25 November 2009

By email: legcon.sen@aph.gov.au

Committee Secretary
Senate Legal and Constitutional Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir/Madam

Submission to Inquiry into the Bankruptcy Legislation Amendment Bill 2009

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to make a submission to the Senate Legal and Constitutional Affairs Legislation Committee's inquiry into the Bankruptcy Legislation Amendment Bill 2009 (the **Bill**).

Consumer Action provided a written submission to the Government on its exposure draft version of the Bill, jointly with the Financial and Consumer Rights Council, in which we expressed support for the general objectives of the Bill, particularly the increase in the creditor's petition threshold from $2,000 to $10,000, while raising concerns about the provisions relating to debt agreements under Part IX of the *Bankruptcy Act 1966* (Cth) (the **Act**). Our comments in this submission are similar to those made previously, given the similarities of the two versions of the Bill.

Minimum amount of remuneration payable

Consumer Action strongly supports Schedule 1 item 11 of the Bill, which will repeal sections 161B(2) and 161B(3) of the Act. Section 161B(2) currently allows a trustee to continue to pursue a debtor for their minimum remuneration entitlement if the debtor's estate does not have sufficient funds, meaning the debt survives bankruptcy. However, bankruptcy is a process that is meant to allow a debtor who is genuinely unable to meet all their debts to make a fresh start after undergoing bankruptcy. As the Explanatory Memorandum to the Bill (the **EM**) states, a general principle of bankruptcy is therefore that a trustee should be remunerated from the bankrupt's estate. Section 161B(2) should therefore be repealed.

Review of trustee remuneration and costs

We support Schedule 1 item 13 of the Bill, which will allow for Regulations to be made creating a new process under which the bankrupt or a creditor of the bankrupt may apply to the Inspector-General in Bankruptcy for a review of trustee remuneration and/or third party costs.

This is an important reform because the Government intends that the new and broader review process will be free to the applicant (EM §40) and that the parties to the review will have to bear their own costs of preparing for and attending reviews.[1] The current taxation process does not, in practice, enable a bankrupt to seek a review of trustee remuneration or third party costs, because by definition the bankrupt does not have the income or funds to pay for seeking the review. Further, at present the process also carries the risk that additional fees will be charged by the trustee due to responding to the review, which would further eat into any equity in assets or funds held by the bankrupt. The current situation leaves a bankrupt person substantially at the mercy of their trustee.

The details of the new process will be contained in the Regulations, thus we cannot comment further on the process until the proposed Regulations are released publicly. We note that the Government has indicated that it will consult further on the content of the Regulations.[2]

Raising the minimum debt for a creditor's petition from $2,000 to $10,000

Raising the threshold amount

We strongly support Schedule 4 Part 1 of the Bill, which increases the minimum debt for a creditor's petition (and creditor-requested bankruptcy notices) from $2,000 to $10,000.

It is important to understand the context of this reform, which, in our view, is long overdue. General bankruptcy can be initiated in two different ways, namely, via a debtor's petition under which a debtor initiates bankruptcy against him or herself, or via a creditor's petition under which a creditor forces the bankruptcy of the debtor over unpaid debts. By far the great majority of bankruptcies that occur in Australia each year are initiated by debtors themselves, not through a creditor's petition. For the latest year, 2008-09, the Inspector-General in Bankruptcy reports that of a total of 27,483 bankruptcies, only 2,113 bankruptcies arose from a creditor's petition. That represents less than 8% of all bankruptcies for the year. Similarly, in the 2007-08 year creditors' petitions accounted for less than 9% of all bankruptcies.[3]

This reform is therefore irrelevant to the majority of bankruptcies that will take place in Australia. It is targeted purely at creditor-initiated bankruptcies. Thus, the issue here is not about setting an appropriate threshold for bankruptcy generally, but about determining in what circumstances bankruptcy should be available to creditors in pursuing debts.

The *Homes at risk* report released by Eastern Access Community Health in November 2007 investigated in detail the practice of using bankruptcy to collect small debts.[4] The report found that the impact on consumer bankrupts who are made bankrupt on a creditor's

[1] *Remuneration of registered trustees: amendments to the Bankruptcy Act and Regulations*, October 2008, p4, available from the Insolvency and Trustee Service Australia website: http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/news+&+events-%3Elaw+reform-%3Etrustee+remuneration+review?opendocument.
[2] As above, p5.
[3] Inspector-General in Bankruptcy, *Annual Report by the Inspector-General in Bankruptcy on the operation of the Bankruptcy Act 2008-09,* p13.
[4] Jan Pentland, *Homes at risk: using bankruptcy to collect small debts*, Eastern Access Community Health, November 2007.

petition, and their families, is significant, with the risk to and loss of family homes of consumer bankrupts in many cases seriously disproportionate to the debts owed. The report concluded, amongst other matters, that:

> A creditor's petition triggers a process which can significantly impact on the homes of debtors and their families. Mainstream creditors are currently paying more attention to the development and implementation of financial hardship policies for debtors in financial difficulty. Attention to responsible collection of debt beyond this stage would be welcomed by financial counsellors. Using the bankruptcy regime to collect small debts should be a last resort.[5]

The purpose of raising the minimum debt amount for a creditor's petition or bankruptcy notice is to prevent the inappropriate use of bankruptcy by creditors in collecting small debts. It affects unfair debt collection practices, not genuine bankruptcy activity.

There is no dispute that if a debtor has amassed a certain level of debt and is unable to pay their debts, their creditors should be able to set in motion bankruptcy proceedings. However, as the EM states, it 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 of all the debtor's creditors (EM §133). By contrast, the use of a creditor's petition by a creditor to collect a small debt owed to them is simply not the purpose for which the bankruptcy laws were enacted.

The use of bankruptcy to collect a small debt is a fringe, not a mainstream, practice and the majority of insolvency practitioners are not involved in administering such bankruptcies. As noted above, creditor's petitions make up only a small proportion of bankruptcies to begin with, and only a minority of these relate to debts under $10,000 – the EM states that during the 2008-09 year, of 1953 sequestration orders (the end result of a successful creditor's petition) made across Australia and matched by amounts in bankruptcy notices, only 217 were for an amount between $5,001 and $10,000 and 174 for an amount between $2,000 and $,5000, totalling 20% of the sequestration orders.

Further, it is very important to note that bankruptcy is not of interest to creditors in pursuing a small debt *unless the debtor has an asset* that can be liquidated in the bankruptcy, usually the family home. Bankruptcy is a more expensive debt collection process that other available options, so it is pursued by a creditor and trustee when they have confidence that the costs associated with it can be recovered from the bankrupt's estate.

In one recent case in which Consumer Action acted, a woman whose sole income was a carer's pension of just over $670 a fortnight, but who owned her home, was sent bankrupt over a 2001 Internet services bill that was originally less than $1,000. $20,000 in trustee fees had been added to the debt when she sought our assistance, to be recouped out of her estate once her home was sold. Of the 13 case studies included in the *Homes at risk* report, in all but one the debtor owned equity in their home, while in the other case the debtor had received a lump sum worker's compensation payment out of which an additional $12,000 in trustee fees had to be paid.[6]

[5] As above, p25.
[6] As above, pp14-16.

Indeed, in its submission to the Government on the exposure draft of the Bill, the Australian Institute of Credit Management clearly stated that creditors use a creditor's petition to pursue a small debt only when an asset is available:

> AICM would also reiterate that the decision to pursue a debt through the provisions of the *Bankruptcy Act 1966* (Cth) is only made when a thorough assessment of the debtor's situation has been undertaken. There is little purpose in seeking to exercise remedies under the Bankruptcy Act if the individual concerned has no assets and little or no income. Creditors' petitions are primarily utilised in situations where the individual has assets and income and is in a position to meet their obligations albeit reluctantly.[7]

Putting a person's home at risk over a small debt might be seen as unpalatable but necessary if no alternatives were available to a creditor to pursue the payment of a small debt. However, this is not the case. On the contrary, there are several other debt collection tools available to creditors to pursue the repayment of small debts, *including through the sale of the debtor's home or another asset*. These include judgment debt recovery enforcement proceedings, accepting payment by instalments, or the sale of the debtor's home by the Sheriff. Arguments that there are no viable alternatives available to creditors to pursue small debts and/or that these processes are too cumbersome to be workable are simply untrue.

What is true is that the costs associated with these processes are generally much lower than the amount of bankruptcy trustee's fees that accrue if the debtor is sent bankrupt. Consumer Action has unfortunately seen several cases in which a trustee has undertaken lengthy and expensive work out of all proportion to the debt or debts to be paid out of the bankruptcy. A number of examples of this practice also appear in the *Homes at risk* report. One recent example from Consumer Action's casework practice is set out below.

Tom's story

Tom (name changed) is a 33 year old man who suffers from bipolar disorder. He owns his home and has a wife and children.

Tom incurred a debt for $3,836.48 with a firm of solicitors. He disputed his costs bill and the firm pursued Tom for the alleged debt, allegedly incurring around $8,000 in collection costs before the firm turned the debt over to another firm to engage in collection activity. This second firm allegedly incurred costs of around another $8,000. The firm then successfully petitioned to bankrupt Tom and a private trustee was appointed upon his bankruptcy.

The total of the legal costs and the trustee's fees was $24,500 when he sought assistance and Tom will lose his home. It is unfair and distressing that a family will lose their home over such a small amount, particularly when the creditor could have applied for an instalment order to repay the debt.

[7] Australian Institute of Credit Management, *Australian Institute of Credit Management Submission re the Bankruptcy Legislation Amendment Bill 2009 – Exposure Draft*, p4.

It is the excessive cost and disproportionate impact of bankruptcy, combined with the existence of alternative debt collection processes, that makes the use of bankruptcy to collect a debt under $10,000 so harsh, unfair and punitive to the debtor.

In this regard, the recent Federal Magistrates' Court case of *Vaucluse Hospital v Phillips* is instructive.[8] In this case the debtor successfully obtained the setting aside of a sequestration order made in relation to an original debt of $4,887.77 for medical treatment. Amongst other matters, the Court pondered:

> There is no evidence before me as to why the creditor did not simply move to recover the judgment debt as against the interest of the respondent in the home that he jointly owns with his father and brother. The process is relatively straightforward and relatively inexpensive.[9]

The Magistrate also quoted the principle that bankruptcy is a question of solvency, not of debt collection, set out by Justice Deane in the Federal Court decision of *Sarina v Council of the Shire of Wollondilly*:

> It does not appear to me that it is possible to divine any policy underlying the provisions of the Act to the effect that a creditor should be entitled to make a recalcitrant debtor bankrupt even though the debtor satisfies the court that he is plainly solvent and able to pay his debts. It seems to me that it may well be that the legislative intent was to leave a creditor, in those circumstances, to the ordinary remedies by way of execution and garnishee.[10]

After citing additional cases accepting this principle,[11] the Magistrate added:

> Aside from the fact that the bankruptcy scheme is intended for those who are insolvent, this principle also protects against a potential practical problem that could develop of trustees feasting on the assets of solvent estates.[12]

In terms of the minimum debt amount, the *Homes at risk* report, which is the only detailed investigation into this issue, concluded that the minimum debt amount should be increased from $2,000 to $10,000. We agree that this is an appropriate level for 2009. The threshold amount was last raised from $1,500 to $2,000 in 1996, however, the original minimum debt amount was, in fact, set in 1966 at $500. This amount has not kept pace with inflation or other market changes, being raised only sporadically since that time.[13] At current values, the $500 original threshold would equate to over $5,000 merely as a result of inflation. In addition, the consumer credit market has been transformed since 1966. Personal debt levels have increasing exponentially and considerably larger amounts of debt are now routinely carried by consumers. Forced bankruptcy in order to liquidate a person's home over a $5,000 debt is a manifestly disproportionate response to the size of such a debt.

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[8] *Vaucluse Hospital Pty Ltd v Phillips & Anor* [2006] FMCA 44 (20 January 2006).
[9] As above at §80.
[10] *Re Ronald Grafton Sarina Ex Parte: the Council of the Shire of Wollondilly* (1980) 43 FLR 163 at 165; affirmed on appeal at (1980) 48 FLR 372.
[11] *Charlwood Industries Pty Limited v Cubitt and Ors* [1995] FCA 1127; *Stankiewicz v Plata* [2000] FCA 1185.
[12] *Vaucluse Hospital Pty Ltd v Phillips & Anor*, above n8, §81.
[13] The original $500 minimum debt amount was raised to $1,000 in 1980, to $1,500 in 1986 and to $2,000 in 1996.

Clarifying what amount the threshold applies to

The Bill raises the minimum debt to $10,000 but does not make any amendments to clarify what amounts the $10,000 must consist of. We strongly recommended to the Government that the increase in the minimum debt amount be coupled with an amendment to clarify that the minimum debt amount relates to the *amount of the original debt owed*, not to the debt owing at the time the creditor's petition is presented (or to the debt owing under the final judgment or order for bankruptcy notices).

We made this recommendation because an original debt amount increases over time as the creditor applies interest, late fees and other charges (such as collection costs) to the alleged debt. We have seen several cases in which a creditor or debt collector owed a small debt below the minimum debt amount in the Act has simply waited until costs have accrued on the debt and, once the debt amount has passed the threshold, they have pursued bankruptcy proceedings.

For example, in the case of the carer's pensioner we represented, cited above, the original debt amount was less than $1,000. Court proceedings were pursued by the debt collector several years later when a judgment for $2,057 could be obtained with interest and costs added, and bankruptcy proceedings were then started on the judgment debt amount, which was just above the current minimum debt amount.

In Tom's case referred to above, if the minimum debt for a creditor's petition had simply been raised to $10,000, Tom's creditor would still have been able to seek his bankruptcy over what was an original alleged debt of less than $4,000. This is because the total alleged debt had reached around $20,000 after adding collection costs, by the time the debt collector initiated bankruptcy proceedings.

Increasing the stay period that follows the declaration of intent to file a debtor's petition from 7 to 28 days

Consumer Action supports Schedule 4 Part 2 item 5 of the Bill, which increases the stay period in relation to a declaration of intention to present debtor's petition from 7 to 28 days. The filing of such a declaration is an act of bankruptcy, thus it has serious consequences and is not merely a way for a debtor to avoid the payment of debts. Within that context, we agree that the current 7 day period does not provide debtors with enough time to then assess their options properly and perhaps negotiate with creditors.

Increasing the debt, income and assets thresholds for eligibility for debt agreements by 20%

Schedule 4 Part 2 item 11 of the Bill expands the eligibility to enter into a debt agreement under Part IX of the Act.

We are generally supportive of the Bill and the policy intent behind its amendments. However, we have major concerns about this proposal. It expands the number of persons who may be able to enter into a Part IX debt agreement, despite ongoing strong concerns about the administration of such debt agreements and their appropriateness for many of the debtors to whom they are marketed and sold.

Given these concerns, the amendment remains controversial and we consider that it would be more appropriate to consider it as part of the more comprehensive review of debt agreements to take place next year. The EM notes that the 2007 review of debt agreements decided to retain the thresholds at their current levels until the next review of debt agreements scheduled for 2010 (§144).

In terms of the concerns about debt agreements, financial counsellors have reported that many of their clients have been lured into unrealistic and unsustainable debt agreements, and we are concerned that the large number of unsuccessful agreements is driven by the large fees retrievable by debt agreement administrators under the agreements. 11,353 debt agreements were proposed in the 2008-09 year and 8,599 of these proposed agreements were accepted by creditors but only 29 agreements were completed during the year.[14] The rate of completed debt agreements has declined markedly since 2003-04 and a mere fraction of accepted debt agreements – 3.7% – have been completed over the financial years of 2006-07 to 2008-09.[15]

Debt agreements must be administered in a manner that realistically assesses the debtor's capacity to pay their debts. However, a 2005 report on Part IX debt agreements by Consumer Credit Legal Service (now Consumer Action) and Eastern Access Community Health, *Debt Agreements: Remedy or Racket?*, found that many debtors failed to comply with their debt agreement after being unable to maintain payments that were unlikely to have been sustainable from the start.[16]

It is also important to recognise that many of the consequences of bankruptcy that a debtor may be seeking to avoid by entering into a Part IX debt agreement will still occur in entering into a debt agreement. For example, entering into a debt agreement will be recorded on a person's credit information file in a similar manner to bankruptcy and the person's name will be recorded permanently on the National Personal Insolvency Index. It is also generally considered an 'act of bankruptcy' under clauses in typical consumer lending arrangements such as mortgages, triggering default or foreclosure options for lenders. After the Australian Competition and Consumer Commission (**ACCC**) had concerns that Australia's largest debt agreement administrator, Fox Symes, was not providing consumers with this information it started legal action against the company in 2004.[17] The matter was settled on 10 June 2006 when Fox Symes and its directors gave enforceable undertakings to the Federal Court on the basis that they did not admit that they engaged in conduct in contravention of the *Trade Practices Act 1974*. The undertakings given by Fox Symes, still in force today, were that for a period of five years it:

- will not make certain statements to customers or potential customers in respect of debt agreement proposals and debt agreements;

[14] Inspector-General in Bankruptcy, above n3, p45.
[15] As above.
[16] Consumer Credit Legal Service Inc and Eastern Access Community Health, *Debt Agreements: Remedy or Racket?*, November 2005.
[17] Australian Competition and Consumer Commission, 'ACCC alleges unconscionable conduct by debt administrator', *ACCC website*, http://www.accc.gov.au/content/index.phtml/itemId/518507/fromItemId/465054.

- will use its best endeavours to inform customers and potential customers that details of a debt agreement proposal or debt agreement are highly likely to be recorded on a person's credit report as maintained by credit reporting agencies;
- will explain the nature and effect of all documents provided to customers and potential customers by Fox Symes, and
- will bring to the attention of customers and potential customers the amount of all fees payable in respect of a debt agreement.[18]

We remain concerned that, in the absence of further provisions better regulating the conduct of debt agreement administrators and fees payable for these agreements, the Bill will merely expand the number of potentially very vulnerable consumers who will be at risk of entering into inappropriate and unfair agreements. Our new financial counselling service, MoneyHelp, has already noted several cases involving debt agreements, indicating that problems remain.

Some recent MoneyHelp case studies

Case study 1
Our client was contacted by a debt agreement administrator and advised to enter a Part IX debt agreement. Our client had no assets and approximately $52,000 in credit card debt. He paid $42,000 or 81% of his debts out plus fees to the debt agreement administrator. Our client was not informed of any other options and believed that by entering into a debt agreement he would be able to obtain a mortgage once he had fulfilled his debt agreement obligations. He was not aware that his debt agreement would be listed on his credit file for 7 years.

Case study 2
Our client entered into a debt agreement to pay $26,000 over a period of 5 years. Our client was told by the debt agreement administrator that once the agreement was paid out (after the 5 yrs), his credit file would be clear. Our client now wants to buy a house and wants the default on his credit information file to be removed. When he detailed his concerns to the debt agreement administrator, they provided him with a letter to give to potential creditors saying that he had entered into a Part IX agreement that is administered in accordance with the *Bankruptcy Act* but is an alternative to bankruptcy. However, they admitted to him that it would remain on his credit history for 7 years.

Case study 3
A debt agreement administrator put forward a Part IX debt agreement proposal to creditors for a couple who wanted to protect the equity in their home, which had a market value $320,000 with a mortgage owing of $250,000. The couple's unsecured debt consisted of a $40,000 tax debt and $17,200 in credit card debt. They had a personal loan secured against their car for $19,500. The proposal was rejected by the creditors but the debt agreement administrator charged the couple $1,900.

[18] Australian Competition and Consumer Commission, 'Fox Symes & Associates Pty Ltd', *ACCC website*, http://www.accc.gov.au/content/index.phtml/itemId/585988/fromItemId/684968.

We have recommended to the Government that it revisit the recommendations of the *Debt Agreements: Remedy or Racket?* report and review the operation of debt agreements over the last three years before making any amendments to this part of the Act.

Other issues not addressed in the Bill

There are various issues relating to bankruptcy reform that have not been addressed in the current Bill. For example, the Government had previously raised a potential reform to the Act to enable earlier discharge from bankruptcy for first-time bankrupts with less complex bankruptcies, but this proposal has not been included in the Bill. In our view it is also time for the Government to reconsider the permanent status of entries on the publicly available National Personal Insolvency Index (**NPII**). Bankruptcy itself lasts for a definite time period and is intended to provide a fresh start for a debtor, however, entries on the NPII are indefinite and thus a bankrupt may be subject to ongoing detriment well beyond the intended time period for the effects of bankruptcy.

Further, as noted above, Part IX debt agreements are due for a more comprehensive review and further reforms could be made to clarify the application of the minimum debt threshold. We have also previously raised concerns with the Government that the Inspector-General in Bankruptcy's ability to review trustee remuneration may be too narrow, with little ability to review whether services performed (as opposed to the remuneration for those services) were appropriate or whether, overall, the work undertaken by a trustee was reasonably necessary, efficient and appropriate, particularly in proportion to the size of the debts and the size of the bankrupt's estate.

It is not possible for the Committee to consider these and other issues relating to bankruptcy legislation reform in this inquiry, however, it does indicate that a more comprehensive review of bankruptcy regulation may be warranted in the short to medium term.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. A large proportion of our advice and casework representation relates to consumer credit and debt issues.

Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Since September 2009 we have also operated a new service, *MoneyHelp*, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians facing or experiencing job loss or reduced working hours to help them manage their money and debt.

We again thank the Committee for the opportunity to provide input into its inquiry into the Bill. Should you have any questions regarding this submission, please contact Nicole Rich at Consumer Action on (03) 9670 5088.

Yours sincerely
CONSUMER ACTION LAW CENTRE

Nicole Rich
Director, Policy & Campaigns

Catriona Lowe
Co- CEO