

## THE BANKRUPTCY REGULATOR

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This client newsletter by ITSA's Bankruptcy Regulation branch will be issued each quarter to registered and controlling trustees. In keeping with one of Bankruptcy Regulation's main purposes it is aimed at informing bankruptcy trustees of changes to bankruptcy law, both legislative and case law, and discussing areas of practice and Inspector-General requirements. Articles are welcome and can be forwarded by email to [br.qld@itsa.gov.au](mailto:br.qld@itsa.gov.au).

### BANKRUPTCY LAW

### PRACTICE

## BLAB 2002

On 21 March 2002, the Attorney-General, the Hon Daryl Williams, AM QC MP, introduced two Bills into Parliament which will amend bankruptcy law.

In introducing the legislation he said "Bankruptcy should be a last resort for people who have overwhelming debts and need a fresh start. However, some people see it as a way to get out of paying debts they can afford to pay. The new bankruptcy laws will make it harder for these people to abuse Australia's bankruptcy system."

Changes under the Bankruptcy Legislation Amendment Bill 2002 include:

- a new discretion for Official Receivers to reject a debtor's petition where it appears that the debtor can afford to pay their debts and the petition is an abuse of the bankruptcy system;
- the removal of early discharge provisions that have permitted some people to be bankrupt for only six months;
- the strengthening of trustee powers to object to the discharge

from bankruptcy of uncooperative bankrupts after the standard three-year bankruptcy period

- the confirmation of the Court's power to annul a bankruptcy if the bankruptcy petition was an abuse of process, even if the debtor is insolvent; and
- an increase in the debt agreement income threshold by 50% to about \$46,800, after tax, to encourage more use of debt agreements as an alternative to bankruptcy.



The Bill will not include the previously proposed mandatory 30-day cooling-off period for people filing for their own bankruptcy.

"Consultation with stakeholders in the personal insolvency industry revealed that most believed it would add unnecessary complexity to the system and questioned whether it would significantly reduce the number of avoidable bankruptcies" the Attorney General commented.

In concluding he added "These amendments are designed to stop abuses of the bankruptcy system and to encourage people to consider alternatives to bankruptcy such as debt agreements. They address concerns that bankruptcy is 'too easy' and better balance the interests of debtors and creditors."

The BLAB has passed through the House of Representatives and will now be considered in the Senate in the Spring sitting.

ITSA will be providing information sessions for practitioners on the legislative changes prior to the legislation commencing.

Details of the 2002 Bankruptcy Law Amendment Bill including the Explanatory Memorandum can be found on ITSA's website [www.itsa.gov.au](http://www.itsa.gov.au) in the Bankruptcy Reforms area.

## Part X Issues

Issues have arisen in some Part X matters with a number of administrations recently subject to complaints by creditors and put under media and the political microscope.

Concerns raised include:

- the extent of enquiries undertaken by the controlling trustees,
- the quality of the opinion provided in the report to creditors recommending the Part X and
- the notice had not been forwarded to the major creditor or if it had it had been to an inappropriate address.

An article is included in this edition on s189A is to assist trustees. ITSA's regulation personnel are responding to these concerns both through continued education and through an increased

### Included Inside This Issue

- 1 BLAB Update
- 2 Part X Issues
- 3 New BR National Manager
- 4 Requirements on Controlling Trustees - s189A
- 5 Recent Case Law incl What is a Quorum? -
- 6 Realisations Charge and Inspection Issues
- 7 Bankruptcy Fraud News

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## CASE LAW

presence at Part X meetings where they will raise issues of concern.

**A** further area where inconsistent and sometimes inaccurate practices have been observed is in Part X administrations and sometimes bankruptcies, involving 2 or more debtors, with the incorrect application of section 110 of the Bankruptcy Act.

The usual requirement is that resolutions in favour are required in each separate estate and the joint estate for a proposal to be accepted.

Joint creditors are entitled to vote only in the joint estate and separate creditors in the relevant separate estate.

The exception to this is when there is no joint estate (ie no joint property to distribute) wherein joint creditors can vote in each separate estate along with the separate creditors.

The implications of this are that Deeds of Arrangement and Assignment are not able to be structured to provide eg for joint property to be sold and applied equally to all creditors. They need to be structured to apply joint property to joint creditors and separate property and contributions to the respective separate estates as outlined in s110.

## Proxy Purchase “Not On”

**B**R have become aware of an occasion where a creditor, initially opposed to a proposal, was paid a substantial sum of money outside of the Part X proposal to appoint a person, from the same firm as the debtor’s solicitor, as their proxy vote on all matters. The proxy holder then voted in favour of the debtor’s proposal. This appears to have been arranged by the debtor’s solicitor.

BR considers this is an abuse of the process and believes that s64ZC(6) gives a controlling trustee sufficient right to reject proxies in favour of the debtor or their legal representative. Should a trustee or controlling trustee become aware at, or prior to, a meeting that this has occurred they should reject the proxy. Alternatively if uncertain

the meeting should be adjourned and the matter referred to BR for investigation.

The Inspector-General will consider funding a controlling trustee for a legal challenge to any such proxy.

## S189A Reports

### A Controlling Trustees Duty

(by BR’s Athena Burton and Charles Smith)

**A**n issue for Controlling Trustees is “what information is required in order to provide creditors with an adequate section 189A report?”

A Controlling Trustee is required to carry out investigations and report to creditors pursuant to s189A in a relatively short time frame and the report is critical to the course of the Part X.

The Bankruptcy Act provides only a brief outline of the details to be included in the report. Further guidance can be obtained from case law and the Personal Insolvency National Standards<sup>1</sup>.

As creditors are generally not in a position to obtain information they rely almost exclusively on the Controlling Trustee to provide the relevant information. The main principles from case law are as follows:

- The purpose of the (s189A) report is to appraise the creditors as to the debtor’s affairs so that creditors can make an informed decision on whether to accept the debtor’s proposal.<sup>2</sup>
- The s189A(1)(b) statement of belief of the Controlling Trustee, must be properly based and with such degree of authority that the creditors can confidently act upon the opinion.<sup>3</sup>
- The underlying basis of the preparation of the s189A report is that of a fiduciary duty to the creditors. A Controlling Trustee

<sup>1</sup> For PINS see [www.itsa.gov.au](http://www.itsa.gov.au) or [www.ipaa.com.au](http://www.ipaa.com.au)

<sup>2</sup> *Moustafa; Cobbs Hill (Tas) Meat Supplies Pty Ltd & Others v Moustafa & Others* [1998] 838 FCA

<sup>3</sup> *Re Messina; Ex p Westpac Banking Corp* (unreported 17 April 1998)

must act in an impartial and independent manner and be impartial to the wishes of the debtor<sup>4</sup>.

It is important for the Controlling Trustee to remember that whilst they are the “agent” of the debtor, from the perspective of furnishing creditors with a s189A report their duty to creditors overrides any duty to the debtor.

The various authorities suggest the following information should be included in the report as a minimum:

1. Debtor’s details, date and type of administration, summary of the statement of affairs. (PINS 2.1.1–2.1.4)
2. An outline of the debtor’s proposal. (PINS 1.2.8 and 11.4)
3. An outline of matters investigated by the Controlling Trustee (PINS 2.1.9)
4. An outline of matters requiring further investigations.(PINS 2.1.11)
5. Comparison of the estimated dividend under the proposal and bankruptcy. (PINS 2.1.7)
6. The basis and method for the Controlling Trustee’s and Trustee’s remuneration and an estimate of the remuneration. (PINS 2.1.13 & 11.4)
7. A list of all creditors and the amount of each debt. (PINS 2.1.5)
8. The Controlling Trustee’s opinion as to whether they believe that creditors’ interests would be better served by accepting the proposal or by the bankruptcy of the debtor. (s189A(1)(b))

It is difficult to prescribe the extent of investigations needed to provide the above. The extent of the Controlling Trustee’s inquiries will depend on the individual circumstances and complexity of the debtor’s affairs.

In the McDougall case<sup>5</sup> it was argued that the Deed of Arrangement was flawed as the Controlling Trustee had not provided certain information, albeit that the information was not known to the Controlling Trustee at the time of

<sup>4</sup> Also see *Moustafa*

<sup>5</sup> *McDougall; Ex p Policy Nominees Pty Ltd & Thomas* {1997} 197 FCA

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the report. Goldberg J concluded that a S189A report needs to set out only that information which is available to the trustee and that the requirement “to prepare and file a report...within 14 days of consenting....gives the Trustee a limited time in which to make relevant enquiries.” However it should be noted that in the McDougall administration the trustee had:

- identified the existence of a family trust
- set out a number of the trusts activities and
- made it clear that in the event of bankruptcy the trustee would most likely have access to trust assets pursuant to Section 139D of the Act

The Court thought this sufficient enquiry and appropriate reporting.

It is therefore suggested that as a minimum level of enquiry basic searches such as property, motor vehicle and company records together with independent advice as to asset worth should be obtained, rather than simply relying on details contained in the statement of affairs.

Similarly as was the case in McDougall, where company/trusts are involved some independent enquiry is necessary to ascertain their activity, worth, the bankrupts involvement and possible antecedent transactions, in order to allow the trustee to comment on the effect of bankruptcy particularly in respect to sections 139D, possible deeming of income and contributions and possible voidable transactions.

In summary, all relevant issues necessary to give the creditors a ‘true and fair view’ of the debtor’s affairs must be commented upon.

Given that the integrity of the Personal Insolvency system is questioned when creditors are not properly informed Bankruptcy Regulation will be examining section 189A reports to ensure that they are adequately prepared and plan to hold information sessions to assist controlling trustees.

These are likely to be towards the end of this year subject to timing of BLAB 2002 presentations.

## PEOPLE

## New National Manager BR

ITSA’s Chief Executive and Inspector-General in Bankruptcy Terry Gallagher recently announced the appointment of Andrew Robinson as the National Manager Bankruptcy Regulation.



Andrew will be based in Brisbane and will lead ITSA’s regulators with responsibility for:

- monitoring the standard of trustees and bankruptcy administration,
- working with trustees to improve bankruptcy knowledge and practice,
- registration of bankruptcy trustees
- investigating complaints against trustees, and
- undertaking specified IG reviews of trustees decisions

Andrew brings 20 years experience in the personal insolvency area to the position and was a Deputy Official Receiver for 8 years. For the last 3 years he has been ITSA’s national business line leader for its bankruptcy administration arm where he has primarily focused on consistency of Official Trustee practice and bankruptcy law interpretation.

Amongst accomplishments in this time Andrew oversaw the design and implementation of GST compliant practices in ITSA’s administrations and was on the ATO’s GST Insolvency Forum. Andrew disclosed that he plans to use his contacts and his experiences as an ITSA trustee to build on the existing relationship between Bankruptcy Regulation (BR) and insolvency practitioners.

“I also plan to draw on feedback provided to BR in ITSA’s client survey”, Andrew stated.

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“Suggestions made by trustees included BR being more visible, having more joint training opportunities and dealing quickly with trustees who contravene the Act, and who don’t consistently display the type of conduct required”.

Andrew considered that “BR will have a greater presence initially by being involved in more regular open forums with practitioners and by attending more creditor meetings”.

Andrew has commenced this initiative having recently been involved in presentations and meetings in Hobart, Adelaide Brisbane and Melbourne.

## How Many Hearts?

(What constitutes a quorum?)

In order to determine whether a quorum is constituted at a meeting it is necessary to refer to section 64N(2) of the Bankruptcy Act.

However in respect to voting, should the words in sub-section 64N(2)(a) “where there is only creditor entitled to vote”, relate to where there is only one creditor of the estate or should they be interpreted with reference to who attends the meeting and whether they have provided a s64ZA statement?

BLAB 2002 amendments propose a change to section 64N(2) to ensure that a quorum will be constituted where a creditor together with the trustee or representative is present.

Until the legislation is amended the current position is reflected in the Huynh case<sup>1</sup>, a decision of a full Federal Court, 20 March 2002.

The Court held that where a meeting is attended by only one creditor, either personally or by proxy, and there are 2 or more creditors in the estate, there is no quorum constituted for the purposes of section 64N(2)(a) of the Act.

### BACKGROUND

On the request of Huynh, a creditor and the appellant in these proceedings, the trustee called a meeting in order to

<sup>1</sup> Huynh v Pascoe {2002} FCA 309

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consider the appointment of a new trustee, pursuant to section 181. At the first meeting and the subsequently adjourned meeting the appellant was the only creditor present. Both meetings were adjourned pursuant to section 64N(3) by the trustee, who took the view that no quorum was present.

The appellant then sought an order under section 178 that the trustee be removed. The main point highlighted in this summary is the context in which section 64N(2)(a) is to be interpreted.

**INITIAL DECISION**

Branson J held that “the question of whether ‘there is only one creditor entitled to vote’ within the meaning of subs 64N(2) is to be determined firstly by reference to the total body of creditors and not by reference only to those present at the meeting.”

In addition the creditor must also then have complied with ss64ZA by having given the trustee a statement of their debt (see section 64D).

**DECISION ON APPEAL**

The Appeal Court upheld the decision with the majority agreeing with the trial Judge’s determination with respect to the interpretation of the relevant words in section 64N.

Conti and Ryan JJ held “That principle, which we consider to be reaffirmed in s64N(2), is that where there are two or more creditors entitled, independently of s64ZA or its predecessors, to vote, a quorum may not be constituted by only one such creditor or his or her proxy or attorney.”

Carr J, in also dismissing the appeal disagreed with Conti and Ryan JJ in relation to the issue of the interpretation of the words in section 64N(2). Carr J held that the subsection should be interpreted in the context of 64ZA.

**WHAT DOES THIS MEAN FOR TRUSTEES?**

The current position is that where there are 2 or more creditors in the estate, to form a quorum and have a valid meeting, at least 2 creditors who are entitled to vote must be present, either personally or by proxy or attorney.

In addition for there to be a creditor “who is entitled to vote” the creditor must have complied with ss64ZA(5) & (6) by having given the trustee a statement under s64D. The proposed BLAB 2002 amendments to section 64N(2) will result in a change to this position so that one creditor and the trustee will constitute a quorum.

**Recent AAT**

In the recent AAT decision of *Jeanette Ayoub v Inspector-in Bankruptcy (2002)* the AAT affirmed the decision of the Inspector-General to refuse to exercise a discretion under regulation 16.10 of the *Bankruptcy Regulations* to waive or remit the whole or part of the Official Trustee’s fees, and pursuant to section 283 of the Act to remit the realisations charge.

The discussion concerning waiver of the realisations charge (pp 16-18) may be of particular interest.

**B(EC) Act Charges****“Up Front” Payments**

Fees are often paid to a trustee prior to the signing of an authority under Part X or consent. The Inspector-General’s ruling is that where the payment represents a preliminary consultation and professional advice prior to a s188 authority being signed or consent this is not a “receipt” by a trustee subject to realisations charge.

However any amount which represents an upfront payment of controlling trustees’ or trustees’ fees is subject to the charge. Such components should be properly brought to account in the Part X accounts of the controlling trustee and trustee if applicable.

**Third Party payments**

In some instances debtors have arranged to pay a trustee the amount of a Part X Deed or Composition net of fees. The fees are then paid by a third party. The Inspector-General’s legal advice confirms realisation charge is payable on funds received from the third party. The receipt should be reflected in the estate account.

**Secured Creditors - R/C Deductions**

Following the Realisation Charge presentations BR was requested to provide a list of what constituted a “permitted deduction” under sub-section 8(3)(b) of the B(EC)A “amounts paid to secured creditors”.

In the absence of a specific reference the definitions under the Bankruptcy Act apply to the B(EC) Act. In this case the definition of a “secured creditor” under section 5 of the Bankruptcy Act applies. This states:

“secured creditor **in relation to a debtor**, means a person holding a mortgage, charge or liens **on property of the debtor** as security for a debt due...**from the debtor**”.

The essential elements have been highlighted. Hence charges, mortgages or liens provided by a trustee over monies due to the trustee for debts incurred by a trustee are not payments to a “secured creditor” within s5 of the Act and do not qualify as a permitted deduction.

It is inappropriate to try to be too prescriptive but by way of example permitted deductions include payments made or money withheld in respect to:

- valid mortgages given by the debtor prior to bankruptcy or Part X to secure housing debt,
- local council rates owing at the time of sale,
- a solicitors lien on funds where the debtor engaged the solicitor prior to bankruptcy ie the work was not undertaken on behalf of the trustee,
- registered bill of sale on plant and equipment given by the debtor to secure business advances.

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Costs that are not permitted “secured creditor” deductions:

- a trustee's legal costs (irrespective as to whether the solicitor has a lien on funds due to the trustee)
- trustee's agent's costs

### Section 161B Monies

Does the realisations charge apply to payments made to a trustee by the debtor pursuant to section 161B?

BR's short answer based on legal advice is “yes”. The Explanatory Memorandum to the Bankruptcy Estate Charges Act 1997 states that “Clause 6 proposes the imposition of a similar charge which will replace the fee imposed by sub-rules 179(2) and (3)”. Sub-rules 179(2) and (3) refer to a fee payable upon furnishing an account to the Registrar in accordance with s175(1)(a) or s211(1) of the Act.

Those sections, now repealed, referred to the account of receipts and payments in respect of the estate that had to be furnished to the Registrar. Former s179(5) imposed a fee on the total amount received by the trustee of the estate, less amounts paid to secured creditors, amounts paid in carrying on the business and any surplus returned to the bankrupt or debtor.

As a trustee's remuneration is reflected in the account of receipts and payments in respect of the estate, it is subject to the B(EC) Act charges. Accordingly a trustee's minimum remuneration received under s 161B including the top up which has been recovered from the bankrupt under s 161B(2), is subject to the B(EC) Act.

### Payment by Creditors to Trustees to cover fees

Are payments by creditors that include funds to cover a trustee's fees and out of pockets “amounts paid to the trustee by creditors under an indemnity in respect of costs” pursuant to sub-section 8(2) of the B(EC)A?

The Inspector-General's legal advice reinforces the principles in s109 that “costs” in this regard only relates to amounts payable by the trustee and not the trustee's fees.

Advances to cover trustee's fees are therefore not payments to the trustee “under an indemnity in respect of costs” within ss8(2) of the B(EC)A.

The out of pocket costs are capable of a costs indemnity and R/C would not be payable on funds received from an indemnifying creditor for this purpose.

### EES/GEERS Payments to a trustee

Money received from DEWRSB under the EESS or GEERS legislation is not monies received by the trustee in their capacity of trustee under the Bankruptcy Act, rather it is a payment made as agent of DEWRSB. Neither funds paid to a practitioner, to be passed on to employees, or fees for providing that service, attract realisations charge.

## Trustee Resigns

As a result of BR's proactive routine inspection program a trustee faced with an inspection and discovery advised BR that he had misappropriated estate trust monies for personal use. At the same time the trustee resigned as a registered trustee.

The matter was referred by ITSA to the state police who have interviewed the trustee and charges are pending. The matter is currently with the state DPP.

## B'rupt Jailed



A 1996 Queensland bankrupt Laurence David Suarez was jailed for seven years in May for a multitude of offences which saw him receive \$1.3 million from a series of fraudulent transactions.

The prosecution followed a co-ordinated effort between the registered

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trustee administering the bankruptcy, ITSA's fraud investigation team, state police and both State and Federal DPP.

Suarez was charged with various state and bankruptcy offences and in handing down his decision Senior Judge Gilbert Trafford Walker indicated that he would have jailed Suarez for longer had he not made a guilty plea on 73 charges and had no other convictions.

He is reported to have taken fraudulent advantage of a number of parties including friends and his employers over a 4 year period. The conviction received good press coverage where it was reported that the state prosecutor took 90 minutes to summarise Suarez's "varied and diverse" offences.

## Fraud Investigators

ITSA's Bankruptcy Fraud Investigation team (BFI), have since September 2001 applied greater resources to bankruptcy offences and have adopted a more streamlined approach to investigations. They are now able to handle and investigate more referrals and have a more focussed service delivery to stakeholders.

BFI investigators are recruited & trained for their offence investigative role and the team is also augmented with out posted AFP Agents.

Meetings have taken place in most states between trustees and BFI head Jeff Hanley which has enabled ITSA to outline its processes and for trustees to provide valuable feedback. Trustees have been offered electronic Offence Referral Forms, Offence check-lists, Contact Details for the entire Fraud Investigation crew to facilitate and enhance the offence referral process.

Jeff has advised that “In the last 9 months 99 referrals have been received from registered trustees compared to 45 referrals received in 12 months prior”. “Referrals from private practitioners have increased 400% in the last 6 months which has led to 40

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briefs recently submitted to the DPP” Jeff said.

It is also pleasing to see that in the last 9 months 35 people have received 89 convictions whilst 20 people were convicted on 33 offences in the 12 months to 31 August 2001.

Trustees should contact BFI upon discovery of potential offences. Successful prosecutions are posted on ITSA's website.



## Inspection Issues

In addition to the Part X and realisation charge issues canvassed above the following are the most common compliance issues that have been identified from the 2002 inspection program of registered trustees and the Official Trustee:

- Non compliance with general meeting procedures including recording attendances, minutes and resolutions passed,
- Inadequate control over assets including insufficient inventories, passport control and inadequate safeguards of the trustees interest in respect to real estate,
- Insufficient examination of creditors claims when determining voting rights,
- Breaches of s168/169 with funds relating to an administration not being receipted into the administration bank account,
- Inadequate internal controls re payment of remuneration resulting in unintentional unauthorised payments, and
- Failure to comply with sub-regulation 4.14.1 requiring a notice to creditors within 28 days.

## CONTACTS

## How to Contact us:



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**NB** \* Mike and Terry have responsibility nationally for Complaints and IG Reviews

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