19 August 2011

Dr R Grant
Acting Committee Secretary
Senate Standing Committee on Economics
Parliament House
Canberra ACT 2600
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Dear Dr Grant

Bankruptcy Amendment (Exceptional Circumstances Exit Package) Bill 2011

Thank you for your letter of 12 July 2011 inviting the Insolvency Practitioners Association (IPA) to make a submission on this Bill. The IPA is the peak professional body representing company liquidators and trustees in bankruptcy, and lawyers, financiers academics and others practising in or otherwise interested in insolvency law and practice. In particular many of our members are trustees in bankruptcy who administer the bankruptcies and Part X agreements under the *Bankruptcy Act* with which this Bill is concerned.

Existing exclusions from divisible property

We wish to put this proposed change in context.

In bankruptcy, generally all property owned by the bankrupt – 'divisible property'- vests in the trustee in bankruptcy for distribution to creditors. This includes property that the bankrupt acquires or is given during the 3 year period of bankruptcy – 'after–acquired property'. See *Bankruptcy Act* sections 58, 116.

There are existing exclusions from divisible property in s 116(2) of the Bankruptcy Act. These include household property of the bankrupt, property used for earning income, superannuation funds, proceeds of injury claims, proceeds of life policies and so on. These categories represent a policy decision in each case that the bankrupt should be entitled to keep certain property for their own personal purposes. If the exclusion is in relation to funds – for example the proceeds of personal injuries awards – the Act protects property purchased with those funds: s 116(3).

Rural and disaster funds

Amounts paid under rural support schemes have also been a long established exclusion in s 116(2)(k)-(ma) of the Act and in the Bankruptcy Regulations - Part 6 Division 2A.

We do not comment on the policy but note that it appears to be on the basis that government grants for farmers are to be regarded as personal to the farmer and should be retained for their own use to assist them in relocating, even if this means their creditors are unpaid. There have been similar grants in others industries, including forestry.

We do note the contrast in approach to 'disaster funding'. There are various Commonwealth and State payments and/or grants for financial assistance relating to natural disasters which are affected by bankruptcy; that is, disaster fund payments made to a bankrupt vest in the trustee for the benefit of the bankrupt's creditors.[1]

[1] Full details of different types of such funding are in the table - *Summary of the bankruptcy treatment of Commonwealth and State financial assistance relating to the 2011 Natural Disasters and treatment of insurance and gifts* – at www.itsa.gov.au

Scenarios

As to the proposed law change, we simply wish to point out some possible scenarios in relation to an insolvent farmer, that is, one who is unable to pay their debts as they fall due, either from their cash reserves or from readily saleable assets:

- an insolvent farmer receiving an exit grant of $150,000 may choose to pay their creditors from the grant (depending on the amount of their liabilities), restore their solvency and otherwise proceed to re-establish themselves; or

- that insolvent farmer may choose to go bankrupt and use the grant for their own purposes. That may be for example to set up a business (although bankruptcy itself my impose impediments to that during the 3 year period of bankruptcy), to buy property (which, if bought substantially from the grant moneys, remains protected from bankruptcy – s 116(3)) - or be applied to living expenses;

- a creditor may apply to the court to order that the farmer be made bankrupt. If the farmer's grant moneys are protected, the creditor may have little incentive to take that action. However the creditor could, as an alternative, simply proceed to use legal recovery processes to garnishee or otherwise try to recoup its debt from the farmer's grant money. That then gives the farmer some incentive, or pressure, to go bankrupt in order to obtain protection from the creditor's claim to the funds.

- If a bankrupt farmer uses that money frivolously [as merely a hypothetical example] that is a matter for them. If they purchase an expensive car with those moneys, that car does not vest in the trustee because of the operation of s 116(3). This is no different from other similar exclusions in bankruptcy. For example, bankruptcy law does not debate what a bankrupt person does with their personal injury moneys, which are also exempt.

Secured creditors

The right of a secured creditor is not affected by bankruptcy – s 58(5) - and it can proceed to realise its security, for example over real estate or personal assets of the bankrupt, including assets that are not divisible. For example, a financier with a valid bill of sale or other security interest over household property can repossess that property even though the property is protected from the bankruptcy trustee under s 116(2). We assume that there would be no valid security that would allow a secured creditor to recoup its debt from such a government grant on its receipt by the bankrupt.

Part X personal insolvency agreements and Part IX debt agreements

These are voluntary compromises or arrangements offered to offerings to creditors by debtors that allow the debtor to avoid formal bankruptcy. As they are voluntary, including as to the extent of the property of the debtor offered, it appears there is no need for this proposed change to include them.

Drafting

Section 116(2)(k) of the Bankruptcy Act says that excluded property includes: "(k) amounts paid to the bankrupt under a rural support scheme prescribed for the purposes of this paragraph." Regulation 6.04A sets out certain prescribed rural support schemes to which it is proposed to add this exit grant. Item 4 of the Bill says that the relevant additions to reg 6.04A "apply in relation to any grant under the Exceptional Circumstances Exit Package made on or after 1 July 2010, where a final order in bankruptcy has not been made before the commencement of this item".

Initially, we query the need for a Bill to in effect amend or add to a regulation.

Apart from that, the words - *where a final order in bankruptcy has not been made* - are unclear. They seem intended to say they apply in relation to any grant to a person under the Exit Package made on or after 1 July 2010 where that person goes bankrupt after the law change commences.

Also, the words "order in bankruptcy" suggest a court order, not a voluntary bankruptcy. If that were the case, we would need to understand the policy behind that.

The Explanatory Memorandum further confuses the issue in that it says: *"where a final order in bankruptcy has not been made, that is, the orders have not been finalised by the courts or the debts paid".*

We suggest that the wording be along these lines:

- that the change applies in relation to any grant to a person under the Exceptional Circumstances Exit Package made on or after 1 July 2010; and
- that the amendments be made apply in relation to bankruptcies for which the date of the bankruptcy ("the date of the bankruptcy" is defined in s 5(1)) is on or after the day on which the amendments commence, assuming that is the intent. This seems to be a standard wording – see for example Act No 106 of 2010 Sch 2 item 16.

Yours sincerely

President