

## First Submission

On 31 January 2018, Pitcher Partners made a submission regarding the Bankruptcy Amendment (Enterprise Incentives) Bill 2017 (First Submission).

On 6 March 2018, Gess Rambaldi and Innis Cull of Pitcher Partners gave evidence before the Senate Legal and Constitutional Affairs Legislation Committee.

This documents represents a supplementary submission on behalf of Pitcher Partners. The purpose of this supplementary submission is to clarify our First Submission and expand upon the proposals we have made.

## Background

The Federal Government is proposing to reduce the term of bankruptcy from three years to one year. Bankrupts would be discharged from bankruptcy automatically after one year, *unless* an objection to discharge had been lodged.

The Government's *intention* is to promote innovation and entrepreneurship, by returning 'genuine/legitimate' bankrupts to the economy faster.

Pitcher Partners supports the Government's intention to promote innovation and entrepreneurship by returning 'genuine/legitimate' bankrupts to the economy faster, but believes that unless better strategies are put in place, the result of the proposals will be to undermine the stated intentions of the Government by allowing Rogue Bankrupts to be discharged after one year.

During our evidence to the Committee, we defined the two relevant categories of bankrupts as follows:

1. **Genuine or Legitimate Bankrupts** – those bankrupts who have failed for honest or 'legitimate reasons'.
2. **Rogue Bankrupts** – bankrupts whose behaviour either pre or post-bankruptcy demonstrates a willingness to abuse bankruptcy and other laws to their benefit at the expense of creditors. They are often dishonest or have engaged in undesirable commercial behaviour.

Pitcher Partners submits that the Government's proposal currently does not satisfactorily distinguish between Genuine Bankrupts on the one hand, who should be discharged after one year, and Rogue Bankrupts who should not be discharged after 1 year.

The Government submits that the current proposal is satisfactory, and that Rogue Bankrupts will not 'slip through the net' because safeguards exist in the form of the current objection to discharge regime. This submission is misplaced for three primary reasons.

- There are no grounds of objection that apply to Rogue Bankrupt's pre-bankruptcy conduct (**Pre-Bankruptcy Grounds**).
- A 12 month bankruptcy is insufficient time to allow a trustee to investigate a Rogue Bankruptcy and identify grounds of objection for Rogue Bankrupts (**Insufficient Time**).
- The current grounds of objection are unsatisfactory. They do not allow a trustee to lodge an objection in sufficiently broad instances of a bankrupt's behaviour (**Unsatisfactory Grounds**).

We will briefly examine each of these matters further.

## Pre-Bankruptcy Grounds

In the absence of non-compliance with obligations post-bankruptcy, Rogue Bankrupts who are dishonest or who engaged in commercial undesirable behaviour *pre- bankruptcy* will be automatically discharged after 12 months under the Government's current proposal.

The Government believes that the safeguard for this is for the trustee to lodge an objection to the Rogue Bankrupt's discharge. This is wrong. *The current grounds of objection to discharge do not extend to pre-bankruptcy behaviour and will not prevent these Rogue Bankrupts from being discharged after 12 months.*

At page 5 of Pitcher Partners' First Submission, we set out nine potential pre-bankruptcy categories of conduct and one post-bankruptcy category of conduct, each of which is a behaviour that demonstrates either 'dishonesty' or 'commercially undesirable behaviour'. This list serves to provide a mechanism to clearly identify Genuine (Honest) Bankrupts and Rogue Bankrupts.

Our list was by no means exhaustive. During the Senate hearing on 6 March 2018, Senator Pratt identified other grounds which demonstrate dishonesty and should prevent a bankrupt from being discharged after 12 months.

#### **Example**

- A bankrupt was declared bankrupt on 1 July 2016.
- Under the current, the bankrupt will be discharged after three years on 30 June 2019.
- The bankrupt has unsecured creditors exceeding \$250 million.
- The bankrupt owes the Australian Taxation Office \$5 million.
- The bankrupt has not lodged tax returns for the 5 years prior to bankruptcy.
- The bankrupt was convicted of fraud six years prior to bankruptcy and spent 12 months in prison.
- Three years prior to bankruptcy, ASIC has banned the bankrupt as a company director for eight years.
- Notwithstanding this, the bankrupt has complied with all of his obligations during the 12 month period post-bankruptcy. No grounds for objection to discharge exist.

***If the Government's proposed law reform is passed, this bankrupt will be automatically discharged from bankruptcy after 12 months and the trustee would be powerless to object to the discharge occurring.***

This outcome is contrary to the Government's stated intention in reforming bankruptcy law and should not be allowed to occur.

Our solution to this outcome is a simple, procedural one to prevent these Rogue Bankrupts from being eligible for discharge after 12 months. We discuss this further below.

#### **Insufficient Time & Unsatisfactory Grounds of Objection**

In our submission, we identified that the investigation of a Rogue Bankrupt's affairs is often complex and always requires time. Our submission identified numerous reasons why 12 months is insufficient time to obtain satisfactory evidence allowing an objection to discharge to be lodged on the basis of the existing grounds.

These reasons included:

- Registered trustees must ask AFSA to issue and serve compulsory notices requiring the production of documents or attendance at interviews pursuant to section 77C of the Bankruptcy Act. Whilst this is a powerful investigative tool, it can take many months for AFSA to process the request, to serve the Notice and for the party then to comply with the notice
- Registered trustees can publicly examine witnesses in the Federal Courts. Again this is a powerful tool. It can take up to six to eight months or longer for an application for a public examination to be processed through the Court, for summonses to be served and for Court hearings to be conducted. It is quite likely that the public examinations will not be concluded within 12 months.
- Rogue Bankrupts do not maintain proper books and records and will not assist in the production of evidence to adequately explain transactions. Trustees in bankruptcy are required to use investigative skills and procedures to obtain evidence, often involving the compulsion of provision of information by financial institutions and third parties. The compulsion process can often take months. In the case of the production of bank statements from financial institutions, the average period of compliance is measured in months.

Additional reasons are contained in our First Submissions.

Two points arise:

- Firstly, the extended investigation time required for many Rogue Bankrupts underscores the need to have some mechanism that identifies them, and prevents them from being eligible for discharge after 12 months.
- Secondly, whilst we have identified pre-bankruptcy conduct which should disentitle a Rogue Bankrupt from eligibility for discharge after 12 months, Rogue Bankrupts often exhibit post-bankruptcy behaviour which should likewise prevent them from being discharged after 12 months. On the existing grounds of

objection, a trustee may not be able to object to such Rogue Bankrupts being discharged on the basis of their post-bankruptcy behaviour.

On page 5 of our First Submission, we identified one post-bankruptcy category of conduct which would prevent a bankrupt from being discharged after 12 months. This was described in our table under category 10 as 'Failure to comply with post-bankruptcy duties and obligations as required by section 77 of the Act'.

We believe that this could be achieved in two ways;

- Firstly, to prescribe post-bankruptcy conduct in accordance with the obligations and duties set out in section 77 of the Act. A failure to comply with the duties and obligations would disentitle a bankrupt from eligibility for discharge after 12 months. We acknowledge that this procedure will be difficult, given that certain duties in section 77 of the Act (such as the 'duty to aid to the utmost in the administration of the estate' are subjective).
- Secondly, and alternatively, the existing grounds of objection should be strengthened as set out in the table on page 6 of our First Submission to broaden the types of conduct which give the trustee a basis to lodge an objection to discharge.

The table on page 6 of our First Submissions set out a comprehensive list of the bankrupt's duties under section 77 of the Act and identified whether a breach of each duty would allow a trustee to lodge an objection to discharge.

The current grounds of objection do not incorporate all of the duties that a bankrupt owes to his trustee and creditors. Section 77 of the Act imposes a broad range of duties and obligations. By extending the grounds of objection to capture all of these duties and obligations, the trustee will have a much stronger ability to hold Rogue Bankrupts properly accountable for their post-bankruptcy conduct.

That table is replicated below for your ease of reference.

<b>Section 77 Obligation</b>	<b>Current Objection Ground</b>	<b>Future Objection Ground</b>
<i>A bankrupt shall, unless excused by the trustee or prevented by illness or other sufficient cause:</i>		
Forthwith after becoming a bankrupt, give the trustee all books (including books of an associated entity) that are in the possession of the bankrupt and relate to any of his/her financial dealings (s 77(1)(a)(i))	No	Yes
Forthwith after becoming a bankrupt, give to the trustee any passport (section 77(1)(a)(ii))	Yes Section 149D(1)(i)(a)	Yes
Attend the trustee whenever the trustee reasonably requires (section 77(1)(b))	Yes Section 149D(1)(m)	Yes
Give such information about any of the bankrupt's conduct and examinable affairs as the trustee requires (section 77(1)(ba))*	Limited Section 149D(1)(d)*	Yes
As soon as practicable after becoming a bankrupt, advise the trustee of any material change that occurred between the time the bankrupt lodged his or her statement of affairs and the time the bankrupt became a bankrupt (section 77(1)(bb))	Yes Section 149D(1)(j)	Yes
If a material change occurred later, advise the trustee of that change as soon as practicable after the change occurs (section 77(1)(bc))	Yes Section 149D(1)(j)	Yes
Attend a meeting of creditors whenever the trustee requires (section 77(1)(c))	Yes Section 149D(1)(l)	Yes
At each meeting of creditors at which the bankrupt is present, give such information about any of the bankrupt's conduct and examinable affairs as the meeting requires (section 77(1)(d))	No	Yes
Execute such instruments and generally do all such acts and things in relation to his or her property and its realization as are required by <u>this Act</u> or by the trustee or as are ordered by the Court upon the application of the trustee (section 77(1)(e))	No	Yes

<b>Section 77 Obligation</b>	<b>Current Objection Ground</b>	<b>Future Objection Ground</b>
<i>A bankrupt shall, unless excused by the trustee or prevented by illness or other sufficient cause:</i>		
Disclose to the trustee, as soon as practicable, property that is acquired by him or her, or devolves on him or her, before his or her discharge, being property divisible amongst his or her creditors (section 77(1)(f))	No	Yes
Aid to the utmost of his or her power in the administration of his or her estate (section 77(1)(g))	No	Yes

\* The most applicable ground of objection referable to the s 77(1)(ba) duty to 'give such information about any of the bankrupt's conduct and examinable affairs as the trustee requires' is set out in s149D(1)(d). This section states that the trustee may object if 'the bankrupt, when requested in writing by the trustee to provide written information about the bankrupt's property, income, or expected income, failed to comply with the request'. Section 149(1)(d) does not extend to 'the bankrupt's conduct and examinable affairs', which term imposes a much greater level of duty than in section 149(1)(d).

Perhaps the biggest failing of the current objection to discharge regime is the failure to allow a trustee to object to a bankrupt's discharge where the bankrupt has failed to 'aid to the utmost of their power in the administration of their bankrupt estate' (section 77(1)(g)).

The importance of the Table on page 6 of First Submission is that it sets out a comprehensive list of the bankrupt's duties under section 77 of the Act and identifies whether a breach of each duty would allow a trustee to lodge an objection to discharge.

### **The Significance of the Problem**

How significant is the problem of Rogue Bankrupts?

Pitcher Partners currently manages in excess of 300 current bankruptcies. Whilst we do not keep statistics directly on point, many of our bankrupts are Rogue Bankrupts whose behaviour either pre or post-bankruptcy demonstrates a willingness to abuse bankruptcy and other laws to their own benefit and to the detriment of creditors.

We accept that Rogue Bankrupts represent a small minority in number of the overall number of bankrupts.

Whilst they are a small minority, Rogue Bankrupts cause vastly disproportionate harm to the Australian economy and creditors in general. Their conduct has often led to multi-millions of dollars in unpaid tax, multi-millions of dollars owed to unsecured creditors and trails of economic loss to numerous creditors who themselves are put under financial stress as result. In addition, the inability to bring Rogue Bankrupts to account has a significant impact on the integrity of bankruptcy and commercial laws and practice and in our opinion, undermines the stated objective of providing incentive to innovation and entrepreneurship.

In our view, the problem of Rogue Bankrupts is sufficiently significant to require the Government's current law reform proposal to be reconsidered.

### **What do we propose?**

We believe that there are simple, administrative solutions to the problem of Rogue Bankrupts.

Firstly, Genuine Bankrupts should be discharged from bankruptcy after 12 months provided that they declare that they have acted honestly and have not engaged in undesirable commercial behaviour. They would do so by completing a form and paying a fee as set out below. This process is not burdensome; similar processes already exist within AFSA and relatively minor modifications are all that is required to achieve the outcomes above. We address this administrative solution below.

Secondly, the existing grounds of objection to discharge should be reviewed and strengthened. As we have discussed above, the existing grounds should be expanded to cover all of the bankrupt's duties in section 77 of the Act.

### **AFSA – Current Systems**

What process does AFSA currently follow at the end of a term of bankruptcy?

As we understand it, AFSA has electronic systems in place that recognise the passage of time since the filing of a Statement of Affairs and records changes in a database to reflect a person's discharge from bankruptcy after three years, if no objection to discharge exists. It requires little direct human intervention in the automated process.

A bankrupt who wishes to obtain confirmation of their discharge of bankruptcy, must complete an online form with AFSA entitled 'End of Bankruptcy Enquiry', a copy of which is attached for your information. You will note that the form includes a declaration completed by the discharged bankrupt which provides that the information submitted is true and correct and has been completed by the named bankrupt. A criminal offence is committed if false or misleading information is provided.

Our proposal is intended to be an addition or extension *to the existing system*.

We will draw a distinction between bankruptcies administered by AFSA and those administered by private trustees.

#### **AFSA Administered Bankruptcies – Our Proposal**

After 12 months, bankrupts whose estate is administered by AFSA would be entitled to complete an online form similar to the 'End of Bankruptcy Enquiry' form. That form would be amended to identify the categories of pre-bankruptcy conduct which the Government is satisfied should disentitle a bankrupt from being eligible for early discharge. We have identified nine categories of pre-bankruptcy conduct. These categories could, if necessary, be the subject of further industry consultation and stakeholder input.

At the time of completing the form, the bankrupt would tick boxes to declare that the prescribed conduct does not exist. The bankrupt would declare that the contents of the form is true and correct, and thereby expose themselves to a criminal offence for submitting false or misleading information.

The bankrupt could pay a modest fee to AFSA. We note AFSA currently charges fees in bankruptcy for other services, such as the processing of requests for overseas travel (currently \$150).

The completed form would be either review manually by AFSA staff within a prescribed time period (say 21 days), or it may be processed automatically. If the bankrupt meets the eligibility criteria, they would be discharged by electronic changes being made in AFSA's databases. The bankrupt would receive electronic confirmation in the same way as currently exists for an End of Bankruptcy Enquiry form.

#### **Private Trustee Administered Bankruptcies – Our Proposal**

For bankruptcies administered by private trustees, the process would be identical, save that the private trustee would receive the fee, would have a prescribed time period (say 21 days) to review and process the form and notify AFSA and the bankrupt of its acceptance or rejection.

An aggrieved bankrupt would have the normal review rights through the Inspector-General, AAT and the Federal Courts.

#### **Issues Raised by Government**

During submissions to the Committee, other stakeholders submitted that our discharge application procedure has the following issues:

- Firstly, the application process will be a burdensome process for bankruptcy. As we understand it, the Government is of the view that the application procedure will create a significant volume of work for AFSA, which is the trustee for the overwhelming majority of existing bankruptcies.
- Secondly, the process will create uncertainty as there is no guarantee that the bankrupt will be released.
- Thirdly, whereas the Government seeks to create simplicity, the application process will 'flip the onus' onto the bankrupt and make the process of a legitimate bankrupt's discharge more difficult.

We respond as follows:

#### **Burdensome Process**

As stated above, a process already exists at AFSA and for all registered trustees that applies at the end of a bankruptcy. As set out above, the application process need not be overly burdensome to either AFSA, the bankrupt or registered trustees. AFSA and the trustees will receive some modest compensation for their time in the form of the application fee.

### **Certainty**

Stakeholders expressed concern that early discharge from bankruptcy will not be guaranteed, due to a perceived uncertainty in the criteria for eligibility. This concern is misplaced. In our opinion, the pre-bankruptcy conduct which would disentitle a bankrupt from eligibility for early discharge is objectively determined, is capable of easy identification and causes no uncertainty.

### **Discharge Process Becomes More Difficult**

Stakeholders are worried that the discharge application process will make the discharge process more difficult for bankrupts. Again, this concern is misplaced.

A review of the application procedure set out above indicates that it is simple, straightforward, readily understandable and represents an extremely minor obligation for a bankrupt wishing to obtain early discharge. Further, it is not dissimilar to the existing process involving 'end of bankruptcy information'.

This concern is easily outweighed by the benefit of preventing Rogue Bankrupts from being automatically discharged after 12 months.

### **Benefits of Our Solution**

The Government's proposed reforms are aimed squarely at 'entrepreneurs and innovators'. Unfortunately, the proposed reforms contain no mechanism to separate these individuals from Rogue Bankrupts who have demonstrated dishonest, undesirable commercial behaviour, and who will simply abuse 12 month bankruptcy and commercial laws.

Consequently, the result of the Government's proposed reform is an 'all or nothing' approach.

Our solution is a third way which we trust will be genuinely and favourably considered by the Committee.

We are willing to assist the Committee and other stakeholders to advance the consideration of the issue, if required.



## End of bankruptcy enquiry

Use this form to request confirmation of your bankruptcy ending.

If your bankruptcy has finished we will send you a letter confirming this. If it hasn't finished yet, we will let you know when it is expected to end.

To find out more about what happens after bankruptcy ends see:

<https://www.afsa.gov.au/insolvency/i-am-currently-bankrupt/what-happens-after-my-bankruptcy-ends>

**Privacy:** The information you are required to provide on this form is collected under, and for the purposes of, the *Bankruptcy Act 1966* or related legislation. The Australian Financial Security Authority has a privacy policy at [www.afsa.gov.au/privacy](http://www.afsa.gov.au/privacy) that provides information regarding the collection, storage, use and disclosure of personal information.

### Your personal details

Title  Given names \*  Surname \*

Date of Birth \*  AFSA administration number  Email address \*

My preferred method of contact is :

Email  Post

**Important:** By selecting 'Submit' upon completion of this form, you are declaring that the information provided is true and correct and that the form has been completed by the bankrupt listed above.

**Knowingly providing false and/or misleading information is an offence under the Criminal Code Act 1995 and penalties apply upon conviction.**

**All Mandatory fields (identified by an \*) must be entered before you can Submit.**

Submit