1 March 2018

Mr Tim Watling
Committee Secretary
Senate Legal and Constitutional Affairs Legislation Committee
Parliament House
CANBERRA ACT 2600
By email: legcon.sen@aph.gov.au

Dear Mr Watling

Bankruptcy Amendment (Enterprise Incentive) Bill 2017

Please find below my submission to the Senate Legal and Constitutional Affairs Legislation Committee's review of the Bankruptcy Amendment (Enterprise Incentive) Bill 2017.

Introduction

I am a discharged bankrupt and accordingly I have personal experience in bankruptcy. My bankruptcy spanned the years 1994 to 1997. I have read all the submission to this inquiry and note, that to date, no submissions have been made by anyone who has been bankrupt.

My bankruptcy resulted from a director's guarantee given in support of a bank loan. It was therefore business related. My business failed in the early 1990s as a result of the *"recession we had to have"* and a bank calling in a loan based on a non-monetary default clause. At that time, I employed over 100 staff. I have rebuilt my businesses since that time.

In my case, the process to start again was despairingly and impossibly difficult. Many other entrepreneurial friends of mine who were also bankrupted at the time, did not try again. The process destroyed them.

My interest is only in the 18% to 20% of bankruptcies that flow from business related activities. All the matters I address, and all the recommendations I make, only relate to these business-related bankruptcies. I have no view on how legislation should treat non-business-related bankruptcies.

Foster entrepreneurial activity and reduce stigmas

The explanatory memorandum to the Bill refers to the aims of the National Innovation and Science Agenda. These aims are *"to foster entrepreneurial behaviour and to reduce the stigma associated with bankruptcy."* These are worthwhile aims.

However, entrepreneurs are generally resilient and resourceful individuals. They can live with a stigma. This is not the issue. I wear my bankruptcy as a badge of honour. I do not keep it a secret and never have. I have already provided a copy of my bankruptcy certificate to this inquiry.

Entrepreneurs cannot however live with the draconian and penal regime that currently accompanies bankruptcy. This regime has more in common with the old English debtors gaol system, rather than a mechanism to foster entrepreneurs to re-engage in business.

A bankrupt entrepreneur cannot start again when the person has no assets other than a $7,800 car, tools worth $3,700 and is burdened with a 3 year period where if the person earns over $53,000, the person pays excess earnings to their trustee. This entrepreneur is treated like a criminal who is regularly required to report to their trustee who acts like a probation officer.

Current Submissions

I have read all the submissions lodged to date.

Many of the submissions are from insolvency practitioners. Some firms are opposed to any relaxation of bankruptcy laws. They seem very concerned that this bill may lead to increased "phoenixing" activity and the emergence of serial bankrupts. I suggest that some of these firms may earn large incomes operating under the current insolvency regime and may be conflicted.

I would argue that the sort of problems they raise should be addressed through other mechanisms. We should not assume that all those who become bankrupt through business related activities are "crooks" and treat them as such.

Moreover, a "phoenix" operation is not always a bad thing. If we are trying to incentivise enterprise and foster entrepreneurial behaviour, then a failed entrepreneur needs to try again. Obviously, when an entrepreneur tries again, this activity will generally be in the industry in which he/she has experience and hopefully will do better the second time around with the experience gained from the earlier failure. This business may well be a "phoenix" operation.

Treating business related bankruptcies differently

The submission from the Attorney General's Department (AG) states that *"the core policy driving this reform is to provide bankrupts with a fresh start."* In order to encourage *"enterprise"* amongst business related bankrupts I suggest that these people need to be treated differently to a person who may regularly incur huge credit card debts and declares bankruptcy on multiple occasions.

Businesses may fail for reasons that are outside the control of the directors. It is these people who should be encouraged to try again and not be treated like "crooks".

In support of this comment, I note that the following submission:

1. CPA Australia Ltd states, "*Among causes of business related personal bankruptcies, economic conditions dominate."*
2. The Law Council of Australia submission states *"The bill does not discriminate between business and non- business bankruptcies."*
3. The Australian Bankers Association suggests *"For the law to provide for an early release mechanism for those business-related bankrupts who have clearly demonstrated sound business acumen and responsibility and for circumstances not under their control, for example due to adverse economic conditions, illness or family disruption, have been unsuccessful in their business ventures".*

This is the group of people that this bill should be targeting with additional concessions to encourage them to have a "fresh start".

Additional concessions for genuine business-related bankruptcies

Other concessions and reforms for business related bankrupts are discussed in the productivity Commission's Inquiry: Business Set-Up, Transfer and Closure. Some aspect of the Chapter 11 insolvency model could be adopted in the Australian context.

As an example, in the USA, different states have different laws. Some concessions to encourage enterprise include:

1. A bankrupt can keep his or her home.
2. A bankrupt can keep a certain amount of assets other than the home of up to $250,000.
3. A bankrupt can present to court, hand over title to all assets, other than those allowed to be retained, and at that time the bankruptcy is over.

These types of provisions would constitute genuine reforms and incentives for a "fresh start."

Income contributions

When an entrepreneur has been declared bankrupt, he will have lost everything. He will have lost his home, holiday home, investments, cars, trucks, equipment and all the things he has used to run his business and make a living. Moreover he has no income. A major problem for many entrepreneurs is that they have been self-employed for many years, perhaps decades or most of their working life. As a result, they are often older and not skilled in a particular area. Therefore, in many cases they are unemployable.

I had coffee yesterday with a man who had his loans defaulted by the NAB in 2014. He and his two brothers, who are in their early 60's, had a family business for decades. They owned and ran 5 service stations and several fast food outlets. Their business had a gross value of $37m. I won't go into the reasons why the bank called in the loan, except to say that these people never missed an interest payment. This man had previously owned a lovely family home. Now he and his wife rent a 2 bedroom flat in Harris Park. All three men are severely depressed and unemployed. One smokes 3 packets of cigarettes a day. They have no assets. They are probably unemployable other than in very menial jobs and have no way of starting a business again.

How would making these people pay income contributions for 3 years possibly achieve anything let alone encourage them to start in business again?

Directors guarantees

All of the business-related bankruptcies that I have seen relate to directors' guarantees given to banks in support of a loan over other security. This is an extremely important matter for business people.

The driving force for the current Banking Royal Commission was the conduct of the banks, primarily the CBA, towards its own commercial customers as well as those of Bankwest.

From correspondence provided by the CBA to the Parliamentary Joint Committee for Corporations and Financial Services inquiry, titled "the impairment of customer loans", we know that Bankwest defaulted and called in thousands of large commercial loans that were classified as performing loans at the time the CBA purchased Bankwest.

A large unknown number of bankruptcies flowed from this single event. These bankruptcies were generally as a direct result of a director's guarantee. Without commenting too much on the behaviour of the CBA, in my opinion the Royal Commission will discover that many business loans were defaulted and called in and directors bankrupted even though the businesses were in good health.

My point here is this. A bank assessed the risk, nominated a loan to value ratio (LVR) with which it was comfortable and advanced a commercial loan. The bank then insisted on a director's guarantee, which is always a non-negotiable condition. However, the value of any assets owned privately by the director is never included in the LVR calculation.

When the loan is defaulted and called in, the bank generally demands payment of any short fall from the director and if the shortfall is not paid, then the bank bankrupts the director.

The problem is that the bank will often rush through a quick sale of the secured property knowing that if there is a short fall they can then attack the company director for the short fall. If this avenue was denied, the bank then would be a lot more diligent in obtaining a reasonable price for the property and recover the full value of the loan from the proceeds of the sale.

Historically, where a director is bankrupted under a director's guarantee, the cause of the business failure may have been outside of the director's control. As an example, in the CBA / Bankwest cases that may be investigated by the Royal Commission, evidence may well be uncovered that would suggest many commercial loans were viable and that the bank defaulted and called in loans so it could reinvest the funds in more profitable areas of the bank.

It is my recommendation that a director's guarantee should never be allowed to be used as grounds for bankruptcy.

Extension of the bankruptcy period

Having been bankrupt, I understand the enormous power that is enjoyed by a trustee in bankruptcy. I was in constant fear that in my case the bank would bring pressure on the trustee to extend the 3-year term. Unfortunately, a trustee can be unreasonably and vindictively influenced by a creditor. There is no right of review for the bankrupt. This is a totally unreasonable situation.

I note that the Australian Bankers Association in its submission refers to a potential early release mechanism with the "*onus of proof to rest with the bankrupt".*

In my case my wife and I had 5 school age children to support. Currently a bankrupt is allowed to keep a car if it is worth less than $7,800 and tools worth not more than $3,700. With 5 dependent children, a bankrupt must make income contribution payments to the trustee on income in excess of $75,939.

With these draconian restraints in place and up against the power and wealth of a vindictive bank it is not realistic to imagine how a person in such a position would have the financial ability or the time to mount a case in support of the "*onus of proof test".*

There needs to be a right of appeal mechanism available to a bankrupt when his bankruptcy is extended by his trustee. This mechanism should be free of charge.

Summary

I support the intent of the bill. However, the reforms suggested will not adequately achieve this intent. Accordingly, I recommend the following additional reforms:

1. The family home should be a protected asset under the Act.
2. Business related bankruptcies should be treated differently to other types of bankruptcies.
3. A business-related bankruptcy should be for 1 day only with no ongoing income contribution obligations or other restrictions provided there was no fraud or past bad behaviour.
4. Directors' guarantees should be prohibited as a mechanism to bankrupt a director.

5. Additional concessions should be provided to business related bankrupts such as those in the system used in the USA as mentioned above. In particular, the bankrupt needs to be left with sufficient assets so that there is a reasonable chance that he/she can make a “fresh start”.
6. There needs to be a right of appeal mechanism available to a bankrupt when his bankruptcy is extended by his trustee. This mechanism should be free of charge.

Yours faithfully,

Peter McNamee