

# OTHER PEOPLE'S MONEY: GAMBLING AND BANKRUPTCY

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*[There has been a renewed focus on gambling and its social consequences. One potential consequence facing gamblers is bankruptcy. This article considers how gambling and gambling debts are treated in bankruptcy. It includes an examination of the extent to which gambling is a cause of bankruptcy; whether gambling debts should be treated differently from other debts; the attempts to deter and/or punish gambling through the use of criminal sanctions in bankruptcy legislation; whether gamblers should be denied, or have delayed, their 'fresh start'; and whether gambling transactions prior to bankruptcy are, and should be, avoidable by the trustee in bankruptcy.]*

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Bankruptcy raises profound moral issues as well as financial ones. It is a concept and an experience surrounded by moral ambiguity and filled with paradox. ... Beyond glimpses, we cannot measure fault, but it affects everything we discuss, for it is central to the moral ambiguity of our subject.<sup>1</sup>

## I INTRODUCTION

This article considers how gambling and gambling debts are treated in bankruptcy. While there is a considerable and growing literature on gambling itself, there is a significant gap when it comes to the relationship between gambling and bankruptcy policy.<sup>2</sup> One gambling study estimated that in 2000–01, Australians lost over \$14 billion on gambling.<sup>3</sup> This is almost \$1000 for every Australian. It is (very conservatively) estimated that in 2004–05 gambling caused 543

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<sup>1</sup> Teresa A Sullivan, Elizabeth Warren and Jay Lawrence Westbrook, *As We Forgive Our Debtors: Bankruptcy and Consumer Credit in America* (1989) 8.

<sup>2</sup> There have been a significant number of Australian surveys of gambling. For a helpful summary of these surveys and other gambling research: see Paul Delfabbro and Amanda LeCouteur, Independent Gambling Authority of South Australia, *A Decade of Gambling Research in Australia and New Zealand (1992–2002): Implications for Policy, Regulation and Harm Minimisation* (2003).

<sup>3</sup> *Ibid* 10.

Australians to go bankrupt, 108 to enter into debt agreements and one to enter into a personal insolvency agreement.<sup>4</sup>

Gambling in Australia, as in many other countries, is a large and growing industry. An extensive enquiry into gambling by the Productivity Commission found that over 80 per cent of Australians gamble, 40 per cent regularly.<sup>5</sup> Per capita expenditure on gambling increased, in real terms, from \$684 in 1993–94 to \$1066 in 2003–04.<sup>6</sup> This growth appears to be a direct result of the legalisation of a broader range of gambling as well as technological developments. Legalised gaming machines have been a primary stimulant.<sup>7</sup> Gambling is more accessible than ever.

This rise in gambling is not confined to Australia.<sup>8</sup> In 1974, for example, Americans spent US\$17.4 billion on gambling.<sup>9</sup> By 1997, this figure had increased to US\$638.6 billion,<sup>10</sup> meaning that the average American spent 50 per cent more on gambling than they did on groceries.<sup>11</sup> *The Economist* reported that ‘Americans now spend more on wagers than they do on theme parks, video games, spectator sports and movie tickets combined’.<sup>12</sup> As in Australia, legalisation has been a major impetus for gambling in the United States.<sup>13</sup>

The gambling industry argues that the gambling phenomenon is a socially beneficial one, with both economic and other benefits. Gambling, it is argued, creates wealth, primarily through employment, consumer spending and increased taxation revenue. The economic benefits of gambling are, however, controversial. Nobel Prize-winning economist Paul Samuelson dismissed the wealth creation argument, stating that gambling simply represents a sterile transfer of

<sup>4</sup> Insolvency and Trustee Service Australia, *Annual Report by the Inspector-General in Bankruptcy on the Operation of the Bankruptcy Act 2004–2005* (2005) tables 5–6. See also below Part II.

<sup>5</sup> Productivity Commission, *Australia’s Gambling Industries*, Report No 10 (1999) vol 1, 2, 13. The report shows that the profile of casino gamblers is biased towards young males and those of Asian background. The profile of gaming machine gamblers shows a slight bias towards the younger and middle-aged. Nevertheless, such is the ubiquity of gambling that there is really no such thing as the ‘typical’ Australian gambler.

<sup>6</sup> Centre for Gambling Research, The Australian National University, *Gambling and Expenditure in Australia: Facts and Issues* (2005) 1 <<http://gambling.anu.edu.au/menu/PDFs/factsheets2005/FactsheetAUSF&I05-Final.pdf>>.

<sup>7</sup> *Ibid* 2.

<sup>8</sup> In many respects the rise in gambling over the last decade in Australia is representative of a similar trend in other countries, but there are also some notable home-grown features. The ‘totaliser’ used in gambling on horseracing was invented in Australia. Australia is also a leader in the technology of gambling machines — ‘pokie’ machines are known as ‘Australian’ machines in other parts of the world. Furthermore, a government-regulated internet casino in the Northern Territory was the first such site in the Organisation for Economic Cooperation and Development: see Productivity Commission, above n 5, vol 1, 7.

<sup>9</sup> Henry R Lesieur, ‘Compulsive Gambling’ (1992) 29(4) *Society* 43, 43.

<sup>10</sup> Robert F Drinan, ‘Government’s Unseemly Promotion of Gambling’ (1999) 35(36) *Catholic Republican Reporter* 27, 27.

<sup>11</sup> ‘When the Wheels Won’t Stop’, *The Economist* (London), 13 December 1997, 22.

<sup>12</sup> ‘Gambling on the Future’, *The Economist* (London), 26 June 1999, 27; see also John Warren Kindt and John K Palchak, ‘Legalized Gambling’s Destabilization of US Financial Institutions and the Banking Industry: Issues in Bankruptcy, Credit, and Social Norm Production’ (2002) 19 *Bankruptcy Development Journal* 21, 25.

<sup>13</sup> Kindt and Palchak, above n 12, 51–2.

funds.<sup>14</sup> Gary Banks, Chairman of the Australian Productivity Commission, agreed:

Unleashing a previously constrained activity like gambling does not in practice create many new jobs. What it does do is enable people to spend more on gambling and less on other things. (The vocal complaints of retailers whenever new gambling operations set up in their vicinity bear testimony to this at work.) But that also means that the jobs and income created in the gambling industry have a counterpart in jobs and income destroyed in other parts of the economy. Except in depressed areas where unemployment is very high, the gambling industry's new jobs will be some other industry's existing jobs.<sup>15</sup>

What can be accepted is that gambling offers the tangible and intangible benefits of an entertainment service. With regard to the latter, the Productivity Commission agreed that

many people gamble because of the enjoyment they get from the venue, the social interaction, the risk, the thrill of anticipation, or some combination of all these ... Gambling venues such as casinos and clubs can also provide an accessible, comfortable and safe social environment, which many people — particularly women, elderly people and ethnic communities — have found appealing.<sup>16</sup>

Whether or not it is still arguable that gambling provides net benefits to society, it is beyond dispute that the rise in the rate of gambling, particularly in the wake of state-sanctioned gambling, has brought with it a range of significant undesirable social consequences.<sup>17</sup> The suggestion that gambling is 'just another industry' has been rejected outright.<sup>18</sup> The negative effects of gambling have prompted many government enquiries and this has resulted in a highly regulated industry.<sup>19</sup> The social costs of gambling are primarily associated with 'problem gamblers',<sup>20</sup> although the costs are not only borne by the gamblers, but also by their families, those with whom they deal, and the broader community. Such

<sup>14</sup> Paul A Samuelson, *Economics* (11<sup>th</sup> ed, 1980) 398; see also *ibid* 54–5.

<sup>15</sup> Gary Banks, Productivity Commission, 'The Productivity Commission's Gambling Inquiry: 3 Years On' (Paper presented at the 12<sup>th</sup> Annual Conference of the National Association for Gambling Studies, Melbourne, 21 November 2002) 5.

<sup>16</sup> Productivity Commission, *above n 5*, vol 1, 15.

<sup>17</sup> As put by Earl Grinols to a US Congressional hearing into gambling:

The essence of the gambling debate from an economic perspective can be understood by asking the question: Does America need another form of entertainment so badly that it is willing to add another social problem to the list that it already deals with such as crime, alcoholism, teen pregnancy, illegal drug use and so on?

Evidence to Committee on Small Business, US House of Representatives, *The National Impact of Casino Gambling Proliferation: Hearing before the Committee on Small Business* (21 September 1994) 8; see also Kindt and Palchak, *above n 12*, 51.

<sup>18</sup> Productivity Commission, *above n 5*, vol 1, 13.

<sup>19</sup> For the history of enquiries and the state of current regulation: see Banks, *above n 15*; Kim Jackson, *Gambling Policy and Regulation* (September 2001) Parliament of Australia: Parliamentary Library <[http://www.aph.gov.au/library/intguide/sp/gambling\\_ebrief.htm](http://www.aph.gov.au/library/intguide/sp/gambling_ebrief.htm)>.

<sup>20</sup> The meaning of this term is considered below: see Part III.

costs include employment problems, criminal behaviour, psychological illnesses, interpersonal problems and, of present interest, insolvency.<sup>21</sup>

The primary focus of this article is on Australian law, but at various points there are comparisons with the insolvency laws of the US and the United Kingdom. Part II of the article considers the extent to which gambling is a cause of bankruptcy. Part III then looks at the threshold issue of identifying the bankruptcy issues that are raised by gambling, including a consideration of the extent to which gambling debts differ from other debts. Part IV considers attempts to deter and/or punish gambling through the use of criminal sanctions in bankruptcy legislation. Part V asks whether gamblers should be denied (or at least have delayed) a 'fresh start' and/or whether gambling debts should be denied release on discharge. Part VI examines whether gambling transactions are, and should be, avoided if the gambler becomes bankrupt.<sup>22</sup> Conclusions are drawn in Part VII.

## II GAMBLING AS A CAUSE OF BANKRUPTCY

A number of jurisdictions, including Australia and the US, have experienced a dramatic rise in personal bankruptcy rates over the last decade.<sup>23</sup> This increase is puzzling as it has occurred in otherwise prosperous times. The concomitant increase in government-legitimated gambling, perhaps coupled with a perceived lesser stigma attached to bankruptcy, offers a plausible explanation.<sup>24</sup> The reduction in business insolvencies over this period seems consistent with such an account.

In Australia, debtors are required to state reasons for entering voluntary bankruptcy. The official records show that, in 2004–05, gambling or speculation caused 480 bankruptcies (three per cent of total bankruptcies for non-business-related insolvencies) and 99 debt agreements (two per cent of total debt agreements for non-business-related insolvencies).<sup>25</sup> In the case of business-related insolvencies, the figures show that 63 bankruptcies (one per cent of total bankruptcies), nine debt agreements (three per cent of total debt agreements) and one personal insolvency agreement (one per cent of total personal insolvency agreements) were stated to have been caused by gambling or speculation.<sup>26</sup>

<sup>21</sup> See generally Delfabbro and LeCouteur, above n 2, 34–74; Productivity Commission, above n 5, vol 1, 23–33.

<sup>22</sup> Other issues, such as proof of gambling debts and the less obvious bankruptcy offences, will not be considered.

<sup>23</sup> For a discussion of the Australian position: see Rosalind Mason and John Duns, 'Developments in Consumer Bankruptcy in Australia' in Iain Ramsay, William C Whitford and Johanna Niemi-Kiesilainen (eds), *Consumer Bankruptcy in Global Perspective* (2003) 227.

<sup>24</sup> In fact, it has been suggested that increased bankruptcies through gambling would in itself decrease the stigma attaching to bankruptcy: Kindt and Palchak, above n 12, 59.

<sup>25</sup> Insolvency and Trustee Service Australia, *Annual Report 2004–2005*, above n 4, table 5. The table indicates that, in the case of non-business-related insolvencies, no personal insolvency agreements were entered into as a result of gambling.

<sup>26</sup> *Ibid* table 6.

However, the Productivity Commission suggested that these figures might be dramatically understated, and that gambling might in fact be responsible for a significantly greater proportion of total bankruptcies.<sup>27</sup> This understatement in the official figures may result from a reluctance by debtors to admit to gambling, particularly in view of the fact that, in Australia, pre-bankruptcy gambling may constitute a criminal offence.<sup>28</sup> The matter is further complicated by the fact that many gamblers use their credit cards to gamble,<sup>29</sup> and so in many cases gambling debt merges into credit card debt.

The extent of the link between gambling and bankruptcy is even less clear in the US where there are no official national statistics on the causes of bankruptcy. There have, nevertheless, been numerous studies with the aim of determining whether there is a causal relationship.<sup>30</sup> An oft-cited study is that undertaken by the SMR Research Corporation in 1997, commissioned by the banking industry. The study found that counties that had casinos had bankruptcy filings at a rate 18 per cent higher than those without casinos. It concluded that gambling was the third most likely cause of bankruptcy and the fastest growing.<sup>31</sup>

However, other studies have challenged the claimed causal link. Two of the most prominent are reviews by the US Treasury<sup>32</sup> and the National Opinion Research Center.<sup>33</sup> The former suggests that a correlation between the number of gambling facilities and high rates of bankruptcy does not necessarily imply causation — the influence of other factors must be considered and more often than not, these communities had high bankruptcy rates prior to the introduction of gambling.<sup>34</sup> The latter suggests that there is no significant change in per capita bankruptcy rates in communities with newly opened casinos.<sup>35</sup> For example, poorer communities, which may be heading towards higher bankruptcy rates in any event, may introduce casinos to boost income.<sup>36</sup> In a similar vein, another study has suggested that while the introduction of casinos might increase the

<sup>27</sup> Productivity Commission, above n 5, vol 3, app R.

<sup>28</sup> Richard Brading, 'Gambling as Cause of Bankruptcy in Australia and the US' (2003) 13(2) *New Directions in Bankruptcy* 16, 17. See also below Part IV.

<sup>29</sup> See Department of the Treasury, United States of America, *A Study of the Interaction of Gambling and Bankruptcy* (1999) 41–4. In Australia, excessive use of credit was the second most common reason for non-business-related insolvencies in 2004–05, accounting for 25 per cent of all bankruptcies, 37 per cent of debt agreements and 26 per cent of personal insolvency agreements: Insolvency and Trustee Service Australia, *Annual Report 2004–2005*, above n 4, table 5.

<sup>30</sup> Some have found such a causal link: see, eg, National Opinion Research Center at the University of Chicago et al, *Gambling Impact and Behavior Study: Report to the National Gambling Impact Study Commission* (1999) <<http://www2.norc.org/new/gamb-fin.htm>>; Mark W Nichols, B Grant Stitt and David Giacomassi, 'Casino Gambling and Bankruptcy in New United States Casino Jurisdictions' (1999) 29 *Journal of Socio-Economics* 247.

<sup>31</sup> For a summary and discussion of these findings: see Department of the Treasury, above n 29, 41–4.

<sup>32</sup> *Ibid.*

<sup>33</sup> National Opinion Research Center at the University of Chicago et al, above n 30.

<sup>34</sup> Department of the Treasury, above n 29, 42.

<sup>35</sup> *Ibid.*; National Opinion Research Center at the University of Chicago et al, above n 30, 70.

<sup>36</sup> Department of the Treasury, above n 29, 24, 42.

bankruptcy rate in the local casino area, it does not have a significant effect on the *national* bankruptcy rate.<sup>37</sup>

All in all, while it is clear that gambling can lead to bankruptcy, just how often this occurs remains contentious. Moral bias and financial interest further confuse the analysis. However, the bankruptcy–gambling link is sufficiently clear and strong to warrant a response as to how, and how well, bankruptcy policy deals with the issues posed by gambling.

### III ISSUES RAISED BY GAMBLING

The argument has been made that gambling debts<sup>38</sup> should be treated in the same manner as other debts — that a debtor heading for bankruptcy who uses a credit card to incur gambling-related debts should be treated no differently from a debtor who spends money on expensive dinners, clothing or holidays.<sup>39</sup> The legality and government endorsement of gambling would seem to add force to such an analogy.

Three responses may be made to such an argument. The first is that gambling may indeed share common characteristics with the debts referred to, but this does not take us any further as all debts of this type potentially create problems in bankruptcy. A debtor heading for bankruptcy demonstrates the classic ‘endgame’ problem in game theory: one party (the debtor) knows the game (liability for debt) is about to end but the other (the creditor) does not.<sup>40</sup> This produces what economists like to call a ‘moral hazard’.<sup>41</sup> Thus the gambler, like the extravagant diner or traveller, will be tempted to abuse the bankruptcy system. The bankruptcy system, assuming that it provides for an ultimate release from debt, creates a ‘perverse incentive’ for debtors to create debt once they know or believe they are heading for bankruptcy. A bankruptcy regime needs to provide for this, whether the debt is a gambling debt or one of the other extravagantly incurred debts.

The second response is that gambling debts do in fact have their own features that distinguish them from other debts. The most significant of these is that, unlike the extravagant dinner or cruise, gambling holds out a tantalising prospect of solvency. Gambling creates a particularly strong perverse incentive: using

<sup>37</sup> John M Barron, Michael E Staten and Stephanie M Wilshusen, ‘The Impact of Casino Gambling on Personal Bankruptcy Filing Rates’ (2002) 20 *Contemporary Economic Policy* 440, 454.

<sup>38</sup> There may also be a question of whether gambling issues can be effectively identified. There are two aspects to this question. One is whether gambling issues are ‘masked’ by other issues, such as credit card debts: see above n 29 and accompanying text. The other is whether gambling issues can be sufficiently isolated. This depends in practice on whether the provisions of the relevant bankruptcy legislation either explicitly raise gambling as an issue — as, for example, in the gambling offence created by s 271 of the *Bankruptcy Act 1966* (Cth) — or create an incentive for a party to raise the issue — as might be the case, for example, with discharge exceptions or transaction avoidance provisions: see below Parts V–VI.

<sup>39</sup> See, eg, Robert V Schaller, ‘Gambling Debts Discharged in Bankruptcy’ (December 1999) *DCBA Brief* <[www.dcba.org/brief/decissue/1999/art21299.htm](http://www.dcba.org/brief/decissue/1999/art21299.htm)>. It is a point also made by the courts on occasion: see *Re Chomakos*, 69 F 3d 769, 772 (Nelson J) (6<sup>th</sup> Cir, 1995).

<sup>40</sup> See generally Eric Rasmusen, *Games and Information: An Introduction to Game Theory* (4<sup>th</sup> ed, 2007); Robert Axelrod, *The Evolution of Cooperation* (revised ed, 2006).

<sup>41</sup> For a discussion of the meaning of this term: see Tom Baker, ‘On the Genealogy of Moral Hazard’ (1996) 75 *Texas Law Review* 237.

'other people's money' (the creditors'), the debtor is effectively encouraged to risk the gambling odds in the hope of hauling themselves out of the mire of debt.<sup>42</sup> This point may justify the need to isolate gambling debts from the other debts referred to earlier.

Finally, a quite different point — in contrast to the other debts, the gambling debt will be, in many cases, incurred by a problem gambler. It is estimated that in Australia, approximately one third of total gambling expenditure is by problem gamblers and that on average, such gamblers lose at the rate of \$250 per week.<sup>43</sup> There are various tests which have been devised to identify problem gamblers.<sup>44</sup> Problem gambling is described by the American Psychiatric Association's *Diagnostic and Statistical Manual of Mental Disorders* as a pathology and so is considered a disease.<sup>45</sup> The Australian position is more cautious.<sup>46</sup> Nevertheless, it seems tolerably clear that problem gambling does not involve an abuse of the bankruptcy system, at least in the sense referred to above, and for this reason it is inappropriate to use bankruptcy policy to deter or punish such conduct.

#### IV GAMBLING AS A BANKRUPTCY OFFENCE

Bankruptcy legislation has historically sought to distinguish the culpable from the 'honest but unfortunate' debtor.<sup>47</sup> An important aspect of this distinction relates to the entitlement of a bankrupt to discharge.<sup>48</sup> Another aspect is the use of criminal sanctions to deter and/or punish what is identified as undesirable conduct leading up to bankruptcy. In this respect, gambling has often been singled out for special treatment.

Section 271(a) of the *Bankruptcy Act 1966* (Cth) makes it an offence for a person who, up to two years prior to presentation of the petition which led to their bankruptcy

materially contributed to, or increased the extent of, his or her insolvency ... by gambling or by speculations that, having regard to his or her financial position at the time and any other material circumstance, were rash and hazardous, being gambling or speculations not connected with a trade or business carried on by him or her.

It is also an offence for a person, between the presentation of the petition and the date of bankruptcy, to have 'lost any of his or her property' by gambling or by speculation that is rash and hazardous.<sup>49</sup> These offences are punishable by

<sup>42</sup> As Thomas Hardy describes it, gambling is 'one testimony among many of the powerlessness of logic when confronted with imagination': *A Laodicean: A Story of To-Day* (first published 1881, 1896 ed) 324.

<sup>43</sup> See Delfabbro and LeCouteur, above n 2, 68.

<sup>44</sup> Ibid 36–49.

<sup>45</sup> American Psychiatric Association, *Diagnostic and Statistical Manual of Mental Disorders* (4<sup>th</sup> revised ed, 2000) 671–4.

<sup>46</sup> See the discussion in Delfabbro and LeCouteur, above n 2, 36–49.

<sup>47</sup> See, eg, *Local Loan Co v Hunt*, 292 US 234, 244 (Sutherland J) (1934).

<sup>48</sup> See below Part V.

<sup>49</sup> *Bankruptcy Act 1966* (Cth) s 271(b).

imprisonment for up to 12 months. The section has its origins in UK bankruptcy law, although the equivalent UK provision has recently been repealed.<sup>50</sup>

It is an extraordinary provision, not least for its retrospectivity. Conduct that is otherwise innocent becomes an offence only if the person subsequently becomes bankrupt. The rationale for the provision was expressed in the following terms by Moule J in 1930:

Where a man is engaged in business and has incurred debts and obligations to his creditors who have been dealing with him in that business, it is a fraudulent act to use money which really belongs to such creditors, by betting on such a 'glorious uncertainty' as a horse race. The betting side of the so-called 'Sport of Kings' must not be allowed to become a pastime for needy persons engaged in commercial pursuits. Trusting to luck is a poor maxim for commercial enterprise. In spite of a success here and a success there, there is, so I understand, but one end in the speculative transaction of backing horses. For those who have their own money to lose, this end is not forbidden, but when it comes to those who are engaged in business transactions, 'investing' (so they call it) their creditors' money at race-meetings, the Court in this jurisdiction is called upon to use some restraining influence.<sup>51</sup>

Section 271 has been little used and highly criticised.<sup>52</sup> The Insolvency and Trustee Service Australia, which has responsibility for bankruptcy administration, has released a policy statement announcing that it 'will not refer a case for prosecution [under s 271] where it appears that the debtor could be classified as having been a "problem gambler" and had not engaged in any associated criminal activity to finance their gambling habit'.<sup>53</sup> The policy statement further explains that the Insolvency and Trustee Service Australia

will consider referring a case to the [Commonwealth Director of Public Prosecutions] only where it involves:

- clear criminality;
- complex offences; or
- ongoing allegations of repeat offending despite warnings to the contrary.<sup>54</sup>

<sup>50</sup> See *Insolvency Act 1986* (UK) c 45, s 362, repealed by *Enterprise Act 2002* (UK) c 40, effective from 1 April 2004. There was a similar provision in early US bankruptcy legislation, although it was confined to gambling that occurred after bankruptcy proceedings had commenced: see David S Kennedy and James E Bailey, 'Gambling and the Bankruptcy Discharge: An Historical Exegesis and Case Survey' (1995) 11 *Bankruptcy Developments Journal* 49, 55–6.

<sup>51</sup> *Re Godfrey [No 2]* (1930) 2 ABC 156, 157–8. The bankrupt in that case was found guilty and sentenced to four months imprisonment: at 158 (Moule J).

<sup>52</sup> For a recent decision: see *R v Nguyen* (1996) 134 FLR 275. See generally Richard Brading, 'Gambling or Hazardous Speculations: Section 271 *Bankruptcy Act* — Do We Need It?' (1999) 8(1) *New Directions in Bankruptcy* 34.

<sup>53</sup> Insolvency and Trustee Service Australia, *Referral of Offences under Section 271 of the Bankruptcy Act 1966 (Rash and Hazardous Gambling)* (2006) 1 <[http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/About%20Us-%3EPublications-%3ECorporate%20Plan%20Document/\\$FILE/s271\\_referral\\_policy.pdf](http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/About%20Us-%3EPublications-%3ECorporate%20Plan%20Document/$FILE/s271_referral_policy.pdf)>.

<sup>54</sup> *Ibid.* In July 2006, the Commonwealth Attorney-General announced a review of the offence provisions of the *Bankruptcy Act 1966* (Cth). This is to be undertaken by the Insolvency and Trustee Service Australia and the Attorney-General's Department. A discussion paper has been released: Insolvency and Trustee Service Australia and Attorney-General's Department, *Review*



Although such case law as there is has tended to give s 271 of the *Bankruptcy Act 1966* (Cth) a restricted scope,<sup>55</sup> it still seems unlikely that it deters gambling. It is more likely that it only succeeds in encouraging debtors to hide their pre-bankruptcy gambling.<sup>56</sup>

What s 271 and Moule J's comments do reflect is a long-established judicial approach to the circumstances surrounding bankruptcy. At first blush, the provision may seem reminiscent of a bygone era in which bankruptcy was aligned with the criminal law, but there is reason to think that the sentiment expressed by Moule J is still prevalent. This can be seen in the circumstances surrounding the recent repeal of the equivalent UK provision, s 362 of the *Insolvency Act 1986* (UK) c 45.<sup>57</sup> The explanation given for the repeal was not expressed in terms of a softening of the policy towards gambling but, by contrast, as an attempt to create a more effective provision. The section was repealed as part of changes to the discharge provisions of the *Insolvency Act 1986* (UK) c 45. These amendments generally reduced the period of bankruptcy to 12 months.<sup>58</sup> However, the *Insolvency Act 1986* (UK) c 45 was also amended to lengthen the period of bankruptcy for 'the small minority of culpable bankrupts.'<sup>59</sup> This occurs through the new regime, under which a court has power to make a Bankruptcy Restrictions Order ('BRO'). A BRO extends the duration of bankruptcy.<sup>60</sup>

The rationale underlying the repeal of s 362 of the *Insolvency Act 1986* (UK) c 45 was to remove the culpable conduct with which it dealt, including gambling, from its cumbersome criminal context so that it could be 'dealt with more effectively as matters of misconduct leading to a BRO'.<sup>61</sup> In fact, examples of conduct that might justify a BRO include rash and hazardous speculation, unjustifiable extravagance in living, gambling or culpable neglect of business.<sup>62</sup> This pragmatic shift in approach was explicitly based on the desirability of identifying and dealing more effectively with blameworthy debtors:

There was broad support for the proposal to make a distinction between bankrupts on the basis of their culpability, provided that the reasons for a bankrupt's

*of the Offence Provisions of the Bankruptcy Act 1996* [sic] (2006). At this stage there does not appear to be a specific proposal to amend s 271.

<sup>55</sup> See, eg, *Marks v The King* (1937) 57 CLR 58, 65 (Latham CJ), 66–7 (Dixon J), where the High Court dismissed a prosecution on the ground that although pre-bankruptcy gambling had been established, the evidence did not establish that the gambling had caused or materially contributed to the bankruptcy. In *R v Nguyen* (1996) 134 FLR 275, 278 (Higgins J), the Supreme Court of the Australian Capital Territory held that an element of the offence is that the gambling be rash and hazardous, and dismissed an indictment which failed to allege this.

<sup>56</sup> What the provision *may* achieve is some deterrence against bankrupts hiding assets and then making unsubstantiated claims that such assets have been lost through gambling. However, such conduct can in any event be dealt with in the objection to discharge process: see, eg, *Bankruptcy Act 1966* (Cth) s 149A(1)(da).

<sup>57</sup> See above n 50 and accompanying text.

<sup>58</sup> *Insolvency Act 1986* (UK) c 45, s 279(1).

<sup>59</sup> Department of Trade and Industry, United Kingdom, *Insolvency — A Second Chance*, Cm 5234 (2001) [1.6].

<sup>60</sup> *Insolvency Act 1986* (UK) c 45, sch 4A s 4.

<sup>61</sup> Department of Trade and Industry, above n 59, [1.32].

<sup>62</sup> *Insolvency Act 1986* (UK) c 45, sch 4A s 2(2)(j)–(k).

failure were tested with appropriate rigour. The proposed 'Bankruptcy Restriction Order' regime was seen by most as offering real and effective protection for the public and the business community against the financially irresponsible or downright dishonest.<sup>63</sup>

The move from the use of criminal sanctions to deter undesirable conduct to having such conduct dealt with as a discharge issue brings us to the next Part of this article.

## V GAMBLING AND DISCHARGE

Discharge from bankruptcy, with its associated release from debt, is a central component of most modern bankruptcy laws.<sup>64</sup> The fresh start that discharge allows debtors is generally considered desirable not only on moral grounds, of fairness to the debtor, but also on economic grounds. Discharge encourages the debtor to return to being a productive member of society and avoids further reliance on social welfare. But discharge comes at a cost. It conflicts with another bankruptcy objective, that of maximising returns to creditors, and potentially undermines an important objective of the law of obligations — the enforcement of promises. As noted above, the availability of discharge in bankruptcy legislation may create a perverse incentive for a debtor to resort to the bankruptcy regime, not for its intended objectives, but to gain the benefit of discharge.<sup>65</sup> One method of identifying, and thus preventing, such an abuse has been to deny discharge to certain kinds of debts and/or to certain kinds of debtors. And so, in broad terms, we again come up against the distinction between the honest but unfortunate debtor and the dishonest or irresponsible debtor. This Part considers how the discharge provisions of the *Bankruptcy Act 1966* (Cth) apply to gambling debts and debtors. Comparisons will be made with the more frequently litigated US regime.

Gambling and discharge may interrelate in two ways:

- 1 Gambling may be categorised as irresponsible conduct that warrants a longer period of bankruptcy than is appropriate for the honest but unfortunate debtor.
- 2 Gambling debts may be exempt from the discharge regime, that is, regardless of the gambling debtor's entitlement to discharge generally, there may be no release from the gambling debt. This is a policy decision that has been made with an eclectic group of other debts, such as fines and student loans.<sup>66</sup>

<sup>63</sup> Department of Trade and Industry, above n 59, [1.3]. Doubts have already been expressed as to whether the BROs will be effective in deterring dishonest debtors: see Stuart McNeill, 'In Debt? Try Bankruptcy Lite', *The Times* (London), 30 March 2004, Law 9.

<sup>64</sup> Discharge and release is not, however, universal. It is not part of the bankruptcy laws, of for example, Scandinavia, Spain or Italy.

<sup>65</sup> See above Part III.

<sup>66</sup> *Bankruptcy Act 1966* (Cth) s 82(3)–(3A).

In relation to the first suggested interrelationship, the legislature has historically treated discharge as a privilege and has been prepared to deny that privilege to those it considers undeserving. Discharge from bankruptcy was introduced into UK law by the *Bankrupts Act 1705*, 3 & 4 Anne, c 4.<sup>67</sup> In these first provisions, discharge was expressly denied to bankrupts who had incurred gambling losses that exceeded a threshold amount. Section XV provided that:

nothing in this Act contained shall extend to Give or Grant any Liberty, Privilege, Benefit or Advantage in this Act mentioned, to any Person ... who shall have Lost in any one Day the Sum or Value of Five Pounds, or in the whole the Sum or Value of One hundred Pounds, within the Space or Term of Twelve Months next preceding his or her becoming a Bankrupt, in playing at or with Cards, Dice, Tables, Tennis, Bowls, Shovel-Board, or in or by Cock-Fightings, Horse-Races, Dog-Matches, or Foot-Races, or other Pastimes, Game or Games whatsoever, or in or by bearing a Share or Part in the Stakes, Wagers or Adventures, or in or by Betting on the Sides or Hands of such as do or shall Play, Act, Ride or Run, as aforesaid.

An interesting amendment was made in 1849. This introduced a classified system of discharge. A 'First Class' certificate of discharge certified that the bankruptcy arose from 'unavoidable Losses and Misfortunes'; a 'Second Class' certificate was for bankruptcies that had not 'wholly arisen from unavoidable Losses and Misfortunes'; and a 'Third Class' certificate was given where the bankruptcy did not arise from 'unavoidable Losses or Misfortunes'.<sup>68</sup> V Markham Lester, in his study of Victorian insolvency, suggests that this classification system, more than any other provision of the time, reveals the prevailing moral view of bankruptcy:

To Victorians, few things were as important as 'character', with its related virtues of thrift, self-help, and individual effort. For an individual to fail financially was to show dishonesty and thus weakness of character. ... Churches treated bankruptcy as a serious moral problem, and some churches disciplined members who became bankrupt. Evangelicals recognized, however, that volatile economic times produced many 'innocent' bankrupts. These innocent bankrupts played the part of the sacrificial offering, atoning for the sins of the commercial world. ... Legislators during the period constantly schemed to punish debtors who became insolvent through fraud and to help innocent debtors who faced bankruptcy through no fault of their own. To this end the *Consolidation Act of 1849* set up the machinery by which courts were to distinguish between moral and immoral businessmen by classifying discharge certificates according to moral culpability.<sup>69</sup>

<sup>67</sup> On the history of discharge: see generally Charles Jordan Tabb, 'The Historical Evolution of the Bankruptcy Discharge' (1991) 65 *American Bankruptcy Law Journal* 325; Ian P H Duffy, 'English Bankrupts 1571–1861' (1980) 24 *American Journal of Legal History* 283; Jay Cohen, 'The History of Imprisonment for Debt and Its Relation to the Development of Discharge in Bankruptcy' (1982) 3 *Journal of Legal History* 153.

<sup>68</sup> *Bankrupt Law Consolidation Act 1849*, 12 & 13 Vict, c 107, sch Z.

<sup>69</sup> V Markham Lester, *Victorian Insolvency: Bankruptcy, Imprisonment for Debt, and Company Winding-Up in Nineteenth-Century England* (1995) 68 (citations omitted).

While this classification system was abandoned in the following decade,<sup>70</sup> in 1883 a ‘Certificate of Misfortune’ was introduced.<sup>71</sup> This allowed a certificate of discharge to provide that the bankruptcy had been caused by misfortune. Certain disqualifications that otherwise applied to discharged bankrupts, such as disqualification to sit in the House of Lords, did not apply where such a certificate was granted.<sup>72</sup>

Both Australia and the US<sup>73</sup> originally adopted the UK approach of denying, or at least delaying, discharge to gamblers. Until recently, the *Bankruptcy Act 1966* (Cth) gave courts discretion to refuse or delay discharge where the bankrupt

brought on, or contributed to, his bankruptcy by:

- (i) rash or hazardous speculations;
- (ii) unjustifiable extravagance in living;
- (iii) gambling or wagering; or
- (iv) culpable neglect of his business affair.<sup>74</sup>

The current discharge regime in Australia does not require court approval for discharge,<sup>75</sup> which is automatic unless the trustee objects. Unlike the UK position explained above,<sup>76</sup> there is no explicit provision for gambling as a ground of objection. Generally, the grounds of objection to discharge are designed to force the bankrupt to cooperate with the trustee.<sup>77</sup> However, recent changes to the *Bankruptcy Act 1966* (Cth) allow objections to discharge on the basis that the bankrupt entered into a transaction at an undervalue or with intent to defeat creditors.<sup>78</sup> The argument that these provisions may render a gambling transaction voidable is considered in the next Part.

A section that might arguably apply in the gambling context is s 149D(1)(g) of the *Bankruptcy Act 1966* (Cth). This allows an objection where the bankrupt, up to five years prior to (and at any point during) the bankruptcy:

- (i) spent money but failed to explain adequately to the trustee the purpose for which the money was spent; or
- (ii) disposed of property but failed to explain adequately to the trustee why no money was received as a result of the disposal or what the bankrupt did with the money as a result of the disposal.

Such an objection does not appear to have been raised in the context of gambling in an Australian court. However, there is a significant body of US case law on a

<sup>70</sup> Ibid 71, 130.

<sup>71</sup> See *Bankruptcy Act 1883*, 46 & 47 Vict, c 52, s 32(2).

<sup>72</sup> In practice, such certificates were rarely granted: see, eg, Muir Hunter and David Graham, *Williams and Muir Hunter on Bankruptcy* (19<sup>th</sup> ed, 1979) 133.

<sup>73</sup> On the US position: see generally Kennedy and Bailey, above n 50.

<sup>74</sup> *Bankruptcy Act 1966* (Cth) s 150(6)(e) (repealed).

<sup>75</sup> See generally *Bankruptcy Act 1966* (Cth) pt VII. The grounds of objection to discharge are set out in s 149D.

<sup>76</sup> See above Part IV.

<sup>77</sup> See *Bankruptcy Act 1966* (Cth) s 149D. The grounds include various failures by the bankrupt to cooperate with the trustee.

<sup>78</sup> *Bankruptcy Act 1966* (Cth) s 149D(1)(aa)–(ab). These grounds were added in 2002.

similar provision in the US *Bankruptcy Code*.<sup>79</sup> Section 727(a)(5) of the Code provides that the court shall grant discharge unless 'the debtor has failed to explain satisfactorily ... any loss of assets or deficiency of assets to meet the debtor's liabilities'.<sup>80</sup>

What is a satisfactory explanation? The US case law is not entirely consistent, but certain principles emerge.<sup>81</sup> One is that it may not be enough for the bankrupt merely to assert that money was lost on gambling. Documentary or other corroborating evidence would normally be required, although it is acknowledged that this is not always available.<sup>82</sup> There has been a suggestion in at least one case that satisfactory may mean 'reasonable' rather than 'credible',<sup>83</sup> but the cases in fact tend to focus on the means by which a bankrupt can provide credible evidence in a bankruptcy context.<sup>84</sup>

The second issue in relation to discharge is whether, even if discharge from bankruptcy is granted, gambling debts should be exempt from the range of claims that are released on discharge. This was the original UK approach. Although such provisions were subsequently abandoned by UK, Australian and US bankruptcy legislation, there are some who argue that they should be reinstated.<sup>85</sup> While there is no explicit gambling exemption in the *Bankruptcy Act 1966* (Cth), the Act does provide that the 'discharge of a bankrupt from bankruptcy does not release the bankrupt from a debt incurred by means of fraud ... to which he or she was a party'.<sup>86</sup> Given that gambling is often funded by cash obtained through credit cards, can it reasonably be argued that such credit card debts incurred by a debtor are debts incurred by means of fraud? That is, that the debtor, at the time of obtaining funds, impliedly represented that he or she had the intention and ability to repay the loan.

Again, this is an argument that has been made in the US but not Australia.<sup>87</sup> Section 523(a)(2)(A) of the US *Bankruptcy Code* provides that a discharge from bankruptcy 'does not discharge an individual debtor from any debt ... to the extent obtained by false pretences, a false representation, or actual fraud'.<sup>88</sup>

<sup>79</sup> 11 USC (2000).

<sup>80</sup> 11 USC § 727(a)(5) (2000).

<sup>81</sup> The following draws on a discussion of the relevant case law which can be found in Kennedy and Bailey, above n 50, 61–70.

<sup>82</sup> See, eg, *Re Wilch*, 157 BR 342 (Bankr ND Ohio, 1993); *Re Yokley*, 61 BR 198 (Bankr WD Ky, 1986); *Re Rowe*, 81 BR 653 (Bankr MD Fla, 1987); *Re Gallini*, 96 BR 491 (Bankr MD Pa, 1989).

<sup>83</sup> *Re Reed*, 700 F 2d 986, 993 (Rubin J) (5<sup>th</sup> Cir, 1983).

<sup>84</sup> See, eg, *Re Gallini*, 96 BR 491 (Bankr MD Pa, 1989). See generally Kennedy and Bailey, above n 50.

<sup>85</sup> See especially Kindt and Palchak, above n 12, 62–4, where the authors provide a suggested draft amendment to the US *Bankruptcy Code*. At a practical level, there may be difficulty in identifying and defining 'gambling' debts. Debts owed to gambling establishments are likely to be minimal. It is far more likely that the debt will be to a credit card issuer but this will be harder to identify.

<sup>86</sup> *Bankruptcy Act 1966* (Cth) s 153(2)(b).

<sup>87</sup> See generally Thomas O Depperschmidt and Nancy Hisey Kratzke, 'Bankruptcy for Gamblers: The Questions of Fraudulent Intent, Dischargeability, and Remedial Policy in Credit Card Cash Advance Cases' (1997) 13 *Bankruptcy Developments Journal* 389; Kennedy and Bailey, above n 50, 77–82.

<sup>88</sup> 11 USC § 523(a)(2)(A) (2000).

Exceptions to discharge are construed narrowly and the onus is on the party seeking to establish that the exception applies.<sup>89</sup> The difference in wording between the Australian and US provisions is not as significant as first appears because US courts have construed ‘false pretences, a false representation, or actual fraud’ as constituting one ground rather than three, and have treated this ground as equivalent to common law fraud.<sup>90</sup>

To establish fraud, the US courts require that five elements be satisfied.<sup>91</sup> As applied to credit card debt, they are:

- 1 the debtor made a false representation to the credit card issuer;
- 2 the debtor knew the representation was false (or recklessly disregarded its truth);
- 3 the debtor intended to deceive the issuer;
- 4 the issuer relied on the representation; and
- 5 the issuer suffered loss as a result.

Credit card issuers have to overcome a number of obstacles in meeting these requirements in a gambling context. The first is to show that a false representation was made by the debtor. Some courts have held that the use of a credit card is an implied representation by the cardholder to the card issuer that the holder has the means and intention to repay the debt that is incurred.<sup>92</sup> However, more recent decisions have tended to reject this.<sup>93</sup> A further difficulty for the issuer is inevitably the question of the debtor’s intent. The test of intent adopted here is critical. If a subjective test is adopted, the likelihood of fraud being established diminishes — the debtor may well have intended to repay the debt, if for no other reason than that he or she is expecting a successful gambling outcome. If an objective test of the debtor’s intent is used, the issuer’s case is far stronger as objectively, the likelihood of repayment will be remote. US decisions have diverged on this issue and the matter has not been settled,<sup>94</sup> although it has been rightly pointed out that a subjective test is potentially meaningless in the gambling context.<sup>95</sup> Despite this, it may be that a subjective test is gaining the ascendancy.<sup>96</sup>

In general, dealing with gambling issues in discharge provisions seems a more appropriate response than the use of criminal sanctions. It has the advantage of directly addressing the perverse incentive issue referred to above. It follows that

<sup>89</sup> *Re Alvi*, 191 BR 724, 728 (Ginsberg J) (Bankr ND Ill, 1996).

<sup>90</sup> *Ibid* 728–9 (Ginsberg J); *Re Kimzey*, 761 F 2d 421, 423–4 (Wood Jr J) (7<sup>th</sup> Cir, 1985); *Citi-bank v Michel*, 220 BR 603, 604 (Aspen CJ) (ND Ill, 1998).

<sup>91</sup> This has been stated a number of times: see, eg, *Re Valdes*, 188 BR 533, 535 (Mannes CJ) (Bankr D Md, 1995); *Re Bartlett*, 128 BR 775, 776 (Federman J) (Bankr WD Mo, 1991).

<sup>92</sup> *Re Phillips*, Adv No 93 A 01635, [5] (Squires J) (Bankr ND Ill, 5 April 1994); *Re Berz*, 173 BR 159, 162 (Schmetterer J) (Bankr ND Ill, 1994).

<sup>93</sup> See especially *Re Alvi*, 191 BR 724 (Bankr ND Ill, 1996).

<sup>94</sup> See generally Depperschmidt and Kratzke, above n 87; Schaller, above n 39; Kennedy and Bailey, above n 50, 77–82.

<sup>95</sup> See especially Depperschmidt and Kratzke, above n 87, 409–10.

<sup>96</sup> Alexander L Edgar and Ellen L Triebold, ‘High Stakes: Gambling on Dischargeability’ (1998) 17(4) *American Bankruptcy Institute Journal* 8.

the recent UK decision to have gambling issues dealt with by a BRO is sensible. Although exempting gambling debts would be a much stronger response, it would pose significant policy problems because unlike the treatment of gambling debts in discharge, there would be no discretionary element. This would be particularly troubling in the case of problem gamblers.

## VI AVOIDING GAMBLING TRANSACTIONS

Can gambling transactions be avoided by a trustee in bankruptcy under the Australian bankruptcy avoidance provisions? The most relevant avoidance provisions are: (a) transactions entered into with the intention of defeating, delaying or hindering creditors;<sup>97</sup> and (b) transactions at an undervalue.<sup>98</sup> The policy behind both sets of provisions is primarily one of fairness to the bankrupt's creditors as a whole, that is, transfers of property by a debtor prior to bankruptcy potentially disadvantage creditors of the bankrupt. On the other hand, the retrospective nature of avoidance provisions, and the fact that they undo otherwise valid transactions, brings them into conflict with other objectives of insolvency law, particularly the need for commercial certainty and for bankruptcy laws to harmonise with the general law. For these reasons, the scope of the avoidance provisions needs to be carefully confined.<sup>99</sup> A key aspect here is the focus on whether 'market value' was given for the debtor's transfer of property. It is generally only when there is inadequate value received by the debtor that creditors in a subsequent bankruptcy are at risk and the avoidance provisions potentially apply.<sup>100</sup> In the gambling context, the argument is that gambling transactions represent a dissipation of funds that would otherwise have been available to creditors — such funds have been transferred, with little or nothing of value received in return.

The potential applicability of the avoidance provisions in the gambling context is suggested by some apparently analogous US case law. For example, in *1992 Republican Senate–House Dinner Committee v Carolina's Pride Seafood Inc.*,<sup>101</sup> a debtor paid US\$500 000 for the privilege of a seat at President George Bush's table at a fundraising dinner. This transaction was subsequently set aside as a

<sup>97</sup> *Bankruptcy Act 1966* (Cth) s 121.

<sup>98</sup> *Bankruptcy Act 1966* (Cth) s 120. The preference provisions of *Bankruptcy Act 1966* (Cth) s 122 might also be relevant in some circumstances. For example, these provisions may apply if the bankrupt paid gambling debts incurred on credit in preference to other debts. Under s 122(2) the creditor would have the onus of establishing that market value was received.

<sup>99</sup> See generally Andrew Keay, *Avoidance Provisions in Insolvency Law* (1997); John Duns, *Insolvency: Law and Policy* (2002) 262–3.

<sup>100</sup> Creditors may be disadvantaged by a transaction even though consideration received by the debtors was adequate. Other aspects of the transaction, such as an extended period of repayment of a loan for example, may make the transaction unfair. Such transactions, which fall within the 'fraudulent transfer' provisions of s 121 of the *Bankruptcy Act 1966* (Cth), are not currently relevant.

<sup>101</sup> 858 F Supp 243 (D DC, 1994). See also J Chadwick Mask, 'Gambling Debts: Should Policy Considerations Affect Their Treatment under the *Bankruptcy Code*?' (1997) 67 *Mississippi Law Journal* 323, 356–7.

fraudulent transfer.<sup>102</sup> Similarly, in *Re Young*,<sup>103</sup> a donation to a church by an insolvent debtor was set aside.<sup>104</sup> At least one commentator has argued that similar reasoning should be applied to pre-bankruptcy gambling.<sup>105</sup>

The relevant provisions of the *Bankruptcy Act 1966* (Cth) are ss 120–1. Section 120 deals with transfers at an undervalue. This section enables a trustee to avoid a transfer of property by a debtor,<sup>106</sup> who later becomes bankrupt, if less than market value was given by the transferee. A transfer of property includes a payment of money.<sup>107</sup> The time period during which transfers are vulnerable under this provision depends on whether the debtor was insolvent at the time of the transfer: if the debtor was insolvent, the relevant period is five years from the commencement of bankruptcy; otherwise, it is two years.<sup>108</sup>

The greatest difficulty facing a trustee relying on this section is the requirement that the debtor did not receive market value from the gambling transaction. Market value is determined at the time of the transfer.<sup>109</sup> There is no definition of market value in the *Bankruptcy Act 1966* (Cth) but it is generally accepted that the term refers to the price obtainable by a willing but not anxious seller from a willing but not anxious buyer.<sup>110</sup> Does a casino, for example, give market value for a gambler's bet? It would seem so, particularly given the arms-length nature of the transaction. In *Re Chomakos*,<sup>111</sup> the trustee sought to recover the bankrupt's pre-bankruptcy gambling losses at the Flamingo Hilton casino in Las Vegas. Under the relevant US law, the trustee was required to show that, in light of all the facts of the case, the debtor had not received 'reasonably equivalent value'<sup>112</sup> for the gambling payments. This term has been held to be similar, although not identical to, market value.<sup>113</sup> The trustee argued that there was no equivalent value given by the casino for the bankrupt's wager.

<sup>102</sup> In fact, only part of the transaction (US\$100 000) was set aside by the Court in this decision. This was because the balance of funds had been provided by a company with which the debtor was associated, not by the debtor himself. The issue of whether the corporate veil should be lifted was left for another time: see *1992 Republican Senate–House Dinner Committee v Carolina's Pride Seafood Inc*, 858 F Supp 243, 250–1 (District Judge Pratt) (D DC, 1994).

<sup>103</sup> 148 BR 886 (Bankr D Minn, 1992); aff'd 152 BR 939 (Bankr D Minn, 1993).

<sup>104</sup> Cf *Re Moses*, 59 BR 818 (Bankr ND Ga, 1986); *Re Missionary Baptist Foundation of America Inc*, 24 BR 973 (Bankr ND Tex, 1982). See also Mask, above n 101, 343.

<sup>105</sup> See Mask, above n 101. See also Robert J Bein, 'Robbing Peter to Pay Paul: Charitable Donations as Fraudulent Transfers' (1995) 100 *Dickinson Law Review* 103, which examines casino losses as fraudulent transfers under § 548 of the US *Bankruptcy Code*; Martin I Klein, 'Sin or Not, Gambling Isn't a Fraudulent Conveyance' (1996) 13 *Bankruptcy Strategist* 7.

<sup>106</sup> The section refers to the transfer being 'void' but it is well established that the transfer is voidable only and so requires action by the trustee to set it aside: see Duns, above n 99, 268. The *Bankruptcy Act 1966* (Cth) provides for the trustee to recover property through an administrative process rather than having to go through the courts: see *Bankruptcy Act 1966* (Cth) pt VI div 4B(J); Duns, above n 99, 250–2.

<sup>107</sup> *Bankruptcy Act 1966* (Cth) s 120(7)(a).

<sup>108</sup> *Bankruptcy Act 1966* (Cth) s 120(1), (3).

<sup>109</sup> *Bankruptcy Act 1966* (Cth) s 120(7)(c).

<sup>110</sup> See *Sutherland v Brien* (1999) 149 FLR 321, 332 (Austin J); *Sellers v One Step Plumbing & Concrete Pty Ltd* (2002) 190 ALR 716, 730 (Weinberg J).

<sup>111</sup> 170 BR 585 (Bankr ED Mich, 1993); aff'd 69 F 3d 769 (6<sup>th</sup> Cir, 1995), cert denied 517 US 1168 (1996). For a general discussion of this case: see Mask, above n 101, 336–45.

<sup>112</sup> For the modern equivalent of the applicable provision: see 11 USC § 548(a)(1)(B)(i) (2000).

<sup>113</sup> It is arguable that whether 'reasonably equivalent value' was received requires a consideration of a wider range of factors than market value alone: see, eg, *Re Chomakos*, 170 BR 585, 592



The trustee maintained that equivalence should be determined by: (a) examining the transaction from the creditors' viewpoint;<sup>114</sup> and (b) considering the benefit received by the debtor in return for the funds gambled.<sup>115</sup> In this case, it was said, such tests showed that there was no reasonably equivalent value provided by the casino. The casino, on the other hand, relied, not only on the entertainment value derived from the gambling itself,<sup>116</sup> but also on the subsidised food, hotel rooms and entertainment that the gambling revenues allowed.<sup>117</sup> The Court rejected the trustee's argument. It emphasised the arms-length nature of the transaction,<sup>118</sup> the good faith of the transferee,<sup>119</sup> and, to a lesser extent, the value of the subsidised services as argued by the casino.<sup>120</sup>

Significantly, however, the Court did indicate that a different factual scenario could lead to a different result:

One could readily conjure up a situation where a 'high roller', whose financial situation is well known, gambles at a casino one or two times shortly before filing bankruptcy and loses an inordinately large amount of money. That factual situation ... contains the seeds of a possibly different result.<sup>121</sup>

Despite this suggestion, and the more exacting standard of market value in the *Bankruptcy Act 1966* (Cth), it is suggested that it will be a rare case in which a court will find that market value was not given to a gambling debtor, at least where the transaction is at arms-length.

Section 121 deals with so-called fraudulent transfers of property.<sup>122</sup> It enables a trustee to avoid a transfer of property where that property would otherwise have been part of the bankrupt estate and the transferor's 'main purpose' was to prevent, hinder or delay the 'process of making property available for division among the transferor's creditors.'<sup>123</sup> The term 'transfer of property' includes a payment of money.<sup>124</sup> Unlike s 120, there is no time limit restricting the transfers that can be avoided under this section. The purpose requirement is central to the operation of the provision and would seem to pose a substantial hurdle to recovery by a trustee. Importantly, s 121 goes on to provide that the purpose element can be met not only by: (a) evidence of the relevant subjective purpose of the transferor; but also (b) 'if it can reasonably be inferred from all the circumstances that, at the time of the transfer, the transferor was, or was about to become, insolvent.'<sup>125</sup>

(Shapero J) (Bankr ED Mich, 1993); *Re Morris Communications NC Inc*, 914 F 2d 458, 467 (Russell J) (4<sup>th</sup> Cir, 1990).

<sup>114</sup> *Re Chomakos*, 170 BR 585, 592 (Shapero J) (Bankr ED Mich, 1993).

<sup>115</sup> *Ibid* 592-3 (Shapero J).

<sup>116</sup> *Ibid* 594 (Shapero J).

<sup>117</sup> *Ibid*.

<sup>118</sup> *Ibid* 593 (Shapero J).

<sup>119</sup> *Ibid* 594-5 (Shapero J).

<sup>120</sup> *Ibid* 594 (Shapero J).

<sup>121</sup> *Ibid* 596 (Shapero J). See also Mask, above n 101, 341.

<sup>122</sup> For the US position on fraudulent transfers in this context: see Mask, above n 101.

<sup>123</sup> *Bankruptcy Act 1966* (Cth) s 121(1).

<sup>124</sup> *Bankruptcy Act 1966* (Cth) s 121(9)(a).

<sup>125</sup> *Bankruptcy Act 1966* (Cth) s 121(2).

If it can be shown that the debtor entered into the gambling transaction with an actual intent to prevent, hinder or delay property being available to creditors, the transaction is, subject to the protective provisions considered below, voidable at the instance of the trustee.<sup>126</sup> Evidence of actual intent would rarely be available, however, and so the trustee would normally need to resort to the deemed purpose provisions — that is, to show that it could reasonably be inferred that the gambler was, or was about to become, insolvent.

Even if the trustee could establish that it was reasonable to infer the gambler's insolvency, a transfer is protected if: (a) market value was given; (b) the transferee did not know, and could not reasonably have inferred, the transferor's purpose; and (c) the transferee could not reasonably have inferred that the debtor was, or was about to become, insolvent.<sup>127</sup> Thus, not only does the trustee face the difficulty of establishing market value discussed above in relation to transfers at an undervalue, but the task is compounded in the case of a fraudulent transfer by the need to establish the latter two elements, neither of which would generally be straightforward in a typical gambling case.<sup>128</sup>

The increasing number of gambling-related bankruptcies presumably makes it more likely that trustees in bankruptcy will test the applicability of the avoidance provisions of the *Bankruptcy Act 1966* (Cth), but it must be noted that the prospect of success appears remote. Market value is the stumbling block. To bring gambling transactions within the avoidance provisions there would presumably need to be a legislative amendment deeming gambling transactions to be transfers for less than market value. To protect the gambling industry, it is likely that a defence would need to be introduced excluding those transactions in which the transferee had no reason to suspect insolvency. The effect of this may be to place an onus on the gambling industry to identify insolvent gamblers. There may be value in such an approach, but it is beyond the scope of this article to examine it.

## VII CONCLUSION

The number of government reports and commissions dealing with the undesirable consequences of gambling attest to its significance as a social problem. The contribution that bankruptcy policy can make to solving these problems will be minor at best. A variety of more appropriate preventative policies, such as capping the number of poker machines, restricting the availability of automatic teller machines at gambling establishments, closer regulation of credit generally and internet gambling particularly, are some of the tried and proposed responses.<sup>129</sup>

<sup>126</sup> See Duns, above n 100, 278; see also above n 101 and accompanying text.

<sup>127</sup> *Bankruptcy Act 1966* (Cth) s 121(4). The burden of proof, although light, is on the trustee: see *Official Receiver v Marchiori* (1983) 69 FLR 290, 294 (Fisher J).

<sup>128</sup> This will, of course, depend on the facts. There may be situations where the debtor's insolvency is apparent to the gambling establishment.

<sup>129</sup> Productivity Commission, above n 5, vol 1, 3–4.

Nevertheless, gambling does raise particular bankruptcy issues that demand effective bankruptcy policies. For example, how do we handle the issue of a perverse incentive to abuse the bankruptcy system? Australia, following the UK lead, has used the criminal law, but this seems singularly inappropriate. Not only does the offence suffer from the blight of retrospectivity, it is more likely to hide gambling conduct than deal with it. Denying gambling creditors the right to prove in bankruptcy was another suggestion by a Member of the US Congress,<sup>130</sup> but this would have minimal impact given that gambling generally involves cash rather than credit transactions. This article considered another option, that of the antecedent avoidance provisions, which might be employed to recover the lost funds for the benefit of creditors in a bankruptcy. The existing provisions do not readily apply to gambling transactions and, although worth further consideration, bold reform would be required to make the provisions readily applicable to gambling transactions.

The US, and now the UK approach, which treats gambling as a discharge issue, is more appropriate than the Australian criminal regime. If it is accepted that gambling debts require explicit treatment, then, at least in the *Bankruptcy Act 1966* (Cth), this would require specific provisions for: (a) delayed discharge where gambling has been a significant factor in the lead up to bankruptcy; and/or (b) an exemption from release on discharge for gambling debts. The rationale for such provisions would be to preserve the integrity and deter misuse of the bankruptcy regime, and perhaps to contribute to deterring gambling. Although it has its proponents,<sup>131</sup> the difficulty with exemption from release on discharge is that it fails to distinguish between gambling debts which constitute an abuse of the bankruptcy system and those which do not. In principle, this distinction needs to be drawn, with adverse discharge consequences confined to the former. For this reason, the issues raised by gambling may be better dealt with on a discretionary basis as a delayed discharge matter.

<sup>130</sup> This was a suggested amendment to § 502(b) of the US *Bankruptcy Code* by Representative Jerrold Nadler. The suggested amendment was to disallow a 'debt incurred in or adjacent to a gambling facility, or a debt which the creditor knew or should have known was intended to be used by the debtor for gambling purposes': see Susan Jensen, 'A Legislative History of the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*' (2005) 79 *American Bankruptcy Law Journal* 485, 506.

<sup>131</sup> Kindt and Palchak, above n 12, 62–4.