

22 JUN 2004

15 June 2004

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Submission No: 5.1

1/14-20 Best Street
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The Secretary
House of Representatives Standing Committee on Legal and Constitutional Affairs
Parliament House
Canberra ACT 2600

Dear Sir or Madam

Supplementary Submission concerning proposed changes to bankruptcy legislation

I lodged my original submission to the Committee on 7 June. Since then, I have become aware that the full impact of the proposed changes is not an unintended consequence of the drafting, but part of a deliberate plan by the Attorney General to drastically increase the scope and cost of personal liability in Australia. (For example, see the comments attributed to the Attorney General in "The new assault on personal assets" p. 29 Australian Financial Review June 12-14).

Now that I understand that the scope of this draft legislation is not unintended, I am making this second submission to the Committee in order to focus on some of the Attorney General's reported comments and on the public policy and economic impacts of this proposal.

My concerns about this legislation are fundamental, so again I won't spend time on some of the more objectionable details of it, like retrospectivity and reversal of the onus of proof.

Who can incur personal liability in business?

Personal liability is incurred by all sole traders, all those operating through a partnership and, to an increasing extent, by directors of companies. In other words, this legislation will affect literally hundreds of thousands of Australian business people.

Until now, business people could avoid total family financial disaster in the event of a personal claim against them by having a spouse or other entity own key assets like the family home or other non-business assets.

This practice is like choosing to drive a car with good safety features – while the likelihood of an accident is not high and you can minimise the risk by driving carefully, sometimes things happen which are beyond your control, and you want to try to keep your family safe in the event something bad does happen.

Simple economics; shocking public policy

In simple terms, what this proposal does is to increase the cost of any personal liability. Under this legislation, the potential cost (which can also be thought of as the price of risk) is now total family financial wipeout.

With the price of risk increased so much, it is inevitable that business people's tolerance (or demand) for risk will be greatly reduced.

This will manifest itself in many ways. Some people (especially those who have already accumulated some family wealth) will cease business activity altogether. Others will continue in business, but seek to minimise the risk of a personal claim by reducing the size of their business or their willingness to take chances. For instance, they might slow the rate of business growth, so as to avoid taking on debt, new employees or other commitments.

The new mantra for business people will be "everything I and my family have is now at risk; I need to be very very careful about what I do. Why risk everything I have worked so hard for?"

This is the last thing Australia needs.

This proposal is already killing appetite for risk

In the last week, I have become aware of an example which shows the disastrous impact of this proposal on risk taking, growth and employment in our community.

A solid well-established virtually debt-free business has abandoned consideration of strategically sensible \$10 million investment, under which it would have added 60 staff. The reason for this was that the directors felt that, given this proposal (under which family assets can be claimed in the event of personal liability) and the current judicial trend towards personal liability for directors, it would not be prudent to take on the additional risk.

The stifling effect of this legislation is not just someone's theory. It is already real, and can only get worse once the broader business community comes to understand how fundamentally the rules will change.

Attorney General's comments on this issue

In the Financial Review piece referred to above, the following two comments were attributed to the Attorney General. He may have been misquoted; the context may be missing, but as reported those comments show a horrifying naivety about the business world.

"risk taking assumes you take a risk"

Made in the context of defending family assets being made subject to creditors claims, this comment totally ignores the fact that anyone who incurs personal liability in business - whether a sole trader, member of a partnership or, increasingly, as a company director - is already taking a real risk on several dimensions:

- a.) the equity capital they have invested in the business (and any retained profits) will be lost in full before any creditor loses a cent.
- b.) reputation. Most business people I know take this very seriously, and go to great lengths to protect it.
- c.) risk of bankruptcy, and the stigma and existing consequences that come with it.
- d.) all personal assets are already exposed to claims.

“bankruptcy law is not meant to be a substitute for professional indemnity insurance”

If this means that a key justification for the proposed changes is that insurance (whether professional indemnity or directors and officers’) operates as a perfect safety net, let me respectfully submit that it is time to think again.

There are many reasons why business people take limited comfort from insurance. These include:

- a.) insurance often isn’t available at all
- b.) while the sum insured may have been appropriate at the time, unforeseen circumstances may render it inadequate
- c.) exclusions apply
- d.) insurers often contest the claim
- e.) insurer may not be around to meet the claim

Conclusion

I have never been involved in making submissions of this kind before. I am doing it now because I am so passionately concerned that this proposal will be a disaster; a disaster for those honest business people and their families who become its victims, sure; but most of all a disaster for our country because the price of risk will become too high. No-one will want to grow their business, no-one will take on new commitments and all of us will pay the price of less wealth and fewer jobs in our community.

Yours sincerely



Rob Backwell