

## **SUBMISSION TO THE ATTORNEY GENERAL**

***BANKRUPTCY LEGISLATION AMENDMENT BILL 2009  
SUBMISSION BY ROGER MENDELSON ON BEHALF OF PRUSHKA  
FAST DEBT RECOVERY PTY LTD (“PRUSHKA”) AND MENDELSONS  
LAWYERS PTY LTD (“MENDELSONS LAWYERS”)***

### **Background Information on Roger Mendelson, Prushka and Mendelsons Lawyers**

1. Roger Mendelson is a practicing lawyer and is principal director of Mendelsons Lawyers. He is also the author of *The Ten Mistakes Businesses Make and How to Avoid Them* and *Business Survival Guide - How to Steer your Business through the Recession*.
2. Mendelsons Lawyers is a wholly owned subsidiary of Prushka.
3. Mendelsons Lawyers comprises sixteen lawyers together with support staff.
4. Prushka has been in business since 1977 as a debt recovery agency. It has 14 offices located around Australia and its head office is located at 8 Station Street, Mitcham Victoria 3132.
5. Prushka is the largest collection agency in Australia by client number. It acts for in excess of 40,000.00 businesses, medical practices, professional practices, individuals and companies across Australia. Its clients range from SME's such as plumbers, medical practices, hospitals, through to large corporate clients such as insurance companies and corporate publicly/listed medical service providers.
6. Mendelsons act primarily for clients referred through from Prushka and handles work exclusively in the debt collection and legal enforcement areas. It directly handles such legal work in all jurisdictions throughout Australia and provides legal enforcement options throughout all jurisdictions in Australia.
7. Mendelsons has a small legal team which exclusively handle bankruptcy and is one of the larger service providers in the bankruptcy jurisdiction in Australia.
8. Due to the range of clients, in terms of geographical location, the diversity of debts handled and its specialized expertise in bankruptcy, the experiences of

Prushka and Mendelsons Lawyers provide a unique insight into the practical conduct of bankruptcy claims.

9. This submission will refer solely to the proposal to lift the threshold to \$10,000.00.

### **Analysis of Mendelsons Bankruptcy Files from July 2008 to August 2009.**

10. Attached is a schedule summarizing the bankruptcy files handled by Mendelson Lawyers from July 2008 to August 2009.
11. The report is based on the 85 bankruptcy files handled during that period and the results are auditable (subject to privacy considerations).
12. 70.5% of the files were for claims where the quantum was below ten thousand dollars and 29.5% of files were for quantum's exceeding ten thousand dollars.
13. 87% of the clients (the petitioning creditors) were SME's. An observation is that notwithstanding the fact that Prushka acts for many large publicly/listed corporate clients, there is a marked reluctance by many of those organizations to use the bankruptcy process. Generally, large corporate clients do not really focus on cash flow, whereas SME's do, because they basically need to recover the money owed to them to survive.
14. The clients are split roughly equally between capital cities and provincial towns and cities.
15. 68% of the debtors were individuals and 32% were business owners.
16. 41% of debtors are located in capital cities, whereas 59% are located in non-capital cities. As Prushka's clients are located primarily in the capital cities, this statistic indicates that it is country/based debtors who are the subject of bankruptcy proceedings more so than city based debtors.
17. There were nil debtors under the age of thirty, 34% were in the age bracket of 30 to 45 whilst 66% of debtors were in the age group from 45+. This statistic clearly confirms the anecdotal evidence of practitioners involved in the bankruptcy jurisdiction that bankruptcy is rarely used against young debtors.
18. Of the 85 files covered by the survey, 49% resulted in the claim being resolved without the debtor becoming bankrupt, 28% resulted in the debtor becoming bankrupt and 19 were still pending. Assuming that the pending files end up in the same ratio, this would produce a result where 64% of files resulted in the debtor not becoming bankrupt but in the debt claim being settled whilst only 36% ending up in the debtor becoming bankrupt.

## **Comment on Mendelsons Figures and Figures Prepared By the Inspector/General in Bankruptcy for the 2007/2008 Year.**

19. Reference is made to the Inspector/General's 2007/2008 report because 2008/2009 was not available as at the time of preparing this submission.
20. Bankruptcy is clearly used in a tiny percentage of debt recovery claims.
21. In Prushka's case, only approximately 0.15% of overdue debts submitted to Prushka proceed through to becoming a bankruptcy file.
22. From the Inspector/Generals report ("IG Report"), there were only 25,970 bankruptcies during that year. However, 91% of those were originated by the debtor and only 9% were originated from creditors. That is, only 2337 bankruptcies were initiated by creditors in the whole 12 month period. As a percentage of debts referred to collection agencies and law firms for collection, the percentage which proceeds through to a sequestration order is almost so small as to be statistically irrelevant.
23. The IG report indicates (table 1) that of the 10,060 bankruptcy notices issued during that period, only 23% resulted in a bankruptcy order. That is, the settlement rate was approximately 77%.
24. The 77% settlement figure indicates that insolvency practitioners are focused on exerting pressure on the debtor to achieve a settlement, rather than simply proceeding through to obtaining a sequestration order with a view to "inflicting pain or revenge" on a debtor.
25. The experience of Mendelsons Lawyers is that the of debtors who settle would not have paid anything unless they had been pressed to do so through the use of the bankruptcy process.
26. The IG report indicates (table 4) that 82% of bankruptcy actions were initiated by individual creditors and not by businesses. This is in line with the Mendelsons figures.
27. The occupational status of debtors (table 7 from the IG report) indicates that 53% are in medium to high level qualification jobs and only 47% are engaged in jobs of either intermediate level or low level.
28. The IG report indicates that 27.5% of debtors made bankrupt were under the age of 34, 27.5% were in the bracket of 35 to 44 and 45% were over the age of 45. This figure indicates a higher percentage of debtors below the age of 35 than in the Mendelson's experiences. This figure may well be distorted by bankruptcies initiated by the Australian Tax Office. The ATO appears to be the largest petitioning creditor by far and normally has the attitude of pursuing a claim right through to bankruptcy, regardless of the commercial consequences.

29. The IG report generally summarizes the situation that Debt Agreements are operating successfully and that the major beneficiaries of the benefits offered by this process are young, under-educated people.

## **Anecdotal Evidence**

30. Mendelsons Lawyers is probably the most diversified practitioner in the insolvency jurisdiction, both in terms of geographical location of clients, nature of the underlying debts and dollar value of the outstanding claims.
31. Tony Hanlon, the senior lawyer responsible for handling the bankruptcy work, usually attends the Federal Magistrates Court bankruptcy hearing every Tuesday and Thursday, representing clients of Mendelsons Lawyers and as such, he has a good “finger on the pulse” in terms of files being handled by other practitioners.
32. Prushka work through a sifting process with debts which come in, with the focus being on obtaining a settlement, being either payment in full, obtaining an agreed reduced lump sum or setting up and monitoring installment arrangements.
33. As Prushka operates entirely on the **No Recovery – No Charge** basis, it has a direct motive in ensuring that it achieves successful recoveries for its clients.
34. Every file which proceeds through to a bankruptcy claim will have been handled by Prushka for a period of usually at least 6 months and in most cases, substantially longer than that. Strenuous efforts would have been made at every stage to effect a settlement and unless there are specific instructions from a client to not accept a settlement or installment arrangement, these would be offered as a matter of course.
35. Files which proceed to legal action in the first place constitute less than 4% of the total number of debts referred to Prushka for collection.
36. At the time legal action is initiated, extensive efforts are made at various points in the process, including prior to issue of legal proceedings, after service of the Complaint (as it is known in Victoria), immediately prior to entering default judgment and again, after default judgment is taken out
37. Prushka will only recommend to clients to proceed to legal action, in the event where the debt does not have a prima facie valid defence or, as in most cases, is simply not disputed at all. Furthermore, the financial position of the debtor will be investigated and recommendation to sue will only be made, in most cases, if there is a viable enforcement method available.
38. It is not commercially viable to sue a debtor who does not either hold a steady job or alternatively, does not have a significant interest in real estate. To sue debtors who do not fall within either of those categories would simply increase

the costs the creditor pays without offering any reasonable prospect of a recovery.

39. Each state offers four major enforcement paths against individuals. They may have different names but they are essentially as follows (using Victorian terms).
- a) Summons for Oral Examination. This is not an enforcement path as such but is a process which requires the debtor to attend at the Magistrates Court to answer questions under oath about his financial position. The experience of Mendelsons Lawyers is that it is totally ineffective and it does not recommend it to its clients.
  - b) Warrant of Execution. This is an order to the sheriff to seize chattels and possessions of the debtor (other than household goods and tools of trade). In Victoria, this enforcement path is next to useless, due to the limited rights the sheriff has and the inefficiencies within the sheriff's office itself. This process is more effective in New South Wales and Tasmania but in other states, it is basically ineffective. Overall, this does not offer an effective enforcement path against individuals.
  - c) Garnishee (or Attachment). This is a more effective tool, provided that the debtor is in full-time or near full-time employment. However, it is only of use where the debtor works in a stable job.
  - d) Bankruptcy. If the debtor owns an interest in real estate and there is a judgment for an amount exceeding \$2,000.00, then bankruptcy offers the only effective and practical option available to the creditor. Without the bankruptcy option, if the debtor has an interest in real estate but does not have a stable job, then there are few practical alternatives.

There are some alternatives to this, depending on the state. For example, in South Australia and Tasmania, there is a process which allows the details of the judgment to be entered on to the title and in Victoria, there is a convoluted, expensive process (seizure and sale of real estate), which ultimately allows for sale of the debtor's equity in the property. For other states, there are no options available.

40. The experience of Mendelsons Lawyers is that the debtors the subject of bankruptcy action have the capacity to either pay the debt in full or to at least offer a good settlement but, simply refuse to do so. Without the bankruptcy process being available, these debtors would not pay.

## **Damaged to Debtor's Credit Rating**

41. The press release put out by the Attorney General on August 25<sup>th</sup> stated that "in the case of young people, this can often prevent them from obtaining a loan for a car let alone a house".

42. This comment displays great ignorance of the credit reporting process.
43. A default judgment being taken out against an individual will result in the credit reporting agencies detailing this on the credit report of the individual. It will stay there for 5 years. Even if the debtor ultimately pays off the judgment amount, the entry will not be reversed. There will merely be another entry recorded, indicating that the judgment has been satisfied.
44. Accordingly, the damage to the credit rating of that individual will have taken place at that stage.
45. This is well prior to any potential bankruptcy proceedings.
46. For practical purposes a judgment for over \$2,000.00 must be taken out prior to service of a Bankruptcy Notice.
47. The issue of a Bankruptcy Notice is not a reportable event and can not be searched by any third party. Accordingly, as long as the debtor either pays up pursuant to the Notice within the 21 day period or otherwise settles the claim, there will be no further adverse report on his credit file.
48. The comment by the Attorney General also displays ignorance of the reality of bankruptcy actions. They are rarely taken out against young people who don't already have a home loan. Indeed, it is likely that the major creditors taking bankruptcy action against young, non-home owning people are other government agencies, such as the ATO.

## **Conclusion**

49. Bankruptcy actions are initiated against a statistically irrelevant percentage of the total number of debtors.
50. Only a small number of law firms carry out bankruptcy work.
51. It is not commercially viable to initiate bankruptcy action against a debtor unless there is a likelihood of a return and thus, the bankruptcy debtors are invariably property owners who have wilfully tried to evade payment of their debts.
52. The main user of the bankruptcy process are overwhelming SME's, not large corporations. Without the option of bankruptcy proceedings, creditors would effectively be left, in many cases, with no enforcement option. This would result in the situation where a legitimately obtained order from an Australian court is simply and practically unenforceable. This would degrade the status of the legal system, because it would produce unenforceable (and thus, meaningless) judgments.

53. An individual creditor has no means of finding out what are the debts a particular creditor owes. For example, a creditor may have a judgment for \$2,500.00 dollars and the debtor may either have no other debts owing, several manageable debtors or may be hopelessly insolvent. It is unfair to criticize a creditor who takes bankruptcy action for a relatively low amount because he simply does not have the means to know what other amounts are owing by that debtor. Bankruptcy offers the tool to handle this situation, because ultimately, bankruptcy action taken by an individual creditor is for the benefit of all creditors. An individual creditor obtains no advantage in being the party to initiate the action, other than receiving preferential payment for most of his costs, in the event that the trustee is able to recover funds.
54. The real power of bankruptcy for creditors lies in the ability to pressure recalcitrant debtors who do have the means to pay but simply refuse to do so. This is borne out by the high settlement figures arising from service of the bankruptcy notice. The public policy ramifications of the proposal will lead to a massive increase in unpaid debts, when debtors become aware that creditors have no viable enforcement process available. The big losers will be SME's and individuals who will be unable to enforce their rights.
55. The fact that 91% of the 2008 bankruptcy orders came about due to action initiated by the debtors themselves indicates that there is a worthwhile role for bankruptcy. The role is to bring the financial situation to a head, settle all claims made by all existing creditors and then allow the bankrupt to move on.

## **Recommendation by Prushka and Mendelsons Lawyers**

56. The \$2,000.00 threshold had not increased since it was mooted in 1988. We would recommend an increase in the minimum limit to \$3,500.00, to roughly take into account inflation over that period.

### **Further information.**

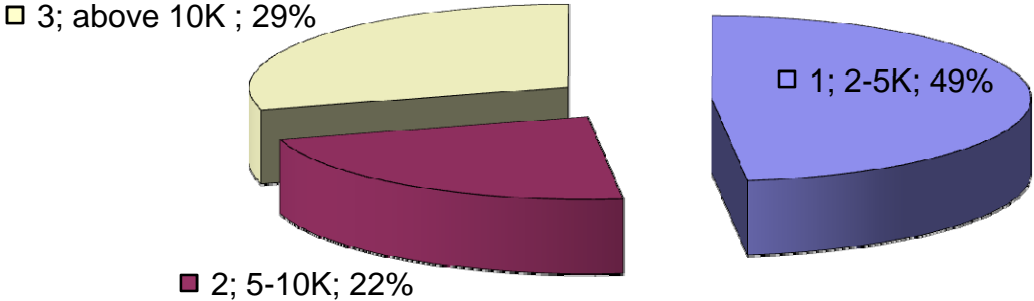
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**MENDELSONS LAWYERS' BANKRUPTCY FILES  
PERIOD JULY 2008 TO AUGUST 2009**

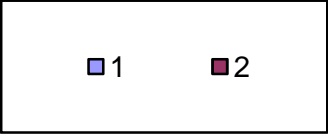
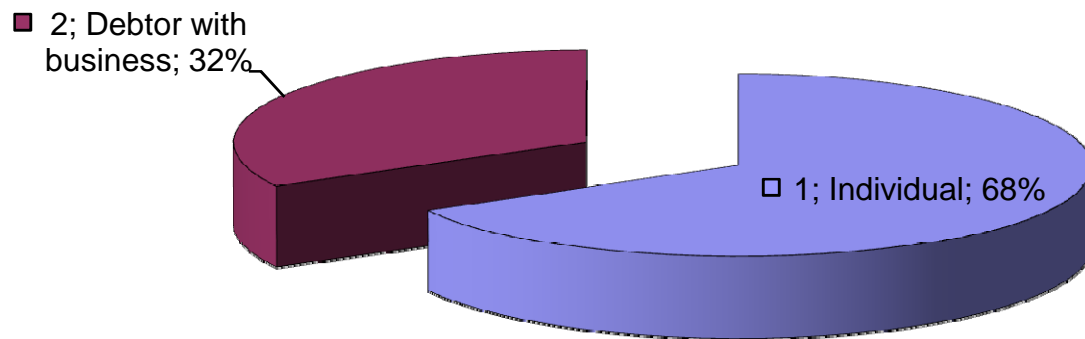


FILES QUANTITY	DEBT AMOUNT			CLT ENTITY			CLT LOCALITY		DTR ENTITY		DTR LOCALITY		DTR AGE GROUP			OUTCOME		
	2 - 5K	5 - 10K	OVER 10K	INDV.	SML/ MED	LRG CORP.	METRO/ CAPITAL	SUBURB/ COUNTRY	INDV.	BUSS OWNER	METRO/ CAPITAL	SUBURB/ COUNTRY	20-30	30-45	45-60	RESOLVED	BANKRUPT	PENDING
85	41	19	25	3	74	8	44	41	57	28	35	50	0	29	56	42	24	19

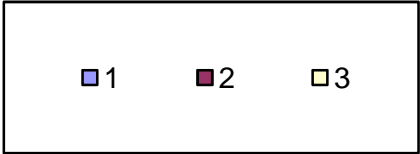
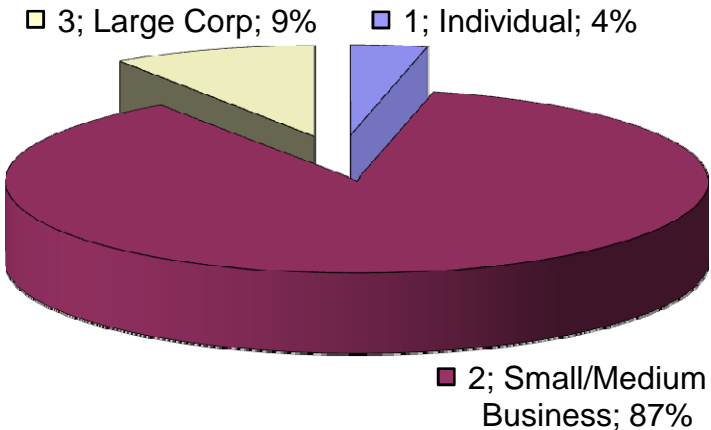
### DEBT AMOUNT



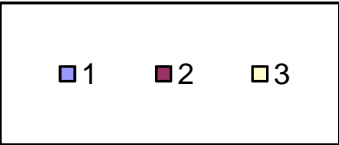
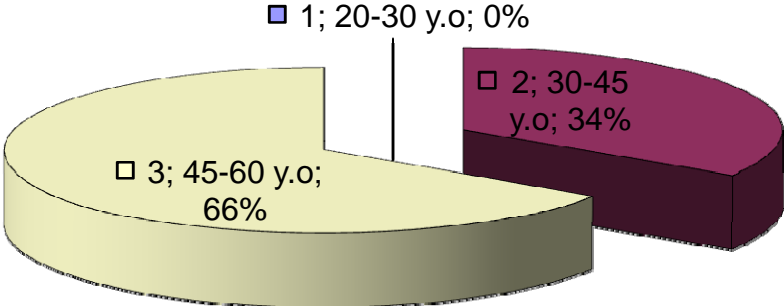
### DEBTOR'S ENTITY



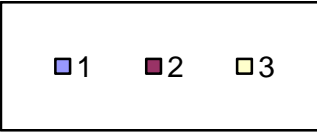
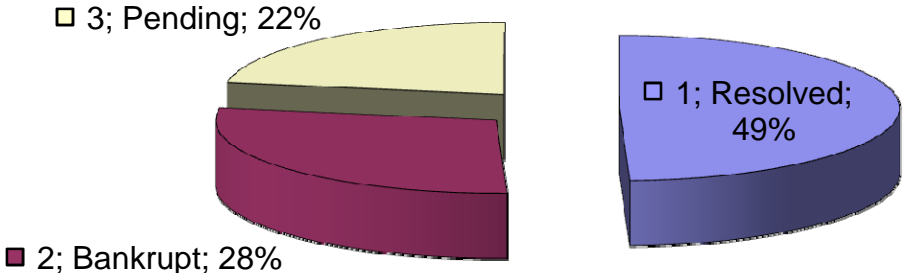
### CLIENT'S ENTITY



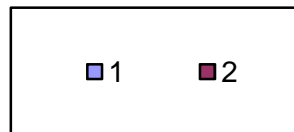
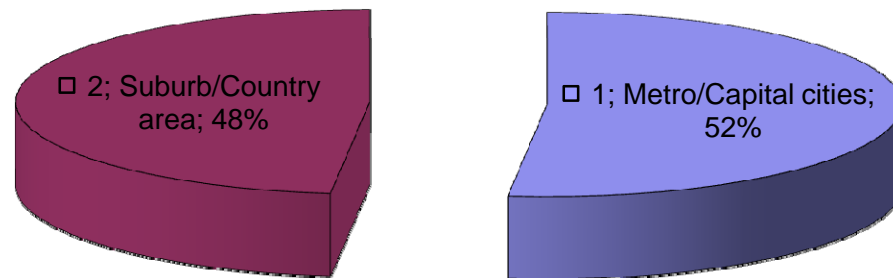
### DEBTOR'S AGE GROUP



# OUTCOME



## CLIENT'S LOCALITY



## DEBTOR'S LOCALITY

