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31 January 2018

Committee Secretary
Senate Legal and Constitutional Affairs Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

By Email: legcon.sen@aph.gov.au

Dear Sir/Madam

Bankruptcy Amendment (Enterprise Incentives) Bill 2017

Submission By Pitcher Partners

We are pleased to have the opportunity to provide feedback on the proposed Bankruptcy Amendment (Enterprise Incentives) Bill 2017.

Please find enclosed our submission.

If you have any queries, please do not hesitate to contact me on

Yours faithfully
PITCHER PARTNERS

G M RAMBALDI
National Chairman
Business Recovery and Insolvency Services

Encl

Ref: GMR | I.375763.1

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Pitcher Partners Submission Summary

Pitcher Partners' submission is summarised as follows:

- We support reforms aimed to promote entrepreneurship and innovation for the middle market and to reduce the stigma associated with bankruptcy.
- We support amendments that facilitate the reduction of the term of bankruptcy from three years to one year for the vast majority of bankrupts.
- We propose that all bankrupts should be entitled to apply for a discharge from bankruptcy after 12 months and that they should be discharged from bankruptcy, unless an objection is lodged by the trustee of their bankrupt estate.
- We propose reforms to improve the ability of a trustee in bankruptcy to object to the discharge of a relatively small number of bankrupts who, pre or post-bankruptcy, have engaged in behaviour which disqualifies them for early discharge (referred to herein as a Category 3 bankrupt).
- We propose reforms to enable a bankrupt who has been discharged to comply with all post-discharge duties, as opposed to relying on the threat of prosecution for offences.

About Pitcher Partners

Pitcher Partners is a full service accounting and business advisory firm with a strong reputation for providing quality advice to privately-owned, corporate and public organisations. In Australia, Pitcher Partners has independent firms in Adelaide, Brisbane, Melbourne, Perth, Sydney and Newcastle. We collaboratively leverage from each other's networks and draw on the skills and expertise of 1,280+ staff, in order to service our clients.

The National Pitcher Partners' Business Recovery and Insolvency Services Practice (the National BRI Practice) is comprised of the four Pitcher Partners BRI Practices that operate out of Pitcher Partners offices in Melbourne, Sydney, Adelaide and Perth. The National BRI Practice has extensive resources and provides corporate and personal insolvency services through its many registered Liquidators and trustees in bankruptcy and their respective staff across all of Australia in a wide range of industries.

Pitcher Partners has considerable experience in administering bankrupt estates, particularly complex bankrupt estates involving significant levels of tax evasion, criminal offences, international asset transfers and difficult investigations. Pitcher Partner has three registered trustees in bankruptcy who, between them, manage one of the largest and most respected personal insolvency practices in Australia.

Proposed Amendments

The Federal Government has introduced the Bankruptcy Amendment (Enterprise Incentive) Bill 2017.

The primary consequences of the Proposed Amendments will be as follows:

- The term of bankruptcy will be reduced from three years to one year. After 12 months from the filing of a Statement of Affairs (SOA), a bankrupt will be automatically discharged from bankruptcy, unless an objection to discharge is lodged within the 12 months. There are no changes to the existing grounds of objection.
- A discharged bankrupt will remain subject to income contribution assessments for three years; being the first year of bankruptcy, and two years after discharge.
- The one year term of bankruptcy will apply to all existing bankruptcies. Therefore, any undischarged bankrupts that have been bankrupt for at least twelve months at the date of enactment of the proposed amendments, will be automatically discharged unless the trustee has already lodged an objection to the bankrupt's discharge or a bankrupt has failed to file a SOA.
- A bankruptcy trustee will continue to be entitled to lodge an objection to a bankrupt's discharge from bankruptcy within the 1st year. In such events, the term of the extended bankruptcy will be either five years or eight years.
- The operation of the offence provisions of s.265 of the Bankruptcy Act 1966 (BA) will continue for so long as the bankrupt remains liable to pay income contributions.

We believe that the proposed amendments, while well intentioned, will fail to strike the proper balance between encouraging entrepreneurship and achieving the objectives of bankruptcy law.

Pitcher Partners supports the view that entrepreneurship will be fostered by facilitating early discharge from bankruptcy which will provide a 'fresh start' to a bankrupt. However, Pitcher Partners also recognises the need to ensure an appropriate balance is reached between encouraging entrepreneurship and ensuring the major objectives of personal bankruptcy law are not undermined, namely an appropriate investigation and/or assessment of a bankrupt's affairs and recovery of assets for the benefit of creditors.

Pitcher Partners is of the view that a small number of bankrupts intentionally abuse bankruptcy laws. The early discharge for these bankrupts would undermine the integrity and trust held in bankruptcy law and practice, and ultimately undermine the cultural shift required in public thinking that would allow personal bankruptcy to be seen as a process which will allow entrepreneurs and business people to get back on their feet relatively quickly.

Our submission therefore focuses on the following:

- Firstly, we seek to ensure that only those bankrupts to whom the Proposed Amendments are intended to benefit, are entitled to be discharged from bankruptcy after 1 year.
- Secondly, we seek to prevent Category 3 bankrupts from obtaining discharge from bankruptcy after 1 year ('Early Discharge') by prescribing pre and post-bankruptcy behaviour or circumstances which would make the bankrupt ineligible for Early Discharge.
- Thirdly, we seek to ensure that all discharged bankrupts continue to comply with all post discharge duties and obligations, upon an Early Discharge from bankruptcy.

Bankruptcy Categories

In our experience, bankrupts fall into three broad categories set out in the following table.

Category	**Description**
Category 1: The 'compliant bankrupt'	This category includes 'consumer' and 'business' bankrupts: ▪ Who comply with their obligations. ▪ Who have little or no divisible property. ▪ Who examinable affairs are straightforward and transparent. ▪ Who co-operate with their trustee. ▪ Who pay income contribution assessments in the manner required by their trustee. ▪ To whom the Proposed Amendments are primarily addressed, who will re-enter the business economy and whose Early Discharge is unlikely to affect the proper administration of their bankrupt estate by the trustee in bankruptcy. ▪ For whom a lengthier period as an undischarged bankrupt would be unnecessary and unfair. **The Pitcher Partners' proposed amendments would facilitate Early Discharge for Category 1 bankrupts.**
Category 2: The 'non-compliant bankrupt'	This category includes: ▪ Bankrupts who do not comply with their obligations. ▪ Bankrupts who do not co-operate with their trustee. ▪ Bankrupts who do not pay income contribution assessments in the manner required by their trustee. Importantly, the conduct of bankrupts in this category will provide a ground(s) of objection to discharge.

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<table>
<tr><th>Category</th><th>Description</th></tr>
<tr><td></td><td>The Pitcher Partners proposed amendments would facilitate Early Discharge for Category 2 bankrupts, but only in the event that they complied with their duties and obligations under the BA.</td></tr>
<tr><td>Category 3:

The bankrupts that are likely to abuse the bankruptcy process</td><td>This category includes:

▪ Bankrupts, who by virtue of their pre or post-bankruptcy conduct and behaviour, should be ineligible for Early Discharge. Such conduct and behaviour should be prescribed to ensure that the discharge process is effective and largely administrative.

▪ Bankrupts whose pre-bankruptcy conduct may be seriously unlawful, such as through tax fraud, tax evasion, breaches of the Corporations Act 2001 and other criminal conduct.

▪ Bankrupts who have histories of serious non-compliance with tax law (say through extended periods without tax lodgements).

▪ Bankrupts who have incurred significant unpaid personal tax liabilities and/or who owe substantial amounts to unsecured creditors (in the multi millions).

▪ Bankrupts who engage in illegal phoenix activity either as a participant, advisor or facilitator.

▪ Bankrupts who have been banned as directors by ASIC or by the Courts.

▪ Bankrupts who improperly use repeated bankruptcy as a means of avoiding creditors.

▪ Bankrupts who fail to maintain proper books, records and accounts that sufficiently disclose their financial position or business transactions.

▪ Bankrupts at whom the Proposed Amendments are not directed, in that these bankrupts are not entrepreneurial or innovative (in any beneficial sense) and in fact cause harm to the Australian economy through their conduct.

Importantly, for the purposes of this submission, the <u>conduct</u> of bankrupts in this category may not provide a ground of objection to discharge within 12 months, based upon the grounds of objection currently set out in s 149D(1) of the Act.

The Pitcher Partners proposed amendments would make Category 3 bankrupts ineligible for Early Discharge, except in exceptional circumstances.</td></tr>
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Under the Proposed Amendments:

- The bankrupts in Category 1 will be discharged after 12 months. This is appropriate.
- The bankrupts in Category 2 will be discharged after 12 months, unless the trustee lodges an objection to discharge within the 12 months. If the Official Trustee or the registered trustee appointed to the estate:
  - fails to identify the objection ground within sufficient time; or
  - simply omits, fails or forgets to lodge an objection within sufficient time.

  the bankrupt will be automatically discharged after 12 months to the potential detriment of creditors and contrary to the interests of justice. It is not acceptable to say that creditors would have rights to pursue the negligent trustee for compensation given the cost, complexity and uncertain outcome of such applications. In any circumstance, it is not appropriate for bankrupts in Category 2 to be discharged *automatically* after 12 months.
- The bankrupts in Category 3 will be discharged after 12 months. This is not appropriate.
  - The bankrupt's commission of pre-bankruptcy fraud, tax evasion and other offences will not, of themselves, provide sufficient bases to object to the discharge of bankruptcy.
  - The bankrupt's ongoing compliance with their obligations (particularly those under s.77) will assist the trustee to investigate the bankrupt's affairs. As we will demonstrate below, after discharge,

there are insufficient and ineffective incentives for a bankrupt to continue to co-operate with their trustee.

– It is contrary to the intention of the proposed amendments to automatically discharge these bankrupts from bankruptcy after 12 months.

The Basis of Our Position

Registered trustees in bankruptcy are well placed to make submissions regarding the proposed early discharge provisions. Australian bankruptcy is administered by the government through the Inspector-General (the Government Trustee) and by private registered trustees. The vast majority of bankrupts in number are Category 1 bankrupts. The vast majority of Category 1 bankruptcies are administered by the government trustee. On the other hand, the vast majority of Category 2 and Category 3 bankruptcies are administered by registered trustees in bankruptcy.

Pitcher Partners' position is informed by our experience of administering thousands of complex bankrupt estates. Our experience indicates the following:

- The investigation of complex bankruptcies can be a slow process.
- Investigations are most often conducted incrementally whilst the trustee attempts to generate a workable understanding of the bankrupt's affairs.
- For information compelled, or interviews compulsorily held pursuant to Notices issued by the Official Receiver pursuant to s.77C of the BA, the time from the initial request to the Official Receiver to the time of the production of information can be anywhere from 60 days to six months or more. The Official Receiver does not process trustees' requests for s.77C notices quickly. Likewise, the recipients of such Notices can frustrate and delay their compliance, which is itself enforced by the Official Receiver
- For information located offshore, a trustee may request an Offshore Information Notice pursuant to s.81A of the BA. Information obtained through this mechanism may not be received for many months from the date of the initial request to issue the notice.
- For public examinations held pursuant to s.81, the time from determining that such an examination is required, to the filing of the Court application for the examination and then to the conclusion of the examinations may be a matter of many months to a year.
- Category 3 bankrupts with access to wealth and/or income often have the resources to hide income or at least hinder the trustee from properly assessing the bankrupt's income. Without cost effective post-discharge incentives, it is likely that a significant number of bankrupts will seek to avoid the two-year post-bankruptcy contribution periods.

Accordingly, our experience indicates that after 1 year of administering a complex bankrupt estate, it is likely that a trustee's investigations will be well advanced, but is often incomplete. Bankrupts who are familiar with the system can 'bend' but not break the rules, frustrating and delaying a trustee's investigations, without leading to grounds of objection to discharge being determined within the first year.

Automatic One Year Bankruptcy vs Eligibility for One Year Bankruptcy

Pitcher Partners proposes a two-pronged approach affecting the ability of a bankrupt to be discharged from bankruptcy. As we will describe below, we submit that all bankrupts should be eligible to apply for 'early discharge' after one year, and that there be an ability given to a trustee to object to the early discharge, on prescribed grounds.

We strongly oppose the 'automatic' discharge from bankruptcy after one year for every bankrupt.

While Pitcher Partners recognises that the prospect of a one year bankruptcy would foster entrepreneurial activity by reducing the restrictions that would otherwise be placed on prospective business people and entrepreneurs, a bankrupt wishing to avail themselves of a 'fresh start' sooner than the three year period of bankruptcy should apply to do so through an administrative process. This process would facilitate the ability of the vast majority of bankrupts to take up the opportunity for a 'fresh start' after one year, but will provide a safeguard to ensure a small minority of 'non-complying' bankrupts are not inappropriately and automatically discharged.

Pitcher Partners proposes the laws be amended to enable the following process to take place:

- All bankruptcies should continue for three (3) years unless the Early Discharge procedure applies.
- After 12 months from the date of filing a statement of affairs (SOA) has elapsed, a bankrupt should be entitled to apply to the Official Receiver for Early Discharge, unless they are not eligible for Early Discharge.
    - The process should be simple and straightforward.
    - The application should require the bankrupt to declare compliance with certain specified obligations (such as the disclosure assets and income and the payment of income contributions).
    - The bankrupt should be required to pay a modest fee for the costs of processing the application.
- A bankrupt would be eligible to apply for Early Discharge, unless one of more of the matters in the following table applies to the bankrupt:

No	Prescribed Pre-Bankruptcy conduct affecting eligibility for Early Discharge
1	Outstanding tax lodgements for three (3) or more of the five (5) years prior to bankruptcy
2	A personal liability to the Australian Taxation Office exceeding $1 mil
3	Total unsecured creditors exceeding $10 mil
4	Deemed 'High Risk Phoenix Operator' (see Federal Government's proposed response – Combatting Illegal Phoenixing)
5	Convicted of fraud or offence of dishonest within 10 years prior to bankruptcy
6	Subject to a director banning by ASIC within last 10 years
7	Maintaining inadequate books and records (see s 270 of the Act)
8	Prior bankruptcy within 5 years
9	Failing to lodge Statement of Affairs within six (6) months of being notified of obligation to do so (noting that the term of bankruptcy does not commence until the filing of the Statement of Affairs).
	Prescribed Post-Bankruptcy conduct affecting eligibility for Early Discharge
10	Failure to comply with prescribed duties and obligations as required by s 77 of the Act (see below)

- In the application for Early Discharge, the bankrupt would be required to declare that none of the matters in the above table applies.
- Upon a compliant application being accepted by the Official Receiver together with payment, the Official Receiver would serve notice of the application on the trustee who would have a short period of time to consider objecting to the bankrupt's application based on specified grounds. These grounds should include any ground of objection currently set out in s 149D(1) of the Act. As we explain below, the grounds of objection should be revised and expanded to provide additional grounds to strengthen the trustee's ability to ensure that certain bankrupts are not inappropriately discharged.
- If the trustee does not object within the prescribed period, the bankrupt would be discharged automatically at the end of a prescribed period after notice of the application was served on the trustee.
- If the trustee does object within the prescribed period, the bankrupt would not be discharged. The bankrupt would be entitled to have the trustee's decision reviewed by the Inspector-General, by the Administrative Appeals Tribunal and ultimately, in the Federal Court.
- A bankrupt should retain the overarching ability to apply to Court for Early Discharge, despite disqualifying grounds existing, if exceptional circumstances apply.

Objection to Discharge Provisions and Ability to Investigate and Recover Assets

In addition, we submit that current provisions relating to the ability of a trustee in bankruptcy to object to a bankrupt's discharge from bankruptcy be improved and strengthened, to ensure that Category 3 bankrupts are not eligible for discharge if they are not complying with the law. The ability to lodge more effective objections

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to discharge on grounds which are easily identifiable and less subjective would prevent uncooperative bankrupts from being discharged from their bankrupt estate, and improve the trustee's ability to investigate and recovery assets for the benefit of creditors.

Section 77 of the BA sets out the primary duties of a bankrupt. Section 77 includes duties to:

- attend the trustee whenever the trustee reasonably requires;
- give such information about any of the bankrupt's conduct and examinable affairs as the trustee requires; and
- aid to the utmost of his or her power in the administration of his or her estate.

Breaches of some, but not all duties in s.77 provide a ground of objection to discharge pursuant to s.149D of the BA. The imposition and enforcement of these duties is an important tool available to a trustee to extend the period of bankruptcy in order to properly investigate a bankrupt's examinable affairs. Upon a bankrupt's discharge from bankruptcy, they cease to owe the trustee the duties set out in s.77. A ground of objection exists where by a 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, fails to comply with the request (see s.149D(1)(d)).

Pitcher Partners submits that the current grounds of objection are insufficient and should be strengthened. Essentially, we believe that a trustee in bankruptcy should be entitled to lodge an objection to discharge in the event that a bankrupt fails to comply with certain specified obligations set out in s.77 in addition to those which may currently lead to an objection being lodged.
The following table sets out the primary duties of a bankrupt set out in s 77. It identifies whether a failure to comply with those duties may currently allow an objection to be lodged. and if not, whether they should.

S 77 Obligation *A bankrupt shall, unless excused by the trustee or prevented by illness or other sufficient cause:*	**Current objection ground**	**Future objection ground**
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 (s 77(1)(a)(ii))	Yes s149D(1)(i)(a)	Yes
Attend the trustee whenever the trustee reasonably requires (s 77(1)(b))	Yes s149D(1)(m)	Yes
Give such information about any of the bankrupt's conduct and examinable affairs as the trustee requires (s 77(1)(ba))*	Limited s149D(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 (s 77(1)(bb))	Yes s149D(1)(j)	Yes
If a material change occurred later, advise the trustee of that change as soon as practicable after the change occurs (s 77(1)(bc))	Yes s149D(1)(j)	Yes
Attend a meeting of creditors whenever the trustee requires (s 77(1)(c))	Yes s149D(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 (s 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 this Act or by the trustee or as are ordered by the Court upon the application of the trustee (s 77(1)(e))	No	Yes
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 (s 77(1)(f))	No	Yes
Aid to the utmost of his or her power in the administration of his or her estate (s 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*'.

In our view, this ground of objection does not sufficiently capture the conduct required by the s 77(1)(ba) duty. There will be instances in which a trustee's investigations will relate to the bankrupt's 'examinable affairs', but not directly relate to a bankrupt's 'property, income or expected income'. In this instance, the trustee would not be entitled to lodge an objection in respect to a bankrupt who fails to provide information about his or her examinable affairs when requested to do so.

Further, the bankrupt's duty to '*aid to the utmost of his or her power in the administration of his or her estate'* (s77(1)(g)) is not currently reflected in any ground of objection. It should be, as it will capture conduct which is preventing the proper administration of a bankrupt estate, but would not currently provide a ground for objection under the existing regime. Whilst such an amendment would significantly strengthen the trustee's ability to lodge objections, the bankrupt has appropriate protections in place through the administrative appeals processes to the Inspector-General, the AAT and the Federal Courts.

In our opinion, the grounds of objection in s149D should be amended to better reflect the broader duties set out in s 77. We believe such grounds for the objection of discharge would prevent Category 3 type bankrupts from currently availing themselves of ineffective bankruptcy laws to obtain a discharge from bankruptcy, where such discharge is clearly inappropriate. The bankrupt's commission of pre-bankruptcy fraud, tax evasion and other offences will not, of themselves, provide sufficient basis to object to the discharge of bankruptcy. The bankrupt's ongoing compliance with their obligations (particularly those under s.77) will assist the trustee to investigate the bankrupt's affairs.

The Importance of the Current Income Contribution Regime

For the 2017 financial year, registered trustees in bankruptcy nationally collected the sum of $37,944,551 in income contributions. Revenue to the Commonwealth (via the 7% realisations charge) was $2,656,118.57. For the same financial year, the official trustee in bankruptcy collected $11,260,565 returning $788,239.55 to the Commonwealth.

Total receipts from bankruptcies for the 2017 financial year were $332,284,807 (registered trustees) and $50,357,226 (Official Trustee in Bankruptcy).

Secured creditors received the greater share of the receipts, receiving $93,382,831 via asset realisations achieved by registered trustees and $8,792,008 from the Official Trustee in Bankruptcy.

For the 2017 financial year, registered trustees nationally distributed the sum of $56,877,566 to unsecured creditors by way of dividends. The Official Trustee in Bankruptcy distributed $14,278,564 by way of dividends for the same period.

Contributions from income represent approximately 20% of total receipts received by the Official Trustee in Bankruptcy and approximately 12% of total receipts received by registered trustees in Bankruptcy.

They are therefore a vital source of dividends to a bankrupt's creditors.

Under the current regime, bankrupts are obligated to pay income contributions until discharge where their income exceeds the prescribed threshold.[1] Under the current regime a trustee in bankruptcy is required to make an assessment of the income likely to be derived or derived by a bankrupt during each Contribution Assessment Period (CAP) of the bankruptcy. A CAP is an annual period that commences on the date of bankruptcy or the anniversary of that date.

Currently, a bankrupt is required to provide his or her trustee with a statement of income as soon as practicable at the start of each year throughout the course of the bankruptcy.

[1] (Currently $55,837.60 for bankrupts without any dependants)

It is an offence punishable by imprisonment to fail to do so.[2] It is also a ground of objection to discharge, the effect of which may extend the period of bankruptcy for up to eight years where a bankrupt fails to provide his or her trustee with written information in regard to income.[3]

Under the current three-year bankruptcy period, we believe that it is harder for an undischarged bankrupt to avoid the income contribution regime. In contrast, the proposed 12-month period of bankruptcy with a further two-year exposure to paying income contributions, without an effective deterrent to minimise avoidance, exposes this potential source of return to creditors to an unnecessary risk.

Case on Point: Peled v Roufeil [2017] FCCA 2342 (31 October 2017 (Peled)

The circumstances considered in the case of Peled, perfectly illustrate the complexities that are regularly encountered by bankruptcy trustees in dealing with bankrupts intent on avoiding the income contribution regime.

In Peled, the bankrupt was a builder who provided his services via a company (Hopetoun Pty Ltd) which was incorporated by the bankrupt and his wife fourteen years prior to the date of bankruptcy.

Hopetoun provided services to a further company owned by the bankrupt's wife, a company which owned and managed twelve units and four shops within a building complex.

Subsequent to becoming bankrupt, the bankrupt informed his trustee that he worked an average of about fifteen to twenty hours per week for Hopetoun 'when it was engaged in building work.'

The bankrupt provided evidence (such as bank statements) purportedly evidencing that his income was well below the threshold required to incur a liability to pay income contributions.

It was not until the third year of the bankruptcy, after extensive investigations conducted by the trustee, that the trustee ascertained that the bankrupt was actively engaged in the day-to-day management of the family business on a full time basis. Towards the end of the third year of the bankruptcy, the trustee re-assessed the bankrupt for all three contribution assessment periods determining that the bankrupt was liable for contributions from his income for each CAP.

Soon after, the trustee also lodged an objection to discharge as the expected date of discharge was imminent.

When the matter was eventually heard in the Federal Court, the Court found that the bankrupt (assisted by the family businesses) had actively sought to avoid the income contribution regime.

Cases such as Peled are common in the Bankruptcy Scenario. At Pitcher Partners we have several bankrupts, generally self-employed or assisted by associated entities, who falsely declare their income.

As mentioned, Pitcher Partners support reforms aimed at promoting entrepreneurship and innovation, but we are of the view that it is imperative to consider how best to incentivise a discharged bankrupt not only to profit from his/her entrepreneurship but to contribute a reasonable portion of those profits back to the creditors of his/her bankrupt estate.

In Peled, the trustee had the availability of the objection to discharge regime. Under the proposed reforms, a bankruptcy trustee would be required to identify the deceptive conduct within the pre-discharge period or, post-discharge, rely on the proposed offence provisions and/or commence debt recovery action in the courts.

Pitcher Partners Recommendations to Incentivise Post Discharge Compliance

In order to rectify what we perceive to be a lacuna in the proposed legislation, particularly in relation to the two-year post-discharge period, we make the following recommendations.

1	Section 222 of the BA be amended to provide that a trustee or the Inspector-General in Bankruptcy may petition for the reinstatement of a bankruptcy where a discharged bankrupt fails to adequately comply with a specific post discharge duty. The purpose of this amendment would be to discourage

[2] Section 139U of the BA

[3] Section 149D(1)(d) of the BA

	bankrupts intent on abusing the 12-month bankruptcy period and to ensure that the public confidence in the personal insolvency system is maintained.
2	The BA be amended to provide that a trustee may register a charge against the personal property of the bankrupt in circumstances where the bankrupt fails or refuses to pay a post-discharge income liability. Under the current garnishee provisions contained in the BA, the trustee may obtain a charge (s.139N) over money or property held by a third party, so far as that money or property is payable or received by that third person in consideration of personal services supplied by the bankrupt.
3	If a bankrupt fails to pay assessed contributions but the trustee can identify commercially realisable chattels such as motor vehicles, the trustee ought to have a power to lodge a charge over the chattel.

Post Discharge Compliance: A Lack of Incentive

Currently, pursuant to s.152 of the BA, all discharged bankrupts are required to '*give such assistance as the trustee reasonably requires in the realization and distribution of such of his or her property as is vested in the trustee*.'

Section 152 is expressly limited to matters concerning vested property. Section 152, together with the proposed reforms, do not adequately address the proposed post discharge duties particularly in regard to a discharged bankrupt's income.

Section 265 of the BA

The proposed amendments attempt to have bankrupts comply after they are automatically discharged after one year, by extending the operation of the offence provisions set out in s.265 during the 'prescribed period'. The prescribed period will be essentially the three years from the filing of the SOA, or for so long as the bankrupt is required to make income contribution payments.

The Explanatory Memorandum states that '*A bankrupt discharged automatically after one year must continue to comply with obligations in section 265 through the period they are obliged to make income contribution payments in order for the trustee to gain important information relevant to the contribution assessment period*'[4].

Pursuant to s.265, a bankrupt, shall, amongst other obligations:

- fully and truly disclose to the trustee all of the property of the bankrupt and its value; and
- fully and truly disclose to the trustee such information about any of the bankrupt's conduct and examinable affairs as the trustee requires.

The BA provides that the penalty for an offence committed under s.265 is a term of imprisonment of one year. A trustee can take action in respect of an alleged offence by referring the bankrupt's conduct to AFSA.

While wider in scope that s.152, s.265 is similarly restricted to imposing obligations and duties on a bankrupt in regard to disclosing 'property' and information.

It is Pitcher Partners' considered opinion that, both in its current form and in the proposed amended form, s.265 is ineffective in enforcing the payment by a discharged bankrupt, of his/her post-discharge income contributions.

The proposed reforms also include amendment to s.277A and subdivision HA of the Act.

Section 277A requires a bankrupt to maintain accurate accounts to clearly explain the 'income derived by the bankrupt' during a contribution assessment period. The penalty for a failure to do so may result in imprisonment for six months. The amended s.277A place a duty on discharged bankrupts to maintain accurate records during the 'prescribed period.'

[4] Bankruptcy Amendment (Enterprise Incentive) Bill 2017 – Explanatory Memorandum – paragraph 78

Subdivision HA of the Act provides that, where the trustee has determined that it is appropriate, a bankrupt with an outstanding income liability is required to deposit all wages received into a supervised account. The penalty for a breach of such a direction, may also result in imprisonment for six months.

In our experience, the threat of imprisonment for failing to comply with a direction to deposit all wages into a supervised account direction is not a sufficient deterrent. It is for this reason that trustees generally do not utilize the supervised account regime. Bankrupts merely ignore the direction or fail to comply, which results in the trustee incurring further time and cost in trying to enforce compliance.

The case of Peled (supra) directly illustrates the weaknesses inherent in a system that relies on offence provisions to encourage a bankrupt to:-

(a) Maintain accurate records of all wages received;
(b) Honestly and frankly disclose income during bankruptcy; and
(c) Payment of an assessed liability notwithstanding that the trustee has identified (as occurred in Peled) the fraudulent non-disclosure of a bankrupt.

It is Pitcher Partners' belief that by placing reliance upon the offence provisions as a means by which to achieve a discharged bankrupt's compliance with post –discharge duties, the proposed legislation fails to consider the most cost effective means by which the interests of creditors are considered.

Grounds of Objection and the Offence Provisions

A ground of objection exists where an undischarged bankrupt has failed to discharge certain duties required by the Act. The purpose of an objection to discharge is not to punish a bankrupt, but to encourage that bankrupt to discharge the otherwise undischarged duty. On the other hand, the purpose of the offence provisions contained in the Act is to punish the bankrupt.

We can compare the above mentioned offence provision with the grounds of objection contained in the act.

- Both, contemplate the trustee requesting information or seeking assistance from the bankrupt.
- Both require the bankrupt (or discharged bankrupt) to provide information to the trustee.
- In the case of the ground of objection, a failure to comply will result in the term of bankruptcy being extended. This is a significant incentive for a bankrupt to comply.
- For alleged breaches of the offence provisions, the time and resources of several government enforcement agencies is consumed with no commercial return to the general body of unsecured creditors impacted by a bankruptcy.

In our experience:

- The threat of the commission of an offence under s 265 (or any other offence provision) is a wholly ineffective tool in procuring a bankrupt's compliance and co-operation.
- The prosecution of an alleged offence by AFSA:
  - requires a high standard of evidence (beyond reasonable doubt) to satisfy the criminal burden of proof;
  - is slow and an outcome is unlikely within 6 to 12 months from the date of the referral;
  - rarely, if ever, results in any term of imprisonment being imposed; and
  - will result in a minor fine being imposed or agreed to.

Amending Section 222 of the Act to enforce Post-Discharge Duties

Putting aside the proposed reforms, currently, the BA provides a commercial means by which an undischarged bankrupt may end his or her bankruptcy earlier than the current prescribed period of three years. Under s.73 of the BA, creditors can be invited by the trustee to formally consider a bankrupt's offer of compromise. Where a bankrupt's creditors vote[5] to accept the bankrupt's proposal, the bankruptcy ends[6] immediately.[7]

[5] By way of special resolution
[6] Annulment
[7] Section 74 of the BA

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The policy behind the s.73 regime is to encourage the otherwise insolvent party to actively engage with his/her creditors in a commercially effective manner in order to achieve a balance of each party's interests.

For the bankrupt, the main interest will be in obtaining 'fresh start' earlier than the prescribed period. For the general body of the bankrupt's unsecured creditors, they can make an informed decision as to whether it is commercially in their interest to agree to the bankrupt receiving this 'fresh start'. The result of the s.73 process is that the bankrupt may have vested property returned[8] to him/her and creditors generally receive a commercial benefit by way of a dividend. A bankrupt's proposal under s.73 can include post-bankruptcy duties such as the payment of contributions from the bankrupt's income.

However, where a bankrupt seeks to game the system by failing to comply with any post annulment duties (such as the payment of income by way of installments), s.222 of the BA provides that the Inspector – General in Bankruptcy (I-G.B), a Creditor or the trustee may apply to the Court for a termination of the accepted agreement. In making such an application, the applicant may, concurrently apply to the Court for a sequestration order, the effect of which would return the otherwise 'released' bankrupt back to bankruptcy.

Section 222 of the Act provides creditors (and thereby the entire personal insolvency system) with a statutory safeguard against conduct willfully aimed at exploiting the availability of an early fresh start from bankruptcy. Section 222 does not require the occurrence of criminal behavior nor require the community to bear the cost and burden of prosecuting criminal behavior.

In our considered opinion, the policy of the proposed reforms to encourage entrepreneurialism coupled with the best interests of the bankrupt's creditors by including the post-discharge income contribution regime is best served by providing either:

(a) an amendment to s.222 to provide that an application may be made by the trustee or the I-G.B for a *termination* of the discharge: or

(b) an amendment to the BA to allow a trustee to apply to the Official Receiver for an administrative reinstatement of the bankruptcy.[9]

Conclusion

It is Pitcher Partners belief that by placing reliance upon the offence provisions as a means by which to achieve a discharged bankrupt's compliance with post –discharge duties, the proposed legislation fails to consider the most cost effective means of balancing the benefits obtainable via entrepreneurial success against the commercial detriment to creditors if they are excluded or hampered from sharing in the fruits of such entrepreneurial success.

As discussed, the Act in its current form, contemplates a means by which certain persons who have been released from bankruptcy may lose their discharged status.[10] The amendments recommended here by Pitcher Partners in relation to s.222 of the BA, not only seek to provide a cost effective deterrent to discharged bankrupts intent on avoiding their post-discharge obligations, they are likely to provide a more cost effective means by which the Government may achieve the policy of its intended reforms.

Accordingly, we humbly recommend that the Government consider our recommendations.

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[8] Re-vested

[9] In making the above recommendation, Pitcher Partners acknowledges that an amendment to the BA in the form suggested in (b) above, might infringe the constitution if one concludes that the Official Receiver would be exercising judicial power as opposed to administrative power.

[10] Or, for the case or Part X administrations, remove the protections provided by the BA.