

**Government response to the Senate Economics References Committee report, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework***

Recommendations	Proposed Government Response
<p><b>Recommendation 1</b> The committee recommends that the corporate insolvency arm of ASIC be transferred to ITSA to form the Australian Insolvency Practitioners Authority (AIPA). The agency should be governed by the <i>Financial Management and Accountability Act</i> under the Attorney General's portfolio.</p> <p>The Memorandum of Understanding between ASIC and ITSA should be updated to ensure that ASIC provides to the new agency adequate resources and the expertise needed to support the oversight of corporate insolvency sector.</p>	<p>Not accepted.</p> <p>A new single regulator is not required in order to address the concerns of the Senate Committee in relation to ASIC's role in regulating the corporate insolvency industry</p> <p>There would be major upfront costs of merging the regulators, which may not necessarily be offset by long-term savings. The extent to which simply unifying the regulator will result in an improved regulatory environment is not clear. Separate policy considerations apply to many aspects of personal and corporate insolvencies and there is not currently sufficient evidence that a one-size-fits-all approach for all issues would necessarily optimise outcomes for stakeholders.</p> <p>The removal of the responsibility for regulation of corporate insolvency from the corporate regulator would be expected to result in corporate insolvency losing its important connections with other parts of ASIC, for example in relation to major corporate administrations, regulation of insolvent trading and of director and corporate misconduct that may have been engaged in leading up to, or during, an insolvency event.</p>
<p><b>Recommendation 2</b> The committee recommends that the government commission the Australian Law Reform Commission to inquire into the opportunities to harmonise Australia's personal insolvency and corporate insolvency legislation. The Commission must report to the government within 12 months of the tabling of this report.</p>	<p>Noted.</p> <p>The Government agrees that there should be greater consistency between the personal and corporate insolvency systems but does not consider it necessary to commission the Australian Law Reform Commission (ALRC) to undertake an inquiry at this time.</p>

	<p>Significant work is already being progressed by relevant government agencies to identify areas for greater harmonisation. An ALRC inquiry may duplicate or delay the progress of this work.</p> <p>The Government will facilitate the closer alignment of the personal and corporate insolvency laws through its discussion paper on regulatory reform options for the registration, regulation, and remuneration of participants of the corporate and personal insolvency industries.</p>
<p><b>Recommendation 3</b> The committee recommends that a 'flying squad' be established within the new insolvency regulator. The unit should be responsible for conducting investigations of a sample of insolvency practitioners, some selected at random, others with the aid of a risk profiling system and market intelligence.</p>	<p>Noted.</p> <p>The Government has released a discussion paper outlining regulatory reform options for the registration, regulation, and remuneration of participants of the corporate insolvency industry on 2 June 2011.</p>
<p><b>Recommendation 4</b> The committee recommends that section 213 of the <i>Australian Securities and Investment Commission Act 2001</i> be replaced with the following:</p> <p>All hearings, evidence and reasons shall be heard or given in open session unless otherwise ordered by a judge of a Court of any State or Territory or the Federal Court of Australia who may, at any time during or after the hearing of a proceeding in the Court, make such order forbidding or restricting the publication of particular evidence, or the name of a party or witness, as appears to the Court to be necessary in order to prevent prejudice to the administration of justice or the security of the Commonwealth. Subject to section 216(2), any past hearings, evidence and/or reasons shall be open to inspection by any person, and a register of past matters with the names of parties shall be published and made available for inspection by the public by means of the internet.</p>	

**Recommendation 5** The committee recommends that the new Insolvency Practitioners Authority establish a licensing system for corporate insolvency practitioners similar to the system currently used by ITSA. Practitioners should be required to renew their license every three years.

The new regulator should have the power to suspend a practitioner's license if they are not adequately insured or if a matter referred to the CALDB is of sufficient concern as to warrant suspension.

**Recommendation 6** The committee recommends that as part of the licensing and re-licensing processes, all corporate insolvency practitioners are required to pay a licensing fee.

**Recommendation 7** The committee recommends that it be a condition of a practitioner's first license renewal (ie: after three years of registration) that he or she has completed the IPAA's Insolvency Education Program.

**Recommendation 8** The committee recommends that the new Australian Insolvency Practitioners Authority set and administer a 'closed book' written examination. The passing of this examination should be a pre-requisite for gaining a license as a corporate insolvency practitioner.

**Recommendation 9** The committee recommends that the new Australian Insolvency Practitioners Authority convene an eight person advisory panel to devise a written examination. The panel should be chaired by the Chairman of the Authority and should also include:

- a representative from the Institute of Chartered Accountants of Australia;
- a representative from the Insolvency Practitioners Association (IPAA);
- an insolvency practitioner nominated by the IPAA;
- two academic experts on insolvency law chosen by the Authority;
- a person nominated by the Australian Bankers' Association;
- a person nominated by the Council of Small Business Organisations of Australia; and
- a person nominated by a consumer advocacy group.

**Recommendation 10** The committee recommends that the new insolvency regulator work with the insurance industry to ensure that insurance companies notify the regulator if a practitioner's insurance lapses or expires. In these cases, the regulator should contact the practitioner immediately and allow the practitioner 14 days to acquire the policy. If this is not done, the regulator must suspend the practitioner's license.

The regulator should sight the insurance documents of practitioners as part of its 'flying squad' activities.

**Recommendation 11** The committee recommends that the *Corporations Act 2001* be amended to impose a penalty on registered insolvency practitioners who operate without PI insurance.

**Recommendation 12** The committee recommends that the major accountancy bodies—the Institute of Chartered Accountants of Australia, CPA Australia and the National Institute of Accountants—establish a fidelity fund to ensure that creditors are insured for fraud and wrongdoing.

**Recommendation 13** The committee recommends that section 1282(2)(a)(i) of the Corporations Act is amended to read:

...is an Australian Legal Practitioner holding a current practising certificate with at least five years' post admission experience as a practising commercial lawyer;

and / or

...holds a Masters of Business Administration with at least five years' commercial experience.

**Recommendation 14** The committee recommends that as part of the proposed licensing system, the insolvency regulator can suspend a liquidator's license if they believe overcharging has occurred.



**Recommendation 15** The committee recommends that section 503 of the *Corporations Act 2001* be amended to insert the following provision:

For purposes of this section, cause shown includes:

- (a) A vote of no confidence by a majority of creditors;
- (b) Where it appears time based charging of the incumbent liquidator has not or will not result in a reasonable cost-benefit analysis for the company.

**Recommendation 16** The committee recommends that the new insolvency regulator work with the IPAA and the Institute of Chartered Accountants to ensure that insolvency practitioners comply with the remuneration report template set out in the IPAA Code of Professional Practice.

**Recommendation 17** The committee recommends that within the new Insolvency Practitioners Authority, there is a unit established that is responsible for gathering, collating and analysing data on a range of corporate and personal insolvency matters. The data must be made publicly available in the Authority's Annual Report and online. There should be no charge for accessing these data.

# **Options paper: a modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia**

Australian Government

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## FOREWORD

We are pleased to release this paper canvassing options for improving the regulation of both the corporate and personal insolvency professions.



The release of this paper follows last year's Senate Economics References Committee inquiry into *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*. The inquiry was established in response to concerns raised about the

effectiveness and timeliness of the operation of the regulatory regime for corporate insolvency.

Australia maintains separate corporate and personal insolvency regimes. The Senate Committee's report raised a number of concerns about the differences in personal and corporate insolvency regulation. These differences reflect the reality that a one-size-fits-all approach to insolvency is not appropriate and will not deliver suitably tailored outcomes for both companies and individuals. There are, however, benefits to be gained from removing unnecessary divergence between the two regimes, including reducing legal complexity, risk, and costs for insolvency practitioners, creditors, shareholders, regulators and other stakeholders. This paper canvasses the possibility of significant coordinated amendments to both the *Corporations Act 2001* and the *Bankruptcy Act 1966*.

This paper is released by us jointly and is the product of work by both of our Departments, as well as the Insolvency Trustee Service Australia and the Australian Securities and Investments Commission. It reflects a commitment to exploring holistic and coordinated solutions to common problems facing both corporate and personal insolvency regulation.

Effective insolvency frameworks are essential if financial distress is to be addressed in a manner that minimises negative outcomes for creditors, debtors, consumers and employees. Effective regimes save businesses that can be saved. They enable individuals and businesses to deal with otherwise insurmountable financial difficulties and to move forward. Both personal and corporate insolvency have a real impact on the level and nature of economic activity taking place within the economy. Effective insolvency frameworks have the potential to reduce the costs of insolvency administrations, to improve recovery rates and minimise the losses experienced by credit providers. This leads to a positive impact on the cost and availability of credit to business and consumers.

A skilled, honest and accountable insolvency profession is vital for the efficient operation of the insolvency regime. Poor performance through negligence or misconduct can have a significant impact on stakeholders, including those insolvency professionals that are performing effectively. The regulatory framework should promote just and fair outcomes. In part, this is achieved through minimising the risk of harm to stakeholders through the timely removal of practitioners who do not meet the necessary professional standards. It is essential that debtors and creditors have confidence in the insolvency system. Misconduct by even a small minority of operators can adversely impact on the level of confidence in the profession.

This paper examines reforms with a view to address possible misconduct in the insolvency profession and to improve the value for money for recipients of insolvency services. It is directed towards doing so by ensuring that the framework for insolvency practitioners:

- promotes a high level of professionalism and competence by practitioners;
- promotes market competition on price and quality;
- promotes increased efficiency in insolvency administration; and
- enhances communication and transparency between stakeholders.

We invite you to submit your views on the issues raised in this paper.

The Hon David Bradbury MP  
Parliamentary Secretary to the Treasurer

The Hon Robert McClelland MP  
Attorney-General



# CONTENTS

<b>FOREWORD .....</b>	<b>I</b>
<b>OPTIONS PAPER .....</b>	<b>IV</b>
<b>GLOSSARY .....</b>	<b>V</b>
<b>PURPOSE OF OPTIONS PAPER.....</b>	<b>1</b>
<b>STANDARDS FOR ENTRY INTO THE INSOLVENCY PROFESSION.....</b>	<b>7</b>
<b>REGISTRATION PROCESS FOR INSOLVENCY PRACTITIONERS .....</b>	<b>15</b>
<b>REMUNERATION FRAMEWORK FOR INSOLVENCY PRACTITIONERS.....</b>	<b>25</b>
<b>COMMUNICATION AND MONITORING .....</b>	<b>38</b>
<b>FUNDS HANDLING AND RECORD KEEPING .....</b>	<b>49</b>
<b>INSURANCE REQUIREMENTS FOR INSOLVENCY PRACTITIONERS .....</b>	<b>61</b>
<b>DISCIPLINE AND DEREGISTRATION OF INSOLVENCY PRACTITIONERS .....</b>	<b>66</b>
<b>REMOVAL AND REPLACEMENT OF INSOLVENCY PRACTITIONERS.....</b>	<b>80</b>
<b>REGULATOR POWERS .....</b>	<b>89</b>
<b>SPECIFIC ISSUES FOR SMALL BUSINESS .....</b>	<b>100</b>
<b>2010 CORPORATE INSOLVENCY REFORM PACKAGE.....</b>	<b>107</b>
<b>APPENDIX ONE: COMPARISON OF CORPORATE AND PERSONAL INSOLVENCY DISCIPLINARY FRAMEWORKS.....</b>	<b>111</b>

## OPTIONS PAPER

### REQUEST FOR FEEDBACK AND COMMENTS

All submissions received will be treated as public documents unless the author of the submission clearly indicates the contrary by marking all or part of the submission as 'confidential' prior to the submission being lodged. Public submissions may be published in full on the Treasury website, including any personal information of authors and/or other third parties contained in the submission. If your submission contains the personal information of any third party individuals, please indicate on the cover of your submission if they have not consented to the publication of their information.

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## GLOSSARY

<b>AAT</b>	the Administrative Appeals Tribunal
<b>ASIC</b>	the Australian Securities and Investments Commission
<b>ASIC Act</b>	<i>Australian Securities and Investments Commission Act 2001</i>
<b>ASIC Regulations</b>	<i>Australian Securities and Investments Commission Regulations 2001</i>
<b>bankruptcy</b>	refers to the personal insolvency liquidation proceedings only
<b>Bankruptcy Act</b>	<i>Bankruptcy Act 1966</i>
<b>Bankruptcy Regulations</b>	<i>Bankruptcy Regulations 1996</i>
<b>CALDB</b>	Companies Auditors and Liquidators Disciplinary Board
<b>COI</b>	committee of inspection or committee of creditors
<b>Controlling Trustee</b>	if a debtor wishes to propose a personal insolvency agreement they must first appoint a controlling trustee under section 188 of the Bankruptcy Act. A controlling trustee investigates the debtor's affairs and convenes a meeting of their creditors
<b>Corporations Act</b>	<i>Corporations Act 2001</i>
<b>corporations legislation</b>	the Corporations Act, Corporations Regulations, ASIC Act, and ASIC Regulations
<b>Corporations Regulations</b>	<i>Corporations Regulations 2001</i>
<b>fiduciary duties</b>	<p>registered liquidators and registered trustees are required to comply not only with their statutory duties, but also with their fiduciary duties under the common law. At common law, a trustee must:</p> <ul style="list-style-type: none"> <li>• act justly, with a high duty of care, reasonable prudence and diligence, demonstrating competence of a high order, honesty, independence and impartiality to a standard that commands and retains the confidence of the Court, of the creditors, the bankrupt and the community;</li> <li>• have regard to the interests of the creditors, the bankrupt and the community;</li> <li>• not act in bad faith, arbitrarily, capriciously, wantonly, irresponsibly, mischievously or irrelevantly to any sensible expectation of the interests of the creditors or without giving a real or genuine consideration to the exercise of the discretion; and</li> <li>• not have, or appear to have, a conflict between the</li> </ul>



interests of the practitioner and his or her duty

<b>Harmer Report</b>	the <i>General Insolvency Inquiry</i> , Report Number 45, completed by the Australian Law Reform Commission, in 1988
<b>insolvency</b>	except where the context otherwise provides, both personal and corporate insolvency
<b>insolvency practitioner</b>	collective term for both registered liquidators and registered trustees
<b>ITSA</b>	the Insolvency and Trustee Service Australia
<b>Official Trustee</b>	Official Trustee in Bankruptcy. The Official Trustee operates as the Government trustee in bankruptcy. In practice it administers the vast majority of bankrupt estates (the remainder are administered by registered trustees)
<b>penalty unit</b>	A term measuring the amount of a fine that may be imposed upon conviction of an offence. Currently one penalty unit is \$110
<b>Personal Insolvency Agreement</b>	A personal insolvency agreement is a voluntary, statutory alternative to bankruptcy which is dealt with in Part X of the Bankruptcy Act
<b>PJC Report</b>	the <i>Corporate Insolvency Laws: A Stocktake</i> , completed by the Parliamentary Joint Committee on Corporations and Financial Services, in June 2004
<b>registered liquidator</b>	a natural person who is registered with ASIC to undertake the external administration of corporate entities
<b>registered trustee</b>	a registered trustee is a private practitioner who administers bankruptcies
<b>Senate Committee</b>	the Senate Economics References Committee
<b>Senate Committee Inquiry</b>	Inquiry initiated by the Senate Economics References Committee into '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'
<b>Senate Committee's report</b>	<i>The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework</i> , Senate Economics References Committee, September 2010
<b>TPC Report</b>	the <i>Trade Practices Commission: Study of the Professions</i> , completed by the Trade Practices Commission, in 1992
<b>Working Party Report</b>	the <i>Report of the Working Party to Review the Regulation of Corporate Insolvency Practitioners</i> completed in 1997

## PURPOSE OF OPTIONS PAPER

1. This paper seeks views from interested organisations and individuals in relation to options for the modernisation and alignment of the corporate and personal insolvency regulatory frameworks.
2. The regulation of corporate insolvency practitioners has been considered recently by the Senate Economics References Committee (the Senate Committee) in its investigation of 'the role of liquidators and administrators, their fees and their practices, and the involvement and activities of the Australian Securities and Investments Commission (ASIC), prior to and following the collapse of a business' (the Senate Committee Inquiry).
3. The Senate Committee's report, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, was released on 14 September 2010. The Senate Committee raised concerns about the conduct of the insolvency profession in Australia, including the adequacy of efforts to monitor, regulate and discipline misconduct. The Senate Committee made a number of recommendations in the areas of regulation, registration and remuneration of the insolvency profession in Australia.
4. The Senate Committee recommended that the corporate insolvency arm of ASIC be transferred to ITSA to form a new personal and corporate insolvency regulator.<sup>1</sup> The Government will not be accepting this recommendation.
5. The removal of insolvency from the responsibility of ASIC would remove substantial efficiencies. ASIC, as the corporate regulator, is responsible for enforcing the whole of Australia's corporate law. The removal of corporate insolvency from the corporate regulator would result in corporate insolvency losing its important connections with other parts of ASIC, for example in relation to major corporate administrations, regulation of insolvent trading and of director and corporate misconduct that may have been engaged in leading up to, or during, an insolvency event.
6. However, in light of the concerns raised in the course of the Senate Committee Inquiry, the Government has decided to review the current regulatory framework applying to insolvency professionals in Australia. This paper discusses options to improve the framework, including in areas not considered by the Senate Committee, such as funds handling, record keeping and communication with creditors.
7. The paper also asks questions about some of the recommendations of the Senate Committee in light of the decision not to merge the insolvency regulators into a new body and the pursuit of greater alignment between the corporate and personal insolvency regimes where appropriate.
8. The Senate Committee's report highlighted the current divergence between the regulatory systems for corporate and personal insolvency and expressed a desire for greater harmonisation of the two. It contained analysis and recommendations in respect of a number of specific regulatory issues.

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1 Recommendation 1 of the Senate Committee's report.



9. This paper provides a comprehensive consideration of the areas for reform identified by the Senate Committee, and a forum for public consideration of its recommendations. Responses to the paper will inform the Government's response to the recommendations of the Senate Committee's report.
10. The paper discusses the features of the current regulatory framework for corporate and personal insolvency practitioners and seeks views in relation to:
  - the registration and deregistration of insolvency practitioners, including what should be appropriate standards for entry into the profession;
  - the framework for effective monitoring of insolvency practitioners' actions by creditors, including the level of communication between creditors and insolvency practitioners;
  - insurance, record keeping, and funds handling rules;
  - the opportunities for court review of insolvency practitioners' actions and relevant remedies for affected parties;
  - the framework for discipline of breaches of the law by insolvency practitioners;
  - the removal and replacement of insolvency practitioners in respect of particular administrations; and
  - the appropriate role of the regulator in oversight of the market.
11. This paper seeks input on these issues in order to inform any potential amendment of the regulatory framework for both corporate and personal insolvency practitioners.

## BACKGROUND

12. Australia currently has separate personal and corporate insolvency systems. This includes separate laws,<sup>2</sup> regulators,<sup>3</sup> agencies responsible for policy development,<sup>4</sup> and ministerial responsibility.<sup>5</sup>
13. A corporate insolvency practitioner may be appointed to administer a company where the company is unable to pay its debts as and when they fall due. The role of the corporate insolvency practitioner is to ensure a fair, efficient and timely redistribution of the company's assets to the company's creditors or to facilitate the reorganisation and rehabilitation of the business in accordance with the legislative and regulatory framework outlined under the *Corporations Act 2001* (the *Corporations Act*).

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2 The laws relating to corporate insolvency are contained in the *Corporations Act 2001*, *Corporations Regulations 2001*, with supporting regulator related provisions in the *Australian Securities and Investments Commission Act 2001*, while the laws relating to personal insolvency are fully contained in the *Bankruptcy Act 1966* and the *Bankruptcy Regulations 1996*.

3 ASIC is the corporate insolvency regulator, while the Insolvency and Trustee Service Australia (ITSA) is the personal insolvency regulator.

4 The Treasury has responsibility for corporate insolvency policy. The Attorney-General's Department has responsibility for personal insolvency policy.

5 The Parliamentary Secretary to the Treasurer has responsibility for corporate insolvency. The Attorney-General has responsibility for personal insolvency.

14. Once registered with ASIC as a registered liquidator under the Corporations Act, a corporate insolvency practitioner can accept appointments: for the voluntary administration of a company; for the winding up of a company; to administer a scheme of compromise or arrangement or a deed of company arrangement; or as a receiver or controller over all or part of the assets of a company.
15. If a person wishes to accept appointments to court liquidations, provisional liquidations or to provide certain kinds of assistance to foreign practitioners in relation to cross-border insolvency matters, the person must be registered as an 'official liquidator' with ASIC. A person cannot apply to be registered as an official liquidator without first applying for and being registered as a registered liquidator.
16. A registered trustee may be appointed to administer the estate of an individual where either: a sequestration order has been made by the Court against the estate of the individual; or the individual has voluntarily presented a debtor's petition to enter into bankruptcy. They may also act as a controlling trustee or as a trustee of a personal insolvency agreement.
17. The regulation of debt agreement administrators will not be considered as part of this paper. The operation of the Official Trustee in Bankruptcy and Official Receiver will likewise not be considered as part of any potential reforms arising from this paper.
18. Insolvency practitioners in both personal and corporate insolvency also play a role in investigating the reasons for the insolvency of the individual or company, as well as in the recovery of assets distributed through transactions completed before the commencement of the external administration or bankruptcy.
19. Both corporate and personal insolvency practitioners are bound by the common law, as well as statutory duties.<sup>6</sup>

## PREVIOUS REVIEWS

20. The regulation of insolvency practitioners, particularly corporate insolvency practitioners, has been the subject of a number of reviews in the past two decades, including:
  - the *General Insolvency Inquiry*, Report Number 45, completed by the Australian Law Reform Commission, in 1988 (the Harmer Report);
  - the *Trade Practices Commission: Study of the Professions*, completed by the Trade Practices Commission, in 1992 (the TPC Report);
  - the *Report of the Working Party to Review the Regulation of Corporate Insolvency Practitioners* completed in 1997 (the Working Party Report);
  - the *Corporate Insolvency Laws: A Stocktake*, completed by the Parliamentary Joint Committee on Corporations and Financial Services, in June 2004 (the PJC Report);

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<sup>6</sup> While the fiduciary duties of insolvency practitioners are recognised, see the Glossary, this paper focuses on the liquidators' statutory obligations.

- the *Rehabilitating large and complex enterprises in financial difficulties* report, completed by the Corporations and Markets Advisory Committee (CAMAC) in October 2004;
- the *Issues in external administration* report, completed by CAMAC in November 2008;
- the Senate Committee report; and
- the *Annual Review of Regulatory Burdens on Business* completed by the Productivity Commission released, on 12 October 2010.

## **GOALS OF INSOLVENCY REFORM**

21. The insolvency system has a significant effect on both the level and nature of business activity taking place within an economy.
22. Through its effect on the prospects and cost of recovering capital provided to businesses that have failed, it is a strong determinant of the level of access to and cost of credit in an economy. Therefore, the insolvency system has a direct and substantial impact upon the level of investment and wealth creation in the economy. Insolvency systems also influence the types of credit provided, and have some influence on the types of investment and business activities that are undertaken.
23. The options in this paper aim to inform the development of future reforms that will ensure the maintenance of public confidence in the insolvency regime and the profession responsible for conducting insolvencies.
24. The regulatory frameworks for insolvency practitioners should promote:
  - consistency for practitioners and other stakeholders operating in both the personal and corporate insolvency industries.
  - increased efficiency in insolvency administration.
  - enhanced communications with stakeholders.
  - market competition on price and quality.
  - a high level of professionalism and competence.
25. An important objective of this paper is to determine whether it is appropriate that an aligned set of provisions be adopted for both the corporate and personal insolvency regimes.

## **Consistency of personal and corporate insolvency systems**

26. Enhancing alignment of Australia's personal and corporate insolvency laws would reduce legal complexity, risk and duplication for insolvency practitioners, creditors, shareholders, regulators and other stakeholders. There is an argument that personal and corporate insolvency laws should differ only where specific corporate or personal insolvency policy considerations outweigh the benefits of alignment.



27. The benefits that may flow from alignment include: increased stakeholder certainty and understanding of their rights and obligations; improvements in insolvency administration service quality and cost; reductions in stakeholder participation costs leading to increased stakeholder participation; improvements in the quality, and reduction in the cost, of regulation of both groups of professionals; and, minimisation of market distortions arising from unjustified divergence.

### **Improving communications with stakeholders**

28. Information asymmetry interferes with the efficiency of the insolvency market and the provision of services to individual external administrations, and contributes to the risk of misconduct by insolvency practitioners. Barriers to creditors obtaining information may perpetuate the 'principal-agent problem' inherent in a practitioner's provision of insolvency services. However, it must be recognised that there may be legitimate reasons for restricting access to some information by stakeholders.
29. Consideration should be given to whether reforms might be put in place that improve access to information by those with an interest in the conduct of insolvency processes, in order to: reduce the uncertainty of expected outcomes arising from insolvency processes; improve stakeholders' ability to assess and compare the value of insolvency services; and improve stakeholders' ability and opportunity to protect their own interests effectively.

### **Increasing efficiency in insolvency administration**

30. Efficiency increases in individual external administrations and personal bankruptcies can be expected to lead to increased returns to creditors, which in turn can be expected to improve the cost and provision of capital and credit in an economy.
31. Insolvency reform should focus on improving the effectiveness of the insolvency framework in supporting these objectives, in order to: reduce the costs involved in external administrations and personal bankruptcies; facilitate appropriate business reorganisations; minimise external effects on the availability or cost of credit to businesses and consumers; and support the efficient reallocation of resources to maximise their most productive uses and minimise market distortions.

### **Promoting market competition on price and quality**

32. The need for the regulation of the insolvency profession to maintain a high standard of professional competence and integrity, as well as competition in the market for insolvency services, may place downward pressure on the price of the service, upward pressure on quality and may promote innovation.
33. Mechanisms governing the selection and removal of insolvency practitioners in a particular external administration also play an important role in promoting competition between insolvency practitioners. The evidence before the recent Senate Committee Inquiry highlighted possible limitations to the powers of creditors to exert appropriate control in relation to the appointment and removal of registered liquidators.
34. By providing creditors with increased powers to affect who will be responsible for the external administration of a company or personal estate from which they are owed



debts, and under what conditions that person will be engaged, insolvency practitioners might be expected to better align their interests with those of the creditors.

### **Strengthening regulatory frameworks**

35. Regulation that promotes a high level of professionalism and competition of insolvency practitioners is essential to retaining confidence in the insolvency system. There are substantial knowledge gaps which are characteristic of the nature of the administration of an insolvency which makes it difficult to externally assess the performance of an insolvency professional.
36. As specialist insolvency administration services, like most professional services, fall into the category of 'credence' goods, consumers are often unable to judge the quality of the service, even after completion. Stakeholders therefore face a number of significant issues when choosing providers, negotiating and setting fees and assessing whether they have received value for money following the provision of those services.
37. Creditors and other stakeholders often lack the knowledge and skills to understand properly the full nature of the 'product' that is being offered by insolvency practitioners, sometimes occasioned by a high level of technical complexity involved in some insolvency administration services.
38. Further, insolvency practitioners provide a highly heterogeneous service and administration may deal with a range of potential subject matters. The tasks performed can often be non-repetitive and atypical. Service standardisation is often impossible or at least inadvisable.
39. Access to information may also be effectively restricted due to the costs to creditors of obtaining that information or the costs to the insolvency practitioners, the estate or other stakeholders of providing that information. If insufficient information is available to creditors or other stakeholders, they may be unable to assess the service (proposed or completed) accurately.
40. As creditors and stakeholders are often unable to tell how the overall result of a liquidation or administration corresponded to the quality of the service provided by the insolvency practitioner, the consumer must be able to trust the insolvency practitioner's advice and reputation. Regulation that promotes a high level of professionalism and competence of insolvency practitioners is therefore essential to retaining confidence in the insolvency system as a whole.<sup>7</sup>

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<sup>7</sup> *Competition in Professional Services*, Organisation for Economic Co-operation and Development, Directorate for Financial, Fiscal and Enterprise Affairs, Committee on Competition Law and Policy, 2000, 2.



# STANDARDS FOR ENTRY INTO THE INSOLVENCY PROFESSION

## FOCUS OF CHAPTER

This chapter seeks comments on options to amend the statutory standards for entry into the corporate and personal insolvency professions. It is important that the requisite skills and knowledge appropriately balance the need to protect consumers by maintaining the high standards of the insolvency profession with the need for a competitive market that provides the best opportunity for maximising returns to creditors.

The entry standards reflect a historical link between accounting professionals and insolvency services that may no longer be appropriate and necessary for the protection of consumers, but which may have a negative effect on the entry of appropriately skilled professionals. Further, there is a divergence in the standards for entry for corporate and personal insolvency professionals that could limit the ability of professionals to work in both systems.

In addition to the divergence in the requirements for entry, there is also a divergence in the flexibility of the separate regulators to promote greater competition while protecting the integrity of the market through the imposition of conditions on new insolvency practitioners entering the market.

This chapter seeks views on whether the current standards of entry are appropriate, whether there should be consistency across the personal and corporate insolvency systems, and whether the regulators should be given more powers to impose conditions on entry.

## CURRENT LAW

### Corporate

41. A person may apply for, and enter, the corporate insolvency market as a provider of external administration services if they meet the requirements set out in Part 9.2 of the Corporations Act. ASIC must grant the registration if, and only if, the applicant:
- (a) holds a tertiary qualification and has passed examinations in such subjects which represent a course of study in accountancy of not less than three years duration and in commercial law (including company law) of not less than two years duration, or has other qualifications and experience that, in the opinion of ASIC, are equivalent to these; and
  - (b) satisfies ASIC as to the experience of the applicant in connection with externally administered bodies corporate; and
  - (c) satisfies ASIC that the applicant is capable of performing the duties of a liquidator and is otherwise a fit and proper person to be registered as a liquidator (that is, meets the fit and proper test).<sup>8</sup>

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8 Section 1282 of the Corporations Act.



42. ASIC interprets the tertiary qualification requirements as being met by studies undertaken on a concurrent basis, so that the requirements can be met through a standard three year commerce degree depending upon the course content.
43. In respect of the experience and capability requirements, ASIC has issued *Regulatory Guide 186 External administration: Liquidator registration* (RG 186) which sets out:
- ASIC's approach to the criteria contained in the Corporations Act that a person must meet to become a registered liquidator;
  - ASIC's approach to what a person must do to remain as a registered liquidator; and
  - the circumstances in which ASIC will register a person as an official liquidator or a liquidator of a specified body corporate.
44. ASIC will not register a liquidator unless they are satisfied with the applicant's corporate insolvency experience and practice capacities, including that the practitioner has worked in corporate insolvency for at least the equivalent of five years full-time over the last 10 years.<sup>9</sup>
45. ASIC must refuse an application for registration as a liquidator if the applicant is disqualified from managing corporations under the Corporations Act, and may (at its discretion) refuse registration if the person is not a resident in Australia. A person cannot be refused registration by ASIC unless they have been given an opportunity to make representations to ASIC in support of their application.<sup>10</sup>
46. ASIC does not have any power to impose conditions of entry on a registered liquidator. This contrasts with its powers regarding auditors, and the powers open to ITSA under the Bankruptcy Act. For example, ITSA may choose to place restrictions on the type of matters a trustee may administer or require the trustee to undertake a specialised course of professional training.
47. If a registered liquidator wishes to be able to accept appointments for court-ordered liquidations, provisional liquidations or certain cross-border insolvency matters, they must be registered as an 'official liquidator' with ASIC. A person cannot register as an official liquidator without registering first as a registered liquidator.<sup>11</sup>
48. A registered liquidator can request registration as an official liquidator by providing ASIC with a written request. Regulatory Guide 186 sets out ASIC's requirements in respect of such a request. These include:
- (a) the reasons why the liquidator wants to register as an official liquidator;
  - (b) the names of the registered liquidators and official liquidators that the applicant has worked with in the last five years;
  - (c) an undertaking to ASIC that, if the applicant is registered as an official liquidator, he or she will not refuse to act as liquidator in a Court winding up solely because

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9 RG 186.19.

10 Subsections 1282(4)-(5), and (10) of the Corporations Act.

11 Section 1283 of the Corporation Act.



the company has no assets or otherwise may not have sufficient funds to cover the anticipated professional costs of the liquidation;

- (d) an acknowledgement that an official liquidator is an officer of the Court, and as a result, has special responsibilities in connection with the winding up of a company when appointed by the Court; and
- (e) payment of the prescribed fee of \$330.<sup>12</sup>

## Personal

- 49. The tertiary education and experience requirements for a registered trustee generally mirror those for a corporate insolvency practitioner,<sup>13</sup> with registered trustees also required to have successfully completed three years of accounting studies and two years of commercial legal studies.
- 50. The tertiary education requirements are also interpreted by ITSA to allow for the three years of accounting and two years of commercial law to be studied on a concurrent basis as part of a standard three year degree.
- 51. In terms of insolvency experience, registered trustees are required to have engaged in relevant employment on a full-time basis for a total of not less than two years in the preceding five years.<sup>14</sup>
- 52. An applicant must have the ability to perform satisfactorily the duties of a registered trustee immediately after registration. However, if the Committee decides that the applicant should be registered, it may decide that specific conditions should apply to the applicant's practice as a registered trustee. Conditions may be varied or removed at a later time by the Committee and the decisions of the Committee are reviewable by the AAT.<sup>15</sup>
- 53. The Committee is granted a discretion to decide in favour of registration if it considers the applicant is suitable even if the Committee is not satisfied that the applicant has the qualifications, experience, knowledge and abilities prescribed by the regulations.<sup>16</sup> For example, an applicant may demonstrate that they are suitable for unconditional registration as a bankruptcy trustee but for failing to possess sufficient experience in respect of controlling trusteeships and personal insolvency agreement. A Committee could recommend registration subject to restrictions upon performing those kinds of administration (such as requiring joint appointments with another trustee), at least for a specified number of appointments.
- 54. In contrast to the requirements for liquidators, there is no general fit and proper person test for registered trustees. Rather, the Bankruptcy Act provides that the applicant cannot be registered as a trustee if they have:
  - been convicted, within 10 years before making the application, of an offence involving fraud or dishonesty;

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12 Section 1283 of the Corporations Act; RG 186.138-139; RG 186.144-153; Corporations (Fees) Regulations 2001.

13 Regulation 8.01 of the Bankruptcy Regulations.

14 Regulation 8.02 of the Bankruptcy Regulations.

15 Subsection 155A (5), sections 155E and 155F of the Bankruptcy Act.

16 Subsection 155A (3) of the Bankruptcy Act.



- been a bankrupt or a party (as debtor) to a debt agreement or Part X administration within 10 years before making the application; or
  - had their registration as a trustee or debt agreement administrator cancelled within 10 years before making the application on certain grounds.<sup>17</sup>
55. There is no equivalent additional level of registration to that of an official liquidator. Registered trustees are eligible for appointment to Part IV (bankruptcies), Part XI (bankruptcies of estates of deceased persons) and Part X (personal insolvency agreement) administrations. Registered trustees are also able to administer Part IX administrations (debt agreements).

## CURRENT ISSUES

### Entry levels for quality practitioners

56. Submissions to the Senate Committee Inquiry raised concerns about the sufficiency of skills and knowledge held by some corporate insolvency practitioners. Ensuring that insolvency practitioners have the appropriate skills and knowledge improves the efficiency and credibility of the corporate and personal insolvency frameworks.
57. It is also important to ensure that the requisite skills and knowledge take into account the effect on competition. Ensuring that all suitably qualified people can enter the market means that there is more competition in the provision of quality services and fees will be lower.
58. The level of competition in the market for insolvency services has been considered by all major reviews of the industry in the past two decades. The Working Party established to review the regulation of corporate insolvency in 1997<sup>18</sup> considered that there was scope to broaden the entry requirements to allow persons in from outside the accounting profession without adversely effecting standards. In relation to what qualifications a liquidator must have, the Working Party stated that it had 'sympathy' for the view that while a registered liquidator needed to have both skills in commercial law and accountancy, it was not necessary for a liquidator to have tertiary qualifications in both areas. They noted that a liquidator could seek expert advice on both legal and accounting issues that arose in an administration.
59. In light of these concerns, the Senate Committee recommended that subparagraph 1282(2)(a)(i) of the Corporations Act be amended to read:
- '... is an Australian Legal Practitioner holding a current practising certificate with at least five years' post admission experience as a practising commercial lawyer; and / or ... holds a Masters of Business Administration (MBA) with at least five years' commercial experience.'<sup>19</sup>
60. In its 2004 report, *Corporate Insolvency Laws: A Stocktake*, the Parliamentary Joint Committee on Corporations and Financial Services recommended that the criteria for registration as a registered liquidator be broadened to recognise qualifications in other areas, including legal practice, and to abolish the dual classification of official and registered liquidators, on the basis that such changes have the potential to encourage

17 Subsection 155A (4) of the Bankruptcy Act.

18 *Review of the regulation of corporate insolvency practitioners: Report of the Working Party*, June 1997.

19 Recommendation 13 of the Senate Committee's Report.



greater competition in the provision of insolvency services and reduce the costs of external administrations.

61. The Corporations Act and Bankruptcy Act already provide both ASIC and ITSA with a discretion to register a practitioner who does not meet the prescribed qualifications and/or experience requirements. Nonetheless, consideration might again be given to whether there would be any benefit to setting out more clearly in the legislation alternatives to the current academic requirements.
62. The current tertiary education requirements for both registered liquidators and registered trustees are stated in the respective statutes as being three years of accounting and two years of commercial law. While both ITSA and ASIC interpret this requirement as being met by concurrent study, consideration might be given to whether the legislation might be amended to clarify this requirement.
63. The absence of clarity in the legislation may have the effect of potential entrants to the market not even considering whether they may be suitable.

## **Conditions on registration**

64. Currently, ASIC is not able to impose conditions, such as in respect of continuing education requirements, on the registration of liquidators. This is in contrast to ASIC's ability to impose conditions on the registration of auditors,<sup>20</sup> and in contrast to the ability of the bankruptcy regulator to impose conditions on the registration of registered trustees. This has the effect of diminishing the flexibility that ASIC has to deal with potential entrants to the profession. Applicants with minor remediable deficiencies cannot be registered with restrictions conditional upon them addressing those deficiencies.

## **REFORM OPTIONS**

### **Option One: maintain the current standards for entry**

65. The current standards for entry for registered liquidators and registered trustees could be maintained with minor amendments to the Corporations Act and Bankruptcy Act to clarify the current statutory tertiary experience requirements. The Corporations Act and Bankruptcy Act could therefore be amended to indicate that the requirement for three years accounting experience and two years commercial law experience can be satisfied through concurrent study.

### **Option Two: expand the scope for insolvency entrants**

66. While it has been recognised in each major report into the insolvency system that accounting skills are essential for insolvency practitioners, it has likewise been recognised that there does not appear to be any need to elevate formal accounting training above legal or business-related training.
67. The Bankruptcy Act and Corporations Act could therefore be amended to remove the discrimination in favour of accounting at the expense of legal studies. That is, the

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20 Under section 1289A of the Corporations Act and regulation 9.2.08 of the Corporations Regulations, ASIC may place conditions on the registration of an auditor relating to education, periodic reviews of work, insurance, or complaint handling systems.



statutory academic prerequisites for registration would be met by study of three years of accounting and two years of commercial law or vice versa.

68. In order to supplement legal and accounting skills, it may be appropriate to require potential entrants to have also completed at least one year of insolvency specific courses. This is currently required for full membership of the IPA and can be taken into account by ASIC as a factor in determining the suitability of an applicant for registration as a liquidator.<sup>21</sup>
69. The Corporations Act and the Bankruptcy Act could be amended to implement Recommendation 13 of the Senate Committee's report that a person should also be eligible for registration as a liquidator if the person:

'... is an Australian Legal Practitioner holding a current practising certificate with at least five years' post admission experience as a practising commercial lawyer;

and / or

... holds a Masters of Business Administration with at least five years commercial experience.'

70. These requirements would not provide for a minimum level of accounting education (or in the case of a person holding an MBA, a minimum level of legal education). These requirements would also not require any minimum level of experience in performing insolvency administration tasks.

### Option Three: alignment of standards for entry

#### Entry levels

71. The current divergence in experience requirements for registered trustees and registered liquidators means that corporate insolvency practitioners may be required to be engaged in relevant experience for three years longer than registered trustees before registration. The Corporations Act could therefore be amended to reduce the requirements for registration as a liquidator to two years of full-time experience in the previous five years, consistent with the current requirements for personal insolvency practitioners.
72. The PJC in its 2004 report *Insolvency Laws: A Stocktake* reviewed the skills required of an insolvency practitioner<sup>22</sup> and (agreeing with the conclusion of the 1997 Working Party report) determined that:

'The Committee strongly endorses the heavy emphasis that ASIC places on practical experience in external administration, especially managerial skills, as a prerequisite for registration as a liquidator and recommends that it should not be weakened. It does, however, recommend that the criteria for registration as an insolvency practitioner be broadened to recognise qualifications in other relevant disciplines including legal practice.'<sup>23</sup>

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21 RG 186.18.

22 At paragraphs 3.78 to 3.95 of the Working Party Report.

23 At paragraph 3.96 of the Working Party Report.

73. The possible effect on the quality of market entrants of any reduction in entry requirements might be offset in personal insolvency by the existing requirement for a Committee to consider the appropriateness of an entrant. A method to achieve similar balance for corporate insolvency practitioners could be through the adoption of a committee system. Another method could include the ability to impose conditions on registration as raised above.
74. The Working Party stated in its Report in 1997 that:
- ‘due to the similarities involved, practice as a registered trustee in bankruptcy, or working directly under the supervision of a registered trustee on business related personal insolvency matters should count toward the experience requirements for registration as a corporate insolvency practitioner, provided that this experience is accompanied by work under the supervision of a registered liquidator.’
75. It is arguable that this observation remains relevant today and that the experience gained by registered trustees should be applicable to the requirements for registration as a registered liquidator and vice versa. While the Working Party favoured the registering body retaining the power to determine what weighting should be given to that experience, there is no evidence that providing the regulators with such a broad discretion has led to movement between the two professions. In order to enhance transparency around the value of such experience, while recognising that the knowledge and competencies gained in one regime will not directly translate to the other:
- the statutory requirements for registration of a liquidator could be amended to allow a registered trustee to qualify for registration as a liquidator where the applicant has at least the equivalent of one year full-time corporate insolvency experience in the last three years and has completed at least one year of corporate insolvency specific courses; and
  - the statutory requirements for registration of a registered trustee could be amended to allow a registered liquidator to qualify for registration as a registered trustee where the applicant has at least the equivalent of one year full-time personal insolvency experience in the last three years and has completed at least one year of personal insolvency specific courses.

### **Conditions on entry**

76. If the entry requirements for registration of a liquidator or registered trustee are amended in the manner considered above, it may be appropriate to amend the Corporations Act to provide ASIC with a power to impose conditions on new entrants where necessary. A Committee that considers an application from a person to become a registered trustee already has the power to decide that an individual should be conditionally registered.
77. Conditions may be applied either to reflect apparent deficiencies or to reflect the fact that the person is a new practitioner.
78. The imposition of conditions may however require further resourcing for ASIC as a result of the ongoing monitoring and compliance activities that would be required to ensure that registered liquidators only act within any imposed conditions.

79. ASIC may be empowered to impose conditions on their own initiative or at the request of the applicant. ASIC might be required to give a registered liquidator an opportunity to appear at a private hearing, and make submissions, where it proposes to impose additional conditions or vary the conditions after registration. Possible examples of conditions on entrants could include:
- restrictions on the size (including corporate structure, for example public, ASX listed, private, managed investment scheme) and type of appointments that a new registered liquidator could undertake for a period of time;
  - a requirement that a person be joint and severally appointed to external administrations with another liquidator (with adequate experience) during his or her first two years of registration;
  - a requirement that an independent practitioner provide ASIC with regular reviews of the new liquidator's performance on selected external administrations over a prescribed period; or
  - the imposition of minimum training and professional development requirements to provide some assurance of maintenance of sufficient technical knowledge.

## DISCUSSION QUESTIONS

80. Are there any concerns with changing the academic requirements to remove the greater emphasis placed upon accounting skills over legal skills, while retaining a minimum level of study in each?
81. Should the gaining of a Masters in Business Administration meet the qualification requirements for registration, if it did not otherwise meet legal and accounting study requirements?
82. Should a minimum level of actual experience in insolvency administration remain a mandatory requirement for registration as a practitioner?
83. Should the experience requirements for registered liquidators be reduced to two years of full-time experience in five years?
84. Should new market entrants be required to complete some form of insolvency specific education before practicing as registered liquidators or registered trustees?
85. Should ASIC be empowered to impose requirements on a registered liquidator as a condition of the registration? What types of conditions should a regulator be empowered to impose upon a new registered liquidator's registration?
86. Should a registered trustee face more streamlined entry requirements than those that exist for a standard applicant for registration as a registered liquidator, and vice versa?
87. Is further formal training necessary to ensure that practitioners that wish to transition between the two professions are able to fulfil their statutory obligations?



# REGISTRATION PROCESS FOR INSOLVENCY PRACTITIONERS

## FOCUS OF CHAPTER

This chapter seeks comments on options to amend the framework for the registration of corporate and personal insolvency practitioners.

The statutory registration processes for insolvency practitioners regulate the opportunities that ASIC and ITSA have to determine who enters into the market for the provision of corporate and personal insolvency services respectively.

The framework for the registration of corporate and personal insolvency practitioners currently diverges significantly. The divergence extends to whether an application for registration is to be made on the basis of an interview and paper application, or a paper application alone; what role the insolvency profession has in the determination of the application; and whether an applicant might be required to sit an examination.

This chapter seeks views on whether an examination or an interview process is necessary, whether the class of official liquidator is needed, whether there should be other classes of insolvency practitioners and whether the period of registration needs to be changed.

## CURRENT LAW

### Corporate

88. A person must apply to be registered with ASIC as a 'registered liquidator' if he or she wishes to act as a liquidator, receiver, receiver and manager, voluntary administrator, deed administrator of a company, or administrator of a scheme of compromise or arrangement. The Corporations Act also provides for a person to be registered as a liquidator only in respect of a specified body corporate.<sup>24</sup>
89. Once registered as a liquidator, a practitioner remains registered until the registration is cancelled or the person dies.<sup>25</sup>
90. The provisions governing the registration of liquidators are contained in Part 9.2 of the Corporations Act. ASIC has issued a regulatory guide – *Regulatory Guide 186: External administration: Liquidator registration* to explain the requirements an applicant must meet to become, as well as the ongoing obligations to remain, a registered liquidator or official liquidator.
91. Currently, ASIC must register a liquidator if, and only if, the applicant: meets the prescribed tertiary qualifications and experience requirements; is able to satisfy ASIC that he or she is capable of performing the duties of a liquidator and is otherwise a fit

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24 Section 1279 and subsection 1282(3) of the Corporations Act.

25 Subsection 1282(8) of the Corporations Act.



and proper person to be registered; is not disqualified from managing a corporation under Part 2D.6 of the Corporations Act; and is resident in Australia.<sup>26</sup>

92. An application for registration as a registered liquidator is made when an applicant lodges a copy of ASIC Form 903B with the regulator and pays the prescribed fee of \$330.<sup>27</sup> The application for registration is usually considered on the papers, although ASIC will, at its discretion, follow up with the referees included in the application, relevant professional bodies, or ITSA to discuss the applicant.<sup>28</sup> ASIC may also conduct an interview or examination; but this is neither required nor ordinary practice.
93. If the application is accepted for lodgement, ASIC will publish a statement on its website that it has received an application from the applicant for registration as a liquidator, and ask for any comments or objections to the registration of that person to be made to it within 14 days. If ASIC proposes to refuse an application for registration, it must give the applicant the opportunity to appear at a hearing on the matter.<sup>29</sup>
94. If a person wishes to accept appointments to court liquidations, provisional liquidations or certain cross-border insolvency matters,<sup>30</sup> the person must apply to be registered as an 'official liquidator' with ASIC. A person cannot be registered as an official liquidator without first being registered as a registered liquidator.<sup>31</sup>

## Personal

95. The Bankruptcy Act provides that a paper application for registration as a registered trustee is made to the Inspector-General in Bankruptcy (the Inspector-General) with the prescribed application fee of \$2,000, but that the application is then assessed by a committee convened for that purpose.<sup>32</sup> The committee must consist of the Inspector-General (or delegate); an APS employee (ordinarily a senior officer from within the Attorney-General's Department); and a registered trustee (registered for at least five years) chosen by the Insolvency Practitioners' Association of Australia (IPA) (the Committee).
96. The Committee is responsible for deciding whether to register an applicant. If the Committee recommends registration of the trustee, the Inspector-General must accept the decision of the Committee and register the trustee. The assessment must include an interview and may require sitting an examination. Each of these requirements for registration as a registered trustee has a statutory basis.
97. The Bankruptcy Act requires that an applicant must be registered if the Committee is satisfied that the applicant: holds the prescribed tertiary qualifications; meets the prescribed experience requirements; has the prescribed knowledge and abilities; has not been convicted for specific offences or been subjected to personal insolvency

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26 Subsections 1282(2) and (4)-(5) of the Corporations Act.

27 Item 3 to the table in Schedule 1 of the *Corporations (Fees) Regulations 2001*.

28 ASIC Information Statement 34 *How to apply for registration as a liquidator*.

29 Subsection 1282(10) of the Corporations Act.

30 Under Regulation 15A.5 of the Federal Court (Corporations) Rules 2000 in respect of orders entrusting the distribution of the debtor's assets to a person designated by the Court (other than the foreign representative) in a cross-border insolvency proceedings, the designated person must be an official liquidator. Appointments by the Court as to official liquidators or provisional liquidators are addressed in subsections 472(1) and 472(2) of the Corporations Act.

31 Section 1283 of the Corporations Act.

32 Section 155 of the Bankruptcy Act.



administration within the last ten years; and has paid the \$1,200 fee for registration.<sup>33</sup> In contrast to registered liquidators, there is no general fit and proper person test.

98. There is a statutory framework for deciding when the Committee must decide that an applicant be registered, when the Committee will have discretion to register an applicant, and when the Committee must not register an applicant.<sup>34</sup> The Committee may register an applicant if it considers the applicant is suitable to be registered despite the applicant not meeting the prescribed qualifications, experience and knowledge requirements set out in the Bankruptcy Regulations.<sup>35</sup>
99. In contrast to the inability of ASIC to apply conditions on the registration of registered liquidators, the Committee may decide that specified conditions should apply to the applicant's practice as a registered trustee.<sup>36</sup> There are no limitations on the form of condition that may be imposed on a market entrant.
100. The registration granted by the Inspector-General to registered trustees has effect for three years, in contrast to indefinite registration of registered liquidators.<sup>37</sup> Registration is extendible upon payment of a fee<sup>38</sup> (which is currently set at \$1,600) and extension of registration is contingent on the applicant providing evidence that the applicant has the requisite insurance.<sup>39</sup>
101. Registered trustees are eligible for appointment to all kinds of personal insolvency administration. There is no equivalent additional level of registration for trustees such as the 'official liquidator' registration level in corporate insolvency.

## **CURRENT ISSUES**

### **Interviews and examinations**

102. Submissions to the recent Senate Committee Inquiry raised concerns about the capability of the current regulatory framework to effectively filter out persons who are not 'fit and proper' to be acting as liquidators, administrators or receivers in Australia.
103. A number of submissions suggested that the registration processes for registered liquidators be tightened through the introduction of an interview and/or examination process for prospective registered liquidators. An interview and examination could require an applicant to demonstrate their understanding of the legislation as well as assessing whether they are 'fit and proper' via consideration of case studies and scenarios including possible ethical and commercial dilemmas that the practitioner can be expected to deal with once registered.
104. The Senate Committee supported corporate insolvency practitioners being required to be screened through an interview with an ITSA-style panel (that is, the committee

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33 Paragraph 155A(2)(a) of the Bankruptcy Act.

34 Section 155A of the Bankruptcy Act.

35 Subsection 155A(3) of the Bankruptcy Act.

36 Subsection 155A(5) of the Bankruptcy Act.

37 Subsection 155A(4) of the Bankruptcy Act.

38 Section 155D of the Bankruptcy Act. Under section 155D(2) a registered trustee's registration cannot be extended if certain payments to the regulator are outstanding.

39 Regulation 8.04 of the Bankruptcy Regulations.



structure) including a compulsory written exam.<sup>40</sup> The Senate Committee recommended that this occur through the creation of a new agency. Amending ASIC's processes for liquidator registration in alignment with the processes under the Bankruptcy Act may address unnecessary divergence.

105. The Senate Committee also recommended that the examination be devised by an advisory panel that would include representatives from accounting, insolvency, banking, small business and consumer groups and academia.<sup>41</sup>
106. The Bankruptcy Act does not explicitly require an applicant to be 'fit and proper', although it does require an applicant to be 'suitable'. A number of the specified criteria for registration address particular factors that may be relevant to whether someone is fit and proper.

## Registration of official liquidators

107. The current distinction between official liquidators and registered liquidators has been a function of the regulatory framework since the establishment of a registration system for liquidators under the *Uniform Companies Acts 1961*. However, the role of official liquidator developed from the common law beginnings of the modern corporate insolvency law, as well as under early Companies Acts in the various State jurisdictions,<sup>42</sup> in order to provide the Court with the ability to appoint a 'properly qualified and fit and proper'<sup>43</sup> liquidator to a matter and that the liquidator 'had no option in the matter, and [...] was bound to act as liquidator in the wind up of a company if so appointed by the Court'.<sup>44</sup>
108. The distinction between official and registered liquidators seeks to provide the Court and the public generally with confidence in the official liquidators' skills. However, court appointments are not necessarily more complex than appointments accepted by registered liquidators. Court appointments often have no assets to distribute and large corporate insolvencies have generally involved voluntary administrations followed by voluntary liquidations – not court ordered windings up.
109. Furthermore, the dual classification imposes an additional regulatory burden on liquidators given the need to comply with the administrative requirement to be appointed as an official liquidator. There is no corresponding tiered arrangement in the personal insolvency framework.
110. In 1997, the Working Party favoured the phasing out of the distinction between official and registered liquidators finding that the 'concept of an official liquidator is largely outdated'.<sup>45</sup> The Working Party therefore recommended that 'in the longer term, the

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40 Recommendation 8 of the Senate Committee's Report.

41 Recommendation 9 of the Senate Committee's Report.

42 See the judgements of Kirby P and McHugh J in *Brian Cassidy Electrical Industries Pty Ltd (in liq) & Anor v Attalex Pty Ltd* (1984) 9 ACLR 289 for a history of the development of the corporate insolvency profession under Australian law.

43 Long Innes J in *Re Austral Knitting Mills Ltd* (1926) 43 WN (NSW) 131.

44 Subsection 227(2) of the *Companies Act 1936*; Practice Note, dated 27 June 1938, by Long Innes CJ in *Equity*, (1938) 55 WN (NSW) 112.

45 Paragraph 6.14 of the Working Party Report.



distinction should be removed in favour of a system whereby the Court may sanction any nominated registered liquidator to perform a court-ordered administration'.<sup>46</sup>

## **Stratification of the corporate insolvency profession**

111. In the Harmer Report, the Australian Law Reform Commission recommended that in place of the official and registered liquidator classification, there should be a new system with three classes of insolvency practitioner with 'Class A' eligible for all personal and corporate insolvency appointments including court appointments and voluntary administrations, 'Class B' eligible for all personal and corporate insolvency appointments except court appointments and voluntary administrations and 'Class C' that would only be able to accept appointments in a member's voluntary winding up, which does not involve insolvency, and to administer a debt payment plan.
112. Arguments for stratification of the corporate insolvency profession in relation to the size, complexity, and industry in which the external administration occurs were also put forward to the Senate Committee Inquiry. There are concerns that a one-size-fits-all approach where a registered liquidator can act as a liquidator, administrator or a receiver of a company ignores the variation inherent in these differing responsibilities. Stratification may allow for the specialisation of corporate insolvency practitioners and could allow for more targeted oversight of the corporate insolvency profession.
113. However, the external administration of a small to medium sized enterprise may not necessarily be any less complex than the external administration of a large corporation. This issue was raised in particular by the Chairperson of the Accounting Professional and Ethical Standards Board who stated that:

'the smaller entity – this is a generalisation – is often less well resourced, has less sophisticated advisers et cetera and has a board that is less sophisticated etcetera ... So it is often the entity that really needs help the most. It often needs it at quite a sophisticated level. If you go up to the other end of the spectrum with big entities, often they are extremely well resourced, they have plenty of advisers and they have plenty of people hanging off them. They often need the resource less.'<sup>47</sup>
114. The Working Party doubted that the further stratification of the corporate insolvency profession would be of any benefit and instead recommended the removal of any distinction between official liquidators and registered liquidators.<sup>48</sup>
115. Stratification would likely result in a greater regulatory burden being placed on all current registered liquidators, as well as any potential entrants.
116. The Working Party further noted that the inclusion of further categories of insolvency practitioners would increase the complexity and therefore the costs associated with administering the system. These costs would need to be either borne by the Government or passed onto practitioners, who would likely pass on those costs to consumers through higher fees.

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46 Paragraph 6.17 of the Working Party Report.

47 Ms Kate Spargo, Senate Economics References Committee Hansard, Reference: Liquidators and administrators, Adelaide, 9 April 2010, page 33.

48 Paragraph 6.14 of the Working Party Report.



117. Stratification of the corporate insolvency profession may have a negative effect on the ability of creditors or directors to engage an appropriately credentialed external administrator, thus putting upward pressure on the remuneration of external administrators. In part this concern is driven by the relatively small size of the insolvency profession. The effects of stratification on the availability of suitable insolvency practitioners may be of particular concern for remote and regional areas.
118. The Corporations Act also provides for a person to be registered as a liquidator only in respect of a specified body corporate.<sup>49</sup> There is no equivalent debtor specific registration in personal insolvency. It might be queried whether the positions in corporate and personal insolvency should be aligned. It might also be queried whether the ability for debtor specific registration in corporate insolvency is in fact utilised and whether alignment may suggest its removal from corporate insolvency law.

### **Period of registration**

119. Currently, registered liquidators are able to remain registered provided they comply with lodgement of annual statements and insurance requirements under the Corporations Act. This contrasts with the requirement for registered trustees to periodically renew their registration subject to satisfying certain criteria.
120. The indefinite nature of liquidator registration limits the control of the regulator to determine the participants in the market by restricting the options for barring a particular registered liquidator from the market.
121. This approach may also not provide for a proactive continuing verification process on factors necessary for the proper performance of a registered liquidator's duties, such as: capability of the human and technological resources of the liquidator's business; supervision and training of staff under the control of the liquidator; and procedures and risk management systems within the liquidator's business.
122. The statutory requirements for renewal of registration under the Bankruptcy Act also do not provide for the consideration of a trustee's history and past conduct in the determination of the extension of the registration. Under the Bankruptcy Act, the Inspector-General is required not to extend the registration only in cases where certain fees and charges have not been paid. The Inspector-General has no discretion to refuse the extension of registration on any other basis.
123. The Senate Committee recommended that the registration of registered liquidators should be required to be renewed every three years;<sup>50</sup> that renewal should be dependent upon the payment of a fee;<sup>51</sup> and that registered liquidators should be required to exhibit completion of the IPA Insolvency Education Program as part of the first renewal following registration.<sup>52</sup>

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49 Subsection 1282(3) of the Corporations Act.

50 Recommendation 5 of the Senate Committee's Report.

51 Recommendation 6 of the Senate Committee's Report.

52 Recommendation 7 of the Senate Committee's Report.



## REFORM OPTIONS

### Option One: enhance ASIC's and ITSA's current registration processes

124. Separate registration structures may be retained, but particular aspects of the process for one regime, might be adopted by the other. Under this option, ASIC would consult on amendments to its regulatory guidance on the current registration processes to bring the corporate and personal insolvency processes into greater alignment; however, a committee structure would not be adopted for the registration of corporate insolvency practitioners.

#### Corporate insolvency enhancements

125. The differences relating to the requirement to interview applicants was highlighted by the Senate Committee.
126. Under the current statutory framework, ASIC must be satisfied that the applicant is capable of performing the duties of a liquidator and is otherwise a fit and proper person to be registered as a liquidator.<sup>53</sup> It is within ASIC's administrative discretion to require an applicant to complete an examination or attend an interview as a way to satisfy this requirement.
127. The interview process may be undertaken through a panel structure. Without legislating for the functions of the panel, its role would necessarily be restricted to that of providing an advisory opinion to ASIC as the ultimate decision maker. To go further by making a decision of the panel binding on ASIC would likely breach principles of administrative law.<sup>54</sup> To ensure natural justice, an applicant would still require a right to be heard by ASIC following any interview held with the panel where ASIC proposes to refuse an application for registration.
128. The corporate insolvency system could be further aligned with the personal system by removing the current distinction between official liquidators and registered liquidators. As noted by the AAT in *Re Lofthouse and Australian Securities and Investments Commission*,<sup>55</sup> the work undertaken in a court-ordered liquidation is no more complex than that undertaken by a registered liquidator in a voluntary administration, or work as a receiver and manager of a large or complex company.<sup>56</sup>
129. The current requirement for an official liquidator to be appointed to a company wound up as a result of a court order could be removed. This would have the effect of allowing any registered liquidator to be appointed by the court as part of a winding up order.

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53 Paragraph 1282(2)(c) of the Corporations Act.

54 The courts have established a number of principles as important to ensuring proper administrative decision making including that 'if legislation gives a designated person the power to decide something, no one else may require that person to make that decision in a particular way. The person can have regard to relevant rules or policies, but should not exercise a discretionary power in accordance with an administrative rule or policy without regard to the merits of the particular case.' See *General information on the Australian Administrative Law System* accessible at [www.ag.gov.au](http://www.ag.gov.au).

55 [2004] AATA 327 (30 March 2004).

56 Paragraph 84 of *Re Lofthouse and Australian Securities and Investments Commission*.



130. This would implement the recommendation of the Working Party in its final report that in the long term, the distinction between official and registered liquidators be removed.<sup>57</sup>

### **Personal insolvency enhancements**

131. The Inspector-General might be empowered to refuse to renew a trustee's registration if a trustee owes money to an estate as a result of the outcome of a remuneration review.<sup>58</sup>
132. The law could be amended to provide that an applicant cannot become a registered trustee until they have demonstrated that they have adequate systems and practices in place (for example, accounting systems, or record keeping systems) to allow them to perform the work. Under guidelines made under subsection 186C(6) of the Bankruptcy Act for the approval of applications for registration as a registered debt agreement administrator, applicants must demonstrate that they have adequate systems and practices in place to allow them to perform the work.
133. The law could also be amended to provide that the Inspector-General must certify that the applicant has adequate systems and practices in place before the application can be assessed by a committee.
134. A fit and proper person test could also be introduced for prospective or registered trustees.

### **Option Two: adoption of committee structure in corporate insolvency**

135. The registration process for registered liquidators could be reformed by adopting the registration processes currently in place for registered trustees.
136. The Corporations Act could be amended to also require that an application for the registration of a registered liquidator must be considered by a three-person committee. In personal insolvency, this Committee consists of an ITSA representative, an appointee of the IPA, and an Australian Public Service employee. This structure could be duplicated in the corporate insolvency context. A corporate insolvency committee might consist of an ASIC representative, an appointee of the IPA, and an appointee of the Minister with responsibility for corporate law.
137. Currently, ITSA must register an applicant if: the committee recommends that the applicant be registered; the necessary fee has been paid; and evidence of professional indemnity insurance is provided. Applying the committee structure to the registration of registered liquidators might provide for greater industry-knowledge in the consideration of new entrants into the corporate insolvency services market. By legislating for the committee to be the decision-maker, the framework would ensure that the views of industry participants are taken into account in the decision to register.
138. Making the committee the decision maker on a registration application would also remove the opportunity for the duplication of processes that would arise where an applicant seeks a right to be heard by ASIC following the rejection of a registration

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<sup>57</sup> Paragraph 6.17 of the Working Group Report.

<sup>58</sup> It is noted there is no power in the Corporations Act in relation to this aspect of reviewing the remuneration of a corporate insolvency practitioner.



request on the basis of, or in spite of recommendations made by, any possible committee that might be convened by ASIC in an advisory capacity.

139. The processes for considering the application could be set out in law or left to the committee so formed to determine – this would include whether an interview is considered necessary to determine whether a given candidate is ‘fit and proper’ or whether an examination is required in order to determine whether a given candidate is capable of performing the duties of a registered liquidator.
140. In order to minimise the ongoing costs of any committee structure to ASIC and any industry member, committees might no longer be convened on an ad hoc basis. Committees might be constituted periodically, for example quarterly or semi-annually.
141. In contrast to Option One above, as any interview would be before the decision-maker there would be no potential for duplicated processes. The applicant would have the right to seek review of an adverse decision of the committee as the primary decision maker through the AAT.
142. The introduction of interview and examination processes for the registration of new registered liquidators may increase the administrative cost of the registration process. This cost could be passed onto the applicant. Currently, there is a significant divergence in the registration fee between corporate (\$330) and personal (\$1,200 plus a \$2,000 application fee) insolvency.
143. This option would achieve the greatest alignment between the registration structures for personal and corporate insolvency.

## **DISCUSSION QUESTIONS**

144. Should an applicant seeking registration as a registered liquidator or registered trustee be required to be interviewed as part of the registration process?
145. Should an applicant seeking registration as a registered liquidator or registered trustee be required to sit an exam as part of the registration process?
146. Should a general ‘fit and proper’ person requirement be imposed for the registration of both personal and corporate insolvency practitioners?
147. If the process for the registration of liquidators is aligned with the process for the registration of registered trustees, what differences should be maintained between the two registration processes?
148. Is it appropriate that the current fee for registration of liquidators be increased to reflect the amendments to registration processes?
149. Should the official liquidator role be maintained?
150. What other aspects of the current Bankruptcy Act committee system might be amended?
151. If registration of a registered liquidator is for a defined period, what conditions should be required to be met for renewal of the registration to occur?

152. Should the renewal process include a fee? Should the fee be commensurate merely with the administrative cost for completing the renewal or should the revenue raised by the fee be used to fund additional oversight of the insolvency market? Should the renewal fee be determined with reference to the numbers and nature of the administrations to which the practitioner is appointed?



# REMUNERATION FRAMEWORK FOR INSOLVENCY PRACTITIONERS

## FOCUS OF CHAPTER

This chapter discusses some of the inherent difficulties present in the nature of specialist insolvency administration services that adversely affect efficient price-setting and seeks comments on possible options for reform to the Corporations Act to address a number of specific issues that are currently present.

The level of remuneration received by registered liquidators was a significant focus of the Senate Committee Inquiry. There is a perception in the community that the level of remuneration claimed by registered liquidators in a number of instances has been disproportionate to the funds available for distribution to creditors.

The Senate Committee's report recognised the complexity of this issue and recommended the opening up of the profession to new entrants as the best way to address the concerns regarding alleged overcharging and over servicing by registered liquidators.

This chapter seeks comments on options that might better: allow competitive forces to impact on the level of remuneration claimed by practitioners; address some of the disincentives to creditors challenging a practitioners' remuneration; and make the duties on registered liquidators more consistent with those on registered trustees with respect to making arrangements where a benefit is received in addition to the remuneration to which the practitioner is entitled.

## CURRENT LAW

### Corporate

153. The remuneration of a registered liquidator appointed to externally administer a company (other than as a receiver and manager) must be approved by the committee of inspection (COI) (if one has been established), the general body of creditors,<sup>59</sup> or the Court<sup>60</sup> (the approving parties).
154. A liquidator's remuneration does not include the costs properly incurred in the external administration (that is, disbursements).<sup>61</sup> Disbursements are recoverable from the administration without approval, provided that they are reasonably incurred. Information must be provided by the practitioner to an approving party to assist it to assess whether or not the remuneration and disbursements are reasonable.<sup>62</sup>

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59 Under subsections 473(4A) and (4B) of the Corporations Act, if a registered liquidator responsible for a Court-ordered winding-up has difficulty reaching a quorum of creditors to approve their remuneration, creditors are taken to have passed a resolution approving up to \$5,000 in remuneration. See also subsection 499(3A) of the Corporations Act for a creditors' voluntary winding up.

60 Subsections 473(2)-(3); 473(5)-(6) and section 449E of the Corporations Act.

61 *Venetian Nominees Pty Ltd v Conlan* (1998) 20 WAR 96 at 100. See also subsection 556(1) and section 443D of the Corporations Act.

62 Subsections 473(12), 449E(5)-(7), and 499(6)-(7) of the Corporations Act.



155. A corporate insolvency practitioner's remuneration may only be drawn from the assets remaining for distribution to unsecured creditors at the completion of an external administration, although where a liquidator preserves or realises property subject to security, the costs and remuneration pertaining to that action may rank in priority to the right of the secured creditor.<sup>63</sup>
156. ASIC, the administrator, or an officer, member or creditor of the company has standing to apply for review of a practitioner's remuneration.<sup>64</sup> The Corporations Act sets out a number of factors which the Court must take into account, when either fixing or reviewing a liquidators remuneration, in determining whether or not the remuneration is reasonable, including the necessity, quality and complexity of any work done or to be done.<sup>65</sup>

## Personal Insolvency

157. The remuneration of a trustee may be determined by a resolution of creditors at a meeting, a resolution of a committee of inspection, or if neither fixes the remuneration, the trustee may apply to the Inspector-General for the Inspector-General to decide the trustee's remuneration if the amount sought is above the statutory minimum fee of \$5,000<sup>66</sup>.
158. If an application is made to the Inspector-General, the Inspector-General must make a decision on the remuneration taking into consideration the nature, complexity and necessity of the work already performed or to be performed.<sup>67</sup> The Inspector-General will not however consider the reasonableness of the rate of remuneration charged by the trustee.
159. If the trustee is seeking remuneration over the statutory minimum, the trustee must provide the creditors with an estimate of the expected total amount of the trustee's remuneration, an explanation of how the remuneration will be calculated, and what effect the remuneration will have on dividends for creditors.<sup>68</sup>
160. A registered trustee is statutorily barred from making any arrangement whereby a benefit is received, either directly or indirectly, in addition to the remuneration to which he or she is entitled.<sup>69</sup>
161. A creditor may apply to ITSA for a review of remuneration claimed by a registered trustee, and the trustee may apply for a review of a bill of costs for services provided by a third party in relation to the administration of an estate.<sup>70</sup>

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63 *Re Universal Distributing Co Ltd* (1933) 48 CLR 171; *Shirlaw v Taylor* (1991) 31 FCR 222 at 230-31.

64 Subsections 449E(2) and 473(5)-(6) and section 504 of the Corporations Act.

65 Subsection 473(10) of the Corporations Act for Court appointed liquidators; section 504 of the Corporations Act for judicial review of liquidator's remuneration.

66 Section 161B; subsections 162(1) and 162(4) of the Bankruptcy Act; Regulation 8.09 of the Bankruptcy Regulations.

67 Section 162(4A) of the Bankruptcy Act; Regulation 8.11 of the Bankruptcy Regulations.

68 Subsection 64U of the Bankruptcy Act.

69 Section 165 of the Bankruptcy Act.

70 Section 167(1)-(2) of the Bankruptcy Act; Regulations 8.12E-8.12L of the Bankruptcy Regulations.



## **CURRENT ISSUES**

### **Integrity of the fee setting process**

162. Due to the nature of specialist insolvency administration services, clients<sup>71</sup> utilising those services face a number of significant issues when choosing providers, negotiating and setting fees and assessing whether they have received value for money following the provision of those services. ASIC's submission to the Senate Committee Inquiry stated that eight per cent of complaints that arise in relation to practitioners concern remuneration, including excessive, and poor disclosure of, remuneration.
163. There are a range of issues that can make it difficult for clients of insolvency practitioners to assess whether they have received value for money, which can impact on the credibility of the integrity of the system. These issues include the heterogeneity of services, information asymmetries and the need to assess significant risk premiums.
164. Improving the ability of fee setters, be they creditors in a bankruptcy or corporate external administration or members in a members' voluntary winding-up, to deal appropriately with these issues may contribute towards improving the management of insolvency practitioner remuneration.
165. Many of these issues also affect an insolvency practitioner's ability to estimate and agree to appropriate fees either in advance of or subsequent to the provision of administration services. They may also affect the ability of third parties to conduct effective reviews of claims for remuneration.

### **Highly heterogeneous service**

166. Insolvency practitioners may provide a highly heterogeneous service. Assessments of the services to be provided, for the purpose of setting appropriate fees, must be made on a case by case basis. This requires greater skill and knowledge, access to appropriate information for each administration and involves higher costs to participants, than when there are more homogenous services being offered.
167. The proper and efficient administration of 'similar' insolvencies may involve significantly different costs. This may occur due to the potential for qualitative factors to have a high impact on costs. For example, the task of selling a building may take significantly more time or require more highly qualified staff due to the nature of the people involved (for example, problem tenants) and not the nature of the asset being realised.
168. Qualitative factors are notoriously difficult to assess. Less information is generally available regarding qualitative factors, which makes accurate assessment difficult. Fee setters (in particular persons setting fees prospectively) are in a poor position to assess appropriate fee levels in administrations where such factors are prevalent.
169. However, many small and assetless administrations can be administered by fairly similar and standard processes, even though the subjects of the companies in external administration may be different. A large portion of total corporate insolvencies are small and low asset administrations:

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71 This term is used to refer to creditors and/or members, depending upon the nature of the relevant insolvency administration.



**Table — Key data from Schedule B reports lodged by external administrators<sup>72</sup>**

Size of company measured by number of FTEs (1 July 2009 — 30 June 2010)	%	Liability size (1 July 2009-30 June 2010)	% of total liabilities
less than 20 FTE	76.7%	less than \$250,000	45.8%
between 20 and 200 FTE	5.0%	between \$250,000 and \$1 million	29.8%
more than 200 FTE	0.4%	between \$1 million and \$10 million	20.2%
Not specified	18.0%	more than \$10 million	4.2%

Source: ASIC, Report 225 Insolvency statistics: External administrators' reports 1 July 2007 — 30 June 2010 (REP 225)<sup>73</sup> Note: FTE = Full-time equivalent employees.

170. An even greater portion of bankruptcies are no asset bankruptcies. ITSA's *Profiles of Debtors 2009*<sup>74</sup> reported that seventy per cent of all bankrupts disclosed no 'divisible' or 'realisable' assets and another fifteen per cent of bankrupts disclosed divisible assets between \$Nil and \$4,999. Seventy-seven per cent had less than \$100,000 of unsecured debt. These very low or nil asset bankruptcies are almost exclusively administered in bulk by the Official Trustee via streamlined and standardised processes.

### Scoping of works forms part of the service

171. Unlike in most service provider/client relationships, the scope of works to be performed is uncertain at the time of engagement of the service provider. It is part of the role of an insolvency practitioner to determine what work should be performed. Additionally, the insolvency practitioner determines the work to be performed without needing to obtain the approval of their clients.
172. The inability of clients to make their own cost/benefit analyses of proposed courses of action and to choose which actions should be undertaken reduces their ability to control costs. The inability to determine what work should and should not be performed also impacts upon their bargaining power with the insolvency practitioner.

### Information asymmetries

173. Information asymmetries exist between debtors, directors, insolvency practitioners, creditors and members. For example, at the commencement of an insolvency administration, the practitioner may have little information about the financial affairs of the debtor. The debtor (or in the case of a company, its directors) may be uncooperative in completing and lodging a Statement of Affairs (or Report as to Affairs).<sup>75</sup>
174. There may be bona fide reasons for restricting the provision of information to clients. For example, the information may be commercially sensitive, or the information may be in respect of potential litigation against one of the clients.

72 Reports lodged electronically by liquidators, receivers and administrators in the format of Schedule B to Regulatory Guide 16. The vast majority of these reports (over 90 per cent) are lodged by liquidators.

73 REP 225 presents statistical findings from reports lodged electronically by liquidators, receivers and administrators from 1 July 2007 to 30 June 2010.

74 Available on the ITSA website – [www.itsa.gov.au](http://www.itsa.gov.au).

75 It might be noted that a personal insolvency practitioner is able to seek assistance from ITSA in obtaining a Statement of Affairs from a recalcitrant debtor. ITSA may use coercive information gathering powers under section 77CA to obtain a completed document. No equivalent assistance exists for corporate insolvency practitioners.



175. Preferences as to the desired level and detail of information exchange may vary between stakeholders. This is particularly so when different assessments of the value of information provision compared to the costs are taken into account. Practitioners have a high degree of control over decisions as to the extent of information provision.

#### **Asymmetries in technical knowledge and skills**

176. Insolvency administration services may involve a high level of technical complexity. Creditors may lack the knowledge and skills to properly understand the full nature of the 'product' that is being offered. It may therefore be difficult for clients to determine what a reasonable and appropriate fee is for such services.
177. Impediments to effective fee setting arising from scarcity of information; a lack of technical knowledge; and skills asymmetry, are only able to be partially addressed through improving access by fee setters to the information held by practitioners about each insolvency administration.
178. The extent of technical knowledge and skills asymmetry may vary greatly. Large institutional creditors and government creditors (such as the Australian Taxation Office) would be expected to possess significant understandings of the operation of the insolvency regime and the tasks being performed by practitioners. Small business creditors and non-business creditors (for example, family members of debtors) may possess little technical knowledge.

#### **Assertions of high rates of fees and the need to assess significant risk premiums**

179. There is no fixed industry wide scale of remuneration in personal or corporate insolvency and very few restrictions on how work can be charged. Fees are most commonly charged at hourly rates which have been scaled to reflect the level of the employees involved with the work, and practitioners generally obtain approval for this fee structure at the start of their appointment or shortly after. Practitioners have two other forms of fee payment: fixed fee and commission based services, each of which is less widely used than an hourly rate.
180. Concerns have been raised about the apparently high rate of fees being charged by practitioners, and whether the rate was unnecessarily so. Because practitioner remuneration is paid from assets, they are often not remunerated in full, or at all, because no assets remain. It has been asserted that this may lead to overcharging for services where there will be money available, as a recoupment action.
181. The unrecovered costs borne by practitioners in assetless administrations, or administrations with insufficient assets to meet remuneration and disbursements incurred, may be seen as being borne by other administrations through the charging of these risk premiums. Concerns have been raised from both within and outside the industry about the effects of this cross-subsidisation.
182. Insolvency administration may also expose practitioners to the risk of significant levels of personal liability. Insolvency practitioners owe fiduciary duties to creditors which may be the basis of actions for negligence. They may also potentially be liable for debts incurred in the course of an administration. This is particularly the case for personal insolvency practitioners, and is relevant to a lesser degree for corporate insolvency practitioners appointed as voluntary administrators.

183. As setting or assessing appropriate fee levels involves an assessment of the risks involved and the determination of an appropriate risk premium, it may be difficult for clients to accurately determine what an appropriate risk premium should be in any given case.

#### **The prevalence of time based charging**

184. Throughout the course of the Senate Committee Inquiry, concerns were raised about time-based charges and whether this system is the most efficient way to remunerate a practitioner.
185. One of the major problems with time-based charges relates to the complexity of insolvencies. It is difficult to ascertain how complex an insolvency will be at the outset of an appointment. Time-based charging is thought to be an uncertain way for creditors to pay remuneration.
186. Time-based charging has been criticised for providing an incentive to assign more highly qualified people than necessary to work on a particular insolvency because of their higher charge out rates, and for rewarding inefficiency. In *Mirror Group Newspapers plc v Maxwell*<sup>76</sup> Justice Ferris stated that 'time spent represents a measure not of the value of the service rendered but of the cost of rendering it. Remuneration should be fixed so as to reward value, not so as to indemnify against cost'.<sup>77</sup>
187. Time-based fees reduce the ability for the recipients to assess the reasonableness of the remuneration and to compare services between practitioners, as there is little indication of the total cost.
188. Further, time based fee arrangements do not effectively transfer the risks of cost blowouts to those best able to manage them. Instead the risks remain with clients.

#### **Fractured decision making by clients**

189. Whereas fees are normally negotiated with service providers by individual clients, the fee setting body in an insolvency administration is a group of individuals or organisations. Generally, creditors as a collective body are empowered to set fees. This may have an adverse effect on the ability of fee setters to organise and cooperate in the assessment, negotiation and setting of fees.
190. The collective nature of the fee setting body may increase monitoring and transaction costs associated with the governance of insolvency administrations.

#### **The conflict between independence, duty and flexibility in fee setting**

191. Fee approvals have the potential to have a coercive effect on the conduct of practitioners and could potentially impermissibly infringe on their independence and the performance of their duties pursuant to the law.
192. The statutory provisions granting creditors fee setting powers do not on their face prevent fee setting arrangements that are conditional upon certain practitioner behaviour or that provide for differential fee entitlements that provide for prohibitively low fee entitlements for specific tasks. However, case law relating to the role of

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76 [1998] B.C.C. 324.

77 At paragraphs 336-337.



insolvency practitioners indicates that it is an essential aspect of their function, as it has historically been understood that they are to act independently and are not subject to direction.

193. The extent to which the law relating to the independence and obligations of practitioners does in fact interfere with flexible fee setting arrangements is uncertain. While the applicable trust law and law on the duty of practitioners to maintain independence appears to be relatively clear; and the law on fee setting is likewise relatively clear, there is a lack of case law on how the two bodies of law interact when they are in conflict.
194. Where work is primarily directed at benefiting fee setters, it may be queried whether they should have the power to approve fees that infringe upon independence. For example, it is unlikely that a creditor could set an entitlement to remuneration (at least without the risk of it being subject to review and amendment by the Court upon an application by a practitioner) with: a fixed sum of fees for initial investigations, initial reporting; a fixed sum or percentage for selling a specified asset; and no remuneration for other riskier more speculative recovery actions that might be contemplated. In respect of the performance of 'public service' functions (such as investigating and referring offences to the regulator), where the 'client' is not merely those with fee setting powers, this may not be appropriate.
195. A related issue is that fee approval does not bind a practitioner to perform work, at least in the absence of an associated undertaking by the practitioner. Fee approvals in insolvency administrations are not therefore a mechanism by which risks of cost blowouts may be transferred to the person who may be in the best position to manage them (that is, the practitioner). For example, creditors approve fees on a time basis capped at \$50,000; this amount being set at the amount the practitioner estimated would be needed to complete the job. Such an approval does not per se require the practitioner to complete the work if fees have accrued to \$50,000 and further work is needed to complete the job. Generally (depending upon the terms of the approval) the practitioner would be entitled to take the \$50,000 in fees notwithstanding the job has not been completed.
196. Fixed fee approvals with associated undertakings to complete specified tasks do not generally occur.

### **Cross engagement by insolvency practitioners**

197. Fee setters, their advisers or their decision makers, may also have commercial relationships with insolvency practitioners. A common example is that a solicitor for a creditor in an administration may be engaged by an insolvency practitioner to perform legal work on behalf of the insolvency administration. The fee setting behaviour of some creditors or their agents (as well as other behaviour that impacts on fee setting, such as initial selection of practitioner) may thereby be consciously or unconsciously influenced by considerations other than maximising the value for money received by all service recipient clients generally.
198. There may be legitimate reasons why cross-referrals are in the interests of clients in a particular matter.



## CURRENT ISSUES

### Apparent lack of price competition

199. Anecdotally, there appears to be little indication of active price based competition occurring between insolvency practitioners.
200. A lack of price based competition may not be unexpected for an industry where 'purchases' by many clients are rare, there is a highly heterogeneous service provided and assigning responsibility for outcomes is difficult.
201. One relevant issue may be the absence of fee negotiation as part of practitioner selection. The negotiation of a satisfactory fee as precondition to appointment of a service provider is a fundamental mechanism for effective price setting present in almost all service provider engagements. This is, generally, not present in insolvency administrations. This may adversely affect the relative bargaining strength of clients to set fees, as well as the level of price competition between insolvency practitioners. Similarly, barriers to the removal of a practitioner may adversely impact upon the bargaining power of fee setters.
202. Competition might be promoted by improving information access, the ability of clients to replace practitioners when they are not satisfied that they are receiving value for money and by opening up the industry to further competition.

### Disbursements

203. Significant concerns have been raised regarding corporate and personal insolvency practitioners incorrectly charging items as disbursements. A practitioner's 'remuneration' does not involve charges which relate to carrying out the insolvency, for example fees charged by solicitors, photocopying and postage costs and retrieval costs relating to recovery of the company's records. For these costs, a practitioner is allowed a right of indemnity, as they are incurred in the performance or exercise of their function as an insolvency practitioner.<sup>78</sup> There is, however, an obligation on the liquidator to ensure that disbursements are only incurred if reasonable and necessary.
204. The Senate Committee Inquiry highlighted issues with the disbursements system. Whilst a practitioner must account to creditors for disbursements they are not subject to the requirement that they receive approval from a specified party, and are instead paid out of company assets.
205. Assertions have been made that the disbursement system can be abused by obtaining payment as a disbursement for actions which should properly have been charged as remuneration. For example, a liquidator may pay disbursements to specialist firms which have been structured to ensure that work done by the practitioner's employees are charged to that separate corporate identity.
206. In addition, improper disbursements can occur when transferring payments where no proper invoices/records exist. In this context, submissions to the Senate Committee raised concerns that the onus is still on a complainant to establish that any disbursements are not reasonable or necessary.

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<sup>78</sup> Section 443D; Paragraphs 556(1) (a) and (c) of the of the Corporations Act; Section 163A and subsection 109(1) Bankruptcy Act.



## Casting vote and practitioner remuneration

207. Where there is no COI, a liquidator is entitled to receive such remuneration as is determined by a resolution of the creditors, members, or by the Court.<sup>79</sup>
208. It is not uncommon for a creditor to appoint a liquidator or administrator as their general proxy at a creditors meeting. Where a liquidator or external administrator, their partners or staff have a general proxy, they must not use such a proxy to vote on approval of their fees. If the creditor has directed the liquidator as proxy holder to vote in a particular manner (known as a special proxy), the liquidator must vote all special proxies as directed, even those against approval of their fees.
209. In personal insolvency, a trustee or associate (defined as a partner or employee of, or a solicitor retained by, the trustee) who holds a creditor's proxy or attorney may not cast the creditor's vote on a motion relating to the trustee's remuneration unless the instrument appointing the proxy or the power of attorney, as the case may be, expressly authorises the trustee to cast the creditor's vote on such a motion<sup>80</sup>.
210. A meeting of creditors to consider a resolution regarding a liquidator's remuneration will be chaired by the liquidator where the creditors decide that to be so or where the creditors do not appoint one of their own to chair.<sup>81</sup> Any resolution where a poll is called by the creditors, including a resolution considering the liquidator's remuneration, will require approval by a majority of the creditors by value, as well as a majority of the creditors by number.<sup>82</sup> Where a majority of the creditors by value vote for a resolution, but a majority of creditors by number vote against, or vice versa, the casting vote will fall to the chair.<sup>83</sup>
211. In *Williams as liquidator of C & D Global Protection Pty Ltd (in liquidation) v CD Protective Services Pty Ltd & Ors (No 3)*,<sup>84</sup> the Queensland Supreme Court found that a liquidator that uses their casting vote in such a situation to vote in favour of their own remuneration will not necessarily be in breach of their fiduciary obligation to creditors.
212. While the *IPA Code of Professional Practice* (the IPA Code) prohibits a practitioner from using a casting vote in any circumstances in relation to a resolution fixing their remuneration,<sup>85</sup> the Court in *Williams* noted that the IPA Code 'is not legally binding and non-compliance with this particular provision of it would not in itself ... be a sufficient basis for an inquiry into a liquidator's conduct'.
213. The concept of a casting vote does not exist in personal insolvency. Resolutions are passed or rejected merely with reference to the value of creditors supporting a resolution (for ordinary resolutions) or a specified combination of value and number supporting a resolution (for special resolutions). Remuneration resolutions may be passed by ordinary resolutions. Aggrieved minority creditors may apply to court for an alteration of the fee approval.

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79 Section 495, paragraph 473(2) and (3)(b), subsection 499(3) of the Corporations Act.

80 Subsection 64ZB(5) of the Bankruptcy Act.

81 Section 497(8) of the Corporations Act, paragraph 5.6.17(1) (a) of the Corporations Regulations.

82 Paragraph 5.6.21 (2) of the Corporations Regulations.

83 Paragraph 5.6.21(4) of the Corporations Regulations.

84 [2010] QSC 224.

85 Rule 21.7.4 of the IPA Code of Conduct.

## Communication of practitioner remuneration

214. The regulatory frameworks for both corporate and personal insolvency provide an opportunity for the approval of remuneration by the creditors of the estate. However, concerns have been raised that the disclosures made by registered liquidators to creditors may contain too much information to be meaningful and easily understood.<sup>86</sup> Vague, unnecessarily complex, or unnecessarily dense remuneration disclosure impedes the ability of creditors to determine the reasonableness of fees proposed.
215. In response to concerns such as those raised above, the Senate Inquiry recommended that the regulator work with the IPA and the Institute of Chartered Accountants to ensure that insolvency practitioners comply with the remuneration report template set out in the IPA Code.<sup>87</sup>

## REFORM OPTIONS

### Option One: status quo with potential conflicts of interest addressed

216. The current arrangements for the approval and challenge of remuneration arrangements could be left largely unchanged, but the potential for conflicts of interest could be addressed.
217. Given that the Bankruptcy Act has recently been amended through the *Bankruptcy Legislation Amendment Act 2010*, this option would not make changes to the personal insolvency framework. This would allow registered trustees to become accustomed to the recent amendments, and for the effectiveness of these reforms to be properly assessed, before further changes were considered.
218. However, the Corporations Regulations could be amended to prevent a registered liquidator from using the casting vote as chair of a creditors' meeting, where the resolution is one for the approval of the remuneration of the liquidator in any external administration. This would address the potential for, and perception of, a conflict of interest where a resolution regarding a liquidator's remuneration is being considered.
219. A similar proposal was made in the PJC Report in relation to administrators,<sup>88</sup> but was not agreed to by the then Government.<sup>89</sup> The formal response to the PJC Report stated that '[t]he exercise of the casting vote is sufficiently regulated by the requirement that it must be exercised in what the administrator perceives to be the overall best interests of the company, and the right of creditors to challenge the exercise of the vote in court. The Government will require administrators to publish reasons for the way they exercise a casting vote. This will inform creditors (and the courts) considering a challenge to a casting vote'.

### Option Two: address the issue of disbursements

220. The current rules relating to remuneration and disbursements might be amended to ensure that payments of a kind that should more appropriately be recovered through remuneration charges:

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86 Hughes B, Pitcher Partners, Submission 47 to the Senate Inquiry, page 2.

87 Recommendation 15 of the Committee Report.

88 Recommendation 3.

89 Government Response tabled in the Senate and the House of Representatives on 13 October 2005.



- may not be charged as disbursements in an insolvency administration (forcing the recovery by practitioners of their costs through remuneration charges); or
- may be charged as disbursements, but are subject to the rules governing remuneration as if they were remuneration (such as in relation to their disclosure, approval and review).

221. Classes of disbursement might be specified for the purpose of these modified rules. Alternatively, these modified rules might also apply to disbursements to the extent that they include a 'profit' margin that benefits, directly or indirectly, the practitioner or a related entity.

### **Option Three: aligned enhancements**

222. The current arrangements for the approval and challenge of remuneration arrangements for insolvency practitioners could be amended in a number of ways to address the issues raised above. Those changes could be adopted in a consistent manner in both corporate and personal insolvency law.

#### **Power for binding creditor resolution capping practitioner fees**

223. Requiring pre-approval of a cap on fees by creditors, in conjunction with increased powers for creditors to remove a liquidator, may better allow competitive forces to impact on the level of remuneration claimed by insolvency practitioners.

224. However, it may be unreasonable for practitioners, as a general rule, to be bound by an estimate of cost or time made prior to appointment (at least unless they voluntarily agree to be so bound in a particular matter). Practitioners could be empowered to seek remuneration above the initial cap through a new creditor resolution or resolution of a COI.

225. The Corporations Act and Bankruptcy Act could be amended to make it mandatory for creditors or a COI to pass a resolution capping fees to a fixed amount. That amount may be revised at a later date by a resolution of a majority of the creditors or a COI.

#### **Incentivise challenges to liquidator remuneration**

226. Regardless of the ability of creditors to cap practitioners' fees, the current disincentives to creditors challenging a practitioner's remuneration could be addressed. Currently, where a creditor successfully challenges the level of remuneration claimed by a practitioner, and succeeds, the savings to the liquidation are simply reinstated into the liquidation as a whole. The individual creditor, or group of creditors, may not therefore see a substantive benefit from the action; while they have exposed themselves to expense and risks of adverse costs orders in seeking a review of remuneration. This creates 'free-rider' issues where creditors are unlikely to have any incentive to challenge a practitioner's remuneration. It may therefore be appropriate to provide an appropriate incentive for a judicial challenge to a practitioner's remuneration.

227. Following amendments to the Bankruptcy Act that apply in respect of bankruptcies commencing on or after 1 December 2010 there is no longer any cost for a creditor (or bankrupt) to challenge a trustee's remuneration claim. Under the previous taxation

regime<sup>90</sup> a creditor or bankrupt seeking to challenge the trustee's remuneration would be liable to pay for the costs of the taxation unless the trustee's claim was reduced by at least 15 per cent. Under the new arrangements, a creditor or bankrupt may apply to the Inspector-General to review a registered trustee's remuneration claim and this process is free of charge to the creditor or bankrupt. In view of this, the argument for priority for the costs of a creditor who successfully challenges a registered trustee's remuneration claim is not as strong in personal insolvency, as there is little risk in making that challenge.

228. The existing laws could be amended to provide that where a creditor or group of creditors successfully challenges the remuneration of a liquidator in Court, the creditor or group of creditors will receive an increased priority in relation to the savings to the liquidation that results from the challenge. Some parallels might be drawn with the existing subsection 109(10) of the Bankruptcy Act and section 564 of the Corporations Act.

### **Alignment of duties**

229. Currently, the Bankruptcy Act may provide more opportunities for dealing with concerns that insolvency practitioners may be obtaining direct or indirect benefits from administrations in a manner that avoid the objects of the remuneration regime.
230. As discussed above, under the Bankruptcy Act the Court is empowered to sanction a practitioner who engages in activities such as those discussed above regarding related corporate entities structured so as to avoid the remuneration provisions.
231. While registered liquidators fall within the statutory definition of an officer and are therefore subject to general directors' and officers' duties, the duty for a director or officer to refrain from obtaining an advantage from their position requires actual impropriety.<sup>91</sup>
232. The Corporations Act could be amended to align with the Bankruptcy Act by stipulating that a liquidator, administrator or receiver will have a statutory responsibility to refrain from making any arrangement where a benefit is received in addition to the remuneration to which he or she is entitled.

### **DISCUSSION QUESTIONS**

233. Should the Corporations Act be amended to include a provision that aligns with the Bankruptcy Act prohibition upon practitioners making any arrangement whereby a benefit is received, either directly or indirectly, in addition to the remuneration to which he or she is entitled?<sup>92</sup> Should such a prohibition be clarified to provide that this extends to charging disbursements with a profit component that may benefit, directly or indirectly, the practitioner?
234. Are the current requirements for the provision of information to creditors to assist them in assessing costs appropriate? Should this information be provided in a standard form? Should these requirements be aligned between corporate and personal insolvency?

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90 As in the legal profession, the reviewing of costs in an insolvency proceeding is referred to a 'taxation of costs'. In this context, 'taxation' refers to the process of review.

91 Section 9 and sections 182-184 of the Corporations Act.

92 Section 165 of the Bankruptcy Act.



235. What could be done to address concerns about cross subsidisation?
236. What could be done to address concerns about inappropriate use of disbursements?
237. Should all fee approval be required to be subject to a cap set by creditors in an external administration or bankruptcy? Is it unreasonable to expect that an insolvency practitioner go back to the creditors in order to seek an increase on the initial remuneration cap?
238. Should a group of creditors (or a single creditor) that successfully challenge an insolvency practitioners' remuneration, receive an increased priority in relation to the savings that may result?
239. Should a registered liquidator, under any circumstances, be able to exercise a casting vote on a motion regarding his or her remuneration or removal?

## COMMUNICATION AND MONITORING

### FOCUS OF CHAPTER

This chapter discusses possible options for reform to empower creditors to gain the information required, and then act on that information, to better protect their interests where they believe that the registered liquidator or registered trustee is not acting in the best interests of the estate.

Personal and corporate insolvency laws contain a number of mechanisms designed to ensure that stakeholders are appropriately informed of debtors' affairs and the process of insolvency administrations. These mechanisms impose obligations upon practitioners to provide specified types of information and rights for stakeholders to make ad hoc requests for information.

However, the sense of powerlessness of creditors, business owners, and employees to adequately monitor external administrations in which they had an interest, and protect those interests, was a common feature of submissions to the Senate Inquiry.

This chapter seeks comments on the amendments needed to provide creditors with more information, the appropriate voting threshold required before a meeting of creditors should be held, the role of the COI and whether creditors should be able to make a binding resolution on a liquidator.

### CURRENT LAW

#### Corporate

##### Communication

240. A registered liquidator's primary method of communication with creditors or committees of creditors is through the provision of information in the documents for creditor or committee meetings.<sup>93</sup> The corporate insolvency framework also provides opportunities for, and places responsibilities upon, registered liquidators to communicate with creditors regarding other limited aspects of an external administration.
241. At the commencement of a voluntary administration, the administrator is required to advertise notice of their appointment in a national newspaper or daily newspaper circulating in the State or Territory where the company has its principal place of business within three business days after the appointment.<sup>94</sup> In the notice convening the second creditors meeting following appointment (within 25 or 30 business days), an administrator is required to provide a report to creditors that sets out, among other

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93 See for example, section 439A of the Corporations Act.

94 Sections 450(A) of the Corporations Act.



things, the state of the company's business, assets, affairs and finances, as well as what options are in the creditors' best interests.<sup>95</sup>

242. In a voluntary winding up, creditors are informed of the winding up through a requirement for the liquidator to convene a creditors meeting within 11 days after the company meeting at which the resolution to wind up the company is passed.<sup>96</sup> Where a voluntary creditor's winding up continues for longer than one year, the liquidator must either convene a meeting of creditors, or prepare a report for creditors setting out: the liquidator's actions, dealings and conduct of the liquidation in the year; a description of the future expected actions, dealings and conduct; and an estimate of when the winding up is likely to be completed.<sup>97</sup> At the completion of a creditors' voluntary winding up, liquidators are required to hold a final joint meeting of the creditors and members to give an account of how the liquidation has been conducted and how company property has been disposed of.<sup>98</sup> There are, however, no such corresponding requirements in a court-ordered liquidation.
243. A liquidator is also required to communicate with creditors regarding a creditor's proof of debt. Generally, a liquidator must notify a creditor within seven days where the creditor's formal proof of debt or claim is rejected by the liquidator, either in whole or in part, and set out the reasons for the rejection.<sup>99</sup>
244. While it is usual practice for a liquidator to communicate with creditors through other circular letters explaining what has occurred in the liquidation, as well as the likely outcome from the creditors' point of view, there is no statutory requirement for this communication to occur.

## Monitoring

245. The obligation on registered liquidators to provide certain information to creditors provides creditors with a base level of knowledge about the commencement and conduct of the external administration. However, the corporations legislation also provides for further access by creditors to information regarding the external administration in certain circumstances.
246. A registered liquidator is required to keep books that give a complete and correct record of the liquidator's administration of the company's affairs, including the minutes of any meetings. The registered liquidator's books must be available at the liquidator's office for inspection by creditors and shareholders.<sup>100</sup> Similarly, an administrator of a company, or of a deed of company arrangement, must make the minutes and records of attendance of creditor meetings available for inspection by creditors or members at the registered office or principal place of business of the company.<sup>101</sup>

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95 Section 439A (3)-(4) of the Corporations Act.

96 Subsection 497(1) of the Corporations Act.

97 Section 508 of the Corporations Act.

98 Section 509 of the Corporations Act.

99 Regulation 5.6.54 of the Corporations Regulations.

100 Section 531 of the Corporations Act; regulations 5.6.01 and 5.6.02 of the Corporations Regulations.

101 Subregulation 5.6.27 (5) of the Corporations Regulations. The *Communication and Monitoring* chapter of this paper discusses further the statutory requirements to disseminate information to creditors.

247. The registered liquidator must lodge a statement of receipts and payments with ASIC every six months after the appointment.<sup>102</sup> The statement is available to the public from any ASIC Business Centre on payment of the relevant fee.
248. The chair of a creditors' meeting must prepare minutes of each meeting and a record of those who were present at each meeting. The minutes must be lodged with ASIC within 10 business days or one month of the meeting.<sup>103</sup> A copy of the minutes may also be obtained from any ASIC Business Centre on payment of the relevant fee.
249. In the case of court-ordered liquidations, creditors may pass a resolution requiring future creditors' meetings to be held, or if creditors representing at least one-tenth in value of all the creditors request in writing that the liquidator convene a meeting, the registered liquidator must do so. Where this occurs, those who make the request or pass the resolution must pay the costs of calling and holding the meeting.<sup>104</sup>
250. A registered liquidator in a court-ordered liquidation must also have regard to any directions given by resolution passed by the creditors or contributories (that is, members of the company liable to contribute to the property of the company if it is wound up) at any general meeting, in respect of the administration of the company's property and the distribution of its property among its creditors. However, he or she is not bound to follow them, and must use their discretion to manage the affairs and property of the company, as well as to distribute its property.<sup>105</sup> This obligation extends to having regard to directions that request the provision of information.

### **Committees of inspection**

251. In corporate insolvency, the practitioner may ask creditors if they wish to appoint a COI.<sup>106</sup> A COI is a smaller body of creditors (and in some cases contributories) which has the role of monitoring the conduct of the liquidator or trustee for the benefit of the wider body. A COI is subordinate to a general meeting of creditors;<sup>107</sup> however, it can play an important role in monitoring the conduct and work of the practitioner.
252. A COI can also play a valuable role where there are contentious or substantial issues in the external administration or bankruptcy requiring the advice (particularly on industry issues), consent or ratification of a workable representative group of creditors or contributories.
253. The Corporations Act and Corporations Regulations set out a range of rules governing the convening of committees, eligibility to act on a committee, the proceedings of committees, their functions, the filling of vacancies, payments and reimbursement of committee members and prohibitions on the receipt of benefits by committee members. The Corporations Act prohibits committee members from purchasing assets from an administration.

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102 Subsection 539 (1) and section 438E of the Corporations Act.

103 Regulation 5.6.27 of the Corporations Regulations.

104 Section 479 of the Corporations Act and regulation 5.6.15(1) of the Corporations Act.

105 Section 479 of the Corporations Act.

106 Committees in voluntary administrations are properly called committees of creditors, however, for ease of reference all forms of creditor committee will be called committees of inspection in this paper.

107 See for example subsection 479(1) of the Corporations Act in relation to conflict between the general meeting and a COI.



254. The rules governing COI's are set out in a range of provisions.<sup>108</sup> The rules generally apply to all corporate insolvencies. The statutory provisions for a COI in a voluntary administration are silent on whether members can receive benefits and enter into transactions.<sup>109</sup>
255. Creditors and contributories of a company in external administration may choose to appoint a COI.<sup>110</sup> A liquidator must, if so requested, convene separate meetings of the creditors and contributories to decide whether a COI should be appointed and, if so, the size and representation of the COI.<sup>111</sup> A separate meeting of contributories is required, even when there is no reasonable likelihood of contributories having a financial interest in the conduct of an external administration.<sup>112</sup> To take part in a COI as a creditors' appointee, a person must be a creditor, a creditors' attorney, or be authorised to act for a creditor in that capacity; to take part as a contributories' appointee the person must be a contributory, a contributor's attorney, or a person authorised by a contributory to act in that capacity.<sup>113</sup>
256. The major function of the COI is to provide a streamlined point of contact for information flow between creditors and the practitioner. This includes providing input to the practitioner, and receiving and considering reports from the practitioner.<sup>114</sup>
257. A COI also has some more specific powers, including to:
- determine the remuneration of a voluntary administrator, administrator of a deed of company arrangement, or liquidator;<sup>115</sup> and
  - in a liquidation, approve compromises of debts in excess of \$100,000 or agreements under which the company's obligations may not be discharged within three months.<sup>116</sup>
258. These powers can also be exercised by the creditors as a whole if a COI is not appointed, and in some instances may be exercised by the Court.<sup>117</sup>
259. A COI acts by a majority in number of its members present at a meeting, but it can only act if a majority of its members attend.<sup>118</sup> This is in contrast to the requirement for

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108 Sections 436E, 436F, 436G, 479, 497, 499, 548, 548A, 549, 550, 551, 552 and 556 of the Corporations Act. See also section 513 of the Corporations Act.

109 See sections 436F and 436G of the Corporations Act for voluntary administrations, cf section 551 for liquidations.

110 See for example subsection 479(1) of the Corporations Act in relation to conflict between the general meeting and COI.

111 Subsection 548 (1) of the Corporations Act in a winding-up; subsection 436E(1) in a voluntary administration.

112 *Jindal Transworld Pty Ltd v Scottsdale Homes No 10 Pty Ltd (No 2)* [2010] SASC 210.

113 Subsections 548(3), 536G (1) and 550 (2) of the Corporations Act.

114 Section 436F of the Corporations Act, less explicitly see also section 479 of the Corporations Act.

115 Sections 449E, 473 and 499 of the Corporations Act.

116 Section 477 of the Corporations Act.

117 For example, the setting of fees by a Court as a final resort in a Court ordered liquidation (subsection 473(b) of the Corporations Act) or the power of the court under section 552.

118 Subsection 549(3) of the Corporations Act.

voting at a general creditor meeting of a 'majority in number and value' where a poll is demanded.<sup>119</sup>

- 260. COI meetings can be arranged at short notice and may be called by any committee member.<sup>120</sup> This means that COI meetings are often cheaper and more efficient than larger creditor meetings. A COI cannot pass resolutions other than at a meeting, such as by circular resolution.<sup>121</sup> Minutes of COI meetings must be prepared and lodged with ASIC within one month.<sup>122</sup>
- 261. In contrast to a creditors meeting, a meeting of the COI called by a member of the COI may be paid for by the external administration if the COI so directs.<sup>123</sup>
- 262. While a liquidator must have regard to the directions of the COI, a resolution or direction of the COI does not have the power to bind the liquidator.<sup>124</sup> While a COI for a voluntary administration (properly known as a creditors' committee) also cannot give directions to the administrator, the administrator must comply with the COI's reasonable requests for information about matters relating to the administration.<sup>125</sup>

## Personal

### Communication

- 263. While registered trustees still communicate through meetings of creditors and/or COIs, their communication increasingly takes the form of correspondence.
- 264. Section 64ZBA sets out how a trustee can put a proposal to creditors without holding a meeting. The registered trustee must give each creditor of the bankrupt a notice stating the fact and date of the bankruptcy, and a summary of the statement of affairs of the bankrupt, within 28 days of receiving the bankrupt's statement of affairs.<sup>126</sup> In contrast to corporate insolvency, a registered trustee is then obliged to report to creditors within three months of the bankruptcy on the likelihood of creditors receiving a dividend before the end of the bankruptcy.<sup>127</sup>
- 265. Required communication includes notifying a creditor when the creditor's proof of debt is rejected, and of the reasons why.<sup>128</sup>
- 266. The registered trustee is also required to give creditors an initial remuneration notice which sets out the method by which the trustee seeks to be remunerated, the rate of remuneration and an estimate of the expected amount of the trustee's remuneration.<sup>129</sup>

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119 Regulation 5.6.19 of the Corporations Regulations.

120 Subregulation 5.6.12(4) and 5.6.12(5) of the Corporations Regulations, or by a liquidator under section 479 of the Corporations Act.

121 *Onefone Australia Pty Limited v One.Tel Limited* [2010] NSWSC 401.

122 Regulation 5.6.27 of the Corporations Regulations; Australian Securities and Investments Commission, *Liquidation: A Guide for Creditors*, December 2008.

123 Subregulation 5.6.15(2) of the Corporations Regulations.

124 Sections 436, 513, 479 of the Corporations Act; Australian Securities and Investments Commission, *Liquidation: A Guide for Creditors*, December 2008.

125 Section 436F of the Corporations Act.

126 Paragraph 19 (1) (a) of the Bankruptcy Act; Regulation 4.14 of the Bankruptcy Regulations.

127 Paragraph 19 (1) (c) of the Bankruptcy Act.

128 Subsection 102 (2) of the Bankruptcy Act.



## Monitoring

267. Registered trustees, like registered liquidators, are required to keep accounts and records that exhibit a full and correct account of the administration of the estate. Creditors, or their agents, may inspect these accounts and records at any reasonable time.<sup>130</sup> Failure by a registered trustee to keep accounts and records is an offence of strict liability.
268. Creditors also have a right to inspect the proofs of debt of other creditors in a bankruptcy in which they have an interest.<sup>131</sup>
269. Additionally, in contrast to corporate insolvency, a registered trustee is required to give information about the administration of the estate to a creditor who reasonably requests it.<sup>132</sup> This obligation is not limited to providing copies of pre-existing written records. This is a major difference in the rights of creditors to information regarding the debtor and the insolvency administration.
270. A registered trustee must convene a meeting of creditors where requested by a group of creditors totalling one-fourth of the estate by value; or by less than one-fourth in value upon lodgement of security for the cost of holding the meeting.<sup>133</sup> A resolution of the creditors meeting giving the trustee a lawful direction, as in corporate insolvency, is not binding on the trustee.<sup>134</sup>

## Committees of inspection

271. A range of different rules govern committees in personal insolvency.<sup>135</sup>
272. Under the Bankruptcy Act, the creditors of a bankrupt may also appoint a COI to deal with the trustee.<sup>136</sup>
273. A COI's purpose as stated under the Bankruptcy Act is to 'advise and superintend' the trustee, which statutorily provides for a more active role than that provided for under the Corporations Act.<sup>137</sup> While the trustee must have regard to any lawful directions of the COI,<sup>138</sup> there is still no power to direct the trustee to do, or not do, certain tasks.
274. A COI must be of between three and five creditors. In order to be eligible to act on a COI a person must be a creditor; a person authorised by a creditor to act on their behalf; or a person whom a creditor intends to authorise to act on their behalf. As in the

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129 Regulation 8.12A of the Bankruptcy Regulations.

130 Section 173 of the Bankruptcy Act.

131 Section 101 of the Bankruptcy Act.

132 Paragraph 19(1) (d) of the Bankruptcy Act; equivalent duties exist in section 170 in respect of bankrupts' request; see also subsection 179(2) of the Bankruptcy Act.

133 Subsection 64 (1) of the Bankruptcy Act.

134 Section 177 of the Bankruptcy Act; *Re Peters* (1960) 18 ABC 213, at 216; *Re Weiss* [1986] FCA 287; *Ling v Enrobrook Pty Ltd* (1997) 74 FCR 19.

135 Sections 64V, 70-72, 109, 257 and Schedule 3 of the Bankruptcy Act.

136 Section 64V of the Bankruptcy Act.

137 Section 70 of the Bankruptcy Act.

138 Section 77 of the Bankruptcy Act.

Corporations Act, a COI under the Bankruptcy Act acts by a majority of members as long as there is a majority in attendance.<sup>139</sup>

- 275. COIs under the Bankruptcy Act may have the right to fix the trustee's remuneration. In contrast to corporate insolvency, this power exists in relation to COIs in a bankruptcy only if it is 'referred' to them by the general body of creditors.<sup>140</sup>
- 276. There are no COIs for controlling trusteeships. In contrast, under corporate insolvency they may be convened for voluntary administrations.
- 277. Many of the 'housekeeping' rules in respect of bankruptcy COIs differ from those in corporate insolvency.

## **CURRENT ISSUES**

### **Limited creditor access to information**

- 278. Generally, insolvency practitioners are obliged to act in the best interests of all creditors;<sup>141</sup> however, there may be limited opportunities for creditors to access the information necessary to determine whether this is actually occurring.
- 279. The limited power of creditors to require the provision of relevant information may be more acute in corporate insolvency, with the absence of any positive rights to access information such as those in the Bankruptcy Act. The difficulty in accessing information may be compounded by the lack of an express obligation on a registered liquidator to communicate the likelihood of a return to creditors in the first place. While common practice in the industry extends well beyond what is strictly legally mandated, higher minimum information standards may reduce the scope for unacceptable practices.
- 280. It should also be noted that there are costs associated with the provision of information to creditors. Reforms that increase the rights of stakeholders need to balance this consideration with the objective of ensuring that stakeholders are appropriately informed.
- 281. The potential inability of creditors to access information about the conduct of the external administration impacts on the ability of creditors to monitor the external administration where there is a perception of overcharging, maladministration or misconduct. The difficulty for creditors to monitor their own interests in an external administration may draw the regulator into disputes that are fundamentally commercial in nature – about whether a service provider is providing value for money, rather than concerning alleged misconduct.

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139 Subsection 70(7) of the Bankruptcy Act.

140 Subsection 64U(7) and section 162 of the Bankruptcy Act.

141 Controllers, managing controllers, receivers and receiver managers generally owe duties to the specific party that has appointed them, such as a secured creditor, subject to some statutory limitations. See for example section 420A of the Corporations Act.



## Cost arising from meetings

282. The Senate Committee found that while creditors in corporate insolvency may have a right to call a meeting where creditors representing 10 per cent in value agree, the cost of calling and holding the meeting acts as an effective deterrent to creditors doing so.<sup>142</sup>
283. Individual creditors may therefore be discouraged from investing resources to monitor administrator performance, as the monitoring may result in benefits to the whole body of creditors while the costs are borne by the individual creditor. The free-rider problem in this instance encourages creditors to refrain from undertaking acts of administrator oversight because it is in their interest for someone else to undertake these acts and bear the costs.
284. This free-rider problem has been addressed through the use of thresholds in personal insolvency that provide that the payment of a security deposit to hold a creditors' meeting is not required unless the meeting is requested by creditors representing less than 25 per cent in value. This allows for the imposition of the cost of creditors' monitoring of practitioners' actions on the insolvent estate where the costs are deemed proportionate and supported by a significant number of creditors.

## Periodic meetings and reporting

285. Industry concerns have also been raised regarding the need for liquidators to report to creditors annually, or hold meetings, about the state of an ongoing liquidation, and the requirement for a final meeting of creditors under an external administration. These concerns relate to the low level of interest by creditors in these reporting mechanisms that lead to a compliance based approach to the completion of these processes.
286. Disclosure obligations on registered liquidators have a cost due to the need for preparation of the documents as well as the mail-out costs. Those costs are ultimately borne by the estate (or by the registered liquidator in an assetless administration). It has been raised that these requirements should be removed as a default requirement. There may be potential for this to occur if interested creditors have access to mechanisms that enable them to reasonably access relevant information.

## Limitations of committees of inspection

287. In the liquidation of One.Tel, the limitations of the powers of a COI were clearly articulated.<sup>143</sup> A COI cannot direct a liquidator in the course of their conduct, as it is the liquidator's responsibility to perform the functions they have been given. A COI cannot therefore be considered as some sort of supervisor from whom it is necessary to obtain permission to do an act.
288. As liquidators are only required to consider, rather than follow, any directions given by the COI, the question is raised as to whether creditors have a realistic recourse should liquidators act to the detriment of creditors and against their express wishes, as indicated by a COI or a general meeting of creditors. In instances where there might be concerns about a liquidator's conduct that cannot be resolved by discussion and

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142 The requirement for creditors to pay the cost of calling and holding a meeting mirrors the requirements on members of a company. See section 249F of the Corporations Act.

143 *Onefone Australia Pty Limited v One.Tel Ltd* [2010] NSWSC 498.

negotiation with that liquidator, an application to the Court by creditors is the only appropriate measure for seeking resolution.

289. There are also questions, in particular in corporate insolvency, as to the extent to which insolvency practitioners are under an obligation to comply with reasonable requests for information from a COI.
290. The limitations on the powers of COIs may result in the underuse of these bodies and may undermine the policy intent of providing for a streamlined and cost-effective manner for interaction between creditors and the liquidator or trustee.
291. There are also limitations on the ability of COIs to determine their own processes for making decisions (for example, via circular resolutions); and in corporate insolvency it may be queried why contributories have a role in the formation and composition of committees in matters in which they have no financial interests.
292. In respect of corporate insolvency, the provisions setting out the rights and rules for committees are spread throughout Chapter 5 of the Corporations Act. This may not facilitate their easy use and understanding by creditors. There is significant divergence between personal and corporate insolvency rules, both in respect of key powers and obligations and in respect of procedural matters.

## **REFORM OPTIONS**

### **Option One: maintain the status quo**

293. The current divergent rules regarding the rights of creditors, including COIs, to obtain information about a liquidation or bankruptcy in which they have an interest could remain the same with a small number of consolidative amendments to facilitate the easier identification of creditors' rights throughout the respective pieces of legislation. This would recognise the differing practical realities that exist between a bankruptcy and a corporate insolvency, including in relation to the size, complexity and number of potential creditors.

### **Option Two: align creditors powers to effectively monitor administrations**

294. Alternatively, the current statutory powers for creditors in a bankruptcy or in a corporate insolvency to access information about the insolvency proceeding could be aligned. This would remove any potential confusion that may arise where creditors are required to deal with the two differing processes.
295. The Corporations Act could be amended to provide that, where 25 per cent of creditors by value wish to call a meeting, the cost of the meeting will be borne by the company. This proposal may improve the engagement of creditors on issues of substantive value to the external administration. A registered liquidator could also be required to call a meeting of creditors for any purpose whenever reasonably requested. This would align with the current cut-off point present in the Bankruptcy Act which would provide for a single rule across the industry, while providing a barrier to the calling of creditors meetings on trivial issues by minority creditors at the expense of creditors as a whole.
296. In order to encourage better understanding and engagement with creditors, the Corporations Act could also be amended to require a registered liquidator to report to



creditors within three months of the liquidation on the likelihood of creditors receiving a dividend before the completion of the liquidation.

297. The Corporations Act could also be amended to require a registered liquidator to give information about the external administration of a company to a creditor who reasonably requests it. This could assist creditors to be able to better understand the circumstances of the external administration, and as a consequence, better protect their own interests, without requiring recourse to ASIC or the courts to obtain that information.
298. Allowing creditors (perhaps collectively by resolution) to request registered liquidators to report, or periodically report, on the performance and costs of the liquidation, where the request is reasonable, may make existing hardwired requirements for annual creditor meetings, specific communications with creditors and final creditor meetings largely redundant. In contrast to the option of facilitating ad hoc requests for information by individual stakeholders, an option of creating obligations for liquidators to provide information requested by creditors collectively could require support from a certain percentage of creditors, or otherwise be made by a COI, to be effective.

### **Option Three: controlling the direction of a winding up**

299. The Corporations Act and Bankruptcy Act could be amended to empower creditors to have greater influence on the direction of the winding up or bankruptcy by allowing creditors to make a resolution directing an insolvency practitioner to act or not act in a certain way.
300. The law could be amended to provide that an insolvency practitioner may be directed by the creditors where the direction is lawful and a threshold level of creditors pass a resolution. For example at least 75 per cent of the creditors by value, and at least 50 per cent by number.<sup>144</sup> Any such reform would be subject to the existing rules that provide that practitioners are not obliged to carry out work for which they will not be remunerated.
301. This reform would provide creditors with an express opportunity to influence the direction of a winding-up or bankruptcy without recourse to the Court. A high threshold for the resolution could limit possible abuse of the process by creditors. This might be supplemented by the power for practitioners to seek court review of improper directions.

### **DISCUSSION QUESTIONS**

302. What amendments should be made to provide creditors with more information or power to monitor the progress of a winding up, administration or bankruptcy?
303. Should creditors have largely the same rights to information and tools to monitor a liquidation, administration, bankruptcy or controlling trusteeship?
304. Are there any impediments to insolvency practitioners communicating with creditors electronically?

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<sup>144</sup> Such a limit would be analogous to that currently in place for a special resolution of members – see section 9 of the Corporations Act.

305. If the statutory frameworks are aligned, are there any modifications necessary to account for the practical differences between the bankruptcy and corporate insolvency frameworks?
306. Would support from at least 25 per cent of creditors be an appropriate threshold in corporate insolvency for requiring a creditors meeting to be held? Given the larger numbers and quantum of claims, would a lower threshold (for example, 10 per cent) be more appropriate? What rules should apply in relation to who bears the costs of holding a meeting of creditors?
307. If liquidators are required to provide all information reasonably requested by a creditor regarding a liquidation or administration and creditors have improved powers to require the calling of meetings, is there any need for default annual meetings, written updates or creditors' meetings at the completion of a winding-up? Could these requirements be amended to a requirement for the practitioner to raise the option of having such updates and meetings with creditors (for consideration and voting) as a default reporting arrangement?
308. Should the role of the COI be given greater prominence in the corporate and personal insolvency systems? If so, how might this occur?
309. Should the rules governing COIs be aligned between corporate and personal insolvency? Are there any specific aspects of COI law that should be otherwise reformed?
310. Should creditors be able to make a binding resolution on a liquidator? If yes, should there be any role for the Court to overrule that resolution (for example, where the Court believes that the resolution is not in the best interests of the creditors as a whole)? Should there be any limit on the type of areas that creditors are able to pass a binding resolution?



## FUNDS HANDLING AND RECORD KEEPING

### FOCUS OF CHAPTER

This chapter discusses the procedural requirements for funds handling and record keeping across corporate and personal insolvency.

The corporate and personal insolvency regulatory frameworks set down a number of procedural rules regarding: the treatment of estate monies; the obligation on registered liquidators and registered trustees to lodge, and have audited, a range of reports and documents with ASIC and ITSA respectively; and the keeping of books and the period of time for which those books must be retained.

These procedural requirements are necessary for the continued confidence of creditors and regulators in the performance of individual practitioners and the integrity of the overall system for insolvency services. The breach of any of these requirements currently incurs relatively minor penalties under both the Corporations Act and the Bankruptcy Act. However, the repeated or continued breach of these procedural matters by insolvency practitioners may indicate weak internal business systems or be a sign of more serious professional misconduct.

This chapter seeks comment on whether procedural requirements for funds handling and record keeping should be aligned across corporate and personal insolvency, and if so which rules should be favoured. It also seeks comment on whether the penalties for breaches of these provisions should be increased to provide a stronger deterrent.

### CURRENT LAW

#### Corporate

##### Funds handling

311. Liquidators must, unless otherwise directed by the court or the COI, operate a bank account for monies received in relation to the winding up of each company. Where the liquidation relates to a pooled group, the liquidator may open a single account for the entire group. Monies must be placed into the account no later than seven days after receipt by the liquidator.<sup>145</sup> Payments out of the account must be by cheque or electronic funds transfer.<sup>146</sup> A breach of any of these requirements is a strict liability offence with a penalty of \$550.<sup>147</sup>
312. Liquidators are also empowered to invest funds held in respect of a liquidation surplus to what is required to answer the immediate demands of the liquidation.<sup>148</sup> There are no such statutory allowances for voluntary administrations or deeds of company arrangement.

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<sup>145</sup> Section 538 of the Corporations Act; Regulation 5.6.06 of the Corporations Regulations.

<sup>146</sup> Regulation 5.6.10 of the Corporations Regulations.

<sup>147</sup> Sections 538 and 1311 of the Corporations Act.

<sup>148</sup> Section 543 of the Corporations Act.



313. ASIC does not have an express power to freeze the accounts of registered liquidators into which money from an external administration is paid. However, ASIC has the power to apply for a Court order to freeze an account of a person (or a person related to them) who may be the subject of an investigation or enforcement action.<sup>149</sup> This is generally limited to accounts the person retains for their personal finances, or for the entity related to the alleged wrong doing.
314. ASIC can also apply to the Court for an injunction to prevent a person from doing certain acts, which may extend to dealing with an account used for the business operations of a company or insolvent company.<sup>150</sup>
315. Without a Court order, ASIC cannot unilaterally issue a notice for a bank or financial institution to freeze an account, including an account used for the business operations of a company or insolvent company.

### **Accounts reporting**

316. Registered liquidators are required to lodge with ASIC an account showing their receipts and payments in respect of each liquidation every six months after appointment. Registered liquidators are also required to provide a statement as to the position of the winding up (other than in provisional liquidations).
317. The liquidator is required to notify every creditor and contributory that the account has been made up when next forwarding any report, notice of meeting, notice of call or dividend.<sup>151</sup> The statutory requirements are broadly similar in respect of voluntary administrations, deeds of company arrangement<sup>152</sup> and controllers of a company.
318. Late fees apply to lodgement of accounts outside of the statutory periods.<sup>153</sup>
319. Data lodged in returns in corporate insolvency is not in a form that lends itself readily to the production of insolvency statistics.

### **Audit of accounts**

320. ASIC may choose to have an audit performed on a liquidator's account by a registered company auditor. The liquidator must give the auditor such books and information as the auditor requires for the purposes of the audit, and if they fail to do so, ASIC may seek a court-order to enforce the requirement. Where ASIC requests an audit, it must provide a copy of the audit report to the liquidator. The costs of the audit are fixed by ASIC and form part of the expenses of the winding up.<sup>154</sup> The statutory power for ASIC is broadly similar in respect of receiverships, voluntary administrations and deeds of company arrangement.<sup>155</sup>

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149 Section 1323 of the Corporations Act.

150 Section 1324 of the Corporations Act.

151 Section 539 of the Corporations Act.

152 Sections 438E and 445J of the Corporations Act. Similar requirements exist for schemes of arrangement and controllerships - paragraph 411(9) (a) and subsection 432(1A) of the Corporations Act.

153 Schedule 1 item 28 of the *Corporations (Fees) Regulations 2001*.

154 Subsection 539(2) and section 556 of the Corporations Act.

155 Subsections 432(2)-432(5), 438E(3)-(7), 445J(3)-(7) of the Corporations Act.



## Keeping proper books

321. A liquidator, provisional liquidator or administrator must keep proper books containing meeting records and other matters that give a complete and correct record of the liquidator's or provisional liquidator's administration of the company's affairs. These must be kept at the offices of the liquidator and be available for inspection by any creditor or contributory, unless the Court otherwise orders. A strict liability offence of five penalty units (currently \$550) applies.<sup>156</sup>

## Retention of books

322. The liquidator must retain all books of the company and of the liquidator that are relevant to the affairs of the company at or subsequent to the winding up of the company for a period of five years from the date of deregistration. The liquidator may subsequently destroy the books unless prohibited by requirements under the *Income Tax Assessment Act 1936*.<sup>157</sup> Subject to ASIC's consent, the books may be destroyed earlier if provided for by:

- the Court in a court-ordered winding up;
- a company resolution in the case of a members' voluntary winding up; or
- a resolution of the COI, or, if there is no such committee, the creditors of the company in the case of a creditors' voluntary winding up.<sup>158</sup>

323. These provisions do not apply to voluntary administrations or deeds of company arrangement.

## Personal

### Funds handling

324. In contrast to corporate insolvency, a registered trustee is not required to open a separate account for each administration.<sup>159</sup> However, the trustee must pay monies in relation to an administration into an account within five days, or otherwise incur a penalty of interest at a rate of 20 per cent per annum on amounts retained over \$50.<sup>160</sup> If a registered trustee pays estate monies into a private account, he or she is guilty of an offence of strict liability with a penalty of \$1,100.<sup>161</sup> Only bankruptcy related moneys are permitted to be held in such an account. A registered trustee must issue receipts in respect of a payment into the estate if asked to do so by the person making the payment and must, wherever practicable, obtain a receipt for a payment made out of the estate.<sup>162</sup>

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156 Section 531 of the Corporations Act, and regulations 5.6.01 and 5.6.02, and subregulations 5.6.27(5) and 5.6.27(6) of the Corporations Regulations.

157 Subsections 542(1) and 542(2) of the Corporations Act.

158 Subsections 542(2) to (4) of the Corporations Act.

159 Section 169 of the Bankruptcy Act.

160 Section 169 of the Bankruptcy Act.

161 Section 168 of the Bankruptcy Act.

162 Section 171 of the Bankruptcy Act. There is no equivalent requirement in the corporate law.

325. These rules also apply to controlling trustees<sup>163</sup> and registered trustees when they are administering personal insolvency agreements.<sup>164</sup>
326. The Bankruptcy Regulations also prescribe a number of other specific record keeping duties in respect of funds.<sup>165</sup> These apply to bankruptcies, compositions or schemes or arrangement, controlling trusteeships, the administration of personal insolvency agreements and administrations of bankrupt deceased estates.
327. A registered trustee must therefore maintain a separate record of receipts and payments for each administration. A registered trustee must verify all payments from an administration, and transfers between estates, by reference to appropriate supporting vouchers and original documents kept on the administration file.<sup>166</sup>
328. In contrast, the corporate law does not mandate specific obligations in addition to the general duty to record such matters as are required to give a complete and correct record of the registered liquidator's administration of the company's affairs.<sup>167</sup>
329. Additionally, for personal insolvency, there are specific obligations to reconcile bank accounts.<sup>168</sup> If a single bank account is kept for two or more administrations, the trustee must collectively reconcile the records for the individual administrations with the bank records each month. A trustee must regularly reconcile the cash book for an administration with the bank records for the administration, in accordance with the amount of activity in relation to the administration. There are no equivalent corporate insolvency obligations.
330. The Inspector-General is empowered to freeze the trust account of a registered debt agreement administrator in certain circumstances. This is done through the giving of an account freezing notice to the relevant bank.<sup>169</sup> The Inspector-General does not have any corresponding power to freeze an account of a registered trustee that is kept (or is purported to be kept) for the estate of a bankrupt.

### Accounts reporting

331. Trustees are required to lodge an annual return with ITSA in respect of a bankrupt's estate if they administered the estate during that financial year.<sup>170</sup> Failure to lodge the return within 35 days after the end of the financial year is an offence of strict liability and attracts a penalty of \$550 (or \$110 if an infringement notice is issued).<sup>171</sup>
332. The information required to be lodged in returns differs significantly between personal and corporate insolvency. Personal insolvency returns must be lodged in the form of a spreadsheet provided by the regulator, with a listing of all matters to which the person is appointed. It requires the provision of figures for the totals of various classes of receipts and payments. In contrast, the corporate insolvency lodgement is a paper form

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163 Section 210 of the Bankruptcy Act provides that Part VIII of that Act, with any modifications prescribed by the regulations, applies in relation to controlling trustee.

164 Section 231(5) of the Bankruptcy Act.

165 Part 2 of Schedule 4A of the Bankruptcy Regulations.

166 Regulation 2.25 of Schedule 4A of the Bankruptcy Regulations.

167 Section 531 of the Corporations Act, regulation 5.6.01 of the Corporations Regulations.

168 See Division 2.7 of the Bankruptcy Regulations.

169 Section 186LB of the Bankruptcy Act.

170 Section 170A of the Bankruptcy Act.

171 Ibid.



for each individual administration (although a scanned copy may be lodged) requiring extensive details of estate transactions (although not in a form that facilitates the production of insolvency statistics).

333. Data lodged in annual returns in personal insolvency is utilised by ITSA in the production of annual statistics in Annual Reports and in the production of their Profiles of Debtors series of publications.

### **Audit of accounts**

334. Under the Bankruptcy Act, the Inspector-General may, on his or her own initiative, at the request of a creditor or the bankrupt, audit the accounts of the trustee or cause them to be audited by an appropriate person. The cost of the audit is borne by the estate. A sanction of five penalty units is applied to the trustee for failing to produce the accounts and records as requested by the auditor.<sup>172</sup>

### **Keeping proper books**

335. The trustee of the estate of a bankrupt is required to keep such accounts and records as are necessary to exhibit a full account of the administration of the estate and shall permit a creditor of the bankrupt to inspect the accounts and records relating to that estate. A sanction of five penalty units is applied if the trustee fails to comply.<sup>173</sup> Where the trustee carries on a business previously carried on by the bankrupt, the equivalent requirements apply.

336. There are also a number of specific record keeping requirements in addition to those relating to funds handling.

337. A separate file must be kept for each administration. Proper written records must be kept in respect of:

- decisions about the identification, protection, realisation or write-off of a significant asset of a bankrupt that may have a material impact on the administration;
- every material decision in an administration, and any supporting documentation relied on in relation to the decision;
- the name of each creditor who received a dividend, the amount of each admitted claim and the amount of dividend paid to each creditor;
- the time spent on work done in conducting an administration; and
- descriptions of the nature of the work.<sup>174</sup>

338. Similar provisions apply in the case of controlling trustees and personal insolvency agreement trustees.<sup>175</sup>

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172 Section 175 of the Bankruptcy Act.

173 Section 173 of the Bankruptcy Act.

174 Sections 173 and 174 of the Bankruptcy Act, Regulations 2.12, 2.16, 2.17, 3.9 of the Bankruptcy Regulations.

175 Schedule 6 parts 3 and 7 of the Bankruptcy Regulations as applied by section 210 of the Bankruptcy Act and Regulation 10.07 of the Bankruptcy Regulations.

## **Retention of books**

- 339. In contrast to the Corporations Act, there is no explicit penalty for the early or unauthorised destruction of records. Instead, the registered trustee may be found to have breached the duty to provide information when reasonably requested which is punishable by a fine of five penalty units, or open to civil action from a third party.
- 340. During the administration of the estate of a bankrupt or debtor, the trustee may destroy or give back to the bankrupt or debtor any books that the bankrupt or debtor gave to any trustee of the estate, which the trustee considers will not help the administration.
- 341. At the end of the administration, the last trustee to administer the estate may give the books provided by the bankrupt or debtor back to the bankrupt or debtor.
- 342. The last trustee may destroy administration books or retained debtor books relating to the estate at least six years after the end of the administration if, by the end of the administration, no property was realised, no dividends distributed to creditors and the trustee was of the view that such distributions could not occur. If property is realised and the trustee has been remunerated from the estate, the books may be destroyed at least 15 years after the end of the administration.<sup>176</sup>

## **CURRENT ISSUES**

### **Divergence of personal and corporate rules**

- 343. The current divergence in rules and requirements for personal and corporate insolvency may create unnecessary complexity and costs for creditors and insolvency practitioners.
- 344. Inconsistent rules make it difficult for creditors of individuals as well as companies to understand how the different regimes apply without an in-depth knowledge of both frameworks (something which creditors are unlikely to have). This lack of knowledge and expertise is not something that creditors themselves can easily address and it may impose both financial and time costs on creditors who wish to obtain information necessary to protect their own interests.
- 345. The divergence also limits the ability for practitioners to easily move between corporate and personal insolvencies as the different approaches to account and record keeping increases costs and the administrative burden on practitioners. Similar but different rules may contribute to error by practitioners through the application of the wrong set of rules in an administration.

### **Minimal penalties for breach of rules**

- 346. The current penalties for a breach of a practitioner's obligations to keep, and retain for the statutory period, books is set at a very low level.
- 347. The penalty for not keeping proper books under both regimes is, depending upon the circumstances, set at a low level of \$550. It is questionable whether the penalty provides an appropriate disincentive to insolvency practitioners from either falsifying or failing to keep a proper record of the liquidation. Ensuring the integrity of the books of a

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<sup>176</sup> Section 312 of the Bankruptcy Act.



liquidation or bankruptcy is paramount to providing creditors with the ability to monitor the progress of an external administration.

348. The penalty for early destruction of the books of a liquidation is set at \$550. There is no equivalent criminal penalty under personal insolvency law. Destroying, or allowing for the destruction of, the books of a liquidation or bankruptcy inhibits the ability of creditors, regulators or other third parties to determine what has occurred in a given administration.

### **Cost of retaining books**

349. The requirement to retain hard copies of the books of every liquidation or bankruptcy undertaken within the previous five, six or 15 year period represents a significant expense for liquidators or registered trustees. Given the advances in electronic means for capturing documentation, it is questionable whether there is a continuing need for the retention of records in hard copy in all cases, or whether the policy intent could be achieved through alternative electronic methods.

## **REFORM OPTIONS**

### **Option One: maintain the status quo with minor enhancements to funds handling**

350. The corporate and personal insolvency systems could continue to diverge with respect to the rules regarding the handling of funds, account reporting, audit of accounts, and keeping and retention of books. The Corporations Act and Bankruptcy Act could, however, be amended to provide greater internal consistency of the application of the funds handling rules within the corporate and personal insolvency frameworks.

#### **Funds handling**

351. While the rules for funds handling would remain divergent between the personal and corporate insolvency systems, the corporate insolvency framework could be amended to explicitly extend funds handling rules to voluntary administration (or deeds of company arrangement).
352. Although the regulators have certain powers to obtain information on bank accounts from which money related to insolvencies is deposited into in some cases, regulators may need the power to move quickly to ensure that creditors' money is protected. The power for the Inspector-General to freeze a registered debt agreement administrator's accounts could be extended to freeze a registered trustee's bank accounts kept under section 169 of the Bankruptcy Act. ASIC may be given an equivalent power.
353. A common set of investment rules in personal and corporate insolvency may not be justifiable, given the existence of the interest charge in personal insolvency and higher levels of funds held in corporate matters.

#### **Requirements to maintain separate accounts**

354. There is a divergence between the two regimes in that liquidators are required to open a separate account for each corporate liquidation (or pooled group of liquidations), whereas a trustee does not need to do so in respect of personal bankruptcies. This option would maintain these differences.

355. This issue has been the subject of the recent case of *Worrell, in the matter of regulation 5.6.06 of the Corporations Regulations 2001*<sup>177</sup> and has been subject to some commentary by the profession.<sup>178</sup>
356. In the *Worrell* case, Greenwood J accepted that a compound account has advantages and disadvantages in terms of the functionality of its modules, reporting and reconciliation processes and the procedures surrounding the operation of the compound account.<sup>179</sup> For example, his Honour accepted that using a single compound account would allow a liquidator to access a higher return on the funds by securing a commercial margin in excess of the interest rate that might apply to a suite of individual accounts.<sup>180</sup>
357. However, his Honour also noted that some of the perceived disadvantages of maintaining separate accounts may not be as significant as previously thought, citing the evidence of a National Australia Bank (NAB) employee about the operation of bank accounts. In particular, NAB did not charge a fee to open or close an account and accounts are generally opened on the same day when complete documentation is received from a practitioner.<sup>181</sup>
358. The question of whether the separation of accounts is desirable must balance questions of transparency, protection of funds and the costs of maintaining separate accounts.
359. It may be considered that the risks associated with using a compound account, such as the increased risk of misallocation, misapplication or misappropriation of funds, which are minimised when a separate account is used for each external administration, outweigh the benefits of lower fees and costs in operating a compound account.<sup>182</sup> Registered trustees may have fewer numbers of bankrupt estates that they are administering and may have a large number of administrations with relatively few receipts and payments making accounting for them much easier than if a number of corporate insolvencies were pooled into a single account. Alternatively, proper funds management utilising modern accounting software may reduce the risks associated with compound accounts to an extent that the costs of separate accounts are no longer justified.

### Audit of Accounts

360. For both corporate insolvencies and bankruptcies, the audit of accounts is discretionary, with costs borne by the audited entity. The differences are that:
- the Inspector-General may audit the trustee's accounts themselves, or get another party to do so, whereas ASIC must submit the liquidator's accounts to a registered company auditor; and
  - a specific penalty is applied to a trustee who does not produce the required information for an audit, whereas a liquidator who does not produce the information may be subject to a court order.

177 (2010) 117 ALD 110, 79 ACSR 437, [2010] FCA 934.

178 For example, 'Insolvency Case Summaries', Australian Insolvency Journal (2010) 22(4) pp 49-50; the IPA at [www.ipaa.com.au/default.asp?menuid=233&artid=733](http://www.ipaa.com.au/default.asp?menuid=233&artid=733).

179 *Worrell* case, at paragraph 93.

180 *Worrell* case, at paragraphs 101 and 105.

181 *Worrell* case, at paragraphs 95-97.

182 ASIC Media Release 22 December 2010, 'Banking requirements reaffirmed for insolvency practitioners'.



361. Given the differences in the financial requirements on companies and individuals, the differences in auditing requirements in the case of corporate insolvencies and bankruptcies may well be justified. For example, allowing a party other than a registered company auditor to audit the accounts of a registered liquidator may be inappropriate, whereas requiring a registered company auditor to audit the accounts of a registered trustee may be considered unnecessarily expensive.

## **Option Two: alignment with enhancements**

### **Funds handling**

362. Irrespective of the merits of maintaining separate accounts, there is the issue of whether divergent positions between corporate and personal insolvency can be justified. An insolvency practitioner could be required to open and operate a separate bank account in respect of each corporate or personal insolvency. This requirement may only apply if the money being held in relation to a particular insolvency reaches a certain threshold.
363. The penalty provisions for not placing money into the appropriate account currently differ for corporate insolvencies and personal bankruptcies. There are differences in respect of:
- the number of days within which money must be deposited, with the regulations allowing five days for registered trustees and seven days for registered liquidators; and
  - how a penalty is applied if the money is not deposited, with five penalty units applying to registered liquidators and interest charged on outstanding moneys applying to registered trustees.
364. The scope of what actions are or are not an offence could also be aligned (for example, not banking in a separate administration account versus banking in a personal account).
365. There are also minor divergences in respect of permissible payment methods and the issuing or obtaining of receipts. Where the rules regarding these matters are already substantively aligned, the current divergence in their drafting could be addressed.
366. The specific duties in respect of record keeping in relation to funds handling and bank reconciliation could be aligned, as well as the permissible payment methods and rules regarding receipting.
367. The systems could also be aligned by empowering ASIC to freeze registered liquidators accounts in the same way that the Inspector-General can freeze those of a registered debt agreement administrator. This freezing power could be extended to all kinds of insolvency administration.

### **Accounts reporting**

368. While the requirements to provide a copy of the accounts relating to each corporate insolvency to ASIC are spelled out in the Corporations Act, the corresponding provision for registered trustees in the Bankruptcy Act is stated in a manner that leaves the ultimate form of information required to ITSA's discretion.<sup>183</sup> Instead, the

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183 Section 170A of the Bankruptcy Act.

lodgement of returns in personal insolvencies derives from a broad information gathering power vested in the Inspector-General under subsection 12(1A) and section 170A of the Bankruptcy Act.

369. The accounts reporting requirements could be aligned by:

- removing the legislative requirements for regular accounts to be submitted in respect of each corporate insolvency to ASIC, while giving ASIC a broad power similar to that provided to the Inspector-General to enable accounts to be provided. The regulators could then cooperatively examine whether requirements should be aligned; or
- introducing a legislative requirement for the lodgement of regular accounts in respect of personal insolvencies.

370. It would not be the purpose of any reforms to remove the requirement to lodge annual returns, given their importance in maintaining transparency and in understanding the extent and nature of activity taking place in the insolvency industry and the economy. Reforms would instead be directed at aligning requirements or, depending upon the option adopted, increasing the ability of regulators to gather relevant information in a manner that minimised regulatory burdens.

371. Improvements in annual return contents and methods for lodgement in corporate insolvency may assist in the production and publication of corporate insolvency statistics. The Senate Committee's report recommended improvements to current capacities to develop insolvency statistics to support research into and regulation of insolvencies.<sup>184</sup>

### **Keeping proper books**

372. The record keeping requirements are quite similar, with more prescription in the case of personal bankruptcy. The book keeping rules could be aligned by amending:

- the Corporations Act to provide more prescriptive requirements in the case of corporate insolvencies; or
- the Bankruptcy Act to make the personal insolvency requirements less prescriptive (such as by removing the provisions for record keeping from the Bankruptcy Regulations, and relying exclusively on the existing provisions in the Bankruptcy Act).

### **Retention of books**

373. The registered liquidator's books for a corporate insolvency, which form the records of administration (as distinct from the books of the debtor or insolvent company) must be kept for five years, or less if agreed by ASIC and the affected parties. For personal bankruptcies, the books of the bankrupt that are relevant to the administration must be kept by the trustee for six or fifteen years following the end of the administration depending on whether property is realised and distributed.

374. The Corporations Act or Bankruptcy Act could be amended to align the period for which records must be retained, and the process by which earlier destruction may be

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184 Recommendation 17 of the Senate Committee's report.



authorised. If this occurs the common periods for which records should be retained would need to be determined.

- 375. Legal mechanisms might be put in place to enable paper records to be destroyed at an earlier date if electronic copies are created and retained. Some classes of records may have different retention periods.
- 376. The Bankruptcy Act could be amended to make the early or unauthorised destruction of books an offence in personal insolvency as well as in corporate insolvency.

### **Auditing of accounts**

- 377. The audit provisions and rules regarding costs could be aligned.
- 378. The power to require an audit to take place under both the Corporations Act and Bankruptcy Act could also be expanded beyond an audit 'of accounts' to a review and report on the conduct of an administration generally by a personal or corporate insolvency expert.

### **Option Three: increase penalties**

- 379. The penalties for breaching the funds handling, record keeping, retention of books, and audit provisions in the Corporations Act and the Bankruptcy Act could be increased to better reflect the important role that these requirements play in ensuring the integrity of the market.
- 380. Civil or criminal penalties could be applied to the lodgement of inaccurate annual reports under certain circumstances.
- 381. Late lodgement, non-lodgement or false lodgement of accounts could also be made a basis for removal from a particular matter. This could be implemented through the regulator being able to require the liquidator to communicate the breach to the creditors, and advise them of their options for removing him or her, either through a creditor vote (as currently possible under the Bankruptcy Act) or through a Court-order.
- 382. Reforms could provide for an increased level of penalty where breaches represent a failure in the business systems of the insolvency practitioner.

### **DISCUSSION QUESTIONS**

- 383. Should the rules governing record keeping, accounting, audits and funds handling in corporate and personal insolvency be aligned? If so, how should this occur?
- 384. If aligned rules on accounts reporting are introduced, what should be the content, form and frequency of the accounts required?
- 385. Are there other record keeping, accounting, audits and funds handling rules that should be mandated for personal and corporate insolvency, in addition to those that currently exist?
- 386. If amendments are made to the personal and corporate law to align the powers of the regulators (in certain circumstances) to freeze the accounts of insolvency practitioners,

in what circumstances should the regulators be able to issue an account freezing notice to a bank?

387. Should the issuing of an account freezing notice require an application to the Courts? For how long should a freezing notice have effect?
388. At what level should the penalties that apply to breaches of the funds handling, record keeping, retention of books, and audit provisions in the Corporations Act and the Bankruptcy Act be set to provide a greater deterrent to potential offenders?
389. Will increasing the penalties make practitioners more likely to pay greater attention to these requirements?
390. Are there additional civil obligations and criminal offences that should be provided for in respect of these areas?
391. If civil or criminal penalties are applied for the lodgement of inaccurate annual reports, under what circumstances should those penalties apply?
392. Should late lodgement, non-lodgement or false lodgement of accounts be a statutory basis for removal? If so, by what process might removal take place?



# INSURANCE REQUIREMENTS FOR INSOLVENCY PRACTITIONERS

## FOCUS OF CHAPTER

This chapter seeks comments on the current insurance requirements for corporate and personal insolvency practitioners and whether they are sufficient.

Submissions to the Senate Committee Inquiry highlighted instances where practitioners had allowed these forms of insurance to lapse to the detriment of third parties. In particular, the Senate Committee's Report raised concerns regarding the current difficulties regulators face in gaining awareness of when the insurance policies of practitioners lapse. In this context the Senate Committee's report recommended the establishment of a fidelity fund.

The chapter explores the concerns raised by the Senate Committee Inquiry and seeks comments on whether: the amendments to the penalty provisions could address the concerns raised by the Senate Committee Inquiry; whether there is room to harmonise the requirements across the Bankruptcy Act and the Corporations Act; and whether there is a role for a fidelity fund.

## CURRENT LAW

### Corporate

393. In order to meet claims that may be made against them in connection with externally-administered bodies corporate, a registered liquidator is required to maintain adequate and appropriate Professional Indemnity insurance (PI insurance), and adequate and appropriate fidelity insurance.<sup>185</sup>
394. ASIC's *Regulatory Guide 194 Insurance Requirements for registered liquidators* (RG 194), outlines ASIC's policy on how it administers the insurance requirements under the Act including guidance to assist registered liquidators to determine what are adequate and appropriate insurance arrangements.<sup>186</sup> A registered liquidator is required to confirm that they hold the appropriate insurance as an element of their annual statement.<sup>187</sup>
395. RG 194 provides a high level of detail of what is expected in relation to insurance. It addresses a range of issues in detail. There is no equivalent document in personal insolvency.
396. In general terms, RG 194 provides that to be considered adequate, professional indemnity cover must meet the quantum requirement of the Institute of Chartered Accountants in Australia (ICAA) (New South Wales) Professional Standards Council (PSC) scheme. The ICAA consider professional indemnity insurance to be adequate where the sum insured for each claim, and for all claims in aggregate, is not less than the lowest of:
- \$20 million; or

185 Section 1284 of the Corporations Act.

186 RG 194.82-194.88 and RG 194.42-194.50.

187 Section 1288 and *Form 908 Annual statement by a liquidator*.



- 10 times the highest gross fees billed by the registered liquidator (or if the registered liquidator is a member or employee of a firm, the highest total of gross fees billed by all registered liquidators who are members or employees of the firm) in a single financial year in relation to a particular insolvency engagement, during the three years prior to the commencement of the insurance policy; or
  - if the registered liquidator has provided insolvency services for less than one full year, either \$750,000 or \$1 million depending on the commencement date of their policy period.<sup>188</sup>
397. In addition, ASIC sets out further requirements concerning adequate and appropriate levels of excess and deductible cover. ASIC advises that the excess for each claim must be set at a sufficiently low level for the liquidator to be able to sustain any claim with certainty and be able to deal with such an excess or deductible as an uninsured loss. The guide also sets out specific minimum excess requirements.<sup>189</sup>
398. The guide does not indicate a specific level of fidelity insurance considered to be adequate for liquidators. Rather, RG 194 outlines the factors which should be taken into account when the company decides which level of cover is appropriate for its circumstances. The guide suggests that, in assessing adequacy, a liquidator should have regard to: prudence and reasonableness; liabilities that might reasonably be expected during the period of cover; and internal aspects of the registered liquidator's firm.<sup>190</sup>
399. A breach of these requirements is an offence of strict liability and the penalty is \$550. If ASIC discovers that a liquidator has contravened the insurance they have the option of cancelling a liquidator's registration.<sup>191</sup> ASIC may do so without referring the matter to the Companies Auditors and Liquidators Disciplinary Board.

## Personal

400. In order to be registered as a registered trustee, a practitioner must satisfy the committee that he or she 'will take out insurance against liabilities that the applicant may incur working as a registered trustee'.<sup>192</sup> A registered trustee must provide proof of retaining these insurance policies in order to extend his or her registration.<sup>193</sup>
401. The Inspector-General may ask a registered trustee to provide a written explanation why they should continue to be registered where the trustee has not kept his or her insurance up to date.<sup>194</sup>
402. A breach of insurance requirements is not an offence.
403. While ITSA does not provide any statutory guidance on what might be considered to be a sufficient level of insurance to satisfy the statutory requirement, it has provided

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188 RG 194.43.

189 RG 194.45.

190 RG 194.84-194.88.

191 Section 1290A of the Corporations Act.

192 Paragraph 155A(2)(b) of the Bankruptcy Act.

193 Regulation 8.04 of the Bankruptcy Act.

194 Paragraph 155H(1)(c) of the Bankruptcy Act.



some guidance in relation to insurance in *Inspector-General Practice Guideline 13 Trustee registered under Bankruptcy Act Registration Process*.<sup>195</sup>

404. ITSA monitors the status of the insurance policies held by each trustee and requires that a practitioner provide a certificate of currency when renewing their registration every three years. ITSA also monitors compliance as part of its trustee inspection program.

## **CURRENT ISSUES**

### **Insurance when responsibilities are breached**

405. An action may be brought by the company, its creditors, a bankrupt's creditors or other affected stakeholders for losses suffered as a result of an act or omission of the registered liquidator or registered trustee. The insurance requirements attempt to ensure that funds are available to compensate claimants for loss suffered.
406. If the practitioner has acted illegally, for example by committing fraud, or intentionally breaching their duties, an insurance company is likely to refuse to cover the breach which will impact on the amount a claimant will be able to recover. Likewise, if the practitioner does not hold insurance, the recovery of any losses suffered due to the breach may be reduced.
407. Insurance cover may also be ineffective if the insured party ceased paying premiums prior to a claim being made or where they have otherwise breached the contract, such as through inadequate disclosures. In either case, claimants may have to rely merely on the practitioner's individual resources, as claims against the insurance will not be met because of the void or nonexistent status of the policy.
408. Concerns were raised during the Senate Committee Inquiry about insurance cover held by practitioners. One area of concern was the inability of the regulator to know when the insurance policy of a liquidator had lapsed. In response, the Senate Committee Inquiry recommended that an obligation be placed upon insurers to notify the regulator if the practitioner's insurance lapses or expires.<sup>196</sup>
409. Dishonest or fraudulent sole practitioners raise a number of problems. In instances of breach in a multi partner firm, the aggrieved party may be able to claim against the firm for the dishonest actions, and the firm may, in turn, be able to claim against the firm's fidelity insurance policy as an innocent party to the breach. However, where there is a sole practitioner, the practitioner may not be able to claim against the fidelity insurance if they were involved in committing the breach.
410. These concerns led the Senate Committee to recommend that a fidelity fund should be established by the major accounting bodies to act as a point of last resort for parties affected by fraud and wrongdoing of insolvency practitioners.<sup>197</sup>
411. Any requirement for practitioners to contribute, either through direct contributions or through a tax, to a fidelity fund would likely be passed on to creditors through higher costs or remuneration. There would be significant costs associated with a fidelity fund.

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195 This Guideline can be found at [www.itsa.gov.au](http://www.itsa.gov.au).

196 Recommendation 10 of the Senate Committee Report.

197 Recommendation 12 of the Senate Committee Report.

412. However, it is important to ensure that there is a significant incentive for practitioners to maintain their insurances and to ensure the insolvency framework reduces the possibility of dishonest behaviour. It may be queried whether current associated criminal penalties for non-compliance with insurance requirements are a sufficient deterrent. The adequacy of penalties may also be queried given the possible magnitude of the loss third parties may suffer due to a breach.

## **Fidelity insurance requirements**

413. The current run-off and fidelity insurance requirements are limited in a number of ways. Typically, an insurance policy runs on a 'claims-made' system. This means that claims made for breaches which occurred during the period of the policy and which are notified to the insurer during this period will be covered. Claims made before the policy came into effect may also be covered if there is a sufficient retroactive clause. However, if the circumstance occurred during the period of the insurance but is not notified until after the policy has expired or been cancelled the policy will not cover this breach unless run-off cover is in place.
414. ASIC's Regulatory Guide requires two forms of run-off cover: automatic and regular. Automatic run-off cover provides for claims when a firm has become insolvent, and regular run off applies when the practitioner ceases to practice in the ordinary course, for example when the practitioner retires. There is no requirement to hold run-off cover which would apply in instances where the insurance policy lapses or is cancelled. However, the industry has raised concerns that insurers will not offer run-off cover for insolvency practitioners.<sup>198</sup>

## **REFORM OPTIONS**

### **Option One: increasing severity of penalties for breach**

415. The penalties for failing to hold insurance could be increased to better reflect the seriousness of the breach, and to represent a stronger deterrent effect.
416. This could be achieved through increasing the pecuniary penalty amount and imprisonment time, and through amending the Corporations Act and Bankruptcy Act to make the breach of the insurance requirements subject to a civil penalty, as well as a criminal penalty.

### **Option Two: required notification of lapsed insurance policies**

417. In addition, the Government could adopt part of the recommendation of the Senate Committee's Inquiry that the insurance industry be required to notify the regulator if a practitioner's insurance lapses or expires, as this would aid the detection of breaches of the insurance requirements.
418. Regardless of the initial costs for set-up of the system by insurance providers, the notification process would also need to address non-renewal by liquidators when transferring to another insurer. It would be problematic and unnecessarily costly if insurance companies in such cases were required to notify ASIC that a contract of insurance had not been renewed.

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198 Ms Denise North, Senate Economics References Committee Hansard, Reference: Liquidators and administrators, Canberra, 12 March 2010, page 51.



419. The implementation of this recommendation would likely impose a significant additional compliance burden on insurance companies. These costs are likely to be passed onto creditors through increased fees.

### **Option Three: establishment of a fidelity fund**

420. The Government could adopt the recommendation made by the Senate Committee that the major accounting bodies should establish a fidelity fund to ensure that creditors are insured for fraud and wrongdoing.
421. The implementation of the fidelity fund would have a high cost on the profession. Given the relatively small number of participants in the industry, and the even smaller numbers of practitioners registered with particular professional bodies (for example, the Institute of Chartered Accountants in Australia), the establishment of a fidelity fund by professional bodies would be unlikely to be cost effective.
422. As there is only very limited evidence of a practitioner letting their insurance lapse, the cost of the implementation of this option may not be commensurate to the risk that is posed. This is understandable given that it is in the interests of practitioners to maintain their insurance. While a fidelity fund could ensure compensation against dishonest or fraudulent practitioners it would be a costly option and would not prevent the dishonest or fraudulent behaviour occurring. It may be considered more appropriate to implement reforms which address the dishonest or fraudulent behaviour directly.

### **Option Four: mandated periodic checking of insurance cover**

423. Alternatively, if the registration of liquidators is limited to a defined period as raised in the *Registration of Insolvency Practitioners* chapter of this paper, any renewal of registration could be contingent on evidence of the practitioner currently holding insurance, as well as evidence of having held appropriate insurance for the entire previous period.

### **DISCUSSION QUESTIONS**

424. Is there a benefit for insolvency practitioners, creditors or other stakeholders in aligning the insurance requirements for liquidators and registered trustees?
425. If the criminal penalty for not complying with insurance requirements is increased, at what level should the penalty be set to provide a sufficient deterrence against breach?
426. Should a fidelity fund be established? If so, how should such a fund be operated and funded?
427. What other reforms might be put in place regarding insurance requirements?



# DISCIPLINE AND DEREGISTRATION OF INSOLVENCY PRACTITIONERS

## FOCUS OF CHAPTER

This chapter looks at the disciplinary and deregistration frameworks that apply to the corporate and personal insolvency regimes and identifies areas which are open to alignment or reform. A number of submissions to the recent Senate Committee Inquiry were critical of the speed, cost and transparency of the disciplinary processes in corporate insolvency.

The current corporate regulatory framework which provides a tribunal for the discipline and deregistration of registered liquidators diverges significantly from the personal insolvency framework that requires a committee to make decisions on the discipline of registered trustees. Appendix One contains a table showing the principal similarities and differences between the two systems.

This chapter seeks comments on options for reform of the discipline and deregistration framework, including options to increase speed and decrease costs, increase transparency, and harmonise the corporate and personal insolvency frameworks in this area.

## CURRENT LAW

### Corporate

428. ASIC has the power to deal with breaches of registered liquidators obligations by cancelling a registered liquidator's registration in limited circumstances, accepting an enforceable undertaking from a registered liquidator, referring the matter to the Companies Auditors and Liquidators Disciplinary Board (CALDB), or taking proceedings through the Court.
429. ASIC may cancel the registration of a registered liquidator where that person becomes an insolvent under administration, is disqualified from managing corporations, or fails to maintain the requisite insurance.<sup>199</sup> In contrast to its limited powers with respect to registered liquidators, ASIC may cancel or suspend the registration of an official liquidator at any time;<sup>200</sup> however, they will remain as registered liquidators unless ASIC takes the further steps to cancel their registration as registered liquidators. ASIC may also require a person registered as an official liquidator to give an undertaking to refrain from engaging in specified conduct except on particular conditions.<sup>201</sup>

### Companies Auditors and Liquidators Disciplinary Board

430. The most common path for the cancellation or suspension of registration or discipline of a registered liquidator is through a referral from ASIC to the CALDB where ASIC believes that the liquidator has breached his or her obligations under the Corporations Act. A liquidator's registration may be cancelled or suspended where the

199 Section 1290A of the Corporations Act.

200 Subsection 1291(1) of the Corporations Act.

201 Subsection 1291(2) of the Corporations Act.



CALDB determines, on the application of ASIC or the Australian Prudential Regulatory Authority, that the practitioner:

- (a) has failed to carry out or perform adequately and properly their duties and functions;
- (b) is otherwise not a fit and proper person to remain registered as a liquidator;
- (c) has failed to lodge an annual statement (in respect of their registration – this does not refer to a failure to lodge annual returns in respect of an external administration);
- (d) has ceased to be resident in Australia;
- (e) is disqualified from managing corporations under Part 2D.6 of the Corporations Act; or
- (f) is incapable, because of mental infirmity, of managing his or her affairs.<sup>202</sup>

- 431. The CALDB is established under the ASIC Act, and operates with functions given to it by the Corporations Act.
- 432. The CALDB is able to establish its own procedures for convening, and conducting, business of a Panel of the CALDB to consider a case.<sup>203</sup> The CALDB classifies matters as being either administrative or conduct in nature, depending on the seriousness of the alleged conduct, with corresponding differing practice and procedure.<sup>204</sup>
- 433. A Panel of the CALDB is constituted by three or five persons<sup>205</sup> and generally, the Panel will determine its own procedures. A question arising at a meeting of a Panel must be determined by a majority of the votes of the members of the Panel present and voting.<sup>206</sup>
- 434. Where an application is made on the grounds (a) or (b) set out above, the CALDB may additionally admonish, reprimand or require undertakings from the practitioner.<sup>207</sup> This gives the CALDB de facto powers to impose conditions on a practitioner.
- 435. The CALDB must not make orders against a person unless they have been given the opportunity to appear at a hearing held by the CALDB and to make submissions to, and adduce evidence before, the CALDB in relation to the matter.<sup>208</sup> The Chairperson of the CALDB may hold pre-hearing conferences if he or she considers that it would assist in the conduct of the hearing.<sup>209</sup>

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202 Section 1292 of the Corporations Act.

203 Subsection 210B(6) of the ASIC Act.

204 See the Companies Auditors and Liquidators Disciplinary Board's *Manual of Practice and Procedure: Conduct Matters, March 2010 Edition*, and *Manual of Practice and Procedure: Administrative Matters*, March 2010.

205 Section 210A of the ASIC Act.

206 Subsection 210B(4) of the ASIC Act.

207 Subsection 1292 (9) of the Corporations Act.

208 Subsection 1294 (1) of the Corporations Act.

209 Section 1294A of the Corporations Act.

## Court

436. The Corporations Act entrenches the Court's power to inquire into a registered liquidator's or provisional liquidator's actions where it appears to the Court that 'a liquidator has not faithfully performed or is not faithfully performing his or her duties' or is otherwise not observing a requirement of the Court or the corporate law. The Court may then take such actions as it thinks fit,<sup>210</sup> including cancellation or suspension of the registered liquidator's registration. The application to the Court may be initiated by ASIC or any person.

## Review of disciplinary decisions

437. Where the CALDB exercises any of the disciplinary sanctions available to it, the registered liquidator has a right to appeal to the AAT, or the Court, to stay the operation of that decision while the appeal is being heard.<sup>211</sup>
438. Similarly, where a committee convened for the purpose of determining the deregistration of a registered trustee makes a decision that affects the rights of a registered trustee, the registered trustee may appeal to the AAT or the Court and have the decision stayed until the registered trustee's appeal rights have been exhausted.<sup>212</sup>
439. Where an appeal against a decision of the AAT is lodged with the Federal Court of Australia, the Court is empowered to stay the effect of the administrative decision until the completion of that appeal.<sup>213</sup>

## Removal from a particular administration

440. The Corporations Act currently empowers the Court to remove a registered liquidator from a position with respect to a particular company and appoint a new liquidator in his or her place.
441. The Court must only remove a registered liquidator and appoint another liquidator in a voluntary or court ordered winding up on cause shown.<sup>214</sup> The Court has limited the exercise of its power to remove to cases of: misconduct by the registered liquidator;<sup>215</sup> cases of personal interest conflicting with the registered liquidators' duty;<sup>216</sup> and cases where it is in the creditors' interests for another person to be appointed.<sup>217</sup> While the expense of replacing the liquidator will be a consideration in determining the interests of the external administration,<sup>218</sup> it will not override the above considerations.<sup>219</sup>

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210 Section 536 of the Corporations Act in relation to a liquidation, or sections 423 or 447E in relation to controllerships and administration respectively. See also section 1321, 598 and 472 for provisional liquidators.

211 By the AAT: Section 1317B of the Corporations Act; Section 41 (2) of the *Administrative Appeals Tribunal Act 1975* (AAT Act). By the Court: Sections 5, 15, and 15A of the *Administrative Decisions (Judicial Review) Act 1977*.

212 *ibid.*

213 Section 44A of the AAT Act, see also section 43 (5C) of the AAT Act.

214 Subsection 473(1) and section 503 of the Corporations Act.

215 *Re Sir John Moore Gold Mining Co* (1879) 12 Ch D 325.

216 *Charterland Goldfields Ltd* (1909) 26 TLR 132.

217 *Re Adam Eyton Ltd* (1887) 36 Ch D 299.

218 *Re Biposo Pty Ltd* (1995) 120 FLR 399 at 403; *Re George A Bond and Co Ltd* (1932) 32 SR (NSW) 301.



442. The Court may remove an administrator of a company under administration or of a deed of company arrangement and appoint someone else.<sup>220</sup> In the absence of a statutory reference to what considerations should be taken into account in coming to that decision, judicial practice has been to restrict removal to where 'it is demonstrated that such an order would be for the better conduct of the administration'<sup>221</sup> or 'whether in the interests of the public the removal of the liquidator would be for the general advantage of persons interested in the winding up'.<sup>222</sup>

## Personal

443. Under the Bankruptcy Act, the Inspector-General may ask a registered trustee to show cause why the trustee should continue to be registered, if the Inspector-General believes that the trustee:
- (a) no longer has a qualification or ability that is prescribed by the regulations;
  - (b) no longer has the ability (including knowledge) to perform satisfactorily the duties of a registered trustee;
  - (c) has been convicted of an offence involving fraud or dishonesty since registration as a trustee;
  - (d) is not insured against liabilities that the trustee may incur, or has incurred, working as a registered trustee;
  - (e) is no longer practising as a registered trustee;
  - (f) has contravened any conditions imposed by the committee on the trustee's practice; or
  - (g) has failed to: exercise powers of a registered trustee properly, or properly carry out the duties of a registered trustee; properly carry out the duties of an administrator in relation to a debt agreement; or comply with a standard prescribed by the regulations.<sup>223</sup>
444. If the Inspector-General does not receive an explanation within a reasonable time, or is not satisfied by the explanation, the Inspector-General must convene a Committee to consider whether the trustee should continue to be registered.<sup>224</sup>
445. A registered trustee will usually be given an opportunity to rectify simple problems. However, if the issue is serious or has not been rectified, ITSA will issue a formal

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219 *Aboriginal & Torres Strait Island Commission v Jurnkurakurr Aboriginal Resource Centre Aboriginal Corporation (in liq)* (1992) 10 ACSR 121 at 127 per Asche J.

220 Section 449B of the Corporations Act.

221 *Network Exchange Pty Ltd v MIG International Communications Pty Ltd* (1994) 13 ACSR 544; 12 ACLC 594 per Hayne J at ACLC 599; quoted in *Dallinger v Halcha Holdings* (1995) 134 ALR 178.

222 *Re Biposo Pty Ltd* (1995) NSWSC (Equity) 1-2 August 1995.

223 Subsection 155H(1) of the Bankruptcy Act.

224 Subsection 155H(2) of the Bankruptcy Act.

notice of that determination to the registered trustee. The registered trustee then has 28 days to explain or show cause why their registration should not be cancelled.<sup>225</sup>

446. The Committee will consider information obtained in the course of the investigation undertaken and interview the trustee and other parties. The Committee may determine that the trustee should continue to be registered, that conditions should be imposed on the trustee's registration, or that the trustee be deregistered.<sup>226</sup> The Inspector-General must comply with the Committee's decision.<sup>227</sup>
447. A registered trustee's registration is automatically cancelled if the trustee becomes bankrupt, becomes a party to a debt agreement as a debtor, or authorises a trustee or solicitor to be controlling trustee of their property.<sup>228</sup>

## **Court**

448. The Bankruptcy Act retains the Court's general power, on the application of the Inspector-General, a creditor or a bankrupt, to inquire into the conduct of the trustee in relation to a bankruptcy and make such order as it thinks proper, including removal of the trustee from office.<sup>229</sup>

## **Review of disciplinary decisions**

449. Where a Committee convened for the purpose of determining the deregistration of a registered trustee makes a decision that affects the rights of a registered trustee, the registered trustee may appeal to the AAT or the Court and have the decision stayed until the registered trustee's appeal rights have been exhausted.<sup>230</sup>
450. Where an appeal against a decision of the AAT is lodged with the Federal Court of Australia, the Court is empowered to stay the effect of the administrative decision until the completion of that appeal.<sup>231</sup>

## **Removal from a particular administration**

451. Section 179 of the Bankruptcy Act currently empowers the Court to inquire into the conduct of a bankruptcy trustee in relation to a specific bankruptcy. The Court is also empowered to remove the trustee from office and 'make [any other] such order as it thinks proper'.<sup>232</sup> This section has been interpreted by the Court as requiring that the consideration of an inquiry and the consideration of a court order be completed as part of a two-step process.<sup>233</sup> However, these two steps may be conflated if the Court sees fit.<sup>234</sup>

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225 Subsection 155H(1) of the Bankruptcy Act; Regulation 8.27 of the Bankruptcy Regulations; paragraph 14 of the *Inspector-General Policy Statement 8 Involuntary cancellation of trustee registration*.

226 Section 155I of the Bankruptcy Act.

227 Subsection 155I(6) of the Bankruptcy Act.

228 Section 182 of the Bankruptcy Act.

229 Section 179 of the Bankruptcy Act.

230 Section 179 of the Bankruptcy Act.

231 Section 44A of the AAT Act; see also subsection 43 (5C) of the AAT Act.

232 Subsection 179 (1) of the Bankruptcy Act.

233 *Re Alafaci* (1976) 9 ALR 262; *Re Gault* (1981) 57 FLR 165; *Re Challen* (unreported, Federal Court, 23 April 1996).

234 *Re Challen* (unreported, Federal Court, 23 April 1996).



452. It is well established that, although the Court is given a broad discretion under section 179,<sup>235</sup> that discretion must be exercised in the interests of the orderly administration of the bankrupt's estate.<sup>236</sup>

## CURRENT ISSUES

### Differences between the corporate and personal systems

453. The Corporations Act and the Bankruptcy Act provide for the cancellation or suspension of registration and discipline of registered liquidators and registered trustees respectively. These frameworks diverge in a number of important ways.<sup>237</sup>
454. Maintenance of two separate regimes creates additional complexity for stakeholders seeking to navigate the disciplinary process; and may therefore create additional costs.
455. The CALDB was established to replace similar State based boards in place at the time of the implementation of the *Corporations Act 1989*. The tribunal nature of the CALDB ensures registered liquidators receive every opportunity for natural justice in a manner similar to what they would face in a Court.
456. In contrast, when the personal insolvency system was overhauled in 1996,<sup>238</sup> the previously Court based disciplinary process was replaced with a flexible committee system that provides for a quick, cost effective approach to dealing with disciplinary matters.
457. The less rigorous Committee system may result in more complex matters needing, in practice, to be taken through the court system rather than the Committee system. However, it may be argued that such matters, when taken through the CALDB regime would be likely to be progressed to the court system in any event. From 1 July 2005 to 30 June 2010, only four matters regarding registered liquidators have been referred to the CALDB.<sup>239</sup> For example, the Mr Stuart Ariff disciplinary proceeding was taken by ASIC directly to the Courts.<sup>240</sup>

### Rogue operators

458. The recent Senate Committee Inquiry has highlighted the reputational damage that has been sustained by the corporate insolvency industry as a result of poor performers or 'rogue' registered liquidators. The potential for the removal of these poorly performing registered liquidators is important in maintaining the integrity and credibility of the system. A lack of confidence in the profession may result in a rise in the cost of obtaining credit as financiers impose increased protections for potential default.
459. Regardless of form, the system for the removal of registered liquidators or registered trustees must seek to balance competing considerations adequately, including the need to:

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235 *Re Alafaci; Registrar in Bankruptcy v Hardwick* (1976) 9 ALR 262 at 267/8 per Riley J.

236 *Re Challen (a bankrupt); Ex parte Brown v Bendeich*, FCA 23/4/1996 per Beaumont J.

237 See Appendix One for details of similarities and divergences of the two frameworks.

238 *Bankruptcy Legislation Amendment Act 1996*.

239 In the same period, CALDB has received 32 auditor-related referrals.

240 *Australian Securities and Investments Commission v Ariff* [2009] NSWSC 829; 08-180 ASIC commences proceedings against Stuart Ariff, 4 August 2008.

- promote confidence in debt recovery mechanisms;
- protect insolvency practitioners from the potential damage to their industry arising from other insolvency practitioners' poor conduct;
- ensure fairness to industry participants in relation to allegations of misconduct, including the right to natural justice as part of the process; and
- protect creditors, shareholders, and employees.

## Speed and cost

460. A number of submissions to the recent Senate Committee Inquiry were critical of the speed and cost of the process arguing that the level of procedural complexity in disciplinary processes is inconsistent with the obligations of the CALDB under the Corporations Act.<sup>241</sup> Cost effectiveness is also affected where respondents choose to use senior legal representation at hearings, and ASIC consequently considers there is a need for it to be likewise represented.
461. The IPA has asserted that the processes before the CALDB are more burdensome than in a court, as most participants, including their legal representatives, do not possess the same familiarity with the CALDB's procedures that they have with a judicial process.
462. Some registered liquidators, who have been before the CALDB, have claimed that ASIC has an advantage of familiarity with the CALDB's procedures when bringing proceedings, given it brings all cases concerning registered liquidators.<sup>242</sup>
463. It has been suggested that the AAT process is quicker, cheaper and has less formality than the CALDB and that, as matters tend to proceed to the Court in any event, the additional level of review adds unnecessary cost and delay. It has also been asserted that it may not be desirable that individuals deal with a specialist tribunal (the CALDB) before appearing in front of a generalist tribunal (AAT).<sup>243</sup>
464. In contrast, the Bankruptcy Act requires a Committee to decide a matter within 60 days of it being convened.<sup>244</sup> The Committee process is relatively inexpensive for both sides as a committee generally only sits for a day in relation to a matter and the legal costs for both sides are comparatively lower.
465. Further, the current scope for disciplining a person who is no longer fit and proper to remain a registered liquidator is constrained heavily by the requirement for ASIC to refer the question of cancelling or suspending a registered liquidator's registration to the CALDB or the Court. As a general principle, ASIC attempts to resource investigations and commence regulatory action for cases that will have a significant regulatory impact. This requires ASIC to consider a range of factors when choosing which matters to pursue and in which forum to pursue them, including the effectiveness of the remedies available, the speed at which the body can consider the

241 See Senate Report, page 76; Mr Geoff Slater, *Committee Hansard*, 13 April 2010, p. 47; Mr Vanda Gould, *Committee Hansard*, 13 April 2010, p. 20.

242 Mr Stephen Epstein, *Official Committee Hansard*, Senate Economics References Committee, Reference: Liquidators and Administrators, Tuesday, 13 April 2010, E 28.

243 See submission to the Senate Committee Inquiry of Mr David Brown and Mr Christopher Symes.

244 Regulation 8.34 of the Bankruptcy Regulations.



matter, and the availability of resources. This includes where ASIC considers referring a registered liquidator disciplinary matter to the CALDB.

## Disclosure of hearings and natural justice

466. In its report, the Senate Committee expressed concern about the transparency of the CALDB's investigative and adjudicative processes.

467. The Senate Committee recommended that section 213 of the ASIC Act, which currently prohibits disclosure of hearings by the CALDB, unless the disclosure is required by law or to fulfil the disciplinary function in relation to the profession, be replaced with the following:

'All hearings, evidence and reasons shall be heard or given in open session unless otherwise ordered by a judge of a Court of any State or Territory or the Federal Court of Australia who may, at any time during or after the hearing of a proceeding in the Court, make such order forbidding or restricting the publication of particular evidence, or the name of a party or witness, as appears to the Court to be necessary in order to prevent prejudice to the administration of justice or the security of the Commonwealth. Subject to section 216(2), any past hearings, evidence and/or reasons shall be open to inspection by any person, and a register of past matters with the names of parties shall be published and made available for inspection by the public by means of the internet.'<sup>245</sup>

468. Under the Bankruptcy Regulations, a Committee is provided with no power to release information given to it in connection with the performance of its functions or the exercise of its powers.<sup>246</sup>

469. The committee established to consider the deregistration of a registered trustee is statutorily required under principles of natural justice to cross examine a person who makes an assertion adverse to the interests of the trustee that is to be relied upon by the committee. This right has been expanded upon in guidance provided by ITSA that states:

'Should assertions be made as to the character of the trustee by any party and the assertions form part of the information on which the committee will rely, the trustee will have a right under natural justice principles to cross examine the person who made the assertion.'<sup>247</sup>

470. A Committee established to consider deregistration of a registered trustee is not able to require the presence or cooperation of a third party witness. This inability to require a third party who has made representations regarding the conduct of the registered trustee, that form part of the evidence being considered by the committee, to be cross-examined by the registered trustee may lead to such evidence not being considered by the committee as to do so would amount to a breach of the registered trustee's rights to natural justice.

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245 Recommendation 4 of the Senate Committee's Report.

246 Regulation 8.32 of the Bankruptcy Regulations.

247 Paragraph 34, *Inspector-General Practice Statement 8: Involuntary Cancellation of Trustee Registration*, January 2009.

## Standing to commence court proceedings

471. In the 2008 case of *Vink v Tuckwell*,<sup>248</sup> the Victorian Supreme Court interpreted the reference in subsection 536(1) of the Corporations Act literally, finding that 'any person' can commence court proceedings in relation to a liquidator's conduct of a liquidation. In the *Vink* case the applicant was not a creditor or shareholder and held no financial interest in the liquidation of the company being liquidated.
472. The *Vink* decision expanded the intended scope of the provision from persons aggrieved by the conduct of the liquidator in connection with the performance of his or her duties to 'any person'. The decision may provide a precedent for vexatious litigation, the disruption of otherwise orderly liquidations, and unnecessary diminution of an insolvent company's assets.
473. Most provisions in the Corporations Act empowering the Court to review a registered liquidator's conduct specify limited classes of persons who may seek a review.<sup>249</sup> There are only two which do not.<sup>250</sup>
474. Likewise, while the equivalent Bankruptcy Act provisions<sup>251</sup> refer to specific categories of applicant, the statutory power to appeal to the Court against a decision of a registered trustee also refers to applications by 'other persons affected'.<sup>252</sup>

## Review of disciplinary decisions

475. Concerns may exist regarding an insolvency practitioner being entitled to continue to act both during the initial disciplinary proceeding and during any subsequent review of any adverse disciplinary decision.
476. The question of whether a person should stand aside in relation to a particular matter pending resolution of any serious allegations might be viewed as a separate issue to whether they have in fact acted improperly and the nature of any sanction that should be imposed.
477. The operation of the AAT Act with the Corporations Act or Bankruptcy Act allows an insolvency practitioner who is subject to a disciplinary sanction to continue to act in his or her capacity as a registered liquidator or registered trustee while those appeals are heard. Where the insolvency practitioner is continuing to act in relation to a matter that formed part of the focus of the disciplinary sanction, a creditor or the regulator may be able to 'show cause' why the practitioner should be removed from the matter. They might also do so prior to the decision in first instance; although this may be less likely.
478. Where the creditor or regulator, on the basis of misconduct proven in other external administrations or bankruptcies, wishes to remove the insolvency practitioner from a current unrelated matter, it is likely that due to the absence of connection between the matters the Court will be unable or unwilling to interfere with the operation of the current matter.<sup>253</sup>

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248 [2008] VSC 206

249 See sections 447E, 472, 477, 598 and 1321 of the Corporations Act.

250 See sections 536 and 423 of the Corporations Act.

251 Sections 178, 179, 185ZBC and 210 of the Bankruptcy Act.

252 Section 178 of the Bankruptcy Act.

253 Sections 449B, 473, and 503 of the Corporations Act and section 179 of the Bankruptcy Act.



## REFORM OPTIONS

### Option One: enhanced status quo

479. The CALDB may be retained as the structure responsible for determining disciplinary actions taken against registered liquidators by ASIC. Disciplinary and deregistration processes would continue to be undertaken by a specially convened committee for actions against registered trustees. This option would align with the views of the Senate Committee that responsibility for discipline of registered liquidators should not be removed from the CALDB.<sup>254</sup>
480. The CALDB processes, however, may be updated to address the concerns raised regarding the speed of resolution of matters brought before it, as well as to address some of the concerns raised by the Senate Committee regarding transparency of the CALDB's processes.

### Amendments to increase speed and decrease costs

481. In order to address concerns regarding the timeliness of decisions made by the CALDB, the timeframes within which a matter must be heard and a decision made could be included in the legislative framework underpinning the CALDB. This may provide greater certainty to parties and ensure that matters are dealt with in a more expedient manner.
482. Imposing time limits processes may also act to funnel more complex matters that may best be considered by the Court away from the CALDB process.
483. Furthermore, amendments could be made to streamline the current processes for the provision of, and response to, the Statement of Facts and Contentions required to be given by ASIC to the CALDB and the respondent as part of any application.<sup>255</sup>

### Transparency of decisions

484. The Senate Committee recommendation to make public the hearings, evidence and reasons for decisions of the CALDB would, subject to court order preventing disclosure, permit all evidence presented to the CALDB to be disclosed to any member of the public and enable members of the public to inspect past cases. Such an amendment would provide greater scrutiny and increased transparency in respect of actions before the CALDB.
485. However, some of the material before the CALDB would be commercially sensitive, the disclosure of which may harm the proper administration of the relevant external administrations. There may also be concerns regarding the fairness to registered liquidators of disclosure of unproven allegations and untested evidence. These arguments must be viewed in light of the fact that, generally, criminal proceedings before a court are conducted in public subject to a power for the Court to restrict disclosure; and the long standing acceptance that this is consistent with the interests of justice.

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<sup>254</sup> Senate Committee's report, paragraph 11.25.

<sup>255</sup> See the Companies Auditors and Liquidators Disciplinary Board's *Manual of Practice and Procedure: Conduct Matters*, March 2010 Edition, paragraphs 3.2 and 3.5(a); and *Manual of Practice and Procedure: Administrative Matters*, March 2010 Edition, paragraph 3.2.

486. Requiring a party to apply to the Court to seek appropriate restrictions may be unduly onerous and may add unnecessary cost and delay to the CALDB processes. If the CALDB was given discretion to restrict disclosure itself, registered liquidators might in any event apply to Court seeking review of decisions not to restrict the disclosure of material – with resulting cost and delay.
487. Alternatively, the Corporations Act may be amended to empower the CALDB to restrict publication on limited grounds for example, in respect of disclosures of commercially sensitive information on the grounds that disclosure would unduly impact on the external administration; and, at the request of ASIC, on the basis that it would adversely affect registered liquidator regulation activities. However, the onus would be left on registered liquidators to apply to court for orders restricting disclosure on other grounds.
488. In relation to personal insolvency disciplinary processes, the Committee processes could likewise be amended to provide a presumption that the Committee should publish its decisions and the reasons for its decisions. The personal insolvency statutory framework could also be amended to provide that Committees be empowered to:
- summon a third party to appear at a hearing to give evidence and be cross examined on that evidence on the basis of natural justice for the registered trustee; and
  - hold pre-hearing conferences if the committee considers that it would assist in the conduct of the hearing.
489. Mechanisms might also be put in place to impose a penalty where witnesses fail to appear or produce a document.

#### **Broaden basis for discipline and deregistration of registered trustees**

490. The law could be amended to provide the Inspector-General with the power to seek (through reference to a Committee) to deregister a registered trustee where the trustee is no longer 'fit and proper'. This would align with the current broad power to do so under the Corporations Act.
491. The law could also be amended to explicitly provide that the Inspector-General could seek to deregister a registered trustee if the Inspector-General believes that the registered trustee is incapable, because of mental infirmity, of managing his or her affairs.
492. Currently, the Inspector-General may only establish a Committee to 'consider whether the trustee should continue to be registered.'<sup>256</sup> The current wording of the statute requires the Inspector-General (or delegate) to consider that a registered trustee should be deregistered before commencing the process for discipline. The law could be amended to reflect that the Inspector-General may make a reference if they consider that the registered trustee should be disciplined but not deregistered.

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256 Subsection 155H (2) of the Bankruptcy Act.



## Option Two: alignment of disciplinary frameworks for practitioners

493. Responsibility for discipline of registered liquidators could be removed from the CALDB and transferred to a new committee system based on the current system for registered trustees. Under the personal insolvency regime, disciplinary and deregistration processes would continue to be undertaken by a specially convened committee for actions against registered trustees. This would achieve greater alignment between the corporate and personal insolvency systems, and promote greater consistency of outcomes for practitioners.
494. The rules governing committees under both systems could be aligned. This may be achieved through the introduction of provisions based upon the relevant provisions of Division 1 of Part VIII of the Bankruptcy Act and subdivisions 1-4 of Division 6 of Part 8 of the Bankruptcy Regulations into the Corporations legislation.
495. Where ASIC or ITSA has reason to suspect that a practitioner has breached his or her obligations to the extent that discipline or deregistration of the practitioner is appropriate, it would be empowered to convene a three person committee to consider the application. In line with the committee system structure currently in place in personal insolvency, the committee for consideration of a registered liquidator might consist of a member of ASIC, a member of the IPA and an appointee of the Minister.
496. The Corporations legislation may be amended to include the requirement for a show-cause notice to be provided by ASIC to a registered liquidator before forming a committee to consider the matter.
497. In accordance with the current framework for registered trustees, the committee might determine its own procedure and would not be bound by any rules of evidence, but would be required to observe natural justice. The committee would be required to provide the practitioner with an opportunity to appear and be heard; and bring evidence before and make submissions in relation to the matter.
498. The aligned committee process might provide that the committee for either a corporate or personal insolvency matter would be:
- empowered to publicise, as it sees fit, the decision and reasons for its decision. There would, however, be a presumption that decisions and the reasoning behind those decisions would be released;
  - empowered to summon a third party to appear at a hearing to give evidence and be cross examined on that evidence to enable natural justice for the insolvency practitioner;
  - empowered to hold pre-hearing conferences if the committee considers that it would assist in the conduct of the hearing;
  - required to decide a matter within a designated time limit; and
  - empowered to determine costs as to the hearing where the insolvency practitioner's registration is cancelled, up to a statutory limit.
499. Penalties might be provided for where the insolvency practitioner or a witness fails to appear or produce a document.

500. The current conflict of interest rules for committees formed under the Bankruptcy Act might be replicated in the Corporations Act with possible amendments to require the disclosure of any potential conflict of interest (personal or pecuniary) to the practitioner and that his or her agreement to continue be obtained.
501. The regulatory frameworks could also be amended to further empower ASIC and ITSA to deal directly with minor breaches such as where an insolvency practitioner breaches a fee cap by an amount under a prescribed level.
502. Such reforms may also involve alignment and possible expansion of the grounds upon which the regulators may deregister a practitioner without recourse to a Board or Committee, as the current grounds under the personal insolvency system in particular are quite limited (for example, the Inspector-General is not empowered to directly deregister a practitioner convicted of an offence involving fraud or that is not insured to work as a registered trustee).
503. The Corporations Act and Bankruptcy Act could be amended to provide ASIC and ITSA with a power to impose specified conditions on a registered liquidator or registered trustee at any time after the liquidator is registered<sup>257</sup> without proceeding through a 'show cause' notice and Committee process.

### **Option Three: enhance the powers of the Court**

504. The Corporations Act and Bankruptcy Act could be amended to clarify that the Court has the power to remove a registered liquidator from an external administration or a registered trustee from a bankruptcy on the application of the regulator or a creditor, where the registered liquidator or registered trustee is before the CALDB or a Committee, or subsequently challenges a disciplinary sanction through the Court or the AAT.
505. In particular, the law might be amended to provide expressly that the Court can take into account public interest considerations when considering the removal of a registered liquidator or trustee. Public interest considerations could include having regard to questions of maintaining public confidence in the corporate insolvency or bankruptcy system. This would be subject to Chapter III of the Constitution. These considerations would need to be balanced against (and might potentially override) considerations of fairness to an individual insolvency practitioner and the financial impact on the external administration or bankruptcy.
506. The law might also be amended to provide creditors with standing to apply to the Court to remove the insolvency practitioner when the creditors are concerned about the insolvency practitioner's propriety where the insolvency practitioner is appealing a disciplinary sanction from the CALDB or Committee concerning an unrelated appointment.

### **DISCUSSION QUESTIONS**

507. Are there any reforms that should be made to either the Committee's or the CALDB's systems of disciplining practitioners to improve their operation?

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<sup>257</sup> ASIC is also has no power to impose conditions on the registration of a registered liquidator – that issue is considered in the *Standards of Entry for Insolvency Practitioners* chapter of this paper.



508. Do you think that aligning the disciplinary frameworks will provide for more consistent and improved outcomes for practitioners and other stakeholders between personal and corporate insolvency?
509. If a Committee structure is adopted for registered liquidators:
- Should there be any amendments to the framework that underpins the current personal insolvency committee system?
  - Should the statutory framework for the committee system currently in the Bankruptcy Act be replicated in the Corporations legislation?
  - Should ASIC be statutorily required to provide a show-cause notice to the practitioner before establishing a committee?
  - Should the committee consist of a member of ASIC, a member of the IPA, and an appointee of the Minister?
  - Should there be a time limit for decisions by the committee? Should it be aligned with the current time limit for bankruptcy?
510. If a Committee structure is not adopted for registered liquidators, what specific reform options should be adopted under either the CALDB or Committee regimes? In particular:
- Should a statutory timeframe be introduced for decisions by the CALDB?
  - Are there any powers that the CALDB currently has that should equally be conferred upon a Committee under the Bankruptcy Act or vice versa?
  - What, if any, other reforms should be made in respect of the transparency of Board and Committee hearings and decisions?
  - Should a committee constituted under the Bankruptcy Act be empowered to summon a third party to appear at a hearing to give evidence and be cross examined?
  - Should mechanisms be put in place to impose sanctions on practitioners or witnesses who fail to attend or provide books to a Committee or Board?
  - Should the Bankruptcy Act be amended to provide ITSA with the express power to seek to deregister a registered trustee where the trustee is no longer 'fit and proper'?
511. If the regulatory frameworks are amended to expand the powers of ASIC and ITSA to discipline insolvency practitioners directly, what minor breaches should those powers extend to?
512. Would the suggested amendments to enhance the powers of the court breach considerations of natural justice?
513. Should the nature of the role of registered liquidators and registered trustees as officers of the court, as well as their inherent fiduciary duties, mean that it is reasonable to empower the Court to direct them to stand aside where there are serious allegations that have yet to be resolved?

# REMOVAL AND REPLACEMENT OF INSOLVENCY PRACTITIONERS

## FOCUS OF CHAPTER

This chapter discusses the current barriers facing creditors wishing to remove a registered liquidator, and contrasts the powers of creditors of an external administration with those of creditors in a bankruptcy.

Submissions to the Senate Inquiry highlighted the difficulties that creditors and members can experience in removing a registered liquidator once appointed to an external administration.

The chapter seeks comments on possible options for reform to the Corporations Act to empower creditors to be better able to remove and replace insolvency practitioners where creditors deem it is in their best interests.

## CURRENT LAW

### Corporate

#### Compulsory winding up

514. Where a company is insolvent, certain parties (although most likely a creditor)<sup>258</sup> may apply to the Court for the company to be wound up in insolvency.<sup>259</sup> The Court may appoint a provisional liquidator at any time after a winding application is filed but before an order to wind up the company is made.<sup>260</sup> The Court appoints an official liquidator, generally the one nominated by the petitioning creditor, once an order is made for a company to be wound up.<sup>261</sup>
515. Where an official liquidator has been appointed by the Court, only the Court may remove the liquidator from acting.<sup>262</sup> Creditors do not have any powers to remove a court-appointed liquidator through a resolution at a meeting of creditors.

#### Voluntary winding up

516. A members' voluntary winding up is initiated where the members of a solvent company pass a special resolution supporting the company being put into liquidation.<sup>263</sup> One or more registered liquidators will be appointed at the company

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258 Section 459P of the Corporations Act.

259 Section 459A of the Corporations Act. Winding up on other grounds is possible: see section 461 of the Corporations Act.

260 Subsection 472(2) of the Corporations Act.

261 Subsection 472(1) of the Corporations Act, rule 5.11 of the *Federal Court of Australia (Corporations) Rules 2000*.

262 Subsection 473(1) of the Corporations Act.

263 Section 491 of the Corporations Act.



meeting that puts the company into liquidation.<sup>264</sup> If more than one liquidator is appointed, the liquidators may be appointed jointly or severally.<sup>265</sup>

517. A creditors' voluntary winding up may be initiated where the members of an insolvent company pass a special resolution placing the company into liquidation,<sup>266</sup> or where following the commencement of a members' voluntary winding up it is found that the company is in fact insolvent.<sup>267</sup>
518. The liquidator appointed under a 'creditors' voluntary winding up must convene a meeting of the company's creditors within 11 days after the day of the commencement of the winding up.<sup>268</sup> At that meeting, the creditors may appoint a new liquidator<sup>269</sup>.
519. Once a voluntary liquidation has commenced, the company members hold no direct right to remove the liquidator. A director or member will, however, retain standing to apply to the Court to have the liquidator removed.<sup>270</sup>
520. Other than the first meeting of creditors, or to fill a vacancy under subsection 499(5) of the Corporations Act, a liquidator will only be able to be removed through a Court order. The Court's specific powers to remove a voluntary liquidator and appoint another are restricted to where cause is shown.<sup>271</sup> Creditors have no general power to remove or replace a liquidator by resolution. However, creditors will have standing to apply for a Court order to remove the liquidator.<sup>272</sup> The Court also has a general power to take such action as it sees fit, where it appears to the Court that the liquidator is failing to faithfully perform his or her duties, or act in accordance with his or her statutory requirements or a requirement of the Court.<sup>273</sup>
521. The Court has applied numerous variations of two tests to determine whether an external administrator should be removed. One is that 'cause shown' can be established to the Court where the external administrator's removal is in the best interests of those who have an interest in the liquidation.<sup>274</sup> The second is that an external administrator can be removed where there is a lack of independence.<sup>275</sup>

### **Voluntary Administration and Deeds of Company Arrangements**

522. Where a company is placed into voluntary administration, the administrator may be removed by the Court generally, and by the creditors under certain circumstances.

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264 Subsections 499 (1); 532 (9) of the Corporations Act.

265 Subsection 473(8), sections 530 and 530AA of the Corporations Act.

266 Section 491 of the Corporations Act.

267 Subsection 496(1) of the Corporations Act.

268 Subsections 496 (1) and 497 (1) of the Corporations Act.

269 Subsection 496 (5) of the Corporations Act.

270 Section 503 of the Corporations Act.

271 Sections 502 and 503 of the Corporations Act.

272 See also *Re GK Pty Ltd (in liq); Ex parte Deputy Commissioner of Taxation* (1983) 1 ACLC 848 at 850.

273 Section 536 of the Corporations Act.

274 *Northbuild Construction Pty Ltd v ACN 103 753 484 Pty Ltd* (2008) 26 ACLC 893 at 895; *Re Eraville Pty Ltd and the Companies Act* (1980) ACLR 203 at 207 per Needham J.

275 *Central Springworks Australia Pty Ltd (Administrator Appointed)* (2000) 34 ACSR 169; *Domino Hire v Pioneer Park* (2003) 21 ACLC 1330.

523. A company's creditors are entitled to remove an administrator and appoint a new administrator by resolution at the first meeting of creditors held within eight business days after the commencement of the voluntary administration.<sup>276</sup>
524. Where at the second meeting of creditors, required to be held within 25 or 30 days,<sup>277</sup> it is decided to enter into a deed of company arrangement, the creditors may pass a resolution to appoint someone else to be the administrator of the deed of company arrangement.<sup>278</sup> Where creditors resolve instead to wind up the company, the creditors may pass a resolution to appoint someone else to act as the liquidator.<sup>279</sup> However, other than at this meeting, creditors have no general power to remove an administrator or appoint a replacement by resolution.
525. The Court also has a general power to remove an administrator of a company under administration or of a deed of company arrangement and appoint someone else as administrator. ASIC, a liquidator or provisional liquidator of the company or any of the company's creditors will have standing to seek such a removal.<sup>280</sup>
526. An application for removal needs to demonstrate that an order would result in the administration being conducted in a better manner.<sup>281</sup> These orders are not made merely on the basis that a creditor, or even the majority of creditors, prefers, or would have preferred, that an administrator made a different decision.<sup>282</sup> This is particularly so where the decisions were 'reasonable commercial decisions in the circumstances.'<sup>283</sup>
527. One or more administrators may be appointed jointly or severally.<sup>284</sup>
528. The Court has a general power to make such orders as it thinks just where an administrator of a company or of a deed of company arrangement has acted or managed the affairs, business or property of the company in a way that has or could prejudice the interests of some or all creditors or members. ASIC, any of the company's creditors or the company's members may apply to the Court for such orders.<sup>285</sup>
529. As with personal insolvency there are a range of technical rules relating to the appointment and removal of practitioners (for example, in respect of how to consent to act, lodgements, advertisements, curing defects, and certificates of appointment). There is some variation between personal and corporate insolvency laws in respect of such matters.

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276 Subsections 436E(2) and 436E(4) of the Corporations Act.

277 Section 439A of the Corporations Act.

278 Subsection 444A(2) of the Corporations Act.

279 Sections 446A and subsection 499 (2A) of the Corporations Act.

280 Section 449B of the Corporations Act.

281 *Peter Stannard Homes Pty Ltd v Lyford* (2000) 18 ACLC 195.

282 *Network Exchange Pty Ltd v MIG International Communication Pty Ltd* (1994) 12 ACLC 594.

283 per Master Bredmeyer in *Peter Stannard Homes Pty Ltd v Lyford* (2000) 18 ACLC 195.

284 Subsection 451A and 451B of the Corporations Act.

285 Section 447E of the Corporations Act.



## Personal

530. The rules governing the appointment and removal of trustees are located in Part VIII of the Bankruptcy Act and Part VIII of the Bankruptcy Regulations.<sup>286</sup>
531. Where a person becomes bankrupt, a registered trustee who consents to act (with the agreement of the petitioning creditor in the case of a creditor's petition or with the agreement of the debtor in the case of a debtor's petition) will become the trustee.<sup>287</sup> If no consent is filed, the Official Trustee becomes the trustee.<sup>288</sup> If the Official Trustee is the trustee, creditors may by ordinary resolution replace it with a registered trustee.<sup>289</sup>
532. A creditor may file an objection to the appointment of a registered trustee with the Court where the appointment was not made in good faith by a majority value of creditors voting; the person is not fit to act as trustee; or that a connection or relationship with the bankrupt would make it difficult for them to act with impartiality in the interests of creditors.<sup>290</sup> The Court may then remove the trustee and appoint another registered trustee.
533. Creditors may also remove a trustee appointed by them by resolution and appoint another trustee.<sup>291</sup> Alternatively a trustee may nominate another trustee to replace him or her as trustee of an estate, provided notice is given to all creditors entitled to receive notice.<sup>292</sup> The notice gives a proposed start date for the new trustee and advises creditors of their capacity to object to the appointment of the new trustee. Where no objection is lodged, the new trustee is taken to have been appointed by the creditors.
534. Although there are no reported cases, the Courts have made orders preventing a change of trustee by creditors' resolution when doing so would amount to an abuse of process.
535. The creditors may, if they think fit, appoint two or more registered trustees jointly, or jointly and severally, to the office of trustee, and in either such case the property of the bankrupt vests in those registered trustees as joint tenants. The creditors may, if they think fit, appoint registered trustees to act as trustees in succession in the event that one or more of the registered trustees appointed declines to act or ceases for any reason to hold the office of trustee.<sup>293</sup>
536. Any vacancy in office results in the Official Trustee automatically becoming the trustee.<sup>294</sup>
537. The rules set out above also apply to controlling trustees.<sup>295</sup>

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286 Sections 156A-161A, 180-182, 210 of the Bankruptcy Act; Regulations 8.06 and 10.07 & Schedule 6 Part 3 of the Bankruptcy Regulations.

287 Section 156A of the Bankruptcy Act.

288 Section 160 of the Bankruptcy Act.

289 Section 157 of the Bankruptcy Act.

290 Section 157 of the Bankruptcy Act.

291 Section 181 of the Bankruptcy Act.

292 Section 181A of the Bankruptcy Act.

293 Section 158 of the Bankruptcy Act; Although see *Condon v Watson* (2009) 27 ACLC 1.

294 Section 160 of the Bankruptcy Act.

295 Section 210 of the Bankruptcy Act applies Part VIII to controlling trustees as modified by Schedule 6 Part 3 of the regulations as applied by regulation 10.07 of the Bankruptcy Regulations.

538. Even where the substantive effect of the personal and corporate insolvency laws are identical, there can be significant variation in the text of the relevant statutory provisions.

## CURRENT ISSUES

### Limited power to remove registered liquidator

539. The Senate Committee Inquiry highlighted the difficulties that creditors and members may currently experience in corporate insolvency in removing a liquidator or administrator once they are appointed. These difficulties arise as a result of the limited opportunities for the removal of both poorly performing liquidators or administrators and those engaged in misconduct.
540. Currently there is only limited scope for creditors themselves to remove a registered liquidator, that is, by resolution at the first meeting of creditors. At this point, it may be unlikely that there will be sufficient knowledge of the registered liquidator or other reason to remove them from office. In addition, unless they are experienced with external administration, they may also lack the expertise to identify whether a particular registered liquidator's skills and experience are appropriate to a given administration or liquidation. Similar concerns may arise for members in a members' voluntary winding up.
541. In part, these problems stem from information asymmetries. Registered liquidators have greater knowledge and access to information than creditors, directors of companies and members and there are not always appropriate incentives for registered liquidators to address these imbalances.
542. In addition, due to the current provisions relating to the removal of liquidators and administrators, corporate insolvency practitioners are unlikely to be subsequently removed unless serious misconduct occurs.
543. Liquidators and administrators may be insulated from the consequences of failing to fulfil their role as they are likely to remain as the liquidator/administrator of a company so long as their actions can be broadly justified in terms of being reasonable commercial decisions.
544. The current provision for a director, creditor or a member of a company to make an application to the Court to remove the liquidator is limited to where 'cause' can be shown. The onus is on the director, creditors or members to demonstrate that an insolvency practitioner should be removed from office. The requirement to show cause when seeking court ordered removal is stipulated in both corporate and personal insolvency.
545. Courts have long held that removal will be dependent on the applicant showing that it is for the 'better conduct of the administration',<sup>296</sup> often through presenting a prima facie case of misconduct or inappropriate conduct by the liquidator<sup>297</sup> which could

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296 *Re Adam Eyton Ltd; Ex parte Charlesworth* (1887) 36 Ch D 299.

297 *Re George A Bond and Co Ltd* (1932) 32 SR (NSW) 301 at 308 per Long Innes J.



include the possibility of a conflict of interest<sup>298</sup> or concerns regarding independence. This presents a significant hurdle for applicants to overcome, given that:

- applicants while seeking a remedy that benefits all creditors, expose themselves individually to the costs and risk of litigation;
- applicants have limited capacity to obtain evidence of misconduct, given that registered liquidators are afforded control over insolvency administrations and the administration's and company's records; and
- courts are generally reluctant to make findings of inappropriate conduct against registered liquidators without strong evidence.<sup>299</sup>

546. As the administration progresses, it becomes more difficult to obtain a Court order to remove the registered liquidator.<sup>300</sup>

547. Aside from the costs involved for members or creditors for seeking to remove a registered liquidator, there is a high potential for the liquidator's costs of defending an action (even unsuccessfully) to be borne by the liquidation or administration. Court based remedies are also associated with significant delay, during which the incumbent may continue to act.

548. The Senate Committee recognised the current limitations in the Corporations Act and recommended that section 503 of the Corporations Act, which provides for Court removal of a liquidator in a voluntary winding up, be amended so that 'cause shown' would include:

'(a) A vote of no confidence by a majority of creditors;

(b) Where it appears time based charging of the incumbent liquidator has not or will not result in a reasonable cost-benefit analysis of the company'.<sup>301</sup>

549. As noted above, similar difficulties do not exist in relation to personal insolvency administrations.

## Transfer of liquidation or administration documents

550. Currently, there is no express statutory mechanism to allow for the transfer of all relevant documents relating to a matter where the creditors or the Court bring about the removal of a liquidator. Upon removal, the administration documents (as opposed to the books of the company itself) may remain the property of the outgoing liquidator, subject to an express order of the Court. This may create a significant disincentive for creditors considering the removal of the administrator or liquidator, as the incoming practitioner may not be able to build on the work already undertaken by the outgoing practitioner. It also provides an uncertain position for creditors and liquidators

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298 *City and Suburban Pty Ltd and Others v Smith (as liquidator of Conpac (Aust) Pty Ltd (in liq)) and Another* (1998) 28 ACSR 328 at 339, per Merkel J.

299 *Re Eraville Pty Ltd & The Companies Act* (1980) 5 ACLR 203.

300 *Re Biposo Pty Ltd* (1995) 120 FLR 299 at 403; *Aboriginal & Torres Strait Island Commission v Jurnkurakurr Aboriginal Resource Centre Aboriginal Corporation (in liq)* (1992) 10 ASCR 121 per Ache J; *Housing Pty Ltd (in liq) v Newcastle Classic Developments Pty Ltd* (1994) 14 ACSR 230 at 233.

301 Recommendation 15 of the Senate Committee's report.



attempting to determine whether the books of the administration are the property of the company or the liquidator.

551. Similarly there is no statutory mechanism to allow for the transfer of all relevant documents in cases where creditors or the Court removes a registered trustee.
552. This barrier to removal from a particular case is not present in other analogous professional contexts. For example, where a solicitor's retainer is terminated before the completion of a matter and the client instructs another legal practitioner to take over that matter, a statutory path for the transfer of documents is set out in the relevant state and territory solicitors' rules. Under these rules, the prior solicitor retains a lien over the files until their fees are paid.<sup>302</sup> There may be scope for the priority rules in both corporate and personal insolvency to address this issue.
553. The inability for a new registered liquidator to access the books and records of the outgoing registered liquidator, and the lack of obligations for an outgoing registered liquidator to co-operate with, and assist, the incoming registered liquidator do not accord with international best practice.<sup>303</sup>
554. Similar issues appear to exist in relation to personal insolvencies.

## REFORM OPTIONS

### Option One: enhanced status quo

555. This option would retain the divergent frameworks for insolvency practitioner removal currently present in the Corporations Act and Bankruptcy Act, while progressing amendments that could make it easier for creditors to remove a liquidator.
556. The Corporations Act could be amended to introduce a requirement that liquidators appointed by the Court must call a meeting of creditors within a specified period following their appointment to confirm the appointment or vote to remove the appointed liquidator and appoint a replacement. This option would provide creditors in a court-ordered liquidation with the same rights as creditors in other corporate insolvencies to remove a liquidator and replace them at the first meeting of creditors. Alternatively, creditors' approval could be obtained through mailing out a notice to creditors, with a requirement for a meeting if approval is not obtained. If such an alternative was adopted, it might apply in all corporate insolvencies in substitution of existing requirements for initial meetings of creditors.
557. The Corporations Act could also be amended to implement a recommendation of the Senate Inquiry to provide that cause is shown in relation to the removal of a liquidator where there is a vote of no confidence by a majority of creditors or where it appears time based charging of the incumbent liquidator has not or will not result in a reasonable cost-benefit analysis of the company. This would provide a two-stage mechanism for the removal of a registered liquidator in a creditors' voluntary winding up where a creditor is otherwise unable to show cause and would empower creditors to remove a registered liquidator for reasons other than gross misconduct.

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302 For example, see rule 23 *Legal Profession (Solicitors) Rule* (Qld); rules 8 and 29 of the *Revised Professional Conduct and Practice Rules 1995* (NSW).

303 See Principle 5 (c) and (d) of the *European Bank for Reconstruction and Development Insolvency Office Holder Principles*, June 2007.



## Option Two: alignment

- 558. This option would amend the Corporations Act to provide creditors with the power to remove a liquidator or administrator by creditors' resolution from any liquidation or appointment under Part 5.3A of the Corporations Act. A liquidator could have the power to approach the Court to defeat such a motion where the resolution is an abuse of process.
- 559. This option would align corporate insolvency with personal insolvency, enabling creditors in a corporate insolvency to remove an administrator or liquidator at any point during a liquidation or administration. This would provide creditors with greater control in an administration or liquidation.
- 560. The distinct barriers to removal from appointment mean that there is less incentive for a liquidator, once appointed, to attempt to minimise the cost of the liquidation or to improve the quality of their outputs. Allowing creditors the power to remove a liquidator for market-related reasons, not only where gross negligence or impropriety is present, may result in more competitive pricing of services, not only initially in order to obtain the work, but on an ongoing basis throughout the administration or liquidation (for example, if creditors feel that they are not getting value for money).
- 561. Breaking down the barriers to removal could also be expected to result in better communication between the liquidator and creditors during the liquidation as the liquidator seeks to ensure that the creditors are satisfied with the propriety of costs and appreciate the work being performed on their behalf.
- 562. There may be circumstances where a change of practitioner is sought to obstruct the proper operation of the insolvency regime. For example, creditors being pursued for preferences may seek a change of practitioner to disrupt litigation in progress. It is noted that there is some unreported case law in bankruptcy relating to the prevention of removals that are abuses of process.
- 563. Creditors may choose unwisely to replace an insolvency practitioner. Their assessments of the practitioner may be incorrect. They may misjudge the benefits of replacement compared with the costs and disruption involved in changing the practitioner. An issue for consideration is whether creditors, as the group who will bear the costs of a decision to change practitioner, should be prevented from making poor decisions that are not otherwise improper. It may be questioned whether more certainty is needed in this regard. This option may involve amendments to both personal and corporate insolvency law to clarify the grounds upon which the Court may intervene.
- 564. It may be queried whether providing creditors with an increased ability to remove a registered liquidator may, however, lead registered liquidators to seek higher remuneration as a form of insurance to offset the potential for removal.
- 565. The Corporations and Bankruptcy Acts could also be amended to provide for the transfer of administration, liquidation, or bankruptcy documents from the outgoing practitioner to the incoming practitioner where a practitioner is removed by the creditors. Without such amendments being made, a significant cost barrier would remain in removing a practitioner, as the incoming practitioner would be required to undertake the same work previously completed by the outgoing practitioner. Any such amendments would build on the current provisions for the transfer of books when a prior practitioner was deregistered or suspended.

566. Insolvency practitioners under both the corporate and personal insolvency systems have current mechanisms to obtain their remuneration once removed, though these will generally involve application to the Court. Neither the corporate insolvency framework, nor the personal insolvency framework, give an outgoing liquidator or trustee a priority for payment of their fees ahead of the incoming liquidator or trustee appointee (that is, they will rank equally).<sup>304</sup> For these reasons, the outgoing practitioner may seek to enforce a lien to protect outstanding fees and costs.
567. This option would ensure that any change of registered liquidator or registered trustee could occur swiftly and with minimal cost. It would reduce the cost and time taken should a liquidator or administrator be removed from office.

## DISCUSSION QUESTIONS

568. Should an initial creditors' meeting in a compulsory winding up at which creditors would have the right to replace or appoint a new liquidator be mandated?
569. If an initial creditors' meeting were mandated for court-ordered windings up:
- Should there be an exception for assetless administrations?
  - Should approval of the appointed registered liquidator be able to be obtained through a mail out? If confirmation/replacement of registered liquidations occurred by postal vote in court ordered liquidations, should this mechanism also replace the opportunity to replace a practitioner provided via initial meetings in other kinds of corporate insolvency?
570. Should creditors in corporate insolvencies be generally empowered to remove a registered liquidator by resolution in the same way as under personal insolvency law?
- What effect, if any, would the potential for removal be expected to have on remuneration arrangements?
  - Does the current scheme for the removal of a registered trustee provided sufficient and clear protections against abuses of process?
571. If creditors are empowered to remove a liquidator in a creditors' voluntary winding up (subsequent to the first meeting), should members have any corresponding right in a members' voluntary winding up?
572. Is there a need to facilitate the transfer of the books of the administration from an outgoing insolvency practitioner to his or her replacement? What barriers, if any, are there to the implementation of such a reform?
573. Are any other amendments necessary to assist creditors to use any new power to remove a registered liquidator? What other administrative arrangements would be required to ensure a smooth transition from one registered liquidator to another?

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304 However, voluntary administrators and controlling trustees have priority over liquidators' and registered trustee's fees (apart from deferred expenses, such as remuneration), in the event that a voluntary administration or controlling trusteeship becomes a liquidation or bankruptcy. See sections 443D and 556 of the Corporations Act and section 109 of the Bankruptcy Act.



# REGULATOR POWERS

## FOCUS OF CHAPTER

This chapter addresses whether the existing legal frameworks support the insolvency regulators in adopting appropriate roles in relation to the promotion of efficient and fair markets for insolvency services. It therefore examines what powers ASIC and ITSA should have to monitor insolvency practitioners, provide information to stakeholders, resolve disputes involving insolvency practitioners and intervene in individual external administrations and bankruptcies.

It does not seek to raise questions of how, within that framework, the regulators should operate. The regulators themselves are best placed to determine what the most appropriate regulatory approach is. The law should provide appropriate and flexible tools to enable the regulators to do so.

This chapter seeks comments on options in respect of: the communication between the two insolvency regulators, communication between regulators and stakeholders, the power of regulators to impose conditions on insolvency practitioners; and the need for an external dispute resolution scheme.

## CURRENT LAW

### Corporate

574. ASIC's functions and powers are conferred by the corporations legislation,<sup>305</sup> including incidental powers to the statutory powers.<sup>306</sup>
575. ASIC has a general power to conduct investigations as it thinks expedient for the due administration of the corporations legislation where, amongst other things, it has reason to believe that a contravention of the law has been committed.<sup>307</sup> Furthermore, ASIC is specifically empowered to investigate where it has reason to suspect that a liquidator may not be faithfully performing his or her duties or may not have in the past.<sup>308</sup>
576. ASIC has the power to examine persons it believes can give it information relevant to a matter it is investigating, or intends to investigate.<sup>309</sup> Division 2 of Part 3 of the ASIC Act sets out the procedural matters with which ASIC must comply with in undertaking an examination, including the requirement for: written notice; that examinations be held under oath or on affirmation; that examinations be held in

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305 Section 11 of the ASIC Act. 'Corporations legislation' is defined in section 5 to mean the ASIC Act and the Corporations Act. This power does not extend to the so-called excluded provision, that is ASIC Act section 12A and Division 2 of Part 2 (which contains the consumer protection provisions in respect of financial services).

306 Subsection 11(4) of the ASIC Act.

307 Part 3 Division 1 of the ASIC Act.

308 Subsection 13(3) of the ASIC Act.

309 Section 19 of the ASIC Act.



private; that a record be kept of the examination; and the role that the examinee's lawyer may play.

577. ASIC is also empowered to obtain access to or inspect the books of a company for the purposes of the performance or exercise of any of ASIC's functions and powers under the corporations legislation; or for the purposes of ensuring compliance with the corporations legislation. Unlike the examination powers referred to previously, these powers may be utilised in the absence of a reason to suspect a contravention has occurred.<sup>310</sup>
578. A company's books may be inspected by ASIC without charge.<sup>311</sup> Books are generally considered to include any books required to be kept by a liquidator (such as administration records).<sup>312</sup> ASIC may issue a written notice requiring the books about the affairs of a body corporate or a registered scheme to be produced to ASIC, including to persons who may have relevant books in their personal possession.<sup>313</sup> When books have been produced or seized, ASIC may inspect, make copies, retain possession of the books or otherwise deal with them.<sup>314</sup>
579. It is within ASIC's administrative functions to inquire into liquidators' actions where it appears to ASIC that a liquidator has not (or may not have) faithfully performed his or her duties or is not (or may not be) faithfully performing his or her duties or another requirement of the corporations legislation.<sup>315</sup> ASIC also has the power to commence a formal investigation in similar circumstances.<sup>316</sup> A decision by ASIC to, or decision not to, inquire into a liquidator as part of its functions may be reviewable by the AAT;<sup>317</sup> however, a decision by ASIC to, or a decision not to, commence an investigation is not reviewable by the AAT.<sup>318</sup>
580. ASIC must take all reasonable measures to protect from unauthorised use or disclosure information given to it in confidence in or in connection with the performance of its functions or the exercise of its powers under the corporations legislation (other than the excluded provisions).<sup>319</sup> ASIC may however disclose information to prescribed professional disciplinary bodies where the information is to be used to perform one of the professional body's functions. The information disclosed to any such body must not be disclosed by that body to any other person or used for a purpose other than for deciding whether or not to take disciplinary or other action, or for taking that action.<sup>320</sup>

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310 Division 3 of Part 3 of the ASIC Act. 'Books' is defined under section 5 of the ASIC Act as including a register, financial report or financial records, a document, banker's books, and any other record of information.

311 Section 29 of the ASIC Act.

312 A liquidator (or provisional liquidator) must keep proper books and record entries or minutes of proceedings at meetings necessary and proper to give a complete and correct record of his or her administration of the company's affairs (section 531 of the Corporations Act; regulation 5.6.01 of the Corporations Regulations).

313 Sections 30 and 33 of the ASIC Act.

314 Section 37 of the ASIC Act.

315 Section 536 of the Corporations Act.

316 Subsection 13 (3) of the ASIC Act.

317 Section 1317B of the Corporations Act; cf subsection 11(4) of the ASIC Act. See also *Rich v ASIC* (2004) 22 ACLC 101; *Re Nickson and Australian Securities and Investments Commission* [2005] AATA 859 per Deputy President Forgie.

318 Section 244 of the ASIC Act.

319 Section 127 of the ASIC Act.

320 Subsection 127 (1) and paragraphs 127 (4)(d) and subsections 127 (4EA) and 127 (4EF) of the ASIC Act.



## Personal

581. Under the Bankruptcy Act, the Inspector-General may make such inquiries and investigations as he or she thinks fit with respect to any bankruptcy or the conduct of a registered trustee in respect of a bankruptcy; the conduct and examinable affairs of a debtor subject to a bankruptcy proceeding; and any offences under the Bankruptcy Act.<sup>321</sup> The Inspector-General's powers may be delegated (as may the powers of the Commission under the ASIC Act).<sup>322</sup> A copy of any report that results from these inquiries and investigations may be given to any person that the Inspector-General thinks fit.<sup>323</sup>
582. The Inspector-General is empowered under the Bankruptcy Act to carry out his or her functions through the discharge of powers to: compel practitioners to provide a report as to the operation of the insolvency law; compel practitioners to provide information regarding an administration; inspect administration records; require the production of administration records; and compel the provision of information in relation to offences from a person.<sup>324</sup>
583. The Inspector-General is entitled to attend any meeting of creditors and is entitled to participate in any such meeting as the Inspector-General thinks fit, although this does not extend to voting.<sup>325</sup>
584. Unlike in corporate insolvency, ITSA may review and redetermine certain decisions made by a practitioner in relation to the assessment and collection of compulsory income contributions and the extension of the term of a debtor's bankruptcy.<sup>326</sup>
585. In contrast to the corporate insolvency framework, the Inspector-General may also exercise any of the powers and perform any of the functions of an Official Receiver in the same way as the Official Receiver.<sup>327</sup> These would include the Official Receivers' powers in relation to registry functions, compulsory examinations<sup>328</sup> and administratively issued authorisations to search premises.<sup>329</sup>

## CURRENT ISSUES

### High threshold to Court initiated investigation

586. In recent times, ASIC has made applications for Court inquiry into an external administration under section 536 of the Corporations Act in instances where the complaint on which ASIC has based its application has detailed serious misconduct, such as misappropriation of funds or fraud.

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321 Subsection 12 (1) of the Bankruptcy Act.

322 Section 11 of the Bankruptcy Act; section 102 of the ASIC Act.

323 Subsection 12(1B) of the Bankruptcy Act.

324 Subsection 12 (2) of the Bankruptcy Act.

325 Section 12 of the Bankruptcy Act. In contrast, ASIC officers are only able to attend creditor meetings where liquidators and/or creditors request or consent to the attendance.

326 Part VI, Division 4B, Subdivision G--Review of assessment and Subdivision HA--Supervised account regime; Part VII, Division 2, Subdivision C--Review of objection.

327 Section 11 of the Bankruptcy Act.

328 Section 77C of the Bankruptcy Act.

329 Section 77AA of the Bankruptcy Act.

587. In applications for inquiry from members of the public (as opposed to ASIC), the Court has interpreted section 536 to require the applicant to show that such an inquiry is warranted by establishing that there is a sufficient basis for making such an order. A sufficient basis is in the nature of a well-based suspicion indicating a need for further investigation, and such an inquiry must serve the public interest, such that it is for the purpose of regulation, supervision, discipline and correction of registered liquidators in the interests of honest and efficient administration of the estates of companies subject to winding up.<sup>330</sup>

### Information flows between regulators

588. In April 2002, ASIC and ITSA signed a Memorandum of Understanding (MOU) to promote cooperation between the agencies and facilitate joint ASIC-ITSA investigations where a director of an insolvent company is also a bankrupt, and where Corporations Act and Bankruptcy Act offences are suspected. The MOU states that the regulators would seek to take a cooperative approach to overseeing the conduct of registered liquidators and registered trustees.
589. One example of information sharing to come out of the MOU process involves matching information from ASIC's public database (ASCOT) with information from ITSA's public database (the National Personal Insolvency Index or NPII). The program is governed by a data-matching protocol. The results of this data-matching program between the ASCOT and the NPII are used by ASIC to (amongst other things):
- identify persons who are recorded on ASCOT as being current officeholders of companies but who are an undischarged bankrupt;
  - update ASCOT; and
  - assess possible breaches of the law.<sup>331</sup>
590. It is also important to ensure that regulators are able to pass on necessary information to other law enforcement agencies, both State and Federal.

### Information flows between regulators and stakeholders

591. Concerns regarding the information flow between regulators and the professional bodies were raised during the recent Senate Committee Inquiry. Interruptions to the information flows can prevent the regulator, or the professional body, from being aware of all facts that could potentially be considered in determining whether a registered liquidator remains a fit and proper person or whether an investigation into a registered liquidator by the regulator may be warranted. The lack of information flow between the professional bodies was discussed in some detail by the IPA President before the Senate Committee Inquiry.<sup>332</sup>
592. Currently, only the Institute of Chartered Accountants in Australia, CPA Australia, and the National Institute of Accountants are prescribed as bodies to which ASIC may

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330 *Kennards Hire Pty Ltd v RMGA Pty Ltd* [2010] NSWSC 1387 at [35]-[37], see also *Lollback v Brakepower Pty Ltd* [2010] NSWSC 1457 at [22]-[23].

331 <http://www.asic.gov.au/asic/asic.nsf/byheadline/Directors+-+Data+Matching+Program+with+ITSA?openDocument>.

332 22 June 2010.



release information for disciplinary purposes.<sup>333</sup> There is no corresponding power to share information with the IPA or the law societies in each State and Territory. As at 31 December 2009, 85 per cent of registered liquidators and registered trustees were members of the IPA.

593. By contrast, the Inspector-General may make such inquiries and investigations as he or she thinks fit with respect the conduct of a registered trustee in respect of a bankruptcy; the conduct and examinable affairs of a debtor subject to a bankruptcy proceeding; and any offences under the Bankruptcy Act<sup>334</sup> and may provide a copy of any report that results from these inquiries and investigations to any person that the Inspector-General thinks fit.<sup>335</sup>
594. The role of the regulator also extends to providing assistance and information to stakeholders, such as creditors, both in relation to the operation of the insolvency regime in general (for example, through information notes) and in respect of particular matters in relation to which the stakeholder may have an interest. A number of submissions to the Senate Committee Inquiry commented on the need for creditors to be able to access better information about their rights.
595. The divergent regulatory approaches undertaken by ASIC and ITSA in relation to surveillance also affect the approaches that the respective regulators take to communicating with creditors. As part of ITSA's complaints handling processes, it may perform an examination of the file about which an allegation has been made and report the findings to the person who made the allegation. ASIC is constrained in the extent of any information that it might otherwise similarly provide.

## Surveillance

596. ASIC currently conducts compliance and transaction reviews of registered liquidators where concerns are raised through complaints or other market intelligence.
597. The Senate Committee Inquiry stated that the current approach to monitoring registered liquidators is inadequate and expressed concern that a complaints system alone cannot deter all misconduct. A number of submissions to the Senate Committee Inquiry made positive mention of ITSA's trustee inspection program; which involves the periodic review of trustee's practices, including the review of samples of files. The committee therefore recommended that a 'flying squad' be established with responsibility for 'conducting investigations of a sample of insolvency practitioners, some selected at random, [and] others with the aid of a risk profiling system and market intelligence.'<sup>336</sup>
598. ASIC is an independent statutory authority responsible for the administration of the corporations legislation. As noted in the *Purpose of Discussion Paper* chapter, matters relating to the approach that the regulator should take in conducting surveillance of the industry are better left to the regulator as they are best placed to determine enforcement priorities and the flexibility needed to deal with those priorities.
599. However, the current wording of some of the statutory powers under the ASIC Act is more restrictive than the commensurate powers for ITSA under the Bankruptcy Act.

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333 Paragraph 127 (4)(c) of the ASIC Act; Regulation 8A and Schedule 3 of the ASIC Regulations.

334 Section 12 (1) of the Bankruptcy Act.

335 Section 12 (1)(b) of the Bankruptcy Act.

336 Recommendation 3 of the Senate Committee's report.

For example, while some of ASIC's powers are exercisable where it suspects that there has been a contravention of the law, the Inspector-General is not similarly constrained. This may limit the ability of ASIC to undertake a more proactive approach to surveillance of the industry.

## **Dispute resolution**

600. The regulatory frameworks for corporate and personal insolvency diverge in the role given to the regulators to facilitate the resolution of disputes between third parties and insolvency practitioners.
601. Under the Bankruptcy Act, ITSA is empowered to review certain specified decisions made by registered trustees on matters such as extending a bankruptcy, issuing an income contribution assessment, and the payment of the trustee's remuneration and third party costs. The corporate insolvency framework does not include comparable provisions relating to the extension of the period of an external administration or issue of an income contribution assessment as these matters do not arise in corporate insolvency. ITSA's processes for resolving such complaints are set out in its information statement *Resolving complaints about trustees and administrators*.
602. Dispute resolution by the regulator can also function as a process for the education of creditors about their rights under the law. The level of communication between ASIC and creditors was raised as a concern during the Senate Committee Inquiry. While the statutory regimes under which ASIC and ITSA operate do not expressly provide that either regulator has a role in providing education and information to stakeholders impacted by the regimes, this is generally considered to be an incidental function of all regulators.

## **Ability to intervene in an external administration or bankruptcy**

603. Irrespective of the rights that exist for a stakeholder to obtain information, there may be cases where these rights may be improperly obstructed by an insolvency practitioner. These situations should be contrasted with circumstances where there may be legitimate reasons for withholding information: such as where information is commercially sensitive, where there are very large costs associated with providing access or the release of the information might disproportionately negatively affect an external administration.
604. An issue that needs to be considered is whether there should be a role for the regulator in directing insolvency practitioners to provide certain information or make certain disclosures to creditors and in otherwise facilitating access by creditors (or other parties, such as the debtor in personal insolvency) to information and records.
605. For example, if a creditor currently requests reasonable details of the fees that have been claimed and paid from the administration in order to compare these against the existing fee approvals, and the request is ignored, the law does not clearly provide the regulators with the power to (a) direct the practitioner to provide this information within a specified time period; (b) request this information from the practitioner and then forward it to the creditor; or (c) inspect the administration file, obtain copies of the relevant invoices and accounting records and provide these to the creditor.
606. Both regulators have varying powers to obtain information regarding administrations for the purpose of investigating possible misconduct, ensuring compliance and to inspect administration records. However, currently there is limited scope for ASIC to



communicate information or provide copies of records to relevant stakeholders that have been obtained through their regulatory activities or under their information gathering powers. In personal insolvency the Inspector-General can provide copies of reports that result from inquiries and investigations.<sup>337</sup>

607. Empowering the regulator to force access to information by stakeholders may decrease monitoring costs and effectiveness (for stakeholders); and may promote confidence through increased transparency. Improving the potential for information to become available may also have a deterrence effect on misconduct. Administrations and practitioners may also avoid ongoing costs where any decisions not to release information are then 'confirmed' by a similar refusal by the regulator to provide access.
608. There are a number of consequences which flow from empowering the regulator to force access to information which need to be balanced against any gains. Disclosure may result in costs to administrations (such as losses from disclosing commercially sensitive information) that are not justified in light of the benefits of disclosure. Disclosure may also result in more direct costs to an administration, in the form of remuneration and disbursements incurred in providing the information. Providing regulators with the power to disclose information may also result in their being exposed to increased workloads. There is also a risk that any such power may result in the regulator second guessing a practitioner on decisions to provide information that are essentially business judgements best left to the practitioner. Some of these disadvantages might be mitigated through imposing appropriate restraints on any rights by the regulator to provide access.

### **Ensuring knowledge requirements are met on an ongoing basis**

609. The registration regimes for both personal and corporate insolvency practitioners impose requirements for practitioners to possess sufficient knowledge and skills to carry out their functions. While the regulators are empowered to monitor ongoing performance and thereby to assess whether a person continued to maintain these requirements, it may be questioned whether the regulators should be provided with a more direct method to assess compliance by being empowered to require a practitioner to sit an oral or written exam. Such a power might also be extended to allow the testing of an insolvency practitioner's staff to determine, for example, whether practitioners have engaged in appropriate delegation or whether the hourly rates of remuneration being charged against a staff member are reasonable.
610. Concerns regarding the maintenance of knowledge may arise due to a practitioner accepting few or no appointments for a significant period of time. Concerns may also arise from the findings of inquiries following complaints or from the results of practice reviews.
611. The result of any examination might be utilised by the regulator to instigate suspension or deregistration proceedings or proceedings to impose conditions.

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337 Section 12(1)(b) of the Bankruptcy Act.

## REFORM OPTIONS

### Option One: increase regulators powers in an aligned manner

612. The Bankruptcy Act and the Corporations Act could be amended to provide ITSA and ASIC with further powers to:
- improve surveillance of the standard of insolvency services being provided by insolvency practitioners;
  - assist creditors to fully exercise the powers that may be open to them; and
  - share information about external administrations, bankruptcies, and insolvency practitioners with interested parties.
613. The Corporations Act could be amended to empower the regulators to direct insolvency practitioners to provide certain information or make certain disclosures to creditors or otherwise for the regulators to communicate information they have obtained about a practitioner's conduct of an external administration to creditors. If such an amendment were made, an insolvency practitioner might have standing to apply to court for orders suppressing the publication of the information on certain grounds. Information might be communicated to creditors in writing or by a meeting of creditors. The decision of the regulator to release relevant information would need to balance the commercial sensitivity of the information and other relevant privacy considerations.
614. The Bankruptcy Act and Corporations Act could also be reviewed, and amended if necessary, to ensure that the regulators are able to communicate with law enforcement agencies, both State and Federal.
615. There are also concerns that an external administrator (or registered trustee) facing removal or questions regarding their conduct may delay the calling of a meeting of creditors or interfere with meeting processes for the purposes of avoiding questions on their conduct or consideration of their removal. Additionally, if the registered liquidator is dishonest, the practitioner, as chair of the meeting, would remain in a position to breach further requirements for the fair conduct of a creditors' meeting to prevent them from being removed.
616. It may therefore be appropriate to amend the Corporations Act and the Bankruptcy Act to empower the regulator to convene a meeting or direct that a meeting be convened and to appoint an independent liquidator or registered trustee (or alternatively the Official Trustee) to chair the meeting, either on the request of a creditor or as a result of other information obtained by the regulator. The Corporations Act could also be amended to align the powers of ASIC to attend, and participate in, creditors meetings with those of the Inspector-General. This could provide an opportunity for the creditors' meeting to be conducted in a timely, fair and impartial manner.
617. Any amendments to empower the regulators to intervene into an external administration or bankruptcy would be made on the basis that regulators should have the flexibility to intervene when they determine that it is in the public interest, taking into account the cost of any intervention on the administration as well as the priorities of the regulator.



618. While the regulator has discretion on how to exercise its regulatory function in relation to proactive or reactive enquiries or surveillances, the scope of ASIC's powers under the Corporations Act may currently present a barrier to it taking a more proactive approach to its surveillance activities. The Corporations Act could therefore be amended to broaden ASIC's powers to ensure that it can attend the premises of a practitioner for the purposes of conducting an inspection of a random sample of files. A clearer statement of the regulators powers in this regard might also be provided for in relation to personal insolvency regulation. Regulators' powers to test competencies could also be enhanced.
619. The law may be amended to formalise the need for information sharing between ASIC and ITSA in relation to investigations or other regulatory activities undertaken by one regulator that may affect equivalent investigations or activities within the responsibility of the other regulator. For example, where investigations are underway by one regulator that raises issues regarding whether the practitioner remains fit and proper. Such information sharing could also assist the regulators to deal with the intersection of the liquidation of small enterprises and the bankruptcy of the directors of the enterprise.
620. The Bankruptcy Act and Corporations Act could also be amended to provide the respective regulators with a power to impose conditions across the market of registered liquidators and registered trustees in respect of specified topics (for example, in relation to continuing education requirements).

## **Option Two: ombudsman**

621. The Senate Committee Inquiry received a number of submissions that referred to the desirability of establishing an Ombudsman as part of the corporate insolvency framework. While the Senate Committee did not make a recommendation about the establishment of an Ombudsman, it noted that should the responsible regulator not handle complaints promptly and effectively, that 'an Insolvency Ombudsman should be seriously considered'.<sup>338</sup>
622. The introduction of a requirement for registered insolvency practitioners to be subject to the decisions of an ombudsman or external dispute resolution body would require a balance between creditors, contributories, and other third-parties having appropriate recourse where their interests have been impacted; and facilitating the efficient and effective operation of the insolvency and bankruptcy system, including not unreasonably burdening liquidators and registered trustees.
623. The scope of potential advantages, and any associated costs, to creditors and liquidators of the establishment of an ombudsman would be dependent on the focus, structure, and placement of the ombudsman. A number of suggestions for the focus of the ombudsman were raised through the Senate Committee Inquiry.

## **DISCUSSION QUESTIONS**

624. Are there unjustified divergences between the powers and roles of the insolvency regulators?

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<sup>338</sup> Paragraph 11.22 of the Senate Committee Inquiry Report.

625. Should a creditor in a corporate insolvency have any right to request that ASIC undertake a review of specified kinds of decision by a liquidator?
626. If ASIC was to be empowered, what types of decisions should ASIC be able to review?
627. The expansion of ASIC's current functions to include such a review power would have some cost. Given the Government's cost recovery policy how should any expansion of powers be funded?
628. Should ASIC and ITSA be given more flexibility to communicate to a complainant (or creditors generally) information obtained by it in relation to the conduct of an external administration?
629. Should regulators be able to require a practitioner to sit an examination to test ongoing compliance with the knowledge or skills requirements for registration? Should such a power be extended to enabling regulators to require persons acting under delegation from practitioners to sit an examination?
630. What powers might be appropriate to provide to regulators to facilitate (if necessary) the rights of creditors to call meetings and to ensure such meetings are held in a transparent manner – in particular in relation to the assessment of votes for and against the retention of the current insolvency practitioner?
631. Does section 536 of the Corporations Act, as currently applied by the Court, provide for the appropriate supervision of registered liquidators by ASIC?
632. Should ASIC be able to share information with the IPA for disciplinary purposes?
633. Should ITSA and ASIC be empowered to impose conditions across the market? If so, what types of conditions should the regulator be empowered to impose?
634. If a new Ombudsman or external dispute resolution scheme were established:
  - Should the new body be a statutory body (for example, the Superannuation Complaints Tribunal) or a private body (for example, the Financial Ombudsman Service)?
  - Should any new body have the ability to hear disputes in both corporate and personal insolvency? Should the new entity be independent of the two regulators?
  - If the body is a statutory entity, what functions of ITSA or ASIC should be given to the new body? Should the body have power to obtain information or to inspect the records of an organisation relevant to the complaint? If the new body is privately run, what protections would need to be put in place to achieve this?
  - How should the new body be funded? Should there be any charge to the complainant to investigate a complaint or should it be funded through an industry levy?
  - Should the body have an explicit educative role?
  - Should the body have the right to deal with systemic issues or commence its own investigation? If the body is a private entity, what powers should it be given to achieve those objectives?



- What types of disputes should the body be able to hear and deal with? Should the body be able to review remuneration? Should this be done through independent cost assessors?

## SPECIFIC ISSUES FOR SMALL BUSINESS

### FOCUS OF CHAPTER

The majority of companies that enter into external administration are small to medium sized enterprises. The frameworks for both personal and corporate insolvency apply a 'one-size-fits-all' approach to the wide array of insolvent estates that an insolvency practitioner might have control over. They do not distinguish between large and small administrations.

Many owners of small businesses use personal assets, often their personal homes, as security for loans taken out for their business. When their businesses fail, small business owners may be placed into bankruptcy as a result of the guarantees made for the loans of their business.

Where this occurs, directors and creditors can find themselves dealing with both a registered liquidator and a registered trustee that are operating under different statutory frameworks. The problems that divergence in the personal and corporate insolvency frameworks can cause for stakeholders discussed throughout this paper are therefore more acute in the case of failed small businesses.

This chapter therefore seeks comments on possible options for reform to the Corporations Act and the Bankruptcy Act to improve the interaction between the corporate and personal insolvency systems for small businesses.

### CURRENT LAW

#### Corporate

635. The corporate insolvency framework applies to all corporations. There is no variation in the framework for small corporations.
636. The Assetless Administration Fund (the AA Fund) was established in 2005 to finance investigations by liquidators in external administrations with no assets, where it appears to ASIC that further investigation and reporting may lead to enforcement action against the director or officers of the company. This approach utilises the skills of private sector practitioners to ensure that ASIC is provided with adequate information to identify and pursue misconduct by company officers in the lead-up to a company failure. Given the lower level of assets in small corporate administrations and the likelihood of insufficient funds being available to fund investigations, the AA Fund plays an important role in relation to small business insolvencies.
637. The scope and overlap of the application of the AA Fund and its personal insolvency equivalent (see below) may be of particular relevance where there are related and interconnected personal and corporate insolvencies with related issues requiring investigation. It has been observed that a common example of such an overlap of issues is where there are related small company liquidations and bankruptcies of former directors. Liquidators can seek funding from the AA Fund to carry out an investigation and report:



- in circumstances where they believe director bannings may be appropriate; or
- for other matters, such as where the liquidator believes there is or may be evidence of possible offences or other misconduct in relation to the Corporations Act.<sup>339</sup>

## Personal

638. The personal insolvency framework applies to debts incurred by individuals operating as sole traders or in partnerships, as well as to company officers who incur debt in their capacity as private individuals.
639. In order to facilitate the proper carrying out of the trustee's statutory and fiduciary duties, the Inspector-General may direct that the Commonwealth underwrite the cost of:
- inquiries in relation to the estate or examinable affairs of a bankrupt, a debtor under Part X, or deceased person whose estate is being administered under Part XI;
  - instituting, continuing or defending legal proceedings relating to the estate or examinable affairs of a bankrupt, a debtor under Part X, or deceased person whose estate is being administered under Part XI; and
  - participation by the trustee in proceedings before the AAT reviewing a decision or determination by the trustee, or reviewing a decision of the Inspector-General on a review of such a decision or determination.<sup>340</sup>

## CURRENT ISSUES

### Problems of regulatory divergence for creditors and directors of small business

640. When a company fails with few or no assets, the registered liquidator may not be able to carry out full investigations into the circumstances of the insolvency or prepare full reports for ASIC. As a result possible offences or other misconduct by company officers may not be brought to ASIC's attention.
641. According to data accumulated by ASIC from Schedule B reports lodged by external administrators for the 2009-2010 financial year, 85 per cent of failed companies had assets of \$100,000 or less.
642. Many owners of small businesses use personal assets, often their personal homes, as security for loans taken out for their business. Where a small business fails, triggering personal guarantees made by a director or directors for corporate borrowings, the calling in of those guarantees may push the director or directors into bankruptcy. In this instance, a registered liquidator may be appointed to deal with the corporate insolvency, while a registered trustee may be appointed to deal with the director's personal insolvency.

<sup>339</sup> See *Regulatory Guide 109 Assetless Administration Fund: Funding criteria and guidelines*.

<sup>340</sup> Section 305 of the Bankruptcy Act; see also *Section 305 Guidelines* available at [www.itsa.gov.au](http://www.itsa.gov.au).

643. For creditors, as well as the directors themselves, this means dealing with two different insolvency practitioners and statutory regimes. Therefore, it is important that the personal and corporate insolvency frameworks facilitate the understanding of stakeholders who interact across the two systems. Alignment naturally assists in this goal.

### **Lack of incentive to commence a formal external administration**

644. Small business owners may be more concerned to keep the business operating at any cost rather than focus on potential issues of insolvent trading; or director penalty notices issued by the Australian Taxation Office. In about 70 per cent of small business failures, there is no debt to a secured creditor and therefore no secured creditors to force a formal appointment of an external administrator.
645. In addition, insolvency practitioners may have little incentive to take on small business cases where assets, and recovery of their liquidation costs, are limited.
646. However, a number of other processes may be dependent on a formal liquidation, including creditors' ability to write-off bad debts for tax purposes, as well as employees ability to access the General Employee Entitlements and Redundancy Scheme (GEERS). It may also result in possible offences or other misconduct by company officers that may not be brought to ASIC's attention.

### **A regulatory grey area**

647. There may be no clear distinction between the issues that fall within the scope of a liquidation of a small company and the related personal insolvency of its directors.
648. Where a registered trustee has been appointed to the personal affairs of a director, and a registered liquidator has been appointed to the affairs of the company, there exists an opportunity for conflict between the administrations. Even where there is no conflict there is the potential for unnecessary duplication of effort by both practitioners.
649. Stakeholders may experience difficulty in determining which practitioner (and which regulator) has responsibility for certain aspects of related insolvencies.
650. These concerns over responsibility for different processes between a registered trustee and a registered liquidator may result in complaints being made to the regulators. As the regulators are responsible only for the conduct of one group of practitioners, the individual responses by each regulator to a complainant may not be able to take a holistic view of the complaint. For example, a creditor may complain that a trustee and a liquidator are duplicating work and separately charging for it and that the practitioners are failing to take reasonable efforts to cooperate with each other.

### **Funding sources**

651. Both the corporate and personal insolvency frameworks provide for access to funding by insolvency practitioners where the assets of the estate do not provide sufficient funds to complete proceedings that ought to be commenced as part of a particular administration. However, the scope of these funding sources is limited to where the benefits to be accrued relate to the specific regulatory system within which the funding is sourced, that is, the AA Fund can only be accessed by registered liquidators for



corporate insolvencies, and section 305 funding can only be accessed by registered trustees for personal bankruptcies. The purposes for which these funding sources may be utilised also vary greatly – section 305 funding can be utilised for a far broader range of issues than the AA Fund. For example, section 305 funding might be provided to fund asset recovery litigation where other sources of funding are not available but it is the public interest that the litigation take place (for example, because recovering business assets would obstruct the ‘phoenixing’ of a business under the name of one of the bankrupt’s associates). The AA Fund could not be used for such a purpose. Investigating the affairs of a bankrupt director and ensuring that they do not retain the benefit of any corporate misconduct is important to ensuring the integrity of the broader corporate regulatory system. Similar considerations apply in respect of bankrupted corporate insolvency practitioners who have engaged in misconduct.

## **Concurrent administrations in relation to small business insolvencies**

- 652. The failure of a small business may result in both the corporation operating the business being placed into external administration and one or more of its directors becoming subject to separate personal insolvency administrations. This commonly occurs due to the existence of directors’ guarantees or loans by directors to the company becoming irrecoverable.
- 653. In such situations it is not uncommon for the corporate and personal insolvency administrations to be handled by the same insolvency practitioner (who holds registration as both a bankruptcy trustee and as a liquidator).
- 654. The administration of multiple related administrations may avoid duplication and inconsistency in the approach taken in progressing these administrations. Some duplication may still occur due to the existence of parallel legal obligations (such as reporting requirements) in each matter that must be complied with separately. Steps to further align these obligations may further reduce costs imposed by unnecessary duplication in such matters.
- 655. However, holding multiple appointments in respect of related matters may result in potential conflicts of interest which the practitioner may need to take additional steps to manage; or which they may be required to avoid altogether. For example, a director’s bankrupt estate may need to lodge a proof of debt in the liquidation of a related company. It would not be appropriate for a practitioner to be both (in different capacities) the creditor lodging a claim and the person adjudicating on that claim.
- 656. Clarification of practitioner’s obligations in respect of conflicts of interests in such situations may assist in ensuring a suitable balance between efficient and appropriate arrangements. Additional mechanisms to manage conflicts may also provide assistance. For example, currently a practitioner must apply to Court to have another practitioner authorised to adjudicate on a proof of debt in which they have a conflict (or to transfer responsibility and authority for any function to another practitioner).

## **Phoenix concerns**

- 657. As part of the Protecting Workers’ Entitlements Package, the Government is committed to amending the Corporations Act to further address phoenix activity by: imposing personal liability on a director for the debts of a successor company using a similar company name or trading style; and permitting ASIC to administratively wind up

companies in certain circumstances, to improve access to the General Employee Entitlements and Redundancy Scheme (GEERS).

658. Phoenix activity is generally considered to have occurred when directors of a company misuse the corporate form with the intention of denying unsecured creditors access to the company's assets in order to meet their unpaid debts. At around the time that the company fails, a new company commences trading and uses some or all of the assets of the former company. The new entity is commonly controlled by the directors or controllers of the failed company, or parties related to them. Often the process is repeated leading to further losses for creditors.
659. When a company enters into liquidation, legal actions which it could have taken prior to the appointment of the liquidator are able to be exercised by the liquidator. These rights to sue will generally be capable of being assigned. However, the liquidator also has rights under the Corporations Act to bring proceedings for damages for breaches of the Corporations Act by the directors, such as breaches of the insolvent trading requirement or other directors' duties, which cannot be assigned.
660. In May 2001, the New Zealand Law Commission released *Report 72 – Subsidising Litigation* that contained a chapter covering the difficulties of obtaining funding for litigation in insolvency situations. In response to that report, the NZ Government introduced a right to sell any right of action that is conferred on the liquidator by the *Companies Act 1993*, provided the Court has approved the assignment. The effect of this amendment is to eliminate, subject to court approval, the restriction on the ability of a liquidator to sell rights of action that are the liquidators.
661. The Corporations Act currently imposes strict requirements on all companies to keep written financial records that correctly record and explain its transactions and financial position and performance and would enable true and fair financial statements to be prepared and audited. The records must be kept for seven years after the transactions covered by the records are completed.<sup>341</sup> It is likely that inadequate records would be kept in cases where a business has illegally transferred assets from the corporation to avoid liability for debts.

## REFORM OPTIONS

### Option One: clarify regulatory obligations of ASIC and ITSA

662. The Corporations Act and Bankruptcy Act could each be amended to ensure that ASIC and ITSA are able to adopt a cooperative approach to investigations of complaints that relate to personal and corporate insolvency. This may involve amendments to their ability to share information. The law might also place a positive obligation upon the regulators to cooperate and assist in the investigations of the other. The methods by which this obligation would be put into place by the regulators would be determined by them, possibly through amendments to the current MOU.
663. This may assist in the regulators ability to adopt a 'one stop shop' approach to interconnected personal and corporate small business insolvencies, under which one complaint may be made to one regulator which then coordinates a single holistic response (if appropriate) from both regulators. Any amended MOU might provide that a specified regulator would act as the 'one-stop-shop' in respect of small business

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341 Section 286 of the Corporations Act.



insolvencies where there are both corporate and personal administrations occurring; at least in respect of complaints by certain parties, such as employees and consumer creditors.

664. The establishment of processes as a result of these new obligations would assist the regulators to ensure a consistent position is taken on which regulator is most appropriate to deal with the wide range of issues that may arise where small businesses fail. This would provide greater certainty to creditors, directors and other stakeholders about which regulator will have oversight of their particular complaint where it is not otherwise clear to the complainant that a potential breach has been committed by one practitioner or the other.

## **Option Two: expand the scope of the AA Fund**

665. Regardless of whether or not new obligations are placed on ASIC and ITSA to clarify the approach of the regulators to the intersection of the personal bankruptcy of directors and the corporate insolvency of the corporate vehicle, amendments could be made to expand the scope of the AA Fund.
666. In order to facilitate investigations of bankrupt directors or liquidators that might have benefits for the integrity of the corporate law, the scope of the AA Fund could be amended and the authority to disseminate information could be modified to allow personal insolvency practitioners to investigate and report in relation to corporate law breaches. The scope of the AA Fund could also be amended to provide for the provision of loans to registered liquidators to facilitate the proper carrying out of the liquidator's fiduciary and statutory duties.
667. Alternatively, the Bankruptcy Act could be amended to expand the scope of section 305 to provide for a registered trustee to access funding where the investigations would promote the integrity of the corporate law.

## **Option Three: amend Corporations Act to address phoenix activity**

### **Liquidator assignment of cause of action**

668. Amendments could be made to the Corporations Act to provide that a registered liquidator would be able to assign actions which vest personally in the liquidator. These would include an action for breaches of insolvent trading laws and directors duties.
669. This option could provide creditors with additional returns in circumstances where liquidators would otherwise not have taken court action due to lack of funding. The sale of the cause of action could also lead to a quicker return for creditors.
670. Approval of the assignment of a cause of action could be through the Court, or alternatively a right of action could be treated like the sale of any other of the assets that a liquidator can undertake in the normal course of an administration.

### **Director disqualification for failure to keep financial records**

671. The Corporations Act could be amended to provide for streamlined disqualification of company directors for failure to deliver to a liquidator an insolvent company's financial records.

672. The potential for disqualification would only be triggered if the company was placed into liquidation under the supervision of a liquidator and the directors did not take reasonable steps to ensure that the company maintained records in accordance with its legal obligations. It would not apply to voluntary administrations.
673. In cases where records are not adequately kept, this proposal would likely lead to a more streamlined disqualification process of directors.

## DISCUSSION QUESTIONS

674. Are any statutory reforms required to assist regulators to provide improved regulation in relation to interconnected personal and corporate insolvencies? Are improvements needed in relation to their capacity to share information and cooperate?
675. If the scope of the AA Fund is broadened to allow for the funding of registered trustees to investigate and report on corporate law breaches, which Corporations Act breaches in particular should be provided for?
676. Should the scope of the AA Fund be broadened to allow for loans to registered liquidators to properly carry out their fiduciary and statutory duties?
677. Should section 305 of the Bankruptcy Act also be expanded to provide for the funding of investigations into corporate law breaches?
678. What steps might be taken to improve efficiency in relation to related personal and corporate insolvencies while appropriately addressing conflicts of interest?
679. What other amendments can be made to assist creditors and directors of small corporates to better engage with the corporate insolvency system?
680. Is there a case for automatic disqualification of directors after a company failure? If so, how many repeated failures should trigger disqualification? Should there be a threshold for failures to trigger disqualification (for example, where less than 50 cents in a dollar are returned to creditors)? Over what period must the failures occur?
681. Should a registered liquidator be able to assign actions which vest personally in the liquidator? If so, should a registered trustee be likewise able to assign rights of action?
682. Should ASIC be able to automatically disqualify a director of an insolvent company who has not taken reasonable steps to ensure that the company has maintained its financial records?



## 2010 CORPORATE INSOLVENCY REFORM PACKAGE

### FOCUS OF CHAPTER

In January 2010, the Government announced a package of reforms to the corporate insolvency system. The reform package adopted substantially all of the recommendations made in the Corporations and Markets Advisory Committee's *Issues in external administration* report, and contained a range of reforms directed at reducing the costs and complexity of insolvency administrations; improving communications with creditors; and reducing the potential for abuse of corporate insolvency law.

Comments are sought on whether any of these proposals might be further tailored to eliminate unnecessary divergence with personal insolvency law.

### ACCESS TO CREDITOR LISTS

683. In a voluntary liquidation where the company is insolvent, a liquidator is required to provide to creditors the names, addresses and estimated amounts owed in respect of all other creditors in the administration. Hard copies of these lists must be sent to all creditors with debts in excess of \$1,000, and upon request to creditors with debts less than this threshold.<sup>342</sup>
684. It was announced that the corporations legislation will be amended to provide that insolvency practitioners should be permitted, but not compelled, to make creditor lists available electronically, rather than posting hard copies.
685. In personal insolvency there is no statutory obligation to provide creditor lists by default. Instead there are rights for creditors to obtain information that they reasonably require (which would be expected to include creditor lists) and rights to obtain lists of proofs of debt that have been lodged by creditors. There are no equivalent rights to obtain such information upon request in corporate insolvency.
686. Personal insolvency grants rights to make ad hoc requests for this information. Corporate insolvency imposes obligations upon practitioners to provide this information without there being a need for a request. The proposed reform amends this slightly to permit corporate insolvency practitioners to make this information available electronically.

### REPLACING A LIQUIDATOR

687. The members in a members' voluntary liquidation or creditors in a creditors' voluntary liquidation may fill any vacancy in the office of liquidator, which may arise if the incumbent ceased to be a registered liquidator, resigns or dies.<sup>343</sup>

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342 Subsections 496(2)-(3) and section 600G of the Corporations Act.

343 Subsections 495(3), 473(7), and 499 (5) of the Corporations Act; under section 502 the Court may also appoint a liquidator if there is a vacancy.



688. It was announced that the corporations legislation will be amended to provide that ASIC would be able to administratively appoint a replacement liquidator when there is a vacancy in office. Public notice of appointments would be required and appointments would have to be in accordance with publicly available guidelines to be developed by ASIC, in consultation with relevant stakeholders.
689. Section 180 and 181A of the Bankruptcy Act provide for comparable mechanisms for filling vacancies.

### **TAKING POSSESSION OF AND TRANSFERRING BOOKS**

690. ASIC does not have a generic power to require the production, and to take possession, of books of a company under external administration. Its powers in this regard can only be used in support of its enforcement and other functions and powers<sup>344</sup>. There is also no power for ASIC to transfer books to another person.
691. It was announced that the corporations legislation will be amended to provide that ASIC, in the event of a vacancy of the position of external administrator, would be able to take possession of books relating to a company in external administration and transfer those books to another external administrator.
692. The Inspector-General's broad information gathering powers may likewise not currently authorise taking possession of and transferring books upon a vacancy.

### **ELECTRONIC COMMUNICATION WITH CREDITORS**

693. The purpose of sending notices to creditors is to ensure that they are informed of events that may affect their rights and, consequently, are given an opportunity to protect those rights.
694. It was announced that the corporations legislation will be amended to provide that external administrators would be permitted to advise, in their first notification to creditors, that all further notices to creditors and other documents relevant to the external administration will be published on a designated website. The first notification would also indicate that a creditor may choose: to register to be notified electronically when new material is placed on the website; or to receive by mail, free of charge, a printed version of these further notices and other documents. If they make no nomination, they would not receive any further notifications.
695. While differing significantly in drafting, corporate and personal insolvency laws in relation to sending notices electronically are currently broadly similar in effect.

### **LODGEMENT WITH ASIC OF DECLARATIONS OF RELATIONSHIP**

696. External administrators in either a voluntary administration or a creditors' voluntary winding up must make declarations to creditors about relevant relationships and/or indemnities.
697. It was announced that the corporations legislation will be amended to provide for the lodgement of these declarations with ASIC.

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344 Sections 28,30 and 33 of the ASIC Act.



698. Declarations of relationship or indemnities do not exist under personal insolvency law. There is however a broad duty in paragraph 2.3 of Schedule 4A of the Bankruptcy Regulations to: notify the creditors, the person who appointed the trustee, a committee of inspection or the Court, as appropriate, of actual or apparent conflicts of interest; and to take appropriate steps to avoid the conflict of interest. There is no duty to notify the regulator. However, the 'consent to act and trustee declaration' form and the 'controlling trustee authority' form both include sections that require the registered trustee to declare any relationships. Unlike in corporate insolvency, conflicts must be lodged with the regulator.

## **PROVISIONAL LIQUIDATOR'S REMUNERATION**

699. Where a person has petitioned the Court for the liquidation of a company, the Court may appoint a provisional liquidator to take control of the company to safeguard the assets of the company pending the outcome of the proceeding. Currently, a provisional liquidator's remuneration must be approved by the Court.<sup>345</sup>
700. It was announced that the corporations legislation will be amended to allow creditors to approve a provisional liquidator's remuneration in cases where the creditors will ultimately bear these costs, subject to the power of the Court to confirm, increase or reduce that remuneration.
701. In personal insolvency, section 50 interim trustees' remuneration is approved by creditors (although also subject to the rights of the Court to approve remuneration also).

## **THE PUBLICATION OF EXTERNAL ADMINISTRATION NOTICES**

702. There are a range of notices that, in the course of external administrations, must be published in the print media.<sup>346</sup> These public disclosure obligations are in addition to obligations for petitioning creditors and for external administrators to communicate directly with known creditors to inform them of certain events.
703. There are significant costs to the administration in complying with these obligations; likewise, there are costs to creditors in monitoring newspapers for relevant notifications (particularly as there is no set newspaper or day of the week on which notices must be published).
704. It was announced that the corporations legislation will be amended to facilitate the future provision of notices via a single website. The reforms will apply to both advertisement requirements and gazettal requirements.
705. There are no gazettal and limited<sup>347</sup> advertising requirements in personal insolvency. Currently the requirement that meetings be advertised can be fulfilled by advertising on ITSA's website<sup>348</sup> in relation to first meetings of creditors called under sections 73 or

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345 Subsection 473 (2) of the Corporations Act.

346 Subsections 412 (1); 412 (4); 436E(3); 439A(3); 446A(5); 449C(5); 450A(1); 465A(c); 491(2); 497(2); 498(3); 509(2); 568A(2); 589(3); 601AA(4); 601AB(3) of the Corporations Act; subregulation 5.3A.07 (5) and regulations 5.6.14A, 5.6.39, 5.6.48, 5.6.65, and 5.6.69 of the Corporations Regulations.

347 Under Part IV Division 6 and under Part X.

348 [www.itsa.gov.au](http://www.itsa.gov.au).

188 of the Bankruptcy Act. Different requirements apply for other categories of meeting.

### **POSTAL VOTING BY CREDITORS**

- 706. Liquidators of court-ordered or creditors' voluntary liquidations cannot enter into compromises of debts in excess of \$100,000 or agreements under which the company's obligations may not be discharged within three months, except with the approval of the Court, of a COI or of a resolution of the creditors. In the case of a members' voluntary liquidation, the relevant approval is by a special resolution of members.
- 707. The law will be amended to allow postal voting in all kinds of liquidations in respect of these matters and in respect of remuneration approvals.
- 708. The Bankruptcy Act allows postal voting for all kinds of resolution in personal insolvency matters.<sup>349</sup>

### **LODGEMENT OF A REPORT AS TO AFFAIRS**

- 709. Directors are required to provide a report as to the affairs of the company in the prescribed form to a liquidator. The law will be amended to provide for the subsequent lodgement of this form by the liquidator with ASIC. This corrects an unintended anomaly introduced by the 2007 insolvency reforms. Prior to 2007 the obligation was upon directors.
- 710. In personal insolvency, bankrupts must lodge a Statements of Affairs. However, as a matter of practice, if a bankrupt sends their Statement of Affairs to their trustee, ITSA expects the trustee to then lodge the original with ITSA.
- 711. Notably, this process is supported in personal insolvency by a power in section 77CA that enables ITSA to compel lodgement of this document. ASIC has no equivalent power.

### **DISCUSSION QUESTIONS**

- 712. In accordance with the principle of alignment set out earlier in this paper, should any of the earlier announcements be reviewed and or modified to more closely align with personal insolvency law?
- 713. Alternatively, is it appropriate that the personal insolvency framework be amended to align with the changes discussed above (where necessary, through introducing affected corporate insolvency mechanisms not currently present in personal insolvency law)?

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349 Section 64ZBA.



## APPENDIX ONE: COMPARISON OF CORPORATE AND PERSONAL INSOLVENCY DISCIPLINARY FRAMEWORKS

	Corporate	Personal
<b>Establishment of decision maker for disciplinary proceedings</b>	Board to have a pool of 13 part-time members able to be selected <sup>350</sup>	No corresponding requirement
	Pool of members generally includes representatives of relevant professional bodies, but their selection on the CALDB is not mandated	A member of the Committee must be a member of the IPA <sup>351</sup>
	Panel of the CALDB constituted either as three or five person panel as determined by the Chairperson <sup>352</sup>	Panel of the Committee constituted as a three person panel determined by the Inspector-General or delegate <sup>353</sup>
<b>Practitioners rights</b>	Right to appeal to the AAT a decision contrary to their interests <sup>354</sup>	Right to appeal to the AAT a decision contrary to their interests <sup>355</sup>
	Opportunity to appear and be heard before Board	Opportunity to appear and be heard before Committee
	Bring evidence before and make submissions in relation to the matter <sup>356</sup>	Bring evidence before and make submissions in relation to the matter <sup>357</sup>
<b>Powers of decision maker</b>	Determine costs as to the hearing where the CALDB exercises any of the disciplinary sanctions available to it <sup>358</sup>	No corresponding power
	Apply Part III of the <i>Crimes Act 1914</i> relating to offences with respect to the administration of justice	No corresponding power
	Summon a person to appear at a hearing to give evidence and produce documents <sup>359</sup>	No corresponding power, however where assertions are made to the character of a registered trustee by a third party, the trustee will have a right to cross examine the person who made the assertion under the requirement for natural justice <sup>360</sup>
	Require evidence be provided on oath or affirmation <sup>361</sup>	No corresponding power

350 Section 203 of the ASIC Act.

351 Section 155H (3)(c) of the Bankruptcy Act.

352 Section 210A of the ASIC Act.

353 Subsections 155H (2)-(3) of the Bankruptcy Act.

354 Paragraph 1317B(1)(c) of the Corporations Act.

355 Subsection 155I (5) of the Bankruptcy Act.

356 Subsection 1294(1) of the Corporations Act.

357 Subregulations 8.27(3) and 8.30 (2) of the Bankruptcy Regulations.

358 Section 223 of the ASIC Act.

359 Subsection 217 (1) of the ASIC Act.

360 A committee must afford a person natural justice: subregulation 8.05H(2) of the Bankruptcy Regulations.

361 Subsection 217(2) of the ASIC Act.



Powers of decision maker (continued)	Determine its own procedure and is not bound by any rules of evidence <sup>362</sup>	Determine its own procedure and is not bound by any rules of evidence <sup>363</sup>
	Chair of the CALDB may certify conduct to the Court, and the Court may order a person to attend or comply with a requirement at a hearing; or punish the person in the same manner as if he or she had been in contempt of Court <sup>364</sup>	No corresponding power
	Board to find a person in contempt of the CALDB <sup>365</sup>	No corresponding power
Duties of decision maker	Give to the practitioner notice in writing of the decision and reasons for it within 14 days <sup>366</sup>	Give to the practitioner notice in writing of the decision and reasons for it within 14 days <sup>367</sup>
	Observe natural justice <sup>368</sup>	Observe natural justice <sup>369</sup>
Penalties	Cancel registration	Cancel registration
	Admonishment or reprimand - requiring an undertaking from the practitioner to engage in or refrain from engaging in specified conduct - requiring an undertaking from the practitioner to refrain from engaging in conduct except on specified conditions <sup>370</sup>	Impose specified conditions on a trustee's practice or on the trustee <sup>371</sup>
	The ASIC Act provides for penalties where a witness fails to: appear, produce a document, or take an oath <sup>372</sup>	No corresponding penalties
Rules in relation to proceedings	No corresponding rule	Committee must decide a matter within 60 days of being convened <sup>373</sup>
	No corresponding rule	A resolution may be passed as at a meeting of the committee through the signing of a document, or identical documents, by each of the members <sup>374</sup>
	If a member of a constituted panel dies, resigns, or is otherwise unable to continue in their role as a member, the proceeding may continue on the agreement of the parties <sup>375</sup>	If a member of a Committee dies, resigns, or is otherwise unable to continue in their role as a member, the proceeding must be reconvened with a replacement committee <sup>376</sup>

362 Paragraph 218 (1) (b) of the ASIC Act.

363 Subregulation 8.05H (3) of the Bankruptcy Regulations.

364 Subsection 219 (7) of the ASIC Act.

365 Section 220 of the ASIC Act.

366 Subsection 1296 (1) of the Corporations Act.

367 Regulation 8.31 of the Bankruptcy Regulations.

368 Subsection 218 (2) of the ASIC Act.

369 Subregulation 8.05H(2) of the Bankruptcy Regulations.

370 Subsection 1292 (9) of the Corporations Act.

371 Subsection 155I (2) of the Bankruptcy Act.

372 Subsections 219 (2) and 219 (4) of the ASIC Act.

373 Regulation 8.34 of the Bankruptcy Regulations.

374 Regulation 8.26 of the Bankruptcy Regulations.

375 Subsections 210A(6-7) of the ASIC Act.

376 Regulation 8.23 of the Bankruptcy Regulations.



<b>Rules in relation to proceedings (continued)</b>	Board may choose to convene a pre-hearing conference <sup>377</sup>	No corresponding power
<b>Protection of decision makers</b>	Board members provided with the same protections and immunities as a Justice of the High Court	No corresponding protection
<b>Conflict of interest for members of decision maker</b>	Board member who has a 'pecuniary or indirect pecuniary interest in a matter being considered' must disclose the nature of his or her interest and then must not be present or take part in any decision of the Panel <sup>378</sup>  No requirement for a Board member with a personal relationship, of a non-pecuniary nature, to disclose that relationship and remove themselves from the matter	Committee member who has a personal or pecuniary interest must disclose the nature of his or her interest  Removal of the member under the Bankruptcy Regulations for a conflict of interest of a pecuniary or personal nature is at the discretion of the Inspector-General <sup>379</sup>
<b>Disclosure</b>	A panel of the CALDB must take all reasonable measures to protect from unauthorised use or disclosure information given to it in confidence in, or in connection with, the performance of its functions or the exercise of its powers <sup>380</sup>  Board required to lodge a copy of decision and publish a copy of that notice in the Gazette within 14 days after decision <sup>382</sup>  Empowered to publicise, as it sees fit, the decision and reasons for the exercises of its powers (but not where it does not exercise its powers) <sup>383</sup>	A panel of a Committee must take all reasonable measures to protect from unauthorised use or disclosure information given to it in confidence in, or in connection with, the performance of its functions or the exercise of its powers <sup>381</sup>  No corresponding obligation  No corresponding obligation
<b>Regulator powers</b>	Cancel a liquidator's registration on certain grounds without referring the matter to the CALDB	No corresponding power

<sup>377</sup> Section 1294A of the Corporations Act.

<sup>378</sup> Subsections 211 (2)-(4) of the ASIC Act.

<sup>379</sup> Paragraphs 8.21(b) and 8.22(2) of the Bankruptcy Regulations.

<sup>380</sup> Section 213 of the ASIC Act.

<sup>381</sup> Regulation 8.32 of the Bankruptcy Regulations.

<sup>382</sup> Section 1296 (1) of the Corporations Act.

<sup>383</sup> Subsection 1296 (1B) of the Corporations Act.

