Official Trustee in Bankruptcy v Kent [2023] FCA 1211

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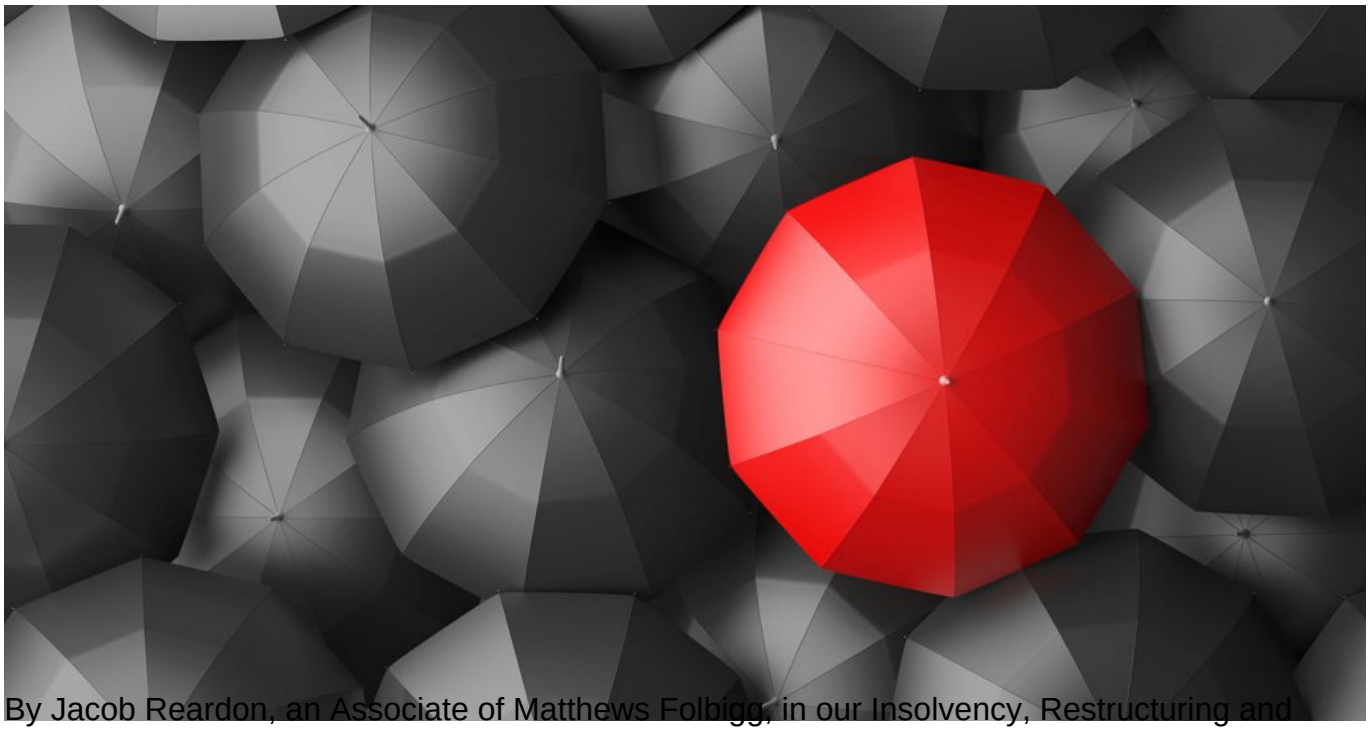

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In an earlier blog, we considered the concept of “the property of the bankrupt” under the *Bankruptcy Act 1966* (Cth) (“***the Bankruptcy Act***”) with reference to the decision *Official Trustee in Bankruptcy v Kent* [2023] FCA 1211 (“***Kent***”). That decision asked whether a bankrupt’s right to be compensated under the Australian Financial Complaints Authority (“**AFCA**”) compensation scheme could vest in a trustee in bankruptcy. While Rares ACJ held this was not the case, it is worth considering the claim brought by Mr Kent in more detail and the reasons for the Court’s decision.

Factual background

In August 2010 Mr Kent and his wife refinanced an existing loan facility into three separate loans over 2 properties in Western Australia. Over the next 2 years further funds were advanced including to purchase additional properties in Western Australia and Victoria, until the combined value of the facilities was nearly $2,000,000.

In December 2015, Mr Kent fell into arrears and in February 2016 he advised the bank that he and his wife were heavily overcommitted and had separated.

By December 2016, the Kents voluntarily surrendered their investment properties, two of which were sold in March 2017 by the bank, leaving a shortfall of approximately $215,000 on one of the mortgage facilities. By April 2017, Mr Kent became bankrupt. In July 2017, the remaining

properties located in Melbourne and Perth were also sold at significant shortfalls as well.

Mr Kent was discharged from bankruptcy on 11 April 2020 and made a complaint to AFCA in June 2020 claiming that, inter alia:

- The lender had engaged in irresponsible lending;
- In the period leading up to his bankruptcy, he and his former spouse had acquired four investment properties and incurred credit card debts to the lender and other financial institutions;
- He had suffered loss in the region of $700,000 to $800,000;
- At the time of taking out the facilities, his combined household income was $150,000;
- As a result of his financial distress he lost his home, then job and he and his wife separated; and
- By 2020, he was living in Sydney while his wife and children continued to reside in Western Australia.

By September 2020, the bank responded to Mr Kent's complaint to AFCA conceding that it raised legitimate responsible lending concerns. In October 2020, Mr Kent informed his trustee that the bank had offered to settle his complaint for $433,512.47 and by December 2020 negotiations about the settlement of the complaint resulted in a deed of settlement which provided that the sum of:

- $433,512.47, being the financial loss suffered by Mr Kent was to be paid to the bankrupt estate and distributed to unsecured creditors in accordance with s 109 of the *Bankruptcy Act.* The bank was the largest unsecured creditor in Mr Kent's estate; and
- $20,000, being compensation for non-financial loss, including stress and inconvenience, was to be paid to Mr Kent directly.

Mr Kent advised the trustee that he did not consent to agree to any monies being paid to the bankrupt estate because he had been fully discharged and that he did not accept the offer. That notwithstanding, the Trustee executed the deed with the bank and informed Mr Kent that the financial loss component of the compensation had been received and that he would be entitled to a small surplus totalling $11,000, following annulment of his bankruptcy.

In February 2021, AFCA subsequently closed its file and Mr Kent indicated that he intended to commence proceedings against the bank. In the meantime, the Trustee sought advice from two prominent insolvency barrister who gave conflicting advice as to whether the financial loss component of the settlement funds vested in the Trustee.

In light of the conflicting opinions, the Trustee commenced proceedings against Mr Kent to seek judicial advice as to whether it would be justified in treating the financial loss component of the proceeds as property of the bankrupt which had vested in it pursuant to s 58 of the *Bankruptcy Act*. Mr Kent filed a cross-claim seeking a declaration that the financial loss component was not property which vested in the Trustee and that the complaint had not been compromised by the entry into of the Deed of Settlement and Release by the bank and the Trustee.

The Trustee's argument

The Trustee argued that the financial loss component of the settlement sum was after acquired property that vested in the trustee in the usual way on the basis that:

- The offer in the deed was a payment to resolve all matter arising out of or in relation to the AFCA complaint; and
- Such a resolution could have been achieved whether or not the AFCA complaint was made purely on the basis of the underlying factual circumstances of Mr Kent's pre-appointment dealings with the bank.

Thus, the thrust of the Trustee's argument was an appeal to substance over form. The underlying facts supported an AFCA complaint *or* a court proceeding (for example, a money claim for damages), so the fact Mr Kent chose the former course, not the latter, did not change the characterisation of the rights he was pursuing as property of his bankrupt estate.

Accordingly, the Trustee contended that it was not appropriate to analyse the complaint only by reference to a claim that Mr Kent may have been able to make pursuant to:

1. Section 133 of the *National Consumer Credit Protection Act 2009* (Cth) ("**the *NCCP***") which prohibit lenders from entering into unsuitable credit contracts; and

2. Sections 178 and 179 of the *NCCP* which provide rights of compensation to victim of irresponsible lending.

(together, "**the *NCCP* Rights**")

Mr Kent's position

Mr Kent argued that at the time of the AFCA complaint, all his claims against the bank under the *NCCP* were statute barred, given the loans granted by the bank were greater than 6 years old. However, Mr Kent contended that the AFCA regime could resolve the complaint and that the bank had engaged with him to do so, supporting his characterisation of the AFCA scheme as a bespoke dispute resolution mechanism that did not involve an assessment of existing legal rights. Therefore, there was no valuable cause of action that the Trustee could give up in exchange for the payment of the financial loss component.

The decision

At [95] to [102] of the decision, Rares ACJ first addressed the structure of the AFCA scheme and observed that determinations made by an AFCA decision-maker are not exercises of judicial power. Instead, a tripartite contract is formed between the complainant, the financial institution, and AFCA, which creates new rights based on what the decision maker "considers fair in all the circumstances", assessed by reference to industry codes or guidance, "good industry practice", and various factors set out in the scheme rules.

Whether the complaint was within the jurisdiction of the AFCA Scheme

Rares ACJ rejected the Trustee's submission that Mr Kent's complaint involved divisible property under s 116(1) of the *Bankruptcy Act*. Section 116(2)(g)(i) excludes from the bankrupt estate any right to recover compensation for personal wrongs. His Honour applied the test from *Cox v Journeaux (No 2)* (1935) 52 CLR 713, which requires one to assess whether the damages are to be estimated by reference to injury to the bankrupt's mind, body, or character, rather than to their property. At [109], Rares ACJ stated:

"It follows that a proceedings involving a cause of action with more than one head of damage, at least one of which involves, predominantly, the bankrupt's mind, body or character, and another or others, only incidentally, his or her property, will be characterised as remaining with the bankrupt…"

Thus, where a cause of action includes co-mingled heads of damage, but is predominantly concerned with the person of the bankrupt, it will be caught by the terms of s 116(2)(g)(i) of the *Bankruptcy Act* and not vest in the trustee. The relevance of the *NCCP* Rights arose in this context.

The NCCP Rights

The Trustee argued that Mr Kent's complaint was based on legal rights under the *NCCP*, particularly ss 133, 178 and 179, and that those rights had vested in the estate under s 58(1) of the *Bankruptcy Act*. To evaluate that claim, Rares ACJ examined the legal foundation of the AFCA complaint. Although AFCA does not enforce the *NCCP* directly, Mr Kent's complaint involved alleged misconduct (irresponsible lending) that would, if litigated, have engaged causes of action under that statute.

This had two implications. First, it confirmed that the subject matter of the complaint fell within the jurisdiction of AFCA, which required that the dispute relate to a financial service and arise from a contract or legal obligation. Rares ACJ found that the subject matter of Mr Kent's complaint, being irresponsible lending, "appear[ed] to be a shorthand or lay reference that could engage concepts covered in Ch 3 of the *NCCP Act* (and so within the requirements of rule B.3.1)" (at [112]).

Second, it allowed the Court to assess whether the underlying rights were "property" that vested in the trustee. Rares ACJ held that they were not. Either the *NCCP* rights were not property at all, or they were excluded under s 116(2)(g)(i) as personal rights to compensation for emotional or reputational harm. This analysis ultimately supported the broader conclusion that the AFCA complaint was a personal right and that the trustee had no power to settle, control or release it.

In short, the subject matter of the NCCP Rights were relevant to AFCA's jurisdiction and the characterisation of the complaint as personal to Mr Kent. The Trustee could not assert control over the rights that neither vested in the estate nor fell within the Trustee's power to compromise them on the basis that they were not property of the bankrupt, either:

1. Capable of vesting pursuant to s 58 of the Act; or alternatively

2. Within the meaning of the exception in s 116(2)(g)(i) of the Act, which excepts from the definition of divisible property rights of compensation that the bankrupt has for "personal injury" or a "wrong done to the bankrupt" as outlined above.

Why were the NCCP rights not property of the bankrupt?

Rares ACJ first considered the general principles relating to the characterisation of property rights which broadly hold that whether something is "property" in law depends on whether it is definable, identifiable and capable of assumption by third parties. The NCCP Rights give an individual a personal right to apply for compensation in the event they suffer loss or damage as a result of irresponsible lending. Such rights are personal in nature and can only be exercised by the person entitled to compensation. In this regard, Rares ACJ said at [123]:

"Here, the text of ss 133(1), 178 and 179 of the *NCCP Act* suggests that the Parliament did not intend to create a proprietary right in a plaintiff to apply for compensation under s 178 or a remedy under s 179, as opposed to conferring a status or entitlement that is personal to that plaintiff, to make such an application to a court for an order in respect of loss or damages that the plaintiff has suffered, or is likely to suffer, as a result of a licensee's contravention or offence against the *NCCP Act*."

The Court considered that the NCCP rights were not capable of vesting under s 58 of the *Bankruptcy Act* because the structure of the *NCCP* meant that a trustee in bankruptcy could not stand in the shoes of the bankrupt or satisfy the precondition of "hardship" that was experienced by Mr Kent. Thus, the Court concluded that the NCCP rights were not capable of vesting, or even if they were, they would fall into the exception in 116(2)(g)(i) of the Act as right to recover compensation for personal wrongs done to the bankrupt. The losses cited by Mr Kent (being the loss of his home, the breakdown of his marriage and his children) were plainly personal to him, also supporting his argument that the NCCP Rights were personal in nature.

AFCA complaint process

At [127] of the decision, Rares ACJ observed that an AFCA complaint is a process for complainants to resolve their personal grievances resulting from irresponsible lending, not the assertion of a cause of action. He therefore considered that the right to lodge an AFCA complaint is not a vested property right capable of being exercised by the Trustee.

Conclusion

Thus the court concluded that the NCCP rights were not property capable of vesting, and even if they were, they would be captured by the exception in s 116(2)(g)(i) of the Act. It therefore followed that the Trustee had no power to bring a claim pursuant to the NCCP Rights or otherwise compromise the complaint. This conclusion is plainly correct as it avoids the perverse outcome whereby the bank, who was the major creditor in Mr Kent's bankruptcy, received back a not insignificant portion of the amount it was required to pay out to compensate Mr Kent for its

irresponsible lending practices.

A copy of the decision can be accessed here

If you would like more information or advice in relation to Insolvency, Restructuring or Debt Recovery law, please contact a Principal of the Matthews Folbigg Insolvency, Restructuring & Debt Recovery Group:

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