

Credit, Debt & Bankruptcy



Worker Advice Line: 9602 3326
Consumer Advice Line: 9629 6300
Rural access: 1300 881 020
Email: advice@consumeraction.org.au

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1 Defences to actions for debt based in contract

A selection of defences which commonly arise in consumer disputes are discussed below. It may also be relevant to consider specific legislative provisions such as those governing:

- door to door sales agreements: *Fair Trading Act 1999* (Vic), ss 60-67,
- consumer credit contracts: *Consumer Credit Code* (www.creditcode.gov.au),
- agreements for the sale of a motor vehicle: *Motor Car Traders Act 1986* (Vic), and
- finance broking agreements: *Consumer Credit (Victoria) Act 1995*, Part IVA.

1.1 Minority

- Supreme Court Act 1986* (Vic), ss 49-51
- Goods Act 1958* (Vic), s 7

The common law rule is that a minor – a person under the age of 18 years – is not bound by a contract. However, this rule does not apply where the contract is for the supply of *necessaries*, ie necessary goods or services. The scope of the term ‘necessaries’ is relative to the social position and means of the minor, the minor’s age and occupation and the type of goods which someone in the minor’s situation might reasonably have been expected to possess. The concept is not limited to the bare essentials of life. See s 7 of the *Goods Act 1958* (Vic).

Furthermore, s 49 of the *Supreme Court Act 1986* (Vic) provides that contracts for the repayment of money lent or to be lent which are entered into by a minor are void, even if the funds of the loan were to be used to purchase necessities.

1.2 Mental disability and intoxication

- Goods Act 1958* (Vic), s 7

At common law, a person will be able to avoid their liabilities under a contract if they can show that:

- they were suffering from such a degree of mental disability or intoxication at the time of making the contract that they were incapable of understanding that contract; and
- the other party to the contract was aware, or ought to have been aware, of this.

However, note that the debtor will generally be required to make restitution of any benefit he or she received.

1.3 Limitation of actions

- *Limitation of Actions Act 1958*, ss 5 & 20

Actions founded on contract and tort may not be brought after the expiration of six years from the date on which the cause of action accrued: s 5

Actions to recover debts secured over either real or personal property have a statutory limitation of fifteen years: s 20

If a court order has been made the time period is 15 years from the date of the order.

The limitation period can be extended in certain circumstances. Importantly, the period will recommence if a debt is acknowledged in writing by the debtor or his or her authorised agent, or if the debtor makes a payment towards the debt.

1.4 Unfair contract terms

- *Fair Trading Act 1999 (Vic)*, part 2B
- *Director of Consumer Affairs v AAPT Ltd* (Civil Claims) [2006] VCAT 1493
- *Jetstar Airways Pty Ltd v Free* [2008] VSC 539

Part 2B is a relatively new provision which makes radical changes to the way in which the concepts of 'unfairness' and 'unconscionability' are applied to contracts. Particularly, it allows a contract to be adjudged unfair based primarily upon considerations of *substantive*, rather than *procedural*, unconscionability.

Under Part 2B, a term in a consumer contract is to be regarded as unfair if, in all the circumstances, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer: s 32W.

Section 32X lists certain objects or effects of contractual terms which a court may take into account in determining whether a term is unfair, for example:

- a) permitting the supplier but not the consumer to avoid or limit performance of the contract;
- b) permitting the supplier but not the consumer to vary the terms of the contract.

An unfair term is void: s 32Y(1).

Part 2B applies to credit contracts entered into after 11 June 2009.

Trade Practices Amendment (Australian Consumer Law) Bill (No. 1) 2010 (Cth) introduces similar provisions, with notable changes, into the *Trade Practices Act 1974* (Cth). These provisions will come into operation on 1 July 2010.

1.5 Unconscionable conduct

- *Fair Trading Act 1999 (Vic)*, ss 7 & 8
- *Trade Practices Act 1974 (Cth)*, ss 51AA & 51AB
- *ASIC Act 1989*, ss 12CA & 12CB

A court may set aside contracts procured by unconscionable conduct. In consumer law, such unconscionable conduct ordinarily arises out of three factors:

- (1) the relationship between the parties which, to the knowledge of the trader, places the consumer at a special disadvantage vis-à-vis the trader;
- (2) the trader's unconscionable exploitation of the consumer's disadvantage; and
- (3) the consequent overbearing of the will of the consumer whereby the consumer is unable to make a worthwhile judgment as to what is in his or her best interests.

Examples of features giving rise to a situation of special disadvantage are famously set out in the judgment of Fullagar J in *Blomley v Ryan* (1956) 99 CLR 362 at 405.

Sections 51AA and 51AB of the *Trade Practices Act 1974* (Cth) enshrine these principles in statute, as do ss 7 and 8 of the *Fair Trading Act 1999* (Vic).

1.6 Misleading and deceptive conduct

- *Fair Trading Act 1999* (Vic), ss 9-13
- *Trade Practices Act 1974* (Cth), ss 52-53B
- *ASIC Act 1989*, ss 12DA-12DC

These provisions are extraordinarily wide in their application and should be considered in all contract disputes. Any circumstance in which a party has suffered loss as a result of another party's failure to tell the truth may give rise to a cause of action under misleading or deceptive conduct.

1.7 Negotiated settlement of disputes

The terms upon which a dispute may be settled are not limited by the technical legal remedies available to the parties. Terms of settlement are as much a product of strategy, commercial considerations and sometimes sheer chutzpah, as they are of legal argument. The following resolutions of debt disputes, either singly or in combination, are commonly obtained by advocates:

- a) payment of a lump sum representing a proportion of the total amount claimed;
- b) payment of a settlement sum by instalments;
- c) freezing interest charges on the outstanding amount while repayment arrangements are in place;
- d) if the debtor has no assets and on Centrelink benefits, wiping the debt entirely.

1.8 Consumer Credit (Victoria) Code (UCCC) and the National Consumer Credit Protection Act 2009 (Cth) (including the NCC)

Consumer Credit legislation offers a number of protections and remedies to consumers, including:

- a) a prohibition on interest rates exceeding 48% for a consumer credit contract and 30% for a mortgage: *Consumer Credit (Victoria) Act 1995* (Does not include fees. Will be subject to reform.)
- b) a protections against unjust establishment/early termination fees: s 72 UCCC/s 78 NCC
- c) a protection against unjust enforcement expenses: s 99 UCCC/s 107 NCC
- d) truth in lending/disclosure requirements, which may attract civil penalties: s15 of the UCCC/s 17 NCC. A civil penalty may result in waiver of interest and fees (and compensation for any loss). Raising systemic issues may lead to a better negotiated outcome.
- e) the power for a Court to reopen unjust contracts, including where a lender has overcommitted the debtor: s70 UCCC/s76 NCC

- f) the power for a Court to amend a contract on the grounds of hardship: s68 UCCC/s72 NCCC
- g) the power to rescind a credit contract where a linked sale contract is terminated or discharged, and hold a credit provider jointly and severally liable for the misrepresentations or breach of contract of a linked supplier: Part 7 of the UCCC/ Part 7 of the NCC

Consumer credit legislation is currently undergoing legislative reform. The *National Consumer Credit Protection Act 2009* (Cth) brings new requirements including:

- a) registration/licensing
- b) responsible lending requirements (generally commences 1 January 2011)
- c) further disclosure requirements - credit guides etc: (commences 1 January 2011)
- d) a prohibition on blackmail securities: s 50 NCC (NCC commences 1 July 2010)

It is important to determine at the outset whether the UCCC/NCC applies: s 6 & 11 UCCC/s 5 & s13 NCC

2 Debtor harassment

- *Fair Trading Act 1999* (Vic), s 21
- *Trade Practices Act 1974* (Cth), s 60
- *ASIC/ACCC Debt Collection Guidelines*
- *ACCC v McCaskey* [2000] FCA 103
- *Collection House v Taylor* [2004] VSC 49
- Harassing behaviour by a creditor or debt collector can be unlawful under s 21 of the *Fair Trading Act 1999*, and under s 60 of the *Trade Practices Act 1974*. According to the *ASIC/ACCC Debt Collection Guidelines* the following conduct may constitute undue harassment and coercion by a debt collector:
 - a) using abusive, threatening, offensive, obscene or discriminatory language;
 - b) using, or threatening to use, violence or physical force;
 - c) communication outside the hours of 7:30 am to 9:00 pm;
 - d) visiting a debtor's place of work;
 - e) disclosing personal information regarding the debtor to a third party;
 - f) making more than 3 unsolicited phone calls per week to a debtor;
 - g) communicating directly with a debtor after being advised that the debtor's representative is acting in the matter.

3 Judgment debt recovery

NB: These materials only consider civil procedure in the Magistrates' Court of Victoria.

- *Magistrates' Court Civil Procedure Rules 2009*, Orders 27 and 28
- *Magistrates' Court Act 1989*, s 111
- *Judgment Debt Recovery Act 1984*
- *Penalty Interest Rates Act 1983*

Where a court order is made in the Magistrates' Court of Victoria, a creditor may take further action to enforce the judgment debt. Interest on the debt will accrue from the date of the judgment under the *Penalty Interest Rates Act 1983*, which currently stands at 10.0%.

3.1 Oral examination

- *MC Rules*, r 27.12.1
- *Judgment Debt Recovery Act 1984*, ss 13-16

A judgment creditor may serve upon a judgment debtor a summons to appear in Court to be questioned about the debtor's financial position. The summons will be accompanied by a series of questions set out in Form 27CC under the *MC Rules*. These questions should be completed prior to attending the examination, which will be conducted by a Registrar, sometimes in the presence of the judgment creditor.

3.2 Instalment orders

- *JDRA*, ss 5-12

A judgment debtor or judgment creditor may apply to the Court for an order to pay a judgment debt by instalments. Such an order will be made *ex parte* in chambers but may be subject to an objection by either party.

While not subject to any formal policy, an order will usually not be made unless the debt – if less than \$10,000 – will be paid off within 3 years. Penalty interest on the debt will continue to accrue while the instalment order is in place.

If an instalment order is in place and is being complied with, or if a copy of an application for an instalment order has been served upon the judgment creditor, all other methods of enforcement of the judgment are blocked.

An instalment order will not be made without the consent of the judgment debtor where they are a recipient of social security benefits: *JDRA*, s 12.

3.3 Warrant to seize property

- *MC Rules*, r 27.09

A warrant to seize property is an order to the Sheriff to seize and sell goods belonging to the debtor unless the debtor pays the amount stated in the warrant. A debtor is entitled to refuse entry to the Sheriff. The Sheriff cannot seize any property which could not be taken from a bankrupt: see s 116 of the *Bankruptcy Act 1966*.

3.4 Attachment of earnings

- *MC Rules*, r 27.13
- *Magistrates' Court Act 1989*, s 111

A judgment creditor may apply to the Court for an order compelling a debtor's employer to deduct instalments from the debtor's salary and pay them to the creditor. Income received as a social security payment can not be subject to attachment.

It is an offence for an employer to dismiss or alter an employee's position due to an attachment of earnings order: *Magistrates' Court Act 1989*, s 111.

3.5 Attachment of debt

- *MC Rules, r 27.27*

A judgment creditor may apply to the Court for an order that a debt owed to the judgment debtor by a third party be paid directly to the creditor in satisfaction of the judgment debt. An order for attachment of debt is known as a garnishee order.

4 Credit reporting

- *Privacy Act 1988 (Cth), Part IIIA*
- *Credit Reporting Code of Conduct*

A credit report, or more technically, a credit information file, is information held by a credit reporting agency – private, non-government companies – regarding an individual or company's credit history. This credit history will encompass loan applications, overdue debts, court judgments and other information deemed relevant to credit worthiness. Credit information files are checked by lenders when assessing applications for credit. Lenders will also give information to a credit reporting agency to include upon a credit information file.

An individual can get a copy of their file free of charge by writing to Veda Advantage at the address below. Dun & Bradstreet also offer credit reporting services to consumer lenders.

The following information can be placed on a credit information file:

- details of all credit applications made to credit providers;
- defaults;
- serious credit infringements (noted as "clearout");
- court judgments;
- bankruptcy.

A default listing can be made if:

- the consumer is 60 or more days in arrears, and
- the creditor has demanded the amount outstanding, and
- the contract or other document has warned the creditor that they will be listed if in default for more than 60 days.

Complaints about credit reporting may be raised with Veda Advantage (www.mycreditfile.com.au) and with the creditor in question. The Financial Ombudsman Service provides a forum for dispute resolution if the matter is unresolved: www.fos.org.au.

5 Bankruptcy

- *Bankruptcy Act 1966*

The *Bankruptcy Act 1966* (Cth) provides a mechanism whereby, once a debtor is declared bankrupt:

- with some exceptions, creditors are prevented from pursuing the bankrupt for payment: s 58(3);
- certain restrictions are placed on the bankrupt's activities, including access to credit and employment opportunities;

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- c) a trustee is assigned to the bankrupt's matter;
- d) the bankrupt's property (with exceptions such as household furniture, personal injuries compensation and certain vehicles) is made available, through the trustee, for distribution amongst creditors: ss 116 & 109;
- e) the bankrupt's conduct and affairs generally may be the subject of investigation and/or examination, although this would be unlikely to happen in most non-business bankruptcies.

Bankruptcy usually lasts for three years, but can be extended if a creditor objects to the bankrupt's discharge on the grounds that the debtor is not co-operative or has committed an offence under the Act.

5.1 Creditors' Petitions

- *Bankruptcy Act 1966*, Part IV, Divisions 1 & 2

Before a creditor can present a valid petition, they must be owed one or more debts by a debtor which total \$2,000 or more, and the debtor must have committed an act of bankruptcy as defined in Division 1 of Part IV of the *Bankruptcy Act 1966*.

Alternatively, two or more creditors whose combined debts are \$2,000 or more may present a combined petition against the debtor: s 44. Note that the amount upon which a debtor may be bankrupted is under review.

In most cases, the creditor will obtain a court judgment before starting the bankruptcy process. Once the creditor obtains a court judgment, they will then apply to the Official Receiver for the issue of a bankruptcy notice. The bankruptcy notice will require the debtor to pay the debt within 21 days (or another time period if the court has ordered). If the debtor does not pay within the time period, they will have committed an act of bankruptcy and the creditor will then be able to file a creditor's petition. There are other acts of bankruptcy which a creditor can use to base a petition on, however creditors rarely do this, preferring to use the failure to comply with a bankruptcy notice as the act of bankruptcy.

5.2 Debtors' Petitions

- *Bankruptcy Act 1966*, Part IV, Division 3

There is no minimum amount that has to be owed before a debtor files a petition for bankruptcy. A debtor wishing to file his or her own petition must complete a debtor's petition for bankruptcy and a statement of affairs. The debtor can hand deliver these to the Official Receiver at the Office of ITSA or send them by post. When the Official Receiver accepts the petition, and allocates a bankruptcy number, the debtor becomes bankrupt.

The Official Receiver may refuse a debtor's petition if it appears that the debtor is misusing the bankruptcy process, and would be able to pay his or her debts if given time.

Once the debtor is bankrupt, the trustee may require an interview and may provide the bankrupt with certain forms to complete. Consumer bankrupts with no assets are not usually required to attend a trustee's office for an interview. The trustee may ask for copies of contracts and documents relating to the debts, and may require the bankrupt to hand over his or her passport.

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It is generally best for the debtor to see a financial counsellor before filing a debtor's petition.

5.3 Provable debts

- *Bankruptcy Act 1966*, ss 82, 153

After bankruptcy a bankrupt is released from *most* provable debts. A bankrupt is not released from any non-provable debts. The term 'provable' means that a creditor can lodge a proof of debt or a claim to be paid, and then be paid a proportion of the money (if any) raised by the sale of the bankrupt's property.

The bankrupt is not released from a provable debt if it was incurred by fraud or is a debt under a maintenance agreement order, or in relation to a bond or to certain other criminal law penalties: s153.

The main categories of debts which are *not* provable are: debts incurred after the date of bankruptcy, court fines (including *Infringement Act* fines) and unliquidated damages.

5.4 Income contributions

- *Bankruptcy Act 1966*, Part VI, Division 4B

It is compulsory for a bankrupt to pay half of net income above the *base income threshold* to the trustee. The base income threshold at 28 April 2010 for an individual with no dependants was \$ \$44 189.60 (indexed) per year (after tax).

5.5 Divisible property

- *Bankruptcy Act 1966*, s 116
- *Bankruptcy Regulations 1996*, regs 6.03 & 6.04

The general rule is that all property owned by the bankrupt at the time of the bankruptcy, or acquired during the bankruptcy, vests in the trustee. However, property which the trustee cannot take from a bankrupt includes the following:

- necessary household property;
- property the bankrupt uses to earn income, not exceeding in total \$3 350.00 (indexed) in value;
- a motor vehicle which does not exceed the value of \$6 700.00 (indexed). If the vehicle is worth more than this, the trustee may take the vehicle and refund the bankrupt;
- the interest of a bankrupt in a regulated superannuation fund;
- the proceeds of certain damages claims for compensation (generally for pain and suffering only);
- policies of life insurance or endowment assurance; and
- the amount of money a bankrupt holds in an RSA (retirement savings account, as defined in the *Retirement Savings Account Act*), and any payment to a bankrupt from an RSA received on or after the date of bankruptcy if the payment is not a pension.

Any divisible property acquired during bankruptcy (unless exempt under s116) forms part of the estate and may be seized by the trustee.

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5.6 Offences

- *Bankruptcy Act 1966*, Part XIV

Offences under the *Bankruptcy Act* may be committed both during the period of bankruptcy and in the period leading up to bankruptcy, and include:

- a) materially contributing to insolvency by gambling, or rash and hazardous speculation;
- b) obtaining, after the date of bankruptcy, credit of \$4 806.00 (indexed) or more without disclosure of the bankruptcy (ss 269, 304A);
- c) leaving Australia with intent to defeat creditors, or without obtaining a court order where required;
- d) incurring, within two years before the date of bankruptcy, a debt of \$500 or more without any reasonable expectation of repayment (ss 265(8), 304A);
- e) obtaining credit or property by fraud after bankruptcy;
- f) disposing of property before bankruptcy with intent to defraud creditors; and
- g) failing to deliver up property divisible among creditors.

It is rare for bankrupts to be prosecuted for such offences.

5.7 Debt Agreements

- *Bankruptcy Act 1966*, Part IX

Under Part IX of the Act, a debtor who earns under \$66 284.40 (indexed) and has unsecured debts of less than \$88 379.20 (indexed), can put a written proposal for dealing with their debts and creditors to the Official Trustee.

A financial counsellor will be able to help a debtor to draft a proposal that offers a compromised payment arrangement to creditors. If the Official Trustee approves the proposal and the debtor is eligible to enter into a debt agreement, the Official Trustee will then ask the creditors to respond to the proposal. If a majority in value of the creditors accept it, then the proposal becomes binding on all creditors.

An industry has grown up which can charge high fees for assisting people to put Part IX proposals to their creditors, and such proposals are being promoted as a preferable alternative to bankruptcy, but this may not always be so. Consider whether bankruptcy or an informal arrangement with creditors is more appropriate.

Part IX agreements, like bankruptcy, will result in a listing on your credit report for 7 years and appear on the NPIL.

Information regarding bankruptcy can be obtained from the government regulator, the Insolvency & Trustee Service Australia: www.itsa.gov.au.

6 Financial counsellors

Financial counsellors can provide assistance and advocacy to people in financial difficulties, and are particularly experienced in negotiating settlements with creditors in debt matters. Clients can be referred to a financial counsellor in their area by calling Consumer Affairs Victoria on 1300 55 81 81 and the Financial and Consumer Rights Council (<http://www.fcrc.org.au>).