

## PART II

### **The evidence that the regulation of the insolvency industry needs reform**

The second part of this report presents the committee's evidence on various aspects of recent events and the current state of play in the insolvency industry in Australia. In so doing, it develops a case that the framework for regulating the insolvency profession in Australia is in need of significant reform.

Chapter 5 examines various **stakeholders' perceptions** of the industry and whether the well-publicised cases of practitioner misconduct reflect the inevitable exceptions in an otherwise well-regulated industry, or whether they indicate systemic regulatory failure.

Chapter 6 develops the analysis on this issue. It looks at the evidence that the **regulatory and disciplinary system** has been unresponsive and ineffective. The chapter also examines some of the reasons why this has been the case, including claims that the regulator is overburdened, unfocussed and inadequately resourced and that the disciplinary body has inadequate powers.

Chapter 7 considers the adequacy of current arrangements for **registering** insolvency practitioners. The chapter looks at claims that the profession recruits too narrowly, that it admits without adequate checks, and that it is too difficult to suspend or dismiss a liquidator once he or she is appointed.

Chapter 8 examines the issue of insolvency practitioners' **remuneration**. In this and in previous inquiries into the insolvency industry in Australia, the issues of the method, level and disclosure of practitioners' fees have been highly contentious. This chapter notes this criticism, but also some important changes in the way that fees are disclosed to creditors.



## Chapter 5

### 'Bad apples' or systemic failure: perceptions of the insolvency industry

*[T]his inquiry involves a consideration of the question as to whether Mr Ariff's conduct was simply that of a rotten apple and an unusual occurrence in the profession. The evidence before the inquiry rather suggests that to have been the case, but that does not deny the desirability for an improvement in the procedures by which insolvency administrators are regulated.<sup>1</sup>*

5.1 This chapter is partly concerned with those cases where liquidators and administrators have failed to carry out or perform their duties adequately and properly. Much of the evidence the committee has received relates to these cases of wrongdoing. The most notorious and well-publicised case is that of Mr Stuart Ariff. Mr Ariff accepted each of 83 allegations of misconduct against him and is prohibited from holding the office of liquidator or administrator for life.

5.2 Table 5.1, reproduced from the Australian Securities and Investments Commission's (ASIC) submission, shows the outcomes of disciplinary proceedings commenced prior to July 2006. Table 5.2 shows the outcomes of referrals since then.

5.3 These cases raise two broader issues. The first is the extent to which the regulatory system is equipped to identify and prosecute prompt action against these wrongdoers. The second, and related, issue is the extent to which these cases reflect systemic abuses in the insolvency industry or whether they are the rare exceptions in an otherwise well-performing industry. These are crucial considerations in assessing the need for reform and the recommendations that the committee should consider.

#### **The Ariff case**

5.4 The committee has received considerable evidence relating to the conduct of Mr Ariff. It took the view that this evidence should be made public. The matter has been resolved in the courts and Mr Ariff has admitted wrongdoing. However, the committee did agree to make confidential Mr Ariff's evidence before the committee in Sydney on 13 April 2010. In addition, it has respected ASIC's request to keep confidential the Appendix to its submission relating to the Ariff matter.<sup>2</sup>

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1 Mr Stephen Epstein, *Committee Hansard*, 13 April 2010, p. 28.

2 ASIC explained in its submission that the material contained in this Appendix is provided confidentially 'because disclosure of the information set out in that appendix may prejudice our ongoing investigation in relation to a number of matters or breach ASIC's legal obligations under s127 of the ASIC Act'. *Submission 69*, p. 7.

**Table 5.1: Outcome of disciplinary hearings\***

Type of proceeding*	Number	Outcome
Disciplinary proceedings (CALDB)	1	Mr McDonald, 2 year suspension
	1	Mr Dean-Wilcocks, 12 month suspension
	1	Mr Albarran, 9 month suspension
	1	Mr Sleiman, Cancellation—upheld on appeal
	2	Mr Andersen, 3 month suspension [Other matter subject to confidentiality]
	1	Mr Lucas, No new appointments for 3 months
	1	Mr Murphy, Reprimand
	1	Mr Edge, Banned for 10 years

\* Deterrence outcomes after July 2006 for proceedings commenced prior to July 2006.  
Source: ASIC, *Submission 69*, pp. 69–70.

**Table 5.2: Outcome of disciplinary hearings\***

Type of proceeding	Number	Outcome
Disciplinary proceedings (CALDB)	1	Mr Dean McVeigh, CALDB ordered 18 month suspension period
	1	Following ASIC advising of its concerns regarding independence, the insolvency practitioner made an application to the court and a special purpose administrator was appointed by the court to address concerns about the independence of the incumbent administrator
	1	Mr Stuart Ariff, Life ban
	1	Court application by practitioner seeking interpretation of statutory provisions relating to maintenance of bank accounts
Enforceable undertakings	2	Mr Civil, Surrender of registration Mr Travers, Surrender of registration
	1	Mr Martin, No new appointments for 4 months and independent practice review
Voluntary surrender of registration	1	Surrendered registration following advice of disciplinary proceedings
Discontinued / insufficient evidence	1	Jurisdictional issues
Ongoing investigations	5	

\* Outcomes of referrals to deterrence since 1 July 2006. Source: ASIC, *Submission 69*, pp. 69–70.

5.5 At its Newcastle hearing, the committee took verbal evidence from the directors of companies prematurely wound up by Mr Ariff and from the various unpaid creditors. These witnesses were:

- Mr Bernard Wood, director of Singleton Earthmoving;
- Mr Ian Fong, a representative of Carlovers Carwash Limited and Berjaya Corporation Berhad;
- Councillor Edward Maher, Deputy Mayor of Armidale Dumaresq Council, who discussed the administration of the YCW Leagues Club;
- Mr Ron Williams, President of Adamstown Rosebud Sport and Recreation Club; and
- Mr Bill Doherty, a former director of Independent Powder Coating.

5.6 The following section sketches what happened to the first four of these businesses. The committee recognises that while these particularly egregious cases are not representative of the practices of most insolvency practitioners, they do indicate the areas of potential abuse and significant gaps in the regulatory system. In particular, Mr Ariff's misconduct underlines the importance of full and accurate disclosure of fees and disbursement payments and the imperative of a prompt complaints system. These themes are examined in later chapters.

### ***Singleton Earthmoving***

5.7 Mr Bernard Wood told the committee that he and his wife were directors of the Singleton Earthmoving business. Following their divorce in 2004, his wife wanted 'a way out'. Her solicitor ordered Mr Wood to pay his wife \$1.5 million or the company would be forced into administration. Mr Wood could not pay this sum. His wife went to Mr Ariff who convinced her to appoint him as the administrator.<sup>3</sup>

5.8 Despite the business being in good shape with no money owing, Mr Ariff then proceeded to forcibly close the business down, taking the assets of the company and of Singleton Earthmoving Equipment Hire.<sup>4</sup>

5.9 In 2005, Mr Wood went to court on the matter and was awarded the equipment back and a sum of compensation for loss of income and legal fees.<sup>5</sup> Mr Ariff, however, escaped penalty.

5.10 Mr Wood twice wrote to ASIC 'early in 2005' to complain about Mr Ariff. ASIC's response was 'get legal advice'. Mr Wood then approached his local member,

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3 Mr Bernard Wood, *Committee Hansard*, 14 April 2010, p. 19.

4 Mr Bernard Wood, *Committee Hansard*, 14 April 2010, p. 20; See also, Mr Paul Gleeson, *Submission 24*, p. 1.

5 Mr Bernard Wood, *Committee Hansard*, 14 April 2010, p. 20.

the Hon. Joel Fitzgibbon MP, who raised the issue in parliament in August 2005.<sup>6</sup> With reference to Mr Wood's experience, Mr Fitzgibbon made the observation, 'I suspect that our Mr Ariff is a bit of a cowboy'. According to Mr Wood, Mr Fitzgibbon also approached the then Treasurer, the Hon. Peter Costello, to instruct ASIC to investigate the issue. Nothing happened, however.<sup>7</sup>

5.11 Mr Wood told the committee that 'Carlovers, Bill Doherty and a group of us...got together' and approached journalist Adele Ferguson.<sup>8</sup> In October 2007, Ms Ferguson wrote an article in the *Weekend Australian* on Mr Ariff's handling of the CarLovers Australia insolvency.<sup>9</sup> It was only then that ASIC got involved (see chapter 6).

### ***Carlovers Carwash Limited***

5.12 Perhaps the most infamous case of insolvency practitioner misconduct was Mr Ariff's administration of Carlovers Carwash Limited. The company, owned by the Malaysian Investment Group Berjaya Limited, was supposed to be in administration for 12 months. Instead, Mr Ariff was the administrator from July 2003 to November 2007. The administration cost the company more than \$11 million, more than double its original debt of \$4.5 million.<sup>10</sup>

5.13 Carlovers noted in its submission that Mr Ariff refused to bring the administration to an end even when his fees and disbursements had soaked up all monies in deed funds and nothing remained for creditors. Mr Ariff took false or non-existent fees and disbursements, over-serviced, prolonged settlements, charged excessively high fees, took fees not approved by creditors and arranged associate companies to circumvent creditor approval for payment of remuneration.<sup>11</sup>

5.14 The Berjaya Corporation made three formal and numerous informal complaints to ASIC between 2005 and 2007. As chapter 6 discusses, ASIC only took action when the media became involved. Berjaya noted that 'the most disappointing aspect of this matter was that when we raised the alarm and desperately needed help, there was no one to turn to'.<sup>12</sup>

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6 The Hon. Joel Fitzgibbon, *House of Representatives Hansard*, 17 August 2005.

7 Mr Bernard Wood, *Committee Hansard*, 14 April 2010, p.21.

8 Mr Bernard Wood, *Committee Hansard*, 14 April 2010, p.21.

9 In evidence to the committee, Mr Doherty tabled a newspaper report by Ms Ferguson and Gary Hughes from *The Weekend Australian* of 13 September 2008, which exposed Mr Ariff's links to 'colourful underworld identity Domenic "Mick" Gatto'. 'One man's trash is another man's pressure', *The Weekend Australian*, 13 September 2008.

10 Carlovers and Berjaya Corporation Berhad, *Submission 26*, p. 1.

11 Carlovers and Berjaya Corporation Berhad, *Submission 26*, p. 1.

12 Carlovers and Berjaya Corporation Berhad, *Submission 26*, p. 2.

5.15 Mr Ariff's uses for Carlovers' stolen money have been well documented in the press.<sup>13</sup> The Berjaya Corporation notes that in addition to personal expenditure, the monies siphoned from the company were used on lawyers to defend himself from allegations.

5.16 Mr Stephen Epstein SC, who acted on behalf of the Berjaya Group in the Carlovers case, explained to the committee how it was difficult to remove Mr Ariff as the administrator. Mr Ariff and his legal advisers composed a deed of company arrangement and the Berjaya Group abandoned their claims as creditors, and therefore had no voting rights. Unsecured creditors, such as the Australian Taxation Office, lost interest in the administration as Mr Ariff's fees ate up any potential dividend. Mr Epstein explained that no-one who could vote had any interest in bringing the administration to an end and Mr Ariff was therefore 'able to continue in office as administrator of this group over the opposition of its owner'.<sup>14</sup>

#### ***Adamstown Rosebud Sport and Recreation Club***

5.17 Mr Ron Williams, President of the Adamstown Rosebud Sport and Recreation Club, told the committee that in 2003–04 the Club was clearly trading insolvent. He consulted the Yellow Pages and found an advertisement for Mr Ariff's services. Mr Williams explained that Mr Ariff 'was the only one in there at the time who came up with company restructuring, administrations and assistance'.<sup>15</sup>

5.18 Mr Ariff advised that the company should go into voluntary administration. He put a motion to the board which was passed and Mr Ariff was appointed as administrator. Mr Ariff established a company deed with the creditors which 'went for four years for \$4000 a month and each month we religiously made that payment'.<sup>16</sup>

5.19 Mr Williams told the committee that his initial concerns were raised following a newspaper report relating to the fees Mr Ariff was charging Carlovers. He rang ASIC to see where his company stood in relation to the matter and subsequently lodged a complaint on behalf of his staff concerning the payment of their entitlements. However, Mr Williams noted that ASIC advised that because the Club was a cooperative, the appropriate avenue was the Office of Fair Trading or legal advice.<sup>17</sup>

5.20 Following reports that Mr Ariff's licence to act as an administrator had been cancelled, the Department of Fair Trading advised the Club that another administrator must be appointed. However, a representative from the insolvency firm Jirsch Sutherland advised the board that another administrator had to be appointed through

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13 See Adele Ferguson, 'Party over, as Ariff told to pay \$4.9m', *Weekend Australian*, 22 August 2009, p. 27.

14 Mr Stephen Epstein SC, *Committee Hansard*, 13 April 2010, p. 28.

15 Mr Ron Williams, *Committee Hansard*, 14 April 2010, p. 27.

16 Mr Ron Williams, *Committee Hansard*, 14 April 2010, p. 27.

17 Mr Ron Williams, *Committee Hansard*, 14 April 2010, p. 27.

the courts and that no money was left in Mr Ariff's account and all his records had been destroyed.

5.21 Mr Williams noted that he was contacted by several people 'including Mr Bill Doherty, a couple from Sydney and a few other people who had been in the same position with Ariff'. The Office of Fair Trading performed an audit of the Club which showed that all payments had been made except for two that were outstanding at the time of Mr Ariff's disbarment.

5.22 Mr Williams told the committee that the Club is now 'in limbo' because Mr Ariff had not paid the monies it was liable for, and the Club did not have the money to get legal advice. There is currently a police process of trying to identify where the money has gone to out of Mr Ariff's accounts and a new administrator was recently appointed. In the meantime, however, the Club has been losing members and income.<sup>18</sup>

### ***YCW Leagues Club***

5.23 Councillor Edward Maher of the Armidale Dumaresq Council told the committee that he became interested in the plight of the Armidale YCW Leagues Club when the board had a meeting and decided to close the Club. He urged the board on several occasions to stay afloat, but they took the decision to go into a voluntary administration and appointed Mr Ariff as administrator. Mr Maher explained that the decision was taken without any reference to the membership of the Club.<sup>19</sup>

5.24 In the early days of the administration, the Leagues Club performed well financially. The manager told Mr Maher it was banking, on average, about \$25 000 a week. However, in 2006, a financial statement showed that in an eight-month period the club had lost \$107 000, of which \$97 000 was Mr Ariff's fee. By the end of the administration, the Club owed in excess of \$900 000.<sup>20</sup>

5.25 The Club owed its major creditor, the St George Bank, approximately \$380 000. Councillor Maher told the committee that the Club banked the money into accounts that were controlled by Mr Ariff, believing that the St George Bank was being paid. It was not. Mr Maher told the committee that St George subsequently sold the debt to a Mr Karas from Melbourne, who appointed a Mr Vartelas as liquidator. The poker machines were sold.<sup>21</sup>

5.26 Mr Ariff then decided that Club would close and called two creditors meetings to seek their approval. However, at the first creditors' meeting, the motion was rejected reflecting the Club's contribution over many years to uniting the local

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18 Mr Ron Williams, *Committee Hansard*, 14 April 2010, p. 27.

19 Mr Edward Maher, *Committee Hansard*, 14 April 2010, p. 75.

20 Mr Edward Maher, *Committee Hansard*, 14 April 2010, p. 75.

21 Mr Edward Maher, *Committee Hansard*, 14 April 2010, p. 76.

community. Another meeting was called where Mr Ariff told the creditors he had found somebody to buy the Club. However, this did not occur and the Club was instead purchased by a local school and, with a Commonwealth government grant, has been turned into a trade training centre.<sup>22</sup>

### ***Mr Ariff's deregistration***

5.27 In August 2009, fully four years after the matter was raised in parliament, ASIC banned Mr Ariff as an official and registered liquidator for life. He accepted that each of the 83 allegations of misconduct against him had been proved. The Supreme Court of New South Wales found that Mr Ariff had not faithfully performed his duties in respect of 16 companies.<sup>23</sup>

5.28 Although Mr Ariff's victims were awarded \$5 million in compensation, they rightly remain bitter. Carlovers' submission noted:

ASIC eventually secured a somewhat hollow victory against Mr Ariff who was banned for life and ordered to make compensation to his victims for \$4.9 million. Mr Ariff was able to keep one step ahead of the law and ASIC. Mr Ariff had time to move his assets to safety and declare bankrupt. His victims are not expected to receive any compensation and are still waiting for criminal actions to commence...To add insult to injury, Mr Ariff has to date not been charged with any crime under the Australian criminal justice system. In most other countries Mr Ariff would have faced charges of criminal breach of trust, embezzlement, theft and false accounting to say the least and if convicted, spend time behind bars. Instead he is walking free and he and his ill gotten gains are enjoying protection under the umbrella of bankruptcy.<sup>24</sup>

5.29 Mr Wood told the committee:

We thought it was a great victory this past August when \$5 million was awarded to a group of us. He walked away. I am broke. I have not paid my IP insurance and we have not seen a cent. We think should ASIC, not having done the right thing by us, be responsible to compensate us? I have lost the business, money, legal fees, et cetera, and that is where we are.<sup>25</sup>

### **Other disciplinary cases**

5.30 The other two cases that attracted the committee's attention during this inquiry were the complaints made and proceedings against Mr Geoffrey McDonald and Mr Dean-Wilcocks. The committee is aware that ASIC received dozens of complaints against both practitioners, dating from the mid 1990s until recently. Several of these

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22 Mr Edward Maher, *Committee Hansard*, 14 April 2010, p. 76.

23 ASIC, 'Liquidator (Stuart Ariff) banned for life', 18 August 2009.

24 Carlovers Carwash, *Submission 26*, pp. 2–3.

25 Mr Bernard Wood, *Committee Hansard*, 14 April 2010, p.21.

complaints were dismissed. However, both practitioners have had disciplinary proceedings and findings against them (see Table 5.1). In both cases, the findings related to the practitioner's lack of independence.

*Mr Geoffrey McDonald*

5.31 In the McDonald matter, ASIC made an application to the CALDB following its investigation into Mr McDonald's conduct while Formula Engineering Pty Ltd was in external administration between April 2000 and January 2003. During this period, Mr McDonald was a partner at Hall Chadwick, which was engaged by the administrator to carry out and perform (and receive fees for) the majority of professional services associated with the external administration.<sup>26</sup>

5.32 However, as Hall Chadwick was the professional accountant for Formula, registered liquidators from Hall Chadwick were prohibited by professional standards from being involved in the external administration process. In 2007, the CALDB suspended Mr McDonald's registration for two years after finding he failed to carry out or perform adequately and properly his duties as a liquidator under section 1292 of the Corporations Act. In September 2008, Mr McDonald appealed the decision to the Administrative Appeals Tribunal (AAT). In December 2009, the AAT upheld the CALDB's decision.<sup>27</sup>

5.33 Mr McDonald provided a submission and appeared before the committee to give evidence. He made brief comment of his experience as the provider of services to Formula Engineering, noting that various other insolvency practitioners had a conflict of interest given their membership of big accountancy firms:

I had a relatively minor role in an insolvency appointment and the accusation was that I had breached the spirit of the ethics of the Institute of Chartered Accountants. At the time, every member of the big four accountancy firms was doing exactly the same. Let me make that point really clear: at the time the big four accountancy firms had an insolvency division. I think you will find in this week's *Business Review Weekly* they mention that insolvency partners broke away from Ernst and Young to become KordaMentha 'because of the conflict of interest'. So what we have is the big four accountancy firms merrily proceeding in conflict of interest and in breach of the Institute of Chartered Accountants ethics rules. That is what I had to deal with.

The creditors also expect you to represent them. I found out the hard way that that is just wrong. If you are sitting there thinking that the creditors, the people who are owed the money, should be represented by the liquidator, that is wrong. I thought that was the case. The Queen's Counsel

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26 ASIC, 'Sydney liquidator's registration suspended', *Media release*, 2 December 2009, <http://www.asic.gov.au/asic/asic.nsf/byheadline/09-240AD+Sydney+liquidator's+registration+suspended?openDocument> (accessed 20 June 2010).

27 ASIC, 'Sydney liquidator's registration suspended', *Media release*, 2 December 2009.

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representing me said there nothing wrong with working closely with the creditors—but, no, you need to be impartial from everyone.<sup>28</sup>

5.34 Mr McDonald noted in his submission that the 'greatest problem' for the insolvency profession is that the members are often in positions of conflict. He admitted that while he has 'tested the boundaries on occasions', he left the profession because of his frustration with these conflicts.<sup>29</sup>

5.35 To illustrate the point, Mr McDonald gave the example of a company director needing to appoint a liquidator. The director approaches one liquidator and explains he is looking at two other liquidators before deciding which one to appoint. Mr McDonald continued:

The liquidator says to himself; “How do I convince the Director, in order for him to sign on the dotted line, to pick me?” “What sales pitch do I use?” “Do I reduce my fees?” “If so, does that mean my office does less work and cuts more corners?” That is not acceptable to me...“Do you say to the director that “I will go easy on you”?”...I did not want to be part of that. But what was said by others when that director went elsewhere to sign up with another liquidator. Then importantly, the person chosen by the director to be “his liquidator” MUST turn on the director. He must investigate the conduct of the director and, in all probability, he must consider suing him for “insolvent trading”. The conflict is obvious.<sup>30</sup>

5.36 Mr McDonald concluded that an insolvency accountant should not be able to give any advice to a company and then subsequently take on the appointment as liquidator.<sup>31</sup>

#### *Mr Ronald Dean-Wilcocks*

5.37 In November 2006, the CALDB cancelled Mr Dean-Wilcocks' registration for 12 months for his failure to abide by professional standards of independence. This followed his failed appeal to the Federal Court challenging the CALDB's December 2005 decision against him.

5.38 The case against Mr Dean-Wilcocks concerned his appointments as administrator of Freedom Pools Pty Ltd, Holilop Pty Ltd and W & C Callen Electrical Pty Ltd. In these appointments, Mr Dean-Wilcocks was found to have had a professional relationship of a practice related to these companies and thereby a

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28 Mr Geoffrey McDonald, *Committee Hansard*, 13 April 2010, p. 39.

29 Mr Geoffrey McDonald, *Submission 33*, p. 7; Mr Geoffrey McDonald, *Committee Hansard*, 13 April 2010, pgs 36 and 39.

30 Mr Geoffrey McDonald, *Submission 33*, p. 9.

31 Mr Geoffrey McDonald, *Submission 33*, p. 9.

conflict of interest. He failed to disclose to creditors the extent of his firm's relationship with related accounting practices in respect to the three appointments.<sup>32</sup>

5.39 In a media statement on the matter, ASIC commented on the finding:

This outcome is important for two reasons. Firstly, it highlights the significant consequences for liquidators who fail to maintain independence and avoid conflicts in the administration of companies over which they are appointed. Secondly, Justice Tamberlin's decision confirms that it is permissible to have regard to professional standards in deciding whether the office of registered liquidator had been 'adequately and properly' carried out or performed.<sup>33</sup>

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Independence is fundamental to ethical standards of professional conduct. Businesses and members of the public must be able to rely on auditors and liquidators to meet their responsibilities as required by the law and their profession. ASIC regards any breaches of those responsibilities as extremely serious and will take appropriate disciplinary action against liquidators and support the orders of the CALDB when challenged.<sup>34</sup>

### **Submitters' reflections on the state of the insolvency industry**

5.40 The committee received a range of comment about the extent to which the well publicised cases of wrongdoing in the insolvency industry reflect generally poor industry practices. At one end of the spectrum, there are those who argue that the industry generally performs well and that Mr Ariff is the exception. At the other end are those who claim the insolvency industry has systemic problems and operates in a regulatory vacuum. Between these positions are more nuanced views, which recognise that there are specific problems that require targeted reform.

5.41 In part, the lack of any consensus on the state of the industry reflects the lack of industry-wide, publicly available data. Chapter 9 of this report discusses the need to develop a more rigorous and consistent basis for collecting and analysing this data.

#### ***A generally well-performing industry***

5.42 Several submitters argued that the 'bad apples' are the exception to an otherwise well performing industry. The Insolvency Practitioners Association of Australia (IPAA), notably, put to the committee that like any other profession, there are a small number of insolvency practitioners who fail to meet the high standards required by law and its own Code of Professional Practice. It observed that of the

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32 ASIC, 'Ronald Dean-Wilcocks suspended as liquidator for 12 months', 21 November 2006, <http://www.asic.gov.au/asic/asic.nsf/byheadline/06-405+Ronald+Dean-Wilcocks+suspended+as+liquidator+for+12+months?openDocument>

33 ASIC, 'Ronald Dean-Wilcocks suspended as liquidator for 12 months', 21 November 2006.

34 ASIC, 'Ronald Dean-Wilcocks suspended as liquidator for 12 months', 21 November 2006.

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113 000 insolvency appointments from 2000–2009, only 14 practitioners had their registration cancelled and only 13 were suspended.<sup>35</sup>

5.43 Ms Denise North, Chief Executive Officer of the IPAA, made a distinction between a 'corrupt' practitioner and a finding that a practitioner has breached the high industry standards. She told the committee:

In the current environment we are aware of a single corrupt liquidator, Stuart Ariff, who has been banned and rejected. We are aware of a lot of allegations of wrongdoing and we are aware of some findings that some practitioners from time to time have fallen down on meeting the high standards. But falling down on meeting high standards is not the same thing as corrupt... There are very, very few corrupt practitioners.<sup>36</sup>

5.44 In its submission, the IPAA emphasised that the issues relating to individual insolvency practitioners have been identified by ASIC, the IPAA and CALDB and appropriately dealt with. It thereby argued that 'the present system is working to produce appropriate outcomes in cases of misconduct'.<sup>37</sup>

5.45 The committee received evidence from large insolvency firms along the same lines. Mr Bryan Hughes of Pitcher Partners argued that in his view:

...99% of Practitioners are hardworking, honest and diligent in carrying out their duties under the Act. It is only the smallest minority of Practitioners who do not comply and therefore to legislate to increase reporting requirements is unjust to the majority, and more importantly costly to the creditors.<sup>38</sup>

5.46 Mr Mark Korda, managing partner at the firm KordaMentha, noted that:

...in any profession there are bad apples and unfortunately the same can be said about the insolvency profession. The case of Stuart Ariff is one such case. We agree that ASIC and IPA need to continue to be actively involved in strengthening the professional reputation of the industry and dealings with the bad apples.<sup>39</sup>

5.47 Mr Michael Mumford, a Research Fellow at the International Centre for Research in Accounting at the University of Lancaster, noted in his submission to this inquiry that the Australian insolvency industry compares favourably with other regimes. He explained:

To an interested UK observer, the regulation of corporate insolvency in Australia appears well-based and thorough. There are an adequate number

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35 IPAA Tabled Opening statement, *Public hearing*, 12 March 2010.

36 Ms Denise North, *Committee Hansard*, 23 June 2010, p. 9.

37 IPAA, *Submission 36*, p. ii.

38 Pitcher Partners, *Submission 47*, p. 2.

39 Mr Mark Korda, *Submission 32*, p. 3.

of practitioners in a competitive market of 576 practitioners, which is well-informed about the reputation of those practitioners. (Note that there are only about 800 appointment takers in the UK, with a somewhat larger number of registered companies.) Indeed...I acknowledge that Australia leads practice in some important respects, notably the emphasis on solvency certification in creditor protection, and (more relevant in the present context) the active role played by ASIC in supporting insolvency practitioners and creditors in investigating and (where appropriate) prosecuting malfeasance by directors and others.<sup>40</sup>

### ***A bad industry***

5.48 In contrast, other submitters expressed frustration that Mr Ariff's case has been interpreted as a one-off. They argued that the problems in the insolvency industry are not rare and isolated, but reflect systemic weakness and regulatory failure. Carlovers Carwash argued in its submission:

There are just too many criticisms of liquidators ranging from excessively high fees, over-servicing, protracted settlements, lack of transparency, conflicts of interest, abuses of power and gross misconduct. We believe this is a systemic problem within the insolvency industry...ASIC should be given more resources and more powers so that it can investigate and address complaints quickly and efficiently. At the moment too many bad apple cases of negligence, fraud and misconduct are slipping through the cracks.<sup>41</sup>

5.49 The theme of systemic decay continued in Carlovers' verbal evidence:

No-one has confidence in the system other than the liquidators themselves. I think too many people have already been harmed to say that this is the work of just a few bad apples and I implore you, our leaders, to rebuild a complete system.<sup>42</sup>

5.50 Councillor Maher of the Armidale Dumaresq Council told the committee that Mr Ariff is not just a one-off and even if he was, the fact that it took so long for the industry to deal with him is indicative of a major problem in the industry.<sup>43</sup>

5.51 Mr Doherty was also scathing of the industry's regulators, including the peak lobbying bodies. He argued that insolvency practitioners operate in a 'policy and regulatory vacuum', of which they take every advantage. He described the Insolvency Practitioners Association, the Institute of Chartered Accountants and the CPAA as

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40 Mr Michael Mumford, *Submission 8*, p. 1.

41 Carlovers Carwash Limited, *Submission 26*, p. 4

42 Mr Ian Fong, *Committee Hansard*, 14 April 2010, p. 37.

43 Councillor Edward Maher, *Committee Hansard*, 14 April 2010, p. 76.

'clubs' which serve no regulatory purpose and 'will undoubtedly want the status quo to remain'.<sup>44</sup>

5.52 Another submitter told of his frustration at what 'little effect' the 2004 report of Joint Parliamentary Committee on Corporations and Financial Services had had on the insolvency profession. He argued that the insolvency rules are not working and that external administrators should be required to act on behalf of creditors rather than their focussing on their potential cash flow. This inquiry, he argued, needs to 'take a step back' and ask whether creditors are receiving dividends, or whether the funds are going to external administrators and their legal advisors.<sup>45</sup>

### *ASIC's view*

5.53 ASIC was asked its view whether the well publicised cases of misconduct were isolated instances or whether the problem was more serious and widespread. The Chairman, Mr D'Aloisio, told the committee that the nature of the problem was somewhere in between. He explained:

I think the way that it has been presented is a bit of a contrast—everything is okay or there are just some bad apples. As you would be aware, life never works in that sort of simple way. There is no question at all that there are bad apples. What we are saying is, in terms of where we are and the evidence we are seeing through the complaints and through the work that our people are doing in the field, we see areas for improvement and our forward program is focusing on those, but we are not extrapolating from that there is a major drama here.

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...we are not seeing the systemic issue. By the same token, we are not at the end of saying, 'They are just a few bad apples; don't worry.' Our view is that there are a number of issues that need to be addressed and that we need to work with the industry and the association, most notably around fees, independence, the issues that we have covered in our forward program and the points I made earlier. So we are probably somewhere towards a few bad apples, but much more towards the centre of those two extremes.<sup>46</sup>

### *The need for targeted reform*

5.54 The need for targeted reform of the insolvency industry was supported by various submitters and witnesses to this inquiry. Dr Vivienne Brand, an insolvency academic at Flinders University, told the committee that the system may be failing to detect the poor operators in the industry. She explained to the committee:

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44 Mr Bill Doherty, *Committee Hansard*, 14 April 2010, p. 11.

45 Name withheld, *Submission 80*, p. 1.

46 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, p. 5.

While there seems to be general agreement amongst people appearing before the committee, and having read some Hansard—and I think there is general agreement from even the committee itself—we are really talking about a few bad apples, not a bad industry. Apples can go bad, as well as starting out that way, and there seems to be a lack of ongoing active review of liquidators, which is concerning.<sup>47</sup>

...

There has been general consensus before the committee that we have in Australia a very good system in Australia that largely works well. There has to be a reason why there are so many really upset creditors. My gut feeling, looking at the statistics from the UK, is we are not picking up a number of people who are not operating so well—not a lot, but enough that might explain why there are so many unhappy creditors.<sup>48</sup>

5.55 Similarly, Mr Stephen Epstein SC told the committee:

[T]his inquiry involves a consideration of the question as to whether Mr Ariff's conduct was simply that of a rotten apple and an unusual occurrence in the profession. The evidence before the inquiry rather suggests that to have been the case, but that does not deny the desirability for an improvement in the procedures by which insolvency administrators are regulated.<sup>49</sup>

5.56 Professor Scott Holmes from the University of Newcastle argued that while the Ariff case is not representative of how practitioners operate, the evidence gathered during this inquiry strongly supported a regulatory response. He told the committee:

I was moved to make a submission to this inquiry as a direct result of the practices of one Stuart Karim Ariff. Although I have had no personal involvement in a business that has been penalised or destroyed by the actions of what I call a rogue administrator, Ariff demonstrated the enticing encouragement provided by the deficiencies of the law and the insufficient response of those who apply it, both regulators and the professional bodies.

Regulations and actions of the regulators will never, however, eliminate behaviour that is deliberately designed to defeat their purpose. In fact, regulations will often establish the parameters in which misbehaviour can be achieved, and that certainly was the case for Mr Ariff. Most of this behaviour is at the margins and does not normally reflect the mainstream compliance of most with both the spirit and letter of the law. However, as it is plain to see from the numerous submissions made to this inquiry, there exists a need to address the current regulatory environment and the function of key regulators to render improvements in order to better insulate companies from the actions of rogue administrators.<sup>50</sup>

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47 Dr Vivienne Brand, *Committee Hansard*, 9 April 2010, p. 4.

48 Dr Vivienne Brand, *Committee Hansard*, 9 April 2010, p. 15.

49 Mr Stephen Epstein, *Committee Hansard*, 13 April 2010, p. 28.

50 Professor Scott Holmes, *Committee Hansard*, 14 April 2010, p. 49.

## Summary

5.57 The committee recognises that no regulatory system is perfect: it is impossible to deter all misconduct. The key question, however, is whether the few cases of proven misconduct reflect how well the regulatory system is otherwise working, or whether they indicate that regulation has been lax and could be improved.

5.58 As chapter 9 discusses, an assessment of the state of insolvency industry in Australia is difficult in the absence of detailed data. Nonetheless, there are clearly several aspects of the regulatory framework that could be improved. Given the importance of maintaining community confidence in the insolvency regime, and the potential for stakeholder dissatisfaction from the insolvency process, the committee believes that significant reform should not wait for precise data verifying the presence of regulatory failure. The following chapters examine the areas where submitters and witnesses have identified regulatory gaps.

