Legal Aid
NEW SOUTH WALES

Submission

Bankruptcy Legislation Amendment Bill 2009

20 November 2009

Submission on behalf of

Legal Aid NSW

to the

Senate Legal and Constitutional Affairs Legislation Committee

Legal Aid NSW is an independent statutory body established under the *Legal Aid Commission Act 1979* (NSW) to provide legal assistance, with a particular focus on the needs of people who are economically or socially disadvantaged. Legal Aid NSW provides information, community legal education, advice, minor assistance and representation, through a large in-house legal practice and through grants of aid to private practitioners. Legal Aid NSW also funds a number of services provided by non-government organisations, including 35 community legal centres and 28 Women's Domestic Violence Court Advocacy Services.

In the financial year of 2007-2008, Legal Aid NSW has provided client services to more than 184,800 clients with civil law matters including information, advice or representation. Legal Aid NSW solicitors frequently advise clients and litigate a range of matters under consumer protection legislation, including many that are credit-related. In the 2007 -2008 financial year, Legal Aid NSW funded approximately 300 consumer law litigation cases. Legal Aid NSW has recognised expertise in the area of consumer credit law and we contribute regularly to law reform at both a State and Federal level and particularly in relation to consumer law.

Introduction

Legal Aid NSW welcomes the opportunity to make a submission to the Committee.

The Explanatory Memorandum ('EM') describes two of the six objects of the Bill to be:

d) to increase the minimum debt for a creditor's petition to reflect changes in the economic environment;
e) to increase the stay period that follows a declaration of intent to file a debtor's petition to allow debtors to better assess their options.

Legal Aid NSW supports the above objects, but is concerned that the proposed amendments need modification to fully achieve these objects. In particular, Legal Aid NSW recommends:

1) that there be a further amendment of the Act to provide that, for the purpose of calculating the minimum debt necessary to petition for bankruptcy, assigned consumer debts be treated as if they are for the amount paid for them rather than their face value; and

2) that the requirement that a declaration of intent be accompanied by a statement of affairs be removed from this Bill.

Although Legal Aid NSW is supportive of the proposed increase of stay period, we are concerned that the amendment in its current state is likely to result in advisors not recommending use of the declaration of intent procedure. This is because non-business debtors are likely to be seeking urgent advice when they are under stress and it will not be advisable for them to file a statement of affairs at that time given the penalties that apply to the filing of inaccurate statements.

Legal Aid NSW is also concerned that early discharge provisions for non-business debtors have not been included in the current amendments. We submit that these provisions would have a significant impact not only on the debtors but also on the wider community by discouraging irresponsible lending.

Increasing the minimum amount of debt for the filing of a creditor's petition

The EM states '[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. Raising the amount of the petitioning creditor's debt will lessen the opportunity to use bankruptcy procedures as a debt collection process.'[1]

Legal Aid NSW agrees with this view. However, the amendments do not appear to address the issue of aggregated debts. It is the increasing experience of consumer advocates that consumer debts are being recovered by assignees whose principal business is the acquisition and recovery of consumer debts. These assignees have, in our experience, often acquired consumer debts for a fraction of their face value. They will also have the opportunity to amalgamate debts owing by a particular consumer to reach the increased minimum for the filing of a creditor's petition.

Legal Aid NSW is concerned that the proposed amendment increasing the minimum amount for which a Bankruptcy Notice can be issued to $10,000 will not prevent such aggregation as the use of such a notice is but one, albeit currently by far the most common, means of establishing the act of bankruptcy necessary to found the creditor's petition. For example, a creditor could also pursue a small debt and utilise the act of bankruptcy under s 40(1)(d) of the *Bankruptcy Act 1966* (Cth) which provides that an act of bankruptcy occurs:

> '(d) if:
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> (i) execution has been issued against him or her under process of a court and any of his or her property has, in consequence, either been sold by the sheriff or held by the sheriff for 21 days; or
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> (ii) execution has been issued against him or her under process of a court and has been returned unsatisfied.'

[1] Explanatory Memorandum – Bankruptcy Legislation Amendment Bill 2009 ('EM'), at pp 22-23.

The creditor could then rely on that act of bankruptcy to found a creditor's petition provided that the creditor could combine other amounts owed to it by that debtor to reach the statutory minimum.

Legal Aid NSW recommends that there be a further amendment of the Act to provide that, for the purpose of calculating the minimum amount necessary to petition for bankruptcy, assigned consumer debts be valued at the amount paid for them rather than at their face value.

Increasing the stay period that follows the declaration of intent to file a debtor's petition

Legal Aid NSW supports the increase of the stay period from 7 to 28 days 'to allow debtors to better assess their options'[2] but believes that this objective will not be achieved because of the proposal to amend s 54A of the Act to require that a declaration of intent to file a debtor's petition under s 54A must be accompanied by a statement of the debtor's affairs.

The rationale for this requirement is '[t]he requirement to file a statement of affairs will mitigate the risk of the debtor dissipating assets during the stay period.'[3]

Legal Aid NSW fails to understand this rationale in relation to non-business bankruptcies. It is our experience that 'the majority of bankruptcies relate to consumer debts and involve bankrupts with relatively few assets and little income. These bankruptcies tend to involve a bankrupt who has simply fallen on hard times rather than misdeed.'[4] For such bankrupts the dissipation of assets is not an issue.

On the other hand, if the aim of the stay is to give non-business debtors the opportunity to consider options other than bankruptcy, the requirement that the declaration of intent be accompanied by a statement of affairs is likely to defeat this object. This is because, from our experience, consumers will often be seeking advice when they are under severe stress because of recovery action by creditors. In such circumstances consumer advisors such as consumer lawyers and financial counsellors are unlikely to recommend to their clients that they rush into the filing of a statement of affairs to obtain the stay that accompanies a declaration of intent since serious sanctions are proposed to apply to the filing of an inaccurate statement of affairs. [5]

If the rationale has any relevance it would be relevant to those with assets they may dissipate and this issue would be more appropriately addressed by ensuring that the stay did not operate to prevent creditors taking action, such as the obtaining of a *Mareva* injunction, to prevent the dissipation of assets.

Legal Aid NSW recommends that the requirement that a declaration of intention be accompanied by a statement of affairs be removed.

[2] EM, at p.2.
[3] EM, at p.24.
[4] EM at pp.2-3.
[5] In its current form, the Bill proposes that the maximum penalty of 12 months applies to an inaccurate statement of affairs. See cl 12 of Schedule 4 Part 2 of the Exposure Draft which amends section 267 of the *Bankruptcy Act* 1966 (Cth).

Early discharge

Legal Aid NSW is disappointed that there has been no amendment to reintroduce an administrative procedure for early discharge similar to that which existed from June 1992 to May 2003.

In this respect we endorse the sentiments expressed in the Australian Law Reform Commission in the report *Insolvency: the Regular Payment of Debts*:

> 'In our view, what conduces to rehabilitation may vary from case to case. If the bankrupt is to truly rehabilitated, his present debt difficulties must first be cured. In addition, he must return to the market with an improved sense of budgeting and of the danger of over-commitment of meagre income. Finally, he must have a proper understanding of credit and a sense of his own responsibilities in the payment of obligations freely undertaken. Rehabilitation and the heightened sense of the obligation to pay one's debts may be furthered by requiring income contributions in a minority of cases. It will certainly not be furthered when such a requirement would impose hardship on the bankrupt and his family. Nor will it be enhanced by rules which delay discharge to those whose circumstances do not permit repayment of their debts. Honest bankrupts require education and assistance. They do not require punishment.'[6]

The report then went on to recommend a six-month discharge period for non-business debtors.

When the Senate Legal and Constitutional Legislation Committee considered the legislation which proposed to, and ultimately did, abolish the early discharge provisions the Labor Senators' Minority Report stated:

> 'The public hearing into the Bills was characterised by a complete lack of evidence as to the need for the abolition of the early discharge provisions. Mr Donald Costello, Acting Adviser, Insolvency and Trustee Service Australia, who provided evidence to the Committee on the policies underlining the proposed changes, summed this up:
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> > There are no statistics which would be available to help make a decision as to whether or not early discharge is an appropriate regime to have. All we can provide is feedback from Credit Union Services Corporation of Australia, which is a significant lending group representing a substantial number of credit unions, plus persistent correspondence from mainly small business creditors over the years who say that it is too easy for people to walk away from their debts.
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> Given the absence of anything other than anecdotal evidence, Labor Senators are reluctant to endorse the approach taken in the Bill.'[7]

The author of a subsequent article in the Melbourne University Law Review considered the arguments for and against administrative early discharge and concluded that it should be reintroduced. He considered some statistics in relation to the early discharge regime which applied from 1992 to 2003. The author found that:

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[6] ALRC Report No 6 (1977), *Insolvency: The Regular Payment of Debt*, at p 68.
[7] Senate Legal and Constitutional Legislation Committee (2001) *Inquiry into the Provisions of the Bankruptcy Legislation Amendment Bill 2001 and the Bankruptcy (Estate Charges) Amendment Bill 2001,* at p.22.

> 'At the end of the 2001-02 financial year, 3.3 per cent of bankrupts who had received an early discharge since 1 July 1992 had gone bankrupt again. This compares favourably with the 7.2 per cent who received a standard discharge and went bankrupt again during the same period.'[8]

This not only challenges the view that the availability of early discharge encourages people to run up debts with a view to avoiding them by way of a 'too easy' bankruptcy but also challenges the view that six months was too short a period for debtors to become better financial managers.

The article's author acknowledged problems with the design of the 1992-2003 regime, for example the discriminatory impact on women of the income requirements in relation to joint debts. However, he argued that these sorts of arguments did not justify abolition of the scheme. The regime should have been modified instead.

The experience of Legal Aid NSW is that bankruptcy with provision for an administrative application for early discharge by consumer bankrupts should not be considered as an 'easy' option, particularly in light of the following considerations:

- The bankruptcy will be recorded on the debtor's credit record for seven years from the date of commencement making it difficult to obtain rental accommodation in the debtor's name and to obtain credit.
- The bankruptcy will remain on the National Personal Insolvency Index for life.
- Not all debts are extinguished, eg court imposed fines.
- Permission needs to be obtained to travel overseas.
- Employment may be affected, eg in the building industry where a licence is required, or where the person is in an occupation (such as courier service) which requires the person to operate his/her own company in order to meet 'independent contracting' arrangements.
- Contributions from income may be required.
- Assets, other than 'protected' assets, will be sold.
- Certain types of legal rights, such as the right to sue for a debt, will cease to be the property of the debtor.
- The ability to litigate certain types of legal actions will be subject to the trustee granting permission.

It is also our experience that debtors do not see bankruptcy as an 'easy' option and are often resistant to suggestions of bankruptcy even in situations where they are hopelessly indebted.

Legal Aid NSW submits that administrative early discharge in the case of non-fraudulent non-business debtors where there is no real prospect of further recovery on behalf of creditors:

- facilitates the rehabilitation of debtors making them more likely to contribute to the economy and less likely to be reliant on the public purse in future;
- reduces the administrative expenses of running the personal insolvency system and frees up money to be used for financial counselling and education; and
- is appropriate given that, according to debtors' statements of financial affairs for 2007-08, 55.32% of non-business bankruptcies were attributed to unemployment,

[8] King, J. [2004] *Moving Beyond the 'Hard'-'Easy' Tug of War: A historical, empirical and theoretical assessment of bankruptcy discharge.* Melbourne University Law Review 22.

domestic discord, or ill health as opposed to 27.55% being attributed to excessive use of credit.[9]

Many of the arguments against early discharge have asserted that early discharge will make bankruptcy 'too easy'. Legal Aid NSW rejects these arguments for the reasons listed above. We also note that from our experience of advising clients in relation to credit problems, many such problems can be attributed to irresponsible lending, particularly in the area of unsolicited credit. Often it is not worth challenging such lending because the client has received a benefit which they will need to repay and they cannot afford to repay this benefit even if there is a finding of unjustness or maladministration, or because the client seeks assistance when it is too late to do anything. Nevertheless it is our experience that these types of practices are significant in forcing people into bankruptcy.

Legal Aid NSW recommends that consideration be given to the early discharge of bankruptcy in the proposed amendments.

Concluding remarks

Legal Aid NSW welcomes the opportunity to provide these comments. Should you require further information, please contact John Moratelli

[9] Inspector-General in Bankruptcy on the operation of the *Bankruptcy Act*. Annual Report 2007-2008, at p.17.