

## INSOLVENCY LAW REVIEW COMMITTEE

Some thoughts on Insolvency and Enforcement, the Rule of Law, the Credit System and the Involuntary Creditor.

(by T R Penny)

General

1 The object of this paper is to draw the attention of the Committee to problems which will arise if insolvency for the small debtor is made too easy. I submit the following basic principles are relevant:-

- (a) The effective enforcement of judgments is essential to the maintenance of the rule of law and the continuance of the credit system.
- (b) The acceptance of financial responsibility is essential to the continuance of a capitalist or "mixed" economy.
- (c) Bankruptcy has hitherto formed an essential part of the enforcement of judgments.
- (d) "Mini-bankruptcy" must not become an easy release from just debts for the incompetent, the irresponsible and the mildly dishonest.
- (e) Registrars of County Courts must be trusted with the widest powers to do what is right and just in each case. Such powers must be effective enough to ensure that the dishonest or evasive debtor is not able to "cock a snook" at his creditors or the court.
- (f) There exists a substantial body of involuntary creditors (defined as "innocent creditors" in my Supplement ILRC 27 para 5 on pages 2 & 3) who have been wronged and expect the Courts to provide an effective remedy for the damage they have suffered.

Rule of Law

2 Every day I deal with individuals and small companies who have failed to meet their liabilities on due date and I therefore see the embryonic insolvents while they are still fighting to continue in business. From such experience I can confirm that at least two thirds of such persons are not in this situation by misfortune beyond their control. They are there because they have been incompetent, reckless, irresponsible or dishonest. I would wish to dispel any impressions the committee may have that such people are to be pitied.

3 The maintenance of respect for the law and belief in the sanctity of contract depends on the general public's belief that a breach will result in some form of effective sanction being available.

4 If the enforcement of credit contracts becomes ineffective, the financiers will have no alternative to the restriction of credit to any but the safest of borrowers, requiring unimpeachable and expensive security or raising the interest charge to cover bad debts. Whichever remedy is used the end result will be a reduction in available credit facilities and/or an increase in the cost of borrowing to honest borrowers.

#### Financial Responsibility

5 In a capitalist or mixed economy the sanctity of contract is fundamental to the existence of business relations. Unless businessmen have a sense of financial responsibility trading will cease and the economy collapse.

6 The sense of financial responsibility has been undermined because of:-

- (a) very generous credit terms granted to individuals;
- (b) a high proportion of loan capital as opposed to risk capital in all types of commercial and professional activity;
- (c) a high proportion of the nation's expenditure being in the hands of Central Government, Local Government, para-Government or big private corporations, all controlled by individuals who have little or no personal stake in the efficient use of the money they control or in keeping down costs; and
- (d) the existence of penal rates of taxation, which result in a high proportion of business expenditure being deductible for tax purposes and which reduces the net cost to the business of wasteful expenditure to the minimum.

7 A restoration of financial responsibility can be achieved partially through the effective enforcement of money contracts.

8 The suggestion that the enforcement of credit contracts, which have been pressed on unwilling or unwary consumers, should be alleviated through the insolvency procedures must be resisted. The legislature has it in its power to restrict the enforceability of credit transactions regarded as unfair to ensure that members of the public are not "conned" into taking credit they cannot afford or do not need. Such a remedy for this alleged evil would not detract from the enforceability of valid contracts or the sanctity thereof.

## Insolvency Administration and the Enforcement Process

9 I think it is generally agreed that bankruptcy proceedings have become a major form of judgment enforcement especially since the abolition of the Judgment Summons in the County Court (save for various Government taxes and imposts).

10 If bankruptcy proceedings are so changed that it is easy for a judgment debtor to obtain an insolvency order on terms which give him an early release from his liabilities there will be little incentive to meet such liabilities either in a lump sum or by instalments.

11 A large proportion of County Court judgments are in respect of debts which were contracted to be paid over a period of years and the debtor is not therefore being harrassed if his "mini-bankruptcy" order requires payment by instalments over a substantial period.

### "Mini-bankruptcy" and the Release of the Debtor

12 The release of the debtor in "mini-bankruptcy" will result in the cancellation of all debts in so far as they remain unpaid on the date of release. This in itself is unobjectionable as the same rule applies on a discharge in bankruptcy or compliance with a reduced-payment Administration Order. If however a short-period instalment order is to become a commonplace or automatic, "mini-bankruptcy" will become a "debtors' charter". Without any stigma or disability he will be able to evade a proportion of his liabilities.

13 Unless there are some continuing sanctions after release the debtor will be able to go out and start all over again.

14 Any suggestions therefore of short-period releases should be very carefully considered.

### The Role of the Registrars

15 County Court and District Registrars are dealing every day with small debtors and acquire a balanced view of the needs of the creditor and debtor respectively. They are if anything inclined to favour the debtor as there is in our judicial system a built-in prejudice in favour of the defendant.

16 Because of their daily experience Registrars are pragmatic rather than legalistic and are always searching for the best results which can be achieved bearing in mind the cost to the parties and to the Government. For example, they will not waste Court time in making orders which are from the start unlikely to be obeyed or incapable of enforcement.

17 Registrars are very conscious of the infinite variety of circumstances which face litigants and they prefer to have as wide a discretion as possible to enable them to make suitable orders in unusual cases rather than having to admit that the order that ought to be made is not within their power.

18 Registrars are fully aware of all the problems of consumer debtors but they are also aware that even before proceedings are filed in the County Court the debtor has been given numerous opportunities to meet his obligations usually on far more favourable terms than those originally contracted for.

#### The Involuntary Creditor

19 Hardly a day passes but an honest citizen is given a judgment in my Court and when he asks for enforcement I have to acknowledge that, if the debtor is not in PAYE employment or in possession of uncharged assets which can easily be attached, there is nothing much he can do about it.

20 The loss of the Judgment Summons as a means of enforcement has meant that bankruptcy is the one remaining procedure effective against the self-employed debtor.

21 If "mini-bankruptcy" is made too easy there will be no effective means left of enforcing the judgments of such people and they will lose completely their faith in the judicial system.

#### Conclusion

22 The message I have tried to get across is to give the Registrar the widest discretion and powers to enable him to be generous to worthy debtors and to ensure the unworthy ones cannot get away with it.