25 November 2009

Mr Peter Hallahan
Committee Secretary
Senate Standing Committee on Legal and Constitutional Affairs
Parliament House
Canberra ACT 2600

Dear Mr Hallahan

Inquiry into the Bankruptcy Legislation Amendment Bill 2009

1. This submission is made by the Insolvency Practitioners Association (IPA) which is the peak professional body representing company liquidators, trustees in bankruptcy and other insolvency professionals.

2. By way of summary, the IPA generally *supports*

- the changes to fixing and reviewing trustee remuneration, although with some queries and comments raised;

- the regularising, and perhaps strengthening, of penalties for some bankruptcy offences,

- removal of the concept of Bankruptcy Districts;

- the increase in the stay period following a declaration of intent to file a debtor's petition, and

- the increase in the debt, income and asset tests thresholds for debt agreements.

3. The IPA *opposes* the increase to $10,000 in the minimum debt for a creditor's petition, which, we point out, is also proposed to apply to bankruptcy notices.

4. We make no particular submissions about the proposed penalties regime, or the long overdue removal of the concept of bankruptcy districts, or the increase in the stay period after a debtor makes a declaration of intent to file a debtor's petition, or the proposed increase in the debt, income and asset tests thresholds for debt agreements. If the Committee requires any particular comments on these issues, we would be pleased to assist.

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$10,000 limit

5. The amount has been set at $2,000 for some time. That figure was proposed in the Harmer Report[1] in 1988 and reasons for that relatively low amount were discussed [391-394].

The Explanatory Memorandum

6. The Explanatory Memorandum to the Bankruptcy Legislation Amendment Bill 2009 gives a number of reasons why that figure needs to be raised. We address those as follows and explain why we disagree with those reasons, or at least say that more information is required before they can be assessed.

7. The Explanatory Memorandum says [133] that

> *"(i)t is wrong to set in motion all the machinery of bankruptcy for the purpose of winding up a debtor's estate when, as is often the case, one creditor has a debt due to him of an amount not much more than $2,000".*

8. This sentence and some following have been taken directly from the 1962 Clyne Committee Report on the operation of the then bankruptcy legislation. That Report said[2]

> *"it is wrong to set in motion all the machinery of bankruptcy for the purpose of winding up a debtor's estate when, as is often the case, one creditor has a debt due to him of an amount not much more than [Fifty pounds] and the assets and liabilities of the debtor are negligible" [emphasis added].*

9. The Clyne report gives a more accurate statement than the Explanatory Memorandum, that the machinery of bankruptcy should not be available in a case where "the assets and liabilities of the debtor are negligible". The Report did go on to say that the amount should be increased "substantially" and that was accepted. However the Clyne Report also noted that an earlier UK report had rejected an increase because "the figure did not have any bearing on the size of the bankruptcy based on the total liabilities and that to increase the figure must have the result of preventing some creditors from making use of the bankruptcy procedure ...".[3]

10. In that respect, the Explanatory Memorandum [134] says that

> *"(d)uring 2008-09, of 1953 sequestration orders made across Australia and matched by amounts in Bankruptcy Notices, 1551 were for an amount greater than $10,000; 217 were for an amount between $5,001 and $10,000; and 174 were for an amount between $2,000 and $,5000".*

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[1] ALRC 45

[2] At [76]

[3] At [77]

11. That is hardly a relevant or helpful contribution to the debate. It does not go on to show whether, for example, in those 174 estates where the creditor's debt was under $5000, (or the 391 under $10,000) how many debts were in fact owed to all creditors; that is, whether in the Clyne Report's analysis, the assets and liabilities of the debtor were "negligible". Conceivably, there could be many creditors owed thousands of dollars. It is information which should have been the subject of dissemination. Some information does show for example that in 2007, 8% of bankrupts had debts below $5,000, another 8% up to $10,000, another 17% up to $20,000, and so on.[4] However, there is no known published correlation between the amount of the petitioner's debt and the amount of the total debts. Some feedback we have from IPA members is that the size of the petitioner's debt is not indicative of the amount of debts generally in estates - that is, a $2,000 debt may reveal total debts of $1 million; or, a $10,000 debt may in fact comprise a total of only $20,000 in debt.

12. Also, while it might be said that a person should not be made bankrupt for a debt of only $2,000, it may also be that if a person cannot pay $2,000 to a creditor, or secure funds to do so, then that may be as much or more an indicator of insolvency as not being able to pay $10,000.

13. The consequence of raising the threshold may be that many insolvent persons are unfairly protected from compulsory bankruptcy. Some petitioners properly pursue bankruptcy for smaller amounts for important policy reasons, or for unlawful conduct, for example in relation to unpaid workers compensation premiums by an employer, non-payment of which is a serious breach of an employer's obligations.

14. As a final comment on this issue, it should be noted that there is no minimum debt figure for the voluntary presentation of a debtor's petition. The only limitation is that, in 2002, the law was changed to allow the Official Receiver to refuse voluntary bankruptcy to a person on certain conditions, including whether their debts could be paid within a certain time: s 55(3AA) *Bankruptcy Act*. According to the relevant Explanatory Memorandum [90] the purpose of the subsection "is to give the Official Receiver a discretion to reject a debtor's petition where it is plain to the Official Receiver that the petition is an abuse of the bankruptcy system".

15. The ITSA annual report for 2008-2009 says that there were 21 instances in that year when a petition was rejected by an Official Receiver as an abuse of the bankruptcy system. These abuses were out of a total of debtor petition accepted of over 25,380.

16. More information is needed on the question whether the size of the petitioning creditor's debt is connected with unnecessary setting in motion the machinery of bankruptcy.

17. The Explanatory Memorandum [133] correctly says that

> *"(i)t is an established principle of the law of bankruptcy that, when a creditor sets in motion proceedings in bankruptcy, they do so for the benefits (sic) of all the debtor's creditors".*

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[4] Personal Insolvency Trends in Australia 1990-2008, Ramsay & Sim (2009) 17 Insolv LJ 69 at 95-96

18. It follows from this principle that the amount of the debt upon which the bankruptcy is based is not that important; it is only a trigger that may then reveal many other and larger debts of other creditors. Indeed a creditor with a larger debt is entitled to either await the outcome of any bankruptcy action by a smaller creditor, or apply to support those proceedings.

19. The Explanatory Memorandum also says [133] that

> *"(r)aising the amount of the petitioning creditor's debt will lessen the opportunity to use bankruptcy procedures as a debt collection process".*

20. There are adequate measures under the law for any inappropriate use of bankruptcy procedures as a debt collection process.

21. The limitations under the law on a creditor using bankruptcy notices to recover debts, such that there is an abuse of process, are quite restrictive. In brief, the law is that an abuse of process "may be made out if the purpose in issuing the bankruptcy notice is to put pressure on a debtor to pay the debt rather than to invoke the Court's jurisdiction in relation to insolvency": see *Yang v Mead* [2009] FCA 1202 and cases there cited. This can come down to the issue whether the creditor knew the debtor was in fact solvent. A creditor will invariably not know the state of the debtor's solvency, only that their own debt is not paid. It would be a rare case where a creditor would be found to have committed an abuse of process based on debt recovery alone.[5]

22. As to creditor's petitions, it is the court that makes the decision whether a person should be made bankrupt and whether the creditor's claim is an abuse. The court has an inherent discretion not to make a bankruptcy order: s 52 BA. A court could dismiss a petition for a petitioner's small debt, in its discretion, but that would be unusual. The court may dismiss a petition if it has evidence of the debtor's solvency, even though the creditor's debt has not been paid.[6]

Debt recovery laws

23. A bankruptcy notice may therefore be legitimately be used to recover a debt. To the extent that it may be overused that way, is perhaps an indication of the inadequate state of Australia's debt recovery laws. They are state based and hence inherently uncoordinated. Recovering a debt 'interstate' is an added burden to a creditor. The bankruptcy laws are federal and this issue does not arise. We have not reviewed the extent of implementation of ALRC 36 - Debt recovery and insolvency – where there laws were reviewed, and recommendations made but the reality is that using bankruptcy for the purposes of recoveries liabilities, within the limits of the law, is well used and acceptable. Any increase in the $2000 would serve to negate or limit that use.

Corporate comparison

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[5] See *Maxwell-Smith v S & E Hall Pty Limited, in the matter of Maxwell-Smith* [2006] FCA 825

[6] *Re Sarina* (1980) 48 FLR 372

24. The equivalent threshold in corporate insolvency is $2000: s 459E, s 9 CA. We are not aware of any suggestions that this figure needs to be changed.

If there is to be an increase

25. In the end result however, if the $2000 threshold were to be increased, we suggest a figure of $5,000.

Remuneration regulations

26. Much of the new remuneration regime is to be contained in the regulations rather than in the Bill itself. We consider that is a good approach because it allows the provisions to be amended more readily as experience with the new regime develops. The IPA has already been asked its initial views on the regulations, by the Attorney-General's Department, in particular as to remuneration.

Remuneration

27. As to remuneration, s 167 of the Bill preserves the right of a bankrupt (or a creditor) to have the Inspector-General review the trustee's approved remuneration.

28. That right to review seek a review of remuneration in corporate insolvency is only available to the court: s 473(6) *Corporations Act.* The IPA generally supports alignment of the laws concerning personal and corporate insolvency, except where the obvious differences necessitate that difference. In the case of approval and review of remuneration, we do not see that there is any reason for the two regimes to be relevantly different.[7]

29. However we appreciate that the review of a bankruptcy trustee's remuneration has been the subject of review for some period of time and the IPA is anxious for the issue to be resolved. Hence this Bill is perhaps not the right time for alignment in this area to be raised. We can agree that a remuneration review by the Inspector-General is satisfactory in the particular circumstances of personal insolvency, rather than simply leaving any review to the court.

30. However this right of a bankrupt or creditor to appeal to the Inspector-General should also be available to the trustee, for example if creditors approve remuneration at one half that claimed by the trustee for no valid reason. This right of a liquidator to appeal (to the court) exists in corporate insolvency: s 473(6) CA.

31. Proposed new section 167 says that the regulations may make provision for how this review is to occur. The IPA suggests that if this right of a bankrupt is to exist, then there should be some high threshold set for a bankrupt [or creditor] to seek to review approved remuneration. There is a long accepted policy of creditors having the authority to fix remuneration in insolvency. We suggest that the regulations should require the Inspector-General to take a 'gate-keeping' role to ensure that only valid and arguable reviews are allowed. This is important given that there is to be no fee or costs for a bankrupt to apply to review remuneration.

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[7] See generally *The alignment of the laws of personal and corporate insolvency* (2009) 9(5) INSLB 78

IPA Code of Professional Practice

32. Although these are issues more for the regulations, we wish to foreshadow that there should be set criteria which have to be met before a review can proceed. These criteria could include whether the trustee has had the remuneration approved by the processes stated in the IPA Code of Professional Practice, including an IPA remuneration report. That is not to say that mere compliance with IPA Code would preclude a review, but that it be one factor. The IPA Code and its principles and guidance on remuneration claims have been in operation since May 2008. The Code sets high standards for disclosure and claims of remuneration by its members.

Remuneration – s 167(1)-(4)

33. Section 167 is not clear whether the matters to be prescribed in the regulations are exhaustive, that is whether s 167(1)-(4) list the only matters which the regulations may prescribe. It may be wise to add "or other regulations necessary or convenient to be prescribed for carrying out or giving *effect* to this Act".

s 167(5)

34. Section 167(5) is satisfactory as it stands, but we suggest the right of recovery should be stayed while there is a review under s 167(6) pending.

reasons for decision

35. Section 162(4) requires the Inspector-General to give written notice of his or her decision as to the amount of the trustee's remuneration. We suggest that *reasons* for the decision should also be required, and words should be added to make that clear. That also applies to decisions under s 167, that reasons should be required. This is so in particular given there is a right of appeal to the court: s 167(7). Written and publicised reasons of the Inspector-General may assist in developing some guidance on remuneration claims.

Annual returns and statistics

36. There is a proposed requirement for an annual return to be lodged by trustees - s 170A (and s 185LEA, as to debt agreement administrators) - which formalises an existing requirement that trustees have had to attend to for some time. The IPA supports the collection of data on personal insolvencies and we would be interested to have input in relation to the information that is collected. As we say earlier in this submission, informed reform of the law requires proper statistical information to be available. At the same time, we would want to assess what work is required of a trustee in preparing and lodging this return, as the time cost would not be a necessary item of remuneration in an estate.

Court orders and the NPII

37. Section 52(1A) requires the creditor who obtained the sequestration order to give a copy to the Official Receiver within 2 days. In this age of electronic communications, we think there should be a requirement, or arrangement, for the court to immediately convey the making of the order to the Official Receiver, for

entry on the National personal Insolvency index (NPII). There is a reasonable expectation that the record is immediately accurate, well within two days, certainly in relation to the serious change of status that bankruptcy involves.

38. The Bankruptcy Rules of the Federal Court and the Federal Magistrates Court in fact refer to a search of the NPII being done "no earlier than the day before the [sequestration] hearing", with which the requirement in s 52(1A) should be compared. The Courts' Rules also require that "within 2 days after the entry is stamped" the creditor must give a copy of the order to the trustee and the Official Receiver. The sequestration order may not be stamped until a day after the order is made - rule 4.08(b). Compliance with section 52(1A) may not always be possible within these time frames.

39. The same comments are made in relation to s 244(14), 245(3) etc in relation to deceased bankrupt estates. See the Courts' Bankruptcy Rules at rule 11.04.

Drafting errors

40. Finally, there are known drafting errors in the *Bankruptcy Act*, many of which have been raised by the IPA and others over some period of time. The courts have also drawn attention to drafting deficiencies. For example:

- the relation back provisions in s 115;
- the discrepancy between the antecedent transaction provisions made applicable by s 231(3) to relation to personal insolvency agreements, and those made applicable by s 188A(4); and
- the deficiency in s 121 revealed by the High Court in *Peldan v Anderson [2006]* HCA 48.

41. This is a general bankruptcy law amendment bill. We suggest that any such errors in the existing *Bankruptcy Act* that are not contentious be remedied in this Bill.

42. Please contact the IPA's Legal Director, Michael Murray, if we can assist or explain further.

Yours sincerely

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Insolvency Practitioners Association