EDMUND BARTON CHAMBERS

EBC SEMINAR SERIES

1. The topic of this paper is the role of Trustees in Bankruptcy and their removal.

2. The *Bankruptcy Act 1966* (**Act**) was amended by the *Insolvency Law Reform Act 2016* (**ILRA**) which made changes to many aspects of the Act. From 1 March 2017 many of the changes took effect. Relevantly, the Insolvency Practice Schedule (Bankruptcy) is found as schedule 2 to the Act and embodies the changes made to the Act by IRLA.

3. The term "*regulated debtor*" is introduced in the amendments which is broader than the previous definition and includes a bankrupt, a person who is subject to a personal insolvency agreement, or whose property is subject to control under Division 2 of part X, or a deceased person whose estate is being administered under part XI, see ILRA s. 5-15.

4. The regulation of a Trustee in Bankruptcy is prescribed most relevantly at s.19 which sets out the duties of the Trustee, *inter alia*, determining the assets and liabilities of the bankrupt estate, investigating transfers of property, reporting to creditors and administering the estate efficiently, and s. 134 which deals with the discretion of the Trustee.

5. A person can become a bankrupt in one of several ways, the first is by filing a debtor's petition, that is, the bankrupt seeking to declare themselves bankrupt,

secondly, by a creditor relying on an act of bankruptcy, most frequently s.40 (1)(g) of the Act, where a creditor has a judgment against the debtor. Other examples include, if a debtor's personal insolvency agreement is set aside. A full description of the various acts of bankruptcy is found in s.40 of the Act.

6. Pursuant to s.58 of the Act, when a bankrupt becomes a bankrupt, the property of the estate vests in the Trustee in Bankruptcy, who may be described pursuant s.161, as "*The Trustee (or Trustees) of the Property of John or Jane Smith, a Bankrupt*".

7. A practice that has developed with Trustees is to do minimal work on a bankruptcy matter when they are not in funds, or the estate is hopelessly insolvent. This practice, however, is fraught with peril as often material facts become apparent to the Trustee, causing them to either embark upon or to defend litigation in the later stages of the administration of a bankrupt estate. In turn, this causes the Trustee to be on the back foot and to be reactive to the situation. In my view, the best advice you can give to a Trustee, irrespective of the solvency of the estate, is to make full and thorough enquiry of the bankrupt estate, consistent with the duties of a Trustee, pursuant to s.19 of the Act.

8. Where a Trustee has concerns about the steps that should be taken in the administration of a bankrupt estate, proper advice, in the circumstances, would be to seek judicial advice pursuant to ILRA s. 45-1(1), formerly s.134(4) of the Act so that the Trustee can have confidence in the steps to be taken, see: Re: *Weber* (2006) 154 FCR 80; [2006] FCA 636. In *Donnelly (Trustee), in the*

matter of Hancock (Bankrupt) v Porteous [2002] FCA 862 at [17] Stone J sets out the relevant principles:

> Section 134(4) of the Act provides that a trustee may at any time apply to the Court for directions "in respect of a matter arising in connexion with the administration of the estate." The Court is not under an obligation to give such directions; it is a matter for it to decide in the exercise of its discretion; *Re Driller* (1972) 21 FLR 159. It is however settled that the Court will not give an advisory opinion in the form of a direction; *Willoughby v Official Trustee in Bankruptcy* [2001] FCA 1345. It is also said that the duty of the judge on a petition for advice is to advise the trustee on questions of law, but not to tell him how to exercise discretionary powers vested in him; *In the Will of Osborne* (1863) 2 SCR (NSW) Eq 89.

9. Frequently, a creditor or even the bankrupt themselves comes into conflict with the actions of the Trustee in administering the estate, a direction to the Trustee pursuant to ILRA s.85-5 following a resolution of creditors can be given. Experience shows that creditors often perceive the proper actions of a Trustee as detrimental to their interests. If a creditor, or creditors are concerned with the administration of the estate by the Trustee, they can seek to have decisions of the Trustee reviewed, pursuant to IRLA s. 45-1 and s. 90-10, formerly s.178 of the Act, alternatively, a meeting of creditors can be convened pursuant to IRLA s. 75-15 and s.90-35, formerly s.64 of the Act, and a vote can be taken as to the removal of the Trustee, if there are sufficient votes in favour of the motion. This approach, which is highly cost effective as compared to litigation, is often overlooked, and should be a starting point for dissatisfied creditor or creditors seeking to remove the Trustee.

10. A Court may remove a Trustee after enquiry pursuant to s. 90-15 (1) and s. 90-

15(3)(b) and may give consideration to a variety of factors as set out in s. 90-15(4).

11. As Buchanan J said in *Patel v Ruhe* [2016] FCA 520 at [33]:

> The tests to be applied are well established, and were not in dispute. The duties of a trustee of a bankrupt estate are set out in s 19 of the Act. Although a trustee may not disregard the legitimate interests of a bankrupt, a primary duty of a trustee is to protect the interests of creditors and recover for the estate such property as may reasonably be recovered in a commercially sound way. Judgments are required. The judgments are ones for the trustee to make and the Court will normally not interfere unless it is clear that some **maladministration of the estate has occurred or is likely** (see e.g. *Re Gault; Gault v Law* [1981] FCA 167; (1981) 57 FLR 165 at 173; *Macchia v Nilant* [2001] FCA 7; (2001) 110 FCR 101 at [50]; *Trkulja v Morton* [2005] FCA 659 at [4]; *Maxwell-Smith v Donnelly* [2006] FCAFC 150 at [53]; *Moore v Macks* [2007] FCA 10 at [30]; *Boensch v Pascoe* [2007] FCA 1977 at [10]-[15]; *Ferella v Official Trustee in Bankruptcy (No 2)* [2011] FCA 619 at [11]- [20]). (Emphasis added).

12. In *Ferella*, the Yates J said at [12] – [20]:

> 13. Trustees in bankruptcy are properly to be regarded as officers of the Court and are subject to the general control of the Court: *Adsett v Berlouis* (1992) 37 FCR 201 at 208; *Wilson v Commonwealth of Australia* [1999] FCA 219 at [44]. Section 179 of the Bankruptcy Act is a specific provision that reflects that position. It is a "supervisory" provision (among other supervisory provisions such as s 178) in aid of the Court's general supervision of trustees who are its officers and "provides what is in substance a power to review acts, omissions or decisions of the trustee": *Macchia v Nilant* [2001] FCA 7; (2001) 110 FCR 101 at [46]; see also at [50]. Its terms are

"wide and general" (*Re Alafaci; Registrar in Bankruptcy v Hardwick* (1976) 9 ALR 262 at 267) and involve the exercise of a "broad discretion as to whether or not there are sufficient grounds to make an inquiry appropriate": *Macchia* at [49]; see also *Turner v Official Trustee in Bankruptcy* [1998] FCA 1558. This is reflected in the width of the relief that may be granted: the Court may remove the trustee from office or make such order "as it thinks proper".

14. Notwithstanding this, it is recognised that the discretion to order an inquiry is tempered by a number of considerations.

15. First, the discretion "must be exercised in the interests of the orderly administration of the bankrupt's estate": *Re Challen (a Bankrupt); Ex parte Brown v Bendeich*(unreported, Federal Court of Australia, Beaumont J, 23 April 1996); *Macchia* at [50].

16. Secondly, the person seeking the inquiry should normally be required to establish "substantial grounds for believing that the trustee erred in the administration" or has engaged in "misconduct": *Re Gault; Gault v Law* [1981] FCA 167; (1981) 57 FLR 165 at 173; *Wilson* at [44]. In this connection "(t)rustees acting honestly, with ordinary prudence and within the limits of their trust, are not liable for mere errors of judgment": *In re Chapman; Cocks v Chapman* [1896] 2 Ch 763 at 776; see also at 778; *Alafaci* at 285.

17. Thirdly, before exercising the discretion, the Court should be mindful of the "well-established policy in bankruptcy legislation that the court should not unduly interfere with the day-to-day administration of a bankrupt's estate by a trustee": *Re Tyndall* [1977] FCA 15; (1977) 30 FLR 6 at 9; *Turner* at 3. Although *Re Tyndall* was a case dealing with s 178 of the Bankruptcy Act, the following observations of Deane J (when in this Court) are equally applicable to s 179. His Honour (at 10) said:

> ... The trustee is made responsible for the administration of the bankrupt estate under the general provisions of the Act. He must, in the course of that administration, make a variety of decisions aimed at enabling the administration to be carried out with promptness and efficiency. Some of these decisions will be business or commercial decisions in which the business or commercial experience of the trustee would itself provide a basis for arguing that, unless it were shown that the trustee's decision was perverse or clearly wrong, it would be inappropriate and unjust for the court to interfere. Again, under the present legislation, the trustee will ordinarily be the official receiver and the court must be conscious of the fact that the official receiver will be made responsible for the administration of an extraordinarily large number of estates. In such circumstances, the administration of the *Bankruptcy Act* demands that the court take into account, in exercising its functions under the provisions of s 178 of the Act, the opinion of the official receiver, as trustee, as to what is expedient in the interests of the prompt and efficient administration of a particular bankrupt estate. That is, however, a completely different thing to saying that the court can only interfere with an act, omission or decision of the official receiver, as such trustee, when it is of the view that the official receiver has acted unreasonably, absurdly or in bad faith in so acting or failing to act or in reaching that decision.

17. Fourthly, the discretionary considerations to be taken into account when considering whether an inquiry should be ordered include the likely utility to be derived from an inquiry. In this connection, the ultimate question to be kept in mind is whether there is a likelihood that "the trustee should be held to account for conduct in the administration of the estate which has affected the bankrupt in some way": *Macchia* at [50]. This does not mean, however, that it is necessary

that there be "a financial aspect" to the complaint that is brought forward as justifying an inquiry: *Maxwell-Smith v Donnelly* [2006] FCAFC 150 at [63].

18. Fifthly, s 179 is not a vehicle for pressing general law claims (such as claims for damages in tort) even though conduct invoking the remedial objectives of the provision may be based upon the breach of general law rights and obligations: *Macchia* at [44] and [50].

19. Sixthly, the availability of general law causes of action and remedies at the suit of the person seeking the inquiry may be a sound discretionary reason why an inquiry should not be ordered under s 179: *Gault* at 173.

20. In *Alafaci*, Riley J (at 268) gave practical guidance about the procedure to be followed in relation to an inquiry pursuant to s 179:

> ... I do not wish to be taken as presuming to lay down any rule as to the procedure to be followed in, or the approach to be made by the court to, a case of this sort; but it seems to me that in such a case there is a preliminary question to be decided by the court – namely on the grounds and facts before it, has a case been made for inquiry into the trustee's conduct? If the answer to that question is "yes", the next question is – what is to be the scope of the inquiry? It may be that the material already before the court sufficiently defines the scope of the inquiry; on the other hand, the court may find it necessary to define the subjects for inquiry – eg in the form: "Did the trustee do (or fail to do) so and so?" – and to give directions before proceeding to inquire. In any event, the court will seek to inquire into specific matters, and to ensure that the trustee is given proper opportunity to prepare and present his case on those matters. If in the course of inquiry into those matters it emerges that there are other aspects of the trustee's conduct in relation to the bankruptcy into which the court, as the authority having

> control over trustees, should inquire, the court will safeguard the interests of the trustee as may be necessary by such means as the granting of adjournments and the giving of directions. It will act similarly as may be necessary when the inquiry is completed and the question then arises of what order or orders, if any, should be made under s 179(1)(a) and (b).

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