Chapter 10: Help, I’m being made bankrupt! Part 2

Updated: 15 April 2025

Content

Summary

This chapter describes the process for making a debtor bankrupt through the courts. It describes the process and your client’s options at each stage.

This is an area where proceedings move fast and legal costs accumulate quickly. If you have a client who has received a Bankruptcy Notice or a Creditor’s Petition, they will need urgent legal advice.

If your client has already been made bankrupt, the first they hear about it (or the first time they are driven to take action) may be when the Trustee freezes their bank account(s). Again, it is important to get advice urgently because there are short time limits for taking action and Trustees costs add up fast.

If your client has been made bankrupt, they need to file a statement of affairs as soon as possible, whether they intend to try to get the bankruptcy set aside or not!

Key terms

Bankruptcy Notice

This is a document issued by the Official Receiver when a creditor applies (and pays the filing fee) and can prove that there is an outstanding judgment (or judgments) against a debtor for $10,000 or more. The judgment(s) must not have been stayed by the court and must not be more than 6 years old. The notice itself does not start any court proceedings. Failure to pay within the time provided is an act of bankruptcy (see below) on which a creditor may then base a Creditor’s Petition.

Creditor’s Petition

This is a formal application to the court to make a debtor bankrupt. This commonly follows an unpaid Bankruptcy Notice (although theoretically there are other acts of bankruptcy on which it could be based – see **Chapter 10 Part 3**). The act of bankruptcy must have occurred in the previous 6 months. There will always be a hearing within a very short time and the debtor must attend or apply to the court for an adjournment if he or she is to have any hope of avoiding bankruptcy.

Sequestration Order

This is an order of the court making a person bankrupt. Most commonly this will be the result of a Creditor's Petition. Your client's options are very few once they have been made bankrupt. Those options they do have are canvassed later in **Chapter 10 Part 4**.

Part 2: Bankruptcy Notices

A creditor can apply to the Official Receiver for a Bankruptcy Notice if:

1. The creditor has:
    - a final judgment or order issued by a court, or enforceable as a court order, against the debtor for **at least $10,000**; or
    - more than one final judgment or order **adding up to at least $10,000** (s 41(1)); and
2. The judgment or order was issued **no more than 6 years ago** (s 41(3)); and
3. The enforcement of the order must **not have been stayed** (s 41(3)); and
4. The creditor pays the AFSA application fee ($470 as at 15 April 2025)

While creditors can claim post judgment interest on a Bankruptcy Notice in certain circumstances, post judgment interest cannot be used to make up the $10,000 minimum required (see Official Receiver's Practice Statement 6 (ORPS6), Applying for a bankruptcy notice). Post judgment interest can be claimed on a Bankruptcy Notice only where it is allowed by the terms of the judgment or the rules of the court in which the judgment was given, the amount is specified and the schedule to the Bankruptcy Notice is completed showing how the interest was calculated. Creditors can choose not to claim the post judgment interest in order to avoid errors in its calculation which may render the Bankruptcy Notice invalid.

Legal fees can only be used to make up the $10,000 threshold where either:

- The amount claimed was included in the original judgment or order as a specific dollar amount; or
- The original judgment or order was for costs generally and those costs have since been taxed (fixed) by the court or assessed by an assessor and a sealed bill of costs or certificate issued. In NSW the certificate of assessment of costs needs to be registered as a judgment in a court of competent jurisdiction before it can be enforced

and form the basis of a Bankruptcy Notice. Get advice about your jurisdiction if necessary.

The Bankruptcy Notice must be served on the debtor within 6 months of the date of issue of the Bankruptcy Notice by the Official Receiver (Bankruptcy Regulations reg. 10). The creditor can apply for additional time to serve a Bankruptcy Notice, but the application must be accompanied by reasons and a description of the attempts made to serve the notice. Another fee must also be paid ($160 as at 15 April 2025).

Personal service is not required (Bankruptcy Regulation reg. 102). This means the Bankruptcy Notice can be posted, e-mailed or faxed to the debtor in accordance with the Electronic Transactions Act 1999. The belief a Bankruptcy Notice must be personally served is a common misconception. If this is the client's only defence/objection he or she will just incur additional costs if they try to fight the Bankruptcy Notice in court.

My client has been served with a Bankruptcy Notice – What now?

The Bankruptcy Notice will usually give your client 21 days to comply (if the Bankruptcy Notice is served outside Australia, it may give the debtor a longer period to comply, but this will be specified in the notice). You should note the date the client received the Bankruptcy Notice on your file and make sure the client is aware of when their time runs out! If there is some confusion as to when the bankruptcy notice was received, for example how long it was in the letterbox, it may be wise to contact the creditor and confirm the start date of the 21 days.

Your client has a number of options apart from doing nothing. Doing nothing is not recommended unless the client is happy to be made bankrupt and understands the consequences (see **Chapter 6**).

If the client can pay the amount claimed, he or she should do so within the 21 days provided by the Bankruptcy Notice to avoid an act of bankruptcy. If your client disputes the debt, he or she should get legal advice immediately (as time limits apply). If something can be done to dispute liability (such as applying to set aside the judgment) then it will need to be done urgently. It may be that the client has simply run out of options to dispute the debt and will need to pay whether they believe they owe the money or not to avoid bankruptcy. Clients find this idea very difficult ('it's just not fair') and it is your role to help them understand how much more unfair it will be if they are forced into bankruptcy.

Reducing the debt below $10,000

Once judgment(s) have been obtained for $10,000 a Bankruptcy Notice can be issued. Importantly, post judgment interest cannot be used to make up the amount, for example a creditor cannot obtain a $9,500 judgment and wait for $500 of interest to accrue to support the issue of a Bankruptcy Notice.

Even if your client can't pay the whole debt, it is worth your client trying to pay the debt down to an amount below $10,000 and keeping all debt owed to the creditor below $10,000. Note that, a bankruptcy notice may be issued, even if the debt is at the time below $10,000 due to a payment, if the judgment debt(s) are above $10,000. In rare cases, the Bankruptcy Notice may even state an amount below $10,000. *Autron Pty Ltd v Benk*, [2011] FCAFC 93.

If all the debts owed to the creditor is less than $10,000 after the expiry of the Bankruptcy Notice period, then the creditor will not be able to establish the grounds required for the issue of a Creditor's Petition. Because of this the creditor may not accept the payments once a bankruptcy notice is issued. Note that they may accept payment and are more likely to do so now than after the issue of a Creditor's Petition.

This will not work where the client owes other amounts to the same creditor because once the act of bankruptcy has been committed (failure to pay in accordance with the Bankruptcy Notice) other amounts which were owed by the client prior the act of bankruptcy can be added to make up the $10,000. This can be particularly apparent in strata disputes, where unpaid levies may continue to accrue simultaneously. Amounts owed to other creditors can also be relied on to make up the $10,000 if those creditors join the proceedings or are substituted as petitioning creditors – this is less common.

Case study

Jane lives in a strata building. She fell behind in her strata levies as she lost her job and was struggling with her mental health during the COVID pandemic. Jane continued to pay as much as she could when she could. Her strata issued her a statement of claim to recover the levies, and shortly after obtaining judgment commenced fresh proceedings for the legal fees incurred. The total of the two judgments exceeded $10,000, and a Bankruptcy notice was issued for $9,900 reflecting the payments she had made since judgment was entered. Jane did not pay the whole balance, and an act of bankruptcy was triggered. As Jane had fallen behind in her levies that were ongoing again, and the strata company claimed she owed the legal fees for pursuing the judgment debt the amount she owed strata again increase over $10,000 and the creditor issued a Creditors Petition.

Setting aside the Bankruptcy Notice on the grounds that it is technically invalid

There are several grounds for setting aside a Bankruptcy Notice. Some examples include:

- the judgment or order on which the Bankruptcy Notice is based was stayed prior to the issue of the Bankruptcy Notice (and **remained stayed at the time** the Bankruptcy

Notice was issued) (s 41(3))
- more than 6 years had expired from date of the judgment or order to the issue of Bankruptcy Notice (s 41 (3));
- the wrong creditor(s) has(have) issued the Bankruptcy Notice;
- the Bankruptcy Notice has been issued against the wrong debtor;
- the debtor does not owe the creditor(s) at least $10,000;
- the Bankruptcy Notice is not in the required form and could mislead the debtor as to what was required to comply or is an abuse of process.

Setting aside the Bankruptcy Notice will usually need to be done by application to the FCFCOA or FCA (as applicable) using the appropriate form with a copy of the Bankruptcy Notice and an affidavit in support (See the court's website). The application will need also to seek an extension of time to comply with the Bankruptcy Notice until the court has heard the case (to avoid committing an act of bankruptcy).

Your client **must get legal advice** before disputing a Bankruptcy Notice. The grounds are very technical and there is no room for general arguments about unfairness, or pointlessness (where the client has nothing). You cannot argue that your client is actually solvent (although you can once the case gets to the Creditor's Petition stage – see **Chapter 10 Part 3**)**.** Your client will be ordered to pay the creditor's costs if he or she is unsuccessful. It is also necessary to complete the correct forms, attach the necessary evidence and file with the Court (within the 21 days on the Bankruptcy Notice) and also serve the application on the creditor within the necessary time limit (in this case 3 days!) (see Rule 3.02 of the Federal Circuit and Family Court (Division 2) (Bankruptcy) Rules 2021).

If your client obtained an instalment order from the original court prior to the date on which the Bankruptcy Notice was issued, then they may be able to argue that the debt was stayed, but only if the instalment order was being strictly complied with.

Case example

A debtor applied to the Local Court to pay a judgment debt by instalments, commencing with a lump sum on a particular date (immediately after the application was lodged) and then a set amount per month on a particular day of the month until the debt was paid. The date for the first payment came and went without the debtor knowing whether the application to pay by instalments had been accepted by the court so she did not make a payment. Even when the debtor was notified in writing that the instalment order had been made, she took three more days to make the first payment. Shortly afterwards, the creditor applied for a Bankruptcy Notice.

The debtor argued that the judgment had been stayed by the application to pay by instalments and the subsequent instalment order and could not therefore form

the basis for a valid Bankruptcy Notice. The Court found that the stay of enforcement ceased to operate when the debtor missed the first payment date (even though the debtor had not yet been notified that the instalment order had been made) and that the Bankruptcy Notice was therefore valid. The Court ordered the debtor to pay the creditor's costs of approximately nearly $10,000 for the hearing & other appearances in relation to the validity of the Bankruptcy Notice in addition to the original debt.

Setting Aside the Bankruptcy Notice on the grounds of a set off or cross claim

Section 40(1)(g) of the Bankruptcy Act says that to avoid an act of bankruptcy a debtor either has to comply with a Bankruptcy Notice (in other words pay the debt) or:

- satisfy the court that they have a counter-claim, set-off or cross demand;
- that is at least equal to the amount claimed in the Bankruptcy Notice AND importantly,
- could not have been set up in the original action.

Section 41(7) also provides that if the debtor applies to the court within the time to comply with the Bankruptcy Notice for an order setting aside a Bankruptcy Notice on the grounds that they have a set off or cross claim as described above, then the time to comply with notice will automatically be extended until the court has made a decision in relation to the application.

It is important that the client understands that it is not enough to allege that a larger amount is owed to them as a cross claim; they must be able to show why they could not legally have raised the cross claim in the earlier case (where the creditor obtained judgment against them). If relying on this approach under s 41(7) the initial affidavit in support of the application MUST satisfactorily address (i), (ii) and (iii) above or the matter may be dismissed. **Clients should not attempt to use these provisions without legal advice!**

Seeking an extension of time to comply with the Bankruptcy Notice because the client has lodged an application to set aside the judgment or appealed the judgment.

If the client has a potential defence to the debt, or cross claim, that was not raised in the original proceedings then it may be possible to apply to set aside the judgment debt. This must be done in the original court where the judgment was made, not in the Federal Circuit and Family Court of Australia (or Federal Court of Australia). Usually, the client will alsoneed to be able to explain why they did not take action when they received the original writ, summons, or statement of claim (or other document initiating legal proceedings), and why they then delayed lodging an application to set aside the judgment. Examples of good reasons include not receiving the court documents or being incapacitated through illness or disability. The client should get legal advice.

> **Remember::** Many clients will claim to have not received court documents but more often than not it turns out that there is an affidavit of service on the court file. The client will need evidence to counter this affidavit if they really believe it is not true. Further, even if the client was not served with the documents, the court will find that they could have taken action as soon as they became aware of the proceedings by any other means (the other side might have correspondence, for example, from the client or their legal representative which shows they knew about the proceedings). This means the bankruptcy proceedings may continue despite the lack of service of the documents.

If applying to set aside the judgment is a realistic possibility, then the client should:

- Apply to set aside the judgment in the original court AND
- Apply to the Federal Circuit and Family Court of Australia (or Federal Court of Australia) for an extension of time to comply with the Bankruptcy Notice (s 41(6A)).

Again, this will require the right forms, evidence, and service on the creditor, so legal assistance is essential (Rule 3.03 of the Federal Circuit and Family Court (Division 2) (Bankruptcy) Rules 2021). The client risks additional costs if the application to set aside the judgment is unsuccessful.

The client should also be aware that the Court has the power under s 41(6C) to refuse to extend time to comply with the Bankruptcy Notice if it is of the opinion that the application to set aside the judgment is not *bona fide* (that is, has no real merit and is being used as a stalling tactic) or is not being prosecuted with due diligence (is being intentionally ‘dragged out’ to buy time).

An extension of time can also be sought if the original judgment or order is the subject of an appeal or other form of review (for example, statutory review of a costs assessment where the Bankruptcy Notice is based on legal fees owing). However, the Court will be reluctant to grant an extension on these grounds unless enforcement of the judgment has also been stayed in the original court. If the judgment was already stayed at the time of the issue of the Bankruptcy Notice, then the Bankruptcy Notice is invalid and can be opposed. If the appeal has been lodged after the date of the Bankruptcy Notice (for example, where leave has been

sought to lodge the appeal after the expiry of the time limit), then the client must also apply to have the enforcement of the judgment stayed at the same time. **Legal advice is essential.**

What if the amount claimed on the Bankruptcy Notice is wrong?

A Bankruptcy Notice will not be invalid simply because the amount claimed is wrong. In order to dispute a Bankruptcy Notice on the basis that the amount claimed exceeds the amount owed (overstates the amount), the debtor needs to give notice to the creditor within the time for compliance with the notice that he or she intends to dispute the validity of the notice on the basis of the misstatement (s 41(5)). The Act does not specify how the notice is to be given, but the client would be wise to notify the creditor in writing and confirm that the creditor has received the notice. The notice should be precise as to the nature of the overstatement of the debt.

The debtor should also pay the amount they agree is owed within the time required by the notice or make an immediate arrangement to pay off the amount they agree is owed. Section 41(6) states that if it is later proven that the Bankruptcy Notice does include an overstatement the debtor will be taken to have complied with the notice if they paid the correct amount within the required time. The debtor should seek legal advice about how to deal with the Bankruptcy Notice in these circumstances.

What if the client cannot afford to pay the amount claimed in the Bankruptcy Notice and has no grounds to either dispute the notice or set aside the judgment?

This is in fact the most common scenario of all. Many clients have not paid the judgment debt because they simply cannot afford it. In some cases, they may have a home, but no cash flow, which is why the creditor is resorting to bankruptcy – to get access to the asset. In this case your client cannot avoid committing an act of bankruptcy. However, they can try to reduce the risk that the creditor will proceed to the next stage of the process by paying as much as they can and trying to come to an arrangement with the creditor to pay the amount outstanding. Always get any arrangement confirmed in writing and impress upon your client the importance of paying in strict accordance with the arrangement.

Lodging an application to pay by instalments after the issue of a Bankruptcy Notice

A debtor can still lodge an application to pay by instalments in the original court after the Bankruptcy Notice has been served. This will NOT affect the creditor's rights to proceed to a Creditor's Petition, but it may make them disinclined to do so. It is important to pay strictly in accordance with the instalment order if it is granted. An instalment order that is being complied with might also be useful in arguing for an adjournment of a Creditor's Petition to give the debtor time to pay, but usually only if the debt will be paid quite quickly (usually

within months, not years). If the creditor objects to the instalment order, however, the client should get very specific legal advice. The instalment order will not prevent the issue of a Creditor's Petition and the debtor could face an adverse costs order as a result of the hearing of the objection. The risk of costs in these circumstances may vary from jurisdiction to jurisdiction.

If a debtor has been served with a Bankruptcy Notice and it has not been paid, set aside, or an extension of time to comply granted by the court then the debtor will have committed an act of bankruptcy (even if they have applied to pay by instalments). This means that the creditor can proceed to a Creditor's Petition. A search of the Commonwealth Courts Portal can show whether a Creditor's Petition has been presented and any relevant court dates.