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Précis Paper

Recent Developments in Bankruptcy Law

A discussion of the recent developments that have taken place in the area of bankruptcy law

Discussion Includes

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Précis Paper

Recent Developments in Bankruptcy Law

1. In this edition of BenchTV, James Johnson (Barrister, Frederick Jordan Chambers, Sydney) and Ian Benson (Solicitor, AR Conolly & Company Lawyers, Sydney) discuss the recent developments that have taken place in the area of bankruptcy law.

Overview

2. The bankruptcy laws in Australia have a long history. They were originally designed to protect debtors. In reality, they do not anymore.

3. They have undergone many changes in the last 30 to 40 years - changes to cater for abuses that took place. Sometimes those amendments worked; sometimes, they did not.

4. As part of a raft of reforms that the Commonwealth was putting together a few years ago, the *Insolvency Law Reform Act 2016* (Cth) came into play, where, in respect of supervision and control of external controllers, an attempt was made to bring the provisions into uniformity between the *Corporations Act 2001* (Cth) and the *Bankruptcy Act 1966* (Cth). The two Acts have now, in effect, been brought together.

5. The new legislation is a product of a more modern style of drafting - it uses different terminology to, and is considerably more lengthy than, the old legislation. It is important for practitioners to note that the *Insolvency Practice Rules (Bankruptcy) 2016* (Cth) are not the Court rules.

6. One good thing that has resulted from the changes is that when referring to a particular section in the *Insolvency Practice Schedule (Bankruptcy)*, there will be very similar (but perhaps not identical) provisions in the same schedule to the *Corporations Act*.

7. There was a lot of confusion between March and September as to what law applied. There are implementation issues with the new legislation, and like any major change in legislation, it will take between 4-5 years before the Courts properly interpret them. General practitioners, though, will not see a lot of this, because the changes relate to:

    - discipline and registration of external controllers
    - the way in which the remuneration, and costs charges and expenses, of external controllers are supervised, regulated, and controlled by the Court
    - (to a lesser extent) the review of decisions of trustees

8. It is important to also realise that under the *Bankruptcy Act*, there has not been any change to the Courts that deal with bankruptcy – that is, the Federal Court, and the Federal Circuit Court. The Family Court has original jurisdiction under the *Bankruptcy Act* when proceedings are on foot in the Family Court under the *Family Law Act* for property proceedings, which means that the Family Court can do anything that any other Court can do under the *Bankruptcy Act*.

9. The Supreme Court of each state or territory cannot exercise powers specifically conferred upon a Court under the *Bankruptcy Act.* This was confirmed by the Full Court in *Truthful Endeavour Pty Ltd v Condon* [2015]. The decision has resulted in quite a few matters from the Supreme Court being transferred to the Federal Court under the jurisdiction of the Courts cross-vesting legislation. It is the Federal Court that predominantly deals with these transferred matters.

10. For some reason, Parliament has not given the Federal Circuit Court powers equivalent to the other two Courts under the *Corporations Act*, which is anomaly because the Federal Circuit Court has original jurisdiction under the *Family Law Act*. This still creates problems at both levels, particularly in the Supreme Court (e.g. exercising powers, dealing with property that vests in a trustee in bankruptcy).

<u>Bankruptcy notices</u>

11. There have not been any changes in respect of bankruptcy notices and creditor's petitions. The traditional way in which bankruptcy notices are dealt with remains the same. The issue of a bankruptcy notice is applied for electronically.

12. The Full Court had to deal with an argument about the validity of bankruptcy notices being issued in *Curtis v Singtel Optus Pty Ltd* [2014]. In this case, the argument was put that at the time of issue of the bankruptcy notice, the judgment was not attached to the bankruptcy notice. The evidence was that it was applied for to be issued electronically. The official receiver, through Australian Financial Security Authority (AFSA), sent an email with three attachments - a covering letter, a bankruptcy notice, and the order.

13. The Full Court said that the bankruptcy notice was valid, it was attached, and it could be fixed. Whether that would stand up in the High Court remains to be seen. It is a practical result, because it would otherwise create a lot of difficulties. But it does create uncertainty as to what the word 'attachment' means.

14. Most bankruptcies are founded on a bankruptcy notice being unsatisfied. A lot of practitioners do not realise that a bankruptcy notice can only be issued if it is applied for

within 6 years of the date of the relevant judgment. There are still many other acts of bankruptcy that can be relied upon.

15. Applications to set aside bankruptcy notices are still being dealt with in the same way – usually, initially before a Registrar acting under a delegation. Registrars are being encouraged to make decisions, unless it becomes contentious, which is a very good approach for the Courts to process a lot of these matters in a more time-cost efficient manner.

Creditor's petitions

16. Equally, on a creditor's petition, the Registrars are dealing with them as much as they can under a delegation. An area of concern is where creditors, who are not secured, but whose debts are notionally novatable or assignable (e.g. strata levies, water rates, etc.), are proceeding to bankrupt people.

17. Most practitioners in NSW would be aware of the issue that getting a certificate from the body corporate means it has to be paid on settlement. A lot of creditors are creditors who have a statutory right of novation of the liability that exists (e.g. strata corporations, water boards). They are usually for relatively small amounts of money, and they get paid on the sale of the property.

Income contribution

18. An area that has arisen in bankruptcy that has also not been changed by the new legislation is the area involving income contribution. An undischarged bankrupt, provided their income (which is defined in s 139L of the *Bankruptcy Act*) as calculated under the income contribution provision is over the threshold, is required to make contributions to their bankrupt estate.

19. A real problem has arisen as a result of a first instance judgment of Justice Pagone, which was confirmed by the Full Court in *Di Cioccio v Official Trustee in Bankruptcy (as trustee of the bankrupt estate of Di Cioccio)* [2015]. In this case Di Cioccio earned some income whilst he was in jail. He became bankrupt, and acquired some property out of the income that he had.

20. The official trustee assessed him, and declared that it was their property - it was after-acquired property (s 58 of the *Bankruptcy Act 1966*). Di Cioccio fought this, and income was effectively found to be after-acquired property. The Regulator has not done anything about this, saying that the trustee has a discretion to allow a person to keep that property under s 134 (1)(ma). This is not sufficient, because historically, before the income contribution scheme was introduced, S 130 of the *Bankruptcy Act* provided that income was not available, unless the Court made an order.

21. Now there is an assessment regime. The review process via the Inspector-General in bankruptcy is another way to review decisions for income contributions, and it is becoming more popular.

22. There are provisions that permit a Regulator, or delegate of the Inspector-General, to say that the decision does not need to be reviewed, and if they want it reviewed, they will have to go to the Administrative Appeals Tribunal (AAT). And then the Inspector-General says that the only decision being reviewed is the decision not to review, so it has to go back to the Inspector-General to make a decision.

23. This of course ignores the express powers that are conferred on the AAT under the *Administrative Appeals Tribunal Act 1975* (Cth). But this was the way that it was determined in *Neffati and Inspector-General in Bankruptcy* [2017]. Again, this decision seems to be wrong - in that it sets up a catch-22. These sorts of decisions give rise to potential criminal offences.

24. Trustees now also make use of the provisions of the administrative anti-avoidance provisions, particularly those contained in s 139Q of the *Bankruptcy Act*, where a trustee can apply to the official receiver to issue a notice under that section, which, in effect, makes a particular structure equivalent to proceedings in a Court, but in an administrative fashion. As part of that notice, the trustee, through the official receiver, requires payment of an amount of money. Under the legislation, a person has 60 days to apply to set that notice aside (s 139 ZS of the *Bankruptcy Act*).

25. Non-compliance with a notice is a criminal offence (it is a strict liability offence).

26. Under the new legislation, one of the areas that is going to stir interest is the removal from the *Bankruptcy Act* itself of the provisions of s 178. S 178, until 1 September, provided for an act, omission, or decision of a trustee to be reviewed within 60 days after the person had become aware of the decision.

27. This has now been repealed. It has now been incorporated as s 90-15 of the *Insolvency Practice Schedule (Bankruptcy).* The persons who can make the claim are identified in s 90-20 of the same schedule.

The *Bankruptcy Amendment Enterprise Incentives Bill 2017* (Cth)

28. Last month, part of the enterprise incentives legislation - the *Bankruptcy Amendment Enterprise Incentives Bill 2017* (Cth) - was introduced. This is the legislation that is going to reduce the standard period of bankruptcy from 3 years to 1 year. It preserves, though, the income contribution scheme for the full period of 3 years.

29. The purpose for making all of these changes is contained in the Explanatory Memorandum.

30. Under s 149D of the *Bankruptcy Act*, there are provisions that permit a trustee to object to discharge to someone if they do not make proper disclosures for income contribution, or do not pay their income contribution.

31. Whilst the income contribution scheme is going to continue for 3 years, that power is now cut off at the end of 12 months. However, these amendments are not going to affect practice immediately.

32. The legislation is likely to go through before Christmas, or in the next sitting. It will only commence 6 months after assent is given to the amendments.

33. The new legislation is going to make it very difficult for trustees, because they have to do things within 12 months. Trustees quite often do not have money or information, and it does take more than 12 months to do a proper investigation.

34. The areas that are very much untouched in bankruptcy at the present time are the superannuation amendments. These amendments have seen very little litigation.

35. Under s 116 (2)(d) of the *Bankruptcy Act*, monies that are contributed to a regulated superannuation fund are not divisible amongst creditors.

36. Then new amendments were introduced, which are difficult to understand, but are designed in the specific instance of superannuation funds (predominately regulated funds) to give the trustees the ability as against the trustee of the fund for monies that have been put into the fund by a bankrupt that might be otherwise able to be attacked to be recovered for the benefit of the creditors.

<u>Regulated funds</u>

37. A regulated fund is one that is regulated under the *Superannuation Industry (Supervision) Act* 1993 (Cth). Once it is regulated, it is always regulated.

38. The area of trust law in insolvency is another area which is partly superannuation, partly family trusts, partly unit trusts. It is untouched because a trust cannot be winded up by an order of the Court.

39. The trust laws in Australia (except in the case of superannuation funds) are regulated under the relevant state Trustee Acts.

40. There is a lot happening in the area of trusts – there are about 508,000 trusts in Australia. Yet very few people really understand how they operate in the insolvency context.

BIOGRAPHY

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Jim was admitted as a solicitor in 1975 and called to the NSW bar in 1991. He is a part time lecturer at UTS. His primary practice is in personal and corporate insolvency including where those areas intersect with family law

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Legislation

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Family Law Act 1975 (Cth)

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