



18th National Conference, Insolvency Practitioners' Association
Sofitel Hotel, Brisbane
Thursday 2 June 2011, 9:00am
Opening Address

The Hon Paul de Jersey AC
Chief Justice

I am grateful to have been given the opportunity to deliver the opening address at this, the Insolvency Practitioners' Association 18th National Conference, and I congratulate the IPA for its initiative in convening the conferences over the years.

The papers to be presented at this conference will canvas a number of issues highly relevant to practitioners, such as the imminent reform of Personal Property Security laws, regulation of the profession and the IPA Code of Professional Practice.

The overall subject for discussion, 'Navigating the Recovery', is very close to the hearts of all of those throughout Queensland, New South Wales and Victoria who have been afflicted by recent floods, and we are pleased to welcome such a large group of delegates to Brisbane for discussion on these issues. Although I believe the title of the conference refers principally to the economic recovery following the global financial crisis, it is also fitting to discuss how the recent natural disasters have affected Australia's recovery.

As such, today I will speak of the impact of the floods on levels of insolvency, and whether this is an appropriate coping mechanism for flood victims.

As everyone is aware, in January this year throughout eastern Australia, and particularly in Queensland, a large number of residences, businesses and rural properties were inundated by pervasive, and in some cases violent, floodwater.

This natural disaster followed after a devastating global man-made financial disaster, which had already generated heavy financial pressure for many individuals and

* I have been greatly assisted in the preparation of this address by my associate, Ms Stacey McEvoy



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businesses. Even before the floods, the Insolvency and Trustee Service Australia bankruptcy statistics for the December 2010 quarter showed Queenslanders turning to insolvency at a higher rate than in other Australian states¹.

My sense was that the frequency of recourse by creditors to securities increased over the last months of last year. The inclusion in credit agreements of provisions charging the borrower's real estate with the repayment of the debt has become commonplace, and with apparently increasing frequency, creditors are enforcing those charging provisions. Sometimes this results in the sale of a family home to aid recovery of disproportionately small amounts – even less for example than \$10,000, although the Court's general practice is to stay the operation of a sale order for a period to give the debtor one last chance to find the money. I am told that the money very often cannot be found because the debtor has in reality reached the end of the line. As I said, these enforcements appeared to me to increase in the latter part of last year.

Allowing also now for natural disaster, the number of bankruptcy petitions is therefore widely expected to rise over coming months². Due to the lag between the occurrence of the crisis and the decision to enter bankruptcy, it is difficult at this stage to estimate the impact of the floods on the number of bankruptcies, however the US experience in this area may offer some guidance. A study of 18 hurricanes which hit the US between 1980 and 2004 reflected an increase in bankruptcy filing rates of about 50% even in the following 12 to 30 months³, with the largest increases occurring in the third year post-disaster.

The lag in filings may be attributable to the fact that there are short-term increases in economic activity following the destruction, as extensive repairs and rebuilding occur with the assistance of widespread and generous government aid. It also takes time for normal

¹ Business related bankruptcies in Queensland – 479; NSW – 394; Victoria – 185; WA – 100. Personal bankruptcies in Queensland – 1196; NSW – 1602; Victoria – 905; WA – 286.

² The Sunday Mail, *Deluged, Belted, Bankrupt*, 6 February 2011; The Sunday Mail, *Flood victims face losing homes*, 29 January 2011.

³ R Lawless, 'Bankruptcy Filing Rates after a Major Hurricane' (2005) 6 Nev LJ 7, 13ff



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economic activity, including by creditors, to resume, particularly as creditors may no longer be sure of the value of a security (such as a home) after the disaster.

These findings confirm the common-sense understanding of most people – that the financial pain for those involved will persist long after the media attention has subsided. The imprint left by a disaster is enormous. Over time, the financial pain for victims may actually increase, as destroyed resources and businesses lead to unemployment, personal savings are depleted, and the value of assets afflicted by the disaster plummets due to re-zoning and keen market awareness of the disaster. Settlements with insurance companies may take months or even years. Local governments also face acute financial stress due to rising expenditure in carrying out repairs, while concurrently, revenue may be decreasing because of the declining business environment.

Currently, bankruptcy petitioners are required to fill out a 20-plus page form requesting a number of details about their financial situation, and specifically the reason they find themselves in financial distress, with the options including: unemployment; adverse legal action; liabilities due to guarantees; gambling, speculation and extravagance; ill health; domestic relationship breakdowns; or excessive use of credit facilities. While business-related petitioners may list the reason for insolvency as 'seasonal conditions, including floods and drought', this option is not available for individuals, and therefore it will be difficult to assess the precise number of personal bankruptcies caused by the floods.

Many individuals and businesses have had to confront the reality of having their home, belongings, cars and paperwork washed away – whilst the obligation to pay for such items persists as well as the need to replace them. In the aftermath of the disaster, many have turned to savings and credit cards simply to meet basic living expenses.

The real challenge in dealing with victims is that the financial obstacles confronting victims vary. For some, bankruptcy may be necessary shortly after the crisis, when homes are lost and jobs destroyed. Others may slowly rebuild and repair, and suffer due to lower paying jobs and lower capital due to the deflated real estate market in flooded areas. Others may not return to their old homes at all, but start a new life in a new area, and face completely



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different financial hurdles. And for still others, who may be covered by insurance, the financial hardship arises out of their temporary but still devastating property loss and disruption to their everyday lives.

While the individual financial situation of each of those involved is unique, and not all of them will turn to bankruptcy, for some it will not be a choice.

Ultimately, the question arises whether the bankruptcy system is well adapted and appropriate for providing relief from the financial devastation that follows a natural disaster. It is plausible that many will require more fundamental financial assistance, beyond the scope of the bankruptcy regime, for a number of reasons.

The commencement of the clean-up effort was accompanied by the numerous inquiries of insurance companies, many of whom had insured victims for 'floods', only to be told that under the terms of their policy, they were not covered for the particular type of damage which had occurred. The fact that such policies will not be paid out may lead people to petition for bankruptcy rather than continuing to struggle to meet mortgage payments while also carrying out home repairs, potentially paying rent in order to live in a habitable environment, and meeting everyday living expenses.

Generally, mortgagees are allowed a short moratorium on mortgage repayments on the grounds of 'financial hardship' and a number of lenders have granted further moratoriums on interest payments. However, the period of such cover is soon to come to an end – and yet the process of repairing one's home or business may continue for a long time into the future, particularly given the strong demand for such services. Additionally, the depreciated value of flooded properties may mean that the value of the mortgage is now far greater than the current value of the property, providing further incentive for default.

Even where individuals are covered by insurance, and may not even need to turn to bankruptcy, the interminable delay in the processing of such claims may push people over the edge. Sanctions are provided in the *Insurance Contracts Act 1984* (Cth) for late payment (s57) and the General Insurance Code of Practice has provisions dealing with the



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resolution of disputes. However, there is clearly a difficulty in reconciling a homeowners' immediate need for funds with the insurance company's need to investigate and quantify a large number of claim, and some delay may be unavoidable.

While bankruptcy may offer immediate relief from creditors, a flood victim is different from the earlier mentioned categories of bankrupts – as their insolvency is due to a single unforeseen exogenous event with devastating consequences. As such, it may be that an adequate injection of capital, rather than liquidation of assets, is the most appropriate solution to the situation.

And yet a bankrupt's difficulties are further compounded by the fact that the trustee of a bankrupt estate will need to determine whether government grants and assistance payments have vested. This may mean that individuals are denied access to the very payments which were designed to assist them in getting their lives back on track, and further extend the period of financial hardship.

Secondly, the disclosure requirements which are obligatory for bankrupts may operate particularly harshly on individuals suffering from flooding. In particular, in a tight rental market, the fact that individuals must disclose their status as an undischarged bankrupt may mean they have difficulty finding somewhere to live, or that a substantial bond is required. Similar disclosure requirements in relation to access to credit for amounts over \$4965 may lead to the imposition of high interest rates. These restrictions, which generally apply to restrict a bankrupt's access to credit on the grounds that they have proven themselves unworthy to manage money, are not appropriate for flood victims.

The critical issue behind all of these difficulties is that bankruptcy law deals only with process, and not the fact-specific circumstances behind each application. Bankruptcy law does not – and never has – made major substantive or procedural distinctions based on why the debtor files. The law simply sets the manner and extent to which debts are to be paid or discharged, allowing the debtor a second chance in society.



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What is the relevance of all this to practitioners? Firstly, the generous contribution of the army of lawyers, who have rallied to the cause of flood victims must be recognised. I am immensely proud of the Queensland legal profession for the immediacy and substantial extent of its pro bono assistance to flood ravaged victims. The response of the legal profession in times of crisis especially, amply rebuts the carping criticism to which the profession is sometimes subjected, of self-absorption and undue materialism.

Secondly, it is important not to advise clients, either personal or corporate, to enter insolvency without canvassing all the relevant options that may be suitable for their circumstances, and ensuring that they are thoroughly informed of the difficulties they will confront, not just the benefits that will flow, as a consequence of their decision.

Thirdly, and with hindsight, it is important for lawyers to provide sound advice on preventive measures, both to business and individual clients. Human beings possess a natural sense of optimism, and prefer to live in a comfortable present, rather than contemplate possible future devastation. As such, many people fail to take out adequate insurance, particularly for disasters, in the belief that it will 'never happen to them'. Even in the legal world, there are those who were sorely affected, losing offices, records and given the long lag in re-starting their business, clients.

Protection against future calamities, particularly where rebuilding occurs on the same site, is an essential part of the recovery process. On the lawyer's part, this may include drawing clients' attention to the precise terms of insurance policies, to ensure they are covered; or on a larger scale, it may involve legislative change to bring consistency to definitions contained in insurance contracts, and encouraging businesses to develop adequate disaster recovery and prevention plans to minimise commercial disruption.

I turn finally to our host. The Insolvency Practitioners' Association is to be commended for tackling a range of important areas of continuing professional development, a number of which are raised at this conference. As a professional association, it discharges a considerable responsibility in relation to continuing professional development, and does so



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well through the publication of guidance such as the Code of Professional Practice. The existence of such leadership is both reassuring and helpful for practitioners.

I conclude by congratulating you, ladies and gentlemen, upon your expertise in what is a difficult area of specialisation, and in wishing you well for the duration, I now with pleasure formally open the Insolvency Practitioners' Association 2011 National Conference.