Australian Government
Australian Financial Security Authority

# AUSTRALIAN FINANCIAL SECURITY AUTHORITY
# PERSONAL INSOLVENCY REGULATOR

December 2017, Volume 15, Issue 4

Supporting better outcomes for consumers, business and the community.

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This newsletter is provided by AFSA's independent Regulation and Enforcement division and is published each quarter to registered trustees, registered debt agreement administrators, controlling trustees, major creditors and financial counsellors.

In keeping with AFSA's fourth corporate goal: quality information, this newsletter aims to inform practitioners of relevant changes to personal insolvency laws, both legislative and case law, and discusses areas of practice and Inspector-General requirements. For more information about AFSA's vision, purpose and goals, see our corporate plan 2017–18.

If you would like to submit an article for inclusion in the next edition of the PIR, please forward it to one of the following:

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AFSA actively seeks contributions from outside parties and the views expressed therein are not necessarily endorsed by, or reflect the views of, the Inspector-General in Bankruptcy, Official Trustee or the Official Receiver.

This issue of the Personal insolvency regulator (PIR) may be cited as *(2017)15(4) Personal insolvency regulator.*

# INTRODUCTION

December 2017, Volume 15, Issue 4

Welcome to the final edition of the Personal Insolvency Regulator for 2017. I'm sure you'll agree that it's been another big year and no doubt 2018 will be as well.

As part of our new look Personal Insolvency Regulator newsletter—and drawing on your feedback—we will no longer include a column from the Inspector-General, but I am confident you will continue to find the content informative and relevant to your role in Australia's personal insolvency system.

I would like to wish you all a very enjoyable festive season and I look forward to working with you in the New Year.

Hamish McCormick
Chief Executive and Inspector-General in Bankruptcy

## Engaging "Lead generating" firms and compliance with Inspector-General Practice Guideline 1 ("IGPG 1")

It has come to AFSA's attention that some Registered Debt Agreement Administrators (RDAAs) are continuing to be approached by, and engage with, lead generating firms who "cold call" debtors to establish whether they are interested in entering a debt agreement or other form of insolvency. The lead generating firm then offer to sell leads for those debtors to the practitioner for payment of a commission or fee.

AFSA has recently sent a communication to all RDAAs requesting that those who engage with lead generating firms cease that engagement. The basis for that request is clearly supported by the best practice guidance provided in the following professional standards and practice guideline:

1. Inspector-General Practice Guideline 1, outlines the Inspector-General's expectations in regard to advertising of debt agreements and includes a statement that debt agreement administrators will be held responsible for any marketing done on their behalf:

*3.11 The IG will hold DAAs responsible under this guideline for any advertising or marketing done by them (or on their behalf), either individually or jointly, and whether expressly or impliedly authorised by them.*

2. The practice is prohibited by PIPA, as stated in their Code of Professional Practice (paragraph 5.3), which states as follows,

*5.3 A member **MUST NOT** accept any referral that contains, or is conditional upon:*

- *referral commissions, inducements or benefits; or "spotter's" fees; or*
- *recurring commissions; or*
- *"understandings" or requirements that work in the administration will be given to the referrer; or*
- *any other such arrangements that restrict the proper exercise of the member's judgment and duties.*

3. The practice is discouraged by ARITA, as mentioned in their Code of Professional Practice (section 11.5).

AFSA has requested that such engagements cease as soon as possible. This issue will be a focus of AFSA's inspection programme of RDAAs in 2017–18.

With respect to IGPG 1 more broadly, AFSA undertakes a monitoring role and proactively contacts RDAAs and brokers that deviate from the expectations required in both IGPG 1 and the relevant ARITA and PIPA Codes of Professional Practice.

RDAAs have been requested to take this opportunity to review advertising and marketing material to ensure it is compliant with IGPG 1 and the relevant codes of professional practice.

Paul Shaw, National Manager
Regulation and Enforcement

## ATO Update: Building Confidence by Managing Risk

While the ATO endeavours in all instances to work with taxpayers to resolve debts, inevitably a small number (less than 1% of tax debtors) end up in insolvency. The ATO is a creditor in a significant number of insolvencies, often the largest creditor and in some instances the only unrelated creditor. There are many insolvencies initiated by the debtor, however the ATO, perhaps by virtue of our size, initiates around 20% of company wind-ups, and around 4% of bankruptcies.

All this makes the ATO a very active creditor and a significant participant in the insolvency sector — and we recognise the important role we play in supporting the integrity and public confidence in the insolvency process. In line with our corporate plan, our actions support a level playing field; encourage willing participation and a positive community perception of fairness in the tax and super system, as well as in the insolvency sector.

To fulfil this role we actively review each of our insolvencies, we use a range of data (including from fellow government regulators) to identify issues and risks, and we take action when it's appropriate to do so. We know from feedback we receive from insolvency professionals that we have broad support in addressing poor behaviour where it has the capacity to undermine the integrity of the system.

## Creditors Meetings

We continue to receive a number of creditors meeting reports and Notice of Proposal to Creditors via post and fax. This can cause unnecessary delays and impacts our ability to efficiently participate in meetings and vote on resolutions. An increasing number of practitioners are now using the business portal secure message facility offered by the ATO; ensuring important messages from the insolvency administration are bought to our attention in a timely manner.

We have recently updated our website to include a general nomination for both corporations and bankruptcies to give you an assurance that receiving reports via the Business Portal is the most effective method for you.

To send a secure message via the Mail option of the Business Portal simply log in, select Mail, select new message, select Insolvency and ensure that you select the Creditors Meeting subject heading before you attach the report and send.

## Managing Business Portal access — 'my credential holder with auto access'

A new feature is now available that will make it easier for you to manage access to the Business Portal within your firm. Through Access Manager you can now assign a Standard user to have *'Business appointment auto access'*.

### Future business appointments:

A credential holder with *auto access* will get access to future insolvency appointments granted to your business by the ATO (Voluntary Administrations and Liquidations).

### Default permissions:

Credential holders with auto access get authorisation to all permissions made available by each business appointment. By default, the ATO grant your business full access to an insolvent entity.

### Managing a credential holder's permissions

To manually select specific permissions for a credential holder, you will have to remove them from auto access, then add them to each business appointment (insolvent entity) separately:

- select 'remove auto access' for the credential holder
- go to 'Whose business I can access'
- select the business (insolvent entity)
- select View authorised credential holders
- select authorise new credential holder
- select the credential holder, set the permissions and save

### Managing access feature

If a credential holder has access to multiple business appointments (but does not have auto access set up), you can use the functions of auto access to easily remove the user's access to all of the business appointments.

### To do this:

- give auto access to the credential holder, then
- remove auto access from the credential holder

### More information

If you would like to find out more about using the ATO Business Portal, managing access or our education visits, please email your contact details to InsolvencyPractitionerServices@ato.gov.au

For general information refer to the insolvency practitioners section on **ato.gov.au/insolvency**

Bronwyn du Mont, Director
Debt — Significant Debt Management
Australian Taxation Office

## Section 77A and Pre-Insolvency Advisors

When conducting investigations into the estate of a regulated debtor, it is the expectation of the Inspector-General that registered trustees will consider the benefits of utilising section 77A of the *Bankruptcy Act 1966* (the Act) where relevant. This involves writing to associated entities of the regulated debtor (or persons in possession of the books of associated entities of the regulated debtor), requiring from them the production of books that are relevant to the investigations being undertaken. It is recognised that registered trustees are generally vigilant and aware of section 77A and regularly issue notices under section 77A to associated entities (as defined by sections 5B to 5E of the Act), which generally include solicitors, accountants, companies and trusts with which the regulated debtor had been involved.

Through our monitoring and inspection programs, AFSA has identified that regulated debtors are increasingly seeking the input of financial or 'pre-insolvency' advisors (who aren't their accountant or solicitor) to assist in the organisation and structuring of their affairs in the lead up to bankruptcy or the submission of a proposal under section 188 of the Act. It is often the case that these advisors will also act as referrer of the job to the respective practitioner, and that they will have had an extensive level of involvement in the financial affairs of the regulated debtor prior to the formal commencement of the bankruptcy or Part X process. On this basis, the information able to be provided by these advisors would be expected to be at least as pertinent to inquiries being conducted into a regulated debtor's estate as that being provided by a solicitor or accountant.

Despite this, it has also been identified that registered trustees don't generally issue notices under section 77A to these advisors for books, as they otherwise would with accountants, solicitors and other associated or related entities.

Given the increased prevalence of these types of advisors and the extent to which they can be involved in the financial affairs of regulated debtors, it is the expectation of the Inspector-General that registered trustees will now, where relevant, issue notices to these advisors under section 77A and require the provision of books as defined by section 5(1) of the Act, to assist in their investigations and ultimately the fulfilment of their duties and obligations.

Matthew Schultz, Senior Inspector
Regulation and Enforcement

## Dealings with vested real property and compliance requirements under sections 58(2) and 132(3) of the Bankruptcy Act 1966 (the Act)

During recent inspections of Trustees' bankruptcy administrations, it has come to AFSA's notice that some practitioners are not applying the principles set out in sub sections 58(2) and 132(3) of the Act when dealing with vested real property.

Subsections 58(2) and 132 (3) deal with transmission of property which vests in equity in the trustee at the date of bankruptcy.

It is the Inspector-General's expectations that trustees consider the following issues and circumstances as appropriate when dealing with the vested real properties.

- Equitable interests in real property that have vested in a trustee may be disposed of by Deed but there are limitations on how this can be undertaken. Principally, such a transfer may still be subject to stamp duty, the non-payment of which could breach the requirements of relevant State and Territory legislation. Where State and Territory Acts impose a requirement to pay stamp duty, including on transfers of equitable interests in some States, trustees should not use their position as a bankruptcy trustee to overcome this.
- There is risk that a Deed could be voidable as a result of poor drafting. A poorly drafted deed risks the trustee being exposed to personal liability for loss.
- In dealing with vested real property involving nil or negative equity, it may be reasonable for a trustee to transfer the vested property to a non-bankrupt spouse/partner under a deed without the trustee first becoming the legal owner of the property. However, it is not reasonable for a bankruptcy trustee to do so in order to secure a commercial benefit from the non-payment of stamp duty.
- It is considered appropriate that trustees will consider becoming the legal owner of real property, and registering transmission, where it is expected that sale of the property will result in a financial benefit to the estate. Many jurisdictions only charge a nominal registration fee (e.g. $20 fee in WA) to register the bankruptcy trustee as legal owner (wholly or partly) of a real property, which also will not be subject to stamp duty. Becoming the legal owner of real property will also benefit the estate by securing the property in the name of the trustee.

## Assignment of Property by a Trustee in Bankruptcy

In the Personal Insolvency Regulator April 2010 issue we reminded practitioners that assigning property to undischarged bankrupts is neither allowed nor effective.

- Subsection 134(1) (a) the Act gives power for a Trustee to sell the property belonging to the bankrupt at the date of commencement of the bankruptcy (except properties pursuant to section 116(2) of the Act) and any after acquired property.
- However it should be noted that where the property, which is subject of any sale action pursuant to section 134, is sold/assigned to the undischarged bankrupt, it is rendered immediately ineffective by operations of section 58 of the Act, with the result that the property re-vests in the trustee.
- The decision in *di Cioccio v Official Trustee in Bankruptcy [2015] FCAFC 30,* suggests that sale of the property vested in the trustee to an undischarged bankrupt will be ineffective because the transferred property will immediately re-vest in the trustee.

Practitioners need to be aware that in the absence of transmitting the estate's interest in property, they are not recognised as the legal owners of that interest when entering into arrangements or otherwise dealing with that interest with third parties.

In dealing with the property as legal owners, once transmission has occurred, the principles of indefeasibility and good title are maintained and legal ownership is passed to the purchaser.

The risk for practitioners and the other parties is that by not transmitting, good title is not passed to the purchaser and if there are subsequent disputes or challenges this may result in adverse outcomes and possible losses to the estate and possibly the practitioner personally.

Paul Devellerez, Assistant Director
Regulation and Enforcement

## FENSOME (Vic): Victorian Engineer pleads guilty to disposal of property after bankruptcy and altering documents

Mr Antony Sean Fensome, a 48 year old engineer from Mount Martha, was sentenced on 7 September 2017 after pleading guilty to disposing of property after bankruptcy, altering records, and leaving Australia without written permission from his trustee.

Mr Fensome filed for voluntary bankruptcy on 11 September 2012 with debts in excess of $83,000. At the time, Mr Fensome jointly owned a property in the United Kingdom which he sold during his bankruptcy period for £225,000.

Following the sale, Mr Fensome provided false information to his trustee about the amount he received, including a false bank account statement and settlement statement, showing he received only £195,000 from the sale. He has since commenced making repayments to his trustee for this amount.

During a voluntary interview with AFSA Investigators, Mr Fensome made admissions that he had provided false information about the amount of surplus proceeds from the sale and that he had produced the false documents to reduce the amount he would have to pay to his trustee.

Mr Fensome also travelled overseas on six occasions during his bankruptcy, without written permission from his trustee.

Magistrate Lethbridge at Dromana Magistrates Court sentenced Mr Fensome to a 15 month Community Correction Order (CCO) and 150 hours of community service.

In sentencing, His Honour noted that the offences were extremely serious and, if not for the defendant's early guilty plea, personal circumstances and repayment schedule, he would have faced a period of imprisonment.

The matter was prosecuted by the Commonwealth Director of Public Prosecutions.

## BRITTON (Qld): Former bankrupt found guilty of two offences

Ms Kim Moira Britton, aged 60, was sentenced at the Proserpine Magistrates Court on 18 September 2017 on two counts of removing property prior to bankruptcy.

On 12 March 2014, Ms Britton was served a bankruptcy notice relating to an unpaid Family Court judgment of $45,000.

Five days later Ms Britton contacted her superannuation providers and requested the cash withdrawal of the balances of her two superannuation accounts.

On 20 March 2014 and 27 March 2014, Ms Britton's superannuation providers paid $25,401.96 and $33,399.06 respectively into accounts in Ms Britton's name.

On 21 March 2014 and 28 March 2014, Ms Britton made 8 cash withdrawals totalling $58,000.

On 20 April 2014, Ms Britton filed for bankruptcy. When questioned by her registered trustee about what she did with the money, Ms Britton advised that she had spent the entire amount on ordinary living expenses.

Ms Britton was convicted and sentenced to six months imprisonment and released immediately on a $3000 good behaviour bond for three years. In passing sentence, the Magistrate took into account the seriousness of the offence and noted the need for deterrence.

The matter was prosecuted by the Commonwealth Director of Public Prosecutions.

## ANDREWS (NSW): Husband and wife plead guilty to offences against the Bankruptcy Act

On 18 October 2017, Danielle Louise Andrews and her husband Dean James Andrews were sentenced at the Downing Centre Local Court for removal and disposal of property with intent to defraud creditors.

In October and November 2014 both Mr and Mrs Andrews were made bankrupt, pursuant to sequestration orders made at the Federal Magistrates Court, after failing to comply with bankruptcy notices brought against them by Andrews Advertising Pty Ltd.

Before bankruptcy, they sold their $2.2 million Oatley home. The sale proceeds of $498,113.10 were deposited in their joint account.

Mrs Andrews then transferred $348,500 to her accountant and withdrew $8,000 in cash. Mr Andrews withdrew $21,000 in cash.

On 25 July 2017, Mr and Mrs Andrews attended the Downing Centre Local Court in Sydney, both entering a plea of guilty for their charges.

Mrs Andrews was sentenced to 12 months imprisonment to be served by way of Intensive Corrections Order. In sentencing, Magistrate Hamilton noted that Mrs Andrews' offence was midrange in seriousness and had some aspect of sophistication. Magistrate Hamilton found she tried to maintain her standard of living despite bankruptcy which her Honour described as an "unrealistic expectation". Magistrate Hamilton gave weight to the fact that Mrs Andrews was the primary and only available carer for her three children, each of whom requires special care.

Mr Andrews was sentenced to 80 hours community service for his part in the removal.

The matter was prosecuted by the office of the Commonwealth Director of Public Prosecutions.

Gemma Denton, Director
Regulation & Enforcement

## The need for speed…dealing with difficult bankrupts

In *Gleeson v Jones* [2017] FCCA 2483 ("*Jones*"), the Federal Circuit Court of Australia considered an Application by Mr Gleeson ("the Trustee"), for a distribution of dividends to the creditors of the bankrupt estate pursuant to s146 of the Bankruptcy Act, 1966 (Cth) ("the Act"), who had proved their debts. Whilst such an Application is fairly common in circumstances where a bankrupt fails to complete and file his/her Statement of Affairs, His Honour Smith J viewed favourably the Trustee's efforts to effectively communicate with the bankrupt in an unorthodox, yet effective manner.

Trustees in Bankruptcy can and often are left with a surplus of funds after selling property (whether real or personal). So how does a Trustee in Bankruptcy communicate with a non-responsive bankrupt who has not filed his Statement of Affairs in order to bring about finality to the bankrupt estate bearing in mind the different modes of communication now available?

### Fact Summary

Mr Jones ("the bankrupt") became a bankrupt on 7 July 2015 upon the making of a Sequestration Order in the Federal Circuit Court of Australia. The Trustee was appointed the Trustee of the property of the bankrupt.

After due enquiries by the Trustee, the Trustee ascertained that the major asset of the bankrupt estate was residential property in Queensland owned solely by the bankrupt ("the Queensland property").

The bankrupt did not agree to voluntarily vacate the Queensland property and so, in the interest of the unsecured creditors of the bankrupt estate, the Trustee took action and formally obtained an order for possession from the Court.

The Queensland property was then sold by the Trustee and the surplus proceeds of sale were deposited into an interest-bearing Bank account in the name of the bankrupt estate.

Based on the surplus funds from the sale of the property, the Trustee was seeking to advance the administration of the bankrupt estate. It is significant to note that the bankrupt had failed to provide a completed Statement of Affairs to his Trustee at the time the sale of the Queensland property was completed.

The Trustee made numerous attempts to procure a completed Statement of Affairs from the bankrupt by:

- writing to the bankrupt and posting his letters to the bankrupt at the Queensland property before the eviction took place
- emailing the bankrupt
- telephone attendances on the bankrupt via his mobile telephone
- text messages to the bankrupt indicating that he had documents he wished to provide him "*to assist with the speedy finalisation of your bankrupt estate*"
- engaging a licensed process server to personally deliver a blank Statement of Affairs to the bankrupt by hand.

Having got no meaningful co-operation or engagement from the bankrupt, the Trustee commenced proceedings seeking an order under s146 of the Act that a distribution of dividends be made to the creditors of the bankrupt estate who have proved their debts and an order that the costs of the Application be paid from the estate of the Respondent bankrupt.

The bankrupt was notified by text message of the time and date of the final hearing of the Trustee's Application, but the bankrupt did not appear at the final hearing.

### The law

Section 54(1) of Act provides that, where a sequestration order is made, the person against whose estate it is made must, within 14 days of being notified of the bankruptcy, file a statement of affairs. A penalty is provided in the event of non-compliance.

In *Re Shaw; Ex parte Official Trustee in Bankruptcy* [1999] FCA 968, Gyles J ("Re Shaw") observed (at [4]) that the purpose of s146 is:-

> *"[t]o give the Court the means of ensuring that the absence of a statement of affairs does not prejudice those with an interest in the bankrupt's affairs."*

His Honour's view of the purpose of s146 of the Act in Re *Shaw* is supported by other provisions contained in Division 5 of Part VI of the Act and particularly, in s140(1) of the Act which requires the Trustee in Bankruptcy to act:-

> *"…with all convenient speed, declare and distribute dividends amongst the creditors who have proved their debts…"*

To enable a Trustee in Bankruptcy to achieve the purpose of s140(1) of the Act, and in the absence of the bankrupt having completed a Statement of Affairs, the Trustee in Bankruptcy may make an Application to the Court that a distribution of dividends amongst the creditors who have proved their debts shall proceed as if the bankrupt had filed a Statement of Affairs and those creditors had been stated to be creditors in it. The Court has a general discretion to make the orders as sought by a Trustee in Bankruptcy in this regard.

In exercising its discretion, the Court in *Jones* asked two questions of the Trustee:

1. *Has the bankrupt failed to file a Statement of Affairs as required by the Act?*
2. *Should the Court exercise its discretion to make an order under s146 of the Act?*

## Has the bankrupt failed to file a Statement of Affairs as required by the Act?

His Honour Smith J was satisfied that the bankrupt was notified of his bankruptcy by at least 22 August 2015 and that as at the date of the final hearing, no completed Statement of Affairs has ever been furnished by the bankrupt to the Trustee. In those circumstances His Honour Smith J was satisfied that the bankrupt had failed to file a Statement of Affairs as required by the Act.

## Should the Court exercise its discretion to make an order under s146 of the Act?

In concluding whether the Court should answer this question in the affirmative, it is necessary for the Court to have regard to the facts and circumstances of the case before the Court, bearing in mind the purpose of s146 of the Act.

In *Jones,* the matters relevant to a determination of this question included:

- whether the creditors were notified of the Application and whether they have had the opportunity to be heard
- what steps had the Trustee taken to identify those creditors
- what are the known assets in the bankrupt estate and
- whether the bankrupt has had the opportunity to address the issues.

All of the Trustee's evidence was accepted by His Honour.

## The decision

His Honour was satisfied that in the circumstances of the case, the bankrupt had failed to file a Statement of Affairs as required by the Act and that the circumstances were such that the Court should exercise its discretion to make an order under s146 of the Act, as the creditors and the bankrupt had the opportunity to address the Court and that making an order under s146 of the Act would achieve the purpose of the provision.

## Other matters/ relevance to insolvency practitioners generally

This decision not only refreshes the mind as to the requirements for obtaining orders under s146 of the Act but it is also useful and a timely reminder to highlight the importance of communications by a Trustee in Bankruptcy and his/her staff and advisors, particularly in view of the introduction of the Insolvency Practice Rules (Bankruptcy) 2016 ("IPR") with respect to communication.

Had the Trustee's communications with the creditors and particularly, with the bankrupt not been so diverse but limited to one form of communication, His Honour may have been reluctant or in fact, he may have refused to exercise his discretion in making the orders as sought by the Trustee. Indeed it can sometimes be the case that text messaging or even seeing if a bankrupt is on mobile apps like Voxer etc could provide alternate yet effective means of communicating with a bankrupt. Trustees should keep pace with the emerging ways in which it is possible to communicate with a bankrupt where more traditional methods are proving ineffective.

It is of paramount importance that all stakeholder groups maintain open and effective communication; *Inspector General in Bankruptcy Practice Statement 22*. Whilst achieving this objective may be difficult at times, which can be quite emotional and personal for those bankrupts and/ or those creditors who, for example, have spent years litigating with the bankrupt prior to bankruptcy, a registered Trustee in Bankruptcy is bound by the standards contained in the Act, the Bankruptcy Regulations 1996 and the IPR.

## Rule 42-15 of the IPR provides:

***"4215 Communication***

3. *(1) Communications by a registered trustee must be:*

   *(a) clear and concise and, where appropriate, expressed in lay terms; and*

   *(b) objective; and*

   *(c) responsive; and*

   *(d) timely; and*

   *(e) expressed in a professionally courteous tone and manner.*

4. *(2) A registered trustee must take care to ensure that all communications, including reports (whether issued personally or by delegation) are accurate and do not omit or obscure information required to be included or relevant to users of the communication.*

5. *(3) A registered trustee must preserve confidential information where necessary, unless disclosure of such information is required by law."*

Trustees need to consider their audience to ensure that their communications with a lay person are expressed in a manner in which a lay person can understand, as distinct from a Trustee's communications with another practitioner or other professional. Further, Rule 42-15(d) IPR reiterates the objectives of s140(1) of the Act by requiring "timely" communications. In *Jones,* the Trustee's communications with the bankrupt were found to be appropriate and alluded to the fact that communications via text message were appropriate in the circumstances of the case to achieve the purpose of s146 of the Act. It is also true to say that His Honour in *Jones* was satisfied that the Trustee's advisors' email correspondence to the known creditors of the bankrupt estate, whereby notice of the s146 Application was given, was a

satisfactory means of communicating to those creditors as opposed to the traditional service of documents via post or personal service.

Rule 42-15 of the IPR is just one of many factors a Trustee in Bankruptcy may need to consider in communicating with stakeholders. Other considerations also include the Inspector General's Practice Directions, in particular Practice Direction 22, and depending on other organizations a Trustee in Bankruptcy is a member, those standards are outlined by Australian Restructuring Insolvency and Turnaround Association (ARITA), Personal Insolvency Professionals Association (PIPA), and the Accounting Professional and Ethical Standards Board (APESB) Standard on Insolvency Services APES 330 also applies to practitioners who are members of CPA Australia (CPAA), Chartered Accountants Australia and New Zealand (CAANZ) or the Institute of Public Accountants (IPA).

### Conclusion

In order to declare and distribute dividends amongst those creditors who have proved their debts in a bankrupt estate where the bankrupt has failed to complete and file a Statement of Affairs, and in administering a bankrupt estate generally, it is important for a Trustee in Bankruptcy to consider the multiple ways of communicating with the bankrupt and other stakeholders such as creditors, to investigate all possible ways of achieving the objectives of Rule 42-15 of the IPR, whether that be by usual forms of communicating or by the increasingly not so unorthodox methods of communicating such as text messages, Voxer, LinkedIn messages, Facebook messages and so forth. Obviously is it also important that appropriate records be maintained on the administration file to be able to demonstrate these forms of communications and responses as was the case in *Jones*.

Bruce Gleeson, Registered Trustee & Liquidator
Jones Partners Insolvency & Business Recovery
&
Daniela Naidenov, Principal Solicitor & Mediator
Daniela Fazio Lawyers Pty Ltd

## Govind Mandri v Alan Richard Nicholls as Trustee for the Bankrupt Estate of Mandri [2017] FCCA 2728

### Catchwords

Bankruptcy – Composition with creditors – bankruptcy upon debtor's petition – consent orders to vacate property – repeated offers to purchase interest in property made by bankrupt or family members – several proposals for composition with creditors of bankrupt's estate – trustee's requests for further information to assess the veracity of offers to finance proposal – application for order that trustee convene meeting of creditors to consider and if thought fit, vote in favour of current proposal – applicable principles – whether the proposal was a proposal made under s 73 of *Bankruptcy Act* – relevant consideration – whether as a matter of discretion court would order that trustee convene meeting where proposal would provide no dividend.

### Facts

On 18 September 2017, Govind Mandri (**Applicant**) filed an application pursuant to sub-s 30(1) of the *Bankruptcy Act* 1966 (Cth) (**Act**) to compel Alan Nicholls (**Respondent**) to convene a meeting of creditors pursuant to s 73.

The Applicant had made three composition proposals. The Applicant provided a copy of his fourth proposal to the Respondent and the parties exchanged correspondence concerning the lack of detail surrounding the offers and whether they were credible or of any substance. As a result, of these exchanges, the Respondent did not convene a meeting of creditors, and this prompted the Applicant to seek orders from the Court to convene a meeting of creditors to consider a proposal for a composition in satisfaction of his debts.

### Court's Analysis

Of relevance in this decision is the Court's guidance when considering whether a proposal satisfies the requirements under s 73 of the Act and in which circumstances a trustee may refuse to convene a meeting of creditors.

### Responsibilities of trustee

The Court considered the observations of Allsop J in *Labocus Precious Metals Pty Ltd v Thomas*[1], emphasizing the trustee's responsibility for making a judgement whether a proposal should be put to creditors at a meeting to consider a proposed composition:

> 53 … the relative merit of a proposal for composition fall for consideration in the first instance by a trustee skilled in and responsible for the business judgment whether a proposal was to the benefit of the bankrupt's creditors generally and then for the body of creditors whose self-interest would inform their consideration

1 [2003] FCA 1154.

> of the proposal: *Labocus* [58], [60], [70]; *Hingston v Westpac Banking Corporation* (2012) 200 FCR 493, [90] (Greenwood, McKerracher and Nicholas JJ).
>
> 54 Once the trustee has determined that the proposal ought to be put to a meeting of creditors, it is for them to make up their own minds as to what it is they wish to do.

## The proposal

The Court went on to consider the application of the Act and *Insolvency Practice Rules (Bankruptcy)* 2016 (**Insolvency Practice Rules**), and noted the direct relationship between sub-s 73(1) and r 75-175 that deals with the calling of a meeting in relation compositions or arrangements. The Court considered each part of the rules, and reiterated the reasoning of *Griffith University v Tang*[2], that a debtor's proposal will not be considered a proposal under sub-s 73 of the Act, unless the criteria prescribed by that subsection are satisfied.

The Court observed that the expression 'proposal' in s 73 of the Act means a *bona fide* proposal, and examined the reasoning of what a *bona fide* proposal constituted in *Re Bendel; Ex parte Pattison*[3], *Labocus Precious Metals Pty Ltd v Thomas*[4], *Hingston v Westpac Banking Corporation*[5] and *Wenkart v Panzer (No 8)*[6].

Of note, was Wenkart v Panzer, where Beaumont J observed:

> … if the trustee does not have sufficient material upon which the trustee could indicate one way or the other whether a proposal would benefit the bankrupt's creditors generally, then, in my opinion, there is no absolute and certainly no unconditional obligation on the trustee to call a meeting.

Additionally, the Court concurred with Allsop J in *Labocus*, that it will in the first instance be a matter for the trustee to judge whether a proposal is sufficient in detail and of underlying commercial substance such that a proposal should be put to a meeting. As such, the Court held a proposal need not only be *bone fide*, but the proposal needs to be detailed and provide sureties or securities to the creditors.

> 113 In light of the reasoning in *Bendel*, *Labocus*, *Hingston* and *Wenkart* considered above, I conclude that once a proposal has been found to be *bona fide*, it will not for that reason alone constitute a proposal that is lodged under s 73. A trustee is not under an unconditional obligation to call a meeting. Upon an assessment of: (a) the *bona fides* of the proposal; (b) the sufficiency and clarity of the terms of the proposal; (c) the offering or absence of any sureties or securities for performance of the composition, and;
>
> (d) other discretionary considerations (e.g. any delay attending the making of the proposal), a trustee may conclude that the proposal is such that a meeting of creditors ought not be convened. It remains important to maintain the distinction between a proposal which engages the obligation to convene a meeting under s 73 and a purported proposal which does not.

## Decision

The Court held that the Applicant bankrupt's compromise offer did not constitute a proposal within the meaning of s 73, so the Respondent trustee was under no obligation to convene a meeting of creditors. The application was dismissed with costs against the Applicant. This decision strengthens the hand of trustees in postponing (and refusing) to convene a meeting of creditors to consider a s 73 proposal in circumstances where:

- the proposal is not *bona fide*;
- the proposal lacks clarity; or
- further investigation is needed.

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Legal Officer
Legal & Governance, AFSA

2 (2005) 221 CLR 99.
3 (1997) 80 FCR 123.
4 [2003] FCA 1154.
5 200 FCR 493.
6 (2004) 135 FCR 422.

## Duarte v Coshott, in the matter of Duarte [2017] FCA 1238

**BANKRUPTCY AND INSOLVENCY** application to set aside a bankruptcy notice — whether valid debt at time of issue — whether amount in bankruptcy notice overstated by reason of payments made by debtor — held: application granted

### Facts

A court had given judgment against the applicant, Ms Duarte, in favour of the respondent, Mr Coshott, in the sum of $25,401.70 which with interest, amounted to $29,108.62. Mr Coshott procured the issue of bankruptcy notice for that sum of $29,108.62. Two weeks after she had received the bankruptcy notice, Ms Duarte wrote to Mr Coshott's solicitors, referring to payments that she said had already been made and certain offsetting sums, and asserted the debt had been paid in full.

Ms Duarte subsequently made an application to dismiss the notice claiming the amount was overstated because the underlying judgment debt had been paid in full; and that the amount claimed in the bankruptcy notice incorrectly stated the amount in fact due by failing to have regard to payments she had made and other garnisheed payments. Based on the evidence before the court it accepted that the judgment debt, in the absence of any claim in the bankruptcy notice for post-judgment interest, was below the $5,000 threshold needed for the valid issue of a bankruptcy notice.

The court summarised further transactions (including the invalidly obtained garnishee orders which reduced the amount owed significantly) and stated that:

> … the case ultimately advanced on behalf of Ms Duarte was that there was either no outstanding amount owing towards the debt claimed in the bankruptcy notice, or sufficiently little outstanding such that there was a material misstatement in the notice. The need for a finding that a misstatement was material is fundamental.

### Court's Analysis

The court's reasoning and decision are evident from the following excerpts:

> 36 Bankruptcy notice cases now need to be considered with *Adams v Lambert* in mind. Pre-2006 authority may need to be checked to ensure it is compatible with the High Court's modern focus on substance rather than form in the application of s 306 of the *Bankruptcy Act:* see *Adams v Lambert* at [34].
>
> …
>
> 38 Following *Adams v Lambert*, when an error in a bankruptcy notice is proven, the issue is whether, objectively determined, a debtor could be misled as to what it is necessary to do in order to comply with the requirements of the bankruptcy notice. If that is the case, such an error is a defect that s 306 cannot cure. In *Adams v Lambert*, there was no doubt that the debtor had to pay a sum which included post-judgment interest. The fact that a mistake had been made in referring to the wrong provision of the *District Court Act 1973* (NSW) was held to be covered by s 306 of the *Bankruptcy Act*. The bankruptcy notice in *Adams v Lambert* was misleading in form but not in substance, as it was clear what the debtor was required to do, namely, to pay the judgment debt, which included pre-judgment interest and post-judgment interest.
>
> …
>
> 41 It is true that a valid s 41(5) notice does not automatically lead to invalidity. That provision is not the source of any power to set aside a bankruptcy notice, as opposed to s 30, which bestows a broad discretion. Further, it falls for consideration whether the relevant misstatement was material, such that it is beyond the purview of s 306(1) of the *Bankruptcy Act*. In this case, that threshold is met in several different ways:
>
> (1) First and foremost, at the time of the issue of the bankruptcy notice, the amount due was below the threshold for a valid bankruptcy notice to issue at all. This is an error that goes to the fundamental conditions on the issue of a bankruptcy notice. On any view, it is a material misstatement as to any obligation to pay by reason of the bankruptcy notice existing at all, as well as being a separate ground for the bankruptcy notice to be set aside.
>
> (2) Secondly, even if the amount due was not below the threshold for the issue of a valid bankruptcy notice — by reason, for example, that the disputed 2013 garnishee payments should not have been deducted — that would still leave a bankruptcy notice seeking payment of $29,108.62, whereas the correct figure was, at most, only $5,836.99 ($29,108.62 minus the sum of $22,361.90 and $909.73). An overstatement of five times the amount due is of the kind that leaves it open to the Court to find that there was a material misstatement within the terms of s 306(1) of the *Bankruptcy Act*.
>
> (3) Thirdly, on the evidence and findings of the Court, by the time that matter was properly before this Court, and certainly by the time of hearing of the application, there was little or no debt left at all. While this does not go to the validity of the bankruptcy notice at the time it was issued, it is relevant to the exercise of the discretion to set the bankruptcy notice aside.

## Decision

The Court held that

> 43 In this case, unlike the situation in *Adams v Lambert*, there was a substantial misstatement in the bankruptcy notice served on Ms Duarte. It would, if left uncorrected, have left Ms Duarte objectively (not subjectively) in the position of being misled by either: requiring payment where there was no valid requirement imposed by the bankruptcy notice to pay anything, due to being under the $5,000 threshold for the valid issue of the bankruptcy notice; or requiring payment of an amount that was more than five times the debt in fact owing, notice having been given for the purposes of s 41(5) of the *Bankruptcy Act* to rely on a misstatement of the amount due.
>
> …
>
> 46 Once Ms Duarte had put Mr Michael Coshott on notice of the inherent defects in his bankruptcy notice by her letter of 11 April 2017, he should have withdrawn that bankruptcy notice, applying *Seovic* reasoning. Ms Duarte should not be out of pocket for legal expenses from that time onwards.

The court granted the application to set aside the bankruptcy notice.

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