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Bankruptcy and Insolvency in Australia

*The Honorable Mr. Justice W.M.C. Gummow**

The Australian Constitution confers upon the Federal Parliament the power to make laws with respect to “[b]ankruptcy and insolvency.”¹ Comprehensive legislation was passed as the Bankruptcy Act 1924 (Cth), succeeded by the Bankruptcy Act 1966 (Cth).

The nature and content of this power indicate two matters to be kept in mind when comparing the Australian position with that in the United States and Canada. First, the federal legislative power is concurrent with, rather than exclusive of, that of the states. Thus, when there appears to be a state law dealing with bankruptcy, the question is not whether this trespasses upon the exclusive province of the Commonwealth’s legislature, but whether the state law must yield because it is inconsistent with a federal statute within the meaning of section 109 of the Constitution. This is important in considering and contrasting the position in Canada as explained in Professor Ziegel’s paper.²

The contrast between the Australian and Canadian bankruptcy jurisdiction was well understood by the Founding Fathers:

The bankruptcy and insolvency jurisdiction is not an exclusive power of the Federal Parliament, like that conferred on the Parliament of Canada; it is a concurrent power. Until the Federal Parliament has passed laws inconsistent with State laws bearing on the question, State laws will remain in full force and effect; and until the Federal Parliament has occupied the whole area capable of being covered by the subject, the States may continue to pass other bankruptcy and insolvency laws, and may enforce them so long as they do not conflict with federal laws (sec. 107-109). The cases decided under the Constitution of the United States are valuable as illustrating the operation of concurrent laws; those under the Canadian Constitution are only useful as decisions showing what insolvency and bankruptcy legislation is capable of including, and as showing what are merely matters of local and private interests.³

* A Justice of the Federal Court of Australia. On March 28, 1995, Justice Gummow was recommended by the Australian Commonwealth government for appointment as Justice of the High Court of Australia.

1. AUSTL. CONST. § 51(xvii).

2. Jacob S. Ziegel, *Secured Transactions in Personal Property and the Federal-Provincial Conflict in Canadian Bankruptcy Law*, 46 S.C. L. REV. 875 (1995).

3. JOHN QUICK & ROBERT R. GARRAN, *THE ANNOTATED CONSTITUTION OF THE AUSTRALIAN COMMONWEALTH* 587 (1901).

The second point concerns the exercise of legislative power with respect to insolvent corporations. In Canada and the United States the corresponding federal legislative powers have been held to extend to liquidations of insolvent corporate trading bodies.⁴ The Founding Fathers intended that the same would be true in Australia.⁵ Nevertheless, the enactment of legislative schemes dealing with corporate insolvency has been left to the states for inclusion in their corporate legislation. Partly, this has been because the Commonwealth lacks the power to deal with all aspects of corporate law, commencing with the power of incorporation. The limit on the federal legislative power was established in 1990.⁶

The consequence has been the enactment, as a federal-state cooperative scheme, of the Corporations Law. Nevertheless, the topics of individual and corporate insolvency and bankruptcy are kept distinct, the former being dealt with in the Bankruptcy Act 1966 and the latter in the Corporations Law. The position is modified to some extent by provisions found in the Corporations Law and in the earlier state statutes that “pickup,” subject to qualifications, the provisions of the federal bankruptcy law dealing with proof and ranking of claims.⁷ Further, the operation of the cooperative scheme results in the exercise by the Federal Court of Australia of jurisdiction, not only in respect of individual bankruptcy pursuant to the federal bankruptcy legislation, but also in relation to corporate matters.⁸ However, as regards bankruptcy, only federal jurisdiction is involved, and this is vested primarily in the Federal Court of Australia.⁹ All appeals must be brought to the Federal Court.¹⁰ There is a provision for the transfer of proceedings from the Federal Court to the Family Court of Australia.¹¹

One contrast with the position in the United States should be noted. There has been no attempt in Australia by the Federal Parliament to create what in the United States is described as “legislative courts,” which operate outside the authority of Article III of the United States Constitution.¹² The

4. See *Victoria v. Commonwealth*, 99 C.L.R. 575, 612 (1957) (collecting the relevant authorities).

5. QUICK AND GARRAN, *supra* note 3, at 586-87; see also *Victoria v. Commonwealth*, 99 C.L.R. at 575.

6. *New South Wales v. Commonwealth*, 169 C.L.R. 482 (1990). The opinion, *The Incorporation Case*, is much-criticized.

7. Corporations Law, § 553E.

8. The operation of the cooperative scheme in relation to jurisdiction of courts, which is quite distinct from the cross-vesting legislation scheme, is explained in *Acton Eng'g Pty. Ltd. v. Campbell*, 31 F.C.R. 1, 8-11 (1991).

9. Bankruptcy Act 1966, §§ 27-39.

10. *Id.* § 39.

11. *Id.* § 35.

12. See *Northern Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982).

jurisdiction in bankruptcy matters exercised by the Federal Court of Australia and by the state courts is federal jurisdiction exercised pursuant to Chapter III of the Constitution.

In practice, there is little or no difficulty encountered with split jurisdiction in the administration of the bankruptcy jurisdiction as regards individuals. The position concerning corporate insolvency is more complex because the courts of the several states, as well as the Federal Court, have concurrent jurisdiction pursuant to the Corporations Law. There is no single intermediate court of appeal. This has led to conflicting decisions in the administration of the Corporations Law as between the states and as between federal and state courts. The High Court of Australia has indicated in strong terms that uniformity of decision in the interpretation of the cooperative corporate law is sufficiently important to require that an intermediate appellate court, and even more a trial judge, should not depart from an interpretation placed upon it by another Australian intermediate appellate court "unless convinced that that interpretation is plainly wrong."¹³

I turn now to consider, by way of contrast particularly with the Canadian position, the law as it has developed in Australia as to the interplay between bankruptcy law and the general rules of property law and the relationship between state and federal Crown debts in insolvent administrations.

The Bankruptcy Act 1966 provides for the administration in bankruptcy of estates of deceased persons.¹⁴ Provision of the same nature had been made in the 1924 Act.¹⁵ The courts have held that subsection 155(2) of the 1924 Act, in conferring on the Federal Court of Bankruptcy power to make an order for the administration in bankruptcy of the estate of a deceased debtor, was not ultra vires the power of the Parliament under section 51(xvii) of the Constitution. In particular, the provision was not rendered invalid by the fact that the court could sequester the estate of a debtor merely because the personal representative could not show that there was a reasonable probability of the estate's meeting its obligations.¹⁶ The federal law makes provisions for administration in bankruptcy not only upon the petition of a creditor, but upon the petition of the administrator of the deceased estate. The practice has been that any estate of any size is subject to administration under the federal law. Nevertheless, it also appears to be an accepted practice that until an order is made on a petition, the laws of the several states dealing with the administration of insolvent estates apply. Whether the federal law covers the field to completely supplant the state laws appears never to have been tested.

13. *Australian Sec. Comm'n v. Marlborough Gold Mines Ltd.*, 177 C.L.R. 485, 492 (1993).

14. Bankruptcy Act 1966, §§ 244-53.

15. Bankruptcy Act 1924, §§ 155-56.

16. *Re Paravicini* 3 A.B.C. 15 (1930). The court referred to the discussion of the phrase "Bankruptcy and Insolvency" in subsection 91 (21) of the British North America Act in *L'Union St., Jacques Dr. Montreal v. Belisle* 6 L.R.-P.C. 31, 36-7 (1874).

Further propositions as to the impact of the federal bankruptcy law upon the general property law of the states are as follows:

- (1) In *Price v. Parsons*,¹⁷ the High Court held that state law rendering an unregistered bill of sale invalid against a trustee in bankruptcy operated concurrently with and was not inconsistent with federal law. The effect of the state law was to swell the assets available in the bankruptcy administration, and the federal law did not state exhaustively which antecedent transactions were to be rendered invalid.¹⁸
- (2) The various states have enacted laws similar to the Elizabethan statute dealing with fraudulent conveyances.¹⁹ In *Williams v. Lloyd*²⁰ the High Court held that in a bankruptcy administration under federal law the Official Receiver might rely upon the provisions of the state statutes to recover fraudulent conveyances. Even though the federal law contained detailed claw-back provisions, it did not cover the field, and the state laws were not inconsistent with the federal statute.²¹ This may be compared with the result in *Robinson v. Countrywide Factors*,²² referred to by Professor Ziegel in his paper.²³ The Australian position is a reflection of the nature of the federal legislative power as concurrent with, rather than exclusive of, that of the states.

I turn now to consider Crown priorities. As in Canada, the Australian constitutional position as revealed in the decisions has been modified by statute to reflect a political arrangement between the respective governments.

The position established by the High Court may be summarized as follows:

- (1) In the absence of valid legislation to the contrary, when debts are due to the Crown in federal and state capacities, the prerogative priority of each abates rateably.²⁴
- (2) A state may not legislatively postpone the priority of the Commonwealth for debts accruing to it under Commonwealth legislation even

17. 54 C.L.R. 332 (1936).

18. *Id.* at 344-46.

19. 13 Eliz., ch. 5 (1570).

20. 50 C.L.R. 341 (1934).

21. *Id.*

22. [1978] 1 S.C.R. 753.

23. See Ziegel, *supra* note 2.

24. Federal Comm'r of Taxation v. E.O. Farley Ltd., 63 C.L.R. 278 (1940).

though the Commonwealth has not legislated inconsistently with state law. The result follows from the nature of the federal structure and the position of the federal government in it, rather than the exercise of legislative powers of the Commonwealth.²⁵

- (3) The Commonwealth may legislate to give its debts priority over secured as well as unsecured debts arising under state law.²⁶
- (4) The Commonwealth's legislative taxing powers generally are concurrent with those of the states, but the powers of the Commonwealth to impose excise taxes and customs duties are exclusive. In the exercise of any of these legislative powers (*e.g.*, the concurrent power to tax income), the Commonwealth may create a priority in its favor in bankruptcy and insolvency that ranks ahead of unpaid state taxes.²⁷
- (5) The priority enjoyed by the Crown under the common-law prerogative and pursuant to statute will not, in the absence of an express provision permitting an appeal against the original assessment, include a tracing remedy into the hands of third-party volunteers taking assets from the taxpayer.²⁸

Finally, according to the Crown Debts (Priority) Act 1981 (Cth), with some specified exceptions, the Crown in right of the Commonwealth subjects itself to state and territory laws with respect to priority. The terms of the principal provision are as follows:

3. Notwithstanding any prerogative right or privilege of the Crown in right of the Commonwealth, the Crown in right of the Commonwealth is subject to any provision of a law of a State or Territory
 - (a) relating to the order in which debts or liabilities of a body (whether corporate or unincorporate) are to be paid or discharged;

25. *Commonwealth v. Cigamatic Pty. Ltd. (In Liquidation)*, 108 C.L.R. 372 (1962).

26. *See generally* Income Tax Assessment Act 1936, § 221P, (dealing with unremitted installments of group tax withheld by employers from the wages of employees, which, in this respect, has never been challenged).

27. *Victoria v. Commonwealth*, 99 C.L.R. 575 (1957). This may be compared with the Canadian position, discussed in Ziegel, *supra* note 2.

28. *Commonwealth v. McCormick*, 155 C.L.R. 273 (1984); *Deputy Comm'r of Taxation v. Brown*, 100 C.L.R. 32 (1957).

- (b) relating to the avoidance of preferences received by creditors of a body (whether corporate or unincorporate); or
- (c) relating to the effect on creditors or members of a body (whether corporate or unincorporate) of a compromise or arrangement between the body and another person or other persons.²⁹

This result may be compared with that later reached in Canada with the 1991 legislation.³⁰

29. Crown Debts (Priority) Act 1981 (Cth) § 3.

30. *See generally* Ziegel, *supra* note 2.