Law Council
OF AUSTRALIA

Business Law Section

9 February 2021

Bankruptcy Team
Attorney General's Department
Australian Government

By email: Bankruptcy@ag.gov.au

Dear Bankruptcy Team,

The bankruptcy system and the impacts of coronavirus

1. This submission concerning the discussion paper on the bankruptcy system and the impacts of coronavirus published by the Attorney-General's Department in January 2021 is made by the Insolvency and Restructuring Committee of the Business Law Section of the Law Council of Australia (the **Committee**).

Submission

2. The Committee's responses to the discussion questions contained in the discussion paper are set out in the attached table.

Conclusion and further contact

3. The Committee would be pleased to discuss any aspect of this submission. Please contact the chair of the Committee, Scott Butler, on 07 3231 7722, if you would like to do so.

Yours faithfully,

Greg Rodgers
Chair, Business Law Section

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Default period of bankruptcy		
No	**Question**	**Response**
1	How do current economic circumstances impact the policy setting for a default period of one year bankruptcy?	A one year default bankruptcy period should not be introduced simply to deal with the possible elevated levels of personal insolvency associated with the effects of COVID-19. It should be introduced if it is considered to be good policy generally.
2	Have stakeholder views about the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 changed due to the impacts of coronavirus?	No. The Committee still supports the changes proposed by the *Bankruptcy Amendment (Enterprise Incentives) Bill* 2017 (**Bill**). After considering the issues identified by the Attorney General's Department in the report of March 2018 of the Legal and Constitutional Legislation Committee, the Committee no longer considers that it would be feasible to distinguish between business related and consumer related bankruptcies and considers that there should be a single regime for all bankruptcies.
3	How might a default period of one year benefit debtors with business related debts such as sole traders?	Currently, a bankrupt can continue to trade as a sole trader, to the extent that is possible with the restrictions placed upon the bankrupt. The main restriction that would impact this is likely to be the restrictions under section 269 and 149D(1)(c) of the *Bankruptcy Act 1966* (Cth) (**Act**) on applying for credit over the statutory threshold (currently $5,881) without disclosing that they are a bankrupt. However, even if discharged, former bankrupts may continue to have difficulty in obtaining credit. Their former bankruptcy status will show up on a credit check and this is likely to influence any potential creditor's decision to provide credit. However, given they will be discharged sooner, it will mean that they will get back to a more normal credit rating earlier than otherwise, although it will still take time. If the bankruptcy arose because of personal debts incurred whilst a director of a company, e.g. by way of guarantee of company debts or under director penalties, they will be able to be directors again and take part in the management of companies sooner and that will assist them to contribute in the economy faster than they otherwise would.
4	Do stakeholders have views on how the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 could be amended to	Options include:

	respond to concerns about the one-year default period being made available to bankrupts for whom such a concession is not a desirable or justifiable outcome?	• The discharge could be made a conditional discharge; the conditions being that no circumstances that fall within section 149D(1) arise, or become known to the trustee, during the next 2 year period. If during the next two years the trustee becomes aware of a ground set out in section 149D to object to a discharge, the trustee may give notice, which has the effect of reinstating their bankruptcy. A bankrupt whose bankruptcy is reinstated should be able to seek review of that decision in the manner they can now. Guidance could also be taken from the qualifying and disqualifying provisions that were previously in place when "*Division 3 – Early Discharge*" of Part VII (s. 149R onwards) was introduced by the *Bankruptcy Amendment Act 1991*. Those provisions were subsequently repealed by the *Bankruptcy Legislation Amendment Act 2002.*[1] • A liability cap. Below the cap a bankrupt is automatically eligible for the one year bankruptcy unless the trustee objects. Above the cap, the bankrupt must apply for discharge after one year and this must be approved by the trustee. The idea behind this liability cap is that the greater the liabilities, the greater the likelihood of more detailed investigations or complexity in the bankruptcy. Guidance could also be taken from the qualifying and disqualifying provisions that were previously in place when "*Division 3 – Early Discharge*" of Part VII (s. 149R onwards) was introduced by the *Bankruptcy Amendment Act 1991*. Those provisions were subsequently repealed by the *Bankruptcy Legislation Amendment Act 2002*. • All bankrupts must apply for early discharge and must address and meet various set criteria in the application (which includes meeting certain conduct requirements during their bankruptcy similar to those set out in section 149D(1)). Bankrupts must be told early on in their bankruptcy that they may apply for early discharge if they meet the criteria. There should be set time periods within which the application must be given to the trustee and when the trustee must deal with it. For example, such an application could have to be given to the trustee within 10 months of the start of the bankruptcy and the

[1] A consideration of the operation of, and arguments for and against, early discharge provisions can be seen in "Moving beyond the 'hard' – 'easy' tug of war: A historical, empirical and theoretical assessment of bankruptcy discharge." By John King. Melb Uni Law Review, accessed at [https://law.unimelb.edu.au/__data/assets/pdf_file/0003/1708095/28_3_4.pdf]

		trustee must decide the application with 20 business days after receiving it. The bankrupt can seek a review of the trustee's decision not to allow early discharge. • To assist trustees to reach earlier conclusions about matters referred to in section 149D(1), all bankrupts could be made to provide certain declarations within a short period after their bankruptcy about their pre-bankruptcy conduct along the lines of some of the matters referred to in section 149D(1), such as whether any transfer is void against the trustee in the bankruptcy because of sections 120, 121, 128B or 128C. False declarations will be an offence and subject to penalties. • There should be a seven year rule - similar to that in section 185C(4)(a), but reduced to seven years. This matches the timeframe in Part 5.3B of the Corporations Act. Ten years is too long. • ASIC's recommendation to the Legal and Constitutional Affairs Legislation Committee in its review of the Bill should be implemented – i.e. a bankrupt that has been discharged early can't be a sole director for another two years. • A bankrupt at the outset must nominate a registered address at which their trustee can serve them (and be deemed to have served them) for a period of three years commencing on their bankruptcy (ie within the period in which income contribution obligations continue to exist). It need not be a street address – possibly even a portal or even something like MyGov.

Debt agreements		
No	**Question**	**Response**
1	What reforms, if any– either on a temporary basis or more permanently – should be made to the debt agreement system to respond to coronavirus?	As the discussion paper notes, data published by AFSA reveals that only 8% of debt agreement debtors were in business. We expect that is because the current liability threshold for debt agreements excludes the vast majority of these debtors being able to access the debt agreement regime. The debt agreement process should be available to any debtor up to a certain liability threshold. This should be

		increased to $1 million excluding employee entitlements to match the threshold for small business restructurings under Part 5.3B of the Corporations Act. Many sole traders have bank debt secured against their family home which finance their trading and so the liability cap needs to be high enough to capture these persons. There should be no maximum asset threshold. The average return from debt agreements is just under 60c in the dollar. Most debtors that look to propose debt agreements have material credit card debts. Those debts have often been bought by large debt collection businesses who require a return higher than the debtor would be able to pay over a three year period from their income before they will vote in favour of a debt agreement. This has led to a substantial number of debtors (with the assistance of ‘debt advisers’) proposing informal debt repayment arrangements with their creditors outside of the debt agreement system, which are typically five years in length, so to be able to provide the returns required for the debt collection businesses. The Committee considers that to deal with these debt administration practices which fall outside of the Act, either: • they could be separately regulated; or • preferably in our view, changes could be made to the Act to encourage them to be, or make it mandatory that they be, undertaken under the umbrella of the Act. If the former is considered to be appropriate, regulation could address the issue of purchasers of consumer debt requiring a certain return in the dollar to make a profit on their purchases, which drive up the length of debt agreements. For example a cap could be placed on the % return they can seek on the recovery of this debt (ie 105% of the amount paid). If the latter is considered to be appropriate, option would be to:

		• increase the maximum period of a debt agreement to five years in all circumstances; or • keep the period at three years and make it unlawful to enter into a repayment arrangement with multiple creditors which is not under the Act. This would be similar to the effect of the former section 213 of the Act, which was repealed in 2004, but be extended to cover Part IX also. The period under section 185C(4) could be reduced to seven years. This will then be in line with the provisions of the small business restructuring under Part 5.3B of the *Corporations Act 2001* (Cth).
2	Are there changes that could be made to the debt agreement system to make it more useable for those with business related debts such as sole traders?	See the answer to question 1
3	Should the income, debt, and/or asset threshold amounts for debt agreements be increased? For example, the income and/or debt threshold could be increased to match the current asset threshold of $236,126.80.	See the answer to question 1
4	Does the impact of the coronavirus give rise to the need to re-consider the term limit of a debt agreement?	See the answer to question 1
5	What are the possible consequences (unintended or adverse) to making reforms to the debt agreement system in response to the impacts of the coronavirus?	That we make changes to the system that are only relevant and needed for a short period (ie 12 to 18 months) after which they are no longer needed. However, the changes we have recommended are fit for the long term and not based on a response only to the COVID-19 pandemic.

6	If you support reforms to the debt agreement, should there be a transition period before any reforms take effect?	No

Personal insolvency agreements		
No	**Question**	**Response**
1	Could personal insolvency agreements play a greater role – either on a temporary basis or more permanently – in settling debts for individuals, including those who have business-related debt (e.g. sole traders), who are in financial distress due to the impacts of coronavirus?	An expanded debt agreement regime, subject only to a liability cap, should be used as the primary tool for dealing with individual's debts. Personal Insolvency Agreements should remain available for those with higher debt levels.
2	Are there barriers to the uptake of personal insolvency agreements?	The greatest barrier is the high cost of the process, given the work that is required by the controlling trustee and the risk, after expending that cost, that the PIA is not approved by the creditors.
3	Could the processes for establishing personal insolvency agreements be streamlined to make them more attractive or more accessible, particularly for individuals with business-related debt?	The PIA process should be kept as is with a view to it only being used by those individuals who have large debts and large estates and that can manage the cost of the process.

Offence provisions		
No	**Question**	**Response**
1	What new or expanded offence provisions could respond to concerns about the	Options include:

	abuse of a one year default period of bankruptcy?	• Add an equivalent of section 79 of the Corporations Act and add being involved in a contravention as being a contravention of the provisions to the following sections: ○ 121, 263, 263C, 265, 265A, 266, 267, 268 and 269 • Add the option of penalties as punishment in sections which only presently provide for imprisonment - eg, ss 80, 139ZO, 139ZP, 139U, 139ZIE. Where there is only imprisonment as a punishment, it may be less likely that steps will be taken to prosecute. We acknowledge bankrupts may have limited resources to pay penalties other than from income on which they will already be paying contributions. • Expand the infringement notice regime under Division 2 of Part 14 of the Bankruptcy Regulations to include breach of sections identified as relevant to preventing abuse of a one year default period of bankruptcy and increase the penalty units able to be imposed under the regime to give it sufficient teeth. • Increase the maximum penalty units under section 77AA to at least 60 penalty units. • Include provisions similar to sections 588FDB, 588GAB and 588GAC of the Corporations Act. • Include provisions similar to part 5.8A of the Corporations Act.
2	What new or expanded offence provisions could respond to concerns about the behaviour of untrustworthy advisors, including pre-insolvency advisors?	See the answer to question 1