

# BANKRUPTCY

## Test for Insolvency

- The debtor is insolvent if they are unable to pay debts as and when they become due (s 5(2))
- Then look at s 40 to determine when a debtor can be forced into bankruptcy.
- What indicated they are solvent? What indicated they are insolvent?

## Acts of Bankruptcy

- Date of the first act of bankruptcy committed by the debtor within the 6 months prior to date of presentment of the petition = commencement of bankruptcy
- A judgement against the debtor by itself does not create an act of bankruptcy or non-payment of a debt, or failure to pay debt or the issuance of a judgement against a debtor, by itself does not create an act of bankruptcy.
- s 40(1)(b) - torn invoice is an AOB under
- s 40(1)(c) - departure/remaining out of Aus constituted an act of bankruptcy:  
*Barton v Deputy Commissioner of Taxation*

### s 40(1)(g)

- failure by the debtor to comply with the notice constitutes an act of bankruptcy.
- debtor may avoid default by paying debt, giving security, or satisfied court that it has cross-claim/set-off for greater/equal amount
- bankruptcy notice should comply with s 41 otherwise held invalid. *Re Wong; Ex parte Kitson*

### s 40(1)(h)

- possible that them saying they cant pay is an act but court will say no bc not unequivocal/clear. "Maybe", "If things do not improve, ill suspend", 'I will not be able to pay my debts until all my customers pay me on time' - not an unequivocal admission of insolvency and therefore not an act of bankruptcy and does not necessarily mean they are insolvent. *Conn v Hanks*. Need to show clear intent they are going no suspend. unequivocal = act

## Creditor's Petition

- Date that petition filed determines which transactions can be challenged
- A creditor (or several creditors acting jointly) can only present a bankruptcy petition where all the following conditions are satisfied:
  - i) the debt owing to the creditor (or joint petitioning creditors) amounts to at least \$5,000 and such debt is a liquidated sum (ie fixed or certain amount);
  - ii) the debtor committed an act of bankruptcy within six months before the presentation of the petition; and
  - iii) at the time when the act of bankruptcy was committed, the debtor had a connection with Australia of a residential or business kind
- An Act of b can be used to found a petition by *any* creditor, not just the creditor who issued the bankruptcy notice.

## Sequestration Order

Where, after hearing the creditor's petition, the court makes a sequestration order against the debtor's estate:

- (a) the debtor becomes a bankrupt and continues a bankrupt until he is discharged or the sequestration order is annulled. s 43(2)
- (b) the property of the bankrupt vests forthwith in the Official Trustee in Bankruptcy
- (c) no creditor to whom the bankrupt is indebted in respect of any debt provable in bankruptcy can enforce any remedy against the person or property of the bankrupt, nor commence any legal proceeding: s 58(3).

### **Statutory duties and obligations imposed on bankrupt debtors**

- s 265 (7) - the debtor can be exposed to criminal sanctions reaching as far back as twelve months pre-petition
- s 265(4): Debtor faces criminal liability for disposal (sale or transfer of title) or encumbrance (giving a third party a security interest) of property that has not been paid for: if done with intent to defraud and goes back 12 months pre-petition
- s 265(8) - Goes back 2 years pre-sequestration order
- s 271: R v Chan - not liable under s 271 as her gambling was not a material contribution of her insolvency
- s 269: Morley v R – entering into a contract for legal services without disclosing bankrupt status
- s 77: Debtor must surrender his or her passport to the trustee

### **Effect of Bankruptcy on Bankrupt Debtor (Civil Proceedings)**

Lawsuits where debtor wants to sue people, ie debtor is NOT being sued:

- trustee decides whether it is worthwhile to continue legal action, if trustee does then they must elect to continue the legal action
- Must make mind up within 28 days of a demand from other party
- Trustee can assign cause of action back to debtor if it decides not to continue with it (stupid bc no money and money would go to trustee in bankruptcy for division among the debtors)
- Trustee has no control over lawsuits commenced by debtor for wrongs, personal injury, or death to self or immediate family: *Griffiths v Civil Aviation Authority*

Lawsuits against debtor are NOT discontinued when they are:

- Those brought by secured creditors
- Those brought by persons with non-provable claims - bankrupt is released from provable debts, but not from non-provable debts.
- Those for 'wrongs' committed by debtor which are covered by 3<sup>rd</sup> party insurance

Non provable debts/claims are:

- unliquidated tort claims – any tortious claims which hasn't been reduced to a fixed amount. BA 82(2)
- claims whose values cannot be fairly estimated during the pendency of the bankruptcy and are therefore not discharged (e.g., guaranteed liability)
- Exclude court penalties and fines imposed on debtor by a court for breach of a law. The government will be waiting for the debtor to come out of bankruptcy and accrue some assets before pouncing on the debtor to collect the fines and penalties.

### **Bankrupt Debtor's Ability to Hold Office and Enter Contracts**

- Debtor cannot hold directorship in a company, or hold public office without court approval
- Debtor may enter into new contracts, subject to trustee's right to intervene-trustee might not intervene as if debtor earns more than prescribed limit, the trustee would be able to use that money to distribute

### **Effect of Bankruptcy on the Bankrupt Debtor's Property**

- The date of the first act of bankruptcy = the date which determines when property of the debtor comes under the control of the trustee in bankruptcy.
- Debtor's property is transferred to trustee in bankruptcy and the debtor is subject to various obligations s 58 and 116,

Property that vest in the trustee are as follows:

- All the bankrupt's property at date of becoming a bankrupt (i.e., from date of sequestration order)
- Most property acquired by bankrupt before discharge from bankruptcy
- Property recovered from voidable transactions (see ss 115, 118, 120-122)

Property that do NOT vest in the trustee in bankruptcy:

- Secured property (BA 58(5)):
- See BA 116(2) for all the following categories of exempt property:
- Household goods and apparel up to reasonable amount
- Tools to earn an income up to prescribed limit (currently \$3,750)
- Vehicle for transportation up to prescribed limit (currently \$7,700)
- Life insurance policy & superannuation funds
- Personal property of the bankrupt that has a sentimental value, and is, of a kind prescribed by regulations, such as sporting and military awards
- Income below prescribed limit + 50% above that. Trustee can go after unearned income
- Property purchased with exempt income
- s 117 - Liability insurance payouts to 3<sup>rd</sup> parties injured by debtor (money flows directly to injured party)

### **Effect of Bankruptcy on Bankrupt Debtor (Earned Income)**

- Debtor can keep earned income up to a prescribed limit (increases with number of dependants) BA 139K, 139L
- For any income earned over the prescribed limit, the debtor keeps 50% of it. The rest will have to be paid to the trustee – called contributions which get deposited into the bankruptcy estate and become available for distribution to all the creditors
- The term 'income' includes gifts and certain suspicious loans received by the debtor from friends and family
- Trustee can garnish debtor's salary or income - Garnishee order is a court order to pay all/part of the bankrupt debtor's salary directly to the trustee.

After-acquired property - Property acquired by the debtor after becoming a bankrupt s 58(6)