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*The Political Economy of Personal  
Bankruptcy in Israel*

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I. INTRODUCTION

IN THE EARLY 1990s, Israel experienced a massive increase in imprisonment orders being issued and executed against non-paying debtors. Partly in response to the plights of those individual debtors, in 1996, the Israeli legislators passed a bankruptcy reform law aimed at revolutionising the fresh-start policy for financially troubled individuals. One of the purported goals of the reform law was to provide a meaningful opportunity for responsible and honest, yet financially troubled individuals to successfully resume their place in society free from their overwhelming debts. This bankruptcy reform marked the first ideological shift in Israeli history from a relatively conservative view to a more liberal view of the fresh-start policy.

This chapter begins with a brief summary of the evolution of the fresh-start policy in Israel. First, it traces the attitude toward debt repayment and financial fresh start in the Jewish tradition. The chapter then picks up the chronicle from the pre-statehood years in Palestine during the British Mandate period and traces the evolution of the fresh-start policy in Israel over its first 50 years.

Following the narrative of the historical evolution of the fresh-start policy in Israel, this chapter summarises the finding of a recent empirical study examining the extent to which the recent reform of the personal bankruptcy regime in Israel has achieved its stated objectives of broadening the opportunity of fresh start for individuals. Also, this chapter examines the extent of uniformity across the four judicial districts in Israel in implementing the recently reformed bankruptcy laws. Lastly, the chapter explores the role that internal legal culture in Israel has had on the implementation of the bankruptcy reform.

II. HISTORICAL EVOLUTION<sup>1</sup>

Long before the establishment of the State of Israel in 1948, Jewish communities around the world struggled with how to treat financially troubled individuals.

<sup>1</sup> The following section is based in part on R Efrat, 'The Evolution of the Fresh-Start Policy in Israeli Bankruptcy Law' (1999) 32 *Vanderbilt Journal of Transnational Law* 49.

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Initially, the Jewish communities were strong advocates of the freedom and dignity of financially troubled debtors. When many non-Jewish legal institutions regularly imprisoned defaulting debtors, Jewish communities originally prohibited such practices. However, beginning in the seventh century, social and economic changes brought about more tolerance towards punitive debt-collection practices in many Jewish communities. The continuing growth of commerce and the persisting custom of debtor's prison outside the Jewish communities culminated, by the 16th century, in widespread acceptance in most of the Jewish communities of imprisoning financially able debtors for failing to pay their debts.<sup>2</sup>

The emerging practice in Jewish communities of imprisoning defaulting debtors, deemed to have financial ability to satisfy debts, was formally adopted in the newly established Jewish state in 1948.<sup>3</sup> Under the new law, a debtor who had the ability to pay her debts but failed to do so was subject to imprisonment for up to 91 days.

Similar to this creditor-oriented debt-collection mechanism, the leaders of the young Jewish State adopted a largely pro-creditor bankruptcy regime modelled after the British Bankruptcy Act of 1914.<sup>4</sup> While this early bankruptcy law recognised the right of the bankrupts to obtain debt forgiveness, it reserved this valuable benefit to financially troubled individuals who were able to repay substantial sums of their outstanding debts.<sup>5</sup>

During the first 30 years of the State of Israel, the legislature and the courts were largely unsympathetic and at times even hostile, to the plights of financially troubled individuals who pursued bankruptcy relief. The legislature's hostility towards bankrupts was initially manifested in the adoption of laws aimed at penalising the bankrupts and indirectly impairing their ability to resume a new chapter in their lives. Beginning in the 1950s, the government banned all individuals who were declared bankrupt from serving as a member of any city council or municipality.<sup>6</sup> In the early 1960s, financially troubled attorneys who

<sup>2</sup> See M Elon, *Herut Haprat Bedarcho Gueyat Hov Bamishpat Ha'Ivri* [Freedom of the Debtor's Person in Jewish Law] 16 & 255–6 (Hotsa 'at sefarim ' a1 shem YL Magnes, ha-Universitah ha-Ivrit, 964 [Jerusalem, Magnes Publication] 1964). See also M Elon, 'The Sources and Nature of Jewish Law and its Application in the State of Israel—Part II' (1968) 3 *Israel Law Review* 88 at 108.

<sup>3</sup> See R Harris, 'Nefilato Ve'aliyato Shel Ma'asar Ha'chayavim' [The Fall and Rise of Debtors' Prison] (1996) 20 *Tel-Aviv University Law Review* 439 at 460–2.

<sup>4</sup> See S Levin, *Pshitat-Regel* [Bankruptcy] 13 (Hotsa ' at Hevrah Yisre ' elit le-hahsharah miktso ' it, [Jerusalem, Israeli Society for Professional Training Publications] 1984); see also CW Fassberg, 'Cross-Border Insolvency in Israeli Law' in *Israeli Reports to the XIII International Congress of Comparative Law* 113–5 (Celia W Fassberg ed, 1990).

<sup>5</sup> Pursuant to the bankruptcy law, a court was precluded from granting the debtor an unconditional discharge if the bankrupt's assets were 'not of a value equal to five hundred mils in the pound on the amount of his unsecured liabilities.' Bankruptcy Ordinance, 1936, Official Gazette, Supp 1, § 26(3).

<sup>6</sup> See The Municipal Ordinance Code (new edition), 1964 § 120(7) (a member of any city council or municipality would be able to resume his position two years after obtaining order of discharge); see also The Local Municipal Ordinance, 1950 § 101(8); Local Municipal Ordinance, 1958 § 11(a)(10).

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1 were declared bankrupt were prohibited from ever practising again.<sup>7</sup> A few  
 2 years later, the government declared that any contractual agency relationship  
 3 automatically terminates upon the bankruptcy declaration of either principal or  
 4 the agent.<sup>8</sup> In the early 1970s, the government announced that a bankrupt indi-  
 5 vidual could no longer enter into any binding contractual relationship.<sup>9</sup>

6 This belligerent attitude towards bankrupts culminated in 1976, when the  
 7 Israeli legislature severely restricted financially troubled individuals' access to  
 8 bankruptcy protection by precluding debtors from bankruptcy relief unless the  
 9 debtors could demonstrate that their petition was likely to benefit creditors.<sup>10</sup>  
 10 The legislature curtailed debtors' access to the bankruptcy process because it  
 11 believed that the recent increase in debtor-initiated bankruptcy petitions, as  
 12 opposed to creditor-initiated petitions, was inconsistent with the original bank-  
 13 ruptcy mandate, which was intended to serve creditors' interests.<sup>11</sup> The legisla-  
 14 ture was also persuaded that it was critical to curtail debtors' access to  
 15 bankruptcy protection because the recent increase in the number of voluntary  
 16 petitions was violating fundamental moral norms of society, was too expensive  
 17 for the government to administer and was harmful to the debtors themselves.<sup>12</sup>

18 Following the 1976 legislative bankruptcy reform, bankruptcy relief was no  
 19 longer available to debtors who had few assets or limited potential for post-  
 20 petition earnings. Courts began interpreting the 1976 legislative reform in a way  
 21 that foreclosed the door of bankruptcy to numerous overly encumbered and  
 22 financially distressed individuals unable to repay a meaningful portion of  
 23 their debts within a reasonable period of time.<sup>13</sup> In routinely turning down the

24 <sup>7</sup> See Chamber of Advocates Law, 1961, 15 L.S.I. 48(3) (1961).

25 <sup>8</sup> See The Agency Law, 1965, 19 L.S.I. 14(a) (1964–65).

26 <sup>9</sup> See The Contracts (General Part) Law, 1973, 27 L.S.I. 4 (1972–73).

27 <sup>10</sup> First, the Israeli legislature added three procedural requirements for commencing bankruptcy  
 28 protection with the aim of reducing the frequency of voluntary bankruptcy petitions. Second, courts  
 29 were granted the authority to deny an application for bankruptcy protection unless the court is  
 30 satisfied that, 'taking into consideration the judgment execution proceedings, which have been  
 31 taken or can yet be taken against the debtor, bankruptcy proceedings are the appropriate course of  
 32 action.' Lastly, a court was granted the power to annul the bankruptcy adjudication of an individ-  
 33 ual if it found that the continuation of bankruptcy would not benefit the creditors. See the 1936  
 34 Bankruptcy Ordinance, § 7 & 29 as amended by 797 SH 106 (1976).

35 <sup>11</sup> See DK (1975) 311 ('Today the bankruptcy process is used by many for illegitimate purposes.  
 36 During the past few years, more than ninety percent of the bankruptcy petitions were initiated by  
 37 the debtors and not by the creditors.')

38 <sup>12</sup> See, eg, Proposed Amendment of the Judgment Execution Law, 1974: Hearings Before the  
 39 Judiciary Comm., 8th Knesset 4 (1974) (statement of the chairman, Mr Verheptig: 'Bankruptcy ruins  
 40 a person economically. It also ruins the morals in the economy.');

41 Draft bill amending the  
 42 Bankruptcy Ordinance (no 8), 1975 H.H., 279 ('[Allowing individuals to resort to bankruptcy  
 43 amounts to] a burden on the courts and the taxpayers.');

44 D K (1976) 1612 (statement of Mr Verheptig: '[I]t is unjustified to ruin someone's source of income . . . and to cause him to be left out of the normal course of life once he becomes bankrupt and he cannot do anything.')

<sup>13</sup> See, eg, C A 3488/93, *Official Receiver v Almochtasev*, 95(2) T E 1330 at 1330. The court of  
 appeals reversed a lower court's decision granting the debtor's application for commencement of  
 bankruptcy protection. The court of appeals reasoned that since the debtor lacks any significant  
 assets for distribution to creditors, there was no place for the debtor in bankruptcy. See also, C A  
 5877/92, *Shafir v. Official Receiver*, 47(4) P D 710, 712: 'When are [bankruptcy proceedings] appro-  
 priate. . . ? The intent is [that the bankruptcy process is appropriate] where it assures the creditors

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bankruptcy relief applications of financially troubled debtors, the courts redirected the debtors back to the judgment execution process.<sup>14</sup>

Unfortunately for those financially troubled individuals who were disqualified from the bankruptcy process, the judgment execution process was not much more hospitable to their needs because it imposed the constant threat of imprisonment for failure to pay. During Israel's early years, several attempts were made to liberalise debtor prison law inherited from the Ottoman Empire; every attempt failed as there was strong resistance coming from the powerful community of judges and the bar association. These well-established groups believed that liberalisation of debtor prison law would impair the only effective tool for dealing with the perceived chronic problem of debt-repayment avoidance by certain segments of the newly formed society in Israel.<sup>15</sup> During parliamentary debate on the reform of debtor prison law, several legislators echoed this sentiment, arguing that existing social conditions in Israel simply made the country ill-prepared to deal with unethical and opportunistic tendencies in some segments of Israeli society. Some legislators were even more explicit and specifically referred to the Sephardic Jews as the problematic segment of Israeli society.<sup>16</sup>

Faced with the strong opposition to any liberalisation attempts towards debtor prison law, the advocates for liberalisation reform eventually settled for a reformed version of the law that in many ways was even more punitive than before. Specifically, in 1968, one newly adopted regulation shifted the burden of proof to a defaulting debtor, desiring to avoid the issuance of an imprisonment order, to establish that there was another way for the creditor to collect his debt. Further in 1968, the legislature made it procedurally much easier for a creditor to obtain an imprisonment order against a defaulting debtor. From then on, creditors no longer needed to obtain a judgment from a court to proceed with a request for the debtor's imprisonment on account of a defaulting promissory note, a returned check, or a bill of exchange.<sup>17</sup> Instead, the creditor would simply need to present the judgment execution officer with any of those documents, and such documents became executable as if they represented a final judgment of a court.<sup>18</sup>

To avoid imprisonment and other collection procedures, the debtors were also required to strictly fulfill the terms of a repayment order issued by an

of at least a reasonable repayment of their claims in a process that will eventually be beneficial to the entire group of creditors.<sup>7</sup>

<sup>14</sup> See 4892/91, *Ashkenazi v Official Receiver*, 48(1) P D 45 at 61.

<sup>15</sup> A typical argument against a reform proposal of the debtor's prison law was stated in a letter dated April 24, 1955, from the District Court Judge Kistner to the Attorney General. In the letter the judge asserted that: '[o]ne should not forget that our nation is in a period of massive immigration and that there are many people who do not have permanent jobs and are making a living out of daily temporary jobs and there are not effective avenues available to the creditor to collect the debt'. See Harris, above n 3, at 474.

<sup>16</sup> See, eg, DK (1957) 96; see also (1960) 1864; D K (1960) 1786.

<sup>17</sup> See Harris, above n 3, at 485.

<sup>18</sup> See HE Baker, 'Legal System' in *The Israeli Year Book 1970*, 119 (L Berger *et al* eds, 1971).

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1 over-burdened judgment execution officer. However, as the rigid and at times  
2 unrealistic repayment demands made by those orders became increasingly more  
3 difficult to satisfy, more debtors found themselves subject to the impending  
4 threat of an imprisonment order.<sup>19</sup>

5 Hence, as a result of these various changes in the law, by the late 1980s insol-  
6 vent individuals with few assets and limited future income potential were in  
7 practice excluded from both the bankruptcy process and the repayment options  
8 traditionally available under the judgment execution process.<sup>20</sup> Consequently,  
9 an increasing number of insolvent individuals faced an impending fate of  
10 imprisonment. Indeed, by the early 1990s, the number of imprisoned debtors  
11 had grown from 30 individuals per year in 1963 to over 24,000 individuals.<sup>21</sup>

12 The massive and almost indiscriminate use of debtor's prison in Israel as a  
13 tool for collection of unpaid debts ceased almost entirely in 1993. Acting in  
14 response to an appeal brought by a recently established grassroots debtor's  
15 organisation, the Supreme Court held that imprisonment orders could be issued  
16 only when the *creditors* can clearly demonstrate that the debtor has the means  
17 to repay the outstanding debt. This very activist decision overturned a tradition  
18 dating from the 1968 legislation that required the debtor, in order to avoid  
19 imprisonment, to prove that the creditor could collect in some other manner.<sup>22</sup>  
20 The Court further found that the judgment execution officer could no longer  
21 issue an imprisonment order without first conducting an adequate investigation  
22 of the debtor's financial affairs to determine whether the debtor indeed had the  
23 financial ability to repay the outstanding debts.<sup>23</sup>

24 The massive increase in the utilisation of debtor's prison in the early 1990s  
25 triggered an ad hoc protest by many who perceived the system to be inherently  
26 unfair. The protest took the form of a letter writing campaign, the development  
27 of an interest group dedicated to helping financially troubled debtors, a litiga-  
28 tion strategy, and, apparently, some suicides. The public pressure resulting from  
29 this ad hoc protest movement was the catalyst of the above-mentioned land-  
30 mark Supreme Court decision on the debtors' prison law in 1993. And the  
31 Court's decision was quite effective. Creditors were unable or chose not to meet  
32 the burden of proof assigned to them by the decision to obtain an imprisonment  
33 order. The practice of imprisoning debtors decreased sharply, though not  
34 entirely.<sup>24</sup>

35  
36  
37 <sup>19</sup> See eg, CA 5503/92, *Kirtzman v Official Receiver*, 49(1) PD 749 at 755–6.

38 <sup>20</sup> See Ashkenazi, 48(1) PD at 57; CC (TA) 2404/90, *Official Receiver v Ron*, 1992(2) PM 182,  
39 184: 'This case is an example of many cases . . . of financially troubled debtors where one judicial  
40 system turns them to another judicial system and the other judicial system returns them back to the  
41 first, in a continuing cycle. This situation resulted from the recent reform in the judgment execution  
42 law . . . .'

43 <sup>21</sup> See DK (1965) 2528; HC 5304/92, *Perach Foundation v Justice Minister*, 47(4) PD 715 at  
44 723–32.

<sup>22</sup> See the text preceding n 18.

<sup>23</sup> See *Perach Foundation*, 47(4) PD 715 at 763–4.

<sup>24</sup> See Harris, above n 3.

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Evidently, the same public pressure was also the catalyst for the reform of the bankruptcy law in 1996.<sup>25</sup> The public pressure for a legislative reform to address the plight of the financially troubled individuals prompted the establishment of a high profile bankruptcy reform commission. While the commission failed to come up with any concrete reform proposal, the commission's deliberations seem to have cultivated some of the basic principles of the landmark 1996 bankruptcy reform. Indeed, the fundamental changes to the fresh-start policy, which were adopted in the 1996 reform, were outlined in a memorandum to the Justice Minister, written by his charismatic and highly influential deputy who herself was a member of the reform commission.<sup>26</sup>

The bankruptcy reform of 1996 was intended to promote two seemingly contradictory goals; while the reform was designed to expand the fresh-start opportunities for certain insolvent individuals, it also had the objective of penalising certain insolvents who pursued the bankruptcy option.<sup>27</sup> The reform broadened the opportunities for a financial fresh start by lifting the restrictive access limitations to bankruptcy relief placed on the financially troubled 20 years earlier. Furthermore, the reform dismissed the requirement that certain debtors formally apply for a discharge of debts and significantly liberalised the standard by which a court evaluates whether to grant a bankrupt an unconditional discharge of debts.<sup>28</sup>

However, to deter the individual from pursuing the bankruptcy option, the reform adopted several provisions aimed at restricting the bankrupt's ability to engage in business transactions upon the filing of his bankruptcy petition. Among other penalties, the bankrupt was prohibited from holding a credit card, retaining an interest in any corporate entity, or maintaining chequing account.<sup>29</sup> These seemingly inconsistent objectives of the bankruptcy reform demonstrated the legislature's persisting preoccupation with neutralising any attempt made by individuals to take unfair advantage of the more liberalised bankruptcy system.<sup>30</sup>

<sup>25</sup> See Efrat, above n 1, at 102–03.

<sup>26</sup> See Memorandum from Davida Lachman-Messer, Deputy Justice Minister, to Dan Meridor, Justice Minister (5 Aug 1992) (on file with author).

<sup>27</sup> See DK (1996) 72, the statement of Yitzhak Levi, chair of the bankruptcy reform, urging the Knesset members to approve the proposed bankruptcy reform as it not only considers the creditors' interests but also serves the legitimate interests of financially troubled individuals.

<sup>28</sup> See the 1980 Bankruptcy Ordinance, §§ 17(b), 18, 63 as amended in 1560 SH 60, (1996).

<sup>29</sup> See the 1980 Bankruptcy Ordinance, §§ 42a as amended in 1560 SH 60, (1996).

<sup>30</sup> In her introductory comments to the bankruptcy reform subcommittee, the Deputy Justice Minister generally described the objectives of the proposed bankruptcy reform to include broad expansion of the debt-forgiveness mechanism for the financially troubled individual who has acted in good faith in incurring his debts and who has no assets to distribute to his creditors. While broadening the fresh-start policy, 'we are not covering our eyes with respect to the fraudulent debtors, and in this [reform proposal] we want to worsen the condition of the debtors in general, and to worsen the condition of fraudulent debtors in particular . . . On the one hand we give the debtor access to bankruptcy but on the other hand, we demand from him many and serious things.'

*Proposed Amendment of the Bankruptcy Ordinance: Hearings Before the Subcomm. on Bankruptcy Reform of the Judiciary Comm.*, 13th Knesset 4 (23 May 1995) (statement of Davida Lachman-Messer, Deputy Justice Minister).

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1        Nonetheless, the 1996 bankruptcy reform evidenced a significant departure  
 2 from the rather restrictive and conservative approach to fresh-start policy in  
 3 Israel. By lifting the access limitations and by liberalising the standards for  
 4 obtaining debt forgiveness, the legislators demonstrated their commitment to a  
 5 bankruptcy regime with some opportunity for a financial fresh start. While the  
 6 reform retained and even intensified the penalties associated with filing for  
 7 personal bankruptcy, the overall departure signalled a new vision for financially  
 8 troubled individuals in Israel.<sup>31</sup>

## III. THE ISRAELI BANKRUPT

13        The liberalisation of bankruptcy law in 1996 did not result in a dramatic  
 14 increase in the number of bankruptcy petitions filed. Israel has a relatively low  
 15 per capita rate of bankruptcy filing. Every year in Israel there is considerably less  
 16 than one bankruptcy filing for every 1,000 people.<sup>32</sup> The bankruptcy filing rate  
 17 in Israel is three times lower than the personal bankruptcy filing rate in England  
 18 and Wales, four times lower than New Zealand,<sup>33</sup> at least seven times lower  
 19 than the consumer bankruptcy filing rate in Australia,<sup>34</sup> 19 times lower than the  
 20 personal bankruptcy filing rate in Canada and 32 times lower than the personal  
 21 bankruptcy rate in the United States.<sup>35</sup> While the limited relief and the high costs  
 22 of bankruptcy may have contributed to the lower rate of bankruptcy filing in  
 23 Israel, Israel's low bankruptcy rate might also be attributed to stringent con-  
 24 sumer credit standards employed by the financial sector, high personal saving

28        <sup>31</sup> See eg, *Proposed Amendment of the Bankruptcy Ordinance: Hearings Before the Subcomm.*  
 29 *on Bankruptcy Reform of the Judiciary Comm.*, 13th Knesset 2 (30 May 1995) (statement of Davida  
 30 Lachman-Messer, Deputy Justice Minister). In arguing in favour of imposing limitations on bank-  
 31 ruptcy petitioners, Ms Lachman-Messer stated '[i]t seems to me that this is the way we can accom-  
 32 plish the balance that is needed between the dignity and respect of the individual on the one hand,  
 33 and the need to deter people from abusing the bankruptcy system . . . '.

34        <sup>32</sup> The personal bankruptcy rate in 1997 was 0.16 per 1,000 Israeli citizens. This figure was cal-  
 35 culated by dividing the number of personal bankruptcy filings in Israel in 1997 by the total number  
 36 of individuals residing in Israel in 1997 that were 20 years old or older. The number of personal  
 37 bankruptcy filings in 1997 was 587. See Computerized Printouts from the Official Receiver of the  
 38 Central, Jerusalem and Southern districts (July–September 1998) (on file with author). The number  
 39 of individuals that were 20 years old or older in 1997 was 3,617,000. See State of Israel Central  
 40 Bureau of Statistics, *Statistical Abstract of Israel 2000*, Figure 2.19 (2000).

41        <sup>33</sup> See TA Sullivan, E Warren and J Lawrence Westbrook, *The Fragile Middle Class: Americans*  
 42 *in Debt* (2000) 259, reporting that in 1997 the personal bankruptcy filing rate per 1,000 citizens was  
 43 .47 in England and Wales; P Heath, 'Consumer Bankruptcies: A New Zealand Perspective', (1999)  
 44 *37 Osgoode Hall Law Journal* 30: 'By 1997, [the personal bankruptcy] figure had reached 70 per  
 100,000 of population.'

41        <sup>34</sup> See R Mason and J Duns, 'Developments in Consumer Bankruptcy in Australia' 2 (July 6,  
 42 2001) (unpublished manuscript, on file with author reporting a national personal bankruptcy rate of  
 43 1.1 per 1,000 head of households).in this volume.

44        <sup>35</sup> See Sullivan, Warren and Westbrook, above n 33, at 259, reporting that in 1997 the personal  
 bankruptcy filing rate per 1,000 citizens was 3.0 in Canada and 5.1 in the US.

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rates, limited public awareness about the availability of bankruptcy relief and expansive social welfare programmes.<sup>36</sup>

As mentioned earlier, financially troubled individuals in Israel generally begin the journey of dealing with their financial crisis in the judgment execution system. Under that system, financially insolvent individuals are ordered by a clerk of the judgment execution court to make monthly payments to the creditors and, in exchange, the creditors are prohibited from pursuing any collection activities against the debtors. However, once a debtor becomes unable to go along with the ordered monthly payments, he becomes vulnerable to various collection remedies, including imprisonment. To escape the draconian nature of imprisonment, some debtors find it necessary to obtain relief under bankruptcy. Indeed, the typical petitioner in Israeli bankruptcy is, by and large, in a terrible financial condition. Most bankrupts are former small business owners. One study showed that, on average, debtors in bankruptcy had assets and income worth half of that owned or earned by the general population, but that bankrupt debtors owe crushingly more, nearly 15 times more than their average annualised income. Moreover, with their lower income, the Israeli bankrupts tend to support larger families, while having only a tenth as much net income as the general population.<sup>37</sup>

Bankruptcy, however, does not necessarily provide many of these financially troubled individuals with a fresh start. A recent study found that the rate of debt forgiveness in the bankruptcy sample was just under four per cent.

## IV. LEGAL CULTURE

## A. Introduction

The dramatic reform of the bankruptcy regime in Israel in 1996 signalled the beginning of an emerging favourable view toward the plight of financially troubled individuals in Israel. However, the legislature's intent aside, a recent empirical study of over 200 personal bankruptcy cases that were commenced after the 1996 reform suggests that, to a large extent, key reform provisions of the recent bankruptcy legislation have not been implemented, but, in fact, ignored. The study indicates that legal culture has had a powerful impact on the actual implementation of legislative reform. More specifically, the findings suggest that the values, attitudes and beliefs shared by key government officials from the Official Receiver's office seem to be playing a critical role in shaping practices in the Israeli bankruptcy system.

<sup>36</sup> See R Efrat, 'Global Trends in Personal Bankruptcy' (2002) 76 *Bankruptcy Law Journal* 81 at 101–08.

<sup>37</sup> See generally R Efrat, 'The Rise & Fall of Entrepreneurs: An Empirical Study of Personal Bankruptcy in Israel' (2002) 7 *Stanford Journal of Law, Business & Finance* 163.



1  
2 **B. Legal Culture in the American Bankruptcy System**

3  
4 Studies have also documented the pervasive and systematic influence legal  
5 culture has had on the operation of American personal bankruptcy system.  
6 A number of studies have found serious disparities in the implementation of  
7 bankruptcy law in different locales in the United States.<sup>38</sup> The authors  
8 concluded that these differences could not be explained by differences in formal  
9 law or by variations in the economic circumstances of debtors in the different  
10 localities. Instead, the authors asserted that the pervasive and systematic dis-  
11 parities are the product of differing local internal legal cultures in bankruptcy.<sup>39</sup>

12 The authors found that the local legal culture in personal bankruptcy in the  
13 United States is cultivated by attitudes, perceptions and beliefs held by a num-  
14 ber of key repeat players. Since attorneys represent the vast majority of peti-  
15 tioners in the United States,<sup>40</sup> attorneys play a key role in influencing the  
16 decisions of their mostly uninformed clients. The authors persuasively argued  
17 that the attorney's own financial interests as well as moral convictions clearly  
18 affect the way in which they influence their clients.<sup>41</sup> However, the attorney's  
19 own financial interests and moral convictions are shaped, to a large extent, by  
20 other dominant forces that make up the local legal culture. These other domi-  
21 nant forces include judges,<sup>42</sup> the United States Trustee and the Chapter 13  
22 Trustees<sup>43</sup> and the local bar.<sup>44</sup>

23  
24 <sup>38</sup> For example, one study has found personal bankruptcy filing rates vary significantly among  
25 the various judicial districts across the United States. After accounting for economic differences, the  
26 study observed statistically significant variation in the filing rates of more than 100% among dis-  
27 tricts within Texas, Florida and Oklahoma. The study also found substantial geographic variation  
28 in the rates by which individual petitioners pursue bankruptcy pursuant to Chapter 7 liquidation  
29 option versus its Chapter 13 repayment plan option. Finally, the study was further able to detect dra-  
30 matic variations in Chapter 13 practices among various districts. See TA Sullivan, E Warren and J  
31 Lawrence Westbrook, 'The Persistence of Local Legal Cultures: Twenty Years of Evidence from the  
32 Federal Bankruptcy Courts' (1994) 17 *Harvard Journal of Law and Public Policy* 801, 828–9. See also  
33 J Braucher, 'Lawyers, and Consumer Bankruptcy: One Code, Many Cultures' 67 *American  
34 Bankruptcy Law Journal* (1993) 501 at 532.

35 <sup>39</sup> See Sullivan, Warren and Westbrook, above n 39, at 806. See also WC Whitford, 'The Ideal of  
36 Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in  
37 Consumer Bankruptcy' (1994) 68 *American Bankruptcy Law Journal* 397 at 406, 408.

38 <sup>40</sup> See S Block-Lieb, 'A Comparison of Pro Bono Representation Programs for Consumer (1994)  
39 Debtors' (1994) 2 *American Bankruptcy Institute Law Review* 37 at 41 (finding that less than 15%  
40 of bankruptcy petitioners were not represented by an attorney).

41 <sup>41</sup> See Braucher, above n 39, at 546–7, 550–1; Sullivan, Warren and Westbrook, above n 39, at  
42 852; WC Whitford, 'Has the Time Come to Repeal Chapter 13?' (1989) 65 *Indiana Law Journal* 85  
43 at 91.

44 <sup>42</sup> Judges' attitudes and perceptions about personal bankruptcy have significant influence on  
45 how the attorneys exercise their power over their clients. For example, judges have reportedly set  
46 attorneys fees that provide financial incentive for attorneys to influence their clients to file under one  
47 chapter as opposed to another. See Sullivan, Warren and Westbrook, above n 39, at 843–5.

48 <sup>43</sup> The United States Trustee and the Chapter 13 Trustees also influence how attorneys advise  
49 their clients in bankruptcy and have helped formulate the local legal culture. An attorney's non-  
50 conformity with the United States Trustee or Chapter 13 Trustees' preferred practices may result  
51 in holding up the client's plan confirmation and/or examining with a high degree of scrutiny the

### C. Legal Culture and Uniformity in Bankruptcy Practice in Israel<sup>45</sup>

The findings of an empirical study of personal bankruptcy undertaken recently in Israel<sup>46</sup> are consistent in some fundamental respects with the empirical findings relating to the operations of the American bankruptcy system. The studies in both countries have demonstrated the impact of legal culture on the lack of uniformity in the practices among various localities in the implementation of the formal bankruptcy law. Similar to bankruptcy practices in the United States, there is substantial variance in bankruptcy practices among the four judicial districts in Israel. While none of the four districts in Israel employ exactly the same practices, there seems to be a major divide between two camps. The dominant creditor-oriented camp is characterised by practices that are primarily aimed at furthering the interests of the creditors in bankruptcy. The central, southern and northern judicial districts all belong to the creditor-oriented camp. In contrast, the emerging debtor- debtor-oriented camp is distinguished by the various practices that are predominantly aimed at enhancing the debtor's fresh-start opportunities. The only judicial district that belongs to this camp is the Jerusalem District.

A sharp difference between the creditor-camp versus the debtor-camp in Israel is the method by which courts arrive at debtors' repayment orders. In Israeli bankruptcy, most benefits awarded to debtors, such as a commencement order,<sup>47</sup>

attorney's fee application. As a result, most lawyers only propose Chapter 13 plans that satisfy the United States Trustee and/or Chapter 13 Trustees' preferred practices relating to the minimum debt repayment percentage. See Braucher, above n 39, at 532.

<sup>44</sup> The bar's collective norms have influential power over the attorneys' action because of the small size of the local bankruptcy bar and the high degree of interdependency among the few bankruptcy attorneys. See Sullivan, Warren and Westbrook, above n 39, at 848–9; Whitford, above n 40, at 409–10.

<sup>45</sup> The following sub-sections in this section are based on Efrat, above n 38.

<sup>46</sup> A random sample of 213 bankruptcy files of individuals was selected, analysed and coded. The schedules found in the bankruptcy files included extensive information on the debtors' financial condition. Also in the bankruptcy files, copies of the Official Receiver's detailed investigatory reports and related documents provided valuable insight of the bankruptcy process. The sample was composed exclusively of individuals who voluntarily filed for bankruptcy between September 1996 and July 1998. The sample of 213 files constitutes 38% of the average annualised number of actual filings during the sample period. For further detail on the methodology of that study, see Efrat, above n 37.

<sup>47</sup> After a petitioner files an application for the commencement of bankruptcy protection, a court must decide whether to issue a commencement order (sometimes referred to as a receiving order). Under the bankruptcy legislation, a petitioner's application for commencing bankruptcy protection should be granted by a judge as long as: (a) the petitioner has debts that amount to no less than 10,000 NIS (approximately \$2,500); (b) the petitioner attached to her application a detailed financial report relating to her family's assets, liabilities, income and expenses; and (c) the petitioner attached a written waiver allowing the Official Receiver to obtain from any source any confidential data on the petitioner's financial affairs. In addition, the petitioner must allege in the application that she is unable to repay her debts. See § 17(a) & (b) of The 1980 Bankruptcy Ordinance, as amended in 1560 SH 60, (1996). However, a court may deny a debtor's application where it determines that the debtor is able to repay her debts or for any other sufficient cause. See *ibid* at § 14.

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1 a stay order, an adjudication order<sup>48</sup> or even a discharge order, are conditional  
2 on the debtors making some kind of monthly repayments to their creditors.  
3 Interestingly, despite inferior household earnings reported by petitioners in the  
4 creditor-camp as compared to the debtor-camp, courts in the two camps issue  
5 orders with similar repayment amounts. The gross monthly household income  
6 of petitioners in the debtor-oriented camp was more than two-third's higher  
7 than in the creditor-oriented camp. Nonetheless, the amount of monthly repay-  
8 ment was approximately the same in the two camps.

9 These differences apparently are the product of diametrically opposed  
10 approaches to calculating the amount the debtor should pay as a condition of  
11 commencing bankruptcy protection or as a condition of being adjudicated  
12 bankrupt. Under the bankruptcy law, a judge is given unfettered discretion to  
13 determine the amount of monthly repayments a debtor must pay as a condition  
14 of commencing bankruptcy protection or as a condition of being adjudicated  
15 as bankrupt.<sup>49</sup> In the debtor-friendly camp, judges generally issued monthly  
16 repayment orders that were principally based on the debtor's ability to pay. In  
17 contrast, in the creditor-oriented camp, judges tended to issue monthly repay-  
18 ment orders that were weighted heavily by the amount of the debtor's debts. As  
19 a result, the inferior earnings of the petitioners in districts belonging to the cred-  
20 itor-oriented camp seem to have played a limited role in affecting the amount  
21 the debtors were ordered to pay to creditors.

22 When compared to petitioners in the debtor-friendly district, petitioners filing  
23 for bankruptcy protection in the creditor-friendly districts also face a delayed  
24 and bureaucratic process. Under the bankruptcy laws in Israel, before the  
25 debtor can be officially declared bankrupt, a court must approve the debtor's  
26 petition by issuing a commencement order. While the average time for a court  
27 in the debtor-friendly district to issue a commencement order was three weeks,  
28 the average time to accomplish the same in the creditor-friendly districts was six  
29 times longer. This delay in the creditor-friendly jurisdictions postpones for that  
30 much longer the bankruptcy adjudication hearing, which is generally scheduled  
31 six months after a court issues the bankruptcy commencement order. Since it is  
32 during that bankruptcy adjudication hearing that a court may consider the issue  
33 of debt discharge, the delay in issuing a commencement order inevitably delays  
34 deliberation on the issue of discharge.<sup>50</sup>

35  
36 <sup>48</sup> Six months after the issuance of a receiving order, the court must conduct a hearing to deter-  
37 mine whether the debtor should be adjudicated and declared bankrupt. A court will generally declare  
38 the debtor bankrupt unless it finds that the debtor was acting in bad faith when she applied for bank-  
39 ruptcy protection, or that the debtor can repay her debts. See § 18e(a)(2) of The 1980 Bankruptcy  
Ordinance, as amended in 1560 SH 60, (1996).

40 <sup>49</sup> See, eg, *Bar Dror v Kasif* 37(3) PD 729 at 734 (holding that a judge is in charge of a debtor's  
41 post-petition earnings and the court has the absolute power to make decisions regarding disposition  
of said earnings).

42 <sup>50</sup> Six months after the issuance of a commencement order, a court must conduct a hearing to  
43 determine whether the debtor should be adjudicated and declared bankrupt. It is at that hearing that  
44 a judge may, for the first time, consider the issue of debtor's discharge. See § 18a(a) & 18e(a)(3) of  
The 1980 Bankruptcy Ordinance, as amended in 1560 SH 60, (1996).

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Not only did it take much longer to obtain a commencement order in the creditor-oriented districts, it was also more cumbersome. For example, petitioners in the debtor-friendly district need not appear for a commencement order hearing. In contrast, petitioners in some of the creditor-friendly districts are required to attend and submit to questioning in a formal hearing for a commencement order.

Other differences between the various geographic regions exist. The four districts in Israel sharply diverge in their approach to debt forgiveness in bankruptcy. Instead of insisting that the debtor initiate an application for debt forgiveness, the 1996 reform enabled a court of its own motion, but no earlier than six months after the bankruptcy petition is filed, to raise that issue of debt forgiveness during the bankruptcy adjudication hearing.<sup>51</sup> While there was at least a good faith attempt to implement this provision of the reform in the debtor-oriented district, the creditor-oriented districts had by and large ignored it. In the debtor-friendly district, discharge was addressed during the first six months of the case in almost 20 per cent of the cases, whereas in the creditor-oriented district it was raised anywhere from none at all to five per cent during the first six months of the case. Even in the few cases where discharge was raised, the judges in the creditor-oriented districts have always opted to deny such relief. In contrast, the courts in the debtor-friendly district have issued a discharge order at the conclusion of each of such hearings where the issue of discharge was raised.

#### D. Actors Shaping Legal Culture

While the studies in the United States and Israel have identified similar experiences in the lack of geographic uniformity in the implementation of bankruptcy law, some important differences in the studies' findings have surfaced. First, the studies in the United States have suggested that the influence of the American legal culture on the operations of the bankruptcy system is a product of the perceptions and views held by a number of key repeat players in the bankruptcy system (including attorneys, judges, United States Trustees, Chapter 13 Trustees and the local bar). In contrast, the study in Israel indicates that the influence of the Israeli legal culture is almost exclusively a product of the Official Receiver's attitudes and perceptions about the role of bankruptcy in Israeli society.

The Official Receiver's almost total control in shaping the legal culture in personal bankruptcy in Israel is due to the lack of interest by creditors, the lack of sophistication and representation by the petitioners and the unmatched deference given to the Official Receiver by judges. Creditors are rarely involved in the Israeli bankruptcy process.<sup>52</sup> The average bankruptcy petitioner has 17

<sup>51</sup> See § 18e(a)(3) of The 1980 Bankruptcy Ordinance, as amended in 1560 SH 60, (1996).

<sup>52</sup> While creditors generally take a passive role in asserting their rights in any given personal bankruptcy case, representatives of the banking industry have taken an active role in influencing the

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1 creditors, but on average only one creditor attends the creditors' meeting.  
2 Creditors have opted not only to stay away from the creditors' meeting, but also  
3 the vast majority of them do not file a proof of claim, only a few of them attend  
4 the important hearing on debtor's bankruptcy adjudication and only a handful  
5 of them ever voice their views when debtors move to reduce monthly payments.  
6 In fact, the Official Receiver indirectly discourages creditors from getting too  
7 involved in the process as it does most of the work for them.

8 Just as creditors are passive players in the Israeli bankruptcy system, so are the  
9 debtors. Debtors in Israel are not influential actors in the bankruptcy system as  
10 most of them are unsophisticated individuals who are not represented by coun-  
11 sel. Most petitioners do not hire attorneys for the entire duration of the bank-  
12 ruptcy process primarily because of the prohibitive costs of representation. As a  
13 result, bankruptcy petitioners in Israel are largely uninformed about their rights  
14 and rarely assert them. The Israeli petitioners seem to rely primarily on the  
15 Official Receiver for advice and direction throughout the bankruptcy process.

16 Despite being repeat players in the bankruptcy process, judges do not seem to  
17 have significant influence over the legal culture in the Israeli bankruptcy system.  
18 Unlike bankruptcy judges in the United States who deal exclusively with bank-  
19 ruptcy matters, there are no judges in Israel that specialise in bankruptcy mat-  
20 ters. Hence, most judges in Israel seem to have limited expertise in that obscure  
21 area of law. As a result, judges, who have only limited expertise and limited time  
22 to devote to each case, tend to defer, to a great extent, to the Official Receiver's  
23 recommendations relating to a debtor's bankruptcy petition. For example, one  
24 study found that the judges strictly followed the Official Receiver's recommen-  
25 dation in 97 per cent of the cases on whether to grant the debtor's application  
26 for commencing bankruptcy protection. Also, judges usually followed the  
27 Official Receiver's position relating to a debtor's application for reduction in  
28 the amount of monthly payments due. Similarly, the judges adopted most of  
29 the Official Receiver's recommendations regarding a debtor's adjudication as  
30 bankrupt. Lastly, the judges followed in most cases the Official Receiver's  
31 recommendation whether to grant the debtor a discharge.

32 Hence, the apathy of creditors, the powerlessness and ignorance of the peti-  
33 tioners, and the deference exercised by the judiciary have all helped the Official  
34 Receiver to become the dominant actor in the Israeli bankruptcy scene. By  
35 becoming the only prominent player in the Israeli bankruptcy system, the  
36 Official Receiver has been enjoying almost the exclusive power to influence and  
37 shape the legal culture in the Israeli bankruptcy regime.

38 The attitudes, perceptions and views of the Official Receiver in Israel help to  
39 explain the regional disparities in bankruptcy practices. The results from the  
40 empirical study indicate that the relatively autonomous directors of the regional  
41 divisions of the Official Receiver coupled with the deeply rooted historical pro-

42 legislative process affecting bankruptcy. See, eg, *Proposed Amendment of the Bankruptcy*  
43 *Ordinance: Hearings Before the Subcomm. on Bankruptcy Reform of the Judiciary Comm.*, 13th  
44 Knesset 1 (30 May 1995).

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creditor institutionalised sentiments in the regional offices of the Official Receiver have contributed to the said disparities. Apparently, the leadership at the highest level of the Official Receiver in Israel, including the Chief Administrator and regional directors, has historically been exceedingly suspicious of the fresh-start policy in bankruptcy. However, with the 1994 appointment to the Official Receiver of a new chief, who was favourably predisposed towards the plight of debtors, one judicial district has embraced a pro-debtor philosophy. Nonetheless, despite the pro-debtor orientation of the new Chief Administrator of the Official Receiver, the continued pro-creditor environment in a number of regional districts of the Official Receiver was made possible by the decentralised functioning of the Official Receiver institution.

Even the pro-debtor orientation of the Jerusalem District seems to be a function of the favourable predisposition of the head of that regional district towards the fresh-start policy in bankruptcy. Indeed, the regional head's firm personal support for the early discharge provision of the bankruptcy reform was manifested in one of the cases in the sample of the study where he made a rare personal appearance before a judge to support the Official Receiver's application for an unconditional discharge of the debtor's debts.

In contrast, the pro-creditor orientation of the Northern, Southern and Central Districts seems to be a function of the firm personal views (as manifested in letters and interviews) held by the three directors of those regional districts against an expansive fresh-start policy in bankruptcy. Underlying the suspicion and, at times, resentment held by the three regional directors of the Official Receiver in the creditor-oriented camp towards the liberalised fresh-start policy is a firm belief that bankruptcy should primarily serve the interests of creditors. The regional directors of the Official Receiver in these three districts have pursued various practices that condition valuable bankruptcy-related debtor's relief on either the debtor furthering the creditors' interests or the debtor obtaining creditors' consent.

For example, the Official Receivers in these three districts have opposed, on many occasions, the debtor's request to reduce the monthly payments the debtor is required to make, reasoning that such relief would impair the creditors' interests in obtaining a meaningful repayment. Also, the Official Receiver in the Central District generally withholds its support for debtor's adjudication as bankrupt unless the few creditors who participate in the process consent. Similarly, the Official Receiver in the Southern and Northern District have withheld their support for debtor's adjudication as bankrupt when they were convinced that the debtor had failed to exert maximum efforts to repay his creditors prior to and during bankruptcy. Lastly, the Official Receiver in the Northern District has an unofficial policy of opposing the debtor's discharge unless he has made payments for a number of years that have reduced the principal balance owed to creditors by at least half.<sup>53</sup>

<sup>53</sup> See Interview with L Bar-Oz, Director of the Northern District's Official Receiver, in Haifa, Israel (9 July 1998).

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1 Also, underlying the distrust and, at times, bitterness of these three regional  
2 heads of the Official Receiver towards the liberalised fresh-start policy is an  
3 unyielding belief that most petitioners are abusing the system and only a  
4 number of deserving debtors should be entitled to bankruptcy relief. To be  
5 regarded as a deserving petitioner, the regional heads of the Official Receiver in  
6 the pro-creditor camp generally must be convinced that the petitioner's current  
7 lifestyle and standard of living are modest. To that extent, the Official  
8 Receiver's investigative unit routinely conducts surprise visits to petitioners'  
9 homes to ascertain whether their standard of living is sufficiently low to justify  
10 adjudication as bankrupt or a reduction in monthly payments. The investigative  
11 unit also conducts the following: a comprehensive search and valuation of the  
12 debtor's assets; one-on-one questioning sessions with the debtor; interviews of  
13 third parties to ascertain the debtor's good faith in becoming insolvent; a  
14 thorough inquiry into the causes of the debtor's bankruptcy; and a review of the  
15 debtor's historical financial performance.

16 Lastly, to be regarded as a deserving petitioner, the debtor must not have  
17 engaged in what the regional heads of the Official Receiver in the pro-creditor  
18 camps deem to be irresponsible conduct. In one case, a pro-creditor regional  
19 head of the Official Receiver opposed the debtor's discharge application partly  
20 because the debtor 'irresponsibly' invested in the stock market. In another case,  
21 a pro-creditor regional head of the Official Receiver opposed the debtor's bank-  
22 ruptcy adjudication because the debtor acted 'irresponsibly' when he previously  
23 got involved in a number of business ventures that have had failed or that were  
24 poorly managed.

## V. CONCLUSION

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28 Modern western legal institutions have generally followed the trend of liberal-  
29 ising their approach to dealing with financially troubled individuals in the  
30 bankruptcy setting. In contrast, the legal institutions in various Jewish commu-  
31 nities in the Diaspora and now in Israel have followed a somewhat different  
32 trend. While initially the Jewish tradition was largely obsessed with promoting  
33 the dignity and freedom of the financially troubled individual debtor, it has  
34 gradually adopted more restrictions, limitations and penalties against such an  
35 individual. Unfortunately, this trend has been reinforced and vigorously  
36 pursued in Israel during most of its first 50 years.

37  
38 To a large extent, this evolution of the fresh-start policy in Israel has been  
39 shaped by the Israeli government's paternalistic orientation.<sup>54</sup> This attitude is

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41 <sup>54</sup> Others have also referred to the Israeli government policies as paternalistic. See Y Aharoni,  
42 'The Israeli Economy: Dreams & Realities' (London, Routledge, 1991) 328; SN Lehman-Wilzig,  
43 'Wildfire: Grassroots Revolts in Israel in the Post-Socialist Era' (Albany, State University of New  
44 York Press, 1992) 22–31; L Sebba, 'Sanctioning Policy in Israel—An Historical (1996) Overview' 30  
*Israel Law Review*. (1996) 234 at 249–56 (describing the penal system in Israel as both welfarist and  
paternalistic).

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reflected in the bankruptcy context by the system's heavy-handed and punitive approach of treating the bankrupt, while at the same time providing a broad level of property exemptions, and, whether or not bankrupt, generous welfare benefits. The government's paternalistic orientation is also reflected in the rationale the government advanced historically for restricting debtors' access to bankruptcy. On several occasions, legislative opponents of a more liberal fresh-start policy contended that it would not be in the debtors' best interests to file for bankruptcy and that the limited access offered to bankruptcy was justified as a way of preventing the debtors from harming themselves.

Moreover, the government's paternalistic orientation is manifested in the active role it has traditionally taken in the debtor-creditor relationship. To that end, the government has undertaken the de facto responsibility of collecting unpaid debts in the market place even on behalf of private creditors. This stems from the government's belief that it must collect these debts as a way of instilling morality and integrity in the country's commercial system. To accomplish those goals, the government has traditionally subsidised and continues to date to subsidise the costs of the debtors' prison system for defaulting debtors and fully finances the costs of the Official Receiver in bankruptcy. The Official Receiver is the governmental agency engaged in what one would expect the creditors to do: investigate the reasons for the financial failure of the bankrupt and vigorously search for his or her concealed assets.

While government officials continuously complain about the rising costs of administering the bankruptcy system, they have not considered turning over the enforcement role to the creditors. Instead, they have placed the blame of cost overruns on the bankrupts by severely curtailing their access to the system. Moreover, by assuming the role of debt collector, the government has not only committed valuable public funds to this endeavour, but has also indirectly contributed to an environment whereby the creditors have passively sat on the sideline while they have delightfully accepted the bankruptcy estate's distributions generated primarily through the government's labour-intensive work.

The 1996 reform of the bankruptcy laws clearly marked an important departure from the traditionally conservative approach to the fresh-start policy in Israel. Regrettably, the groundbreaking 1996 bankruptcy reform has not been uniformly implemented. This chapter summarises evidence that supports the proposition that the internal legal culture has contributed to the wide disparities in bankruptcy practices followed by the various judicial districts in Israel. Indeed, the values, attitudes and beliefs shared by key government officials from the Official Receiver's administrative office seem to be playing the critical role in shaping practices in the Israeli personal bankruptcy system.

In addition to demonstrating the dramatic impact of the Official Receiver institution on the legal culture in the Israeli bankruptcy system, the chapter calls into question the present role of the Official Receiver in the bankruptcy regime. As stated earlier, like its counterpart in the United States and Canada, the Official Receiver in Israel has a facilitative role in the bankruptcy process. It



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1 serves as a depository of bankruptcy documents and as a liaison between the  
2 debtor, the creditors and the court. However, in stark contrast to its counterpart  
3 in the United States and Canada, the Official Receiver in Israel has assumed an  
4 investigatory role in the bankruptcy process. In that capacity, the Official  
5 Receiver routinely conducts an exhaustive investigation of the debtor's financial  
6 condition and the causes of bankruptcy.

7 These painstaking investigative efforts by the Official Receiver not only  
8 unduly infringe on the debtor's privacy, but also are inefficient and only mar-  
9 ginally effective. The Official Receiver's sweeping investigatory efforts unduly  
10 infringe on the debtor's privacy because they are highly intrusive. Admittedly,  
11 most of the Official Receiver's investigatory efforts are aimed at promoting the  
12 creditors' legitimate collection interest. Nonetheless, invasion of privacy  
13 inevitably results when a government agent from the Official Receiver conducts  
14 surprise inspections of a debtor's home to ascertain whether the debtor  
15 possesses any consumer goods that are deemed luxuries, such as brand name  
16 appliances, a personal home computer or a relatively new car. Infringement of  
17 the debtor's privacy also results when an Official Receiver's agent suggests to  
18 the court that the debtor's request for bankruptcy relief should be denied  
19 because the debtor has incurred certain 'unnecessary expenses,' such as  
20 television cable fees or newspaper subscription fees.

21 Beyond privacy concerns, the current role of the Official Receiver raises some  
22 efficiency concerns. Since creditors are arguably the more efficient risk bearers  
23 in a credit transaction,<sup>55</sup> it is the duty of legislators to provide creditors with  
24 incentives to engage in due diligence when extending credit. However, when a  
25 government assures creditors that it will undertake and finance investigation  
26 and collection activities for the creditors' bad debt, it provides little incentive for  
27 creditors to engage in the necessary level of due diligence. By handling and pay-  
28 ing for most of the collection costs in bankruptcy, the government in Israel has  
29 reduced the costs of bad loans to creditors, and thereby made the need for cred-  
30 itors' due diligence less apparent. Further, by agreeing to finance investigative  
31 costs in bankruptcy, the government has assumed a role that presumably can be  
32 handled just as effectively but with more efficiency by creditors, who are in the  
33 business of lending and collecting money.<sup>56</sup> The efficiency argument against a  
34 government role in investigating insolvencies is particularly compelling in the  
35 Israeli bankruptcy system since relatively sophisticated creditors—primarily  
36 financial institutions—are by far the largest creditors in the pool of bankruptcy  
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39 <sup>55</sup> See SL Harris, 'A Reply to Theodore Eisenberg's Bankruptcy Law in Perspective' (1982) 30  
40 *UCLA Law Review* 327 at 362; M Howard, 'A Theory of Discharge in Consumer Bankruptcy' 48  
41 *Ohio State Law Journal* (1987) 1047 at 1063-4; TH Jackson, 'The Fresh-Start Policy in Bankruptcy  
42 Law' 98 *Harvard Law Review*. (1985) 1393 at 1399.

43 <sup>56</sup> To address the collective action problem, whereby some creditors may be reluctant to under-  
44 take collection costs and then have to share with other creditors the benefits derived from such  
efforts, reform legislation may consider the establishment of a creditors' committee feature,  
whereby costs of the committee will be borne by the bankruptcy estate.

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creditors.<sup>57</sup> Lastly, from an overall public policy consideration, it seems unnecessary and unwise to use scarce public resources to subsidise the enormous investigation and collection efforts relating to bad credit extended largely by sophisticated, private creditors.

Finally, the current role of the Official Receiver in Israel is not cost effective. While no exact figures are available, the expanded role of the Official Receiver in the Israeli bankruptcy system is costly.<sup>58</sup> The fixed, as well as the marginal costs associated with retaining a staff of investigators, financial analysts, attorneys and administrators who are expected to vigorously lead the investigative efforts relating to each bankruptcy petition must be significant. The costs seem to be especially unjustifiable in light of the small potential returns to creditors in most cases. While no published data is available on the actual bankruptcy repayment rate, the repayment rate in the parallel system of civil judgment execution, where the government is equally involved in the collection process, is a dismal five per cent of total debts.<sup>59</sup> Similar concerns about the cost effectiveness of an expansive government role in the bankruptcy system were voiced in England in the early 1980s, before it abandoned the discretionary discharge regime.<sup>60</sup> Scholars in the United States have also expressed uneasiness about the cost effectiveness of proposed legislation that would have mandated a larger governmental role in personal bankruptcy.<sup>61</sup>

A reconceptualisation of the Official Receiver's role in the Israeli bankruptcy system should take the burden and expense of investigation away from the Official Receiver. Such a move might prompt creditors to extend credit more efficiently, and assume the role and costs of bad-debt investigation. This shift would eliminate unnecessary public expenditure and make the creditors bear the collection costs arising out of defaults. This would place the burden of default on the party presumably able to absorb the costs most efficiently.

In addition to reducing the government's role in bankruptcy, there is an urgent need to give debtors more power. As suggested earlier, due to lack of representation, bankruptcy petitioners in Israel are largely uninformed about their rights and hence they rarely assert them. Instead they tend to rely on the Official

<sup>57</sup> More than 50% of the debtors' average total debts are owed to relatively sophisticated financial institutions. The average debt owed by the bankrupt population to financial institutions was 562,642 NIS. The average total debt owed by the bankrupt population was 1,120,942 NIS. A similar finding was reported in a Canadian bankruptcy sample. See I Ramsay, 'Individual Bankruptcy: Preliminary Findings of Socio-Legal Analysis' (1999) 37 *Osgoode Hall Law Journal* 15 at 53–4 ('Debts owed to financial institutions represent over two-thirds of total debt outstanding.').

<sup>58</sup> See A Shaharabani-Bomgertan *et al.*, 'The Reform in Bankruptcy Law' (1996) 7 *Haglim* 14 at 14.

<sup>59</sup> See R Harris, 'From Imprisonment to Discharge: Setting an Agenda for Reform in Debtor-Creditor Law' (2000) 23 *Tel-Aviv University Law Review* 641 at 641, quoting a newspaper article that reported that only 5% of debts submitted for collection in the Israeli judgment execution system are collected despite the substantial public resources expended on the collection undertaking.

<sup>60</sup> See DG Boshkoff, 'Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings' (1982) 131 *University of Pennsylvania Law Review* 69 at 102.

<sup>61</sup> See E Warren, 'The Bankruptcy Crisis' (1998) 73 *Indiana Law Journal* 1079 at 1090–1.

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1 Receiver for advice. Since the Official Receiver does not generally view itself  
2 as an advocate for debtors, the reliance of debtors on the Official Receiver is  
3 misplaced.

4 Debtor empowerment in Israeli bankruptcy practice could be achieved, to an  
5 extent, by making it possible for more debtors to be represented by attorneys.  
6 An increased rate of representation would result in increased access to available  
7 debt relief in bankruptcy, since attorneys would likely assert available rights on  
8 behalf of the debtors and as the attorneys would presumably serve as a watch-  
9 dog against government and creditor overreaching. Recent elimination of pro-  
10 hibitions on attorney advertising<sup>62</sup> should, in the foreseeable future, enhance  
11 competition for rendering legal services, reduce the costs of legal representation,  
12 and lead to increased affordability and hence to a higher rate of represented and  
13 empowered debtors in the Israeli bankruptcy system.<sup>63</sup>

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41 <sup>62</sup> See Attorney Bar ordinances, 2001, KT 6094, 629.

42 <sup>63</sup> Empirical studies in the US suggest that increased advertising by attorneys reduces the price of  
43 legal representation in the long run. See Federal Trade Commission Staff, *Improving Consumer*  
44 *Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising* (November  
1984).

