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Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Sir/Madam,

RE: Submission to the Inquiry into Liquidators and Administrators

I wish to make a submission to your Committee in respect of the above inquiry.

I have been involved in the insolvency profession for many years and therefore I find the terms of reference to be very wide; "This inquiry will investigate the role of liquidators and administrators, their fees and their practices, and the involvement and activities of the Australian Securities and Investments Commission, prior to and following the collapse of a business."

I suspect that you are seeking comments generally, rather than solutions to any problem. It may be that the following comments identify the existence of problems.

Qualifications

I am well qualified to make submissions to this Inquiry.

I practice as both a Barrister and Accountant.

I commenced in the insolvency profession as an accountant in 1982.

I was made a partner of Hall Chadwick, through its predecessor firm Love & Rodgers, on 1 July 1986 at the age of 23.

I became a Registered Company Liquidator on 1 July 1988, an Official Liquidator on 4 June 1991, a Registered Trustee in Bankruptcy on 27 September 1996 and a practicing Barrister on 22 August 1996.

In mid 2008 I decided to leave the insolvency profession as an accountant and concentrate my efforts at the NSW Bar. It has been a wonderful change.

I have had many ups and downs in my career as an accountant.

I have controlled and administered possibly over 2,000 appointments, both personal and corporate. On average I was appointed jointly or severally to 100 assignments each year for over 20 years.

I have contributed to law reform proposals.

I wrote a 73 page discussion paper for the IPAA on deficiencies in the law on Voluntary Administrations back in 1995. I was on the National Strategic Planning Committee for the IPAA back in about 1997.

I was the leading contributor to the June 1998 report issued by the Legal Committee of the Companies and Securities Advisory Committee on Corporate Voluntary Administration ('the CASAC Report'), being noted in that report on 99 occasions as having made submissions to that enquiry. The report is known as the Legal Committee of the Companies and Securities Advisory Committee, Corporate Voluntary Administration Report, Companies and Securities Advisory Committee, Sydney, 1998.

I have run leading cases in this area; McDonald v ASIC, McDonald v DCT, McDonald v Hanselmann.

I have been appointed to administer the affairs of well known companies or people such as Traveland, Firepower and Jim Byrnes.

I have had to deal with the disciplinary procedures that apply to Liquidators.

I have presented seminars for many professional organizations.

I have dealt with the large and small, honest and dishonest. I know this profession better than most.

Typical "client"

There is a whole debate about the use of the word client by an insolvency accountant.

I will discuss this problem further under the heading of conflict. I have produced an experts report on the subject (see Annexure "A")

I will take the laymen's understanding that the company to which a liquidator is appointed, or the person's estate over which a bankruptcy Trustee is appointed, is the client.

The average client is involved in small or medium business.

This needs to be appreciated, as this fact in itself imposes restrictions on the way in which the insolvency of that client can be administered.

In recent times, many larger companies have faced insolvency, but that is not the norm during ordinary economic times.

It must be appreciated that there will be business failures during normal times. These clients may be the victim of another person failing to pay them, or may be people who simply should not be in business. Whatever the reason, the average insolvency client is an SME.

The failure of micro businesses is not that prevalent, as they are too small to get credit in the first place. Their failure or closure usually results in the proprietor losing their money and not making any formal insolvency appointment.

It is the SMEs that over-extend themselves.

The particular industry in which insolvencies are prevalent is the building industry.

This high rate of failure is a result of the low barrier to entry.

It is easy to be in business for yourself as a small subcontractor in the building industry. In many cases, no qualifications are needed. If you are prepared to work hard and have some trade skills, then away you go!

However, often these highly skilled people have little or no knowledge of administrative responsibilities, such as accounting, law or finance. They simply can't control the finances if a problem arises. In the building industry, rest assured that there WILL BE A PROBLEM.

So, these businesses have a high rate of failure.

But, as a result of the low barrier to entry, they can set up again very quickly and easily. This influences that high rate of insolvency.

Compare an accountant who is suspended from membership of the ICA and loses his tax Agents license to the position of a painter who goes bankrupt and simply sets up a new company (with his wife!) or business and starts again. This debate quickly moves towards the recent investigation by the Australian Taxation office into "Phoenix Companies". I refer you to my submission to that investigation.

The fact is that many SMEs fail.

<u>Role of the Liquidator</u>

When a business fails, someone must clean up the mess.

In many respects, that is the role of the liquidator. It is not necessarily a pleasant one.

The circumstances require a neutral party to take control.

In the US, the system allows the directors to stay in charge of their failed company.

In Australia, the circumstances require the appointment of a new person to take control.

It needs to be appreciated that when a company goes broke, the insolvency rarely happens overnight.

There will be a period of time during which the warning signs exist and the alarm bells will be ringing louder. The financial position deteriorates and the debts are not paid.

This naturally causes distrust.

Then there will be a point where there is an admission of failure by the proprietor. This is emotional for any director/bankrupt.

This admission is also somewhat terminal for the business' operations. Once the directors admit that there is a problem, by saying something to the staff or by admitting that the company is insolvent in an email to a creditor, then everyone understandably acts very much in their own self interests.

This will damage any going concern business.

It will also mean that, unless there are rules to determine what happens to a company once it goes broke, the people are likely to succeed in helping themselves over others. Might will be right.

There needs to be a law on liquidations, to govern the process when the company goes broke and to stop the self help actions.

There needs to be a new person placed in control of the company.

This person is the liquidator. It is a necessity of business life. They need to get about stopping the self-help actions, selling off the remaining assets, investigating the records and distributing whatever funds are available.

I find that the person needs to have commercial experience, rather than legal expertise.

They have to make decisions, rather than give advice to others about the decision to be made.

The difference between the profession of insolvency accountant and that of a Barrister appearing before the Supreme and Federal Court judges is remarkable.

Give me the Judges any day!

I will leave with my accounting friends those little old ladies that have lost their $100 deposit and are blaming you, the liquidator, for not getting it back. When your Y Gen staff don't return their phone call to explain their position, they then go to ASIC, the IPAA and their local member to complain about you and their lost $100.

I am sorry, but it happens like this all the time.

Regardless, the role of Liquidator involves making hard decisions. In many cases, you are damned if you do and damned if you don't.

As a bankruptcy trustee, I recently had to litigate against the NAB. The major creditor refused to provide any assistance to fund the litigation. He complained that the case was a waste of time. I was able to settle fairly quickly and the estate received $20,000 net of costs. The major creditor then complained that the amount was not enough!

Also, in this case, he had a priority such that the extra $20,000 should now, other things being equal, be paid to him.

But, the starting point remains that someone needs to appoint the Liquidator. It is best that this appointment occur voluntarily by the people in control of the company.

The Voluntary Administration laws, created by Australia's Ron Harmer, have been widely acclaimed around the world as one of the best laws in this area. They have been adopted in other countries.

These laws allow the directors to appoint an Administrator (who may ultimately become the Liquidator).

The fact that the directors have to make the appointment AND choose the Administrator has been widely criticized. The directors get to choose the person who will investigate the directors.

Again, the issue of conflict arises.

But, our system is correct in that it removes the directors from having control of the assets.

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The role of an Administrator was meant to be different to that of a liquidator.

Unfortunately, the Government failed to adopt one of the recommendations of the Harmer report of 1988 and the process of going into voluntary liquidation remained cumbersome. This was corrected in 2008, some 15 years or so after the 1993 Harmer law changes.

So, for many years, directors would appoint an administrator even if the company was to go straight into liquidation. This was possible under the laws and necessary in many cases (e.g. compliance with a Directors Penalty Notice).

Of recent times, the role of an Administrator has moved towards being a business savior.

However, the stigma was created from the original days and most people see the appointment as being marginally different from that of a Liquidator.

This has caused the emergence of a new profession, called Turnaround Management.

This is huge in the USA.

But, there are some key differences between Australia and the USA which will mean that Turnaround management may never succeed in this country, despite the positive objectives of the role.

In the USA, a small business could employ up to 250 people. In Australia, a similar company would be considered large.

What follows is that the average business in the USA is better resourced than that of the Australian equivalent.

The involvment of a Turnaround manager costs money. The average small business in Australia simply cannot afford to pay for the highly specialized and ongoing assistance.

Furthermore, the director's obligations and exposure once a company becomes insolvent are far more onerous in Australia compared to many countries.

I understand that the Government is reviewing this area of the law.

The fact that a Turnaround Manager may be deemed to be a director and then personally liable for the debts of the company he/she was trying to save, means that the role is too risky compared to the limited returns.

The role of a Turnaround Manager will be limited to large companies. This will somewhat limit the expansion of the profession. In many ways, the big 4 accounting firms have been doing this work, as consultants to clients, for many years.

Remuneration and Liability

The issue of fees or remuneration is the most heated topic when talking about Liquidators.

I am told "you guys get paid well", or "you guys really know how to charge".

The remuneration of any person should be a function of their qualifications, responsibilities and exposure/risks.

There are very few professions in which it is normal to get sued personally every month. This is the life of a Liquidator.

There are very few professions where you take control of the mess created by someone else, with the objective of salvaging something extra for other people (the creditors) by trying to sell a business as a going concern rather than liquidation fire-sale of the assets, yet you are personally liable for all of the debts that are incurred whilst you continue trading.

The risk is high.

What is the reward?

There is rarely any thanks.

The only reward can be the fees.

The system of time cost has become entrenched. This does not reward any efficiency, nor any risk taking.

The recent law changes of 2008/9 and the new ethical guidelines have only deepened the role of time costing in the way of Liquidators are remunerated.

However, these changes are merely about approving the level of remuneration.

What remains as a regular problem is the ability of the client to pay any remuneration.

In many cases, the Liquidator simply does not get paid.

This is a position to be avoided, by any business. In fact, what respect would any creditor have for a Liquidator, as a business man, if he was prepared to work without any prospect of being paid.

Naturally, Liquidators want to be paid.

The law properly recognizes that they must be paid with priority.

The law could be clarified further to make sure that the Liquidator is paid “reasonable fees”, for the work done to preserve and realize assets, before any other debts, secured or unsecured are paid. However, this is a minor technicality.

The problem with remuneration also stems from the fact that there are limited resources.

The more paid to the Liquidator, the less available for payment to the creditors.

This increases the animosity and the level of conflict.

Alternatively, if a company or person wishes to propose a settlement with the creditors, then the costs of the insolvency accountant add significantly to the amount that is needed to be able to make a worthwhile offer.

Some one bears the cost.

The conflict will never be overcome.

What is challenging is the system for fixing the appropriate amount.

Again, I have written an article on the subject, appearing in lawyers Weekly magazine (see annexure “B”).

<u>Conflict</u>

The greatest problem for the insolvency profession is that the members are often in positions of conflict and the system simply allows it to happen.

I have tested the boundaries on occasions, but this is with the bar set at a particular level.

I find it to be deceptive and dishonest.

I changed my profession because of the frustration with the conflicts within insolvency.

The problem is best illustrated by examples.

A director walks into the office of an advisor.

The same type of person walks into my office now as they did some three years ago.

Now as a barrister, I have clear boundaries. This person is my client. They will always be my client. I will not be acting against them. I will fight heart and soul for them.

As an accountant, the position was different.

The person, being a company director, needs to appoint a Liquidator. Assume that the decision has been made. No need to consider whether or not to do it. He needs to.

He says that he is seeing three liquidators, before deciding upon one to appoint.

The liquidator says to himself; “How do I convince the Director, in order for him to sign on the dotted line, to pick me?”

“What sales pitch do I use?”

“Do I reduce my fees?”

“If so, does that mean my office does less work and cuts more corners?”

That is not acceptable to me.

He then says to himself; “What else can I do?”

“Do you say to the director that “I will go easy on you”?”

I have never said that. I did not want to be part of that. But what was said by others when that director went elsewhere to sign up with another Liquidator.

Then importantly, the person chosen by the director to be “his liquidator” MUST turn on the director. He must investigate the conduct of the director and, in all probability, he must consider suing him for “insolvent trading”.

The conflict is obvious.

An insolvency accountant should not be able to give any advice to a company and then subsequently take on the appointment as Liquidator. The circumstances are different for an Administrator.

The conflict is also obvious where a firm acts for a bank.

I approached a Big 4 firm recently, on behalf of a client and asked if they would consent to be the Administrator on a large resort. A bank was owed about $30million.

The partner of the Big 4 firm said that the bank was their client and they could never act without the banks agreement.

How can these firms ever accept any appointment voluntarily as a Liquidator if a bank is involved.

They see the banks as their clients and they service them accordingly. I respect that fact. But the appointment as Liquidator involves duties to all creditors and the company as a whole.

Those firms must not act voluntarily on any appointment other than a Receivership appointed by the Banks

It is wrong. It has been ignored for years.

I could go on further, but time will not permit.

I would be pleased to elaborate upon these thoughts at the upcoming senate hearings, if that will be of assistance.

Yours sincerely

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