

DEBTORS – BANKRUPTCY AND ITS ALTERNATIVES

Two ways for an insolvent individual to become bankrupt:

1. The Court may make a **sequestration order under s 52** upon presentation of a creditor's petition by a creditor; or
2. Insolvent debtor may file a **debtor's petition under s 55** (Refer to Page 6)

Other options → Part 9 Debt Agreement? Part 10 PIA?

NB: Bankrupt may want to wait to be served with bankruptcy notice and then go bankrupt

Involuntary Bankruptcy (PRESENTING A CREDITOR'S PETITION)

- ✓ NB: Debtor needs a connection with Australia
- ✓ Step 1 - Need to create an act of bankruptcy: s 40
 - **Most common act of bankruptcy - Failure to comply with a bankruptcy notice: s 40(1)(g)**
 - ✓ Creditor must have obtained a court judgment (final judgment or final order) (**s 41(1)(a)**) execution has not been stayed
 - ✓ AFSA / Official Receiver issues a bankruptcy notice to creditor
 - ✓ Creditor serves bankruptcy notice on debtor which specifies the time that debt needs to be repaid (usually within 21 days from date of delivery / handed to debtor)
 - → If debtor doesn't pay or doesn't get bankruptcy notice set aside, debtor has committed an act of bankruptcy → (Refer to Step 2 on the next page) Creditor can issue a bankruptcy petition (can get a creditor's petition) in either Federal Circuit Court or Federal Court
 - NB: Bankruptcy notice must be served within 6 months (**s 44(1)(c)**)
 - **Setting aside bankruptcy notices (see *Kleinwort*)**
 - 1. Are they defective or irregular?
 - A bankruptcy notice can be invalid and liable to be set aside if it contains a fundamental defect or error: ***Kleinwort***
 - A bankruptcy notice is a nullity if it fails to meet a requirement made essential by the Act (decided by process of statutory construction) OR could reasonably mislead the debtor as to what is necessary to comply with the notice: ***Kleinwort*** (objective test)
 - ***Kleinwort*** – Understatement/overstatement of what creditor was owed may be misleading particularly if notice can produce uncertainty as to whether debtor is required to pay amount in fact due or amount specified in the notice.
 - In the case, notice was not misleading as it made clear that if debtor pays the sum specified in the notice (although understatement), then notice is satisfied
 - 2. If the defect or irregularity substantive or formal, has it occasioned substantial injustice to the debtor?
 - Notice can still be valid if defect or irregularity is merely formal, and does not result in substantial injustice to the debtor and the injustice cannot be remedied by a court order: **s 306**

- **Adam v Lambert** – HC looked at s 306(1) and found that citing wrong statute in the case was a formality error, and therefore not a nullity
- **Extending time of compliance with bankruptcy notice**
 - **Section 41(6A)** - Court may extend time for compliance where, before expiration of time fixed for compliance:
 - Proceedings to set aside a judgment in respect of which the bankruptcy notice was issued have been instituted by debtor; or
 - An application has been made to the court to set aside the notice
 - Deemed extension until application is decided: **s 41(7)**
 - **Section 41(6C)** – Where Court is of the opinion that the proceedings to set aside the judgment or order have not been instituted bona fide; or are not being prosecuted with due diligence, Court shall not extend time for compliance.
- Other acts of bankruptcy - Debtor:
 - Makes a conveyance or assignment of their property for the benefit of their creditors: **s 40(1)(a)**
 - Makes a conveyance, transfer, settlement, disposition, creates a charge over property: **s 40(1)(b)**
 - With intent to defeat/delay their creditors, they (i) depart Australia; (ii) depart usual house/place of business; (iii) absents themselves; (iv) keeps house: **s 40(1)(c)**
 - Execution issued against them under court process and their property has been sold or held by Sheriff: **s 40(1)(d)**
 - If debtor presents debtor's petition: **s 40(1)(daa)**
 - If debtor presents to the Official Receiver a declaration under s 54A: **s 40(1)(da)**
 - If debtor gives Official Receiver a Part 9 debt agreement proposal: **s 40(1)(ha)**
- → 'An act of bankruptcy creates a presumption that the debtor is unable to pay their debts (debtor is insolvent).'
- ✓ Step 2 – Debt must total \$5000 (s 44(1)(a))
- ✓ Step 3 – Each of those debts must be a liquidated sum ("sum certain") due at (partly in) law or in equity: s 44(1)(b)(i)
 - NB: Equitable debt: E.g. if trustee misappropriated trust assets, that would create an equitable debt because trustee is obligated to restore the trust in equity
- ✓ Step 4 – Each debt must be payable either immediately or at a certain future time: s 44(1)(b)(ii)
 - Cannot bankrupt someone on a contingent debt
- ✓ Step 5 – Creditors' petition must be presented against debtor within 6 months of the act of bankruptcy: s 44(1)(c)
- ✓ Step 6 – Court must be satisfied of s 52 matters
 - Must prove: **(s 52)**
 - (a) The matters stated in the petition – **Act of bankruptcy**

- (b) Service of the petition - **Must be personally served on the debtor unless you have a substituted service order**
 - Can leave it at place of business: Reg 16.01 (Bankruptcy Regulations)
 - (c) The debts are still owing – **Must verify debt has not been repaid**
And if satisfied, court MAY make a sequestration order under **s 52** (vesting property in trustee and makes person bankrupt).
- If court is not satisfied, or debtor can rebut presumption and satisfy that they're solvent, or there is cause for sequestration order to not be made → Court may dismiss the application: **s 52(2)**

Consequences

- → Where a sequestration order is made, within 14 days of notification of bankruptcy, bankrupt must furnish a statement of their affairs to the Official Receiver: **s 54(1)**
 - Time of discharge does not start running until statement of affairs is lodged
- Creditor can't enforce remedy against person or property of bankrupt. Without leave of the court, can't commence or continue legal proceedings: **s 58(3)**
 - Creditors' rights change from a right to sue them and seize their property to a right to prove the bankrupt estate
- A bankruptcy continues until the bankrupt is discharged or the bankruptcy is annulled: **ss 43(2) and 55(8)**
 - Once someone is bankrupt (e.g. debtor's petition), they cannot be made bankrupt again (e.g. by creditor's petition): **s 55; s 154(1)**
 - **Clyne v DCT** - Court held it is an abuse of process for debtor to present petition to make it impossible for creditors to obtain sequestration order and for further process of shortening the relation back period particularly in relation to property that would otherwise vest in the trustee
 - Court has power to annul a bankruptcy where it is satisfied, that the debtor's petition ought not to have been presented or accepted by the Registrar: **s 154(1)** (e.g. abuse of process)
- **RELATION BACK DATE FOR CREDITOR'S PETITION** - The bankruptcy shall be deemed to have relation back to, and to have commenced at, the time of the commission of the earliest act of bankruptcy committed within 6 months preceding the date when the creditor's petition was presented: s 115(1)

Enforcing personal guarantees (written promise to pay someone else's debts)

- If deed, it is enforceable in absence of consideration
- If not deed, you need consideration – sufficient to provide credit to third party at request of a guarantor (provided money is actually advanced)
 - Assuming there is a default (e.g. of Great Northern) and guarantee has consideration, then can enforce

Voluntary Bankruptcy

- ✓ Debtor needs a connection with Australia: **s 55(2A)**
- ✓ Individual must fill out a particular form and present statement of affairs (assets and liabilities) to Official Receiver: **s 55(2)** (Filing a debtor's petition)
- ✓ If Official Receiver accepts the petition under **s 55** → Person becomes a bankrupt

Consequences

- Debtor's petition - Bankruptcy shall be deemed to have commenced at the of the presentation of the petition, **UNLESS** he/she has committed an act(s) of bankruptcy within the 6 months preceding the date when the petition was presented, in which case the bankruptcy is deemed to have relation back to, and to have commenced at, the time of the commission of the first of those acts: **s 115(2)**

Part 9 - Debt Agreement

- ✓ → For debtors with small amount of debt, low income and few assets
- ✓ Check if they are disqualified for any of these reasons:
 - They have been a bankrupt, given a s 188 authority (Pt X) or party to a debt agreement in previous 10 years
 - Unsecured debts exceed \$100,664.20: **s 185C(4)(b)**
 - Assets exceed \$100,664.20: **s 185C(4)(c)**
 - After tax income in year beginning at time of proposal is greater than \$75,498.15: **s 185C(4)(d)**
- **Procedure**
 - ✓ Debtor must be insolvent
 - ✓ Debtor provides written proposal for an agreement and statement of affairs to the Official Receiver
 - → Written proposal must identify debtor's property, specify how the property is to be dealt with and give authority to a specified trustee (nominated person) to deal with the identified property in terms of the proposal: **s 185C**
 - Making a written proposal is an act of bankruptcy: **s 40(1)(ha)**
 - ✓ Official Receiver writes to each of the affected creditors and asks whether proposal is accepted: **s 185EA**
 - → Proposal for debt agreement must be accepted by majority in value of creditors: **s 185EC(1)**
- If proposal is accepted → **Consequences:**
 - Debt agreement made in accordance with the proposal: **s 185H**
 - Debtor is released from the debts the subject of the agreement: **s 185F**
 - There is a moratorium (suspension) on proceedings against the debtor
 - Secured creditors' rights are not affected
 - Debt agreement administered by registered debt administrator (approved by AFSA)
 - Trustees in bankruptcy can administer and do not have to be separately registered