THE LAW SOCIETY
OF NEW SOUTH WALES

Our ref: BusLaw: GUlb1163610

28 June 2016

The Manager
Corporations and Schemes Unit
The Treasury
Langton Crescent
PARKES ACT 2600

By email: insolvency@treasury.gov.au

Dear Sir/Madam,

Improving Bankruptcy and Insolvency laws - Response to Proposals Paper

The Law Society appreciates the opportunity to comment on the "National Innovation and Science Agenda-Improving bankruptcy and insolvency laws Proposals Paper".

Law Council submission

The Proposals Paper raises three topics for potential reform with the aim of driving a "cultural shift" from penalising and stigmatising failure, to providing a "better balance between encouraging entrepreneurship and protecting creditors". While the Law Society supports reform in this area, we are concerned to ensure that any changes do not unduly burden practitioners administering the process.

The Law Society supports the submission made by the Law Council of Australia ("LCA submission"), which is attached.

The Law Society's comments below complement the LCA submission.

Summary

In summary, the primary position of the Law Society on the three main topics is that:

1. The Law Society does not support reducing the current default bankruptcy period from three years to one year.

   To fulfil the overall objective of the proposed reforms, any proposal to reduce the default period should be targeted to business-related bankruptcy, specifically to bankruptcies directly resulting from the failure of a business that commenced within the previous five years of the date of bankruptcy. It should be the responsibility of the bankrupt to provide evidence to the trustee that the circumstances permitting early discharge apply to them;

2. The Law Society supports Safe Harbour Model B; and

3. The Law Society supports the proposal to address the problems caused by the use of ipso facto clauses, but has raised some additional matters that must be addressed below.

1. Reducing the default bankruptcy period

The overall objective of this proposal is to encourage innovation and entrepreneurship. However, the vast majority of bankruptcies arise from consumer debt and non-business related reasons. The LCA submission notes that, according to AFSA bankruptcy statistics for the year ending on 13 June 2015, just over 20% of bankruptcies were business related (19% for year ended 30 June 2014). These statistics rely upon the reasons for bankruptcy given by a bankrupt in their statement of affairs. It is reasonable to assume the actual proportion of business bankruptcies would be smaller than reported because of the reluctance to admit personal circumstances as the reason for the bankruptcy.

Out of the business related insolvencies, it cannot be assumed that all of those that enter bankruptcy do so as a result of a failed start-up business. We suggest that a review needs to be undertaken of failing entrepreneurial enterprises as it is possible, if not likely, that many of these businesses use corporate structures. Such a review would also reveal whether the types of creditors that are caught up by the bankruptcy process, in most instances, are those likely to be involved in funding entrepreneurial activity.

We suggest that the proposal of reducing the period of bankruptcy from three years to one year may not achieve its purpose of encouraging innovation and business start-ups if the entrepreneurs targeted are not, at the present time, part of the demographic of individuals entering bankruptcy.

The proposed reduction of the period of bankruptcy needs to take into account the impact of that reduction on the largest group of stakeholders in the bankruptcy regime – the creditors. An unfortunate byproduct of reducing the period of bankruptcy could potentially be that the creditors may be unnecessarily adversely affected. This is the likely result of tighter time constraints placed on a trustee which may reduce the ability of a trustee to realise after acquired assets by reducing the time available to do so by two thirds.

1.1. Misconduct

Many individuals entering into bankruptcy may not provide sufficient material to a trustee in the very early stages of bankruptcy to enable the trustee to properly and comprehensively conduct investigations of a bankrupt's affairs and to bring those investigations to a conclusion. Similarly, time constraints may affect the trustee's ability to determine whether the bankrupt has engaged in the requisite misconduct to warrant an objection to discharge. Under the present regime, it is not unusual for a trustee's investigations to continue through the entire three years of bankruptcy.

The proposed shortening of the period of bankruptcy will mean that a trustee will be under an enormous amount of pressure to undertake all investigations quickly. This may result in realisable assets or voidable transactions being missed. The consequence of that is not to encourage entrepreneurial endeavour but to detrimentally affect the rights of creditors to receive the greatest possible return.

If the one year period of bankruptcy is to be adopted, the criteria of possible objections to discharge available to a trustee ought to be expanded and the standard of evidence required reduced.

1.2. Ongoing obligations for bankrupts

The practical challenges faced by a trustee in requiring investigations to be undertaken and completed in less than one year are not easily overcome.

A trustee relies heavily on the ability to ensure compliance by a bankrupt to assist the trustee and produce documents and information that enable proper investigations to be undertaken.

1.2.1. Requirement to assist trustee

It is not uncommon for a trustee to uncover antecedent transactions, and possibly other realisable assets, well into the second and third years of the period of bankruptcy.

The Proposals Paper refers to a power for a creditor or other affected person to apply to the Court where a trustee objects or fails to object to discharge. This provides little comfort to creditors. Where a trustee fails to object to a person's discharge from bankruptcy, that bankruptcy will have already ended. A Court would be reluctant to reinstate a bankruptcy, when any such application is likely to be heard at a date possibly 6 to 18 months after discharge.

Proposal 1.2.1a.

It is proposed to amend the *Bankruptcy Act 1966* (Cth) to ensure the obligations of a bankrupt to assist in the administration of their bankruptcy remain, even after they have been discharged, to allow for the proper administration of bankruptcy. We suggest that, if the period of bankruptcy is shortened, consideration could be given to expressly retaining the following:

- A bankrupt's obligations under section 77 to provide the trustee with any documents or information relating to his or her examinable affairs and to attend any meeting (however, the requirement to provide his or her passport to the trustee, under subsection(1)(a)(ii)), should be excluded); and

- The requirements, subject to penalties, under section 139U of the Act, to provide certain statements of income.

Proposal 1.2.1b.

The Government also seeks views on what incentives and mechanisms should be in place to ensure compliance with obligations after discharge.

Ordinarily, a trustee will find it extremely difficult to obtain or compel the co-operation of a bankrupt to assist with investigations into the bankrupt's financial affairs after discharge from bankruptcy. While under the current regime there is a possible penalty of imprisonment for up to six months, the number of prosecutions is low. Information should be sourced as to how often such prosecutions are being pursued and convictions achieved. If these difficulties are already being faced by trustees, then shortening the period within which there is a sanction for a failure to co-operate,

is likely to hamper a trustee's ability to seek and obtain meaningful responses to the trustee's investigations.

If a bankrupt is already discharged from bankruptcy there is little incentive to assist a trustee, as there is nothing that a trustee is able to offer in return for the co-operation that is required.

This leaves the option of sanctions. The current sanctions are under-utilised. Consideration may need to be given to a variety of sanctions including fines/penalty units or alternatively a mechanism to enable the trustee to compel compliance whether by order of the Court or formal Notice issued by the Australian Financial Security Authority.

1.2.1. Income contributions

The proposal seeks to separate the obligation to pay income contributions from the default bankruptcy period. Instead, individuals will continue to pay income contributions for three years even with the reduction in the default period. Where the period of bankruptcy is extended to five or eight years, income contributions will also be payable for that extended period.

A bankrupt is already under a requirement to make income contributions for any period of bankruptcy that is extended under an objection. Accordingly, the proposal sees no significant change to the regime under a lengthened period of bankruptcy.

However, if discharge occurs after one year, this would reinforce the necessity to bolster the coercive powers of a trustee to seek and obtain information in relation to the quantum and source of income for the purpose of the calculation of contributions.

1.3. Restrictions

1.3.1. Access to Credit

Proposal 1.3.1a.

The Government proposes to reduce credit restrictions to one year, subject to any extension for misconduct.

The provision of credit is, as it has always been, a discretionary matter for the credit provider. There are no restrictions in seeking or obtaining credit under the current regime, so long as the individual's bankruptcy is disclosed. In the interests of the continued protection of creditors, both secured and unsecured, the transparency that the existing provisions provide should be continued.

Proposal 1.3.1b.

The Government proposes to retain the permanent record of bankruptcy in the National Personal Insolvency Index.

The Law Society supports the retention of the Index.

Query 1.3.1.

The Law Society does not support reducing the retention period for personal insolvency information in credit reports.

While a debtor should be entitled to make submission on the length that the record is retained, consideration should also be given to the purpose that the register and commercial credit reporting services serve and the importance of the availability of that information. Credit providers and other persons involved in conducting transactions with bankrupts and former bankrupts are entitled to be aware of a bankruptcy and make their own assessment on the provision of credit or otherwise.

1.3.2. Overseas Travel

While the current regime requires a bankrupt to give their passport to a trustee upon request, it is a process that is no longer insisted upon and is little utilised.

The Law Society supports the proposal suggested by the Law Council of Australia for a security bond to be provided to a trustee.

1.3.3. Licences and Industry Associations

The Law Society supports the consultation process proposed.

General Comments

If the proposal to implement a reduced period for bankruptcy ultimately does not proceed, consideration could still be given to the following changes

- Amending sections 77 and 272 in relation to the delivery up of a bankrupt's passport and the prohibition on travel, as well as regulating criteria to allow the entrepreneurial bankrupt to make applications to their trustee for travel, if necessary.

- Amending section 269 under which a bankrupt must disclose the bankruptcy to credit providers, if that is considered to be appropriate; and

- Amending section 206B of the *Corporations Act 2001* (Cth) to the extent that it is considered necessary and appropriate.

2. Safe Harbour

As stated earlier, the Law Society supports the LCA submission. We make the additional comments below.

The Law Society suggests that further consideration needs to be given to all of the possible consequences and effects that such a safe harbour may have in relation to transactions that are voidable under the other provisions of the *Corporations Act 2001.*

For example, the safe harbour carve out applies to directors of companies in circumstances where a "debt was incurred as part of a reasonable step to maintain or return the company to solvency". No carve out is afforded to a creditor who continues to support the company and receives payment of a debt. If the company ultimately fails, the creditor may be required to repay funds determined to be preferences, in circumstances where the director could potentially escape liability for the same transaction due to the safe harbour provisions.

This model seeks to provide directors who are acting in the best interests of the company and its creditors, with a safe harbour. However, this must be weighed against, and appropriate provision made for, the impact on those creditors who are involved in transactions undertaken in an attempt to return the company to profitability.

3. Ipso Facto Clauses

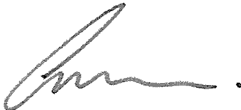
The Law Society supports the LCA submission. In addition, we suggest that consideration needs to be given to the effect of this proposal on creditors, who may be subject to claw back provisions, and how protection may be afforded to those that are required to maintain contractual relations with a struggling entity.

For example, if the company is undertaking a scheme of arrangement for the purpose of avoiding administration or insolvent liquidation, then the creditor:

- will be forced to continue its contractual obligations to the company;
- will then either be clearly on notice, or at the very least have reasonable grounds for suspecting, that the company was insolvent at the time of transactions taking place after the point at which the company is seeking to restructure or turnaround; and
- will not have the protection afforded by section 588F, yet still be exposed to the claw back provisions for payments that it received during that time.

If you have any questions in relation to this submission, please contact Liza Booth, Principal Policy Lawyer, by email at liza.booth@lawsociety.com.au or phone (02) 9266 0202.

Yours faithfully,



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26 May 2016

Dear Sir or Madam,

Submission in response to the Treasury 'National Innovation and Science Agenda – Improving bankruptcy and insolvency laws'

This is a joint submission by the Insolvency and Reconstruction Committee and the Corporations Committee of the Business Law Section of the Law Council of Australia ('the Committees') in response to the release of the Treasury Discussion Paper 'National Innovation and Science Agenda – Improving bankruptcy and insolvency laws' on 29 April 2016 (the 'Discussion Paper').

Summary

While we would prefer to see a more significant modification of insolvent trading laws, the Committees strongly support Model B.

We prefer Model B over Model A, due to the need to increase the confidence of boards and to encourage them to take good faith steps to restructure companies. We think the proposed "carve out" will be a simpler way to address the issue and will instill more confidence than a defence, because it minimises the likelihood of litigation and calls upon insurance policies.

We recommend that some aspects of Model A be incorporated into either regulations or regulatory guidance relating to Model B to clarify the meaning of "reasonable steps" and to require the appointment of a registered restructuring advisor.

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Introduction

We welcome the opportunity to comment on the proposals set out in the Discussion Paper issued on 29 April 2016. The consideration of amendments to encourage and facilitate restructuring and to reduce the stigma attached to business financial distress and failure are measures that our Committees have been advocating for several years through Senate Economics References Committees, the Financial System Inquiry and in response to the Treasury Discussion Paper 'Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration' in 2010.

In our view, the need for these reforms is long overdue and we welcome the opportunity to contribute our views for consideration on the final form of the amendments through this submission.

Comments on the insolvency regime

<u>*Support for the cultural shift*</u>

The Discussion Paper raises three topics for potential reform arising from the 'culture and capital' part of the Innovation and Science Agenda released on 7 December 2015. They aim to drive a 'cultural shift' from penalising and stigmatising failure to providing a 'better balance between encouraging entrepreneurship and protecting creditors. We fully support this change in emphasis.

The public discourse concerning Australian insolvency law is frequently one of blame and punishment, emphasising widespread dissatisfaction from creditors and other key stakeholders. One factor contributing to this feeling of frustration is that the vast majority of businesses enter external administration with few or no assets.

A widely held belief among insolvency practitioners and business advisors is that businesses enter external administration too late when little can be done to save the business. If business people could be encouraged to be pro-active and to seek and act on advice earlier this would provide more flexible options for saving the business. However, business people are reluctant to seek help in part due to the stigma of insolvency and failure. The Innovation Statement and the reforms proposed in this Discussion Paper will go a considerable way to reframing the dialogue to focus on positive efforts to restructure and rescue distressed businesses.

Directors should not face personal liability

The current liability framework imposed on company directors by federal, state and territory laws is too harsh in imposing personal liability for good faith business decisions. This stifles entrepreneurial risk taking and causes boards to focus too much on compliance and legal risk management instead of strategic oversight of operational decision-making.

It is the experience of many members of the committees that business people are reluctant to take on board positions because of the risks of personal liability, including for insolvent trading.

In our view, insolvent trading imposes liability on directors which is much too strict in the instance where directors try to avoid the company's insolvency by engaging in good faith restructuring efforts. In doing so, these directors may face potentially significant personal liability for all unsecured debts incurred by the company during the restructuring. If the restructuring efforts fail and the company eventually enters liquidation, a liquidator or a creditor may seek to take action against the directors, not because of any culpable or reckless behaviour, but because they were directors who allowed the company to continue trading during a time when it was insolvent.[1] Accordingly, the directors may be inclined to put the company into voluntary administration as a precautionary measure to avoid that personal liability or to resign from their position rather than participate in restructuring efforts.

We note our fundamental objection to the current insolvent trading liability framework, which overly penalises directors for not shutting down the business at the first suspicion of insolvency. We support the repeal of Pt 5.7B, Divisions 3 and 4 of the *Corporations Act 2001* (Cth) (the **Act**).

The insolvent trading regime was introduced in the 1960s at a time when the liability framework for company directors was much different, and expectations much lower, than today. In our view, the exponential rise in personal liability risks for company directors, together with the more comprehensive disclosure framework in place for companies, renders insolvent trading unnecessary and fundamentally unhelpful. Insolvent trading sets the wrong incentives for directors of companies entering financial distress, which is the incentive to either close the business or resign. This is counter-productive to the principles underpinning the Innovation Statement.

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[1] See, for example, *McLellan, in the matter of The Stake Man Pty Ltd v Carroll* [2009] FCA 1415.

Australia's insolvent trading laws are widely recognised as being some of the harshest in the world. Amendments to recognise the value of good faith restructuring efforts by providing protection to directors, within reasonable limits, to encourage them to participate in good faith efforts to rescue the business will help bring Australian laws into line with other developed economies. While we wish to state that our preferred approach is to repeal insolvent trading, we accept that this was not raised by the Discussion Paper and we respond to the Paper below.

Defence of good faith restructuring

Attempting a restructure (or 'workout') in good faith is currently not recognised as a defence to insolvent trading under section 588H of the Act. Indeed, courts recognise that directors can act honestly and reasonably in trying to save the company but nonetheless breach insolvent trading laws.[2]

Preference for Model B

The Treasury Discussion Paper has raised two potential models (Model A and Model B). Model A represents a safe harbour defence for directors who engage in good faith restructuring efforts while Model B represents a carve out for good faith restructuring. **The Committees strongly support Model B**, but recommend that some aspects of Model A be incorporated into either regulations or regulatory guidance to clarify what reasonable steps may involve and to require the appointment of a registered restructuring advisor.

We favour the Model B instead of the proposed defence to increase directors' confidence that if their restructuring efforts fail, and they act in good faith and seek out and act upon appropriate professional advice, then they will be protected from insolvent trading. Accordingly, the directors will be more inclined to endeavour to undertake the restructure.

Model A

The introduction of Model A would add to the existing defences in s 588H.

Providing a defence will involve the directors needing to establish the elements after a claim under s 588G has already been proven against them. In our view, adding a defence will not provide sufficient confidence to encourage directors to participate in good faith restructuring efforts because the risk of litigation under s 588G remains.

[2] Ibid.

As one respondent to the Treasury's survey of directors in 2008 noted: "I don't feel as if my actions will put me at ultimate risk but I may lose 5 years of my life proving it."

Furthermore, Model A (in our view) involves too many elements for directors to prove.

Model B

We favour Model B because it offers a simpler and more streamlined approach that will provide clarity for directors when participating in good faith restructuring. We recommend that some (but not all) elements of Model A be incorporated into Model B to ensure that the provision provides clear guidance to directors during restructuring efforts.

The introduction of a defence to address director concerns about challenges to good faith business decisions in the form of the statutory business judgment rule in section 180(2) of the Act has been roundly criticised for failing to fulfill its purpose. In our view, the introduction of a safe harbour defence will produce a similar outcome.

Directors who are concerned about the risk of litigation for insolvent trading will be reluctant to engage in good faith restructuring efforts. This may cause more companies to be put into voluntary administration earlier than necessary (to take advantage of the existing defence to insolvent trading in s 588H(5)) or more directors simply resigning from their boards to eliminate the risk altogether.

Neither outcome supports effective restructuring efforts and in our view Model B should be the preferred approach because it will provide an effective presumption against liability, which a liquidator (or creditor) will need to overcome in order to pursue insolvent trading claims. Those who act consistently within the carve out can be confident that they are far less likely to be sued and hence may be more likely to continue to assist with good faith restructuring.

Bankruptcy period

Reducing the default period of bankruptcy and addressing some of the punitive aspects of bankruptcy will also assist in helping to reduce the stigma of business failure. However, we recommend that the measure be targeted to business-related bankruptcy and not to the vast majority of personal bankruptcies being consumer bankruptcies.

There are different policy considerations between business and consumer bankruptcy that may justify a more nuanced approach to reducing the term of bankruptcy to a default of one year. Although the Committees have some concerns about the practical operation of this measure, which are outlined below, we are supportive of trying to reduce bankruptcy

stigma provided the operation of the new provisions can be practically managed in a way that will ensure bankrupts and former bankrupts will comply with their legal obligations so as to protect creditor interests and discourage reckless credit behaviour.

Ipso facto clauses

The third element of the Discussion Paper is to address the significant adverse commercial effects of contractual clauses that allow for termination or variation of the contract due to insolvency or external administration of a party to the contract. These clauses are referred to as 'ipso facto clauses' because they operate automatically and this can have the effect of severely limiting restructuring options.

Ipso facto clauses can effectively destroy the value of an otherwise viable business and thereby result in lower returns to creditors and increasing dissatisfaction with the insolvency process.

We have long advocated for reform of ipso facto clauses and strongly support this initiative, although we have some suggestions for consideration regarding the operation of the provision, discussed below. Introducing this reform will significantly assist the use of external administration procedures (such as voluntary administration) to restructure and rescue companies entering financial difficulties.

Specific comments

In this section we provide our comments on the specific questions asked in the Discussion Paper.

Reducing personal bankruptcy

Query 1.1

The overall objective of the proposals is to encourage innovation and entrepreneurship. The vast majority of bankruptcies arise from consumer debt and non-business related reasons. Approximately 20% of bankruptcies for the year ended 30 June 2015 were business related (19% for year ended 30 June 2014).[3] These statistics rely upon the reasons for bankruptcy given by a bankrupt in their statement of affairs. It is reasonable to assume the actual proportion of business bankruptcies would be smaller than reported because of the reluctance to admit personal circumstances as the reason for the bankruptcy.

[3] Source: www.afsa.gov.au/resources/statistics.

Having regard to the above objective to encourage innovation and entrepreneurship the discharge from bankruptcy after one year should only apply to bankruptcies that were directly resulted from or substantially resulted from the failure of a business that commenced within the previous 5 years of the date of bankruptcy. This is a reasonable period for the business to test its viability.

Many overseas jurisdictions distinguish between consumer bankruptcies and bankruptcies that are the result of business activity.[4]

It will be the responsibility of the bankrupt to provide evidence to the trustee that these circumstances permitting early discharge would apply to them. The trustee will be required to make a decision in respect of the early discharge of bankrupt within a certain period of time. If a bankrupt is not satisfied with the decision of the trustee the decision will be subject to review by the Inspector General in Bankruptcy as is currently in case with objections to discharge. The bankrupt may then appeal to the AAT or the Federal Court as is currently the case with objections to discharge.

The trustee must also be satisfied there are satisfactory arrangements in place to satisfy the obligations of compulsory income contributions for the following two years.

There is also the issue of the treatment of after acquired property. There will need to be a carve out for inheritances and winnings derived within the two years after the early discharge.

There will also have to be obligations on the former bankrupt to provide information to the trustee in bankruptcy as required to assist in the administration of the bankrupt estate during the subsequent 2 years. (See Query 1.2 below). We note the comments made in the ARITA submission to this Discussion Paper and add our support to those recommendations on this matter.

Query 1.2.1a

The Committees question whether, if obligations still continue after the one -year period, would that mean that a former bankrupt is an "insolvent under administration"?

This will be less of an issue if early discharge only applies to less than 20% of bankruptcies. Information required will be in respect of compulsory income contributions and certain after acquired property, namely winnings and inheritances. There will also

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[4] INSOL International, *Consumer Debt Report II, Report of Findings and Recommendations* (2011), 3.

need to be a general obligation to provide information to a trustee in respect of the administration of the bankrupt estate.

It is necessary to have these post early discharge obligations because otherwise there would be fewer funds available in the estate for distribution to creditors and to meet the costs of the administration of the estate. Without these on-going obligations there would be less funds available from the Estate Interest Charge and Asset Realisation Charge, which is paid from the bankrupt estates to the Commonwealth to meet the costs of AFSA.

Query 1.2.1b

The Committees express concern about the practical logistics of how this will work. Currently, the main way to require bankrupts to comply is the "threat" of an objection to discharge and an extension of the bankruptcy. This would not apply to bankrupts where there has been an early discharge. The Committees are concerned about the apparent contradiction of the label of bankrupt ending after one year, but the obligations of bankruptcy extend beyond one year. The Committees are also concerned about how far the obligations will extend: is this just for income contributions or other obligations of bankrupts as well?

Failure to comply with the post early discharge obligations would be an offence subject to the existing Infringement Notice system in the Bankruptcy Act. The process of issuing warnings, infringement notices and follow up enforcement will require additional resources in the Enforcement area of AFSA.

Another incentive could be to extend automatic disqualification from managing a corporation (section 206B of the Act) to people who have outstanding notices to provide information to a trustee in bankruptcy where those outstanding notices have been outstanding for more than one month. ASIC could add those persons to the disqualified persons register on receipt of evidence from the trustee of the outstanding notice. The trustee could have an obligation to advise ASIC that the notice has been satisfied and ASIC will remove the person from the disqualified persons register. The person may refer the notice from the trustee to the Inspector General in Bankruptcy for review.

These proposed arrangements are consistent with the automatic disqualification that applies to a person subject to a composition under section 73 of the Bankruptcy Act, whereby the bankruptcy is annulled but the debtor has ongoing obligations.

Failure to comply with the post-bankruptcy obligations can mean that the "obligation period" is extended for a further three or five years in a similar way to the current extension of the period of bankruptcy. The period could be automatically extended as long as there are outstanding obligations that have been outstanding for more than a month. A trustee could be expressly empowered to require a security bond to assist with compliance with post-bankruptcy obligations. The security bond would be automatically released to the estate for distribution in the normal course if there are outstanding obligations after service of the requirements on the discharged bankrupt or their nominee for service if they are overseas. The requirement for and size of the bond can be subject to review by the Inspector General.

We note the comments made in the ARITA submission to this Discussion Paper and add our support to those recommendations on this matter.

Proposal 1.2.2

Retaining a longer period of income contributions may result in greater returns to creditors if bankrupts are able to earn increased income following the termination of their bankruptcy. We repeat our concerns about enforcement of this obligation once formal bankruptcy has ended.

Query 1.3.1a

This seems to flow as a natural consequence of the proposed reduction of bankruptcy to one year.

Query 1.3.1b

The Committees have no comment in response to this query.

Query 1.3.1

The Committees are of the view that it would not be appropriate to reduce the retention period for personal insolvency information in credit reports. The debtor should be entitled to make submissions of a certain length providing explanations and they should be available as part of credit reporting.

Query 1.3.2

The restriction on overseas travel will not be necessary in the case of a debtor subject to early discharge because it will be a requirement for early discharge that suitable arrangements are in place to ensure they comply with their ongoing obligations. One of

the ongoing obligations will be the requirement to provide current contact details to the trustee including an address and contact person in Australia who will accept service of notices.

A trustee could also be expressly empowered to require a security bond to assist with compliance with post-bankruptcy obligations. The security bond would be automatically be released to the estate for distribution in the normal course if there are outstanding obligations after service of the requirements on the discharged bankrupt or their nominee for service if they are overseas. The requirement for and size of the bond can be subject to review by the Inspector General.

The Committees also query what is meant by "subject to any extension for misconduct". Presumably that is referring to 'subject to extension of the bankruptcy period'. The period of the travel restriction should be the same as the period of bankruptcy (that is, 1 year in the case of early discharge or three years unless extended). The proposal set out in the Committee's submission is that it will be one of the pre-conditions of early discharge that suitable arrangements are in place to ensure that the former bankrupt complies with their ongoing obligations, if any.

Safe harbour for insolvent trading

Query 2.2

The Committees strongly favour Model B rather than Model A for reasons discussed above. If Model A were chosen as the preferred reform then we have a number of suggestions and comments outlined below under the specific queries.

Query 2.2.1a and 2.2.1b

While the Committees support the need to appoint a restructuring advisor, we suggest that there be an ability to appoint a restructuring advisor who can act in a number of capacities, and not solely as a restructuring advisor.

In our experience, companies will often appoint consultants to advise them on a range of strategic matters. It is possible to appoint a restructuring advisor who brings a variety of capabilities to the role, which can include restructuring advice.

If the role were restricted to restructuring advice only we believe this would send a negative signal to creditors and to the broader market and may trigger the need to publicly disclose this (for disclosing entities under the Act) which could reduce confidence in the future of the business and frustrate viable restructuring efforts.

In short, appointing a person designated 'restructuring advisor' would be likely to send a negative signal to the market that the company is insolvent or likely to become insolvent. Changing the public perception of good faith restructuring efforts will be enhanced if a restructuring advisor could be appointed for a full range of professional advice. This would also provide a more comprehensive response to the company's financial challenges.

The Committees support the need for restructuring advisors to have appropriate levels of experience, qualifications and to be members of a recognised professional association. The Committees recommend that a current membership (including a current practising certificate if applicable to that profession) be an essential and ongoing requirement. We support the commendts made in the ARITA submission to this Discussion Paper on the need for restructuring advisors to have appropriate levels of experience and qualifications and to be members of professional associations with appropriate frameworks for ethics, professional conduct, discipline and education.

The three bullet points listed on page 12 are a minimum. The Committees note that some professional associations have membership and disciplinary procedures approved and administered by foreign bodies. Query whether members of those associations only should be included in the list of acceptable restructuring advisors.

The Committees do not support the limitation of restructuring advisors to registered company liquidators only as there are other professional backgrounds such as law, banking and finance that may provide appropriate skills and knowledge to fulfill the role of a registered restructuring advisor.

The Committees strongly advocate that ASIC should maintain a register of restructuring advisors and require inclusion on that register as an essential element of the defence.

We also recommend that ASIC should produce regulatory guidance as to what qualifications and experience are needed for inclusion in the register and what circumstances (such as prior offences or disqualification from professional associations) may warrant a person being prevented from registering as a restructuring advisor. ASIC registration should also require the maintenance of professional indemnity insurance and risk management systems, similar to requirements for AFSL holders.

Requiring ASIC registration and current membership of a recognised professional association assist in addressing community and business concerns about pre-insolvency advisors and their potential adverse influence on restructuring efforts.