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Bankruptcy Legislation Amendment Bill 2002

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I N F O R M A T I O N A N D R E S E A R C H S E R V I C E S

Bills Digest
No. 142 2001-02

Bankruptcy Legislation Amendment Bill 2002

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Law and Bills Digest Group
15 May 2002

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Bankruptcy Legislation Amendment Bill 2002

Date Introduced: 21 March 2002

House: House of Representatives

Portfolio: Attorney-General

Commencement: On Proclamation.

Purpose

To make a number of significant changes to the *Bankruptcy Act 1966* which, it is hoped, will encourage debtors to seriously consider using alternatives to bankruptcy where possible, and will make bankruptcy less of an ‘easy option’.

Background

Most of the provisions in this Bill (the 2002 Bill) were contained in the Bankruptcy Legislation Amendment Bill 2001 (the 2001 Bill). The 2001 Bill was introduced into the House of Representatives on 7 June 2001. It was ultimately passed by the Senate on 27 September. But it lapsed when Parliament was prorogued for the 2001 General Election.

This Digest is written against the background of the Digest of the 2001 Bill. The purpose of this Digest is to trace through the issues raised in the Senate and by the Senate Legal and Constitutional (Legislation) Committee in their consideration of the 2001 Bill. The material in the 2001 Digest is not reproduced here, except to help explain the these issues.

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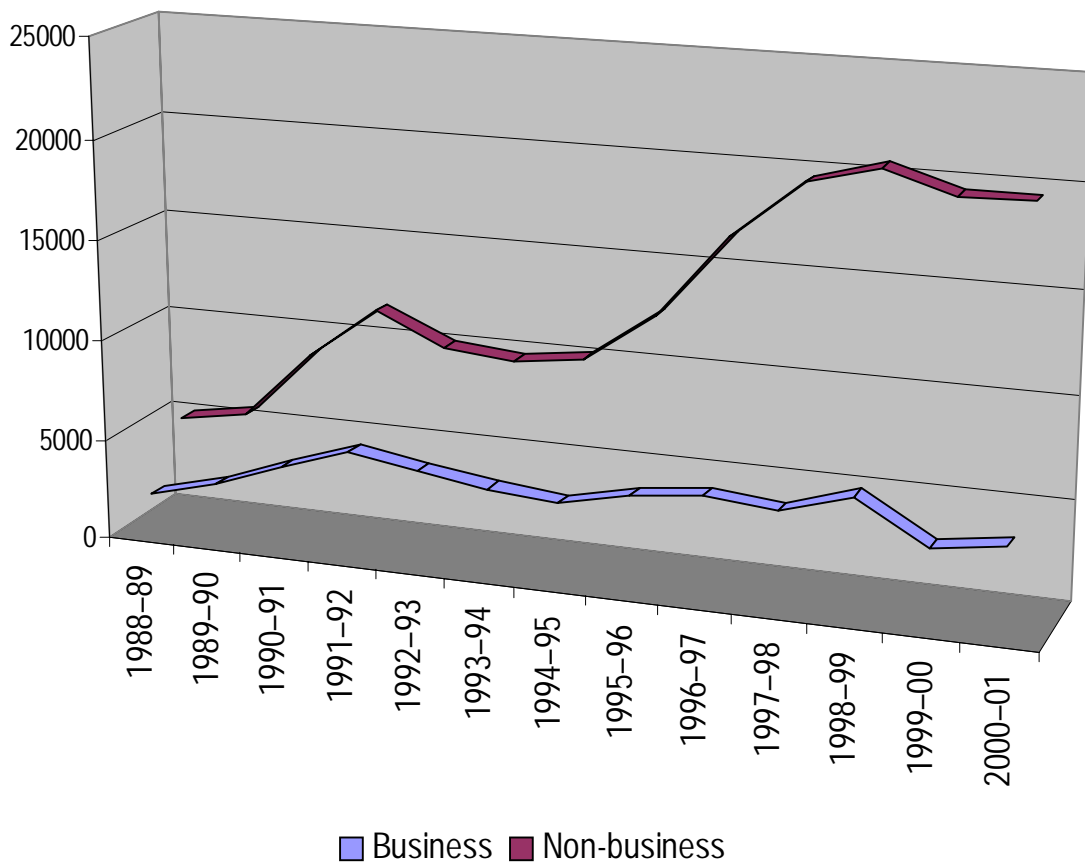
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Increase in Bankruptcies

Bankruptcies have increased threefold over the past ten years to a level of 23 298 in 1999-2000, compared with 8493 in 1989-1990. However, there have been fluctuations in the annual number of bankruptcies over time. The majority of bankruptcies are not business-related. In the financial year 1999-2000 there were 3899 (16.7%) business-related bankruptcies¹ and 19 399 (83.3%) non-business bankruptcies. The proportion of business-related bankruptcies has halved in the last 10 years, from 34.7 per cent in 1989-90.²

Business and Non-Business Bankruptcies 1988/89 – 2000/01³

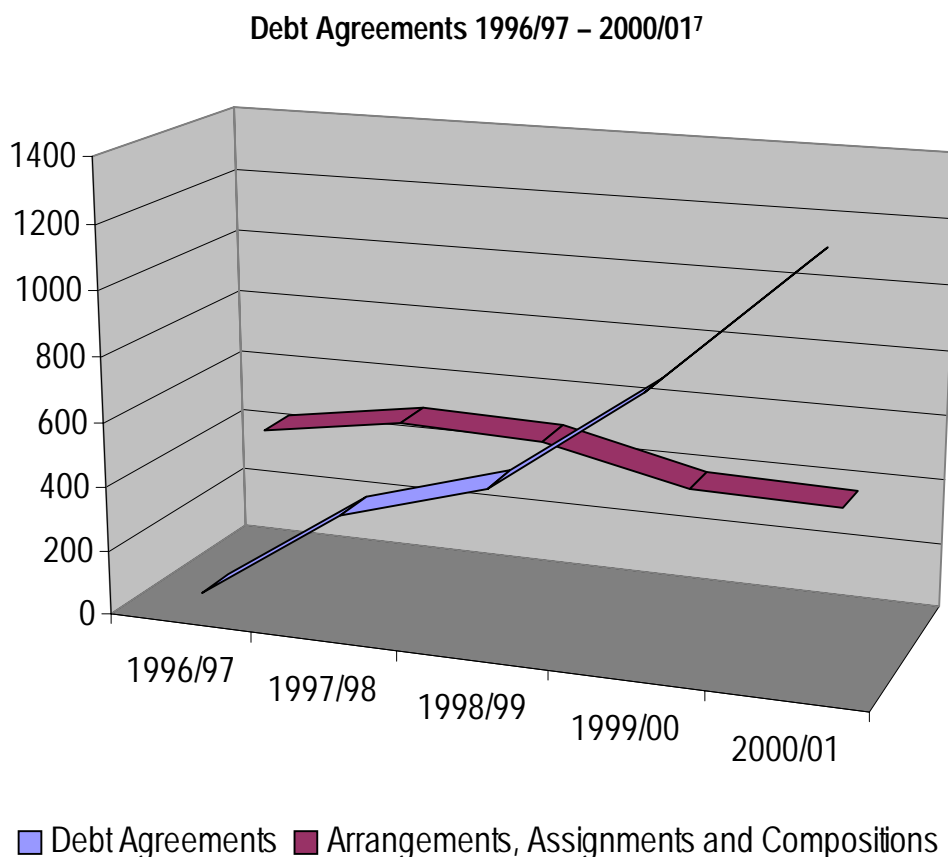


There were also 801 Part IX debt agreements accepted by creditors in 1999-2000.⁴ The use of debt agreements has increased exponentially since they were first introduced in 1996. There were 47 debt agreements in 1996-1997, 369 in 1997-1998, and 480 in 1998-1999.⁵ Moreover, the number of debt agreement *proposals* has 'risen sharply' in the last year 'to around 420 per month, well over double the rate of 2000-01'.⁶

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In contrast to bankruptcy and other alternatives to bankruptcy, the use of Part X arrangements has declined significantly. In 1999-2000, only 453 arrangements, assignments and compositions under Part X were accepted,⁸ compared with approximately 800 a decade ago.⁹ This decline is not solely attributable to the introduction of the alternative Part IX debt agreements, as it began several years prior to 1996.

Commenting on the general increase in the incidence of bankruptcy, Terry Gallagher, the Inspector-General in Bankruptcy, has stated that '[w]hile it is no easier to go bankrupt now than it has been for many years,' the increase in bankruptcies has had a range of contributory factors such as 'excessive borrowing prompted by ready credit availability, perceptions of attainable living standards and a lessening of the stigma of bankruptcy'.¹⁰

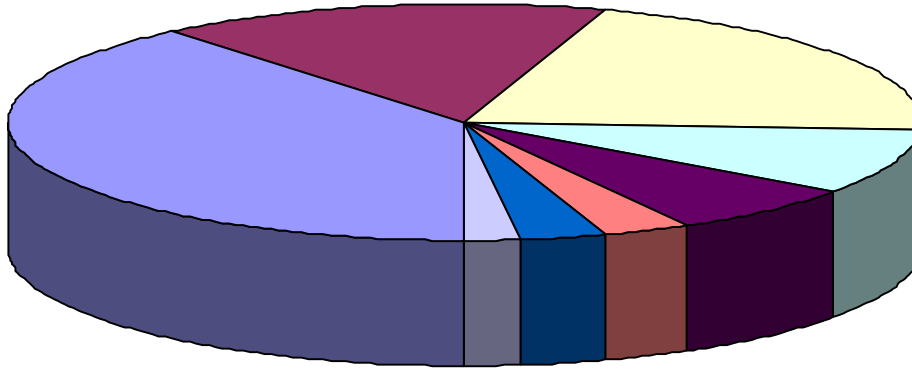
At any given time, the key causes of non-business bankruptcy, identified by the bankrupts, seem to be unemployment, followed by domestic discord and then excessive use of credit.

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Stated Causes of Non-business Bankruptcy 2000/2001¹¹



- | | | |
|-----------------------------|---------------------------|---------------------------|
| ■ Unemployment | ■ Domestic discord | ■ Excessive use of credit |
| ■ Ill health | ■ Adverse litigation | ■ Gambling or speculation |
| ■ Liabilities on guarantees | ■ Other causes not stated | |

The Issues

The Digest to the 2001 Bill stated that the major reforms it proposed were:

- the introduction of a mandatory 30 day cooling-off period to encourage debtors to enter into a settlement with creditors
- giving the Official Receiver a discretion to reject a debtor's petition which appears to be an abuse of the bankruptcy process
- the abolition of early discharge provisions
- strengthening trustees' power to make objections to discharge
- strengthening the Court's power to annul bankruptcy, and
- doubling the income threshold for debt agreements.¹²

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The Digest grouped the major reform proposals into three main groups: 'provisions aimed at making bankruptcy more difficult, those which encourage use of alternatives to bankruptcy, and those which address abuses of the bankruptcy system'.

Making bankruptcy more difficult

The key issue in making bankruptcy more difficult was the early discharge provisions.

Currently, the standard period of bankruptcy is three years.¹³ After three years, bankruptcy is automatically discharged unless an objection to discharge is lodged. However, a bankrupt is eligible for early discharge of bankruptcy at any time after 6 months, if he or she satisfies certain criteria. Early discharge is only available for those on a low income who are unable to pay their creditors at all, or who are unable to pay the trustee's remuneration and expenses in full.¹⁴ A person may not apply for early discharge if his or her debts exceed 150 per cent of his or her income, or he or she is otherwise disqualified.¹⁵

The 2001 Bill proposed to abolish the early discharge provisions altogether.¹⁶ This would make the minimum period of bankruptcy three years without exception.

The former Minister for Justice and Customs explained the abolition of early discharge provisions by saying: 'many creditors feel that the possibility of being released from bankruptcy after six months does not reflect the serious nature of the decision to become bankrupt.'¹⁷ It was also felt that early discharge provisions 'discourage debtors from trying to enter formal or informal arrangements with their creditors to settle debts, and provide little opportunity for debtors to become better financial managers'.¹⁸

Other justifications advanced by the Government were:¹⁹

- they were initially intended to apply to those who became bankrupt out of misfortune rather than misdeed, but it seems inappropriate to thus imply that all those with some assets or income have been guilty of incurring debts in bad faith, and
- they apply in a discriminatory way, by excluding women who have joint debts with, and generally a lower income than, their spouse, and thus are caught by the 150% rule.

However, the Digest noted an earlier proposal to reduce the standard period of bankruptcy to two years rather than three,²⁰ as a trade-off for removing the early discharge. It noted that this proposal had not been carried through in the provisions of the 2001 Bill.

Encouraging the use of alternatives to bankruptcy

The main issue under this heading was a proposed 30 day cooling-off period.

Currently, there is effectively an optional 7 day cooling-off period in the *Bankruptcy Act 1966*. This arises because a debtor has a choice to simply present a debtor's petition for bankruptcy, or to first present a declaration of intention to present a debtor's petition. If a debtor lodges a declaration of intention, a 7 day stay period applies during which most debts (excepting secured debts and child maintenance obligations) are frozen and cannot

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be enforced by creditors.²¹ At the end of this period, the protection is removed, and the debts become enforceable again. A debtor may, but does not have to, present a debtor's petition after lodging a declaration of intention.

The 2001 Bill repealed the provisions dealing with a declaration of intention and the 7 day stay period because it proposed the introduction of a mandatory 30 day cooling-off period after a debtor's petition is presented. Under this proposal debtors would not become bankrupt until 30 days after presenting their petition. This would have given debtors who may have acted hastily an opportunity to reconsider whether bankruptcy is the best option and creditors an opportunity to negotiate an alternative arrangement with the debtor.²²

The 2001 Bill also sought to double the income eligibility threshold for Part IX debt agreements. These agreements are intended to provide a simple, low cost alternative to the various Part X arrangements. They are currently only available to debtors whose annual after-tax income is less than \$32 041. This relatively low threshold has been criticised as denying a considerable number of debtors 'any realistic alternative to bankruptcy'.²³

The Digest noted support for the expansion of eligibility for debt agreements, which will allow many middle income earners to access this alternative to bankruptcy. At the same time, however, it noted concern that this could result in low-income debtors entering into private arrangements with creditors which they are unable to fulfil, because they are unlikely to be able to afford an accountant to negotiate the agreement on their behalf.²⁴ A similar concern was noted about the mandatory 30 day cooling off period, which would give creditors time to approach debtors with alternative repayment options.²⁵ The concern was a product of the difference in bargaining power between some debtors and creditors, which may lead debtors to agree to terms or arrangements which they are unable to meet.

Committee

The 2001 Bill was referred to the Senate Legal and Constitutional Legislation Committee on 20 June 2001. The Committee reported on 7 August. The Committee report focused mainly on two issues raised above: the provisions for early discharge and the cooling off period.

Early Discharge

In relation the early discharge provisions, the report canvassed the various opposing views. It acknowledged arguments in the Explanatory Memorandum that early discharge was seen as making bankruptcy 'too easy' and that the provisions disadvantaged bankrupts with assets and income and effectively discriminated against women. It also acknowledged arguments put by community legal services that early discharge appropriately targeted small poor bankrupts, encouraging early recovery, produced efficiencies for government administrators and the courts, and affected large creditors like banks and credit card and finance companies rather than small business.²⁶ Additional arguments were put that the main advantage of early

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discharge was (merely) psychological and that any practical advantages were undermined by the fact that bankruptcy remained listed with the Credit Reference Association for 7 years.²⁷

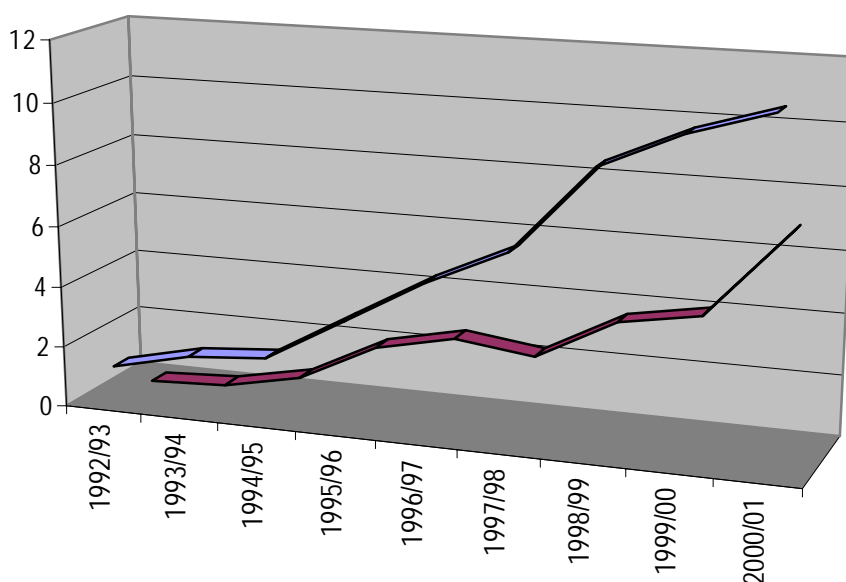
In summary, the strongest argument appears to be that early discharge makes bankruptcy too easy. However, the difficulty for the Committee was that it 'encountered a lack of data on the impact of early discharge since its introduction'.²⁸ Perhaps the strongest supporting evidence was given by ITSA which stated that since the introduction of the early discharge provisions, there had been a steady rise in the number of repeat bankrupts following early discharge.²⁹ However, this may not be significant, given the increase in repeat bankruptcies generally (see graph below).

However, the key issue seems to be that removing early discharge has an adverse impact on low income earners. The early discharge provisions were originally introduced to alleviate the disadvantage faced by low income earners, by removing the need to make an application to the court.³⁰ Significantly, in evidence to the Committee, the Law Council of Australia 'expressed the view that the existing provisions had never worked as intended' *but* had neither 'added anything' or 'represented a major problem in the implementation of the legislation'.³¹ Another witness noted a variety of reasons that could explain the growth in bankruptcies, including the nature of credit reporting system and the growth in personal credit.³²

In a minority report Labor Senators noted that 'the abolition of the early discharge provisions will only affect low-income earners and only in respect of their first bankruptcy'.³³ They recommended that the early discharge provisions be retained. In the majority report, the Committee noted that 'notwithstanding the absence of hard data' it considered that the benefits were 'essentially intangible' and that they applied 'in a discriminatory manner'. The Committee simply noted that it was 'arguable that [the] legislation should be amended'.³⁴

Given this apparently open ended recommendation, it is worth noting that the while the Committee referred to the proposed alternative to early discharge (the proposal to reduce the standard period of bankruptcy from three years to two years) it did not make any comment.³⁵

Repeat Bankruptcies as a percentage of Bankruptcies after Discharge 1992-2001³⁶



Thi.

■ % Repeat Bankruptcies after Standard Discharge
 ■ % Repeat Bankruptcies after Early Discharge

nents.
 tus of the Bill.

Cooling-Off Period

In relation to the cooling-off period, the report canvassed the issues above. In favour of the proposal, it acknowledged an argument by the Credit Union Services Corporation of Australia Ltd (CUSCAL) that the cooling-off period provided a novel circuit breaker, giving creditors 'for the very first time' advance notice of an impending bankruptcy and 'an opportunity to seek an alternative arrangement' with debtors such as 'extended repayment options, reducing interest or a whole range of things that are available [to creditors]'.³⁷ Against the proposal, the report acknowledge arguments by a community legal service that the cooling-off provisions would introduce 'confusion and needless paperwork', would not assist most bankrupts who may have tried all other options, and could 'enable private trustees to abuse the debtor'.³⁸ The Law Society was ambivalent on the policy issues but questioned whether the increased complexity and administrative burden was justifiable.³⁹ It noted the possibility that a debtor could give preference to one creditor over another in negotiations over a single debt. It also noted that, due to a bar over debts incurred during the cooling off period, debtor's petitions would operate differently to creditors petitions.⁴⁰

The Committee was equivocal in its support. It noted that the cooling-off period was 'worthwhile in principle' but that its 'practical operation ... remains to be resolved'.⁴¹ While it thought that the proposal would not lead to 'undue complexity' it recommended that the operation of the cooling-off period provisions be reviewed after 3 years.⁴²

Senate

The Senate passed the Bill with amendments on the last sitting day before the election. The principal amendments made by the Senate were:⁴³

- An extension of time for early discharge from 6 months to 2 years.
- The repeal of section 271 of the *Bankruptcy Act 1966*. That section provides that a person is guilty of an offence if they 'materially contributed to or increased the extent of their insolvency' (in the period of 2 years leading up to their bankruptcy) or 'lost any of [their] property' (in the period between petition and bankruptcy) 'by gambling or by speculations' that were 'rash and hazardous'. While prosecutions under this section are rare, welfare groups working with problem gamblers were concerned that section 271 may discourage such people from seeking assistance with their problems.
- An amendment to the *Corporations Act 2001* to permit to recovery of performance related bonuses paid to company officers where the company later becomes insolvent and to make companies liable for the debts of related bodies corporate. The provisions would apply to a performance related bonus of more than \$40 000 paid to a director or executive officer who has a remuneration package in excess of \$100 000 per annum.

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Main Provisions

As indicated, the provisions in this Bill have largely been reproduced from the 2001 Bill. However, a number of changes have been made, reflecting, in part, the comments above.

Changes

Debt Agreements

As noted above, the 2001 Bill proposed to double the income eligibility threshold for Part IX debt agreements. The present Bill seeks only to increase that threshold by 50% 'in light of the increased take up of debt agreements'.⁴⁴ The change is effected by **item 150**. As a result of this amendment the threshold will rise from \$32 041 to \$48 061.

Cooling-Off Period

The Bill does not proceed with the proposed 30 day cooling-off period. The decision to delete the proposal 'was taken after careful consideration of the issue, and followed re-cavassing the views of stakeholders in the personal insolvency industry'. '[I]n particular', it took 'due notice of the recent sharp increase in the number of debt agreements'. Thus, the Attorney-General, in his Second Reading Speech, commented 'a key purpose of the cooling-off period – to encourage people to consider the consequences of, and alternatives to, bankruptcy – is being achieved to a noticeable degree by the debt agreement process'.⁴⁵ The Attorney-General also referred to the issues raised above. As a result, the Bill does not seek to repeal Div. 2A of Part IV (debtor's declaration of intention to present a petition) or to amend section 82 (to bar proof of debts during the cooling-off period).

Other Amendments

The Second Reading Speech notes that the Bill makes other changes to the Act including:

- 'streamlining meetings procedures'
- 'simplifying the mechanism for changing trustees'
- 'bringing controlling trustees and debt agreement administrators under the regulatory purview of the Inspector-General [in Bankruptcy]'
- allowing creditors 'to permit a bankrupt to retain "sentimental property"'
- clarification of qualifying requirements for registered trustees, and
- delegation of certain administrative powers to trustees allowing them to permit debtors to travel overseas and to determine hardship under the income contribution scheme⁴⁶

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Administrators

Currently, debt agreements are administered by persons nominated in the debt agreement. This may be the Official Trustee, a registered trustee or another person.⁴⁷ In future, Official Receivers rather than the Official Trustee will have responsibility for the functions relating to debt agreements (**items 144–149, 151, 153, 155–166**).

The Bill proposes amendments to deal with succession where the administrator dies (**item 168, proposed sections 185ZA–ZC**). Whoever the administrator (defined to include the person nominated in a debt agreement or appointed under these provisions: **item 1**) the Inspector-General in Bankruptcy must appoint an Official Receiver for the District to take over the debt agreement (**proposed section 185ZB**). The Official Receiver may appoint another person as administrator, subject to any previous or subsequent appointment made by the parties by variation of the debt agreement (**proposed section 185ZG**).

Administrative Review Tribunal

A number of the amendments proposed in the 2001 Bill anticipate the creation of the new Administrative Review Tribunal. However, the Administrative Tribunal Review Bill 2000 was not passed in the previous Parliament. While the Attorney-General has said that he is 'keen to ... resolve the future of the Administrative Review Tribunal',⁴⁸ the relevant legislation had not been introduced into Parliament at the time of writing.

Concluding Comments

All of the proposed bankruptcy reforms are ostensibly intended to reduce the incidence of bankruptcy and to promote the use of alternatives such as debt agreements. However, there would still seem to be questions as to whether the measures will achieve their aims. As the experience of the Senate Legal and Constitutional Committee demonstrates, it can be extremely difficult to identify the factors that have determined the growth in private bankruptcies or the factors that might influence the uptake of alternatives to bankruptcy.

One of the obvious factors contributing to bankruptcy would seem to be stressors that are related to, or exacerbated by, low income, such as unemployment and domestic discord. Another factor would seem to be the ready availability of consumer credit. Many of the measures in the Bill appear to be targeted predominantly at low income earners. Some might ask whether other measures are being introduced to deal with credit availability.

Some of the adjustments made in the present Bill (reducing the proposed increase in the income eligibility threshold for debt agreements and abolishing the cooling-off period) are based on the apparent increase in the popularity of debt agreements (or applications). In effect, the Government has relaxed some of the incentives for debt agreements on the basis that the work is already being done within the confines of the existing system. Arguably, this raises its own questions. Aside from the general argument that none of the measures in

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this Bill are necessary to increase the uptake of alternatives to bankruptcy, there may be arguments regarding the need to relax the other elements of the legislative package.

Endnotes

- 1 A business related bankruptcy is defined as being one in which an individual's bankruptcy is directly related to his or her proprietary interest in a business or company: Insolvency and Trustee Service Australia, *Annual Report 1999-2000*, Table 2.2, p. 8.
- 2 ITSA, *Annual Report 1999-2000*, Table 2.2, p. 8.
- 3 ITSA, *Annual Report 1999-2000*, Table 12, p. 6
- 4 ITSA, *Annual Report 1999-2000*, Table 16.1, p. 35.
- 5 ITSA, *Quarterly Bankruptcy Statistics – Debt Agreements*, http://law.gov.au/aghome/commaff/itsa/stats/Qtr_Pt_IX.pdf (accessed 4 July 2001).
- 6 The Hon. Daryl Williams MP, Bankruptcy Legislation Amendment Bill 2002, Second Reading Speech, House of Representatives, *Debates*, 21 March 2002, p. 1844.
- 7 ITSA, *Annual Bankruptcy Statistics for the financial year ended 30 June 1998 – 30 June 2001*, at http://www.itsa.gov.au/aghome/commaff/itsa/frame_statistics.html (accessed 13 May 2002).
- 8 These comprised 48 assignments, 205 arrangements and 200 compositions: ITSA, *Annual Report 1999-2000*, Table 17.1, p. 40.
- 9 Although there were only 561 Part X arrangements in 1989-1990, this figure was unusually low, as the figures for the preceding and following years were 795 and 805 respectively. This increased to 953 in 1991-1992, before beginning a steady decline. See ITSA, *Quarterly Bankruptcy Statistics – Part X Administrations*, http://law.gov.au/aghome/commaff/itsa/stats/Qtr_Pt_X.pdf (accessed 4 July 2001).
- 10 Terry Gallagher, Inspector-General in Bankruptcy, ITSA, *Reforms to the Bankruptcy Act*, http://law.gov.au/aghome/commaff/itsa/frame_bankreforms.html (accessed 3 July 2001).
- 11 Insolvency and Trustee Service Australia, *Annual Report 1999-2000*, Table 12, p. 17
- 12 Katrine Del Villar, Bankruptcy Legislation Amendment Bill 2001, [Bills Digest No. 8 2001-2002](#).
- 13 Section 149 of the *Bankruptcy Act 1966*.
- 14 Section 149T of the *Bankruptcy Act 1966*.
- 15 Section 149Y of the *Bankruptcy Act 1966*. Other disqualifications include previous bankruptcy, or failure to disclose a number of matters, including beneficial interests in property, existing liabilities, or projected income.
- 16 See **item 154** of the 2001 Bill. **Items 33, 46, 52, 65, 129, 132, 215 and 216** repeal other references to the early discharge provisions.

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- 17 Senator the Hon Amanda Vanstone, 'New Bankruptcy Laws Address Community Concern', Media Release, 11 May 2000.
- 18 The Hon Daryl Williams MP, second reading speech on the Bankruptcy Legislation Amendment Bill 2001, House of Representatives, *Hansard*, 7 June 2001, p. 26305.
- 19 See Don Costello, Acting Adviser, ITSA, 'Bankruptcy Reforms Package' in *New Directions in Bankruptcy* (March 2001) Vol 11 No 1, http://www.itsa.gov.au/aghome/commaff/itsa/frame_pubs.html (accessed 2 July 2001).
- 20 Senator the Hon Amanda Vanstone, 'New Bankruptcy Laws Address Community Concern', *Media Release*, 11 May 2000.
- 21 See Division 2A of Part IV of the *Bankruptcy Act 1966*.
- 22 The Hon Daryl Williams MP, second reading speech on the Bankruptcy Legislation Amendment Bill 2001, House of Representatives, *Hansard*, 7 June 2001, p. 26305.
- 23 *Explanatory Memorandum*, p. 11.
- 24 Kath Cummins, 'Harder line on bankruptcy', *Financial Review*, 12 May 2000.
- 25 *ibid.*
- 26 Senate Legal and Constitutional Legislation Committee, Inquiry into the Provisions of the Bankruptcy Legislation Amendment Bill 2001 and the Bankruptcy (Estate Charges) Amendment Bill 2001, August 2001, paras 3.2–3.18 and paras 4.2–4.6.
- 27 Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 3.17
- 28 Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 4.5.
- 29 ITSA stated that the statistics show 'a steady rise in the number of bankrupts who were granted an early discharge from a post 1 July 1992 bankruptcy and have become bankrupt once again since', quoted in Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 3.15.
- 30 Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 3.3.
- 31 Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 3.12.
- 32 Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 4.5.
- 33 'Labor Senators Minority Report' in Senate Legal and Constitutional Legislation Committee, *op. cit.*
- 34 Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 4.6.
- 35 Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 3.18.
- 36 Source: Senate Legal and Constitutional Legislation Committee, *op. cit.*, Table 2, p. 10. The statistics were provided by ITSA.
- 37 Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 3.24.
- 38 Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 3.26.
- 39 Senate Legal and Constitutional Legislation Committee, *op. cit.*, para 3.27.

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- 40 Senate Legal and Constitutional Legislation Committee, op. cit., para 3.30.
- 41 Senate Legal and Constitutional Legislation Committee, op. cit., paras 4.7–4.8.
- 42 Senate Legal and Constitutional Legislation Committee, op. cit., paras 4.13.
- 43 Bankruptcy Legislation Amendment Bill 2001, Bankruptcy (Estate Charges) Amendment Bill 2001, *Senate Journals*, No. 69 of 217, 27 September 2001, p. 5075.
- 44 The Hon. Daryl Williams MP, Bankruptcy Legislation Amendment Bill 2002, Second Reading Speech, House of Representatives, *Debates*, 21 March 2002, p. 1844.
- 45 The Hon. Daryl Williams MP, Bankruptcy Legislation Amendment Bill 2002, Second Reading Speech, House of Representatives, *Debates*, 21 March 2002, p. 1844.
- 46 The Hon. Daryl Williams MP, Bankruptcy Legislation Amendment Bill 2002, Second Reading Speech, House of Representatives, *Debates*, 21 March 2002, p. 1844.
- 47 Section 185C(2)(c), *Bankruptcy Act 1966*.
- 48 Daryl Williams MP, '[Portfolio Priorities in the Howard Government's Third Term](#)', Address to senior officers of the Attorney-General's Department , Robert Garran Offices, Canberra 5 February 2002.

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