



BANKRUPTCY

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BANKRUPTCY

Bankruptcy is the process of administering the Estate of a person who is unable to pay their debts as and when they fall due (i.e. Insolvent).

The key stakeholders in a Bankruptcy are the:

- Bankrupt;
- Trustee; and
- Creditors (secured and unsecured).

Each has a role to play and must understand their responsibilities, obligations, the timing of required actions and the ramifications of non-delivery.

Bankruptcy provides the mechanism for the following objectives to be met:

- Provide relief to the Debtor (i.e. Bankrupt) by enabling them to be released from the burden of their liabilities and an opportunity for a fresh start (after due process);
- Provide equitable distribution of essentially all the Bankrupt's assets to all Creditors; and
- Enable an investigation of the Bankrupt's affairs and the circumstances leading up to their insolvency.

Becoming a Bankrupt

There are two ways in which a person may become a Bankrupt, via a Debtor's Petition (voluntary) or a Creditor's Petition (involuntary).

Debtor's Petition

This process involves the Debtor completing and lodging a Debtor's Petition and Statement of Affairs with the Official Receiver at the Insolvency and Trustee Service Australia (ITSA). The Debtor becomes Bankrupt on the same

day as the petition is accepted by the Official Receiver at ITSA.

Creditor's Petition

A Creditor makes an application to the Federal Court or Federal Magistrates Court to Bankrupt a Debtor. The process of making a person Bankrupt by way of a Creditor's Petition usually involves the following steps:

1. A person incurs debt and does not repay the debt. A Statutory threshold is set by the Government.
2. The Creditor obtains a judgment of a Court to confirm the debt owed by the person (Debtor).
3. The Creditor obtains a Bankruptcy Notice and serves this upon the Debtor requiring payment within a set time period.
4. If the Debtor does not pay within the time period set in the Bankruptcy Notice, the Creditor obtains a Creditor's Petition, which is filed with the Court and served upon the Debtor. It sets a hearing date at which the Court will determine if the Debtor should be made Bankrupt.
5. If an agreement is not reached between the parties prior to the Court hearing or the Debtor does not raise a defence to the Creditor's Claim that is accepted by the Court, the Court issues a Sequestration Order against the Estate of the Debtor, resulting in the Debtor becoming Bankrupt.

Choice of Trustee

The person who handles the administration of the Bankrupt Estate is called the Trustee.

The Trustee can either be a Registered Trustee (private individual) or the Official Trustee (a Government Institution) who primarily performs as a safety valve and acts where a Registered Trustee has not consented to act as Trustee of the Bankrupt Estate.

A Registered Trustee is therefore only appointed when he or she consents to act as the Trustee with their consent filed either by:

- The Debtor in conjunction with the Debtor's Petition and Statement of Affairs, or
- The Creditor in conjunction with the Creditor's Petition.

It should be noted that both the Official Trustee and Registered Trustee have the same obligations in respect of administering a Bankruptcy and that remuneration of both is drawn from the Bankrupt Estate where monies are available.

Functions of a Trustee

The Bankruptcy Act establishes the functions of the Trustee. The Trustee is an Officer of the Court and is obligated to thoroughly discharge his/her duties. The functions of a Trustee include but are not limited to:

- Request the Bankrupt to complete various income and asset questionnaires.
- Carry out searches to determine the existence of any assets that may be owned by the Bankrupt. These searches will include motor vehicle, property, boats and Australian Securities and Investment Commission (ASIC).
- Enquires with banks as to the existence of any accounts either jointly or individually in the name of the Bankrupt and request the

bank to forward such funds to the Trustee.

- Assess the Bankrupt's income annually and if it is above a certain base level, the Bankrupt will be required to make contributions to the Trustee. The Bankrupt is required to contribute 50% of any net income earned in excess of the threshold amount.
- Notify Creditors within 28 days of receipt of the Bankrupt's Statement of Affairs advising of the Bankruptcy and providing a summary of the Statement of Affairs.
- If necessary, convene a meeting of Creditors to discuss the Debtor's affairs and circumstances leading up to the Bankruptcy.
- Hold periodic discussions with the Bankrupt concerning his/her affairs and in certain circumstances will discuss with the Bankrupt putting a proposal to their Creditors for the annulment of the Bankruptcy.
- Where necessary, examine the Bankrupt and other related parties with a view to discovering any undisclosed property owned by the Bankrupt or establishing offences, which the Bankrupt may have committed.
- Pay dividends to Creditors as expeditiously as possible.
- Monitor the Bankrupt's affairs for the period of the Bankruptcy to ensure "after acquired" property such as an inheritance or a windfall gain is correctly distributed to Creditors.

What happens upon Bankruptcy?

Control of the assets vest in the Trustee

Upon becoming Bankrupt, the Bankrupt's divisible property vests in the Trustee. This means that with the exception of certain assets that are listed in a later section, all property the Bankrupt owns, has a right to, or an interest in, or acquired during the Bankruptcy, is in the control of the Trustee.

Exempt Property

As mentioned, not all property vests in the Trustee. Property that does not vest includes:

- Property held by the Bankrupt in trust for another person;
- Necessary household property and effects;
- Items used by the Bankrupt in earning income by personal exertion (i.e. tools of trade) to the value of \$3,350 (this is an indexed amount and will change over time);
- A motor vehicle to the value of \$6,700 used by the Bankrupt primarily as a means of transport (this is an indexed amount and will change over time);
- A Bankrupt's interest in a regulated superannuation fund or an approved deposit fund or policies of life assurance or endowment assurance in respect of the life of the Bankrupt or the Bankrupt's spouse except superannuation funds relating to contributions made to defeat creditors;
- Any right of the Bankrupt to recover damages or compensation for personal injury or wrong done to the Bankrupt or their family or in respect of a death of a member of the Bankrupt's family; and
- Amounts paid to the Bankrupt under a scheme established between the Commonwealth and the States under the Grants (Rural Reconstruction) Act 1971 being amounts paid by way of a loan as assistance for the purpose of rehabilitation.

Effect on the Bankrupt

For the period of Bankruptcy, the Bankrupt must:

- Complete and file with the Official Receiver a Statement of Affairs, detailing among other things, the Bankrupt's financial position (assets and liabilities);
- Provide details of his/her income as required by the Trustee and in some instances contribute a percentage of income to the Estate;
- Give such information about his/her conduct and examinable affairs as the Trustee requires;
- Give to the Trustee all books and records relating to his/her examinable affairs;
- Attend upon the Trustee when required;
- Surrender their passport to the Trustee;
- Obtain the Trustee's approval to travel overseas;
- Attend a meeting of Creditors and provide information if required by the Trustee;
- Execute such documents as the Trustee or the Court orders;
- Disclose to the Trustee all assets and liabilities as soon as practicable including any "after acquired" divisible property;
- Not obtain credit exceeding \$4,692 (CPI adjusted) without disclosing the Bankruptcy to the credit provider;
- Comply with directions of the Trustee;
- Advise current address and daytime telephone number to the Trustee;
- Not sell or otherwise deal with any property existing as at the date of Bankruptcy as all divisible property vests in the Trustee; or
- Not take part in the Management of a Company without the leave of the Court.

Effect on Creditors

Unsecured Creditors

The major effect Bankruptcy has on unsecured Creditors is that Creditors are no longer able to pursue the Bankrupt for outstanding debts unless permission of the Court is obtained. In addition, unsecured Creditors are no longer able to enforce remedies against property of the Bankrupt as the property vests in the Trustee for the benefit of all Creditors.

Creditors' rights against the Bankrupt lie in their ability to claim in the Bankrupt Estate and participate in any dividend that may be paid from funds recovered by the Trustee. Upon the Bankrupt's discharge from Bankruptcy, the Bankrupt receives a release from provable debts generally.

Some debts will not be extinguished as a result of the Bankruptcy such as those incurred by means of fraud, penalties or fines imposed by a Court, sums payable under a maintenance agreement or order and HECS debts.

Secured Creditors

Secured Creditors with valid security are able to enforce their rights pursuant to the charges or securities they hold over assets of the Bankrupt.

Secured Creditors are entitled to claim as an unsecured Creditor in the Bankrupt's Estate for the amount by which their debt exceeds the value of the property over which they hold security.

Where a secured Creditor has realised its security, it may lodge a claim in the Bankrupt's Estate for any resultant deficiency.

Creditor's rights in a Bankruptcy

A Creditor can obtain information from the Trustee about the administration of the Estate, requiring a Trustee to call a meeting of Creditors in some circumstances, remove a Trustee via process or appeal to the Court against a Trustee's decision and fix and review the Trustee's remuneration.

Term of Bankruptcy

The standard period of Bankruptcy is three years from the date of the filing of the Statement of Affairs.

It is important to note, that where the Bankruptcy is initiated via a Creditor's Petition and the Court issues a Sequestration Order deeming the person Bankrupt, the Bankruptcy period does not start until the filing of the Statement of Affairs. In some cases where a Bankrupt will not co-operate and file a Statement of Affairs, the person can remain Bankrupt indefinitely.

Annulment of Bankruptcy

An Annulment means that the Bankruptcy is taken to have never occurred and whilst this is not strictly speaking the case, it does carry weight with financiers and indicates creditworthiness over and above a "discharge" from a Bankruptcy.

A Bankruptcy can be annulled in instances where:

1. All the Creditor's debts and subsequent costs of the Bankruptcy Administration have been paid in full;
2. The Bankrupt puts forward a proposal through the Trustee to the Creditors and the proposal is accepted by the Creditors by special resolution (see below); or
3. By an Order of the Court.

Composition or Arrangement with Creditors – Section 73 proposals

A proposal pursuant to Section 73 of the Act is effectively a Part X proposal within a Bankruptcy. A proposal may be in the form of a composition or a scheme of arrangement. This process involves the Bankrupt agreeing to terms with Creditors through the Trustee to make a payment or payments to Creditors, which they accept in full and final satisfaction of their debt. In this case, the Bankruptcy is annulled upon the Creditors accepting the Bankrupt's proposal at a meeting convened to consider the proposal.

It does not have to represent a payment of 100 cents in the dollar and may include a payment by way of a lump sum or over a period of time.

The Trustee shall convene a meeting of creditors to consider the Bankrupt's proposal and is obligated to form an opinion in respect of the proposal offered by the Bankrupt. The Trustee can ask for any approved outstanding remuneration and funds to cover the cost of convening the meeting, to be paid prior to convening the meeting.

Antecedent / Voidable Transactions

The Bankruptcy Act allows for certain transactions that occur prior to the Bankruptcy to be recovered by a Trustee. Such transactions are often referred to as antecedent or voidable transactions. The main reason for these provisions in the Bankruptcy Act are to ensure assets of the Bankrupt that would be recoverable in a Bankruptcy, but have been disposed of prior to Bankruptcy, can be "clawed back" and received by a Trustee with proceeds distributed to Creditors. This ensures no Creditors or other persons receive an unfair priority or benefit.

The law in regard to antecedent or voidable transactions is complex and the relevant transactions must occur within specific timeframes. To recover one of the above transactions, a Trustee will generally write to the relevant party stating the case why the Trustee assesses the transaction is voidable. If a settlement cannot be reached between the parties, a Trustee must seek recovery via issuing a notice that is obtained from the Official Receiver or by an Order of the Court.

Distributions / Dividends to Creditors

The Trustee will collect the funds and/or property available in the Bankrupt Estate and distribute it to Creditors when the Trustee believes sufficient funds are available.

The Bankruptcy Act provides that prior to the payment of a dividend, the Trustee must issue a notice to those Creditors who have not lodged a formal claim (known as Proof of Debt), requiring them to lodge a claim by a certain date. If Creditors do not lodge a formal claim by the required date, they may be excluded from receiving a dividend. The Trustee must then wait a further 21 days (after the date by which claims must be lodged) before the dividend is paid.

The Bankruptcy Act provides for certain priorities to be applied to different classes of Creditors when a dividend is paid. The funds available to pay a dividend are to be distributed according to these priorities.

Public Record

Bankruptcy details are available to the public via a Government database known as the National Personal Insolvency Index ('NPII') and usually on databases of credit reference agencies. Access to the Government database can be obtained by contacting ITSA or information brokers such as Australian Business Research ('ABR').

Details of the Bankrupt's name, address, date of birth, occupation and the number of the Bankrupt's Estate will remain on the NPII forever.

Disclaimer: *The information presented in this brochure is a broad outline of the Bankruptcy provisions of the Bankruptcy Act. As is the case with all such matters any interested parties should rely upon the formal advice of their Solicitor.*



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