Bankruptcy
Submission No: 65

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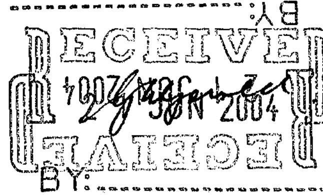

18 June 2004

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Ms Gillian Gould
Committee Secretary
House of Representatives Standing Committee on
Legal and Constitutional Affairs
Parliament House
CANBERRA ACT 2600

and by email

Dear Ms Gould

Bankruptcy Legislation Amendment (Anti-Avoidance & Other Measures) Bill 2004
Exposure Draft

Thank you for referring this matter to the Law Society for comment. As you are aware the timelines are extremely short and the Bill is complex. We understand feedback needs to be lodged by today in relation to this draft Bill.

In the extraordinarily short time allowed for comment it has not been possible for our Society to undertake a detailed analysis of the likely operation of these complex proposed amendments to the *Bankruptcy Act* and the *Family Law*, amendments comprising some 71 pages. In those circumstances this submission should be regarded as preliminary only. We anticipate making further and more detailed submissions subsequently.

The fundamental tenet of the Act causes serious concern. It seeks to change fundamental principles of civil responsibility which could operate to significantly inhibit people with family and other responsibilities from entering or continuing professional practice, significantly increases likely reliance on insurance with a consequent effect in significantly raising professional fees and costs of public, and is likely to act to the significant prejudice of families and children.

Fundamental change to civil responsibility

Central to the concerns held by the Law Society are the effect these changes will have on the ability of practitioners to practise the law and provide for their families.

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Unlike the majority of businesses in society lawyers are ethically required to practice in person, ie. not behind a corporate limited liability veil. Additionally there is a requirement to effect professional indemnity insurance. All lawyers are required to have such cover and do have such cover as a condition of practice. Accordingly the public are already protected from negligence of solicitors up to a statutory minimum amount which from the next financial year we understand will be $1.5 million inclusive of costs throughout Australia.

There is a further existing incentive for lawyers to pay their bills and act competently. If they are sued beyond their level of professional indemnity cover or elect not to pay their debts they are and will continue to be subject to bankruptcy proceedings. In South Australia, and as we understand it in the future throughout Australia a bankrupt may not continue to practice law without the specific permission of the relevant professional association. Certainly in South Australia were the Supreme Court at the instigation of the Law Society or Bar Association to conclude that a practitioner had deliberately embarked upon a course of conduct to avoid the payment of his or her ordinary debts and in particular the Tax Office with a view to strategically going bankrupt on a periodic basis there is little doubt the practitioner would be struck or suspended from practice. Accordingly whilst such strategies have apparently occurred in the past in New South Wales it certainly would not occur in South Australia. We understand that legal and other professional associations Australia-wide share the view that members who commit such conduct would not be permitted to practise in their field.

Accordingly the fundamental ill to which the amendments are directed, ie. high value professionals deliberately not paying their bills with a view to avoiding their debts by quarantining their assets with family members, is rapidly ceasing to be applicable, certainly in the case of the legal profession.

The vast majority of business persons are in any event entitled to limit their liability by way of a corporate trust or other structure.

Up until now it has been regarded as a sensible precaution for lawyers, who in every other respect practise ethically, responsibly and pay their debts, to settle some assets on family members. This often does no more than reflect the substantial non-financial contributions that spouses and other family members make. The additional purpose of providing for the security of the family should an unforeseen civil liability beyond the scope of professional indemnity cover strike the chief breadwinner (particularly late in life when there is no ability to reconstitute the lost assets) has always been considered prudent and completely ethical.

The new proposed provisions concerned allow for the bankruptcy trustee to recover any assets transferred by the bankrupt to any person so long as the bankrupt still receives or may receive some direct or indirect benefit however small from those assets. This applies even if the asset was sold for full value in the ten year period prior to the bankruptcy or for any period at all prior to the bankruptcy (perhaps 20 or 30 years) if full value was not given for the transfer. This also applies to property where the bankrupt has assisted in paying the property off even if the property was initially bought by another family member.

This is a fundamental change to the principle that breadwinners have been entitled to and for the most part expected to support their families and responsibly financially assist their spouses and children. No longer can such provisions be relied upon by families.

Oppression of Families

Accordingly a very wide range of property can be clawed back. This has the danger of being likely to act onerously and oppressively to the family of the bankrupt. If a parent bought a child a car 15 years prior to bankruptcy and got a lift to the airport once or twice in that time the trustee in bankruptcy could take that vehicle from the bankrupt's child's custody. If the family home is in joint names and is paid for primarily by the bankrupt then the family home including the interest held by the innocent spouse could be obtained by the trustee in bankruptcy notwithstanding that the spouse has in family law terms contributed 50% through her or his domestic and non-fiscal efforts to the acquisition of that home. At present, appropriately only the bankrupt's half share of the house can be attached.

Driving responsible practitioners out of the profession

If the proposed amendments proceed in their current form they will act as a significant disincentive for people to enter the practice of the law. Those prepared to enter the practice of the law will need to insure for every eventuality and for the occasional extreme claim. As you are aware professional indemnity insurance is now significantly higher than it used to be and basic cover for each solicitor in this State is now approximately $5,000.00 a year, ie. $100.00 a week.

In the practice of the law it is always possible to in an isolated case make a mistake and for catastrophic or higher than usual damages to be awarded. In the absence of legislation capping liability, it is usually quite uneconomic to insure for such rare and isolated events. So long as lawyers are able to sensibly devolve some family property on other family members to provide some degree of ongoing security then many lawyers will regard only the reasonable and ordinary level of insurance as being appropriate. Once this changes, and all family assets can be clawed back effectively from anyone, a sensible lawyer providing for his or her family will need to attempt to insure for the catastrophic event. If a sole practitioner practising as a solicitor sought for $20 million, a conceivable but unlikely claim, the premium would cost between $21 and $25 thousand dollars ie. Of the order of up $500.00 a week. Many such practitioners would be unable to afford this extra cost and would be driven out of the practice of the law.

There is the possible further consequence that prudent, sensible careful members of the profession would cease practise whilst those who less prudent, sensible and careful continued.

All of these effects are highly undesirable for the community and unfairly target professionals attempting to responsibly practice the profession of the law.

A Better Way

If the aim of the legislation is to attack professionals who simply structure their professional life with a view to deliberately going bankrupt and not paying their ordinary day to day debts (including those to the Tax Office) then it would be much more effective to simply target that kind of conduct.

The Law Society's concern is not to protect these people, indeed we are in favour of some sensible methodology for preventing such strategies.

We recommend that the anti-avoidance legislation in question be recast to require a threshold test which addresses the reason for the bankruptcy. If on the balance of probabilities a Court were to hold that the bankruptcy has occurred as a part of or a consequence of a strategy designed to not pay the bankrupt's ordinary anticipated debts, then all the anti-avoidance provisions could apply. The legislation could specify a range of factors be considered such as:

(a) The income and ongoing liabilities of the bankrupt since the commencement of their working life.

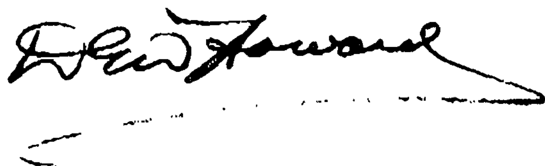
(b) Whether there has been a course of conduct in not paying debts or a particular category of debts (for example the Tax Office).

(c) Whether there has been any sensible or apparently genuine attempt to resolve their debt issues and embark on a course of repayment and to liquidate excess family assets to meet ordinary day to day debts.

As an alternative the legislation could provide that if bankruptcy has occurred as a result of a other catastrophic award of damages (broadly defined) unrelated to debts incurred in ordinary day to day business or practise then these anti-avoidance provisions should not apply.

We strongly urge that the Parliament reconsider this legislation as it is likely to produce significant harm both to the profession of the law and other professional as well as to the general public who seeking professional services at a reasonable prices.

Yours sincerely



D G W Howard
PRESIDENT