

## **The No Asset Procedure - Easy bankruptcy?**

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Emily Walton, associate, and Edward Burrell, former solicitor, with Wynn Williams & Co, look at this from the points of view of both a creditor and a debtor.

*Imagine you are \$40,000 in debt. With the cost of living today, paying off this amount legitimately will take you years.*

*Now imagine someone offers you a way to wipe all your debts in a year by curbing your spending and keeping your credit below \$1,000. Creditors cannot touch the car you just bought for \$5,000, any of your household and personal effects, or your tools of trade. After a year, your \$40,000 debt will be wiped and you will be back to a clean slate.*

Welcome to the No Asset Procedure (NAP), which is one of the procedures available to debtors under the Insolvency Act 2006.

If given this opportunity would you turn it down? To many debtors the scheme sounds generous and therefore attractive, but the very generosity of the scheme makes it a source of annoyance and frustration to creditors.

Many people in debt are now choosing to enter the NAP, rather than file for bankruptcy or take other steps to pay off their debt, to the financial disadvantage of their creditors. Adding to creditors' frustrations is the fact that provided debtors genuinely meet the entry criteria for the NAP, creditors can do nothing to prevent it.

### **How does a debtor get into the NAP?**

It is reasonably easy for people to be accepted into the NAP. To satisfy the Insolvency Act criteria for entry to the NAP, a debtor:

- must have no realisable assets (excluding household and personal effects, tools of trade, and motor vehicles worth up to \$5,000);
- must not have been admitted to the NAP or adjudicated bankrupt before;
- must have total debts between \$1,000 and \$40,000; and
- must have no means of being able to repay the debts (note that a person in paid employment may still qualify).

### **How to prevent a debtor entering the NAP?**

The Official Assignee cannot admit a debtor to the NAP in certain situations; for example, where a debtor has concealed assets with the intention of defrauding creditors (for example, by transferring property to a trust) or where the debtor has incurred debts knowing that the debtor is unable to repay.

Limitations applying to a debtor's conduct are similar to those for bankruptcy – conduct that would be an offence when bankrupt would also prevent a debtor from entering into the NAP regime.

As well, if a creditor is going to bankrupt the debtor and bankruptcy is materially better for the creditor, then the Official Assignee may refuse entry to the NAP.

## What happens to the debts?

Debts (meaning the money the debtor owes) become unenforceable once a debtor enters the NAP. Creditors cannot take steps to enforce the debts; that is, they cannot sue the debtor in court to recover the debt.

When the debtor automatically leaves the NAP (termination by discharge) in 12 months time, all the debtor's debts are cancelled as though they never existed. The unsecured creditors can no longer sue the debtor or take any other enforcement action for the money.

Termination can occur in other ways too. In some cases debts are not cancelled – for example, by a successful creditor's objection or by the debtor's own application.

## What can creditors do about a debtor's entry into NAP?

Creditors can do very little. Creditors are formally advised of a debtor's entry into the NAP only after the Official Assignee has accepted the debtor's application. Once notified, creditors can object to a debtor's acceptance into the NAP, but their objections will succeed only if the debtor should not have been allowed into the NAP anyway (that is, where the Official Assignee overlooked something).

Objections by creditors are likely to succeed where creditors know something about a debtor's assets – for example, that they have concealed assets that the Official Assignee does not know about at the time of entry into the NAP.

Assuming a debtor meets the entry criteria and has not been disqualified through conduct, unsecured creditors will not be able to pursue their debts either during the 12 months of the NAP or after it has ended.

## Advice to creditors

1. To protect money owing to you, take security using the Personal Property Securities Act 1999. The NAP does not affect secured creditors. Even if your security is not of first ranking priority, any security is better than nothing.
2. If you are in business, place a limit on the credit you will allow. You are giving cash to a complete stranger and trusting them to pay you back later. Minimise your losses by limiting the dollar amount of unsecured credit you will provide.
3. Monitor accounts or accept cash only. Do not let your customers incur a large amount of credit without watching the payments closely. If your debtors miss their monthly payment (without a reasonable explanation), stop providing your goods or services to them until you receive a payment.

Alternatively, do not offer credit. Cash on delivery avoids any credit problems.

4. Defer court proceedings. If you have a cause of action against someone you believe is about to enter the NAP, consider delaying your proceedings until after the debtor is discharged from the NAP. This is helpful if you are claiming damages in tort or equity (for example, a claim for vehicle repair costs resulting from the defendant's negligent driving). If successful, your judgment will become a debt that arose after discharge from the NAP and is therefore unaffected by it.

Beware, however, that if your claim is for breach of contract for non-payment of an agreed sum, enforcement of the outstanding debt incurred before the debtor's entry to the NAP and your right to sue, will be prevented by the NAP.

5. Monitor debtors' participation in the NAP. The Official Assignee has established processes to allow this monitoring. Debts are wiped only where the NAP is terminated by discharge after 12 months. Any other type of early termination (for example, by a successful creditor's objection or at the debtor's request) means you can again proceed against that particular debtor.

### **Considerations for debtors**

The NAP at first sight appears to have many advantages for debtors, but some aspects of the NAP can have lingering repercussions.

1. As soon as a debtor applies for entry into the NAP, the debtor cannot get credit over \$100 without first informing the credit provider that they have applied for entry.
2. If accepted into the NAP, a debtor's ability to get credit will be limited. It is an offence to obtain credit over \$1,000 without telling the creditor they are in the NAP. The punishment for this offence is a year's imprisonment and/or a fine up to \$5,000.
3. A debtor can enter into the NAP only once. Next time the debtor is in financial trouble, the debtor will be facing bankruptcy.
4. Realistically, the debtor won't be able to obtain significant credit for a long time after the NAP. Do not underestimate how important a person's credit history is, especially in today's current economic climate. Every time a credit check is undertaken, the debtor's entry into the NAP will be revealed. While the debtor may no longer have debts owing, the debtor will have to again build up trust with creditors, who may be particularly cautious.
5. Some debts are not wiped and continue to be enforceable, including:
  - maintenance orders under the Family Proceedings Act 1980;
  - child support payments under the Child Support Act 1991;
  - student loans;
  - court fines and reparations (criminal only).

### **Summary**

The NAP provides a challenge to creditors and an incentive to closely monitor accounts payable. With the current recession, the NAP is becoming increasingly popular with debtors and that trend is unlikely to diminish in the near future. For debtors, while the NAP may seem an easy way out, they should think carefully about it – the NAP may have long-lasting effects on their credit status and their ability to obtain credit that may not be immediately obvious.