

Insolvency Law Reform Bill and Practice Rules Proposals

Submission by the Financial Rights Legal Centre

The Financial Rights Legal Centre (*formerly known as the Consumer Credit Legal Centre (NSW)*) is a community legal centre that specialises in helping consumer's understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the Credit & Debt Hotline, which is the first port of call for NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. Financial Rights took over 22,000 calls for advice or assistance during the 2013/2014 financial year.

Financial Rights also conducts research and collect data from our extensive contact with consumers and the legal consumer protection framework to lobby for changes to law and industry practice for the benefit of consumers. We also provide extensive web-based resources, other education resources, workshops, presentations and media comment.

This submission is an example of how community legal centres utilise the expertise gained from their client work and help give voice to their clients' experiences to contribute to improving laws and legal processes and prevent some problems from arising altogether. Federal Government changes to Community Legal Services Program funding agreements in mid 2014 restrict policy and law reform that community legal centres can undertake with Federal Government funds. These restrictions have the potential to deprive Government and others from valuable advice and information and reduce efficiency and other improvements in the legal system. For more information please see <http://www.communitylawaustralia.org.au/law-reform-and-legal-policy-restrictions/>

Thank you for the opportunity to comment on the Insolvency Law Reform Bill

General comments

As a community legal service providing both legal advice and financial counselling to the public, we receive many calls about personal bankruptcy and other insolvency options under the Bankruptcy Act. Those calls range from people who are contemplating bankruptcy as a solution to insurmountable debt to those who being made bankrupt by their creditors and those who have already become bankrupt, in some cases without their knowledge or understanding of the process.

We generally support any provisions which will make Trustees more accountable. However, we note that the commentary in the Explanatory Memorandum is almost exclusively about the rights of creditors, and

accountability to creditors. We note that debtors and bankrupts are fundamentally affected by insolvency laws, and their perspective should be balanced with the needs of creditors. In the examples given below there is little conflict between the concerns of creditors and debtors at all, and in some cases their concerns coincide completely.

Bankruptcy Advice Calls to Financial Rights Legal Centre by calendar year	2010	2011	2012	2013	2014	Total
Credit and debt bankruptcy (unspecified)	633	716	598	506	420	2,873
Debtor's Petition	11	17	19	15	25	87
Bankruptcy Notice	184	166	127	98	99	674
Creditor's Petition	59	71	101	64	67	362
Part IX Agreement	49	97	79	93	70	388
Total	936	1,067	924	776	681	4,384

Specific Provisions

We support the creation of a Register of Trustees as described in the Explanatory Memorandum. We also support the more prescriptive requirements of Trustees seeking registration or renewal and the changes to the disciplinary powers of the Inspector General.

The main purpose of this submission, however, is

1. To make observations about the difficulties encountered by debtors in challenging Trustee's remuneration and other expenses and make recommendations for improvement.
2. To outline some deficiencies in the obligations placed on trustees in relation to Part X Agreements.

1. Trustee's Fees

While concerns about the level of Trustee's remuneration are primarily the prerogative of creditors there are two situations where they become a key concern for the debtor:

1. When seeking to challenge a sequestration order (often made in their absence)
2. When seeking to annul a bankruptcy (either because they have always had the means to pay their debts and either did not know about or did not understand the proceedings, or because they have acquired substantial funds since the bankruptcy, through an inheritance for example).

In our experience the expenses of administering a bankrupt estate (including trustee remuneration) can be very considerable, even in circumstances where the debts were very small, or the administration very short.

Case study 1

A caller to our service had been made bankrupt in 2013 over strata fees. The judgment debt was for \$20,000. She had considerable equity in her apartment. Her parents had now offered to put up the funds to annul the bankruptcy. The trustee said that this would take about \$75,000.

Seeking to have a sequestration order set aside

The first point in time where trustee's fees become an issue is when a debtor becomes aware that there has been a sequestration order made against him or her and is seeking to have that order set aside. Usually there will be at this point an amount of Trustee's fees claimed as a result of the administration of the estate to date.

The fees claimed by trustees at this point vary considerably. It was noted in *Vaucluse Hospital Pty Ltd v Phillips & Anor [2006] FMCA 44 (20 January 2006)* for example that "the debt was for a relatively small sum, which is equivalent to **only one third** of the trustee's claims for remuneration and expenses. The debt was for hospital fees the bankrupt thought were covered by his medical insurance. The bankrupt is unable to properly manage his own affairs. The debt was paid by his father soon after the sequestration order was made. He is solvent and should never have been made bankrupt.....Had the trustee proceeded cautiously, few expenses needed to be incurred in this administration in the early stages it had reached before payment." [Riethmuller FM, emphasis added]. In this matter an application for review of a sequestration order had been made within 3 weeks and yet the trustee claimed \$14,000 in remuneration and expenses. The Federal Magistrate noted a number of seeming anomalies in the trustee's claims and observed in passing that the "bankrupt is a disability pensioner unable to properly manage his own affairs receiving a fortnightly pension of little more than the trustee's hourly rate".

In the majority of such cases, however, there is no review of the claims by the trustee by the court to expenses, and such costs are usually borne by the debtor in an attempt to obtain a sequestration order set aside by consent. This puts the debtor in an extremely powerless position in relation to questioning the trustee's fees, because the only alternative is to continue with a set aside application that they may not win (adding to the cost of ultimately annulling the bankruptcy).

There is also a tension between steps that a trustee reasonably needs to take to protect the estate versus the unnecessary incurring of fees and charges.

Case study 2

The A family migrated to Australia in the early 80's from Macedonia. Mr and Mrs A Senior and their son and daughter-in-law (Mr and Mrs A Junior) jointly owned two units in Sydney.

Mr and Mrs A Senior worked as cleaners and their English skills were poor. Whilst they understood they owned both properties with their son, they had little understanding that they had joint obligations under the mortgage and in relation to strata fees. Mr A Junior was out of work due to a back injury and Mrs A Junior received Centrelink benefits as she cared for their two young children. Mr A Junior, who had primary responsibility in paying the mortgage, fell behind on the mortgage and the strata fees. In August 2009 a *Statement of Claim* was issued and served for the outstanding strata fees. After 28 days judgment was entered against them for \$5,200 including legal fees.

Two days after the judgment was entered, a *Bankruptcy Notice* was issued and subsequently served on all of them. But they did not respond to the *Bankruptcy Notice* so they each committed an *act of bankruptcy*.

Between December and January *Creditor's Petitions* were served on all of them, and a date was set for a hearing at the (then) Federal Magistrate's Court. But, they did not show up to the *Petition Hearing*.

In February 2010, they all were made Bankrupt by *sequestration order* in their absence by the Registrar of the Federal Magistrates Court. They received *Statements of Affairs* in the post and were contacted by the Trustee. 16 days after the orders were made they sought advice from our service.

We applied for a review of the Registrar's decision. We immediately advised the trustee in writing of the review and advised them in light of the review to keep the costs to a minimum.

In the meantime on our advice, the clients paid the original judgment debt. We commenced negotiations to have the *sequestration order* set aside by consent.

The trustee sent a representative to the Federal Magistrate Court hearings to represent the interests of the trustee. The trustee was reluctant to provide evidence of the steps and costs that had been taken in respect of the matter or the basis of their standing in the re-hearing of the sequestration order.

Eventually it was agreed that the clients would pay the reduced Trustee's costs of \$3,000 (less than they originally claimed) and the legal costs of the petitioning creditor and the proceedings were settled and not required to be determined.

In total, the clients paid \$11,000 to avoid bankruptcy. The original strata levy debt was \$3,000.

Recommendation

AFSA should issue guidance on how trustees can balance the need to protect the legitimate interests of creditors with the need to minimise costs for debtors seeking to set aside or annul a bankruptcy.

There should be a process for trustee's fees to be reviewed in the context of court proceedings, where the debtor accepts liability in principle but disputes the amount.

Annulment

When a client discovers that they are bankrupt after the event, or comes into money during the period of their bankruptcy, they will seek to have the bankruptcy annulled. To do so they will need to pay:

- The debts;
- Contractual interest to the date of annulment;
- The trustee's remuneration and any other costs incurred by the trustee in the administration of the estate; and
- The government imposed realisations charge.

There is a process for disputing fees. The bankrupt will receive a notice and they have 28 days to challenge the fees by lodging an application for review with the Inspector General. It is our understanding that the intention is to replicate the current rules which are found largely in the Bankruptcy Regulations and the *Inspector-General Practice Statement 16 - Reviewing Remuneration of Trustees and Costs of Third Party Service Providers, Released 1 December 2010, Updated 1 August 2013*.

In short, our point is not that Trustee's fees are often too high, although that does sometimes seem to be the case, but rather that it is impossible for the debtor to be able to make a judgment about whether they are reasonable or not. Further, the process for challenging the level of remuneration claimed presumes a level of knowledge and understanding on the part of the debtor they simply do not have in most cases.

For example Reg. 8.12F(1) provides that the Inspector-General must refuse to accept an application where (Reg. 8.12F(1)) among other things:

- *The applicant has not adequately particularised the issue giving rise to the review.*

The Practice Statement further clarifies) that claims with only general phrases like "*remuneration appears excessive*" or "*every item of work is disputed*" will not be considered adequate to justify a review. Unfortunately in most cases bankrupts will have nothing further on which to base their complaint than a vague sense that the amount claimed seems like too much. Bankrupts have no knowledge of the obligations of trustees, or of what is a reasonable cost for performing those tasks.

Case study 3

A caller to our service went bankrupt in 2012 on \$157,000 credit card debt. She is now in 2014 expecting inheritance of possibly around \$350,000. The trustee in bankruptcy has asked the executors to put the full amount into their account.

They have so far refused to provide itemised figures in writing, but over the phone they have provided the following estimates:

- \$170,000 total debt (appears to include a double count of one debt which they are willing to fix)
- \$91,000 in interest, approximated at 20% per year
- \$56,000 in trustee fees
- \$20,000 as 6% realisations charge
- \$11,000 for contingencies

She can't understand how it could cost so much. She had no property when she went bankrupt except \$700 worth of shares which the trustee sold. She also never earned enough to require contributions to be estimated and collected. She does not understand what they have done for their money.

Case study 4

A man from a non-English speaking background says he was forced into bankruptcy the year prior to calling our service. He had not aware of those proceedings. He owed \$4600 and \$29,000 on a charge card and credit card respectively. The trustee is charging a further \$16,000 for their fees. The trustee has lodged caveat on his home he owns with his wife. His children are helping him get the money to pay out the bankruptcy. He wants to know whether the \$16,000 is a reasonable amount.

Case study 5

A woman sought advice from our Supreme Court mortgage hardship duty service. She clearly had some cognitive difficulties and kept changing her story. In summary she had been made bankrupt and she owned a property with her mother. She said that her mother had paid 100% of the purchase price of the property. We tried with little success to explain the bankruptcy process to her. It was clear she was being obstructive but unclear how much was intentional and how much stemmed from a genuine inability to comprehend the process. The trustee's fees stood at that point at \$130,000.

"Exceptional circumstances" – may include but is not limited to (PS 16, para 3.7):

- Evidence provided of errors on the part of trustees or their staff requiring remedial action including work done poorly and having to be reworked
- Systemic and justified complaints made to AFSA Regulation about conduct which indicates trustee or staff have been performing unnecessary work or work not properly executed
- Evidence of inefficiency or inappropriate billing practices having been discovered (either by applicant or AFSA Regulation staff upon investigation) e.g. giving routine work to expensive senior staff, charging for communication with regulator, or inordinate delays without explanation in the distribution of the estate.

Most bankrupts would be unable to identify any of the above from the material they are privy to. The vast majority would not even be able to identify these types of issues if they were given access to the files. It is useful that the Inspector General can apply its own knowledge of any of the above, but they would only have such knowledge in a minority of cases.

For most applicants they have no knowledge of what is a reasonable amount of fees in any given situation.

We note that there are certain tasks that the Trustee is required to do by law for which he or she is entitled to be remunerated despite the fact that they do not generate any additional funds for the estate (for example, reporting to creditors, lodging statutory records with AFSA and maintaining accounts). There is no guidance available as to what is a reasonable amount to charge for such activities and what characteristics of a particular estate might make such duties more or less complicated or time consuming.

The Practice Statement also sets out the types of considerations that will be taken into account in a review:

- Was the work performed within the scope of the Trustee's powers?
- Was the work performed prior to the appointment of the Trustee?
- Did the Trustee undertake a proper assessment about whether a particular cost was reasonable given the value and complexity of the administration (keeping in mind that the fact that certain expenses appear pointless in hindsight - because little or no additional funds were recovered for the estate - is not sufficient to render the original decision to undertake the action/cost unreasonable)?
- Were there instances of double billing for essentially the same tasks, obvious inefficiency, incompetency (charging for organising invalid creditor's meeting), billing at senior staff rates for routine, non-complex tasks?
- Did the Trustee behave appropriately and properly manage any conflicts of interest?

- Did the Trustee properly record work done and costs incurred?
- Did the Trustee drag out the administration unnecessarily (incurring additional costs) once the bankrupt indicated a willingness and ability to pay out all debts and expenses?

Not only is it beyond most bankrupts to identify any of the above, it is not clear to us that there is any reliable way of determining this without a full review of the trustee's file by someone with adequate knowledge of the trustee's duties and the circumstances of the administration.

We note that the Inspector General expects that where the Bankrupt is solvent or has the resources to pay out all debts the trustee should identify this early and give the Bankrupt an opportunity to pay and take advantage of section 153A before incurring any unnecessary expense. The regulator undertook a review of a sample of administrations that were annulled pursuant to 153A of the *Bankruptcy Act* in 2011/12 and ordered a reduction in fees in a small number of cases. We support the regulator undertaking such initiatives, but they cannot replace a practical and accessible review process.

Recommendation

There Review Process should be revised to ensure that the bankrupt does not have to identify or particularise matters of which they cannot be expected to be aware. For example, once a review application has been lodged, the Inspector General could be required undertake an initial review of the remuneration and expenses charged to ensure that they are proportionate for the size and complexity of the administration. A simple questionnaire for completion by the bankrupt and the trustee could provide some basic information about the particular administration, along with an internal guide setting out likely fee and cost ranges. Where it appears that the amounts charged exceed the amount expected in the circumstances, or one or more of the above problems currently referred to in the Practice Statement as exceptional circumstances, have been identified, the Inspector General or the bankrupt, then the Inspector General should agree to undertake a more thorough review of the evidence.

2. Part X Personal Insolvency Agreements

The Financial Rights Legal Centre has been involved in past reviews of Part IX of the Bankruptcy Act, and has expressed many concerns about the operation of that Part in practice. Until recently, we have had little contact with Part X because the type of client we assist would not be likely to have sufficient income or assets to be considering a Part X Personal Insolvency Agreement. Recent calls to our centre have led us to hold some concerns in this area as well:

Duties and obligations of the Controlling Trustee

Case study 6

A woman owns a house with a mortgage of \$200,000 or so over a house worth about \$700,000. She has an income of around \$60,000 a year.

She went to a commercially operated debt consultant (and registered Debt Agreement Administrator) on a friend's recommendation, to get a Part IX Debt Agreement ("Debt Agreement") for three unsecured debts totaling about \$40,000. She wanted a repayment arrangement over 3 years. The fees for this consultant were over \$8,000.

As the equity in her home was greater than the threshold for a Debt Agreement, she was put in a Part X Personal Insolvency Agreement ("PIA") instead, incurring another \$8000 in trustee fees in the process.

The client had no understanding what a PIA would involve. She did not understand that she would be handing over complete control of her assets to a trustee, who would be required to look after the best interests of her creditors. She was not warned that this control could lead to the forced sale of her home, or to her forced bankruptcy. This trustee did not recommend the repayment arrangement the client wanted. Instead, they recommended that the creditors give the client time to refinance, which was never the client's intent.

Under intense pressure, the client started steps to refinance with 'second tier lenders' which also required her to incur fees to go through a budgeting service.

In this particular case, the client managed to get assistance from yet another agency to organise repayment arrangements with her creditors and she was entering into negotiations to contest the many fees charged to her.

The client should never have been put into this situation to begin with. Prior to being put into the PIA, her creditors had not taken any legal action against her. Her safest course would have been to negotiate with her creditors individually and to seek the advice assistance of a free financial counsellor in that process. Free external dispute resolution services would also have been available to help put repayment arrangements in place. She could have considered a refinance or sale of the property on her own terms without incurring the additional fees and future repercussions of insolvency solutions under the Bankruptcy Act.

The duties of the Controlling trustees as expressed in Inspector-General Practice Direction 12 Controlling Trustee's Roles and Duties include acting in an impartial and independent manner, impartial to the wishes of the debtor. They also include administering the estate in the interests of the creditor and the bankrupt and exercising their public duties under the Act. It is not clear where, in this process, anyone has a duty to the debtor to suggest that they should not be considering a Personal Insolvency Agreement at all?

One of the options canvassed in the most recent review of Part IX Debt Agreements was an obligation on the Registered Trustee to ensure that a Debt Agreement was at the very least not completely unsuitable for the debtor. This was in response to widespread criticism by stakeholders about debtors entering Debt Agreements, which were patently a terrible option in the debtor's circumstances, on the recommendation of a Debt Agreement Administrator who stood to gain financially from the debtor's decision as result of their upfront and ongoing fees. It seems that a similar conflict exists for controlling trustees who also stand to gain commercially from undertaking the work of a controlling trustee.

Case study 7

A recent caller to our service and his wife had jointly entered into a Personal Insolvency Agreement about 3.5 years ago. They had credit card debts totally approximately \$70,000. They were paying off their home and did not want to go bankrupt. They have been paying about \$1,300 per month (it varied over time) totaling about \$30,000. Payments were meant to be forwarded to his creditors every quarter.

He had not paid for 4 or 5 months and the creditors had started to contact him. It transpired that they had not received a cent from the administrator and his total debts remain at \$70K.

He contacted trustee and was told that because he had varied the agreement so often they had kept all payments to go towards their fees for arranging the variations.

The caller advised he was not made aware that he would be liable for fees every time they had to change the agreement, nor was he told that his payments would be kept towards fees rather than paid to his creditors. He said that if he had known that, he would have paid the creditors directly and he would have paid a big chunk of his debts by now.

The issue of Debt Agreement Administrators being paid in preference to, and sometimes to the exclusion of, creditors was a major problem in the first few years of operation of Part IX. After the 2005 review the rules were changed to ensure that Debt Agreement Administrators could only accept their fees as a fixed percentage of any payment by the debtor, with remainder being compulsorily distributed to creditors. This produced a fairer outcome for creditors, at the same time as giving a greater incentive to Debt Agreement Administrators to ensure that Debt Agreements were sustainable and more likely to continue until completion. Upfront fees (incurred for the preparation of the agreement prior to its acceptance by creditors) are an exception.

The case study above suggests that there needs to be far greater accountability to both debtors and creditors in relation to the amount of fees charged for both set up and variation of Personal Insolvency Agreements also, and the manner in which these are distributed (as between the trustee and the creditors).

Recommendation

The rules in relation to PIAs should be reviewed to ensure that:

1. debtor's are not inappropriately steered into PIAs and that the fees for PIAs, including variations, are clearly communicated to debtors,
2. there is proportionate distribution of payments to creditors and
3. debtors are given statements showing how their payments/property are being applied to fees and creditor distributions.

Part IX Debt Agreements

We note that there have been no amendments recommended as a result of the review of Debt Agreements undertaken in 2011/12. We have serious concerns about Debt Agreements (included in many previous submissions) and urge the Government to take action in response to that review.

Concluding Remarks

Thank you again for the opportunity to comment on the Australian Government's Discussion Paper. If you have any questions or concerns regarding this submission please do not hesitate to contact the Financial Rights Legal Centre on (02) 9212 4216.

Kind Regards,



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