# CONSUMER BANKRUPTCIES: AN AUSTRALIAN PERSPECTIVE©

BY ROSALIND MASON*

Over the past three decades, Australia has experienced a significant increase in the number of consumer bankruptcies. Until the early 1970s, the number of business and consumer bankruptcies was approximately equal, whereas in 1997 to 1998, for every business-related bankruptcy, there were approximately four consumer bankruptcies. This article gives a concise overview of insolvency laws in Australia, in particular the administrations applicable to individual debtors. Next, it briefly describes current Australian scholarship on consumer bankruptcy, before outlining pertinent bankruptcy and consumer credit regulation. Suggestions to decrease consumer bankruptcy numbers include extension of the "cooling-off period" for those intending to petition voluntarily, encouragement to consumers to enter debt agreements with creditors, and better use of the *Consumer Credit Code* remedies.

Pendant les trois derniers décennies, l'Australie a connu une grande augmentation dans le nombre de faillite des consommateurs. Jusqu'au début des années 1970, le nombre de faillites de consommateurs et d'entreprises était à peu près égal, tandis qu'en 1997 et 1998, pour toute faillite d'entreprise, il y avait approximativement quatre faillites de consommateurs. Cet article donne un survol concis des lois de l'insolvabilité en Australie, plus particulièrement des administrations relatives aux individus débiteurs. Ensuite, il décrit brièvement les recherches actuelles en Australie sur la faillite, avant de donner un aperçu du règlement concernant la faillite et le crédit. De parmi les suggestions pour diminuer le nombre de faillites de consommateurs sont l'extension de la durée de «the cooling-off period» pour ceux qui veulent pétitionner volontairement, l'encouragement des consommateurs de conclure des accords de dettes avec les créanciers, et un meilleurs usage des remèdes du *Code de crédit des consommateurs*.

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## I. INTRODUCTION

Following the stock market crash of the late 1980s and the subsequent notorious financial collapses of well-known corporate groups such as Bond, Qintex, and Lintner, insolvency law gained some rare publicity in the Australian press. With the simultaneous financial demise of many of the entrepreneurs who had founded corporate empires, such as Alan Bond, Christopher Skase, and Abe Goldberg, personal insolvency or bankruptcy law also captured the public (and political) interest. So much so, that the proposed changes to the bankruptcy legislation in 1992 (designed to curtail "high flyers"[1]) were popularly called the "Skase amendments" as they nearly coincided with Christopher Skase's departure from Australia.

Yet the reality is that the majority of bankrupts in Australia do not fit the description of former corporate high flyers enjoying lifestyles of undiminished splendour.[2] A 1998 study by the Insolvency and Trustee Service Australia (ITSA) into the socio-economic situation of those who became bankrupt during 1997 revealed that the profile of a "typical bankrupt" was male, single (including a single parent), under 40 years of age, unemployed, owed creditors approximately A$14,150, had a pre-bankruptcy annual income of A$13,400 (which dropped to A$10,600

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[1] The changes included an income contribution scheme for undischarged bankrupts and revised the grounds for objecting to an automatic discharge.

[2] See *Bond* v. *The Trustee of the Property of Bond* (1994), 125 A.L.R. 399 at 414 (F.C.A.), French J. [hereinafter *Bond*]. See also M. Murray, "Lifestyles of Undiminished Splendour—Bankrupts on Fringe Benefits" (1994) 6:4 J. Insolv. Prac. Assoc. Austl. 6.

after becoming bankrupt), and who also had an 8 per cent chance of being a previous bankrupt.[3]

This and other data compiled by the ITSA, as well as research being undertaken by others—including the national finance industry association, the Australian Finance Conference (AFC),[4] and the Centre for Australian Financial Institutions[5]—is contributing to a better understanding of the Australian dimension of the problem of consumer bankruptcy.

This article gives a concise overview of the regulation of insolvency in Australia and, in particular, the insolvency administrations available for individuals who are unable to meet their debts as they fall due. It then briefly describes current scholarship on consumer bankruptcy, and finally, outlines aspects of bankruptcy and consumer credit regulation relevant to the topic.

## II. AUSTRALIAN INSOLVENCY LAW

Australian law distinguishes between the insolvency of personal and corporate debtors. Under the *Commonwealth of Australia Constitution Act*, the federal Parliament has power to make laws with respect to "bankruptcy and insolvency."[6] The laws dealing with personal bankruptcies and alternative arrangements with creditors are found in the *Bankruptcy Act*.[7] Corporate insolvencies are regulated by the Corporations Law[8] which, while nationally uniform, is for constitutional reasons enacted through state and territory legislation.[9] However, in

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[3] See Insolvency and Trustee Service Australia, *Profiles of Debtors Who Became Bankrupt or Entered into Debt Agreements in 1997* (Canberra: Insolvency and Trustee Service Australia, 1998) at 19.

[4] See S. Edwards, "Consumer Bankruptcy: A Finance Industry Perspective" *New Directions in Bankruptcy* (May 1998) 16 [hereinafter "A Finance Industry Perspective"]; and S. Edwards, "Lending Money and Getting It Back" (Insolvency and Trustee Service Australia, Second National Bankruptcy Congress, Melbourne, 5 November 1998) [unpublished].

[5] See J. Kumar, R. Mason & D. Ralston, "Consumer Bankruptcies: Causes and Implications for the Credit Industry" (1998) 17:3 Econ. Papers 18.

[6] See *Commonwealth of Australia Constitution Act*, s. 51(xvii) [hereinafter *Constitution Act*].

[7] 1966 (Cth) [hereinafter *Bankruptcy Act*].

[8] See *Corporations Act*, 1989 (Cth), s. 82 ("The Corporations Law") [references to section 82 of this *Act* will hereinafter be referred to as the "Corporations Law"].

[9] The Commonwealth's power to enact corporations legislation under section 51(xx) of the *Constitution Act*, *supra* note 6, applies to "[f]oreign corporations, and trading or financial corporations formed within the limits of the Commonwealth." In *New South Wales* v. *The*

practice the laws operate as a national scheme and are regulated by the Australian Securities and Investments Commission.[10] While various law reform bodies and committees of review have pondered a merged regulatory framework for personal and corporate insolvencies,[11] there is no indication at present that the policymakers intend to change the current regime.[12]

## III. PERSONAL INSOLVENCY ADMINISTRATIONS

A number of options are available to a person who is insolvent and unable to pay his or her debts as they come due.[13] In addition to informal action taken outside the regulatory framework, debtors may either have their estates administered in bankruptcy, or enter into binding arrangements with creditors to satisfy their debts in part or in full. A person may become bankrupt voluntarily upon his or her own petition, or involuntarily upon a creditor's petition.

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*Commonwealth* (1990), 169 C.L.R. 482 (H.C.A.), the High Court of Australia held that this section did not allow the Commonwealth to make laws for the incorporation of trading or financial corporations as opposed to making laws to regulate their subsequent activities. The *Corporations Legislation Amendment Act*, 1990 (Cth) made the Corporations Law, *supra* note 8, applicable to the Australian Capital Territory under the Commonwealth's general authority to make laws for the territories: see *Constitution Act*, *supra* note 6, s. 122. Each State and the Northern Territory has since passed corporations legislation that the Corporations Law, as in force for the time being, is to apply in their respective jurisdictions: see *Corporations (New South Wales) Act*, 1990 (N.S.W.); *Corporations (Victoria) Act*, 1990 (Vic.); *Corporations (Queensland) Act*, 1990 (Qld.); *Corporations (South Australia) Act*, 1990 (S.A.); *Corporations (Western Australia) Act*, 1990 (W.A.); *Corporations (Tasmania) Act*, 1990 (Tas.); and *Corporations (Northern Territory) Act*, 1990 (N.T.).

[10] The scheme does have "technical" implications. For example, in *Re Wakim* (1999), 163 A.L.R. 270 (H.C.A.), the High Court of Australia held that a cross-vesting of jurisdiction scheme which purported to vest state jurisdiction in federal courts was invalid. The Federal Court of Australia's company law jurisdiction is now severely limited. Previously, parties freely chose between the State and Territory Supreme Courts and the Federal Court when initiating civil proceedings under the Corporations Law.

[11] See Australia, Law Reform Commission, *General Insolvency Inquiry* (Canberra: Australian Government Publishing Service 1988) at para. 933 [hereinafter *General Insolvency Inquiry*]; Trade Practices Commission, *Study of the Professions: Final Report* (Canberra: Australian Government Publishing Service, 1992) at 73 (Accountancy); and Working Party, *Review of the Regulation of Corporate Insolvency Practitioners* (Canberra: Australian Government Publishing Service, 1997) at 66-69.

[12] On a practical level, this division means that different government bodies regulate personal and corporate insolvency administrations. Individuals fall under the Insolvency and Trustee Service Australia (ITSA), while companies fall under the Australian Securities and Investments Commission. Different government departments are responsible for policy and reform matters: personal insolvency falls under the Attorney General's Department (ITSA), and corporate insolvency falls under the Treasury.

[13] See *Bankruptcy Act*, *supra* note 7, s. 52.

Personal insolvency administrations are conducted by both the public and private sector. Bankruptcies may be administered by trustees from either sector, although the vast majority are administered by the public sector—in effect, the ITSA's Official Receivers. In 1997-1998, of the 24,408 new bankruptcies (voluntary and compulsory), 95 per cent were administered by Official Receivers,[14] and 5 per cent by private registered trustees. Recent legislative amendments permit formal arrangements with creditors to be administered by Official Receivers as well as by private registered trustees, although these are likely to remain the domain of the private sector.[15] Proposals for debt agreements by low-income debtors are processed by the public sector, whereas the administration of approved agreements may be administered either by the public or private sector.

### A. *Sequestration*

#### 1. Debtor's petition

A debtor may become bankrupt voluntarily by presenting a petition to an Official Receiver, together with a Statement of Affairs containing personal details and details of assets, liabilities, and income.[16] If the documents are in the correct form, and no creditor's petition is pending, the Official Receiver must accept the petition, and the person becomes bankrupt on the day the petition is accepted.[17] The Official Receiver automatically becomes the trustee, unless the debtor nominates a private registered trustee who has previously signed a consent to act.

By far, the largest proportion of bankruptcies result from the debtor's own petition. In the 1997-1998 financial year, 94 per cent of

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[14] The Official Trustee, a corporation sole with perpetual succession (see *Bankruptcy Act*, *supra* note 7, s. 18) is the trustee of any estate for which no private registered trustee is appointed. In practice, the Official Trustee acts through the Official Receivers, who conduct the administration of estates for each bankruptcy district (state or territory).

[15] See Australia, House of Representatives, *Bankruptcy Legislation Amendment Bill 1996: Explanatory Memorandum* (Canberra: Australian Government Publishing Service, 1996) at para. 137.2 [hereinafter *Amendment Bill Memorandum*] which stated: "It is intended that the power of the Official Trustee to accept authorities [to commence a formal Part X arrangement with creditors] should be exercised only in very exceptional circumstances … ."

[16] A debtor's petition may be presented by an individual, by a partnership, or by joint debtors: see *Bankruptcy Act*, *supra* note 7, ss. 55-57.

[17] *Ibid.* s. 55(4).

bankruptcies resulted from debtors' petitions and 6 per cent from creditors' petitions.[18]

2. Creditor's petition

Compulsory bankruptcy results from a creditor's petition presented at a Federal Court Registry. The prerequisites are an act of bankruptcy within the previous six months, a specific jurisdictional link with Australia, and a liquidated sum of A$2,000 owing by the debtor to the creditor.[19] The most common act of bankruptcy relied upon is a failure to comply with a bankruptcy notice.[20] In 1997-1998, 7,265 bankruptcy notices were issued, and there were only 1,664 petitions.[21]

Initially, all creditors' petitions are heard by a Registrar exercising delegated powers.[22] At the hearing of the petition, the creditor must prove the matters stated in the petition, the service of the petition, and that the debt relied upon is still owing.[23] Nevertheless, the court has complete discretion in deciding whether or not to make a sequestration order. While the High Court has referred to the public interest in the cessation of unremunerative trading and the rights of creditors whose debts are not paid,[24] courts will not make such orders lightly, due to the drastic change in status that bankruptcy brings.[25]

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[18] Each year the Inspector-General of Bankruptcy, who has the general administration of the *Bankruptcy Act*, is required to report to the relevant minister on the operation of the *Act*, a report that includes much useful information on bankruptcy within Australia: see *ibid.* s. 12(1)(d). For quarterly and annual statistics, see online: Insolvency and Trustee Service Australia <http://law.gov.au/itsa/frame_statistics.html> (date accessed: 5 September 1999).

[19] See *Bankruptcy Act*, *supra* note 7, ss. 43-44.

[20] *Ibid.* s. 40(1)(g).

[21] This number comprises petitions by both creditors and persons administering deceased estates, although the latter are presumably small in number.

[22] See *Federal Court Rules*, Order 77, Rule 7, online: Federal Court of Australia <http://www.fedcourt.gov.au/order77.pdf> (date accessed: 9 September 1999). The potential outcomes are adjournment, dismissal, withdrawal, or a sequestration order: see A. Keay, *Insolvency: Personal and Corporate Law and Practice*, 3d ed. (Sydney: John Libbey & Co., 1998) at 51.

[23] See *Bankruptcy Act*, *supra* note 7, s. 52.

[24] See *Rozenbes* v. *Kronhill* (1956), 95 C.L.R. 407 at 414 (H.C.A.).

[25] See Keay, *supra* note 22 at 52, citing Bowen C.J., and Sweeney and Burchett JJ., in *Re: Neil Robert Russell* v. *Australia and New Zealand Banking Group Limited* (1987), 14 F.C.R. 72 at 75 (F.C.A.).

B. *Part X Arrangements*

The *Bankruptcy Act* also provides for alternative arrangements into which a debtor may enter with creditors so as to avoid bankruptcy.[26] Under Part X arrangements, a debtor who is insolvent signs a section 188 authority in favour of a trustee or solicitor[27] to take control of the debtor's property, and to call a meeting of creditors at which a proposal is made by the debtor.

Prior to the meeting, the controlling trustee sends the creditors a report on the debtor's affairs; an opinion as to whether the creditors' interests would be better served by either accepting the debtor's proposal, if any, or by bankruptcy; and a statement about the possible resolutions that may be passed at the meeting.[28] In order to achieve an arrangement that is binding on all creditors with provable debts, the proposed arrangement must be approved by special resolution, that is, by a majority in number and at least 75 per cent in value of the creditors voting at the meeting.[29]

The options available under Part X are (1) a deed of assignment, by which a debtor assigns all divisible property for the benefit of creditors;[30] (2) a composition pursuant to which creditors agree to accept either repayment over time by instalments, or part payment in full satisfaction; or (3) a deed of arrangement, which is an arrangement to repay debts, whether in whole or in part, and which does not fall within the other two categories.[31]

From the debtor's point of view, arrangements have the advantage of avoiding the stigma of bankruptcy, the cost of court proceedings, and untoward publicity, as well as the limitations that are placed on undischarged bankrupts. Except in a few situations, after-

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[26] For a discussion of non-statutory alternatives, such as private informal arrangements with all creditors (potentially voidable under section 213 of the *Bankruptcy Act*, *supra* note 7), see A. Keay & P. Kennedy, "To Bankrupt, or Not to Bankrupt? The Question Faced by All Insolvency Advisers: Part One" (1993) 1:4 Insolv. L.J. 187.

[27] A registered liquidator or solicitor must sign a consent in writing or, if the Official Trustee is to be appointed, the written approval of an Official Receiver to name the Official Trustee in the authority must be obtained: see *Bankruptcy Act*, *supra* note 7, s. 188(2).

[28] *Ibid.* ss. 189A-189B.

[29] *Ibid.* s. 204.

[30] Divisible property is property that, with the exception of property acquired on or after the day the deed of assignment was executed, would be divisible amongst the debtor's creditors if he or she had become bankrupt on that day: *ibid.* s. 187, "divisible property."

[31] *Ibid.* ss. 187, 204.

acquired property is not affected, and the debtor is not required to make contributions from income to creditors. Arrangements also tend to minimize the extent to which the affairs of the debtor are examined, and the debtor's exposure to criminal prosecution may be less. The advantages for creditors include an independent controller of the debtor's assets from the time the Part X procedure is initiated, and often the creditors will receive a distribution sooner than they would in a bankruptcy.[32]

### C. *Part IX Debt Agreements*

In 1996, a new form of administration was introduced with Part IX debt agreements. Debt agreements are intended to be "a viable low-cost alternative to bankruptcy for low-income debtors with little or no property, with few creditors, and with low levels of liability, for whom entry into a Part X administration is not possible because of inability to meet set up costs."[33] To be eligible, a debtor must have limited assets and liabilities (less than A$54,254.20), and an annual after-tax income of less than A$27,127.10.[34]

Under the Part IX procedure, the debtor submits a proposal and a Statement of Affairs to the Official Trustee (in effect, the ITSA), who determines whether the debtor meets the eligibility requirements under Part IX.[35] The ITSA then advises the creditors of the proposal, provides a summary of the debtor's statement of affairs, and allows the creditors to vote on it either at a meeting or by post.[36] While the proposal is being processed, a moratorium applies to creditors proceeding against the debtor in respect of frozen debts.[37] The debt agreement becomes

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[32] For further discussion of the advantages and disadvantages of arrangements for debtors and creditors, see Keay, *supra* note 22 at 164-66.

[33] *Amendment Bill Memorandum, supra* note 15 at para. 135.16.

[34] These sums are linked to Base Income Threshold Amount (*i.e.*, seven times the basic rate of the partnered pension under the *Social Security Act*, 1991 (Cth)). For the latest indexed figures, see online: Insolvency and Trustee Service Australia <http://law.gov.au/itsa/frame_curr.html> (date accessed: 5 September 1999). A debtor is disqualified from eligibility for a debt agreement where, during the past ten years, he or she has been a bankrupt, a debtor under a debt agreement, or has signed an authority under section 188 of the *Bankruptcy Act*, *supra* note 7.

[35] See *Bankruptcy Act*, *supra* note 7, ss. 185C-185E.

[36] *Ibid.*

[37] *Ibid.* s. 185F. This does not apply to debts arising under a maintenance agreement or maintenance order: *ibid.* s. 185.

effective when the proposal is accepted by a majority and at least 75 per cent (in value) of the creditors voting before the deadline.[38] The agreement remains in force until it ends, is varied, or is terminated.[39]

Due to the restricted eligibility criteria, the creditors are likely to receive very little, if anything, through bankruptcy, and there is the potential for creditors to receive more funds because the agreements are set up by the ITSA. However, creditors may have difficulty in making an informed decision on the proposal because they may feel that the debtor has not disclosed all of his or her assets. Also, where the debtor proposes to make small payments or payments over a long period of time, processing the payments may be more costly to a creditor than simply writing the debt off.[40]

## IV. CONSUMER BANKRUPTCY

Information on bankruptcy in Australia can be obtained from the Inspector-General in Bankruptcy's annual report to Parliament on the operation of the *Bankruptcy Act*, and from the ITSA, which maintains the National Personal Insolvency Index. This is an index of all proceedings which have occurred under the *Bankruptcy Act* and its predecessors.

The following statistical information is based on the 1997-1998 *Annual Report*.[41] In 1997-1998, there were a total of 24,408 bankruptcies—an 11.8 per cent increase on the previous year.[42] Of these, 4,854 (19.9 per cent) were business-related, and 19,554 (80.1 per cent) were non-business bankruptcies.

The distinction between business and non-business bankruptcies depends upon whether or not an individual's occupation and cause of bankruptcy are related to any proprietary interest in a business or

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[38] The deadline is generally the twenty-fifth working day after acceptance of the proposal for processing: *ibid.* s. 185(2).

[39] *Ibid.* ss. 185A-185B.

[40] See K. Smith, "Debt Agreements—A New Alternative for Debtors" *New Directions in Bankruptcy* (July 1997) 21. Other weaknesses that have been identified with the regime are the low qualifying income threshold, the long period (ten years) for disqualifying prior insolvency administrations, and the complicated variation and termination provisions.

[41] See Inspector-General in Bankruptcy, *Annual Report on the Operation of the Bankruptcy Act 1966* (Canberra: Australian Government Publishing Service, 1998) [hereinafter *Annual Report*].

[42] There were also 349 debt agreements (a large increase from the previous financial year, even taking into account the fact that they were first introduced in December 1996) and 427 Part X arrangements (a 15.78 per cent increase on 1996-1997).

company. This classification as business or non-business (or consumer) bankruptcy is based upon the trustees' inquiries, including the bankrupt's Statement of Affairs and the bankrupt's occupational status prior to bankruptcy. Until 1972-1973, the number of business and consumer bankruptcies was approximately equal.[43] In recent years, while the number of business-related bankruptcies has remained relatively steady, consumer bankruptcies have grown significantly.[44]

These record levels of bankruptcy have occurred "despite an expansionary economy and record low interest rates. While economic factors such as unemployment have contributed to rising bankruptcy rates, lenders and mortgage insurers have noted an increasing tendency for borrowers to seek early bankruptcy rather than resolve problems with lender institutions."[45]

Research in other jurisdictions, which highlights a strong correlation between the number of consumer bankruptcies and the growth in the volume of consumer credit, is supported by Australian statistics.[46] A further statistical correlation between the number of consumer bankruptcies and unemployment rates is supported by the soaring unemployment rates in Australia in 1991-1992. However, the current trend of increasing bankruptcies, despite a lower unemployment rate, suggests that factors apart from unemployment rates are responsible for the rise.[47]

As far as the causes of consumer bankruptcies are concerned, there is a dearth of research evidence. In the late 1980s, a study was undertaken in Melbourne utilizing interviews with a sample of undischarged, voluntary consumer bankrupts. The study established a link between creditor harassment and the decision by over-committed debtors to petition for their own bankruptcies.[48]

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[43] See M. Ryan, "Consumer Bankrupts in Melbourne" (1993) 28 Austl. J. Soc. Issues 34 at 35 [hereinafter "Consumer Bankrupts in Melbourne"].

[44] See Appendix, Figure 1, below.

[45] Kumar, Mason & Ralston, *supra* note 5, citing Council of Financial Supervisors, *Annual Report* (Sydney: Reserve Bank of Australia, 1998) at 22.

[46] See Appendix, Figure 2, below.

[47] See Kumar, Mason & Ralston, *supra* note 5 at 20.

[48] See M. Ryan, *The Last Resort: An Empirical Study of Non-Business, Voluntary, Undischarged Bankrupts in Melbourne, Australia* (Ph.D. Thesis, La Trobe University, 1989) [unpublished]. Most respondents (60 per cent) were not employed at the time of their bankruptcy; indeed for 70 per cent of the unemployed debtors, insolvency had come about while they were in receipt of welfare payments on a long-term basis: see "Consumer Bankrupts in Melbourne," *supra* note 43 at 43-44.

In June 1998, allegations of harassment resulted in the Australian Competition and Consumer Commission announcing a research project on section 60 of the *Trade Practices Act*[49] offences.[50] Section 60 prohibits the use of physical force or undue harassment[51] or coercion[52] in connection with the supply or possible supply of goods or services, or payment for goods or services.[53]

Some general information on the causes of bankruptcy is contained in the Inspector-General of Bankruptcy's *Annual Report*.[54] However, these causes are self-attributed, and are classified and categorized from information provided by the bankrupts themselves. For 1997-1998, the five major causes identified by bankrupts as reported by trustees are as follows:[55]

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[49] 1974 (Cth).

[50] See Australian Competition and Consumer Commission, *Undue Harassment and Coercion in Debt Collection*(Canberra: Australian Competition and Consumer Commission, 1999), online: Australian Competition and Consumer Commission <http://www.accc.gov.au/docs/catalog.htm> (date accessed: 4 September 1999).

[51] Harassment is conduct that causes distress, agitation, anxiety, or worry to the recipient; interferes with the recipient's peace and quiet; and/or amounts to pestering or plaguing with repeated requests or demands. It is undue when the conduct is either persistent or, if a one-off occurrence, is excessive, improper, inappropriate, or unnecessary.

[52] Coercion means a negation of choice that can be created by either physical means (*e.g.*, threats of violence) or non-physical means (*e.g.*, threats to reputation or peace of mind). Coercion occurs when unacceptable or illegitimate pressure is brought to bear on one party by another, such pressure being a factor that persuades the victim to undertake a particular course of action.

[53] Some non-exclusive examples cited are telephone communications between 9 p.m. and 8 a.m. (unless the trader has been advised by the recipient that calls within this time period, or a part of this time period, are acceptable and convenient); telephone communications or visits at a person's workplace, where the trader has been asked not to contact the person at work; misrepresentation about the consequences of non-payment or of the debt recovery process; disclosure of information, or threat of such disclosure, to third parties who do not have a clear and legitimate interest in the information (*e.g.*, employers, neighbours, welfare agencies, or government agencies); contacting the consumer when asked to deal directly through an adviser (solicitor, financial counsellor, etc.); and misrepresentation that the trader is a solicitor, is employed by a solicitor, is an independent debt collector, is a bailiff, or is a police officer.

[54] *Supra* note 41.

[55] A study of official files of bankrupts and Part X debtors for the period 1976-1990 was undertaken by Joan Carr to ascertain the social and ethnic backgrounds of debtors, as well as the business characteristics and reasons behind failure. As she noted, a methodological problem was that the officials dealing with bankruptcy petitioners and Part X debtors were involved in a labelling process that was shaped by bureaucratic and legal constraints (*i.e.*, they categorize the responses from bankrupts according to pre-set categories on an official form). Also, causality could not be attributed to the eleven official factors because it was not known for certain that, where bankruptcy did not occur, those factors were not present: see J. Carr, "Business Failure and Social Inequality" (1994) 29 Austl. J. Soc. Issues 195 at 198.

**TABLE 1**
**MAJOR CAUSES OF BANKRUPTCIES IN AUSTRALIA**

| *Business Bankruptcies** | | *Consumer Bankruptcies* | |
|---|---|---|---|
| *Major Causes* | *Per Cent* | *Major Causes* | *Per Cent* |
| Economic conditions | 14.86 | Unemployment | 36.27 |
| Lack of business ability | 11.75 | Domestic discord | 13.37 |
| Excessive interest | 10.73 | Excessive use of credit | 11.65 |
| Lack of capital | 10.69 | Ill health | 6.79 |
| Excessive drawings | 4.09 | Adverse litigation | 3.69 |
| Total | 52.12 | | 71.77 |

* A large percentage (39.1) of business bankruptcies were recorded in the Inspector-General in Bankruptcy, *Annual Report on the Operation of the Bankruptcy Act 1966* (Canberra: Australian Government Publishing Service, 1998) at 44 as "other causes or causes not stated."

Other causes of bankruptcy that have been identified are changing societal and ethical values; consumer awareness of bankruptcy as an option to discharge debt; a competitive retail financial services market using aggressive advertising; the availability of credit for young, low-income consumers who have traditionally been a high-risk group; and gambling.[56] Gambling may be under-represented as a factor in the official statistics, given that the factors are based on information provided by the bankrupts. This is because it is an offence for a bankrupt to have materially contributed to his or her insolvency, or increased its extent, by gambling during the two years before presentation of the petition.[57]

## V. REGULATORY DIMENSION TO CONSUMER BANKRUPTCIES

Recently the AFC has referred to anecdotal evidence of a rise in consumer bankruptcies as follows:

> Feedback from member companies of the Australian Finance Conference (AFC) over recent times has drawn attention to the trend for consumer bankruptcy to be initiated by debtors rather than by creditors, involving relatively small amounts outstanding

[56] See D. Ralston, "Bankruptcy and Credit Risk" (Yarran and Baxter 1998 Lending Conference, Sydney, 7-8 May, 1998) [unpublished].

[57] See *Bankruptcy Act*, *supra* note 7, s. 271(a).

> (estimated average, $2,500) and frequently with little or no prior indication or warning of financial difficulties. This avoidable outcome is of serious concern.[58]

Similar concerns about consumer bankruptcies were expressed in submissions to the Australian Law Reform Commission's *General Insolvency Inquiry*[59] conducted in the late 1980s. In addressing the question of whether alternatives should replace voluntary bankruptcies, the Commission noted in its findings:

> One criticism which was made … was that it is "too easy" to become bankrupt. While, in some cases, that may be a legitimate criticism, other submissions … expressed the firm view that voluntary bankruptcy serves an essential and largely humane purpose in the present credit economy because in many cases it is the only realistic means to deal, in a conclusive fashion, with the financial affairs of an insolvent person. There is compelling evidence that many persons who become bankrupt have no assets and are either not in receipt of income or not able to contribute anything from their income to their creditors.[60]

### A. *Debt Agreements*

The Australian Law Reform Commission concluded in the *General Insolvency Inquiry* that there was a need in Australia to provide an inexpensive and expeditious means for persons (particularly those in receipt of sufficient regular income) to be able to make an agreement with their creditors for a scheme of repayment. An amended form of the recommended Debts Payment Plan[61] has now been implemented in the new Part IX of the *Bankruptcy Act*.

Following the introduction of Part IX to the *Act* on 16 December 1996, 48 debt agreements were implemented prior to 30 June 1997. The statistics for the 1997-1998 financial year show an increase to 349 debt agreements. An interesting difference has emerged between districts. In Western Australia and Tasmania, where members of the private sector (*i.e.*, registered trustees, financial advisers, and others) have assumed the administration of approved agreements, there have been significant increases in the number of debt agreements.

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[58] "A Finance Industry Perspective," *supra* note 4 at 16.

[59] *Supra* note 11.

[60] *Ibid.* at para. 424 [footnotes omitted].

[61] *Ibid.* at para. 432.

**TABLE 2**
**PART IX DEBT AGREEMENTS**

| *District* | *1996-1997* | *1997-1998* | *Per Cent Change* |
|---|---|---|---|
| New South Wales | 13 | 30 | 130.77 |
| Australian Capital Territory | 3 | 7 | 133.33 |
| Victoria | 3 | 15 | 400.00 |
| Queensland | 7 | 27 | 285.71 |
| South Australia | 3 | 14 | 366.67 |
| Northern Territory | 0 | 0 | 0 |
| Western Australia | 18 | 152 | 744.44 |
| Tasmania | 1 | 104 | n.a. |
| Total | 48 | 349 | 627.08 |

Source: Insolvency Trustee Service Australia, "Administrations Under the Bankruptcy Act 1966 Statistics (Provisional) Financial Year Ended 30 June 1998," online: Insolvency Trustee Service Australia <http://law.gov.au/itsa/frame_statistics.html> (date accessed: 4 September 1999).

Little additional information is available at this time on the implementation of debt agreements. However, it appears that in Western Australia, during 1997-1998, about 80 per cent of debt agreements involved payments by instalment over 24–48 months, and the average return promised by debtors was around 70 cents on the dollar (Australian). Some 12 per cent of agreements were terminated through the debtor's default, and it is anticipated that this percentage may rise over time.[62]

## B. *Education*

The *General Insolvency Inquiry* also recommended that a federally-funded public insolvency service be set up to provide basic information and referral services. Its role would be to inform debtors about the nature of the available legal alternatives, the procedures involved, and their impact on the debtor.[63]

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[62] Telephone conversation with John Sherwood, Deputy Official Receiver, Perth, Western Australia (12 August 1998).

[63] See *General Insolvency Inquirysupra* note 11 at para. 475.

On 3 January 1989, a pre-bankruptcy moratorium was introduced to minimize the risks of mistaken and hasty bankruptcies.[64] Where a debtor has decided to present a voluntary petition, a limited stay may be obtained against civil debt-recovery processes.[65] This cooling-off period of seven days is intended to allow the debtor time to consider alternative courses of action. Prior to accepting the declaration of intention to present a petition, the Official Receiver must give the debtor prescribed information on alternatives to, and consequences of, bankruptcy.[66] The same information must also be given to the debtor before the Official Receiver accepts a debtor's petition.[67]

The AFC has stated that it would prefer this cooling-off period to be extended to twenty-eight days, during which time "all affected creditors can assess the debtor's circumstances and agree amongst themselves and with the debtor on an outcome that serves best the collective interests of all parties."[68] Debtors may also contact credit counselling agencies for advice.[69]

### C. *Exempt Property*

One of the possible factors influencing a debtor's decision to enter into bankruptcy is the value of his or her assets that are exempt from the estate administered.[70] In Australia, property that is excluded from divisible property is listed in section 116(2) of the *Bankruptcy Act*, with certain criteria amplified in subsequent subsections and in the *Bankruptcy Regulations*. Exempt property includes the following:

1. Property held by the bankrupt in trust for another person.

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[64] According to Emma Swart and Jenny Lawton, when legal and financial counselling services are approached for bankruptcy advice, it often appears that the debt may not be enforceable or that liability may not exist: see E. Swart & J. Lawton, "Voluntary Bankruptcy—The Ultimate Consumer Protection" (1992) 66 L. Inst. J. 62.

[65] See *Bankruptcy Act*, *supra* note 7, s. 54A

[66] *Ibid.* s. 54D. See also Regulation 4.11 of the *Bankruptcy Regulations*, online: Australasian Legal Information Institute, <http://www.austlii.edu.au/au/legis/cth/consol_reg/br251/> (date accessed: 9 July 1999) [hereinafter *Bankruptcy Regulations*].

[67] See *Bankruptcy Act*, *supra* note 7, s. 55(3A)

[68] "A Finance Industry Perspective," *supra* note 4 at 17.

[69] These include Credit Line in New South Wales, and the Financial and Consumer Rights Council in Victoria.

[70] See F.H. Buckley & M.F. Brinig, "The Bankruptcy Puzzle" (1998) 27 J. Legal Stud. 187 at 199.

2. The bankrupt's household property.[71]
3. Property used by the bankrupt in earning income by personal exertion up to approximately A$2,600,[72] or as increased by creditors or the court.
4. Property used by the bankrupt primarily as a means of transport up to a maximum of approximately A$5,000, or such greater amount as approved by creditors.
5. Prescribed interests in life assurance or endowment assurance, as Well as in regulated superannuation funds or approved deposit funds.[73]
6. Prescribed rights of the bankrupt to recover, as well as actual recoveries of damages or compensation for personal injuries, and property purchased with such protected money.[74]
7. Amounts paid to the bankrupt by way of loan as assistance for the purpose of rehabilitation, household, or re-establishment support under various state and federal rural support statutes.

Unlike North American jurisdictions, the Australian *Act* does not contain interstate differences.[75]

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[71] This means household property of a kind prescribed by the regulations or exempted by creditors' resolution. Regulation 6.03(2) of the *Bankruptcy Regulations*, *supra* note 66, states that divisible property does not extend to household property (including recreational and sports equipment) that is reasonably necessary for the domestic use of the bankrupt's household, having regard to current social standards. As well as listing certain items in Regulation 6.03(3), Regulation 6.03(4) describes criteria that must be considered by the trustee: the number and ages of members of the bankrupt's household, as well as their special health or medical needs, if any; any special climatic or other factors (including geographical isolation) of the place where the residence is located; whether the property is reasonably necessary for the functioning or servicing of the household as a viable and properly run household; and, finally, whether the costs of seizure, storage, and sale of the property would be likely to exceed the sale price of the property, or whether, for any other reason (*e.g.*, costs of transport), the sale of the property would likely be uneconomical.

[72] The maximum amounts permitted in the regulations for income-producing property and means of transport are indexed in accordance with the Consumer Price Index rate.

[73] The effect of changes to the superannuation provisions is that approximately A$870,000 of the bankrupt's superannuation assets is not divisible among creditors: see A. Yeo, "Protection of Superannuation Assets: Potential Problems for Bankruptcy Trustees?" (1996) 4:4 Insolv. L.J. 191.

[74] These include rights for personal injury or wrong done to the bankrupt, the spouse of the bankrupt, or a member of the family of the bankrupt; and rights in respect of the death of the spouse of the bankrupt, or a member of the family of the bankrupt.

[75] See J.S. Ziegel, "Canadian Perspectives on the Challenges of Consumer Bankruptcies" (1997) 20 J. Consumer Pol'y 199; and Buckley & Brinig, *supra* note 70.

D. *Discharge—Fresh Start*

Among the principles identified by the Law Reform Commission to guide the development of a modern insolvency law for Australia was one that stated that "[t]he end result of an insolvency administration, particularly as it affects individuals, should, with very limited exceptions, be the effective relief or release from the financial liabilities and obligations of the insolvent."[76] Thus, a bankrupt gains automatic discharge from bankruptcy three years from the date on which he or she files a Statement of Affairs, unless an objection to the discharge is lodged.[77] In certain circumstances, a bankrupt may also be able to apply for an early discharge six months after that filing date.[78]

Once a debtor becomes bankrupt, creditors who have provable debts or claims[79] against the bankrupt lose their right to pursue the bankrupt to recover such debts or claims[80] and, instead, obtain a right to prove debts with other creditors in the distribution of the estate (*i.e.*, the bankrupt's divisible property).[81] The significance of the discharge is that it releases the bankrupt from all provable debts, and provides the opportunity for a fresh start.

Another factor that may give debtors pause to think about the ramifications of going bankrupt is how long the debtor retains the status of an undischarged bankrupt and the limitations that this may impose. For example, a bankrupt is required to assist the trustee in administering the estate,[82] to notify the trustee of any change of name or address,[83]

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[76] *General Insolvency Inquirysupra* note 11 at para. 33.

[77] See *Bankruptcy Act*, *supra* note 7, s. 149.

[78] *Ibid.* s. 149S. Under section 149T of the *Bankruptcy Act*an early discharge is only available where (1) there is insufficient money available to pay the remuneration or expenses of the trustee in full, or there is no money to pay a dividend to creditors; (2) either the bankrupt has not entered into a transaction void against the trustee or, if he or she has done so and the trustee were to take action, no dividend would be paid to creditors; and (3) the income likely to be earned by the bankrupt in the year following the application will not be sufficient to require an income contribution by the bankrupt. Under sections 149X-149ZE of the *Act* the bankrupt may be disqualified from early discharge where, for example, he or she has been bankrupted or entered into an arrangement with creditors within the past ten years, whether within Australia or a foreign country.

[79] *Ibid.* s. 82.

[80] *Ibid.* s. 58(3).

[81] *Ibid.* s. 108.

[82] *Ibid.* s. 77.

[83] *Ibid.* s. 80.

and to surrender his or her passport to the trustee.[84] While they are bankrupt, bankrupts must disclose their status in applying for credit of A$3,419 or more.[85]

Another potential disincentive for a debtor declaring bankruptcy is the possibility of not only forfeiting after-acquired property, but also making compulsory income contributions to the divisible estate. In 1991, Division 4B[86] was introduced into Part VI of the *Bankruptcy Act* because of the inadequacies of section 131.[87] Now a trustee may assess a bankrupt's income for a twelve-month "contribution assessment" period[88] and, if the income exceeds the "actual income threshold amount" applicable to the bankrupt,[89] he or she is liable to pay to the trustee a contribution to his or her estate.[90] The amount to be paid is calculated by deducting the actual income threshold amount from the assessed income, and dividing that amount by two. The definition of income under section 139L is very broad,[91] and may include the value of benefits provided to a bankrupt in other than an employment context (*e.g.*, gifts and expense payments), and "loans" by associated entities. The bankrupt is required to provide information about income to the trustee and the trustee has powers to claim additional information where he or she suspects false or misleading material has been provided.[92] The decision to assess a bankrupt may be reviewed by the Inspector-General.[93]

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[84] *Ibid.* s. 77(a)(2).

[85] *Ibid.* s. 269. For the latest indexed figures, see online: Insolvency and Trustee Service Australia <http://law.gov.au/itsa/frame_curr.html> (date accessed: 5 September 1999). While it is unlikely to affect non-business bankrupts, they must not manage a corporation without the leave of the court (see Corporations Law, *supra* note 8, s. 229) or act as principals of businesses in certain professional areas, such as solicitors or real estate agents.

[86] See *Bankruptcy Amendment Act* 1991 (Cth), s. 25.

[87] Section 131 was repealed by section 24 *ibid.* It provided that a bankrupt was able to retain income for his or her benefit, subject to any court order to the contrary.

[88] See *Bankruptcy Act*, *supra* note 7, s. 139K.

[89] This is linked to the base income threshold amount, which is increased by percentages depending upon the number of dependants supported by the bankrupt: *ibid.*

[90] *Ibid.* s. 139P.

[91] It was amended by the *Bankruptcy Legislation Amendment Act* 1996 (Cth) after the decision in *Bond*, *supra* note 2.

[92] See *Bankruptcy Act*, *supra* note 7, ss. 139U-139V

[93] *Ibid.* s. 139ZA. The decision may also be reviewed by the Administrative Appeals Tribunal: *ibid.* s. 139ZF.

The bankrupt must pay the income contribution at a time specified by the trustee, although payments may be permitted by instalments.[94] The trustee may recover as a debt due to the estate any contribution not so paid.[95] The Official Receiver, on his or her own motion or at the request of a registered trustee, may also collect the contribution from persons other than the bankrupt (*e.g.*, someone holding money for, or on account of, the bankrupt).[96]

Where a bankrupt is liable to pay a contribution, he or she is not permitted to leave Australia without the court's consent.[97] Also, a bankrupt is disqualified from applying for an early discharge where the income to be derived during the period of one year from the application will exceed the actual income threshold amount.[98] Introduction of the income contribution scheme has meant that creditors are looking for equivalent benefits in any Part X arrangements proposed by debtors to avoid bankruptcy.

A bankruptcy may be extended where a trustee or an Official Receiver lodges an objection to a bankrupt's automatic discharge. The grounds of objection are intended "to encourage bankrupts to co-operate with the trustee and act with integrity."[99] They include matters such as failure to disclose information about assets, liabilities, and/or income, or engaging in misleading conduct after the date of bankruptcy that involves amounts of more than $3,419.[100]

### E. *Consumer Credit Legislation*

The other side to the consumer bankruptcy issue is, arguably, the role of consumer credit. In Australia, the regulation of consumer credit falls within the states' jurisdiction. In 1994, a uniform national scheme for consumer credit legislation, incorporating a Consumer Credit Code,

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[94] *Ibid.* s. 139ZG.

[95] *Ibid.*

[96] *Ibid.* ss. 139ZK, 139ZL.

[97] *Ibid.* s. 139ZU.

[98] *Ibid.* s. 149T.

[99] Keay, *supra* note 22 at 150.

[100] See *Bankruptcy Act*, *supra* note 7, s. 149D. For the latest indexed figures, see online: Insolvency and Trustee Service Australia <http://law.gov.au/itsa/frame_curr.html> (date accessed: 5 September 1999).

was introduced.[101] The Code applies to credit contracts where the debtor is a natural person; the credit is provided wholly or predominantly for personal, domestic, or household purposes; a charge is made for the credit; and the credit is provided in the course of a business.[102] The relevance of the Code for consumer bankruptcy is that it is "based on the principle of truth-in-lending … to allow borrowers to make informed choices when purchasing credit."[103] Thus, the disclosure requirements imposed on credit providers under the Code prior to, at the time of, and during, the credit contract is intended to minimize poor credit decisions by consumers.[104]

The Consumer Credit Code also makes it possible for a debtor to seek variation of contractual terms during temporary financial difficulties. Under section 66(1) of the Code, a debtor who is unable to meet his or her obligations under a credit contract, because of illness, unemployment, or other reasonable cause, and who reasonably expects to be able to discharge them if the terms of the contract were changed,[105] may apply to a credit provider to change the contract. If the credit provider refuses to agree, the debtor may apply to the court to vary the credit contract. [106]

A debtor may also apply to the court to reopen and review unjust contractual provisions.[107] If a credit provider fails to take into account a consumer's ability to repay at the time of entering the credit contract, the court may determine the contract to be unjust, and may reopen the transaction. Section 70(2) of the Consumer Credit Code provides:

> In determining whether a term of a particular credit contract, mortgage or guarantee is unjust in the circumstances relating to it at the time it was entered into or changed, the Court is to have regard to the public interest and to all the circumstances of the case and may have regard to the following—
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> …

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[101] See *Consumer Credit (Queensland) Act* 1994 (Qld), Appendix 36 ("Consumer Credit Code") [references to Appendix 36 of this *Act* will hereinafter be referred to as the "Consumer Credit Code"]; see also R. McDougall, Q.C., "An Introduction to the Consumer Credit Code" (1996) 15 Austl. Bar Rev. 4.

[102] See Consumer Credit Code, *supra* note 101, s. 6(1).

[103] *Consumer Credit (Queensland) Bill* 1994 (Qld.), "Explanatory Notes" at 1.

[104] See Consumer Credit Code, *supra* note 101, ss. 14-18.

[105] The kinds of changes permitted by the Code include extending the contract and lessening payments, and postponing the payment dates.

[106] See Consumer Credit Code, *supra* note 101, s. 68.

[107] *Ibid.* s. 70.

> (l) whether at the time the contract, mortgage or guarantee was entered into or changed, the credit provider knew, or could have ascertained by reasonable inquiry of the debtor at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship … .[108]

The AFC has argued that these provisions should reduce the need for consumers to go bankrupt.[109] If the cooling-off period available for voluntary bankruptcies was extended from seven to twenty-eight days, these provisions could arguably be used more effectively.

## VI. CONCLUSION

Even as long ago as 1604, the British Parliament recognized a public policy dimension to insolvency which takes it beyond the mere resolution of competing debtor and creditors' interests. The preamble to the statute began with these words: "For that Fraudes and Deceipts as new Diseases daylie increase amongst such as live by buyinge and sellinge, to the hinderance of Traffique and mutuall Commerce, and *to the general Hurte of the Realme*, by such as wickedly and wilfullie become Bankrupts … ."[110]

Insolvency means that a debtor has failed to meet his or her financial obligations, and bankruptcy law seeks to promote commercial morality.[111] This is evident in the voidable antecedent transaction provisions,[112] and in debtor misbehaviour comprising criminal offences.[113]

However, the public interest may also be served by looking to ways to decrease the number of bankruptcies, particularly consumer bankruptcies. Potential responses mentioned in this paper have been to make better use of the Consumer Credit Code remedies, to extend the

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[108] *Ibid.* s. 70(2). See also P. Bingham & R. Low, "Re-opening Unjust Contracts" (1996) 70:6 L. Inst. J. 42.

[109] See "A Finance Industry Perspective," *supra* note 4 at 17.

[110] *An Acte for the better Reliefe of the Creditors againste suche as shall become Bankrupts*, 1604 (U.K.), 1 Jac. I, c. 15, s. 1 [emphasis added].

[111] It also seeks to encourage honest trading and to lessen the number of failures: see U.K., Insolvency Law Review Committee, *Insolvency Law and Practice*, Cmnd 8558 (London: Her Majesty's Stationery Office, 1982) at para. 49.

[112] An example of a voidable antecedent transaction provision is one that claws back into the divisible property amounts fraudulently conveyed away.

[113] Materially contributing to the insolvency through gambling is one example of such misbehaviour.

cooling-off period for those intending to petition voluntarily, and to encourage greater use of debt agreements.

It must surely be "to the general Hurte of the Realme" for a society to have so many individuals with the status of "bankrupt," and to have so many credit providers dealing with debtor default, of which apparently there is often no advance warning.[114] Thus, scholarship that promotes a comparative perspective on the multi-faceted issues associated with consumer bankruptcy is to be applauded for the sake of the various "Realmes" involved.

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[114] See Kumar, Mason & Ralston, *supra* note 5.

# APPENDIX

**FIGURE 1**
**BANKRUPTCY RATES**

**FIGURE 2**
**BANKRUPTCY RATES AND CONSUMER CREDIT**
**(PERSONAL LOANS)**