Bankruptcy Reform: The Significance of Systematic Data and Consultative Processes in Developing Our Bankruptcy Law

*Keith Bennetts**

In the three decades following the implementation of the Clyne Report,[1] Australian lawmakers have been inclined to ignore the bankruptcy system in times of economic prosperity. In times of significant bankruptcy numbers, however, often accompanied by a sense of concern in the community, the legislators have shown a tendency to become agitated about how the legal system deals with bankruptcy issues. Occasionally the legislators have been galvanised into action, not so much as a result of recessionary pressures on the system, but more in an effort to accommodate an emerging political agenda (for example, diverting bankruptcy administrations to the private sector), or the recommendations of an influential body (for example, a Royal Commission).

Accordingly, in the past three decades we can readily identify Bankruptcy Act initiatives which have either been the product of political values or perceived inefficiencies made apparent by pressures on the system, resulting in what may be described as special interest enactments, frequently having far-reaching consequences. Although filling in gaps in this manner has often resulted in necessary and effective outcomes, there has been the occasional vociferous criticism of what have been perceived as well-intended but ill-advised enactments.[2]

So what are the implications of these developments for bankruptcy reform? It is suggested that it is essential for the future of bankruptcy law that change to the personal insolvency system outgrows the ups and downs of the Australian economy and the whims of politicians. The law and practice of bankruptcy needs to acquire a meaningful, stable place in our legal system and not be seen by the community and our legislators as an area deserving of attention only in times of recession or political activity and only then to give effect to ad hoc, special interest measures. How can this change of focus be achieved? In the following discussion it is suggested that much turns on the establishment of policy-driven reforms implemented through the wider collection of systematic data, and the more

* Senior Lecturer in Law, University of Adelaide; consultant, Finlaysons, Adelaide.

1 Report made in 1962 by the Committee, under the chairmanship of Sir Thomas Clyne, appointed by the Attorney-General to review Commonwealth bankruptcy law.

2 See eg letter from Mr R W Harmer, Commissioner of the Law Reform Commission's General Insolvency Inquiry, "Flawed Bankruptcy Law" *Australian Financial Review*, 3 November 1994 at 20. The writer in commenting on changes to the Bankruptcy Act considered that they had "every mark of a hurried 'political' reaction to media views about a very few bankrupt persons".

effective employment of consultative and review processes in both the formulation of policy and proposed reforms.

Bankruptcy Policy

At the outset it should be acknowledged that the first steps towards a stable bankruptcy reform programme have already been taken, for one of the noticeable trends emerging from the Canberra bureaucracy since the early 1990s has been the attempt to establish a policy environment for personal insolvency law. Although the initiation of the reform process was given impetus by recessionary times, the response from Canberra has been to undertake revision of the Bankruptcy Act 1966 (Cth) in accordance with wide-based policy justification.

This approach has resulted in a regime of compulsory contributions from income by bankrupts whose income is above a specified threshold amount, a new body of rules regulating discharge from bankruptcy, administrative processes associated with antecedent transaction avoidance powers, and debt arrangements for low income debtors.

Here, arguably, for the first time since 1966 we are able to identify changes (or proposed changes) to the Act which reflect serious thinking about the policy objectives of a personal insolvency regime. This current thinking in Canberra needs to be recognised and supported by all sectors having an interest in the future operation of the Bankruptcy Act. However, policy-driven reform has the potential for controversy and requires caution, policy justification and effective consultation in its implementation.

One of the reasons for potential controversy in this area is the divergent values which different sectors of the community, including the political sector, may hold towards the objectives of a personal insolvency system. There are a number of examples which illustrate the point.

One recent instance of policy controversy relates to non-work related benefits received by bankrupts (for example, benefaction to bankrupts from family or friends). The proposal that such benefits should be valued by the trustee as income of the bankrupt, and contribution levied accordingly, has generated conflict along the lines that such proposal reflects a "lynching party mentality", being an overreaction to the "Gucci bankrupts", and results in discouragement of bankrupt support from family or friends, in the same way that s 116 of the Bankruptcy Act inhibits post-bankruptcy gifts of property to a bankrupt.[3]

On a broader level, it is not uncommon for certain interest groups to relate the primary objective of bankruptcy to maximising returns to creditors. Others, however, hold the view that an effective bankruptcy system should send the clear message to creditors that their losses are the result of all that has occurred before

3 For an excellent paper which identifies the competing policy arguments relating to this issue see M Murray, "Lifestyle of Undiminished Splendour — Bankrupts on Fringe Benefits" (1994) 6(4) *Australian Insolvency Bulletin* 6.

bankruptcy, and that it is not a primary function of the bankruptcy system to turn around a debtor's financial position or to operate as a debt collection process of last resort. Those who hold this latter view advocate that the system's primary objectives should be to administer the debtor's estate, to defray loss in an orderly manner, and to provide the debtor with a fresh start.

It is apparent that opposed views of this kind will continue to generate very different ideas as to how the Bankruptcy Act should operate in the future. For this reason the advocates of policy-driven reform must be prepared to justify their proposals in the face of keen special interest opposition. Otherwise policy-makers run the risk of succumbing to such interests and promoting ad hoc, special interest enactments to appease their concerns.

In this regard, and with the future of the bankruptcy system in mind, two suggestions are offered which may assist in the consolidation of the policy-driven reform process. The first relates to the role of empirical research in formulating bankruptcy policy.

Empirical Data in Bankruptcy Reform

It is apparent that empirical research has not to this point in time played a significant role in the formulation of bankruptcy policy in this country. At the present time the Canberra bureaucracy appears to gather a range of statistics such as the annual number of new bankruptcies, the ratio of business to non-business bankruptcies and the number of bankruptcies per capita, which offer small assistance in the making of bankruptcy policy. As a result, the formulation of our bankruptcy policy usually reflects fundamental assumptions of fact unsupported by empirical research. The concern is obvious. Unverified, factual assumptions may result in proposed legislative reforms which are inappropriate, giving rise to antagonism and widely held opinion that special interests are being accommodated without proper justification. The position was recognised by the then Shadow Attorney-General, Amanda Vanstone when she observed that:

> If you take an ordinary Australian, give him a little bit of sun, a bottle or two of red, a deck chair and a barbecue, then he will be able to tell you how to run the world. It is the same with a bureaucrat and a whiteboard.
>
> But when you leave the room with the whiteboard, you quickly discover that not everybody agrees with you about how to run the world, and it is not always possible to get all those foolish people to change their minds.[4]

Without empirical research in bankruptcy law reform it is apparent that what are being offered as policy-driven reforms are being supported by unsystematic data, such as bureaucratic value-judgments, anecdotal data or information based on expert opinion.

It is worthwhile briefly describing these last two forms of data which to this point in time appear to have featured significantly in the bankruptcy law reform

4 R Evans, "Law Reform and the Art of the Possible" (1995) 69 *Law Institute Journal* 970.

process. Anecdotes are observations arising from personal experience. Favourite anecdotes in the bankruptcy context relate to bankruptcy abuse — accounts of debtor practices or legal loopholes which outrage public opinion. The major weakness of anecdotal information is that it relates to the exceptional or unusual case. As a result, policy decisions influenced by anecdotal data run the risk of generating major legislative reforms which may be costly and inconvenient to implement and which are designed to redress behaviour only rarely encountered.

It would appear that a common source of information employed in the development of our bankruptcy policy emanates from the experiences, observations and insights of persons actively associated with the bankruptcy jurisdiction, such as the courts, Insolvency and Trustee Service Australia (ITSA), registered trustees, official receivers, the credit industry and the social welfare system. Such information is distinguishable from anecdotal data for it is founded on expert experiences derived from numerous cases usually extending over considerable periods of time.

Although deserving of much consideration and due weight, such expert data potentially carry with them a number of weaknesses. For example, experiences may be recounted because they are exceptional, intriguing, complex, dramatic, or reflect the values of the expert relating them. With both anecdotal data and expert observations it is apparent that the problem encountered is the extent to which the information can be afforded general application. In this regard we need to compare both anecdotal and expert data with empirical information which may be described as representative and systematic collected data.

The comparison has parallels with the diagnosis of a patient's medical condition. Diagnosis may be attempted by interviewing and soliciting responses from the patient. Alternatively, the patient's blood may be the subject of analysis. Sometimes the final diagnosis from both approaches may correspond — however, reliable diagnosis and treatment will be better served when based on the empirical data, not the subjective responses of the patient.

An example from recent Bankruptcy Act reforms well illustrates the point being made. In 1992, s 139ZQ was introduced into the Bankruptcy Act 1966,[5] providing an administrative means for effecting trustee recoveries pursuant to their avoidance powers under the Act. The section was immediately recognised for its highly innovative approach but became the subject of significant criticism both from the courts[6] and the legal profession (the New South Wales Bar Association considered the section involved "a fundamental challenge to the rule of law" concluding that "the whole regime is quite draconian").[7]

In the Explanatory Memorandum accompanying the Bill which introduced the provision, the following reasons were offered justifying the provision (paragraph

5 See Bankruptcy Amendment Act 1991 (Cth).

6 See eg *Re Pearson; ex p Wansley* (1993) 46 FCR 55 at 59–60.

7 A Diethelm, "The Bankruptcy Amendment Act 1992" (1992) 4(1) *Australian Insolvency Bulletin* 11 at 18.

25.97):

- "many transactions which are entered into by a bankrupt before bankruptcy, and which are void against the trustee of the bankruptcy, cannot be set aside because the trustee has no or insufficient funds to mount a court action to have the transaction set aside"; and
- "thus making the recovery of funds into bankrupt estates simpler and more cost effective and ensuring a better return to creditors."

For present purposes the question for consideration is whether systematic data were gathered in support of the justifications offered for the introduction of this significant and controversial provision. For example, were systematic data gathered to address questions of the following kind:

- Over a reasonable period of years, how many bankruptcy estates revealed instances of trustee recoveries being frustrated for the sole reason that the trustee had insufficient funds to have the transaction set aside?
- How many of these instances, if recovery had been effected, would have resulted in a better return to creditors?
- How many instances in which lack of funds was a factor also involved other grounds which would have influenced the trustee's decision to abandon the recovery?

The point is this: for such a highly innovative provision embodying a new policy direction, the justifications being offered for its introduction demanded a satisfactory level of empirical verification.

At the time of its introduction no collected data supporting the need for the provision were offered with the result, it is suggested, that the provision was not accompanied by any meaningful debate in which the published reasons for its introduction were able to be scrutinised and verified.

The above example provides weight to the suggestion that systematic data gathered either through regular collection or through episodic, one-shot forays into selected bankruptcy areas should be encouraged as a prerequisite to bankruptcy policy-making. It is only data of this nature which are capable of providing the generalised insights that the formulation of bankruptcy policy requires. The collection of systematic data relating to bankruptcy will have the desired effect of elevating the level of debate about policy conclusions on which future legislative reforms may be based.

Although a case for the greater employment of empirically-based research in this area has been put forward, it is, in the interest of balance, desirable to recognise some of the risks and limitations associated with the collection and use of such data. They include:

- the need for expert design, collection and interpretation of the data;
- the process may be time-consuming and expensive;
- the ever present risk that collected data may be the subject of manipulation, abuse or misinterpretation which will be difficult to detect;
- the lack of confidence in the neutrality of those who compiled the data (for example, government agencies) may have an impact on its ultimate usefulness

necessitating the publication of the data for scrutiny;

- the time lag between collection, publication and legislative response may undermine the utility of such data; and
- the fact that some important data are not measurable on a quantitative scale. For example, the degree of compulsive spending habits of consumer bankrupts cannot be established on a quantitative scale. The question as to how many consumer bankrupts have a credit card debt exceeding $5,000 is an entirely different question to one which asks how many consumer bankrupts have demonstrated compulsive credit card purchases. The first is measurable on a quantitative scale, the second only through trained observation and interpretation.

To summarise the above discussion, it has been suggested that the future of bankruptcy necessitates a change in attitude towards bankruptcy reform. We should not be willing to accept proposals for reform which as a result of missing data and factual gaps cannot be verified. We should begin to recognise the essential role of measurable data in our policy debates, and proceed with caution where such is unavailable. Insistence that policy-makers provide empirical data in the policy-making process should begin to see both regular and episodic collection of data being given proper recognition. In the end, with the support of such data, policy-driven reform processes will be more able to survive the demands of special interest groups and political influence and avoid the ill-advised enactments which such influences are capable of producing.

As a final comment, it is of interest to note that the Australian Society of Certified Practising Accountants has established an Insolvency and Reconstruction Centre of Excellence which is presently reviewing the Bankruptcy Act to determine whether administrative processes associated with personal insolvency are being performed as efficiently and cost effectively as they might. The Centre has stated that it is concerned to look at the cost to the general community of personal insolvencies from a social, monetary and administrative perspective.

Significantly, the Centre has, at the very outset, found itself questioning whether bankruptcy data being collected at present are appropriate or whether other more useful statistics are available. To achieve this the Centre has established a bankruptcy statistics cell to determine the types of personal insolvency statistics that are being collected and to recommend which personal insolvency statistics should be gathered.[8] This is an important initiative, for the Centre has quickly recognised that it will not be in a position to conduct a meaningful review of bankruptcy policies and outcomes without gathering relevant empirical data from which conclusions may be drawn.

Consultative Processes

The second suggestion which may assist in the further development and

8 "Finding a Better Way" (1996) 66(2) *Australian Accountant* 50.

recognition of policy-driven bankruptcy reform relates to the consultative process.

Although recent years have seen a concerted effort by our policy-makers to introduce a substantial process of consultation concerning the content of bankruptcy reform proposals (for example, discussion papers, meetings with insolvency practitioners, lawyers and finance industry groups) it is widely believed that the consultative process is not as effective as it should be. Bodies such as the Law Council of Australia and the Insolvency Practitioners' Association of Australia (IPAA) in addressing this problem have proposed the establishment of a standing advisory body comprising representatives of professional and other interested associations, including ITSA, the IPAA, and the Law Council, to continuously review the operation of the Act, formulate bankruptcy policy and consider proposed reform of the Act.

It is apparent that such a body would have a more proactive and representative role than is currently available to interested parties responding to discussion papers and the like. This approach accords with one commentator's observations that:

> In terms of any legislation that passes through the Parliament, you need to be inclusive. You need the bureaucrats and ministers, the Members of Parliament, legal practitioners, all working together.[9]

In this respect "all working together" means more than merely being afforded an opportunity to comment on proposed reforms.

Needless to say a committee of the kind proposed would give rise to an additional line in the Attorney-General's budget. However, in terms of effective, expedient and representative law reform, this is a readily justifiable cost.

Conclusion

In summary the future of bankruptcy administrations in this country is dependent on the quality of our laws which constitute the personal insolvency system. In respect of our laws it has been suggested that the recent trend towards policy-driven reform needs to be encouraged and further developed. However, effective long-term policy-driven reform can be sustained only through the collection of verifiable, systematic data which will elevate the level of policy debate in this country.

Finally, the process of reform needs a standing, representative, consultative body to be actively involved in the formulation of both policy and proposed reforms. Such a body accords with the concept of open government and would take giant steps towards establishing confidence in the personal insolvency reform process in this country.

9 R Evans, above note 4 at 971.

A sign inside the Nurrungar Prohibited Area, before and after Nurrungar was declared a peace zone by a unanimous decision at the Nurrungar protest camp meeting, Easter 1993. Photos by Bob Berghout.