The Parliament of the Commonwealth of Australia

Senate Legal and Constitutional Legislation Committee

Consideration of legislation referred to the Committee

Inquiry into the Provisions of the Bankruptcy Legislation Amendment Bill 2001 and the Bankruptcy (Estate Charges) Amendment Bill 2001

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1.1 On 20 June 2001 the Selection of Bills Committee recommended that the provisions of the Bankruptcy Legislation Amendment Bill 2001 (the Bill) and the Bankruptcy (Estate Charges) Amendment Bill 2001 (the Estate Charges Bill) be referred to the Senate Legal and Constitutional Legislation Committee for inquiry and report before 7 August 2001.[1] The Senate subsequently agreed to this referral.[2]

Reason for Referral

1.2 In recommending that the Bills be referred, the Selection of Bills Committee drew particular attention to the impact on low-income earners of the abolition of the 'early discharge' provisions in the Bill.[3]

Conduct of the Inquiry

1.3 Following the reference, the Committee sought submissions from interested organisations and individuals. In response, the Committee received a total of 9 submissions, including 4 supplementary submissions. Submissions are listed at Appendix 1 to this report.

1.4 With one minor exception (which is considered in Chapter 3), none of the submissions raised any issues concerning the provisions of the Estate Charges Bill.

1.5 The Committee held a public hearing in Sydney on 19 July 2001. Witnesses who appeared at this hearing are listed at Appendix 2 to this report.

Note on References

1.6 Submission page references in this report are references to the page numbers of individual submissions received. References to the *Hansard* transcript of the Committee's public hearing are references to the proof *Hansard*. Page numbers may vary slightly between the proof and the official Hansard transcript.

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1 Selection of Bills Committee, *Report No 8 of 2001*.

2 *Journals of the Senate*, No 192, 20 June 2001, p 4538.

3 Senate *Hansard,* (proof), 20 June 2001, p 24656.

CHAPTER 2

THE BILLS

Introduction

2.1 The Bankruptcy Legislation Amendment Bill 2001 (the Bill) and the Bankruptcy (Estate Charges) Amendment Bill 2001 (the Estate Charges Bill) were introduced in the House of Representatives on 7 June 2001.

2.2 In introducing the Bill, the Attorney-General stated that bankruptcy had been devised "as a shield that might be used, in the last resort, by an impecunious debtor to seek relief from his or her overwhelming debts. Over the years, some unscrupulous debtors have learned to use bankruptcy as a sword to defeat the legitimate claims of their creditors".[1]

Purpose of the Bankruptcy Legislation Amendment Bill 2001

2.3 In general terms, therefore, the Bankruptcy Legislation Amendment Bill 2001 proposes to amend the *Bankruptcy Act 1966* (the Act) to address concerns that the bankruptcy system is biased towards debtors, who are not encouraged to think seriously about declaring themselves bankrupt.

2.4 The Bill also seeks to address unfairness and anomalies, particularly in relation to the operation of the early discharge arrangements and the lack of effective sanctions on uncooperative bankrupts. Finally, the Bill proposes a series of amendments to streamline the administration of bankruptcies by trustees, and makes a number of consequential amendments. [2]

2.5 Specifically, the Bill:

- introduces a mandatory 30 day cooling-off period for most debtors who petition for bankruptcy – during this period, the debtor may withdraw their bankruptcy petition;
- gives Official Receivers a discretion to reject a debtor's petition where it appears that, within a reasonable time, the debtor could pay all the debts listed in his or her statement of affairs and that the debtor's petition is an abuse of the bankruptcy system;
- abolishes early discharge from bankruptcy;
- strengthens the objection-to-discharge provisions of the Act by making it easier for trustees to lodge objections to a person's discharge from bankruptcy and more difficult for bankrupts to sustain challenges to objections;

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1 House of Representatives *Hansard*, 7 June 2001 p 26305

2 Explanatory Memorandum, Bankruptcy Legislation Amendment Bill 2001, para 2.

- makes clear that a bankruptcy can be annulled by the Court whether or not the bankrupt was insolvent when a debtor's petition for bankruptcy was accepted; and
- doubles the current income threshold for debt agreements to allow and encourage many more debtors to choose this alternative to bankruptcy.[3]

Purpose of the Bankruptcy (Estate Charges) Amendment Bill 2001

2.6 The Bankruptcy (Estate Charges) Amendment Bill 2001 proposes to exempt any surplus in a bankrupt estate from the scope of the realisations charge. It will also remove current payment obligations for the interest charge and the realisations charge if the amount otherwise payable is less than $10 in a charge period, close some charge avoidance opportunities and simplify some of the administrative provisions in the Principal Act.

Consultation

2.7 The Bills were developed following an extended period of consultation with key stakeholders in all States, and consideration in exposure draft form by the Bankruptcy Reform Consultative Forum (which comprises the Law Council of Australia, the Insolvency Practitioners Association of Australia, the Australian Bankers' Association, the Australian Finance Conference, the Australian Financial Counsellors and Credit Reference Agency (AFCCRA), and Credit Union Services Corporation Australia Ltd (CUSCAL). As a major creditor in many significant bankruptcies, the Australian Taxation Office is also represented on the Forum).[4]

2.8 While this consultative approach is to be commended, the Wesley Community Legal Service observed that "proper consultation with interested and relevant community based welfare organisations did not occur but rather lip service was paid to a few select organisations … financial counselling organisations were not consulted properly".[5]

Broad support for the Bills

2.9 A number of submissions expressed broad support for the Bills. For example the Law Council of Australia expressed support for the majority of the proposed changes which, it considered, "should remedy a number of technical issues and perceived weaknesses in the administration of the Act".[6] CUSCAL – the peak industry body for Australian credit unions – welcomed the proposals in the Bill which it saw as positive for credit union members.

2.10 In its submission, Insolvency and Trustee Service Australia (ITSA) stated that members of the Bankruptcy Reform Consultative Forum "generally were supportive of the

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3 Explanatory Memorandum, Bankruptcy Legislation Amendment Bill 2001, para 3.

4 *Submission 1*, Insolvency and Trustee Service Australia, p 16.

5 *Submission 5*, Wesley Community Legal Service, p 1

6 *Submission 4*, Law Council of Australia, p 2.

measures [proposed in the Bill] although AFCCRA had reservations about the abolition of early discharge."[7]

2.11 Wesley Community Legal Service expressed concern that the Bill would generally disadvantage many of the poor in society and their families, and would only benefit professional debt collectors.[8] It expressed opposition to many of the other provisions in the bill (including giving the Official Receiver a discretion to reject a debtor's petition) on these grounds.

2.12 During the inquiry, submissions raised major concerns about the introduction of the cooling off period and the abolition of the early discharge provisions. In addition, the Law Council raised a number of questions concerning the effect of some of the technical provisions in the Bill. These issues are discussed in detail in Chapter 3.

7 *Submission 1*, Insolvency and Trustee Service Australia, pp 16-17

8 *Submission 5*, Wesley Community Legal Service, p 1

CHAPTER 3

ISSUES RAISED BY THE BILL

Introduction

3.1 Issues raised during the Committee's inquiry included the consequences of the abolition of the early discharge provisions, the effect of the 30-day cooling-off period, and the effect of a number of technical amendments. These are dealt with in detail below.

Abolition of early discharge

3.2 The standard period of bankruptcy is 3 years. Under the early discharge provisions in Division 3 of Part 7 of the Act, certain debtors (principally consumer debtors with low asset backing) may apply to be discharged from bankruptcy after 6 months.

The existing provisions

3.3 The early discharge provisions were inserted in the Act in 1992. In introducing these provisions, the then Minister noted that low income earners had been disadvantaged by previous early discharge provisions, which involved making an application to the court:

> Low income earners are greatly disadvantaged by this system and have no real opportunity to avail themselves of it. Commonly, persons who succeed in obtaining orders for discharge have become bankrupt as a result of failed business activities, and seek early discharge so as to enable them to resume such activities. These are usually also persons who have the capacity to contribute to the estate from income, but do not so. The proposals in the Bill will restore equity to the operation of the early discharge system, and the eligibility and disqualification criteria are designed to ensure that where a person has become a bankrupt because of commercial culpability, he or she is disqualified from early discharge.[1]

3.4 In its submission, ITSA stated that the 1992 amendments were introduced in an attempt to deal appropriately with the then relatively recent phenomenon of 'consumer' bankruptcies (ie bankruptcies resulting from an inability to repay consumer credit debts). The stated intention was that such debtors – whose bankruptcy was due "more to misfortune than misdeed" – could be discharged from bankruptcy after 6 months provided that certain tests were met. In general terms a bankrupt could seek early discharge provided that:

- there was no money in the estate to pay remuneration to a trustee or a dividend to creditors;
- the bankrupt had not disposed or property in a transaction void against the trustee; and
- the bankrupt's income was less than a threshold amount.

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1 *Second Reading Speech*, Bankruptcy Amendment Bill 1991, Senate, *Hansard*, 14 November 1991, p 3128.

3.5 If these eligibility criteria were met, a number of qualifying tests were then applied. In general terms, a bankrupt was disqualified from early discharge if he or she:

- had been bankrupt or entered into a Part X arrangement in the previous 10 years; or
- had given false or misleading information about his or her assets, liabilities or income; or
- had unsecured liabilities exceeding 150% of his or her income in the year prior to the date of bankruptcy.[2]

Deficiencies in the current provisions

3.6 The Explanatory Memorandum to the Bill states that these early discharge provisions "are most often cited as the cause of concern that bankruptcy is too easy"; are seen to "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".[3]

3.7 The EM also states that the provisions operate in discriminatory ways because:

- bankrupts who had assets or income sufficient to make a contribution to the estate were disqualified from early discharge, but were no less worthy of early discharge; and
- in allowing only those with debts less than 150% of income to apply, the provisions discriminated against women who had joints debts with their spouse, but who generally had a lower income.[4]

Support for the existing provisions

3.8 The Wesley Community Legal Service was of the view that the existing early discharge provisions operated fairly and conveniently:

> These provisions are currently only available to small debt bankrupts who are experiencing their first bankruptcy. These provisions allow families to recover quickly and return to some kind of normality. Early discharge encourages small debt low income bankrupts and their families to recover and get on with their lives. The vast majority of their creditors are banks, credit card companies and finance companies and not small business. Early discharge is clerically convenient for ITSA and the Federal Court. It recognises the vast difference between large bankrupts and the small poor bankrupts.[5]

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2 *Submission No 1*, Insolvency and Trustee Service Australia, p 12.

3 Explanatory Memorandum, Bankruptcy Legislation Amendment Bill 2001, para 51.

4 Explanatory Memorandum, Bankruptcy Legislation Amendment Bill 2001, para 53.

5 *Submission No 5*, Wesley Community Legal Service, p 2.

3.9 These views were supported by the West Heidelberg Community Legal Service, which rejected the argument that provisions which allowed people without means to bring some stability to their lives could be said to discriminate against people who had means. The Legal Service also questioned the need for the abolition of early discharge and the evidence which supported it:

> In the 1970s … bankruptcy was being utilised as a threat by creditors, and another form of harassment of debtors on low incomes. In my submission the innovative development of the use of bankruptcy by community legal centres and financial counsellors actually derives from the inappropriate behaviour of creditors and their representatives in the legal and debt collection industry.
>
> People on low incomes were book-ended. Offering credit to people on social security benefits, who had little ability to repay, and then threatening them with litigation when the inevitable occurred, and they couldn't keep up the repayments, is a constant. The very people who apparently complain about bankruptcy being "too easy" today are part of the crowd who used it as a bludgeon in the past.
>
> In summary I ask: where is the evidence to establish that early-discharge provisions for low income earners are misused? How is a single parent with a couple of young children, on social security benefits, who has had a car accident, going to manage her meagre income better if she remains an undischarged bankrupt for 3 years, rather than 6 months?[6]

The need for the amendments

3.10 ITSA told the Committee that the proposed removal of early discharge was a "judgment call" based on "feedback from Credit Union Services Corporation Australia Ltd, 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".[7]

3.11 In its submission, CUSCAL made no specific comment on the abolition of early discharge but, at the Committee's hearing, drew attention to the view that early discharge actually disadvantaged low income earners:

> On one hand, you have got a piece of legislation that which says that after six months you can get an early discharge. That perhaps creates a perception that in six months time you can start again and therefore bankruptcy is not such a difficult option. On the other hand, we know that the seven year rule applies and it will still show up on your credit advantage file seven years later. There is that disparity between those two provisions.
>
> We see this bill as saying: it is not actually over after six months; this is a serious step; you do need to consider it seriously because you are not going to be out of this in six months.[8]

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6 *Submission No 3*, West Heidelberg Community Legal Service, p 2.

7 *Transcript of evidence*, Mr Don Costello, p 2.

8 *Transcript of evidence*, Mr Lovney, pp 12-13.

3.12 In its submission, the Law Council also made no specific comment on these provisions but, at the Committee's hearing, expressed the view that the existing provisions had never worked as intended, and not added anything in the time they had operated, but had not represented a major problem in the implementation of the legislation.[9]

3.13 ITSA provided the Committee with some statistical information on bankruptcies and the operation of early discharge.[10]

TABLE 1: EARLY DISCHARGE APPLICATIONS *

	1999/2000	2000/2001
Total new bankruptcies	23,298	23,907
Applications for early discharge	8560	5583
Early discharge applications withdrawn	63	42
Early discharge applications rejected	1028	475
Early discharge applications granted	7555	5153
Early discharge applications granted (%)	86%	91%

* Numerical discrepancies a result of applications not finalised and carried over

3.14 In response to questioning about the number of bankrupts who were granted early discharge and who again experienced debt problems, ITSA provided the following statistics:

TABLE 2: REPEAT BANKRUPTS AFTER EARLY DISCHARGE

Fin Year	Total bankruptcies	Standard discharges	Repeat bankruptcies	%	Early discharges	Repeat bankruptcies	%
1992/93	14852	7671	114	1.25	1022	0	-
1993/94	14166	12300	259	1.84	4013	5	0.13
1994/95	14132	15095	362	2.06	3355	22	0.66
1995/96	17324	13800	607	3.53	3378	66	1.95
1996/97	21830	12337	815	5.01	4590	113	2.51
1997/98	24408	12208	1009	6.21	6326	138	2.18
1998/99	26376	14492	1522	9.04	7328	262	3.57
1999/2000	23298	17123	1880	10.21	7680	309	4.02
2000/01	23907	18448	2377	11.02	6061	417	6.88
Total	**180293**	**123474**	**8945**	**-**	**43753**	**1332**	**-**

9 *Transcript of evidence*, Mr Lhuede, pp 18-19.

10 *Submission 1A,* Insolvency and Trustee Service Australia, Attachment A, pp 1-2

3.15 ITSA states 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".[11]

3.16 ITSA also referred the Committee to an instance of apparent abuse of the bankruptcy system. A bankrupt who had been unemployed for 10 years, and whose income (presumably from social security) in the year prior to bankruptcy was $8580, had two creditors – a tyre retailer, owed $340, and an exhaust and muffler service, owed $650. The former debt was not disclosed on the bankrupt's statement of affairs and the creditor objected to the petition as it appeared that the debtor had petitioned for bankruptcy solely to avoid having to pay for the tyres. The debtor attributed his non-payment for the tyres to a motor vehicle accident. The second debt had been incurred despite the debtor's inability to pay the earlier debt.

3.17 ITSA also referred the Committee to the work of Ms Betty Weule of Credit Line Financial Services.[12] Discussing the effectiveness of early discharge, Ms Weule stated that:

- early discharge is regarded as the main reason for lack of creditor confidence in the bankruptcy system – creditors believe that there is little incentive for debtors to look for alternatives if they can 'get out' in 6 months;
- the main benefit of early discharge to the bankrupt is psychological – minimising the stress, shame and loss of self-respect created by bankruptcy;
- early discharge provided no real advantages for bankrupts as a bankruptcy remained listed with the Credit Reference Association for 7 years;
- early discharge discriminated against women and debtors with some means; and
- one of the practical reasons for introducing early discharge was not the rehabilitation of the bankrupt but rather to achieve cost savings in the administration of estates.

3.18 Ms Weule noted a proposal to remove early discharge accompanied by a reduction in the period of bankruptcy to two years unless the trustee lodged an objection.[13] This proposal was considered during preliminary consultation on this Bill, but apparently rejected.[14]

Cooling-off period

3.19 In relation to most debtors who petition for their own bankruptcy, the Bill proposes to introduce a mandatory 30 day cooling-off period, which will replace the existing optional 7

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11 *Submission 1B*, Insolvency and Trustee Service Australia, p 3.

12 Betty Weule, 'Early discharge – is it needed? *New Directions in Bankruptcy*, July 1999, included in *Submission 1A*, Insolvency and Trustee Service Australia, pp 2-3.

13 Betty Weule, op cit.

14 *Transcript of evidence*, Mr Lovney, p 16; *Submission 5*, Wesley Community Legal Service, p 2.

day cooling-off period. During this time (ie within 30 days of the Official Receiver accepting a petition), the debtor may withdraw that petition.

Eligible debtors

3.20 Debtors excluded from access to the cooling off period are:

- partnership debtors;
- deceased estates;
- debtors who carried on a business at any time in the 30 days preceding the petition;
- debtors the subject of a creditor's petition or of a specified legal proceeding which is scheduled for substantive hearing within 60 days of the date of the debtor's petition; and
- debtors who, in the 12 months before petitioning, unsuccessfully attempted to make alternative arrangements under the Act (eg if his or her creditors rejected a Part IX debt agreement proposal, or a Part X arrangement was terminated, or a post-bankruptcy composition or scheme was annulled under section 75(4)).

The need for the amendment

3.21 The delay afforded by the cooling-off period is intended to allow debtors who might have acted too hastily in petitioning for bankruptcy to reconsider their decision. It is also intended to allow creditors to be informed of the bankruptcy petition and to have an opportunity to negotiate alternative arrangements with debtors.[15]

3.22 While this amendment was designed as a circuit breaker to allow debtors and creditors to negotiate and consider their positions, ITSA suggested that, ultimately, it provided creditors with no greater safety than they currently enjoyed:

> There is no great difference between the cooling-off period and what happens now. Before a debtor comes in and petitions for bankruptcy now and until the very day that they petition, they are free to do whatever they like with their assets. The mere fact that a cooling-off period has been created does not change the debtor's capacity to dispose of assets if they are so minded. We do not see it as being in substance different from the present position.[16]

Support for a cooling-off period

3.23 The cooling-off period was enthusiastically supported by CUSCAL, which saw it as a unique opportunity to help debtors avoid bankruptcy:

> The experience of our industry at the moment is that a member may petition for bankruptcy. They may not be in arrears. There may not be any indication that that

15 *Submission 1*, Insolvency and Trustee Service Australia, p 3.

16 *Transcript of evidence*, Mr Costello, p 8.

> member is facing financial difficulty. The first time that the credit union will be aware that their member is in financial difficulty is when they receive the notification from ITSA that that person has gone bankrupt. Now, within 30 days, we will be able to approach our member and try to come to an arrangement. That does not necessarily have to be a formal arrangement such as a debt agreement. It could be what is often the case now when we do see members in financial difficulty, and that is negotiating extended repayment periods, reducing interest or a whole range of things that are available to us.
>
> Our interest in our members is paramount in this 30-day cooling-off period. It will provide us, for the very first time, with the opportunity to seek an alternative arrangement … this package of reforms provides us an opportunity to prevent people going bankrupt.[17]

3.24 Bankruptcies also had a significant effect on the profitability of individual credit unions – reducing profits by 20% for smaller, and 10% for larger, credit unions, with a median number of bankruptcies per credit union of 16 (from a range between 3 and 189) and a median value of $5933 (from a range between $2150 and $8929).[18]

3.25 Many aspects of the practical operation of the cooling-off period – for example, the need to prescribe a new period of 5 working days within which creditors would receive a copy of the debtor's petition – had not been finalised. These were to be discussed and resolved by the Bankruptcy Reform Consultative Forum at its next meeting and included in regulations yet to be drafted.[19]

Opposition to a cooling-off period

3.26 The proposed cooling-off period was not supported by the Wesley Community Legal Service, which suggested that the current approach worked very well. It stated that a 30 day cooling off period would create "confusion and needless paperwork" and would achieve little. Most of the Service's clients "have thought long and hard about bankruptcy and have tried all other options". The Service considered that this amendment, when coupled with the other changes proposed in the bill, would "enable private trustees to abuse the debtor".[20]

3.27 The Law Council neither supported nor opposed the policy decision to introduce a cooling off period,[21]but doubted that a sufficient case had been made out "to warrant the introduction of what will be a complex and administratively difficult procedure which will act as a condition precedent to becoming bankrupt".[22]

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17 *Transcript of evidence*, Ms Smith, p 11.

18 *Submission 2A,* Credit Union Services Corporation, pp 1-2.

19 *Transcript of evidence*, Ms Smith, p 13.

20 *Submission 5*, Wesley Community Legal Service, p 2.

21 *Submission 4,* Law Council of Australia, p 5

22 *Submission 4*, Law Council of Australia, p 2.

> The major concern of the Law Council is the complexity of the cooling-of period and the premises upon which all those amendments have been brought. We question the reasoning behind its introduction and consider that it is not going to necessarily alleviate the perceived problem. The complexity this adds to the Act does not warrant that amendment. If it is going to be introduced in some formal manner, it is our view that it would be more appropriate to actually place the affairs of the debtor under the control of a registered trustee or the Official Trustee, with a necessary charge back over those assets or that property for the trustee's fees etc. I think that, from practice, it tells me that people who file a debtor's petition will not have any realisation of what it all means, even with this new mechanism, until such time as something impacts directly on their affairs. An act like the freezing of a bank account makes the debtor it up very quickly and realise just what it means when they go bankrupt …[23]

3.28 In response, ITSA denied that the cooling-off procedures would be complex or difficult.[24] It acknowledged the argument that formally placing a debtor's assets and property under the control of a trustee might act as a deterrent to a hasty petition for bankruptcy, but pointed out that the scope for this was very limited – the vast majority of bankruptcies are sought by people who own no divisible property or assets.[25]

3.29 The LCA also adverted to a possible conflict in the distribution of assets depending on whether the cooling-off period applied or if a sequestration order had been made. Recognising that debts might be incurred during the cooling-off period, the Bill includes proposed new subsection 82(2A). This makes clear that such debts are not provable in the bankruptcy, and are placed in the same category as current post-bankruptcy debts. The Law Council stated that this provision might lead to different results for creditors:

> There is a concern that the rules governing the realisation of property and its distribution to creditors are being fundamentally altered by these provisions and the introduction of a new sub-section 82(2A). On a creditor's petition, all debts up to the date of bankruptcy are provable. Debts incurred after the presentation of the debtor's petition but before the date of the bankruptcy will not be entitled to a rateable distribution of property in the bankruptcy. There will therefore be different outcomes with respect to returns to creditors depending on whether the debtor presents a petition or a sequestration order is made against his or her estate. Such lack of uniformity invites abuse and should be avoided wherever possible.[26]

3.30 The Law Council also acknowledged the potential for preferential dealings when negotiating over a single debt in isolation from all other creditors.

3.31 Noting that debtors filing for bankruptcy were already provided with written information about alternatives, the LCA doubted that a debtor would, in fact, change his or her mind during the cooling off period:

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23 *Transcript of evidence*, Mr Lhuede, p 18.

24 *Submission 1A,* Insolvency and Trustee Service Australia, p 6.

25 *Transcript of evidence*, Mr Costello, p 8.

26 *Submission 4*, Law Council of Australia, pp 6-7; *Transcript of evidence*, Mr Lhuede, p 21

> What will happen is that people will simply file their debtor's petition, go away and forget about it, and 30 days later they will be bankrupt and they will be none the wiser and the creditors will be none the better off.[27]

Technical concerns

3.32 The Law Council queried the effect of a number of the technical and administrative provisions in the Bill.[28] These included:

- whether it may be necessary to amend paragraph 40(1)(g) to provide that a bankruptcy notice may be based on multiple final judgments or orders;
- whether a meeting of creditors (under proposed new section 64ZBA) might be manipulated in circumstances in which not all creditors received notice of the meeting, and whether the new provision should require a minimum response level from creditors;
- whether, in order to accord with general superannuation policy, section 116(2) of the Act and proposed new subsection 109(1A) should be looked to at to see whether a superannuation sum that has vested in a bankrupt should be treated in the same manner as an interest in a regulated superannuation fund that has not yet vested in a bankrupt;
- whether the form Statement of Affairs should be amended to require a bankrupt to provide the information relevant to an exercise of discretion under proposed section 139T;
- given the restriction on the ability of a bankrupt to seek review of an income contribution assessment directly to the ART, whether the Act should include a provision enabling an extension of time for making a review application to the Inspector-General – without such a provision, a bankrupt may be prevented from seeking review through unforeseen circumstances, "resulting in severe hardship and penalties";
- whether the Act should make clear that the Court may extend the time for making an application under section 178 of the Act; and
- whether the reference in proposed new paragraph 149(1A)(c) to paragraph 149D(1)(h) should be a reference to paragraph 149D(1)(f).

3.33 ITSA responded to these specific suggestions as follows:[29]

- no further amendment of section 40(1)(g) is necessary because the existing amendment will permit the aggregation of the debt amounts in two or more final judgments or orders;

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27 *Transcript of evidence*, Mr Lhuede, p 21

28 *Submision 4*, Law Council of Australia, pp 4-9.

29 *Submission 1B*, Insolvency and Trustee Service Australia, pp 1-5.

- it is possible that the new meeting procedures might sometimes be abused, but, on balance, this risk of abuse is outweighed by the administrative efficiencies for trustees – to require particular response levels as suggested "would be likely to make the proposed new procedures of little or no value to trustees";
- the protection of superannuation once it has vested in a bankrupt is a general superannuation policy issue, and the bill is not an appropriate vehicle to address it;
- the suggestion that the Statement of Affairs form be amended will be considered in ITSA's next revision of the form;
- paragraph 33(1)(c) appears to confer the necessary power to extend the time for making a review application to the Inspector-General or an application to the Court; and
- the erroneous cross-reference to paragraph 149D(1)(h) would be corrected by a Chairman's amendment.

The Estate Charges Bill

3.34 In relation to the Estate Charges Bill, the Law Council also queried whether the provision of third party funds to facilitate either a Part X arrangement or a proposal under section 73 ought be subject to the Estate Charge. Such funds did not form part of the debtor's estate – making them subject to the charge would act as a deterrent to such proposals.[30]

3.35 In response, ITSA stated that this amendment was a revenue measure directed at bringing schemes of arrangement and section 73 compositions within the scope of the realisations charge. The amendment was being made to correct a distortion which presently favoured section 73 arrangements over Part X arrangements, because the latter were subject to the charge while the former were not.[31]

30 *Submission 4*, Law Council of Australia, p 2.

31 *Submission 1A*, Insolvency and Trustee Service Australia, p 6.

CHAPTER 4

CONCLUSIONS

Introduction

4.1 The Committee's inquiry indicates general support for most of the provisions in the Bills. However, the West Heidelberg Community Legal Service suggests that there is no evidence to indicate abuse of the early discharge provisions, and Wesley Community Legal Service suggests that the bill draws no distinction between billion dollar and hundred dollar bankrupts.[1] It also suggests that some of the proposed changes will disadvantage the poor and create a new 'privatised' debt recovery industry.

Early discharge

4.2 With regard to early discharge, it is clear that creditors believe that it has provided an incentive for some debtors to opt for bankruptcy rather than look for an alternative approach.

4.3 By making early discharge available only to those without means, the provisions do discriminate against those with some assets or income, who may equally be victims of misfortune rather than misdeed, and by making early discharge available only where a person's debts are less than 150% of their income, the provisions do effectively discriminate against women, whose income is often lower than that of men.

4.4 It is also clear that the benefits of early discharge are largely intangible and psychological. While a bankrupt may be formally discharged after 6 months, and may no longer face the stigma of bankruptcy, in a practical sense the fact of a person's bankruptcy remains on their credit reference file for at least 7 years and affects most of their financial affairs for that time. A survey has also suggested that a significant percentage of debtors prefer to 'do their full time'.[2]

4.5 The Committee's inquiry encountered a lack of data on the impact of early discharge since its introduction. In the words of one witness:

> The discussion that you have been having with ITSA is about whether you believe, or whether ITSA believes, that the abolition of early discharge will or will not impact on low income consumers. I guess we would defer to ITSA and also to the consumer credit representatives. There is certainly some evidence from Betty Weuhle that early discharge does not necessarily advance the interests of low income earners, but there does not appear to be a lot of evidence at all on this issue. There is some recognition that, since the introduction of early discharge, bankruptcies have increased. I guess the question is: is that due to the early

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1 *Submission 5*, Wesley Community Legal Service, p 1.

2 Betty Weule, 'Early discharge – is it needed?', included in *Submission 1A*, Insolvency and Trustee Service Australia.

> discharge provisions or was that going to happen anyway, and will withdrawing it make a difference? I am not sure that there is any data that would support that debate, but I think that is the debate. Has the introduction of early discharge underpinned the increase in personal bankruptcies or has that been about the system of credit reporting that we use in this country, of negative exception reporting versus positive reporting? Has it been about the growth of personal credit? Has it been about a number of factors? If you change the early discharge, will that fix the problem? I am not sure that there is any data to say that one way or another.[3]

4.6 In these circumstances, and notwithstanding the absence of hard data, where the benefits provided by legislation are essentially intangible and apply in a discriminatory manner, it is arguable that that legislation should be amended.

Cooling off period

4.7 With regard to the cooling-off period, it is clear that this proposal is worthwhile in principle. Some debtors may choose to make use of alternatives to bankruptcy if given an opportunity to discuss these with their creditors.

4.8 However, it is also clear that the practical operation of the cooling off period – particularly in circumstances where there are multiple creditors – remains to be resolved, as indicated in the following exchange at the Committee's hearing:

> **Senator COONAN**—What I am really concerned about is that, assuming there are four unsecured creditors, whom you would all rank equally, presumably, if this person goes bankrupt, how do you look after the debtors' interests by going to all the other creditors? Would you see that as your role, to be contacting other creditors?
>
> **Ms Smith**—I do not necessarily think that that is our role, to be contacting other creditors. There are provisions in the existing Bankruptcy Act that talk about creditors meetings and outline how they are to be conducted, et cetera.
>
> **Senator COONAN**—I am just interested to know how you have thought through this cooling-off period and how you are actually going to be providing this assistance to the debtor. If you cannot talk to the other creditors, how would you juggle all the priorities and work out something sensible?
>
> **Mr Lovney**—I guess we see this provision as offering an advantage over the existing circumstances, in that it does offer that cooling-off period.
>
> **Senator COONAN**—I understand that. I am just wondering how you see it working.
>
> **Mr Lovney**—We would see the debtor playing a role in helping to liaise between the different creditors and working out, if they can, if they are able to avoid bankruptcy, some means of prioritising one amongst the others. It may well be that one is quite happy to negotiate, whereas others are not interested, in which case we would expect that the debtor would take that into account when negotiating.[4]

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3 *Transcript of evidence*, Mr Lovney, p 16.

4 *Transcript of evidence*, p 14.

4.9 It has been suggested that introducing a cooling-off period may lead to certain other consequences. For example, it is possible that, during this period, some creditors might seek to pressure some debtors who have filed for bankruptcy, though ITSA has drawn attention to the ACCC Guidelines under section 60 of the *Trade Practices Act 1974* concerning a debtor's right not to be harassed.[5]

4.10 It is also possible that a bankrupt might dispose of assets during this period, or that assets might be disposed of in a manner that prefers one creditor to another. However, the Committee accepts the evidence of ITSA that "there is no great difference between the cooling-off period and what happens now,"[6] and the evidence of CUSCAL that a cooling-off period "offers an advantage over what we currently see, which is nothing".[7]

4.11 The Committee supports the introduction a cooling off period in principle, and acknowledges that accompanying regulations will need to be drafted, in consultation with the Bankruptcy Reform Consultative Forum, to resolve various practical matters such as the timely provision of information by ITSA to creditors.

4.12 The Committee does not consider that introducing a cooling-off period should lead to undue complexity in the administration of the law, but is concerned by the observation of the Law Council of Australia that it may lead to different outcomes for creditors depending on whether a debtor's petition is presented or a sequestration order is made against a debtor's estate.[8] The Committee considers that ITSA should address this issue.

4.13 Given that the proposed cooling-off period remains somewhat undefined in scope, benefit and practical effect, the Committee considers that its operation should be reviewed after 3 years.

Technical amendments

4.14 As noted in Chapter 3, the Law Council of Australia drew attention to a number of consequences which it saw arising out of some of the technical amendments proposed in the Bill.

4.15 ITSA has responded to these suggestions, asserting that some are unnecessary, some are undesirable and acknowledging that others may be examined or amendments made.

4.16 The Committee is not in a position to reach a considered conclusion about these matters and considers that the Bankruptcy Reform Consultative Forum and the Attorney-General's Department should examine them and respond as appropriate.

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5 *Submission 1A*, Insolvency and Trustee Service Australia, p 6.

6 *Transcript of evidence*, Mr Costello, p 8

7 *Transcript of evidence*, Mr Lovney, p 15.

8 *Submission No 4*, Law Council of Australia, p 6

Recommendations

1. The Committee recommends that the Bill be passed.

2. The Committee recommends that the cooling-off period should be reviewed 3 years after its introduction.

3. The Committee recommends that the feasibility of the various technical amendments suggested by the Law Council of Australia be assessed by the Bankruptcy Reform Consultative Forum and the Attorney-General's Department.

Senator Marise Payne
Chair

LABOR SENATORS MINORITY REPORT

BANKRUPTCY LEGISLATION AMENDMENT BILL 2001

BANKRUPTCY (ESTATE CHARGES) AMENDMENT BILL 2001

The Bankruptcy Legislation Amendment Bill 2001 and Bankruptcy (Estate Charges) Amendment Bill 2001 make a number of changes to bankruptcy law. The last major overhaul of bankruptcy legislation was in 1996. The 1996 Bill was substantially based on Labor's 1995 Bill and incorporated amendments recommended by the Senate Legal and Constitutional Legislation committee in September 1995. It is appropriate, particularly given public concern in relation to the misuse of bankruptcy provisions by wealthy debtors, that the legislation be reviewed at this time.

Labor Senators share the Committee's view that the Bills should be passed with the exception of the issue relating to the abolition of the early discharge provisions contained in the Principal Bill.

Early discharge provisions

Labor Senators suggest that great caution is required in respect of the abolition of the early discharge provisions as it is possible that those who will be affected by this measure may be among the most vulnerable.

Administrative early discharge provisions were introduced in 1992 in response to concerns that low-income earners did not have any real capacity to avail themselves of the existing early discharge provisions that required an application to the Federal Court. At that time, only a very small proportion of bankrupts availed themselves of the early discharge provisions, because of the costs involved with making an application to the court. In almost all cases where early discharge was sought, the order was granted.

In respect of early discharge, the second reading speech tabled by Senator Bob McMullan on 22nd August 1995 stated:

> Commonly, persons who succeed in obtaining orders for discharge have become bankrupt as a result of failed business activities, and seek early discharge so as to enable them to resume such activities. These are usually also persons who have the capacity to contribute to the estate from income, but do not do so. The proposals in the Bill will restore equity to the operation of the early discharge system, and the eligibility and disqualification criteria are designed to ensure that where a person has become a bankrupt because of commercial culpability, he or she is disqualified from early discharge.

Under the current early discharge provisions, a bankrupt may apply for early discharge after 6 months from the time when he or she files a statement of affairs with the Registrar.

The eligibility criteria are that:

- the bankrupt has no or insufficient divisible property to enable a dividend to be paid;
- the bankrupt has not disposed of property in a transaction that is void against the trustee; and
- the bankrupt earns an income that is less than the actual income threshold amount applicable to him or her at the time the application for early discharge is made.

Disqualifying criteria include where:

- the bankrupt has previously been a bankrupt;
- the unsecured liabilities of the bankrupt exceed 150% of his or her income in the year prior to the date of bankruptcy;
- more than 50% of the bankrupt's unsecured liabilities are attributable to the conduct by the bankrupt of business activities; and
- the bankrupt has given false or misleading information about his or her assets, liabilities or income.

From these qualifications and disqualifications, it is clear that the abolition of the early discharge provisions will only affect low-income earners and only in respect of their first bankruptcy. Early discharge is not available in respect of second and subsequent bankruptcies.

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:

> 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 Ltd, 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.

Given the absence of anything other than anecdotal evidence, Labor Senators are reluctant to endorse the approach taken in the Bill. In our view, the Government has not offered a convincing rationale which would prevail over the reasons given for the introduction of the early discharge provisions in 1992.

Mr Adrian Lovney, the General Manager of Public Affairs and Compliance for the Credit Union Services Corporation, offered the following insight during the Committee hearing:

> One of the other proposals at the very early stages of this debate, in conjunction with the removal of the abolition of early discharge, was the reduction of the

> absolute period of bankruptcy from three to two years. Many people viewed that as representing a compromise. Our understanding is that proposal was withdrawn by the government but that it did have some support…
>
> It is not clear to me… why that proposal was withdrawn, but it was certainly on the table. Much of this debate is characterised by a compromise between two opposing sides, debtors and creditors, and it is interesting that neither of those groups is here today and that we are stuck in the middle.

It strikes Labor Senators that, in the absence of a compelling justification for the abolition of the early discharge provisions, an amendment to retain the early discharge provisions is desirable.

Accordingly, Labor Senators **recommend** that the Bill be amended to retain the early discharge provisions.

Senator Jim McKiernan	**Senator Barney Cooney**	**Senator Joe Ludwig**
Deputy Chair	**Member**	**Participating Member**

ADDITIONAL COMMENTS OF SENATOR COONEY

BANKRUPTCY ARISES OUT OF A RELATIONSHIP

The provision by one person to another of goods, services or loans establishes a relationship between them. Like most relationships this one brings rights and responsibilities to the people involved.

Receivers of goods, services and loans become indebted to their providers. At times this debt is not met in the way it ought be. In certain circumstances bankruptcy becomes one of the tools available to a creditor to use against a debtor. In certain circumstances the same tool is available to the debtor for him or her to obtain relief from his or her predicament.

IMPACT LARGELY DETERMINED BY LEGISLATION

The consequences flowing to creditors or debtors through bankruptcy will depend largely on the legislative provisions which determine and in what circumstances it is to be available to those who want to use it, how and in what circumstances a person is to be released from its embrace, and what entitlements and obligations it visits upon the parties involved.

BANKRUPTCY IN A VARIETY OF CIRCUMSTANCES

People entering into that area which makes them subject to bankruptcy came from a range of moral positions. Some use it to avoid meeting debts which they have incurred irresponsibly and even criminally. Others become bankrupt despite conducting themselves in the most honest and conscientious way. Likewise the moral standing of creditors who petition for bankruptcy varies. Some have induced and even entrapped the debtor towards his or her fate. Some have been irresponsible in allowing the debtor to reach insolvency. Some have been tricked by the debtor into extending him or her credit. Some have been exploited by the debtor in the most reprehensible fashion. Some have been treated by the debtor with indifference and contempt.

LEGISLATION SHOULD COMPREHEND THIS

Bankruptcy legislation should comprehend the various circumstances which bring people to its use. It should not treat either creditors or debtors as if their conduct was immutable in its

moral worth. Bankruptcy legislation must condition the law so that it is able to resolve matters which arise out of a relationship which is productive of a multiplicity of issues.

LEGISLATION GIVES TOO MUCH TO PRIVATE TRUSTEES

This legislation seeks to give more power to a group external to the relationship between creditor and debtor. That group is constituted by private trustees. This legislation will augment the opportunity for this group to garner more by way of fees from the debtor's estate leaving less for his or her creditors. This group should not be rewarded to the extent that this legislation will make possible.

LEGISLATION TOO DRACONIAN

The Bankruptcy Legislation Amendment Bill 2001 risks being too draconian in much of its operation. It too greatly restricts the relief available to people overwhelmed by debt. In many cases it will impact over harshly on men and women who, before their bankruptcy, were of modest means and limited financial experience and who are inveigled into debt by the very people who then seek to strip them of their income and assets. Further their modest estates will hear the heavy and increased costs of private trustees. In a moral sense these men and women deserve better than they will get under this legislation.

TOO MUCH WEIGHT PLACES ON THE MONETARY DIMENSION AND TOO LITTLE ON THE SOCIAL AND MORAL ONES.

These Bills give too much weight to the monetary dimensions of the relationship between creditor and debtor. It gives too little weight to social and moral issues such as the obligation to lend responsibly and without offering undue enticements, such as the particular circumstances in which a person became indebted, such as the demands fairness might make that a person be discharged from bankruptcy expeditiously.

LACK IN CONSULTATION

It is right to take proper account of the submissions made the Wesley Community Legal Centre and the West Heidelberg Community Legal Service. A suggestion has been made that "proper consultation with interested and relevant community based welfare organisations did not occur but rather lip service was paid to a few select organisations……financial counselling organisations were not consulted properly (sec 7-8 of the Main Report).

CASE FOR CHANGE NOT MADE OUT

The case for legislative change in bankruptcy law has not been well enough made out. Consultation with bodies like the two legal services referred to above has fallen short of what is appropriate. Bankruptcy has the potential to cripple people financially, socially and in terms of their morale and even to ruin their lives. The law relevant to it should not be changed, at least until more people have been consulted than is presently the case.

Senator Barney Cooney

Committee Member

APPENDIX 1

ORGANISATIONS THAT PROVIDED THE COMMITTEE WITH SUBMISSIONS

Organisation	Sub No.
Insolvency and Trustee Service Australia	**1**
Insolvency and Trustee Service Australia	**1A**
Insolvency and Trustee Service Australia	**1B**
Credit Union Service Corporation	**2**
Credit Union Service Corporation	**2A**
West Heidelberg Community Legal Service	**3**
Law Council of Australia	**4**
Law Council of Australian represented by Gadens Lawyers	**4A**
Wesley Community Legal Service	**5**

APPENDIX 2

WITNESSES WHO APPEARED BEFORE THE COMMITTEE

Public Hearing, Monday 2 April 2001 (Canberra)

Mr Don Costello, Acting Adviser, Insolvency and Trustee Service Australia

Mr Michael Lhuede, Chair, Bankruptcy Subcommittee, Insolvency and Reconstruction Committee, Law Council of Australia

Mr Adrian Lovney, General Manager, Public Affairs and Compliance, Credit Union Services Corporation (Australia) Ltd

Ms Karen Smith, Public Affairs Adviser, Credit Union Services Corporation (Australia) Ltd