

Chapter 2

Key concerns regarding the BAEI bill

2.1 Many submissions that the committee received were from firms specialising in bankruptcy and personal insolvency. These submitters focused on the amendments in Schedule 1 concerning the reduction of the default period, which would limit the restrictions placed on a bankrupt, such as directorship and travelling internationally, to one year rather than three years. These key concerns included:

- inconsistency between the bill's intention and its practical operation;
- the reduction in the default period;
- lack of anti-abuse provisions;
- operation of the income contribution obligations scheme;
- impact on the debt agreement regime; and
- inconsistency with other laws requiring financial reporting.

2.2 This chapter discusses the main concerns raised by submitters about the Bankruptcy Amendment (Enterprise Incentives) Bill 2018 (BAEI bill).

Will the bill succeed in fostering entrepreneurship and reducing stigma?

2.3 A number of submitters raised concerns that the BAEI bill would not achieve its stated intention of fostering entrepreneurship.¹

Distinguishing between personal and business bankruptcies

2.4 Submitters argued that the majority of bankruptcies in Australia are in relation to personal or consumer debt. Submitters suggested that approximately 20 per cent of personal bankruptcies are business-related, the remainder being personal or consumer-related bankruptcies.² Furthermore, the Australian Financial Security Authority (AFSA) provided statistics suggesting that the main reasons for personal bankruptcy are excessive use of credit, unemployment, or loss of income, as opposed to business-related reasons.³

2.5 The Assistant Minister explained in the BAEI bill's second reading speech that distinctions between personal and business bankruptcies can be blurred in cases where owners of small businesses need to secure business loans with their personal assets or provide personal guarantees.⁴

1 See for example, J P Downey & Co Ltd, *Submission 2*, BAEI bill, p. 1.

2 SellersMuldoonBenton, *Submission 7*, BAEI bill, p. 2; CPA Australia, *Submission 8*, BAEI bill, p. 1; and Australian Restructuring Insolvency & Turnaround Association (ARITA), *Submission 10*, BAEI bill, p. 1.

3 Mr Michael Lhuede, *Submission 3*, BAEI bill, p. 5.

4 Senator the Hon. James McGrath, Assistant Minister to the Prime Minister, *Senate Hansard*, 19 October 2017, p. 8030.

2.6 The Department stated that it had considered restricting the application of the proposed one-year default term to business-related bankruptcies, but found that it was extremely difficult to draw a distinction between personal and business-related bankruptcy:

There is the abstract notion of how you define it, what basis you define it on and who falls through the cracks as a result of that. There's also the real world blur between the two, and that comes to the fore for small businesses and sole traders. Small businesses often need to secure their business loan with their own personal finances—use their own credit cards to fund their business—and at that point it's even harder than in the abstract to define the difference between the two.

Moreover, even if theoretically it was possible to draw a distinct line, whilst yes, the centre of gravity of the government's policy intention here is to encourage entrepreneurship, it's to reduce the stigma of bankruptcy across the board, to encourage people to engage in business ventures—whether that be people who are already engaged in business ventures to re-engage, or people who are not yet engaged in business ventures to become engaged in business ventures. Even if you could draw that line and only allow one-year bankruptcy for business bankruptcy, there are people who might be going through what is able to be defined as personal bankruptcy. This reform would encourage them and allow them to step out of that as quickly as possible and allow them to undertake business ventures should they choose to do so.⁵

Fostering entrepreneurship

2.7 The BAEI Explanatory Memorandum draws a connection between the reduction in the default period and the intended aim of fostering entrepreneurship:

As part of the National Innovation and Science Agenda these reforms aim to foster entrepreneurial behaviour and to reduce the stigma associated with bankruptcy. Reducing the automatic discharge to one year will reduce stigma, encourage entrepreneurs to re-engage in business sooner and encourage people, who have previously been deterred by the punitive bankruptcy laws, to pursue their own business ventures.⁶

2.8 Mr Michael Lhuede, an insolvency practitioner, noted that this bill's provisions are similar to those enacted in the *Bankruptcy Amendment Act 1991* (Cth), which was subsequently changed in the *Bankruptcy Legislation Amendment Act 2002* (Cth). Mr Lhuede argued that the 2002 amendments arose in recognition that the earlier provisions had encouraged debtors to act irresponsibly in relation to bankruptcy.⁷ He further expressed concern that the BAEI bill 'advances a proposition

5 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, Attorney-General's Department (AGD), *Proof Committee Hansard*, 6 March 2018, p. 55.

6 BAEI Explanatory Memorandum, p. 2.

7 Mr Michael Lhuede, *Submission 3*, BAEI bill, pp. 2–4.

that may well favour a regime designed to promote entrepreneurship over individual responsibility for financial decisions'.⁸

2.9 Many submitters expressed concerns that the measures in the BAEI bill, namely the proposed reduction in the default period, would not foster entrepreneurship. CPA Australia stated that its previous submission to the Treasury Proposals Paper 'National Innovation and Science Agenda-Improving bankruptcy and insolvency laws' (Proposals Paper) outlined its concern with this approach, stating that the types of people and the reasons behind personal bankruptcies did not indicate that entrepreneurs were routinely bankrupted, and that the proposal to foster entrepreneurship was 'illusory'.⁹

2.10 Evidence collected by the committee suggested that the industry was divided on whether the amendments proposed by the bill would achieve its objectives. The Australian Restructuring Insolvency & Turnaround Association (ARITA) stated:

...among our members who practice in the field of personal insolvency (bankruptcy) there are divided views as to whether this stated goal will be achieved by the reduction of the default bankruptcy period to one year. Apart from scepticism as to the 'untapped entrepreneurialism' which will be engaged by a one-year default period of bankruptcy, registered trustees are more familiar than most with the practices and behaviour of those debtors who will seek to either abuse or 'game the system' of a one-year bankruptcy for their own benefit (and to the detriment of creditors).¹⁰

2.11 Nonetheless, the Attorney-General's Department (the Department) advised that the bill would positively affect a number of entrepreneurs who are currently impeded by bankruptcy restrictions. According to AFSA statistics, approximately 35 per cent of all debtors in a bankruptcy between September and December 2017 self-reported that their bankruptcy was related to business-incurred debt.¹¹ The bill would therefore address a large number of relevant business-related bankruptcies and thus assist in fostering entrepreneurship.

Reducing stigma

2.12 Many submitters were generally supportive of the BAEI bill's aim to reduce the perceived stigma associated with bankruptcy.

2.13 For example, the Law Council of Australia (Law Council) noted that the bill seeks to implement changes recommended by the Proposals Paper. The paper noted that the aim of the reforms was to drive a 'cultural shift' away from the perceived

8 Mr Michael Lhuede, *Submission 3*, BAEI bill, p. 5.

9 CPA Australia, *Submission 8*, BAEI bill, p. 1.

10 ARITA, *Submission 10*, BAEI bill, p. 5.

11 Mr Michael Johnson, Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, BAEI bill, p. 55.

failure of bankruptcy, and encouraging entrepreneurship. To this end, the Law Council was supportive of the bill's aim.¹²

2.14 However, some submitters were sceptical that the bill's measures would actually counter the stigma of bankruptcy.¹³ The Commercial and Property Law Research Centre (CPLRC) noted recent Australian research indicating negative public attitudes toward people who are, or have been, bankrupt.¹⁴ The study suggested that there is a divergence in attitudes between business and consumer bankruptcies, as business-related bankruptcies are perceived as attributable to 'unscrupulous entrepreneurs'. The study concluded that a reduction in the default period for business-related bankruptcies may increase stigma by perpetuating current attitudes.¹⁵

2.15 Similarly, the Australian Banking Association (previously the Australian Bankers' Association) argued that the bill would not affect the stigma of bankruptcy because:

...reducing the discharge period alone would have no effect on the numerous restrictions (for example, barriers to entry to professions) which currently exist, which add to the stigma of bankruptcy in employment and business.¹⁶

2.16 However, the Department stated that the proposed reduction of the default period, and consequently other associated limitations on travel and other matters, would reduce the stigma attached to bankruptcy by encouraging entrepreneurs to move onto new business ventures:

The Productivity Commission found Australia's current personal insolvency laws put too much focus on stigmatising and penalising failure. A reduced bankruptcy term is designed to decrease the stigma associated with entering into bankruptcy by recognising the importance of giving bankrupts a fresh start. This reduced period is designed to encourage entrepreneurs who have previously been deterred by punitive bankruptcy laws to pursue their own business ventures. This of course includes people who have already experienced bankruptcy. Not only will these people be able to exit bankruptcy and therefore enter into business again sooner; they will also be less deterred from taking sensible risks in future business endeavours. However, this also covers people who have never been through bankruptcy but who might be deterred by the stigma of the regime from taking the same sensible risks that are necessary to make a successful business. Certain

12 Law Council of Australia (Law Council), *Submission 9*, BAEI bill, p. 1.

13 See, for example, Ms Karen Cox, Coordinator, Financial Rights Legal Centre, *Proof Committee Hansard*, 5 March 2018, p. 13; Mr John Winter, Chief Executive Officer, ARITA, *Proof Committee Hansard*, p. 57; Mr Clifford Mearns, Director, SRMC Limited, *Proof Committee Hansard*, 6 March 2018, p. 24.

14 Commercial and Property Law Research Centre (CPLRC), *Submission 19*, BAEI bill, pp. 5–6.

15 CPLRC, *Submission 19*, BAEI bill, p. 6.

16 Australian Bankers' Association (ABA), *Submission 15*, BAEI bill, pp. 1–2.

restrictions, such as overseas travel, obtaining credit and company board eligibility, will be lifted after the one-year default bankruptcy period.¹⁷

Reduction of the default period

2.17 A significant number of submitters objected to the bill on the grounds that a reduction of the default period would have unintended and far-reaching consequences.¹⁸ A submitter representing personal insolvency and accounting firms told the committee that industry members do not support a reduction in the default period, citing concerns regarding the potential for abuse and unintended consequences.¹⁹

2.18 Some submitters noted that the majority of bankruptcies are consumer-related, rather than business-related.²⁰ These submitters argued that, as bankruptcy tends to be in relation to consumer debt, targeting all bankruptcies indiscriminately will create unintended consequences in addition to failing to promote entrepreneurship.²¹

2.19 The Law Council recommended that a distinction should be drawn in the bill between consumer-related personal bankruptcies and business-related bankruptcies.²²

2.20 This was similarly suggested by Pitcher Partners, who also submitted that the bill should establish three categories of bankrupts in order to reflect the differing circumstances:

- Category 1, which deals with 'compliant bankrupts' who are fully compliant with their obligations, have little or no divisible property, pay income contribution assessments in the manner required by their trustee and where a longer period as an undischarged bankrupt would be unnecessary and unfair;
- Category 2, which deals with 'non-compliant bankrupts' who do not comply with obligations, co-operate with their trustee or pay income contribution assessments in the manner required by their trustee; and
- Category 3, which deals with bankrupts likely to abuse the bankruptcy process, including those whose pre- or post-bankruptcy conduct and behaviour are risky or unlawful, those who are non-compliant with tax law or have unpaid tax liabilities, or those who engage in illegal phoenix activities.²³

17 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 5 March 2018, p. 1.

18 See for example, Law Council, *Submission 9*, p. 2; J P Downey & Co, *Submission 2*, pp. 1–2; and DCS Group Australia, *Submission 4*, BAEI bill, pp. 1-5.

19 CPA Australia, *Submission 8*, BAEI bill, pp. 1-2.

20 See for example, Law Council, *Submission 9*, BAEI bill, p. 1; and ABA, *Submission 15*, BAEI bill, pp. 1–2.

21 Mr Michael Lhuede, *Submission 3*, BAEI bill, p. 5; Law Council, *Submission 9*, BAEI bill, p. 2.

22 Law Council, *Submission 9*, BAEI bill, p. 2.

23 Pitcher Partners, *Submission 12*, BAEI bill, pp. 2–3.

2.21 Pitcher Partners argued that bankrupts in Categories 1 and 2 should be eligible for a reduction in the default period, provided that those in Category 2 were compliant with duties and obligations under the Act. However, Pitcher Partners stated that those in Category 3 should not be eligible for a one year default period except in exceptional circumstances.²⁴

2.22 Further, Pitcher Partners stressed that the one year period should not be an automatic discharge but instead that eligibility for early discharge should be assessed. They also stated that the trustee be empowered to object to early discharge, on prescribed grounds which were outlined in detail in their submission.²⁵ Pitcher Partners stated:

While Pitcher Partners recognises that the prospect of a one year bankruptcy would foster entrepreneurial activity by reducing the restrictions that would otherwise be placed on prospective business people and entrepreneurs, a bankrupt wishing to avail themselves of a 'fresh start' sooner than the three year period of bankruptcy should apply to do so through an administrative process. This process would facilitate the ability of the vast majority of bankrupts to take up the opportunity for a 'fresh start' after one year, but will provide a safeguard to ensure a small minority of 'non-complying' bankrupts are not inappropriately and automatically discharged.²⁶

2.23 AFSA noted that the reduction of the default period would not restrict the time period that a bankrupt trustee can administer a bankrupt estate.²⁷ AFSA further noted that:

The reduction of the default period will directly impact on:

- *Objections*: The period of time a trustee can lodge an objection to discharge will be reduced. This has implications for incentivising cooperation by debtors with the process post-discharge and may impact on the volume of objections to discharge lodged by trustees, particularly in the lead up to commencement of the reforms.
- *After acquired property*: Shortening the default bankruptcy period will impact on the value of after-acquired property vesting in bankrupt estates. For example, it is less likely that inheritances received after the commencement of bankruptcy would vest in the estate with a shortened bankruptcy period.
- *NPII [National Personal Insolvency Index] and credit reporting*: On commencement of the reforms AFSA (as administrator of the National Personal Insolvency Index) and credit reporting bodies would need to

24 Pitcher Partners, *Submission 12*, BAEI bill, p. 3.

25 Pitcher Partners, *Submission 12*, BAEI bill, pp. 4–5.

26 Pitcher Partners, *Submission 12*, BAEI bill, p. 4.

27 Australian Financial Security Authority (AFSA), *Submission 14*, BAEI bill, p. 5.

ensure that the personal insolvency records of affected individuals reflect the change to the default bankruptcy period in a timely way.²⁸

2.24 The Australian Securities and Investments Commission (ASIC) similarly raised concerns about whether the proposed one year default period would be sufficient to protect creditors, consumers and financial investors. ASIC stated:

Businesses regulated by ASIC (which offer financial products and services to the public) often fail because the owner/manager lacks the necessary business acumen and fails to keep adequate accounts and records. A question therefore may arise as to what is an appropriate period to allow a businessperson, whose business fails and is disqualified as a director, to undertake appropriate education and skills development training to reduce the risk of future failures[.]²⁹

2.25 ASIC further noted the risk posed by a shortened period of directorship disqualification under the default bankruptcy period, which it could unintentionally promote excessive risk-taking.³⁰

2.26 ASIC recommended amending subsection 201A(a) of the *Corporations Act 2001* (Corporations Act) to require that a person made bankrupt within the last three years cannot be included for the purpose of satisfying the minimum director requirement, which currently provides that a proprietary company have at least one director. ASIC stated that if a proprietary company has as its sole director a person made bankrupt in the past twelve months, 'risks such as inadequate skills and excessive risk-taking within the company are exacerbated'.³¹ According to ASIC, the suggested amendment would be consistent with the bill's objectives and enable bankrupt persons to act as directors, but would also require that management of a company be shared with at least a third party who would also be responsible for the company's actions and be subject to the care and diligence obligations under the Corporations Act.³²

2.27 In the second reading speech, the Assistant Minister to the Prime Minister explained that the reduction in the default period was appropriate for the majority of bankrupts. The Assistant Minister stated:

One year is sufficient time for the administration of the vast majority of bankruptcies. Currently, where more time is required, trustees can continue to administer a bankruptcy after discharge. This may occur for various reasons, including: ongoing investigations, assets to be realised, outstanding income contributions, and incomplete distribution of funds. This safeguard

28 AFSA, *Submission 14*, BAEI bill, p. 5.

29 Australian Securities and Investments Commission (ASIC), *Submission 6*, BAEI bill, p. 2.

30 ASIC, *Submission 6*, BAEI bill, p. 2.

31 ASIC, *Submission 6*, BAEI bill, p. 3.

32 ASIC, *Submission 6*, BAEI bill, p. 3.

will continue to operate to ensure trustees can properly administer a bankruptcy even after a bankrupt's one year discharge.³³

2.28 Some submitters also raised concerns regarding the capacity for creditors to recover debts owed within the one year default timeframe proposed by the bill. One submitter noted that unless AFSA was able to action all referrals promptly, income contribution collections may diminish.³⁴

2.29 The Department noted concerns raised by submitters regarding the one year default period. The Department stated in its submission that a number of suggested solutions had been considered during the stakeholder consultation period:

Limiting a one year bankrupt to first-time bankrupts, or restricting access to return bankrupts to once every 10 years, would contradict one of the core aims of the reforms, being to reduce the stigma associated with bankruptcy. To effectively combat the stigma, the reforms must ease bankruptcy laws for all debtors, without discrimination.³⁵

2.30 The Department explained that:

...the intent of government in putting these reforms forward is that if you are going to encourage risk-taking, risk-taking by definition is going to result in failure sometimes. So, if you are going to encourage risk-taking you have to tolerate failure. If you are going to tolerate failure, saying you're only going to tolerate failure once, or tolerate failure twice, but then the third time you're going to say that necessarily means you're a bad person as opposed to an unlucky person, or you took a risk that just didn't turn out, is contrary to the intention.³⁶

2.31 Further, the Department advised that treating distinct groups of bankrupts differently would be contrary to the bill's intention of simplifying the regime and lead to additional burdens on regulatory bodies.³⁷

2.32 However, the committee also notes that some submitters were supportive of the reduction of the default period.³⁸ The Financial Rights Legal Centre, Financial Counselling Australia and Consumer Action Law Centre (FRLC, FCA and CALC) stated:

[The amendment] strikes an appropriate balance between the interests of creditors, and ensuring that bankruptcy enables a fresh start for debtors, and is not needlessly punitive. Reducing the bankruptcy period as described in

33 Senator the Hon. James McGrath, Assistant Minister to the Prime Minister, *Senate Hansard*, 19 October 2017, p. 8029.

34 Mr Geoff Green, *Submission 1*, BAEI bill, p. 2.

35 AGD, *Submission 17*, BAEI bill, p. 2.

36 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 64.

37 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 60.

38 Justice Connect, *Submission 18*, BAEI bill, pp. 1–2.

the bill is likely to have a fairly minimal effect on the amounts recouped by creditors from bankrupt estates, but significantly improves the bankrupt's opportunities for early financial rehabilitation and participation in economic activity.³⁹

Lack of anti-abuse provisions

2.33 Many submitters expressed concerns that the proposed amendments do not contain anti-abuse provisions. The submissions raised two issues in particular: the possibility of serial bankrupts, and the perceived increased risk of phoenix activity.

2.34 It was observed that the reduction of the default bankruptcy could potentially increase the risk of serial bankrupts abusing the proposed system. Pitcher Partners stated to the committee that it manages a number of 'rogue' bankrupts who actively abuse the bankruptcy system:

We say rogue bankrupts are those bankrupts whose behaviour either pre-or post-bankruptcy demonstrates what we would call a willingness to abuse bankruptcy and other laws to their benefit at the expense of others. They are often dishonest or have engaged in undesirable commercial behaviour. A significant proportion of rogue bankrupts have complex affairs. They involve tax avoidance, fraud or evasion and sometimes even serious criminal conduct.⁴⁰

2.35 Pitcher Partners argued that the legislation should aim to balance the need to reduce perceived stigma with the risk of rogue bankrupts abusing the system.⁴¹ They proposed that this could be achieved by implementing three changes to the bill:

- Clearly identifying and separating rogue bankrupts from eligibility for the one-year default period by prescribing behaviour or events that would restrict the rogue bankrupt from seeking early discharge;
- Strengthening the objection-to-discharge procedures; and
- Incentivising post-discharge compliance through the income contribution assessment period.⁴²

2.36 The Law Council recommended that the bill provide that a bankrupt should be required to demonstrate to the trustee that their bankruptcy is in relation to business-related debt. The trustee would subsequently be empowered to decide whether to approve the early discharge, subject to the review of the Inspector General in Bankruptcy.⁴³

39 Financial Rights Legal Centre, Financial Counselling Australia and Consumer Action Law Centre (FRLC, FCA and CALC), *Submission 13*, BAEI bill, p. 2.

40 Mr Gess Rambaldi, Partner, Pitcher Partners, *Proof Committee Hansard*, 6 March 2018, p. 5.

41 Mr Gess Rambaldi, Partner, Pitcher Partners, *Proof Committee Hansard*, 6 March 2018, p. 5.

42 Mr Gess Rambaldi, Partner, Pitcher Partners, *Proof Committee Hansard*, 6 March 2018, p. 5.

43 Law Council, *Submission 9*, BAEI bill, p. 2.

2.37 Some submitters raised concerns about the bill adequately protecting against phoenix activity.⁴⁴ The Australian Criminal Intelligence Commission (ACIC) stated in its submission that its intelligence suggested that the reduction of the default bankruptcy period may increase the risk of serious and organised crime groups exploiting the bankruptcy provisions. It stated:

Through the use of illegal phoenix activity as a business strategy by serious and organised crime groups, ACIC intelligence indicates that there are individuals who exploit bankruptcy provisions to facilitate illegal activity. These individuals and groups are often aided by professional facilitators, who are intrinsic enablers of serious and organised financial crime. A current concern to the ACIC are liquidators and unregistered pre-insolvency advisors who are developing a niche in the criminal environment by facilitating and promoting the exploitation of bankruptcy provisions and illegal phoenix type activities. For example, by encouraging directors and accountants to transfer assets to new entities for less than market value, or to destroy or alter company records.⁴⁵

2.38 Some submitters suggested that the risk of abuse of the proposed regime may undermine public confidence in the strength of bankruptcy laws, especially in the case of high-profile examples.⁴⁶

2.39 The Department noted that existing compliance mechanisms in the wider bankruptcy regime provide anti-abuse protections:

So the bankruptcy regime provides a mechanism for consequences when risks are taken and fail without being unduly punitive and discouraging that sort of risk-taking but understanding that there is that risk for people to abuse the system. The rating already includes a number of safeguards, and those safeguards will either be retained or enhanced through these reforms. There are four safeguards, in particular, I draw senators' attention to. These are the income contribution payments; the objection to discharge regime; the Official Receiver's rejection of a petition power; and interim control orders under section 50 of the bill.⁴⁷

2.40 The Department further noted that provisions in the BAEI bill are designed to combat potential abuse, such as a proposed commencement date being six months after Royal Assent to enable trustees to prepare objections to discharge of bankruptcies on foot.⁴⁸

2.41 The Department also pointed to the income contribution obligations as a mechanism to enforce compliance and deter abuse:

44 DCS Group Australia, *Submission 4*, BAEI bill, pp. 2–3.

45 Australian Criminal Intelligence Commission, *Submission 16*, BAEI bill, p. 1.

46 ARITA, *Submission 10*, BAEI bill, pp. 1–2.

47 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 5 March 2018, p. 3.

48 AGD, *Submission 17*, BAEI bill, p. 2

This is the first safeguard; bankrupts will still be required, if they earn over the income threshold, to make income contributions for the full three years, as is the case now, and there are also a number of mechanisms in the act to ensure and facilitate the payment of those payments, including garnishee notices and the supervised account regime.⁴⁹

2.42 Additionally, the Department advised the committee that the Government's priority was to simplify the bankruptcy regime in order to assist genuine bankrupts:

I'd like to say it's a balance. Sure, we could introduce a regime to make it particularly complicated and have criteria that have to be assessed. We could probably not guarantee but we would probably have a very good shot that all these so-called rogue bankrupts would be excluded or given a more punitive or more difficult regime. But the consequence of that would be that the majority of bankrupts, who aren't rogue bankrupts, would have to go through a far more complicated, far more administratively involved process to get into bankruptcy. That's pretty much the antithesis of what the government is seeking to achieve with these amendments, which is a combination of the stigma notion, but there's a sub-element of that, which is simplification—trying to make the bankruptcy regime a bit simpler, a bit more efficient.

...

The safeguards in the system, I would assert, are sufficient to allow mechanisms for those rogue players, such as the ability for the official trustee to reject the petition based on grounds of abuse.⁵⁰

Income contribution obligations

2.43 The bill proposes to extend income contribution obligations for discharged bankrupts for a minimum period of two years following discharge, or, in the event of the bankruptcy's extension due to non-compliance, for a period of five to eight years.⁵¹

2.44 Submitters were generally supportive of the extension to income contribution obligations. For example, FRLC, FCA and CALC noted in its submission that, while it supported the income contribution payments scheme as a method of enforcing post-bankruptcy compliance, there had been no change to rules regarding financial hardship. They recommended amending:

- Section 139T, which details situations in which the income contribution assessed produces an immediately harsh result, to include a situation where the assessment is valid at the time it is made but can no longer be met because of a subsequent change of circumstances;

49 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 5 March 2018, p. 3.

50 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 59.

51 BAEI Explanatory Memorandum, p. 2.

- Section 139ZH, which provides that there is no refund payable regarding overpaid contributions. This was argued to be unduly harsh in situations where overpayment is not due to any act or omission of the bankrupt and provides an incentive for bankrupts to under-estimate income, and it was recommended to account to the bankrupt where overpayment occurs in the final contribution assessment period; and
- Allowing bankrupts to keep income earned after bankruptcy at the discretion of the trustee.⁵²

2.45 ARITA recommended amendments to improve a bankrupt's accountability to the trustee:

The extension of income contribution obligations for two years following an automatic discharge after one year is an important measure to accompany any decision to reduce the default bankruptcy period. While there are measures open to a trustee in bankruptcy to enforce these obligations post-discharge, it is worth considering whether a breach of a discharged bankrupt's obligations of payment and provision of information should constitute an 'act of bankruptcy' under s 40 of the Act. This would make it easy and less costly to bring about a second bankruptcy for any discharged bankrupts who default on their income contribution obligations.⁵³

Impact on debt agreement regime and other alternatives under the Act

2.46 A number of submitters raised concerns that the proposed amendments would negatively impact on the debt agreement regime.⁵⁴ Mr Lhuede argued that the development of the debt agreement regime could be seen as a reflection of the social perception of the stigma associated with bankruptcy. Mr Lhuede further noted:

If that attitude is being discouraged in favour of being accepting of financial failure then we may well be altering the very assumptions on which debtors to date have been willing to reach agreement under Part IX with their creditors. Any changes to the Act should be careful to avoid any distortions that would discourage debtors from reaching commercial arrangements with creditors under Part IX of the Act.⁵⁵

2.47 Additionally, the submission stated that the proposed one-year default period may significantly impact on post-bankruptcy arrangements with creditors under section 73 of the Act.⁵⁶

2.48 The Department advised the committee that the intention of the bill, in addition to the BADAR bill (considered in the next chapter), was to provide choice for

52 FRLC, FCA and CALC, *Submission 13*, BAEI bill, pp. 3–5.

53 ARITA, *Submission 10*, BAEI bill, pp. 1–2

54 See for example, J P Downey & Co, *Submission 2*, BAEI bill, pp. 1–2.

55 Mr Michael Lhuede, *Submission 3*, BAEI bill, p. 5.

56 Mr Michael Lhuede, *Submission 3*, BAEI bill, p. 5.

debtors. The Department stated that bankruptcy is suitable for certain situations while debt agreements are better for others, and the Government sought to provide options for individual situations.⁵⁷

Inconsistency with other laws requiring financial reporting

2.49 The committee received submissions that the proposed amendments would result in inconsistency with other legislation and industry rules which place restrictions on bankrupts.⁵⁸

2.50 SellersMuldoonBenton noted in its submission that the bill's proposal to eliminate the need for individuals to disclose their bankrupt status after the one-year default period is inconsistent with financial practices requiring full reporting. They note:

Most applications for finance, leases etc will note or ask whether the individual has been bankrupt or subject to another form of insolvency within the past 7-10 years. It is unclear how the responses to this question will be dealt with any differently due to the change[.]⁵⁹

2.51 It was further observed that current credit reporting requirements also require disclosure regarding bankruptcy.⁶⁰

2.52 FRLC, FCA and CALC submitted that the bill does not change the rules regarding deletion of information from credit information files under section 20X, Part IIIA of the *Privacy Act 1988* (Cth). They stated:

At present, bankruptcy is retained on a person's credit report for the longer of 2 years from discharge or 5 years from the date of bankruptcy – effectively a minimum of 5 years. If the period of bankruptcy is reduced by 2 years then, logically, the period that bankruptcy remains on credit reports should also be reduced by 2 years, creating an effective minimum of 3 years.⁶¹

Other issues

2.53 In its submission, ASIC suggested that the Corporations Act could be amended in relation to disqualification of directors who have been made bankrupt.⁶² ASIC recommended that section 206F of the Corporations Act be amended to provide for:

57 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 61.

58 See: SellersMuldoonBenton, *Submission 6*, BAEI bill, p. 1;

59 SellersMuldoonBenton, *Submission 6*, BAEI bill, p. 1.

60 SellersMuldoonBenton, *Submission 6*, BAEI bill, p. 1.

61 FRLC, FCA and CALC, *Submission 13*, BAEI bill, p. 4.

62 ASIC, *Submission 6*, BAEI bill, pp. 2–4.

- expanding ASIC's powers in order to direct the bankrupt person to take specific actions prior to participating in the management of a company, such as corporate and financial management training;
- increasing the maximum length of disqualification from five years to seven years in order to deter phoenix activity; and
- providing for automatic disqualification where a director has been an officer of four or more corporations that have wound up in the previous seven years and where, in each case, a liquidator has lodged a report under the Act's requirements under section 533(1). This process determines whether the wound up companies are related, thus further deterring phoenix activity.⁶³

2.54 ASIC made further recommendations regarding section 206BA(5) of the Corporations Act. Under section 206B(3) of that Act, a bankrupt is automatically disqualified to manage a corporation if they are an undischarged bankrupt. Section 206BA enables ASIC to apply to court to extend the period of automatic disqualification by up to 15 years if a person has been convicted of a relevant offence, while section 206BA(5) allows the Court to have a broad discretion in taking any appropriate matters into account. ASIC recommended that the scope of section 206BA(5) be broadened to enable ASIC to apply to extend the period of disqualification to run a corporation where the person is an undischarged bankrupt in situations where it can be demonstrated that there are serious concerns regarding a person's capacity to manage a corporation.⁶⁴

2.55 The Law Council also made a number of recommendations for minor technical amendments to the bill.⁶⁵ The Department confirmed to that these recommendations were being considered;⁶⁶ however, in response to a question on notice, the Department outlined its reasons why the suggested amendments were not accepted.⁶⁷

63 ASIC, *Submission 6*, BAEI bill, pp. 2–4.

64 ASIC, *Submission 6*, BAEI bill, p. 4.

65 Law Council, *Submission 9*, BAEI bill, pp. 3–4.

66 Mr Michael Johnson, Acting Assistant Secretary, Civil Law Unit, AGD, *Proof Committee Hansard*, 6 March 2018, p. 62.

67 AGD, answers to question on notice, 6 March 2018 (received 14 March 2018), pp. 6–7. The full response is available on the committee's website.