



14 September 2009

By email: bankruptcy@ag.gov.au

Bankruptcy Policy Branch
Civil Law Division
Attorney-General's Department
Central Office
3-5 National Circuit
BARTON ACT 2600

Dear Sir/Madam

Submission on Bankruptcy Legislation Amendment Bill 2009 - Exposure Draft

The Financial and Consumer Rights Council (**FCRC**) and Consumer Action Law Centre (**Consumer Action**) welcome the opportunity to comment on the exposure draft of the Bankruptcy Legislation Amendment Bill 2009 (the **Amendment Bill**).

The FCRC and Consumer Action support the general objectives of the Amendment Bill, specifically increased protections for low to middle income debtors. The Government is commended for its proposal to increase the creditor's petition threshold from \$2,000 to \$10,000, and to increase the stay period following a declaration of intent from 7 to 28 days.

We have some concerns about the provisions in the Amendment Bill raising the debt, income and asset tests thresholds for debt agreements by 20%, thereby increasing the number of debtors who may be eligible to enter into such debt agreements under Part IX of the *Bankruptcy Act 1966* (Cth) (the **Act**). Our comments about this and other issues are set out below.

Minimum amount of remuneration payable

We strongly support Schedule 1 item 11 of the Amendment Bill, which repeals section 161B(2) of the Act. Bankruptcy is intended to allow a debtor who is genuinely unable to meet all their debts to make a fresh start after undergoing bankruptcy. However, as it stands section 161B(2) unfairly allows a trustee to continue to pursue a debtor for their minimum remuneration entitlement if the debtor's estate does not have sufficient funds, meaning the debt survives bankruptcy. We agree that a general principle of bankruptcy is that a trustee should be remunerated from the bankrupt's estate and section 161B(2) should therefore be repealed.

Review of trustee remuneration and costs

We support Schedule 1 item 13 of the Amendment Bill, which provides for a new process to be made by Regulations, under which the bankrupt or a creditor of the bankrupt may apply to the Inspector-General in Bankruptcy for a review of trustee remuneration and/or third party costs.

In particular, we support the Government's intention that this process will be free to the applicant (Explanatory Memorandum §40) and that the parties to the review will have to bear their own costs of preparing for and attending reviews.¹ In the past we have noted that the current taxation process in practice prevents a bankrupt from seeking a review, because they have little income with which to fund a review and the process could result in further fees being charged by the trustee which would eat into any equity in assets or funds held by the bankrupt.

However, given that the details of the new process will be contained in Regulations, it is difficult to comment further without seeing the proposed Regulations. We note that it has been envisaged that the draft Regulations will be the subject of further consultation.²

We do have concerns that the ability of the Inspector-General to review trustee remuneration may remain too narrow under the Regulations. At present the taxation process is inflexible in that it requires an item by item assessment of the bill of costs rather than an overall assessment of the work performed and the fees claimed. We recommend that the Regulations be drafted to enable the Inspector-General to review not only whether the remuneration for a particular service performed was appropriate but also whether the services performed themselves were appropriate. We also recommend that the Regulations enable consideration of whether overall the work undertaken by a trustee was reasonably necessary, efficient and appropriate, particularly in relation to the size of the debts and the size of the bankrupt's estate. We have unfortunately seen several cases in which a trustee has undertaken lengthy and expensive work out of all proportion to the debt or debts to be paid out of the bankruptcy. A number of examples of this practice also appear in the *Homes at risk* report released by Eastern Access Community Health in November 2007.³ This report is discussed further below.

¹ *Remuneration of registered trustees: amendments to the Bankruptcy Act and Regulations*, October 2008, p4, available from the Insolvency and Trustee Service Australia website: <http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/news+&+events-%3Elaw+reform-%3Etrustee+remuneration+review?opendocument>.

² As above, p5.

³ Jan Pentland, *Homes at risk: using bankruptcy to collect small debts*, Eastern Access Community Health, November 2007.

Raising the minimum debt for a creditor's petition from \$2,000 to \$10,000

Raising the threshold amount

We strongly support Schedule 4 Part 1 of the Amendment Bill, which increases the minimum debt for a creditor's petition (or creditor-requested bankruptcy notice) from \$2,000 to \$10,000.

This issue was also discussed in detail in the *Homes at risk* report.⁴ That report found that the impact on consumer bankrupts who are made bankrupt on a creditor's petition, and their families, is significant, with the risk to and loss of family homes of consumer bankrupts in many cases seriously disproportionate to the debts owed. The report concluded, amongst other matters, that:

A creditor's petition triggers a process which can significantly impact on the homes of debtors and their families. Mainstream creditors are currently paying more attention to the development and implementation of financial hardship policies for debtors in financial difficulty. Attention to responsible collection of debt beyond this stage would be welcomed by financial counsellors. Using the bankruptcy regime to collect small debts should be a last resort.⁵

There are several other debt collection tools available to creditors to pursue the repayment of small debts, including judgment debt recovery enforcement proceedings, accepting payment by instalments, or even the sale of the debtor's home by the Sheriff. The costs associated with these processes are generally much lower than the amount of bankruptcy trustee's fees if the debtor is sent bankrupt. For example, in one recent case in which Consumer Action acted, a woman whose sole income was a carer's pension of just over \$670 a fortnight was sent bankrupt over a 2001 Internet services bill that was originally less than \$1,000, and \$20,000 in trustee fees had been added to the debt when she sought assistance.

It is also important to note that bankruptcy is not generally pursued by a creditor to collect small debts unless the debtor has an asset that can be liquidated in the bankruptcy, usually the family home. In the above Consumer Action case, for example, the pensioner owned her home. Of the 13 case studies included in the *Homes at risk* report, in all but one the debtor owned equity in their home, while in the other case the debtor had received a lump sum worker's compensation payment out of which an additional \$12,000 in trustee fees had to be paid.⁶ This indicates that bankruptcy is used as a more expensive process when the creditor and trustee have confidence that the costs associated with it can be recovered. This is unfair and punitive to the debtor.

Further, the minimum debt amount has not been raised since 1996 when it was increased from \$1,500 to \$2,000. Even taking the original minimum debt amount of \$500 set in 1966, at current values that would equate to over \$5,000. In addition, the consumer credit market has been transformed since 1966 with personal debt levels increasing exponentially and

⁴ As above.

⁵ As above, p25.

⁶ As above, pp14-16.

considerably larger amounts of debt being routinely carried by consumers. Forced bankruptcy in order to liquidate a person's home over a \$5,000 debt is a disproportionate response. The *Homes at risk* report also concluded that the minimum debt amount should be increased from \$2,000 to \$10,000.

Clarifying what amount the threshold applies to

The Amendment Bill raises the minimum debt to \$10,000 but does not make any amendments to clarify what amounts the \$10,000 must consist of. We strongly recommend that the increase in the minimum debt amount be coupled with amendments to clarify that the minimum debt amount relates to the amount of the original debt owed, not to the debt owing at the time the creditor's petition is presented (or to the debt owing under the final judgment or order for bankruptcy notices).

We make this recommendation because an original debt amount increases over time as the creditor applies interest, late fees and other charges (such as collection costs) to the alleged debt. We have seen several cases in which a creditor or debt collector owed a small debt below the minimum debt amount in the Act has simply waited until costs have accrued on the debt and, once the debt amount has passed the threshold, they have pursued bankruptcy proceedings. For example, in the Consumer Action case cited above, the original debt was for less than \$1,000. Court proceedings were pursued by the debt collector several years later when a judgment for \$2,057 could be obtained with interest and costs added, and bankruptcy proceedings were then started on the judgment debt amount, which was just above the current minimum debt amount.

Another recent case study that we have previously raised is repeated below:

Tom's story

Tom (name changed) is a 33 year old man who suffers from bipolar disorder. He owns his home and has a wife and children.

Tom incurred a debt for \$3,836.48 with a firm of solicitors. He disputed his costs bill and the firm pursued Tom for the alleged debt, allegedly incurring around \$8,000 in collection costs before the firm turned the debt over to another firm to engage in collection activity. This second firm allegedly incurred costs of around another \$8,000. The firm then successfully petitioned to bankrupt Tom and a private trustee was appointed upon his bankruptcy.

The total of the legal costs and the trustee's fees was \$24,500 when he sought assistance and Tom will lose his home. It is unfair and distressing that a family will lose their home over such a small amount, particularly when the creditor could have applied for an instalment order to repay the debt.

If the minimum debt for a creditor's petition had simply been raised to \$10,000, Tom's creditor would still have been able to seek his bankruptcy over an original alleged debt of less than \$4,000, because the total alleged debt by that time had reached around \$20,000.

Debt agreements

Whilst we are generally supportive of the Amendment Bill, we have concerns about the proposal to expand eligibility to enter into a debt agreement under Part IX of the Act, given our concerns about the administration of debt agreements under Part IX of the Act.

Of the 9118 debt agreements proposed for the 2007-2008 financial year, 6542 of these proposed agreements were accepted by creditors and only 27 were completed. Further, the success of these agreements in recovering debts for creditors is very low, with a mere 1.1% of accepted debt agreements completed over the financial years of 2005-2006 to 2007-2008.⁷ The rate of completed debt agreements has declined markedly since 2002-2003.⁸

Financial counsellors have reported that many of their clients have been lured into unrealistic and unsustainable debt agreements, and we are concerned that the large number of unsuccessful agreements is driven by the large fees retrievable by debt agreement administrators under the agreements. Debt agreements must be administered in a manner that realistically assesses the debtor's capacity to pay their debts. However, a 2005 report on Part IX debt agreements by Consumer Credit Legal Service (now Consumer Action) and Eastern Access Community Health, *Debt Agreements: Remedy or Racket?*, found that many debtors failed to comply with their debt agreement after being unable to maintain payments that were unlikely to have been sustainable from the start.⁹ A copy of this report is attached to this submission.

It is also important to recognise that many of the consequences of bankruptcy that a debtor may be seeking to avoid by entering into a debt agreement will occur with a debt agreement. For example, entering into a debt agreement will be recorded on a person's credit information file in a similar manner to bankruptcy and the person's name will be recorded permanently on the National Personal Insolvency Index. It is also generally considered an 'act of bankruptcy' under clauses in typical consumer lending arrangements such as mortgages, triggering default or foreclosure options for lenders. After the Australian Competition and Consumer Commission (**ACCC**) had concerns that Australia's largest debt agreement administrator, Fox Symes, was not providing consumers with this information it started legal action against the company in 2004.¹⁰ The matter was settled on 10 June 2006 when Fox Symes and its directors gave enforceable undertakings to the Federal Court on the basis that they did not admit that they engaged in conduct in contravention of the *Trade Practices Act 1974*. The undertakings given by Fox Symes, still in force today, were that for a period of five years it:

- will not make certain statements to customers or potential customers in respect of debt agreement proposals and debt agreements;

⁷ Inspector-General in Bankruptcy, *Annual Report by the Inspector-General in Bankruptcy on the operation of the Bankruptcy Act 2007-2008*, p42.

⁸ As above.

⁹ Consumer Credit Legal Service Inc and Eastern Access Community Health, *Debt Agreements: Remedy or Racket?*, November 2005. See Appendix 1

¹⁰ Australian Competition and Consumer Commission, 'ACCC alleges unconscionable conduct by debt administrator', *ACCC website*, <http://www.accc.gov.au/content/index.phtml/itemId/518507/fromItemId/465054>.

- will use its best endeavours to inform customers and potential customers that details of a debt agreement proposal or debt agreement are highly likely to be recorded on a person's credit report as maintained by credit reporting agencies;
- will explain the nature and effect of all documents provided to customers and potential customers by Fox Symes, and
- will bring to the attention of customers and potential customers the amount of all fees payable in respect of a debt agreement.¹¹

We remain concerned that, in the absence of further provisions better regulating the conduct of debt agreement administrators and fees payable for these agreements, the Amendment Bill will merely expand the number of potentially very vulnerable consumers who will be at risk of entering into inappropriate and unfair agreements. We therefore recommend that the Government revisit the recommendations of the *Debt Agreements: Remedy or Racket?* report and review the operation of debt agreements over the last three years before making any amendments to this part of the Act. As the Explanatory Memorandum to the Amendment Bill notes, the 2007 review of debt agreements decided to retain the thresholds at their current levels until the next review of debt agreements scheduled for 2010 (§144). We strongly recommend that Schedule 4 Part 2 item 11 of the Amendment Bill, which raises the threshold amounts for debt agreements, be postponed for consideration during the more comprehensive review of debt agreements which should take place next year.

About the FCRC

The FCRC is the peak body for Financial Counsellors and community based organisations in Victoria who are concerned with the rights of low income and vulnerable consumers.

The FCRC is an independent not-for-profit organisation which is primarily funded by the Department of Justice and has been in operation since 1996.

Amongst other things, the FCRC provides a support network for approximately 200 member Financial Counsellors, primarily through ongoing training, education and professional development seminars. Additionally, the FCRC is active in promoting the rights of consumers and seek to achieve this by the provision of consumer information and community education, as well as effective casework support and advocacy.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. A large proportion of our advice and casework representation relates to consumer credit and debt issues. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

¹¹ Australian Competition and Consumer Commission, 'Fox Symes & Associates Pty Ltd', ACCC website, <http://www.accc.gov.au/content/index.phtml/itemId/585988/fromItemId/684968>.

Should you have any questions regarding this submission, please contact Nicole Rich at Consumer Action on (03) 9670 5088 or Kristen Gobbo at the FCRC on (03) 9663 2000.

Yours sincerely

FINANCIAL AND CONSUMER RIGHTS COUNCIL



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Attach.