DEBT AGREEMENTS

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Contents

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1. Debt Agreement Defined

Debt agreements are arrangements between a debtor and creditors to deal primarily with unsecured debts that would be provable if the debtor were to become bankrupt. They are legally binding arrangements regulated by the Bankruptcy Act. Debt agreements are intended for people with modest levels of income, unsecured debt and unprotected assets. References in this paper such as (s. 185 C (4)) are references to sections of the Bankruptcy Act 1966 (Commonwealth). An important advantage of debt agreements is that the debtor does not become bankrupt.

1.1 History

Debt agreements have a long history. The Australian Law Reform Commission Report 6 tabled in November 1977 considered whether the traditional processes of bankruptcy were adequate in dealing with small debtors wishing to compromise or discharge their debts. Debt agreements were first introduced by legislation passed in 1996 (1). The initial form of debt agreements was quite simple. A person could be their own debt agreement administrator. There was no registration requirement for administrators, and some people thought financial counsellors might put together debt agreements for their clients. To the surprise of the people who planned the scheme, commercial operators entered the field, with substantial advertisement of their services. Federal Parliament decided it was necessary to amend the system, and on 1 July 2007 a modified system of debt agreements came into operation. (2) There were some important changes. In particular, the new legislation introduced a system of automatic termination of debt agreements if they were not complied with. Debt agreements entered into before 1 July 2007 are not subject to automatic termination. In this paper I shall refer to debt agreements entered into before that day as 'old debt agreements.'

1.1.2 Automatic Termination

Debt agreements entered on or after 1 July 2007 are subject to an automatic termination system (ss. 185LC and 185 QA). The automatic termination provisions are not applicable to old debt agreements. If a person entered an old debt agreement, and it has not been ended by completion, by resolution of the creditors, or by court order, then it is still in force, whether or not anything has happened in relation to it for many years. The effect of this is that there are old debt agreements sailing on across the financial ocean with nobody on board, like the Mary Celeste. The best way of finding out if a debt agreement has been terminated is to check the National Personal Insolvency Index (NPII). This requires comprehensive details of debt agreements to be recorded, including termination (3).

1.1.3 2019 Changes

The debt agreement system has now been modified in important ways again, with effect from 27 June 2019. The latest set of changes are set out in the Bankruptcy Amendment (Debt Agreement Reform) Act 2018. I will deal with the changes below at relevant points in the text, but in brief the changes are:

* From 27.6.19 only the Official Trustee, a registered trustee or a registered debt agreement administrator can administer a debt agreement.

* The value of a debtor's property (divisible assets) to be eligible to enter a debt agreement has been doubled.

* The new legislation introduces a payment to income ratio, to ensure debtors do not enter a debt agreement requiring them to pay unrealistic amounts.

* The Official Receiver can now refuse to accept a debt agreement proposal if the Official Receiver believes it would cause the debtor undue hardship.

* A debt agreement is now limited to a total duration of three years, or five years if the debtor has an interest in a house which is the debtor's home.

* The definition of a three-month arrears default has now been clarified.

1.2 Mutually Exclusive with Bankruptcy

Though debt agreements are regulated by the Bankruptcy Act, a debtor who enters a debt agreement does not become bankrupt. This is important for some debtors. Debt agreements and bankruptcy are mutually exclusive alternatives. A person who is bankrupt cannot enter a debt agreement (s. 185 C (4)), and a person who is a debtor in a debt agreement cannot petition in their bankruptcy without permission from the Federal Court or the Federal Circuit Court of Australia (s. 55 (5A)). Breaching these provisions is an offence, for which a person can be prosecuted. (s.267).

1.3 Records and Financial Reputation

Many debtors are keen to protect their financial reputation, though an objective observer may think they do not have much of a financial reputation to protect. The effect of debt agreements on a person's financial reputation is not as long-lasting, in that the NPII record of a debt agreement is deleted after a set period of time, whereas a record of a bankruptcy stays on NPII records permanently. Detail of this is set out in paragraph 7.1 of this paper. The Privacy Act sets out a table in section 20X which provides credit reporting records of a bankruptcy and a debt agreement are retained on a comparable formula. Detail of this is set out in paragraph 7 of this paper.

2. Eligibility to Enter a Debt Agreement

Debtors are **ineligible** to enter a debt agreement if they:

2.1. Are solvent and able to pay their debts as they fall due: s.185 C (1)

2.2. At any time in the past ten years have been bankrupt, or a debtor in a debt agreement, or have given an authority under section 188 of the Act to a registered trustee, the Official Receiver or a solicitor to call a meeting of creditors and to take control of the debtors' property: s. 185C (4)

2.3. Have unsecured debts totalling more than $118,063.40 which is referred to as the threshold amount: s. 185 C (4). The threshold amount is an inflation-adjusted figure, which is twice the base income threshold amount (BITA), which changes twice a year in March and September.

2.4. Have unprotected property, which could be distributed amongst the creditors if the debtor becomes bankrupt, of more than twice the threshold amount: s. 185 C (4). This is currently $236,126.80.

2.5. Are likely to earn an after tax income, that is, gross income less tax and Medicare levy, in the first year of the debt agreement of more than three-quarters of the threshold amount: s.185 C (4). The current income upper limit for eligibility is $88,547.55 net. (Liability to pay child support is **not** deducted from income in this calculation: (s. 185C (5))

2.6. For the purpose of calculating a debtor's level of unsecured debt, the amount by which the value of a debt exceeds the value of the security given for it is included. That is, any likely shortfall is added in. For example if a debtor owns a house worth $400,000 and $420,000 is owing on it, the sum of $20,000 is included in the amount of unsecured debt: s. 185 C (5).

3. The Shape of Debt Agreements

A debt agreement is shaped by a debt agreement proposal which is given by the debtor to the Official Receiver. The proposal must be in writing and in the approved form: s.185C (1) and (2). The proposal must:

3.1 Contain detail of the debtor's property that is to be dealt with under the agreement, and specify how the property is to be deal with: s.185C (2) (a) and (b);

3.2 Authorize a person who is the Officer Trustee, a registered bankruptcy trustee or a registered debt agreement administrator to deal with the property;

3.3 Provide that all the debts in the agreement rank equally, and if the total amount to be paid is insufficient to pay all of the debts in full, the debts are to be paid proportionately;

3.4 Provide that no creditor is entitled to receive more than the amount of its debt;

3.5 Fix the amount of each debt at the time the acceptance of the proposal for processing is recorded on NPII (the National Personal Insolvency Index);

3.6 If a creditor is a secured creditor the proposal must provide that if the creditor does not realize its security while the debt agreement is in force, that creditor's debt is taken to be the amount of any shortfall between the amount of the debt and the value of the security;

3.7 If a creditor is a secured creditor, provide that if the creditor realizes its security while the agreement is in force, the creditor's debt is taken to be the amount of the shortfall;

3.8 Be signed and dated by the debtor (s. 185C).

4. Length of Debt Agreement

A debt agreement proposal cannot provide for payments to go on for longer than three years if the debtor is not a home owner, and for no more than five years if the debtor is a home owner: s 185C (2AA). A home owner is a person whose principal place of residence is a home they own, or in regard to which they have a long-term lease: s.185C (2AB).

A long term lease is defined in section 185C (5) as a lease granted by the Commonwealth or a State or Territory government for a term likely to exceed twenty years, calculated at the time the lease is granted.

A person holding property on an ordinary lease, for example a normal residential tenancy, a life interest or an interest held on trust for another person are defined as not being home owners: s. 185C (2AB).

5. Home Not To Be Divided in Debt Agreement

If a debt agreement made by a home-owner provides for payments to continue for more than three years, but no more than five years, their home cannot be part of the property to be divided amongst creditors in the debt agreement: s. 185C (2AC).

6. Debt Agreements Can Only Be About Money

A debt agreement proposal must not provide for the transfer of property, other than money, to a creditor: s. 185C (2A). In the early days of debt agreements debtors could propose a sale of their home, and division of the net proceeds amongst their creditors. This is no longer permitted. There is nothing to stop a debtor selling a home, then proposing a debt agreement to divide the net proceeds amongst their creditors.

7. Administrative Aspects of Debt Agreement Proposal

7.1 Explanatory Statement

A debt agreement proposal given to the Official Receiver must be accompanied by an explanatory statement in the approved form: s. 185C (2B). This can be set out as part of the proposal.

7.2 Proposed Administrator's Consent

When a debt agreement proposal is given to the Official Receiver it must be accompanied by a certificate signed by the proposed administrator. This certificate must state:

* the proposed administrator consents to being the administrator of the debt agreement;

* the proposed administrator has given the debtor the information prescribed by the regulations;

* unless there is a subsection 4C certificate in place, that the administrator has reasonable grounds to believe that the debtor will be able to pay in accordance with the debt agreement. A section 4C certificate is described below.

* that the debtor's statement of affairs and explanatory statement are accurate and complete;

* if a broker referred the debtor to the proposed administrator, the certificate must set out the relationship between the broker and the proposed administrator, and details of any payments made or to be made to the broker;

* if a creditor in the proposed debt agreement is related to the proposed administrator through family, business, corporate or trust arrangements (s. 5) the nature of the relationship s. 185C (2D) (g).

8. Section 4C Certificate

As set out in the opening part of this paper, one important aim of the 2019 amendments is to prevent debtors entering a debt agreement which requires payments beyond their capacity to pay. This is complicated by the fact that the legislation sets out to cater for persons who are or are not home-owners, and are of various income groups. Subsection 185C (4) (e) sets out a formula designed to ensure a debtor is not over-committed. The formula is:

$$\frac{\text{Total of the payments that the debtor would be required to make under the debt agreement} + \text{Low income debtor amount (see subsection (5))}}{\text{The debtors after tax income (see subsection (5) in the year beginning at the proposal time.}}$$

Subsection 185C (4B) provides that the Minister may, by legislative instrument, determine a percentage for the result of this calculation (which may exceed 100%), and a low income debtor amount. At the time of writing (June 2020) the Minister has not determined a percentage or an amount. This means that at the present time this particular test cannot be applied to a debt agreement proposal.

The 2019 amendments also recognize that in some exceptional cases there may be a reason why a person whose income is low can usefully go into a debt agreement requiring substantial payments. One example may be a debtor who has a partner or parent who is willing to assist them make payments. Subsection 185C (4C) provides that a proposed administrator can give a debtor a certificate signed by the proposed administrator saying that in the circumstances the proposed administrator is satisfied the debtor is likely to be able to pay in accordance with the agreement.

Summary

As these arrangements are novel, and rather complicated, it may be useful to set out the three categories established by the Act as follows:

A. Homeowners within the meaning of 185C (2AB) can enter a debt agreement with payments extending over a period up to five years: s. 185C (2AA) (b).

B. Debtors who are not homeowners, but who have income sufficient to meet the payments (and qualify under the formula when the Minister sets the figures) can enter a debt agreement for a period up to three years: s. 185C (2AA) (a).

C. Debtors who are not homeowners, and who do not have sufficient income to meet the payments, can enter a debt agreement for a period up to three years if they have a certificate under subsection 185C (4C).

9. Debt Agreements: One Debtor Only

A debt agreement proposal can only be made by one person: s. 185C (2E).

10. A Fossil

A throwback to the early days of debt agreements, as described in 1.1 above is that debt agreement proposals may provide for any matter relating to the debtor’s financial affairs: s. 185 (C (3). In practice debt agreements provide for a series of payments by the debtor to the administrator in order to pay the creditors, and the administrator’s fees.

11. Debt Agreement Administrators

Eligible Administrators

Only the Official Trustee, a registered bankruptcy trustee or a registered debt agreement administrator (who cannot be the debtor) can be the administrator of a debt agreement: s. 185C (2) (c).

11.1 Basic Eligibility Test

The following persons are **ineligible** to be a debt agreement administrator:

* **an insolvent under administration** which includes

* a person who, in the preceding ten years, has been a bankrupt, or a debtor in a debt agreement or Part X administration;

* a person whose registration as a bankruptcy trustee has been terminated on certain grounds in the preceding ten years;

* a person who is prohibited from taking part in the management of a company;

* a person who has been deregistered as a Corporations Act liquidator in the last ten years;

* a person convicted of fraud or dishonesty in the preceding ten years;

* a person whose registration as a debt agreement administrator has been cancelled on certain grounds, or who has been declared ineligible to act as an administrator; (s. 186 A (1)).

* a person who has been declared ineligible to act as administrator: (s. 186A (1)).

Similar tests apply in relation to the eligibility of companies to be debt agreement administrators.

11.2 Registration of Administrators

To become registered as a debt agreement administrator, a person or company must pass the basic eligibility test, have the knowledge and ability to perform satisfactorily the duties of an administrator, and have such qualifications and experience as are prescribed from time to time by the regulations to the Bankruptcy Act. They must have appropriate insurance, and be a fit and proper person: (s. 186C)

11.3 Duties of Administrators

A debt agreement administrator must certify, as part of accepting the nomination to administer the debt agreement that the debtor has received information about alternative means of dealing with financial difficulty; based on information available at the time of the proposal, that the debtor can afford to make the promised payments; and that the administrator has a reasonable basis for believing that the debtor has properly disclosed their affairs to creditors: (s. 185 C (2D)).

A debt agreement administrator must deal with the debtor's money and property in accordance with the debt agreement, and must give to the debtors and creditors information about the debt agreement which they reasonably request: (s. 185 LA).

If a debtor is in default of a payment required by the debt agreement for three months, the administrator must notify creditors of this in writing: (s. 185 LB).

A three month default is:

* at the beginning of a three-month period immediately preceding the time when the calculation is done one or more payments became due and payable, and

* throughout the three-month period the debtor was in arrears in respect of any or all of those payments, and

* either - the total amount the debtor was in arrears exceeds $300, or 20% of the total of all the due payments at the beginning of the three-month period, whichever is the higher, or

* if the total of all of the due payments at the beginning of that three-month period was $300 or less no payment was made in that period to reduce any of the due payments.

If a debtor is in default for six months, the administrator must notify the Official Receiver (at AFSA): (s. 185 LC). This triggers an automatic termination of the debt agreement. The debt agreement is terminated when the declaration by the Official Receiver that it is terminated is recorded on the National Personal Insolvency Index. (s. 185 QA).

An administrator must keep a separate bank account for monies received from debtors, keep accounts of dealing with the money of each debtor, and co-operate with any inquiries made by the Inspector-General in Bankruptcy: (s.185 LE).

12. Fees

There is a debt agreement proposal lodgement fee of $200. There are some fee exemptions for some persons receiving certain emergency payments under specified Natural Disaster Relief and Recovery programs, and there is a realizations charge of 7% of the amount realized under the debt agreement. This is usually the amount paid by the debtor under the debt agreement. It is paid to the Federal Government as a fee. If the Official Trustee is appointed administrator of a debt agreement the Official Trustee is entitled to a fee of 20% of the value of the proposal accepted by creditors. (4)

12.1 Fees of Administrators

If a debt agreement provides for payment of the administrator, the agreement **must** set out:

a) the percentage which the total of fees payable to the administrator represents of the total amount payable by the debtor under the debt agreement;

b) that where the debtor pays an amount towards their obligations under the agreement, a sum which does not exceed that percentage must be paid to the administrator as part of their fee. The effect of this is that a steady and proportionate amount of the debtor's payments under the agreement go to the administrator as a fee, rather than a large up-front amount (s. 185 C (3A)).

12.2 Compare Fees

Though the Bankruptcy Act requires disclosure of fees to be charged, and the percentage which they represent of the total amount payable by the debtor, there is no regulation of the amount of the administrator's charges. It is therefore recommended that a debtor compare the fees to be charged by various administrators before deciding which administrator to use.

13. VARYING OR ENDING A DEBT AGREEMENT

13.1 Old and New Agreements

As mentioned in paragraph 1.1 above, the legislation relating to debt agreements was amended substantially with effect from 1 July 2007. The new legislation applies to debt agreements entered into on and after that date. The old legislation continues to apply to old debt agreements (5).

In the matter of varying or ending a debt agreement, the most important of the new provisions which does not apply to old debt agreements is the automatic termination provisions. Section 185 LB and 185 LC in the new legislation relating to three month and six month arrears defaults have no equivalent in the old legislation. Accordingly, if an old debt agreement has fallen by the wayside and been ignored for many years, it still exists and will continue to exist until it is terminated by one of the means set out in the Act. A debt agreement does not end because the debtor has died. Section 185 Q (1) in both the old and new legislation provides that a debtor's personal representative (executor or administrator) can apply to a court for an order terminating a debt agreement if the debtor has died. See paragraph 5.7 below relating to death and debt agreements.

In reading the material following, it should be noted that the old legislation relating to varying and ending a debt agreement followed the same general pattern, but the old legislation was much simpler and briefer. For example, 185M is in similar form in the old legislation, but it had no equivalents to 185 MA, 185 MB, 185 MC and 185 MD in the current legislation. You can view the old legislation by selecting the **historical** tab on the comlaw website (www.comlaw.gov.au). The old legislation had no equivalents to the provisions for withdrawal of a proposal to vary or terminate a debt agreement contained in 185 MD and 185 PD of the new legislation.

14. Varying a Debt Agreement

A debtor or creditor who is a party to a debt agreement may set about varying a debt agreement by giving the Official Receiver a written proposal to vary the agreement. The proposal must be in the approved form, and accompanied by an explanatory statement in the approved form: (s. 185M (1)).

The Official Receiver must process this proposal, which means the Official Receiver circulates the proposal and explanatory statement to the creditors and a request that they advise in writing if they wish to accept it, and tell them of the person to whom they should reply and the deadline for replying. (s. 185 MA). The provisions of 185MA relating to varying a debt agreement have similar requirements relating to ensuring debt agreements are limited to a total duration of three years, or five years if the debtor is a home-owner, and affordability, as are described in paragraphs 4 to 8 above in relation to formation of debt agreements.

If the proposal to vary the agreement is accepted by a majority in value of the creditors who reply before the deadline, then the debt agreement is varied accordingly: (s. 185 MC).

14.1 Withdrawal of Proposal to Vary Debt Agreement

In the interval between the giving of a proposal to vary a debt agreement, and that proposal being accepted by the creditors, the proposal may be withdrawn by the Official Receiver. The Official Receiver may do this if it becomes evident that the explanatory statement put forward with the proposal omitted something significant, or was incorrect in a significant way. If the Official Receiver makes a declaration that the proposal is withdrawn, written notice of this, and the reasons for it, must given to the debtor and affected creditors. They may apply to the AAT for a review of that decision. (s. 185 MD)

15. Ending a Debt Agreement

a) By Completion - A debt agreement ends when all of the obligations under it have been discharged: s.185 N (1). If a debt agreement ends in this way and there is some superfluous property left that was not required to be distributed, that superfluous property reverts to the debtor: s. 185 N (2). The Official Receiver is required to give the debtor a certificate stating that the debt agreement is ended: s. 185 N (3). As noted above, a debt agreement will automatically terminate after six months default in payments. This is applicable only to debt agreements proposed on or after 1 July 2007.

b) By Proposal - Just as a debt agreement can be varied by a proposal put forward by the debtor or a creditor who is part of it, so also can a debt agreement be terminated by a proposal: s. 185 P. The process is similar to that outlined above for variation. A written proposal to terminate and an explanatory statement is given to the Official Receiver, who must process this proposal by circulating it to the affected creditors in a way similar to that for varying a debt agreement. A decision is made by a majority in value of affected creditors who reply before the deadline: (s. 185 PC).

The proposal to terminate a debt agreement can be withdrawn by the Official Receiver in a way similar to that applicable to withdrawing a proposal to vary a debt agreement (s. 195 PD).

c) By The Federal Court - A debtor, a creditor or the Official Receiver may apply to the Federal Court or the Federal Circuit Court for an order terminating a debt agreement: s. 185 Q (1). A creditor making an application of this sort can also, at the same time, apply to the Court for a sequestration order: s. 185 Q (2). If a creditor does this, the Court can both terminate the debt agreement, and declare the debtor bankrupt in the same proceeding: s 185 Q (5). This possibility should be drawn to the attention of a debtor who has very strong reasons for wishing not to become bankrupt.

A Court can make an order terminating a debt agreement if it is satisfied:

* that the debtor has failed to carry out a term of the agreement, and it is in the creditor's interests to terminate the agreement; or

* that carrying out the agreement would cause injustice or undue delay to the creditors or the debtor; or

* that for any other reason the debt agreement should be terminated, and it is in the creditors' interests to terminate it.

Similar provisions apply to the estate of a debtor who has died (s. 185 Q). See 5.7 of this paper for more detail.

15.1 Automatic Termination

As set out in 5.1 above, debt agreements entered into on or after 1 July 2007 automatically terminate if there is a six month default. This does not apply to debt agreements entered into before that date. (s. 185 QA).

15.2 Choosing a Mode of Termination

It is very common for debtors who enter a debt agreement to encounter difficulty in making payments as time goes by. This may be because of an adverse change in their circumstances, or may be due to the fact that the original calculations used to set the payment rate were unduly optimistic. If the debtor does not wish to go on, for example by proposing a varied agreement with lower payments, but prefers to become bankrupt the question then arises of which course is best.

The planners of the legislative scheme envisaged that a debtor experiencing difficulty in meeting payments required under a debt agreement would either propose a variation to a lower payment, or propose a termination. However, it seems in practice that many debtors who encounter difficulty making the payments become disenchanted with the debt agreement, and decide bankruptcy may be easier and cheaper. For these debtors, the best mode is to cease making payments, and allow the automatic default provisions to operate. This gives the debtor a brief respite between making payments under the debt agreement and becoming bankrupt, while they still enjoy the protection from creditors enforcement action which the debt agreement gives them. This will usually be the cheapest and simplest course of action, and it is worth considering.

If debtors contact the administrator and say they are experiencing difficulty in making the payments, the administrator may well discuss varying the debt agreement, or putting forward a proposal to terminate it. The disadvantage for the debtor of proceeding this way is that the administrator is entitled to charge for its services, and circulating a proposal to terminate the debt agreement may bring it to an end faster than letting the six-month default run its course. This reduces the interval the debtor has between ceasing payments under the debt agreement, and becoming bankrupt.

16. Death and Debt Agreements

The general picture is that death of a debtor does not, of itself, bring a debt agreement to an end.

Part IX of the Bankruptcy Act, which relates to debt agreements, does not make express provision for the death of a debtor in a debt agreement, however the Act envisages that a debt agreement will go on despite the death of the debtor.

This is notable in sections relating to voiding and terminating debt agreements. Section 185T of the Act provides that if a debt agreement or the accompanying statement of affairs was not in compliance with the Act, the Official Receiver, a creditor, the debtor or the debtor's personal representative if the debtor has died can apply to the Court for an order that the debt agreement is void.

Section 185P of the Act provides that a creditor, the debtor or the debtor's personal representative if the debtor has died may give the Official Receiver a written proposal to terminate the debt agreement.

The implication of these sections is that if the debtor has died, the personal representative can deal with issues arising from the debt agreement.

16.1 Continuing a Debt Agreement After the Death of a Debtor

In some circumstances it may be desirable, from the point of view of the debtor's family, to continue with the debt agreement even if the debtor dies. For example, if the debt agreement is complied with, fully paid out and completed, then there may be more property available for the debtor's family than would be the case if the debt agreement came to an end, and a creditor sought to have the debtor's estate wound up as an insolvent deceased estate under Part X1 of the Act.

The Act specifically envisages that a deceased debtor's personal representative may carry out the debt agreement: section 185Q (4) (a). While the debt agreement remains in force, creditors are very limited in what they can do (section 185K).

16.2 Terminating a Debt Agreement After the Death of a Debtor

If a debtor in a debt agreement dies, the executor or administrator of the debtor's deceased estate may conclude that they cannot go on with the debt agreement. If, for example, the debtor was working and making regular payments from income, it may well not be possible for the regular payments to continue. In those circumstances, the executor or administrator may decide to do nothing. This will mean that a three-month default and a six month default will occur, and the debt agreement will then be terminated by the Official Receiver (section 185QA).

17. Comparison With Bankruptcy

For a debtor with a very low income, no property other than protected property, and no particular future financial prospects, bankruptcy is quicker, easier and does not require anything to be given to creditors. There are no filing fees on a debtor's bankruptcy petition.

For a debtor who is relatively young and with good financial prospects, or a debtor whose work may be adversely affected or ended by bankruptcy, debt agreements are attractive. The extra time and effort, giving to creditors income and property otherwise protected is justified by the benefits of not being bankrupt.

One very important difference between bankruptcy and debt agreements is that once a debt agreement is in place and the debtor is making payments regularly in accordance with it, it is not likely to be revisited if a debtors' financial situation improves substantially. If, for example, the debtors' income improves, the debtor is not re-assessed, as happens in bankruptcy. If the debtor in a debt agreement received a windfall such as a lottery win or inheritance, this does not vest in the administrator. There is a theoretical possibility that if the creditors knew of a major change in the debtors' circumstances, they could apply to a Federal Court to terminate the debt agreement (s. 185 Q (4) (c)), or could propose a variation to the Official Receiver (s. 185 M (1)). This may be a realistic possibility if the debtor is known personally to the creditors, but is less likely in the case of a debtor whose creditors are major financial corporations based in another state.

For those debtors in between these clear positions, it may be useful to propose a debt agreement which is not too onerous. If the debt agreement proposal is rejected they could become bankrupt, and leave an interval for creditors to give up hope, then propose a composition under section 73 which could produce an annulment. If that is refused, a debtor can allow a further lapse of time, and then if finances improve, arrange an annulment by payment out in full under section 153 A.

However some categories of employment, such as service in the Police Force, may be adversely affected by a debt agreement or a personal insolvency arrangement. Further information about the effect on employment of entering a debt agreement can be found in the item 'Bankruptcy and Employment' January 2016 on the FCAWA website. Counsellors should always point out to debtors considering their alternatives the importance of finding out the effect of the alternatives on their employment.

A number of stages in the debt agreement process constitute an act of bankruptcy: (s. 40 (1) (ha) – (hd)). The making of a proposal for a debt agreement and the making of a debt agreement, are recorded in the National Personal Insolvency Index: s. 185 F. (Regulation 13.03 and Schedule 8). If debtors do not wish to become bankrupt, or to have their insolvency made publicly known, they should be cautioned about the implications of a debt agreement.

The shorter time for which information relating to debt agreements is retained on NPII, in comparison with bankruptcy information, will attract some debtors to debt agreements rather than bankruptcy.

18. Effect on Credit History

Credit reporting information relating to debt agreements can be retained by a credit reporting body for varying periods of time, depending on whether the debt agreement ends by being fully paid in accordance with the agreement, or otherwise.

If a debt agreement ends by being paid out in full, the retention period for which the information can be held by a credit reporting body is the later of:

* Five years from the date the agreement is made, or
* The day on which the debt agreement ends.

If a debt agreement ends otherwise, for example after a six-month default, the retention period for which information can be held about it in the records of the credit reporting body is the later of:

* Five years from the date the agreement is made, or
* The period of two years starting on the day the agreement was terminated under the Bankruptcy Act (6).

18.1 NPII Records

The retention period for information on the National Personal Insolvency Index relating to debt agreements is limited, in comparison with NPII records relating to bankruptcy, which are permanent. Information about debt agreements is removed from NPII one month after the follow days:

* if a debt agreement ends by completion of all obligations it creates: the later of five years from the date the debt agreement was made, or the day on which it ends;

* if a debt agreement ends by acceptance of a termination proposal, by court order, by a six-month default or the bankruptcy of the debtor: the later of five years from the date the debt agreement was made, or two years after the debt agreement is terminated;

* if a Court makes an order declaring all of a debt agreement void; the later of five years from the date the debt agreement was made, or two years after the court order is made (7).

Information about debt agreement proposals is removed from NPII within one year of any of the following occurring:

* the proposal is withdrawn;
* the proposal is not accepted by the creditors;
* the acceptance of the proposal for processing is cancelled;
* the proposal lapses because no replies are received from creditors, or the debtor dies before a debt agreement is made (8).

NOTES:

1. Bankruptcy Legislation Amendment Act 1996 (Commonwealth)
2. Bankruptcy Legislation Amendment (Debt Agreements) Act 2007
3. Bankruptcy Regulations 1996 - Regulation 13.03 and Schedule 8

4. Bankruptcy (Estate Charges) Act 1997, the Bankruptcy (Estate Charges) (Amount of Charge Payable) Determination 2015 and Bankruptcy (Fees and Remuneration) Determination 2015
5. Bankruptcy Legislation Amendment (Debt Agreement) Act 2007
   Schedule 2 paragraph 80
6. Privacy Act 1988 (Commonwealth) s. 20 X
7. Bankruptcy Regulation 13.05A
8. Bankruptcy Regulation 13.05B

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CASE STUDY - NO. 1

DEBT AGREEMENTS

Percy has come to see you about the possibility of entering a debt agreement. He introduces his friend Edward, who Percy plans to appoint as administrator of his debt agreement.

Edward is very willing to share his knowledge. He says you learn more about insolvency being broke for ten minutes than you learn reading about the subject for ten years. Edward explains that he had a few annoying creditors back in 2004 when he was living in Melbourne. Debt agreements were quite a new thing then, so he decided to give it a try. He signed up, and made a few payments. However, making the payments interfered with his ability to save up for his overseas trip. He stopped making payments on the debt agreement in September 2004. By the time he got to March 2005, when he was planning to fly to London, he was still a bit short of the sum he need for his travels. He went to his bank in Melbourne and got a cash advance up to his credit card limit. He took with him letters from his debt agreement administrator and his bank, and wrote to them from London. As far as Edward is aware, his debt agreement administrator and his bank think he is still in London.

Shortly before he left London in February 2014, Edward arranged a check of his credit report in Australia. It made no reference to his debt agreement, or any debt to his bank. Edward believes the fact that his credit report does not show the debt agreement means that it must be finished.

Edward asks:

1. Does the fact that his credit report makes no reference to his debt agreement mean that the debt agreement is ended?
2. Are there other ways of finding out what happened to the debt agreement? If so:

3. Which way is most reliable?

4. Which way is least likely to have undesirable consequences?

5. Is it important for Edward to find out if his debt agreement still exists? If so, why? If not, why not?

Before coming to see you, Edward did some research. He did not find much information about debt agreements, but he found some material about bankruptcy. He read that if you are a bankrupt, it is an offence to leave Australia without your trustee's permission, and it is an offence to borrow more than $5,387 without disclosing your bankruptcy. When Edward left Australia in 2005 he did not tell his administrator he was going, nor did he tell the bank when he got the cash advance of $6,000 that he was in a debt agreement. Edward asks:

6. Was it an offence for him to leave Australia in 2005 without the permission of his debt agreement administrator?

7. Was it an offence for Edward to borrow $6,000 in 2005 without telling his bank that he was a debtor in a debt agreement?

Since Edward has been back in Australia he has lived in Perth. He has used a different bank from the one he dealt with up to 2005. He is concerned that if he deals with his old bank it may wish to sue him for the debt he incurred in 2005, or take some other action against him. He asks:

8. Can his old bank sue him now for the debt he incurred in 2005?

9. Is the debt incurred in 2005 part of his debt agreement?

10. Can the bank take any other action against him now in relation to the debt he incurred in 2005?

At this point Percy becomes rather impatient. He made this appointment for himself, and invited Edward only because, up to date, Edward has been his trusted financial adviser. Percy is a real estate sales person, who holds a real estate sales person's licence. He has been doing very well in the post few years, however the downturn in the real estate market recently has made things rather difficult. He has had to keep using his credit card, to keep up appearances, but recently the bank with whom he has dealt for many years has frozen his account, because he has exceeded his credit limit. Very quickly he arranged a new credit card with a new bank, before the bad news from the old bank got out. However, the old bank has started to get quite unpleasant about his debt to it, and Percy feels he has to do something to suppress news about his debt situation. Edward made some very discreet inquiries, and learned that bankruptcy may have an adverse effect on Percy's work status. Edward has suggested exploring the option of a debt agreement. Percy asks:

11. Would entering a debt agreement have an adverse effect on Percy's career in real estate?

12. Do you know the answer to question 11? If not, how would you deal with Percy's question?

You ask Percy's income. Percy leans forward and asks in a quiet voice whether this is confidential. He asks that you do not write down his answer. He says that his take home after tax income is actually $6,000 per month, or $72,000 per annum. However, he does have the benefit of a mobility package arranged by his employer worth $30,000 per annum. This has been cleverly arranged so that it is not part of his taxable income. It puts him in the driver's seat of a BMW with hands-free phone and printer.

13. Does Percy's income fit within the eligibility criteria for a debt agreement?

Percy says that his wife Ella has a small part-time job working in a child care centre at which she ears $25,000 per annum.

Percy asks:

14. Will Ella's income affect his eligibility to enter a debt agreement?

Ella and Percy have a one year old child named Egbert, who is completely dependent on them. Percy feels that Egbert should pull his weight in some way. Percy asks:

15. Does the fact that Egbert is a dependent on Percy and Ella affect Percy's eligibility to enter a debt agreement?

Percy leans forward and asks Edward to close the blinds to your office. Percy says in a conspiratorial whisper that he has a child support liability of $6,000 per annum that neither Ella nor his employer knows about. Percy asks:

16. Will his debt agreement income eligibility be affected by his child support liability?

Percy says that, when all is said and done, his financial reputation is really the only thing that matters. Percy asks:

17. If he enters a debt agreement will this show up on his credit report?

Percy says that a man in his position cannot, realistically, curtail his expenditure or incurring of debt just because things in his industry are a bit quiet. He asks:

18. Will entering a debt agreement limit his capacity to get further credit?

Percy says that, from time to time, the real estate agency for which he works conducts training events in Bali, to keep down the overhead costs of the event. He asks:

19. Would entering a debt agreement limit his ability to travel overseas?

Percy announces that he does not intend to be a real estate sales person all his life. He plans quite soon to establish his own real estate company, of which he will be managing director. He asks:

20. Would entering a debt agreement affect his ability to be a managing company director?

Edward has been growing a bit impatient with all this focus on Percy. He says the real focus of his conversation should be his eligibility to be the administrator of Percy's debt agreement. Edward asks:

21. Is he eligible to be the administrator of any debt agreement Percy may decide to enter?

Ian Macdonald
June 2020

CASE STUDY – No. 2

DEBT AGREEMENTS

Penny is coming back to see you this afternoon. You have a comprehensive file note of your discussion with her, and she has sent you a list of questions she wants to ask you this afternoon. Her essential problem is that she is financially over committed. She admits she has a spending problem. She says that she has times when she is full of confidence, optimistic, the world is her friend and nothing is a problem. Then at other times her confidence and optimism desert her, and she has trouble getting out of bed and going to work, let alone doing anything adventurous. Penny is 29 years of age, single, and with no specific work qualifications, and no family responsibilities. Her questions revolve around a number of issues. The first is her work.

WORK

Penny has been employed as a public servant since she completed school. Her department is now downsizing due to budgetary constraints, and she is eligible for a retrenchment package of $55,000 which is her annual salary. She find it difficult to decide whether or not to accept that offer. The lump sum would be enough to pay off her credit cards, but she would miss the regular salary, and would be entirely dependent on her other job at the gym.

THE GYM

Penny has part-time work at her local gym. She is officially classified as an instructor, but her main task is to sign up new members. She gets a commission for each new member she signs up, and sometimes the commissions have been enough to help her pay all her bills. However, when they haven't she has had to rely on her credit cards to pay her rent.

THE RENT

A year ago she was in a very positive mood, and decided to rent a flat with ocean views to cheer herself up. The flat is in a very sought-after area, and the rent is $600 per week. The agent suggested she sign a three-year lease, to give herself security of tenure and peace of mind. As she is one year into the lease, she has two years to go before she can leave. She has calculated that she will need to pay $62,400 over the remainder of the lease. At one point when she was low in confidence she made inquiries about getting out of the lease, but the agent said the owner never lets anyone out of a lease, no matter what happens.

THE CAR

For some years Penny had pictures of luxury European cars in scenic surroundings on her walls to inspire her to greater things. Two years ago she went into a show-room just to have a look, and sat in one. She told a salesman that she was just looking, because she could not possibly afford one. The salesman told her he could get her into the car for less than $200 per week. This sounded very appealing. She left the show-room in her new car, with the contract on the seat beside her. It requires her to pay $800 per month for four years, with a balloon payment of $28,000 at the end of the contract. She is halfway though the contract now. She has calculated that $800 per month for the next two years will cost her $19,200, and with the balloon payment she is committed to pay a total of $47,200. She has checked a number car sales websites, and the car is currently worth $25,000. Checking on four year old models of the same car, she thinks it will be worth $18,000 when the contract is finished. The car is security for the credit contract.

THE CARDS

Penny has a credit card which has reached its maximum credit limit of $20,000. Penny says she has been a little bit naughty in getting her credit limit up to $20,000. She really needed the higher credit limit to manager her expenses. She got the higher limit by filling out forms, telling the bank her income was $80,000 per annum. She says this was sort of true, because the gym was a bit behind in paying her and her best friend Kim who also works as an instructor and salesperson, and she and Kim threatened the gym that if they were not paid what they were owed they would both walk, and take with them the customers they had signed up. The manager was a bit panicked by this, and gave both of them $5,000. Penny calculated that if she and Kim pressured the manager like that every couple of months she would earn $30,000 per annum from the gym, which would take her income to $85,000 per annum. In the light of that, she reasoned guessing her income at $80,000 was not too far out. In fact, her taxable income last year was $65,000, and she estimates this current year her income will be $70,000 if she does not resign from the public service.

AN INHERITANCE

In response to your question about possible windfalls which may come her way, Penny says it is possible that her grandmother may die and leave her a substantial sum, though she hopes grandma does not die any time soon, because they get on very well. However it is possible, because grandma is a little like Penny in personality. Every so often she gets sick of taking her prescription medicine. She throws the tablets out the window, and rings the doctor and tells him he is a quack. If grandma did die, Penny says that grandma's pastoral station would be sold, and even if she only got the same amount as the other family members, she would receive $750,000. She suspects, from things grandma has said, that she may well receive a larger share. She is weighing up the alternatives of bankruptcy, a debt agreement or toughing it out.

QUESTIONS

The questions Penny wants you to answer this afternoon are:

1. She just cannot make up her mind whether to take the $55,000 redundancy package, or not. Getting $55,000 would enable her to pay off her credit card, which is the most pressing debt, however she would miss the salary coming in. She asks: what would **you** do?

2. If Penny became bankrupt, and then received a lump sum of $55,000 while she was bankrupt, what would happen to the $55,000?

3. If Penny entered a debt agreement, and then received a lump sum of $55,000 while she was in the debt agreement, what would happen to the $55,000?

4. If Penny became bankrupt now, what would happen to her obligation under the lease on her flat to pay $62,400 over the next two years?

5. If Penny entered a debt agreement now, what would happen to her obligation under the lease on her flat to pay $62,400 over the next two years?

6. If Penny became bankrupt now, what would her options be in regard to the car contract? How much would the debt in the bankruptcy be?

7. If Penny entered a debt agreement now, what would her options be in regard to the car contract? How much would the debt in the debt agreement be?

8. If Penny became bankrupt now, are her actions in increasing her credit card limit likely to create any problems?

9. If Penny entered a debt agreement now, are her actions in increasing her credit card limit likely to create any problems?

10. If Penny became bankrupt now, and then grandma died and left her $750,000 while she was still bankrupt, what would happen to the money?

11. If Penny entered a debt agreement now, and then grandma died and left her $750,000 which she was still in the debt agreement, what would happen to the money?

12. Penny is concerned about her credit history shown in her credit information file. What would be shown:

12.1 - if she became bankrupt?

12.2 - if she entered a debt agreement?

13. In preparation for your interview with Penny, you have downloaded the current indexed amounts from the AFSA website. You see the current limit for unsecured debts for eligibility to enter a debt agreement is $105,086.80. Is Penny eligible under this test to enter a debt agreement?

14. Are there any other issues that come to your mind after reviewing the material you have about Penny?

Ian Macdonald
June 2020