Chapter 10: Help, I’m being made bankrupt! Part 4

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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 4: Sequestration orders

A sequestration order is the legal term for a court order making a person bankrupt. The court has the jurisdiction to make a sequestration order if (s 43(1)):

- The person has committed an act of bankruptcy AND
- The person had the required connection with Australia at the relevant time AND
- A creditor has petitioned the court in accordance with the procedures outlined in the previous sections (and established the requisite facts).

Upon the making of a sequestration order, a debtor becomes a bankrupt and remains a bankrupt until they are either discharged or the bankruptcy is annulled (s 43(2)). However, the time until automatic discharge does NOT start until the debtor files their statement of affairs (s 149), so it is important that they do so as soon as possible. The requirement to file a statement of affairs applies even if the debtor has applied to have the decision reviewed or appealed.

A sequestration order has been made against my client – Is there anything they can do?

A sequestration order will usually be made by a Registrar of the Federal Circuit and Family Court of Australia. It may be made upon the first date of the hearing of the Creditor's Petition if the Registrar is satisfied that all the relevant requirements have been met and the debtor has been duly served. However, if a sequestration order is made by the Registrar, then the debtor has 21 days to seek a review of that decision (Federal Circuit and Family Court of Australia (Division 2) (Bankruptcy Rules) 2021 2.02(3)).

On a review of a sequestration order the debtor will need to show that the order should not have been made. Bankrupts are automatically entitled to a review of a Registrar's decision (s 256(2) of the *Federal Circuit and Family Court of Australia Act* 2021) the review hearing

will be like the Creditor's Petition hearing conducted all over again, taking into account any information that was before the Registrar at the time of the Registrar's decision, and any information that has since come to light.

For a successful application to have the sequestration order reviewed your client must show that:

- one or more of the matters required to be proven at the Creditor's Petition hearing was in fact not true (see above); or
- he or she is solvent (see above); or
- there is another good reason why the sequestration order should not have been made.

It is not sufficient to show that the creditors are unlikely to benefit from the bankruptcy (because, for example, the debtor has no assets or no equity in their assets). There is no general rule that the sequestration order must be in the interests of the creditors.

The debtor should get legal advice. Usually, the debtor would ask for the sequestration order to be set aside and the Creditor's Petition dismissed. It may also be necessary to ask in the alternative for the bankruptcy to be annulled under s 153B, although this may incur additional costs because the Trustee may be required by the Court to prepare a report.

Before the hearing the debtor should:

- pay the debt (if possible) or seek legal advice as to whether they have a realistic possibility of setting aside the sequestration order on other grounds (if a set aside or appeal in relation to the original judgment is to be made it should preferably have been filed by the time the bankruptcy matter comes before the court)
- complete their statement of affairs
- request/warn the Trustee not to incur further costs.

> **Note:** It is very important to warn the Trustee of the debtor's intention to challenge the order as soon as possible because this will be taken into account when the Judge decides whether to set the sequestration order aside or annul the bankruptcy. If the bankruptcy is annulled, then the Trustee is able to recover their costs and expenses directly from the estate and only give the debtor what is left. If the sequestration order is set aside, then the Trustee is likely to be left to whatever remedies he or she may have at common law (and this would usually be only to recover expenses rather than hourly fees).

The Trustee's costs start accumulating **immediately** after the *sequestration order* is made and the Trustee is appointed. These costs can quickly amount to a substantial sum depending on the circumstances.

A review application might first be considered by a Registrar, who would determine whether the parties are ready to argue their cases on the review application (The Registrar cannot

actually hear the application, only deal with preliminary appearances). Alternatively, it might be up to a Judge. If the parties are not ready an adjournment may be granted. Typically, on the first return date of the review application the court will be prepared to grant an adjournment as long as an adjournment does not prejudice the creditor(s).

On review, the Judge is reviewing the order 'de novo'/ over again as if it is the first time (without being bound by previously submitted arguments or facts) and has broad powers to make a range of orders depending on the circumstances as presented at that time, including for example:

- setting aside the sequestration order
- annulling the bankruptcy under s 153(B) of the Bankruptcy Act
- confirming the sequestration order.

If the debtor's only reason for setting aside the sequestration order is that they have sufficient assets to ultimately pay the debt, and there is no good reason why they have not done so before, then it is likely the court will decide to annul the bankruptcy rather than set aside the sequestration order to ensure the Trustee is able to recover his or her costs. A successful application to set aside the bankruptcy will be closer in effect to undoing the bankruptcy altogether. Annulment, on the other hand, will end the bankruptcy, but will not make it as if it never happened. For example, the person will still have been 'bankrupt' in any context where this is relevant and any offence against the Act committed while bankrupt could still be prosecuted.

In *Pattison v Hadjimouratis* (see later in this Chapter) the court agreed to set aside a sequestration order in circumstances where the debtor had given the relevant documents to his solicitor and the solicitor had failed to take any action or provide advice. The Trustee appealed because he would be deprived of his substantial remuneration and argued that the bankruptcy should be annulled instead. The Federal Court refused to overturn the decision to set aside the sequestration order but confirmed that the debtor had to pay both the Trustee and the creditor's legal costs of the original set aside application hearing (but not the Trustee's remuneration for work on the bankrupt estate). The trustee had to pay the costs of the appeal.

Case study

The A family migrated to Australia in the early 80s 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. A Statement of Claim was issued and served for the outstanding strata fees. After, 28 days judgment was entered against them for $3,200 including legal fees. At that time a creditor only needed a debt of $2,000 to file a Creditor's Petition.

Two days after the judgment was entered, a Bankruptcy Notice was issued and subsequently served on Mr and Mrs A Senior and Junior. But the A's did not respond to the Bankruptcy Notice so they committed an act of bankruptcy.

Subsequently Creditor's Petitions were served on all the A's, and a date was set for a hearing at the (then) Federal Magistrate's Court. But the A's did not show up to the Petition Hearing.

Ultimately the A's were made bankrupt by sequestration order in their absence by the Registrar of the (then) 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 Consumer Credit Legal Centre ('CCLC').

CCLC applied for a review of the Registrar's decision. In the meantime, on CCLC's advice, the A's paid the original judgment. CCLC commenced negotiations to have the sequestration order set aside by consent. Eventually it was agreed that the A's would pay the Trustee's costs of $3,000 and the legal costs of the petitioning creditor.

In total, the A's paid $11,000 to avoid bankruptcy. The original strata levy debt was about $3,000.

What if the 21 days is already up?

Section 33(c) of the *Bankruptcy Act* and s 256(1)(b) of the *Federal Circuit and Family Court of Australia Act* 2021 give the court a general power to hear applications to extend the time to do certain things under the Act. Your client can apply to the Federal Circuit and Family Court of Australia for leave to apply for a review of the registrar's decision out of time, particularly if there is a good reason for their failure to do so earlier. However, the court will also consider the likely success of the review application as a relevant consideration to whether time will be extended.

Example 1: Pattison v Hadjimouratis [2006] FCAFC 153

A judgment debt was entered against Mr Hadjimouratis on 20 May 2004. On 13 October 2004 he was served with a Bankruptcy Notice and then on 23 March

2005, a Creditor's Petition. He left these documents with his then solicitors who did not take any action or advise him what he should do. He was made bankrupt by a sequestration order made by a Registrar in his absence on 3 May 2005.

Unsurprisingly, he then instructed new solicitors. These solicitors first of all wrote to the Trustee indicating that their client was solvent and wanted to pay his debts and bring the bankruptcy to an end. However, the solicitors reviewed their client's options after being told by the Trustee that the costs of annulling the bankruptcy would be $47,500, (some $33,000 over Mr Hadjimouratis' initial debts of about $14,000).

On 20 July 2005, Mr Hadjimouratis' solicitors lodged a notice of motion in the (then) Federal Magistrate's Court seeking (among other things) an extension of time to apply for a review of the Registrar's decision (over 75 days after it was made), and an order setting aside the sequestration order, or alternatively an order annulling the bankruptcy. On 7 October 2005, after hearing submissions from Mr Hadjimouratis' solicitors and the Trustee, a Federal Magistrate ordered that the sequestration order be set aside, but that Mr Hadjimouratis pay the costs of the proceedings of both the Trustee and the petitioning creditor.

The Trustee appealed, arguing that the bankruptcy should have been annulled so that he would have been able to recover his remuneration and expenses from the estate in accordance with the Bankruptcy Act Section 154. The Federal Court found that the Federal Magistrate had the discretion to set aside the sequestration order or annul the bankruptcy according to the circumstances. They also found that the Federal Magistrate was correct in taking into account that the Trustee had early notice that the debtor was allegedly solvent (two weeks after the sequestration order), despite the fact that the formal application to review the decision was not made for some time after that date. This meant that he had warning to proceed cautiously in incurring costs in administering the estate. The Judges said that it may have been different if he had not had such notice and an annulment may have been more appropriate. The fact that the bankrupt had not ignored the notices but had sought legal assistance (and was let down by his solicitors) was also doubtless relevant to the decision to set aside rather than annul the bankruptcy.

Example 2: trustees fees reasonable: *Mutton (liquidator) v De Matteis, in the matter of De Matteis Pty Ltd (in liq)* [2023] FCA 1649

A sequestration order was made by a Registrar on 23 February 2023 against the estate of the respondent Lucas Emilio De Matteis on a petition presented by Car Stackers International Pty Ltd. This order related to the unpaid amount of a

default judgement debt being $35,351.72. In the preceding period, Lucas Emilio De Matteis Pty Ltd was substituted as the petitioning creditor.

Significantly, a few weeks prior to the hearing, the parties reached an agreement that the petition should be dismissed, and the sequestration order set aside. However, the Trustee, Mr Stephen Michell, did not consent to these orders and contested that the payment of his remuneration, costs and expenses should be ordered.

At the hearing on this matter, Mr De Matteis submitted that if he was burdened with the costs, it would diminish the necessary protection of the *de novo* hearing. In particular, he highlighted that the Trustee had been put on notice of the application for review and was required to act with caution when incurring expenses, and he hence questioned whether the expenses incurred were proportional and in good faith. This argument was contextualized by the fact that the Trustee claimed to have incurred almost 80% of the estimated remuneration that was anticipated for completion of administration of the estate (an expense bill of approximately $41,165).

While the Court dismissed the Trustee's argument that they had legal authority to make the setting aside of the sequestration order conditional on payment of the Trustee's costs and that it was appropriate to do so, they did accept that they have the power to make consequential orders as to trustee costs. The Court concluded that while in many cases burdening the debtor with reimbursement costs is acceptable if the debtor contributed to the making of a sequestration order by failing to deny the act of bankruptcy or failing to bring forward evidence of solvency. Additionally, they found the expenses incurred in this case to be reasonable because the Trustee has statutory obligations to continue with the administration of the order unless the petition is dismissed. Therefore, the court ordered the payment of the Trustees reasonable remuneration by Mr De Matteis, although capped at $35,000.

Therefore, Mr De Matteis is required to pay almost the entire amount of the initial debt to the Trustee by failing to comply with the bankruptcy notice or engaging in negotiations about the debt at an earlier stage.

What if the order was made by a Judge and not a registrar?

The decision of a Judge of the Federal Circuit and Family Court of Australia can only be overturned on appeal to the Federal Court of Australia. An appeal is a very formal and technical legal procedure generally based on a legal ground (not a rehearing 'de novo' as is the review of a Registrar's decision) and the possibility of a costs order against the bankrupt is a very real risk. If your client wants to pursue this course of action, they need urgent legal advice. Generally, an appeal must be lodged within 28 days after the date the judgment was pronounced or order was made (rule 36.01, 36.03 Federal Court Rules 2011; FCA Form

121), although an extension of time to appeal may be given in appropriate cases (rule 36.05 Federal Court Rules 2011; Form 67).

If your client does not have a good reason for failing to take action earlier, or the court rejects the client's application for an extension of time to appeal, or refuses to overturn the sequestration order, then the client will remain bankrupt until they are discharged, or the bankruptcy is annulled. If there are grounds, an annulment application can be made at any time in the Federal Circuit and Family Court of Australia. Discharge and annulment of a bankruptcy are covered in **Chapter 8**.

My client has been made bankrupt – what now?

Lodge a statement of affairs!

If your client has been made bankrupt, they have 14 days from the date they are notified of the bankruptcy to lodge a statement of affairs with the Official Receiver and the Trustee (s 54 *Bankruptcy Act*). Failure to do so may result in a civil penalty. The Official Receiver can also require the bankrupt to lodge his or her statement of affairs by issue of a written notice to this effect (s 77CA). Failure to comply with this notice attracts a criminal penalty including potential imprisonment, although the bankrupt may argue a defence of reasonable excuse (s 267B).

The bankrupt should lodge a statement of affairs even if considering a review or appeal application, or are of the view that they are, or may soon be, in a position to get the bankruptcy annulled.

Lodging a statement of affairs is extremely important: under the *Bankruptcy Act*, a bankrupt will be automatically discharged from bankruptcy 3 years from the date they lodge their statement of affairs. This means that even if the 14 days has passed (even long passed), the debtor needs to lodge their statement of affairs with the Official Receiver as soon as possible to start the clock running on their bankruptcy. If they do not lodge a statement of affairs the bankruptcy will never end.

> **Note** (Lawyers – If your client needs help completing their statement of affairs you can refer them to a Financial Counsellor for assistance). The process will then continue exactly as if your client filed a Debtor's petition – see **Chapters 6 and 8**.

Importance of a bankrupt complying with orders of the court

Once your client is given a Bankruptcy Notice or a Creditor's Petition it is important that you advise your client not to:

- abscond (run away or hide); or

- conceal or remove any property that might be taken upon bankruptcy

with the aim of avoiding the payment of debts, or to prevent or delay the bankruptcy proceedings.

It is also important that your client does not:

- destroy, conceal, or remove any documents relating to their financial affairs; or
- conceal or remove any property without permission of the trustee (once bankrupt); or
- fail to comply with any order of the court or obligation under the *Bankruptcy Act* (for example, the obligation to provide a statement of affairs).

If your client breaches any of the above, they face the risk of being arrested and prosecuted under s 78 of the *Bankruptcy Act*.

See checklist for this chapter in Chapter 11: Tools and Resources