See *NZ Shop Employees Industrial Assn of Workers v Attorney-General* [1976] 2 N.Z.L.R. 521 at 529, 535 (C.A.). The *Economic Stabilisation Act 1948* was repealed in 1987 as part of New Zealand's economic reform: see *Economic Stabilisation Act Repeal Act 1987* [1987] 2 N.Z. Stat. 1317, No. 126, s. 2.

²⁸ See New Zealand, Office of the Minister of Finance, *Economic Management* (Wellington, N.Z.: Office of the Minister of Finance, 1984) at 81, online: New Zealand Treasury <<http://www.treasury.govt.nz/pubs/bmb/brief84/contents.htm>> (date accessed: 13 August 1999). Of the total public debt, \$9.4 billion was owed externally in foreign currency: *ibid.*

Robert Muldoon found it necessary to call a snap general election on 14 June 1984. Following that election, on 14 July 1984, a new Labour government, under David Lange's leadership, was elected to power. Like its counterparts in Australia and the United Kingdom, the New Zealand Labour Party had been seen as associated with the trade union movement and socialist policies generally. That perception of the Labour Party was to change dramatically.

In the following nine months, a series of events transformed New Zealand from one of the most heavily regulated economies in the Western world to one of the least regulated economies. One of the first steps taken by the government was to devalue the New Zealand dollar by 20 per cent, in order to stem the massive outflow of foreign exchange during the period between the announcement of the election and the election itself. The freeze on interest rates was lifted almost immediately; controls on wages, prices, and rents were also subsequently removed. By 2 March 1985, New Zealand had floated its dollar on the foreign exchange markets. Although these changes were implemented because there were no other realistic options, they still could not have taken place without two significant, yet fortuitous, events.

The first event was the election of a Labour government, which took office facing a grave economic crisis. In order to cope with the crisis, the government quickly deprived New Zealand's main export earners (the rural sector) of their subsidies, and farmers were forced to bear increasing interest payments while the economy was being restructured. It is extremely unlikely that those steps would have been taken under a National Government, because the rural sector comprised a significant portion of the National Party's constituency. However, the changes that were made were both fundamental and necessary, and they have forced New Zealand farmers to become more efficient and competitive.

Second, just as it would have been unlikely for the National Party to embark upon a restructuring of the rural economy, it was equally unlikely that the Labour Party would enact legislation deregulating the labour market. This did not occur until the National Party was returned to power at the 1990 general election. In 1991, reform of the labour market, in a manner consistent with other economic reforms, was achieved through passage of the *Employment Contracts Act 1991*²⁹

²⁹ [1991] 1 N.Z. Stat. 184, No. 22. The long title to the *Employment Contracts Act 1991* states that the *Act* is "to promote an efficient labour market" and, in particular,

- (a) To provide for freedom of association:
- (b) To allow employees to determine who should represent their interests in relation to

The economic reforms from 1984 had the long-term objective of returning New Zealand to prosperity by laying the groundwork for a future recovery. This was done by completely overhauling the public service,³⁰ reforming the banking system,³¹ reforming structures used to operate the ports and the energy sector,³² and introducing the profit motive for trading entities operated by the government. In place of state-controlled trading entities, the government introduced the concept of state-owned enterprises to run such ventures with a view to profit for the government as shareholder.³³

employment issues:

- (c) To enable each employee to choose either—
 - (i) To negotiate an individual employment contract with his or her employer; or
 - (ii) To be bound by a collective employment contract to which his or her employer is a party:
- (d) To enable each employer to choose—
 - (i) To negotiate an individual employment contract with any employee;
 - (ii) To negotiate or to elect to be bound by a collective employment contract that binds 2 or more employees:
- (e) To establish that the question of whether employment contracts are individual or collective or both is itself a matter for negotiation by the parties themselves

The Employment Tribunal was set up as a specialist tribunal to resolve disputes founded on employment contracts, and the Employment Court was created to act as an appellate court from the Employment Tribunal and was also given certain original jurisdiction. Under section 3(1) of the *Act*, and subject to specific provisions of the *Act*, the tribunal and the court have exclusive jurisdiction to hear and determine disputes based on an employment contract. An appeal lies from the Employment Court directly to the Court of Appeal (thus bypassing the High Court) but generally only on questions of law: see section 135 of the *Act*.

³⁰ The *State Sector Act 1988* [1988] 1 N.Z. Stat. 224, No. 20 replaced the *State Services Act 1962*, [1962] 2 N.Z. Stat. 832, No. 132 and a number of other enactments dealing with the public service. The new *Act* provides for the appointment of chief executives to run the departments, and allows the chief executives to be appointed from the private sector. The provisions have, to a large extent, removed the power of the public service to influence the implementation of government policy.

³¹ Reference has already been made to the reforms achieved by the *Reserve Bank of New Zealand Amendment Act 1986* *supra* note 14, and the *Reserve Bank of New Zealand Act 1989* *supra* note 14. The latter *Act* devised a mechanism for policy objectives to be agreed upon with the governors of the Reserve Bank. The policy objectives include the maintenance of a low rate of inflation. The new regulation of the banking system led to the increase of services made available to banking customers of the type already outlined.

³² See *Port Companies Act 1988* [1988] 1 N.Z. Stat. 592, No. 91; and the *Energy Companies Act 1992*, [1992] 2 N.Z. Stat. 859, No. 56.

³³ See *State-Owned Enterprises Act 1986* [1986] 3 N.Z. Stat. 1306, No. 124.

III. THE 1967 BANKRUPTCY LAW REFORMS

The enactment of the *Insolvency Act 1967* was not preceded by any fundamental review of insolvency law in New Zealand. Rather, the review of the 1908 legislation drew more on English³⁴ and Australian³⁵ law reform reports. The *Act* was designed to liberalize bankruptcy concepts in New Zealand.³⁶

Before considering the reforms enacted in 1967, it is necessary to say something about terminology. "Bankruptcy" is a term of art. It refers to the status of a person, not a corporation, who either files a debtor's petition in bankruptcy, or is adjudged bankrupt by the High Court on the petition of a creditor.³⁷ In contrast, the term "insolvency" denotes a state of things. It means the inability of a person to pay debts from his or her own resources as they fall due.³⁸ As Peter Blanchard³⁹ said in a commentary on the unreported decision of Richardson J. in *Re Northridge Properties Limited*,⁴⁰ the thrust of this concept is not to require a person to keep in cash a sum sufficient to meet all outstanding indebtedness, however distant the date of payment may be. Rather, it is to have assets available that, if realized, will produce sufficient money to

³⁴ See U.K., Bankruptcy Law Amendment Committee, *Report of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment* Cmnd 221 (London: Her Majesty's Stationery Office, 1957).

³⁵ See Commonwealth of Australia, *Report of the Committee Appointed by the Attorney General of the Commonwealth to Review the Bankruptcy Law of the Commonwealth* (Canberra: Government Printer, 1962).

³⁶ See generally E.H. Flitton, "The Insolvency Act, 1967" [1968] N.Z.L.J. 394; P.D. McKenzie, "Insolvency Act 1967" (1968-69) 3 N.Z.U. L. Rev. 210; and *Spratt and McKenzie's Law of Insolvency* *supra* note 1 at 1-6.

³⁷ A debtor's petition may be filed under section 21 of the *Insolvency Act 1967* *supra* note 1, while the prerequisites for an adjudication in bankruptcy by the court, on a petition brought by a creditor, is governed by section 23 of the *Act*. The power to make an order of adjudication is found in section 26 of the *Act*.

³⁸ See *Laws NZ*, *supra* note 1, "Insolvency," para. 1. See also *Attorney-General for British Columbia v. Attorney-General for Canada* [1937] A.C. 391 (P.C.); *Rees v. Bank of New South Wales* (1964), 111 C.L.R. 210 at 218 (H.C.A.); *Ebbett v. Official Assignee in Bankruptcy* [1991] 4 N.Z.B.L.C. ¶99-249 (H.C.); and *Re Gladding King Real Estate Ltd (in liquidation)* [1993] M.C.L.R. 204 at 220 (H.C.). Finally, see *Re Northridge Properties Limited* (13 December 1977), Auckland M 46/75 (N.Z. S.C.), in which there is a useful discussion of the problems that are caused when conversions of assets into money extends beyond two or three weeks, at which point another set of debts is likely to fall due. Regrettably, this decision has never been reported, although relevant extracts from the case may be found in "Insolvency and Companies" Comment [1983] N.Z.L.J. 44.

³⁹ Now Justice Blanchard of the Court of Appeal of New Zealand.

⁴⁰ *Supra* note 38.

pay all indebtedness, and ensure that funds are still available to meet other indebtedness as it matures.⁴¹ This observation is relevant to those who use credit cards. Using available credit lines to meet present debts, but having insufficient ability to pay the credit card debt and the high interest that will consequently accrue, is likely to mean that the debtor is insolvent for the purpose of that definition.

For the first time, the *Insolvency Act 1967* allowed a debtor to make a formal proposal to creditors to satisfy indebtedness that could operate outside the bankruptcy regime, and enable the debtor to avoid the stigma of bankruptcy. This was achieved through Part XV of the *Act*, which provided the debtor with a flexible mechanism for making proposals to creditors that required approval by specified majorities of creditors, and the sanction of the High Court.⁴² Also, a procedure known as a summary instalment order was introduced to deal with debtors whose indebtedness was relatively small; even now, it applies only to persons who have debts of less than \$12,000.⁴³ It is a useful provision in concept, but is infrequently used because of the costs involved and the very low level of debt to which it relates.

In addition, the focus of bankruptcy administration moved from being quasi-penal in nature⁴⁴ towards the dual purpose of (1) maximizing returns to creditors, and (2) rehabilitating the debtor. However, there was little of substance to support the second objective, other than a change in the law that made it easier to obtain a discharge from bankruptcy.⁴⁵

Finding that critical balance between maximizing returns to creditors, and the need to rehabilitate a debtor—while also dealing appropriately with commercially undesirable behaviour—is much the same problem identified in the preface of the recent report of the National Bankruptcy Review Commission to the United States Congress, which is “the need to maintain—and, in some instances, to

⁴¹ See also *Bank of Australasiav. Hall* (1907), 4 C.L.R. 1514 at 1543 (H.C.A.), Isaacs J.

⁴² See generally *Laws NZ*, *supra* note 1, “Insolvency,” paras. 449-75. See also A. Sawyer, “Proposing an Alternative to Bankruptcy: Part XV in Retrospect” (1995) 6 *Canta. L. Rev.* 175; and P. Heath, “Proposals Under Part XV Insolvency Act: Is the Public Interest Relevant?” [1991] *N.Z.L.J.* 52.

⁴³ See *Insolvency Act 1967*, *supra* note 1, ss. 146-52, as am. by *Insolvency Amendment Act 1990* [1990] 1 *N.Z. Stat.* 92, No. 7, s. 6. See also *Laws NZ*, *supra* note 1, “Creditors’ Remedies,” paras. 125-30.

⁴⁴ See, for example, *Re Davies* (1907), 26 *N.Z.L.R.* 254 (S.C.).

⁴⁵ Compare sections 107-10 of the *Insolvency Act 1967*, *supra* note 1, with section 127 of the *Bankruptcy Act 1908* *supra* note 2.

restore, balance [between the interests of creditors and debtors].”⁴⁶ It can not, of course, be said that the *Insolvency Act 1967* was intended specifically to deal with what is now known as the “consumer bankrupt.” Such a person was unknown in New Zealand in 1967. The complications of life brought about by the move towards a cashless society, together with other deregulating activity in New Zealand that has removed the government’s paternalistic approach towards its citizens, have exposed the problems we are grappling with today.

Nevertheless, it can be said that the changes introduced in 1967 to allow automatic discharge from bankruptcy are equally relevant to consumer bankruptcies. Generally speaking, a person will be discharged from bankruptcy after the expiry of three years from the date of adjudication.⁴⁷ It is open, however, to the Official Assignee (the public official charged with the duty of administering bankrupt estates) or a creditor (with the leave of the High Court) to object to a discharge.⁴⁸ If an objection is raised, the Court will then consider, in determining whether to grant or to refuse an order of discharge, the affairs of the bankrupt; the causes of the bankruptcy; the manner in which the bankrupt has performed duties imposed upon him or her under the *Insolvency Act 1967* or obeyed orders of the court; the bankrupt’s conduct both before and after bankruptcy; and any other fact, matter, or circumstance that would assist the court in making its decision.⁴⁹ In *Re Anderson*, Penlington J. emphasized the need for a proper investigation of all the facts and circumstances of the particular bankruptcy.⁵⁰ In considering whether an application for discharge should succeed, the court should have regard to the interests of the bankrupt, the creditors, and the public. In the context of the public interest, the court should consider questions of commercial morality and whether the bankrupt had engaged in fraudulent or dishonest behaviour, recklessness, or gross negligence. A synonym for “commercial morality” would be “undesirable commercial behaviour.”⁵¹

⁴⁶ National Bankruptcy Review Commission, *Bankruptcy: The Next Twenty Years, Final Report* (United States: Government Printing Office, 1997) at i, online: National Bankruptcy Review Commission <<http://www.nbr.com/reportcont.html>> (date accessed: 7 July 1999).

⁴⁷ See *Insolvency Act 1967* *supra* note 1, s. 107(1).

⁴⁸ *Ibid.* s. 107(3).

⁴⁹ *Ibid.* s. 109(2).

⁵⁰ See *Re Anderson* (14 April 1992), Hamilton B 213/89 (N.Z. H.C.).

⁵¹ *Ibid.*

A bankrupt may also seek a discharge from bankruptcy before the three year period expires. If such an application is made, the same criteria that apply to objections to a discharge must be taken into consideration by the court.⁵² The court may make absolute orders of discharge or impose terms on the discharge.⁵³

A discharge from bankruptcy releases the bankrupt from all debts provable in the bankruptcy, with specified exceptions.⁵⁴ Debts that are not released on discharge include (1) liability incurred by means of fraud or fraudulent breach of trust to which the bankrupt was a party;⁵⁵ (2) any debt or liability for which the bankrupt has obtained forbearance by any fraud to which the bankrupt was a party;⁵⁶ (3) any judgment debt or amount payable under a contribution order or order of discharge for which the bankrupt is liable;⁵⁷ (4) any amount payable under a maintenance order made under the *Family Proceedings Act 1980*⁵⁸ and (5) any amount payable under the *Child Support Act 1991*.⁵⁹ A secured creditor will continue to have rights under the security, even after discharge from bankruptcy.⁶⁰ Debts not provable in bankruptcy include⁶¹ (a) claims for future spousal or child maintenance,⁶² (b) claims against minors,⁶³ and (c) claims which should not be admitted for public policy reasons.⁶⁴

⁵² See *Insolvency Act 1967* *supra* note 1, ss. 108-09. Concerning discharges from bankruptcy, see generally *Laws NZ*, *supra* note 1, "Insolvency," paras. 410-29.

⁵³ See *Insolvency Act 1967* *supra* note 1, s. 110.

⁵⁴ *Ibid.* s. 114. See also *Laws NZ*, *supra* note 1, "Insolvency," para. 424. Note that the bankrupt is released from all debts *provable* in the bankruptcy, not only debts *proved* in the bankruptcy: see *Perrott v. Newton King Ltd*, [1933] N.Z.L.R. 1131 at 1152 (C.A.) [hereinafter *Perrott*].

⁵⁵ See *Insolvency Act 1967* *supra* note 1, s. 114(a).

⁵⁶ *Ibid.* s. 114(b).

⁵⁷ *Ibid.* s. 114(c). A "contribution order" is an order for payment of monies to the Official Assignee out of the wages of a bankrupt.

⁵⁸ *Ibid.* s. 114(d), as am. by *Family Proceedings Act 1980* [1980] 2 N.Z. Stat. 862, No. 94, s. 189(1).

⁵⁹ See *Insolvency Act 1967* *supra* note 1, s. 114(e), as am. by *Child Support Act 1991* [1991] 3 N.Z. Stat. 1732, No. 142, s. 252.

⁶⁰ See *Insolvency Act 1967* *supra* note 1, s. 3(3). See also *Lamont v. Bank of New Zealand* [1981] 2 N.Z.L.R. 142 (H.C.), in which the court distinguished *Perrott* *supra* note 54.

⁶¹ See generally *Laws NZ*, *supra* note 1, "Insolvency," para. 351.

⁶² See *Re Davidson, Ex Parte Davidson* (1882), N.Z.L.R. 2 S.C. 55.

⁶³ See *Minors' Contracts Act 1969* [1969] 1 N.Z. Stat. 402, No. 41, s. 6.

⁶⁴ This includes claims with an element of fraud: see *Re Sullivan* (1904), 7 G.L.R. 376 (S.C.).

Provisions also exist that enable the court to place prohibitions on bankrupts from continuing in business on their own account, or being directly or indirectly involved in the management of a company after the debtor's discharge from bankruptcy. These provisions are aimed at protecting the commercial community rather than penalizing the bankrupt.⁶⁵

IV. CONSUMER BANKRUPTCY IN NEW ZEALAND: FACTS AND PRACTICE

No separate statistics are kept of consumer bankruptcies in New Zealand. The New Zealand Insolvency and Trustee Service, which is part of the Ministry of Commerce, treats bankruptcies as falling into "complex" and "non-complex" categories. "Non-complex" bankruptcies generally arise when (1) assets are under \$10,000 in value; (2) liabilities are no more than \$100,000; and (3) there are no contentious issues. This general categorization is not dissimilar from the definition of "consumer debtor" in section 66.11 of the Canadian *Bankruptcy and Insolvency Act*⁶⁶ which, in dealing with consumer proposals, refers to a maximum debt level of C\$75,000 or such other maximum sum as may be prescribed by regulation.

Not all "non-complex" bankruptcies will be consumer bankruptcies. All that I can do here is to estimate the number of consumer bankruptcies in New Zealand. An experienced former Official Assignee has informed me that approximately 60 per cent of all personal bankruptcies fall within the consumer bankruptcy rubric, but this begs the question of how one defines a consumer bankrupt. Subject to this caveat, reproduced below is a table of personal bankruptcies, which has been updated by reference to statistics provided to me recently by the Ministry of Commerce for the 1998 year.

⁶⁵ For the practical application of these provisions, see the following cases dealing with comparable provisions in the *Companies Act 1955* [1955] 1 N.Z. Stat. 569, No. 63: *Ramsay v. Sumich*, [1989] 3 N.Z.L.R. 628 (H.C.), Sinclair J.; and *Re Focas & Ors* [1993] 6 N.Z.C.L.C. ¶96-595 (H.C.), Jaine J.

⁶⁶ R.S.C. 1985, c. B-3 [hereinafter *BIA*].

TABLE 1
PERSONAL BANKRUPTCIES

<i>Year Ended 30 June</i>	<i>Number</i>
1980*	530
1985*	849
1990	1,900
1991	2,052
1992	2,837
1993	2,532
1994	2,312
1995	1,963
1996	2,158
1997	2,464
1998†	2,974

Source: Statistics New Zealand, *New Zealand Official Yearbook 1998* (Wellington, N.Z.: Government Printer, 1998) at 497.

* Year ended 31 March.

† 1998 data supplied by the Ministry of Commerce.

Apart from the 1980 and 1985 figures (which are included for historical purposes), it can be seen that, between 1990 and 1998, the number of bankruptcies in New Zealand rose from 1,900 to 2,974, an increase of 1,074 or almost 50 per cent. Further, the June 1998 figure is the highest number of bankruptcies recorded in New Zealand. Assuming a stable ratio of consumer bankruptcies to total bankruptcies, the percentage increase in consumer bankruptcies will also have been in the order of 50 per cent.

Returning to the credit card statistics mentioned earlier, we find that, in 1990, the total value of credit card sales was \$3.2 billion, compared to the total outstanding advances of \$951 million. The ratio of outstanding advances to the total value of credit card sales in 1990 was 30.1 per cent. In 1997, the total value of credit card sales was \$6.9 billion, compared to outstanding total advances of 1.9 billion, or 27.5 per cent of the total.⁶⁷ These figures represent the annual value of sales by credit cards issued by all registered banks in New Zealand together with American Express and Diners Club.⁶⁸

What the credit card sales statistics do not reveal is how many individuals have refinanced elsewhere in order to pay off credit card

⁶⁷ See *Yearbook*, *supra* note 5 at 507.

⁶⁸ *Ibid.*

indebtedness running at a higher rate of interest. The current average credit card interest rate in New Zealand is around 18 per cent per annum.

All that can be gathered from the official statistics is that about one-third of all credit card debt remains outstanding, and accumulating interest at a high rate. Most of that money goes overseas, since 95 per cent of the assets of New Zealand banks are owned offshore.⁶⁹ Both of the major credit card companies, American Express and Diners Club, are also owned offshore.

In New Zealand's changing social environment in the post-deregulation era, there is an increasing gap between the wealthy and the poor. The "trickle down" theory appears not to have worked. In November 1997, the average weekly income was between \$630.19 and \$657.75 per week (gross), depending upon whether overtime was available for the particular employee.⁷⁰ Mention has already been made of the fact that almost one in every four New Zealanders receives some form of state benefit allowance.

V. INSOLVENCY LAW REVIEW

In December 1988, the (then) Law Reform Division of the Department of Justice released a discussion paper entitled *Insolvency Law Reform*⁷¹ Submissions were sought by 15 February 1989. The review contemplated by that discussion paper has not yet taken place. The Ministry of Commerce (which is responsible for insolvency law in New Zealand) is about to embark on an insolvency law review which, hopefully, will lead to new legislation in, or shortly after, the year 2000. Accordingly, issues of the type discussed in this symposium are truly timely from a New Zealand perspective.

I am not in a position to add anything of substance to the question of how consumer bankruptcies should be administered, having regard to the legislation currently in force in New Zealand. I propose, therefore, in the next part of this article, to consider the options available to New Zealand to address consumer bankruptcy issues more adequately in its reform of bankruptcy law.

⁶⁹ Based on figures to the end of December 1997, published in Reserve Bank of New Zealand, *Financial Statistics* (June 1998) at 78-84.

⁷⁰ See *Yearbook supra* note 5 at 319.

⁷¹ See New Zealand, Law Reform Division, *Insolvency Law Reform: A Discussion Paper* (Wellington, N.Z.: Department of Justice, 1988).

VI. SOME THOUGHTS ON LAW REFORM

A. Purpose of Insolvency Law

The overriding purpose of insolvency law is to determine which of two or more innocent parties should bear a loss. It is implicit in the fact of insolvency that there is not enough money to go around. Thus, it is necessary for the law to make clear choices and to draw lines which may, in any given case, seem harsh. There are many tensions in this particular area of law. How should the rights of a spouse and children be weighed against the right of a creditor to receive payment of a due debt? What justification is there for requiring certain debts (*i.e.*, wages owing to the debtor's employees) to be paid in priority to other unsecured debts? These are difficult questions, but ones that must be addressed all the same. If they are not addressed, then certain economic consequences may follow, some of which may not be beneficial from a community perspective. It is in this context that one must consider the role of the state.

B. Role of the State

The role of the state clearly goes beyond establishing an insolvency law framework. In our increasingly cashless society, the basics of budgeting should be the starting point. Not so long ago, very little was purchased with credit; much of a family's supplies were acquired with cash. In the current environment, it is important to educate children about the responsibilities involved in budgeting one's finances. In turn, that education should teach the value of thrift.

However, a balance must also be struck between the macro-economic need for consumption to maintain the buoyancy of the economy, and the need of individuals to budget wisely so that a buffer is available to cushion unforeseen financial reverses. Governments also need to strike a balance in their competing demands for spending (at a macro-economic level) and thrift (*i.e.*, for retirement saving). Governments must determine the values they wish to instil. Trustees in bankruptcy who are left to "counsel" debtors are doing little more than applying sticking plasters when the patient is seriously ill. The state has an obligation to educate its citizens in the prudent use of credit so that good judgement will be exercised in determining when to spend and when to save.

Like many other countries engaged in financial deregulation, New Zealand has adopted the “user pay” principle. Regulation 63 of the *Insolvency Regulations 1970* provides that “[w]here a bankrupt has no available assets, the Assignee shall not be required to incur any expense in relation to his estate without guarantee from the creditors, or some of them.”⁷² The Official Assignee is a public servant employed by the Ministry of Commerce.⁷³ Public interest duties are imposed on Official Assignees by the *Insolvency Act 1967* the decision whether or not to request a public examination of a bankrupt applying for a discharge is one;⁷⁴ the right to apply to the court for business prohibition orders⁷⁵ is another. In my view, the state’s duty to prosecute commercial crimes is a third.⁷⁶

It is useful to consider what was said in the World Bank’s report in 1997.⁷⁷ The World Bank’s view was that “five fundamental tasks lie at the core of every Government’s mission, without which sustainable, shared, poverty-reducing development is impossible.”⁷⁸ These five fundamental tasks are (1) establishing a foundation of law; (2) maintaining a non-distortionary policy environment, including macro-economic stability; (3) investing in basic social services and infrastructure; (4) protecting the vulnerable; and (5) protecting the environment. The Report continues by pointing out that a survey commissioned especially for the World Bank, comprised of domestic entrepreneurs in 69 countries, confirmed anecdotal evidence that many countries lack the basic institutional foundations for market development. The Report continues:

High levels of crime and personal violence and an unpredictable judiciary combined to produce what this Report defines as the “lawlessness syndrome.” Weak and arbitrary state institutions often compound the problem with unpredictable inconsistent behaviour. Far from assisting the growth of markets, such actions squander the State’s credibility and hurt market development.⁷⁹

⁷² *Supra* note 4.

⁷³ In fact, section 15 of the *Insolvency Act 1967*, *supra* note 1, requires all Official Assignees to be salaried state servants. See also *Laws NZ*, *supra* note 1, “Insolvency,” para. 159.

⁷⁴ See *Insolvency Act 1967*, *supra* note 1, s. 109.

⁷⁵ *Ibid.* s. 111.

⁷⁶ *Ibid.* s. 129.

⁷⁷ See The World Bank, *World Development Report 1997: The State in a Changing World* (New York: Oxford University Press, 1997) [hereinafter “Report”].

⁷⁸ *Ibid.* at 4.

⁷⁹ *Ibid.*

There must be an incentive for people to pay their debts. It is a fundamental premise of the law of contract that people will honour their bargains. This translates in many cases to payment for goods or services received. If a debtor knows that if assets are divested, no investigation will follow unless the creditors are prepared to throw good money after bad, the debtor has little incentive to behave honestly. There are economic as well as social imperatives requiring state intervention to ensure adherence to these standards; these imperatives are, in truth, no different from the need for an independent police force to enforce the standards laid down by the criminal law.

The first question, therefore, is whether there is a need for the state to take a lead role, either within or outside of its insolvency law system, to provide education facilities to those who lack budgeting skills, and to provide appropriate incentives to people to pay their bills. A debtor who has the ability to manage his or her own budget should not, it seems to me, be encouraged to view the prospect of bankruptcy as a means of garnering assets for which he or she has not paid by disposing of assets (directly) for his or her family's benefit, and (indirectly) for the purpose of avoiding contractual obligations that the debtor had promised to keep. In my view, governments have a strong interest in developing policies in this area to provide incentives for both established and developing free markets, and to ensure that adequate funding will be available to implement those policies.

C. Definitional Problems: What is a "Consumer Bankrupt"?

The next issue concerns the definition of the term "consumer bankrupt." At one level, a consumer bankrupt can be defined as any person who has become bankrupt through means other than business activity. At another level, a consumer bankrupt may be defined as a person, whether in business on his or her own account or in partnership who, through lack of budgetary skills, has been unable to pay his or her debts. Such a person may be on a high or low income. Some low-income earners are thrifty. Some high-income earners are spendthrifts. A third possibility is the arbitrary use of a dollar value of liabilities to determine whether a bankrupt should be classified as a consumer bankrupt.⁸⁰

It may not matter which of the first two definitions is used. The third definition causes problems, because it assumes that all bankruptcies falling under a prescribed dollar amount are due to the

⁸⁰ See, for example, *BIA*, *supra* note 66, s. 66.11, which provides the definition of "consumer debtor" for the purposes of Part III, Division 2 of the *Act*.

same causes: a proposition that cannot be sustained. An example is a failed small business operated as a company that is placed in liquidation for reasons other than fraud or mismanagement, and where the directors have guaranteed the company's debts. What is important in dealing with bankruptcies is to address their underlying problems.

The underlying problem in a consumer bankruptcy is the inability to manage debt in our increasingly cashless society. The temptation to buy goods or services one cannot otherwise afford (because of insufficient cash) is greater because of our increasing access to credit. The poor exponent of the art of budgeting does not allow for the inevitable interest bills that follow; or indeed, for the ongoing cost of maintaining the value of the goods that have been acquired on credit.

As I suggested earlier, education at the school level may be part of the prescription. By the time the insolvency administrator appears on the scene, the doctor who, by proper diagnosis and treatment can cure the patient, has turned into an undertaker who can only bury or cremate the victim. Can the undertaker be given a different incarnation? Why not make the undertaker the skilled surgeon operating on the emergency room table who, through use of skills in financial management, can assist the debtor to cope better in a society in which it is increasingly necessary to manage one's credit as well as one's cash? If the result is a borrower who is better educated in the art of budgeting, much will have been achieved for society.

If we are to improve the integrity, accountability, and efficiency of the bankruptcy system (this being one of the themes correctly referred to in the Report of the National Bankruptcy Review Commission in the United States) it is necessary to provide solutions to a problem when it is capable of being solved. It may come back to instilling old-fashioned values, such as living within one's budget, and not incurring debt that one cannot reasonably expect to repay: in a word, "thrift." I suggest it is false to consider options to deal with consumer bankruptcies from the perspective of a consumer's choice of remedies. Surely, government has a responsibility to select the principles and values by which it wishes to govern, and to put in place educative and legislative means to achieve those ends. The unlucky debtor may be given a fresh start. He or she should also get proper advice on how to remedy the problems that have caused the bankruptcy. Bankruptcy should never be an easy option to increase one's wealth or to avoid (by removing) problems which, with proper management, could be solved by agreement with creditors. The bankruptcy process should not be considered as a sticking plaster when it could be a drug capable of curing serious illness.

All of these issues are relevant in New Zealand today. Since financial deregulation, New Zealanders have had to take increased personal responsibility for payment of much of their (and their children's) health and education costs. They have to provide for their retirement, and are expected to invest money for that purpose knowing that the investment may fail, and that the government will not come to their rescue. The *Employment Contracts Act 1998*⁸¹ has resulted in more people working as independent contractors than as employees, and has had both good and bad effects. Some benefits previously enjoyed by employees have been lost. Flexibility has been gained. In New Zealand, we do not have the problem of tort claims for personal injury, as all personal injuries suffered through accidents are covered by the *Accident Rehabilitation and Compensation Insurance Act 1992*⁸². However, the statutory regime provides far less compensation than one could expect if able to sue in tort. It also provides far less by way of compensation than was originally intended when the *Accident Compensation Act 1972*⁸³ was enacted.

One option for dealing with consumer bankruptcies is to catch them earlier in the system. New Zealand has advantages in this respect over other countries. Unlike the United States, Canada, and Australia, New Zealand is a unitary state with a unicameral Parliament, and so does not face the problems encountered in federal insolvency systems because of excessive levels of exempt property allowed under state law. New Zealand does embrace the concept of exempt property, but has generally kept it within reasonable limits.⁸⁴ At present, under both the *Matrimonial Property Act 1976*⁸⁵ and the *Joint Family Homes Act 1964*⁸⁶ property levels of up to \$82,000 are prescribed as protection against creditors.⁸⁷ New Zealanders are starting to have gambling problems. Casinos have recently been authorized and sports betting has also been

⁸¹ *Supra* note 29.

⁸² [1992] 1 N.Z. Stat. 64, No. 13.

⁸³ [1972] 1 N.Z. Stat. 521, No. 43.

⁸⁴ Examples are the modest levels of exemption for tools of trade and furniture: see *Insolvency Act 1967*, *supra* note 1, s. 52. See also *Laws NZ*, *supra* note 1, "Insolvency," para. 255.

⁸⁵ [1976] 3 N.Z. Stat. 2148, No. 166.

⁸⁶ [1964] 1 N.Z. Stat. 253, No. 45.

⁸⁷ See *Joint Family Homes (Specified Sum) Order 1996* S.R. 1996/175; and *Matrimonial Property (Specified Sum) Order 1996* S.R. 1996/176. These limits are reviewed every two years. See also *Official Assignee v. Lawford*, [1984] 2 N.Z.L.R. 257 (C.A.).

introduced. It will be interesting to follow the impact of these factors on future bankruptcies in New Zealand.

VII. CONCLUSION

In my view, the objective of bankruptcy is to maximize recovery for creditors who have lost money, while enabling an unfortunate debtor to make a fresh start and, conversely, penalizing debtors who are guilty of reprehensible commercial conduct. If the law becomes too pro-debtor, there is a danger that the emphasis on rehabilitation will also eliminate the consequences of undesirable commercial conduct. This will mean a loss of incentives for citizens to honour their contractual promises. The suggested introduction in the United States of measures to prevent irresponsible lending will also be watched with interest in New Zealand.

A balance also needs to be struck between personal insolvency law and family law to ensure that innocent spouses and children do not suffer unfairly through misfortune or misconduct of the debtor spouse.

Models for reform can build on the Canadian model, which provides for budgetary counselling.⁸⁸ Another option is the introduction of more efficient methods of debt recovery. This will permit the early identification and treatment of insolvent persons so that their affairs can be dealt with in a manner appropriate to their individual circumstances, taking into account the competing interests of debtor, creditor, and society.⁸⁹ This can be done by judgment creditors seeking examinations of debtors, not for the purpose of enabling a creditor to gain priority over other creditors but, rather, to allow an independent and experienced person to consider the debtor's circumstances, and to determine whether a collective enforcement mechanism will best suit the debtor's and creditor's needs. Insolvent persons should be encouraged to face their creditors at the earliest possible time. If they are willing to do so, they should receive help. If they are unwilling to co-operate, then there should be as few obstacles as possible for creditors seeking collective administration for the benefit of all. The adoption of this model would give greater weight to the interests of the collective body of

⁸⁸ See *BIA*, *supra* note 66, Part XI and Part III, Division 2 in relation to consumer proposals.

⁸⁹ See generally New Zealand, Department of Justice, *Future Initiatives for the Administration of Insolvency in New Zealand* (Wellington, N.Z.: Department of Justice, 1991) at 6. This proposal is not currently under active consideration in New Zealand, but will, I hope, be taken into account in the insolvency law review.

creditors than to the “first come, first served” principle, which applies to the enforcement of judgments by individual creditors.

While it is important to recognize that constraints on public expenditures limit the amount of investigation and administration that can be conducted, it is also important to bear in mind the public interest issues to which I have referred. If keeping a promise is at the heart of the law of contract, the honouring of contractual obligations should be given the same weight in devising a workable insolvency law.