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Committee Secretary
Senate Legal and Constitutional Committee
PO Box 6100
Parliament House
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25 November 2009

Our ref SKM 080553

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Dear Committee Secretary

Inquiry into the Bankruptcy Legislation Amendment Bill 2009

This submission is solely directed to the proposed increase in the minimum debt for the bankruptcy notice and creditors petition from $2,000 to $10,000.

The arguments in support of this increase are, with respect, misconstrued and unsupported.

In my legal practice, I act almost exclusively in relation to insolvency related matters. As well as corporate insolvency, I act for bankruptcy trustees, as well as for both creditors and debtors in respect of personal insolvency. From my experience, there is insufficient evidence that the bankruptcy system is in the danger of abuse against which this amendment is said to be required.

The proposed amendment is suggested to "reflect changes in the economic environment" (*Bankruptcy Legislation Amendment Bill 2009* Explanatory Memorandum, 1(d) ("the explanatory memorandum")).

The explanatory memorandum raises two points in support of the increased amendment:

1. The increased threshold will "lessen the opportunity to use bankruptcy procedures as a debt collection process".

2. The significant change in the value of money and levels of individual indebtedness since 1996. This point particularly focuses on the quantum of debts in bankruptcy notices issued during 2008 to 2009, of which 11% were for amounts between $5,001 and $10,000, and 9% were for amounts between $2,000 and $5,000.

The second reading speech raises a further possible justification for the proposed increase, in that the Attorney-General indicated that:

"Bankruptcy is a complex and costly process. It is costly to the parties affected and to the community. It is therefore inappropriate to use it to recover debts of not more than $2,000" (Hansard page 11168).

In response to these justifications, it is submitted that:

1. The statistics used to support the need for amendment are misleading or of no relevance;

2. There are strong disincentives already in the bankruptcy system (including the costs involved) to using bankruptcy as a debt collection technique;

3. The costs and complexity of the bankruptcy system are themselves a protection against any abuse of the system by a lone creditor owed under $10,000, as the proposed amendment seems to fear.

Misleading Statistics

The statistics, relied upon in the explanatory memorandum to justify the proposed amendment, are misleading. The mere fact that a bankruptcy notice has issued for an amount less than $10,000 does not:

- Indicate in any way the debtor's total debt. A bankruptcy notice and creditor's petition are filed on behalf of one only of any number of creditors. It is pointless to look to these figures as a guide to the level of a debtor's overall indebtedness;

- Even necessarily indicate the level of debt to the petitioning creditor. A bankruptcy notice is construed strictly, and requires a judgment debt. Where there are different judgments, or other claims which may exist, a creditor may well seek to issue a bankruptcy notice for part or one of those debts, and determine whether the debtor is solvent, before pursuing other claims. For example, I presently have one matter where a creditor has obtained costs orders in my client's favour respect of a number of proceedings. The total of those costs orders will be many tens of thousands of dollars. Because of the expense of obtaining an assessment, leading to a judgment, my client has decided to issue a bankruptcy notice for one such judgment (which is less than $10,000) before deciding whether to incur the costs and expense of further assessments.

It is true that the bankruptcy system is not a debt collection process. However it is equally trite to observe that the system relies upon an individual creditor commencing proceedings on behalf of his or her own debt. Unless and until a sequestration order is made, and a statement of affairs completed (together with the trustee's investigations) the full extent of the debtor's liabilities are unknown, and should not be relied upon as the basis for suggesting that the law needs to be amended.

So if these statistics are misleading, are there any which can assist in determining whether amendment is required? The Insolvency and Trustee Service Australia (ITSA) publishes statistics on the profiles of debtors who enter formal personally insolvency administration. According to the *Profiles of Debtors* publications, the level of debtors entering personal insolvency with debt levels of less than $10,000 has in fact **decreased** by 47% between 2002 and 2007 (which is the date of the last *Profiles of Debtors* publication). Unfortunately, the statistics do not differentiate between debtors' petitions (where the debtor files for his or her own bankruptcy) and creditors' petitions, which are the subject of the proposed amendment.

The statistics are as follows:

Year	Percentage of Debtors with debts less than $10,000
2002	30%
2003	27%
2005	20%
2007	16%

These statistics do not tell the whole story. Nor, unfortunately, is there more recent information on these figures. Nevertheless, it must be regarded as unreliable to base the suggested need for this amendment on the statistics included in the explanatory memorandum.

Bankruptcy as a Debt Collection Procedure

It is trite, as the explanatory memorandum observes (at [133]), that bankruptcy is not a debt collection procedure.

However it is misconceived to assert that therefore "it is wrong" to proceed to bankruptcy where a debt is not much more than $2,000. This is to impose a moral judgment on the intentions of creditors who file creditors' petitions in respect of debts less than $10,000, based solely on the quantum of their debt.

There are a number of safeguards in the bankruptcy system against creditors using bankruptcy as anything other than a last resort.

Firstly, the explanatory memorandum and second reading speech appear to assume that bankruptcy is an 'easy' or 'quick' alternative to other methods of a creditor seeking to recover a debt, or that bankruptcy is not being used as a "last resort" (Hansard 11168). This ignores the complex and costly procedure required in the majority of cases which rely upon failure by the debtor to comply with a bankruptcy notice:

1. First, the creditor must prepare a court document and pay a filing fee in order to commence proceedings against the debtor. The debtor must usually be personally served with a copy of the claim of the creditor. The debtor has 28 days to respond;

2. Second, assuming the debtor does not take any step to deal with the debt, or the claim, the creditor must prepare and file further court documents to apply for and obtain a judgment of the court;

3. Third, the creditor must prepare and lodge a bankruptcy notice, and pay a lodgement fee to the Official Receiver. Although the *Bankruptcy Regulations* prescribe various methods, it is ordinarily prudent to personally serve the debtor with the bankruptcy notice. The debtor has 21 days to respond;

4. Fourth, assuming the debtor does not take any step to deal with the debt, or the claim, the creditor must prepare and file a creditor's petition in either the Federal Court or Federal Magistrates Courts. The creditor must pay a further filing fee. The

creditor's petition must be personally served, and the debtor will have 4-6 weeks on average, before the matter is returnable before the Court.

5. Fifth, the creditor must attend to preparing various other court documents and searches, in preparation for the hearing. If all is in order, a sequestration order will be made and the debtor will become bankrupt.

All of this process, cost, time and effort, are for the majority of bankruptcies, unfortunately of little utility. In 86% of cases of all bankruptcy (debtors and creditors petitions) the bankrupt will have less than $5,000 in realisable assets (*Profiles of Debtors 2007* at page 14). From my experience I would suggest that the results may be better in relation to bankruptcy following creditor's petitions, since creditors will often have considered whether there is any prospect of recovering the costs, before proceeding down the path of bankruptcy. Nevertheless these statistics confirm that it is only the foolhardy creditor who uses bankruptcy other than as a last resort.

Secondly, having regard to the processes set out above, there are a number of alternatives to bankruptcy for debtors who are unable to deal with debts of less than $10,000. Apart from informal and formal arrangements with the creditor, the debtor has the choice of filing an application to pay a judgment debt by instalments, which will be considered as a relevant factor in a bankruptcy court refusing to make a sequestration order (see for instance *Klinger v. Nicholl* [2005] FCAFC 153 per Moore J at [4]; Emmett J (with whom Tamberlin J agreed) at [32]-[34]). There are also debt agreements under Part IX and personal insolvency agreements under Part X, although the costs and expense of the latter procedure would be prohibitive. At almost any stage in the minimum 3-4 months it takes to obtain a sequestration order against a debtor, most of these options are available.

Thirdly, the system already protects against the perceived abuses of the lone creditor with a debt less than $10,000. At its heart, the jurisdiction to make a sequestration order is discretionary. This discretion operates in adjournments of a creditor's petition where the court is persuaded that the debtor is putting in place steps to pay the debt (eg *Shipton Lodge Cobbitty Pty Ltd v Coshott* [2008] FMCA 1294). It also operates in the discretion of the court to refuse to make a sequestration order, and to dismiss the proceedings (eg *Australia & New Zealand Banking Group Pty Ltd v Foyster* [2000] FCA 400, per Hely J, at [16]-[19]).

For all of these reasons, the bankruptcy system is well prepared to meet the concerns which are said to be prompting the proposed amendment.

Operation of the Proposed Amendment

A further concern is whether and to what extent small business will be able to absorb the costs and impact of the proposed amendments.

The grim reality of debt recovery is that for the reasons set out above, bankruptcy is already a step of last resort for creditors. Increasing the threshold to serve a bankruptcy notice and file a creditor's petition will not reduce any perceived abuses of the bankruptcy system. However it will in effect lead to creditors being forced to consider writing off debts

Larger creditors such as financial institutions, the Australian Taxation Office, and utilities, are better resourced to absorb bad debts of up to $10,000. With the exception of the ATO, they are also better placed to refuse to provide credit, at least without security. Alternatively, they are in a better position to make a commercial or policy decision to provide credit of up to $10,000 in the knowledge that at the end of the day this amount may not be recoverable.

Individual creditors and small businesses are much less capable of in effect writing off debts under $10,000. Individual creditors and small business, do not always have this luxury. It is, with respect, somewhat insulting to suggest that simply because they have debts less than $10,000 these creditors have "other options" which they have somehow failed to explore and which would lead to a recalcitrant debtor complying with his or her obligations. There is no evidence whatsoever that these "other options" are not being pursued, such that bankruptcy is in deed the last option for creditors who are prepared to embark upon the cost, time and effort involved in proceeding to bankruptcy.

Having advised numerous debtors facing bankruptcy proceedings, I can attest to the not uncommon inclination of debtors to wish to avoid the consequences of bankruptcy, without being prepared to face the implications of insolvency, even in the face of strong advice as to both. An increase to the threshold will simply allow debtors to avoid their obligations longer, and incur greater debt, with greater fiscal implications to the community.

The second reading speech talks about the costs of bankruptcy and bankruptcy proceedings to the community. It only takes a simple mathematical calculation to determinate that the costs to the community of one creditor actively prosecuting one debt of less than $10,000, up until bankruptcy, is far less than the costs to the community generally, of many creditors each incurring a debt to the same debtor, of $10,000, which they are unable to recover.

It is respectfully submitted that there has been no case made for any change to the threshold amount.

Please do not hesitate to contact the writer, if I can be of further assistance.

Yours faithfully
Bartier Perry

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