Reforms to Australian personal insolvency law

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The Australian Government has announced four short-term law reform priorities to improve the personal insolvency system, and an alternative 1-year period for low-asset bankruptcies. At the same time, a parliamentary report has recommended a comprehensive inquiry into both corporate and personal insolvency.

Australian bankruptcy law never properly responded to some of the more fundamental recommendations of the 1988 Harmer Report,[1] for example that the doctrine of relation back be abolished — a "fictitious, artificial and abstract concept . . . rarely understood"[2] — along with the act of bankruptcy — "a relic from the past where debt carried social stigma and public approbation"[3] — and that the "unnecessarily complicated" form of bankruptcy notice, subject to "excessive technical dispute", be replaced.[4]

Over 35 years later, the extent of any reform by government is to lift the threshold for the issue of a bankruptcy notice from $10,000 to $20,000, and increase the days for a debtor's compliance from 21 to 28, and remove debt agreements as a trigger for an act of bankruptcy. A limited response to a 1-year bankruptcy period is also offered.

These are rather limited, also because the government is yet to respond to the Parliamentary Joint Committee on Corporations and Financial Services (PJC) Report on Corporate Insolvency in Australia of July 2023,[5] which recommended a "comprehensive" review of both personal and corporate insolvency law, with a road map of how that should be pursued.

The government response in defence might be that these personal insolvency reforms come from the separate "roundtable" meeting of bankruptcy stakeholders, in March 2023, chaired by the Attorney-General,[6] from which a reform agenda was taken, and which would not intrude upon any more comprehensive review.

The minor changes

The technical changes in the law announced from that reform agenda are these.

To increase the monetary threshold for involuntary bankruptcies

It is proposed to increase the threshold for the issue of bankruptcy notices and creditors' petitions from $10,000 to $20,000, as indexed.[7]

Involuntary bankruptcies, ordered by the court as sequestration orders, comprise under 10% of all bankruptcies. We are not told how many notices or creditors' petitions are issued or presented in the $10,000 to $20,000 range but it would not be large.

The higher $20,000 threshold would be more likely aimed at limiting the use of bankruptcy notices, and petitions, as debt recovery mechanisms. While the courts once regarded the use of bankruptcy processes for debt recovery as akin to extortion,[8] the present proscription is narrow[9] and it is well-acknowledged that many a bankruptcy notice is issued and served for that purpose. Also, the courts no longer query the withdrawal of a petition[10] if the creditor is paid by the debtor, or the debt is compromised, even if that might be a preferential payment.[11]

Nevertheless, it might be queried whether notices and petitions should be issued relying upon the implied or real threat of bankruptcy, rather than have the creditor pursue standard debt recovery mechanisms, or at least for moderately small amounts. The sum of $20,000 might be seen as appropriate.

The broader issue, beyond the narrow perspective of this proposed reform, is the extent to which a single creditor should be able to initiate bankruptcy proceedings against a debtor at all, for whatever amount. This right has been questioned as being inconsistent with the modern goals of bankruptcy unless it can be shown that all creditors would collectively serve to benefit from the bankruptcy.[12] Given that bankruptcy dividend returns average around 2c/$,[13] for a creditor to pursue a debtor to bankruptcy in order to recover money owing from divisible property must be rare, or unwise, unless particular circumstances exist. This issue might be left for any comprehensive review.

An increase in the timeframe during which a debtor may respond to a bankruptcy notice from 21 days to 28 days

Apparently, this will take some pressure off debtors — or prolong it.

To reduce the period a discharged bankruptcy is publicly recorded on the NPII to 7 years

The period of time that a discharged bankrupt's name is publicly recorded on the National Personal Insolvency

Index (NPII) is indefinite. It is to be reduced to 7 years following the 3-year minimum discharge period, that is, at least 10 years in all. This brings bankruptcy in line with "spent convictions" for serious crimes under the Crimes Act 1914 (Cth). The fact of a bankruptcy is important legally, and it would still be apparent on court and asset registers.

To remove the proposal or acceptance of a debt agreement as an act of bankruptcy

The extent to which acts of bankruptcy arise from a Pt IX debt agreement[14] must be minimal, noting again that acts of bankruptcy including "keeping house" and departing from one's dwelling-house were recommended for repeal by the 1988 Harmer Report.

The impact

It is boldly said that these changes will "ensure a fairer outcome for debtors" and reduce the "stigma" of bankruptcy.[15] Whereas, among all the reforms that might have been made, these are quite limited.

One-year bankruptcy

A 1-year period of bankruptcy was first proposed in 2015, then again in 2021.[16] The 2023 roundtable participants continued to identify it as a "long-term" reform priority. In part response, a procedure modelled on New Zealand's No Asset Procedure[17] is proposed by the government, a Minimal Asset Procedure, as an alternative and perhaps short-term solution, outlined in a discussion paper.[18]

Minimal Asset Procedure

The New Zealand model provides an alternative personal insolvency option that allows a person with debts of between NZ$1,000 (New Zealand's bankruptcy threshold) and NZ$50,000 and who holds no realisable assets to be cleared of their debts. The No Asset Procedure is less restrictive than bankruptcy and usually lasts for 1 year. A person is only able to enter into the Procedure once.[19]

The paper refers to other international models which are intended to achieve similar purposes. These include the Debt Relief Order in England and Wales,[20] the Minimal Asset Process in Scotland and the Debt Relief Notice in Ireland. These processes are compared in the discussion paper.

It is said that a "Minimal Asset Procedure would clear a person's debts and allow access to a fresh start sooner than a bankruptcy, where that person has no other way to pay. Importantly, it should also leave creditors no worse off — meaning Australia's personal insolvency system remains fair and balanced".

It estimates over a quarter of bankrupts (26.8%) would qualify, that is, those with under $50,000 in liabilities and less than $10,000 in assets.

The discussion paper refers to this group or "cohort" existing in the current consumer environment of non-traditional forms of credit such as buy-now-pay-later options which are apparently leading to an increasing number of debtors who are in financial distress.

Proposed elements of the Minimal Asset Procedure

These are the proposed elements of a Minimal Asset Procedure in Australia:

- there be a maximum debt threshold of $50,000 to enter the procedure
- it would last for 12 months, with a period of 4 years post-discharge to be listed on the NPII
- a maximum threshold for income would be determined for eligibility for entry. The base income threshold amount (BITA) is mentioned as a guide, being the amount which allows a bankrupt person to earn a certain amount before being required to pay income contributions. The BITA informs the annual income threshold amount (AITA)[21] which for a person with no dependants is around $70,000 after tax as at April 2024. The AITA increases based on the number of the person's dependants
- a maximum threshold of $10,000 in assets to be eligible for entry, with exceptions for tools of trade, and a vehicle
- a debtor may only enter into the procedure once and
- overall, the procedure should be less onerous than a bankruptcy

This cohort must satisfy these three elements:

- lack of assets, ie under $10,000
- low income, yet to be set but say $70,000
- low debts, under $50,000

Impliedly, there is no dividend to be paid to creditors.

A Minimal Asset Procedure would need to fit within the existing four personal insolvency options of temporary debt protection, Pt IX debt agreements, Pt X personal insolvency agreements and bankruptcy.

An additional factor is that these types of bankruptcy would only be taken on by the Official Trustee and the procedure would therefore reduce costs and time for the Commonwealth.

Measures to ensure no abuse or gaming of the procedure would be required.

Comment

After explaining the basics of bankruptcy, and its rather severe impact, *Keay's Insolvency* says that:

> 4.15 . . . In the case of a bankrupt who has no divisible assets and limited income, and who is of limited focus of inquiry by the trustee, bankruptcy may have a little negative impact at all. That raises the question as to the need for the long three-year period before the person is released from being labelled a "bankrupt".[22]

In that respect, one perspective on this proposed reform is that it provides a practical solution in seeking to assist debtors for whom bankruptcy has little negative impact anyway, because they have no assets to vest, an income below the contribution threshold, and from which creditors would not benefit by way of a dividend. As explained, relying upon 2021–22 figures, the discussion paper says that 26.8% of personal insolvencies[23] had less than $50,000 in liabilities and less than $10,000 in assets.

These are typically consumer debtors. While the numbers of bankruptcies remain at historic low levels,[24] the paper says there is an increasing number of debtors who are in financial distress because of the ready access to a wider range of consumer credit. It is recognised that in the society generally, greater access to credit provides a valid rationale for increased relief for consumer debtors. Insolvency law is said to represent a trade-off for the deregulation of consumer lending by way of offering insurance against the risks of lending with the premiums financed through increases in the cost of credit.[25] Rather than overly restrict credit, the losses incurred through those who become overly committed, including to the extent of entering insolvency, are factored into the costs of credit and the premiums charged.[26]

These bankruptcies would be administered by the Official Trustee, claimed to be at less cost than a 3-year bankruptcy.

The focus is therefore not on bankruptcy itself, which would remain unchanged for the other 75% of ineligible debtors.

As to that group and bankruptcy overall, of 8019 bankrupt estates finalised in 2022–23 only 15.3%, or 1227, paid a dividend, averaging 10.04c/$. Overall, unsecured creditors received an average dividend of 2.19c/$. Pt IX and Pt X creditors fared better.[27]

The law reform proposal gives no assistance to debtors who do not meet the proposed criteria, but from whose bankruptcy creditors would still not benefit and for whom the label of "bankrupt" can have "potentially life-long consequences", as the discussion paper explains.

Among this group might be the upwards of 40% of bankruptcies that arise from business failure, including of sole traders and of company owners. For them, the minimum 3-year bankruptcy continues to apply.

In principle, the offering of a particular mechanism that takes a group outside the strict bankruptcy system according to set criteria is beneficial. Pt IX debt agreements are an example. Any such reform has to sit well among the other remaining options available, in terms of fairness and consistency. Reforms in 1992 allowed discharge of 60% of bankrupts after 6 months[28] to deal with the then relatively recent phenomenon consumer bankruptcies. These reforms were later seen as not being fair or consistent in making bankruptcy too "easy", as discouraging debtors from trying to enter payment arrangements and as providing little incentive for debtors to become better financial managers.[29] This contrasted with the standard 3-year bankruptcy for other debtors.

Most bankruptcies in fact produce no dividend return to creditors, and the vast majority produce no meaningful dividend. While the Minimal Asset Procedure might be validly aimed at those with low debt, income and assets, other groups might also have valid reasons for bankruptcy reform. In particular, there is no law reform support for the majority of small businesses that fail due to economic conditions or otherwise, in contrast to the government's ready support for those operating through a company. While the pandemic prompted the small corporate business restructuring process in 2021,[30] which specifically excludes personal liabilities, proposals in 2021 for some comparable relief for small trader businesses did not proceed.

These and other reforms remain on the law reform agenda of matters to be attended to.

The PJC Report

While these personal insolvency reforms are proceeding in advance of any comprehensive review prompted by the PJC Report on Corporate Insolvency, the PJC did itself and through submissions recognise the relevance to many issues within its corporate insolvency inquiry.[31] Several connections were also identified at the 2023 roundtable, including, as mentioned, the need for a co-ordinated insolvency regime for small business and resolving the law's separate and inconsistent treatment of bankrupts and of sole owner directors.

Among the PJC recommendations, there are fundamental issues to examine such as the principles and objectives of insolvency law generally, and the interaction between personal and corporate insolvency, and collection of relevant data. The complex corporate insolvency pathways, and level of court involvement, came under scrutiny, in comparison with the simpler

models in personal insolvency. In some other respects, corporate insolvency has simpler processes. In both respects, New Zealand law offers useful models.

Other particular issues to which personal insolvency could contribute include the gender imbalance among liquidators, remuneration of liquidators and practitioners' independence requirements. A fundamental issue is the need to consider whether a government liquidator comparable with the Official Trustee is required. The PJC reported that around 90% of companies in insolvency produce no dividend to unsecured creditors and with around half having assets worth under $10,000.[32] In contrast, the proposed Minimal Asset Procedure is only feasible in handling assetless estates because we have the government Official Trustee.[33]

Summation

In the end, these personal insolvency reforms may be useful in their limited context but if a comprehensive review of both personal and corporate insolvency law does proceed, a deeper examination of the aims of insolvency and what existing processes could be improved, or replaced, including those in personal insolvency, would be required.

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Footnotes

1. Australian Law Reform Commission *General Insolvency Inquiry* Report 45 (1988) www8.austlii.edu.au/au/other/lawreform/ALRC/1988/45.pdf. Commonly known as the "Harmer Report".
2. Above, at [697].
3. R Mason and S O'Mahony "Perspectives on Australian Bankruptcy Law through the prism of the World Bank Report on the Treatment of the Insolvency of Natural Persons" (2014) 14(3) *QUT Law Review* 3.
4. Above n 1, at [363].
5. Parliamentary Joint Committee on Corporations and Financial Services *Corporate Insolvency in Australia* Final Report (2023) https://parlinfo.aph.gov.au/parlInfo/download/committees/reportjnt/RB000055/toc_pdf/CorporateinsolvencyinAustralia.pdf.
6. Which I was pleased to attend: Ministerial Roundtable on Personal Insolvency: summary: www.ag.gov.au.
7. See Bankruptcy Act 1966 (Cth) s 5; r 10A. All sections references are to this Act unless otherwise stated.
8. See *Re a Debtor* (1929-31) 2 ABC 164; see NJ Simpson *The Law of Bankruptcy Notices and Creditors' Petitions*, LexisNexis, 2020, at [3.69] (NJ Simpson).
9. The onus is on the debtor to show abuse: *Nobarani v Mariconte* [2021] FCAFC 96; BC202104800 at [32]. See NJ Simpson, above, at [3.64].
10. Above n 7, s 47(2).
11. M Murray "The courts and debt recovery — a response to ON THE BEAT" (2012) 12(9) *INSLB* 189.
12. See J Kilborn and A Walters "Involuntary bankruptcy as debt collection: multijurisdictional lessons in choosing the right tool for the job" (2013) 87 *Am Bankr LJ* 123. See also J Westbrook "The Retreat of American Bankruptcy Law" (2017) 17(1) *Queensland University of Technology Law Review* 40.
13. Australian Financial Security Authority (AFSA), Annual Administration Statistics, 2022–23, "Rate of Return" accessed 6 September 2024 www.afsa.gov.au/about-us/statistics/annual-administration-statistics/rate-return.
14. Above n 7, s 40(1)(ha)–(hb).
15. Hon Mark Dreyfus KC MP "Bankruptcy law reforms" media release (8 July 2024) www.markdreyfus.com/media/media-releases/bankruptcy-law-reforms-mark-dreyfus-kc-mp/. See P Ali, L O'Brien and I Ramsay "'Short a Few Quid': Bankruptcy Stigma in Contemporary Australia" (2015) 38(4) *UNSW Law Journal* 1575.
16. Attorney-General's Department *The bankruptcy system and the impacts of coronavirus* Discussion paper (2021) www.ag.gov.au/sites/default/files/2021-01/discussion-paper-bankruptcy-system-and-the-impact-of-coronavirus.pdf.
17. Insolvency Act 2006 (NZ), Pt 5, Subpart — 4.
18. Attorney-General's Department *Minimal Asset Procedure* Discussion Paper (2024) https://consultations.ag.gov.au/legal-system/personal-insolvency-minimal-asset-procedure/user_uploads/minimal-asset-procedure-discussion-paper.pdf.
19. See T Keeper "New Zealand's No Asset Procedure: A Fresh Start at no Cost?" (2014) 14(3) *QUT Law Review*.
20. See House of Commons Library, "Debt Relief Orders (DROs)", July 2024, accessed 6 September 2024 https://commonslibrary.parliament.uk/research-briefings/sn04982/.
21. Above n 7, s 139K.
22. M Murray and J Harris *Keay's Insolvency — Personal and Corporate Law and Practice*, 11th edn, Thomson Reuters, 2022, referring to Attorney-General's Department *Bankruptcy system — options paper* (2022) www.pipa.net.au/wp-content/uploads/2022/02/Bankruptcy-System-Options-Paper.pdf.
23. These appear to include Pt IX and Pt X agreements, as well as bankruptcies.
24. Around 12,000 for 2023–24, well below the long-term average of over 23,000: AFSA *State of the Personal Insolvency System Report* (2023).
25. Above n 19, at 84.
26. See The World Bank *World Bank Report on the Treatment of the Insolvency of Natural Persons* Report (2013) 31. See also, D Milman "The liberalisation of bankruptcy law" in *Re-examining*

Insolvency Law and Theory, Perspectives for the 21st Century, E Ghio, J Wood and J Gant (Eds), Edward Elgar Publishing, 2023.

27. Above n 13.
28. Sen A Vanstone "Bankrupts and cheats: the unlucky and the crooked" AICM National Conference (11 May 2000).
29. Senate Legal and Constitutional Legislation Committee, *Inquiry into the Provisions of the Bankruptcy Legislation Amendment Bill 2001 (Cth) and the Bankruptcy (Estate Charges) Amendment Bill 2001 (Cth)* (August 2001).
30. Corporations Act 2001 (Cth), Pt 5.3B.
31. Above n 5.
32. Above n 5, Ch 2. Liabilities were mostly in the $250,000 to $1 million range.
33. As to such a role, see M Murray and J Harris "Rebuilding the structure of the Australian insolvency system" (2022) 22(1&2) *INSLB* 17; see also P Heath "Insolvency Law Reform: The Role of the State" (1999) *NZ L Rev* 569.