

1.0 INTRODUCTION

The Bankruptcy Act 1966 ("the Act") provides a mechanism for debtors to enter into formal binding compromise arrangements with their creditors to settle their debts and avoid bankruptcy. Subject to their circumstances, a debtor can consider an arrangement under Part X or Part IX of the Act. Alternatively, debtors have the option of not utilising the Act and attempting to negotiate an informal binding arrangement with their creditors.

2.0 PART X – PERSONAL INSOLVENCY AGREEMENTS

2.1 Overview

Part X of the Act enables debtors to propose a formal compromise with their creditors, which is documented in a Personal Insolvency Agreement ("**PIA**"). These agreements are individually tailored to suit the debtor's unique financial circumstances. Typically, the offer of compromise will be in the range of 5 to 20 cents in the dollar, but could be higher or lower. The arrangement will often provide for monies to be paid on account of the debtor either by way of lump sum or by instalments over a certain period of time. The arrangement can also provide for sale of specified assets with the remaining assets to be retained by the debtor.

2.2 The Process

The provisions of Part X are invoked by the debtor signing, what is called a Section 188 Authority, authorising either a Registered Trustee, a Solicitor or the Official Trustee (who is then referred to as the Controlling Trustee) to call a meeting of his or her creditors and to take control of his or her property. At the same time, the debtor must provide the Controlling Trustee with a written proposal, a draft PIA and a Statement of Affairs outlining, inter alia, all known assets and liabilities of the debtor (subsections 188(2C) and 188(2E) of the

Act). A PIA takes the form of a deed and must include specified terms as set out in section 188A).

The Controlling Trustee immediately takes control of the debtor's property and commences an investigation into the affairs of the debtor (subsection 190(2)). In addition, the Controlling Trustee is required pursuant to subsection 189A(1) to prepare and issue a report to creditors:

- (i) summarising and commenting upon the information about the debtor's affairs; and
- (ii) stating whether he or she believes that the interest of creditors will be better served by accepting the debtor's proposal or by the bankruptcy of the debtor.

A meeting to consider the debtor's proposal must be held not more than 25 working days after the appointment or 30 working days if the appointment was made in December (subsection 194(1)). Pursuant to subsection 204(1), creditors at the meeting may resolve by special resolution that:

- a. the debtor be required to execute a PIA; or
- b. the debtor's property be no longer subject to control; and /or
- c. the debtor be required to present a debtor's petition within 7 days from the day the resolution was passed.



A special resolution requires 50% in number AND 75% in value of creditors present at the meeting, voting in favour of the resolution (section 5).

In the event that the proposal is accepted by creditors, then the PIA must be executed by the debtor and the Controlling Trustee within 21 days from the day on which the special resolution is passed (subsection 216(1)).

Once all the terms of the agreement are satisfied, the debtor is discharged from the PIA (section 232). Creditors, with the written consent of the debtor, can vary the terms of a PIA by way of special resolution at a meeting convened for that purpose (section 221A). If the debtor is in default and is unable to rectify that default, then the PIA can be terminated by either the Trustee (section 222A of the Act) or by creditors passing a special resolution at a meeting held for that purpose (section 222B). In addition and in specific circumstances, the Court may also set aside a PIA and make such orders as it sees fit (section 222).

2.3 The Effect on the Debtor

On signing a Section 188 Authority, the debtor will lose control of his or her property. Control of property that is excluded under the PIA will revert to the debtor on execution of the PIA. In addition and pursuant to subsection 206B(4) of *the Corporations Act 2001*, a person is disqualified from acting as a director of a corporation if that person has entered into a PIA and the terms of the agreement have not been fully satisfied.

2.4 The Effect on Creditors

The effect of appointing a Controlling Trustee is that creditors are unable to commence or continue any further action for the recovery of their debts from the debtor until the outcome of a subsequent meeting of creditors is known. The rights of a secured creditor remain intact.

Once the PIA has been signed, creditors, whether present at the meeting or not, are bound by the terms of the PIA and cannot take any action to recover their debts outside the PIA.

2.5 Commentary

Entering into a PIA will not be an appropriate alternative for all debtors especially those with no resources (or access to limited resources) and relatively nominal debt exposure. The main reason for this is that the cost of proposing an arrangement under Part X of the Act can be prohibitive. In this regard the Controlling Trustee is obligated to carry out the tasks detailed earlier herein and will incur significant time charge in doing so. As there is no guarantee that the proposal will be accepted by creditors, the prospective Controlling Trustee will normally seek a cash advance (or some other form of security) to meet his estimated costs in acting in that role. Furthermore, the debtor will need to fund the cost of preparing a formal deed setting out the provisions of the arrangement.

In considering whether or not to put a proposal to his or her creditors, a debtor should also take into account the likelihood of the proposal being accepted bearing in mind that under the Act, a special resolution is required (being 50% in number and 75% in value of creditors voting on the resolution). From experience, we have found that some creditors will vote against a proposal on the basis of policy, notwithstanding the commerciality of the proposal.

Nevertheless, entering into a PIA does have its advantages some of which are summarised here under:

- (i) The debtor avoids the stigma of bankruptcy;
- (ii) A PIA provides for the flexible administration of the debtor's affairs including the opportunity to carry on business, which is difficult for an undischarged bankrupt;
- (iii) The execution of a PIA avoids Court process;
- (iv) The return to creditors under the PIA is invariably greater than that if the debtor was made bankrupt.
- (v) subject to the terms of the PIA, there is no requirement to contribute after- acquired property or income;
- (vi) the PIA will normally terminate within the short to medium term.

3.0 PART IX DEBT AGREEMENTS

3.1 Overview

Part IX of the Act provides another alternative to bankruptcy by giving debtors who have a relatively low income, minimal assets and low debt levels, an inexpensive mechanism to reach a binding debt agreement with their creditors to release them from



their debts. Pursuant to subsection 185C(4) of the Act, a debtor cannot utilise this part of the Act if she or he has:

- (i) within the previous ten (10) years, been bankrupt, a party to a debt agreement or given an authority under section 188 of the Act;
- (ii) unsecured debts that are above the specified threshold amount;
- (iii) property, which would be divisible among creditors in a bankruptcy, that is above the threshold amount;
- (iv) after tax income in the year beginning at the proposal time that is likely to exceed 75% of the threshold amount.

The current threshold amounts are set out in the table below.

	Current Threshold Amount (\$)
Unsecured Debts	\$107,307.20
Property	\$107,307.20
After Tax Income	\$80,480.40

3.2 The Process

To initiate a Debt Agreement, a debtor must give the Official Receiver a written proposal for a binding agreement between the debtor and his or her creditors (subsection 185C(1) of the Act. Any such proposal must be in the approved form; identify the property to be dealt with under the agreement; specify how it is to be dealt with and authorise the Official Receiver, a registered Trustee, or another person, to deal with the property as specified (subsection 185C(2)).

The proposal must be accompanied by a statement of the debtor’s affairs (subsection 185D(1)). If the proposal is accepted by the Official Receiver, the Official Receiver must write to creditors asking them whether the proposal should be accepted (subsection 185EA(1)). The proposal is accepted if the majority in value of creditors who reply state that the proposal should be accepted (subsection 185(EC)(1)).

The Debt Agreement ends when all the obligations that it created have been discharged (subsection 185N(1)). At that time, the debtor is released from all debts which would be provable in a bankruptcy (subsection 185NA(1)). This release from debts will

not occur if the Debt Agreement is declared void by the Court (subsection 185NA(2)). The Act also provides a mechanism to vary a Debt Agreement (subsection 185(M)(1)).

3.3 The Effect on Creditors

All creditors with provable debts are bound by the Debt Agreement, even those who voted against the proposal (section 185NA). While the Debt Agreement is in force, creditors cannot take or continue action against the debtor for recovery of their debts (subsection 185K(1). A Debt Agreement does not affect the rights of a secured creditor to realise or otherwise deal with the creditor’s security (section 185XA).

3.4 Commentary

O’Brien Palmer does not administer Debt Agreements. Readers requiring further information should access the web site maintained by the Australian Financial Security Authority at www.afsa.gov.au.

4.0 INFORMAL ARRANGEMENTS

An informal arrangement is simply an arrangement not made under the Act that a debtor makes with his or her creditors to settle his or her debts. Normally an adviser such as the debtor’s accountant, would firstly write to creditors summarising the debtor’s financial position and putting forward a settlement proposal. Follow up contact by either the debtor or the advisor is recommended with the aim of addressing any concerns the creditor may have and reinforcing the benefits of the proposal. Preferably, any agreement reached with creditors should be documented by way of deed.

Informal arrangements are more likely to proceed in circumstances where there are a small number of creditors involved and some goodwill still exists between the parties. The difficulty is that just one hostile creditor can make the arrangement unworkable.

It should be noted that individuals who may be facing bankruptcy should seek immediate professional advice in relation to their specific circumstances.

Should you have any enquiries in relation to bankruptcy, Personal Insolvency Agreements or any associated issue, then please feel free to contact us at O’Brien Palmer for an obligation free assessment of your options and circumstances.

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Other Services

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- Security Reviews
- Management Reporting
- Cash-Flow Management
- Turnaround Management

Without obligation or cost, we are available for an initial consultation. Please contact:

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