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27 May 2016

The Manager, Corporations and Schemes Unit
Financial Systems Division
The Treasury
Langton Crescent
PARKES ACT 2600

Submission via Email insolvency@treasury.gov.au

Dear Sir

## Submission on Improving Bankruptcy and Insolvency Laws – Proposals Paper April 2016

We welcome the opportunity to comment on the Federal Government's Proposal Paper on Improving bankruptcy and insolvency laws which was announced as part of the National Innovation & Science Agenda reforms last year.

We comment on certain aspects of the paper on which we received feedback from our members. These comments are set out in relation to the three measures highlighted in the paper.

### Reducing default bankruptcy period

While supporting the aim of encouraging innovation and appropriate risk taking in business development, the statistics available from the AFSA website show that when analysing the cause of bankruptcy, the majority of all bankruptcies are non-business related.

www.afsa.gov.au/resources/statistics/socio-economic-statistics/causes-1/causes-non-business-related

Given these statistics, it may be unlikely that reducing the bankruptcy period to one year alone would be a catalyst for encouraging more risk taking in business. Our members have mixed views therefore about whether the reduction of the default bankruptcy period will achieve the desired outcomes.

For certain non-business bankruptcies, the proposal to reduce the default bankruptcy period is not likely to have a material impact on the unsecured creditors of those bankruptcies. This is because these bankruptcies will not result in a return to creditors and a one year timeframe will be sufficient to allow for adequate investigations to be undertaken and concluded.

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However, for more complex non-business or business bankruptcies, our members report the major difficulty in practice is the ability to obtain timely information and accurate records from the debtor or their related parties. This can require the issue of formal notices to related parties of the debtor and their advisors, applying for Notices to be issued on third parties such as banks to obtain relevant financial records, or also conducting public examinations of the bankrupt and other parties. In such circumstances, investigations are very likely to extend beyond one year. It is important that if a one year default period is pursued, that there be powers for a bankruptcy trustee to easily extend the period where such co-operation has not been forthcoming. This would also be an appropriate safeguard for creditors of the debtor so that their position is not unwittingly eroded by the proposed change.

The process for the bankruptcy trustee to extend the bankruptcy period or to object to discharge also needs to be refined so it is not prohibitive on the bankruptcy trustee. Key matters which we believe need to be enacted are:

- Strengthening the provisions of Section 149D of the Bankruptcy Act to include:

    - Where there is a need for further time to investigate transactions where the bankrupt's obligation to assist the bankruptcy trustee is required;

    - Where there may be some prejudice to otherwise allowing the discharge to occur (i.e. some potential loss of a recovery or return to unsecured creditors as a result of the bankrupt's willingness to provide assistance); and

    - Situations where the bankruptcy trustee has not obtained timely information from the bankrupt, or otherwise been obstructed in the course of the process, or where records have not been made available.

  In practice, these are common ways that those seeking to misuse the process can hinder bankruptcy trustees.

- Making amendments to Section 149C of the Bankruptcy Act that reverses the burden of proof such that an objection is granted if there is a reasonable basis, as opposed to a scenario in which it is not granted unless proven. There are already appropriate mechanisms in the Bankruptcy Act whereby the bankrupt can apply for a review of the objection if they wish. We are particularly focused on ensuring that in the reduction of the default period there is an adequate positive obligation on the bankrupt to genuinely assist their bankruptcy trustee. Where they do not, the ability for the bankruptcy trustee to extend the bankruptcy period needs to be able to be undertaken in a routine and cost effective manner.

It should be recognised that there may be applications to extend or object to discharge which will not have been necessary prior to a reduction of the default period. This may impact on the resources AFSA needs to make available should the proposal proceed.

A major concern arising from a shorter default period is the ability to require a bankrupt to meet their obligations after discharge. Our members report that the current legislative penalty is not effective due to the burden of proof, and the time and cost involved in taking action.

A strong incentive to encourage compliance with the Bankruptcy Act by the bankrupt would be to make the failure of the bankrupt to discharge obligations after the default period constitute an act of bankruptcy. Where this act of bankruptcy occurs, consideration could be given to streamlining the process for a subsequent bankruptcy.

An alternative possibility is that a default period applies but with bankruptcy trustees having the ability to require a bankrupt to meet their obligations after discharge. Ability to re-activate the bankruptcy could be an effective penalty as long as it was supported by a simple process. However we note that this option does introduce uncertainty which may not be beneficial and could impose difficult practicalities.

The ability to collect income contributions after discharge is a particular area of concern in practice. If the default period is shortened, there must be appropriate mechanisms to encourage compliance by the bankrupt. Examples of the types of mechanisms are mentioned above. This could be further enhanced if there was notation on the National Personal Insolvency Index reporting the default.

We have contemplated the balance between supporting entrepreneurship and equity for those dealing with an individual who has entered into bankruptcy (either voluntary or otherwise). We recognise that there will be those who seek to misuse the system. We suggest therefore that it may be appropriate to build in a safeguard for a subsequent bankruptcy. This could be built into the trustees' options to apply for an extension as highlighted above. This would only be effective if the trustee option was a simple process.

**Introducing a safe harbour for directors from personal liability for insolvent trading in certain circumstances**

We support options to allow a potentially viable business the opportunity to restructure to preserve value. We recognise that there is a belief that a restructuring option is not always followed because of directors' personal liability concerns under the current legislation.

If either of the proposed safe harbour models were adopted, we believe there will need to be a professional restructuring advisor appointment. A professional restructuring advisor will have skills and competencies required to enable the value in the business to be realised. The appointment should be notified to ASIC (and ASX where required). Without a formal notification, the timing of decisions can be disputed. In any subsequent challenge, the timing will be important in ascertaining when the safe harbour provisions commence. This is particularly so if Model B were adopted and it is used as a defence.

In relation to Model A, we note that there are a number of issues which would need to be addressed for the model to be enacted effectively. These matters include:

- The current proposals use a number of subjective terms, such as "reasonable" and "appropriate". These terms will need to be defined but our experience is that legislation is not an effective mechanism for such specifics.

- The restructuring adviser must provide an opinion that the company can be returned to solvency in a reasonable period of time. It is possible that such an opinion would in practice be subject to several caveats due to limitations of information available or opinions that can be drawn.

- The proposed role of the restructuring advisor is broad and there is potential for directors to use the appointed of such an advisor to avoid their responsibilities for the entity.

- We suggest that the restructuring adviser be able to be appointed by a majority of directors as well as by the company. This is permitted in a Voluntary Administration situation and could avoid unnecessary delay in an appointment.

- In relation to the areas where the safe harbour provisions would not be available:
    - Failure to lodge multiple BAS – a definition of "multiple" may be required as well as an indication of the time period for determining non-lodgement. There should also be reference to late lodgement of BAS.
    - Significant failure to pay – a definition of "significant" may be required.

**Making "ipso facto" clauses unenforceable**

We support options to maintain value when there is a chance of a future for the business. The arbitrary removal of a key element of a business when there is an opportunity to restructure and retain value is not in the best interests of business as a whole (including other creditors and employees).

On balance therefore we believe it is appropriate to make such clauses unenforceable. To avoid adverse consequences we agree the removal of the clause should only be available for formal insolvency appointments (i.e. voluntary administrations, all types of liquidations and certain receivership types where the business is being managed or operated) because in those situations creditors have protections for continued trading, for example the personal guarantee of the insolvency practitioner for ongoing trading.

We note concern that contracts may be rewritten to introduce clauses to circumvent this provision. We agree with the paper explicitly recognising this concern and seeking to introduce anti-avoidance mechanisms.

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If you have any questions regarding this submission, please contact Liz Stamford (Audit and Insolvency Leader) via email; liz.stamford@charteredaccountantsanz.com.

Yours sincerely

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