Bankruptcy Examinations and the Involvement of Creditors

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Introduction

With the commencement of a person's bankruptcy one might be tempted to think that the involvement of creditors, who have directly or indirectly precipitated the bankruptcy, is at an end. Such a conclusion would be erroneous. Although creditors often regard bankruptcy as the sign to forget the debt owed by the bankrupt because, historically, creditors receive relatively little or nothing from bankruptcy estates, they do have a number of opportunities to contribute to the administration of the bankrupt estate[1]. Often their involvement can be invaluable to the trustee in bankruptcy who has been charged with the task of administering the estate.

One of the major avenues available to creditors who wish to be associated with the administration of a bankrupt estate is to become involved in public examinations held in conjunction with the bankruptcy.

The Bankruptcy Act 1966 (Cth) (hereafter referred to as "the Act") provides, in sections 69 and 81, the power to conduct the public examination of bankrupts and other persons associated with bankrupts. The power is an investigatory power[2] granted, ostensibly, so that persons, including the bankrupt, who may have information about the estate can be required to answer questions before a court, registrar or magistrate. This is manifest in the comment of Paine J. in Re Anderson; Ex parte Official Receiver[3] when he said:

> "It is of the utmost importance that a trustee should have this power of investigating all matters relating to the estate which he is called upon to administer, and much of what might often be lost to the creditors if he were more compelled to rely upon such information as the bankrupt may be able or willing to give, and such facts as he can ascertain from persons ready to assist him voluntarily".[4]

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1 See the discussion in Part III, Chapter 8 of Keay, Insolvency: Law & Practice, Longman Professional, Melbourne, 1992

2 R v Zion [1986] V.R. 609, 614

3 (1937) 10 A.B.C. 284

4 Ibid. 288.

Creditors may attend examinations initiated by the trustee in bankruptcy and, in certain circumstances, they may themselves be able to initiate examinations. This paper, primarily discusses the role which creditors can play during the course of examinations and in what circumstances they are entitled to seek the issue of a summons requiring a person to attend an examination.

Examinations

As indicated above the Act provides in sections 69 and 81 for public examinations. The operation of the former section is now repealed.[5] However, it still may be used to examine bankrupts who were bankrupted before 22 June 1991. While s.81 has always allowed the examination of bankrupts, trustees preferred to bring applications for the examination of bankrupts pursuant to s.69 because the process of initiating the examination was simpler and s.69 expressly abrogated the privilege against self-incrimination.[6] Since the repeal of s.69, s.81 has become the primary instrument for the examination of all eligible persons. The section has, since the repeal of s.69, abrogated the privilege against self-incrimination in the case of bankrupts.[7]

As there are likely to be trustees of estates of bankrupts, who became bankrupt before 22 June 1991, wishing to invoke s.69. This paper will address the rights of a creditor in examinations bought under that section.

Section 81 permits a trustee in bankruptcy or a creditor of a bankrupt to apply to the Court or the Registrar in Bankruptcy for the issuing of a summons which will compel the bankrupt (referred to in the section as "the relevant person") or "an examinable person" in relation to the bankrupt, to attend before the Court or the Registrar to be examined in relation to a particular bankruptcy.[8] "An examinable person" is defined in s.5(1) as including, inter alia:

* a person known or suspected of possessing property of the bankrupt;
* a person believed to be indebted to the bankrupt;
* any person capable of giving information about the bankrupt or the bankrupt's examinable affairs;
* a person who possesses books relating to the bankrupt or to the bankrupt's examinable affairs.

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5 By the Law and Justice Legislation Amendment Act 1990, s.14(1)

6 s.69 (12)

7 s.81 (11AA)

8 s.81 (1)

The person summoned may be examined on oath before the Court, the Registrar or a magistrate about the bankrupt and his or her "examinable affairs"[9]. The term "examinable affairs" was introduced by a 1987 amendment to the Act[10] and means:

> (a) the person's [bankrupt's] dealings, transactions, property and affairs; and
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> (b) the financial affairs of an associated entity of the person [the bankrupt], in so far as they are, or appear to be, relevant tot he person [the bankrupt] or to any of his or her conduct, dealings, transactions, property and affairs.

The definitions, "examinable person" and "examinable affairs", are both very broad and allow for the examination of a wide range of persons concerning a wide range of matters.

As indicated above, creditors are entitled to apply for the examination of the bankrupt or an "examinable person" pursuant to s.81.[11]

The Role Of Creditors

Unlike s.81, s.69 does not permit creditors to apply for the examination of a bankrupt. Furthermore, creditors are not allowed to demand that the trustee apply for an examination under s.69. This is to be contrasted with England where one-half, in value, of the bankrupt's creditors can require the trustee to apply for an examination.[12] Until 1981 the public examination of bankrupts in Australia was mandatory. When the legislation was amended in 1980[13] the legislature saw fit to give the right to apply for the examination of bankrupts under s.69 only to the Official Receiver or the trustee of the estate. No reason for this omission is evident from the Parliamentary Papers or the Explanatory Memorandum. One reason for this might be that the legislature wanted to avoid unnecessary examinations initiated by belligerent creditors who wanted to harass the bankrupt. Admittedly, a creditor may apply for the examination of the bankrupt under s.81 but to obtain such an examination reasons must be proffered and a registrar is entitled to decline to permit such an examination. Under s.69 if an examination is sought no reasons have to be given and the registrar will automatically allow an examination if the bankrupt was bankrupted before 22 June 1991.

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9 s.81 (1A)

10 Bankruptcy Amendment Act 1987

11 s.81(1)(a)

12 Insolvency Rules 1986, r.6.173

13 Bankruptcy Amendment Act 1980, s.38(1)

Notwithstanding the fact that creditors are unable to apply under s.69 for the examination of bankrupts, s.69(9) permits a creditor to take part in the examination. This was first allowed in England in 1883.[14] The first Federal statute in Australia, enacted in 1924, allowed a creditor to take part in the examination if the creditor had had a proof of debt admitted.[15] According to Clyne J. in Re Bainbridge[16] that meant that the creditor's proof had been admitted to rank for dividend.[17]

When the bankruptcy legislation was amended substantially in 1966 the requirement that a creditor had to have a proof of debt admitted was removed. Since 1966 any creditor of the bankrupt has been allowed to ask questions at the examination. It is submitted that this may create a difficulty for the registrar before whom the examination is to take place. The editors of Australian Bankruptcy Law & Practice point out that now the registrar 'will have to satisfy himself on the hearing of the examination that a person wishing to question the examinee is, in fact, a creditor'.[18] Such a requirement places an extra demand on the registrar who sits with the purpose, ostensibly, of hearing an examination and not to determine who can ask questions. The demand is made more burdensome by the fact that no criteria is provided by the Act concerning the definition of a creditor. One would assume that the term is limited to creditors with a debt provable in the bankruptcy.[19] The registrar may have to hear evidence as to the existence of the debt; if the bankrupt does not admit the debt and opposes the right of the alleged creditor to take part in the examination it may lead to a prolix inquiry and it may be necessary for the examination to be adjourned in order to allow the alleged creditor time in which to present sufficiently probative evidence of the alleged debt.

The relevant English provision, s.290 of the Insolvency Act 1986, requires a creditor to have tendered a proof in the bankruptcy before he, she or it can ask questions. It is submitted that that is preferable to the position under s.69(5) as it removes any need for a protracted consideration as to whether the person who wishes to take part in the examination is, in fact, a creditor of the bankrupt.

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14 46 & 47 Vic. c52

15 s.68(4)

16 (1949) 14 A.B.C. 203

17 Ibid, 204

18 McDonald, Henry & Meek, 1 Australian Bankruptcy Law & Practice (5th ed, edited by C. Darvall and N. Fernon, 1977) 1810

19 Only creditors with a debt provable in the bankruptcy are entitled to apply for an examination under s.81 (s.81(1)(a))

20 (1986) 68 A.L.R. 603

In Re Clyne; Ex parte Deputy Commissioner of Taxation[20] the bankrupt did not deny that the Deputy Commissioner of Taxation was one of his creditors but he did argue that the creditor's role was subsidiary in a s.69 examination and should be restricted to supplementing the questions of the trustee.[21] That argument was rejected by Jackson J. who said:

> "It is true that s.69(1) does not give a creditor, but does give the trustee, the right to apply for the examination of the bankrupt. Once the examination has commenced, however, the creditor is given by s.69(9) a statutory right to take part in the examination. The creditor's right to do so is not expressed to be in any way subsidiary to, or different from, that of the trustee and it may be expected that in many cases their areas of interest will be different. There is no reason why a creditor may not ask questions relating to a matter already the subject of questions by the trustee, although it may be that the person before whom the examination is conducted would decline to allow a question to be put if it were unduly repetitious."[22]

A creditor is permitted to apply under s.81(1)(a), for the examination of a bankrupt or an examinable person. The English bankruptcy legislation has never expressly permitted a creditor the same right. However, since the Bankruptcy Rules of 1870 which were passed pursuant to the Bankruptcy Act 1869, the English courts have accepted the fact that a creditor could apply provided that the application was verified by affidavit.[23] The Insolvency Rules 1986 which now regulate bankruptcies in England give the court the discretion to permit a creditor to attend an examination and put questions to the examinee, but only through the applicant for the examination who would be the Official Receiver or the trustee.[24] While examinations under s.81 are held in public in Australia, in England examinations equivalent to examinations under s.81 are held in private and therefore attendance is restricted. In England a creditor can now no longer apply for the examination of a person under the equivalent of s.81.[25]

If a creditor wishes to apply for the examination of a person under s.81 the creditor must demonstrate that the examination is designed to benefit the creditors in general. In Ex parte Nicholson ; In

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21 Ibid, 610

22 Ibid

23 For example, see r.171 of the Bankruptcy Rules 1870; Re the London Gas Light Company : Ex parte Webber (1872) 26 L.T. 226; Ex parte Nicholson; In re Willson (1880) 14 Ch.D.243

24 r.9.4(4)

25 Insolvency Act 1986, s.366. I. Fletcher in The Law of Insolvency, 1990 at p. 140 argues that a creditor may apply for an examination on the basis of the decision in Re Taylor; Ex parte Crossley (1872) L.R. 13 Eq. 409 despite the wording of s.366

re Willson[26] James L. J. (with whom the other judges of the Court of Appeal agreed) said:

> "It would be a sad, and monstrous thing if any one who claimed to be a creditor of a bankrupt was entitled ex debito justitiae to summon for examination anybody whatever whom he might wish to examine as to the estate and the dealings of the bankrupt... If the trustee declines to make the application, that is not a conclusive reason for refusing if made by a creditor, provided that the creditor makes out a prima facie probability that some benefit will result to the estate from the examination".[27]

This view has met with wide approbation in England and Australia.[28] The rationale for this view is that the examination process is not designed to allow a creditor to make out a case against the estate, the examinee or for any other indirect purpose. This was pointed out in Re Imperial Continental Water Corporation.[29] That case involved a consideration of the equivalent section to s.81 in the Companies legislation.[30] A creditor of a company being wound up had obtained an order for the examination of the directors. The creditor had earlier brought an action against the directors claiming that they should pay what he was allegedly owed. The directors applied to have the order set aside. Chitty J., at first instance, and the Court of Appeal on appeal allowed the application. The Court of Appeal said that the power to examine should not be used for the purpose of giving a creditor some benefit in enforcing his own personal rights against the directors.[31] The examination should be utilised to benefit the creditors generally.[32]

In the 1987 amendment to s.81, s.81(1C) was introduced. This provided that a registrar or the Court was permitted to impose on a creditor, who had applied for an examination, such terms as to costs as was thought proper before issuing a summons. The Explanatory Memorandum is silent on the rationale for this, but it is probable that it was designed to allow the registrar or the Court faced with an application which is questionable to impose a provision as to costs in order to dissuade an applicant from misusing the procedure. It could also have been inserted to ensure that there is money available to pay

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26 (1880) 14 Ch.D. 243

27 Ibid, 247

28 In re Imperial Continental Water Corporation (1886) 23 Ch.D. 314; In re Easton; Ex parte Davies (1891) 8 Mor. 168; Re Andrews (1958) 18 A.B.C.. 181; Re Hodder; Ex parte Cougle (1965) 7 F.L.R. 436; Re Weiss (1983) 74 F.L.R. 259.

29 Ibid

30 Companies Act 1862 (U.K.) s.115

31 (1880) 23 Ch.D. 314,321

32 Ibid ; Re Pesic (unreported, 25 February 1987, Federal Court, Neaves J.)

the costs of an examinee who is granted his or her costs under s.81(14).

Sometimes trustees will not apply for an examination because of a lack of funds. In such a case the creditors or a creditor may agree to indemnify the trustee if he or she decides that there might be benefit enjoyed in pursuing an examination. If the trustee is given financial assistance it is incumbent on him or her to ensure that he or she does not act in any other manner than independently; the trustee is not to "yield or appear to yield to partisan considerations in submitting to the urgings of a creditor in conjunction with accepting financial assistance from a creditor".[33]

Commonly the trustee of the bankrupt estate will apply for the examination of persons pursuant to s.81. If he or she does so creditors are entitled to take part in the examination and be represented by counsel or a solicitor.[34] It may be necessary for a creditor to demonstrate, before taking part in the examination, that he or she has or had a debt provable in the bankruptcy because s.81(1)(a) defined "creditor" in these terms.

If a creditor decides to take part in a s.81 examination which has been initiated by the trustee the role of the creditor is not, it is submitted, to be seen as subsidiary to that of the trustee. While the trustee, naturally, will usually assume the lead in such examinations the creditors should not be restricted to merely supplementing the trustee's questions. The comments of Jackson J. in Re Clyne ; Ex parte Deputy Commissioner of Taxation[35], which were discussed earlier in relation to s.69, are, it is contended, equally applicable to s.81 examinations. According to Jackson J., a creditor ought to be able to ask questions which may not relate to a matter already the subject of questions asked by the trustee.[36] His Honour made it clear that questions would not be tolerated if they are "unduly repetitious".[37]

It is interesting to note that at present s.597 of the Corporations Law, which provides for the examination of persons, usually in relation to the liquidation of a company, does not permit creditors to seek the examination or to take part in an examination ordered at the request of a liquidator. However, the Corporate Law Reform Bill proposes that creditors be entitled to take part in an examination and in doing so be represented by a lawyer.[38]

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33 Re Allebart Pty Ltd [1971] N.S.W.L.R.24,28, per Street J.

34 s.81(8)

35 Supra n. 20

36 Ibid, 610. One assumes that the major restrictions would be that the questions are relevant and not vexatious

37 Ibid

38 Clause 597(5A)

Conclusion

Under either s.69 or s.81 of the Bankruptcy Act creditors may take part in the examination of a bankrupt which has been initiated by the trustee or Official Receiver.

Creditors are permitted to apply for an examination under s.81 but must convince a registrar that an examination is warranted. Such an application is likely to be successful provided that the aim of the examination is to benefit the bankrupt estate and is not for some ulterior purpose.

It is submitted that it is crucial that creditors be given these opportunities to be involved in the examination process. A trustee may fail to examine the bankrupt or some third person because of recalcitrance or other reason(s) and although this would be infrequent it is only proper that a creditor be given an avenue to initiate the process 38. A creditor may be able to exert pressure on a trustee informally and at creditors' meetings but he, she or it may not succeed in persuading the trustee to act and the creditor cannot force the trustee to act by obtaining an order of the court. When all is said and done the creditors bear the burden of the bankruptcy and it is only fair that they be granted the right to examine the bankrupt or "an examinable person" if the trustee fails to act.

It might be said that a drawback with allowing creditors to be involved is that they are not sufficiently dispassionate and may be motivated by emotion or vengeance and waste the time of the registrar or court. This apparent danger is mitigated in practice. In a s.69 examination the registrar can disallow questions put by a creditor at an examination if those questions are irrelevant, insulting or oppressive. Furthermore, to obtain an examination under s.81 the creditor must satisfy a registrar that the examination is warranted. When the examination takes place the registrar, again, is able to stop the creditor from acting improperly by asking irrelevant, embarrassing or oppressive questions.

Often creditors are desirous of simply asking a few questions and then they are satisfied. To deny them access to the examination process would be inequitable. It is submitted that this has been recognised by the Commonwealth legislature in the Corporate Law Reform Bill in that the current situation of not permitting the involvement of creditors has been overturned. The commentary to the Bill does not give any reason for this proposed change but it is submitted that the reason is to bring s.597 into line with s.81 of the Bankruptcy Act.