

OUT16/20964

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Dear Sir or Madam,

Improving Bankruptcy and Insolvency Laws

Thank you for giving the Office of the NSW Small Business Commissioner (OSBC) the opportunity to provide feedback on the Improving Bankruptcy and Insolvency Laws Proposals Paper of April 2016.

The OSBC is committed to supporting and improving the operating environment for small businesses throughout NSW. The role of the OSBC is to:

- provide dispute resolution services;
- deliver quality business advice through our Small Biz Connect program; and
- speak up for small business within government.

The OSBC works closely with small businesses and industry to identify regulatory requirements that place an unnecessary burden or cost on small businesses across a wide range of sectors. This extends to acting as the NSW small business representative on a range of government agency consultations, reviews and reforms.

Reducing the default bankruptcy period

Small businesses can be both creditors and debtors - therefore any reforms to Australian bankruptcy and insolvency law should achieve a balance between protecting and advancing the interests of both.

The OSBC offers in-principle support for the proposal to amend the *Bankruptcy Act 1966* to reduce the default bankruptcy period and related restrictions to one year where the bankrupt has not committed an offence. This amendment may encourage entrepreneurs to start new businesses, innovate, engage in responsible risk-taking and re-enter the economy after business failure by removing the penalty for business failure and reducing the stigma associated with bankruptcy.

However, these objectives must be balanced with the need to protect small business creditors, bearing in mind that reducing the default bankruptcy term reduces the time available to creditors to claim debts. Retaining the trustee's ability to object to discharge from bankruptcy and to extend the period of bankruptcy to up to eight years should be expected to encourage debtors carry out their required duties towards creditors.

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To facilitate this, the standard of evidence and criteria required for a trustee to make an objection should, on the one hand, not be overly onerous or practically difficult to meet, but at the same time be sufficiently high to ensure objections are reasonably founded.

The criteria for lodging an objection to discharge of bankruptcy could include considerations such as:

- the bankrupt has started a new business in the same industry to prevent unsecured creditors from accessing the bankrupt's assets (i.e. the business has engaged in phoenixing);
- the bankrupt has previously been bankrupt;
- there is evidence of insolvent trading; and
- the bankrupt has engaged in certain related party transactions prior to the trustee's appointment.

Requiring a discharged bankrupt to assist their trustee in administering their bankruptcy and to pay any outstanding income contributions for three years after discharge - or five or eight years where the period of bankruptcy is extended – should be expected to provide further protection for creditors.

Introducing a 'safe harbour' from personal liability for directors

Insolvent trading provisions are designed to preserve and maximise the pool of assets in the event of insolvency and encourage directors to fulfil their obligations with respect to the company's unsecured creditors. However, insolvent trading provisions may make directors risk-adverse, leading them to put companies into voluntary administration or liquidation early for fear of personal liability, even where the company could have traded out of its temporary financial difficulties. From this point of view, creating a 'safe harbour' to encourage directors to restructure and work harder to keep their businesses viable is in the interests of both creditors and debtors.

Regardless of which of the proposed models is adopted, strict conditions and controls should be in place to ensure that creditors are not disadvantaged by an unsuccessful company restructure. For example, if a director relies on the erroneous opinion of a qualified restructuring advisor that the company can return to solvency and the company nonetheless goes insolvent, creditors may be more disadvantaged than they would have been had the 'safe harbour' provisions not existed because neither will be paid and they cannot seek legal redress against the director or restructuring advisor for insolvent trading.

To minimise the risk of restructuring advisors providing erroneous advice, advisors should be required to possess an extensive, proven record of experience in a similar position advising companies on similar issues related to cash flow and restructuring, and be of upstanding ethical and moral character, as determined by a rigorous accreditation assessment process conducted by an independent regulatory body.

In addition, a judicial or regulatory body such as ASIC should establish specific criteria to guide or direct an advisor in forming an opinion as to a company's viability. Although the advisor would utilise his or her professional expertise, knowledge and experience in forming that opinion, the determination of a company's viability should not be left exclusively to the advisor's discretion.

Making 'ipso facto' clauses unenforceable during a company restructure

The OSBC notes that much of a company's value may often lie in its contracts and not its physical assets. As such, where there has been no breach of contract, such as a payment default, 'ipso facto' clauses should be made unenforceable to ensure that failure by creditors to uphold contracts during a company restructure does not contribute to business failure.

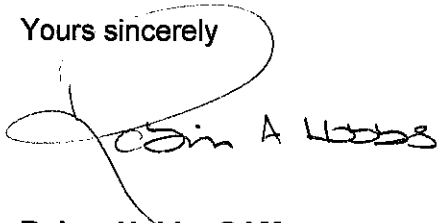
Concluding remarks

The OSBC offers in-principle support for the bankruptcy and insolvency law reforms, providing that adequate controls are in place to protect the interests of creditors.

The OSBC's Small Biz Connect Advisors can provide practical, subsidised advice to assist small businesses with cash flow difficulties and restructuring to get their businesses back on track. This kind of early intervention may help prevent a small business from going bankrupt. The OSBC is also looking into how to encourage prompt payment by suppliers to ensure that businesses are paid on time, which positively impacts on their cash flow and ability to pay creditors.

Should you wish to discuss any of the issues raised in this submission, please contact Tamsin Reeves, Advisor, Advocacy on 02 8222 4828 or at tamsin.reeves@smallbusiness.nsw.gov.au.

Yours sincerely



Robyn Hobbs OAM
NSW Small Business Commissioner

25 May 2016