CREDIT ISSUES

WOODGATE & CO.

Turnaround & Insolvency

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ONE YEAR BANKRUPTCIES ARE NEARING REALITY

Introduction

The Coalition's National Innovation and Science Agenda has prompted the introduction of further insolvency law reform.

Those reforms have sought to encourage innovation, reasonable risk-taking and to reduce the stigma currently associated with business failure.

Part of the agenda has been the reduction of the default period of bankruptcy from three years to one year. This aims to decrease the stigma associated with bankruptcy, to encourage entrepreneurs to re-engage in business sooner and encourage people, who have previously been deterred by so-called punitive bankruptcy laws, to pursue their own business ventures.

This change will become law six months after the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 ("the Bill") receives Royal Assent, which is hoped to be soon.

Reforms under the Bill

The Bill reduces the default bankruptcy period from three years after a Statement of Affairs ("SOA") is lodged with the Official Receiver, to one year after lodgement.

Reducing the default bankruptcy period consequently reduces the length of time that a bankrupt is subject to the following:

(a) disclosure of being an undischarged bankrupt when applying for credit;
(b) seeking permission to travel overseas; and,
(c) restrictions on attaining certain licences and entering certain professions.

The Bill expressly states that income contribution obligations will extend for a minimum period of two years following discharge or, in the event that a bankruptcy is extended due to non-compliance, for a period of five to eight years.

Commencement of reforms

The reduced bankruptcy period will commence six months after the Bill receives Royal Assent. This is to allow Trustees in Bankruptcy and the Official Receiver to assess their current undischarged bankruptcy matters and determine whether or not to prepare objections to discharge.

Current bankrupts will be discharged if at the commencement of the Bill one year has already expired since the bankrupt filed a SOA with the Official

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Receiver. Other ongoing bankruptcies will be discharged on the day after the first anniversary of the filing of the SOA with the Official Receiver.

Current undischarged bankruptcies that have already had their bankruptcy extended to five or eight years before commencement of the Bill, will not automatically be discharged until that five or eight year period expires.

Previous legislation

A reduced period of bankruptcy was previously introduced in the Bankruptcy Amendment Act 1991 and then repealed in the Bankruptcy Legislation Amendment Act 2002.

From 1992 to 2003 a bankrupt was able to apply for an early discharge any time after six months. Early discharge was limited to bankrupts who were unable to pay their creditors at all, or unable to pay the Trustee's remuneration and expenses in full.

It is worth noting that there was recognition of a reckless bankrupt, whose bankruptcy had arisen from disregard or carelessness in incurring debt that could not be repaid. A reckless bankrupt met the criteria of having debts that exceeded 150% of their income in the year prior to bankruptcy and was disqualified from an early discharge.

Interestingly, when the government sought to repeal early discharge, it was responding to concern that bankruptcy was too easy an option to get out of one's responsibility to pay one's debts. At the time, the Australian Financial Security Authority ("AFSA") provided evidence that the introduction of early discharge had seen an increase in repeat bankruptcies following early discharge. The repeal of early discharge aimed to restore community confidence in the bankruptcy system, by clamping down on those who use bankruptcy in a mischievous or improper way. The government also sought to encourage people contemplating bankruptcy to consider the seriousness of the step they were about to take and to try alternatives to bankruptcy.

Submissions regarding the Bill

A number of submissions regarding the Bill were made to the Senate Legal and Constitutional Affairs Legislation Committee ("the Committee").

Submissions raised concerns that the Bill would not achieve its stated intention of fostering entrepreneurism.

This was a concern driven by statistics disclosing that the majority of bankruptcies result from personal financial matters rather than business-related matters. In particular, AFSA attributed personal bankruptcy to excessive use of credit, unemployment, or loss of income, as opposed to business-related reasons.

Other submissions were sceptical as to whether the Bill would actually reduce the stigma associated with bankruptcy. Business-related bankruptcies were perceived as attributable to unscrupulous entrepreneurs and the Bill would not counter the numerous restrictions, i.e. barriers to professions, which add to the stigma of bankruptcy in employment and business.

AFSA submitted that a reduced bankruptcy period would not affect the continued administration of an estate after discharge. Furthermore, in the second reading speech by the Assistant Minister to the Prime Minister, the view was expressed that a year was sufficient to administer the majority of bankrupt estates and, if more time was required, Trustees were able to administer an estate after discharge.

The Australian Securities and Investment Commission expressed concern about one year being insufficient for bankrupts to undertake appropriate education and skills development training to reduce the risk of future failures.

The Committee noted the concerns raised in the submissions regarding the reduction of the default period and the overriding aim of ensuring that creditors, who are often the losers in bankruptcy reform, should be protected. However, the Committee found that the proposed one year default period was appropriate, and that across the board the reform would reduce the stigma of bankruptcy and encourage people to engage in business ventures.

Conclusion

The challenge to bankruptcy law, or insolvency law as a whole, is to strike the right balance between encouraging entrepreneurship and protecting creditors.

Only time will tell if the reform will strike the right balance and meet its aim of encouraging entrepreneurship.

But you have to wonder whether history will simply repeat itself. Will public perception be that being bankrupt for a year is too easy? Will there be criticism that one-year bankruptcy will encourage people to enter into bankruptcy, rather than engaging with creditors or considering alternatives to bankruptcy?

Having regard to the number of bankruptcies currently relating to credit card debts and the like, will the reforms see an increase in debtor's petitions relating to people who spend beyond their means? And will this see an increase in costs borne by the general public as lenders attempt to offset the increased liability as a result?

There is the worry that the new bankruptcy law will encourage, or at least incentivise, reckless risks. Dishonest people will inevitably take advantage of the reduced bankruptcy period.

Experienced Trustees will have many examples of bankrupt estates in which a bankrupt hid assets or income prior to and in the first year of bankruptcy which were then subsequently identified. They comment that the amendments in the Bill do not contain any anti-abuse provisions.

Bankrupts can already shorten their bankruptcy by putting a proposal to their creditors which, if accepted, results in the bankruptcy being annulled. Arguably, this mechanism under Section 73, allows an entrepreneur, who has the support of creditors, to extract themselves from bankruptcy. If there is sufficient goodwill towards a bankrupt from creditors, then such a proposal is likely to be supported.

Ultimately, it is a question of whether legislation will turn around prevailing market sentiment to the extent that the business community is willingly prepared to transact with someone discharged from an abbreviated bankruptcy.

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