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Bankruptcy for the Poor?

Stephanie Ben-Ishai* and Saul Schwartz**

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** Professor, School of Public Policy and Administration, Carleton University.

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1. Introduction

Should the bankruptcy process be more readily available to poor Canadians? Several different jurisdictions have recognized that it is can be difficult for poor debtors to file for bankruptcy due to the associated out-of-pocket costs and have identified forms of relief that can assist them in obtaining a fresh start. This paper addresses the question of whether Canadian debtors who cannot afford to pay the normal fees charged by bankruptcy trustees should have low-cost access to bankruptcy through a mechanism other than the summary administration procedure. We draw on two sources to shed light on this question: (1) a comparative analysis of different approaches adopted in the United States, Australia, New Zealand, the United Kingdom and the Netherlands; and (2) our findings from a series of semi-structured interviews with bankruptcy trustees. Bankruptcy trustees in Canada are the private intermediaries (often accountants) who are regulated and licensed by the Office of the Superintendent in Bankruptcy (OSB) and serve as gatekeepers to the consumer bankruptcy process.

The research question under consideration goes to the heart of the long-standing debate about the ease with which debtors should be able to obtain a full discharge of their debts through the bankruptcy process. On one side of the debate are those who believe that the vast majority of debtors filing bankruptcy are honest but unfortunate and seek relief from their debts only as a distasteful last resort. Those on the other side of the debate believe that many who file for bankruptcy could repay their debts if only they were more diligent in their work habits and more careful in their spending habits. These two views lead to different conclusions about any initiative that makes bankruptcy more accessible. Those adhering to the first view believe that greater accessibility will not dramatically increase the numbers of debtors who file for bankruptcy since bankruptcy is sought only as a last resort. Those who hold to the second view believe that the barriers to bankruptcy, both monetary and non-monetary, must be kept high in order to discourage large numbers of debtors from seeking bankruptcy.

As demonstrated through our interviews with a number of bankruptcy trustees, this general debate spills over into the narrower debate about the subset of debtors who have so little income that they cannot pay a trustee's normal fees, even if those fees can be paid over the nine months of a typical summary administration.

A key issue for this paper is defining what we mean by "poor debtors." All debtors filing for bankruptcy attest to the fact that they are insolvent, unable to make debt payments as they come due. In that sense, all bankrupts are poor. However, most of those filing for bankruptcy have sufficient income to make relatively small monthly payments to the trustee, drawing either upon their earnings or upon friends and family. We are interested here in the much smaller group of debtors whom the trustee has deemed as lacking the funds to pay the normal fees. In such cases, the trustee must decide whether to accept lower-than-normal fees or to turn the debtor away.

We asked each of the trustees that we interviewed to characterize such debtors and found that they shared a common vision. As one trustee put it: "These are people who live a

marginal existence, on social assistance, living in government-subsidized housing and with no prospects for changing this around.”¹ That same trustee stated that such debtors have “no income, no friends, no family” and are “by themselves and at the end of their rope.” Others spoke of debtors with physical or cognitive disabilities² or of lone mothers who are immigrants with limited ability to speak English or French.³ Women seem to figure prominently among poor debtors, most likely reflecting the feminization of poverty that has occurred in recent decades. In our view, the key element of this characterization is the strong likelihood that these debtors will experience *persistent* poverty, with or without their debts. They are not using the bankruptcy system to discharge their debts with the goal of moving on to a comfortable middle-class existence. We concur with the views of the trustees and henceforth will use the term “poor debtors” to refer to debtors seeking bankruptcy who cannot pay the trustee’s normal fees and who seem unlikely to attain anything but a low income for the foreseeable future.

The existence of poor debtors has long been known. The unresolved question is whether there are large numbers of debtors who are unable to go through the bankruptcy process because they are unable to pay the trustee’s fees. The trustees with whom we spoke were unanimous in their opinion that the number of poor debtors who were unable to file for bankruptcy was quite small.⁴ The reason, in their view, is that they were themselves willing to handle the file of any debtor who appeared before them and that they felt that debtors in other places would be able to find a trustee to take their case.

The trustees we interviewed recognized that poor debtors are usually judgment proof and face no real prospect that a court would allow their creditors to take any action against them. Each trustee said that they informed debtors of what it meant to be judgment proof, explaining that the debtors could stop collection efforts by telling the collection agencies of their inability to pay. However, the trustees did not equate “judgment proof” with “not in need of bankruptcy.”

As one trustee put it, “creditors are very aggressive and they [the debtors] reach a breaking point. I always tell them they are judgment proof but this doesn’t help them in dealing with creditors on a day-to-day basis.”⁵ Another trustee stated that even though he always informs poor debtors that they are judgment proof, debtors often have an emotional need to be debt-free; he gave an example of handling the bankruptcy of someone on their deathbed, a debtor who wanted to die debt-free.⁶ The trustees interviewed expressed a surprising lack of concern with administering bankruptcies for debtors who were clearly judgment proof. Even if these debtors are judgment proof, the trustees believe they require protection from overly-enthusiastic collection efforts; debtors “believe creditors when they say they are going to do something” and “just not

¹ Interview with Trustee 4, 15 September 2006.

² Interview with Trustee 5, 20 September 2006.

³ Interview with Trustee 1, 18 August 2006.

⁴ Trustees 2, 3, 5, and 6.

⁵ Interview with Trustee 8, 8 September 2006.

⁶ *Ibid.*

answering the phone can be difficult and they may not have the money to change the telephone number.”⁷ Some expressed sympathy towards debtors who not only face harassing collection efforts, but also hear misrepresentations of what might happen if they fail to make payments.

The debtors that these trustees have in mind should be distinguished from so-called no-income, no-asset (NINA) debtors.⁸ In the Canadian context, NINA debtors have no non-exempt assets to liquidate and no income above the OSB’s Surplus Income Standards. In such cases, there is only a small prospect of a significant dividend for creditors. Estimates suggest that 70 to 80 per cent of bankruptcies in Canada are filed by NINA debtors. Most of these debtors, however, are able to pay the normal trustee fees, spread out over the nine months of the summary administration. They are poor, but the depth of their poverty is far less than that of the debtors described above.

As background, a short summary of the operation of the OSB’s Surplus Income Guidelines is in order. Debtors who have income above the OSB’s Surplus Income thresholds must make contributions to the estate during the bankruptcy period. For example, a bankrupt in a family unit of 2 with \$2800 of available monthly income would be required to pay \$181 per month in Surplus Income Payments until they are discharged from bankruptcy. The Surplus Income thresholds are based on the Low Income Cut-Offs (LICO) published by Statistics Canada. Any analysis of Surplus Income payments requires an analysis of the Statement of Receipts and Disbursements (SRD) which shows the receipts coming into each estate and the payments (including trustee fees and creditor dividends). From January 1, 2006 to December 31, 2006, the SRD was electronically-submitted for 29,379 summary administration bankruptcies (see Appendix C for a description of these data). In roughly 20 percent of these files (5,739/29279), the debtor was required to make payments from their Surplus Income under Section 68 of the BIA; in the other 80 percent, no requirement to make Surplus Income payments was imposed. Of the 5,739 cases required to make Surplus Income payments, 63 percent (3,635/5,739) paid a creditor dividend and 37 percent did not. For the 3,635 cases that paid a dividend, the average dividend paid was \$1,982 (with a standard deviation of \$3,964). For the 23,640 estates without a Surplus Income requirement, 28 percent paid a dividend and 72 percent did not; the mean dividend among those who paid a dividend was \$1,106 with a standard deviation of \$2,261.⁹

To summarize, the trustees interviewed held a common conception of the characteristics of the debtor who could not afford to pay trustees’ fees. Even though the typical such

⁷ Interview with Trustee 3, 8 September 2006. That same trustee noted that many people now have only a cell phone and pay for minutes even when someone calls them. Calls from collection agencies can therefore be expensive for the debtor.

⁸ In the deliberations of the OSB’s Personal Insolvency Task Force some five years ago, there was substantial discussion of the idea of creating a new and simpler insolvency procedure for NINA debtors. In the end, it was decided that a streamlined version of the existing summary administration procedure would adequately address the issue.

⁹ Calculations by the Business Intelligence Centre of the Office of the Superintendent of Bankruptcy. See also Appendix C.

debtor is judgment proof, the trustees still felt that they deserved the right to file for bankruptcy. Moreover, we should be careful not to confuse the relatively small number of poor debtors currently seeking bankruptcy with the very large number of debtors who have no non-exempt assets and no income above the OSB's Surplus Income Guidelines.

2. Do the Poor Need Bankruptcy?

The poor in the context of consumer bankruptcy are not only insolvent at the time of filing for bankruptcy, but are likely to have been poor for some time and are likely to remain in poverty for the foreseeable future. Their current earnings prospects are dim and their life circumstances are such that any upward economic mobility will be impeded by significant barriers.

However, for one of two reasons, some might question whether the poor need bankruptcy. The first reason has already been discussed. Many of the poor are judgment proof and, in principle, can simply refuse to respond to collection efforts. Nonetheless, that seemingly simple refusal is far more difficult than one might think and judgment proof debtors frequently appear in trustees' offices seeking bankruptcy protection.

The second reason for believing that the poor do not need bankruptcy is the idea that the poor do not accumulate very large debts and therefore have little need for bankruptcy protection. In this section, we use the 1999 Survey of Financial Security to illustrate that the so-called "democratization of credit"—the extension of credit throughout the income distribution—has proceeded to the point where even families in the lowest deciles of family income have significant debts.

Tables 1 and 2 show the distribution of various kinds of debt across the deciles of family income. Families in the bottom three deciles almost certainly have incomes that are less than the relevant Statistics Canada Low Income Cut-Off (LICO) and therefore might qualify as poor by our definition.¹⁰

Table 1 makes clear that significant proportions of the poor have debts in each of the categories listed. To be sure, families in the lowest three deciles are *less* likely to have various types of debts than those in the higher deciles, but one in four has credit card debt and one in six hold other debts. Since bankruptcy is a situation facing only a minority of debtors, these proportions are large enough to suggest that a significant minority of poor families will have significant debts coming due at a time when their income is low. The amounts shown in Table 2 are averages only for those who have positive amounts of debt in each category, but their size once again suggests that poor families may acquire significant debts, especially in relation to their low income.

¹⁰ There is, however, an important difference between the poor families in Tables 1 and 2 and poor families as we think of them in the context of bankruptcy. In our conception, poor families seeking bankruptcy protection are not only poor at a single point in time but are likely to remain poor for the foreseeable future. Because there is considerable mobility in and out of poverty in Canada, a significant minority of families in the lowest deciles of family income in Tables 1 and 2 are likely to move out of poverty in future years.

We note in passing that student loan debts are an important type of debt held by the poor, both in terms of frequency and size, and student loans are not dischargeable through bankruptcy. We see that the families in the lowest decile are the *most* likely to hold student loans, partly because those loans are directed to students from low-income families and partly because there is a correlation between the incomes of parents and children. If the debts of a poor family become overwhelming, it may make sense to file for bankruptcy in order to discharge the debts that are dischargeable and to then focus on repaying the student loans that are not dischargeable.

Table 1: Proportion of Families with Various Types of Debt

Deciles of Family Income	Mortgage	Vehicle Loans	Credit Cards	Student Loans	Other Debts	Total Debt
Less than \$12,250	0.07	0.06	0.25	0.13	0.17	0.50
12,250-18,000	0.09	0.09	0.24	0.09	0.15	0.47
18,000-24,700	0.14	0.14	0.32	0.10	0.20	0.57
24,700-31,850	0.22	0.19	0.39	0.10	0.24	0.65
31,850-40,000	0.32	0.24	0.42	0.12	0.27	0.72
40,000-49,000	0.41	0.28	0.46	0.10	0.32	0.78
49,000-60,850	0.45	0.31	0.47	0.11	0.35	0.81
60,850-76,800	0.53	0.34	0.48	0.12	0.40	0.84
76,800-105,300	0.52	0.34	0.45	0.10	0.39	0.83
More than 105,300	0.47	0.23	0.30	0.05	0.39	0.76

Source: 1999 Survey of Financial Security (unweighted). See Schwartz, S. and S. Baum, "How Much Debt is Too Much? Benchmarks for Manageable Debt in Canada and the United States" in Bruce Doern and Christopher Stoney, eds. *Universities and the Powering of Knowledge: Policy, Regulation and Innovation* (University of Toronto Press, forthcoming 2007), Chapter 7. Note: All debts are reported for the family as a whole.

Table 2: Amount of Debt Outstanding for Families with Non-negative Debt

Deciles of Family Income	Mortgage	Vehicle Loans	Credit Cards	Student Loans	Other Debts	Total Debt
Less than \$12,250	\$62,260	\$6,968	\$2,064	\$11,961	\$6,562	\$19,430
12,250-18,000	52,348	8,338	1,957	12,013	8,601	19,875
18,000-24,700	51,815	8,113	2,233	9,983	6,307	23,651
24,700-31,850	51,783	9,393	2,551	11,593	8,171	29,248
31,850-40,000	58,804	9,835	2,696	10,611	9,021	39,202
40,000-49,000	65,158	10,897	2,998	10,093	9,126	48,871
49,000-60,850	70,281	11,005	3,186	9,619	11,740	58,561
60,850-76,800	75,093	12,054	3,479	9,979	14,589	69,382
76,800-105,300	80,899	14,469	3,786	9,769	17,632	77,080
More than 105,300	117,558	16,108	4,721	12,354	33,266	109,512
No. of Families	5,098	3,506	5,993	1,615	4,592	10,543

Source: 1999 Survey of Financial Security (unweighted). See Schwartz, S. and S. Baum, "How Much Debt is Too Much? Benchmarks for Manageable Debt in Canada and the United States" in Bruce Doern and Christopher Stoney, eds. *Universities and the Powering of Knowledge: Policy, Regulation and Innovation* (University of Toronto Press, forthcoming 2007), Chapter 7. Note: All debts are reported for the family as a whole.

3. Overview of the Canadian System

One option facing poor but heavily indebted Canadians is to do nothing. Whatever threats might be made by collectors and regardless of the persistence of their calls and visits, such individuals are likely to be judgment proof and the threats and calls will eventually stop. “Doing nothing”, however, when faced with persistent and threatening collection calls is easier said than done. Few know the law well enough to know that the threats are empty and that the calls will stop sooner rather than later. For those who seek to resolve their debt situations, bankruptcy can be the best option. The other major option - credit counselling as currently practiced in Canada — is unlikely to be successful because poor debtors often lack the financial resources to make the payments required by a debt management plan.

The premise of this paper is that there may be debtors in need of bankruptcy who cannot afford the fees that trustees ask. As background, a short summary of the rules that govern the fee-setting behaviour of trustees is in order. Rule 128(1) of the BIA sets out the method in which maximum fees are to be calculated.¹¹ Essentially, these maximum fees are a function of the amount of receipts coming into the estate. The fee schedule sets out the maximum fees that a trustee can collect (the first \$975, plus 35 percent of the next \$1,025, plus 50 percent of everything above \$2,000 to a maximum of \$10,000). In practice, it seems that trustees try to realize at least \$1,500 to \$1,700 on each file. Of course, they are free to take less if they so choose.

At the onset of a bankruptcy, the level of receipts is generally unknown since it will depend on the amount the trustee earns for the estate by selling the debtor’s assets and on the refunds, if any, from the trustee’s filing of the debtor’s tax returns. In deciding whether or not to accept the case, trustees must decide if they are likely to be paid for their efforts. In many cases, debtors have no non-exempt assets and the amounts that can be expected from the debtors’ tax returns are not enough to bring the receipts of the estate up to an acceptable level. In such cases, trustees are allowed to ask the debtors to make payments to the estate, over the course of the nine months of the bankruptcy. In a significant minority of bankruptcies, these voluntary payments comprise the bulk of the receipts of the estate.¹²

¹¹ See Appendix B.

¹² For summary administration bankruptcies with SRDs electronically-submitted between January 1, 2006 and December 31, 2006, the proportion of receipts consisting of voluntary payments by the debtor can be estimated (see Appendix C). Voluntary payments were made in 77 percent of the cases. Voluntary payments made up more than 50 percent of the receipts in 49 percent of the cases and were more than 75 percent of the receipts of the estate in 25 percent. A controversial issue here is that the voluntary payments that trustees are allowed to ask of debtors become part of the estate and cannot be returned to the debtor should actual receipts turn out to be unexpectedly large. If trustees expect that receipts from the sale of non-exempt assets or from tax refunds will cover trustees’ usual fees, they will presumably lower or eliminate the voluntary payments. The only mechanism driving trustees to lower their fees in such cases, however, is potential competition from other trustees.

The problem for the poor debtors is that trustees may decide, rightly or wrongly, that the receipts of the estate, including any voluntary payments that the debtor can afford, are not likely to reach an acceptable level. If so, the trustee need not accept the case.

In talking to the trustees, we realized that a poor debtor who decides to seek bankruptcy in Canada and cannot afford to make the voluntary payments required by most trustees has two options. First, the debtors may try to find a trustee who will handle the file at a lower-than-normal price. Second, the debtors might seek help from the Bankruptcy Assistance Program (BAP) operated by the OSB.

a. Relying on Area Trustees

Conceivably, debtors who seek help from trustees in their area might be turned away by all of them. None of the trustees that we interviewed, however, believed that large numbers of poor debtors were in fact being turned away due to their inability to pay trustees' fees. Even if some area firms were unwilling to accept the files, the trustees thought that poor debtors would be able to find at least one trustee who would be flexible in the fees that he or she asked. The majority of the trustees we interviewed indicated that they themselves would never turn away a debtor seeking bankruptcy if they thought that the only obstacle to bankruptcy was the level of their fees. Most would agree with one trustee's statement that she "would never refuse someone who cannot afford the fee."¹³ However, the decision to be flexible on fees is not automatic; the trustees described the decision as one made on a case-by-case, dependent upon the information gleaned during their initial interviews with the debtor.

The trustees were willing to go beyond their own personal experience to suggest that such flexibility is quite common among trustees. While this flexibility may be common, it may not be universal. One trustee said that the national firms in her location did not lower their fees if the debtor could not pay.¹⁴ Another trustee (from a national firm) said that firms that were busy were unlikely to be flexible in their fees.¹⁵

In some cities, area trustees have gotten together and decided to handle the cases of poor debtors according to an agreed-upon formula. Such voluntary plans are not new. In 1969, the *Globe and Mail* reported that "a newly formed group of Ontario bankruptcy trustees has agreed to negotiate a plan for reduced-cost service to debtors who cannot afford the usual \$500 fee for personal bankrupts."¹⁶ The plan was aimed at "the honest debtor who deserves the benefit of the bankruptcy but can't finance it himself."¹⁷

¹³ Interview with Trustee 1, 18 August 2006.

¹⁴ Interview with Trustee 2, 8 September 2006.

¹⁵ Interview with Trustee 9, 29 November 2006.

¹⁶ Loren Lind, "New service offered to lower costs of bankruptcy" *Globe and Mail* (6 February 1969) 35. It is important to note that in that era the summary tariff was a flat \$450 fee plus \$50 for disbursements. This was the maximum fee possible for such files regardless of the amount of work performed. At that time

In 1994, trustees in the Halifax region agreed that, as a group, they would handle the bankruptcies of anyone who needed the service and could not afford it.¹⁸ That agreement has persisted over time and today poor debtors are asked to pay only \$250.¹⁹ Similarly, trustees in Edmonton agreed in 1999 to a similar arrangement for dealing with what are now known as “450 cases” because the out-of-pocket costs (and therefore the fee charged) at that time amounted to \$450.²⁰

Apart from the reports of trustees, however, there is no way to determine precisely how many debtors are simply turned away, who do not approach trustees because they think they will be unable to afford the normal fees or who cannot afford upfront payments of \$250-\$450.²¹

b. The Bankruptcy Assistance Program

The OSB administers a little-used program called the Bankruptcy Assistance Program (BAP).²² Trustees must agree to be part of the program and those who do so are placed on a list of available trustees. The program then assigns listed trustees to administer the files of debtors who have approached at least two trustees to handle their bankruptcies but who have been turned away because of their inability to pay the normal fees.

Very few cases are actually filed under the BAP program. Of the 29,379 summary administration cases with electronically-submitted SRDs received between January 1 and December 31 2006, only 304 were BAP cases.²³ Our interviews illustrate, however, that it would be a mistake to assume that the number of poor debtors is equal to the number of BAP cases. For example, in the cities where an agreement exists among trustees to handle poor debtors in a certain way, trustees will often not refer poor debtors to the BAP program, but will simply administer the cases themselves. Perhaps a better measure of the number of poor debtors is the number of cases in which receipts are less than \$500; of

the vast majority of trustees required that the \$500 had to be paid up front before the bankruptcy would be filed. Email from Dave Stewart, Deputy Superintendent of Bankruptcy, 24 October 2006.

¹⁷ *Ibid.*

¹⁸ Interview with Trustee 6, 20 September 2006.

¹⁹ The fee is still \$250 in Halifax even though out-of-pocket costs are now higher. *Ibid.*

²⁰ Interview with Trustee 3, 8 September 2006.

²¹ We note that this is a common situation in evaluating program participation; since information on non-participants is rarely collected, there is no effective way to estimate their number apart from anecdotal evidence from practitioners.

²² The statutory source for the BAP is a directive known as "Directive No.11" made pursuant to the BIA. Section 5(4)(b) to (e) of the BIA provides the OSB with the power to make directives. Directive No. 11 was first issued on October 23, 1986. See: <http://strategis.ic.gc.ca/epic/internet/inbsf-osb.nsf/en/br01331e.html> for the actual directive.

²³ Calculations by the Business Intelligence Centre of the Office of the Superintendent of Bankruptcy. See also Appendix C.

the above-mentioned 29,075 non-BAP summary administration bankruptcies, receipts were less than \$500 in 1,056 of the files.²⁴

There is no set fee charged by trustees for BAP cases. As in all summary administration cases, the trustee collects GST refunds and any tax refund arising from the pre-bankruptcy tax return. For poor debtors, these sources might yield only a small amount of money. In such cases, most of the trustees that we interviewed ask that the debtor pay for the \$75 filing fee and the \$180 cost of the two counselling sessions up front, allowing the debtor to pay off any remaining voluntary payments that may be required by the trustee with small payments over the nine months of the bankruptcy.

One trustee told us, however, that BAP cases in her area were often almost as remunerative as non-BAP cases, with the trustee realizing fees close to the usual amount charged.²⁵ The Edmonton trustee that we interviewed stated that the GST refunds usually cover the out-of-pocket costs and that she had only lost money on two of the “450 cases” that she has handled since 1999.²⁶ Another trustee informed us that he averages \$1,000 to \$1,200 on a BAP case as opposed to the \$1,200 to \$1,500 that he charges for a typical summary administration.²⁷

Looking at the receipts and disbursements for the 304 BAP cases with SRDs electronically-submitted in calendar 2006, we see that the average trustee fee in these cases was \$1,500 with a standard deviation of \$986. This mean seemed surprisingly high and we thought it might be influenced by a handful of cases in which the receipts of the estate (and thus the trustee’s fee) were inflated by unusual circumstances. For example, one BAP debtor received a \$39,000 inheritance during his bankruptcy. However, the median trustee fee is \$1,594 suggesting that the few cases with large receipts were not the main factor underlying the high mean. Voluntary payments from the debtors were not common; such payments were made in only 61 of the 304 cases.

Even though the average fees on BAP cases seem high to us, one trustee felt that there was no unmet need for bankruptcy in his area. He thought that all those who sought help in his area were being served and, furthermore, extensive advertising by trustees meant that no needy debtors were unaware of the option of filing.²⁸ Another trustee observed that because the ability of trustees to oppose the bankrupt’s discharge for unpaid fees provided security that their fees would be paid few debtors were turned away. The same trustee, however, also observed that the costs of attending at court for the discharge hearing might be excessive for a trustee operating on his or her own.²⁹

²⁴ The number of cases with receipts less than \$500 is not necessarily the number of cases filed by poor debtors. As we will see later in the paper, many BAP cases have receipts greater than \$500.

²⁵ Interview with Trustee 3, 8 September 2006.

²⁶ *Ibid.*

²⁷ Interview with Trustee 5, 20 September 2006.

²⁸ Interview with Trustee 5, 20 September 2006.

²⁹ Interview with Trustee 9, 29 November 2006.

c. Discussion

We believe that the lack of uniform treatment of poor debtors is a major impediment to equal access to bankruptcy. In effect, their bankruptcies are handled in a way similar to how paupers received aid before the advent of modern social assistance systems, when local charities, local churches, or municipal governments took up the task of providing for the destitute. As a result, the nature of the assistance that the poor received varied widely across Canada. Some received the assistance that they required, while others did not. Similarly, some poor debtors have low-cost access to bankruptcy; others do not. A broad assessment of the situation suggests that most of those who seek bankruptcy are able to file. The cost of filing varies across the country, however, so the extent to which *low-cost* access is available is unknown.

Debtors who cannot afford to pay trustee fees can use the BAP program, but few do. Instead, some individual trustees and groups of trustees take it upon themselves to provide service to poor debtors. The Halifax and Edmonton agreements discussed above are examples of collective action of the sort that local charities might have undertaken to help the poor in the nineteenth century.

While the analogy to 19th century social assistance is apt in some ways, it is less appropriate in others. For trustees specializing in consumer bankruptcies, fee flexibility is sometimes a good business decision rather than pro bono work. Most small businesses need to maintain a steady volume of cases in order to keep the staff busy. During periods when full-price cases are scarce, servicing poor debtors “keeps the lights on” even if the profit on such cases may turn out to be low or non-existent.³⁰ The idea is that “anything is a contribution to overhead.”³¹ The marginal cost of such cases is very small since the staff is already on site and may be underemployed during slow periods. The files of poor debtors may therefore have a positive effect on the economic viability of trustees’ businesses, helping them cover overhead during slow periods. Two of the interviewed trustees even thought that removing the files of poor debtors might endanger the economic viability of trustees who specialize in consumer bankruptcy.³² The trustee from the large firm also noted this phenomenon when he said that he did *not* have to worry about cash flow and therefore did not need to take on the files of poor debtors for that reason.

4. Should Poor Debtors Have Financially Accessible Options for Bankruptcy?

The American In Forma Pauperis Experience

The American academic literature has tackled the issue of whether poor debtors should be allowed to file in forma pauperis petitions in bankruptcy. In the United States, the authority to proceed in forma pauperis is granted by statute, and is meant to provide

³⁰ Interview with Trustee 3, 8 September 2006.

³¹ Interview with Trustee 5, 20 September 2006.

³² Interview with Trustee 3, 8 September 2006; Interview with Trustee 6, 20 September 2006.

indigent litigants with meaningful access to the federal courts, equivalent to the access available to those who can afford to pay.³³ When an individual successfully petitions to proceed in forma pauperis, certain costs and fees are waived.³⁴ Those who argue against allowing in forma pauperis proceedings in bankruptcy stress the cost implications of waiving fees: the amount of fees collected by the system would decrease.³⁵ Furthermore, critics assert, nearly everyone who files for bankruptcy relief will ask that fees be waived, and therefore screening mechanisms will have to be introduced adding time and expense.³⁶ Opponents suggest that a fee waiver system would encourage unnecessary and improper bankruptcy cases.³⁷ Individuals would file for bankruptcy even when there is no benefit in doing so—because debtors who cannot afford the filing fee are typically judgment proof.³⁸ Such a system may also be subject to abuse or fraud: critics argue, for example, that a fee waiver system will increase the number of people who file to benefit from an automatic stay, with no intention of following through to a discharge.³⁹

In the American context, some commentators assert that a fee waiver system is unnecessary because the filing fees can be paid in installments, and as such access to the system is denied only in rare circumstances.⁴⁰ Otis B. Grant argues that the filing fee must be retained because of the easy availability of discharge: if a debtor believes that discharge is costless, Grant asserts, he or she will be more likely to use it.⁴¹ Bankruptcy must have a cost, he states, because otherwise creditors will shift the cost of bankruptcy to the buyers of goods.⁴² Lastly, Michael Markham and Bethann Scharrer argue that proceeding in a bankruptcy case is “nothing more than a privilege,” and thus “it seems logical that proceeding in forma pauperis in bankruptcy is also only a privilege.”⁴³

Harry Sommer succinctly states the argument in favour of being able to proceed forma pauperis in bankruptcy filings: “Equal justice under the law.”⁴⁴ His response to the argument that the filing fee is low enough, and can be paid in installments, is that “...those who make [the argument] must be shockingly unfamiliar with the plight of

³³ Michael E. Markham & Bethann Scharrer, “In Forma Pauperis: An Unnecessary Privilege in Bankruptcy” (1994) 73 Am. Bankr. Inst. L. Rev. 73 at 77.

³⁴ *Ibid.* at 78. In the United States, some costs and fees are not waived. For example, witness fees and expenses are not among the fees and costs waived.

³⁵ *Ibid.* at 90.

³⁶ *Ibid.*

³⁷ *Ibid.*

³⁸ Elizabeth C. Wiggins *et al.*, *Implementing and Evaluating the Chapter 7 Filing Fee Waiver Program* (Federal Judicial Center, 1998), online:

<http://www.fjc.gov/library/fjc_catalog.nsf/autoframepage!openform&url=/library/fjc_catalog.nsf/Publication!openform&parentunid=76FF032DF9BA521B85256CA300688AE3> at 21.

³⁹ *Ibid.* at 22.

⁴⁰ *Ibid.* at 22.

⁴¹ Otis B. Grant, “Are the Indigent Too Poor for Bankruptcy? A Critical Legal Interpretation of the Theory of Fresh Start within a Law and Economics Paradigm” (2002) 33 Univ. Toledo L. Rev. 773 at 792.

⁴² *Ibid.* at 793.

⁴³ Markham & Scharrer, *supra* note 32 at 83.

⁴⁴ Harry Sommer, “In Forma Pauperis in Bankruptcy: The Time has Long since Come” (1994) 2 Am. Bankr. Inst. L. Rev. 93 at 97.

those in poverty in this country.”⁴⁵ Sommer notes that people file for bankruptcy for other reasons than to protect assets: to prevent a utility shutoff, to protect a driver’s licence, to participate in a government program, to prevent garnishment of wages (which is allowed in some states), or to fend off harassing or abusive calls from creditors/collection agencies.⁴⁶ He considers the fears of overburdening the court system with more paperwork to be overstated,⁴⁷ and argues that the solution to abuse is not to restrict access to the system but to address problem directly: the possibility that some might abuse the system is not a reason to reject a proposed reform.⁴⁸

5. Models for Reform

A number of jurisdictions have followed on concerns such as those expressed by Sommer, recognized that it can be difficult for poor debtors to file for bankruptcy due to the associated costs, and have identified forms of relief that assist poor debtors in obtaining a fresh start. The following section documents the available and proposed bankruptcy services for the poor across the United States, Australia, New Zealand, England and Wales, and the Netherlands.

a. United States

Title 28 of the United States Code represents the American in forma pauperis statute, allowing an individual to file civil actions in federal courts without paying the requisite filing fee.⁴⁹ A person seeking to proceed in forma pauperis must file an affidavit showing an inability to pay the associated costs.⁵⁰ Section 1930 governs the payment of fees in bankruptcy courts. As the statute was previously worded, bankruptcy courts did not fall under the definition of a “court of the United States”, and therefore had no authority to allow in forma pauperis proceedings.⁵¹ A 1973 decision of the U.S. Supreme Court held that there was no constitutional right to obtain a discharge of one’s debts in bankruptcy, concluding that the fee provisions of the Bankruptcy Code at the time were not an unconstitutional denial of due process rights.⁵² Thus, the legislation and jurisprudence

⁴⁵ *Ibid.* at 100. Notice that Sommer’s statements reflect the findings on the need for bankruptcy for the poor from our interviews of Canadian bankruptcy trustees.

⁴⁶ *Ibid.* at 103-104. See also Susan D. Kovac, “Judgment-Proof Debtors in Bankruptcy” (1991) 65 Am. Bankr. L.J. 675 at 678-681 for a discussion of the benefits and costs of bankruptcy for judgment-proof debtors; and Nathaniel C. Nichols, “The Poor Need Not Apply: Moralistic Barriers to Bankruptcy’s Fresh Start (1993-1994) 25 Rutgers L.J. 329 at 351-353, where he points out that filing for bankruptcy is an effective way for a poor family to prevent the stoppage of a utility service, while providing for a fresh beginning with the utility service.

⁴⁷ Sommer, *supra* note 43 at 105.

⁴⁸ *Ibid.* at 107.

⁴⁹ Markham & Scharrer, *supra* note 32 at 73.

⁵⁰ *Ibid.* at 77.

⁵¹ See *ibid.* at 80 for an overview of the decisions which have held that bankruptcy courts are not courts of the United States.

⁵² *Ibid.* at 74-75; see *United States v. Kras* 409 U.S. 434 (1973).

previously precluded the application of Title 28 to the initial filing fee for a bankruptcy petition.⁵³

Under section 418 of the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (and codified at Title 28 of the United States Code), however, individual Chapter 7 filers may now file an application to waive the filing fee at the same time as they file the bankruptcy petition.⁵⁴ Under the new legislation, a district or bankruptcy court may waive the filing fee for an individual debtor who (a) has income less than 150 per cent of the poverty guidelines last established by the U.S. Department of Health and Human Services; and (b) is unable to pay that fee in installments.⁵⁵ For individual debtors whose filing fees have been waived, the bankruptcy or district court may also waive other fees.⁵⁶ The Code also allows for the payment of the filing fee in installments.⁵⁷

Congress implemented a pilot program in 1994 in six judicial districts to study the effect of waiving the \$175 filing fee for individual Chapter 7 debtors who were unable to pay the fee in installments.⁵⁸ The study found that an application for waiver of the filing fee was filed in 3.4 per cent of all non-business Chapter 7 cases, and granted in 2.9 per cent of the cases.⁵⁹ The report concluded that the fee-waiver program may make the bankruptcy system more accessible to low-income debtors: almost 11 per cent of the successful fee-waiver applicants stated that they would not have filed for bankruptcy had there been no fee-waiver program.⁶⁰ In particular, the committee concluded that the program may have enhanced access to the bankruptcy system for indigent single women.⁶¹ Debtors whose filing fees were waived were more likely to obtain a discharge compared to debtors whose applications were denied.⁶² The report noted that there was an increase overall in Chapter 7 and Chapter 13 filings during the period of study, complicating the assessment of whether the program increased Chapter 7 filings. The study concluded, however, that only a “small fraction” of the increased filings were due to the program.⁶³ Assuming applications would be filed and granted at the same rate as occurred in the pilot program, the study predicted that a national fee-waiver program

⁵³ Sommer, *supra* note 43 at 95.

⁵⁴ *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, s. 418, codified at 28 U.S.C. § 1930(f)(1-3).

⁵⁵ “Judicial Conference of the United States Interim Procedures Regarding the Chapter 7 Fee Waiver Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005” (11 August 2005), online: U.S. Courts <<http://www.uscourts.gov/bankruptcycourts/jcusguidelines.html>>.

⁵⁶ 28 U.S.C. § 1930(f)(2). The fees that may be waived are those prescribed under 28 U.S.C. §§ 1930(b) and (c).

⁵⁷ Bankruptcy Rule 1006; 28 U.S.C. § 1930(a). Upon petition, the court may grant leave to pay in installments. The number of installments shall not exceed four, and the final installment shall be payable not later than 120 days after filing the petition. For cause shown, the court may extend the time of any installment, provided the last installment is paid not later than 180 days after filing the petition.

⁵⁸ See Wiggins *et al.*, *supra* note 37.

⁵⁹ *Ibid.* at 1.

⁶⁰ *Ibid.* at 4.

⁶¹ *Ibid.*

⁶² *Ibid.*

⁶³ *Ibid.* at 6.

would cost approximately \$4.7 million in lost filing fees, \$74,000 in waived miscellaneous fees for in forma pauperis debtors, and \$1.5 million in salary for additional office clerk personnel (a total cost of approximately \$6.3 million).⁶⁴ To fund the program, the study recommended that Congress increase the judiciary's appropriation by this amount,⁶⁵ or request authorization for application of the U.S. Treasury share of the filing fee to cover the cost.⁶⁶

In addition to filing fees, U.S. debtors often are confronted with legal fees as they navigate the complex bankruptcy process. As one commentator notes, it is unlikely that a no-asset Chapter 7 filer can afford to pay a bankruptcy attorney up front.⁶⁷ Without a retainer, a bankruptcy attorney is unlikely to pay the requisite filing fees or perform other pre-petition services because the debtor's obligation to pay for these services are likely to be discharged in the bankruptcy proceeding.⁶⁸ Most courts have held that pre-petition attorney fees are dischargeable, forcing bankruptcy attorneys to "get creative" if they wish to get paid.⁶⁹ Kerry Heydel Ducey recommends exempting pre-petition bankruptcy attorney fees from discharge, which would in turn encourage counsel to represent "even the poorest of debtors" by removing the risks of representing those who may be unable to pay their legal fees in advance.⁷⁰ Under 28 U.S.C. § 1915(e)(1), the court may request an attorney to represent someone who is unable to afford counsel, although most bankruptcy judges have decided that they do not have the authority to do so.⁷¹

b. Australia

The vast majority of bankruptcies in Australia are administered by Official Receivers, although bankruptcies may be administered by trustees from either the public or private sector.⁷² Australia's bankruptcy regime provides 3 alternative bankruptcy options, two of which are low-cost options. First, under s. 55 of the *Bankruptcy Act 1966*, a debtor may apply for bankruptcy without the need for court involvement. A debtor may become bankrupt by presenting a petition and statement of financial affairs to an Official Receiver. If the documents are in correct form and there is no creditor's petition pending, the Official Receiver must accept the petition. The individual becomes bankrupt on the day the petition is accepted, and the Official Receiver automatically becomes the trustee

⁶⁴ *Ibid.* at 12. The study did indicate that the cost might rise significantly if fee waivers were automatically based on a bright-line income standard.

⁶⁵ This represented 2/10 of one per cent of the judiciary's total fiscal appropriation for 1997: *ibid.* at 13.

⁶⁶ *Ibid.*

⁶⁷ Kerry Heydel Ducey, "Bankruptcy, just for the Rich? an Analysis of Popular Fee Arrangements for Pre-Petition Legal Fees and a Call to Amend" (2001) 54 Vand. L. Rev. 1665 at 1667.

⁶⁸ *Ibid.*

⁶⁹ *Ibid.* at 1671.

⁷⁰ *Ibid.* at 1672.

⁷¹ Richard H.W. Maloy, "Should Bankruptcy be Reserved for People Who have Money? Or is the Bankruptcy Court a Court of the United States?" (1997) 7 J. Bankr. L. & Prac. 3 at 28. The courts have generally found that due to the *Kras* decision, the section is inapplicable to bankruptcy proceedings.

⁷² Rosalind Mason, "Consumer Bankruptcies: An Australian Perspective" (1999) 37 Osgoode Hall L.J. 449 at 453. The Official Receiver in Australia is a person who administers statutory functions under the *Bankruptcy Act 1966* for the Australian government.

unless the individual nominates a privately registered trustee.⁷³ In most cases, the bankrupt will be automatically discharged after three years.⁷⁴

Second, bankruptcy is available under Part X of the *Bankruptcy Act* – a higher cost, more sophisticated process involving lawyers. Third, debt agreements under Part IX of the *Bankruptcy Act* are available to represent a low-cost alternative to bankruptcy for those who can afford to make some payments.⁷⁵ Proposals for debt agreements by low-income households are processed by the public sector.⁷⁶ When debt agreements were introduced in 1996 they were intended as a “viable low-cost alternative to bankruptcy for low-income debtors with little or no property, with few creditors, and with low levels of liability, for whom entry into Part X administration is not possible because of inability to meet set up costs.”⁷⁷ Debt agreements release the debtor from debts which would be provable in bankruptcy in the same way that bankruptcy releases his or her debts.⁷⁸ Under this procedure, a debtor submits a proposal to the Official Trustee, who determines whether the debtor meets the eligibility requirements.⁷⁹ The Insolvency and Trustee Service Australia (ITSA) advises creditors of the proposal and allows creditors to vote on it, during which time creditors’ proceedings are stayed for enforcement of debts.⁸⁰ If the proposal is accepted by a majority in dollar value and at least 75 per cent of creditors voting before the deadline, the debt agreement becomes effective.⁸¹ Research conducted by the ITSA in 2003 has shown that 65 per cent of debtors who entered into debt agreements had income less than \$30, 000, and “unemployment” followed by “excessive use of credit” were the main attributed reasons for insolvency.⁸²

⁷³ *Ibid.* *Bankruptcy Act 1966* (Cth) as amended, s. 55.

⁷⁴ The bankrupt will be automatically discharged after three years, unless (i) an early discharge from bankruptcy has been granted by the trustee (only applies to bankruptcies in existence prior to 5/5/03), (ii) an objection to discharge has been filed by the trustee, or (iii) the bankruptcy has been annulled. See ITSA, “Bankruptcy – Long Version,” online: <<http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/bankruptcy-bankruptcy+long+version?opendocument#Discharge>>.

⁷⁵ See ITSA, online: <<http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/debt+agreements-%3Epart+ix+debt+agreements?opendocument>>. See also ITSA, “Review of Debt Agreements Under Part IX of the Bankruptcy Act 1966,” online: <http://www.imal.com.au/template/files/27/220805_Debt_Agreements_Consultation_Paper.pdf> [Review of Debt Agreements].

⁷⁶ Mason, *supra* note 72 at 453. When debt agreements were first introduced, the cap on income was set at approximately \$26, 000. In 2003, this was raised to approximately \$48, 000. Set up costs referred to here refer to Part X administration.

⁷⁷ *Bankruptcy Legislation Amendment Bill 1996: Explanatory Memorandum*, at para. 135.16, cited in Mason, *ibid.* at 456.

⁷⁸ Betty Weule, “Debt Agreements: can they work?” (2000) 10:1 *New Directions in Bankruptcy* 11. Note, however, that the debtor must make payments.

⁷⁹ The Official Trustee in Australia is the government equivalent of a registered private trustee.

⁸⁰ Debts or liabilities arising from a maintenance agreement or maintenance order are not stayed. The ITSA is the agency that becomes the trustee when a private bankruptcy trustee is not appointed in a bankruptcy or other arrangement under the *Bankruptcy Act*.

⁸¹ Mason, *supra* note 72 at 456-457.

⁸² ITSA, *Review of Debt Agreements*, *supra* note 68 at 4.

Under the Australian government's cost recovery policy, the ITSA has adopted a formal cost recovery regime in respect of fees and charges payable under the *Bankruptcy Act* and related legislation. In 2004, the ITSA undertook a review of its fees and charges, identifying which services should be cost recovered, the type of charge to apply, who should pay, and which services would be more appropriately covered through general taxation.⁸³ The new fees and charges are effective from July 1, 2006. There is no fee for processing debtor petitions or debt agreement proposals.⁸⁴ The review recommended that a general levy be imposed on debt agreements, noting that the use of debt agreements had steadily increased since they first became available.⁸⁵ The government, however, decided against imposing a levy on debt agreements to ensure that the agreements "...continue to be available as a viable alternative to bankruptcy for many debtors."⁸⁶

The ITSA's Cost Recovery Impact Statement indicated that a \$250 fee would have to be charged to recover the processing costs of debtors' Section 55 petitions and debt agreement proposals.⁸⁷ The ITSA deemed, however, that this fee would not be consistent with broader bankruptcy objectives in providing a broad community benefit and not just relief for debtors.⁸⁸ During the consultation process, proponents of the fee argued that debtors receive a direct benefit, and given that debtors would not have the same debt servicing burdens once their petition is accepted, they should be able to afford the fee.⁸⁹ Critics argued that it would be counter-intuitive to subject debtors facing financial hardship to the fee and that its imposition would deny many debtors access to the system.⁹⁰ Creditors noted that ultimately they would end up paying the fee in many cases, as debtors would choose not to pay certain bills, or would acquire additional credit to pay the processing fee.⁹¹

Apart from charging no processing fees associated with Section 55 bankruptcy petitions and debt agreements, Australia's regime allows a debtor proceeding through the higher cost Part X bankruptcy procedure to apply to have other fees associated with bankruptcy waived. Examples of other fees include the following: a \$400 fee for the issue of bankruptcy notices; an ITSA administration of estate fee for bankruptcy and debt agreements, set at \$3000 plus 20 per cent of the money received; or for debt agreements,

⁸³ *Bankruptcy Legislation (Fees and Charges) Bill 2006*, Bills Digest no. 110 2005-06, online: Parliament of Australia < <http://www.aph.gov.au/LIBRARY/pubs/BD/2005-06/06bd110.htm> > [Bills Digest no. 110 2005-06].

⁸⁴ See fee schedule, effective 1 July 2006, online: Insolvency and Trustee Service Australia <[http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/about%20us->cost%20recovery->cost%20recovery%20documents/\\$file/itsa_fees_and_charges_1_july_2006.pdf?openelement](http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/about%20us->cost%20recovery->cost%20recovery%20documents/$file/itsa_fees_and_charges_1_july_2006.pdf?openelement)>.

⁸⁵ Bills Digest no. 110 2005-06], *supra* note 75. See also ITSA, "Cost Recovery Impact Statement" (February 2005), online: <[http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/About%20Us->Cost%20Recovery->Cost%20Recovery%20Documents/\\$FILE/CRIS_230205.pdf?OpenElement](http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/About%20Us->Cost%20Recovery->Cost%20Recovery%20Documents/$FILE/CRIS_230205.pdf?OpenElement)> at 19.

⁸⁶ Bills Digest no. 110 2005-06], *ibid.*

⁸⁷ Cost Recovery Impact Statement, *supra* note 77 at 3.

⁸⁸ *Ibid.*

⁸⁹ *Ibid.* at 17-18.

⁹⁰ *Ibid.* at 18.

⁹¹ *Ibid.*

a fee representing 20 per cent of the value of the proposal accepted by creditors.⁹² Subregulation 16.11 of the Bankruptcy Regulations provides for waiver or remission of fees by the Inspector-General, if the Inspector-General is reasonably satisfied that (a) payment of the fee by the person liable to pay it has imposed, or would impose, undue hardship on the person; or (b) because of other exceptional circumstances, it is proper and reasonable to do so.⁹³ The regulations define undue hardship as “hardship that is unusual and exceptional in comparison to the hardship arising in the normal course of bankruptcy.”⁹⁴

c. New Zealand

The New Zealand government has recently introduced the *Insolvency Law Reform Bill* which includes a “no income no asset procedure” as an alternative to adjudication on a debtor’s application.⁹⁵ The proposed reforms are set to expand the role of the Official Assignee, whereby all debtors will have to consult with an Official Assignee before invoking any of the proceedings, making bankruptcy an administrative procedure.⁹⁶ Under the proposed new regime, a debtor will be required to file a financial statement of affairs with the Official Assignee before pursuing bankruptcy or the no asset procedure option.⁹⁷ The Official Assignee will not only provide advice and information, Thomas Telfer notes, but render substantive decisions on the options pursued.⁹⁸ Telfer cautiously suggests that the retention of the Official Assignees’ monopoly over bankruptcy administration may avoid some of the problems associated with a private trustee system, such as Canada’s, where private trustees face potential conflicts of interest. However, Telfer does draw attention to the multiple roles the Official Assignee will have to play under the proposed reforms and the potential for conflicts.⁹⁹

The New Zealand Ministry of Economic Development describes the no asset procedure as providing “...an alternative to bankruptcy for insolvent debtors with nominal debts, no assets and who have no means to repay the debt.”¹⁰⁰ Part 5, subpart 4 of the bill sets out

⁹² See Bills Digest no. 110 2005-06, *supra* note 83.

⁹³ Bankruptcy Regulations 1996 – Reg. 16.11(1) and (2), online: Australasian Legal Information Institute <http://www.austlii.edu.au/au/legis/cth/consol_reg/br1996251/s16.11.html>.

⁹⁴ *Ibid.*, Reg. 16.11(3).

⁹⁵ *Draft Insolvency Law Reform Bill* (April 2004), online: Ministry of Economic Development (New Zealand) <<http://www.med.govt.nz/upload/21201/draft-bill.pdf>> [*Draft Insolvency Law Reform Bill*].

⁹⁶ Thomas G.W. Telfer, “New Zealand Bankruptcy Law Reform: The New Role of the Official Assignee and the Prospects for a No-Asset Regime” in *Consumer Bankruptcy in Global Perspective*, Johanna Niemi-Kiesilainen, Iain Ramsay & William C. Whitford, eds. (Oxford and Portland: Hart Publishing, 2003) 247 at 248. The Official Assignee is a statutory position created by the Insolvency Act 1967. When an Official Assignee is appointed to act in respect of a bankruptcy, they act as an officer of the court.

⁹⁷ *Ibid.* at 257; Insolvency Law Reform Bill, Explanatory Note, online: <<http://www.knowledge-basket.co.nz/gpprint/docs/bills/20050141.txt>> [Explanatory Note].

⁹⁸ Telfer, *ibid.* at 257.

⁹⁹ *Ibid.* at 258-259.

¹⁰⁰ Ministry of Economic Development, “Bankruptcy Administration: No Asset Procedure and Insolvency Act Changes – Regulatory Impact Statement” (1 December 2003), online: Ministry of Economic Development (New Zealand) <http://www.med.govt.nz/templates/MultipageDocumentTOC____6249.aspx>.

the rules relating to the no asset procedure. The starting point is the same for proceeding in bankruptcy: furnishing a statement of the debtor's affairs. Based on the statement of affairs, the Assignee will decide whether the debtor qualifies for entry to the no asset procedure. The bill outlines criteria for entry to the no asset procedure: no assets, total debts between \$1,000 and \$40,000, no means to repay any amount, and a clean financial record (not previously bankrupt, not previously admitted to the no asset procedure).¹⁰¹ Once admitted to the no asset procedure, the debtor enjoys a moratorium on his or her debts—with some exceptions, they cannot be enforced while the debtor is in the no asset procedure. After 12 months, the debtor is discharged and the debts are cancelled.¹⁰² However, if the no asset procedure terminates at any time before the 12-month period has elapsed, the debtor's debts will become enforceable.¹⁰³

The Assignee will have a limited role in the process because the debtor by definition has no assets: he or she must ensure that an applicant is qualified for entry, provide creditors with an opportunity to object to a debtor being admitted to the no asset procedure, ensure that a debtor who has been admitted improperly is removed, and terminate the no asset procedure at the request of the debtor if the Assignee is satisfied that the debtor, through changed circumstances, can make payment towards his or her debts.¹⁰⁴ The benefit of the no asset procedure is that an individual's debts are cancelled on discharge. Telfer notes that the Official Assignee will have to play a gate-keeping function through the control of access to the regime.¹⁰⁵ He argues that if the no asset procedure adopted by Parliament incorporates a number of subjective standards (such as entry criteria to determine who may access the procedure), the benefits of a streamlined no fault bankruptcy procedure will be lost.¹⁰⁶

Under the system currently in place in New Zealand, a debtor may apply to a District Court for a summary installment order if his or her debts amount to less than \$12 000, where a District Court Judge makes an order that is binding on creditors. An installment order provides that a debtor may pay back his or her debts without the threat of legal action while the order is in force; the process is administered by a third party supervisor and imposes no costs on the debtor.¹⁰⁷ If a debtor decides to petition for bankruptcy, there is a \$40 filing fee in the High Court, although a debtor may apply to have the fee waived if he or she cannot afford the cost.¹⁰⁸ However, if a debtor wishes to apply for an early discharge (prior to the end of the three year period) she must retain counsel and appear in the High Court at considerable expense.

¹⁰¹ See Explanatory Note, *supra* note 88; *Draft Insolvency Law Reform Bill*, *supra* note 86, cl. 347.

¹⁰² *Draft Insolvency Law Reform Bill*, *ibid.*, cl. 357.

¹⁰³ *Ibid.*, cl. 356.

¹⁰⁴ *Ibid.*, cl. 347-351, 354, and 355. See also Explanatory Note, *supra* note 88.

¹⁰⁵ Telfer, *supra* note 96 at 265.

¹⁰⁶ *Ibid.* at 268.

¹⁰⁷ Insolvency and Trustee Service (New Zealand), Personal Bankruptcy Toolkit, online: <www.insolvency.gov.nz/its-docs/I/its-bankruptcy-manual-28June.pdf> at 6.

¹⁰⁸ *Ibid.* at 7.

d. England and Wales

England and Wales have also embarked on insolvency law reform, proposing a no income, no asset (NINA) procedure similar to that in New Zealand. In 2004, the Department for Constitutional Affairs (DCA) published a consultation paper entitled “A Choice of Paths: better options to manage over-indebtedness and multiple debt.”¹⁰⁹ With regard to “can’t pay”¹¹⁰ debtors, the paper proposed two options: the introduction of a court-based debt relief order and a NINA procedure.¹¹¹ Under the former option, a debtor would be released from his or her debts after 12 months unless a creditor could provide evidence of non-declared assets. The recommendations for this option included a debt limit and an unspecified fee for debtors to enter the scheme.¹¹² Since the publication of this report, the England and Wales’ insolvency service has focused on the latter NINA option, and developed what it deems “...a non-court based scheme of debt relief that would alleviate debt in certain cases where there is currently no realistic alternative, but which is simple and likely to be relatively cheap to administer.”¹¹³ The scheme is aimed at those people who cannot pay “even a portion of their debt within a reasonable timeframe”¹¹⁴—people with no assets, very little income, and a relatively low level of liabilities, and who cannot access any of the debt solutions available (such as bankruptcy).¹¹⁵

In March 2005, the Insolvency Service published a paper for discussion focusing solely on the NINA procedure, recognizing that “[t]here is a category of person who has fallen into debt and has no way out of it.”¹¹⁶ U.K. research has shown that “the great majority of people who fall into arrears with their household bills or credit commitments do so because they are in financial difficulty resulting from a change in circumstance or living long term on a low income.”¹¹⁷ These debtors simply lack the money to make payments on time, and include people on low incomes who face unexpected expenditure, people who have had a sudden substantial fall in income leaving them unable to meet all their commitments, and people with mental health problems which impair their ability to

¹⁰⁹ Department for Constitutional Affairs, “A Choice of Paths: better options to manage over-indebtedness and multiple debt” (20 July 2004), online:

<<http://www.dca.gov.uk/consult/debt/debt.pdf#search=%22A%20Choice%20of%20Paths%3A%20%20better%20options%20to%20manage%20over-indebtedness%20and%20multiple%20debt%22>>.

¹¹⁰ “Can’t pay” in this context refers to debtors who cannot pay off their debts as opposed to debtors who cannot pay trustee fees.

¹¹¹ *Ibid.* at 43.

¹¹² *Ibid.*

¹¹³ The Insolvency Service (United Kingdom), “Relief for the Indebted – An Alternative to Bankruptcy” (March 2005), online:

<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/consultationpaperwithnewannex1.pdf> at 5 [“Relief for the Indebted”].

¹¹⁴ *Ibid.*

¹¹⁵ *Ibid.* at 18.

¹¹⁶ *Ibid.* at 12.

¹¹⁷ Nicola Dominy & Elaine Kempson, “Can’t Pay or Won’t Pay?: A Review of Creditor and Debtor Approaches to the Non-Payment of Bills” (2003). For a summary of the report, see Department for Constitutional Affairs (United Kingdom), online: <<http://www.dca.gov.uk/research/2003/4-03es.htm>>.

manage their finances.¹¹⁸ In England and Wales, the current fee to petition for bankruptcy is £310, even if the debtor qualifies for remission of or exemption from court fees. The current fee for administering bankruptcy is £1625.¹¹⁹ Ideally, the U.K. report notes, each bankruptcy estate should cover the costs of its administration. However, this does not always occur, with the result of bankruptcies where there are assets subsidizing those where there are none. Waiving the £310 fee, the report argues, would mean that cross subsidization between cases would increase.¹²⁰

The NINA scheme proposed by the paper would be operated by Official Receivers, who would be responsible for making debt relief orders that would result in debtors being discharged from their debts after a period of one year. The procedure would require an up front entry fee, but less than the deposit required to initiate bankruptcy proceedings. As well, debtors would have to meet certain criteria to make use of the scheme.¹²¹ The consultation paper proposed a restriction on number of times a person could apply for an order, and recommended the use of an approved intermediary to collect information about the debtor's affairs, assist in filling out forms, and filter unsuitable applicants.¹²² To balance the rights of creditors, the paper suggested a means for creditors to object to the making of an order on various grounds, such as failure to disclose assets, income or liabilities.¹²³ The scheme would preserve the ultimate right of appeal to the courts.

After the consultation paper was published and comments received, the Insolvency Service published a second paper highlighting the responses.¹²⁴ The paper put forth the following recommendations:¹²⁵

- an up front, non-refundable fee paid by debtor to administer the debt order relief scheme, no more than £100;¹²⁶
- an administrative order, without the intervention of the courts;
- a restriction on the number of times a debtor can obtain an order (no more than once every six years);
- the use of an approved intermediary by the debtor when applying for an order, with intermediaries to be properly funded;
- a cap on permitted liabilities of £15 000;¹²⁷

¹¹⁸ *Ibid.*

¹¹⁹ "Relief for the Indebted," *supra* note 113 at 13.

¹²⁰ *Ibid.*

¹²¹ See *ibid.* at 25-28 for possible entry criteria: total liabilities of less than £15 000, a surplus income of no more than £50 per month after necessary living expenses, and no realizable assets over £300.

¹²² *Ibid.* at 23.

¹²³ *Ibid.* at 31.

¹²⁴ The Insolvency Service (United Kingdom), "Relief for the Indebted -- an Alternative to Bankruptcy: Summary of Responses and Government Reply" (November 2005), online: <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/relieffortheindebtedanalternativetobankruptcyresponse.pdf#search=%22%22Relief%20for%20the%20Indebted%22%22>.

¹²⁵ *Ibid.*, at 5-7.

¹²⁶ For further detail, see *ibid.* at 12-13.

- a cap on surplus income of £50 per month with surplus income determined through a common financial statement, with the ability to review the cap so it can be amended if appropriate;
- an asset limit at £300, but kept under review so it can be amended if appropriate; and
- provision for an appropriate range of remedies to tackle misconduct by the debtor.¹²⁸

More recently, the U.K. government has put forward recommendations for the other option identified in the 2004 report: the availability of a court based debt relief order. Rather than implementing a court-based debt relief order, however, the DCA has advocated the administrative NINA scheme, deeming the court-based option not cost effective for “can’t pay” debtors.¹²⁹ These reforms are encompassed in the *Draft Tribunals, Courts and Enforcement Bill* as a means to provide debt relief for people in England and Wales who cannot access currently available remedies, and who have no way to pay what they owe.¹³⁰

An annex to the bill outlines the various options considered by the U.K. government for “can’t pay” debtors: removing the requirement for people without assets or surplus income to pay a deposit when presenting a petition for bankruptcy; persuading creditors to voluntarily write off debt where there is no prospect that the debt will be paid within a reasonable amount of time; or introducing legislation to enable poor people who are financially excluded to access a system of debt relief.¹³¹ Preferring a legislative response, the report suggests that the proposal for the NINA scheme would benefit the indebted individual in terms of reduced stress and the effect on health accompanying it,¹³² provide an opportunity for a fresh start and allow him or her to “learn to manage their finances in more favourable circumstances”,¹³³ and free up court time in cases where creditors are pursuing enforcement action where there is no hope of repayment.¹³⁴ The DCA anticipates the scheme will entail initial set up costs, but with an upfront fee (less than current bankruptcy deposit), it will be possible to meet ongoing administration costs.¹³⁵

¹²⁷ The paper recommends that secured debt be included for the purposes of ascertaining the level of liabilities; the position of secured creditors would not be affected as they would retain their security. *Ibid.* at 22.

¹²⁸ See *ibid.* at 31-35 for further detail.

¹²⁹ Administration Orders, Enforcement Restriction Orders and Non-Court Based Debt Management Schemes (July 2006), online: <<http://www.official-documents.co.uk/document/cm68/6885/6885.pdf>> at 109.

¹³⁰ The Insolvency Service, “Plans to Bring Debt Relief to the Socially Excluded,” n.d., online: <<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/intermediariesworkinggroup/debtrelief.htm>>.

¹³¹ Department for Constitutional Affairs (United Kingdom), *Tribunals, Courts and Enforcement Bill: Regulatory Impact Assessments*, Part V, “Debt Relief Orders – full RIA” (July 2006), online: <<http://www.official-documents.co.uk/document/cm68/6885/6885.pdf>> at 117-118.

¹³² *Ibid.* at 126.

¹³³ *Ibid.*

¹³⁴ *Ibid.* at 127.

¹³⁵ *Ibid.* at 129-130.

The DCA predicts the number of people who would use the NINA scheme would plateau at 34, 000 to 36, 000 after two years, and would increase or decrease with the number of bankruptcies after that point.¹³⁶ Approximately 11 per cent of people currently presenting a bankruptcy petition would be eligible for the new scheme.¹³⁷ The scheme, the DCA predicts, will apply to a substantial portion of those seeking advice for debt related problems, who owe less than the proposed liability cap of £15, 000 and/or are not homeowners.¹³⁸

The NINA procedure is not currently in effect in England and Wales.

e. The Netherlands

The Dutch bankruptcy procedure is of relatively recent origin, dating back only to 1998. Accordingly, a less detailed account is provided of this system. The Dutch experience is especially relevant to this paper because the majority of the overindebted in the Netherlands are poor in the sense used in our discussion of the Canadian situation. Prior to the introduction of a bankruptcy procedure in the Netherlands, insolvent debtors could attempt to come to voluntary agreement with their creditors, aided by counsellors from non-profit organizations.¹³⁹ Failing that, judicial enforcement of the debts would generally lead to all of the debtor's income above the social minimum¹⁴⁰ being assigned to the creditors.

The 1998 bankruptcy law is known by its Dutch acronym WSNB (wet schuldsanering natuurlijke personen or law on debt rehabilitation of natural persons).¹⁴¹ From a North American perspective, the WSNB is more similar to a lengthy court-ordered repayment plan than to a fresh start. Eligible debtors must agree to live at the social minimum for three years, giving over the remainder of their income to their creditors. The agreement is supervised by court-appointed trustee who monitors the debtor's financial situation with the aid of a "postblokkade" which involves all of the debtor's mail being opened by the trustee.¹⁴² Debtors can use the WSNB only if they have previously tried, and failed, to come to a voluntary agreement with their creditors.¹⁴³

¹³⁶ *Ibid.* at 115.

¹³⁷ *Ibid.* at 127.

¹³⁸ *Ibid.* at 115.

¹³⁹ The main actors in this area are the network of municipal banks (known by their Dutch acronym, VKB) which are supervised and funded by Dutch municipalities. Apart from the VKB, debt counselling is done by an array of government social welfare agencies, non-profit organizations and church groups.

¹⁴⁰ The "social minimum serves as a policy boundary by which people have access to sufficient financial resources to achieve a 'minimum acceptable lifestyle' for the Netherlands."

http://internationalezaken.szw.nl/index.cfm?fuseaction=dsp_rubriek&rubriek_id=190093 (viewed 17 December 2006). Used for a variety of purposes, the social minimum was €578.24 a month for a single person and €1,156.54 for a couple in 2004-2005.

¹⁴¹ See www.wsnp.rvr.org, a website devoted to the WSNP for details about the law

¹⁴² For an English language description of the Dutch law see Jason Kilborn, "The Hidden Life of Consumer Bankruptcy Reform: Danger Signs for the New U.S. Law From Unexpected Parallel in the Netherlands" (2006) 39 Vanderbilt Journal of Transnational Law 77. See also Huls, Nick, Nadja Jungmann and Bert Niemayer, "Can Voluntary Debt Settlement and Consumer Bankruptcy Coexist? The Development of

In Jason Kilborn's 2006 article, he makes reference to a 1997 report that 71 percent of debtors seeking debt counselling had income less than \$12,000 (roughly the Dutch social minimum).¹⁴⁴ The director of a prominent municipal bank (or VKB in its Dutch acronym) in the northeast of Holland recently reported that roughly 80 per cent of those seeking debt counselling relied on social welfare payments.¹⁴⁵ These debtors pay no out-of-pocket costs for either debt counselling or for their participation in the WSNB. All costs are paid either by municipal governments (which pays the counsellors an annual fee for each of their activities) or by the creditors. The various costs of the WSNB, such as the fee paid to the court-appointed trustee, are drawn from the payments made by the debtor from their income above the social minimum. In effect, since these funds would otherwise accrue to the creditors, creditors pay for these services.

Middle-class overindebtedness is relatively rare in the Netherlands. While the use of consumer credit is rising, it remains well below the level of other European countries and far below North American levels. The requirement that debtors using the WSNB live at the social minimum for three years is therefore less burdensome than it would be if the majority of debtors were not already living at that level.

In summary, the Dutch bankruptcy system disproportionately serves poor debtors who rely on social welfare payments. No out-of-pocket costs must be paid by the debtor to gain access to the judicial debt adjustment procedure or to use the debt counsellors provided by the municipalities. That said, the WSNB does not provide the sort of fresh start that is available in the other jurisdictions canvassed.

6. Possible Models for the Canadian Bankruptcy System

The most problematic aspect of the current Canadian system is that depending on where they live, poor debtors in Canada apparently face different prospects for being able to access the bankruptcy system and face different costs for doing so. In each interview, drawing on the Australian model, we suggested an option that would see poor debtors fill out a simple set of forms and then go to a kiosk in the local shopping mall where the

Dutch Bankruptcy Law" in (eds.) Niemi-Kiesilainen, Johanna, Iain Ramsay and William Whitford, *Consumer Bankruptcy in Comparative Context*, (Oxford: Hart Publishing, 2003). In addition, Nadja Jungmann recently published her Ph.D. thesis on Dutch insolvency law. See http://www.aup.nl/do.php?a=show_visitor_booklist&b=auteursaz&auteur=Jungmann%2C+Nadja.

¹⁴³ One of the unintended side-effects of the introduction of the WSNB has been the declining rate of successful voluntary agreements. The success rate has fallen to about 10% after being close to 50% early in the 1990s. The intended effect of the WSNB was exactly the opposite — to increase the success rate of voluntary agreements. By paying the costs of the judicial procedure from payments that would otherwise have gone to creditors, the framers of the legislation hoped to make the judicial procedure relatively unattractive. However, creditors seem to believe that the benefits of the oversight of the court-appointed trustee are large enough to offset the relatively small increased cost. See Huls. et al., *ibid.*

¹⁴⁴ Kilborn 2006, *supra* 142 at 13.

¹⁴⁵ Interview with Harro Norder, director of the Volkscredietbank Noord-Ost, December 2006.

forms and supporting documents could be filed and the bankruptcy accomplished. We also discussed a variant in which a trustee (or other qualified insolvency professional) might assess the debtor's case before he or she was eligible to use the kiosk. None of the trustees interviewed thought that either option was a good idea.

a. Trustee's Views on Possible Models

Unanimity Against a Government-Operated System

Perhaps not surprisingly, the private trustees that we interviewed were unanimous in rejecting the idea of a new government-funded and government-staffed program that would handle the bankruptcies of poor debtors. Several recognized that their opposition would be expected given that any new government-provided service would compete with their own practice. However, it seems clear that their opposition goes beyond simple self-interest.

The trustees agreed that a trained professional should be fairly closely involved in order to handle unexpected situations. One noted that the “trustee learns more about the cases over the nine months, information that would not be available at the time of application.”¹⁴⁶ With this in mind, all of the trustees we spoke to expressed the belief that a government program would require one of two unpalatable staffing options. One option would involve the training of a whole new cadre of insolvency professionals to replace the work now done by trustees. The trustees saw little benefit in training a new group to undertake work that they themselves have been trained to do. A second option would be to use less well-trained staff on the assumption that poor debtors will have simple bankruptcy cases; the trustees thought that such staff would not be able to handle the particularities that often arise even in simple cases. Several harked back to the days of Federal Insolvency Trustee Agency (FITA) which seems to be universally reviled as having failed because of the incompetence of its staff.¹⁴⁷ One said that there are “lots of horror stories from FITA. Files that never got closed, people not getting real assets.”¹⁴⁸ Another believed that “the government employees [of FITA] were not qualified [to administer bankruptcies].”¹⁴⁹ Still another asserted that “the system collapsed because the government was not equipped to handle it and debtors were not advised properly” and that “debtors were not discharged [because] the system was not tracking them.”¹⁵⁰

¹⁴⁶ Interview with Trustee 2, 8 September 2006.

¹⁴⁷ The federal government introduced FITA in 1972 to provide services for those debtors who could not afford a trustee. By 1977, between one third and one half of bankruptcies proceeded under FITA. The program was discontinued in 1979: Igor Livshits, James McGee & Michèle Tertilt, “Accounting for the Rise in Consumer Bankruptcies in Canada and the United States,” (9 March 2005) online: York University Department of Economics <<http://dept.econ.yorku.ca/seminars/2004-2005/BankruptcyRise.pdf#search=%22FITA%20bankruptcy%22>>. Despite the oft-heard opinion that FITA was disastrous because bankruptcies were mishandled by incompetent or poorly trained staff, we have seen no documentary evidence of the shortcomings of FITA.

¹⁴⁸ Interview with Trustee 8, 8 September 2006.

¹⁴⁹ Interview with Trustee 3, 8 September 2006.

¹⁵⁰ Interview with Trustee 1, 18 August 2006.

Unanimity Against Making Access Too Easy

The trustees we interviewed had either participated in a BAP case or worked on a number of files with less than \$500 in receipts. All but one were working in firms in which a large part of the work was in consumer bankruptcy and all showed considerable understanding and sympathy for the plight of poor debtors. Nonetheless, even these trustees felt strongly that bankruptcy should not be made too easy and that the absence of significant barriers would lead to the abuse of credit and to the abuse of the bankruptcy system.

Apart from their concerns about the staffing of the kiosks, the trustees felt that the kiosk option (or any sort of “car wash” form of bankruptcy) would not provide enough rehabilitation (such as they believe arises from mandatory bankruptcy counselling). A system that allowed too easy a discharge would not teach the debtor any lessons about the misuse of credit and would presumably lead to repeated credit trouble. One trustee felt that counselling made debtors face their responsibility for incurring the debts that led to the bankruptcy and thought that bankruptcy “shouldn’t be a wash.”¹⁵¹ Others¹⁵² were concerned that the debtors would not learn anything if the procedure were too simple: “They need to learn something so they don’t come back.”¹⁵³ Another thought that in the current system, “the debtors have responsibilities—to get counselling, to report changes in their situation, to make monthly payments, to turn over their financial affairs to the trustee.”¹⁵⁴

b. Options from Other Jurisdictions

A review of the systemic attempts to address the issue of access to bankruptcy for the poor in the United States, Australia, New Zealand, England and Wales, and Netherlands presents two main options for reform to the Canadian system:

- i. Fee waiver provisions in bankruptcy proceedings; and/or
- ii. A no income no asset procedure with either a public or private intermediary.

The experience of the American pilot project undertaken in the mid-1990s suggests the number of bankruptcy filings will not increase significantly with the availability of a fee waiver system. Australia and New Zealand are the only jurisdictions to provide no fee options to process debtor petitions or debt agreement proposals. Although the Australian government has considered adopting fees to help fund the system, it has recently concluded that this would conflict with the public policy objectives of the Australian

¹⁵¹ Interview with Trustee 8, 8 September 2006.

¹⁵² Interview with Trustee 5, 20 September 2006; Interview with Trustee 3, 8 September 2006.

¹⁵³ Interview with Trustee 5, 20 September 2008.

¹⁵⁴ *Ibid.*

bankruptcy system, and as such it is more appropriate that the processing costs be funded by taxpayers.

Australia, New Zealand, and England and Wales have all adopted or considered administrative solutions to assist low income debtors. Australia's Section 55 system for example allows individuals to quickly be declared bankrupt without the involvement of the courts. Recognizing that poor debtors require an alternative to filing for bankruptcy in the courts, England and Wales and New Zealand are proposing NINA procedures where debtors may obtain a discharge after one year. The advantages of these procedures include a streamlined, out-of-court, less costly process for the debtor. In the Netherlands, where the poor are the majority of those seeking debt resolution, debtors pay no fees.

c. Recent Canadian Reform Efforts

During the deliberations of the Canadian Personal Insolvency Task Force (PITF), a subgroup was assigned to address issues around the "administration process." The subgroup quickly became focused on the idea of creating a "fast track" process for the many bankruptcy files that are quite simple, involving no significant assets and little prospect of creditors receiving any significant dividends.

A key decision, made without extensive open discussion, was that the "fast track" process would lie within the existing Canadian bankruptcy system. The essential features of that system—the administration of bankruptcies by private sector trustees, fees paid to trustees who have the discretion to ask for voluntary payments, and substantial information provided to creditors and to the OSB—would be maintained. The primary alternative—a public system with low fees and limited information provided either to creditors or to the OSB—was not seriously discussed despite the efforts of Iain Ramsay, one of the subgroup members. In a discussion on the Australian system, the subgroup wrote that, given the current Canadian system, a shift to a system with the role of trustee filled by a public actor would be "politically unfeasible."¹⁵⁵

The definition of eligibility for the "fast track" process was not based on any notion of the need for low-cost bankruptcy services. The subgroup mentioned that there are no reliable data suggesting that there is an issue with access to bankruptcy for poor debtors,¹⁵⁶ and one member questioned whether the subgroup should address affordability at all.¹⁵⁷ Instead, "fast track" bankruptcies would be those that seemed to be pose few administrative burdens. In its recommendations for the summary process, the subgroup suggested that trustees need not produce a section 170 report in cases where first-time bankrupts receive an automatic discharge, have no oppositions filed, have no

¹⁵⁵ "Preliminary Draft #2" (PITF subgroup deliberations, 27 November 2000) [unpublished] at 6.

¹⁵⁶ *Ibid.* at 9.

¹⁵⁷ John Eisner quoted in "Record of Decision From Conference Call" (PITF subgroup deliberations, 15 November 2000) [unpublished].

surplus income, and pose no other issues.¹⁵⁸ The group also recommended that the OSB letter of comment, which was mandatory in the previous system, become optional at the OSB's discretion.¹⁵⁹ Because "fast track" debtors would have no significant assets and no income above the OSB's Surplus Income Guidelines, their cases would require less trustee time to dispose of their assets or collect Surplus Income payments.

The subgroup (and the PITF as a whole) decided not to tackle the controversial issue of the fees charged by the trustees. Within the framework of Rule 128(1),¹⁶⁰ trustees set these fees themselves (often by asking for voluntary payments), presumably in line with what the market will bear. The subgroup recommended more transparency in trustee fees, with some members suggesting that allowing trustees to advertise their prices might create competition, drive prices down, and give "incentives for efficiency in administration."¹⁶¹ However, other members expressed reservations, as "debtors contributions... are subject to change during a bankruptcy, making it impossible to fix a cost."¹⁶² If the "fast track" procedure leads to a lower amount of time spent on most cases, competition among trustees may lead to lower fees. However, the market for trustee services is far from the model of perfect competition since trustees must be licensed (limiting the supply of those authorized to administer bankruptcies), there is at least the possibility of collusion among trustees in establishing fees (via practices on voluntary payments), and consumer information is quite imperfect. Several of the trustees we interviewed thought that competition would *not* drive down fees.

The Joint CAIRP/IIC submission to the Standing Senate Committee on Banking, Trade and Commerce¹⁶³ acknowledges that the dissenting members of the PITF raised several issues in respect of access to the process that require further investigation and study, including: how the costs of an alternative process would be covered; how access for such debtors would be increased through any alternative process; and how the integrity of the system would be maintained or enhanced. CAIRP/IIC made two recommendations in respect of access to information and assistance to debtors with no assets and no income. First, they recommended that where bankruptcy would be a helpful remedy, "there should

¹⁵⁸ "Synopsis of Working Group 1 Recommendations: Summary Process" (PITF subgroup deliberations,) [unpublished] at 3. Section 170 of the BIA provides that as part of the bankruptcy discharge process, the trustee must prepare a report in the prescribed form with respect to:

(a) the affairs of the bankrupt,
(b) the causes of his bankruptcy,
(c) the manner in which the bankrupt has performed the duties imposed on him under this Act or obeyed the orders of the court,
(d) the conduct of the bankrupt both before and after the date of the initial bankruptcy event,
(e) whether the bankrupt has been convicted of any offence under this Act, and
(f) any other fact, matter or circumstance that would justify the court in refusing an unconditional order of discharge.

¹⁵⁹ *Ibid*, at 4.

¹⁶⁰ See *supra* page 8 for a detailed discussion.

¹⁶¹ Preliminary Draft #2, *supra* note 156 at 9.

¹⁶² Guylaine Houle quoted in "Record of Decision" (PITF subgroup deliberations, 1 December 2000) [unpublished].

¹⁶³ CAIRP/IIC Joint Submission 2003, at 68-69.

be enhanced information to debtors regarding their options, including greater awareness of the trustee referral program [the BAP].” Second, they recommended that “for individuals who do not even need access to the system...the Superintendent’s office, by enhancing its current information dissemination, could address issues such as garnishees and how to get them lifted or reduced; how to stop harassing phone calls from collection agencies; strategies to deal with temporary layoffs and salary reductions; and key telephone numbers through which to access these remedies and other public agencies.”¹⁶⁴

Neither of the CAIRP/IIC recommendations were adopted in the Report of the Standing Senate Committee on Banking, Trade and Commerce [Senate Report].¹⁶⁵ The Senate Report did not address trustee fees directly.¹⁶⁶ While the PITF Final Report did include many of the subgroup’s recommendations, it did not explicitly refer to a “fast track” process, but suggest reforming the current system in such a way that section 170 reports and OSB letters of comment are produced “by exception rather than by rule.”¹⁶⁷ The PITF Final Report agreed with the subgroup that in simple bankruptcy cases, without complicating factors like surplus income or an opposition filed, there should not be a requirement that the trustee produce a section 170 report.¹⁶⁸ As well, if the OSB does not feel that there are issues or problems, the PITF recommended that it not be required to issue a letter of comment.¹⁶⁹ The Senate Report largely endorsed the PITF Final Report’s “by exception rather than by rule” proposal, writing that the changes would “respect the fundamental principles of efficiency and effectiveness.”¹⁷⁰ Unlike the PITF subgroup, the Senate Report recognized that “access to the bankruptcy system is increasingly compromised for low-asset, low-income debtors,” although it did not recommend adopting a NINA process.¹⁷¹

Most recently, Statute c. 47¹⁷² has followed the recommendations of the PITF Final Report and proposed the following revision to section 170(1) of the *Bankruptcy and*

¹⁶⁴ *Ibid.*

¹⁶⁵ Report of the Standing Senate Committee on Banking, Trade and Commerce, “Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies’ Creditors Arrangement Act*” (November 2003), online: Senate of Canada, Banking, Trade and Commerce Committee <www.senate-senat.ca/bancom.asp> [Senate Report].

¹⁶⁶ Report of the Standing Senate Committee on Banking, Trade and Commerce, “Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies’ Creditors Arrangement Act*” (November 2003), online: Senate of Canada, Banking, Trade and Commerce Committee <www.senate-senat.ca/bancom.asp> [Senate Report].

¹⁶⁷ Canada, Office of the Superintendent of Bankruptcy, *Final Report*, (Ottawa: Personal Insolvency Task Force, 2002) [PITF Final Report] at 55.

¹⁶⁸ *Ibid.* at 57.

¹⁶⁹ *Ibid.* at 62.

¹⁷⁰ Senate Report, *supra* note 166 at 38.

¹⁷¹ *Ibid.*, at 168.

¹⁷² *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies’ Creditors Arrangement Act and to make consequential amendments to other Acts*, 1st Sess., 38th Parl., 2005 (received Royal Assent on 25 November 2005; not currently in force), online: Parliament of Canada <http://www2.parl.gc.ca/HousePublications/Publication.aspx?Language=E&Parl=38&Ses=1&Mode=1&Pub=Bill&Doc=C-55_4> [Statute c. 47].

Insolvency Act (BIA): “The trustee shall, *in the prescribed circumstances and at the prescribed times*, prepare a report, in the prescribed form, with respect to...” The previous wording simply stated, “The trustee shall prepare a report in the prescribed form with respect to...”¹⁷³ The clause-by-clause briefing for the proposed legislation states that the rationale behind the revision is to streamline the process by limiting the circumstances under which the report must be prepared.¹⁷⁴ The briefing anticipates that a section 170 report will only be required where the bankrupt has Surplus Income; where an opposition to the bankrupt's discharge has been filed; where the bankrupt has been bankrupt on a previous occasion; where there is any reason that would require a court hearing of the discharge; or where the trustee, for other reasons, determines that the report would be required.¹⁷⁵

Statute c. 47 also provides for the following new section (s. 156.1) to allow bankrupts to enter into an agreement to pay for the trustee's fees after the bankruptcy period:

An individual bankrupt who has never before been bankrupt under the laws of Canada or of any prescribed jurisdiction and who is not required to make payments under section 68 to the estate of the bankrupt may enter into an agreement with the trustee to pay the trustee's fees and disbursements if the total amount required to be paid under the agreement is not more than the prescribed amount and that total amount is to be paid before the expiry of the 12-month period after the bankrupt's discharge. The agreement may be enforced after the bankrupt's discharge.¹⁷⁶

The clause-by-clause briefing notes that this new section is intended

...to provide a mechanism which will enhance accessibility to the insolvency system for individuals who do not have surplus income and who may otherwise have difficulty paying the costs associated with the administration of a bankruptcy. In some circumstances, especially bankruptcies with small estates, it is difficult for a person to find a trustee willing to act for them because the trustees require payment for their services. If the estate is too small, no trustee will act. This has the effect of leaving the vulnerable person without professional assistance during a difficult experience. By providing that the bankrupt may pay for the trustee's services after the bankruptcy period, the reform should ensure that more

¹⁷³ See “BIA Discharge of bankrupts: Clause by Clause Briefing Book” (n.d.), online: Corporate and Insolvency Law Policy (Industry Canada) <<http://strategis.ic.gc.ca/epic/internet/incilp-pdci.nsf/en/cl00814e.html#7>>.

¹⁷⁴ *Ibid.*

¹⁷⁵ *Ibid.*

¹⁷⁶ Statute c.47, *supra* note 170; “BIA: Administration of Estates: Clause by Clause Briefing Book” (n.d.), online: Corporate and Insolvency Law Policy (Industry Canada) <<http://strategis.ic.gc.ca/epic/internet/incilp-pdci.nsf/en/cl00813e.html>>.

people get the assistance they need. Balancing this reform is the limit on fees that can be charged by a trustee pursuant to the rules.¹⁷⁷

7. Recommendations

In this final section of the paper, we propose three sets of recommendations. Each set of recommendations addresses the two principal flaws we believe are present in the current Canadian system:

- a. No national and even local uniformity exists in the treatment of poor debtors.
- b. Poor debtors face informational and financial barriers that may impede equal access to the fresh start provided by bankruptcy.

Within each set of our recommendations, there are some that may be implemented quite quickly and with limited cost to the OSB. Others will take longer to implement and will require additional consultation and funding.

The two flaws highlighted by our research do not lead us to recommend the adoption of a separate bankruptcy scheme for poor debtors. Instead, following the lead of other jurisdictions, we recommend that Canada adopt a BAP program that eliminates the out-of-pocket costs for poor debtors. These costs could be eliminated with a combination of fee waivers (e.g., waiving the OSB's filing fee) and government subsidy (e.g., having the OSB pay for the mandatory counselling sessions). A BAP program that demands no out-of-pocket payments by poor debtors would address the financial barriers they face. To deal with the informational barriers, we recommend the creation of an impartial agency that provides advice and support to poor debtors trying to deal with collection efforts. By making the judgment-proof status of poor debtors clear, such advice and support would limit the number of debtors who use the bankruptcy process. To increase the uniformity and certainty of bankruptcy across the country, we propose a method for creating parity while encouraging the voluntary agreements among trustees that exist in some cities.

a. Reform of BAP Regulations

Our research suggests that a thorough revision of the rules governing the operation of the BAP program is necessary. Our review of the program suggests that the following changes are highly desirable.

A. Widespread and improved publicity of the BAP is required.

One reason for the infrequent use of the BAP is that the OSB has made no systematic efforts to make its existence known to poor debtors. Much more information on the operation of the BAP program should be made easily accessible to debtors and trustees.

¹⁷⁷ BIA: Administration of Estates: Clause by Clause Briefing Book, *ibid.*

Detailed information on the BAP should be provided to poverty clinics, credit counsellors and trustees. The information on the OSB website related to the BAP should be updated and improved. The information is difficult to find and does not give a balanced and accurate sense of the program. For example, the website currently gives the impression that the BAP requires pro bono work by trustees.

B. A clear eligibility standard for the BAP should be put into place.

Further consultation should be undertaken to determine the exact nature of a new BAP eligibility standard. Based on our research to date, we recommend a standard involving low current income and a long-term history of receipt of government transfers. Using low current income alone might lead to abuse by debtors who only temporarily have low income. The appropriate requirement might be that eligible debtors must be in receipt of government transfers (such as income assistance, unemployment insurance or disability benefits) for twelve of the previous eighteen months. Some form of procedural fairness will need to be built into such a bright line eligibility standard. For example, appeals should be allowed by a debtor who is newly poor or disabled and likely to stay that way.

Under this new eligibility standard, the requirement that debtors must visit two trustees to qualify for the BAP should be eliminated. This requirement imposes an additional barrier to bankruptcy that other higher income debtors do not face. The current requirement has a detrimental impact on women in particular, as they must often find child care for their children as they move around the city obtaining opinions from two trustees.

C. Fees for debtors who qualify for the BAP should be waived.

Ideally, poor debtors should be able to file for bankruptcy without paying any of the out-of-pocket costs. Receipts from tax refunds would remain in the estate as would any proceeds from the sale of non-exempt assets. The fee waiver could be financed by a combination of OSB waivers, OSB payments to trustees for counselling or pro bono work by trustees. Further consultation needs to be done with trustees, combined with a careful cost analysis by the OSB, in order to determine the ideal solution. In the interim, we recommend that the \$75 filing fee be eliminated and that the OSB cover the cost of both counselling sessions. The high mean level of fees in BAP cases means that trustees can recover significant amounts without voluntary payments.

D. The BAP should provide that the OSB will file the bankruptcy as a last resort.

The regulations (and the expanded publicity recommended above) should indicate the OSB's commitment to ensuring that the bankruptcy will be filed in a timely fashion even if no private trustee is forthcoming, and even if an OSB official must administer the bankruptcy.

b. Working Toward Uniformity

Poor debtors throughout Canada should have access to the reformed BAP. However, our interviews suggested that trustees are not happy with the existing BAP and, where possible, prefer to rely on voluntary agreements among area trustees or on the good will of individual trustees. At least until the reformed BAP can gain the trust of trustees, we recommend that the voluntary agreements among trustees be encouraged and perhaps expanded in scope. However, these voluntary systems should be at least as cheap as BAP. A first step would be to assess the extent of the geographic coverage of the agreements. CAIRP could become involved by surveying their members to make an inventory of such agreements. Second, the OSB should keep track of files where receipts are low to see if they are spread, in a representative way, across the country.¹⁷⁸

E. The OSB should establish, by directive, a system for registering city specific fee agreements reached by trustees.

While we believe that the voluntary agreements should be encouraged, we also think the OSB should make sure that it is aware of all such agreements and that the terms of the agreements are consistent with the aim of the reformed BAP — ease of access and no out-of-pocket costs to the debtor. In the end, it is not obvious whether it will be better to have only a reformed BAP, only a set of voluntary agreements or a combination of the two. Informed decision-making about the need for the BAP can only be made if a close watch is kept on the operation of the voluntary agreements.

c. Impartial Agency

F. An impartial agency should be created to give poor debtors advice on how to deal with their debt.

Currently, Canadian debtors have no place to turn for impartial debt advice. Debtors can seek advice from credit counseling services but these are either financed by creditors or are for-profit, fee-charging entities; most require 100 percent repayment.¹⁷⁹ Trustees are another possible source but they have a clear incentive to recommend bankruptcy. The creation of a neutral agency that provides advice on debtors' rights vis-à-vis their creditors and suggests the most appropriate remedy is recommended. We recommend the creation of an impartial debt advice agency in 2 to 3 pilot sites in the short term (Toronto, Montreal and Vancouver).

¹⁷⁸ To aid in this effort, the SRD should be modified so that voluntary payments are shown in a uniform way. As explained in Appendix C, the current form does not allow all voluntary payments to be identified.

¹⁷⁹ The Office of Consumer Affairs recently published a study of credit counseling which highlights the lack of regulation of that industry and its potential bias.

Appendix A

Description of Trustees Interviewed

Trustee 1

Trustee 1 works in Montreal in a mid-market, regional Chartered Accountant and Consulting firm with offices in Toronto and Montreal. She has recently moved offices and the exact number of files and division of consumer/commercial files is not yet available. The primary target market for the firm is privately held companies ranging from \$10 million in revenues to complex organizations with annual revenues of \$150 million.

Trustee 2

This trustee works in the Windsor area, administering approximately 100 bankruptcy files per year. Ninety-five percent of her business encompasses consumer bankruptcies.

Trustee 3

Trustee 3 is a sole practitioner in Edmonton, previously having worked for large accounting firms and other sole practitioners. She has a social work background. Trustee 3's practice is composed entirely of consumer bankruptcies, administering about 250 files per year. She has twenty years of experience in the bankruptcy field.

Trustee 4

Trustee 4 is part of a mid-size accounting firm in Toronto where he heads the insolvency division. He has been in practice since the early 1980s, formerly with large accounting firms. He is a specialist in both corporate and personal bankruptcy, providing consulting services to both debtors and creditors.

Trustee 5

Trustee 5 is a sole practitioner in London, Ontario. His firm primarily administers consumer bankruptcies, with 95 per cent of the business focusing on consumer files.

Trustee 6

Trustee 6 works in Halifax, Nova Scotia, in an office of four trustees; he specializes in the areas of financial restructuring, receivership, and bankruptcy. Trustee 6's firm undertakes both corporate and consumer bankruptcies, handling about 500 consumer bankruptcies each year.

Trustee 7

Trustee 7 works for a small firm with offices in Toronto, Kingston, and Brockville. The business handles mostly consumer files, approximately 400 per year. He has worked as a trustee for 10 years.

Trustee 8

This trustee has worked six of her 11 years as a trustee in private practice. She currently handles bankruptcy files in the Greater Toronto Area, administering approximately 400 bankruptcies each year.

Trustee 9

This trustee works at a national firm in Ottawa.

Bankrupt

A female poor debtor (under our definition) who has been through the bankruptcy system two times. The second time she was assigned into bankruptcy it was under the BAP program. She was referred to us by her BAP trustee.

Appendix B

BIA, Rule 128(1)

Also, see OSB Circular 2, which was introduced in 1999 and imposes the \$10,000 maximum.

TRUSTEE'S FEES AND DISBURSEMENTS IN SUMMARY ADMINISTRATION

128. (1) The fees of the trustee for services performed in a summary administration are calculated on the total receipts remaining after deducting necessary disbursements relating directly to the realization of the property of the bankrupt, and the payments to secured creditors, according to the following percentages:

- (a) 100 per cent on the first \$975 or less of receipts;
- (b) 35 per cent on the portion of the receipts exceeding \$975 but not exceeding \$2,000; and
- (c) 50 per cent on the portion of the receipts exceeding \$2,000.

(2) A trustee in a summary administration may claim, in addition to the amount set out in subsection (1),

- (a) the costs of counselling referred to in subsection 131(2);
- (b) the fee for filing an assignment referred to in paragraph 132(a);
- (c) the fee payable to the registrar under paragraph 1(a) of Part II of the schedule;
- (d) the amount of applicable federal and provincial taxes for goods and services; and
- (e) a lump sum of \$100 in respect of administrative disbursements.

(3) A trustee in a summary administration may withdraw from the bank account used in administering the estate of the bankrupt, as an advance on the amount set out in subsection (1),

- (a) \$250, at the time of the mailing of the notice of bankruptcy;
- (b) an additional \$250, thirty days after the date of the bankruptcy; and
- (c) an additional \$250, four months after the date of the bankruptcy.

(4) Subsections (1) to (3) apply to bankruptcies in respect of which proceedings are commenced on or after September 30, 1997 and the accounts are taxed on or after April 30, 1998.

Appendix C

The data analysis reported at several points in the text was conducted by the Business Intelligence Centre (BIC) of the Office of the Superintendent of Bankruptcy (OSB). The statistical analysis of consumer bankruptcy was greatly eased by the advent of electronic filing on January 1, 2002; most documents related to consumer bankruptcies are now electronically submitted and can be quickly and accurately analyzed.

Two factors determined our choice of a data file on which to base our analysis. First, our analysis was concerned with trustee fees and creditor dividends, so we needed a sample of bankruptcies that had electronically-submitted Statements of Receipts and Disbursements (SRD). The SRD shows all receipts and disbursements arising from a consumer bankruptcy, including trustee fees, voluntary payments by debtors and dividends disbursed to the creditors. The trustee typically submits the SRD to the OSB at least nine months after the bankruptcy was filed, close to the date when the bankruptcy file is closed. Second, most bankruptcies filed by poor debtors will be summary administration cases so we wanted to limit the analysis to such files.

These two factors led us to choose to analyze all summary administration bankruptcies for which a Statement of Receipts and Disbursement was electronically-submitted between January 1, 2006 to December 31, 2006. According to BIC, there were 29,279 such bankruptcies available for analysis.

Note that these are not all summary administration bankruptcies *filed* in calendar 2006. Because of the lag between the filing of a bankruptcy and the submission of an SRD months (and possibly years) later, many of the bankruptcies that we analyze will have been filed in calendar 2005 (and, for a small number, in 2004). Furthermore, we are looking only at SRDs submitted electronically. Nonetheless, we do not expect that substantial bias is introduced by our use of electronically-submitted SRDs. Finally, not all of the bankruptcies in our analytic file were closed in calendar 2006. After the trustee submits the SRD, the OSB sends the trustee a letter of comment approving the closing of the file. For that reason, not all bankruptcies for which an SRD was received in calendar 2006 will have been closed in calendar 2006.

All of the statistical information in this paper was generated by BIC using the 29,279 electronically-filed cases with SRDs. Many variables, including the dividend paid to creditors and the level of trustee fees, can be accurately derived from the electronically-filed cases. However, the value of voluntary payments made by the debtor to the trustee must be estimated because trustees are not required to report such payments in a consistent fashion. Most trustees, however, report them by noting their existence in the SRD. For example, a particular dollar amount in the receipt portion of the SRD might be identified as “voluntary payment” or “payment by debtor”. In some cases, however, voluntary payments will have been made but there is no way to identify them on the SRD.