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A BRIEF INTRODUCTION TO BANKRUPTCY

In difficult financial times bankruptcy is not only the last resort for the individual concerned but it can be the final option for a creditor to receive any return of a debt that has been incurred. Making someone bankrupt can be a complex process and one where it is best to seek legal advice.

The Bankruptcy Act sets out what an act of bankruptcy can be, with the most common act of bankruptcy being the failure of a debtor to pay a creditor's debt within 21 days from the date the notice was given. The debt must be at least \$2,000.00 in order to make anyone bankrupt. That failure to pay can amount to an act of bankruptcy and the creditor may then make an application to the Court for a Creditor's Petition. The Court will not make someone bankrupt unless it is completely satisfied that an act of bankruptcy has occurred and that the debtor was completely aware that the bankruptcy proceedings were underway. It is therefore very important that all documents are personally served on the debtor. There may be several hearings until the Court is satisfied that the debtor should be made bankrupt and when that occurs the Court will grant a Sequestration Order. The Sequestration Order is the order that makes a person bankrupt.

Do you have a provable debt against a bankrupt?

If someone is made bankrupt a trustee is appointed by the Insolvency and Trustee Service Australia ("ITSA"). The job of the trustee is to manage and distribute the funds of the estate. When a person becomes bankrupt the trustee informs all creditors of the bankruptcy. For the trustee to know exactly what the funds of the estate are they will require the debtor to complete a Statement of Affairs and all creditors must complete a Proof of Debt. The trustee is not required to inform anyone with a possible provable debt that they intend to pay a dividend unless the Proof of Debt has been completed. For this reason it is imperative for a creditor to accurately complete the Proof of Debt form and send it to the trustee as soon as possible. A dividend, or payment, will only be paid out to the creditors who have completed a Proof of Debt and that debt has been proved by the trustee. A creditor must include in a Proof of Debt the particulars of the debt, must



substantiate the debt if possible and must state whether they are a secured creditor. Substantiation of a debt can be through documents such as receipts or judgments. If this sort of substantiation is not possible the trustee is likely to require a creditor to verify the debt in the form of a statutory declaration.

Provable and non-provable debts

When someone becomes bankrupt not all the debts are considered provable. If a debt is non provable the trustee will not be required to consider that debt when dividing the funds of the estate and they are debts that the debtor is still required to pay. Therefore bankruptcy only releases a person from provable debts.

The Bankruptcy Act 1966 (Cth) provides that all debts and liabilities, present or future, certain or contingent, to which a bankrupt was subject at the date of the bankruptcy are provable in his or her bankruptcy. There are of course exceptions to this provided in the Bankruptcy Act.

Any debt or interest that was incurred after the date of bankruptcy is considered non provable and should



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not be included by a creditor when completing the Proof of Debt. A debtor (or bankrupt) on the other hand is required to include all provable and non provable debts when completing their Statement of Affairs and must also include debts that are owed jointly with another person.

There are some debts that a debtor will still have to pay during bankruptcy proceedings as they are deemed non provable. Such debts include fines, HECS and HELP debts, and damages from accidents. A debtor is still required to pay for essential services, such as electricity, to avoid disconnection. After bankruptcy a bankrupt is still liable to pay some debts including their HECS or HELP debts and child support payments.

On the other hand, a secured debt and therefore one where there is a secured creditor, is regarded as one where the creditor holds a security over an asset. This entitles them to take and sell that asset. A secured creditor can surrender his or her security and prove the whole debt to the trustee. Often however the secured creditor will sell that asset in an attempt to recover the money owed. In the event that there is any deficiency in the sale of that asset, the deficiency may be included on the Proof of Debt as a provable debt. An example of this situation is a mortgagee repossession. In the event that there is a shortfall after the sale of a house the mortgagee is entitled to complete a Proof of Debt form and notify the trustee of that shortfall. The creditor's legal costs to the point after bankruptcy are non provable and must be borne by the creditor. If however a judgment was obtained by the creditor prior to the date of bankruptcy they are considered provable.

There are also debts that are considered unsecured which are also provable in bankruptcy. Such examples of these can include credit card debts, personal loans or debts arising from a trade loan.

All provable debts in bankruptcy are rated equally and if the proceeds of the bankrupt are insufficient to meet them all the trustee will divide the funds equally between the creditors.

As can be shown from this discussion bankruptcy can be a complex process particularly as it often can



involve a number of stakeholders. In order to ensure that the process is managed effectively and all entitlements are distributed proportionally it would be best to seek legal advice. If you believe that you may be a creditor who has a provable debt or you may be considering going bankrupt to manage your liabilities please contact our office.