



1 YEAR BANKRUPTCY: THE RISK TO CREDITORS

A Bill has been introduced to the Commonwealth Parliament to reduce the period of bankruptcy from 3 years to 1 year. If passed, there will be a number of changes.

What is changing?

1. The bankruptcy period begins from the date the statement of affairs ("**SOA**") is filed by a bankrupt person, and ends (discharge) 3 years later unless the bankruptcy trustee objects to discharge and extends the bankruptcy. The SOA is a document completed by the bankrupt and which outlines the bankrupt's financial position.
2. It is proposed to reduce this default period of 3 years to 1 year, so that after only 1 year of being bankrupt, a person:
 - a) may become a Director of a company again.
 - b) won't be required by law to disclose that they are a bankrupt on credit applications.
 - c) can travel overseas without needing the permission of the bankruptcy trustee.

What isn't changing?

3. Not all aspects of a bankruptcy are changing. Some of the matters which will not change are:
 - a) The requirement for bankrupt to make payments to the bankruptcy trustee (for distribution to creditors) from their income for 3 years (ie a further 2 years after discharge), if certain income thresholds are exceeded.
 - b) The vesting of bankrupt's property in the bankruptcy trustee. Upon becoming bankrupt, the bankrupt's property vests in the bankruptcy trustee and remains with the bankruptcy trustee even after discharge. For example, the bankrupt's home, if owned by the bankrupt, will be "lost" when it vests in the bankruptcy trustee and does not revert back to the bankrupt once discharged (whether it be after 1 year, 3 years, or any other period).



- c) The requirement for the bankrupt to keep the bankruptcy trustee updated as to their place of residence, and any change of name, during the full 3 years. However, now this must occur within 10 business days of the change, and includes phone number changes.

Why the change?

4. The aims of the amendments, as stated in the Explanatory Memorandum to the Bankruptcy Amendment (Enterprise Incentives) Bill 2017, is:

As part of the National Innovation and Science Agenda these reforms aim to foster entrepreneurial behaviour and to reduce the stigma associated with bankruptcy. Reducing the automatic discharge to one year will reduce stigma, encourage entrepreneurs to re-engage in business sooner and encourage people, who have previously been deterred by the punitive bankruptcy laws, to pursue their own business ventures.

Observations

5. The aims are noble. Bankruptcy is meant to be a fresh start for those with insurmountable debt.
6. Reducing risk to entrepreneurs should allow more risks to be taken, and the fresh start to be more readily utilised. It is only by the taking of risk by entrepreneurs that any advances are achieved.
7. However:
 - a) Based on my experience it is not the length of time of bankruptcy that is a deterrent to risk taking (in fact, many people don't seem to realise now bankruptcy lasts 3 years), but rather it is the "loss" of assets in bankruptcy which is the deterrent. That isn't changing.
 - b) It is also arguable an "easier out" by way of a shorter bankruptcy period may:
 - i. Result in bankruptcy being more readily sought, rather than attempts being made to repay debts in full.
 - ii. Incentivise *reckless* risks. The unscrupulous will inevitably take advantage; phoenix activity may become more prevalent, as it becomes "worth a shot" to try, and perhaps "puppet directors" (usually men/women of straw) may also become more prevalent, as the risk in assuming the obligations of directorship (ie bankruptcy and its consequences) align more closely to their compensation for such risk (ie their fee).
8. For those who genuinely and properly take advantage of the protection from legacy debts that bankruptcy offers, a quicker "fresh start" may still be difficult to attain if:



- a) The bankrupt is still left with no assets post-bankruptcy against which to secure any finance for the next venture; and
- b) Trade creditors, lenders and investors become increasingly wary in general, and tighten up lending and credit policies.

Minimising the risk to you, creditors

9. If the amendments are passed and become law how best should you, trade creditors/lenders/investors, deal with the increased risk *to you* of a shortened bankruptcy period enjoyed by debtors? Perhaps:
 - a) Tighten up lending/investing policies and properly set your risk appetite;
 - b) Require security; and
 - c) Make enquiries. Much information is available publicly, including ASIC searches, Landgate searches, Credit searches, and the NPII (National Personal Insolvency Index). These would allow you to determine true owners of businesses, what they own, their credit rating, and whether they have been bankrupt previously.
10. Of course, further enquiries such as those outlined above cost money. But:
 - a) Doing the searches allows you to better tailor your contractual relations at the outset, to ensure you are paid;
 - b) Not doing doesn't change the underlying facts as to the financial position of who you deal with, it only means you will be unaware of important facts;
 - c) If there has been a previous bankruptcy, you can undertake a qualitative inquiry about the *reasons* for that bankruptcy, and you will be the Judge; and
 - d) Anyone who has suffered a bad debt due to a debtor's insolvency now probably appreciates that the cost of such investigations is better treated as a cost of doing business, or indeed a *saving* (saving your business from doing work/supplying goods which are ultimately not paid for, and which might leave you in your own financial distress).

Murfett Legal is available to assist you with those enquiries and investigations, as well as contract preparation, reviews and negotiations. We can also prepare contract terms and conditions, which grants the ability to take valid security under the Personal Property Securities Act (PPSA) as well as security over real property.

Murfett Legal also has a long-standing and successful Litigation and Debt Collection team, to assist with recovery of unpaid debts. Our areas of expertise (including Insolvency Law) allow us to create solutions and achieve commercial results.

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