

THE PHILOSOPHY AND DESIGN OF CONTEMPORARY CONSUMER BANKRUPTCY SYSTEMS: A CANADA- UNITED STATES COMPARISON[©]

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The rapid increase in the number of consumer bankruptcies in Canada and the United States over the past fifteen years has again focused attention on the philosophy and design of modern insolvency systems, and on the similarities and differences in the approaches adopted in Canada and the United States. In this article, the author points out that the single most important difference is that the United States has historically subscribed to the debtor's right to a "fresh start" after surrendering the debtor's non-exempt property, whereas Canadian law never has, and does not now, confer an absolute right of discharge. Although critical of many aspects of the recent amendments to the Canadian *Bankruptcy and Insolvency Act (BIA)*, the author concludes that the qualified fresh-start policy followed by Canadian law is conceptually sound. At the same time, he indicates his preference for the more flexible, judicially-supervised surplus income regime in force before 1997, in place of the mandatory, surplus-income payment requirements introduced in the 1997 amendments to the *BIA*.

L'augmentation rapide dans le nombre de faillites des consommateurs au Canada et aux Etats-Unis pendant les quinze dernières années, a une fois de plus attiré l'attention sur la philosophie et la conception de systèmes de faillite modernes, et sur les similarités et les différences entre les approches adoptées au Canada et aux Etats-Unis. Dans cet article, l'auteur indique que la plus importante différence unique, c'est que les Etats-Unis ont historiquement souscrits au droit du débiteur pour un «nouveau départ», après avoir rendu la propriété non-exemptée du débiteur, tandis que la loi canadienne n'a jamais, et jusqu'à jour, conféré le droit absolu à un acquittement. Bien qu'il critique plusieurs aspects des amendements de la *Loi sur la faillite et l'insolvabilité* du Canada, l'auteur conclut que la politique du «nouveau départ» conditionnel suivie par la loi canadienne est conceptuellement judicieuse. En même temps, il indique sa préférence pour le régime du surplus de revenus, plus flexible et judiciairement surveillé, enforcé avant 1997, au lieu des exigences obligatoires de remboursement du surplus-revenus, introduites dans les amendements de la *Loi sur la faillite et l'insolvabilité* en 1997.

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I. INTRODUCTION

These are anxious times for bankruptcy policymakers, though history teaches us that turbulence has been the hallmark of bankruptcy law during much of its evolution, at least in common law jurisdictions. Throughout much of the nineteenth century, controversy swirled around the content and structure of bankruptcy legislation, the role of voluntary and involuntary bankruptcies, whether debtors should be allowed a statutory discharge from their liabilities and, in the case of Canada and the United States, the roles the federal governments should be playing in this branch of commercial law.

The current controversies differ because their primary focus is consumer bankruptcies. They have been triggered in Canada and the United States, and to a lesser extent in other common law jurisdictions, by the rapid rise in the number of consumer bankruptcies over the past ten years or more.¹ Critics on both sides of the border, notably the

¹ Between 1985 and 1997, Canadian consumer insolvencies grew more than fourfold from 19,752 in 1985 to 90,034 in 1997. The comparable figures for the United States were 341,233 and 1,350,118, also a fourfold increase. By way of comparison, individual insolvencies in England and Wales were 6,778 in 1985 and 24,420 in 1997, also an increase of just under 400 per cent. However, the insolvency rate per 1,000 persons in England and Wales was only 0.47 in 1997 compared to 3.00 in Canada and 5.1 for the United States. The number of consumer insolvencies in Australia amounted to 8,761 in 1986-1987 and 22,285 in 1996-1997, also a very substantial increase. The insolvency rate for Australia in 1996-1997 was 1.20, nearly three times the rate for England and Wales. All of these statistics are taken from 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].

Those depressed by these numbers and the rapid escalation of the consumer bankruptcy rates in Canada and the United States may derive some comfort from Peter Coleman's account of the incidence of debt problems in the early history of the United States: see P.J. Coleman, *Debtors and Creditors in America: Insolvency, Imprisonment for Debt, and Bankruptcy, 1607-1900* (Madison, Wis.: State Historical Society of Wisconsin, 1974) at 287-88, where he writes that,

[t]he crude and imperfect evidence of the late eighteenth century suggests that as many as one householder in three may each year have been hauled into court as a defaulting debtor, and that by the early nineteenth century one householder in every five would, during his working lifetime, fail outright rather than merely default on a particular debt. The incidence of difficulty probably rose as the century advanced. For example, three Philadelphians in every eight spent some time in a debtors' prison in the late 1820's, and the equivalent of one householder in each one hundred applied for a discharge under the short-lived national bankruptcy law of 1841. Nearly thirty-four thousand persons petitioned under the act and almost \$400,000,000 in debts were written down, an average of more than \$11,000 a case.

consumer credit industry, complain that it is too easy for consumers to go bankrupt and obtain a discharge, and that this leads to great abuses.

In the United States these complaints, as well as other factors, led to the establishment of the National Bankruptcy Review Commission (NBRC) in 1995 and subsequently to the introduction of congressional bills² which, had they been adopted, would have resulted in the adoption of a means test for bankruptcy petitioners. In Canada, the formal thrust of the 1997 amendments to the Canadian *Bankruptcy and Insolvency Act* (*BIA*)³ is not to deny petitioners access to the bankruptcy door. Instead, the goal is to encourage consumers to opt for the proposal route under Part III, Division 2 of the *Act* through the adoption of mandatory income payment requirements and cognate provisions. The means may be different, but the message is the same in both countries: consumer debtors with surplus income must be prepared to pay off at least part of their debts or stay clear of straight bankruptcy altogether.

These recent developments warrant an article in their own right. However, since they are only part of a much broader series of questions concerning the role and philosophy of modern consumer bankruptcy systems, I will address them in that context.

A preliminary issue much debated in the nineteenth century—should consumers be allowed to go bankrupt and obtain absolution from their debts?—was resolved in the United States with the passage of national bankruptcy legislation in 1898,⁴ and in Canada with the adoption of the *Bankruptcy Act*⁵ of 1919. As I will explain presently, unlike in the United States, the unconditional entitlement to a fresh start has never been part of Canadian law. It is still not the law, although in most cases (perhaps as high as 90 per cent) consumers obtain an unconditional discharge. What may be fairly claimed is that modern

² See *Bankruptcy Reform Act of 1998* H.R. 3150, 105th Cong. (1998); and *Consumer Bankruptcy Reform Act of 1997* S. 1301, 105th Cong. (1997). See also J. Braucher, "Options in Consumer Bankruptcies: An American Perspective" (1999) 37 *Osgoode Hall L.J.* 155. The two bills expired with the adjournment of Congress for the mid-term elections in November 1998. However, new bills have been introduced in the 106th Congress incorporating similar means-testing provisions, and I have been advised that one of the bills is likely to receive congressional approval: see in particular *Bankruptcy Reform Act of 1999* H.R. 833, 106th Cong. (1999); and *Bankruptcy Reform Act of 1999* S. 625, 106th Cong. (1999).

³ R.S.C. 1985, c. B-3 [hereinafter *BIA*], as am. by *An Act to amend the Bankruptcy Act and to amend the Income Tax Act in consequence thereof* S.C. 1992, c. 27, s. 2 [hereinafter *1992 Amendments*].

⁴ See *An Act To establish a uniform system of bankruptcy throughout the United States* §41, 30 Stat. 544 (1898) [hereinafter *National Bankruptcy Act of 1898*].

⁵ 1919 (Can.), 9 & 10 Geo. V, c. 36 [hereinafter *1919 Act*].

common law jurisdictions share the common philosophy that the “honest but unfortunate debtor” should be able to make a fresh start. Where they differ is in determining when that point has been reached.

The availability of bankruptcy relief for consumers in common-law systems is in striking contrast to the position in many civil law countries, where bankruptcy is either a non-existent option or only available after all other avenues of relief have been exhausted. In those countries, the stigma of bankruptcy and repugnance of any official philosophy encouraging dispensation from consumer debts is still very strong.⁶

These alternative civil law approaches to the management of consumer debt in an era of bountiful consumer credit raise challenging questions about lifestyles and legislative approaches. How successful are the civilian approaches, and is their success contingent on maintaining a firm lid on the consumption of consumer credit? Of what use is a more or less mandatory income payment program, coupled with intensive counselling, for debtors who have no surplus income, but nevertheless have managed to run up sizeable debts? How true is it to say that a strong social safety net dispenses with the need for a fresh start policy, or is this only a debate over the right kind of packaging and acceptable nomenclature?

These questions are addressed to some extent in other articles in this Symposium. I will turn now to my basic theme. This is the philosophy and design of consumer bankruptcy systems in common law jurisdictions that proceed from the premise that no distinction should be drawn between business and non-business debtors in their ability to obtain relief from the burden of debt.

II. CANADIAN AND AMERICAN SYSTEMS AS A BASIS OF COMPARISON

My comparison will be between the Canadian and American systems. I have chosen the Canadian system because I know it best and because it serves as a proxy for the British system from which it is derived. There are still more important reasons for comparing the Canadian and American experiences and approaches. Although the

⁶ See J. Niemi-Kiesiläinen, “Changing Directions in Consumer Bankruptcy Law and Practice in Europe and USA” (1997) 20 *J. Consumer Pol’y* 133; and J. Niemi-Kiesiläinen, “Consumer Bankruptcy in Comparison: Do We Cure a Market Failure or a Social Problem?” (1999) 37 *Osgoode Hall L.J.* 473 [hereinafter “Consumer Bankruptcy in Comparison”].

population of the United States is nine times greater than Canada's, our lifestyles are similar in many respects. Both countries have federal systems of government and private law rules based predominantly on common law concepts. Both have market-driven economies. Both are very heavy users of consumer credit. Both have experienced an explosive growth in the number of consumer bankruptcies over the past twenty-five years. One difference between the two countries is that Canada has a significantly stronger social safety net than the United States—through, for example, the existence of a national medicare system, programs of child support and support for single parents, paid maternity leave for new mothers, and better benefits for unemployed workers.

Another important difference is that the Canadian insolvency system and its underlying philosophy have developed quite independently of the American system. The critical questions for consideration therefore are whether the Canadian system has struck a better balance than has the American system between the legitimate and non-legitimate uses of bankruptcy for the discharge of consumer debts, and whether any apparent difference between the two systems is a matter of detail, and only masks a deeper social and economic reality.

III. THE FAULT LINES OF COMPARISON

I believe the similarities and differences between the Canadian and American systems can best be exposed in terms of the following series of questions, which constitute the fault lines of many modern bankruptcy systems:

1. How does the debtor enter the bankruptcy process and who administers the debtor's bankruptcy?
2. How much of the debtor's property must the debtor surrender to the bankruptcy estate? Does it include any part of the debtor's income prior to the debtor's discharge? What part of the debtor's property is exempt from the trustee's reach, and how are secured claims treated?
3. When is the debtor entitled to apply for a discharge or is discharge automatic at some point? May the court refuse a discharge or impose conditions for a discharge? In particular, may the court require payment of some or all of the outstanding debts from the debtor's future income? What types of claim are excluded from discharge?
4. What alternative statutory schemes are in place to enable or encourage a debtor to avoid straight bankruptcy, and to enter into an

arrangement or compromise of his or her debts (“plan” or “proposal”) with his or her creditors? What are the preconditions for a successful plan or proposal? What are the consequences of the debtor’s failure to live up to the terms of the plan or proposal?

5. Does the regime permit reaffirmation of pre-bankruptcy debts?

6. What role does counselling play as part of the debtor’s rehabilitation, whether in a straight bankruptcy or as part of a plan or proposal?

IV. OVERVIEW OF THE CANADIAN BANKRUPTCY SYSTEM

A. *Constitutional and Historical Aspects*

In order to make my answers to these questions intelligible to an American reader, I must begin with some background strokes about the Canadian insolvency system. In Canada, as in the United States, the federal government is constitutionally empowered to adopt bankruptcy and insolvency legislation.⁷ The difference between the two countries is that, in Canada’s case, the federal government is, on paper at least, invested with an exclusive jurisdiction to legislate on questions of bankruptcy and insolvency. In practice, Canadian courts have tolerated, though not consistently, a substantial amount of overlap between federal and provincial law as long as the provincial law is not in direct conflict with federal law. In any event, the federal bankruptcy system is premised on a largely provincially-originating substratum of property and other pre-bankruptcy rules,⁸ so that provincial law exerts a powerful influence on the resolution of bankruptcy disputes.

Canada’s first insolvency Act, which only applied to traders, was adopted in 1869⁹ and was replaced by a later Act in 1875.¹⁰ The *1875 Act*

⁷ See *Constitution Act, 1867*(U.K.), 30 & 31 Vict., c. 3, s. 92(13), reprinted in R.S.C. 1985, App. II, No. 5 [hereinafter *Constitution Act, 1867*]. See also U.S. Const. art. I, § 8, which provides that “Congress shall have power ... [t]o establish a uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States”

⁸ See *BIA, supra* note 3, s. 72(1), which provides that “the provisions of this Act shall not be deemed to abrogate or supersede the substantive provisions of any other law or statute relating to property and civil rights that are not in conflict with the Act”

⁹ See *The Insolvent Act of 1869*(Can.), 32-33 Vict., c. 16 [hereinafter *1869 Act*].

¹⁰ See *The Insolvent Act of 1875*(Can.), 38 Vict., c. 16 [hereinafter *1875 Act*].

was widely criticized, and it was repealed in 1880.¹¹ Between 1880 and 1919, Canada had no general bankruptcy legislation at all. However, in 1882 the federal government adopted winding up legislation for insolvent trading corporations and other corporate enterprises.¹²

The first comprehensive Canadian bankruptcy legislation was adopted in 1919. The *1919 Act*¹³ was heavily influenced by the British *Bankruptcy Act, 1883*¹⁴ and its general conceptual structure. The *1919 Act* differed from the British *Act* in two important respects. First, it did not follow the British precedent of relegating corporate insolvencies to a separate legislative regime; for the most part, the *1919 Act* applied the same rules to natural and legal persons. Second, the *1919 Act* adopted a different structure for the administration of insolvent estates and their supervision that, in Canada's case, was strongly privately oriented.¹⁵

The British influence on subsequent Canadian legislation has been very limited. I have already mentioned the substantial independence of Canadian insolvency legislation from American influences. Since 1919, Canada has generally preferred to cultivate a home-grown product.

The *1919 Act* was extensively revised in 1949.¹⁶ Comprehensive proposals for new revisions were presented by a federal Study Committee in 1970.¹⁷ However, these were never translated into legislation despite the introduction of several bills between 1975 and 1984. Beginning with the Mulroney Conservative administration, later governments opted for a phased-in program of bankruptcy reform.¹⁸ Two important amending acts have so far seen the light of day, the first

¹¹ See *An Act to repeal the Acts Respecting Insolvency now in force in Canada* 1880 (Can.), 43 Vict., c. 1.

¹² See *An Act respecting Insolvent Banks, Insurance Companies, Loan Companies, Building Societies and Trading Corporations* 1882 (Can.), 45 Vict., c. 23.

¹³ *Supra* note 5.

¹⁴ (U.K.), 46 & 47 Vict., c. 52 [hereinafter *1883 Act*].

¹⁵ See further T.G.W. Telfer, "The Canadian Bankruptcy Act of 1919: Public Legislation or Private Interest?" (1994) 24 Can. Bus. L.J. 357.

¹⁶ See *Bankruptcy Act, 1949* (Can.), 13 Geo. VI, c. 7 [hereinafter *1949 Act*].

¹⁷ See Canada, *Bankruptcy and Insolvency: Report of the Study Committee on Bankruptcy and Insolvency Legislation* (Ottawa: Information Canada, 1970) (Chair: R. Tassé). John Honsberger, Q.C., Canada's leading bankruptcy scholar, was a key member of the Committee.

¹⁸ See J.S. Ziegel, "Canada's Phased-in Bankruptcy Law Reform" (1996) 70 Am. Bankr. L.J. 383 [hereinafter "Bankruptcy Law Reform"].

in 1992,¹⁹ and the second in 1997.²⁰ A third round of amendments is envisaged for adoption early in the twenty-first century.

B. *The 1992 and 1997 Amendments*

So far as the topic of this article is concerned, the 1992 amendments were important because they greatly simplified the procedure for the handling of discharges for personal bankrupts, and because they introduced a separate regime for the making of consumer proposals as an alternative to straight bankruptcy. The 1997 amendments added another very significant chapter to the treatment of consumer bankruptcies; section 68 of the *BIA* was completely re-written to require debtors, between the time of bankruptcy and the time of their discharge, to pay over their surplus income based on standards issued by the Superintendent of Bankruptcy (“Superintendent”).²¹

New provisions were also added to the *BIA* dealing with the debtor’s application for a discharge. Section 170.1 of the *BIA* requires the trustee’s report to the court hearing the discharge application to report whether the debtor has complied with the section 68 income payment requirements,²² and whether the debtor chose the bankruptcy route for resolving his or her indebtedness when the debtor could have made a viable proposal.²³ The trustee’s report may also include recommendations with respect to whether the debtor’s discharge should be made conditional.²⁴ If such a recommendation is made, it will be treated as an opposition to the discharge. Another amendment, this one to section 173,²⁵ adds to the list of circumstances precluding the court from granting the debtor an unconditional discharge if the debtor has failed to comply with a section 68 income payment requirement, or if the

¹⁹ See *1992 Amendments supra* note 3.

²⁰ See *An Act to amend the Bankruptcy and Insolvency Act, the Companies’ Creditors Arrangement Act and the Income Tax Act* S.C. 1997, c. 12, s. 2 [hereinafter *1997 Amendments*].

²¹ See Office of the Superintendent of Bankruptcy, *Directive No. 11: Surplus Income* (issued 30 April 1998), online: Office of the Superintendent of Bankruptcy <<http://strategis.ic.gc.ca/SSG/br01055e.html>> (date accessed: 19 August 1999) [hereinafter *Directive No. 11*].

²² See *BIA, supra* note 3, s. 170.1(2)(a).

²³ *Ibid.* s. 170.1(2)(c).

²⁴ *Ibid.* s. 170.1(3).

²⁵ *Ibid.* ss. 173(m)-(n), as am. by *1997 Amendments supra* note 20, s. 103(1).

debtor chose the bankruptcy route when the debtor could have made a viable proposal.

In short, Canadian consumer creditors and their allies won a major victory in making sure that future bankrupts would not be able to shrug off their debts as easily as their predecessors had allegedly done in the past.

C. Administrative and Judicial Structures

In theory at any rate, Canadian bankruptcies are creditor driven, and the judicial role is minimized. At the apex of the administrative hierarchy sits the Superintendent, a federally appointed official, who appoints or recommends the appointments of all trustees in bankruptcy²⁶ and official receivers.²⁷ Official receivers are full-time federal officials located in the bankruptcy districts into which Canada is divided. Their functions include receiving assignments in bankruptcy, appointing a trustee if none is designated in the assignment, and conducting inquiries into the causes of bankruptcies.²⁸

In practice, the trustee, who is not a government official, is the most important cog in the administrative wheel. The trustee is required to be licensed by the Superintendent,²⁹ and is usually a chartered accountant specializing in insolvency law. Canadian trustees differ from their American counterparts in two important respects. First, Canadian trustees are drawn exclusively from the private sector and are not public officials, although for some purposes they may be treated as officers of the court. Second, most consumer bankruptcies are initiated and processed by trustees without the intervention of an attorney. Canadian debtors are free to retain an attorney to prepare the assignment, but few consumers would find it efficient to do so since it would involve the payment of two sets of fees—the attorney's and the trustee's. Canadian trustees widely advertise their services on cable television and in the Yellow Pages of the local telephone directory, and less frequently on local television.³⁰ They frequently operate from more than one office

²⁶ *Ibid.* ss. 5(3)(a), 13.

²⁷ *Ibid.* s. 12.

²⁸ *Ibid.* ss. 49(3)-(4), 161.

²⁹ *Ibid.* s. 13. A substantial number of trustees are former official receivers.

³⁰ Some large firms of trustees with many offices are estimated to spend \$100,000 or more annually on advertising. Other trustees spend very little and rely primarily on word of mouth recommendations. Directive No. 30R, issued by the Office of the Superintendent in Bankruptcy,

and rely heavily on non-professional staff to help them process large numbers of consumer bankruptcies.³¹ As a rule, the trustee is nominated to serve in this capacity by the debtor in a voluntary assignment or by the petitioning creditor in an involuntary bankruptcy. Although the Canadian system might be perceived as giving rise to conflicts of interest, so far neither the courts nor the Superintendent have raised objections to it.

The trustee's appointment is required to be confirmed at the first meeting of creditors, but this is usually only a formality. Once appointed, the trustee is invested with legal title to all the assets of the estate,³² and can sue and be sued in his or her capacity as trustee. Unlike American law,³³ the *BIA* does not conceptualize the debtor's estate as constituting a separate legal persona.

The role of an inspector of the bankrupt's estate is comparable to the role of a director of a business corporation. Inspectors are elected by the estate's creditors.³⁴ They supervise the trustee's activities and are required to give their approval to all important decisions made by the trustee.³⁵ In practice, in straight bankruptcies, most unsecured creditors take very little interest in the administration of the estate, since they know that ordinarily very little will be left of the estate after the claims of secured and preferred creditors have been satisfied.³⁶

Once the bankrupt's assets have been gathered in and realized, it is the trustee's responsibility to distribute the net proceeds among the creditors with proven claims in accordance with the priorities established

makes a modest attempt to regulate some aspects of trustees' advertising, though not the amount of advertising or the media through which it may be carried: see Office of the Superintendent of Bankruptcy, *Directive No. 30R: Advertising by Trustees* (issued 4 January 1991), online: Office of the Superintendent of Bankruptcy <<http://strategis.ic.gc.ca/pics/br/dir30r.pdf>> (date accessed: 19 August 1999). Note too that section 202(1)(f) of the *BIA*, *supra* note 3, makes it an offence for any person directly or indirectly to solicit or canvass any person to make an assignment or a proposal under the *Act*, or to petition for a receiving order. The provision may be vulnerable to attack as an unconstitutional infringement on freedom of expression under section 2(b) of the *Canadian Charter of Rights and Freedoms* Part I of the *Constitution Act, 1982* being Schedule B to the *Canada Act 1982* (U.K.), 1982, c. 11.

³¹ In a large population centre, such as Toronto, a single office may process several hundred consumer bankruptcies a year. Several large firms of trustees also operate across Canada.

³² See *BIA*, *supra* note 3, s. 71(2).

³³ See 11 U.S.C. § 541(a) (1998) [hereinafter *Bankruptcy Code*].

³⁴ See *BIA*, *supra* note 3, s. 116(1).

³⁵ *Ibid.* s. 30(1).

³⁶ In a typical estate, non-preferred, unsecured creditors will be lucky to collect even five cents on the dollar of their proven claims. In a consumer bankruptcy they will often receive nothing.

in the *BIA*.³⁷ Where the debtor's estate, after the claims of secured creditors have been deducted, amounts to less than \$5,000, the estate may be administered summarily ("summary administration").³⁸ This reduces the role of creditors in the administration of the estate still further. Recent statistics show that 90 per cent or more of consumer bankruptcies are administered summarily.³⁹

The court structure under the Canadian bankruptcy system differs fundamentally from the structure of its American counterpart. Canada has no separate system of bankruptcy courts.⁴⁰ Instead, the superior courts in each of the provinces are invested with plenary bankruptcy jurisdiction.⁴¹ Rights of appeal lie from their decisions to the provincial courts of appeal, and thence to the Supreme Court of Canada.⁴² In practice, a bankruptcy judge will seldom be involved in a consumer bankruptcy, and then only at the discharge stage if the discharge is opposed, which is rare.

V. INITIATING A CONSUMER BANKRUPTCY PROCEEDING

It is very easy for a Canadian consumer to go bankrupt under the *BIA*.⁴³ It appears to be even easier than it is for an American consumer to

³⁷ See *BIA*, *supra* note 3, s. 136. Creditors are divided into secured, preferred, ordinary, and deferred unsecured creditors.

³⁸ *Ibid.* s. 49(6). The consequences of a summary administration are spelled out in section 155.

³⁹ See T. Craddock, "Bankruptcy Discharge Statistics, 1988-1998" in *Roundtable on Recent Consumer Bankruptcy Developments: Materials for Distribution* (Faculty of Law, University of Toronto, 21 July 1999) [unpublished, on file with author] 1 at 1-6 [hereinafter *Roundtable*].

⁴⁰ Canada has a system of federal courts encompassing the Federal Court of Canada (FCC), with a trial and appellate division, and the Supreme Court of Canada. The Supreme Court of Canada is the final appellate tribunal on questions of provincial as well as federal law. The jurisdiction of the FCC is limited to matters of federal law and does not include bankruptcy law. The reason for this anomaly is historical. The FCC was only established in 1971 and, at this late date, it would have been very unpopular politically for the federal government to transfer bankruptcy jurisdiction to the federal courts. It should also be appreciated that under Canada's constitution all superior court judges are appointed by the federal government: see *Constitution Act, 1867* *supra* note 7, s. 96. This explains why the federal government felt quite comfortable about leaving bankruptcy jurisdiction in the hands of provincial court judges.

⁴¹ See *BIA*, *supra* note 3, s. 183(1).

⁴² *Ibid.* ss. 183(2)-(3).

⁴³ I am referring to the ease of acquiring the status of a bankrupt, not to the quite separate question of obtaining a discharge from the debtor's liabilities.

go bankrupt under the *Bankruptcy Code*⁴⁴ The simple qualifying requirements under Canadian law are that the consumer must be insolvent, must reside or have property in Canada, and that his or her debts amount to \$1,000 or more.⁴⁵ In terms of the paperwork, all that is required is a written assignment—a standard document of a couple of pages, accompanied by a preliminary statement of affairs, the nomination of a trustee who has agreed to act on the debtor's behalf (rarely a problem since trustees advertise widely), and “acceptance” of the assignment by the official receiver.⁴⁶ The official receiver cannot refuse to accept the assignment if the documents are in order. A modest filing fee is payable, but it only amounts to \$50. Unlike in the United States, there is no judicial intervention at this stage. Likewise, there is no enquiry before the assignment becomes effective, as there may be under the British system, to determine the circumstances leading to the bankruptcy.

The *BIA* has no precise counterpart to the “abuse” provision in section 707(b) of the United States *Bankruptcy Code*. Section 181(1) of the *BIA* confers a seemingly open-ended jurisdiction on the Canadian bankruptcy court to annul an assignment, but apparently there are no reported cases of this discretion having been exercised because the consumer could have made a viable proposal.⁴⁷ However, this pro-debtor position must not be misconstrued. It does not mean that everything is plain sailing once the debtor has made his or her assignment. Rather, as is explained in Part VII(B), below, as a result of the 1997 amendments to the *BIA*, the debtor may face two formidable hurdles. First, if the debtor has non-exempt income, he or she may be required to pay it over to the trustee.⁴⁸ Second, if the trustee is of the

⁴⁴ *Supra* note 33.

⁴⁵ See *BIA*, *supra* note 3, s. 2, “insolvent person.”

⁴⁶ *Ibid.* ss. 49(3)-(4). See also *Rules Amending the Bankruptcy and Insolvency Rules* (O.R./98-240, s. 1, Rule 85; and Forms 22-23. Section 49(4) of the *BIA*, *supra* note 3, requires the official receiver to appoint a trustee selected, as far as possible, by reference to the most interested creditors if ascertainable at the time. I am told this does not happen in practice, and that the assignment completed by the debtor usually includes the name of the trustee consulted by the debtor.

⁴⁷ The case law is collected in L.W. Houlden & G.B. Morawetz, *The 1999 Annotated Bankruptcy and Insolvency Act* (Scarborough, Ont.: Carswell, 1998) at D§32 [hereinafter *The Annotated Bankruptcy and Insolvency Act*]. The court also has general jurisdiction under section 187(5) of the *BIA*, *supra* note 3, to review, rescind, or vary any order made under its bankruptcy jurisdiction. This power does not seem to apply to an assignment, since an assignment does not derive its force from a court order.

⁴⁸ See *BIA*, *supra* note 3, s. 68.

view that the debtor could have made a viable proposal to his or her creditors under Part III, Division 2 of the *BIA* and so reports to the bankruptcy court,⁴⁹ the court will not be able to grant the debtor an unconditional discharge.

VI. SCOPE OF THE BANKRUPTCY ESTATE, EXEMPTIONS, SECURED CLAIMS, AND STATUS OF FUTURE INCOME

In this area, the fault lines between the Canadian and American approaches deepen perceptibly, and we encounter the first phase of the treatment of future income that so deeply divides the two systems. I will address each sub-question in the order in which it appears in the title of this section.

A. *Scope of the Bankruptcy Estate*

Under the *BIA*, after the debtor's assignment, the trustee succeeds to all of the debtor's property, unless exempted.⁵⁰ "Property" is defined non-exhaustively in the *Act* and includes all real and personal property, present and future, wherever located.⁵¹ It is this comprehensive definition and its extension to after-acquired property that provides the historical explanation for what Americans would regard as a major deviation from the fresh start policy.⁵² Anglo-Canadian lawyers, on the other hand, have been exposed for so long to the definition that they see nothing incongruous about all of the debtor's non-exempt property falling into the estate prior to an unconditional discharge of the debtor's liabilities.

⁴⁹ *Ibid.* s. 170.1(2)(c).

⁵⁰ *Ibid.* s. 71(2).

⁵¹ *Ibid.* s. 2, "property." See also subsections 67(1)(c)-(d), which state the following:

- (1) The property of a bankrupt divisible among his creditors shall comprise ...
- (c) all property wherever situated of the bankrupt at the date of his bankruptcy or that may be acquired by or devolve on him before his discharge, and
- (d) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit.

⁵² This is because section 541(a)(1) of the *Bankruptcy Code*, *supra* note 33, only vests in the debtor's estate all non-exempt legal and equitable interests of the debtor in property "as of the commencement of the case."

B. *Exempt Property*

In the area of property excluded from the estate, Canadian and American law share familiar territory. Both systems agree that the debtor must not be stripped of all assets. The debtor and his or her family must be allowed to keep the basic necessities of life, and the debtor must be able to pursue his or her livelihood. Canadian law, however, goes further than American law in allowing the scope of the exemptions to be determined by provincial law. There is no optional list of federal exemptions in the *BIA* as there is under section 522 of the *Bankruptcy Code* Table A-1⁵³ shows, as might be expected, that the Canadian provinces differ widely in their exemption policies, although not as widely as the American states differ among themselves. Alberta and Saskatchewan confer the most generous exemptions, with Quebec ranking third.⁵⁴ Ontario, Canada's richest and most populous province, has the dubious distinction of having the most parsimonious exemptions.

Chart 1⁵⁵ tracks the provincial bankruptcy rates against the provincial exemptions. American authors have frequently debated the impact of high exemptions on bankruptcy rates; the better view appears to be that there is no consistent correlation between the level of exemptions and the number of bankruptcies. As Chart 1 shows, this also appears to be true of the Canadian provinces for the 1991–1996 period. Ontario, with the lowest exemptions, had above average bankruptcy rates. Saskatchewan, with the highest exemptions, had below average bankruptcy rates.

C. *Status of Secured Claims*⁵⁶

It appears that the bankrupt American consumer receives substantially better treatment in retaining property subject to a security interest than does a Canadian bankrupt. This is even truer with respect

⁵³ See Appendix, Table A-1, below.

⁵⁴ British Columbia would have ranked third if recent amendments, which came into effect after 1997, had been included in the Table.

⁵⁵ See Appendix, Chart 1, below.

⁵⁶ For a much more detailed treatment of this topic, see the following articles in this Symposium: T.M. Buckwold, "Holding the High Ground: The Position of Secured Creditors in Consumer Bankruptcies and Proposals" (1999) 37 *Osgoode Hall L.J.* 277; and W.C. Whitford, "Secured Creditors and Consumer Bankruptcy in the United States" (1999) 37 *Osgoode Hall L.J.* 339.

to an American debtor's position under a Chapter 13 plan. Under both Chapters 7 and 13 of the *Bankruptcy Code*, the debtor has the benefit of the automatic stay provided by section 362(a) and, with respect to Chapter 7 filings, is given the option of returning the collateral; redeeming it for its actual value if it is exempt property under section 522 and involves personal property intended primarily for personal family or household use;⁵⁷ and redeeming the property for the full amount of the debt in other cases. Still another option open to the debtor, if the secured party agrees, is to reaffirm the security agreement.⁵⁸ Since most bankrupt debtors are not in a position to redeem (if they could raise the cash it is unlikely they would have gone bankrupt in the first place), the reaffirmation route is a common option in the United States, just as it is in Canada, for items essential to the debtor's lifestyle or livelihood.⁵⁹ Under Chapter 7, the debtor may also avoid nonpurchase-money security interests in exempt household goods and other personal property.⁶⁰ It appears to be unsettled whether the *Bankruptcy Code* permits the debtor to retain the collateral by simply maintaining the payments, a solution that would obviously be a debtor's first choice.⁶¹

A Chapter 13 plan clearly permits a debtor to reinstate a security agreement in default by offering a cure,⁶² including cure of mortgage payments in default on a home mortgage, after the mortgagee has accelerated payments due under the mortgage and commenced foreclosure proceedings.⁶³ Chapter 13 also permits a plan to modify the rights of secured creditors, unless they concern a security interest on the debtor's principal residence.⁶⁴ On both these grounds (as well as others)

⁵⁷ See *Bankruptcy Code*, *supra* note 33, §§ 521(2)(A), 722.

⁵⁸ *Ibid.* § 524(c).

⁵⁹ However, as discussed in Part X, below, the *BIA* contains no statutory safeguards to protect the debtor against abusive reaffirmation agreements.

⁶⁰ See *Bankruptcy Code*, *supra* note 33, § 522(f)(1)(A).

⁶¹ See *In re Gerling* 175 B.R. 295 (Bankr. W.D. Mo. 1994) and earlier case law cited therein.

⁶² See *Bankruptcy Code*, *supra* note 33, § 1322(b)(3).

⁶³ See *In re Taddea* 685 F.2d 24 (2d Cir. 1982).

⁶⁴ See *Bankruptcy Code*, *supra* note 33, § 1322(b)(2). In *In re Taddea*, *supra* note 63, the Court of Appeals for the Second Circuit distinguished between the right to cure and the right to modify and held that the debtor's right to cure also extended to home mortgages.

the debtor has a strong incentive to invoke Chapter 13 to keep secured creditors at bay.⁶⁵

The Canadian position is substantially different. There is no automatic stay in a straight bankruptcy for the debtor's benefit against the enforcement of a security interest. However, the trustee can apply for a stay that, if granted, cannot exceed six months.⁶⁶ There is a similar but expanded provision in the case of a consumer proposal under Part III, Division 2.⁶⁷ It only has a limited effect because a secured creditor is not bound by a proposal, even if it has been accepted by the other creditors, unless the secured creditor has filed a proof of claim.⁶⁸ The *BIA* has no counterpart to section 522(f)⁶⁹ of the *Bankruptcy Code*. However, the exemption legislation in several of the provinces invalidates nonpurchase-money security interests in exempted property.⁷⁰

As far as rights of redemption under the Canadian legislation are concerned, in a straight bankruptcy that right is conferred on the trustee under section 128(3) of the *BIA* on payment of the debt or the value of the security as assessed by the secured party. However, it is not clear to

⁶⁵ See E. Warren & J.L. Westbrook, *The Law of Debtors and Creditors: Text, Cases, and Problems*, 3d ed. (Boston: Little, Brown, 1996) at 338ff.

⁶⁶ See *BIA*, *supra* note 3, s. 69.3(2). Business debtors have much more significant protection under section 244, which requires a secured creditor holding a security interest in all or substantially all of the debtor's inventory, accounts receivable, or other property to give the debtor ten days' notice before enforcing the security interest. For the history of this restriction, see "Bankruptcy Law Reform," *supra* note 18 at 399.

⁶⁷ See *BIA*, *supra* note 3, s. 69.2(4).

⁶⁸ *Ibid.* s. 66.28(2)(b). Debtors under a Part III, Division 1 proposal are better off because secured parties can be included in a proposal without their consent. However, the proposal will not bind the secured creditors until they approve it by the requisite majority in number and value of claims. These features explain why secured creditors are subject to an automatic stay under sections 69(1) and 69.1(1). The position under a Part III, Division 2 proposal is ambiguous because of the provisions in sections 66.34 and 66.4(1).

⁶⁹ See note 60, *supra*, and accompanying text.

⁷⁰ It has been held in Ontario that the exemptions in the *Execution Act*, R.S.O. 1990, c. E-24 do not apply to secured parties; they apply only to creditors levying execution against the debtor's property: see *Re Vanhove* (1994), 20 O.R. (3d) 653 (Ont. Ct. (Gen. Div.)). The Canadian Bar Association-Ontario Subcommittee on the Ontario Personal Property Security Act has made recommendations to the Ontario government for amendments to the Ontario *Personal Property Security Act*, R.S.O. 1990, c. P-10 [hereinafter *OPPSA*], and other legislation. The amendments will include a provision entitling a consumer debtor to claim the same exemption from enforcement of a security interest as is available to a debtor under the *Execution Act* see Canadian Bar Association-Ontario, *Submission to the Minister of Consumer and Commercial Relations Concerning the Personal Property Security Act* (Toronto: CBAO, 1998) at 34-36 (Recommendation 28). Note that the provincial personal property security legislation also contains a provision precluding a security interest in after-acquired consumer goods unless the debtor acquires rights in the goods within ten days after the secured party has given value.

what extent this right also enures for the benefit of the debtor. With respect to rights of reinstatement of the security agreement after default by the debtor, many of the provincial personal property security statutes contain varying rights of reinstatement in favour of consumer debtors.⁷¹ Presumably, these rights survive the consumer's bankruptcy, at least in the case of property excluded from the trustee's reach under section 67(1) of the *BIA*. In the case of a consumer proposal, section 69.2(4) of the *BIA* also appears to confer an implicit right of reinstatement in the consumer's favour, not limited to residential real estate, in the case of security for a debt that does not become due until more than six months after the date of approval or deemed approval of the proposal. However, the right is contingent on the court first issuing a stay of proceedings by the secured creditor, and the stay cannot exceed six months.⁷²

Based on the above summary, one may fairly conclude that the *BIA* has so far paid very little attention to the needs of insolvent consumers holding motor vehicles, essential household items, and other property subject to a security interest and necessary for the consumer's livelihood and general well-being. However, I understand the practical position is substantially better than the black letter law; trustees will usually cooperate in allowing the debtor's budget to include payments on secured claims for essential items, including payments on a home mortgage and a vehicle required for transportation, and secured creditors will be equally amenable to such arrangements because it usually also serves their interests.⁷³

D. *Surplus Income Payment Requirements*

I have already summarized the 1997 amendments to section 68 of the *BIA*⁷⁴ that require the trustee to fix the share of the debtor's income that the debtor is required to pay to the trustee for distribution

⁷¹ See, for example, *OPPSA*, *supra* note 70, s. 66(2).

⁷² A further difficulty arises because it is not clear whether section 69.2(4)(b) of the *BIA*, *supra* note 3, applies where the secured party has invoked an acceleration clause, thereby taking the debt out of subsection 4(b) and bringing it under subsection 4(a) as a debt due at the date of approval. Section 66.34 invalidates acceleration clauses based on the consumer debtor's insolvency or the fact of a proposal having been filed. However, given the history and origins of the section, it is likely that it was only meant to apply to executory contracts and not to security agreements.

⁷³ However, it is not clear to what extent these sensible practices can be continued, having regard to the surplus income payment requirements under section 68 and the Superintendent's cost of living standards under that section: see Part IV, above.

⁷⁴ See Part IV(B), above.

among the creditors.⁷⁵ This requirement is such a radical departure from American philosophy that more needs to be said about it.

The concept of requiring the debtor to pay over surplus income already appeared in the British *Bankruptcy Act, 1914*.⁷⁶ However, the requirement was not triggered until the court made such an order on the trustee's application. In practice, it appears, trustees generally abstained from using this power, preferring to wait until the debtor made his or her discharge application.⁷⁷ The debtor's quest for an easy discharge order was regarded as providing sufficient incentive for him or her to turn over part of his or her surplus income voluntarily before the discharge hearing. If the trustee made an application for an income payment order, one of the factors required to be taken into consideration by the court was "essential" expenditures incurred by the debtor for the maintenance of the debtor, his or her family, and dependants. This formula still appears in the current British *Insolvency Act 1986*.⁷⁸

The Canadian story is more complicated. As previously indicated, section 67(1)(c) of the *BIA* and its predecessors have long provided that, subject to the authorized exemptions, the debtor's present and future property belongs to the estate. However, there was considerable uncertainty whether "property" included the debtor's income. In *Industrial Acceptance Corp. v. Lalonde*,⁷⁹ the Supreme Court of Canada held that it did. The result was regarded as unsatisfactory, since it meant either that the trustee could require the debtor to turn over all of the debtor's income or that the debtor was only entitled to claim the exemptions applicable under provincial non-bankruptcy law. To clarify the position, section 68 (then section 39A) was added to the *BIA* in 1966,⁸⁰ authorizing the trustee to make an application to the court for an income payment order, and requiring the trustee to do so if required by the inspectors. The amendment only applied to the debtor's earnings from employment. The court was given complete discretion in responding to the application, "having regard to the family

⁷⁵ Commonly referred to in Commonwealth insolvency literature as an income payment order.

⁷⁶ (U.K.), 4 & 5 Geo. V, c. 59, s. 51. See further U.K., Insolvency Law Review Committee, *Insolvency Law and Practice*, Cmnd 8558 (London: Her Majesty's Stationery Office, 1982) (Chair: Sir K. Cork) at paras. 591-97 [hereinafter "Cork Report"].

⁷⁷ See "Cork Report," *supra* note 76.

⁷⁸ (U.K.), 1986, c. 45, s. 310 [hereinafter *Insolvency Act 1986*]. See also I.F. Fletcher, *The Law of Insolvency*, 2d ed. (London: Sweet & Maxwell, 1996) at 203-05 [hereinafter *Law of Insolvency*].

⁷⁹ [1952] 2 S.C.R. 109.

⁸⁰ See *An Act to amend the Bankruptcy Act*, S.C. 1966, c. 32, s. 10.

responsibilities and personal situation of the bankrupt.”⁸¹ In a later decision, the Supreme Court of Canada held that section 68 constituted a complete code with respect to the trustee’s power to attach a debtor’s earnings.⁸²

In practice, the result appears to have been very similar to the British experience—in consumer cases, trustees were reluctant to exercise their powers because it was time consuming, because the trustees were poorly paid for such efforts, and because there was no consistency in the payment orders made by courts.⁸³ In 1991, the Superintendent sought to bring some moral suasion to bear by issuing a directive that incorporated the Superintendent’s “Guidelines” for calculating surplus income.⁸⁴

This is where matters stood when Working Group 1 of the Bankruptcy and Insolvency Advisory Committee (BIAC), established by the federal government in 1993 to make recommendations with respect to Phase II of the revision of the *BIA*, reviewed the position. The creditors were still very unhappy about the trustees’ failure to exercise their section 68 powers. The federal officials probably shared the sentiment. In any event, section 68 was completely revised,⁸⁵ adding enormous muscle to the section to ensure that future debtors paid over their surplus income, and trustees would not neglect their obligations. Some sense of the importance that the federal officials attached to these goals may be gleaned from the sheer length of the revised section 68: no less than 14 subsections, to which must be added another four printed pages in the Superintendent’s supporting directive of 30 April 1998, as modestly amended on 5 January 1999.⁸⁶

⁸¹ *Ibid.*

⁸² See *Marzettiv. Marzetti* [1994] 2 S.C.R. 765.

⁸³ The pre-1998 case law is summarized in *The Annotated Bankruptcy and Insolvency Act* *supra* note 47, F§52.

⁸⁴ See Office of the Superintendent of Bankruptcy, *Directive No. 17R2: Surplus Income* (issued 18 April 1990). The directive was revised on 2 April 1993.

⁸⁵ See *1997 Amendments* *supra* note 20, s. 60.

⁸⁶ See *Directive No. 11* *supra* note 21. The use of statutory guidelines in lieu of discretionary court orders to determine a debtor’s quantum liabilities has also been adopted by the Canadian federal government for parental support obligations under the *Divorce Act* R.S.C. 1985 (2nd Supp.), c. 3, as am. by *An Act to amend the Divorce Act, the Family Orders and Agreements Enforcement Assistance Act, the Garnishment, Attachment and Pension Diversion Act and the Canada Shipping Act* S.C. 1997, c. 1: see *Federal Child Support Guidelines* S.O.R./97-175, which was considered for the first time at the appellate level in *Francis v. Baker* (1998), 38 O.R. (3d) 481 (C.A.), currently on appeal to the Supreme Court of Canada. The partiality for regulatory standards to determine surplus income of bankruptcy debtors is not peculiar to Canada; it also appears in the

The following are the key features of section 68 as amplified by the directive. The trustee is initially responsible for determining the debtor's monthly income after deducting expenses reflecting the debtor's personal and family situation.⁸⁷ In the case of an employed debtor, the expenses cover statutory payments for income taxes and the like, and may include non-discretionary expenses, such as child support and spousal maintenance payments.

The trustee must next determine the debtor's available surplus income by consulting the Superintendent's Standards (see Table 1, below) showing the allowable living expenses for a person in the debtor's personal or family situation. These standards were apparently derived from a Statistics Canada compilation of the income requirements of low-income individuals and families.⁸⁸ As of January 1999, the cost of living allowance was \$1,492 for a single person, \$1,864 for a couple, and \$2,319 for a family of three.

The Superintendent's directive provides that where the total monthly surplus income of the debtor is equal to or greater than \$100 and less than \$1,000, the debtor is required to pay 50 per cent of the surplus income as calculated under the directive.⁸⁹ If the surplus income is \$1,000 or greater, the trustee must require the debtor to pay over at least 50 per cent, and may require payment of up to 75 per cent.⁹⁰

Australian *Bankruptcy Act* and supporting regulations: see *Bankruptcy Act* 1966 (Cth), Part VI, Division 4B [hereinafter *Bankruptcy Act 1966*]. See also D.J. Rose, *Australian Bankruptcy Law*, 10th ed. (North Ryde, N.S.W.: Law Book, 1994) at 152-53; and Commonwealth of Australia, *Bankruptcy Legislation Amendment Bill 1995: Report by the Senate Legal and Constitutional Legislation Committee* (Canberra: The Committee, 1995) at 49-57.

⁸⁷ See *Directive No. 11*, *supra* note 21, s. 4(1).

⁸⁸ See National Council of Welfare, *Poverty Profile 1994* (Ottawa: National Council of Welfare, 1996) at 89, which provides Statistics Canada cut-off figures for low-income families for 1995.

⁸⁹ See *Directive No. 11*, *supra* note 21, s. 5(2)(a).

⁹⁰ *Ibid.* s. 5(2)(b).

TABLE 1
SUPERINTENDENT'S STANDARDS:
1999 TOTAL MONTHLY SURPLUS INCOME

Net Monthly Income	Persons (\$)						
	1 (1492)	2 (1864)	3 (2319)	4 (2807)	5 (3138)	6 (3468)	7 (3799)
1592	100	0	0	0	0	0	0
1692	200	0	0	0	0	0	0
1792	300	0	0	0	0	0	0
1992	500	128	0	0	0	0	0
2192	700	328	0	0	0	0	0
2392	900	528	0	0	0	0	0
2592	1100	728	273	0	0	0	0
2792	1300	928	473	0	0	0	0
2992	1500	1128	673	185	0	0	0
3192	1700	1328	873	385	0	0	0
3392	1900	1528	1073	585	254	0	0
3592	2100	1728	1273	785	454	124	0
3792	2300	1928	1473	985	654	324	0
3992	2500	2128	1673	1185	854	524	193
4192	2700	2328	1873	1385	1054	724	393

Source: Office of the Superintendent of Bankruptcy, *Directive No. 11: Surplus Income* (issued 30 April 1998), Appendix "A," online: Office of the Superintendent of Bankruptcy <<http://strategis.ic.gc.ca/SSG/br01055e.html>> (dated accessed: 19 August 1999). The Superintendent's Standards are derived from information provided by Statistics Canada. The standards consist of the 1997 base established by Statistics Canada plus a 1.2 per cent adjustment to the standards due to the 1998 Consumer Price Index, plus a 1.6 per cent adjustment to standards representing the Superintendent's projection for the 1999 Consumer Price Index. The amounts shown above represent the monthly total surplus income of the bankrupt over the standards, from which the surplus income payment should be calculated.

It is important to emphasize that the directive applies a uniform standard of cost of living allowances for all debtors in the same family situation, regardless of their social, economic, or geographic background and location.⁹¹ Seemingly, the trustee has no discretion in determining the debtor's living needs, except insofar as they fall under the heading of "non-discretionary monthly expenses."⁹² If the debtor wants more, the debtor can ask for mediation. If this is not successful, the trustee can apply for a court hearing. Conversely, if the official receiver or a creditor disagrees with the amount of surplus income determined by the trustee, either of them can require mediation and, like the debtor or trustee, also ask for a court hearing. If there is a court hearing, it is not clear how much discretion the bankruptcy court has in determining the amount of the debtor's surplus income. Section 68(10) of the *BIA* requires the court to act in accordance with the standards established in subsection 68(1) (*i.e.*, the standards set by the Superintendent), and "having regard to the personal and family situation of the bankrupt." These criteria seem to be the same as those incumbent on trustees. As a result, unless courts are willing to massage the quoted words beyond their intended meaning, or somehow to find that the Superintendent's Standards are too rigid, debtors may find that section 68 has forced them into a procrustean bed.⁹³

⁹¹ During the discussions preceding the adoption of the directive, the Canadian Insolvency Practitioners Association urged the adoption of differential scales depending on the debtor's province of residence and the size of the community of the debtor's residence, but its efforts were unsuccessful. The pre-1998 guidelines also drew no geographical distinctions with respect to differences in the cost of living within a province and between the provinces. This silence influenced the court's decision in *Re Demyen*(1999), 4 C.B.R. (4th) 67 (Sask. Q.B.), in which the court rejected the trustee's argument that the debtor should be required to hand over a larger share of his income because the cost of living in Regina, Saskatchewan, was lower than elsewhere in Canada.

⁹² *Directive No. 11*, *supra* note 21, s. 4(1).

⁹³ At the Conference, David Stewart, District Assistant Superintendent, Toronto, presented a report on the preliminary effects of the 1997 amendments to the *BIA*: see D. Stewart, "A Brief Review of Preliminary Data since the April 30th Amendments" (Conference on the Contemporary Challenges of Consumer Bankruptcies in a Comparative Context, Faculty of Law, University of Toronto, 21-22 August 1998) [unpublished] at 3, which included the following information for the Toronto bankruptcy district for the months of May through July 1998:

[O]ut of a total of 3270 personal bankruptcies 472 (14.4%) of them had surplus income in accordance with the standards. Of the 472, 363 (76.9%) have agreed to make monthly payments in accordance with the standards while the remaining 109 (23.1%) have agreed to make payments for lesser amounts. 58 (53.2%) individuals of the group of 109 have agreed to pay monthly amounts within \$100 of the amounts established by the standards; 35 (32.1%) individuals of the 109 have agreed to pay monthly amounts of between \$100 to \$300 below the standard; and 16 (14.7%) individuals of the group of 109 have agreed to make payments more than \$300 below the standards.

Later statistics for the whole of Canada collected by the OSB for the period May-October 1998

Even if one accepts the conceptual soundness of a surplus income payment requirement, I am not persuaded that we need the remarkable complexities of section 68. I am also sceptical that the formidable resources of the Canadian federal government should be marshalled to act as debt collector for creditors who, in many cases, will have extended consumer credit on a consensual basis and should largely be able to look after their own interests. As I note below, since 1919 Canadian courts have exercised a very broad discretion in determining the terms of a debtor's discharge. They may still have that discretion and, if they do, the Canadian Parliament may unwittingly have introduced a double standard for curial review: one in entertaining applications to determine surplus income payment requirements, and another in setting discharge terms.

VII. DISCRETIONARY DISCHARGES OR STATUTORY FRESH START?

I come now to the single most important difference between the Canadian and American bankruptcy systems. This is the fact that, under Canadian law, the court makes the final decision about the disposition of the debtor's pre-bankruptcy debts, whereas American law entitles the debtor to a discharge, subject to a long (and growing) list of exclusions. This assumes the debtor has not forfeited the right of a discharge altogether because of the types of misconduct and other events listed in section 727 of the *Bankruptcy Code*. These and other qualifications to the American debtor's right to a discharge should caution us against drawing simplistic conclusions about the differences between the Canadian and American discharge rules. I will address the Canadian position first, and then discuss the American position to the extent that their rules are not referred to in the description of the Canadian position.

showed that out of a total of 42,009 personal bankruptcies, 4,550, (10.8 per cent) had surplus income in accordance with the regulatory standards. Of the 4,550 that had surplus income, 3,883 (85.3 per cent) agreed to make monthly payments in accordance with the standards, while the remaining 667 (14.7 per cent) agreed to make payments for lesser amounts: see *Roundtable, supra* note 39.

A. Canadian Position

The discharge provisions in the Canadian *1919 Act*⁹⁴ were based on the discharge provisions in the British *1883 Act*,⁹⁵ as re-enacted in the British *Bankruptcy Act, 1914*.⁹⁶ The *1883 Act* enshrined for the first time a general discharge policy for non-trader debtors as well as trader debtors,⁹⁷ thereby marking a major step in the evolution of the British bankruptcy system.

There was some criticism in Canada about the decision to follow the structure and concepts in the *1883 Act* instead of allowing Canadian drafters to prepare an essentially home-grown product.⁹⁸ However, the commentators agreed that the fresh start policy in the American *National Bankruptcy Act of 1898*⁹⁹ was quite unacceptable in Canada, and that discretionary discharge rules administered by the courts struck a much better balance between the interests of creditors, debtors, and society. Lewis Duncan, a highly regarded Toronto insolvency practitioner, expressed a common sentiment when he wrote that

laxity in the administration of this part of the [United States] Act has been one of the principal causes of the dissatisfaction with United States Bankruptcy statutes, which have too often been administered as if they were a clearing house for the liquidation of debts, a sort of constant Jubilee.¹⁰⁰

Under the provisions of the Canadian *1919 Act*, the debtor was entitled at any time after making the assignment to apply for a discharge order.¹⁰¹ The trustee was required to file a report with the court before the hearing, which the court was then obliged to take into account in making its order. Except in the circumstances described in section 58(5), the court had a complete discretion (1) to grant or refuse the discharge; (2) to suspend the effectiveness of the order for a specified time; or (3)

⁹⁴ *Supra* note 5.

⁹⁵ *Supra* note 14.

⁹⁶ *Supra* note 76.

⁹⁷ *Supra* note 14, ss. 28-31.

⁹⁸ See T.G.W. Telfer, *Reconstructing Bankruptcy Law in Canada: 1867 to 1919. From an Evil to a Commercial Necessity* (S.J.D. Thesis, Faculty of Law, University of Toronto, 1999) [unpublished] at 313-14. I am much obliged to Tom Telfer, a former graduate student of mine, for making a copy of his excellent thesis available to me.

⁹⁹ *Supra* note 4.

¹⁰⁰ L. Duncan, *The Law and Practice of Bankruptcy in Canada* (Toronto: Carswell, 1922) at 38.

¹⁰¹ *Supra* note 5, ss. 58-59.

to make a conditional order linked to the debtor's future earnings or his or her income or after-acquired property.¹⁰² Pursuant to section 58(5), the court had to refuse or suspend the discharge for a minimum period of two years if the debtor had committed an offence under the *Act* or had committed an offence connected with the bankruptcy proceedings, unless the court determined for special reasons to make another order.

On proof of the facts enumerated in section 59, the court was likewise obliged to refuse or suspend the discharge for a minimum of two years. The period could be reduced if the only complaint about the debtor's conduct was that his or her assets were worth less than fifty cents on the dollar. Alternatively, the court could require the debtor to consent to judgment against him or her out of future income or after-acquired property. The nine situations enumerated in section 59, apart from the deficiency in the debtor's assets, covered various forms of pre-bankruptcy misconduct by the debtor and included the fact that the debtor had been a previous bankrupt.

A suspensory or conditional order made under section 58(5) was not unremitting. The court could modify its order after a year, if satisfied that there was no reasonable prospect of the debtor being able to meet the terms of the order.¹⁰³

The revisionary *1949 Act*,¹⁰⁴ while making various minor changes to the discharge provisions, added a new feature by deeming the debtor's assignment to trigger an application for discharge.¹⁰⁵ This could be heard no sooner than three months, and no later than twelve months, after the debtor's assignment.¹⁰⁶ In order to simplify the administration of the discharge machinery still further, the 1992 amendments to the *BIA* added a provision entitling a first-time bankrupt to an automatic discharge nine months after the assignment unless, before the expiration of this period, the trustee, the Superintendent, or a creditor filed an objection.¹⁰⁷

From the *1919 Act* onwards, the trustee has always been obliged to furnish the court with a report on the debtor's conduct before and during bankruptcy, and to state his or her opinion about the probable

¹⁰² *Ibid.* s. 58(4).

¹⁰³ *Ibid.* s. 58(5).

¹⁰⁴ *Supra* note 16.

¹⁰⁵ *Ibid.* s. 127.

¹⁰⁶ *Ibid.* s. 127(2).

¹⁰⁷ See *BIA*, *supra* note 3, s. 168.1(1)(f), as am. by *1992 Amendments supra* note 3, s. 61(1).

cause or causes of the bankruptcy, and whether the deficiency between the estate's assets and liabilities had been satisfactorily accounted for.

The 1949 *Act* also amended the earlier legislation by drawing a distinction between those situations in which the court had complete discretion in dealing with a discharge application, and those in which it was required to dismiss the application or make a conditional order.¹⁰⁸ The latter situation involved a much enlarged list of thirteen species of pre-bankruptcy and intra-bankruptcy misconduct,¹⁰⁹ the one most commonly relied on by creditors being that the debtor's assets were worth less than fifty cents on the dollar of the debtor's unsecured liabilities.

B. 1997 Amendments

This discharge structure still exists but, as previously noted, a sharp twist was added to it by the 1997 amendments to the *BIA*. The trustee's report to the court must now include a recommendation whether the discharge order should be conditional,¹¹⁰ having regard to (1) whether the bankrupt has complied with the section 68 requirements for the remittance of the bankrupt's surplus income; (2) the total amount paid over by the debtor to the estate; and (3) whether the debtor could have made a viable proposal.¹¹¹ If a debtor objects to the trustee's recommendation he or she can ask for mediation.¹¹² If the issues are not resolved by mediation, the court will proceed with the hearing of the discharge application.¹¹³

The list of circumstances enumerated in section 173(1), now fifteen in number, requiring a court to dismiss the application or to make a conditional or suspensory order, has also been amended to match the trustee's new reporting obligations. They now include the fact that the bankrupt has failed to meet his or her section 68 payment obligations or could have made a viable proposal.¹¹⁴ The 1997 amendments must surely have met the creditors' fondest expectations.

¹⁰⁸ *Supra* note 16, s. 129.

¹⁰⁹ *Ibid.* ss. 130(1)(a)-(m).

¹¹⁰ See *BIA*, *supra* note 3, s. 170.1(1).

¹¹¹ *Ibid.* ss. 170.1(2)(a)-(c).

¹¹² *Ibid.* s.170.1(4).

¹¹³ *Ibid.* s.170.1(7).

¹¹⁴ *Ibid.* ss. 173(1)(m)-(n), as am. by 1997 Amendments *supra* note 20, s. 103(1).

C. *The Real World of Consumer Debtors and Discharge Applications*

The rationales for the immense efforts put into the 1997 amendments and supporting directives and rules under the *BIA* were the following.¹¹⁵ It was said that a large number of Canadian consumers were abusing the bankruptcy system, that “going bankrupt” had become too easy, that bankruptcy had lost its stigma, and that many of the bankrupts had surplus income and could have made a viable consumer proposal. Many anecdotal stories were cited to support these allegations, but no independent statistical studies were cited, although the large Canadian credit grantors could easily have sponsored such studies or made available their own records for public examination and study.¹¹⁶

The cumulative evidence provided by the available Canadian studies do not support the allegations. Undoubtedly, a modest percentage of bankrupts have a sizeable surplus income¹¹⁷ (although there is a good deal of controversy and confusion over what that percentage is), but they do not represent the norm. In what is still a leading Canadian study based on a large sample of bankrupts, Wayne Brighton and Justin Connidis reported that consumer bankrupts did not “fit the stereotype of ‘high rollers walking away from their debts’ while holding on to substantial assets.”¹¹⁸ The authors also found that consumer bankrupts were primarily drawn from the lowest socio-economic levels, although they emphasized (as later studies have also emphasized) that consumer bankrupts are not a homogeneous group.¹¹⁹

¹¹⁵ See J.S. Ziegel, “Canadian Bankruptcy Reform, Bill C-109, and Troubling Asymmetries” (1996) 27 *Can. Bus. L.J.* 108 at 111-12.

¹¹⁶ I spent many hours before the Conference trying to persuade senior officials at major Canadian banks to participate actively at the Conference and to present statistical reports on their banks’ experience with consumer payment delinquencies and consumer insolvencies. My efforts were unavailing. I also persuaded a friend of mine, a former chief economist and vice-president of one of the banks, to intercede on my behalf, but he was no more successful. After looking into the position, the present chief economist of the bank told us that, in addition to time constraints, the bank’s data simply were not good enough to provide the basis for reliable statistics. In 1997, I also approached the vice-president of another major bank, who had played a very active role in Working Group I of the Bankruptcy and Insolvency Advisory Committee (BIAC). At her request I supplied her with a list of written questions involving the bank’s consumer credit granting practices and statistical experience. She replied that most of the questions involved proprietary information, and that there was no point in her meeting with me.

¹¹⁷ See note 93, *supra*.

¹¹⁸ J.W. Brighton & J.A. Connidis, *Consumer Bankrupts in Canada* (Ottawa: Consumer and Corporate Affairs Canada, 1982) at 76.

¹¹⁹ *Ibid.* Summary.

The median indebtedness was \$10,865, but median assets were only \$400.¹²⁰ The median assets realized amounted to \$528,¹²¹ and only about 6 per cent of the sample of consumer bankruptcies yielded \$2,000 or more.¹²² In only about one-fifth of the cases was any money available for distribution among creditors after meeting the trustee's fees and expenses. The typical amount available for distribution was \$100–\$249.¹²³

In their 1998 study for the Office of Consumer Affairs of Industry Canada, Saul Schwartz and Leigh Anderson found that the sample of those seeking bankruptcy protection was much poorer economically than the general population.¹²⁴ Much larger percentages were found in the lower parts of the distribution (51.8 per cent of the bankrupts had less than \$25,000 in annual incomes versus 33.1 per cent of the general population), and few were found in the upper parts (3.7 per cent of the bankrupts had incomes greater than \$75,000 versus 15.5 per cent of the general population).¹²⁵

The distribution of monthly incomes and expenses in the Schwartz and Anderson study also “clearly” demonstrated the severe economic problems faced by the consumers in their sample; almost one-third reported no monthly take-home pay, while the median pay for those reporting a positive value was only \$1,300 per month.¹²⁶ Schwartz and Anderson found that

[o]verall, median net monthly income from all sources was \$1,400; that monthly income would translate into an annual income of \$16,800, if it continued for 12 months. By way of comparison, the Statistics Canada Low Income Cut-Off (LICO) for a single adult living in a large urban area was \$16,874 in 1995. For a family of four, the LICO was

¹²⁰ *Ibid.* at 40, Table 15.

¹²¹ *Ibid.* at 60.

¹²² *Ibid.* Table 33. The median realized assets are higher than the median declared assets because apparently they include intangible assets, such as post-bankruptcy income tax refunds, which are not included in the statement of assets at the time of bankruptcy: see *ibid.* at 40, 60.

¹²³ *Ibid.* at 64.

¹²⁴ See S. Schwartz & L. Anderson, *An Empirical Study of Canadians Seeking Personal Bankruptcy Protection* (Ottawa: Industry Canada, 1998) at 8, online: Industry Canada <<http://strategis.ic.gc.ca/SSG/ca00889e.html>> (date accessed: 16 July 1999). A summary of the authors' findings appears in this Symposium: see S. Schwartz, “The Empirical Dimensions of Consumer Bankruptcy: Results From a Survey of Canadian Bankrupts” (1999) 37 *Osgoode Hall L.J.* 83.

¹²⁵ See Schwartz & Anderson, *supra* note 124 at 8.

¹²⁶ *Ibid.* at 9.

\$31,753. Monthly expenses followed roughly the same pattern as monthly income, with a median of \$1,460.¹²⁷

Schwartz and Anderson also found that more than one-half of the potential bankrupts had monthly expenses that were equal to or greater than their monthly income. Only about 37 per cent had a monthly surplus, but it was usually quite small.¹²⁸ The authors therefore concluded that the possibility of even the debtors in their sample with surplus income being able to repay their debts, given their current income, was “remote.”¹²⁹

Equally discouraging is the fact that the sponsors of the 1997 amendments to the *BIA* ignored the impact of consumer credit on the rapid increase in the number of consumer bankruptcies, and the close correlation between the two. The volume of consumer credit in Canada grew 1,600 per cent between 1966 and 1994 (in absolute dollars terms), and doubled between 1985 and 1995.¹³⁰ The number of Canadian consumer bankruptcies grew from 1,903 in 1966 to 65,432 in 1995.¹³¹

Nevertheless, the focus of the 1997 amendments to the *BIA* was on the alleged abuses of the consumer bankruptcy system; there was never a suggestion that the consumer credit industry had contributed to the problems through the ready availability of consumer credit and the high cost of that credit.

D. Absence of Creditor Opposition to Discharges

Leaving aside the important demographic and economic data about bankrupts, it is also relevant to note creditors' actual reaction to consumer bankruptcies. By all accounts, prior to the 1997 amendments to the *BIA*, Canadian creditors only opposed discharges in a very small number of cases. It appeared to be less than 5 per cent, after excluding

¹²⁷ *Ibid.* [footnote omitted].

¹²⁸ See *ibid.* at 9; 26, Table 6 (Panel C).

¹²⁹ *Ibid.* at 9. When I prepared this article in the summer of 1998, the results from Iain Ramsay's empirical study, "Individual Bankruptcy: Preliminary Findings of a Socio-Legal Analysis" (1999) 37 *Osgoode Hall L.J.* 15, were not available to me. I have therefore not included them either in this modestly revised version of the article.

¹³⁰ See J.S. Ziegel, "Canadian Perspectives on the Challenges of Consumer Bankruptcies" (1997) 20 *J. Consumer Pol'y* 199 at 204-05, Fig. 1 [hereinafter "Canadian Perspectives"].

¹³¹ *Ibid.* at 201, Table 1.

trustees' objections.¹³² Ironically, in Toronto, trustees were the most common objectors on the ground that they had not been paid the fees and disbursements to which they were entitled.¹³³ Another common ground of objection by trustees was that the debtor had not attended the mandatory two counselling sessions required by the *BIA*.¹³⁴

Revenue Canada and other federal and provincial agencies also objected intermittently if the debtor owed taxes¹³⁵ or a large sum on account of student loans.¹³⁶ Other types of creditors were largely

¹³² Unfortunately, hard data were not available to me. My estimate is based on many conversations with trustees, official receivers, and masters in bankruptcy in Toronto and Edmonton.

¹³³ The fees are determined by the regulations under the *BIA*. Where this objection is raised the court usually grants the discharge order on condition that the debtor agrees to consent judgment for the amount in issue. That amount is payable to the estate but, since the trustee ranks third among preferred creditors, the prospect of the trustee ending up with most of the post-discharge payments by the debtor are very good: see *BIA*, *supra* note 3, ss. 136(1)(b)(ii)-(iii).

¹³⁴ *Ibid.* s. 157.1(3).

¹³⁵ See L. Frank, "Strategic Consumer Bankruptcies" (Conference on the Contemporary Challenges of Consumer Bankruptcies in a Comparative Context, Faculty of Law, University of Toronto, 21-22 August 1998) [unpublished].

¹³⁶ Before the 1997 amendments to the *BIA*, federal and provincial loan grantors were in the same position as other creditors with debts owed to them, and were therefore subject to the same discharge provisions. The effect of section 178(1)(g) of the *BIA*, *supra* note 3, as am. by *1997 Amendments supra* note 20, s. 105(2), was to prevent discharge of the student loan debt where the bankruptcy occurred before the date on which the bankrupt ceased to be a full- or part-time student, or within two years after the date on which the student ceased to be a full- or part-time student. Pursuant to section 178.1 of the *BIA*, *supra* note 3, as am. by *1997 Amendments supra* note 20, s. 105(3), two years after a bankrupt had ceased to be a full- or part-time student, a court could grant dispensation from section 178(1)(g) if the court was satisfied that (1) the bankrupt had acted in good faith in connection with the bankrupt's liabilities under the loan; and that (2) the bankrupt had and would continue to experience financial difficulty to such an extent that the bankrupt would be unable to pay the liabilities under the loan. Without prior warning, the February 1998 federal budget announced the federal government's intention to postpone a bankrupt's ability to obtain a discharge from student loans for a ten-year period, and to repeal the court's dispensing powers under section 178.1. Despite strong protests from student associations, trustees, and the Canadian Bar Association, the government proceeded with the amendments: see *Budget Implementation Act, 1998*, S.C. 1998, c. 21, ss. 103, amending *BIA*, *supra* note 3, s. 178. On the whole problem of student loans, see S. Schwartz, "The Dark Side of Student Loans: Debt Burden, Default, and Bankruptcy" (1999) 37 *Osgoode Hall L.J.* 307.

At my request, Martha Hundert, LL.B. III, University of Toronto, 1998-99, prepared a table analyzing opposed student loan discharge applications, which provides detailed information about the 94 reported discharge applications she was able to find on Quicklaw. Sixty-three of the cases were from Saskatchewan; British Columbia was second with 15; and Ontario was last with only 1 reported objection. Average monthly income of debtors in the 75 reports where this information was available was \$2,239; median monthly income was \$2,040. The average percentage of outstanding student loans to total indebtedness was 85.73 per cent. (Seventy-three reports contained sufficient information for this percentage to be calculated.) The number of cases where the percentage of outstanding student loans exceeded 50 per cent was 64; the percentage equalled 100 per cent in 28 cases. The average monthly payments ordered to be paid by the debtors was \$253.30.

conspicuous by their absence. The reason often given for their failure to object to the discharge, or to attend the court hearing if they did object, was that these creditors did not find it a productive use of their employees' time.

E. *How Canadian Courts Exercise Their Discretion*

Still, undoubtedly there are cases where the debtor has substantial surplus income, so it is of interest to learn how Canadian courts exercised their discretion on discharge applications prior to the 1997 amendments coming into effect in April 1998. Dozens of such cases have been reported since the *1919 Act*.¹³⁷ Between 1992 and 1998, Quicklaw¹³⁸ reported 94 cases alone involving objections to the discharge of student loans, but only 20 cases involving non-student loans.¹³⁹

It seems that Canadian courts made a conscientious effort to distinguish between different types of debt: consumer debts versus non-consumer debts, tort claims versus contractual debts, debts owing to government agencies versus debts to private sector creditors (to cite some of the distinctions), as well as the debtor's conduct and culpability, if any. The courts also frequently reaffirmed the need to balance the public interest with the debtor's need to rehabilitate himself or herself and to start a new economic life. In *Westmore v. McAfee*,¹⁴⁰ a leading appellate decision, the British Columbia Court of Appeal attempted to distil the following criteria from earlier case law: (1) the court must have regard to the interests of the public, the bankrupt, and the creditors; (2) it is undesirable that a citizen should be so weighed down by debt as to be incapable of carrying out the regular duties of citizenship; (3) one object of the *BIA* is to enable an honest debtor to secure a discharge to get on with his or her life; (4) the bankruptcy courts should not be treated as a clearing house for debts, irrespective of the circumstances

(Sixty-seven reports contained the requisite information.) The average duration of conditional discharge order was 62 months: see M. Hundert, "Analysis of Opposed Student Loan Discharge Applications 1992-1998" (July 1998) [unpublished, on file with author].

¹³⁷ *Supra* note 5. See also L.W. Houlden & G.B. Morawetz, *Bankruptcy and Insolvency Law of Canada*, vol. 2, 3d ed., looseleaf (Toronto: Carswell, 1998) at H§16.4ff [hereinafter *Bankruptcy and Insolvency Law of Canada*] for annotations on the case law.

¹³⁸ Quicklaw is Canada's counterpart to Westlaw in the United States.

¹³⁹ For details of the student loan discharge applications, see note 136, *supra*. The number of non-student loan cases is based on a numerical count by Martha Hundert.

¹⁴⁰ (1988), 23 B.C.L.R. (2d) 273 (C.A.).

under which they were created; and (5) the success of any bankruptcy system depends on the administration of the discharge provisions.¹⁴¹ As will be observed, the criteria are unexceptional in themselves, but they do not add up to a tidy, coherent, and carefully dovetailed set of guidelines. At the end of the day, much discretion still rested with the bankruptcy judge.

F. Impact of Trustee's Report

A troubling question raised by the 1997 amendments is how far a judge is free to discount the trustee's report that the debtor is in breach of section 68 of the *BIA* or that the debtor could have made a viable proposal. If the trustee's report is conclusive on these issues, how far does it tie the hands of the court in disposing of the discharge application? On the strength of sections 172(2) and 173(1)(m) and (n), it seems clear that the court cannot grant an unqualified discharge even if the court believes this to be the best solution. The court must either dismiss the application or, more realistically, make a conditional order. If the court opts for a conditional order requiring future payments by the debtor, is it bound to apply the Superintendent's Standards? Section 172(2) does not so provide, but if the court is free to ignore the standards this may establish a double standard of liability for debtors: one governed by section 68 before the discharge application and the other by whatever conditional order the court deems appropriate in the circumstances. On the other hand, if the court believes it is administratively, if not legally, obliged to apply the Superintendent's Standards, this may seriously diminish the discretionary role that Canadian courts have exercised for close to eighty years. Creditors may welcome such a development; I would regard it as a regressive step.

G. A British Codicil

Since the Canadian discharge system was borrowed from England, it may be instructive to explain what has happened to the British discharge rules over the past twenty-five years. In 1957, the Blagden Committee criticized the technical intricacies of the discharge

¹⁴¹ *Ibid.* at 280.

provisions.¹⁴² In 1976, the British *Insolvency Act* was amended to introduce an automatic discharge rule in a limited number of cases.¹⁴³ The automatic discharge was triggered five years from the date of bankruptcy.¹⁴⁴

In its 1982 report, the Cork Committee recommended drawing a distinction between a liquidation of assets order (LAO) and a bankruptcy order for individual insolvents, and would have allowed a discharge from an LAO one year after an income payment order had been made.¹⁴⁵ The Committee disapproved of an automatic discharge from a bankruptcy order, but would have permitted the bankrupt to make a discharge application one year after the bankruptcy adjudication. As before, the court would have retained the right to suspend the discharge order or to make it absolute or conditional.

The British government did not adopt these recommendations. Instead, the *Insolvency Act 1986*¹⁴⁶ introduced a more lenient discharge system.¹⁴⁷ Pursuant to section 279, persons not made bankrupt in the preceding fifteen years are entitled to an automatic discharge in regular cases three years after the bankruptcy order, and after two years in summary administration cases. Where the debtor has failed to comply with his or her bankruptcy obligations, the official receiver may apply to the court for an order that the relevant period shall cease to run. In that case, the order may either specify a suspensory period or may impose conditions to be met by the debtor before the running of time can resume.¹⁴⁸

Where an automatic discharge period applies, an income payment order may not be made at the time of discharge or, if the order was made earlier, it will only continue beyond the date of discharge if

¹⁴² See U.K., Board of Trade Bankruptcy Law Amendment Committee, *Report of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment* 221 (London: Her Majesty's Stationery Office, 1957) (Chair: J.B. Blagden) at paras. 53-78.

¹⁴³ (U.K.), 1976, c. 60, s. 7.

¹⁴⁴ The details will be found in I.F. Fletcher, *Law of Bankruptcy* (Estover, U.K.: Macdonald and Evans, 1978) at 306-10. See also Justice, *Bankruptcy* (London: Stevens & Sons, 1975) at paras. 58-71.

¹⁴⁵ See "Cork Report," *supra* note 76 at para. 605.

¹⁴⁶ *Supra* note 78.

¹⁴⁷ See *Law of Insolvency*, *supra* note 78 at 307-09.

¹⁴⁸ See *Insolvency Act 1986* *supra* note 78, s. 279(3).

the order so provides. However, the order can only run for a maximum period of three years from the date of the order.¹⁴⁹

It will therefore be seen that the current British discharge system is substantially more favourable to the debtor than the Canadian system. Under the British system, only the official receiver can apply to have the running of time suspended for an automatic discharge, and then, only where the debtor has breached his or her statutory obligations. Also, the discharge order is absolute. While an income payment order may run beyond the date of the automatic discharge if the order so provides, it has a finite life span. No less important, both the making of an income payment order and its amendment rest with the court. The court's discretion is not circumscribed by statutorily sanctioned surplus income standards as is true under the *BIA*.

The liberalization of the British discharge rules might have been expected to lead to a rapid increase in the number of British personal bankruptcies, but it has not happened. In the year following the adoption of the *Insolvency Act 1986* the number of individual bankruptcy orders actually dropped slightly—from 7,093 in 1986 to 6,994 in 1987.¹⁵⁰ As late as 1989, the number of bankruptcy orders was still only 8,138. It is true that there was a rapid escalation and de-escalation in the number of bankruptcies between 1991 and 1997 (the number was 32,106 in 1992 and 19,892 in 1997),¹⁵¹ but by all accounts this had more to do with the state of the British economy than with the more generous discharge rules introduced by the 1986 legislation. It is also significant that the great majority of personal bankruptcies in the United Kingdom involve traders and professional persons, with employed and unemployed bankrupts apparently only accounting for about one-quarter of the total number of bankrupts.¹⁵²

The British figures suggest, as is true in North America, that the character of the bankruptcy regime available to consumers is only one component in a complex mix of social, economic, and legal factors.

¹⁴⁹ *Ibid.* s. 310(6)(b).

¹⁵⁰ See Craddock, *supra* note 1 at 14. Craddock's statistics are corroborated by statistics and other information provided to the author by Peter Joyce, Inspector General of the British Insolvency Service: see Letter from P. Joyce (20 August 1998).

¹⁵¹ See Craddock, *supra* note 1 at 14.

¹⁵² See Society of Practitioners of Insolvency, *Personal Insolvency in the United Kingdom 1997-98: Report of 1997 Survey* (London: Society of Practitioners of Insolvency, 1998) at 4. Peter Joyce's statistics show that the ratio of consumer debtors to other debtors varied from 17 per cent to 28 per cent between 1988 and 1997, and that there appears to be a definite upward trend in the ratio. (I am most grateful to Peter Joyce and John Francis, Technical Secretary of the Society of Practitioners of Insolvency, for providing me with these data and other information.)

Nevertheless, the introduction of the concept of an automatic discharge for first-time bankrupts in England and Wales,¹⁵³ without regard to the debtor's pre-bankruptcy conduct, has drawn fire from influential critics who fear that it might lead to a "progressive erosion of the standards of commercial morality."¹⁵⁴ Happily, so far the British statistics do not support these apprehensions.

VIII. THE AMERICAN FRESH START POLICY: IS THERE A RAPPROCHEMENT?

The description in the preceding section of the surplus income payment, and now much less discretionary Canadian discharge system, is likely to make an American reader feel very reassured about the merits of the fresh start policy. However, it would be a mistake to throw out the baby with the bathwater. There are many possible variations of an income payment and discretionary discharge system, and the Canadian model is only one of them. If proponents of a discretionary discharge system need to justify their approach, the burden is no less great on those supporting a fresh start policy. Its superiority, in moral, economic, and social terms, would not be self-evident to most Commonwealth observers.

A. *Exceptions to the Fresh Start Rule*

Even in its home territory, the fresh start policy has been under regular attack since the turn of this century,¹⁵⁵ and well before the ascendancy of the modern consumer credit industry. The critics have not all been self-serving creditors, and have included some very reputable scholars.¹⁵⁶ In any event, the United States does not have an

¹⁵³ Scotland has its own insolvency law: see *Bankruptcy (Scotland) Act 1985*(U.K.), 1985, c. 66. For further discussion of personal bankruptcy in Scotland, see M. Adler, "The Overseas Dimension: What Can Canada and the United States Learn from the United Kingdom?" (1999) 37 *Osgoode Hall L.J.* 415 at 417-19.

¹⁵⁴ *Law of Insolvency*, *supra* note 78 at 309.

¹⁵⁵ For the details of efforts to modify the fresh start policy between 1898 and 1982, see D.G. Boshkoff, "Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings" (1982-83) 131 *U. Pa. L. Rev.* 69 at 112ff.

¹⁵⁶ See, for example, T. Eisenberg, "Bankruptcy Law in Perspective" (1980-81) 28 *U.C.L.A. L. Rev.* 953 at 976-91. For a recent criticism of existing abuses, accompanied by very unorthodox recommendations, see L.M. LoPucki, "Common Sense Consumer Bankruptcy" (1997) 71 *Am.*

unadulterated fresh start policy; as William Whitford suggests, it would be more accurate to describe it as a “stale start” policy.¹⁵⁷

Under Chapter 7 of the *Bankruptcy Code*, a consumer’s right to go bankrupt and to obtain a clean discharge under section 727(a) is subject to four important exceptions: (1) the “abuse” doctrine in section 707(b);¹⁵⁸ (2) the long list of liabilities excluded from discharge in section 523;¹⁵⁹ (3) the denial of a discharge for misconduct under section 727;¹⁶⁰ and (4) denial of a discharge where the debtor has been granted a discharge in a case commenced within six years before the filing of the petition.¹⁶¹ Cumulatively, the exceptions significantly dilute a pure fresh start commitment and invite us to reconsider the foundations of the policy.

A brief look is warranted at each of these exceptions. Despite its controversial origin and obvious vagueness, the section 707(b) “abuse” doctrine appears to draw its inspiration from the same conceptual source as the Canadian trustee’s obligation under section 170.1 of the *BIA* to report to the court whether the trustee believes the debtor could have made a viable proposal. I appreciate that some American critics regard section 707(b) as an anomaly that is antithetical to the true spirit of the fresh start policy, and that others have criticized its vagueness and the great variations in implementation in the substantial abuse standard.¹⁶² Nevertheless, it could be argued, just as persuasively, that section 707(b) reflects the view of a significant constituency that a discharge rule that only requires the debtor to surrender his or her existing non-exempt assets easily lends itself to abuse, particularly where the debtor is in a position to pay all or a substantial part of his or her debts out of future

Bankr. L.J. 461.

¹⁵⁷ W.C. Whitford, “Changing Definitions of Fresh Start in U.S. Bankruptcy Law” (1997) 20 J. Consumer Pol’y 178 at 191.

¹⁵⁸ See *Bankruptcy Code* *supra* note 33, § 707(b), which provides:

After notice and a hearing, the court, on its motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor.

¹⁵⁹ See note 164, *infra*, and accompanying text.

¹⁶⁰ See *Bankruptcy Code* *supra* note 33, §§ 727(a)(2)-(7).

¹⁶¹ *Ibid.* §§ 727(a)(8)-(9).

¹⁶² See W.R. Wells, J.M. Kurtz & R.J. Calhoun, “The Implementation of Bankruptcy Code Section 707(b): The Law and the Reality” (1991) 39 Clev. St. L. Rev. 15; and Warren & Westbrook, *supra* note 65 at 416-17.

income.¹⁶³ A non-American observer might put the question differently and enquire about the economic and social imperatives of a rule that limits an insolvent debtor's liability to his or her existing assets. I return to the question below.

Turning to the next exception, non-dischargeable debts under section 523, common law jurisdictions with discretionary discharge systems also have non-dischargeable debts. However, the list of exceptions in section 523 is substantially longer than the list in section 178 of the *BIA*, and very much longer than the modest British and Australian lists of non-dischargeable debts. Section 523 contains eighteen exceptions (several of them with very complex structures),¹⁶⁴ including a broad exception for income, property, and employment taxes, compared to the nine Canadian exclusions,¹⁶⁵ and four each for England and Wales,¹⁶⁶ and Australia.¹⁶⁷

It is a matter for conjecture whether the American list would be nearly as long if the United States had a discretionary discharge regime, and what the practical impact is of such a long list. Are the debts ever collected, or are they based on a vague hope that the debtor may some day inherit a large fortune or win a rich lottery prize? It would be helpful to see some empirical studies on these issues. One is also troubled by the rationales of some of the exclusions. Presumably the non-dischargeability of taxes¹⁶⁸ is based on the involuntary character of the credit, although a sceptic might suggest that the tendency of governments to prefer their claims over the claims of other creditors is just as influential.¹⁶⁹ A further complication is that a debtor who has completed all payments under a Chapter 13 plan is entitled to a

¹⁶³ See *In re Walton*, 866 F.2d 981 (8th Cir. 1989).

¹⁶⁴ See, for example, *Bankruptcy Code*, *supra* note 33, §§ 523(a)(1) (income, property, employment, or excise debts for varying periods); 523(a)(2) (debt relating to fraudulent conduct); 523(a)(3) (creditors not disclosed by debtor); 523(a)(5) (debt owed for alimony, maintenance, or support of spouse or child pursuant to agreement or order); 523(a)(15) (debt not of the kind described in subsection 5 that is incurred by the debtor in the course of a divorce or separation unless non-discharge will cause hardship to debtor); 523(a)(16) (debt for a fee or assessment to a membership association for cooperative housing and condominiums); and 523(a)(18) (debt owed under state law to a state or municipality that is in the nature of support and is enforceable under the United States Social Security Act).

¹⁶⁵ See *BIA*, *supra* note 3, s. 178(1).

¹⁶⁶ See *Insolvency Act 1986* *supra* note 78, ss. 281(3)-(6).

¹⁶⁷ See *Bankruptcy Act 1966* *supra* note 86, ss. 153(2), 153(2A).

¹⁶⁸ See *Bankruptcy Code* *supra* note 33, § 523(a)(1).

¹⁶⁹ For an insightful analysis of these issues, see K. Gross, *Failure and Forgiveness: Rebalancing the Bankruptcy System* (New Haven, Conn.: Yale University Press, 1997) c. 7.

discharge of all debts provided for by the plan, including most of the debts excluded from discharge under section 523 in the case of a straight discharge.¹⁷⁰

The third exception to the fresh start entitlement, found in section 727(a) and based on the debtor's pre-bankruptcy or post-bankruptcy misconduct, has no counterpart in the Canadian or English legislation. In both jurisdictions¹⁷¹ the debtor's misconduct is a discretionary ground on which the court may deny the discharge, postpone it, or impose conditions, but there is no mandatory rule of denial. This observer is struck by the contrast between the very generous fresh start impulse in Chapter 7 on the one hand, and the strict denial rules in section 727 on the other.

The rationale for the fourth exception, denial of a discharge where the debtor has obtained a discharge within the preceding six years,¹⁷² is again obviously based on a desire to avoid abuse of the bankruptcy process. What is noteworthy is the rigidity of the exclusion in sections 727(a)(8) and (9). The court is given no discretion, regardless of the particular circumstances. This is in contrast to the Canadian position, where a previous bankruptcy merely precludes the court from granting the debtor an unconditional discharge.¹⁷³

B. Rationales of the Fresh Start Policy⁴

I return to the question I posed earlier. The justification for the American fresh start policy appears to rest on one or more of the following grounds:

1. Historical, political, and cultural factors.

¹⁷⁰ See *Bankruptcy Code*, *supra* note 33, § 1328(a)(2). In practice, it appears that American bankruptcy courts are reluctant to approve Chapter 13 plans involving major reductions in section 523(a) liabilities: see, for example, *In re Kourtakis* 75 B.R. 183 (Bankr. E.D. Mich. 1987) and earlier authorities cited therein. See also note 218, *infra*, and accompanying text.

¹⁷¹ See *BIA*, *supra* note 3, s. 172(2); and *Insolvency Act 1986* *supra* note 78, s. 279(3).

¹⁷² See *Bankruptcy Code*, *supra* note 33, §§ 727(a)(8)-(9).

¹⁷³ See *BIA*, *supra* note 3, ss. 172(2), 173(1)(j). Note however that section 173(1)(j) applies to any previous bankruptcy or proposal made by the debtor, no matter how distant in time. However, since the Canadian court has a very broad discretion under section 172(2), it could discount the earlier bankruptcy or proposal by suspending the discharge for only a token period where it felt that there was no causal connection between the earlier event and the current discharge application.

¹⁷⁴ Because of space constraints, the arguments in this section are only presented in truncated form. I hope to be able to develop them more fully on a future occasion.

2. Impounding a consumer bankrupt's future income would violate the 13th Amendment to the United States Constitution against involuntary servitude.

3. A coercive payment regime will provoke the consumer's resistance and encourage the consumer to change jobs or otherwise become less productive, and perhaps to disappear completely.

4. It is much better to secure the debtor's consent to a voluntary payment system by giving the debtor incentives that are not available in a straight bankruptcy.

5. The British-style income payment and discretionary discharge system is based on the historical role of the British insolvency legislation as a creditors' debt collection instrument. This was not true of the United States *National Bankruptcy Act of 1898* because pre-bankruptcy debt collection rules generally fall under state jurisdiction.¹⁷⁵

6. The British-style income payment and discretionary discharge system is intrusive, paternalistic, and subjective, since no two debtors or their families have the same needs or face the same circumstances.¹⁷⁶

7. An attempt to engraft a means test on what is already a very complex and overburdened American consumer bankruptcy system would be the straw that breaks the camel's back.¹⁷⁷

8. Since the bulk of consumer bankruptcy debts today consist of consumer credit liabilities, it is more efficient to oblige the credit industry to internalize its losses, or to tighten its credit granting standards if creditors believe their losses are too high, than to expect consumers to resist the impulse for instant gratification encouraged by the ready availability of consumer credit.¹⁷⁸

9. There is no evidence of large scale abuses in the existing bankruptcy system; the overwhelming percentage of those seeking Chapter 7 bankruptcy protection are hopelessly insolvent and would not be able to pay off their indebtedness in any reasonable time frame even

¹⁷⁵ See Boshkoff, *supra* note 155 at 106.

¹⁷⁶ *Ibid.* at 120-23. See also J. Braucher, "Lawyers and Consumer Bankruptcy: One Code, Many Cultures" (1993) 67 Am. Bankr. L.J. 501 at 583 [hereinafter "Lawyers and Consumer Bankruptcy"].

¹⁷⁷ See E. Warren, "A Principled Approach to Consumer Bankruptcy" (1997) 71 Am. Bankr. L.J. 483 at 505-06 [hereinafter "A Principled Approach"]; the metaphor is mine, not Warren's.

¹⁷⁸ See T.H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge, Mass.: Harvard University Press, 1986) at 234-36.

if means testing and a mandatory Chapter 13 regime were to be introduced.¹⁷⁹

C. Response to Rationales

From this author's perspective, the rationales I have listed above differ widely in their persuasiveness. The historical reason explains how the fresh start policy came to be adopted by Congress and why it still has such a powerful hold in the United States. However, it does not tell us why it should be retained in the totally different social and economic environment of the twenty-first century and whether it is a suitable model for non-American societies.

The suggestion that an income payment order amounts to involuntary servitude strikes me as strained, despite the support the notion has received from respectable sources.¹⁸⁰ Whether in England under the *Insolvency Act 1986* or in Canada under section 68 of the *BIA*, such an order or its equivalent are not intended to wrest the last penny from an unfortunate debtor and the debtor's family.

The argument that involuntary payment orders are counterproductive is more persuasive, and is also familiar to us from such diverse fields as family support orders and garnishments of wages. Unfortunately, there appears to be no hard evidence about the effectiveness of payment orders in England and other Commonwealth jurisdictions, and it is too soon to assess the results of the new section 68 regime in Canada. Even if the results were mediocre, would this be a sufficient reason to abandon the concept in the absence of a better alternative?

Obviously, a consensual payment plan is much more attractive, but there are two difficulties. The first is to determine what incentives will be sufficient to draw good prospects into the plan without overcompensating planholders. The second is to prevent the wrong debtors from being pressured into a plan. There is much evidence in the United States about the second danger¹⁸¹ and disturbing statistics about

¹⁷⁹ See T.A. Sullivan, E. Warren & J.L. Westbrook, "Consumer Bankruptcy in the United States: A Study of Alleged Abuse and of Local Legal Culture" (1997) 20 J. Consumer Pol'y 223.

¹⁸⁰ See, for example, the United States Supreme Court decision in *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934).

¹⁸¹ See, for example, W.C. Whitford, "The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy" (1994) 68 Am. Bankr. L.J. 397; and "Lawyers and Consumer Bankruptcy," *supra* note 176.

the high failure rate in Chapter 13.¹⁸² In short, we need to be careful not to oversell the blessings of voluntary plans and proposals.

Douglass Boshkoff's observation¹⁸³ that the British bankruptcy system is intended to serve as a creditors' collection instrument is partially true,¹⁸⁴ but is it not also true of the American bankruptcy system? Historians tell us that the ability to substitute the collective remedy of a bankruptcy scheme for the widely divergent state collection laws for individual debts was a key objective of nineteenth-century creditors, in both Canada and the United States, in pressing for the adoption of a federal bankruptcy Act.¹⁸⁵

This brings me to the weighty complaints about the intrusiveness and subjectivity of British-style payment orders and conditional discharges. The subjectivity cannot be denied. Still, I question whether the experience is as traumatic and humiliating to debtors as the critics imply it is. Boshkoff himself expresses his admiration for the professional skill and sensitivity with which English judges have exercised their powers;¹⁸⁶ on the whole, the available Canadian evidence shows that Canadian bankruptcy judges, registrars, and masters in bankruptcy have exhibited the same features in applying the pre-1997 statutory provisions.¹⁸⁷

The seventh rationale for maintaining the fresh start principle in the United States obviously deserves careful attention. As a Canadian, I am not in a position to assess the gravity of the administrative problems likely to be triggered by the introduction of a means test in the United States. It may be that, as in Canada under the 1997 amendments to the

¹⁸² According to the Administrative Office of the United States Courts, 36 per cent of the Chapter 13 cases filed between 1979 and 1988 resulted in a discharge, 49 per cent were dismissed, and 14 per cent were converted to Chapter 7: see M. Bork & S.D. Tuck, *Bankruptcy Statistical Trends: Chapter 13 Dispositions* (Washington, D.C.: Administrative Office of the United States Courts, 1994).

¹⁸³ See Boshkoff, *supra* note 155 at 103, 105-06.

¹⁸⁴ Only partially because, since 1883, the courts have been obliged to balance creditors' claims against the debtors' means, and the need for debtors to rehabilitate themselves.

¹⁸⁵ See, for example, Coleman, *supra* note 1, c. 2; and Telfer, *supra* note 98, c. 5 II, 6 II.

¹⁸⁶ See Boshkoff, *supra* note 155 at 124.

¹⁸⁷ Arguably, some Canadian judges' treatment of student loan discharge application reflect a higher degree of moral censure: see note 136, *supra*. However, the judicial reaction only reflects a widely shared sentiment that students have a particular obligation to repay subsidized loans designed to enable them to acquire valued skills and better paying jobs. The weakness of this sentiment lies in the assumption that student loan schemes are well administered and that they ensure that students are properly counselled before enrolling in a program. For further discussion, see Schwartz, *supra* note 136.

BIA, much of the burden of applying a means test could be shifted to trustees or other administrative agencies. The real issue, it seems to me, is whether we believe it is reasonable to require individual debtors, consumers, and non-consumers to contribute a portion of their future income for a limited period towards the reduction of their debts.

Forcing the consumer credit industry to internalize its losses is a very attractive proposition. I have made the suggestion myself elsewhere.¹⁸⁸ Both Canada and the United States have many consumer credit regulations but few, if any, are designed to force credit grantors to be more discriminating and less aggressive in selling credit. The reverse is true. The dismantlement of usury and small loan ceilings in both countries has encouraged creditors to increase their marketing efforts.¹⁸⁹ The volume of consumer credit continues to grow, the rates are high because of “rationed” consumers or consumer insensitivity to rates,¹⁹⁰ and those who can afford to pay the least tend to pay the most.

Valid as these arguments are, they do not answer the troubling question whether it is fair and efficient to lump all creditors together and why, if we want creditors to internalize their losses, we allow them to file proofs of claim at all. There is also the further issue of what we should do with the wide range of non-consumer credit claims, consensual as well as non-consensual tax claims, government sponsored student loans, alimony and support orders, as well as private loans and other non-commercial debts. In Canada, tax claims and student loans are a significant factor in consumer bankruptcies.

The ninth rationale, the denial that there is evidence of substantial abuse of debtors resorting to bankruptcy when they have the means to pay off a substantial part of their debts, raises issues common to Canada and the United States, but with this difference: Canadian creditors have not had to support their allegations of consumer abuses

¹⁸⁸ See “Canadian Perspectives,” *supra* note 130 at 215.

¹⁸⁹ See L.M. Ausubel, “Credit Card Defaults, Credit Card Profits, and Bankruptcy” (1997) 71 *Am. Bankr. L.J.* 249 at 260-61. In Canada, the statutory ceiling on interest rates on loans by banks was repealed in 1967. The ceiling on interest rates charged by consumer loan companies under the federal *Small Loans Act*, R.S.C. 1970, c. S-11, was replaced in 1981 by a criminal usury ceiling in the federal *Criminal Code*: see *An Act to amend the Small Loans Act and to provide for its repeal and to amend the Criminal Code* S.C. 1981, c. 43, s. 9. On the latter development, see J.S. Ziegel, “Bill C-44: Repeal of the Small Loans Act and Enactment of a New Usury Law” *Comment* (1981) 59 *Can. Bar Rev.* 188.

¹⁹⁰ As of 1 June 1998, interest rates on general credit cards in Canada varied between 8.9 per cent and 18.9 per cent, with most of the rates being at the high end. The rates for in-house credit cards averaged 28 per cent: see Office of Consumer Affairs, *Credit Card Costs* (June 1998), online: Industry Canada <<http://strategis.ic.gc.ca/SSG/ca01057e.html>> (date accessed: 17 July 1999).

with their own industry sponsored studies because they have had the ready ear of the federal government without them.

Still, even discounting the many anecdotal stories of abuses, both Canadian and American studies¹⁹¹ show some percentages of consumers with substantial incomes who presumably could afford to make payments, but prefer the straight bankruptcy solution to the discipline of the proposal or Chapter 13 route. The question we need to answer is whether these debtors deserve a windfall and whether, on a cost-benefit analysis, society is better off, socially and economically, giving them a free ride than adopting (or, in Canada's case, retaining) an objectionable income payment and conditional discharge regime.

D. *My Own Position*

So far as Canada is concerned, my own partiality is for a British-style discretionary discharge system—the system that obtained before the 1997 amendments to the *BIA*—because it seemed to work tolerably well. It avoided the shortcomings and complexities of the American fresh start system without hitching the courts to the consumer credit industry bandwagon. Consumer creditors largely abstained from filing objections to discharges, and that was their prerogative. If they did raise objections, the courts were in a good position to balance the social interests of the community against the debtor's income and expenses, and the merits of the creditors' claims. As I have previously indicated,¹⁹² Canadian courts implicitly and explicitly applied a priority ranking to different types of claims in weighing any objections, and in this way the courts were able to indicate their belief that credit grantors should do more to police their own practices.

Canadian debtors who had special needs, or were anxious to avoid the stigma of bankruptcy, were free of course to opt for a proposal under Part III, Division 2, although only a small percentage did.¹⁹³ As I

¹⁹¹ For a discussion of these findings in Canada, see Schwartz & Anderson, *supra* note 124 at 26, Table 6 (Panel C); for a discussion of these findings in the United States see Sullivan, Warren & Westbrook, *supra* note 179 at 236-37. For the early results in the Toronto bankruptcy region under the Superintendent's statutory standards, see note 93, *supra*.

¹⁹² See Part VII(E), above.

¹⁹³ In 1993, the number of consumer proposals was 1,791, or 3.29 per cent of the number of consumer bankruptcies. The number more than doubled to 4,737 proposals in 1997 and the percentage grew to 5.55 per cent. The raw data was supplied by the Office of the Superintendent of Bankruptcy, Ottawa; I am grateful to Vic Liu for calculating the percentages. The number of consumer proposals has jumped since the coming into effect of the 1997 amendments, and

explain in the next section of this article, Canadian creditors missed a valuable opportunity to make the proposal route more attractive when Part III, Division 2 was introduced in 1992, and when it was amended in 1997.

IX. ALTERNATIVES TO STRAIGHT BANKRUPTCY¹⁹⁴

An insolvent Canadian consumer seeking relief from his or her indebtedness other than through bankruptcy¹⁹⁵ has the following options. He or she may select a statutory consolidation of his or her debts under Part X of the *BIA*, or make a proposal to his or her creditors under Part III, Division 2.¹⁹⁶ The critical difference between a statutory consolidation and a proposal under Division 2 is that the former provides for no remission of any part of the debt, whereas Division 2 clearly contemplates it, although it is not mandatory.¹⁹⁷ Still another route open to Canadian consumers is to seek the assistance of a non-profit debt repayment and credit counselling service, such as the ones that have been active in Ontario for more than thirty years,¹⁹⁸ or of a

amounted to 7,064 in 1998. This change is not surprising, since both consumers and trustees now have a strong incentive to follow the proposal route—consumers because of the pressures exerted by the 1997 amendments, and trustees both for this reason and the fact that the amended *Bankruptcy Regulations* entitle them to retain a much higher percentage of the payments made under a proposal than was allowed under the old rules.

¹⁹⁴ See also S.J. Ruthen, “Alternatives to Personal Bankruptcy in Canada” (Conference on the Contemporary Challenges of Consumer Bankruptcies in a Comparative Context, Faculty of Law, University of Toronto, 21-22 August 1998) [unpublished].

¹⁹⁵ Recall that in Canada, a debtor who opts for a reorganizational proposal under Part III of the *BIA* or for a consolidation order under Part X is not treated as a bankrupt person, though the bankruptcy rules will apply where appropriate: see *BIA*, *supra* note 3, s. 66(1).

¹⁹⁶ The consumer may also make a proposal under Part III, Division 1 of the *BIA*, and must do so if his or her total indebtedness, excluding a mortgage debt on the consumer’s principal residence, exceeds \$75,000: see *BIA*, *supra* note 3, s. 66.11, “consumer debtor.” Until 1992, only one set of provisions were available for both commercial and consumer proposals: see *Bankruptcy Act*, R.S.C. 1985, c. B-3, ss. 50-66. What is now Part III, Division 1 was extensively revised in the 1992 amendments, and a new Division 2 was added to cater to the needs of consumers: see *1992 Amendments*, *supra* note 3, ss. 18-31 (Division 1), 32(1) (Division 2).

¹⁹⁷ See *BIA*, *supra* note 3, ss. 66.11, “consumer proposal,” s. 2, “proposal.”

¹⁹⁸ The largest and oldest of the credit counselling agencies in Ontario is Credit Counselling Service of Toronto, which was established in 1965. There are now 27 non-profit credit counselling agencies in Ontario who are members of an umbrella organization, the Ontario Association of Credit Counselling Services (OACCS). “Credit counselling” is a misnomer, since from the beginning the agencies have been equally active in running debt management programs for the benefit of debtors and their creditors. For example, in fiscal year 1997-1998, the OACCS opened 13,944 new counselling cases and 4,275 new debt management files. A total of \$22.5 million was distributed to creditors under debt management plans: see Ontario Association of Credit Counselling Services,

commercial debt adjustment service. Credit counselling agencies are strongly supported by Canadian creditors. Undoubtedly they provide a very useful service, but their overall impact on the Canadian consumer insolvency scene is modest, since, apart from their counselling functions, they only act as debt prorating agencies; they have no power to grant debt relief themselves and do not ordinarily seek remission from any part of their clients' debts. Their job is to obtain creditors' acceptance to a payment plan over an agreed number of years.

Commercial debt adjustment companies surface in Canada from time to time, but they currently have a low visibility. They appear to have been totally eclipsed by the statutory options open to insolvent consumers and by the successful advertising for business by trustees. The following remarks are limited to the debt adjustment regimes under the *BIA*.

Part X of the *BIA* has its genesis in orderly payment of debts legislation adopted in Manitoba during the Depression, and subsequently copied in Alberta.¹⁹⁹ The Supreme Court of Canada held the legislation *ultra vires* the provinces in a 1960 decision as an encroachment on the federal government's exclusive insolvency jurisdiction.²⁰⁰ This forced the federal government to introduce legislation of its own, and it did so in 1966 by adding Part X to the *BIA*.²⁰¹ Part X only applies to those provinces that have elected to adopt it; only six provinces have done so.²⁰² The total number of consolidation orders made in 1995 amounted to 2,078, or somewhat less than 4 per cent of the number of personal bankruptcies declared that year.²⁰³

Part III, Division 2 was added as part of the major amendments to the *BIA* in 1992 in order to give consumer insolvents a more flexible and attractive reorganizational regime than Part X. The hope has been only partly realized. The number of consumer proposals filed in 1995, at 2,419,²⁰⁴ was only 341 more than the number of Part X orders. The

Annual Report 1998 (Toronto: Ontario Association of Credit Counselling Services, 1998).

¹⁹⁹ See Alberta, *The Orderly Payment of Debts Act* S.A. 1959, c. 61; and Manitoba, *Orderly Payment of Debts Act* S.M. 1932, c. 34.

²⁰⁰ See *Validity of The Orderly Payment of Debts Act, 1959* (*Alta* [1960] S.C.R. 571).

²⁰¹ *An Act to amend the Bankruptcy Act* S.C. 1966, c. 32, s. 22.

²⁰² For the list, see Office of the Superintendent of Bankruptcy, *Annual Statistical Summary for the 1995 Calendar Year* (Ottawa: Industry Canada, 1995) at 38.

²⁰³ *Ibid.*

²⁰⁴ See Craddock, *supra* note 1 at 1. The number has since been revised to 2,655: see T. Craddock, "Consumer Proposals: National and Regional Statistics" in *Roundtable*, *supra* note 39, 7 at 7.

number has since grown to 4,737 in 1997,²⁰⁵ or 5.35 per cent of the number of consumer bankruptcies—still well below the almost 30 per cent ratio of Chapter 13 plans to Chapter 7 filings in the United States. However, the Division 2 filings may be expected to rise in light of the 1997 amendments to the *BIA* and the new surplus income payment provisions in section 68.²⁰⁶

There appear to be many reasons for the lesser popularity of Part III, Division 2 proposals in Canada as compared to Chapter 13 in the United States. To begin with, a Part III, Division 2 proposal has a much lower monetary ceiling than a Chapter 13 proposal and only covers aggregate debts up to a maximum of \$75,000, excluding debts secured by the debtor's principal residence, or as prescribed by regulation.²⁰⁷ Still more important is the fact that a secured creditor cannot be bound by a proposal without its consent.²⁰⁸ In practice, trustees appear to be able to work their way around this difficulty; nevertheless, the exclusion of secured claims compromises a debtor's bargaining position.

Another important difference is that a proposal requires creditor consent before it can become effective.²⁰⁹ On the other hand, approval of the proposal by the court is not a precondition, as it is of a plan under Chapter 13, unless the administrator or a creditor requests a court hearing.²¹⁰ If court review occurs, the court must refuse its approval if it concludes that the terms of the proposal are not reasonable or fair to the debtor or the debtor's creditors.²¹¹ The court may also decline its approval if the debtor has committed described offences under the *Act*.²¹² It is well known that the American bankruptcy judge plays a much more central role in the approval process and other aspects of a Chapter 13 plan.²¹³

²⁰⁵ See Craddock, *supra* note 1 at 1. This number has since been revised to 4,727: see "Consumer Proposals: National and Regional Statistics" in *Roundtable*, *supra* note 39 at 7.

²⁰⁶ See note 193, *supra*.

²⁰⁷ See *BIA*, *supra* note 3, s. 66.11, "consumer debtor." See also *Bankruptcy Code*, *supra* note 33, § 109(e).

²⁰⁸ See *BIA*, *supra* note 3, s. 66.28(2)(b).

²⁰⁹ The creditors' consent is assumed if creditors, having in the aggregate at least 25 per cent in value of the proven claims, do not require a meeting, and if a meeting is not asked for by the official receiver: see *ibid.* ss. 66.14(b)(iv), 66.15(2), 66.17, 66.18.

²¹⁰ *Ibid.* s. 66.22(1).

²¹¹ *Ibid.* s. 66.24(2).

²¹² *Ibid.* s. 66.24(2)(a).

²¹³ On the judge's approval role, see *Bankruptcy Code*, *supra* note 33, § 1325.

Part III, Division 2 is also harsher than Chapter 13 in dealing with breaches of the terms of an approved proposal. On application, the court may annul the proposal on such grounds, as well as for other reasons and, if an annulment order is made, the debtor is deemed to have made an assignment in bankruptcy.²¹⁴ Still more important, there is an automatic annulment where the debtor has been in default of monthly payments for more than three months,²¹⁵ but annulment does not result in a deemed bankruptcy.²¹⁶ A Canadian judge, unlike his or her American colleague,²¹⁷ has no power to grant the debtor a discharge from the debtor's remaining debts because of the hardship to the debtor in being required to continue with the proposal. Even if the Canadian debtor successfully completes the terms of the proposal, he or she still faces the same number of non-dischargeable debts as the debtor would face in a straight bankruptcy; unlike an American debtor,²¹⁸ the Canadian debtor does not receive even partial relief.

It is difficult to predict the impact of the 1997 amendments on Part III, Division 2 proposals. Because of substantial improvements in the fee structure, trustees have a much stronger incentive than before to steer debtors towards a proposal. Debtors with surplus income may also feel they can secure a better deal under a proposal than with the payments they would be required to make under section 68. However, the reverse may happen. Creditors may decline a proposal they would have accepted before the 1997 amendments if it does not oblige the debtor to pay as much as he or she would be required to pay under section 68 and the Superintendent's Standards.

Given Canadian creditors' complaints that Canadian consumers were abusing the bankruptcy system and should be encouraged to make proposals, one might have expected the credit community to prod the federal government into removing some of the many flaws in Part III, Division 2 described above. That this did not happen is a telling commentary on the absence of a consumer voice in the drafting of Canadian insolvency legislation, as well as creditors' ambivalence in pursuing their own self-interests.

²¹⁴ See *BIA*, *supra* note 3, ss. 66.3(1), (5)(a). See also *Bankruptcy Code*, *supra* note 33, § 1307(c) (the court may convert a Chapter 13 case to a Chapter 7 case).

²¹⁵ See *BIA*, *supra* note 3, s. 66.31(1).

²¹⁶ See *Bankruptcy and Insolvency Law of Canada*, *supra* note 137, E§12.

²¹⁷ See *Bankruptcy Code*, *supra* note 33, § 1328(b).

²¹⁸ *Ibid.* § 1328(a). See also *In re Kourtakis*, *supra* note 170; and Warren & Westbrook, *supra* note 65 at 377.

X. THE STATUS OF REAFFIRMATION AGREEMENTS

The question of when agreements between a debtor and his or her creditors reaffirming the debtor's obligations discharged by the bankruptcy should be recognized, and the kind of safeguards necessary for the debtor's protection, has long been debated in the United States. Reaffirmation agreements are regulated by the *Bankruptcy Code*.²¹⁹ The topic was extensively discussed by the National Bankruptcy Review Commission,²²⁰ which concluded that the *Bankruptcy Code* provisions were inadequate.²²¹ It therefore recommended additional safeguards.

Because of American experience with reaffirmation agreements, an American observer will be surprised to learn that the topic is not even mentioned in the *BIA*, and was not discussed as part of the deliberations leading to its amendment in 1992 and 1997. In my view, this is further evidence of the extent to which the Working Group studying consumer bankruptcy issues was obsessed about consumer abuses and blind to creditor abuses. In fairness to the Working Group, it must be added that reaffirmation agreements do not enjoy a high profile in Canada, and have attracted very little academic attention. Also, very little appears to be known about how widely reaffirmation agreements are relied on by Canadian creditors to undo the "mischief" caused by a debtor's discharge from bankruptcy.²²²

However, it would be a mistake to conclude that reaffirmation agreements are not used in Canada. The case law clearly shows the contrary.²²³ Reaffirmation agreements are governed in Canada by general contract principles. This means that while a debtor's bare promise after discharge to pay a pre-bankruptcy debt will be

²¹⁹ See *Bankruptcy Code*, *supra* note 33, §§ 524(c), (d).

²²⁰ See "A Principled Approach," *supra* note 177 at 498-502.

²²¹ The evidence before the Commission showed that 42.2 per cent of Chapter 7 debtors agreed to reaffirmations. The Commission was also concerned that reaffirmations enabled "high end," well-advised debtors to manipulate the bankruptcy system by reaffirming selected debts, while walking away from other, more onerous ones. The Commission proposed to address these problems by banning reaffirmation of unsecured debts completely, and limiting reaffirmation of secured debts to the value of the collateral: see *ibid.* at 499-501.

²²² I have asked various trustees, and only one had had first-hand experience with a reaffirmation agreement. The others had heard vague rumours about this or that creditor trying to use reaffirmation agreements, but the stories were insubstantial.

²²³ See the annotations in *Bankruptcy and Insolvency Law of Canada* *supra* note 137, H§24 (6-145-6-147).

unenforceable,²²⁴ the promise will be enforceable if it is supported by new consideration, such as a creditor's promise to renew a line of credit or to make a new loan.²²⁵ The position is the same with respect to the debtor's reaffirmation of his or her personal obligations under a secured loan.²²⁶

XI. THE ROLE OF CREDIT COUNSELLING IN THE CONSUMER BANKRUPTCY SYSTEM

This topic is discussed in detail in other articles in this Symposium,²²⁷ and I do not want to anticipate what the authors have to say about it. However, the origins of the provision in the *BIA* introducing counselling requirements for debtors²²⁸ are important, and warrant a comment about the mindset of those who proposed the amendment and of the committee of the Canadian House of Commons that accepted it.

Originally, Bill C-22 contained a provision²²⁹ requiring the Superintendent to make counselling facilities available on an optional basis to bankrupt consumers. A group of credit counselling agencies

²²⁴ See *Heather & Sonv. Webb* (1876), 2 C.P.D. 1 (H.C.J.); and *Trans Canada Credit Corp.v. Wolfe* (1994), 28 C.B.R. (3d) 237 (Man. Q.B.). The position is the same in England: see *Law of Insolvency*, *supra* note 78 at 319.

²²⁵ See, for example, *Jakeman v. Cook* (1878), 4 Ex.D. 26 (H.C.J.).

²²⁶ See *Bankruptcy and Insolvency Law of Canada supra* note 137, H§24 (6-146). Difficulties arise in Canada where the debtor remains in possession of collateral after bankruptcy, and continues to make payments after his or her discharge without an express reaffirmation agreement. Some Canadian courts have implied a reaffirmation or novation agreement in such circumstances: see, for example, *Seaboard Acceptance Corp.v. Moen* (1986), 62 C.B.R. (N.S.) 143 (B.C. C.A.), criticized in *Bankruptcy and Insolvency Law of Canada supra* note 137, H§24 (6-146), and in T.M. Buckwold, "Post-Bankruptcy Remedies of Secured Creditors: As Good as it Gets" (1999) 31 Can. Bus. L.J. 436. The decision can probably be justified on the ground that the lessor in that case was never notified of the debtor's bankruptcy: see J.S. Ziegel, "Post-bankruptcy Remedies of Secured Creditors: Some Comments on Prof. Buckwold's Article" (1999) 32 Can. Bus. L.J. 142 at 142-47. The *BIA* has no provision requiring the debtor or the debtor's trustee to advise the secured creditor of the estate's intentions with respect to collateral in the estate's possession after bankruptcy. The assumption seems to be that the initiative rests with the secured creditor, since the secured creditor is entitled to demand release of the collateral unless the trustee elects to redeem the property: see *BIA, supra* note 3, ss. 69.3(2), 128(3).

²²⁷ See R.E. Berry & S.L.T. McGregor, "Counselling Consumer Debtors Under Canada's *Bankruptcy and Insolvency Act* (1999) 37 *Osgoode Hall L.J.* 369; and "Consumer Bankruptcy in Comparison," *supra* note 6.

²²⁸ See *BIA, supra* note 3, s. 157.1, as am. by *1992 Amendments supra* note 3, s. 58.

²²⁹ See Bill C-22, *An Act to enact the Wage Claim Payment Act, to amend the Bankruptcy Act and to amend other Acts in consequence thereof* 3d Sess., 34th Parl., 1991, s. 118.

recommended that counselling be made mandatory and a condition of a first-time individual bankrupt receiving an automatic discharge under section 168.1 of the *BIA*. The committee accepted the recommendation, and the counselling requirement now appears in section 157.1(1) of the *BIA*.²³⁰

The underlying rationale for the amendment was that, since many bankruptcies were said to be caused by consumers' inability to manage their budgets and to use credit wisely, some instruction on these matters would serve a beneficial purpose.

The new provisions are controversial because they are mandatory; because they do not distinguish between the actual grounds of a bankruptcy such as poor budgetary skills and financial problems precipitated by loss of a job or illness in the family; and because they draw an invidious distinction between individual bankrupts, and officers and directors of a corporation whose poor management skills may have caused the bankruptcy of their corporation. Just as striking is the fact that the House of Commons committee, during the hearings on the provisions, never considered the possibility that the credit granting policies of a credit grantor may have contributed to the debtor's problems, and that the *BIA* should contain sanctions for irresponsible credit granting practices.

XII. CONCLUSION

It may seem extravagant to talk about the philosophy and design of Canadian and American bankruptcy systems, given the tremendous pressures brought to bear by influential groups on the drafting process and the distorting effect this has on any consistent architecture. But, at least in the United States, the issues are vigorously debated in public, and scholars from diverse disciplines have carefully analyzed the opposing policies and the data said to support them.

We in Canada, with a fraction of the American population but spread across a landmass of five thousand miles, are not so fortunate. Serious public debate of the issues canvassed in this article has been very modest, and Canadian scholars are only now beginning to take an interest in insolvency problems.

²³⁰ The 1997 amendments to Part III, Division 2 of the *BIA* extended the counselling provisions by requiring the administrator of a consumer proposal to provide, or provide for, counselling for the consumer debtor in accordance with directives issued by the Superintendent: see *BIA*, *supra* note 3, s. 66.13(2)(b).

Our Parliamentary system has also not helped. It has meant that once an influential lobby (in the bankruptcy area this means the consumer credit industry or Revenue Canada) has caught the government's ear and the relevant bill has been drafted, its adoption is almost a foregone conclusion. Committee proceedings in the House of Commons and the Senate are often only symbolic exercises, since few members of Parliament or senators belonging to the government party are in a position, or willing, to challenge cabinet decisions. There is the further complication that most Canadian politicians find consumer insolvency problems unappealing and unhelpful in promoting their careers.

Subject to these important procedural caveats, it can be confidently claimed that American consumer insolvency law is much more pro-debtor than Canadian law. In Canada's case, the balance has been tilted still more strongly in the creditor's favour as a result of the 1997 amendments.

The key issue dividing the American and Canadian systems, and dividing the American system from most other bankruptcy systems, is whether or not the debtor's future income should be made available to pay off some of the debtor's debts, and if so, how. After examining the many rationales supporting the American fresh start philosophy I have, with some trepidation, expressed my preference for a judicially-oriented conditional discharge system, but stripped of the coercive features added by the 1997 amendments. At the same time, the difference between the Anglo-Canadian mandatory payment systems and a voluntary incentive-driven Chapter 13 plan strikes me as only a difference in degree and methodology. The goals are the same in both cases.

Much of the rhetoric accompanying the debate about alleged consumer abuses has not been supported by reliable data. This is particularly true in Canada where accessible data about many essential aspects of consumer bankruptcies are still missing. I have also expressed my concurrence with those critics who complain that the role of the consumer credit industry in contributing to the high insolvency rates has been largely ignored.

Two other aspects of the Canadian and American consumer insolvency systems also require further investigation. One is peculiar to Canada. The other applies to both countries. The problem particular to Canada involves the multiple roles of trustees in serving the consumer, the bankruptcy court, the Superintendent, and the consumer's creditors. The conflict has become much more acute since the 1997 amendments. I believe it needs to be addressed.

The other aspect involves the increasing complexity of the consumer insolvency systems in both countries. In Canada, the additional costs fall on the consumer's shoulders, although definitionally he or she is already insolvent. The concept of summary administration of small estates was supposed to address the problem but, it too, in Canada's case, has been seriously weakened by the 1997 amendments. I believe the concept of expeditious administration of small estates (redefined to include debtors with low incomes) needs to be revitalized so that the debtor's meagre resources are not frittered away on fees and disbursements.

