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THE UNIVERSITY OF MELBOURNE

GRADUATE SCHOOL OF BUSINESS ADMINISTRATION

34TH ADVANCED MANAGEMENT PROGRAM

WEDNESDAY 14 JULY 1982

WHATEVER HAPPENED TO INSOLVENCY REFORM?

The Hon. Mr. Justice M.D. Kirby
Chairman of the Australian Law Reform Commission

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LAW REFORM AND BUSINESS

The Australian Law Reform Commission was established in 1975. It is a permanent national institution. It receives references from the Federal Attorney-General. With the aid of relevant consultants from all disciplines and from various branches of business and industry, the Commission then proceeds to prepare a report. The report is tabled in Parliament by the Federal Attorney-General. A number of the reports have led on to legislation for the improvement of the Federal legal system in Australia. If I can adopt an analogy apt for a management school, we are a kind of efficiency audit on the Federal legal system. However, our resources are small. Accordingly, what we can achieve is small too. Once our reports are delivered, their implementation depends entirely upon the interest taken in them by the relevant Minister, the Cabinet and, ultimately, the Federal Parliament.

A number of the tasks given to the Law Reform Commission would be of interest to participants in an advanced management program. The very process of law reform - law improvement and law modernisation, should be of interest to you as managers and as citizens. Some of the tasks given to us are of special concern to business. I believe it is likely that the Federal involvement in

business law will expand, to meet the demands of nationwide regulation, nationwide administration and uniform enforcement of the law affecting business in Australia. Though federation has many advantages for liberty and occasional advantages for experimentation and law development, in areas of business operation, it can result in the confusing application to the one company and indeed the one series of operations of varying and even conflicting laws, applicable from one jurisdiction to another. Nowhere is this more of a problem than in the application of the law to technologies which are instantaneous and nationwide, such as computer technology linked to telecommunications. It is to be hoped that, in Australia, despite our Federal legal system, we can avoid the disadvantages and inconvenience including for business, of different regulations affecting this new technology, from one jurisdiction to the next.

A number of the tasks assigned to the Law Reform Commission are of specific interest and concern to business. Three of them I will identify but not elaborate. These are:

* Class Actions: An enquiry into whether we should introduce the United States legal procedure of class actions. This is a procedure by which a representative action can be mounted on behalf of numerous persons similarly affected by an alleged legal wrong. If products are mass produced with a defect giving rise to a cause of action, American jurists regard it as unreasonable to insist that the law should continue to deliver justice on an individual case-by-case basis. Because the problem was mass produced so, it is said, the delivery of justice should be mass produced and not confined to expensive craftsmanlike procedures of earlier times. Opponents of class actions point to the use of the procedure to 'blackmail' business and to 'rope in' people who would never ordinarily have brought a legal claim. Nevertheless, United States supporters of the class actions declare that it is the 'free enterprise alternative to government legal assistance'.
* Insurance Contracts: Secondly, the Commission has been asked to look at insurance contracts law reform. Laws created in an earlier time to regulate the insurance relationship may not be appropriate for our times, when insurance is sold to

ordinary citizens by radio, newspaper and television. The Law Reform Commission has completed a major report on insurance contracts. It is with the printer now and will be tabled in Federal Parliament in the next session. It represents the most comprehensive review of this important area of law ever carried out in Australia.

* Privacy: A third area of interest to business and management is our enquiry into privacy protection. In this enquiry, the Law Reform Commission is examining powers of intrusion, search and seizure by public officials, the whole procedure of electronic and other surveillance, the dangers to individual privacy from the growing computerisation of personal information including blacklists and credit records, and the development of direct marketing: the so-called 'junk mail" and telephone canvassing. All of these matters will be covered in a report which is now nearing completion and which should be in the hands of the Federal Attorney-General early next year - proposing a Federal Privacy Act to complement and stand beside the Freedom of Information Act. The process of opening up certain records to rights of inspection and of closing up others which has begun in the Federal public sector will spread to the State public service. Furthermore, business operations will not be immune from this historical development towards greater openness of administration.

There have, of course, been very many law reforms, including at the Federal leval, which affect business and which have not originated in the Australian Law Reform Commission. I suppose the most significant of these must be the enactment of the Trade Practices Act 1974 and the coming into force of the new companies and securities legislation. However, important work has been done and is being done in the Law Reform Commission relevant to the law governing business in Australia. It is about one such project - our enquiry into consumer indebtedness - that I want principally to speak today. In view of certain recent developments, and indeed the times we are living through, this reference has a special relevance to us all just now.

THE PROBLEM OF DEBT AND INSOLVENCY

Those of you who read the Melbourne Age last week will recall front page stories on consumer debt in Australia.[1] According to the Age, 'with the recession deepening and the likelihood of hard times ahead, many Australians are seriously entangled in debt'.[2] Consumer credit rose last year by $1605 million to $9635 million. At the December quarter it had reached $11,352 million excluding mortgage repayments. It was pointed that this was only $5 million less than the Federal Government's total security and welfare budget for the financial year just ended. By way of contrast, in 1976 Australians owed $3888 million to consumer finance organisations. The figures just quoted are separate from the amounts involved in home purchase. After the United States of America and Canada, Australians have the biggest average dependence on consumer credit. In December 1981 each adult Australian owed, on average, $1062 to various sources of credit. This could be broken down to:

Finance companies $374
Bankcard $125
Bank Personal Loans $358
Credit Unions $193
Retailers $12

Many of the stories in the Age articles were addressed to the problem of harassment and unfair or unlawful collection practices engaged in by creditors to recoup debts owed. Attention was paid to the steady growth in personal bankruptcies and in the proportion of consumer debtors opting for bankruptcy and the steady increase in consumer related debts as the cause for the credit predicament disclosed at bankruptcy. A consumer credit legal service has been established in Victoria. Community groups have long been offering advice and assistance to people whose debts get beyond them. Although there are fraudulent and recklessly irresponsible debtors, the picture emerging from the analysis of consumer debt in Australia is all to often one of incompetence rather than fraud. Naivete rather than recklessness. Bad luck can also play a part. People can suddenly and unexpectedly lose their jobs and be unable to repay their debts. People can be injured, especially in non-compensable circumstances and be unable to pay their debts. A

breadwinner can die and leave his family unprotected and unable to meet the credit repayments. Interest rates can rise and become so crippling that escape from the debt burden becomes difficult: leading to the borrowing from Bankcard to repay a retailer or other creditor.

There is, of course, another side to the coin. Creditors are not part of the charitable network of society - though sometimes, by extension of time, waiver of penalties and writing off debts, they can be charitable. Creditors are themselves under pressure. Interest rates continue to rise throughout the world and the morning's trading on Wall Street ultimately has a ripple effect that is felt in the four corners of Australia. Directors and managers of finance houses, banks and other lending institutions are accountable to their shareholders. Many of them express the concern that the public morality of repayment of debts which underpins the system of consumer credit, should not be undermined by laws, bureaucracies or practices which condone unjustifiable failure to repay debts when due.

The issues of consumer debt and insolvency which I have just been addressing are not merely local concerns. Any of you who take the American magazine Time will know that the cover story for the issue of 31 May 1982 was 'The American Way of Debt'.[3] Personal indebtedness in the United States, including household mortgages has risen from an average of $3613 for each American in 1975 to what Time calls a 'backbreaking' $6737 in 1981. Personal bankruptcies numbering 179,194 in 1978 reached 456,194 in 1981.

> 'The basic fact...is that millions of Americans are in trouble. They went into debt because cheap credit made living easy and because inflation seemed to guarantee big annual salary increases and the prospect of repaying debts with cheaper dollars. But now many consumers face very unpleasant consequences. Not just the poor, who have always lived on the brink, but the prosperous and hopeful middle class. The recession and high interest rates threaten all illusions.'[4]

Hard times have also been reflected in the steady rise of personal and business insolvencies in the United Kingdom. Recognition

of the trends caused the United Kingdom government to establish, in 1977, a committee for the review of insolvency law and practice. The chairman of that committee, Sir Kenneth Cork was described in the Economist 'Britain's king corporate undertaker'.[5] The Cork report delivered in recent weeks distills the wisdon of 250 organisations and individuals, and 200 meetings. It contains at least 500 recommendations. Its major effort is to re-examine insolvency laws as they operate in a community of mass consumer credit. Among the chief recommendations of the Cork Committee are some which we will have to examine in Australia in context of reform of our own bankruptcy laws. Like those examined by Cork, our laws are inherited from Victorian England - before Henry Ford launched the mass produced consumer product, when consumer credit was virtually unavailable and when debt was a moral blemish to be punished by imprisonment and bankruptcy: a stigmatised loss of status from which one could never recover one's good name.

The main objectives identified by the Cork Committee to justify its many proposals were:

* To simplify insolvency procedures, to harmonise bankruptcy and company liquidation procedures wherever possible;
* To introduce new voluntary procedures for insolvency, in the hope of rescueing failure businesses;
* To improve the standards of the administration of the insolvent funds;
* The increase the funds available to unsecured creditors of insolvent debtors; and
* To impose more severe penalties on the directors of insolvent companies found to have acted irresponsibly.

For present purposes, the most interesting provisions are those which deal with what I will call 'the small but honest' debtor The Cork Committee proposed:

* The establishment of a special insolvency court which could hear applications rapidly, within 14 to 21 days.
* Provision of a sole ground upon which an insolvency application could be made, namely that the debtor was

unable to pay his or its debts.

* The provision of greater flexibility to make an order appropriate to the debtor's circumstances in order to reduce the time and effort trustees have to spend on small estates.
* The provision of a Debt Arrangement Order, where unsecured liabilities are less than 10,000 pounds and where there are no major assets. Such an order would provide for the realisation of specified assets by the debtor and to the payment by instalments from the debtors future income of the whole of part of his debts.
* Debtors would be automatically discharged after one year.
* Bankruptcy would be reserved for the more serious cases in which fraud or public wrongdoing was suspected. The aim would be to distinguish the small but honest debtor whose problems were basically those of incompetence or ill-fortune rather than deliberate wrong doing. Whether the debtor was a private individual or a company, the object of Sir Kenneth Cork and his committee was to face up to the problems undreamt of when the Victorian lawyers framed bankruptcy legislation, and to provide a simplified procedure, short of bankruptcy, for dealing with individuals who are incompetent rather than dishonest. Cork Committee estimated that its proposals would reduce by 90% the number of individuals who had to be declared bankrupt. Instead small but honest debtors would undergo a 'debt arrangement order' with the repayment, so far as possible, of their debts out of future income.

INSOLVENCY: THE REGULAR PAYMENT OF DEBTS

You will forgive me if I say that the deliberations of the Cork Committee in England in the subject of consumer indebtedness appeared painfully familiar to me when I read them. They reflect the thinking in the report delivered by the Australian Law Reform Commission in 1977, just about the time when the English committee was beginning its deliberations. Naturally, we sent a copy of our report to the Cork Committee. On the principle that imitation is the highest form of flattery, I am gratified. I would

.. even more gratified if the fact that this distinguished English committee has now come up with proposals very close to those advanced by the Australian Law Reform Commission in 1977 - five years ago - hastened the consideration of the Commission's recommendations in those quarters in Canberra where they are still under study. I am not sure precisely where the report is. It was the old Department of Business and Consumer Affairs. It is now presumably with the Attorney-General's Department. One might hope that the return of insolvency law to the ministerial responsibilities of the Law Minister will hasten the somewhat leisurely consideration of the report, now five years old. The time between the delivery of the report and the present day, far from diminishing the need for the scheme proposed by the Commission, seems to me to have increased the urgency of providing a better national system for consumer insolvency. Mind you, it would be necessary to reconsider at least one recommendation. The Commission proposed that its scheme should apply to non-business debtors with total debts not exceeding $15,000. The passage of the years and the erosion of inflation make it appropriate that this sum should be reviewed upwards. It is notable that the Cork Committee designed its debt arrangement order for those with unsecured liabilities less than 10,000 pounds. So we are both talking of a relatively small consumer debtor.

A thumbnail sketch of the Law Reform Commission's scheme can be quickly given. It too proposed a change in bankruptcy law so that, short of bankruptcy, insolvent debtors could have a means of rearranging their debts and avoiding bankruptcy. The proposal envisaged establishment of what we called 'A Regular Payment of Debts Program'.[7] Such a program would be available outside bankruptcy. It would provide a means by which a person who was insolvent i.e. unable to pay his debts would be able to secure, by simple and inexpensive procedures, a short moratorium on debts, during which time he would receive debt counselling and advice on the establishment of a repayment program. Allowance could be made for composition or rateable reduction of debts. But the main objective of the Australian Law Reform Commission was a scheme which would be good for debtors and creditors. Instead of the expensive and tardy procedures presently used - which merely snowball the problems of the debtor and sometimes even land him

imprisonment - a system would be instituted to permit repayment of the whole or part of the debt out of future income. It was good for creditors because they would recoup monies owed, they would inherit a debtor with better idea of handling his debts and they would avoid the destructive loss of time and funds expended on legal process. It was good for the consumer debtor because it helped avoid the indignity of bankruptcy or other court process, it instilled self-respect and it provided for regular payment of aggregate debts so that the community's public policy in favour of debt repayment would be underlined.

To avoid expensive bureaucratic procedures, the Commission proposed that debt counsellors could come not from just the normal professional groups such as solicitors, trustees or tax agents, but also from voluntary community organisations, increasingly building up expertise in the specialised business of debt counselling.

One recommendation in the Law Reform Commission's report was that a non-business bankrupt should be automatically discharged from the bankruptcy 6 months after the commencement of bankruptcy, unless an objection was made in the final month of that period either by the creditor or the official receiver. A similar recommendation seems to have been made in the Cork report, although the period of one year rather than six months has been proposed. In Australia, the Bankruptcy Act was amended in 1980 to the extent that the period of five years previously provided has now been reduced to three years.[8] However, the pathetically small amounts recovered from consumer bankrupts out of non-exempt assets, and disclosed in the Law Reform Commission's report show what a wasteful and expensive business our present bankruptcy procedure involves - humiliating to the consumer debtor, of no great use to the consumer creditor and cost intensive for the Australian tax payer who has to foot the bill for the cumbersome, antique Victorian procedures which still survive.[9]

Now, I have to confess to you that there was nothing terribly novel or dazzlingly original in the Law Reform Commission's report on insolvency and the regular payment of debts. In fact as disclosed in the report, the scheme offered to the Federal authorities was simply an adaptation for this country of the wage

ner schemes which have been operating for more than 40 years in the United States of America. They are not suitable for every debtor. But they are suitable for debtors who have a future income out of which debts can be paid. How much better is it that our laws should be adapted to provide that people pay aggregate debts that they are encouraged to do so by our laws and procedures and that they are encouraged to pay their creditors rather than to get further into the mire of debt by accumulating further expensive recovery costs. The wage earner schemes have been operating successfully in the United States and, to meet new circumstances, have recently been extended to small businesses.[10]

This, is the position that has been reached. In the biggest credit economy of them all, the United States, the emphasis of the legal response to consumer indebtedness to twofold. First, there is voluntary bankruptcy, with quick discharge, except in fraudulant cases, little but current assets for the present creditors but protection for future creditors by the credit reference system. Secondly, there are wage earner plans by which, after a short moratorium, the debts are reorganised and aggregated, occasional debt counselling is offered and, short of bankruptcy, a system efficiently devised to permit the debtor the self respect of repayment and the creditor the advantage of recouping most, at least, of his loss from the future income of the debtor.

Is this not a sensible scheme? Is it not an appropriate one to adopt in Australia, with necessary variations for our own needs? Is it not better to face up to the problems of consumer credit? By debt counselling, is it not better to tackle the underlying disease (incompetence in handling credit) rather than concentrating, as the law has tended to do, on the latest symptoms (particular unpaid debts)? The Australian Law Reform Commission thought that this was the way ahead. It expressed its recommendations as long ago as 1977. Its views have lately gained further strength from the report of the Cork Committee in England. It avoided the Scylla of a large bureaucracy and the Charybdis of undue economic 'dogoodism', undermining of the public policy in the repayment of debts. The report was prepared by a strong team which included Mr. John Cain, now Premier of Victoria, who was then a part-time member of the Law Reform Commission. So far it has not attracted

Federal legislation, save for the amendment to the Bankruptcy Act I have mentioned. A Bill based on the report was passed through the South Australian Parliament but has not yet been proclaimed to commence. The problem is a national one and the Australian Constitution confers power on the Federal Parliament to make laws with respect to bankruptcy and insolvency. But the problem is also a human one as the recent stories of people getting out of their depth or suffering unemployment or misfortune disclose. Wealthy people and those with a good credit rating can organise their debts and secure a short moratorium in their repayment by the facility of a credit card. They can repay their aggregate debts and they can do so by instalments. But people who have got into difficulties, who have no credit card and an uncertain credit rating, do not enjoy this facility. If we are serious about tackling the problem of consumer indebtedness - very much a problem of our times - I suggest that the Australian Law Reform Commission's 1977 report would repay careful study. Law reformers have to be patient. I have the patience of Job. I am encouraged to these observations solely by the recent reports of the recommendations made in England and by the growing seriousness for many Australians - creditors and debtors alike - of the problems of consumer indebtedness in a time of economic recession.

DEBT RECOVERY

The report of the Australian Law Reform Commission on insolvency law was the first stage of a two part enquiry. For want of resources, the second stage has been postponed and is only now being revived upon the completion of our insurance contracts report. The second stage deals with the reform of the whole process of debt recovery. It involves an examination of the procedures we currently follow in recovering debts. These include instalment orders, imprisonment, recovery against goods, recovery against land, attachment of wages and other income and use of the credit reference system.

In order to gain a more detailed knowledge of the operation of the existing debt recovery system in Australia and to provide comparative information by which we could test our tentative thinking, the Australian Law Reform Commission has conducted a

detailed survey of the debt recovery procedures available under w South Wales law. We have done this with the assistance of the New South Wales Government and the New South Wales Law Reform Commission. This survey has involved the detailed examination of every aspect of 'the life' of some 2,570 debt recovery actions commenced in N.S.W. during the year 1975. The Australian Bureau of Statistics has advised on the design of this survey. I am sure that more and more law reform will be based on empirical research of this kind and less on hunch and guess work. The object of the survey has been to examine the ways in which various creditors used different procedures and the effectiveness of different procedures. A number of other research studies are being undertaken. These are looking at:

* the time that would be taken, if more reliance were had upon conducting an oral examination of the debtor before recovery procedures were ordered;
* the extent to which imprisonment for debt related purposes and the extent to which criminal process are being used to facilitate debt recovery in Australia;
* the factors that lead creditors to choose different procedures, such as recovery against wages (garnishment) or recovery against goods or land; and
* the extent to which bad debts are rising with the current recession. Upon this matter, the Commission will need the assistance of the Australian Finance Conference.

I hope that within the next year, the Commission will be in a position to report on the reform of Australian debt recovery laws and to suggest more modern, efficient and cost effective procedures that avoid the diseconomies, humiliations and efficiencies of the present procedures which ante-dated the rapid expansion of consumer credit after the second World War and which have not taken them into account nor taken into account the expansion and legitimate use of the credit reference system to protect creditors. Although changes in bankruptcy law have been introduced[11] including changes in the administration of the Bankruptcy Act arising out of the review of Commonwealth functions[12], these are developments which fall short of the complete review of the Bankruptcy Act recommended in the Law Reform Commission's 1977 report.[13] In that report the

Commission recommended that reference be made to it for the complete overhaul of Australia's bankruptcy laws. It was urged that Australian bankruptcy legislation should not be allowed 'to fall further behind its United States and Canadian equivalents'.[14] No such reference has been made to the Commission. The Cork report and the growing relevance of bankruptcy and insolvency laws may justify reconsideration of this recommendation.

CONCLUSION

I have talked of a somewhat specialised project of the Law Reform Commission. It is not the most inspiring project we have and in fact debt, consumer indebtedness, insolvency and bankruptcy may be seen by some as depressing and tiresome topics. But this is a net of the law that is catching more and more of our fellow citizens. If we are serious about improving the efficiency and justice of the legal system, we will devote adequate resources to examining the operation of current laws and procedures. We will do this especially when it can clearly be established that the social base upon which the current laws were drawn has shifted as significantly as it has, between Victorian England when debt was immoral to modern Australia when debt is almost compulsory. This is a classic case for law reform. The Clink Prison from which debtors in Dickens' time were sent in boatloads to the Australian colonies has been pulled down. Those of you who have wandered along the south bank of the Thames in London will still find the relics of the Clink Prison, if you look hard enough. Unfortunately, it is not necessary to be so perspicacious when the other relics of the debt laws of Victorian England are to be found. They can be seen in every State of this Commonwealth. Our bankruptcy, insolvency and debt recovery laws have simply not kept pace with the growth of consumer credit and hence of consumer indebtedness. Justice and efficiency require that we reexamine those laws. In part the Law Reform Commission has already done this. In part the project is still continuing. Justice and efficiency suggest that the proposals already made should receive attention before too long.

FOOTNOTES

1. See The Age, 6 July 1982, 1, 6; 7 July 1982, 1, 15.

2. The Age, 6 July 1982, 1.

3. Time, 31 May 1982, 46.

4. Ibid, 47.

5. The Economist, 12 June 1982, 97; The Age 12 June 1982, 20.

6. E.J.R. Souster, 'Insolvency Practice After The Cork Report' The Accountant, Vol 186, 828; 17 June 1982 16. See also Accountancy, July 1982, 7.

7. Australian Law Reform Commission, Insolvency:The Regular Payment of Debts (A.L.R.C. 6), 1977, ix.

8. Bankruptcy Amendment Act 1980, s 72(1) inserting s 149 in the Act

9. ALRC 6, 64.

10. The wage earner schemes in the United States were extended to apply to small businesses. Bankruptcy Act, Public Law 95-598 which came into force on 1 October 1979.

11. Bankruptcy Amendment Act 1980

12. Commonwealth Functions (Statutes Review) Act 1981

13. ALRC 6, 80.

14. Ibid.