Submission to Senate Inquiry into Liquidators and Administrators.

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This submission focuses on the regulation and licensing of insolvency practitioners (including, but not limited to, liquidators and administrators).

Submitters' Qualifications

We are both experienced teachers, writers and researchers of insolvency law, and both members of the Law Council and Insolvency Practitioners Association. Associate Professor Symes is a co-author of Australian Insolvency Law (LexisNexis, 2009) and is Consulting Editor, and an author of, the Insolvency sections of Laws of Australia including Company Liquidations and Bankruptcy. Associate Professor Brown is a former consultant to the New Zealand government and Law Commission on insolvency law reform, and recently authored the chapter on 'Insolvency Practitioners' and 'Voluntary Administration' in Heath and Whale on Insolvency (LexisNexis, New Zealand).

This week we delivered a paper (an unpublished working draft) entitled 'Better Regulation of Insolvency Practitioners: Cracking the Code", to the Corporate Law Teachers Association. Our submission draws on material from that paper. [1] In our paper we examine the role for self-regulation or co-regulation, and the place and status of Codes in the regulatory structure. We examine the Insolvency Practitioners Association Code of Professional Practice, and attempt to 'benchmark' Australia's framework for regulation of insolvency officeholders against international and local standards.

In the light of this we question whether some additional layer of independent review or complaints mechanism might be justified in terms of stakeholder confidence in the system, whether the licensing criteria can be more finely attuned to their objectives, and whether the current disciplinary procedure for liquidators is optimal.

In our paper we test the case for regulation of insolvency practitioners against the mainstream justifications for regulation of professions. We explain why some regulation of the insolvency profession is more than justified, and then go on to review the existing regime.

Reviewing the existing licensing regime

The existing regime of licensing through ASIC as set out in sections 1282 et seq. Corporations Act should be maintained, but should be strengthened in the following ways, particularly when the Australian regime is benchmarked against international standards, and also in view of the difficulty for creditors and even courts, of assessing whether remuneration of practitioners is appropriately measured and represents value.

[1] The Paper is attached, but it is an unpublished working draft and should not be reproduced or cited without permission.

Since the licensing regime was initiated and developed, the Insolvency Practitioners Association has developed and improved professional standards. These have been used by the courts, by the CALDB and by ASIC as benchmarks of prevailing professional best practice.

We think that any regulatory regime should now give formal recognition and move towards a co-regulatory system, given the maturity which has now been reached by the profession's setting of its own standards through the IPA Code of Professional practice. However, although the IPA Code, launched in 2008, is an impressive starting-point, there are aspects of the Code, and its enforcement and embedding into the regulatory framework, and aspects of IPA's disciplinary, enforcement and complaints procedures, that need to be improved before it can be said that Australia has a world-class structure which is, and is perceived to be, rigorous and independent.

ASIC licenses practitioners as 'registered liquidators' (or 'official liquidators', who are appointed from among registered liquidators), [2] and only registered liquidators can take appointments as liquidators, administrators, and receivers. [3] (We note that it seems somewhat archaic, in view of the popularity of Voluntary Administration and the rescue culture, that the regulator still licenses 'liquidators' as the default insolvency office.[4]) ITSA registers trustees in relation to bankruptcy, and also now licenses debt agreement administrators.[5] We note that ITSA seems to have more provision in place for routine inspections of practices than is the case with ASIC.

It also seems somewhat questionable whether it was correct, in the Corporations Amendment (Insolvency) Act 2007, to remove the need to show evidence of membership of a relevant professional body. [6] In light of our arguments above, we think that this is not only a relevant criterion for licensing, but on one model, a necessary one.

Turning to the existing regime for licensing, we recommend that the licensing criteria need to be fine-tuned so that they are more tied to the objectives of regulation quality and integrity. The government should consider:

(a) Changing the terminology to move away from 'registered' liquidators , since liquidation is only one role of an insolvency practitioner, and probably not the one which the Government wishes to emphasise.
(b) Abolishing the separate category of 'official liquidator', since the qualifications and entry criteria are now identical, and the method of selecting 'official liquidators' is not

[2] See generally sections 1282- 1298A Corporations Act 2001
[3] *Stocktaking exercise on regulation of professional services, overview of regulation in the EU Member states*, 2003, cited in *Regulation of legal and medical professions in the US and Europe, a Comparative Analysis*, Nuno Garoupa, Working Paper, 2006, FEDEA www.fedea.es

[4] For example the European Bank for Reconstruction and Development ("EBRD") Insolvency Office Holder principles, 2007, EBRD; The Insolvency Practitioners Association's Code of Professional Practice distinguishes a class of 'practitioners', SIP 9 in the UK applies to 'Office holders'.
[5] Part IX Bankruptcy Act 1966, amended 2007. See Inspector-General Practice Statement No.4, *Guidelines and Processes for Registration of Debt Agreement Administrators*, March 2007, ITSA
[6] Formerly in s1282(2)(a)(i) Corporations Act

transparent- all licensed practitioners should be eligible and willing to take on court-appointed liquidations

(c) Spelling out in more detail the requirements for 'fit and proper' in the legislation, and ensuring that the legislation requires experience and education in all forms of insolvency appointment, particularly liquidations and voluntary administrations

Towards a Co-Regulatory Framework

The Insolvency Practitioners Association of Australia (IPA) is the specialist professional body. Many or most of its members belong to other professional bodies, most notably the ICAA or CPA. This means that they may be governed by more than one code of conduct and/or ethics, but that is not in itself unusual. [7] In addition, the Accounting Professional Ethical Standards Board produces a relevant code. Both the ICAA and CPA Australia have adopted the Code of Ethics for Professional Accountants as issued by APESB , APES 110. APES110 is materially consistent with the International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants. APESB issued APES 330, Insolvency Services', in September 2009 and the standard will be effective from 1 April 2010.[8]

The benefit of having APES 300 is that coverage of the combined codes is extensive in terms of percentage of insolvency practitioners now bound by a Code. There may still be a few insolvency practitioners who can become registered liquidators through licensing by ASIC, even though they are not current members of either the ICAA or CPA. We regard it as unacceptable , and contrary to international best practice, that such people could in theory be licensed without being bound by any enforceable code of conduct.

We believe that, subject to improvements with the enforcement mechanisms for the Codes, the IPA and APESB Codes can be used as the basis for a co-regulatory approach, as hinted at by the Federal Attorney-General in his speech to the IPA in Sydney, May 2008.

The IPA's disciplinary enforcement mechanisms have been largely, due to its constitution, reactive to findings by ASIC and CALDB or the court. IPA is currently reviewing its discipline regime- proposed changes, to be voted on at a special general meeting in February, and this will strengthen the IPA's ability to suspend or remove membership.

We believe the Senate Inquiry should investigate whether a co-regulatory model might lead to more effective regulation and closer scrutiny and enforcement. There are various models for achieving co-regulatory co-operation here:

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[7] The CPP deals with conflict between Codes and states that if the CPP imposes a higher standard, it will prevail on practitioners

[8] "member" is defined as a member of a professional body that has adopted this standard as applicable to their membership, as defined by that professional body and "member in public practice" is defined as "member irrespective of classification in a firm that provides professional services".

(a)Mandating that licenses will only be issued to members of a professional body that subscribes to the IPA Code of Professional Practice and/or the APESB's APES 300 standard, or alternatively, incorporating an enhanced and agreed version of the IPA Code in Regulations

(b)Entering into a co-regulatory partnership with the IPA, but this will depend on :

a. Requiring all licensed practitioners to belong to the IPA or at least (if that is not acceptable) a body which subscribes to its code or a similar code such as APES 300
b. enhancement of the IPA's CPP by strengthened disciplinary structure (currently being reviewed by the IPA), and a mandatory insolvency continuing education requirement,
c. Ensuring that the IPA has a programme of training about the Code, and ensuring that its members, and their firms, generate a culture of compliance

ASIC AND CALDB

The Companies Auditors and Liquidators Disciplinary Board's jurisdiction to hear cases brought by ASIC in respect of registered liquidators emerged from its historical jurisdiction over auditors. We understand that few cases, especially under the 'conduct' category, are brought before the Board by ASIC. The Board can only determine cases brought before it by ASIC. We doubt that this is because there are hardly any cases of practitioner misconduct or default, and therefore it must be surmised that ASIC is not devoting sufficient time and resources to the monitoring and investigation of insolvency practitioners. We do not have access to any evidence to support this however, but recommend that the Inquiry should focus on the extent to which ASIC currently devotes time and resources to its licensing and monitoring functions in respect of registered liquidators, and the policy and operations regarding referral of cases to the CALDB.

In any event, we recommend a review of the jurisdiction and operation of the CALDB in relation no insolvency practitioners. We are concerned that, in addition to the fact that few insolvency practitioner cases come before it, complex issues of insolvency law, practice and remuneration, once decided by the board, may be appealed to a generalist single judge of the Administrative Appeals Tribunal.

An Independent Body is required

We also suggest, as others have done, that irrespective of a co-regulatory approach and formalisation of the role of the Code of Professional Practice, there is room for an independent person or agency to assess, review and hear complaints in relation to insolvency practitioners. This person or agency, on an Ombudsman or assessor model, can in particular (a) be a channel for aggrieved creditors and other members of the public dealing with insolvencies and insolvency practitioners (b) review and comment on the evolving professional standards, and make recommendations accordingly, (c) assess and review practitioners' fees. Despite the Principles in the CPP, and the guidelines from the courts in terms of disclosure of information about remuneration and expenses, it is very difficult, even for courts, to assess and review levels of remuneration, and

courts have expressed reluctance or concern about their role in this respect, yet there is inevitably creditor perception that remuneration may be excessive. There needs to be a specialist and independent assessment of remuneration as it is not something which should take up judicial time, but is something in which the public needs confidence that the co-regulatory model, when combined with competitive remuneration amongst private practitioners, is delivering value for money. See the further development of this proposal in the final section of this submission, Remuneration.

Benchmarking against International Standards of practitioner regulation

The regulatory framework needs to be benchmarked against domestic and international standards. (In addition, we trust the Inquiry will consider the approach of other studies into the value and competitiveness of insolvency practitioners' services- see for example, in the UK, in addition to a professional body's survey of the cost of insolvency services,[9] the Office of Fair Trading has recently launched a market study of the insolvency industry. [10] The study "will look at the structure of the market, the appointment process for insolvency practitioners and any features in the market which could result in harm, such as higher fees or lower recovery rates for certain groups of creditors". This follows on from a World Bank report on the cost of closing a business worldwide, including time in administration, percentage of fees in relation to asset recovery, and returns to creditors. [11])

A conference held in Sydney in 1999, Insolvency Systems in Asia, sponsored by OCED, APEC, World Bank, AusAID and Treasury, led to an initiative taken up by the World Bank and the European Bank for Reconstruction and Development, Insolvency Officeholder Principles. [12]

There are 12 Principles in the EBRD document. Of those that are relevant to standards and licensing, it is to be noted that Principle 1(e) is a requirement for continuing education, 1(f) requires renewal of registration subject to various factors including continuing education, and 1(f) is licensing of a corporate body where the principals are licensed, and accountable for the body.

Under Principle 6, Standards of Professional and Commercial Conduct, suggests (a) that primary legislation should prescribe basic standards for all officeholders, with a subset of professional standards being made by regulations, or by a recognised professional body that requires member officeholders to comply. Under Principle 8, governing Regulatory and Disciplinary Functions, the Principles state that a government or professional body should have appropriate regulatory, investigative and disciplinary functions, though each jurisdiction should decide the appropriate body. Among remedies, 8(d) includes the power to require compensation of third parties, and require the officeholder to undergo further education and training.

Under Principle 12, a Code of Ethics, the EBRD state that the law should encourage and facilitate a professional body to develop a code of ethics for officeholders, and the law could compel the

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[9] R3 published a report called 'The Value of the Insolvency Industry', July 2008, which is available at www.r3.org.uk/publications/default.asp?dir=professional&pag=Thensolvencyindustry&i=475.

[10] http://www.oft.gov.uk, Press Release 12 November 2009

[11] This forms part of the World Bank's 'Doing Business' project assessing business regulation around the world on a number of criteria, see http://www.doingbusiness.org/documents/fullreport/2010/DB10-full-report.pdf

[12] EBRD, June 2007

application of a code of ethics, either by setting that code or requiring that a code established by a professional body be recognised as binding on officeholders.

We have also taken into consideration the Guidelines for Drafting of Voluntary Industry Codes issued by the ACCC in 2006. Regulations under the Trade Practices Act can declare a code to be a voluntary industry code. Two pertinent aspects of a successful voluntary code which are also identified by the ACCC, and which are not a feature of the IPA Code at present, are:

(a) Where the self-regulatory body comprises representatives of key stakeholders, including consumers, government and community groups
(b) Wide coverage of those bound by the code, an effective complaints handling system, commercially significant sanctions for non-compliance, and dissemination of information and training about the Code.

Remuneration and the Regulatory Gap

In most major jurisdictions, courts, exercising their ultimate powers to review remuneration or to supervise insolvency practitioners, have expressed concern about the level and/or the method of remuneration of insolvency officeholders, or about deficiencies in the information supplied to creditors. [13]

Insolvency is a situation where there is not enough money to go around, and many creditors have limited understanding, and low tolerance, for practitioners who seem to them to run up large bills at excessive charge-out rates. Approval may be obtained from creditors meetings and/or any creditors committee (or committee of inspection), but in some situations recourse will be required to the courts. It is in the area of remuneration that the most obvious conflict between the commercial interests of the practitioner and his or her firm, and the interests of the creditors and the wider public interest is manifest. For that reason, it constitutes a large part of insolvency professional bodies' codes of conduct. Thus, in the IPA CPP, three broad 'remuneration principles' are set out,[14] which take up over twenty pages of the Code, and then a further template of a remuneration report.

Nevertheless, ultimately, unless there are to be restrictions or caps on the rate or total amount of fees chargeable, it is very difficult for a court as final arbiter to assess or fix 'reasonable' remuneration. The court will invariably look at the information provided as to activities, seniority of staff and time spent, but courts have not been keen to take on this role beyond that. [15] If expert evidence is used in order to justify rates and work, the problem of regulatory capture extends to expert witnesses,[16] who invariably will be reluctant to express a strong view that rates are unreasonable. Courts have expressed the view that this is not really a judicial role, and is more akin

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[13] *Mirror Group Newspapers PLC v Maxwell (No.2)* [1998]1 BCLC 638 and *re Peregrine Investments Holdings Ltd*. [1998] 2 HKLRD 670
[14] These are (i) Necessary and Proper; (ii) Meaningful disclosure and (iii) Approval before drawing, see Part B 12-14, and also Part C, 20 for template report.
[15] See *re Stockford*,[2004] *Conlan v Adams*[2008] WASC 201
[16] See n above

to the taxing or assessment of lawyers' bills which is traditionally performed by court masters or registrars, and is a quasi-administrative exercise.

In *A Judicial Perspective on Insolvency Law and Practice*, [17]Associate Judge Doogue of the New Zealand High Court, identified problems with the task confronting the court. In a very thorough recent case of the New Zealand High Court on remuneration of insolvency practitioners, in *re Roslea Path Ltd*. , the Court paraphrased Associate Judge Doogue's comments:

" (a)On the basis of information required to be put before the Court, Associate Judges find it difficult to determine reasonableness of particular charges

(b)There is an inability for the Court to test evidence of senior practitioners who corroborate evidence of quantum of fees. While in general most practitioners appeared cognisant of their obligations as expert witnesses, there remained 'some questions about the source and quality of the evidence before the Courts'.

(c) Value of work is rarely ever addressed. Whilst having the benefit of liquidators' reports, the court did not generally receive comment from experts tying the appropriate level to the value of word done having regard to factors and outcomes. Allied to this problem was the difficulty in using only time-based charging as a method to fix remuneration.
(d) Is it appropriate for remuneration of liquidators to be isolated from accountancy practice generally- information vacuum on acceptable hourly rates?
(e) Have market forces imposed the discipline envisaged by *Medforce?*[18] In particular, to what extent is there true competition for appointment as liquidators?
(f) If a petitioning creditor is one of many who will carry the cost, there is little motivation to inquire; also if a surplus is to be returned to shareholders, it is they, not the creditor, who will be affected."

These issues are also relevant in Australia, and show the difficulties for creditors and courts in obtaining objective and comparative information in order to make an informed decision about IP's remuneration.

There is no statutory direction or formula to provide a basis for calculating remuneration. The statutory expectation is that it be "reasonable".[19] There is also a judicial expectation that it be "reasonable".[20] But there is no fixed scale and no legislative direction on permissible methods , apart from s 473(3) which goes the closest by stating "remuneration by way of percentage or otherwise". In Australia it is the time basis of assessment that is common and it is likely to stay that way.[21] The CPP provides four options that include both percentage and time basis.[22]

[17] LexisNexis Corporate Insolvency conference, Feb 2009
[18] This is a reference to the leading New Zealand case, which attempted to lay down guidelines for recording and disclosure, and was approved in *Stockford* (2004) 52 ACSR 279 by Finkelstein J
[19] The court when exercising power to review must have regard to whether remuneration is reasonable for example see s473(10) for court appointed liquidators.
[20] See *Re Korda*; *Stockford Ltd* (2004) 52 ACSR 279.
[21] Gronow, *McPherson's Law of Company Liquidation* para 8.2470.
[22] See Part B, Section 13.2 CPP

The leading guideline in Australia is Finkelstein J's judgment in *Re Korda: Stockford Ltd* [23] This approach was recently endorsed by the Court of Appeal of Western Australia in *Conlan v Adams* .[24] the 2007 amendments to the Corporations Act incorporated some aspects of the ideas in the case law and IPA Code.

A published scale can give certainty, and give the courts a ready-made pathway to follow when called upon to either set or review remuneration. [25] In the 1990s ASIC's forerunner issued a recommended scale,[26] and the IPAA had a scale from at least the 1970s. However, this ceased in 2000.[27] However, insolvency services are different from other areas of professional pricing, because there is a clear and direct relationship between the rate and amount charged by IPs, and the actual outcome for creditors , so that it can hardly be said to be just a matter of regulating quality. Currently the IPA recommends that members use their usual hourly rates and comply with the CPP.[28] However, we wonder whether there should be a turn to recommended rates to give some guidance to creditors and others.

No amount of information or guidelines in a Code about method and basis of calculation can prevent allegations that actual rates applied to time spent are excessive. If this is something that courts do not feel resourced or inclined to do, what other solutions might there be? Given that the professional body itself cannot provide that level of independence, and that expert witnesses similarly can only give a certain amount of comfort, is there a role for some other body, perhaps an insolvency services ombudsman or similar insolvency assessor.[29] In re *Roslea Path* the New Zealand High Court noted that[30] the Law Commission had suggested consideration to reposing function of fixing liquidators remuneration in a new statutory officer charged with all public functions under the Companies Act 1993. Notwithstanding that the specific recommendation was rejected by the Government of the day. The High Court suggested that: "Parliament may wish to reconsider (as a matter of competing priorities) whether the task of approving liquidators' remuneration is better undertaken by busy Associate Judges or through some other administrative process".

[23] (2004) 52 ACSR 279 ; 140 FCR 424

[24] [2008] 65 ACSR 521

[25] See the comments of Barker AACJ in *Gallagher v Dobson* [1993]3 NZLR 611 cited in *re Roslea Path Ltd*. (in liq), HC Tauranga, CIV 2005-470-611, 17/12/09

[26] *Re Fine Food Distributors Pty Ltd* (1993) 9 ACSR 599.

[27] *Gould v CALDB[2006]FCA*

[28] Part B, section 13.2

[29] In England and Wales, the Court may appoint an assessor or costs judge to report, and then hear an application either with or without that assessor suitably qualified persons to act as assessors. See Practice Statement of Registrar Baister [2004] discussed in *re Roslea Path Ltd. (in liq)*.

[30] New Zealand Law Commission "Promoting Trust and Confidence" Study Paper 11 (NZLC, Wellington, 2001) para 170, Part II