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Perspectives on Australian bankruptcy law through the prism of the World Bank report on the treatment of the insolvency of natural persons

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The insolvency of natural persons raises questions not only for a nation's economy but also for its concern for equity. The World Bank has recently released a Report on the Treatment of the Insolvency of Natural Persons to guide nations in addressing the issues raised by an individual debtor's insolvency. A brief review of Australia's personal insolvency laws shows that it addresses many of the issues raised by the Report. However two areas are identified as worthy of further investigation by policy-makers and scholars to better address a concern for equity.

I. INTRODUCTION

The insolvency of natural persons, ie, an individual's inability to pay debts such that collective action is required, raises some different policy and regulatory issues to those which apply where a legal entity, typically a company, is insolvent. This is the case whether personal insolvency is addressed through sequestration of the debtor's estate or through a formal arrangement with creditors to accept, say, a payment plan in discharge of their debts.

Personal insolvency law and practice¹ must deal with the human dimension of overwhelming debt. This raises specific issues for the debtor him or herself that do not arise in a corporate insolvency, such as exempt household property and discharge from or 'life after' bankruptcy. The human dimension may also extend to the debtor's family, as recognised in Australia where the calculation of a bankrupt's income contributions to the estate includes consideration of their dependants.

In January 2011, the World Bank² (whose overarching mission is to reduce poverty)³ for the first time asked its Insolvency and Creditor/Debtor Regimes Task Force to consider personal insolvency. A meeting in Washington included two sessions on Best Practices in the Insolvency of Natural Persons,⁴ examining both the diversity in the treatment of insolvent natural persons and the need for the development of insolvency regimes for natural persons and the link to credit expansion and financial stability. The Task Force noted the importance to the international financial architecture of the modernisation of domestic laws and institutions in place to deal with the risk of personal indebtedness, in particular, in light of the

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¹ This article uses the term 'personal insolvency law' to describe the insolvency of natural persons – in part to highlight the human dimension. It is also used instead of the more common term in Australia of 'bankruptcy law', which in some jurisdictions, most notably the United States, signifies insolvency more broadly.

² A multilateral organisation established in 1944 to assist with post-war reconstruction and development:

<www.worldbank.org>

³ The World Bank, *The World Bank Group Goal*, 6

<<http://www.worldbank.org/content/dam/Worldbank/document/WB-goals2013.pdf>> .

⁴ Susan Block-Lieb, *Rapporteur's Synopsis*, The World Bank Insolvency and Creditor/Debtor Regimes Task Force Meeting (11 January 2011)

http://siteresources.worldbank.org/EXTGILD/Resources/WB_TF_2011_Consumer_Insolvency.pdf .

recent financial crisis. It noted that while it was important to recognise the diversity in domestic policy and values in respect of this issue, globalisation and expansion of access to finance had changed the character and scale of the risk of consumer insolvency in many similar ways across the world.⁵

During 2011, the World Bank and the Task Force established a working group to examine the issue of natural person insolvency and produce a “reflective” report “suggesting guidance for the treatment of the different issues involved, taking into account different policy options and the diverse sensitivities around the world”.⁶ In December 2012, the drafting committee⁷ presented on the issues and main topics to be included in the report. Subsequently the World Bank Report on the Treatment of the Insolvency of Natural Persons was issued “to help policymakers develop a better sense of the social and economic benefits of some of the modern approaches to the regulation of the insolvency of natural persons.”⁸

This article provides an overview of the Report’s findings, in particular the core legal attributes of an insolvency regime for natural persons and briefly comments on the presence or otherwise of these attributes in Australia’s personal insolvency regime. It then explores two issues highlighted by this review of Australia’s regime as worthy of consideration by policy-makers and scholars when examining ways to improve Australian personal insolvency law. They are (i) the relevance of ‘acts of bankruptcy’ in a modern bankruptcy law and (ii) the treatment of a debtor’s home in a bankruptcy.

II. WORLD BANK REPORT ON THE TREATMENT OF THE INSOLVENCY OF NATURAL PERSONS

A. Background

The Report’s main objective is “to provide guidance on the characteristics of an effective insolvency regime for natural persons and on the opportunities and challenges encountered in the development of such a regime.” It does not seek to identify “best practice”, but rather to provide guidance on “policy issues”,⁹ exploring the advantages and disadvantages of solutions to the numerous practical issues that have to be confronted.

By the term ‘insolvency’, the Report means “any system for alleviating the burdens of excessive debt and allocating benefits and losses, both among creditors and as between creditors and natural person debtors”.¹⁰ Essentially, it sees insolvency regimes for natural persons as:

a final stage of the enforcement system, in particular the procedural regime for enforcing obligations and property rights. Less directly, but no less importantly, [they] implicate salient

⁵ Eg see comments of Chief Counsel in the World Bank, Vijay S Tata at *ibid* [17].

⁶ Insolvency and Creditor/Debtor Regimes Task Force, Working Group on the Treatment of the Insolvency of Natural Persons, *Report on the Treatment of the Insolvency of Natural Persons* The World Bank (“World Bank Report”), [8].

http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf.

⁷ The drafting committee comprised Jason Kilborn (Chair), Charles D Booth, Johanna Niemi, Iain DC Ramsay and José M Garrido (Secretariat).

⁸ World Bank Report, above n 6, [13].

⁹ *Ibid* [10] – [11].

¹⁰ *Ibid* [17].

issues of data protection and personal privacy, as well as a host of social and economic regulatory issues such as individual counseling, education, social welfare provision, and family and housing policy. Both practically and as a matter of legal policy, financial distress and insolvency are inextricably linked with credit extension, banking, taxation, and business entrepreneurship, as well as with the more fundamental laws of contractual and delictual obligations and property—and the interaction of the obligations and property regimes.¹¹

The Report limits the scope of its discussion of insolvency regimes for natural persons, to:

- (a) the treatment of already existing insolvency, not the prevention of insolvency; and
- (b) The treatment of insolvency, not poverty.

It describes insolvency regimes as “less like social *assistance*, and more like social *insurance*, protecting individuals from financial tragedy.”¹² To address the definitional issues of differentiating between the ‘pure’ consumer debtor versus those debtors engaged in business, it focuses on the “issues most implicated by the ‘human factor’ inherent in any insolvency case involving a natural person as debtor.”¹³ However the Report does not ignore the fact that insolvency relief for natural persons also includes “a powerful element of economic concern.”¹⁴ In particular, it acknowledges that natural persons are commonly burdened with heavy debt when business ventures fail, either from debts incurred in businesses carried out in their own name or being made personally liable for debts of companies with limited liability of which the individual was associated. This is particularly relevant when considering how the evolving nature of many trades and occupations has resulted in the individual undertaking such trade on their own account, rather than as employees.¹⁵

Benefits of an insolvency regime for natural persons fall into at least three distinct categories – those for creditors; for debtors and their families; and for society. The benefits for creditors largely revolve around an insolvency regime being a collective approach - having an independent administrator who acts in the interests of all in maximising the value of assets and distributing them fairly among the collective of creditors.

For debtors, an insolvency regime provides relief, for example by way of moratorium on creditor enforcement and by providing a solution to overwhelming financial obligations. It can also extend benefits to the debtor’s family. An insolvency regime can “provide quite direct and often immediate relief from the stress, anxiety, and other negative emotional and physical reactions associated with inability to manage debts”.¹⁶ As the Report highlights, there are morbidity aspects of excessive debt, such as serious physical and mental problems for debtors, arising from the fear and anxiety of the inability to repay debt, harassment from creditors and nagging feelings of failure.¹⁷

The benefits for society, both at a national and international level, as outlined¹⁸ include:

- (a) establishment of proper account valuation;

¹¹ Ibid [25].

¹² Ibid [35].

¹³ Ibid [46].

¹⁴ Ibid [50].

¹⁵ Ibid [48].

¹⁶ Ibid [73].

¹⁷ Ibid [71] – [72] footnote omitted.

¹⁸ Ibid [76]-[111].

- (b) reduction in wasteful collection costs and destroyed value in depressed asset sales;
- (c) encouragement of responsible lending and reduction of negative externalities;
- (d) concentration of losses on more efficient and effective loss distributors;
- (e) reduction of the costs of illness, crime, unemployment and other welfare-related costs;
- (f) increased production of regular taxable income;
- (g) maximisation of economic activity and encouragement of entrepreneurship; and
- (h) enhancement of stability and predictability in the broader financial system and economy.

B. Core legal attributes of an insolvency regime for natural persons

Against this background, the Report proposes core legal attributes of an insolvency regime for natural persons, listed under 6 categories. These are briefly described below together with a short commentary on the way in which the Australian regime displays many of these attributes.

1 General Regime Design

First, a formal insolvency system acts “to encourage informal negotiation and resolution, as creditors and debtors ‘bargain in the shadow of insolvency.’”¹⁹ The Australian insolvency regime distinguishes between individual (or natural person) and corporate debtors. The laws dealing with personal bankruptcies and alternative arrangements with creditors are to be found in the *Bankruptcy Act 1966* (Cth) with corporate insolvency administrations regulated by the *Corporations Act 2001* (Cth). This bifurcation of insolvency law has resulted in separate regulatory bodies for personal and corporate insolvency administrations. Natural person insolvency administrations are regulated by Australian Financial Security Authority (AFSA)²⁰ established as an executive agency within the Attorney-General’s portfolio. Corporate debtor insolvency administrations are regulated by Australian Securities and Investments Commission (ASIC).²¹

The Australian personal insolvency regime favours informal and formal negotiated solutions between the debtor and creditors. The Report refers to the important role that consumer and debt counsellors can play in advising debtors and negotiating on their behalf with creditors.²² The AFSA website includes in its options for dealing with unmanageable debt to ask for help from financial counsellors.²³ The ASIC website, MoneySmart, likewise refers to financial counselling services available around Australia under the Managing Debts tab.²⁴

The Australian personal insolvency regime also promotes formal alternatives to a court sequestration order based on a creditor’s petition through voluntary bankruptcy procedures;²⁵

¹⁹ Ibid [127].

²⁰ Previously known as the Insolvency & Trustee Service Australia (ITSA).

²¹ ASIC is established under the *Australian Securities and Investments Commission Act 2001* (Cth) <<http://www.asic.gov.au/>>.

²² World Bank Report above n 6, [127].

²³ <https://www.afsa.gov.au/debtors/financial-counsellors>

²⁴ <https://www.moneysmart.gov.au/managing-your-money/managing-debts/financial-counselling>

²⁵ For example a debtor’s petition pursuant to s 55 *Bankruptcy Act 1966* (Cth). Informal negotiation is encouraged by a moratorium on creditor action under Part IV Division 2A and a Declaration of Intention to Present a Debtor’s Petition.

post-bankruptcy compositions;²⁶ personal insolvency agreements;²⁷ and debt agreements.²⁸ However, some of the problems that the Report identifies with informal negotiation and resolution resonate with the Australian experience, in particular, the intransigence of some creditors making negotiations impossible, the reluctance of public creditors (including tax authorities) to accept negotiated approaches and the general lack of incentive for many financial institutions to engage in meaningful negotiations meaning that in practice it is not easy for debtors to reach voluntary arrangements with creditors.²⁹

2 *The institutional framework*

On the institutional framework for the insolvency of natural persons, an insolvency regime should “minimize overall social costs [including] error costs in determining the validity of debts and levels of repayment, and costs to creditors, debtors and third parties. It should provide timely outcomes and achieve confidence in its operation by stakeholders and the general public.”³⁰

Australia’s institutional framework reflects a well developed system of consumer and commercial credit with “banking regulations, procedures for the enforcement of judgment debts, credit reporting and data privacy regulations, financial education programs, debt counselling services, and housing and social welfare policy”.³¹

AFSA acts as a specialist agency, responsible for the administration and regulation of the personal insolvency system. Its services include ensuring compliance by debtors, bankrupts and their associates, practitioners and others with the requirements of the *Bankruptcy Act 1966* (Cth) and associated legislation; maintaining the National Personal Insolvency Index; registering all bankruptcies, debt agreements and personal insolvency agreements; and regulating the administrations and activity of trustees and debt agreement administrators.³² However it also administers, as the Official Trustee, more than 80% of bankrupt estates annually and as such, it may not necessarily be perceived as a “neutral policeman”³³ in ensuring public confidence in the integrity of the insolvency system.³⁴

3 *Access to the formal insolvency regime*

Standards of access to individual insolvency and restructuring procedures should be “transparent and certain while ensuring against improper use by either creditor or debtor”.³⁵

²⁶ *Bankruptcy Act 1966* s 73.

²⁷ *Bankruptcy Act 1966* Part X. These are preferable to informal workouts under contract law which only bind those creditors who assent to them: Michael Murray and Jason Harris, *Keay’s Insolvency: Personal and Corporate Law and Practice* (Lawbook Co, 8th ed, 2013) [8.05].

²⁸ *Bankruptcy Act 1966* Part IX.

²⁹ World Bank Report above n 6, [409].

³⁰ *Ibid* [151].

³¹ *Ibid* [152].

³² <https://www.afsa.gov.au/about-us/introduction-to-us>

³³ World Bank Report above n 6, [158].

³⁴ Perhaps to address such perceptions, AFSA states that the Regulation and Enforcement business area acts independently from AFSA’s other business areas and reports directly to the Inspector-General of Bankruptcy: <<https://www.afsa.gov.au/about-us/introduction-to-us/business-areas/business-areas>. Also see Official Trustee Practice Statements: <<https://www.afsa.gov.au/about-us/policies-and-practices/official-trustee-practice-statements/official-trustee-practice-statements>>.

³⁵ World Bank Report above n 6, [185].

In Australia both creditors and debtors can initiate proceedings and many aspects raised by the Report about access are adequately addressed in Australia's personal insolvency regime.

One aspect that does bear consideration by policy makers, and is explored later in this article, is the role of "acts of bankruptcy" in the process of entry into insolvency proceedings. Of the two traditional standards for entry – cessation of payments and a balance sheet test, the Report notes that the cessation of payments is the primary test for natural persons. However, it goes on to say:

Some countries [eg Australia] include further "acts of bankruptcy" as a trigger for an insolvency application. These are historical criteria that fit uneasily into contemporary personal insolvency law where the central issue is inability to repay rather than wrongful actions by debtors.³⁶

Some jurisdictions create high initial barriers to access, based on a debtor's conduct. In Australia, access is subject to conditions, such as a minimum level of debt; a jurisdictional connection (not mentioned in the Report); and certain procedural requirements (including an "act of bankruptcy" for a creditor's petition). In other jurisdictions, there is more open access³⁷ to the system but debtors may be sanctioned for their conduct. The Australia regime also includes sanctions against bankrupts.³⁸

4 *Participation of creditors*

In a personal insolvency regime, creditors may play a more limited role in the establishment of a payment plan or other requirement for relief than in a corporate insolvency.³⁹ While in Australia, creditors play a role in approving compositions post-bankruptcy (though some systems have done away with the submission and verification of creditors' claims entirely in so called "assetless" bankruptcies),⁴⁰ as noted above, the attitudes and relative incentives of creditors in pre-bankruptcy negotiations will largely influence the role that the creditors will play. For instance the Report noted that in some systems tax authorities and other governmental actors are prohibited by law from voting to offer relief from public debts⁴¹ and creditor passivity may result in only a few creditors participating and so procedural requirements may be linked to proportions of those voting.⁴²

5 *Solutions to the insolvency process and payment of claims*

Payment of creditors' claims has historically been through the liquidation and distribution of the debtor's estate and, more recently, through some contribution from a debtor's future income.

³⁶ Ibid [187].

³⁷ Under open access "an individual who meets an insolvency test such as inability to pay debts as they fall due" without more may gain access to an insolvency procedure permitting an ultimate discharge of debts: World Bank Report above n 6, [188].

³⁸ For example, bankruptcy offences (such as *Bankruptcy Act* s 265(8)) and the extension of the period of bankruptcy through objection to discharge (see *Bankruptcy Act* s 149B ff).

³⁹ World Bank Report above n 6, [208].

⁴⁰ Ibid [216].

⁴¹ Ibid [213].

⁴² For example, in Australia acceptance of a debt agreement must be by a majority in value of the creditors who reply by the deadline (*Bankruptcy Act* s 185EC).

In Australia a bankrupt's estate is realised and distributed to creditors however, as the debtor requires assets with which to support themselves and their families, there is a list of exempt property.⁴³ Australia adopts the generally held principle that exemptions do not interfere with security interests granted over assets that otherwise would be exempt⁴⁴ and it includes in the bankrupt's estate after-acquired property up to discharge.⁴⁵ Another area in which Australia differs from some jurisdictions, and which is explored later in the article, is that there is no exemption for the family home.⁴⁶

Contemporary issues around exemptions include their extent (in light of the modern trend of enabling debtors to have a true fresh start);⁴⁷ and questions of efficiency (because "the administrative costs incurred in liquidating low-value assets rarely represent an efficient use of resources").⁴⁸

Australia has also adopted payment of claims through income contribution. Insolvency regimes "commonly require some contribution from debtors' future income in exchange for whatever benefit the system offers (usually a discharge of unpaid debt)".⁴⁹ In designing a regime, relevant factors to consider include what counts as income (actual or projected) and as expenses - for example necessities required for a dignified existence.⁵⁰ The Australian system⁵¹ appears more workable than some proposed in the Report.

6 Discharge

A principal purpose of a personal insolvency regime is "to re-establish the debtor's economic capability, in other words, *economic rehabilitation*".⁵² The Report describes three elements of rehabilitation: (i) freedom from excessive debt (the most effective being "a fresh start");⁵³ (ii) non-discrimination (equal treatment with non-debtors after receiving relief); and (iii) an ability to avoid becoming excessively indebted again.⁵⁴

Unless discharge is respected after the insolvency procedure has concluded, the benefits of a fresh start may be illusory for a debtor. The Report refers to two other elements as ancillary support for the concepts of discharge and rehabilitation:

⁴³ The Report refers to three different approaches for deciding which property may be exempted: World Bank Report above n 6, [222 ff]. Australia has adopted the second approach: setting out categories of particular assets (and values) for these assets that the debtor may seek to get exempted.

⁴⁴ World Bank Report above n 6, [228].

⁴⁵ Ibid [257].

⁴⁶ Ibid [240].

⁴⁷ Ibid [254].

⁴⁸ Ibid [256]. A minority of regimes has all but excluded no income, no assets debtors from relief: [298].

⁴⁹ Ibid [261].

⁵⁰ One jurisdiction includes charges for the use of mobile phones and internet access: Ibid [296].

⁵¹ See *Bankruptcy Act* Part VI Division 4B and for a general description:

<<https://www.afsa.gov.au/debtors/bankruptcy/bankruptcy-overview/employment-income-contributions>>

⁵² World Bank Report above n 6, [359].

⁵³ Historically this has meant a straight discharge (freed without a payment plan), however now some jurisdictions, including Australia, have an "earned fresh start". For example, discharge occurs after a partial repayment of debt or at least 3-5 years of income contribution: World Bank Report above n 6, [361].

⁵⁴ This may require some attempt to change debtors' attitudes concerning proper credit use: World Bank Report above n 6, [359]. There is a growing interest in financial education and some jurisdictions require debtors to engage with budget and debt counsellors.

(1) The principle of non-discrimination - “discrimination issues have rarely been discussed in this context and there seems to be no explicit prohibition against discrimination in most laws addressing the insolvency of natural persons.”⁵⁵

(2) The inculcation of a more healthy and responsible use of credit⁵⁶ – as a goal and a result of debt relief procedure, this is much more difficult to achieve or measure.⁵⁷

One limitation on rehabilitation can be the scope of claims that are discharged. In Australia, some debts that are not created in the market context are excluded – such as sums payable under child maintenance agreements; penalties and fines; certain student loans.⁵⁸

C. Summary

In summary then, many of the core legal attributes of an insolvency regime for natural persons proposed by the Report are present in the Australian personal insolvency regime and the advantages and disadvantages of various solutions to practical issues faced by such regimes resonate with the Australian experience.

Some aspects of the Report’s guidance on policy issues are worthy of further research and consideration by Australian policy-makers and scholars. In particular:

- Is there still a role for acts of bankruptcy, eg in access to bankruptcy; determination of the commencement of bankruptcy; identification of the bankrupt’s divisible estate; and as evidence of ‘insolvency’ in the context of a failed attempt at a personal insolvency agreement?
- Should a bankrupt’s family home be treated differently under Australia’s exempt property provisions?

These are now addressed in more detail.

III. ACCESS TO THE FORMAL BANKRUPTCY REGIME: ACTS OF BANKRUPTCY

A feature of Australian personal insolvency law is that the solvency (or otherwise) of a debtor is not necessarily the primary focus of inquiry when a debtor or creditor seeks the protection of the bankruptcy regime. This is somewhat of an anomaly and is inconsistent with the notion that insolvency is a financial condition where a person is unable to pay their debts such that insolvency should be empirically identifiable and verifiable.⁵⁹

A. Debtor’s petition: A solvency test?

⁵⁵ World Bank Report above n 6, [365].

⁵⁶ Australia limits repeat filings of debtor’s petitions under *Bankruptcy Act* s 55(3AA).

⁵⁷ World Bank Report above n 6, [366].

⁵⁸ See *Bankruptcy Act* s 82.

⁵⁹ Duncan Henderson, ‘Inability to pay debts: where are we now?’ (2011) 24(4) *Insolvency Intelligence* 54.

In Australia, voluntary bankruptcy is initiated by a debtor presenting a petition⁶⁰ to an Official Receiver together with a statement of affairs, which contains personal details and details of assets, liabilities, and income. The Official Receiver also requires an acknowledgment from the debtor that they have read the prescribed information.⁶¹ Generally, unless the Official Receiver decides to reject the petition because it fails to comply with the procedural and formal requirements⁶² and territorial requirements,⁶³ and assuming that the debtor is not party to a debt agreement or personal insolvent agreement, the Official Receiver *must* accept the petition⁶⁴ and the person becomes bankrupt on the day the petition is accepted.

At no point does the *Bankruptcy Act 1966* (Cth) specifically state that the debtor must be able to satisfy any particular test of insolvency, nor does the Act state that the grounds of the petition must be founded in insolvency. The grounds for a debtor's petition are ultimately, compliance with the formal statutory requirements.

While the Official Receiver has discretion to reject a debtor's position for "abuse of process" this is a limited power. To do so, the Official Receiver must be able to establish that were the debtor not to be made bankrupt, the debtor would be likely (either immediately or within a reasonable time) to be able to pay all debts specified in the statement of affairs *and* that either: (i) it appears that the debtor is unwilling to pay one or more debts to creditors (either generally or to a particular creditor(s)); or (ii) the debtor has been made bankrupt on a debtor's petition at least 3 times previously or at least once in the previous 5 years.⁶⁵

This does not constitute a reliable mechanism to ensure that only insolvent debtors are voluntarily made bankrupt. First, mere solvency is insufficient to enable the Official Receiver to exercise its discretion; one of the two "aggravating factors" must be present. Secondly, even if the circumstances are present, the power remains discretionary. Thirdly, there is no requirement on the Official Receiver to consider each petition in the first place,⁶⁶ so, not only is it a discretionary power, the Official Receiver does not have to turn its mind to whether circumstances are such that the discretion is even exercisable in the first place.⁶⁷ Further, s 55(3AA) is only intended to capture the most obvious and blatant cases of abuse of

⁶⁰ A debtor's petition may be presented by an individual, by a partnership or by joint debtors (*Bankruptcy Act* ss 55–57).

⁶¹ Bankruptcy Regulation 4.11 states that, at the time of presentation of the debtor's petition, the Official Receiver must give the debtor information about alternatives to and consequences of bankruptcy, sources of financial advice and guidance to persons facing or contemplating bankruptcy, and information about the debtor's right to choose administration either by a registered trustee or the Official Trustee, and a statement about certain acts of bankruptcy. The Official Receiver must not accept a debtor's petition unless the debtor has given a signed acknowledgment that the debtor has received and read the prescribed information.

⁶² *Bankruptcy Act* s 55(3) gives the Official Receiver discretion to reject a petition based on inadequacies in the petition or statement of affairs.

⁶³ *Bankruptcy Act* s 55(2A).

⁶⁴ *Bankruptcy Act* s 55(4).

⁶⁵ *Bankruptcy Act* s 55(3AA).

⁶⁶ *Bankruptcy Act* s 55(3AB).

⁶⁷ William Morgan, 'Personal Insolvency Regime Changes in the United Kingdom and Australia' (2003) 11 *Insolvency Law Journal* 221, 225.

the system⁶⁸ with one commentator suggesting that it is aimed at debtors who accumulate large debts (in particular tax debts), which they have the capacity to repay, but who go bankrupt as a means to avoid them.⁶⁹ As a result, it has been argued s 55 does not introduce a solvency test into the debtor's petition regime,⁷⁰ and a review of the specific wording of the legislation supports this conclusion.

While there is judicial commentary to the effect that the ability of debtors to procure their own bankruptcy should only be available to debtors who are, as a matter of fact, insolvent,⁷¹ this has generally been in the context of considering whether or not to exercise the court's discretion⁷² to annul an existing bankruptcy.⁷³ This is a discretionary power⁷⁴ and is only invoked on an application to annul an existing bankruptcy (often on the debtor's own application). As a result, notwithstanding such judicial commentary, there is in fact no solvency test imposed on debtors who seek their own bankruptcy. This is particularly relevant when considering some of the criticisms of the bankruptcy law in particular, whether bankruptcy is seen as an 'easy option' for a debtor who has accumulated debt and wants a 'way out'.⁷⁵

In comparison, in England and Wales, the legislation specifically states that the sole ground of a debtor's petition is an inability to pay debts.⁷⁶ While this approach has not been immune from criticism in respect of the 'easy' ability for a debtor to file for bankruptcy,⁷⁷ it evidences a focus on actual insolvency before a debtor can present a petition. New Zealand, on the other hand, maintains a similar approach to the Australian legislation.⁷⁸

B. Creditor's petition: Time to say goodbye to the act of bankruptcy?

Compulsory bankruptcy results from a creditor's petition for which the pre-requisites are an act of bankruptcy within the previous six months, a specific jurisdictional link with Australia and a liquidated sum of \$5,000 owing by the debtor to the creditor due now or at some certain

⁶⁸ Bankruptcy Legislation Amendment Bill 2002 (Cth) Explanatory Memorandum, para 39.

⁶⁹ Michael Murray 'Bankruptcy Reform Continued' (2002) 2 (8) *Insolvency Law Bulletin* 134.

⁷⁰ Morgan, above n 67, 226.

⁷¹ For example, see *Re Mottee: Ex parte Mottee and Official Receiver* (1977) 16 ALR 129.

⁷² A person can apply to the court for it to exercise its discretion to annul a bankruptcy pursuant to *Bankruptcy Act* s 153B. This can be on the grounds that either (i) that the Official Receiver should not have accepted the petition; or (ii) the debtor's petition should not have been presented in the first place. Case law suggests that annulment on the first ground is limited to situations where the procedural requirements were not complied with, see *Orix Australia Corporation Ltd v McCormick* (2005) 145 CLR 244. However the second ground can be made out if it can be shown that the bankrupt was not in fact insolvent at the time of the debtor's petition.

⁷³ *Re Almassy* (1999) 92 FCR 597, [14] and see *Dubow v Official Receiver* [2013] FMCA 217.

⁷⁴ However, the case law seems to provide little guidance as to the grounds upon which that discretion should be exercised. For example, in *Seeger v Seeger* [2000] FCA 732, the fact that the debtor was solvent at the time the debtor's petition was presented, on its own seemed to be sufficient justification for Dowsett J to annul the bankruptcy.

⁷⁵ Indeed concern over the perceived bias towards debtors in the legislation and a desire to encourage debtors to think more seriously about the decision to become bankrupt was a specific policy consideration behind the Bankruptcy Amendment Bill 2002, see n 70 para 2.

⁷⁶ *Insolvency Act 1986* (England and Wales) s 272(1).

⁷⁷ Harold Godwin, 'Are Bankruptcy Proceedings Becoming Too Easy?' (2012) 156 (34) *Solicitors Journal*.

⁷⁸ *Insolvency Act 2006* (NZ) ss 45-46.

future time.⁷⁹ The most common act of bankruptcy relied upon is a failure to comply with a bankruptcy notice.⁸⁰

Effectively, a creditor seeking to bankrupt a debtor is not complaining of the debtor's inability to pay debts per se, instead the creditor is complaining about the act of bankruptcy committed by the debtor.⁸¹ Thus the insolvency of the debtor is shown, not by the inability to pay the debt owed, but by the effectively unrelated act of bankruptcy.⁸² The practical effect of this is that the courts look at the act of bankruptcy as the indicator of a person's insolvency, rather than any specified and verifiable inability to pay debts.⁸³ This approach to an insolvency test has been described by commentators as "rather curious"⁸⁴ and "quaint".⁸⁵ The conceptual problem (as with debtors' petitions) is that this approach does not reflect the underlying principle of bankruptcy, which is the inability of an individual to pay their debts.⁸⁶ Instead it focuses on some act of public notoriety as evidence of bankruptcy, a relic from the past where debt carried social stigma and public approbation.⁸⁷

England and Wales requires a more direct analysis of the actual insolvency of the individual before a creditor's petition can be accepted so that a creditor must show a liquidated present (or future) debt of at least £750, which the debtor appears either to be unable to pay, or to have no reasonable prospect of being able to pay,⁸⁸ creating an insolvency test based on an inability to pay debt. The legislation goes on to provide that a creditor can only evidence such inability by establishing the existence of specific and proscribed circumstances.⁸⁹

The United Kingdom approach arose out of recommendations of the Cork Committee that the sole basis of an insolvency order should be the debtor's inability to pay his or her debts.⁹⁰

⁷⁹ *Bankruptcy Act* ss 43 – 44.

⁸⁰ *Bankruptcy Act* s 40(1)(g).

⁸¹ United Kingdom Insolvency Law Review Committee, *Report on Insolvency Law and Practice*, Cmnd 8558, Her Majesty's Printing Office, London, 1982, 524.

⁸² Peter Walton, 'Inability to Pay Debts: Beyond the Point of No Return' (2013) (2) *Journal of Business Law* 212, 218.

⁸³ *Slack v Bottoms English Solicitors* [2002] FCA 1445.

⁸⁴ Walton, above n 82, 216.

⁸⁵ David Brown, 'Law Reform in New Zealand: Towards a Trans-Tasman Insolvency Law?' (2007) 15 *Insolvency Law Journal* 148, 151.

⁸⁶ It is conceded that solvency is a defence in the event of a creditor's petition pursuant to *Bankruptcy Act* s 52(2)(a). However, this is a discretionary power and the court has specifically stated that solvency itself will not void a creditor's petition, it is simply a factor which the court may consider in determining whether to set aside a creditor's petition, eg, *Sarina v Council of the Shire of Wollondilly* (1980) 48 FLR 372, 376-377. From a conceptual point of view, this does not operate as a solvency test; a creditor is still able to present a creditor's petition without first having to establish actual insolvency of the debtor.

⁸⁷ World Bank Report above n 6, [122].

⁸⁸ *Insolvency Act 1986* (England and Wales) s 267(2).

⁸⁹ A creditor must establish either (i) the serving of a statutory demand on the debtor in respect of the debt owed and at least 3 weeks having elapsed since the demand was served and the demand having been neither complied with nor set aside; or (ii) execution or other process issued in respect of the debt on a judgment or order of any court in favour of the petitioning creditor, or one or more of the petitioning creditors to whom the debt is owed, having been returned unsatisfied in whole or in part. See *Insolvency Act 1986* (England and Wales) s 268(1). Note also s 268(2) which provides a modified test in respect of future debts (ie where the creditor has based the petition on a debt owed in the future).

⁹⁰ United Kingdom Insolvency Law Review Committee, *Report on Insolvency Law and Practice*, Cmnd 8558, Her Majesty's Printing Office, London, 1982, 535.

Walton notes that while the Cork Committee failed in its aim of creating a unified test of insolvency applicable to individual and corporate debtors,⁹¹ the resultant legislation did succeed in establishing a requirement (in both corporate and individual insolvencies) for proof that a debtor is, as a matter of fact, unable to pay his or her debts.⁹²

So while the concept of an act of bankruptcy perished following the Cork Committee review, the act of bankruptcy survived Australia's own review of its bankruptcy laws (culminating in the Harmer report of 1988 (the "Harmer Report"))⁹³. The Harmer Report specifically recommended that the act of bankruptcy be abolished, preferring instead proof of insolvency by reference to "observable and limited presumptive evidence of that state".⁹⁴ It criticised the concept of the act of bankruptcy as an unnecessarily complicated, lengthy and costly process when the act of bankruptcy being relied upon was a failure to comply with a bankruptcy notice (most commonly relied upon by creditors).⁹⁵ Further it went on to argue that the requirement for an act of bankruptcy mirrored the 16th century origins of bankruptcy law, requiring some act of notoriety tending to establish that the debtor was in fact insolvent, and noting that many acts of bankruptcy are "ancient in origin, largely irrelevant and rarely, if ever, used."⁹⁶ The Harmer Report recommended a simpler less time consuming mechanism, which would require a creditor to establish insolvency of a debtor on the grounds of (i) failure to comply with statutory demand;⁹⁷ (ii) unsatisfied execution of a judgment against the property of a debtor; or (iii) departure from or remaining out of Australia by a debtor with the intention of defeating, delaying or obstructing a creditor.⁹⁸ Notwithstanding these recommendations, Australia's bankruptcy régime continues to eschew identifiable and verifiable proof of insolvency at the time a petition is presented. In respect of a creditor's petition and the act of bankruptcy, this raises another related point.

C. Acts of bankruptcy: the doctrine of relation back

The act of bankruptcy is not only a requirement for a creditor's petition; it also dictates the date of the commencement of the bankruptcy and is the basis for (amongst other things) the doctrine of relation back.⁹⁹ The date of commencement of the bankruptcy is, in the case of a creditor's petition, the earliest act of bankruptcy within the period of six months prior to the presentation of the creditor's petition.¹⁰⁰ In the case of a debtor's petition (and assuming that the debtor has committed an identifiable act of bankruptcy) an act of bankruptcy can also

⁹¹ For instance Walton notes (above n 82, 219) that the *test* of being unable to pay debts differs in respect of individuals and companies and indeed in respect of individuals, it depends on the identity of the petitioner.

⁹² Walton, above n 82, 219. In *BNY Corporate Trustee Services Limited v Eurosail* [2013] UKSC 28, the UK Supreme Court considered the legislative history of the *Insolvency Act 1986* (England and Wales and Scotland) s 123 and the cash flow and balance sheet tests for insolvency. At [37] Lord Walker discussed the limitations of both tests and the circumstances where a balance sheet test becomes the only sensible test.

⁹³ Law Reform Commission, *General Insolvency Enquiry*, Report No 45 (1988).

⁹⁴ *Ibid* 368.

⁹⁵ *Ibid* 360.

⁹⁶ *Ibid* 363.

⁹⁷ Note that the Harmer Report specifically recommended that a statutory demand be supported by a judgement.

⁹⁸ Law Reform Commission, above n 93, 365.

⁹⁹ The commencement date is also the reference date in relation to the voidable transaction provisions.

¹⁰⁰ *Bankruptcy Act* s 115(1).

dictate the commencement of the bankruptcy.¹⁰¹ The practical effect of an act of bankruptcy is that while the date of bankruptcy (the formal date upon which the sequestration order is made or the debtor's petition is accepted) dictates when the property of the bankrupt vests in the trustee in bankruptcy,¹⁰² the property that so vests is all property held by the bankrupt at the commencement of the bankruptcy, and any property acquired by the bankrupt after the commencement of the bankruptcy but prior to the date of discharge.¹⁰³ So the commencement of the bankruptcy marks the time at which the items of property which vest in the trustee constituting the "property of the bankrupt" are to be identified.¹⁰⁴ This is known as the doctrine of relation back.

Australia retains this doctrine notwithstanding that it has been abolished in the United Kingdom¹⁰⁵ and New Zealand¹⁰⁶ (both of which deem bankruptcy to commence on the date that the bankruptcy order is made).¹⁰⁷ The doctrine of relation back was also heavily criticized in the Harmer Report, which referred to it as a "fictitious, artificial and abstract concept and rarely understood"¹⁰⁸ and the report noted that the submissions made to the enquiry were generally in support of removing this doctrine. It went on to recommend that bankruptcy should (in the case of creditor's petitions), commence on the date that the order is made.¹⁰⁹

There is some merit in these criticisms. In effect, the doctrine deems the bankruptcy to have commenced at an earlier point than it actually did.¹¹⁰ Further as case law has previously identified,¹¹¹ the doctrine of relation back creates an artificial construct which results in all property of the bankrupt at the date of commencement of the bankruptcy theoretically vesting in the trustee, such that any alienation of that property in that period is an alienation of the property that belongs to the estate and not the debtor and liable therefore to be set aside.¹¹²

¹⁰¹ *Bankruptcy Act* s 115(2) which provides for commencement in respect of a debtor's petition: under court direction, the commencement date will be the date specified by the court; if the petition was presented when at least one creditor's petition is pending against the debtor and the debtors petition is accepted without court direction, the commencement date will be the date of the earliest act of bankruptcy upon which any of the existing creditor's petitions were based; if the petition was presented when the debtor had committed at least one act of bankruptcy in past six months, the commencement date is the earliest act of bankruptcy within that 6 month period; and if the petition was presented with no act of bankruptcy, the commencement date is the date of the presentation of the petition.

¹⁰² See *Bankruptcy Act* s 58(1).

¹⁰³ *Bankruptcy Act* s 116 (1)(a).

¹⁰⁴ *Anscor Pty Ltd v Clout* (2004) 135 FCR 469, 481 per Lindgren J.

¹⁰⁵ However, see *Nationwide Building Society v Wright* [2010] 2 WLR 1097 which noted that there is a very limited doctrine, being a restriction on dispositions during the period between the presentation of the bankruptcy petition and the vesting of the bankrupt's estate in the trustee.

¹⁰⁶ New Zealand has admittedly retained the concept of an act of bankruptcy (which must have occurred no more than three months prior to the date of the presentation of the petition) as the basis of a creditor's petition: see *Insolvency Act 2006* (NZ) s 16(1).

¹⁰⁷ *Insolvency Act 1986* (England and Wales) s 278 (a) (when the order is made) and *Insolvency Act 2006* (NZ) s 55 (when the person is adjudicated bankrupt).

¹⁰⁸ Law Reform Commission, above n 93, 697.

¹⁰⁹ *Ibid* 398.

¹¹⁰ *Ibid* 696.

¹¹¹ Unlike antecedent property transactions that require a specific quality or circumstance to a transfer before it can be set aside: see *Bankruptcy Act 1966* ss 120-122.

¹¹² *Re Docker* (1938) 10 ABC 198.

However, in a practical sense, the doctrine is subject to quite broad exceptions such that a person who acquires property from a bankrupt in the relation back period is protected if they can show that the transfer was at market value (if it was a conveyance or transfer of property), the transferee did not have notice of presentation of a petition when the transaction was made, and the transaction was made in good faith and in the ordinary course of business.¹¹³ The Harmer Report noted that in reality the doctrine was rarely relied upon, and subject to the strengthening of the antecedent property transaction provisions, its loss would be not be significant. In the same respect, Taylor notes that it is the very overlap of the relation back period and the antecedent property transaction provisions which led New Zealand to abolish the former, noting in particular the government's view that it does not serve anyone to have two sets of rules serving the same purpose.¹¹⁴

This criticism calls into question the need for this additional level of complexity and rules. The various antecedent property provisions dealing with transactions for undervalue;¹¹⁵ transfers to defeat creditors;¹¹⁶ and preferences¹¹⁷ already provide a comprehensive regime for the trustee to undo transactions where they should not stand to the detriment of creditors. These give the trustee an ability to look back a number of years and challenge transactions and have property recovered, including (but not limited to) during the relation back period. They enable the trustee to overturn certain transactions, where it would be against public policy to deprive the bankrupt's creditors from the proceeds of the relevant assets, providing a set of principles and grounds on which it will be deemed appropriate to reclaim property. Now that the United Kingdom has removed the act of bankruptcy and the United Kingdom and New Zealand have both removed the doctrine of relation back, there are strong arguments to re-visit the Harmer Report's recommendations.

This would have the benefit of simplifying and streamlining the bankruptcy procedure, removing two concepts from Australian bankruptcy law, one a relic from a past approach to bankruptcy, the other an unnecessary level of complexity. It would also go one step closer to harmonising the Australian and New Zealand regimes, with harmonisation and coordination of business law being a key goal of the various Trans-Tasman agreements.¹¹⁸ It has been noted that although these memoranda do not necessarily mean adoption of identical laws, the aim is that regard shall be had to whether there are sound commercial reasons for particular laws to be different.¹¹⁹

A stated aim in respect of amendments to the *Bankruptcy Act 1966* (Cth) has been for a more streamlined, modern and efficient bankruptcy régime (albeit one that adequately protects both

¹¹³ *Bankruptcy Act* s 123(1).

¹¹⁴ Lynne Taylor, 'Report from New Zealand: The Progress of Insolvency Law Reform in New Zealand' (2001) 9 *Insolvency Law Journal* 105, 106.

¹¹⁵ *Bankruptcy Act* s 120.

¹¹⁶ *Bankruptcy Act* s 121.

¹¹⁷ *Bankruptcy Act* s 122.

¹¹⁸ See for example Memorandum of Understanding Between the Government of New Zealand and the Government of Australia on the Coordination of Business Law (December 2013)

https://www.dfat.gov.au/fta/anzcerta/memorandum_of_understanding_business_law.html viewed 16 December 2013 which replaced the Memorandum on Coordination of Business Law (dated 22 February 2006).

¹¹⁹ Brown above n 85, 151.

creditors and debtors).¹²⁰ With the release of the World Bank Report, it is timely for policy-makers to consider reviewing this fundamental concept in Australia's bankruptcy law that is out of step with similar jurisdictions that have undergone reform in these areas.

IV. LIQUIDATION OF ESTATE AND DISCHARGE: TREATMENT OF THE FAMILY HOME

A second area in which policy-makers may consider whether Australia's regime would benefit from consideration of different approaches in other jurisdictions is whether there should be some form of exemption from the divisible estate for the family home.¹²¹ It is interesting that the Report in referring to the human side of insolvency states:

Debtors' homes are usually their most valuable asset, and in many cases, the asset in which debtors have lost the most equity. It is arguably also the most important asset psychologically, for the home provides shelter for the family and serves as the family meeting point. Thus, losing one's home in foreclosure or insolvency can take a significant toll on a debtor. The family home is thus arguably one of the most important assets to be protected.¹²²

The Report also noted that some countries have developed some forms of temporary protection measures (in the context of both mortgage foreclosures and insolvency cases), recognising the value of home ownership to both human wellbeing,¹²³ as well as broader economic considerations, such as the cost of providing alternative accommodation, and the impact of large scale foreclosures.¹²⁴

A. Rehabilitation and the Treatment of the Family Home in Bankruptcy

While the bankrupt's creditors will likely view the bankrupt's home merely as a valuable financial asset, to the bankrupt (and indeed the bankrupt's family), the family home is something much more than simply an asset with a particular financial value. As a result, the family home frequently becomes a source of conflict between the competing interests in bankruptcy.¹²⁵ It is therefore noteworthy that the home is not recognised as a special category of asset in Australia and enjoys no direct protection under the bankruptcy regime. Instead, it simply forms part of the property of the bankrupt that will vest in the trustee on bankruptcy.¹²⁶ By failing to give the family home special status or protection in the context of claims by creditors, this can result in entire families being displaced with repercussions not

¹²⁰ Bankruptcy Legislation Amendment Bill 2002, above n 68, para 2 and para 4 and Bankruptcy Legislation Amendment Bill 2010 (Cth) Explanatory Memorandum, para 7.

¹²¹ World Bank Report above n 6, [232].

¹²² Ibid [240].

¹²³ To some degree they have even been recognised in human rights instruments, such as the UN Covenant on Economic, Social and Cultural Rights of 1966 (article 11). Australia signed the *UN Covenant on Economic, Social and Cultural Rights of 1966* on 18 December 1972 and ratified on 10 December 1975. In the Australian Human Rights and Commission report on compliance in 2009, the only reference to article 11 housing dealt with indigenous housing.

¹²⁴ World Bank Report above n 6, [332].

¹²⁵ Lee Steyn, 'Treatment of a Debtor's Home in Insolvency: Comparative Perspectives and Potential Developments in South Africa' (2013) 22 *International Insolvency Review* 144, 145.

¹²⁶ *Bankruptcy Act* s 116.

only for the particular family but for the wider society.¹²⁷ Following the release of the World Bank Report, should Australian policy-makers and scholars consider placing the home in a special category of asset in bankruptcy, and should Australian bankruptcy law seek to protect the family home, or at least some element of value in it, by way of a homestead exemption?

B. The Home beyond its value as a capital asset

To deal with the home by way of simply aggregating it in with all other assets, ignores the unique character of the home apropos the debtor and the debtor's family and the emotional and financial cost on the bankrupt and the bankrupt's family of losing the home. To consider the home as a separate and unique asset, one must of course consider what it is that gives the home this character. Fox¹²⁸ analyses the differing "values" that a home might have. She recognises 4 fundamental ones: (i) home as a physical structure; (ii) home as a territory; (iii) home as a means of identity and self-identity for its occupiers; and (iv) home as a social and cultural phenomenon. So in this sense, the home provides things to its occupiers that are not always capable of clear enunciation but nevertheless provide an essential and powerful role in their daily life. In arguing that the family home should be afforded a level of protection under bankruptcy law in Australia, Altobelli¹²⁹ focuses on the security (both physical and emotional) that the home provides to families, acting as the cornerstone of the family unit and impacting on the economic wellbeing of the family.

As a result, the emotional and social cost of losing the family home can be considerable, not just for the bankrupt, but also for the bankrupt's family.¹³⁰ This can result in incredible hardship for all the occupiers of the home, not least of which the children, who lose not only the physical needs of space and shelter, but also the focal point of their lives.¹³¹ The loss of the family home can lead to family breakdowns, periods of uncertainty and insecurity, increased reliance upon social welfare and an increased risk of homelessness, when no alternative living arrangement can be found.

The bankrupt's home therefore is frequently the source of conflict within a bankruptcy due to the desire of creditors to target this valuable asset.¹³² The problem is trying to balance the interests of the occupiers, with those of the creditors however, there is a conceptual problem with balancing these conflicts. As Fox notes, there has been insufficient development in respect of enunciating socio-legal recognition of the special nature of the home (over and above its conception as a capital asset with a set value).¹³³ This creates the risk that any

¹²⁷ Tom Altobelli, 'The Family Home in Australian Law' (Paper presented at the 7th Australian Institute of Family Studies Conference, Sydney Convention and Exhibition Centre, Darling Harbour Sydney, 24 July 2000), 1.

¹²⁸ Lorna Fox, 'The Meaning of Home: A Chimerical Concept or a Legal Challenge?' (2002) 29(4) *Journal of Law and Society* 580, 581.

¹²⁹ Altobelli, above n 127, 4-8.

¹³⁰ For an interesting study in relation to the foreclosure crisis in the USA, see G Thomas Kingsley, Robin Smith, and David Price, *The Impact of Foreclosures on Families and Communities*. Washington D.C. (The Urban Institute, May 2009) in which the authors point out the cost to families as well as communities.

¹³¹ Altobelli, above n 127, 20 citing Peter F McDonald (ed), *Settling Up: Property and Income Distribution on Divorce in Australia* (Australian Institute of Family Studies, Prentice Hall, Australia, 1986), 151.

¹³² Steyn, above n 125, 145.

¹³³ Fox, above n 128, 596.

discussion of an interest that an occupier might have in a property over and above its conception as a capital asset, will simply be reduced to the realm of sentiment or emotion, which risks being trivialized, or considered uncomfortable territory for legal analysis, with the inevitable result that the claims and interests of creditors often triumph. As Moore notes, the concept of ‘home’ is difficult to explicitly define and manipulate.¹³⁴ Consequently, it may be too easy to subjugate these values to the easily identifiable financial interests of the creditors.

It is this dichotomy which lies at the heart of the problems surrounding the family home. Without some formal recognition of the interests in the home beyond the potential financial return to creditors, it seems difficult to imagine that the true interests are being balanced appropriately. This discussion is relevant both to circumstances where the courts have to decide where the balance lies in a dispute between occupiers and a creditor looking to realise the family home, as well as broader policy discussions surrounding home protection measures and the importance of the family home to the aims of rehabilitation.

C. Protecting the Family Home: Some Examples

1 *International experience*

Notwithstanding Fox’s concerns many jurisdictions have recognised the importance of the family home by developing some form of home protection measures for occupiers when the legal owner of the property becomes a bankrupt.¹³⁵ These vary greatly in their nature from jurisdiction to jurisdiction so it is not possible to identify a common approach.¹³⁶ They range from formal homestead exemptions in the USA and Canada¹³⁷ to procedural requirements imposed on trustees seeking to sell.¹³⁸ For instance, England and Wales have introduced measures that include requiring a court order to effect the sale of the land and giving the courts the power to postpone the sale of the home by the trustee,¹³⁹ as well as giving non-bankrupt spouses who have acquired statutory rights of occupation (under the family law provisions) the right to enforce those as against the trustee.¹⁴⁰ It is notable that in this respect, the bankruptcy laws of England and Wales specifically target the home as a special category of asset. Amongst New Zealand’s measures, a spouse whose name is not on the legal title can, in some circumstances, claim a “protected interest” in the proceeds of sale in an amount equal to half the equity in the home up to a maximum sum of \$103,000.¹⁴¹

¹³⁴ Jeanne Moore, ‘Placing *Home* in Context’ (2006) 20 *Journal of Environmental Psychology* 207, 208.

¹³⁵ World Bank Report above n 6, [241].

¹³⁶ Donna McKenzie Skene, ‘The Composition of the Debtor’s Estate on Insolvency: A Comparative Study of Exemptions’ (2011) 20 *International Insolvency Review* 29, 35.

¹³⁷ As to which see below.

¹³⁸ Steyn, above n 125, 148.

¹³⁹ *Insolvency Act 1996* (England and Wales) s 335A (in situations where the spouse or former spouse is a joint owner of the land); s 336 (in respect of statutory rights acquired by a spouse under the *Family Law Act 1996* (England and Wales)); s 337 (in respect of bankrupts who occupy the property pursuant to a beneficial interest). In each of these, the court can take into account the interests of the spouse and children as well as the interests of the creditors.

¹⁴⁰ *Insolvency Act 1996* (England and Wales) s 336.

¹⁴¹ *Property (Relationships) Act 1976* (NZ) s 20B.

In Australia, there is no specific protection afforded to bankrupts or occupiers under the bankruptcy legislation. If the bankrupt is the sole owner, and no other person has an interest (legal or equitable) in the property, neither the bankrupt nor the bankrupt's family has any right to remain in possession of the home. If the home was jointly owned by the bankrupt and the non-bankrupt spouse, the joint tenancy severs as a matter of law, and the non-bankrupt spouse's interest remains as a tenant in common with the trustee (as a result of the interest of the bankrupt vesting in the trustee).¹⁴² While the trustee will usually give the non-bankrupt spouse the opportunity to purchase the trustee's share, if the non-bankrupt spouse cannot, the trustee can apply for a court order to sell the property.¹⁴³ If the non-bankrupt spouse has no legal title, they still may be able to claim some equitable interest in the property (or a part of the property), either by way of express or constructive trust, with such interest being able to be raised as against the trustee.¹⁴⁴ Likewise, any order made in respect of the property under the *Family Law Act 1975* (Cth) prior to the bankruptcy will continue to bind the trustee¹⁴⁵ and property settlement orders under s79 *Family Law Act 1975* (Cth) can be made against property that has vested in the trustee¹⁴⁶ and a spouse can also claim legal or equitable rights under pursuant to s78 *Family Law Act 1975* (Cth) as against the trustee.¹⁴⁷

Nevertheless, there is no protection specifically directed at the family home. These protections apply to all property, not simply the home, so they do not represent an attempt to create a regime to recognise the unique nature of the home. At best the non-bankrupt spouse's interest in the proceeds of sale¹⁴⁸ will likely be preserved. These protections would not prevent a forced sale of the home itself and they do not protect any value of the bankrupt's interest in the home as against the trustee.

D. Protecting the family home: The interaction of the goal of rehabilitation

The lack of specific home protection not only represents a regime failure to recognise the particular nature of the home, but it also runs counter to one of the central themes of

¹⁴² *Bankruptcy Act 1966* s 58; *Sistrom v Urh* (1992) 40 FCR 550; [1991] FCA 315.

¹⁴³ Murray and Harris above n 27, [4.45].

¹⁴⁴ So for instance, a wife who claimed a constructive trust over half the value in the family home was able to raise this against the trustee in bankruptcy: *Parsons v McBain* (2001) 192 ALR 772. Further it was held in *Draper v Official Trustee in Bankruptcy* (2006) 236 ALR 499 that where a wife and husband were joint tenants in a home immediately prior to the bankruptcy of the husband, not only did the wife remain entitled (both legally and beneficially to her uncontested half share in the home, it would at least be open to her to challenge the trustee's legal (and purported beneficial) share in the husband's half interest in the property by arguing that the husband's half share in the property was only ever held by him as trustee on her behalf and therefore, the trustee took that half share subject to that equitable interest. While this case turned on the fact that the husband's name on the legal title was a formality only, and requested by the mortgagee bank, it does show the extent of the potential application of the constructive trust as against a trustee.

¹⁴⁵ *Bankruptcy Act* s 59A.

¹⁴⁶ *Property Law Act 1975* (Cth) s 79(1)(b).

¹⁴⁷ In family law proceedings against a bankrupt, the trustee will become a party to those proceedings and can make submissions in favour of the creditors, which will need to be taken into account by the court. Note in particular the list of matters to be taken into account under s 75 which applies to both property settlement proceedings under s 79 and maintenance proceedings under s 74 where the interests of creditors are just one matter to take into account along with the interests of dependents.

¹⁴⁸ These would not have vested in the trustee anyway.

bankruptcy, that is rehabilitation. Traditionally the law concerning debtors was underpinned by a quasi-criminalisation of debt (as well as a significant social and moral stigma)¹⁴⁹ with the aim of bankruptcy law to ultimately deter default and punish defaulters.¹⁵⁰ While the laws regarding debtors and bankruptcy may well have moved away from the formal concepts of punishment,¹⁵¹ bankruptcy procedures may be seen as a means of debt recovery for creditors. However, the World Bank Report states a principal purpose of a personal insolvency regime is “economic rehabilitation”.¹⁵²

The fresh start available to a bankrupt is found within the concept of discharge. Immediately upon becoming bankrupt, a debtor obtains protection from creditors enforcing their debts.¹⁵³ The practical effect is that a bankrupt (subject to some exceptions) is no longer obliged (or able) to pay his or her debts (with the creditors having to prove in and recover against the bankrupt’s estate) and is formally released from those debts on discharge from bankruptcy.¹⁵⁴ Discharge is directly related to the idea of rehabilitation and a fresh start enabling the debtor to rehabilitate into the credit community, and to live, trade and participate in normal everyday life¹⁵⁵

While rehabilitation through discharge has been recognised as a fundamental goal of bankruptcy law,¹⁵⁶ the practical ability of the bankrupt to return to a normal life and make a fresh start requires consideration.¹⁵⁷ Australian bankruptcy law exempts some forms of property¹⁵⁸ in order both to maintain some way of life during bankruptcy as well as to assist a bankrupt in achieving a fresh start through the retention of property to a modest value. This has been seen by the courts as “a desirable exception to the general rule that all the bankrupt’s property is divisible among his or her creditors”.¹⁵⁹ In promoting the rehabilitation of the bankrupt, should there be an exemption, and if so to what extent, in respect of a family home.

E. Is it time to open the door to a homestead exemption?

¹⁴⁹ AN Lewis and Dennis J Rose, *Australian Bankruptcy Law* (10th ed, Law Book Company Ltd, Sydney 1994), 8.

¹⁵⁰ Murray and Harris, above n 27, 32.

¹⁵¹ Though note some judicial statements that recognise that some elements of modern bankruptcy law still reflect somewhat quasi-penal characteristics. See, eg, *Kyriackou v Shield Mercantile Pty Ltd* [2004] FCA 490, 36.

¹⁵² World Bank Report above n 6, [359]. Murray and Harris above n 27, 32 refer to a more long-term and broader purpose, ie, the rehabilitation of the bankrupt by giving the chance of a “fresh start”.

¹⁵³ *Bankruptcy Act* s 58(3), subject to secured creditors who are protected pursuant to s 58(5).

¹⁵⁴ *Pitman v Pantzer* (2001) 115 FCR [10].

¹⁵⁵ John Tribe, ‘Discharge in Bankruptcy: An Historical and Comparative Examination of Personal Insolvency Relief in England and Australia’ (2012) 20 *Insolvency Law Journal* 240, 245.

¹⁵⁶ Bankruptcy Amendment Bill 1991 Explanatory Memorandum, para 2 and in the context of the English and Welsh legislation Enterprise Insolvency Service Policy Unit: Bankruptcy: A Fresh Start (2000), para 7.

¹⁵⁷ The ability off a discharged bankrupt to enjoy a fresh start is subject to a number of hurdles, not least of which is the social stigma and potential discrimination suffered. See the comments of Mike Bailey, NSW Financial Counsellor’s Association: Gareth Hutchens, ‘Going Bust: a new start but tough life’ *Sydney Morning Herald* (online), 25 March 2012 <<http://www.smh.com.au/national/going-bust-a-new-start-but-tough-life-20120324-1vqs4.html>>.

¹⁵⁸ These include certain household property, property used as a means of transport and property used to earn income (in each case up to proscribed levels) see *Bankruptcy Act* s 116(2).

¹⁵⁹ *Tiver v Official Trustee in Bankruptcy* (2010) 269 ALR 522, 532 per Besanko J.

The concept of a “homestead exemption” is one which is recognised in North America, but has not been adopted outside of the USA and Canada. As a result, jurisdictions such as Australia, New Zealand and the United Kingdom, maintain the basic position that the interest of the bankrupt in the bankrupt’s home prima facie, vests in the trustee upon bankruptcy. The principle of a homestead exemption is that some value of the bankrupt’s interest in his or her home is exempted from the bankrupt’s estate and does not form part of the assets available to the trustee in order to settle the debts of the bankrupt. In the USA, the federal Bankruptcy Code provides for an exemption not to exceed \$15,000 in value in the equity of the bankrupt’s home where it is used as a residence.¹⁶⁰ However, as states can opt out of this and apply their own level of exemption, the value of the exemption varies greatly from state to state, ranging from an unlimited dollar value exemption to no exemption at all.¹⁶¹ Likewise in Canada, federal law provides for the sheltering of certain exempt assets (including an amount of equity in a bankrupt’s residence), but, like the USA the actual levels of exemption are a matter for each province and therefore vary from province to province.¹⁶²

The homestead exemption will not necessarily prevent the home from being sold, particularly if the relevant exempt amount is less than the overall equity in the home.¹⁶³ However, even if the home is sold, that protected portion of the proceeds will not revert to the trustee, it will instead revert to the bankrupt who can then use it to purchase another home or at least towards the provision of other suitable accommodation.¹⁶⁴ Therefore, even if the concept of ‘home’ as discussed is lost, the bankrupt is still given the means to source an alternative home with funds that would otherwise have been distributed amongst the creditors.¹⁶⁵

The US homestead exemption has been described as a means to “prevent private destitution and hardship, to support and stabilize the home and family unit, and to prevent impecunious debtors from burdening the public purse by resorting to charity and welfare programs”.¹⁶⁶ The financial, psychological and social cost of losing one’s home, without any form of safety net would appear to be a considerable hurdle to the debtor’s rehabilitation. It has been noted (in support of a homestead exemption) that taking a family home simply makes the family homeless and miserable, and creates deleterious effects on the family as a unit, and the relationships within it.¹⁶⁷

¹⁶⁰ *Bankruptcy Code* s 522(d)(1).

¹⁶¹ Steyn, above n 125, 149.

¹⁶² Benjamin Geva and Stephanie Ben-Ishai, ‘Canada: The Origins of Canadian Bankruptcy Exemptions: Federalism, the Relevance of US Law and the Prospects for Reform’ (2009) 20 *Journal of Banking and Finance Law and Practice* 270.

¹⁶³ Steyn, above n 125, 149.

¹⁶⁴ *Ibid.*

¹⁶⁵ Lewis refers to the very different position of the discharged bankrupt in America, who may (depending on the bankrupt’s state of residence) have retained some value in the family home, or even the entire home itself, to that in Australia and argues this reflects the significant and broad focus on a fresh start as the focus of bankruptcy law in America: Paul Lewis, ‘The Future of Personal Bankruptcy: A Comparative Analysis – Part 1’ (2004) 5 *Insolvency Law Bulletin* 33.

¹⁶⁶ *In re Johnson*, 124 BR 290 (BankrDMinn 1991), 296.

¹⁶⁷ Harry D Boul, ‘The Need for a Rational Homestead Exemption in Missouri’ (2013) 69 *Journal of the Missouri Bar* 264, 266.

However, the concept of a homestead exemption is not without criticism. It is considered unfair on creditors who have been left out of pocket, particularly those whose debts have been used in the purchase or maintenance of the property. As Wilson notes, many American commentators criticise the Texas homestead exemption (which is an unlimited amount) as being simply a means for wealthy debtors to escape liability in bankruptcy¹⁶⁸ and Barros notes that, at least in those jurisdictions with unlimited exemptions, the doctrine operates to over-protect the interests of the home at the expense of creditors' interests.¹⁶⁹ The very nature of a homestead exemption is such that it does specifically favour the interests of occupiers over creditors to some extent, so the issue for Australia would be to arrive at a (national) level of exemption that while recognising the interests of the creditors, provides an adequate level of exemption in order to facilitate the stated aim of rehabilitation.¹⁷⁰

Of course any discussion regarding homestead exemptions (and indeed most other forms of home protection measures) must be tempered by the realisation that the existence of a secured creditor will necessarily affect the position of the family home. Australian bankruptcy law specifically protects secured creditors in the event of bankruptcy, preserving a secured creditor's rights to deal with, and enforce its security.¹⁷¹ The practical effect of this is that the secured creditor has the freedom to deal with the secured property, and this commonly entails the mortgagee exercising its rights to take possession and affect a forced sale.¹⁷² In this situation, the home will in effect, cease to be an asset available for distribution amongst the other creditors.¹⁷³

F. Summary

It seems to be an anomaly in a country such as Australia where home ownership is so highly valued,¹⁷⁴ that the home, with all its antecedent qualities and values, does not enjoy specific recognition as a special category of asset when a debtor becomes bankrupt. By treating the home as simply another asset, the personal insolvency regime is failing to properly address the place of the home in family and social life. If we are to continue to focus on rehabilitation and a fresh start it is important to consider what role a homestead exemption could have in achieving that aim in Australia. As noted, the loss of the family home can have a devastating impact on both the bankrupt and the bankrupt's family which can impact the

¹⁶⁸ Allen Wilson, 'More than just a Boon: How Texas Homestead Law Helped Insulate Texas from the Foreclosure Typhoon' (2012) 64 *Baylor Law Review* 999.

¹⁶⁹ D Benjamin Barros, 'Home as a Legal Concept' (2006) 46 *Santa Clara Law Review* 255, 285.

¹⁷⁰ More detailed discussion of the issues and consequences involved in the introduction of such an exemption are beyond the scope of the present article and merit more detailed research, in particular into 'unintended consequences' and 'moral hazard'.

¹⁷¹ *Bankruptcy Act* s 58(5). The ability to securitise debt is essential to the provision of credit in Australia, and the removal of this protection would likely affect the availability of credit.

¹⁷² As to the options open to a secured creditor, see Lewis and Rose above n 149, 108-109 and the summary of a secured creditor's options pursuant to *Bankruptcy Act* s 58(5) and s 90.

¹⁷³ However, note that the balance (if any) of the proceeds of sale, after the mortgage has been satisfied in full, will revert to the trustee.

¹⁷⁴ The Bureau of Statistics estimates that since the 1966 census, the level of home ownership has ranged between 68% and 70% of home occupiers: Australian Bureau of Statistics 2012 *Australian Year Book* Cat No 1301 (online)

<<http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/1301.0~2012~Main%20Features~Housing~21>>.

ability of the bankrupt to rebuild his or her life. Beyond just focusing on the impact on occupier's personally, there is also the social element, including the ongoing cost to society of people being made homeless, the breakdown in family life and the cost of the provision of support services to those affected.¹⁷⁵ The release of the World Bank Report provides an opportunity for policy-makers to debate the relevance of some form of homestead exemption to support the goal of debtor rehabilitation.

V. CONCLUSION

This brief overview of the Australian personal insolvency law against the background of the World Bank Report on the Treatment of the Insolvency of Natural Persons with its core attributes for an effective insolvency regime for natural persons shows that the Australian regime already addresses many of these attributes.

The Report usefully adopts a perspective that concentrates on the human side of insolvency – on the implications for individuals of overwhelming debt. When talking of debt relief, it notes “the desire to relieve individual suffering is more direct and more central in the context of natural person insolvency”.¹⁷⁶

In that context, two areas have been identified through the review whereby the World Bank's fundamental concern for equity highlights matters worthy of consideration by policy-makers and scholars to improve Australian personal insolvency law. These are, the removal of acts of bankruptcy from the Australian regime and the consideration of limited special treatment of the home within the bankrupt's estate, for the purposes of enhancing economic rehabilitation and the notion of a fresh start, particularly from the perspective of addressing the morbidity aspects of excessive debt.

¹⁷⁵ In its review of all forms of public housing assistance, the Sterling Committee for the Review of Government Service Provision noted that in 2011-2012 the state and territory governments spent \$3.9 billion on social housing and the Commonwealth government spent \$2.2 billion in the same period. At 30 June 2012, there were 323,423 households occupying social housing with 164,323 applicants on a waiting list. This does not include the other forms of housing assistance (eg, rent assistance).

¹⁷⁶ World Bank Report above n 6, [393].