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# Consumer bankruptcy

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Martin Ryan

## *Is there a link between creditor harassment and consumer bankruptcy?*

As a result of high levels of consumer lending, at least 100 000 Australian families are estimated to be overcommitted.<sup>1</sup> Overcommitment can lead to such consumers defaulting on their debts and ultimately having to resort to bankruptcy. It has been estimated that of non-business (consumer) debtors who are declared bankrupt 85% do so on their own petitions.<sup>2</sup>

The numbers of those petitioning for bankruptcy has increased markedly in the last ten years, particularly for consumer debtors who petition for their own bankruptcy. In the 1991-92 financial year there were 16 780 bankruptcies, an all-time peak and in the same year, consumer bankruptcies accounted for 68% of all bankruptcies, rising from 43% in 1972-73.<sup>3</sup>

One of the benefits that bankruptcy provides for the defaulting debtor is that no unsecured creditor can enforce any remedy, e.g. judgment proceedings or execution of goods, nor begin any new legal proceedings against the bankrupt. A creditor's only available remedy is to lodge a proof of debt to the bankrupt's trustee and hope that they will receive moneys in this way. Bankruptcy thereby gives the debtor relief from legal proceedings and the threat of them.

### **Creditor harassment**

There appears to be no generally accepted definition of what constitutes debt collection or creditor 'harassment'. The term can have a range of definitions from debt collection activities that are patently illegal such as the threat and use of physical violence through to activities which most people would consider to be unfair or offensive such as telephone calls late at night or the threatening of a debtor's children.

Kelly, Kercher, and the Australian Law Reform Commission have examined creditor harassment in the Australian context.<sup>4</sup> Kercher obtained evidence of a wide variety of harassment techniques by asking casual questions of acquaintances and concluded '... that unfair debt collection tactics are widely used in Australia'.<sup>4a</sup>

Two more recent studies have given further insight into the nature of creditor harassment. Victorian financial counsellors collected 64 cases featuring unfair creditor tactics and compiled a report of these case-histories.<sup>5</sup> A report published by a Canberra debt counselling service was based on the results of a debt harassment 'phone in' in that city.<sup>6</sup> It found that of the 68 complaints received, the main forms of harassment reported were:

- continual phone calls at work;
- abusive and threatening language;
- harassment of minors;
- late and early visits to the place of residence (from 5 a.m. to 11 p.m.);
- contacting relatives, friends and neighbours;
- threats of physical violence and loss of property;
- pressuring of women to pay the debts of estranged husbands; and telegrams sent from creditors to debtors requesting urgent contact but only giving a first name.

Finance company in-house collections accounted for 67% of the complaints.

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**Legal remedies against creditor harassment**

Creditor harassment tactics are subject to a number of remedies in Australia. These include remedies through the common law and various State and federal legislation. Kercher<sup>7</sup> has summarised these remedies:

- Common law remedies of tort and the criminal law are available to debtors.

*Trade Practices Act 1974* (Cth) which contains four provisions of potential benefit to harassed debtors (s.52, s.53(g), s.53A(2) and s.60). Kercher noted that these sections have a number of defects:

- (a) 'harassment' is not defined and there have not been any cases in connection with ss.53A(2) or 60 yet to produce such a definition;
- (b) the Act does not provide a detailed list of prohibited collection activities such as the hours in which a creditor may call a debtor;
- (c) the provisions use general terms such as 'misleading,' 'harassment' and 'coercion'.

There is State legislation with several States having *Fair Trading Acts* which contain the same prohibitions and remedies as the *Trade Practices Act*, but they cover individuals as well as corporations.

State law also requires the licensing of debt collectors, with legislation providing direct and indirect control over harassment. Most States also require the licensing of credit providers which has resulted in indirect coverage for harassment. State *Credit Acts* have the potential to restrict harassment by provisions dealing with limitations on the repossession of secured goods.

**Creditor harassment and bankruptcy**

If defaulting debtors, in general, were subjected to the levels of harassment reported in existing Australian studies, it would be expected that potential insolvents, given the even greater seriousness of their financial situation, would be subjected to even greater harassment. There appeared to be some evidence, based on two American studies,<sup>8</sup> of a link between creditor harassment and the decision to petition for bankruptcy, particularly as a precipitant or immediate cause. It was decided to explore this relationship in some depth in an Australian context as a part of a study utilising interviews with a sample of Melbourne undischarged, voluntary consumer bankrupts.<sup>9</sup> Some of the study's findings have previously been reported.<sup>10</sup> It was thought that creditor harassment, combined with insolvency, would be a major precipitant for defaulting debtors to petition for bankruptcy.

The definition of creditor harassment used in the study was '... the use of unfair non-judicial tactics in an attempt to coerce payment of a civil debt'.<sup>11</sup> The term was used to describe methods of non-judicial coercion which the person using the term 'harassment' finds objectionable. The definition was also designed to incorporate collection methods that may appear to be reasonable and proper as an individual method, but when used in combination with other methods and in such frequency and duration that may have been subjectively perceived by the debtors as 'harassment.'

For this study, 76 undischarged, non-business voluntary bankrupts were interviewed on average 17 months after their petition for bankruptcy, of whom 31 were male, 29 were female and 16 were joint bankrupts. They were interviewed between late 1987 and June 1988. These 76 people represented 19% of the 400 non-business bankruptcies in the Melbourne

metropolitan area from 1 March 1986 to 28 February 1987. Names and addresses of bankrupts were published regularly at this time in the *Age* shortly after their petitions were presented. Requests for interviews were sent to 242 bankrupts whose names were randomly selected after they appeared in this newspaper in the selected year.

The interview had a number of questions specifically related to creditor harassment including questions on debt collection methods used, the identity of the main harassing creditor, the frequency and length of time that pressure was maintained, the time period between commencement of strong pressure and declaring bankruptcy and the impact of pressure from creditors on the decision to petition for bankruptcy.

**Results**

Respondents were questioned about which collection methods were used in their cases by being asked to select from an extensive list of these. The results are reported in *Table 1*.

**Table 1:**  
Collection methods used by creditors pre-bankruptcy

Method	Frequency	Percentage
Telephoned at home	44	57.9
Threatened legal action	40	52.6
Being sent non-abusive letters	27	35.5
Came to home	25	32.9
Telephoned at work	25	32.9
Being sent abusive letters	19	25.0
Sent telegrams	15	19.7
Contacted your relatives	12	15.8
Used threatening or abusive language	10	13.2
Talked to employer	9	11.8
Contacted neighbours	5	6.6
Threatened children	1	1.3
Used physical violence	1	1.3
Anything else	6	7.8

It can be seen that a wide variety of methods were employed. The most widespread method used was telephoning debtors at home with 57% (44 cases) receiving such calls. This was closely followed by threats of legal action. Fifty two per cent (40 cases) received such threats. A quarter of the sample (19 cases) received letters they felt were abusive. Just under one-third (25 cases each) had creditors come to their home and the same proportion were telephoned at work. Less frequent were sending telegrams (19%), contacting relatives (15%), using threatening or abusive language (13%), talking to employer (11%), other methods (7%), contacting neighbours (6%) and one instance each of threatening children and using physical violence.

The child who was threatened was aged four at the time, and was told over the telephone by the credit-provider's collection officer: 'Your mummy is going to go to prison because that's where she belongs'. In the case of physical violence, the person was grabbed and pushed by the creditors, but was not actually struck by them.

The debtors were questioned about the times that creditors visited their homes, as the times of these visits very much helped to determine how much stress debtors associate with them. Eleven people (44% of those visited) had visits at hours that would be considered unreasonable, with visits after 9 p.m. and before 9 a.m. on weekdays. Visits were reported as early as 6 a.m. and as late as 2 a.m.

Data on the number of collection methods used with each person was also obtained. Seven per cent of the bankrupts had no collection methods used with them at all, except for sending of accounts. Eighty nine per cent of the bankrupts had been subjected to five methods of collection or less. Eleven per cent were exposed to six or more, with one person being subjected to nine methods and another to 11 methods.

Respondents were asked who the main harassing creditor was in their case, according to type of creditor. *Table 2* shows the responses to this question.

**Table 2:**  
Main harassing creditor (N = 64)

Type of Creditor	Frequency	Percentage
Finance company	34	53
Bank	10	15
Ministry of Housing	6	9
Retail store	4	6
Estate agent	2	3
Solicitor	2	3
Insurance company	1	1
Credit union	1	1
Employee	1	1
Private investigator (either acting for an insurance company or a solicitor)	1	1
Local small business	1	1
Telecom	1	1
Car rental firm	1	1
Other vehicle driver	1	1
Do not know who creditor was	1	1
	64	

Twelve people reported that they had not been subjected to any creditor harassment so were excluded from the responses to this question.

This table shows that finance companies were the main harassing creditor for just over half of those who considered themselves to be harassed. Of these 34, 21 (61% of them) mentioned two large bank-owned finance companies – the first was mentioned by 12 people (35%) and the other by nine (26%). These two companies were the main harassing creditor for 32% of all those who had been subjected to harassment. Banks were the next highest category with 15%, followed by the Ministry of Housing (State Government department responsible for public housing) with 9% and retail stores with 6%. The remaining 17% was spread among a variety of credit-providers and services.

The bankrupts were then asked how often they were being contacted about this main harassing creditor at the time they were putting pressure on them. *Table 3* gives the responses for this question.

**Table 3:**  
Frequency of contact with debtor by main harassing creditor (N = 61)

Frequency of contact	Frequency	% (of 61)
(1) At least once a day	8	13.1
(2) Several times a week	19	31.1
(3) Once a week – every 2 weeks	19	31.1
(4) Every 3 weeks – once a month or more	15	24.5

It can be seen from this table that 44% had contact at least several times a week with the main harassing creditor and

13% had contact of at least once a day. Close to another one-third had contact of once a week to every fortnight with their creditor. Twenty four per cent had contact only at three weekly intervals or more.

The length of time that strong pressure was maintained by the creditor was also sought and the data reported in *Table 4*.

**Table 4:**  
Length of time of strong pressure by creditor (N = 49)

Length of time	Frequency	Percentage
Less than one month	8	16.3
From one-three months	7	14.2
From 3-6 months	19	38.7
More than 6 months	15	30.6

\* 27 judged that they did not have strong pressure applied.

This indicates that just under 70% had strong pressure maintained for three months or more and just under half of these for six months or more. Fourteen per cent had such pressure for three to six months and only 16% for less than a month.

When the bankrupts were asked about how this pressure affected them, 83% reported the effect to be moderate to severe, 11% reported the effect to be mild and 5% reported it did not have any effect.

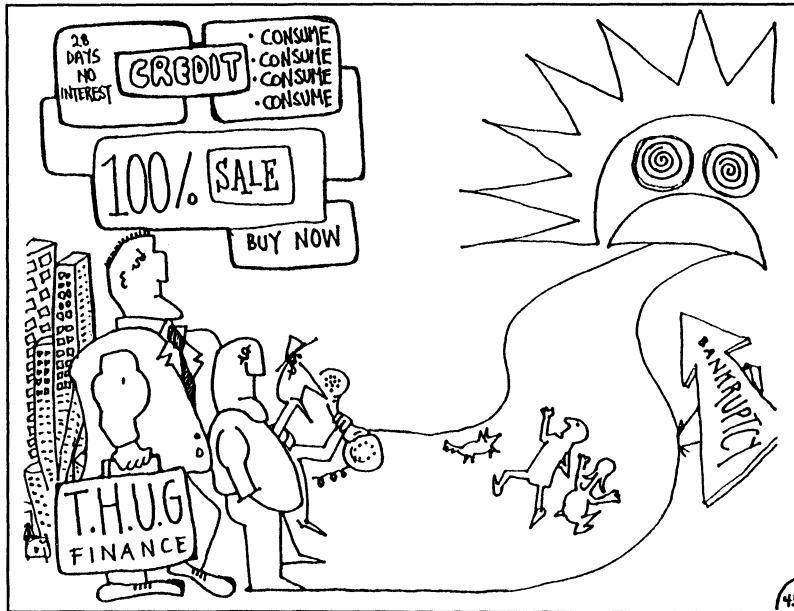
The major question related to extra-legal collection methods was: 'What effect did this pressure from the creditors have on your decision to go bankrupt, and in what way?' The responses are in *Table 5*.

**Table 5:**  
Effect of pressure from creditors on decision to petition for bankruptcy

Level of effect	Frequency	Percentage
Inappropriate	11	14.5
No effect	8	10.5
Small effect	12	15.8
Significant effect	28	36.8
Crucial effect	17	22.4
Total	76	100.0

Eleven people judged that they did not have strong pressure applied and ruled themselves as being ineligible to answer this question. Most significantly, 36% thought it had a significant effect and 22% that it was crucial to their decision. With the latter two categories combined, it means that 59% of all those in the study thought that pressure from creditors had an important part in their decision to petition for bankruptcy. If the inappropriate category (11 people) is subtracted from the total, this means that 45 of 65 were in this important effect category (69%).

Further questions arose from the study, namely whether particular variables could be isolated that best indicated the differences between those who perceived themselves to be harassed by creditors and felt this pressure was highly influential in their decision to petition for bankruptcy, and the group who thought they had not been harassed by creditors at all, or minimally so, and that such pressure from creditors did not play a part in the decision to bankrupt.



The composite picture that emerged of the most harassed debtor is one of a married person whose wife is in full-time employment, owing between \$10 000 and \$19 999 in total to creditors. They were indebted to at least one finance company, which was the main source of pressure, on their overdue loan or hire purchase contract, and it was likely that the credit they had received from the finance companies for the purpose of paying off a car was in the form of hire purchase or an unsecured personal loan. The bankrupts will have discussed their financial difficulties with their lender who was likely to be unsympathetic to their plight and/or to have given advice which was seen by the debtor as unhelpful.

In contrast, the person who was a member of the 'least harassed' group was likely to be single or a sole parent. If they were married, their spouse was not likely to be in full-time employment. If they did name a main harassing creditor, it was unlikely to be a finance company, and they were unlikely to have discussed their financial difficulties with any of their lenders. They were also unlikely to be paying off a car at the time of bankruptcy and the amount that they owed in total was less than \$5000.

Was this pressure from creditors relieved after these debtors petitioned for bankruptcy? When asked about post-bankruptcy attempts to collect debts by creditors, 44 people (57%) had creditors contact them under such circumstances. Creditors are supposed to be notified of a debtor's bankruptcy as soon as possible by the Official Receiver's staff, but at the time of the study there could have been a delay of some months before this is done. So it is difficult to determine exactly how many of the creditors who did contact bankrupts after their petition knew of their bankruptcy and were trying to collect money.

Finance companies contacted bankrupts in 41% of the cases involved, followed by others (mainly small businesses, tradesmen and utilities) with 32%. Retail stores and banks contacted bankrupts in just over 10% of cases each. Other categories accounted for less than 10%.

The methods by these creditors to try to collect money and their order of use appeared to be similar to the pattern pre-bankruptcy: sending letters and telephoning at home being used as the first means of collection, with visits to the home

and legal action being used as secondary methods. Ten (22%) had tried to pay these debts after contact from the creditor.

### Who gets harassed?

Paradoxically, it appears that debtors who communicate with their creditors, instead of relieving their problems, find they are placed under further pressure by the creditor. This could be explained by the fact that the debtor has initiated contact with the creditor. First, this illustrates that the debtor is contactable, in that their address is known and they are likely to have given a home phone number. Second, their work phone number is also likely to be known. Third, it signifies to the creditor that this particular person wants to pay their debts and, therefore, from their viewpoint is likely to pay if subjected to pressure by them. Despite this willingness to repay, the creditor reasons that such a debtor still requires coercion to fulfil their promises.

This coercion is required because the creditor will be warned by the contact from the debtor that this person has financial difficulties. If the debtor is in trouble with repaying this particular creditor, he/she may be likely to be troubled with other creditors as well. Therefore the creditor needs to pressure the debtor to ensure that they are paid, even if it is at the expense of other creditors. A creditor that is perceived as being 'altruistic' will be disadvantaged economically, as the aggressive creditor is likely to be repaid something, while the passive, 'altruistic' ones are not likely to be paid at all by the hard-pressed debtor.

Finance companies tend to lend to high risk people and often have a collection section geared to aggressively collect debts. Collection can then be quickly activated when default seems imminent and when there is that likelihood of losing money to other competing creditors.

In direct contrast to the harassed debtor, the person in the 'least harassed' debtor group was unlikely to have contacted their lender at all because:

- there would have been no reason to do so as they may well be up to date with repayments; or
- they had deliberately chosen not to contact them.

The creditor may well not know where this particular debtor was located. As they are regarded as uncontactable and as 'professional debtors',<sup>12</sup> they are thought to be totally unwilling to repay, and are subjected to less pressure. The other consideration taken into account by creditors was the fact that they may not have owed much money. They are unlikely to owe more than \$2000 to any particular lender, so the creditor may well have considered that such a small debt was not worth pursuing.

### Preventing creditor harassment – before and after bankruptcy

The findings of this study indicate that harassment of debtors is a problem both before and after bankruptcy and there should be effective remedies available to curb it at both points.

Recent government studies have examined means of preventing creditor harassment.<sup>13</sup> As the latter report noted, '... the lack of criminal and civil remedies for harassment of

debtors was a serious deficiency in the system'. The failure to control harassment of debtors is even more pertinent when defaulting debtors feel they have been forced into bankruptcy by creditors' collection tactics; certainly the majority of those in this study held such an opinion.

Another reason to argue for reform to curb creditor harassment is that defaulting debtors still remain the powerless group in the debt collection process. As evidence of this, no one in the study had brought any complaint against any creditor as a result of what they considered to be pre-bankruptcy harassment. The fact that one owes money to a creditor, combined with the prohibitive costs of legal action, may be sufficient to keep many silent despite the abuse and stress to which they had been subjected.<sup>14</sup>

In contrast, after the petition for bankruptcy, a number had been prepared to complain to the Official Receiver's staff about continuing efforts by creditors to collect debts despite their petition. Possibly this post-bankruptcy distinction makes a key point. Prior to bankruptcy, debtors are not aware that they can complain about creditor harassment or who to complain to. With the bankruptcy petition, debtors are informed that they cannot be harassed and are specifically protected by the *Bankruptcy Act*. They are told it can be remedied and are directed to a source of help, i.e. their trustee.

Kercher regards the *Debt Collection Bill* presented to the Victorian Parliament by the Labor Government in 1990 as a '... model harassment control Bill'.<sup>15</sup> It would have overcome many of the deficiencies of existing Acts as it listed a series of prohibitions of harassment activities and there was a criminal fine able to be imposed. This Bill also sought to regulate debt collection through up-graded licensing provisions and regulations dealing with prohibited conduct and harassment. These regulations also covered companies, such as finance companies and banks, involved in debt collection activities, not just those required to be licensed as debt collectors. Unfortunately, there is no sign that the Kennett Liberal-National Party Government intends to reintroduce the Bill in any form.

If harassment by creditors is of concern prior to bankruptcy, it is of even greater concern when such pressure occurs after a debtor has petitioned for bankruptcy as the findings of the present study revealed did occur in a number of instances. Such collection attempts by creditors should be prevented first by prompt handling of bankrupts' estate administration. The process of notifying creditors of a debtor's bankruptcy seems to take several months and, in the meantime, creditors may continue to contact the bankrupt. Most contact the bankrupt because they are unaware of the bankruptcy, but others appear to deliberately persist in trying to collect money after they have been made aware of the bankruptcy. It is distressing for a bankrupt debtor to be contacted by a creditor when they believe that this will not happen again. This is particularly distressing if such collection attempts by creditors were a prime reason for the debtor petitioning for bankruptcy. Creditors who knowingly attempt to collect a provable debt, that is contravene s.58(3) of the *Bankruptcy Act* 1966, should be subjected to legal sanctions. An offence and penalty against this section should be added to the Act.

## Conclusion

From the findings, support was found for the hypothesis that creditor harassment combined with insolvency would be a

major precipitant for defaulting debtors to petition for bankruptcy. The most direct evidence for this hypothesis came from the finding that 59% of the respondents thought that pressure from creditors played a significant to crucial role in their decision to petition.

Given that this study has established a link between excessive creditor harassment and the decision by overcommitted debtors to petition for their own bankruptcies, it becomes even more imperative that real legal reform, and the will and resources to implement it, to protect the most powerless consumers from creditor harassment takes place.

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