Chapter 10

Options to improve the framework for regulating and remunerating the insolvency profession in Australia

10.1 This inquiry has gathered evidence indicating that there are several points of weakness in the regulation of the insolvency profession in Australia. Chapter 7 discussed various options to tighten the registration process and broaden the professional base. This chapter focuses on the options to reform the regulatory and disciplinary framework and the method for remunerating practitioners. In this context, the committee has heard several options, which include:

- creating a specialised insolvency regulator (paragraphs 10.3–10.17);
- a systematic, annual or biennial review of all insolvency practitioners (paragraphs 10.19–10.27);
- the creation of a 'flying squad' to monitor practitioners on a profiling basis (paragraphs 10.28–10.29);
- abolishing the Companies Auditors and Liquidators Disciplinary Board (CALDB) or limiting its role to more serious matters (paragraphs 10.30–10.32);
- establishing an insolvency ombudsman to oversee the profession and adjudicate on complaints made against insolvency practitioners (paragraphs 10.33–10.48);
- introducing provisions similar to the Chapter 11 Bankruptcy process in the United States (paragraphs 10.49–10.58);
- various options to improve the basis for remunerating practitioners, from establishing a tendering process to legislating the Insolvency Practitioners Association's remuneration report template (paragraphs 10.61–10.78); and
- various options to improve the system for registering practitioners, from a licensing system to an interview process to a written examination (paragraphs 10.79–10.84).

10.2 This chapter discusses the range of views that the committee has received on these proposals. As the options to reform the registration system have been discussed in chapter 7, the chapter gives only a brief summary of these proposals.

A specialised insolvency regulatory agency

10.3 Past inquiries into Australia's insolvency industry have raised the possibility that the personal bankruptcy regulator and the corporate insolvency regulator could be merged to form a single agency governed by the same processes and procedures.

10.4 The 1988 Harmer Report, for example, noted that there does not appear to be any constitutional impediment to federal insolvency legislation covering both individuals and companies. It listed three arguments in favour of integrating individual and corporate insolvency:

- there are many aspects of insolvency law affecting the individual and the corporation that are, or should be, the same;
- with a single statutory scheme, one government would have effective control of policy in relation to insolvency and changes could be made expeditiously; and
- there would be greater efficiency and cost savings from common procedures.[1]

10.5 The Harmer report also listed arguments against unifying insolvency legislation. These include the many areas peculiar to individuals and corporations and the many areas of individual and corporate insolvency in more urgent need of reform. The Law Reform Commission's view was that while there may be advantages in unified insolvency legislation:

> [I]t is more important to concentrate on the particular reform proposals put forward in this Report than to be overly concerned with attempting to put the two very different aspects of insolvency law into one Act.[2]

10.6 The 2004 Parliamentary Joint Committee (PJC) on Corporations and Financial Services acknowledged that administrative arrangements for insolvency reflect the different historical evolution of personal and corporate insolvency systems, rather than a development based on logic or policy. It considered that a merger of the two systems could produce public benefits including cost savings, a single system for the registration of practitioners and greater consistency in the law and the formulation of policies.

10.7 However, in the absence of any concrete proposal for a merger of corporate and personal insolvency law, the committee made no firm recommendation. Instead, it recommended that the government ensure that personal and corporate insolvency laws are harmonised wherever possible.[3] The Government's response was to note that the Insolvency and Trustee Service Australia (ITSA) and Australian Securities and Investments Commission (ASIC) have entered into a Memorandum of Understanding … and will continue to consult in the development of insolvency / bankruptcy policy.[4]

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1 Law Reform Commission, 'General insolvency inquiry', *Report No. 45*, 1988, p. 13.

2 Law Reform Commission, 'General insolvency inquiry', *Report No. 45*, 1988, p. 13.

3 'Corporate Insolvency Laws: A stocktake', *Parliamentary Joint Committee on Corporations and Financial Services*, June 2004, pp. 227–228.

4 Government response to the Parliamentary Joint Committee on Corporations and Financial Services, 'Corporate Insolvency Laws: A stocktake' http://www.aph.gov.au/Senate/committee/corporations_ctte/completed_inquiries/2002-04/ail/gov_response/gov_response.pdf (accessed 10 July 2010).

10.8 During the course of the current inquiry, the Productivity Commission released a draft report of its Annual Review of Regulatory Burdens on Business. Chapter 4 of the report contained a section on insolvency practitioners. It focussed on a submission from the Insolvency Practitioners Association of Australia (IPAA) which stated the Association's concern that the different regulatory treatment of the administration of personal insolvency and corporate insolvency is imposing an unnecessary regulatory burden on insolvency practitioners.[5] The IPAA's submission highlighted:

> …the costs of dealing with separate regulators—…ITSA [Insolvency and Trustee Service Australia] and ASIC—and keeping up-to-date with changing compliance and reporting requirements of both; and the costs of practitioners setting up compliance systems, collecting information, preparing and checking reports, form-filling, document storage, for both.[6]

10.9 The Productivity Commission noted that, in principle, there are likely to be efficiencies in having a single regulator take responsibility for both areas of insolvency law. These benefits include pooling of regulatory resources, greater consistency in decision-making and benefits for business in dealing with one regulator. However, the Productivity Commission also observed that if ITSA was merged into ASIC, there is a risk of a loss of focus or a transfer of resources to other regulatory activities. Alternatively, if ASIC's insolvency functions and responsibilities are merged into ITSA, there may not be the same cost savings or administrative efficiencies given ITSA's range of non-insolvency functions.[7]

10.10 The Productivity Commission recommended that a taskforce be established to examine the case for making one regulator responsible for both personal and corporate insolvency law. The taskforce would also identify personal and corporate insolvency provisions that could be aligned. In this context, the Productivity Commission urged that:

> where there is a clearer case for harmonised provisions (perhaps in relation to such procedural matters as hiring and firing practitioners, setting and reviewing remuneration, record keeping and reporting, holding of meetings and determining voting entitlements) changes should be implemented as soon as practicable, rather than waiting for agreement to be reached in relation to more complex or controversial matters.[8]

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5 Productivity Commission, 'Annual Review of Regulatory Burdens on Business', June 2010, http://www.pc.gov.au/__data/assets/pdf_file/0008/99224/07-chapter4.pdf (accessed 1 July 2010).

6 Productivity Commission, 'Annual Review of Regulatory Burdens on Business', June 2010, p. 145.

7 Productivity Commission, 'Annual Review of Regulatory Burdens on Business', June 2010, p. 149.

8 Productivity Commission, 'Annual Review of Regulatory Burdens on Business', June 2010, p. 150.

Submitters' views

10.11 Several witnesses to this inquiry queried why there should be separate regulators for personal and corporate insolvency. Dr David Morrison from the University of Queensland commented that in terms of the conduct matters that ITSA and ASIC deal with in insolvency, there is no substantive difference in their role. He told the committee that:

> At the moment they are only separate by historic accident—namely, there is a Commonwealth Bankruptcy Act and therefore a regulator, and a Commonwealth Corporations Act in cooperation with the states and therefore a regulator attached to that body. But if you look at this in terms of subject matter and you look at the issues that are being raised by people who deal with that subject matter, what difference does it really make whether or not my business is incorporated? The difference it makes is that if my business is incorporated then ASIC deals with me and if my business is not incorporated then it is a bankruptcy matter. But from the point of view of outsider, the person who deals with the business, and from the point of view of my conduct or the insolvency professional that manages it in the end game, it is all the same.[9]

10.12 Associate Professor David Brown of Adelaide University Law School also questioned whether there is any need for different systems of registration for personal and corporate insolvency practitioners. He commented:

> …it is interesting that ASIC registers liquidators and that is what the legislation requires it to do but, as we have seen, we are not just talking about liquidators these people do administrations, receiverships and of course also bankruptcy work for which there is a different registration system through ITSA. I query whether we really need two separate registration systems when both are essentially the same people wearing different hats…[10]

> …if you are an insolvency practitioner in the provinces who is doing a bit of insolvency and bankruptcy work and also liquidations and receiverships, you would be asking yourself why you are subject to the different regulatory bodies.[11]

10.13 Some submitters drew the committee's attention to potential operational difficulties with a single insolvency regulator. Ms Veronique Ingram of ITSA observed that merging ITSA with the insolvency arm of ASIC would be complex. First, she noted that ITSA currently has the advantage of a single focus on the bankruptcy of individuals, which is less complex than the insolvency of corporations.

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9 Associate Professor David Morrison, *Committee Hansard*, 23 June 2010, p. 17; See also Dr Anderson, *Committee Hansard*, 23 June 2010, pp. 20–21.

10 Associate Professor David Brown, *Committee Hansard*, 9 April 2010, p. 17.

11 Associate Professor David Brown, *Committee Hansard*, 9 April 2010, p. 21.

Second, she told the committee that even with a single regulator, corporate insolvency matters would still require ASIC's involvement:

> …it is very difficult to divorce insolvent trading from the regular operation of the company in the sense that, if you had a separate regulator, you would have to work very closely with ASIC. Also with the fact that you are looking at antecedent transactions you have all these issues where breaches of directors duties are all core Corporations Act obligations on those involved in companies, so you are taking it out of that regime and putting it in another. I think that raises real complexity issues. You would have to build in a lot of bells and whistles to make it work.[12]

10.14 Nonetheless, Ms Ingram did note that she could see no reason why some of ITSA's processes and legislative provisions could not be transferred into the Corporations Act.[13]

10.15 ASIC does not believe that separating its corporate insolvency function to a separate body will lead to better outcomes. ASIC's Chairman, Mr Tony D'Aloisio, contrasted the roles of ITSA and ASIC's corporate insolvency responsibilities, noting that the Commission deals with 'a much more complex area'. He added:

> …we think that the way it is structured, with the Corporations Law aspects and the liquidators and insolvency practitioners we are talking about, it does logically fit within ASIC's role. ASIC is the oversight body for a whole range of gatekeepers—auditors, accountants, boards, CEOs, financial officers and so on—from the birth to death of corporations…It is an issue for the committee to separate that out into personal bankruptcy. I do not think that by separating in that way you will get improved results, because improved results are going to go with the expertise that is needed to handle complex groups and investigations.[14]

10.16 Mr D'Aloisio told the committee that in separating the corporate insolvency area from ASIC, care needs to be taken to ensure that the current level of expertise is replicated in the new organisation. He gave the example that:

> If you are winding up a major financial institution that is engaged in over-the-counter trading in the wholesale market with CDOs and so on, you really have to have expertise to analyse and understand those issues in a collapse situation. ASIC does have that expertise in its other groups so, if you are minded to take that area out, all I am saying is that one of the things you need to look at is the resources that are needed to replicate that expertise.[15]

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12 Ms Veronique Ingram, *Committee Hansard*, 13 April 2010, p. 59.

13 Ms Veronique Ingram, *Committee Hansard*, 13 April 2010, p. 59.

14 Mr Tony D'Aloisio, *Committee Hansard*, 23 June 2010, p. 30.

15 Mr Tony D'Aloisio, *Committee Hansard*, 23 June 2010, p. 32.

Complaints handling

10.17 A potential criticism of the proposal to merge ASIC's insolvency function into ITSA is that complaints about insolvency practitioners would not be directed through ASIC's online complaints handling system. The committee acknowledges that ASIC's system for complaint handling has improved and will continue to be enhanced as part of ASIC's forward program. However, it also notes that ITSA has an efficient and well-developed complaints handling process. As Mr Jeff Hanley of ITSA told the committee:

> A large part of the work we do is complaints handling. That may be a bankrupt, a debtor, a creditor or an interested party who just wishes to make a complaint. We will go and perform an inspection. Our inspectors will physically go into the practice and examine the allegation, and then we will report the findings to the person who made the allegation.[16]
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> …
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> Our inspections are usually quite fast, so it is not as if they are going to have to wait six months before they can continue actioning it. We aim to inspect a number of administrations in a matter of days.[17]

Proactive regulation

10.18 Several submitters to this inquiry have argued that the regulation of corporate insolvency requires a more proactive approach than simply the current complaints based system. In this context, two options were raised. The first option is a systematic annual or biennial review of all insolvency practitioners. The second proposal is a model based on a sample, some selected at random, other by profiling. This is the idea of a 'flying squad'.

Systematic surveillance—an annual or biennial review

10.19 Evidence provided to this inquiry has contrasted ASIC's reactive complaints handling approach to ITSA's proactive biennial review of all practitioners. Several submitters argued that the corporate insolvency sector needs to adopt ITSA's approach.

10.20 The IPAA, notably, strongly advocated the implementation of a proactive annual review process of all practitioners through a certain number of randomly selected files. It argued that a proactive annual review will give a better sense of how a particular practice is running and also a sense of the industry wide issues.[18] The IPAA noted of ITSA's biennial surveillance of all practitioners that:

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16 Mr Jeff Hanley, *Committee Hansard*, 13 April 2010, p. 62.

17 Mr Jeff Hanley, *Committee Hansard*, 13 April 2010, p. 63.

18 IPAA, *Committee Hansard*, 12 March 2010, p. 41.

> The scope and regularity of review arguably identifies underperforming practitioners more promptly, and enables ITSA to take timely disciplinary action (ie through education, suspension, termination of registration) against practitioners. The regularity of the practitioner review also identifies early trends in industry behaviour.[19]

10.21 The Institute of Chartered Accountants argued along the same lines. It recommended in its submission that ASIC conduct a regular inspection program of registered and official liquidators. It also suggested that ASIC assess ITSA's annual inspection program for suitability and adaptability to the corporate insolvency practice.[20] Mr Lee White from the Institute explained the merit of a proactive regulatory approach in the following terms:

> I would put to you, Chair, that when practitioners know that they might get a knock on the door, rather than waiting for complaints to happen, it actually smartens everyone up. I think that is actually a good message.[21]

10.22 Former insolvency practitioner, Mr Geoffrey McDonald, told the committee that ITSA's proactive surveillance system could be readily replicated in the corporate insolvency sector. He observed that ITSA's system is effective without being adversarial:

> The system is that your files are audited on a random basis once a year by an independent section of the Insolvency Trustee Service Australia. Last week I had my files audited—I still have a few follow-on files as a trustee in bankruptcy. I got the phone call on Monday and they said, 'We're going to be around, are you available next week?' I said, 'Yes', and they said, 'Well, lock the days in and we'll tell you two days before which files we're going to review'. So you have got enough time to find them and to get them in order, but not to fix them. It is just the way it is, and you accept that—this is the way it is going to be. You make sure your files are up to date and you make sure they are up to date all the time because you are expecting this. When the people do arrive they are pleasant, they are good to deal with and they will give you an interim report. They will make mistakes, but it will not be an adversarial situation; they will say, 'Oh, we did not see that report—it must have been misfiled'. Or, 'We missed it in the file'. Fine—no-one gets upset by that. They classify the errors, A to C—A is serious—and you learn from it. If next year you keep on making the same mistakes it means there is a system problem and they would deal with it. I am aware that a number of registered trustees have, following these types of annual review, volunteered to hand in their licenses. That sounds like a reasonable system. It involves some resources and it involves an attitude as well. I

19 IPAA, Submission 36, p. vi. See also Mark Robinson, *Committee Hansard*, 12 March 2010, p. 39.

20 The Institute of Chartered Accountants in Australia, *Submission 66*, p. 4.

21 Mr Lee White, *Committee Hansard*, 12 March 2010, p. 57.

> commend that system, and I think it could easily be replicated for corporate insolvency.[22]

10.23 Indeed, ITSA itself has emphasised that its annual inspection program is primarily aimed at providing constructive feedback to practitioners to improve compliance and practice. It noted that the majority of practitioners welcome the feedback and are willing to rectify non-compliance. ITSA can cancel the practitioner's registration, but only in serious cases.[23]

10.24 ITSA argued in its submission that the benefits of its proactive approach are 'demonstrable'. It noted the recent example of the identification of major systemic error in the practice of a debt agreement administrator through the annual inspection program in August 2009. The practitioner was deregistered.[24]

ASIC's view

10.25 ASIC has estimated that for it to obtain a similar level of monitoring of registered liquidators to that of the ITSA surveillance model (reviewing each liquidator on an annual or biennial basis), it would require an additional:

(a) 65 FTEs for a visit to each liquidator annually;

(b) 31 FTE's for a visit to each liquidator on a biennial basis.[25]

10.26 ASIC Commissioner Mr Michael Dwyer told the committee that given the additional costs that would be incurred from adopting ITSA's surveillance model, it is questionable whether this change in policy would be appropriate. He explained that:

> …the additional resources that we have identified in our second submission would be substantial, and the cost benefit of those additional resources as against the impact of annual or biannual reviews of practitioners would be fairly line ball. I am not saying it would not have an impact; it would. It is a question of whether that cost is justified.[26]

10.27 ASIC's Chairman told the committee that the cost-benefit analysis would have to weigh the monetary cost of the additional resources with the benefit that systemic surveillance would have in deterring and detecting misconduct, as well as correcting any public perception of practitioner misconduct. He recognised that in making this assessment, 'different people have different judgments'.[27]

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22 Mr Geoffrey McDonald, *Committee Hansard*, 13 April 2010, p. 42.

23 ITSA, *Submission 48*, p. 3.

24 ITSA, *Submission 48*, p. 3.

25 ASIC, *Supplementary submission*, p. 19.

26 Mr Michael Dwyer, *Committee Hansard*, 23 June 2010, p. 35.

27 Mr Tony D'Aloisio, *Committee Hansard*, 23 June 2010, p. 35.

Random surveillance—A 'flying squad'

10.28 Other submitters advocated random surveillance of practitioners through a 'flying squad'. Dr Vivienne Brand of Flinders University identified a flying squad as 'the number one priority' to reform oversight of the insolvency industry. She told the committee that one of the principal benefits of a random surveillance model would be to act as a deterrent to misconduct.[28] The other major benefit is better detection of misconduct:

> A brief review of the UK insolvency regulator statistics suggests that they get a far higher strike rate on identification of misdemeanours from investigations, which they have initiated on a profiling basis or on a random basis, than on the number of misdemeanours they pick up from complaints. That is, there is a far higher strike rate than from complaints. Complaints do not seem to be a particularly effective way of identifying problems. That is perhaps not surprising because there are pretty significant information and resource asymmetries between the consumers of liquidation services and the liquidators. People who are involved in liquidations as creditors often do not have a lot of expertise. They may not know when misdemeanours are occurring and, conversely, they may think they are occurring when they are not. So it is particularly important to have a very active regulator.[29]

10.29 Other submitters were also supportive of a random, proactive regulatory approach. Mr Ian Fong, representing Carlovers Carwash Pty Ltd, told the committee that 'setting up small, nimble, flexible independent teams would certainly help'.[30] Mr Steven Kugel argued in his submission that the committee must consider an annual audit of registered liquidators' files on a random basis.[31]

The Companies Auditors and Liquidators Disciplinary Board

10.30 As chapter 4 discussed, the CALDB is the disciplinary body for the insolvency industry. Chapter 6 canvassed various criticisms of the CALDB, including its lack of independence from ASIC, the prolonged time (and cost) it takes to reach a finding, the few cases it has referred and its consideration of inconsequential matters.

10.31 The committee received some guidance on how best to reform the disciplinary process. Mr Vanda Gould made the wholesale recommendation that the:

> …CALDB should be abolished and its responsibilities absorbed into the Administrative Appeals Tribunal. The discipline of insolvency practitioners should be overseen by the Federal Court or state supreme courts, which hear company matters involving insolvency every day of the week. Above all, a practitioner should have a right at all times to appeal directly to the

28 Dr Vivienne Brand, *Committee Hansard*, 9 April 2010, p. 12.

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

30 Mr Ian Fong, *Committee Hansard*, 14 April 2010, p. 41.

31 Mr Steven Kugel, *Submission 3*, p. 1.

> Federal Court, just as a taxpayer can today. The broad policy objective should be to facilitate the resuscitation of companies where possible.[32]

10.32 The Institute of Chartered Accountants of Australia (ICCA) observed that the disciplinary process is 'not operating effectively'. It noted the prolonged time that the CALDB takes to adjudicate on matters. It also expressed concern that ASIC and practitioners are increasingly defaulting to enforceable undertakings (EU) to resolve matters, which lack the transparency and accountability of the CALDB.[33] Accordingly, the ICCA recommended that:

> …an open and independent process is considered by the Inquiry to deal with matters of a certain size. This process would deal with these matters more transparently than an EU and in a more timely manner compared to the CALDB tribunal. We consider the EUs should be reserved for matters where the practitioner has admitted guilt.[34]

An Insolvency Ombudsman

10.33 The committee maintains that the best regulatory framework overseeing the insolvency industry combines proactive (profiling and random annual reviews) and reactive (responding to complaints received, professional disciplinary reports or media reports) elements. It is concerned that ASIC's monitoring of insolvency practitioners is largely reactive in nature.[35]

10.34 This emphasis on proactive regulation, however, should not discount from the importance of complaints based surveillance. By necessity, complaints must remain a critical part of the monitoring process and for creditors to voice their concerns. The key issue for the committee is whether the regulatory agency is the best body to receive and respond to these complaints in an effective and timely manner.

10.35 Several submitters to this inquiry suggested that an independent insolvency Ombudsman should be established. Dr Brand, Associate Professor Christopher Symes and Mr Jeffrey Fitzpatrick argued in their submission that an insolvency Ombudsman should be considered as an option for creditors to pursue a complaint. The Ombudsman would be responsible for investigating the complaint and making a recommendation about the liquidator's ongoing registration or licensing.

10.36 The academics viewed an 'Office of the Insolvency Ombudsman' as being 'perfectly placed' to assist ASIC and the CALDB to have all registered liquidators satisfy the fit and proper requirement.[36] They suggested that the ombudsman could

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32 Mr Vanda Gould, *Committee Hansard*, 13 April 2010, p. 20.

33 Institute of Chartered Accountants of Australia, *Submission 66*, p. 1.

34 Institute of Chartered Accountants of Australia, *Submission 66*, p. 1.

35 See Fitzpatrick, Symes and Brand, *Submission 6*, p. 11.

36 Dr Brand, Associate Professor Symes and Mr Fitzpatrick, *Submission 6*, p. 21.

attend committees of creditors to listen to complaints made against a liquidator or administrator.[37] The academics also raised the possibility that an ombudsman could have an educative role so that the creditors have access to information on fees.[38] They argued that notwithstanding the detailed disclosure on fees through the IPAA's Code of Professional Practice, first time creditors often need other channels for assessing whether fees represent value for money.[39]

10.37 Associate Professor Brown and Associate Professor Symes identified a threefold role of an insolvency ombudsman: giving a voice to aggrieved creditors; reviewing and commenting on evolving professional standards; and assessing and reviewing practitioners' fees.[40] In terms of providing creditors with an avenue for complaint, Associate Professor Brown told the committee that:

> …the problem is creditors' perception. A lot of the complaints which are received—and the IPA receives a lot of complaints, by the way, not just ASIC, about insolvency practitioners and procedures—are based on misunderstanding the nature of insolvency work and of course…can often involve a certain amount of anger because everybody to some extent loses out on an insolvency. There are not many winners. Therefore, a valve for dealing with these complaints plus, perhaps, an educational role for an ombudsman's office would certainly target that gap which exists at the moment in terms of creditor information and a feeling that creditors are being short-changed in some way in terms of information or having a voice for their concerns.[41]

10.38 In terms of reviewing practitioners' fees, Associate Professors Symes and Brown commented:

> No amount of information or guidelines in a Code about method and basis of calculation can prevent allegations that actual rates applied to time spent are excessive. If this is something that courts do not feel resourced or inclined to do, what other solutions might there be? Given that the professional body itself cannot provide that level of independence, and that expert witnesses similarly can only give a certain amount of comfort, is there a role for some other body, perhaps an insolvency services ombudsman or similar insolvency assessor.[42]

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37 Associate Professor Symes, *Committee Hansard*, 9 April 2010, p. 3.

38 Mr Jeffrey Fitzpatrick, *Committee Hansard*, 9 April 2010, p. 13.

39 Associate Professor David Brown, *Committee Hansard*, 9 April 2010, p. 18.

40 Associate Professor David Brown, *Submission 40*, p. 4.

41 Associate Professor David Brown, *Committee Hansard*, 9 April 2010, p. 17.

42 Associate Professor David Brown, *Submission 40*, p. 8.

10.39 Associate Professor Brown also flagged the issue of funding an ombudsman as a matter for consideration, noting that the banking and finance ombudsman model is not a user pays but a respondent pays model.[43]

10.40 Mr Stephen McNamara, a director of a small law firm acting for directors and guarantors of companies in liquidation, supported the idea of an insolvency ombudsman to expedite the complaints process. He told the committee that an ombudsman would be able to quickly deal with several small matters, whereas ASIC has more substantive corporate governance matters with which to deal.[44]

10.41 Mr Greg Nash told the committee that an ombudsman may lead to small matters being settled without being referred. If a creditors' committee says to the liquidator that it will take a matter to the ombudsman, the liquidator may well choose to resolve it beforehand.[45]

Professional bodies' view of an Insolvency Ombudsman

10.42 ASIC has argued that the case for an insolvency ombudsman needs to be made in terms of what it could add to current processes. In its supplementary submission, ASIC noted that there is merit in considering the introduction of an internal dispute resolution (IDR) mechanism because it is often the most efficient and cost-effective way to deal with complaints. However:

> …any proposal would require comprehensive industry consultation…The insolvency practitioner is usually trying to allocate insufficient funds to a range of people who might not understand why they are to receive less than 100 cents in the dollar. Therefore, imposing a requirement for insolvency practitioners to have an IDR scheme may result in significant burdens on an insolvency practitioner. It is likely that the additional resources and costs required to implement and maintain an IDR scheme will be passed on to stakeholders by way of increased fees.[46]

10.43 ASIC's Chairman, Mr Tony D'Aloisio, was cautious about the idea of an insolvency ombudsman:

> If it is considered that an ombudsman would provide additional value in oversight of what ASIC does in this area, again it is a matter for the committee…It is simply an issue of trying to understand what value would be added. In fairness to the point, it probably does deal with some of the perception issues we talked about earlier because it is another avenue to look at what we are doing. But my sense of it is that we are one of the agencies that are very, very significantly subject to oversight.[47]

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43 Associate Professor David Brown, *Committee Hansard*, 9 April, p. 18.

44 Mr Stephen McNamara, *Committee Hansard*, 9 April 2010, p. 40.

45 Mr Greg Nash, *Committee Hansard*, 14 April 2010, p. 5.

46 ASIC, *Supplementary submission*, p. 22.

47 Mr Tony D'Aloisio, *Committee Hansard*, 23 June 2010, p. 41.

10.44 The IPAA argued in its submission that given the importance of maintaining community confidence in the insolvency regime, and the potential for stakeholder dissatisfaction from an insolvency, the role of an insolvency ombudsman should be considered. It suggested that an ombudsman may be appropriate as a separate layer of review of practitioner conduct, beyond that maintained by ASIC, the IPAA and other professional bodies.

10.45 Significantly, the IPAA did not view the role for an insolvency ombudsman as a complaints handling body. Nor would its role be to review the legally and commercially based decisions of practitioners. Rather, in the IPAA's assessment, the role of the ombudsman would be:

> …more in terms of arbitration and facilitating better understanding and education as to the complainants and bringing the requisite parties together in a more productive way such that the issues can be understood.[48]

10.46 Mr Donald Magarey, Chairman of the CALDB, explained to the committee that any proposal to establish an insolvency ombudsman must consider whether it will have a purely investigative role or whether it will also adjudicate on matters. He explained:

> Someone has to do the work to investigate the complaint and someone else has to do the work to decide on the complaint and make the orders. Whether you make those the same person or whether you keep them separate—and if you keep them separate, who they are; whether it is ASIC or an ombudsman or some other organisation and you keep the board as the adjudicator function—you are really trying to work out different ways to achieve exactly the same goal.[49]

10.47 Interestingly, Mr Magarey considered that the IPAA could perform the role of an ombudsman. He told the committee that given its knowledge of the insolvency industry, and provided it is well resourced, the IPAA could deal with complaints and concerns.[50] However, as the following chapter notes, a key advantages of an insolvency ombudsman would be its independence from professional associations and the regulator.

10.48 The Accounting Professional and Ethical Standards Board told the committee that an appropriate qualified ombudsman could identify quickly for creditors whether a practitioners' fees and practices were reasonable. Ms Kate Spargo, a Chairperson for the board, told the committee:

> …if you say to an experienced insolvency practitioner, 'Go and have a look at meeting A, B and C and see whether it is fine, a bit dicey or somewhere

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48 IPAA, *Supplementary submission*, pp. 3–4; See Mr Mark Robinson, *Committee Hansard*, 23 June 2010, p. 6.

49 Mr Donald Magarey, *Committee Hansard*, 13 April 2010, p. 7.

50 Mr Donald Magarey, *Committee Hansard*, 13 April 2010, p. 44.

> in the middle,' they would be able to tell you very quickly. They would say, 'I think this all looks fine,' or they would say, 'We've got a problem with these practitioners,' because they are overdoing the work or overdoing the fees or whatever. So an experienced person who knows what they are looking for, and who remains current, would be of enormous idea—but not someone who does not have that ongoing working knowledge and perception and currency.[51]

Voluntary administration and Chapter 11 Bankruptcy process

10.49 Both the Australian voluntary administration (VA) procedure and the Chapter 11 Bankruptcy process in the United States have as their goal the realisation of greater value through the restructuring of a distressed company rather than its immediate liquidation.[52] Unlike Part 5.3A of the *Corporations Act*, however, the chapter 11 process allows business owners the opportunity and the time to reorganise and restructure in order to pursue their long–term objectives (and not those of their creditors).[53]

10.50 The argument against the current system in Australia is that strict laws on insolvent trading promote the early involvement of advisors. These advisors identify the company's liability and recommend that as it is insolvent, an administrator needs to be appointed. The business is handed over and, without exploring the options to restructure, liquidation proceeds.[54]

10.51 Some submitters to this inquiry flagged the possibility of Australia adopting corporate insolvency legislation similar to the Chapter 11 process. The following comment, from Mr Bill Doherty, gives a sense of this desire:

> Surely the companies and their own accountants could come up with a scheme like chapter 11 where they notify ASIC, 'Hey, we are in trouble here', and allow them to trade up to the point. Then maybe you bring in a liquidator when all that is required is the chopping and getting rid of everything still, because that is all they do. There is no incentive for an administrator to do anything else but chop the assets, take their fees, 'See you later. Next job, please.'[55]

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51 Ms Kate Spargo, *Committee Hansard*, 9 April 2010, p. 35.

52 Baker & McKenzie, *US Chapter 11 and Australian Voluntary Administration Compared*, October 2008, p. 1.

53 Ian Bickerdyke, Ralph Lattimore and Allan Madge, *Business failure and Change An Australian Perspective*, Productivity Commission, December 2000, p. xxii. http://www.pc.gov.au/research/staffresearch/bfacaap/bfacaap.pdf (accessed 24 June 2010).

54 See Professor Scott Holmes, *Committee Hansard*, 14 April 2010, p. 52. The committee is certainly aware that in the case of the deregistered liquidator, Mr Stuart Ariff, this process was expedited to ensure his appointment (see chapter 5).

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

10.52 Professor Scott Holmes from the University of Newcastle recommended the idea of a moratorium. He argued in his submission that under this arrangement:

> Directors would be able to openly and expressly invoke a moratorium from the duty not to trade whilst insolvent for the purpose of attempting a reorganisation of the company outside of external administration. The moratorium would apply for a limited period and would be subject to termination by creditors.[56]

10.53 Professor Holmes argued that by involving creditors in the process, they are aware of the risks to their own businesses. Before registering for a moratorium period, the directors of the company will need a detailed business plan, with clearly identified milestones and report back dates. The plan must be approved by 75 per cent of creditors and registered with ASIC.[57]

10.54 In his verbal evidence to the committee, Professor Holmes emphasised the need to given companies the option 'to work things through'. Instead of having to get external advice they cannot afford, the company would be able to take advice from appropriate professionals who are registered under the moratorium.[58]

Concerns with the Chapter 11 model

10.55 Other submitters have expressed concern at further moves to facilitate the reorganisation of an insolvent company. Mr Stephen Epstein SC noted in his submission that while voluntary administration has become the most significant form of insolvency administration, the Australian VA provisions are something of a 'work in progress'. He noted that section 445 of the *Corporations Act* was introduced in 2007 to constrain inappropriate use of creditor power in the termination of a deed of company arrangement. In Mr Epstein's opinion:

> The balance may now however, have swung too far in the opposite direction—so the administrator of the deed can become indefinitely entrenched in office. It is suggested that further amendment to the legislation could be considered, perhaps in which a prima facie outer limit of 12 months is prescribed as the maximum duration for which a deed administrator may hold office, in the absence of creditors renewing that appointment.[59]

10.56 This concern with the length of time that a deed administrator may hold office is not new. The 2004 Parliamentary Joint Committee on Corporations and Financial Services commented that most submissions that mentioned the Chapter 11 model were strongly against its introduction based on concerns with the company remaining in the hands of the debtor and the length of the process. The PJC concluded it was:

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56 Professor Scott Holmes, *Submission 21*, p. 16.

57 Professor Scott Holmes, *Submission 21*, p. 16.

58 Professor Scott Holmes, *Committee Hansard*, 14 April 2010, p. 51.

59 Mr Stephen Epstein, *Submission 28*, pp. 2–3.

> …not persuaded to the view that an insolvency procedure modelled on Chapter 11 of the US Bankruptcy Code is appropriate for the Australian corporate sector. Nor does it consider that wholesale amendments to the voluntary administration procedure to conform to Chapter 11 would have the potential to make a significant improvement in outcomes that are presently achievable under the VA procedure.[60]

10.57 A 2000 Productivity Commission Staff Research Paper observed that the available evidence suggested that the Chapter 11 model rarely established viable businesses in the long run. It noted:

> It may be economically and socially beneficial in that it gives debtors a second chance and thereby encourages growth of the private sector and the entrepreneurial class. On the other hand, there are moral hazard problems associated with giving debtors immediately realisable second chances, since it increases the potential returns from excessively risky behaviour. Moreover, a creditor-oriented system, as in Australia, does not preclude the continued involvement of the debtor. But the debtor would have to convince the creditors that they were efficient custodians of the business. It is not clear that debtors should be given second chances without a strong governance regime outside their influence that would punish incompetent or self-serving behaviour. The empirical evidence suggests that US chapter 11 proceedings rarely establish long run viable businesses. Only around 6.5 per cent of businesses emerge from chapter 11 as an ongoing entity. In comparison, the Canadian system of reorganisation, which gives more emphasis to creditors' rights, has a success rate ten times higher.[61]

10.58 Mr Vanda Gould noted in his evidence to this committee that under Chapter 11 receiverships in America, all creditors can be dealt with by the court appointed person who manages the totality of the pool of creditors and is responsible for the different priorities between them. He added:

> Perhaps going to a chapter 11 is one step too far for us. I would say that, in the Australian context, the big step forward would be to get rid of receivers and managers.[62]

Corporate responsibility and phoenix companies

10.59 The committee has not examined in any great detail the issue of directors' corporate responsibilities and the problem of phoenix companies. It does note, however, the importance of a corporate governance framework that penalises insolvent trading (see chapter 4). There must be strong disincentives to set up a

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60 Parliamentary Joint Committee on Corporations and Financial Services, 'Corporate Insolvency Laws: A stocktake', 2004, p. xxi.

61 Ian Bickerdyke, Ralph Lattimore and Allan Madge, *Business failure and Change An Australian Perspective*, Productivity Commission, December 2000, pp. 90–91. http://www.pc.gov.au/research/staffresearch/bfacaap/bfacaap.pdf (accessed 24 June 2010).

62 Mr Vanda Gould, *Committee Hansard*, 13 April 2010, p. 20.

company, send it into liquidation and then start again with a view to evading taxation and employee entitlements. Businesses must not be allowed to structure their arrangements through insolvency in a way that dishonestly maximises personal wealth or creates an unfair competitive advantage.

10.60 In this context, the committee welcomes Treasury's November 2009 Proposals paper 'Action against fraudulent phoenix activity'. The committee urges the government to consider carefully the paper's key options for reform and to take action. Increasing the Tax Office's bond against anticipated income tax liabilities from a director in cases where the ATO suspects phoenix activity is a sound option.[63] The committee also supports the proposal to extend the director penalty regime to cover liabilities such as the superannuation guarantee and indirect taxes including the GST and excise tax.[64]

Remuneration

10.61 Chapter 8 discussed concerns with the remuneration of insolvency practitioners. The committee has received several suggestions during this inquiry on how to improve the system for paying liquidators and administrators. These range from various forms of price setting, to a market-based tendering process, to further improving the disclosure and itemising of fees.

Fee setting and pricing control

10.62 As chapter 8 noted, the 1982 UK Cork Report recommended that the remuneration of the practitioner should be fixed by the creditors' committee. It noted that this could be on a percentage basis or otherwise but the creditors must take into account the time, complexity, risk and effectiveness of the job, as well as the value of the assets sold. The Report also noted that where the creditors and the liquidator are unable to agree, the remuneration should be fixed by the Department of Trade.[65]

10.63 In similar vein, a few submitters to this inquiry have proposed that scale rates should be reintroduced for registered liquidators and bankruptcy trustees. One submission noted that this was the case in the late 1990s, before the IPAA abolished the rates. The submitter argued that each staff member should have pre-requisite education and experience for each scale rate.[66] The schedule of fees would be reviewed annually by agreement between ASIC, the IPAA and the CPA.

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63 Treasury, Actions against fraudulent phoenix activity, *Proposals paper*, November 2009, p. 14; http://www.treasury.gov.au/documents/1647/PDF/Phoenix_Proposal_Paper.pdf (accessed 27 July 2010).

64 Treasury, Actions against fraudulent phoenix activity, *Proposals paper*, November 2009, p. 14.

65 'Insolvency Law and Practice', *Report of the Review Committee*, 1982, pp. 207–208.

66 Name Withheld, *Submission 93*, p. 1.

10.64 Another submitter observed that in their reports to creditors, voluntary administrators quote an arbitrary figure for future fees. The submitter argued that unless there is a Committee of Creditors appointed, the liquidator will be able to draw any future fee they like provided there are funds in the bank. He claimed that fee decisions are often based on cash available from the various bank accounts that the administrator controls.[67]

10.65 The submitter proposed that the insolvency profession be abolished, because 'their primary focus should be to act on behalf of creditors, and not to base jobs on what potential cash flow they can earn'. Short of this, he suggested that assignments must be completed within the agreed timeframe with Directors. If there is clearly no likelihood of any return to creditors from an external administration, 'the company should go straight into liquidation'.[68]

10.66 Carlovers Carwash (see chapter 5) argued that the insolvency industry should be restructured so that it is 'effectively run by the government'. It recommended that ASIC should tender insolvency work on a fixed price basis and appoint a practitioner to put the company into voluntary administration. The practitioner would recommend a deed of company arrangement or a liquidation, which would be sanctioned by ASIC and put to a vote of creditors. Carlovers also argued that ASIC should hold the casting vote and should choose the lawyers and independent experts.[69]

10.67 Professor Scott Holmes of the University of Newcastle doubted the efficacy of the hourly fee system. He argued that consideration should be given to fixed or capped fee models, which are linked to the value of assets under administration.[70]

10.68 In this context, Professor Holmes proposed that the voluntary administrator should provide creditors with a 'baseline value' for the business. This value should be reviewed by an independent administrator and the values for material assets certified by an accredited industry valuer. He suggested that if in the course of the administration the voluntary administration seeks to dispose of an asset at a value less than 20 per cent of the valuation, a formal creditors meeting is required to approve the sale.[71]

A set fee for 'no asset' jobs

10.69 This inquiry also raised the possibility of a tiered system whereby assetless administrations could be handled through a separate procedure with different fee scale to those jobs where assets are involved. The IPAA commented that this type of system

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67 Name withheld, *Submission 80*, p. 2.

68 Name withheld, *Submission 80*, p. 3.

69 Carlovers Carwash, *Submission 26*, p. 4.

70 Professor Scott Holmes, *Submission 21*, p. 18.

71 Professor Scott Holmes, *Submission 21*, p. 18.

would require the government to perform assetless administrations, similar to ITSA's role in assetless personal bankruptcies.[72]

Competitive tendering

10.70 Other submitters argued that, notwithstanding the unique nature of the market for insolvency professionals in Australia, price control by government will not be effective in reforming the fee system. Rather, they claimed that the key is to create more competition for appointments.

10.71 Mr Nicolas Bishop proposed a round robin or random allocation of administrators, with ASIC assigning three administrators to any given case. Under this system, creditors will choose one administrator out of the three (by vote), at the first meeting. He envisaged that this will force the administrators to pitch their service to the creditors, who will make their decision on a range of factors including value for money and the practitioner's reputation.[73]

10.72 Mr Bishop suggested that there should be some financial compensation for the losing administrators in the tendering process, provided they have met 'minimum hurdles'. Further, creditors' committees should be given the option of a 'No Confidence' vote.[74]

Broadening the base

10.73 The other option for increasing industry competition and putting downwards pressure on fees is to broaden the recruiting base for insolvency practitioners. Mr Geoffrey Slater, a barrister, proposed amending section 1282(2)(a)(ii) of the *Corporations Act* to enable registration of an Australian Legal Practitioner with an least five years' post admission experience and at least 10 Corporations Act matters involving corporate insolvency.[75]

Better disclosure on fees

10.74 The other option to improve the fee system is to continue to improve disclosure. Professor Holmes suggested that the voluntary administrator should provide a report on fees to creditors on an agreed regular basis. He proposed that this report should conform to the format provided in the IPAA Code of Professional Practice.[76]

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72 Mr Mark Robinson, *Committee Hansard,* 23 June 2010, p. 7.

73 Mr Nicholas Bishop, *Submission 74*, p. 8.

74 Mr Nicholas Bishop, *Submission 74*, p. 8.

75 Mr Geoffrey Slater, *Correspondence*, Letter to Senator John Williams dated 21 May 2010, p. 3.

76 Professor Scott Holmes, *Submission 21*, p. 18.

10.75 Mr Jeffrey Knapp, an accounting academic at the University of New South Wales, argued in his submission that overcharging by insolvency professionals could be curbed if there was a requirement for timely accrual based accounts. He emphasised that these accounts must disclose the amount of professional fees in the same way that auditors' accounts are lodged.[77]

10.76 Mr Ron Coomer argued in his submission that while insolvency practitioners claim they are only charging their scheduled rates, there is a need for a more efficient process. He suggested that Form 524 be modified to make insolvency practitioners report to ASIC the asset surplus or deficiency of a company excluding their fees.[78]

Better information on fees

10.77 As Chapter 8 mentioned, ASIC is currently undertaking a remuneration project. ASIC's Chairman told the committee that the aim of the project is:

> …to improve the information that is available to creditors and their rights in relation to remuneration. It is looking at issuing a regulatory guide on what at least ASIC would consider as reasonable remuneration. It is looking at whether we can make use of external cost assessors in particular surveillances that we may undertake in relation to the reasonableness of fees.[79]

10.78 ASIC noted in its submission that as part of its forward program, it aims to obtain statistical data from practitioners to allow an assessment of the relationship between asset recoveries, remuneration charged and returns to creditors. The results will be made available to creditors and the market (see chapter 9).[80]

Registering practitioners

10.79 Chapter 7 of this report canvassed the various options to improve and reform the registration of corporate insolvency practitioners. This section briefly summarises these options.

Broadening the base

10.80 As noted earlier, if the policy objective is to encourage greater competition in the insolvency profession, the obvious option is to amend section 1282 of the *Corporations Act* to broaden the qualifications for registering as a practitioner. Mr Slater supports eligibility for legal practitioners. His argument is not only that a broader recruiting base would break the current monopoly rents that the profession currently enjoys, but that insolvency professionals require quasi-judicial skills.

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77 Mr Jeffrey Knapp, *Submission 86*, p. 2.

78 Mr Ron Coomer, *Submission 52, Supplementary*, p. 4.

79 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, p. 3.

80 ASIC, *Submission 69*, p. 80.

A licensing system

10.81 Several witnesses favour a licensing scheme in preference to a registration system. The argument here is that licenses offer more flexibility for the regulator to review, suspend and cancel a practitioner's appointment. The IPAA argued that licenses would enable terms and conditions to be applied so that the regulator can judge how a practitioner performs. Licensing would also facilitate a reapplication process whereby a practitioner's past conduct can be taken into account.

A panel interview

10.82 A panel interview, in addition to the current processes to register as an insolvency practitioner, was mooted by several witnesses. ITSA currently conducts these interviews, ASIC is currently considering the option, and the IPAA and the Institute of Chartered Accountants both support the idea. The rationale for an interview is that a face to face discussion enables more to be gleaned about the applicant's character. ITSA currently interviews as part of its licensing process.

A written exam

10.83 The committee is aware that if a person does not present well at an ITSA interview, the Service may require the applicant to sit a written examination.[81] There is no written test required to become a registered liquidator. Mr Geoffrey Slater told the committee that both the United Kingdom and the United States have a written exam to register an insolvency practitioner. As chapter 7 noted, he argued the need for a closed-book exam such that applicants have to prove their understanding of the concepts behind equitable principles and company law.[82]

Stratifying registration

10.84 Some submitters favoured a registration or licensing system whereby practitioners qualify for particular types of insolvency work. Depending on their skills and experience, they would be assigned to jobs of a particular size and complexity. As noted above, a licensing system would be best suited to this stratified approach.

Professional indemnity insurance

10.85 Chapter 7 observed that there is lack of effective monitoring of corporate insolvency practitioners' PI insurance. ASIC currently checks PI insurance through practitioners' annual statements, but there is a lag between the time these are completed and when they are viewed by ASIC. Again, the contrast is with ITSA's system whereby trustees' PI insurance is checked upon registration, annually and upon renewing their license every three years.

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81 See Associate Professor David Brown, *Committee Hansard*, 9 April 2010, pp. 20–21.

82 Mr Geoffrey Slater, *Committee Hansard*, 13 April 2010, pp. 51–52.

10.86 A key option for reform is to require insurance companies to notify the regulator as soon as an insolvency practitioner's PI insurance lapses or expires. The regulator would require the practitioner to update his or her insurance within a short period and, failing that, will have their license suspended.

Summary

10.87 This chapter canvassed various options to reform the regulation, registration and remuneration of the insolvency profession in Australia. They are by no means a complete list, but they do reflect the evidence given to the committee by submitters and witnesses. The following chapter gives the committee's views on these matters and makes several recommendations.