Law Council
OF AUSTRALIA

Business Law Section

25 February 2022

Ms Georgina Watson
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Attorney-General's Department
4 National Circuit
BARTON ACT 2600

By email: bankruptcy@ag.gov.au

Dear Ms Watson

Bankruptcy system – Options Paper January 2022

1. This submission, which is in response to the Bankruptcy System Options Paper published in January 2022 (**Options Paper**), is made by the Insolvency & Restructuring Committee of the Business Law Section of the Law Council of Australia (the **Committee**).

Key Points

2. The key matters the Committee wishes to bring to the Department's attention are as follows:

   (a) The Committee does not support a one-year bankruptcy and expresses concern that the attempts to address issues with its potential operation will lead to greater uncertainty, complexity and cost.

   (b) The Committee supports a more efficient mechanism for dealing with the vast number of "consumer" bankrupts. With the potential for increased insolvency risk for consumer bankrupts driven by the increase in "buy now pay later" credit products there is now greater need than ever to address whether such insolvencies ought properly be administered under the guise of the existing *Bankruptcy Act 1966* (Cth) (**Bankruptcy Act**) regime or whether they should more properly be regulated under a separate and distinct consumer debt relief enactment.

   (c) If, nevertheless, government policy is that a one-year bankruptcy period should be introduced then it ought not be the default period. Rather a bankrupt should be required to apply for early discharge upon the conclusion of one year with an open-ended discretion of the bankruptcy trustee professional whether to grant such application.

Submissions – reduction of bankruptcy period to one year

3. The Committee makes the following comments in respect of the specific questions raised by the Department for consultation on reduction of the bankruptcy period from 3 years to one year.

Appropriateness of reducing the default bankruptcy period

Please provide any views you have about reducing the default bankruptcy period from 3 years to one year.

4. The Turnbull Government's National Science and Innovation Agenda published in 2015 was the genesis of the present view that the default period of bankruptcy should be reduced to one year.[1] It was followed by a Proposals Paper dated April 2016 titled "Improving Bankruptcy and Insolvency Laws",[2] that sought to justify this material alteration to long standing bankruptcy law on the basis of a perception that one-year bankruptcy would encourage entrepreneurship. Arguably, this view is somewhat illusory and lacks foundation in fact. The Committee has been unable to locate any empirical evidence that suggests a one-year bankruptcy period would support an increase in entrepreneurship.

5. To the extent there is any extrinsic evidence available, it supports the proposition that, rather, a majority of bankrupts would be classified generically as "consumer" or non-business bankrupts. The four primary reasons for bankruptcy cited by bankrupts were unemployment, excessive use of credit, marital breakup and ill health.[3]

6. Having regard to the profile of debtors referred to above and the complex and onerous obligations and processes of bankruptcy, it is the Committee's view that those obligations and processes are unnecessary in the vast majority of cases and impose unnecessary financial and emotional burdens and stresses on debtors and unnecessary costs and administrative burdens on AFSA and trustees. The commercial proliferation of "pay day" lenders and other "buy now pay later" credit products in recent years has been dramatic. The risks of exposure to these products are reflected in media commentary.[4]

7. The Committee recognises that "early" discharge from bankruptcy has been tried before. The objectives of the *Bankruptcy Amendment Act 1991* (Cth), which introduced the current objection regime and the concept of "early discharge", were described within the Explanatory Memorandum as follows:

> *Bankruptcy has traditionally had two principal aims, the first being the return of funds to creditors and second the rehabilitation of the bankrupt. …….. Similarly, access to early discharge from bankruptcy has been denied to many bankrupts because of the costs associated with obtaining an early discharge. The 2 main purposes of the Bill are to establish a more efficient and effective means of securing contributions from the income of a bankrupt and to enhance the opportunities of persons with levels of debt*

[1] https://www.industry.gov.au/sites/default/files/July%202018/document/pdf/national-innovation-and-science-agenda-report.pdf.
[2] https://treasury.gov.au/sites/default/files/2019-03/C2016-017_pp_NIS_insolvency_measures.pdf.
[3] See generally AFSA's publication Profile of a Debtor last published 2011
[4] https://www.abc.net.au/news/2022-02-04/cigno-loans-debt-spirals/100800224.

that they have no prospect of repaying to begin the process of financial rehabilitation at an early date.[5]

8. Yet only 10 years later on 21 March 2002 the then Attorney-General, the Honourable Daryl Williams AM QC MP, issued a press release stating:

> *Bankruptcy should be a last resort for people who have overwhelming debts and need a fresh start. However, some people see it as a way to get out of paying debts they can afford to pay.*
>
> *The new Bankruptcy laws will make it harder for these people to abuse Australia's bankruptcy system.*
>
> *Changes under the Bankruptcy Legislation Amendment Bill 2002 include:*
>
> - *A new discretion for Official Receivers to reject a debtor's petition where it appears that the debtor can afford to pay their debts and petition is an abuse of the bankruptcy system;*
> - *The removal of early discharge provisions that have permitted some people to be bankrupts for only six months;*
> - *The strengthening of trustee powers to object to the discharge from bankruptcy of uncooperative bankrupts after the standard three year bankruptcy period;*[6]

9. This response had been flagged almost two years earlier by the then Minister for Justice and Customs, the Honourable Senator Vanstone. In a paper7 delivered to the Australian Institute of Credit Management National Conference on 11 May 2000 the Minister stated:

> *The plain fact is that Community confidence in the bankruptcy system has eroded.*
>
> *The concern used to be that big business flouted bankruptcy laws. The concern now is that small consumer debtors do not take bankruptcy seriously. This is fuelled by rising numbers of bankrupts. Bankruptcies have increased threefold over the last ten years. Bankruptcies have increased threefold over the past five years, to a level of 26,376 in 1998-99. Most of the growth is in "consumer bankruptcies".*
>
> *The rising numbers are due to the following factors; excessive borrowing prompted by ready credit availability, perceptions of attainable living standards, and a lessening of the stigma attached to bankruptcy.*
>
> *We cannot ignore the fact that community confidence in the bankruptcy system has eroded. That confidence must be restored.*
>
> *The government has developed a package of reforms to restore confidence in the bankruptcy system.*
>
> *We want to:*

[5] *Explanatory Memorandum to Bankruptcy Legislation Amendment Bill 1991* at [2].
[6] Copy Press Release attached.
[7] Copy attached.

- *Make it clear to debtors that bankruptcy is a serious choice.*
- *Ensure that bankrupts who misbehave or don't cooperate are dealt with, and importantly,*
- *Allow people who are insolvent to quickly make a fresh start.*

10. The Explanatory Memorandum to the Bankruptcy Legislation Amendment Bill 2002 stated:

> *The Bankruptcy Legislation Amendment Bill 2002 (the Bill) will make a number of significant changes to bankruptcy law. The changes address concerns that the bankruptcy system is biased toward the debtor and that debtors are not encouraged to think seriously about the decision to declare themselves bankrupt. The changes also address unfairness and anomalies, particularly in relation to the operation of the early discharge arrangements and the lack of effective sanctions on uncooperative bankrupts.*

11. There is a need for a better balance between the demands for alleviating the burdens of bankruptcy on the majority of bankrupts considered "consumer" bankrupts as against maintaining the integrity of our bankruptcy laws which serve a fundamental role in Australia's robust economy by encouraging debtors to think carefully before going bankrupt having regard to its consequences.

12. By creating a "one system fits all", uniform one-year bankruptcy the government would put at risk the positive role our current bankruptcy laws play while still failing to address the underlying problems of applying onerous, complex and expensive bankruptcy administration upon consumer bankrupts (albeit for one year).

13. It is the Committee's view that the answer to this dilemma is to create a separate debt forgiveness regime entirely outside of the existing Bankruptcy Act into which Part IX of the Act should also sit as a unified body of law for addressing consumer indebtedness.

14. It is the Committee's view that if the Government is not prepared to address the underlying issue in this manner, then the alternative and better way forward to that of a one-year bankruptcy is to revert to an early discharge regime but without the technical complexity that characterised that regime in the past. In this regard, a bankrupt ought to be permitted to apply to his or her trustee to be discharged from bankruptcy at the end of one year from the date of filing his or her statement of affairs. The trustee should have a broad discretion to grant or refuse such application based upon potential return to creditors and the past and present conduct of the bankrupt. That decision would be reviewable by the Inspector-General and thereafter by the AAT.

15. The historical precedent of early discharge being repealed due to its complexity forewarns the issues that will arise in what the Committee considers is an overly complex mechanism being proposed for extending bankruptcy beyond one year.

Exclusion from a one-year bankruptcy

If the default period for bankruptcy is reduced to one year, which of the following reasons should exclude someone from a one-year bankruptcy? You may select more than one.

16. This consultation question proposes various possible options in response to this question:

    (a) They have been bankrupt before;

    (b) They have been banned as a director;

    (c) They had a bankruptcy extended through an objection to discharge;

    (d) They have been convicted of certain offences; or

    (e) None of the above, anyone should be able to access a one-year bankruptcy.

17. The Committee's view is this approach is overly codified and complex and will result in a greater cost burden on all stakeholders. In particular, the Committee makes the following observations with respect to the proposed exclusions:

    (a) They have been bankrupt before

    A common cause of secondary bankruptcy is the inability to pay income contributions in the first bankruptcy. The automatic extension to three years in secondary cases might not be warranted in all cases, for example, where intervening events such as ill health and/or unemployment might mean the inability to pay contribution obligations is beyond the debtor's control.

    (b) They have been banned as a director

    This is an obvious case where extension is warranted. But those who have been banned have by that fact conducted themselves in a manner warranting banning and it is such cases where the three year bankruptcy should be maintained. More importantly bankruptcy for three years means a person is by reason of that fact alone already banned from managing a corporation. However, noting the complexity of these suggestions the question arises what would happen if the specific prohibition is successfully reviewed? Does the bankruptcy, by now longer than one year, immediately terminate?

    (c) They had a bankruptcy extended through an objection to discharge

    Again, this is an obvious case where extension is warranted. However, bankrupts might co-operate for one year and then, upon discharge, be free to thumb their noses at any demands of the trustee. It does not fix the problem of securing co-operation in what will be a materially truncated period to that which has historically been available. Again, noting the complexity of these suggestions, the question again arises what would happen if the objection is successfully reviewed? Does the bankruptcy immediately terminate?

    (d) They have been convicted of certain offences

    The Committee supports this as a ground of extension. Offences should be based upon financial impropriety or previous bankruptcy offences (noting that a

previous bankruptcy may extend the period in any event under the above criteria).

(e) *None of the above, anyone should be able to access a one-year bankruptcy*

For the reasons expressed above the Committee does not support one-year bankruptcy. However, to the extent it should be available it should be for those administrations described generically as consumer bankruptcy where there is no prospect of realisations and no culpable conduct.

Are there any other reasons that someone should be excluded from a one-year bankruptcy? Please list other reasons that should exclude someone from a one-year bankruptcy and why.

18. For the reasons stated above, the Committee considers that a simpler system is preferable, whereby the Trustee has discretion to grant early discharge based on a series of factors.

Eligibility for early discharge

Should a repeat bankrupt that meets certain eligibility criteria (e.g. has satisfied all their tax obligations, has not engaged in voidable transactions, has been cooperative throughout the bankruptcy process etc.) be able to apply for early discharge from a 2-year or 3-year bankruptcy after the first year.

19. The Committee considers the inclusion of layers of complexity in this manner will be of little utility other than in a small fraction of cases and does not warrant the significant (most likely unfunded) investigatory costs and burdens that will be imposed on a trustee in having to address such claims.

Updated grounds for an objection to discharge

Please provide any views you have about proposed new grounds for objection to discharge, as listed in the options paper.

20. The Options Paper notes that the government is considering making a bankrupt's failure to satisfy several requirements under section 77 and 80 of the Bankruptcy Act grounds for objection to discharge.

21. The Committee supports this initiative and is of the opinion that this measure should be adopted quite apart from any consideration of one-year bankruptcy. However, this enhancement to encouraging compliance by a bankrupt in a one-year bankruptcy regime will be of little moment as it can be assumed that a bankrupt is likely to become less compliant once discharged.

Strengthening Bankruptcy Act offence penalties

Are there certain Bankruptcy Act offences which could have penalties strengthened to target abuse of a one-year bankruptcy? Please list any offences provisions that could have penalties strengthened and why.

22. As enunciated above, the Committee considers that access to early discharge should be structured in a less complex and easier to apply manner. Adding penalties to

target abuse causes additional complexity to an already complex regime, and may not achieve its ends.

23. Nonetheless, if and to the extent that government policy requires this step in any event, offences which might be considered for strengthened penalties might include those in respect of non-disclosure of assets or income.

Promotion of debt agreements

Operation of debt agreements under the Bankruptcy Act

24. Part IX of the Bankruptcy Act (Debt Agreements) was introduced into the Act by the *Bankruptcy Legislation Amendment Act 1996*.[8] The new Part IX created "a new form of insolvency administration to be known as debt agreements, for low income indigent debtors for whom administrations under Part X are not a feasible option".[9] As noted in the Report of the Senate Legal and Constitutional Legislation Committee to that Bill the objective of the Part was "to give consumer bankrupts an accessible alternative to bankruptcy".[10] In its submission to the Senate Legal and Constitutional Legislation Committee of May 1995, the Law Council of Australia's Insolvency & Reconstruction Committee noted:

> *"The success of the new debt agreements provisions will depend on the way in which they are administered and whether both debtors and creditors consider them to be a valid and credible alternative to legal and other measures which could otherwise be taken"*

25. While the operation of Part IX has not been without its problems, if success is to be determined by numbers of debtors taking up the option of Part IX and dividends to creditors then its evolution into what it has become today should be considered a success. The annual administration statistics published by AFSA show the following take up of Part IX nationally since 1997-98 as follows:

	Part IX	**All**[11]
1997-98	369	25,267
1998-99	480	27,329
1999-00	802	24,679
2000-01	1,223	25,611

[8] No.44 of 1996.

[9] Explanatory Memorandum to the *Bankruptcy Legalisation Amendment Bill 1995*, [3(f)].

[10] Report of the Senate Legal and Constitutional Legislation Committee into the *Bankruptcy Legalisation Amendment Bill 1995;* September 1995, 36.

[11] The third column titled "All" is the total number of all bankruptcy, Part IX and Part X administrations in that corresponding year.

	Part IX	All[11]
2001-02	3,258	27,877
2002-03	4,445	27,517
2003-04	5,382	26,170
2004-05	4,682	25,403
2005-06	4,866	27,351
2006-07	6,517	32,002
2007-08	6,620	32,928
2008-09	8,564	36,536
2009-10	8,427	36,539
2010-11	8,052	31,518
2011-12	8,955	31,506
2012-13	9,652	30,822
2013-14	10,705	29,514
2014-15	10,911	28,288
2015-16	12,150	29,527
2016-17	13,597	30,161
2017-18*	14,834	31,859
2018-19	11,549	27,058
2019-20	[stats not in AFSA annual report]	20,762
2020-21	3,731	10,612

26. Noting that Part X administrations have always been a small fraction of total administrations,[12] what these numbers show is that numbers of bankruptcy/Part X

[12] In 2020-2021 there were only 89 Part X administrations.

administrations remained relatively static while Part IX administrations flourished until the 2017-2018 financial year. In 2018-2019 there was the first material drop in numbers in Part IX administrations (by 22.1%). The 2019-2020 and 2020-2021 financial years are likely outliers due to the flow-on effects of the Covid-19 pandemic and the intervening government response to limit the any insolvency fall out of COVID on the economy.

27. To put these numbers into context AFSA published[13] figures disclosing total dividends paid to creditors under Part IX together with dividend rates for the years commencing from 2016-2017:

	Total Dividends to Creditors	**Dividend rate**
2016-2017	$145,436,618	59.68 cents/$
2017-2018	$148,363,919	57.05 cents/$
2018-2019	$150,740,307	53.52 cents/$
2019-2020	$193,288,333	55.57 cents/$
2020-2021	$184,072,866	54.90 cents/$

28. This compares to bankruptcy dividends paid over the same period as follows[14]

	Total Dividends to Creditors
2016-2017	$72,961,083
2017-2018	$69,856,677
2018-2019	$85,899,315
2019-2020	$69,622,754
2020-2021	$68,206,535

29. If an objective of our insolvency law is to encourage debtors to seek resolution by agreement with their creditors as opposed to going bankrupt, then on any view Part IX has been a success.

[13] AFSA website https://www.afsa.gov.au/statistics/annual-administration-statistics.

[14] AFSA website https://www.afsa.gov.au/statistics/annual-administration-statistics.

Extension of default term limit for debt agreements

Should the default term limit for debt agreements be extended to 5 years? If the default debt agreement term is extended to 5 years, should the home ownership exception remain, to allow a debtor with a real interest in property to propose a longer debt agreement beyond a 5 year default term?

30. It is the opinion of the Committee that a default term of 5 years will better facilitate the continued take up of Part IX as a means of debtor resolution of claims by consumer debtors. The anecdotal evidence to date, reflected to some degree in the aforementioned figures, is that 3 years is an insufficient amount of time to deliver the return to creditors being demanded by institutional creditors and the costs of administering a Part IX agreement.

31. The Committee further expresses the opinion that Part IX should be taken out of the Bankruptcy Act and form part of a new debt forgiveness regime whereby debtors are not required to offer terms beyond their means so as to meet demands of institutional creditors requiring a minimum base line dividend as the price of supporting a proposal.

Variation of debt agreement

Section 185M of the Bankruptcy Act gives debtors the flexibility to vary their debt agreement to up to 5 years if they suffer a substantial and unforeseen change in circumstances. What form should this variation exception take if the default term for debt agreements is extended to 5 years?

32. Debtors and creditors should be free to agree terms within a 5 year contribution period. However, Part IX should form part of a new debt forgiveness regime whereby debtors are not required to offer terms beyond their means so as to meet demands of institutional creditors requiring a minimum a base line dividend as the price of supporting a proposal.

Increased eligibility thresholds

Should the eligibility thresholds for debt agreements be increased?

33. Consistent with the Committee's view that Part IX should be separated out from the existing bankruptcy regime and form part of a consumer debt forgiveness regime, the Committee considers that any increase in threshold levels of eligibility should be considered in the context of what the Government considers a "consumer bankrupt". No increase should be made simply to broaden its eligibility to cases which ought properly be administered in bankruptcy.

Reduction in exclusion period for proposing debt agreements

Should there be a reduction in the exclusion period for proposing debt agreements?

34. Yes. In line with the aforementioned view that Part IX should be separated out from the existing bankruptcy regime and form part of a consumer debt forgiveness regime the Committee considers that any change in threshold levels of eligibility should be considered in the context of what the Government consider a "consumer bankrupt". That said, there is a case to limit eligibility for those who seek to enter a second debt agreement within 5 years of ending an earlier debt agreement, in order to avoid abuse.

Lodgement of a debt agreement as an 'act of bankruptcy'

The lodgement of a debt agreement should no longer be considered an 'act of bankruptcy'.

35. Consistent with the view that Part IX is for consumer debtors, the Committee agrees that proposing or entering a Part IX agreement ought not be considered an act of bankruptcy. This is because bankruptcy is inapt in its application to consumer debtors.

Submissions – targeting untrustworthy advisors

Appropriateness of requiring information about pre-insolvency advisors and advice

Please provide any views you have about the proposed requirements to provide and collect information about pre-insolvency advisors and advice, as detailed in the options paper.

36. The Committee observes that, despite near universal support conceptually for cracking down on problematic pre-insolvency advisors, there is no consensus on (indeed no real suggestion of) a set of defined characteristics of "untrustworthy advisors".

37. Any attempt to create a regulatory environment without a clear definition of its target must be considered with caution.

38. The Committee recognises that a means to track referrals gives enormous power, particularly with modern data analytics providing the ability to target individuals suspected of irregular behaviour. However, such profiling is prone to misinterpretation and the drawing of improper (and possibly plain wrong) inferences.

39. Parties should not be required to have to disclose their professional advisers for several reasons:

    (a) First, advisers are already highly regulated. For instance, a specialist bankruptcy lawyer or restructuring advisor may well be expected to attract common inquiries from insolvent debtors. One might expect that that advisor's name would appears frequently in statements of affairs. It is not appropriate for those advisors to have their work called into question simply because they are commonly involved in this important work.

    (b) Secondly, it is fundamental to the administration of justice that insolvent or potentially insolvent debtors (like all people) have access to professional advice in assessing and structuring their affairs. The very fact that a person has taken advice may well be privileged, and legislation requiring the disclosure of that fact (let alone the substance of the advice) is an unwelcome attack on the rule of law.

40. Issues of confidentiality, privacy and privilege have not been addressed by this proposal.

41. The Committee further queries the necessity for such proposal in light of the recent amendments effected by the *National Consumer Credit Protection Regulations 2010* (Cth).

Appropriateness of requiring information about pre-insolvency advisors and advice

In an effort to target untrustworthy advisor activity, which Bankruptcy Act offences should include an offence to advise, instruct, assist or counsel any person to commit, or attempt to commit, that offence? You may select more than one. Are there any other existing Bankruptcy Act offences which should include an offence to advise, instruct, assist or counsel any person to commit or attempt to commit that offence?

42. The Committee's view is that to the extent there is any gap in the law that prevents the prosecution of those aiding and abetting a breach of the Bankruptcy Act then such gap should be filled.

Conclusion and further contact

43. The Committee would be pleased to discuss any aspect of this submission.

44. Please contact the chair of the Committee Chris Pearce on (08) 6169 2503 or at chris.pearce@blackwall.legal, or Michael Lhuede on (03) 8665 5506 or at mlhuede@piperalderman.com.au if you would like to do so.

Yours faithfully

Philip Argy
Chair, Business Law Section