

AN ALTERNATIVE APPROACH TO THE TREATMENT OF PENALTIES AND FINES IN BANKRUPTCY

PETER SISE*

Currently, penalties and fines are not provable in bankruptcy. This article examines the policy behind this approach and its consequences. It then suggests an alternative approach where penalties and fines are provable, but are subordinated to other unsecured debts and are not released upon the discharge of the bankrupt. Although this approach is not perfect, it addresses some of the difficulties of the current approach and balances the goals of protecting the bankrupt from pressure by creditors during the term of their bankruptcy, deterring and punishing misconduct, and giving the bankrupt a 'fresh start' upon their discharge.

I INTRODUCTION

Section 82 of the *Bankruptcy Act 1966* (Cth) ('*Bankruptcy Act*') specifically provides that certain debts are not provable in bankruptcy. One category of debt that is not provable is 'penalties or fines imposed by a court in respect of an offence against a law'.¹ How fines and penalties should be treated in bankruptcy involves weighing various policy aims, such as the objective of bankruptcy law of giving a person a 'fresh start' from previous financial difficulties and the aim of criminal law of holding a person to account for transgressions.

This article examines the policy behind the exclusion of penalties and fines from provable debts. It will then propose that penalties and fines be provable provided they (i) rank behind other unsecured debts in relation to the payment of any dividend and (ii) are not released upon the discharge of the bankrupt.

II THE CURRENT POSITION REGARDING PENALTIES AND FINES

A *The Operation of s 82(3)*

Section 82(3) of the *Bankruptcy Act* provides:

Penalties or fines imposed by a court in respect of an offence against a law, whether a law of the Commonwealth or not, are not provable in bankruptcy.

The key phrases in s 82(3) are 'offence against a law' and 'imposed by a court'. In *Mathers & Anor v Commonwealth*² ('*Mathers*'), Heerey J considered whether a pecuniary penalty imposed under s 76 of the *Trade Practices Act 1974* (Cth) for contraventions of competition laws was imposed in respect of an 'offence against a law'. His Honour concluded that an 'offence against a law' does not have to be a criminal offence but may simply be the failure to do something

* LLB (Hons) (The University of Melbourne), Senior Associate, Clayton Utz. The views expressed in this article are those of the author and not of Clayton Utz.

¹ *Bankruptcy Act 1966* (Cth) s 82(3).

² (2004) 134 FCR 135.

prescribed by statute which results in a penalty. Accordingly, a criminal offence is only one form of offence.³ More specifically, his Honour said:

The word ‘offence’ has no fixed technical meaning in the law: *Kingswell v The Queen* [1985] HCA 72; (1985) 159 CLR 264 at 276. A failure to do something prescribed by a statute may be described as an offence although Parliament does not impose a criminal sanction upon it, but a mere pecuniary sanction which is to be recovered as a civil debt: *Brown v Allweather Mechanical Grouting Co Ltd* [1954] 2 QB 443 at 447.⁴

Mathers concerned the exclusion of fines and penalties from provable debts under s 553B(1) of the *Corporations Act 2001* (Cth), which is the corporate insolvency equivalent of s 82(3) of the *Bankruptcy Act*. Like s 82(3), s 553B(1) uses the phrase ‘offence against a law’ and is hence relevant to s 82(3).⁵

Whether a fine or penalty is ‘imposed by a court’ depends on the procedure for imposing the fine and will vary from case to case. The Full Federal Court decision of *State of Victoria v Mansfield*⁶ (*Mansfield*) provides an instructive analysis of whether 72 parking fines were ‘imposed by a court’.⁷ In that case, the Court concluded that a parking fine was ‘imposed by a court’.⁸

It is not entirely clear whether a ‘law’, for the purposes of the phrase an ‘offence against a law’, must be a statute or may also be a rule of the common law. There is nothing in the wording of s 82(3) which suggests that ‘law’ is limited to statute and no case law which suggests that it is. For that reason, a penalty imposed for a common law offence, such as bribing a public official or misconduct in public office, may fall within s 82(3).

B *The Objectives of Penalties and Fines*

From the overview of s 82(3) of the *Bankruptcy Act* in the previous paragraphs, it can be seen that this section may apply to a wide array of fines and penalties. Some of these may punish egregious behaviour and hence be vigorously pursued by the relevant regulator while others, such as the parking fines considered in *Mansfield*, may simply be imposed to ensure the orderly operation of society and hence not be pursued as vigorously. Despite these differences, all fines and penalties appear to have two objectives: (i) deterring behaviour by an individual offender and the general public which the State considers undesirable; and (ii) punishing an offender.⁹ The relative importance of these two objectives may vary depending on the conduct to which the penalty relates. For example, the serious breaches of competition laws considered in *Mathers* needed to be strongly deterred and arguably warranted punishment. By contrast, the

³ Ibid 139 [26].

⁴ Ibid 139 [25].

⁵ Heerey J noted that the similarities between bankruptcy and corporate insolvency ‘are obvious’ and that ‘one would need strong textual and policy grounds for imputing to Parliament an intention that a creditor with a debt of exactly the same nature would be entitled to prove in a corporate insolvency but not in a bankruptcy’: ibid 137 [11].

⁶ (2003) 130 FCR 376.

⁷ Ibid 385–91 [25]–[47].

⁸ Ibid 391 [47].

⁹ Simon Bronitt and Bernadette McSherry, *Principles of Criminal Law* (Thomson Reuters, 3rd ed, 2010) 17 [1.60]. See also Michael Murray, ‘Penalties and Fines in Bankruptcy’ (2004) 14(1) *New Directions in Bankruptcy* 16, 18 where Murray says, ‘Penalties or fines are moneys payable to the State as statement of the fact that the conduct involved should be punished and be deterred’.

parking fines considered in *Mansfield* were perhaps less motivated by a need for punishment and more by a need to deter behaviour that could disrupt the orderly operation of society.

The first of these objectives (deterrence) has been recognised in relation to criminal behaviour¹⁰ and in relation to pecuniary penalties. Two of the more significant pieces of legislation that impose pecuniary penalties are the *Corporations Act 2001* (Cth) ('*Corporations Act*') and the *Competition and Consumer Act 2010* (Cth) ('*Competition and Consumer Act*').¹¹ In relation to pecuniary penalties imposed under the *Corporations Act*, Santow J in *ASIC v Adler (No 5)*¹² said: 'It is well established that the principal purpose of a pecuniary penalty is to act as a personal deterrent and a deterrent to the general public against a repetition of like conduct'.¹³

In relation to the *Competition and Consumer Act*, the Full Federal Court in *ACCC v Dataline.Net.Au Pty Ltd (in liq)*¹⁴ unanimously said:

The primary objective of imposing a pecuniary penalty ... is deterrence with a view to putting a 'price on contravention that is sufficiently high to deter repetition by the contravener and by others who might be tempted to contravene the Act' ... Accordingly, a pecuniary penalty ought to be imposed ... sufficient to deter him [the respondent] from engaging in further contraventions ... (specific deterrence) and to deter members of the public from engaging in similar conduct (general deterrence) ...¹⁵

Closely linked with the objective of deterrence is the objective of protecting the public and maintaining order through discouraging misconduct.

The second objective of fines and penalties, as identified above (punishing the offender), has been recognised in relation to criminal behaviour.¹⁶ The objective does not appear to be as important for pecuniary penalties imposed under the *Corporations Act* and *Competition and Consumer Act*. In relation to the *Corporations Act*, Santow J in *ASIC v Adler (No 5)* acknowledged that pecuniary penalties have a 'punitive character' but maintained that they are 'principally' aimed at deterrence.¹⁷ The role of punishment in setting pecuniary penalties under

¹⁰ Bronitt and McSherry, above n 9, 17 [1.60].

¹¹ It is interesting to note that s 82(3AA) of the *Bankruptcy Act* specifically provides that a pecuniary penalty under the *Corporations Act* is not provable. Hence, s 82(3) does not need to be relied on to exclude such a penalty from provable debts. There is no equivalent to s 82(3AA) for pecuniary penalties imposed under the *Competition and Consumer Act*, so s 82(3) must be relied on for such penalties.

¹² (2002) 42 ACSR 80.

¹³ *Ibid* 114 [125] citing *ASC v Donovan* (1998) 28 ACSR 583.

¹⁴ (2007) 161 FCR 513.

¹⁵ *Ibid* 527 [60] (citations omitted). This decision concerned the predecessor of the *Competition and Consumer Act*, being the *Trade Practices Act 1974* (Cth). The Court cited numerous authorities in support of this proposition, including *Trade Practices Commission v CSR Ltd* (1991) ATPR 41-076, 52,152 (per French J); *Trade Practices Commission v Stihl Chain Saws (Aust) Pty Ltd* (1978) ATPR 40-091, 17,896 (per Smithers J); *ACCC v George Weston Foods Ltd* (2000) ATPR 41-763, 40, 986 (per Goldberg J); *NW Frozen Foods Pty Ltd v ACCC* (1996) 71 FCR 285, 294-5 (per Burchett and Kiefel JJ); *Schneider Electric (Australia) Pty Ltd v ACCC* (2003) 127 FCR 170, 172 (per Sackville J); and *ACCC v Dermalogica Pty Ltd* (2005) 215 ALR 48, 495 (per Goldberg J). See also *ACCC v TPG Internet Pty Ltd* (2013) 250 CLR 640, 659; *ACCC v Coles Supermarkets Australia Pty Ltd* [2015] FCA 330, [10]; and *ACCC v Energy Australia Pty Ltd* [2015] FCA 274, [102].

¹⁶ Bronitt and McSherry, above n 9, 17 [1.60].

¹⁷ (2002) 42 ACSR 80, 114 [126]. Cooper J in *ASC v Donovan* (1998) 28 ACSR 583 said that a pecuniary penalty's 'purpose in an appropriate case is to punish, but principally imposition of a pecuniary penalty is to act as a personal deterrent and a deterrent to the general public against a repetition of like conduct': at 608. In *ASIC v Vizard* (2005) 145 FCR 57, Finkelstein J listed 'retribution (where punishment is imposed simply because the offender deserves it)' as one of the factors relevant to determining a pecuniary penalty: at 64 [30]. However, his Honour then said that deterrence was still the 'governing principle': at 65 [33].

the *Competition and Consumer Act* is unresolved, but there are some decisions saying that punishment is a relevant objective.¹⁸

The two objectives of deterrence and punishment distinguish fines and penalties from other unsecured liabilities of a bankrupt. Most unsecured liabilities are compensatory in nature whether they provide compensation for goods or services provided by the creditor to the debtor as part of a commercial transaction, or compensate the creditor for a civil wrong committed by the debtor, such as a breach of contract, tort, or misleading or deceptive conduct.¹⁹

C *The Policy Behind Penalties and Fines Not Being Provable*

The providence of s 82(3) is not entirely clear. It was observed by the Full Federal Court in *Mansfield* that s 82(3) was introduced into the draft bill, which became the *Bankruptcy Act*, before its second reading.²⁰ The Full Federal Court assumed that the provision was included to implement the policy espoused in *Re Bradbury; Ex parte The King*,²¹ which was that bankruptcy should not be allowed to free someone from a penalty or fine.²² The Full Federal Court noted that s 82(3) is based upon two further objectives: (i) fines and penalties are imposed to meet the public interest in punishing an offender and (ii) the interests of ordinary creditors should not be adversely affected by the wrongdoing of the bankrupt.²³ These two objectives were noted by the Australian Law Reform Commission ('ALRC') in its report, *Principled Regulation: Civil and Administrative Penalties in Australian Federal Regulation*.²⁴

D *Problems With Penalties and Fines Not Being Provable*

Bankruptcy has several aims, two of which are (i) relieving the bankrupt from pressure from creditors²⁵ and (ii) providing an equal distribution of the bankrupt's assets amongst all creditors.²⁶ These two aims flow from a 'collectivist' view of insolvency administration. 'Collectivism' dictates that individual creditors must surrender the right to pursue their debt and take part in a collective process with other creditors.²⁷ Since fines and penalties are not provable, the regulator who pursues those fines does not take part in the collective process, but rather acts individually. This causes several problems which are addressed below.

¹⁸ See *ACCC v SIP Australia Pty Ltd* (2003) ATPR 41-937, [24]–[25]; *ACCC v Ithaca Ice Works Pty Ltd* (2002) ATPR 41-851, [50]; *ACCC v J McPhee & Son (Australia) Pty Ltd (No. 5)* (1998) ATPR 41-628, 40,892; *ACCC v Australian Safeway Stores Pty Ltd* (1997) 75 FCR 238, 241–2; *Trade Practices Commission v Stihl Chain Saws (Aust) Pty Ltd* (1978) ATPR 40-091, 17,896.

¹⁹ Please note that a *demand* for unliquidated damages arising other than by reason of a contract, promise or breach of trust is *not* provable (s 82(2)). However, a judgment debt for a fixed amount is provable.

²⁰ *Mansfield* (2003) 130 FCR 376, 386 [32].

²¹ (1931) 3 ABC 204.

²² *Ibid* 209.

²³ *Mansfield* (2003) 130 FCR 376, 386 [33].

²⁴ ALRC, Report No 95 (2003) [32.147].

²⁵ Michael Murray and Jason Harris, *Keay's Insolvency* (Thomson Reuters, 8th ed, 2014) 33 [2.30].

²⁶ *Ibid* 33 [2.25].

²⁷ Andrew Keay, *Avoidance Provisions in Insolvency Law* (Law Book Company Limited, 1997) 35–40; Andrew Keay, 'In Pursuit of the Rationale Behind the Avoidance of Pre-Liquidation Transactions' (1996) 18 *Sydney Law Review* 55, 61–5; Andrew Keay, 'An Exposition and Assessment of Unfair Preferences' (1994) 19 *Melbourne University Law Review* 545, 550. Keay was addressing corporate insolvency but the principle of 'collectivism' appears applicable to bankruptcy as well.

1 Stay of Execution Against the Bankrupt

One of the ramifications of s 82(3) is that there is no stay preventing a regulator from pursuing the bankrupt for a fine or penalty. Section 58(3)(a) forbids a creditor from enforcing a remedy against a bankrupt in respect of a *provable debt*. Further, s 60(1)(b) empowers the Court to stay any legal process, whether civil or criminal, brought against a bankrupt or their property in respect of a *provable debt*. Since a fine or penalty is not provable, ss 58(3)(a) and 60(1)(b) do not apply. This could expose the debtor to pressure from a regulator in respect of a fine or penalty. This would be contrary to one of the objectives of bankruptcy identified above, being to relieve the bankrupt from pressure from creditors. Also, the bankrupt could be exposed to penal orders or seizure of property.²⁸ Both of these are considered separately below.

In relation to penal orders, since s 60(1)(b) does not apply to a fine or penalty, it is possible that a fine or penalty could be converted into a community service order or imprisonment during the term of the bankruptcy.²⁹ This may not only be harsh to the bankrupt but could prejudice the interests of unsecured creditors because the bankrupt may find it difficult (or impossible in the case of imprisonment) to earn income that could be distributed as a dividend to creditors.

In relation to seizure of property, s 118 of the *Bankruptcy Act* provides some protection from a regulator enforcing a fine or penalty by seizure, but not complete protection. Section 118(1) forbids a creditor from *retaining* the proceeds of seizure and sale of property of the bankrupt. This prohibition applies in relation to non-provable debts, and hence fines and penalties are captured. However, s 118(1) does not forbid the seizure and sale of property, just the *retention* of the proceeds by the creditor. A creditor who has seized and sold property is required to disgorge the proceeds to the trustee, less the taxed costs of their actions. The creditor may then prove for the disgorged amount even if their debt was non-provable.³⁰ Section 118 does not prevent civil enforcement measures being taken against property that is not divisible amongst the bankrupt's creditors. Such property includes items which are important for the bankrupt's day-to-day existence, such as certain household property and certain items used to earn income. If non-divisible property is sold and seized, the proceeds must be returned to the bankrupt by

²⁸ The enforcement of fines and penalties is largely addressed by State and Territory legislation. Section 15A of the *Crimes Act 1914* (Cth) states that a State or Territory law relating to the enforcement of a fine applies to a person convicted in that State or Territory of an offence against a law of the Commonwealth. The regimes in the three most populous States may be summarised very briefly as follows. In New South Wales, the *Fines Act 1996* (NSW) allows the Commissioner of Fines Administration to order the seizure of property if a debtor defaults in paying a fine: s 72. The Commissioner may order an attachment of earnings (s 73) or community service (s 79). If a debtor fails to comply with a community service order without reasonable excuse, the Commissioner may order their imprisonment: ss 86(1) and 87. In Victoria, the *Sentencing Act 1991* (Vic) allows a court to order seizure of property of a debtor or their imprisonment, if they are arrested on default of payment of a fine: ss 69E, 69H(2)(b) and 69H(2)(c). A court may order the debtor to perform community service upon default of payment: s 69D. If a warrant for seizure of property is returned because there is insufficient property to levy the fine upon, a court may order imprisonment or community service: s 69M. In Queensland, the *State Penalties Enforcement Act 1999* (Qld) allows the registrar of the State Penalties Enforcement Registry to issue an 'enforcement order', an 'enforcement warrant' or a 'fine collection notice' for a fine imposed by a court for an offence: sub-ss 34(1)(a), (3), (4). If a debtor defaults under an 'enforcement order', the registrar may issue an arrest and imprisonment warrant: ss 51(1)(a), 52(2). The registrar may issue a warrant for seizure of property following the issue of an 'enforcement warrant' or 'fine collection notice', but the warrant does not extend to property which is not divisible amongst creditors in bankruptcy: ss 61(b), 63(2)(a). A defaulting debtor may also be imprisoned under s 119.

²⁹ See above n 28.

³⁰ See *Bankruptcy Act 1966* (Cth) s 118(3) and *O'Mara Constructions Pty Ltd v Avery* (2006) 151 FCR 196, 206–7.

the trustee, less the taxed costs incurred by the creditor who seized the property.³¹ Hence, assets which are non-divisible may be seized and sold by a regulator.³² If this occurs, the bankrupt will still receive the proceeds of the sale, but since the taxed costs of the action are retained by the regulator, the bankrupt will receive an amount that is less than the market value of the property and perhaps nothing at all if the property was of little value. Further, this 'refund' to the bankrupt does not cure the disruption suffered by the seizure and sale of their property.

It is submitted that the seizure and sale of property as part of the enforcement of a fine or penalty may be of considerable concern to a bankrupt. This concern is ameliorated by the fact that a court is not required to order the seizure of property³³ and may consider it inappropriate in the case of an undischarged bankrupt. Still, a bankrupt would receive more complete protection if such enforcement measures were entirely barred by the *Bankruptcy Act*. This would be achieved by making fines and penalties provable and hence engaging ss 58(3)(a) and 60(1)(b).

On one view, a bankrupt should not be relieved from penal sanctions and enforcement measures relating to a penalty or fine because this is part of the punishment for the transgression they have committed. There is merit in this argument. However, one must weigh this against the fact that subjecting the bankrupt to penal sanctions and enforcement measures during the administration of the bankruptcy may distract (or entirely prevent) them from earning income which could be distributed to creditors. Hence, the creditors are ultimately made to suffer for the bankrupt's transgression and the regulator's desire to punish the bankrupt. It is submitted that this is unfair to unsecured creditors. It seems particularly unfair that the one opportunity unsecured creditors have to receive some payment before their debts are forever discharged can be diminished by the actions of a regulator who can pursue their debt freely at any time, including after the administration has ended.

2 Inefficiencies

The regulator who issued the fine or penalty will not share in the benefits of the work performed by the trustee since the regulator is not entitled to prove in respect of a fine or penalty. The trustee will administer the estate of the bankrupt for three years or perhaps longer in order to satisfy provable debts. Following the discharge of the bankrupt, creditors with non-provable debts are likely to repeat the actions taken by the trustee, such as examine the now-discharged bankrupt, seize and liquidate assets and attach a portion of the now-discharged bankrupt's income. If creditors with non-provable debts are allowed to share in the benefits of the trustee's work, it may reduce the need to repeat that work themselves at a later stage. A situation where certain creditors may repeat work already performed by the trustee seems inefficient. Repeating the work of the trustee is a corollary of a creditor not taking part in the 'collective' process.

3 Antecedent Transactions

Penalties and fines are not subject to the rules regarding preferences under s 122 of the *Bankruptcy Act* or transfers to defeat creditors under s 121. This is due to s 123(4) which states that nothing in the *Bankruptcy Act* invalidates a payment made by a debtor, on or before the

³¹ *Bankruptcy Act 1966* (Cth) ss 118(1), (4).

³² As noted in n 28 above, a warrant for seizure of property under the *State Penalties Enforcement Act 1999* (Qld) does not apply to non-divisible property.

³³ The enforcement measures referred to in n 28 above are discretionary. The body ordering the measures 'may', as opposed to 'must', order them.

date on which they became bankrupt, in respect of a fine or penalty.³⁴ Allowing a regulator of a fine or penalty to retain a preferential payment may disadvantage other creditors while allowing them to retain a transfer that defeats creditors will almost certainly disadvantage other creditors. This is contrary to one of the objectives of bankruptcy law noted above, being an equal distribution of the bankrupt's assets amongst all creditors.

The risk of a preferential payment is not to be dismissed lightly given that the debtor may be keen to pay a fine due to the risk of it being converted into a community service order or imprisonment.³⁵ Overall, there is good reason to remove s 123(4) from the *Bankruptcy Act*.

III AN ALTERNATIVE APPROACH TO PENALTIES AND FINES

An alternative approach to fines and penalties during bankruptcy is as follows: (i) fines and penalties should be provable; (ii) s 123(4) should be removed so that the regulator of a fine or penalty is subject to the rules regarding antecedent transactions; (iii) the right of the regulator to receive a dividend should rank beneath that of other unsecured creditors; and (iv) the bankrupt should not be released from the fine or penalty upon their discharge.

This alternative approach is not entirely new to the *Bankruptcy Act*. From 5 June 1987 until 1 January 2003, an amount payable as a 'pecuniary penalty order' made under the *Proceeds of Crime Act 1987* (Cth) was provable but was not released on the discharge of the bankrupt.³⁶ However, the amount was not subordinated to other debts.

A Why Penalties and Fines Should Be Provable

There are three reasons why the regulator of a penalty or fine should be permitted to prove. First, making a fine or penalty provable means that it is captured by ss 58(3)(a) and 60(1)(b) of the *Bankruptcy Act* and hence enforcement action cannot be taken against the bankrupt. As noted above, enforcement actions by regulators could not only lead to hardship for the bankrupt but reduce the return to all creditors.

Secondly, allowing the regulator to prove may encourage them to fund recovery actions brought by the trustee. This point has been noted by the ALRC.³⁷ The regulator may have greater resources than other creditors since it is a government entity and hence may be better placed to fund recovery actions.

Thirdly, if the regulator is forbidden from pursuing the bankrupt during the administration of the bankruptcy and is forbidden from retaining the proceeds of an antecedent transaction, it seems only fair that the regulator should be permitted to prove. For the reasons already noted, the regulator should be prevented from pursuing the bankrupt in respect of fines and penalties during the administration of the bankruptcy and, further, s 123(4) should be removed so that the regulator is subject to the provisions regarding antecedent transactions. If these amendments are made and the regulator is not allowed to prove, the regulator will have no prospect of recovering the fine or penalty during the administration of the bankruptcy. This

³⁴ This concern was noted in the report of the ALRC, *Securing Compliance: Civil and Administrative Penalties in Australian Federal Regulation*, Discussion Paper No 65 (2002) [32.153].

³⁵ *Ibid.*

³⁶ See *Proceeds of Crime (Miscellaneous Amendments) Act 1987* (Cth) ss 4, 8, 10 and *Proceeds of Crime (Consequential Amendments and Transitional Provisions) Act 2002* (Cth) sch 4 ss 11, 20.

³⁷ ALRC, above n 34, [32.155].

would be unfair to the regulator. Admittedly, the regulator could still pursue the bankrupt after their discharge, but that is likely to require the regulator to wait at least 3 years.

B Why A Regulator Should Rank Behind Other Unsecured Creditors

The ALRC has previously recommended that fines and penalties be provable,³⁸ but has made no recommendation as to whether they should be given a lower or higher priority than other unsecured debts. It is submitted that fines and penalties should be subordinated to other unsecured debts.

If fines and penalties rank equally with other unsecured debts, unsecured creditors will bear the consequences of the bankrupt's wrongdoing. This would be unfair to unsecured creditors. This problem has been noted before.³⁹ For instance, it was acknowledged during the introduction of the predecessor of s 553B of the *Corporations Act*, being s 553B of the *Corporations Law*. As noted above, s 553B is the corporate insolvency equivalent of s 82(3) of the *Bankruptcy Act*. Section 553B of the *Corporations Law* was introduced by the *Corporate Law Reform Bill 1992*. The Explanatory Memorandum for that Bill said:

Under subsection 82(3) of the *Bankruptcy Act*, penalties or fines imposed by a court in respect of an offence against the law, whether the law of the Commonwealth or not, are not provable in a corporate winding up. The Harmer Report recommended that fines imposed before or after the commencement of a winding up should be admissible in corporate insolvency ... The recommendation of the Harmer Report is not implemented in the Bill ... In the case of a corporate insolvency, it is difficult to justify 'penalising' creditors for a wrong committed by the company.⁴⁰

How the injustice to unsecured creditors would arise can be illustrated by the following simple example. Consider a bankrupt who has \$5000 of assets and two unsecured creditors who are each owed \$5000. The bankrupt also owes a penalty of \$90 000 to a regulator. If the penalty ranked equally with the two unsecured debts of \$5000, the two unsecured creditors would each receive \$250 and the regulator would receive \$4500. This is because there is a fund of \$5000 and total claims of \$100 000 which results in a dividend of 5 cents per dollar. A dividend of 5 cents per dollar results in a payment of \$250 to each unsecured creditor in respect of their \$5000 debt (ie 5% of \$5000) and a payment of \$4500 to the regulator (ie 5% of \$90 000).⁴¹ If the penalty ranked below the two debts of \$5000, the unsecured creditors would each receive \$2500. This is because there is a fund of \$5000 and total claims of only \$10 000 due to the penalty of \$90 000 being subordinated. The resulting dividend is 50 cents per dollar for the two unsecured creditors, so they each receive \$2500 in respect of their \$5000 debt (ie 50% of \$5000). The regulator receives nothing because the fund of \$5000 has been exhausted by the two unsecured creditors. As this example illustrates, if the penalty is allowed to rank equally with the two unsecured debts, the unsecured creditors will receive a lesser dividend simply because the bankrupt committed a wrong. In this way, the punishment which ought to be borne by the bankrupt is imposed on the unsecured creditors through making them effectively pay a

³⁸ Law Reform Commission, *General Insolvency Law Inquiry*, Report No 45 (1988) [792] and *ibid* recommendation 32–3.

³⁹ See Michael Murray, 'Fines and Penalties – Provable in Bankruptcy?' (2000) 10(3) *New Directions in Bankruptcy* 13, 13–4.

⁴⁰ Explanatory Memorandum, *Corporate Law Reform Bill 1992* (Cth) [854].

⁴¹ This example is an over-simplification as it ignores the remuneration of the trustee amongst other things, but it still illustrates the point.

penalty of \$2250 each (ie the difference between the \$2500 they each receive if the penalty is subordinated and the \$250 they receive if there is no subordination).

It is submitted that it is acceptable for an unsecured creditor to receive a dividend of less than 100 cents in the dollar due to financial imprudence on their behalf, such as lending money to the debtor without taking security or without performing adequate due diligence. In those circumstances, the unsecured creditor is the author of their own misfortune. However, it is unacceptable for an unsecured creditor to receive a lower dividend due to the punishment that should be borne by the bankrupt being passed on to the unsecured creditor. This is clearly at odds with one of the objectives of penalties, being to punish the offender rather than an innocent party. Admittedly, the problem of a punishment intended for the bankrupt being passed to unsecured creditors may exist in other circumstances, such as judgment debts for exemplary damages, which are provable. However, the fact a problem exists elsewhere is no reason for not addressing it in another situation.

One undesirable outcome of subordinating fines and penalties is that it may discourage a regulator from funding recovery proceedings brought by the trustee. If a regulator is to receive any dividend, unsecured creditors will have to receive complete repayment of their debts. This is very unlikely to occur.⁴² This difficulty may be partially alleviated by s 109(10) of the *Bankruptcy Act* which permits the Court to order that a creditor, who has indemnified the trustee against recovery costs, be given an advantage over other creditors regarding the distribution of the recovered property.

It may seem unfair to subordinate a regulator to other unsecured creditors, but any unfairness is mitigated by the following three factors. First, the regulator will not have its debt (being the fine or penalty) released upon the discharge of the bankrupt and hence has an advantage over other unsecured creditors in that it may still pursue the bankrupt after their discharge. Secondly, the regulator is a government-funded entity and is hence unlikely to be as financially vulnerable as other unsecured creditors. Thirdly, the regulator is not a commercial enterprise and is hence unlikely to be as concerned as other unsecured creditors by the prospect of receiving a lesser dividend. In relation to this third point, unsecured creditors are likely to have provided goods or services to the bankrupt in the expectation of receiving payment and may be relying on such payment for their continued existence. By contrast, a regulator is unlikely to have provided any goods or services to the bankrupt and is unlikely to be relying on the payment of a fine or penalty for its continued existence.⁴³

C *Why Fines and Penalties Should Not Be Released Upon Discharge of the Bankrupt*

It is submitted that fines and penalties should not be released upon the discharge of the bankrupt for three reasons. First, a discharge from bankruptcy should give the bankrupt a 'fresh start' from previous financial errors but this 'fresh start' should not go so far as to exonerate them from previous misconduct. One of the primary objectives of the *Bankruptcy Act* is to provide a bankrupt with a 'fresh start' in the form of a discharge from debts and liabilities that existed

⁴² For the 2012–2013 financial year, the Australian Financial Security Authority reported that only 8.81% of bankruptcies paid a dividend to unsecured creditors and for those that did pay a dividend, the average dividend was 7.07 cents per dollar: see Veronique Ingram, 'AFSA Update' (2013) 25(4) *Australian Insolvency Journal* 44, 45.

⁴³ Similarly, Michael Murray says that a penalty is payable to the State not as recompense for loss or damage suffered by the state but primarily to deter misconduct. This objective is achieved even if the penalty is not paid. Hence, it is a 'bonus' for the state if it actually receives payment: Murray, above n 9, 18.

at the date of bankruptcy.⁴⁴ Some have referred to the ‘fresh start’ as ‘the guiding principle of bankruptcy law’.⁴⁵ If this ‘fresh start’ amounted to an exoneration from previous misconduct, the deterrent effect of fines and penalties could be harmed, which may consequently affect the prevention of wrongdoing and the protection of public order. As noted above, deterrence is one of the objectives of fines and penalties. It is noteworthy that a bankrupt is not discharged from a debt incurred by fraud or fraudulent breach of trust.⁴⁶ This exclusion for fraud is consistent with the policy that a bankrupt should not be exonerated from misconduct.

Secondly, it seems unjust to allow a bankrupt to avoid the punishment, which is imposed by a fine or penalty, by undergoing a non-punitive process such as bankruptcy. The *Bankruptcy Act* recognises the importance of punishing misconduct as can be seen from Part XIV, which allows for prison sentences and fines for various types of misconduct. For example, a person who conceals property of a bankrupt with the intent of defrauding creditors may be imprisoned for up to five years⁴⁷ while a bankrupt may be imprisoned for up to one year for failing to fully disclose property to their trustee.⁴⁸ The *Bankruptcy Act* specifically states that a person may be prosecuted for any offence under the Act after they have been discharged from bankruptcy.⁴⁹ Hence, the *Bankruptcy Act* recognises the need to punish misconduct and that such punishment should continue after the bankruptcy process has ended.

Thirdly, the opportunity to gain exoneration from previous misconduct could lead to debtors using bankruptcy to avoid the payment of fines and penalties. This could undermine the goals of deterrence and punishment which are inherent in fines and penalties.

The ALRC has previously recommended that fines and penalties be released upon discharge of the bankrupt with the regulator having the option of applying to a court, prior to the discharge of the bankrupt, for an order that the outstanding fines or penalties not be released.⁵⁰ The ALRC considered it appropriate for the regulator to bear the onus of making the application because it will be ‘comparatively better resourced than a bankrupt’.⁵¹ The regulator may be better resourced but it is undesirable that it be made to bear the onus of upholding a fine or penalty when it previously bore the onus of having the fine or penalty imposed to begin with. The debtor/offender is effectively being given a further appeal against the imposition of the fine or penalty where the onus is borne by the respondent of the appeal rather than the appellant.

The ALRC also considered it appropriate that the court exercise ‘judicial discretion’ when considering whether to release the penalty or fine and should consider the ‘severity of the penalty, the nature of the offence, and the conduct of the bankrupt’.⁵² There is nothing objectionable about ‘judicial discretion’, but such discretion should be exercised by the court that imposed the original penalty or fine (and preferably the same judge). The judge who

⁴⁴ Nicola Howell, ‘The Fresh Start Goal of the Bankruptcy Act: Giving a Temporary Reprieve or Facilitating Debtor Rehabilitation?’ (2014) 14(3) *QUT Law Review* 29, 31, 46 and 47. Howell concludes that an ‘analysis of the key primary and secondary documents supports the view that one of the objectives of the Bankruptcy Act is to provide the opportunity for a fresh start to debtors’ (at 46) but this objective is not explicitly stated in the Act (at 47) and the concept of a ‘fresh start’ is not currently well defined (at 51). See also Murray and Harris, above n 25, 32 [2.30].

⁴⁵ Murray, above n 9, 18.

⁴⁶ *Bankruptcy Act 1966* (Cth) s 153(2)(b).

⁴⁷ *Ibid* s 263(1)(a).

⁴⁸ *Ibid* s 265(1)(a).

⁴⁹ *Ibid* s 275.

⁵⁰ ALRC, above n 34, recommendation 32-3.

⁵¹ *Ibid* [32.168].

⁵² *Ibid*.

imposed the fine or penalty is likely to be better acquainted with the facts justifying the imposition of the fine or penalty than another judge sitting several years later. Further, the proposal of the ALRC could lead to the strange situation where a lower court is reviewing a penalty or fine imposed by a higher court. In an earlier report, the ALRC recommended that fines and penalties should not be automatically discharged because the imposition of fines and penalties is a matter better dealt with by the original sentencing court.⁵³ It is submitted that this earlier recommendation of the ALRC is preferable.

IV CONCLUSION

Fines and penalties are not ordinary unsecured debts and a regulator is not an ordinary unsecured creditor. For this reason, fines and penalties should be treated differently during the administration of a bankruptcy. At present, they are treated differently but in a way which is not entirely satisfactory. Currently, fines and penalties survive bankruptcy. It is submitted that this should continue since providing a release would exonerate the debtor from misconduct rather than provide them with a 'fresh start' free from previous financial errors. Such exoneration could undermine two of the goals of imposing fines and penalties, being deterrence and punishment of wrong-doing.

Currently, fines and penalties are not provable. It is submitted that they should be provable so that the regulator of the fine or penalty is restrained from pursuing the bankrupt by ss 58(3)(a) and 60(1)(b) of the *Bankruptcy Act*; has an opportunity to share in the benefits of the work performed by the trustee; and is given some incentive to provide financial assistance for recovery proceedings brought by the trustee. Section 123(4) of the *Bankruptcy Act* should be removed so that fines and penalties are subject to the rules regarding antecedent transactions. Fines and penalties should rank behind other unsecured debts so that the punishment imposed on the bankrupt is not effectively transferred to all unsecured creditors.

⁵³ Law Reform Commission, *General Insolvency Law Inquiry*, Report No 45 (1988) [792].