The Senate

Economics
References Committee

The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework

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Acronyms

AAT	Administrative Appeals Tribunal
AFS license	Australian Financial Service License
ALRC	Australian Law Reform Commission
APESB	Australian Professional and Ethical Standards Board
APRA	Australian Prudential Regulation Authority
ASC	Australian Securities Commission
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
CA	Corporations Act
CALDB	Companies Auditors and Liquidators Disciplinary Board
CPA	Certified Practising Accountants
EDR	external dispute resolution
EU	enforceable undertakings
FTE	full time equivalent
ICCA	Institute of Chartered Accountants of Australia
IDR	internal dispute resolution
IPAA	Insolvency Practitioners Association of Australia
ITSA	Insolvency and Trustee Service Australia
MBA	Master of Business Administration
OFT	Office of Fair Trading
PI	Professional Indemnity
PJC	Parliamentary Joint Committee
VA	voluntary administration

Glossary [1]

Administrator (also known as voluntary administrator)	A person appointed in a voluntary administration to determine whether a company should come under administration according to an approved deed of company arrangement, be wound up, or revert to normal operation. [2]
Charge	A form of security for a debt taken by a creditor over company assets.
Committee of creditors	A small group of creditors, or their representatives, often appointed by the creditors of a company at the first meeting in a voluntary administration. The committee's role is to consult with the voluntary administrator and to receive and consider reports by the voluntary administrator. The committee may be called upon to approve the voluntary administrator's fees. The voluntary administrator must report to the committee when it reasonably requires.
Committee of inspection	A small group of creditors and shareholders, or their representatives, often appointed by the creditors and shareholders of a company in liquidation to assist the liquidator. The committee is often called on to approve the liquidator's fees and sometimes to approve the compromise of debts or the entry into contracts extending beyond three months by the liquidator.
Compulsory winding up (also known as court liquidation)	A winding up of a company that starts as a result of a court order, made after an application to the court, usually by a creditor of the company.
Controller	A person appointed by a secured creditor to deal with assets subject to a charge. Includes a receiver, and receiver and manager.
Creditor	A person who is owed money.

1 Unless otherwise indicated, definitions are derived from Australian Securities and Investments Commission, *Insolvency: A Glossary of Terms*, December 2008.

2 P. Butt (ed.), *Butterworths Concise Australian Legal Dictionary*, Third Edition, LexisNexis Butterworths, Chatswood, 2004, p. 14.

Creditors' voluntary winding up	A winding up of a company initiated by the company's creditors. A creditors' voluntary winding up may be initiated only if the company in insolvent. [3]
Deed administrator	The external administrator appointed to oversee a deed of company arrangement.
Deed of company arrangement	A binding arrangement between a company and its creditors governing how the company's affairs will be dealt with, which may be agreed to as a result of the company entering voluntary administration. Aims to maximise the chances of the company, or as much as possible of its business, continuing, or to provide a better return for creditors than an immediate winding up of the company, or both.
Director	A person appointed as a director of a company who is then responsible for directing and managing the affairs of a company.
External administrator (also known as insolvency practitioner)	A general term for an external person formally appointed to a company or its property. Includes provisional liquidator, liquidator, voluntary administrator, deed administrator, controller, receiver, and receiver and manager.
Fixed charge	A charge taken by a lender over particular assets of a company. The company may not dispose of these assets without the consent of the lender.
Floating charge	A charge taken by a lender over general assets of a company. The company is usually able to use and dispose of these assets (e.g. stock, debtors) in the ordinary course of business without the secured creditor’s consent. A floating charge converts to a fixed charge over those assets if certain events listed in the charge document occur. These usually include the appointment of a liquidator or other external administrator.
Insolvent	Unable to pay all debts when they fall due for payment.

3 P. Butt (ed.), *Butterworths Concise Australian Legal Dictionary*, Third Edition, LexisNexis Butterworths, Chatswood, 2004, p. 105.

Liquidation (also known as winding up)	The orderly winding up of a company’s affairs. It involves realising the company’s assets, cessation or sale of its operations, distributing the proceeds of realisation among its creditors and distributing any surplus among its shareholders. The three types of winding up are: compulsory (court-ordered), creditors’ voluntary and members’ voluntary.
Liquidator	A person appointed, in a winding up of a company, to assume control of the company's affairs and to discharge its liabilities in preparation for its dissolution. The liquidator ascertains the liabilities of the company, converts its assets into money, terminates its contracts, disposes of its business, distributes the net assets to creditors and any surplus to the proprietors, and extinguishes the company as a legal entity by formal dissolution.[4]
Member (of a company)	A shareholder.
Members’ voluntary winding up	A form of winding up for solvent companies, initiated by the company.
Priority creditor	An unsecured creditor entitled to be paid ahead of other creditors (e.g. employees).
Provisional liquidator	A liquidator appointed by the court to preserve a company’s assets until a winding up application is decided.
Realise	Convert assets into cash, often by selling them.
Receiver	An external administrator appointed by a secured creditor to realise enough assets subject to a charge to repay a secured debt. Less commonly, a receiver may also be appointed by a court to protect a company’s assets or to carry out specific tasks.
Receiver and manager	A receiver who has, under the terms of their appointment, the power to manage the company’s affairs.

4 P. Butt (ed.), *Butterworths Concise Australian Legal Dictionary*, Third Edition, LexisNexis Butterworths, Chatswood, 2004, p. 265.

Receivership	An insolvency procedure where a receiver, or receiver and manager, is appointed over some or all of the company’s assets.
Scheme of arrangement	A reorganisation of a company's capital structure or rescheduling of its debts, following a period of financial difficulties. The purpose is to meet the demands of creditors while avoiding liquidation.[5]
Secured creditor	A creditor who has a security (e.g. charge or mortgage) over some or all of a company’s property.
Security	Any right or interest in property that renders the repayment of a debt more secure and certain.[6]
Solvent	Able to pay all of one's debts, as and when they become due and payable.
Unsecured creditor	A creditor who does not hold a security over a company’s property.
Voluntary administration	A process begun by the appointment of an administrator to a company that is in financial difficulties (but could possibly be saved), during which the administrator investigates its affairs to recommend to creditors whether it should come under administration according to a deed of company arrangement approved by its creditors, be wound up, or revert to normal operation by its directors.[7]
Winding up order	A court order for the winding up of a company. The first step in a compulsory winding up. Usually made after an application by a creditor.

5 P. Butt (ed.), *Butterworths Concise Australian Legal Dictionary*, Third Edition, LexisNexis Butterworths, Chatswood, 2004, p. 388.

6 P. Butt (ed.), *Butterworths Concise Australian Legal Dictionary*, Third Edition, LexisNexis Butterworths, Chatswood, 2004, p. 391.

7 P. Butt (ed.), *Butterworths Concise Australian Legal Dictionary*, Third Edition, LexisNexis Butterworths, Chatswood, 2004, p. 452.

List of Recommendations

Recommendation 1

11.9 The committee recommends that the corporate insolvency arm of ASIC be transferred to ITSA to form the Australian Insolvency Practitioners Authority (AIPA). The agency should be governed by the *Financial Management and Accountability Act* under the Attorney General's portfolio.

11.10 The Memorandum of Understanding between ASIC and ITSA should be updated to ensure that ASIC provides to the new agency adequate resources and the expertise needed to support the oversight of corporate insolvency sector.

Recommendation 2

11.12 The committee recommends that the government commission the Australian Law Reform Commission to inquire into the opportunities to harmonise Australia's personal insolvency and corporate insolvency legislation. The Commission must report to the government within 12 months of the tabling of this report.

Recommendation 3

11.18 The committee recommends that a 'flying squad' be established within the new insolvency regulator. The unit should be responsible for conducting investigations of a sample of insolvency practitioners, some selected at random, others with the aid of a risk profiling system and market intelligence.

Recommendation 4

11.27 The committee recommends that section 213 of the *Australian Securities and Investment Commission Act 2001* be replaced with the following:

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

Recommendation 5

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

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

Recommendation 6

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

Recommendation 7

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

Recommendation 8

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

Recommendation 9

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

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

Recommendation 10

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

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

Recommendation 11

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

Recommendation 12

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

Recommendation 13

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

> …is an Australian Legal Practitioner holding a current practising certificate with at least five years' post admission experience as a practising commercial lawyer;
>
> and / or
>
> …holds a Masters of Business Administration with at least five years' commercial experience.

Recommendation 14

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

Recommendation 15

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

> For purposes of this section, cause shown includes:
>
> (a) A vote of no confidence by a majority of creditors;
>
> (b) Where it appears time based charging of the incumbent liquidator has not or will not result in a reasonable cost-benefit analysis for the company.

Recommendation 16

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

Recommendation 17

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

Chapter 1

Introduction

Background

1.1 The role of an insolvency professional is to take control of the insolvent business, secure and recover its assets, achieve order for creditors and employees and seek to maximise returns to creditors in accordance with statutory priorities. Insolvency practitioners are required to act in the interests of creditors and employees and in the public interest.[1] They are entitled to claim remuneration for necessary work that is properly performed.

1.2 In performing this role, it is crucial that all stakeholders have confidence in the insolvency regime and its practitioners and regulators.[2] The insolvency regime is an important part of a well-governed polity and efficient economy.[3] A well-devised regime will enhance the willingness of people to lend money to businesses, minimise the costs incurred by vulnerable creditors (such as employees), and promote overall business dynamism by allowing businesses to reorganise rather than close.[4]

1.3 Australia's insolvency regime has evolved from the United Kingdom's practices and procedures. The system is designed to protect the interests of creditors, who have control over the direction and pace of procedures. The obvious contrast is with the United States where the debtor has control of the process.[5]

The focus of the inquiry

1.4 This inquiry is concerned with the conduct of the insolvency profession in Australia and the adequacy of efforts to monitor, regulate and discipline misconduct. This conduct is regulated by the *Corporations Act 2001*, the regulator's guidance and through industry codes.

1.5 The Australian Securities and Investments Commission (ASIC) administers the insolvency provisions of the *Corporations Act*. The Act provides that a liquidator

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1 Insolvency Practitioners Association of Australia, *Submission 36*, p. ii.

2 Insolvency Practitioners Association of Australia, *Submission 36*, p. ii.

3 The Hon. Michael Kirby, 'Bankruptcy and insolvency: Change, policy and the vital role of integrity and probity', *Insolvency Practitioners Association National Conference*, Adelaide, 19 May 2010, p. 26.

4 Ian Bickerdyke, Ralph Lattimore and Allan Madge, *Business Failure and Change An Australian Perspective*, Productivity Commission, December 2000, pp. 76–77. http://www.pc.gov.au/research/staffresearch/bfacaap/bfacaap.pdf (accessed 24 June 2010).

5 Ian Bickerdyke, Ralph Lattimore and Allan Madge, *Business Failure and Change An Australian Perspective*, Productivity Commission, December 2000, pp. 86–87.

must be registered with ASIC in order to practise in the industry and details the requirements for obtaining registration as a liquidator. There is no licensing regime similar to that for financial services. The registration requirement aims to ensure that a person who wishes to practise as a liquidator has the appropriate education, experience and is a 'fit and proper person'.[6]

1.6 In addition to these provisions, insolvency practitioners must comply with ASIC's regulatory guidance on the adequate and proper performance of their functions.[7] Since 1996, ASIC has produced several regulatory guides relating to registered liquidators, which include guides on criteria for registering as a liquidator and the insurance requirements for registered liquidators. The guides are intended to explain the principles underlying ASIC's approach, when and how ASIC will exercise specific powers under legislation and practical guidance on compliance.[8]

1.7 The Insolvency Practitioners Association of Australia (IPAA) has devised a Code of Professional Practice to serve as a 'fundamental building block upon which the insolvency profession sets and manages standards of professional conduct'. The Code establishes the mandatory requirements that insolvency practitioners must: be and be seen to be independent when accepting an appointment; communicate with affected parties in a manner that is 'honest, open, clear, succinct and timely'; attend to their duties in a timely way; and provide sufficient, open and clear disclosure when making a claim for remuneration.[9]

1.8 Other peak bodies set their own (complementary) standards for insolvency practitioners. The Accounting Professional and Ethical Standards Board (APESB), notably, has recently issued a new professional standard which sets mandatory independence requirements for insolvency practitioners.[10] The new standards are aligned with the requirements of the IPAA's Code of Professional Practice.[11]

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6 ASIC, *Submission 69*, p. 6.

7 ASIC, *Submission 69*, p. 36.

8 ASIC, 'Regulatory guides', http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Regulatory%20guides (accessed 20 June 2010).

9 IPAA, *Code of Professional Practice for Insolvency Practitioners*, 2008, p. 9.

10 The previous standard was APS 7, which was issued in March 1998 by the National Councils of the Institute of Chartered Accountants in Australia and the Australian Society of Certified Practising Accountants. APS 7 covers the application of the Fundamental Principles of Professional Conduct as contained in the Code of Professional Conduct.

11 'Insolvency practitioners and new independence requirements: New standard 300 released', http://sites.thomsonreuters.com.au/tainsight/2009/10/01/insolvency-practitioners-and-new-independence-requirements-revised-standard-apes-330-released/

Conduct of the inquiry

1.9 On 25 November 2009, the Senate referred to the Economics References Committee an inquiry into the role of liquidators and administrators, their fees and their practices, and the involvement and activities of ASIC, prior to and following the collapse of a business.

1.10 The inquiry was instigated by Senator John Williams, National Party Senator for New South Wales. Senator Williams has publicly expressed his concern and frustration at the conduct of some insolvency practitioners, the harm caused to businesses and creditors by this conduct and the perceived lack of action by ASIC.[12]

Submissions

1.11 The committee advertised the inquiry in *The Australian* on 2 December 2009, 9 December 2009, 27 January 2010, 10 February 2010, 24 February 2010, 10 March 2010, 24 March 2010, 7 April 2010, 21 April 2010 and 5 May 2010. It invited submissions by 12 February 2010. The committee received 95 submissions of which 50 were made public. Appendix 1 lists the public submissions.

1.12 The submissions that the committee made confidential fell into two broad categories. Several were not made public at the request of the submitter. The remaining confidential submissions contained adverse comment about individuals and organisations and/or contained evidence relating to matters before the courts.

1.13 As far as possible, the committee sought to make submissions public. In some cases, it opted to protect individuals and organisations adversely named by deleting their names while making the submission public. Some submissions were made public with the submitter's name withheld.

1.14 While it received several submissions relating to specific cases, the committee made no attempt to adjudicate on these details. To the extent that it did consider these cases, its interest was purely in the observations that could be made of the broader insolvency profession and regulatory regime.

Public hearings

1.15 The committee held public hearings in Canberra on 12 March, Adelaide on 9 April, Sydney on 13 April, Newcastle on 14 April and again in Canberra on 23 April 2010.

1.16 At both its Canberra hearings, the committee heard evidence from ASIC and the IPAA. At its hearing in Adelaide, the committee received evidence from several

12 Senator John Williams, 'Opinion piece', http://www.johnwilliams.com.au/index.php?option=com_content&view=article&id=144:opinion-piece&catid=26:media&Itemid=176

academic experts specialising in the area of insolvency law. In Sydney, the committee heard from the Companies Auditors and Liquidators Disciplinary Board (CALDB) and the Insolvency and Trustee Service of Australia (ITSA), among others. At its Newcastle hearing, the committee's evidence focussed on hearing from the 'victims' of Mr Stuart Ariff, a Newcastle liquidator found guilty of 83 charges of gross misconduct. Mr Ariff has been banned as a registered practitioner for life.

1.17 The committee received evidence in camera on three occasions. In Adelaide, it went in camera to hear from Mr John Viscariello, whose evidence related to matters before the courts. In Sydney, it took evidence in camera from Mr Owen Salmon, who gave his evidence via teleconference. The committee also received in camera evidence from Mr Ariff. It wrote to Mr Ariff on 10 March 2010 inviting him to give evidence at either the committee's Sydney or Newcastle hearings. The committee heard evidence from Mr Ariff in Sydney on 13 April.

1.18 Details of the hearings and the witnesses who appeared at them are contained in Appendix 2.

Acknowledgements

1.19 The committee thanks all those who have assisted with this inquiry. It is grateful to those who made written submissions and to those who contacted the secretariat to check on the inquiry's progress. The committee appreciates their efforts and interest.

1.20 The committee also thanks those who gave verbal evidence to this committee. It understands that this inquiry has dealt with issues of personal anguish, frustration and disappointment for many individuals. In this context, the committee would particularly like to acknowledge the evidence given by Mr Bill Doherty, Mr Ron Williams, Mr Bernard Wood, Mr Ian Fong, Mr Richard Wright and Councillor Edward Maher. The committee sympathises with the plight of these witnesses, most of whom are the 'victims' of Mr Ariff. Some of their experiences are described in more detail in chapter 5 of this report.

1.21 The committee also thanks Ms Denise North and Mr Michael Murray from the IPAA. Mr Murray in particular has given generously of his time and resources. The secretariat would like to thank him for lending the committee some key source documents and travelling to Canberra on 4 June 2010 to discuss various inquiry-related matters with secretariat staff.

Past inquiries and reform

1.22 Australia's insolvency regime is not a new area of inquiry. In 1988, the Australian Law Reform Commission (ALRC) conducted a major review of Australia's insolvency laws. The Harmer report, as it is known, was implemented by the *Corporate Law Reform Act 1992*.[13]

1.23 This Act introduced Part 5.3A of the *Corporations Act*. The aim of this Part is to provide an opportunity for an insolvent company to reach an arrangement with their creditors which addresses the creditors' debts and enables the company to continue trading. As it is not always possible for the company to continue, the Part also seeks to provide for the business, property and affairs of an insolvent company to be administered in a way that results in a better return for the company's creditors and members than would result from an immediate winding up of the company.[14]

1.24 In 1997, a Working Party comprised of a Treasury and an Australian Securities Commission (ASC) official and private firm partners released a report titled *A Review of the Regulation of Corporate Insolvency Practitioners*.[15] The report made several recommendations including:

- a cost-benefit analysis of merging the personal and insolvency frameworks;
- broadening entry requirements for registration so that persons with various combinations of qualifications and experience are eligible;
- making the passing of a written examination a requisite for registration;
- making PI insurance an ongoing requirement of registration;
- an annual reporting statement by practitioners (rather than a triennial statement);
- educating creditors and practitioners about the different methods of fee setting available and the rights which creditors have to establish fees;
- encouraging the practice of capping fees; and
- a better explanation of how hourly rates are calculated, particularly in connection with overheads and disbursements.[16]

1.25 In 2004, the Parliamentary Joint Committee (PJC) on Corporations and Financial Services tabled its report *Corporate Insolvency Laws: A stocktake*. The PJC made a number of recommendations including a proposal that creditors be able to

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13 The Law Reform Commission, *General Insolvency Inquiry*, Report No. 45, 1988.

14 Section 435, *Corporations Act 2001*

15 The Working Party was established in 1993 by the then Commonwealth Attorney-General the Hon. Michael Lavarch MP.

16 Report of the Working Party, 'Review of the regulation of corporate insolvency practitioners', June 1997.

appoint a different person as liquidator when the administration ends and the company proceeds into liquidation.[17]

1.26 In 2007, the *Corporations Amendment (Insolvency) Act* introduced several significant reforms to the insolvency regime. These included: protecting the priorities of employee creditors; practitioners declaring prior advisory and other relevant relationships; criteria for a court to assess the reasonableness of a practitioner's claim for remuneration; enhanced powers for ASIC to investigate liquidators and review their fees; and improvements to the practitioner registration process.[18] These reforms were, in part, a response to the PJC report. The IPAA has noted that 'many of these 2007 reforms still need time to gain traction for their benefits to be recognised, and for any difficulties with them to be identified'.[19]

1.27 The committee also notes that during the course of this inquiry, the United Kingdom's Office of Fair Trading (OFT) released a study of the market for corporate insolvency practitioners. The report focussed on the remuneration and regulation of insolvency practitioners. It found that ineffective oversight of the profession could lead to longer administrations, the sale of assets below market value and inappropriate initiation of insolvency.[20] The OFT recommended establishing an industry-funded independent complaints handling body with powers to review fees and actions, impose fines and return overcharged fees to creditors.[21] Chapter 11 of this report considers some of these proposals.

Context of the inquiry

1.28 This inquiry was conducted at the tail end of the Global Financial Crisis. While Australia avoided recession, insolvencies increased nonetheless (see Chart 2.1). The number of external administration insolvencies rose from 7,521 in 2007 to 9,113 in 2008 to 9,437 in 2009.[22] It is particularly important in this environment that the public has confidence in the insolvency regime and the profession responsible for conducting insolvencies.

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17 'Corporate Insolvency Laws: A stocktake', Parliamentary Joint Committee on Corporations and Financial Services, June 2004.
See Anthony Housego and Bernard Poole, Bills Digest No. 180, 2006–07, Parliamentary Library, 14 June 2007, http://www.aph.gov.au/library/pubs/bd/2006-07/07bd180.htm (accessed 24 June 2010).

18 IPAA, *Submission 36*, p. 2.

19 IPAA, *Submission 36*, p. 3.

20 Office of Fair Trading, *The market for corporate insolvency practitioners: A market study*, June 2010, p. 61, http://www.oft.gov.uk/shared_oft/reports/Insolvency/oft1245 (accessed 20 July 2010).

21 Office of Fair Trading, *The market for corporate insolvency practitioners: A market study*, June 2010, p. 7.

22 IPAA, *Submission 36*, p. 34.

1.29 Unlike the 1988 Harmer, 1997 Working Party and 2004 PJC inquiries, this inquiry is set against a backdrop of various findings of insolvency practitioner misconduct. Since July 2006, there have been 14 matters referred from ASIC's Insolvency and Liquidators team to CALDB and the courts. Among these matters is the life ban of Mr Ariff. Since July 2006, there have also been nine other disciplinary outcomes relating to insolvency practitioner misconduct from investigations commenced before July 2006. These include the suspension of a number of practitioners.[23]

1.30 These findings, and the media publicity they have attracted, have undoubtedly tainted the reputation of the profession. Dr Colin Anderson, from the Queensland University of Technology, has noted that if the success of a profession is dependent on how well it maintains the confidence of its clients and the public, 'perhaps the Senate inquiry suggests some confidence has been lost in recent times'.[24]

1.31 Certainly, the committee is concerned about this misconduct and the effect it has had on the reputation of the industry. However, it rejects the characterisation that this inquiry is in some way a knee-jerk reaction to the case of Mr Ariff and a few others. While these cases are significant and deserve attention, their real interest is in the questions they raise about the extent of practitioner misconduct in the profession and the adequacy of efforts to oversee and regulate the insolvency regime in Australia.

Key themes and the structure of the report

1.32 This report centres on three key themes: the registration of practitioners; the remuneration of the profession; and the regulation of the insolvency regime. The committee's evidence has raised significant questions about the adequacy of existing arrangements in all three areas.

1.33 The report is divided into three Parts. Part 1 (chapters 2–4) provides some background to the insolvency industry. Chapter 2 presents available data on the state of the industry. Chapter 3 examines the role and duties of liquidators and administrators in the insolvency process in Australia. Chapter 4 gives a brief summary of the role of the regulator, ASIC, the disciplinary body, the Companies Auditors and Liquidators Disciplinary Board (CALDB), and the main professional body, the Insolvency Practitioners Association of Australia.

1.34 Part 2 has four chapters (5–8). Chapter 5 looks at submitters' perceptions of how the insolvency regime is currently operating. In particular, it considers views on whether the Ariff case is an exception to an otherwise well performing industry, or whether it reflects more widespread problems with the conduct and oversight of insolvency practitioners.

23 ASIC, *Submission 69*, pp. 69–70.

24 Dr Colin Anderson, *Submission 79*, p. 1.

1.35 Chapter 6 examines the adequacy of the regulatory framework. In particular, it looks at the evidence that ASIC and the CALDB have been unresponsive and ineffective in their oversight of the insolvency regime. It considers 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.

1.36 Chapter 7 is concerned with the registration of insolvency practitioners. It considers criticism that the process and standards for registering practitioners is inadequate and needs to be strengthened. There are three contexts to this criticism: 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.

1.37 Chapter 8 deals with the remuneration of insolvency practitioners. 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. The chapter discusses these criticisms and concerns that practitioners have been able to inflate their fees through disbursement payments.

1.38 Part 3 of this report builds on the evidence of Part 2 to consider the options to reform the insolvency regime in Australia. Chapter 9 looks at the vexed issue of insolvency data and in particular, the lack of detailed, free and publicly available statistics on the state of the industry. It considers the merit of a system of data collection and analysis.

1.39 Chapter 10 considers a range of options to sharpen the incentives for both insolvency practitioners and regulators to act in the public interest. Some of these options seek to develop existing practices through better disclosure, complaints handling and outreach programs. Other options propose significant structural reform including the creation of a single insolvency regulator with a 'flying squad' to monitor practitioners and a system of licensing. The final chapter of this report gives the committee's view on these options and presents a number of recommendations.

PART 1

The first part of this report has three chapters. Chapter 2 sketches the **state of the insolvency industry** in Australia, noting the number of insolvencies over the past decade, the number of registered liquidators, the size of liquidation firms, a profile of companies in voluntary administration, a snapshot of different firms' hourly fee scales and data on the number of complaints about insolvency practitioners.

Chapter 3 provides a fairly detailed explanation of the various **terms and processes** in the operation of the insolvency industry. It covers the role of liquidators, administrators and receivers, the voluntary administration process including the first and second creditors' meetings, creditors' scheme of arrangement and the 'fit and proper' provisions of the *Corporations Act 2001*.

Chapter 4 gives a brief summary of the role of the regulator, ASIC, the disciplinary body, the Companies Auditors and Liquidators Disciplinary Board (CALDB), and the main professional body, the Insolvency Practitioners Association of Australia.

Chapter 2

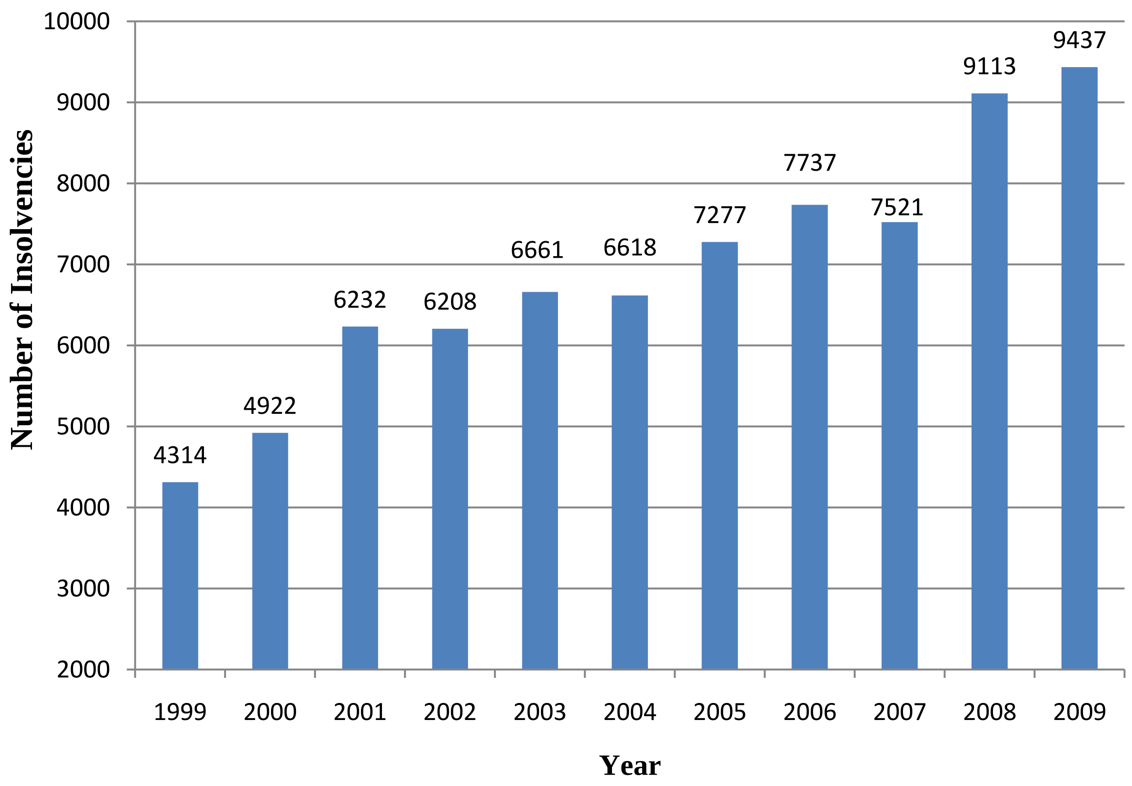
An overview of the corporate insolvency industry in Australia

2.1 This chapter presents some of the publicly available data on the insolvency industry in Australia. It comes mainly from the Australian Securities and Investments Commission's (ASIC) submission.

2.2 The data presented below is a highly truncated picture of the insolvency industry. One of the main themes of this report is the need to improve the collection and analysis of statistics on the insolvency industry. Presently, there is clearly a lack of detailed data. These issues are discussed in more detail in chapter 9.

2.3 Chart 2.1 shows that the number of insolvencies in Australia over the eleven year period more than doubled, from 4,314 in 1999 to 9,437 in 2009. The largest annual increase over the period was in 2008 when the number of insolvency increased by nearly 18 per cent on the previous year.

Chart 2.1: Number of insolvencies in Australia 1999-2009



Source: Secretariat using data from Insolvency Practitioners Association, *Submission 36*, p. 34.

2.4 The number of registered liquidators has fallen from 895 in July 2000 to 662 in March 2010. However, this decrease can partly be explained by inactive liquidators ceasing their registration. ASIC estimates that 105 liquidators fall into this category.[1] Nonetheless, the data suggest that the ratio of insolvencies to practitioners has probably increased.

Market size

2.5 ASIC noted in its submission to this inquiry that the Australian insolvency industry consists of 662 registered liquidators and 492 official liquidators.[2] Each year there are between 7500 and 10,000 companies entering external administration for the first time.

Industry profile

2.6 As of December 2009, there were 273 insolvency firms operating in Australia. Chart 2.2 shows a profile of these firms based on the number of registered liquidators per firm. It shows that 29 per cent of all registered liquidators work in firms with only one registered liquidator. Half of all registered liquidators work for firms with four registered liquidators or less. Roughly a quarter of all registered liquidators are employed in firms that have 20 or more registered liquidators.

2.7 The largest 13 firms have more than 10 registered liquidators. Together, these firms have 251 registered liquidators and account for 39 per cent of total current external administration appointments. These firms include KordaMentha, Hall Chadwick, McGrathNicol and Pitcher Partners.

2.8 There are 248 firms with four registered liquidators or less. They accounted for 50 per cent (331) of the registered liquidator population (see Chart 2.2). Table 2.1 shows, therefore, that half the registered practitioners work for the largest 25 firms (ie: those with more than four registered practitioners).

Table 2.1

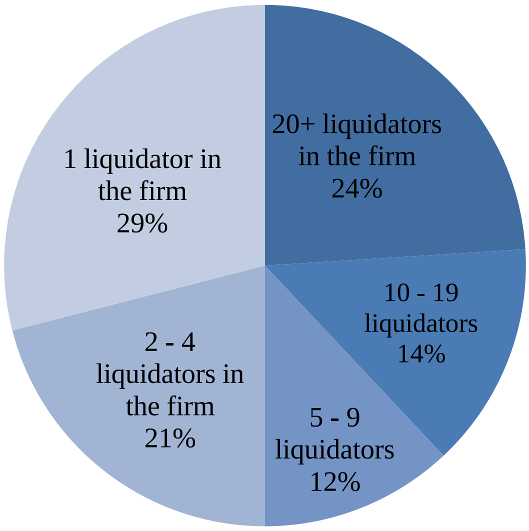
Number of insolvency firms (by number of practitioners)	Number of practitioners
Largest 13 firms (more than 10 practitioners)	251 practitioners
Next largest 12 firms (between 5 and 9 practitioners)	80 practitioners
248 firms with 4 or less practitioners	331 practitioners
273 insolvency firms	**662 practitioners**

Source: Information gathered from paragraphs 2.5 to 2.8.

1 Correspondence, Mr Justin Owen, Manager Government Relations, ASIC, 22 July 2010.

2 ASIC, *Submission 69*, p. 101.

Chart 2.2: Number of registered liquidators by firm size (December 2009)



Source: ASIC, *Submission 69*, p. 101.

Table 2.2: Profile of companies in external administration

	2006–07	2005–06	2004–2005
Employees—Companies with less than 20 FTE employees	82%	84%	83%
Assets—Companies with assets of $100,000 or less	87%	86%	84%
Unsecured creditors owed $500,000 or less	82%	82%	82%
Unsecured creditors—no. of creditors less than 50	88%	87%	85%
Deficiency—EXADs with asset deficiency $500,000 or less	76%	75%	75%
Dividends to unsecured creditors of 10 cents in the dollar or less	96%	96%	95%
Secured creditors—EXADs with no secured creditor	73%	69%	66%

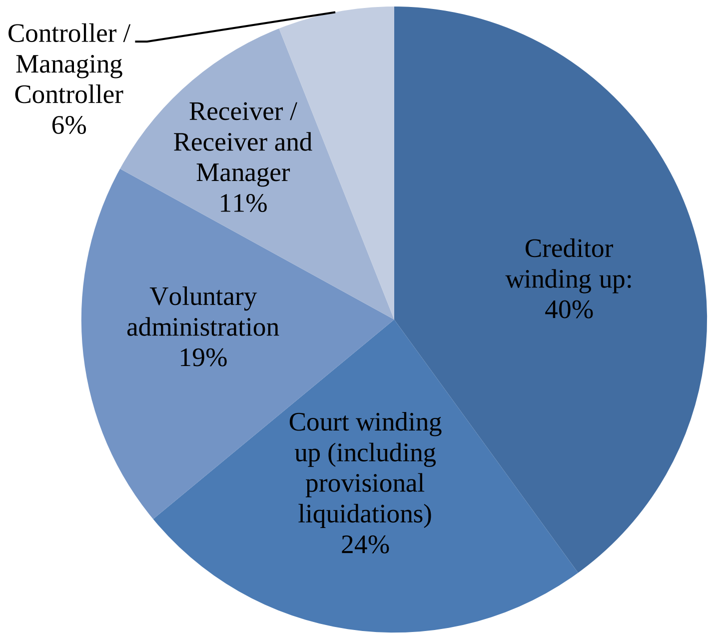
Source: ASIC, *Submission 69*, p. 103. EXADs—external administrations

2.9 Table 2.2 shows that the majority of appointments involve small to medium proprietary limited companies. In 2006–07, these companies had less than 20 employees (82 per cent), less than $100 000 in assets (87 per cent) unsecured creditors owed $500 000 or less (82 per cent).

2.10 A large number of external administrations have no secured creditors (73 per cent). A large percentage estimated a deficiency of up to $500 000 and most (96 per cent) estimated returns to unsecured creditors of less than 10 cents in the dollar.[3]

2.11 Chart 2.3 shows the types of external administration appointments in Australia from July 2008 to June 2009. Creditor winding-up accounted for 40 per cent of all external administrator appointments. Court appointed winding-up accounted for 24 per cent of all external appointments. Voluntary administrations accounted for one-fifth of the total.

Chart 2.3: Total external administration appointments, July 2008–June 2009



Source: ASIC, *Submission 69*, p. 104.

2.12 Liquidators undertaking an external administration are remunerated from the assets of the company. Most registered liquidators will charge fees on a time charged basis using a fee scale. The scale reflects the qualifications and experience of the staff involved. Table 2.3 gives examples of different sized firms' scales within the Sydney market.

3 ASIC, *Submission 69*, p. 103.

Table 2.3: Examples of different firms' hourly fee scales

Position	Small firms	Medium sized firms	Large firms
Registered liquidator and partner	$460	$550	$690
Director	—	$440	$550
Manager	$340	$385	$435
Supervisor	$275	$270	$312
Senior accountant	$225	$235	$250
Accountant	$165	$195	$210
Support staff	$145	$130	$130

Source: ASIC, *Submission 69*, p. 104.

ASIC's activities

2.13 Table 2.4 shows the number of complaints and enquiries to ASIC on all matters and on insolvency matters specifically. It shows that complaints on insolvency related matters account for 3.6 per cent of all complaints to ASIC over the July 2006 to December 2009 period. There were, on average, 3.5 complaints against insolvency practitioners for every 100 insolvency appointments over the period.

Table 2.4: Complaints volume trend

	2006–07	2007–08	2008–09	to Dec 2009	Total/Average
Total complaints and enquiries finalised	11,455	12,514	14,543	6,650	45,162
Total insolvency appointments	11,966	12,524	15,567	7,028	47,085
Total complaints and enquiries against insolvency practitioners	406	352	633	256	1,647
Total complaints and enquiries against insolvency practitioners excluding duplicates	344	317	438	230	1,329
% insolvency practitioner complaints and enquiries of total complaints and enquiries	3.5%	2.8%	4.4%	3.8%	3.6%
% insolvency practitioner complaints and enquiries of total appointments	3.4%	2.8%	4.1%	3.6%	3.5%

Source: ASIC, *Submission 69*, p. 133.

2.14 Of particular note is the spike in the number of complaints against insolvency practitioners to ASIC from 352 in 2007–08 to 633 in 2008–09. Excluding duplicate complaints, the increase was from 317 to 438 complaints. These increases were proportionately much greater than the increase in the number of insolvency appointments between these years.

Final comment

2.15 This chapter provides a brief sketch of the insolvency industry in Australia. Above all, it illustrates the paucity of data collected on the industry.

2.16 Chapter 9 notes that ASIC has published a document titled *External administrators: Schedule B statistics 1 July 2004–30 June 2007*.[4] Schedule B statistics are required to be lodged by a liquidator under section 533 of the *Corporations Act 2001*. ASIC's report collated Schedule B data to indicate the profile of companies in external administration, the causes of company failure and estimated dividends to unsecured creditors. However, this information is both limited and dated. Chapter 9 suggests the way in which the regulator should analyse and publish a fuller picture of the state of the insolvency industry.

4 ASIC, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_132.pdf/$file/REP_132.pdf (accessed 20 June 2010).

Chapter 3

The role and duties of liquidators and administrators in the insolvency process in Australia

3.1 This chapter examines the role and duties of liquidators and administrators in the insolvency process in Australia. It is divided into the following eleven sections:

- the role of an administrator (paragraphs 3.4–3.6);
- the role of a receiver (paragraphs 3.7–3.9);
- the role of a liquidator (paragraph 3.10);
- secured and unsecured creditors (paragraphs 3.11–3.12);
- the voluntary administration process (paragraphs 3.13–3.27);
- deeds of company arrangement (paragraphs 3.28–3.41);
- the process of a receivership (paragraphs 3.42–3.48);
- creditors' scheme of arrangement (paragraphs 3.49–3.50);
- the liquidation or 'winding up' process (paragraphs 3.51–3.83);
- the treatment of employees' entitlements (paragraphs 3.84–3.102); and
- the 'fit and proper' requirement of the *Corporations Act 2001* (paragraphs 3.103–3.117).

The administration of companies in financial difficulty

3.2 A company is classified as being solvent if, and only if, it is able to pay all of its debts as and when they become due and payable (subsection 95A(1)), otherwise the company is insolvent (subsection 95A(2)). Where a company is in financial difficulty and it appears that it may become insolvent (or already is insolvent), there are several forms of external administration available whereby control of the company's affairs is taken from the company's directors and put into external hands. These forms of external administration include:

- voluntary administration;
- receivership;
- creditors' scheme of arrangement; and
- winding up.

3.3 'Winding up' is the terminal mode in the life cycle of a company, which results in the closure of its operations. Portions of the business may be resurrected after sale by the liquidator. The other three forms of external administration may avoid the finality of this outcome.[1]

The role of an administrator—an overview

3.4 The role of an administrator is to take control of a company and its property and to investigate its affairs. An administrator must be a registered liquidator. The administrator is required to hold an initial meeting of creditors at which creditors may consider whether a committee of creditors should be appointed to liaise with the administrator, in order to ensure that all creditors are kept fully informed. During this meeting, creditors may also resolve to replace the administrator.

3.5 The administrator is also required to call a second meeting of creditors. Prior to this meeting, the administrator must provide a statement to creditors outlining the administrator's opinion in relation to what should happen to the company, the basis of that opinion and any other information necessary for the creditors to make an informed decision. At this second meeting, the creditors are able to decide if:

- the company should be wound up;
- the administration should end; or
- the company should execute a deed of company arrangement (section 439C of the *Corporations Act 2001*[2]).

3.6 If creditors resolve to either enter into a deed of company arrangement or to wind up a company, the administrator may become the administrator of the deed of company arrangement or the liquidator, depending on the wishes of creditors (section 446A).[3]

The role of a receiver—an overview

3.7 A receiver is generally appointed by a secured creditor to:

- collect and sell enough of a company's assets to repay a debt owed to the secured creditor; and
- pay out the money collected in the order required by law.

3.8 Receivers must also report to the Australian Securities and Investments Commission (ASIC) any possible offences or other irregularities that they find.

3.9 A receiver's primary duty is to the company's secured creditor. The main duty owed to unsecured creditors is an obligation to take reasonable care to sell property

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1 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, p. 122.

2 All references to sections in this chapter refer to the *Corporations Act 2001 (Cth)*.

3 The Treasury, *Submission 18*, pp 4–5.

for not less than its market value or, if there is no market value, the best price reasonably obtainable.[4]

The role of a liquidator—an overview

3.10 In ordinary circumstances, the role of a liquidator is to take control of, and to wind up, a corporation. The liquidator may:

- collect, protect and realise the company's assets;
- investigate and report to creditors about the corporation's affairs, including voidable transactions and claims against the corporation's officers;
- enquire into the failure of the corporation and possible offences by people involved in the corporation and report to ASIC;
- distribute the proceeds of realisation of assets including processing claims by creditors—first to secured creditors, then priority creditors (including employees), followed by unsecured creditors; and
- apply for deregistration of the company on completion of the liquidation.[5]

Secured and unsecured creditors

3.11 A creditor of a company is a person who is owed money by that company. Usually, a creditor is owed money because they have provided goods or services, or made loans to the company. An employee who is owed money for unpaid wages and other entitlements is also a creditor. Generally, there are two basic categories of creditor:

- a secured creditor is someone who has a charge, such as a mortgage, over some or all of the company's assets to secure a debt owed by the company. In particular, lenders usually require a charge over company assets when they provide a loan; and
- an unsecured creditor is a creditor who does not have a charge over the company's assets.

3.12 Employees are a special class of unsecured creditor. Employees' outstanding entitlements are usually paid in priority to the claims of other unsecured creditors.[6]

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4 Australian Securities and Investments Commission, *Receivership: A Guide for Creditors*, December 2008, p. 2.

5 The Treasury, *Submission 18*, p. 4.

6 Australian Securities and Investments Commission, *Voluntary Administration: A Guide for Creditors*, December 2008, p. 1.

Voluntary administration

3.13 Voluntary administration was introduced in 1993 to provide an inexpensive procedure capable of being implemented swiftly (part 5.3A of the *Corporations Act*). Voluntary administration provides several options to creditors for dealing with a financially troubled company. Some possible outcomes of voluntary administration include:

- ending the voluntary administration and returning the company to the directors' control;
- the company resuming operations but with a deferred or reduced debt burden under a deed of company arrangement approved by creditors;
- a secured creditor exercises its rights to appoint a receiver to obtain repayment of its debt by disposal of company assets; or
- the creditors vote to wind up the company and appoint a liquidator.

3.14 Voluntary administration seeks to maximise the chances of an insolvent company surviving or, if it (or parts of it) cannot be saved, to achieve a better return for creditors and members than would result from an immediate winding up of the company (section 435A). [7]

Commencement and effect of voluntary administration

3.15 Voluntary administration is usually initiated by the company itself when directors resolve that:

- in their opinion the company is insolvent or likely to become insolvent at some future time; and
- an administrator of the company should be appointed (subsection 436A(1)).

3.16 While a company is under administration, the administrator has control of the company's property and business (section 437A). The powers of other corporate officers, including directors, are suspended during the administration and may not be exercised except with the written approval of the administrator (subsection 437C(1)). However, company officers are not removed from their offices by the appointment of an administrator (subsection 437C(2)).

3.17 It is also possible, although much less common, for a voluntary administrator to be appointed by a liquidator of a company (section 436B) or by a substantial chargee: that is, a secured creditor who is entitled to enforce a charge over the whole, or substantially the whole, of the company's property (section 436C). A liquidator may appoint themselves (or a partner, employee or associate) as administrator with the leave of the court or where the appointment is approved by resolution at a meeting of

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7 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, p. 123.

creditors. If, under administration, the company then executes a deed of company arrangement, the court may stay or terminate the winding up. Winding up (liquidation) is discussed in further detail below.

3.18 An administrator must notify secured creditors of their appointment as soon as practicable, but no later than the next business day (subsection 450A(3)). Soon after an administrator's appointment it is possible for a substantial chargee to enforce its charge, usually by the appointment of a receiver (section 441A). An administrator's powers are subject to those of the chargee and its receiver: if a substantial chargee decides to enforce its charge it effectively supplants the administration (subsection 442D(1)). However, if they wish to override the powers of the administrator, a substantial chargee must enforce its charge in relation to all of the relevant property—it does not have the option of appointing a receiver to only a part of the relevant property (subsection 441A(1)(b)). This is generally referred to as the 'all or nothing' rule, which is justified on the basis that a company's assets should be administered either by a receiver or an administrator free of the problems that may arise in a system of divided or competing control of the assets. Receivership is discussed in further detail below.

3.19 If there is no substantial chargee or it does not enforce its charge, during the period of administration there is a general moratorium upon actions or proceedings against the company and its property by creditors and owners or lessors of property used by the company (sections 440A–440D and 440F). This moratorium is intended to provide a period for investigation and collective assessment of options without a general scramble for individual recovery. This generally means that while a company is in voluntary administration:

- unsecured creditors cannot begin, continue or enforce their claims against the company without the administrator's consent or the court's permission;
- owners of property (other than perishable property) used or occupied by the company, or people who lease such property to the company, cannot recover their property;
- except in limited circumstances (for example, where there is a substantial chargee as discussed above), secured creditors cannot enforce their charge over company property;
- a court application to put the company in liquidation cannot be commenced; and
- a creditor holding a personal guarantee from the company's director or other person cannot act under the personal guarantee without the court's consent. [8]

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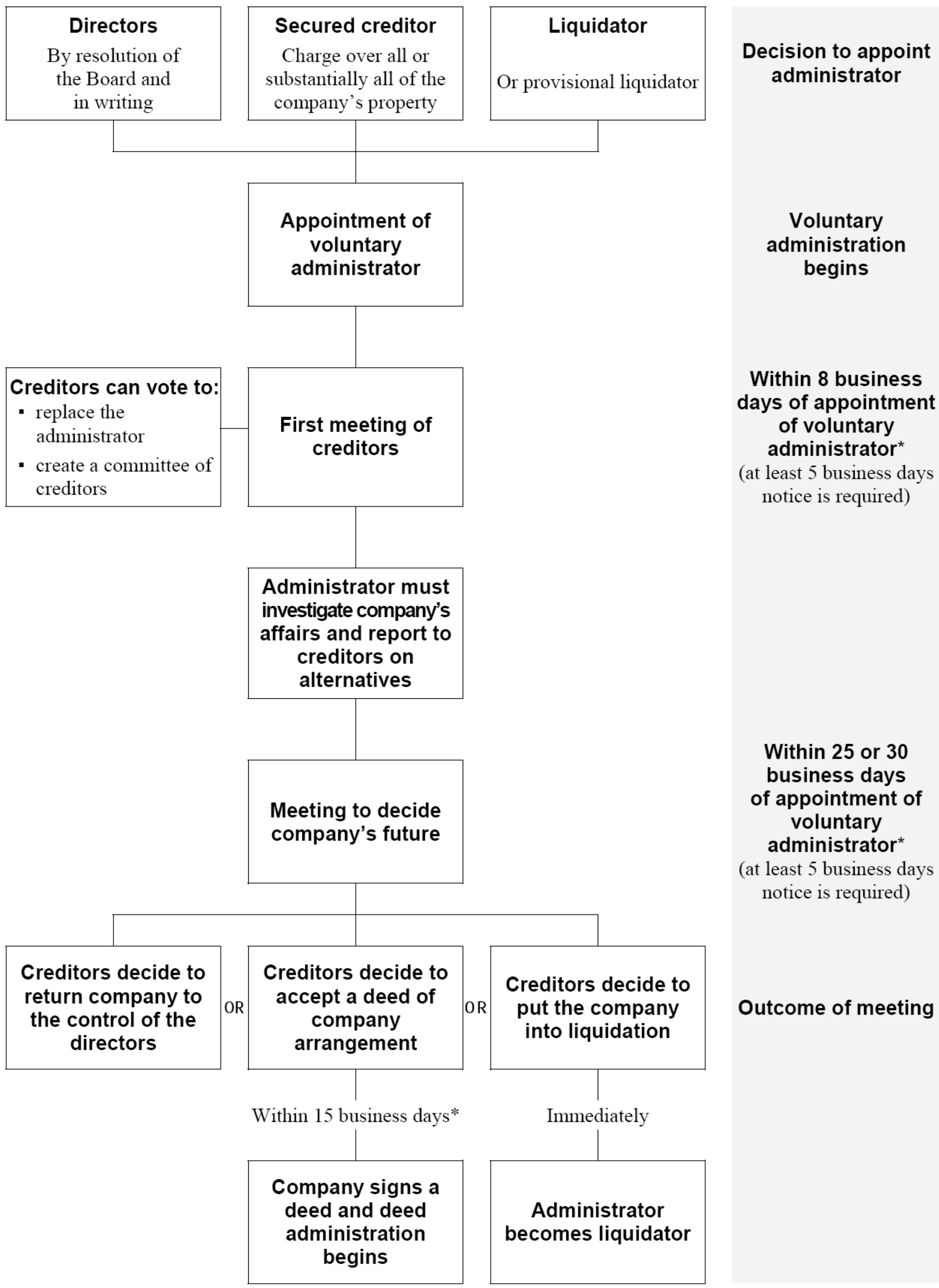
8 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, pp 123–126; and Australian Securities and Investments Commission, *Voluntary Administration: A Guide for Creditors*, December 2008.

Chart 3.1: The Voluntary Administration Process[9]



* Unless the court allows an extension of time.

9 Australian Securities and Investments Commission, *Voluntary Administration: A Guide for Creditors*, December 2008, p. 2.

First creditors' meeting

3.20 As soon as practicable, an administrator must investigate the company's business, property and financial circumstances (section 438A), and within strict but not inflexible time limits, convene two meetings of creditors to take decisions in relation to the administration. An administrator must convene the first meeting within eight business days after the voluntary administration begins. In convening the meeting an administrator must:

- give written notice of the meeting to as many of the company's creditors as reasonably practical; and
- publish a notice of the meeting in an appropriate newspaper (section 436E).

3.21 The administrator must send to creditors, with the notice of first meeting, declarations about any relationships they may have, or indemnities they have been given, to allow creditors to consider the administrator's independence and make an informed decision about whether they want to replace them with another administrator of the creditors' choice.

3.22 At this meeting:

- a determination is made about whether to appoint a committee of creditors to consult with (but not give directions to) the administrator (sections 436E–436F); and
- creditors may replace the administrator with a qualified person of their choosing (subsection 436E(4)).

3.23 The role of a committee of creditors is to consult with the administrator about matters relevant to the administration and receive and consider reports from the administrator. The committee can also require the administrator to report to them about the administration. It may also approve the administrator's fees.

Proposals to nominate an alternative administrator

3.24 A creditor who wishes to nominate an alternative administrator must approach a registered liquidator before the meeting and get a written consent from that person that they would be prepared to act as administrator. The proposed alternative administrator should give to the meeting declarations about any relationships they may have, or indemnities they have been given. The administrator will only be replaced if the resolution to replace them is passed by the creditors at the meeting.[10]

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10 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, pp 123–126; and Australian Securities and Investments Commission, *Voluntary Administration: A Guide for Creditors*, December 2008.

Second creditors' meeting—deciding the company's future

3.25 It is the second meeting of creditors where the major decisions in relation to the administration are made. This meeting is usually held about five weeks after an administrator is appointed, although this is extended to six weeks at Christmas and Easter. An administrator must give written notice to creditors and advertise this meeting in the same way as for the first meeting. With the notice of meeting, an administrator must:

- provide a report to creditors about the company's business, property, affairs and financial circumstances;
- provide a statement setting out their opinion (and reasons for their opinion) about whether it would be in the creditors' interests for the company to execute a deed of company arrangement, for the administration to end, or for the company to be wound up; and
- if a deed of company arrangement is proposed, provide a statement setting out details of the proposed deed (section 439A).

3.26 At this meeting the creditors may resolve that:

- the administration should end (and the company be returned to the control of its directors)—a rare occurrence;
- the company be wound up; or
- the company execute a deed of company arrangement (section 439C).

3.27 If creditors resolve that the company should be wound up, the administrator becomes the liquidator unless creditors vote at the second meeting to appoint a different liquidator of their choice. The liquidation proceeds as a creditors' voluntary liquidation.[11] Winding up (liquidation) is discussed in further detail below.

Deeds of company arrangement

3.28 Deeds of company arrangement are sometimes referred to as 'moratorium deeds' (in which a company is granted an extended period in which to repay its debts in full) or 'compromise deeds' (under which creditors agree to receive less than their full debt). If creditors vote for a proposal that the company enter a deed of company arrangement, the company must sign the deed within 15 business days of the creditors' meeting, unless the court allows a longer time. (If this does not happen, the company will automatically go into liquidation, with the administrator becoming the liquidator.) The deed administrator is usually the administrator of the company, unless the creditors appoint someone else at the meeting (sections 444A–444B).

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11 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, pp 123–126; and Australian Securities and Investments Commission, *Voluntary Administration: A Guide for Creditors*, December 2008.

3.29 It is the role of the deed administrator to ensure the company (or others who have made commitments under the deed) carries through these commitments. The extent of the deed administrator's ongoing role is set out in the deed. Creditors also have the right when a deed of company arrangement is proposed and considered at the second meeting to negotiate consequences of failure to meet such deadlines into the terms of the deed.

Distribution of funds

3.30 The order in which creditor claims are paid depends on the terms of the deed. Sometimes the deed proposal is for creditor claims to be paid in the same priority as in a liquidation. Other times, a different priority is proposed. However, the deed must ensure employee entitlements are paid in priority to other unsecured creditors unless the eligible employees agree by a majority in both number and value to vary their priority. Treatment of employees' entitlements is discussed in further detail below.

Potential impact on small unsecured creditors

3.31 A deed of company arrangement binds all unsecured creditors (even if they voted against the proposal). The deed also binds secured creditors and owners and lessors of property used by the company who voted for the deed, and the company and its officers and shareholders (sections 444D and 444G).[12] Professor Bob Baxt and Mr Jason Harris suggest that:

> …the freedom and flexibility offered by the deed of company arrangement procedure can have disastrous consequences for small unsecured creditors. It is not hard to imagine that a deed of company arrangement may be supported by large creditors because it unduly favours their interests at the expense of small creditors. It must be remembered that s 444D binds all unsecured creditors to the effect of the deed, meaning that there is the potential for smaller creditors to be locked in to an unfair proposal (particularly given that voting at creditors' meetings is heavily influenced by the value of debt owed to each creditor, meaning that small unsecured creditors may have very little opportunity to influence the process of outcomes of voluntary administration).[13]

3.32 However, Professor Baxt and Mr Harris contend that section 445D, whereby the court can terminate a deed of company arrangement, 'provides an effective protection measure to ensure that deeds do not operate outside the purposes of Part 5.3A.'[14] The objects clause for Part 5.3A specifies that the object of the Part is to

12 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, pp 123–126; and Australian Securities and Investments Commission, *Voluntary Administration: A Guide for Creditors*, December 2008.

13 R. Baxt and J. Harris, *Corporations Legislation 2009*, Thomson Reuters, Pyrmont, 2009, pp 521–522.

14 R. Baxt and J. Harris, *Corporations Legislation 2009*, Thomson Reuters, Pyrmont, 2009, p. 522.

provide for the business, property and affairs of an insolvent company to be administered in a way that:

- maximises the chances of the company, or as much as possible of its business, continuing in existence; or
- if it is not possible for the company or its business to continue in existence—results in a better return for the company's creditors and members than would result from an immediate winding up of the company (section 435A).

Conclusion of a deed of company arrangement

3.33 A deed may come to an end because the obligations under the deed have all been fulfilled and the creditors have been paid. The deed may also provide that the company will go into liquidation if the deed terminates due to certain conditions being met. Another way for the deed to end is if the deed administrator calls a meeting of creditors, and creditors vote to end the deed. This may occur because it appears unlikely that the terms of the deed can be fulfilled. At the same time, creditors may be asked to vote to put the company into liquidation.

3.34 As noted above, the deed may also be terminated if a creditor, the company, ASIC or any other interested person applies to the court and the court is satisfied that:

- creditors were provided false and misleading information on which the decision to accept the deed proposal was made;
- the administrator's report left out information that was material to the decision to accept the deed proposal;
- the deed cannot proceed without undue delay or injustice; or
- the deed is unfair or discriminatory to the interests of one or more creditors or against the interests of creditors as a whole (section 445D).

3.35 If the court terminates the deed as a result of such an application, the company automatically goes into liquidation.[15]

Administrators' fees

3.36 An administrator is entitled to receive remuneration as determined:

- by agreement between the administrator and the committee of creditors (if any); or
- by resolution of the company's creditors; or
- if there is no such agreement or resolution—by the court (subsection 449E(1)).

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15 Australian Securities and Investments Commission, *Voluntary Administration: A Guide for Creditors*, December 2008.

3.37 Generally, an administrator's fees will be paid from available assets, before any payments are made to creditors. Apart from fees, administrators are entitled to reimbursement for out-of-pocket expenses that have arisen in carrying out the administration. This reimbursement does not usually require approval.

3.38 To be effective, a resolution of the company's creditors specifying an administrator's remuneration must deal exclusively with remuneration of the administrator, i.e. the resolution must not be bundled with any other resolution (subsection 449E(1B)).

3.39 Before remuneration is determined by agreement between an administrator and a committee of creditors, or by resolution of the company's creditors, the administrator must prepare a report setting out:

- such matters as will enable the committee of creditors (or the company's creditors) to make an informed assessment as to whether the proposed remuneration is reasonable;
- a summary description of the major tasks performed, or likely to be performed, by the administrator; and
- the costs associated with each of those major tasks.

3.40 The administrator must give a copy of the report to each member of the committee of creditors at the same time as the member is notified of the relevant meeting of the committee, or where the remuneration is determined by resolution of the company's creditors, at the same time as the creditor is notified of the relevant meeting of creditors (subsections 449E(5–7)).

3.41 A court may, on the application of ASIC, the administrator, or an officer, member or creditor of the company, review the administrator's remuneration and confirm, increase or reduce it (section 449E).[16]

Receivership

3.42 Securities given by companies to lenders usually grant the lender the right, when default occurs, to appoint a person to take possession and control either of a particular asset (or group of assets), or the whole of the property and undertaking of the company. This person is known as a receiver and is empowered to deal with these assets in such a way as is necessary to obtain repayment of the debt that is the subject of the security. An overview of the role of a receiver is provided at paragraphs 3.7–3.9 above. While receivership does not necessarily result in the winding up of the company, it is a common outcome because the remaining assets will usually be inadequate to repay unsecured debts. This is particularly so given the commercially

16 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, pp 123–126; and Australian Securities and Investments Commission, *Voluntary Administration: A Guide for Creditors*, December 2008.

traumatic circumstances of receivership and its negative effect on the company's business operations.[17]

3.43 The security (or charge) held by a secured creditor under which the appointment of a receiver is made may comprise:

- a fixed charge over particular assets of the company (e.g. land, plant and equipment); and/or
- a floating charge over assets that are used and disposed of in the course of normal trading operations (e.g. debtors, cash and stock).[18]

Distribution of funds

3.44 The money from the realisation (sale) of these assets must be distributed by the receiver as follows:

- money from the sale of fixed charge assets is paid to the secured creditor after the costs and fees of the receiver in collecting this money have been paid; and
- money from the sale of floating charge assets is paid out as follows: first, the receiver's costs and fees in collecting this money; second, certain priority claims, including employee entitlements (if the liability for these has not been transferred to a new owner); and, third, repayment of the secured creditor's debt.

3.45 Any funds that are left over are paid to the company or its other external administrator if one has been appointed. (It is possible for a company in receivership to also be in provisional liquidation, liquidation, voluntary administration or subject to a deed of company arrangement.)

3.46 The receiver has no obligation to pay any other unsecured creditors for outstanding pre-appointment debts.[19]

Receivers' fees

3.47 As noted above, the receiver is generally entitled to be paid their fees from the money realised from the charged assets. How the fees are calculated is usually set out in the charge document and appointment document. Unsecured creditors have no role in setting or approving the receiver's fees. However, ASIC, a liquidator, voluntary administrator or deed administrator may apply to the court for the receiver's remuneration to be reviewed (section 425).

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17 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, pp 126–127.

18 Australian Securities and Investments Commission, *Receivership: A Guide for Creditors*, December 2008, pp 1–5.

19 Australian Securities and Investments Commission, *Receivership: A Guide for Creditors*, December 2008.

Conclusion of a receivership

3.48 A receivership usually ends when the receiver has collected and sold enough assets to repay the secured creditor, completed all their receivership duties and paid their receivership liabilities. Generally, the receiver resigns or is discharged by the secured creditor. Unless another external administrator has been appointed, full control of the company and any remaining assets goes back to the directors. Although, as noted above, while receivership does not necessarily result in the winding up of the company, it is a common outcome because the remaining assets will usually be inadequate to repay unsecured debts. [20]

Creditors' scheme of arrangement

3.49 A creditors' scheme of arrangement is another device that may be used by a company in financial difficulty in an effort to prevent the company from facing the prospect of being wound up. Under a creditors' scheme of arrangement a company facing the prospect of insolvency may restructure its debts through a compromise of creditors' claims similar to that which may be reached under a deed of company arrangement.

3.50 A creditors' scheme of arrangement is initiated by application to the court for an order that a meeting of creditors be convened and for approval of an explanatory statement to be sent to creditors with the notice of meeting (sections 411 and 412). The meeting (or separate meetings where creditors interests are different in relation to the proposed arrangement) considers the proposed scheme. A scheme binds creditors only if it is approved by a majority of creditors in each class who between them hold at least 75 per cent of the total debt of those creditors who are present in person or by proxy at the meeting. Furthermore, the compromise (i.e. the scheme of arrangement) must also be approved by the court (subsection 411(4)). The creditors' scheme of arrangement option was never common and has now been eclipsed by the voluntary administration procedure which is generally regarded as being subject to less formality, delay and expense and greater flexibility of outcome.[21]

Winding up (liquidation)

3.51 Winding up is the process leading to the liquidation of a company and termination of its registration and existence. The purpose of liquidation of an insolvent company is to have an independent and suitably qualified person (the liquidator) take control of the company so that its affairs can be wound up in an orderly and fair way for the benefit of all creditors.

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20 Australian Securities and Investments Commission, *Receivership: A Guide for Creditors*, December 2008.

21 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, p. 130.

3.52 Under Australian law there are three types of winding up—members' voluntary (this can only be used by solvent companies), creditors' voluntary, and compulsory.

Members' voluntary winding up

3.53 As noted above, members' voluntary winding up can only be used by solvent companies. The directors are required to make a declaration to the effect that the company is capable of paying its debts in full within a period of 12 months. The members of the company decide who will be appointed as liquidator and what their remuneration will be, subject to the court's ability, upon an application being made, to review a liquidator's remuneration.

Creditors' voluntary winding up

3.54 Creditors' voluntary winding up is the most common type of liquidation and is used where a company is insolvent. A company may enter a creditors' voluntary winding up where:

- as noted above, creditors vote for liquidation following a voluntary administration or a terminated deed of company arrangement; or
- an insolvent company's shareholders resolve to liquidate the company and appoint a liquidator.

Compulsory winding up

3.55 Compulsory winding up is effected by an order of the court. It most commonly arises where a creditor petitions the court to have a company wound up on grounds of insolvency, relying on failure of the company to comply with a demand for repayment of a debt (section 459A). The liquidator is appointed by the court and is an officer of the court.

Effect of winding up on company officers and creditors

3.56 In any form of winding up, while a company is being wound up a person cannot perform or exercise, and must not purport to perform or exercise, a function or power as an officer of the company (section 471A(1)). Powers with respect to the company and its property vest in the liquidator who may carry on the business of the company so far as is necessary for the beneficial disposal or winding up of the business (section 477). It is important to note that a winding up order does not affect the rights of secured creditors to realise or otherwise deal with the security (section 471C). However, a winding up order can have significant effects on unsecured creditors because legal proceedings may then only be brought against the company with the leave of the court. [22]

Distribution of funds

3.57 After a liquidator has realised the assets of a company, the resulting funds are used to pay creditors. The general rule is that all debts and claims proved in winding up rank equally and, if the property of the company is insufficient to meet them in full, they must be paid proportionally (section 555). However, there are exceptions to this general rule. Firstly, as the winding up order does not affect the rights of secured creditors, the funds available for distribution to other creditors are determined after enforcement of their securities. Generally, the order in which remaining funds are distributed is:

- costs and expenses of the liquidation, including liquidators' fees; then
- outstanding employee wages and superannuation; then
- outstanding employee leave of absence (including annual leave, sick leave—where applicable—and long service leave); then
- employee retrenchment pay; and finally
- unsecured creditors.

3.58 Each category is paid in full before the next category is paid. If there are insufficient funds to pay a category in full, the available funds are paid on a pro rata basis (and the next category or categories will be paid nothing). [23]

3.59 As a liquidator's primary duty is to all of the company's creditors it has generally been held that all shareholders' claims rank behind creditors' claims and therefore shareholders are unlikely to receive any funds in an insolvent liquidation unless they also have a claim as a creditor. However, a decision of the High Court in *Sons of Gwalia v Margaretic*[24] determined that certain compensation claims by shareholders against a company are not subordinated below the claims of other creditors. At the time of writing, the Corporations Amendment (Sons of Gwalia) Bill 2010 is before Parliament and seeks to reverse the effect of the High Court's decision. Therefore, if the bill is passed, it would return the law to a situation where all claims

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22 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, pp 127–130; The Treasury, *Submission 18*, p. 4; and Australian Securities and Investments Commission, *Liquidation: A Guide for Creditors*, December 2008.

23 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, pp 127–130; and Australian Securities and Investments Commission, *Liquidation: A Guide for Creditors*, December 2008.

24 *Sons of Gwalia Ltd v Margaretic* (2007) 232 ALR 232.

against an insolvent company from shareholders would rank equally and be postponed until all other creditors' claims are paid.[25]

Creditors' meetings

3.60 In both types of insolvent winding up, the liquidator is generally not required to call a creditors' meeting unless a matter requires creditor approval. In a compulsory winding up, the only exception is if creditors pass a resolution requiring a creditors' meeting to be called, or at least one-tenth in value of all the creditors request the liquidator in writing to do so. However, it is unusual for this to happen, as those who make the request or pass the resolution must pay the costs of calling and holding the meeting.

3.61 In a creditors' voluntary winding up, the liquidator must hold an annual meeting of creditors or lodge a report with ASIC on the progress in the administration. If they choose not to hold the meeting, the liquidator must tell creditors that the report has been prepared and provide them with a copy if asked. The report must set out:

- an account of the liquidator's acts and dealings and the conduct of the winding up in the preceding year;
- a summary of the tasks yet to be done in the liquidation; and
- an estimate of when the liquidation is expected to be finalised.

3.62 In a creditors' voluntary winding up, the liquidator must also hold a joint meeting of the creditors and members at the end of the winding up. Creditors can require the liquidator to call a creditors' meeting at other times, the same as in a court liquidation, as long as they pay the associated costs.

3.63 In both types of winding up, a meeting may need to be convened by the liquidator to determine their remuneration.

Committees of inspection

3.64 The liquidator may also ask creditors if they wish to appoint a committee of inspection and, if so, who will represent the creditors on the committee. A committee of inspection assists the liquidator, approves fees and, in limited circumstances, approves the use of some of the liquidator's powers, on behalf of all the creditors. Committee meetings can be arranged at short notice, which allows the liquidator to obtain quickly the committee's views on urgent matters. Shareholders may also be members of the committee.

3.65 Creditors in both types of insolvent liquidation can request that the liquidator call separate meetings of shareholders and creditors to decide whether a committee of inspection should be appointed and, if so, who will represent the shareholders and creditors on the committee.

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25 Corporations Amendment (Sons of Gwalia) Bill 2010, *Explanatory Memorandum*, p. 6.

3.66 A committee of inspection acts by a majority in number of its members present at a meeting, but it can only act if a majority of its members attend. A liquidator must consider any directions given by the committee of inspection, but is not bound to follow them. [26]

Creditors' rights

3.67 In addition to rights involving meetings and the distribution of funds discussed above, the other rights of unsecured creditors include the right to:

- receive written reports about the liquidation;
- inspect certain books of the liquidator;
- inform the liquidator about their knowledge of matters relevant to the affairs of the company in liquidation; and
- complain to ASIC about the liquidator's conduct in connection with their duties.

3.68 Creditors can also apply to the court if they are dissatisfied with an act, omission or decision of a liquidator. This includes if a creditor seeks:

- to challenge a liquidator's decision not to admit a proof of debt or claim, either for voting or dividend purposes; and
- a review of the liquidator's fees, in certain circumstances.

3.69 If a company fails to meet its obligations under a charge (e.g. mortgage), a secured creditor can appoint an independent and suitably qualified person (a receiver) to take control of and realise some or all of the charged assets, in order to repay the secured creditor's debt. This right continues after the company goes into liquidation. Receivership is discussed in detail above.

3.70 Another option available to a secured creditor is to ask the liquidator to deal with the secured assets for them and account to them for the proceeds and costs of collecting and selling those assets.

3.71 A secured creditor is entitled to vote at creditors' meetings for the amount the company owes them that exceeds the amount they are likely to receive from realisation of the charged assets. The secured creditor can participate in any distribution of funds to unsecured creditors on a similar basis. [27]

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26 Australian Securities and Investments Commission, *Liquidation: A Guide for Creditors*, December 2008.

27 P. Redmond, *Companies and Securities Law: Commentaries and Materials*, Fifth Edition, Thomson Reuters, Pyrmont, 2009, pp 127–130; The Treasury, *Submission 18*, p. 4; and Australian Securities and Investments Commission, *Liquidation: A Guide for Creditors*, December 2008.

Liquidators' fees

3.72 A liquidator is entitled to be paid for the work carried out on the liquidation, but only if there are assets available. The liquidator cannot be paid until the amount of fees has been approved by one of the methods set out in the Corporations Act.

3.73 In a compulsory winding up, the amount of fees is approved by:

- agreement with a committee of inspection (if there is one); or
- a resolution passed at a creditors' meeting; or
- the court.

3.74 A liquidator must try to get approval by each of these methods, in turn.

3.75 In a creditors' voluntary liquidation, a committee of inspection or creditors may approve the fees.

3.76 If no fees have been approved in a compulsory winding up or a creditors' voluntary winding up, the liquidator may draw fees to a maximum of $5000 where they have called a meeting of creditors but not obtained approval for their fees because the meeting did not have a quorum.

3.77 The court has the power to review the amount of fees approved in a similar way to those of an administrator or receiver (sections 473 and 504).

3.78 If creditors are asked to approve fees either at a meeting of a committee of inspection or in a general meeting of creditors, the liquidator must provide creditors, at the same time as the notice of the meeting, a report that contains sufficient information to assess whether the fees claimed are reasonable. The report should set out:

- a description of the major tasks performed;
- the costs of completing these tasks; and
- such other information that will assist in assessing the reasonableness of the fees claimed.

3.79 Apart from fees, the liquidator will also be entitled to reimbursement for out-of-pocket expenses that have arisen in carrying out the liquidation. This reimbursement does not require committee, creditor or court approval. However, creditors have a right to know what funds were spent on these costs and why they were spent. [28]

28 Australian Securities and Investments Commission, *Liquidation: A Guide for Creditors*, December 2008.

Conclusion of the winding up

3.80 A winding up effectively comes to an end when the liquidator has realised and distributed all the company's available property and made their report to ASIC.

3.81 As noted above, in a creditors' voluntary winding up, the liquidator must hold a final joint meeting of the creditors and members to give an account of how the liquidation has been conducted and how company property has been disposed of. After the final meeting is held, the company is automatically deregistered by ASIC three months after a notice of the holding of the meeting was lodged.

3.82 In a compulsory winding up, the liquidator is not required to hold a final meeting of creditors. After the liquidator decides that the company's affairs are fully wound up, they may:

- seek an order for release from the court;
- seek an order for release and that ASIC deregister the company; or
- if there are insufficient assets to obtain a court order for the company's deregistration, request that ASIC deregister the company.

3.83 A company ceases to exist after it has been deregistered.[29]

Treatment of employees' entitlements

Voluntary administration

3.84 If a voluntary administrator continues to operate the business, they must pay out of the assets available to them ongoing wages for services provided and other employee entitlements that arise after the date of their appointment. These payments are treated as an expense of the voluntary administration.

3.85 The appointment of an administrator does not automatically terminate the employment of the company's employees. As a result, unless the administrator adopts the employment contracts or enters into new contracts of employment with employees, they are not personally liable for any employee entitlements that arise during administration.

3.86 As voluntary administration is an interim form of external administration, employee entitlements that arose prior to voluntary administration are not usually paid during voluntary administration. How and when these employee entitlements are paid depends on the option passed at the second creditors' meeting (i.e. company returned to directors, a deed of company arrangement, or liquidation).

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29 Australian Securities and Investments Commission, *Liquidation: A Guide for Creditors*, December 2008.

Company is returned to directors' control

3.87 If the company is returned to the directors, the directors will be responsible for ensuring that the company pays outstanding entitlements as they fall due. As noted above, it is only in very rare circumstances that creditors will resolve to return the company to the control of its directors.

Deed of company arrangement

3.88 If creditors approve a deed of company arrangement, the priority in which outstanding employee entitlements are paid depends on the terms of the deed. A deed of company arrangement must ensure that employees' entitlements have the same priority as in a liquidation unless the eligible employees agree by a majority in both number and value to vary this priority. This means that unless a variation to priority is agreed to, in a deed of company arrangement employees have the right, if there are funds left over after payment of the fees and expenses of the voluntary administrator and deed administrator, to be paid their outstanding entitlements in priority to other unsecured creditors.

3.89 Priority employee entitlements are grouped into classes and paid in the following order:

- outstanding wages and superannuation; then
- outstanding leave of absence (including annual leave and sick leave, where applicable, and long service leave); and then
- retrenchment pay.

3.90 Each class is paid in full before the next class is paid. If there are insufficient funds to pay a class in full, the available funds are paid on a pro rata basis (and the next class or classes will be paid nothing).

3.91 If a deed proposal seeks to vary the priority for employee entitlements, the administrator must call a meeting of eligible employees giving at least five business days notice of the meeting. They must give to eligible employees at the same time as the notice of meeting a statement setting out:

- their opinion about whether the proposed variation would result in the same or better outcome for employees than if the company went into liquidation;
- their reasons for this opinion; and
- any other information to help them make an informed decision about varying the priority.[30]

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30 Australian Securities and Investments Commission, *Voluntary Administration: A Guide for Employees*, April 2010.

Receivership

3.92 As in a voluntary administration, if a receiver continues to operate the business, they must pay out of the company assets available to them, ongoing employee wages for services provided and other employee entitlements that arise after the date of appointment. These payments are treated as an expense of the receivership.

3.93 The appointment of a receiver and manager does not automatically terminate the employment of the company's employees. As a result, unless the receiver adopts the employment contracts or enters into new contracts of employment with employees, they are not personally liable for any employee entitlements that arise during the receivership.

3.94 If the company's business is sold by the receiver as a going concern, it may be that most, if not all, of the company's employees will keep their jobs. In this case, it is usual for the new owner to take over the company's liability for outstanding employee entitlements.

3.95 If there are insufficient funds to pay all creditors in full, the money from the realisation of assets must be distributed as follows:

- money from the sale of fixed charge assets is paid to the secured creditor after the costs and fees of the receiver in collecting this money have been paid; and
- money from the sale of floating charge assets is paid out as follows:
  - the receiver's costs and fees in collecting this money; then
  - certain priority claims, including employee entitlements (if the liability for these hasn't been transferred to a new owner); and then
  - repayment of the secured creditor's debt.

3.96 In both cases, any funds left over are paid to the company or its external administrator, if one has been appointed.

3.97 If employee entitlements are to be paid by the receiver under a floating charge, the payments must be made in the order outlined in paragraphs 3.88 and 3.89.[31]

Winding up (liquidation)

3.98 In most cases, the winding up of a company terminates the employment of employees.

3.99 Employees have the right, if there are funds left over after payment of the fees and expenses of the liquidator, to be paid their outstanding entitlements in priority to

31 Australian Securities and Investments Commission, *Receivership: A Guide for Employees*, April 2010.

other unsecured creditors. In a similar way to what occurs under voluntary administration and receivership, priority employee entitlements are grouped into classes and paid in the order outlined in paragraphs 3.88 and 3.89.

3.100 Employees may also be entitled to make a claim against the General Employee Entitlements and Redundancy Scheme (GEERS). GEERS is administered by the Department of Education, Employment and Workplace Relations. It is a basic payment scheme designed to assist employees whose employment has been terminated due to the liquidation or bankruptcy of their employer.

3.101 If the liquidator continues to operate the business for a short period to help in the winding up, employee entitlements accruing during this period (on terms agreed with the liquidator) are paid out of available assets as a cost of the winding up and before other outstanding employee entitlements.

3.102 If a committee of inspection is formed employees can nominate a representative to be on this committee and have a say in matters that may impact on their interests. As noted above, a committee of inspection is formed to assist the liquidator, approve their fees and, in limited circumstances, approve the use of some of their powers. [32]

Duties and responsibilities of a liquidator and the 'fit and proper' provisions of the Corporations Act

3.103 In the winding up of a company a liquidator owes fiduciary duties to the company, its creditors and members. In addition to these fiduciary duties, liquidators owe other more specific duties as outlined in the Corporations Act and in case law.

Fiduciary duties

3.104 Relevant statute and case law stipulates that, as a fiduciary, liquidators must:

- act honestly.
- avoid conflicts of interest—that is, a liquidator must not permit their personal interests to conflict with those to whom a duty is owed. This obligation applies in a number of ways. For example, a liquidator must not profit from their position, either directly or indirectly, except by way of remuneration for work done (section 182). Furthermore, a liquidator is not at liberty to make contracts with the company.
- act impartially—that is, a liquidator must not favour anyone and must not act as the agent of any group.

32 Australian Securities and Investments Commission, *Liquidation: A Guide for Employees*, January 2008.

Duties of care and skill

3.105 As professionals, high standards are required of liquidators in the carrying out of their tasks. For example, a liquidator should complete the administration of a company within a reasonable time and without protracting the liquidation where there is no reason to do so. A liquidator may be in breach of duty if they do not seek the advice of professionals in areas in which they are not qualified, for example, a solicitor in respect of a legal issues or a valuer regarding the value of property.

3.106 A liquidator is required to act with a reasonable degree of care and skill and liquidators can be liable at common law for failure to exercise due care and skill in performing their duties. Furthermore, as an officer of the company, a liquidator can be liable under section 180, which requires liquidators (and other officers) to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:

- were a director or officer of a corporation in the corporation's circumstances; and
- occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

Other duties

3.107 Other duties owed by liquidators include:

- a duty to exercise discretion—that is, while liquidators are entitled to seek advice and appoint agents, they must not delegate the exercise of their professional judgment and discretion;
- a duty not to make improper use of inside information to gain an advantage (section 183);
- a duty to ascertain and take possession of assets;
- a duty to preserve assets;
- a duty to realise assets;
- a duty to lodge a notice of appointment with ASIC and to register for GST;
- a duty to keep records and accounts;
- a duty to report and investigate;
- a duty to settle list of contributories; and
- a duty to ascertain liabilities.[33]

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33 M. Murray, *Keay's Insolvency: Personal and Corporate Law and Practice*, Sixth Edition, Lawbook Co., Pyrmont, 2008, pp 258–262.

The 'fit and proper' provisions in the Corporations Act

3.108 As highlighted above, high standards are required of liquidators in the carrying out of their tasks. Section 1282(2) stipulates that applicants for registration as liquidators will satisfy minimum educational and experience criteria and demonstrate that they are capable of properly performing the duties and functions of a liquidator. In addition to these requirements, ASIC must be satisfied that the applicant 'is otherwise a fit and proper person'.

3.109 Mr Jeffrey Fitzpatrick, Dr Vivienne Brand and Associate Professor Christopher Symes suggest that:

> The fit and proper person requirement aims to ensure that the general community can have confidence that those seeking registration and those currently holding registration as liquidators possess 'sufficient moral integrity and rectitude of character' as to permit them to be entrusted with significant financial responsibility and personal discretionary power. Public trust in the reliability of liquidators is paramount to maintaining market confidence in company operations in Australia.[34]

3.110 Currently, 'fit and proper person' is not defined in the Corporations Act. In *Hughes and Vale Pty Ltd v State of NSW (No 2)* Chief Justice Dixon and Justices McTiernan and Webb stated that the purpose of the fit and proper person test was 'to give the widest scope for judgment and indeed for rejection...it would be unwise to attempt any definition of the matters which may legitimately be inquired into; each case must depend upon its own circumstances'. ASIC's interpretation of 'fit and proper' is consistent with this judgment.[35]

Initial application for registration

3.111 ASIC's Regulatory Guide 186, specifies that for the purposes of section 1282(2) an applicant for registration as a liquidator is 'otherwise a fit and proper person' if ASIC is satisfied that an applicant has honesty, integrity, good reputation and personal solvency—as well as, an overall capability to perform the duties and functions of a liquidator. ASIC considers applicants in view of:

- the fiduciary nature of a liquidator's duties and function;
- the fact that liquidators often have control of very large amounts of money, other property, financial facilities and financial obligations that belong to third parties;
- the need for a liquidator's words and actions to be regarded with complete trust by persons who deal with them;

34 Mr Jeffrey Fitzpatrick, Dr Vivienne Brand and Dr Christopher Symes, *Submission 6*, p. 2.

35 Mr Jeffrey Fitzpatrick, Dr Vivienne Brand and Dr Christopher Symes, *Submission 6*, pp 3–4.

- any criminal records, disqualification order, or pending legal or disciplinary action;
- referees' opinions;
- residency status; and
- if the applicant is a registered trustee, their record and reputation in that role.

3.112 Mr Fitzpatrick, Dr Brand and Associate Professor Symes suggest that:

> Applicants, by their professional conduct, must continually demonstrate that they can maintain the standards expected of their profession. Factors such as timeliness, truthfulness and personal integrity when dealing with clients and professional bodies demonstrate whether an individual applicant possesses the relevant attributes to be a liquidator.[36]

3.113 ASIC considers an applicant is not a fit and proper person to be registered as a liquidator if:

- in the last ten years, the applicant has been convicted of an offence of which one element was dishonesty; or
- the applicant has been found civilly liable for any breach of trust, breach of fiduciary duty, dishonesty, gross negligence or recklessness in the course of their professional duties; or
- the applicant has been convicted of a serious tax offence; or
- the applicant is personally insolvent; or
- the applicant is disqualified from managing a corporation; or
- the applicant cannot satisfy ASIC that they have full mental capacity.

3.114 ASIC also regards favourably current membership of a body—such as the Institute of Chartered Accountants, CPA Australia or the Insolvency Practitioners Association of Australia—that monitors the professional performance of its members and has disciplinary functions because such bodies usually require their members to be fit and proper persons.

Ongoing registration

3.115 In addition to the initial registration provisions, to remain registered with ASIC as a liquidator they must continually perform adequately and properly the duties and functions of a liquidator and remain a fit and proper person. Section 1292(2) provides that ASIC may apply to the Companies Auditors and Liquidators Disciplinary Board (CALDB) to cancel or suspend a liquidator's registration if they are 'otherwise not a fit and proper person to remain registered as a liquidator'.

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36 Mr Jeffrey Fitzpatrick, Dr Vivienne Brand and Dr Christopher Symes, *Submission 6*, p. 5.

3.116 To perform adequately and properly the duties and functions of a registered liquidator means that the liquidator must comply with all the obligations applicable to them in their capacity as a liquidator. As noted above, these obligations include general legal requirements to exercise reasonable care, competence and skill, and to perform all liquidator duties with the highest standards of honesty and integrity and the statutory duties of company officers, including discharging duties with care and diligence and good faith.[37]

3.117 The 'fit and proper' provisions are discussed in chapter 7.

37 Mr Jeffrey Fitzpatrick, Dr Vivienne Brand and Dr Christopher Symes, *Submission 6*, pp 5–10.

Chapter 4

The role of the regulator, disciplinary body and industry representative: ASIC, the CALDB and the IPAA

4.1 This chapter briefly outlines the intended role of the main agencies overseeing the insolvency industry in Australia. Subsequent chapters critique the way in which these agencies have performed their roles.

Australian Securities and Investments Commission

4.2 The Australian Securities and Investments Commission (ASIC) is the main regulator for insolvency practitioners and stands above what it calls other 'gatekeepers':

> Our oversight role in this industry is really complemented by the roles of others, loosely called gatekeepers, to protect creditors. You have, of course, the professional associations such as the IPA, and the objective certainly seems to be that insolvency be administered as a profession—like accountants, auditors and lawyers. ASIC has worked with the IPA on the development of its code of professional practice, and ASIC supports IPA's work in improving standards. You also have the courts: court-appointed liquidators play an important supervisory role. You have creditor committees that are elected for certain insolvencies. They play an oversight role in providing advice and approving remuneration. You also have creditors themselves, who play a pivotal role in appointing administrators and maintaining the administration process.[1]

4.3 ASIC describes its oversight responsibilities as including:

- administering the registration of liquidators to ensure that applicants meet the minimum entry-level statutory criteria;
- encouraging compliance with the law by working to improve guidance to insolvency practitioners regarding ASIC's expectations within the legal and regulatory framework in which they operate;
- monitoring the compliance of insolvency practitioners with the regulatory regime, through monitoring and acting on complaints and undertaking reviews of registered liquidators and their conduct;
- taking enforcement action where it appears there has been misconduct; and

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1 Mr Tony D'Aloisio, Chair, ASIC, *Committee Hansard*, 12 March 2010, p. 2.

- educating, informing and assisting stakeholders to ensure that they are properly informed about insolvency laws and processes and their rights and obligations.[2]

4.4 ASIC describes a relatively minimalist regulatory approach:

> The economic philosophy underlying the Australian regulatory regime is that markets drive efficiency and that markets operate most efficiently when there is a minimum of regulatory intervention. This philosophy can loosely be called 'efficient markets theory'.[3]

Insolvent trading and ASIC's role

4.5 A company is insolvent if it is unable to pay all of its debts when they fall due. Section 588G of the *Corporations Act 2001* states that a director has a positive duty to prevent insolvent trading. A debt must not be incurred if the company is already insolvent at the time the debt is incurred or if by incurring a debt the company becomes insolvent.[4]

4.6 One of ASIC's key responsibilities is to prevent insolvent trading: it can take a director to court on a claim that he or she has traded insolvent. A registered liquidator or creditor of a company may also bring proceedings against a director to recover compensation for loss resulting from insolvent trading.

4.7 In July 2010, ASIC published a regulatory guide to help directors understand and comply with their duty to prevent insolvent trading. The guide noted that directors should actively monitor the solvency of the company, investigate financial difficulties, obtain advice from an appropriately qualified person where necessary, and consider and act appropriately on that advice.[5]

4.8 The committee notes that the number of 'windings up' will depend to some extent on the way in which directors of a company exercise corporate responsibility. This, in turn, will depend on the adequacy of structures to encourage this responsibility and deter companies from becoming insolvent. Mr D'Aloisio was asked for his opinion as to whether the current framework was adequate to promote corporate responsibility and prevent insolvencies. He responded:

> …in our system there will be corporate failures. The risk and reward equation is that from to time to time there will be failures. What tends to happen is that, at the smaller end of the market, there are more failures

2 ASIC, *Submission 69*, pp 8-17.

3 ASIC, *Submission 69*, p. 19.

4 ASIC, *Regulatory guide 217: Duty to prevent insolvent trading*, July 2010, p. 6, http://www.asic.gov.au/ASIC/asic.nsf/byHeadline/10-164AD%20ASIC%20releases%20guidance%20on%20a%20director%E2%80%99s%20duty%20to%20prevent%20insolvent%20trading?opendocument (accessed 27 July 2010).

5 ASIC, *Regulatory guide 217: Duty to prevent insolvent trading*, July 2010, p. 9.

> because the risk taking, cash flow management and so on for those companies probably is not as strong as it is with the large companies. I think overall the system is working well.[6]

Companies Auditors and Liquidators Disciplinary Board

4.9 The role of the Companies Auditors and Liquidators Disciplinary Board (CALDB) is to determine the appropriate disciplinary action once ASIC has identified some wrongdoing:

> Our purpose is basically the protection of the public interest in relation to the disciplinary function over auditors and liquidators…We have no investigative powers ourselves. Cases are referred to us either by ASIC under the act or by APRA. In dealing with those cases and making our orders we are totally reliant on evidence presented to the board and on the expertise of members of the panel.[7]

4.10 The Chair of the CALDB described the Board's role as being:

> …to protect the public interest by ensuring that the regulatory system for disciplining members of the auditing and liquidating professions who fail to perform their professional duty adequately are appropriately dealt with.
>
> Firstly, so that the particular person concerned is properly dealt with and deterred from engaging in further conduct of the same or similar nature.
>
> Secondly, so that the other members of the profession can see that that particular conduct has led to that particular result…deterring them from engaging in the same or similar conduct.
>
> Thirdly, to reassure the public that the regulatory system is there and that it is working effectively…so that the public can have confidence in the services provided by auditors and by liquidators...[8]

4.11 After receiving an application from ASIC (or the Australian Prudential Regulatory Authority) the CALDB panel organises a pre-hearing conference (usually by teleconference) to allow the issues under dispute to be refined and agreed upon by the two parties, and a hearing date is set.[9] The evidence is then gathered, with the parties exchanging documents so that the hearing can be as efficient as possible. The process leading up to the hearing itself generally takes around six months to complete.[10]

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6 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, pp. 18–19.

7 Mr Donald Magarey, Chairman, CALDB, *Committee Hansard*, 13 April 2010, p. 2.

8 Mr Donald Magarey, Chairman, CALDB, *Committee Hansard*, 13 April 2010, p. 6.

9 *CALDB Manual of Practice and Procedure: Conduct matters*, pp 7-10. Available at http://www.caldb.gov.au/CALDB/CALDBWeb.nsf/byheadline/Procedures?opendocument

10 Mr Donald Magarey, Chairman, CALDB, *Committee Hansard*, 13 April 2010, p. 4

4.12 The hearing can take 2–3 weeks, after which the panel gives its determination. If the determination is against the respondent, a final, short hearing is held to determine what order the board should make. The whole process should generally be completed within 12 months.[11] If the respondent is unhappy with the decision, they can refer their case to the Administrative Appeals Tribunal to be reviewed. It can subsequently be referred to the Federal Court of Australia.[12]

Insolvency Practitioners Association of Australia

4.13 The Insolvency Practitioners Association of Australia (IPAA) is the peak membership body for the industry. It has over 1700 members including over 500 registered liquidators and 185 bankruptcy trustees.[13] This represents 85 per cent of registered liquidators and bankruptcy trustees in Australia as of December 2009.[14] Membership is voluntary, and the IPAA is not involved in the registration of liquidators in Australia. All IPAA members are affiliated with either:

- the Institute of Chartered Accountants in Australia;
- CPA Australia; or
- the Law Societies in each state.

4.14 The IPAA's regulatory role has three elements:

- the setting of standards (guides and codes);
- the delivery of education through member training programmes; and
- the disciplining of members who are proven to have breached IPAA standards.[15]

4.15 The IPAA's Code of Professional Practice states principles of conduct and gives detailed practice guidance, in many cases setting a standard above the legal requirements. The IPAA also offers guidance to its members on the law and practice of insolvency, through telephone and email guidance, web and journal notifications, and training and conference sessions.[16]

4.16 The IPAA has no formal investigative powers. If investigations by other bodies establish that a member has breached the law, or professional codes of conduct, the IPAA's primary sanction is to remove the member's IPAA membership.[17]

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11 Mr Donald Magarey, Chairman, CALDB, *Committee Hansard*, 13 April 2010, p. 4

12 *CALDB Manual of Practice and Procedure: Conduct matters*, p. 18.

13 IPAA, *Submission 36*, pp 27-28.

14 IPAA, *Submission 36*, p. 28.

15 IPAA website, *Regulating our Members*, http://www.ipaa.com.au/default.asp?menuid=169 (accessed 17 June 2010).

16 IPAA, *Submission 36*, pp 15-16.

17 IPAA, *Submission 36*, p. 28.

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.[1]

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.[2]

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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.[3]

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.[4]

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.[5] 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.[6] 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.[7]

5.11 Mr Wood told the committee that 'Carlovers, Bill Doherty and a group of us…got together' and approached journalist Adele Ferguson.[8] In October 2007, Ms Ferguson wrote an article in the *Weekend Australian* on Mr Ariff's handling of the CarLovers Australia insolvency.[9] 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.[10]

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.[11]

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'.[12]

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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.[13] 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'.[14]

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'.[15]

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'.[16]

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.[17]

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.[18]

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.[19]

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.[20]

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.[21]

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

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.[22]

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.[23]

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. [24]

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.[25]

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.[26]

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.[27]

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

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.

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

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.[29]

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.[30]

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.[31]

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.[32]

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.[33]
>
> …
>
> 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.[34]

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.

113 000 insolvency appointments from 2000–2009, only 14 practitioners had their registration cancelled and only 13 were suspended.[35]

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.[36]

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'.[37]

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.[38]

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.[39]

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.[40]

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.[41]

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.[42]

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.[43]

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

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'.[44]

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.[45]

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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> …
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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.[46]

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.[47]
>
> …
>
> 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.[48]

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.[49]

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.[50]

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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.

Chapter 6

The evidence of regulatory failure and the need for a more proactive approach

> *Insolvency professionals are more likely to act opportunistically and in their self-interest to the detriment of third parties when the regulatory framework settings are weak...When ASIC cannot or will not act against the repeated misdemeanours of major accounting and insolvency firms…do not be surprised if a culture of fearlessness spreads throughout the industry and gambles are taken on white collar crime.*[1]

Identifying regulatory failure

6.1 The previous chapter noted the range of stakeholders' views on the current state of the insolvency industry in Australia. Some submitters claimed the 'bad apples' were cases of the regulator identifying and acting on misconduct in an otherwise well performing industry. Many other submitters argued that the 'bad apples' reflected a deeper malaise in the industry, not only in the practices of insolvency practitioners but in the regulatory framework to monitor their conduct.

6.2 Insolvency practitioners are over represented in complaints made to the Australian Securities and Investments Commission (ASIC). ASIC's submission notes that between July 2006 and December 2009, it received a total of 45 162 complaints and inquiries: 1647 or 3.6 per cent of these were against insolvency practitioners (see chapter 2). By comparison, the number of insolvency firms (662) as a proportion of the companies that ASIC regulates economy-wide (1.7 million) is extremely small.

6.3 It is difficult to quantify the extent of misconduct in the insolvency industry beyond what ASIC's outcomes and the Companies Auditors and Disciplinary Board's (CALDB) findings would indicate. However, the number of complaints against insolvency practitioners is significant compared with the small number of findings against administrators and liquidators. As one submitter noted:

> …a review of recent statistics on the number of liquidators under investigation by ASIC suggests the current supervision regime may bring to light fewer transgressions than might be expected given the number of active liquidators in Australia and the complexity of many liquidations. The most recent Annual Report of the CALDB indicates only one uncompleted and one new conduct matter for the report year. ASIC's Insolvency Update

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

> of March 2008 identified only nine liquidators subject to disciplinary action, out of a total pool of 1146 registered liquidators.[2]

6.4 The committee recognises these statistics are a fairly crude indicator of regulatory failure. One could reasonably contrast the number of insolvency appointments with the number of cancelled and suspended registrations—as the Insolvency Practitioners Association of Australia (IPAA) has done—and reach a conclusion that the industry is performing well.[3]

6.5 Nonetheless, the evidence gathered by this committee over the past six months strongly suggests that there have been significantly more transgressions by insolvency practitioners than those identified by ASIC and prosecuted by the CALDB. In this context, this chapter draws attention to the deficiencies of these agencies in regulating the insolvency industry and offers a course for reform.

Criticism of ASIC's role

6.6 A central theme of this inquiry has been the criticism of the role of ASIC as the principal regulator of the insolvency industry in Australia. There are four areas of concern:

- ASIC's reliance on complaints instead of proactive profiling of the insolvency industry (paragraphs 6.7–6.14);
- ASIC's slowness in responding to complaints, particularly in the those cases where significant wrongdoing has been subsequently found (paragraphs 6.15–6.26);
- whether ASIC provides adequate information and guidance for the various stakeholders in the insolvency industry (paragraphs 6.27–6.29); and
- whether ASIC is adequately resourced to monitor the insolvency industry (paragraphs 6.30–6.33).

ASIC's reactive, complaints-based approach

6.7 The first criticism of ASIC in its monitoring of the insolvency industry is that its regulatory mindset and approach is overly reactive. Instead of conducting its own surveillance of the practices of liquidators and administrators, ASIC relies on a complaints-based approach which reacts to existing problems rather than deterring future misconduct.

6.8 The committee heard from insolvency law academics based in Adelaide that the approach to regulating the insolvency profession in Australia is reactive. Dr Vivienne Brand of Flinders University contrasted ASIC's *modus operandi* with that

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2 Dr Vivienne Brand, Associate Professor Christopher Symes and Mr Jeffrey Fitzpatrick, *Submission 6*, p. 12.

3 See paragraph 5.42.

of the United Kingdom's insolvency regulator. Based on the official statistics, she noted that the UK regulator gets a far higher strike rate on identification of misdemeanours from investigations initiated on a profiling basis than on the number of misdemeanours identified from complaints. Dr Brand told the committee that 'complaints do not seem to be a particularly effective way of identifying problems'.[4]

6.9 Dr Brand reasoned that the complaints based process is quite limited given that creditors often do not have a lot of expertise. Creditors may not know when misconduct is occurring or, conversely, they may think it is occurring when it is not. Accordingly, Dr Brand argued that it is 'particularly important to have a very active regulator' and that the seeming lack of ongoing active review of liquidators is 'concerning'.[5]

6.10 In this context, Dr Brand drew the committee's attention to the usefulness of profiling. She noted that the Legal Practitioners Conduct Board in South Australia has done profiling of its profession and found that those most likely to offend are middle aged, have been in practice for some time, and have pressures of home life and career. Dr Brand told the committee that this type of profiling could also have useful application in the insolvency context.[6]

6.11 In similar vein, the IPAA strongly advocated in its submission the implementation of a proactive annual review process of all practitioners through a certain number of randomly selected files. Mr Mark Robinson, President of the IPAA, argued that this type of review:

> …will give a better sense of how a particular practice is running and also a sense of what the industry wide issues are. I think a proactive regular review process with a wide scope may well uncover problems before they escalate.[7]

ASIC's view

6.12 ASIC noted in its evidence to the committee that its investigative work in the insolvency area combines active surveillance activity developed through close consultation with the profession with the information it receives from complaints. ASIC Commissioner Mr Michael Dwyer told the committee that:

> The selection of firms we choose to surveil is based around, firstly, our understanding of the industry which we maintain through close liaison with the profession and with other professional bodies. That allows us to understand what is happening within the profession. Obviously from that information and depending on other information we collect through our

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

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

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

7 Mr Mark Robinson, *Committee Hansard*, 12 March 2010, p. 41.

> complaints area, we then determine which firms we think may have issues which require further surveillance. We narrow down what potentially would be bad apples and may focus more on some of those programs or some of those firms. We select different sized firms— and we understand that processes in perhaps some of the larger firms allow them to have better quality control—and we take that into account and the other issues I have mentioned in determining which firms we surveil.[8]

6.13 Mr Stefan Dopking of ASIC similarly told the committee that ASIC's investigation processes combine an analysis of industry data with the evidence it receives from complaints. He explained:

> In selecting the industry, we do have a good selection of data available within our systems that will help us to identify the size and the volume of jobs that a practitioner might have. So, once that reaches a certain level, it tells a certain message. Within each of those jobs we are told the age of the jobs, and documentation is lodged which we can review once we trigger that. We also have complaints that we receive. Through the liaison structure we do have whispers, and so we also have quite extensive experience within our own staff.[9]

6.14 The committee draws attention to the following comments from ASIC's Chairman, Mr Tony D'Aloisio, which seem to indicate the rather passive approach the regulator takes to insolvency matters. In giving an overview of the regulator's work in the insolvency area, the Chairman's first observation emphasised the role of others:

> [T]he legislative framework that we working under, like the rest of the Corporations Act, is essentially self executing. Basically it is up to the people who are affected by the laws to comply with them. ASIC's role is oversight and its regulatory functions are set out in the act. Our oversight role in this industry is really complemented by the roles of others, loosely called gatekeepers, to protect creditors.[10]

ASIC's unresponsiveness to complaints

6.15 A second criticism of ASIC, and a significant theme of this inquiry, has been the unresponsiveness of the regulator to the complaints it receives about the conduct of a liquidator or administrator. The committee received many submissions noting that their complaint to ASIC about the conduct of an insolvency practitioner was either not answered, answered months later, or simply filed on a database with no subsequent action. The following excerpt, in a submission from Mr Stephen Koci, gives a good sense of this inertia:

> …I wrote to ASIC about the above company and the administrator on the 7th May 2009 [and] I wrote again on the 28th May 2009 as I had not heard

8 Mr Michael Dwyer, *Committee Hansard*, 12 March 2010, p. 6.

9 Mr Stefan Dopking, *Committee Hansard*, 12 March 2010, p. 7.

10 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, p. 2.

> anything from ASIC not even receipt of my letter. I then rang ASIC on the 5th June 2009…and ASIC could…find no reference to my letter…then when they rang me back they still could…find no reference to my letter and suggested I fax the letter…
>
> I did and then I got another call from ASIC to state…they actually did have my letter…and that it was being referred to the Melbourne office and would be done urgently. I wrote to ASIC again on the 11th June 2009, 16th June 2009 and on the 25th June 2009, 4th July 2009 and the 23rd July 2009 to state my ongoing anger at ASIC and there [sic] shockingly slow response to this urgent matter…
>
> [F]inally I received a letter dated the 29th July 2009 from Tony D'Aloisio the Chairman of ASIC, that letter took ASIC over 2 months to send from my initial complaint and all it said was basically ASIC was going to take no action and just told me information that I knew and was on the public record. Basically…ASIC just brushed my concerns away and while they took their time the administrator was destroying the company.[11]

6.16 Mr Stephen McNamara, a director of a small law firm acting for directors and guarantors of companies in liquidation, was also critical of ASIC's unresponsiveness. He told the committee that in his experience:

> …the only avenue that seems to be available to directors and guarantors et cetera at the moment is to go to ASIC. But ASIC is generally too slow and does not get on top of the problem quickly enough. As I said, these people have usually been seriously affected, their lives are under serious stress and they need something to happen quickly—and that just does not occur.[12]

6.17 Mr Duncan Ross expressed similar frustration at ASIC's lack of system and response to his complaint. He explained in his submission that in late 2008, he lodged a complaint with ASIC about an insolvency practitioner and, having heard nothing 'for some weeks', contacted ASIC by phone. ASIC advised that Mr Ross' complaint had been 'lost in the system' and asked him to relodge it.[13]

6.18 Mr Ross then provided ASIC with several documents relating to his complaint but was advised that the regulator would not act any further. ASIC gave no reasons why it would not investigate. Mr Ross elaborated:

> General comments from speaking with a number of ASIC staff over a period of some months gave me the impression that they were very selective about choosing their battles. This appears to me to be more about taking public scalps rather than enforcing the law.[14]

6.19 Mr Doherty described his experience with ASIC as follows:

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11 Mr Steven Koci, *Submission 85*, pp. 2–3.

12 Mr Stephen McNamara, *Committee Hansard*, 9 April 2010, p. 36.

13 Mr Duncan Ross, *Submission 41*, p. 2.

14 Mr Duncan Ross, *Submission 41*, p. 3.

> If you make a complaint against ASIC you get on their website and fill in a complaint form and hope for the best. I did that three times. Nothing really happened except that I was going to get added to their database again and again. Most of the others also had the same experience. About six months after ASIC launched their court action I thought to myself, 'I will just see how this system works', so I put in another electronic complaint. Do you know what I got back? 'Thank you for your correspondence of 1 May 2009. The issues you have raised will receive careful consideration and ASIC will contact you again in due course.' At least two companies that I am aware of have been told outright by ASIC that ASIC was simply not resourced to handle complaints less than $10 million. That does not really augur too well for the 99 per cent of the 1.7 million corporations in Australia that they are charged to protect, does it?[15]

6.20 Mr Greg Nash, appearing before the committee in a private capacity, speculated on the reasons why ASIC has been unable to respond to complaints in a timely manner. He told the committee:

> I can only presume that it is either underresourced or negligent, because there are so many complaints and so little action; it can only be saying, 'We can't be bothered', or, 'We are not going to do it for other reasons' which are inappropriate, or, 'We have not got the people to do the investigation.' As I said, the difficulty with white-collar crime is that a lot of it is to do with opinion. A lot of it is to do with accounting and it is fairly resource heavy.[16]

The lack of regulatory response to the Ariff case

6.21 The regulator's lack of responsiveness is most damning in the Ariff case. The committee queries why both ASIC and the IPAA took so long to identify Mr Ariff as a practitioner that should be investigated. As chapter 5 noted, these agencies received numerous complaints on the matter from several parties, including:

- Mr Bernard Wood, who complained to ASIC twice in early 2005;
- Carlovers, which complained to ASIC three times between 2005 and 2007;
- the Armidale Dumaresq Council, which received acknowledgement of a complaint related to the YCW League Club, but has not heard from ASIC since;[17]
- Mr Ron Williams, who lodged a complaint but was told by ASIC to refer the matter to the Office of Fair Trading or get legal advice; and
- Mr Bill Doherty, who complained to ASIC on three occasions and to the IPAA, CPA and ICAA 'more than 50 times'.[18]

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

16 Mr Greg Nash, *Committee Hansard*, 14 April 2010, p. 6.

17 Councillor Edward Maher, *Committee Hansard*, 14 April 2010, p. 77.

6.22 The IPAA told the committee that following Mr Doherty's complaint in 2006, it wrote to Mr Ariff to seek his response which, at the time, the Association accepted as 'appropriate'. It eventually referred the matter to ASIC for investigation, but only after several subsequent complaints—'more than 10 maybe'.[19] Still, the IPAA rejected suggestions that the complaints were to no avail: 'Mr Ariff has been struck off, he has been banned for life, so it was to some avail'.[20]

6.23 Chapter 5 noted that media publicity prompted ASIC's eventual action in the Ariff matter.[21] In evidence to the committee, Mr Doherty lamented that the regulator only becomes involved 'once it is on the front page'[22] and were it not for the media, Mr Ariff 'would still be playing'.[23] Mr Ron Williams of the Adamstown Rosebud Sports Club expressed the same view.[24] Carlovers described ASIC's eventual response as 'too slow, too little, too late'.[25]

Small businesses

6.24 Some submitters noted that ASIC and government agencies tend not to be concerned with the insolvency complaints of small businesses. As Mr Doherty argued in his submission: 'It is of concern when the peak (and only) regulator expresses to a complainant that they are not funded to deal with difficulties of value less than $10 million'.[26] Mr Ron Williams presumed that the Department of Fair Trading did not take action in his case because the Club is too small and the amount of money missing or stolen too insignificant.[27] Mr Ian Fong of Carlovers also identified a problem with ASIC responding to small business complaints. He told the committee that ASIC should either be better resourced or there should be another division within ASIC to deal with problems of small to medium sized businesses.[28]

18 Mr Bill Doherty, *Submission 9*, p. 1.

19 Ms Denise North, *Committee Hansard*, 12 March 2010, p. 42.

20 Ms Denise North, *Committee Hansard*, 23 June 2010, p. 13.

21 See also Jeffrey Fitzpatrick, Christopher Symes and Vivienne Brand, *Submission 6*, p. 12.

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

23 Mr Bill Doherty, *Committee Hansard*, 14 April 2010, p. 10.

24 Mr Ron Williams, *Committee Hansard*, 14 April 2010, p. 28.

25 Carlovers Limited, *Submission 26*, p. 2.

26 Mr Bill Doherty, *Submission 9*, p. 5.

27 Mr Ron Williams, *Committee Hansard*, 14 April 2010, p. 32.

28 Mr Ian Fong, *Committee Hansard*, 14 April 2010, pp. 45–46.

ASIC's view

6.25 ASIC's Chairman has recognised that the complaints handling process generally is an area that ASIC needs to improve. He also accepted that it took too long to respond to the McVeigh and Ariff cases.[29] Mr D'Aloisio told the committee:

> …when we look at this industry overall we think that improvements are needed, as is clearly evidenced by our work in progress and the forward program…But we do not have evidence of systemic failure or widespread abuse. In saying that, we are not in any way taking away from those who have suffered where there has been misbehaviour. We need to also, I guess, bear in mind that creditors are upset when money is potentially lost and do not readily appreciate the value of money going to a liquidator as fees rather than as dividends to them. All in all, we do not feel there is widespread abuse or systemic failure, but we certainly feel that there is a need to make improvements…One piece of evidence that helped support our view is our complaints handling…In the 3½ years from July 2006 to December 2009 there were some 47,085 insolvency appointments. We received 1,647 complaints or 3.6 per cent on practitioner misconduct…We are not suggesting that this evidence is conclusive and that everything is all right; we are simply saying that there is a need to improve and our forward program and our current work is aimed in that direction.[30]

6.26 In its submission to this inquiry, ASIC noted a number of new initiatives it is conducting to improve its complaints handling process. In particular, ASIC's forward program includes the continuing upgrade of its online portal including the online complaints facility on ASIC's website.[31]

Lack of communication with creditors

6.27 A third and related area of concern with ASIC's (and the IPAA's) role in insolvency matters is the lack of communication between the regulator and creditors. The committee received evidence that creditor education has been a neglected area.

6.28 In their submission, Carlovers Carwash (see chapter 5) recommended that the government pass laws to force insolvency practitioners and their industry bodies to educate the public about the administration process and their rights and obligations. It argued that this information should be accompanied by clear and adequate warnings. Mr Ian Fong, representing the company, explained to the committee that this information need only be:

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29 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, p. 15.

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

31 ASIC, *Submission 69*, p. 16.

> …a simple sheet where, No. 1, you say creditors have a right to terminate the appointment of an administrator by a majority vote. That would be good. It is just what you can do to protect your rights.[32]

6.29 Mr Nicholas Bishop argued in his submission to this inquiry that there needs to be much better publicly available information about creditors' rights. He noted that it is not feasible in many cases for creditors to obtain professional advice, because of cost, and most creditors will be unfamiliar with the process. Mr Bishop identified the need to publicise and clearly explain the following issues:

- it is possible for creditors to vote to replace the administrator at the point of voting to go into a Deed of Company Arrangement (at the second creditors' meeting);
- it is possible for an administrator to seek an extension of time for the second creditors' meeting from the Supreme Court;
- the meaning of a Deed of Company Arrangement and what is permissible and prohibited;
- the priorities in Schedule 8A of the Corporations Act need to be stated in simpler language; and
- the possibility that during a Voluntary Administration, a major creditor could put the company into receivership.[33]

Is ASIC under resourced?

6.30 The fourth criticism made of ASIC during this inquiry is that it is under-resourced to perform the job it is required to do in the insolvency area. At its first public hearing for this inquiry, the committee asked ASIC's Chairman whether the regulator has the resources to meet its responsibilities in insolvency. Mr D'Aloisio gave the following response:

> In relation to resources, at a broad level, clearly, we have a program and we are implementing the program across a range of areas and, as I have said on other occasions, we are resourced to do what we are doing. That applies to this area as well.[34]

6.31 Mr D'Aloisio explained to the committee that ASIC had increased the resources devoted to insolvency matters over the past few years. The catalyst for this increase was the 2007 legislation, which was followed by ASIC's 2007–2008 strategic review. In that review:

> …insolvency or liquidation was identified as a key area of focus, particularly as we were then planning on the basis that at some point there

32 Mr Ian Fong, *Committee Hansard*, 14 April 2010, p. 45.

33 Mr Nicholas Bishop, *Submission 74*, p. 5.

34 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, p. 16.

> would be a downturn—which, of course, would lead to a greater number of insolvencies. That led ASIC to recommend that a dedicated commissioner be appointed, and subsequently the government appointed Commissioner Dwyer. It led to the IPL—the Insolvency Practitioners and Liquidators, a dedicated team of some 30 full-time equivalents…and it led to additional resources from other areas, such as in misconduct and breach reporting; the office of Chief Legal Officer and deterrence teams were directed to assist.[35]

6.32 Although stating that ASIC is not under resourced, the Chairman admitted that he was unsure as to whether ASIC's slow response times could be attributed to the regulator simply not acting or whether it indeed lacked the resources to do so. On this matter, he told the committee:

> I am not in a position to give you a concluded view on that at the moment. The position we took when we did the strategic review of ASIC and put addition resources in this area and, as you can see, from the forward program, is that we should be doing more. We are doing more and trying to be quicker with the deterrence mechanisms. I am not in a position to make a judgment at the moment as to whether the regulatory system itself needs further overhaul; I am just not sure. I think we need to do a lot more work ourselves in enforcing the existing law.[36]

6.33 Mr Doherty argued that there is a disconnect between Mr D'Aloisio's statement that ASIC is adequately resourced and its lack of responsiveness to complaints about insolvency practitioners. He interpreted this incongruence as:

> …simply an admission that he does not have a clue what is expected by the public of ASIC. What did ASIC actually do in the case of Ariff after being forced to act by the press? I have to say that their actual investigators, when they were finally assigned to the task, were very good and dedicated people. But they obviously lacked resources. I was getting calls at 11 o'clock at night. I cannot understand how they can keep their morale to the level that they have given the conditions they work in.[37]

Criticism of the Companies Auditors and Liquidators Disciplinary Board

6.34 As chapter 4 discussed, the role of the CALDB is to investigate conduct matters referred to it by ASIC pursuant to section 1292 of the *Corporations Act 2001*. A panel is appointed to conduct confidential hearings to discuss whether a registered liquidator: has failed to carry out their duties and functions adequately and properly; is not a fit and proper person to remain registered; is subject to disqualification; or is otherwise ineligible to remain registered. The panel has the power to cancel or suspend a liquidator's registration; and/or admonish or reprimand; and/or require the liquidator to give an undertaking.

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

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

37 Mr Bill Doherty, *Committee Hansard*, 14 April 2010, p. 10.

6.35 The CALDB has no power to investigate cases. Rather, ASIC is responsible for investigating complaints and, where it thinks appropriate, will refer a matter to the CALDB for adjudication.[38] By statute, the CALDB is independent of ASIC, although it receives its funding from ASIC's budget.

6.36 In his 2007 ruling on the High Court appeal cases of Mr Vanda Gould and Mr Richard Albarran, Justice Michael Kirby noted that a professional disciplinary board might not have been the only way to provide discipline for company liquidators. However, in Justice Kirby's opinion, 'it offered advantages over the courts of cost-saving, speed, flexibility and specialist knowledge'.[39]

6.37 The committee's evidence is that, on at least some of these scores, the CALDB has been found wanting. There have been various criticisms including that the Board lacks independence from ASIC, takes a prolonged time (and cost) to reach a finding, has few cases referred and makes few findings, and is often referred inconsequential matters.

Independence from ASIC

6.38 Mr Donald Magarey, Chairman of the CALDB, confirmed that the activities of the Board are 'totally contingent' on what ASIC may or may not direct it to do.[40] However, he stressed that under statute and in practice, the Board is 'completely independent' from ASIC.[41]

6.39 Mr Vanda Gould argued in his submission that the CALDB sees its role as little more than an enforcement arm of ASIC and that ASIC is highly selective as to whom it prosecutes.[42] He elaborated on this view in his evidence to the committee:

> …it is important to understand that ASIC is highly selective as to who it prosecutes. Some practitioners have a relationship with ASIC which in practical terms precludes prosecution. The truth is that any practitioner in a fishing expedition, like I experienced, would arguably have blemishes of the type found in the 46 charges…laid against me by ASIC. Whilst I successfully defeated the 46 charges, it took more than eight years until I

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38 ASIC operates a national 'Auditors and Liquidators Watchlist' ('Watchlist'). It is an intermediate measure for dealing with conduct, which in ASIC's opinion is culpable but not sufficiently serious to warrant taking the case to the CALDB. The Watchlist is periodically reviewed and entries removed after three years if no new matters of concern have been detected. Liquidators whose names are entered on the Watchlist are informed of that entry but it is not open for public inspection.

See Dr Brand et al, *Submission 6*, p. 12.

39 *Albarran v Companies Board* (2007) 231 CLR 378, 95 (Kirby J).

40 Mr Donald Magarey, *Committee Hansard*, 13 April 2010, p. 9.

41 Mr Donald Magarey, *Committee Hansard*, 14 April 2010, p. 15.

42 Mr Vanda Gould, *Submission 4*, p. 3.

> was wholly exonerated, subject to making a small qualification, at the end of 2009.[43]

6.40 Mr Geoffrey McDonald, a former insolvency practitioner (see chapter 5), was also critical of what he saw as the CALDB's subservience to ASIC. He told the committee that:

> …when ASIC picks you as the one that they want to target and can find one of the things that go wrong and you are not one of the chosen ones, they will put you up to CALDB and they will rubberstamp it. It would be interesting to see how many cases before CALDB have been lost. I understand it is 100 per cent in favour of ASIC. I do not know of any tribunal that goes 100 per cent to nil over years. So I would be very interested in seeing that statistic. It was told to me by the people at CALDB. After two years of that particular person being there, they knew of statistics where ASIC had a 100 per cent success rate over two years.[44]

A protracted process

6.41 Mr Geoff Slater, a barrister, argued in his evidence that the CALDB process simply takes too long. He noted one case that took 12 months to resolve, adding:

> …if…I am a fisherman and I run a commercial fishing boat and I have got a few hundred thousand dollars worth of fish in my hold that are frozen and the electricity is about to be cut off or something like that, 12 months just is not good enough. There needs to be a system in place operationally in the course of insolvency where people can get immediate relief before the farm is sold or whatever is about to happen. I think that is something that shows that CALDB is a complete policy failure.[45]

6.42 The committee heard criticism that the appeal process is also protracted. Mr Gould has argued that the disciplinary framework leaves too much to the discretion of ASIC and provides practitioners with no direct access to the Federal Court.[46] Associate Professor David Brown and Associate Professor Christopher Symes from the University of Adelaide have expressed their concern that complex issues of insolvency law, practice and remuneration, once decided by the board, may be appealed to a generalist single judge of the Administrative Appeals Tribunal.[47]

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43 Mr Vanda Gould, *Committee Hansard*, 13 April 2010, p. 19.

44 Mr Geoffrey McDonald, *Committee Hansard*, 13 April 2010, p. 43.

45 Mr Geoff Slater, *Committee Hansard*, 13 April 2010, p. 47.

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

47 Associate Professor David Brown, *Submission 40*, p. 5.

Few cases and few findings

6.43 Dr Vivienne Brand, Mr Jeffrey Fitzpatrick and Associate Professor Symes have observed that CALDB's workload and output have not been great. They noted in their submission that:

> The CALDB Annual Report for 2008 reveals that there were no new applications before the Board for liquidators conduct, one uncompleted matter at year end, and one matter appealed to the AAT. In the 2009 Annual Report there was one new application and one uncompleted matter at year end. While these numbers appear sparse, especially in light of the number of registered liquidators in Australia, further research on these matters is required before any sound conclusions can be drawn.[48]

6.44 Associate Professors Brown and Symes drew attention to the fact that few cases—especially under the 'conduct' category—are brought before the CALDB by ASIC. He added:

> …we doubt that this is because there are hardly any cases of practitioner misconduct or default, and therefore it must be surmised that ASIC is not devoting sufficient time and resources to the monitoring and investigation of insolvency practitioners. We do not have access to any evidence to support this however, but recommend that the Inquiry should focus on…the policy and operations regarding referral of cases to the CALDB. In any event, we recommend a review of the jurisdiction and operation of the CALDB in relation to insolvency practitioners.[49]

6.45 Mr Magarey was asked whether the Board's role extended to pursuing liquidators suspected of misconduct. He gave the following response:

> I do not see it as part of our purpose to get rotten apples off the street. If we were created for a different purpose or if our purpose were changed by legislation to give us those powers, we would exercise them. We might have to be differently resourced if we had to start investigating complaints that came in, and we might have to conduct our proceedings differently. We would then do that. That might then produce the sorts of results that you are talking about, about rotten apples. We would be able to do that and we would do it. I do not want to say whether that is a better policy result than the existing system.[50]

Trivial matters

6.46 Mr Gould described some of the allegations made against him by the CALDB as 'technical to the point of triviality'.[51] The Institute of Chartered Accountants of

48 Dr Brand et al., *Submission 6*, pp. 13–14.

49 Associate Professor Brown and Associate Professor Symes, *Submission 40*, p. 4.

50 Mr Donald Magarey, *Committee Hansard*, 13 April 2010, p. 10.

51 Mr Vanda Gould, *Committee Hansard*, 13 April 2010, p. 19.

Australia (ICCA) argued in its submission that the CALDB should be reserved for auditors and insolvency practitioners who have made serious breaches of the Corporations Act. It considered that the referral of inconsequential matters to the Board 'might negatively impact on how the CALDB process is perceived'. The ICCA held that minor breaches relating to administrative matters should be dealt with through the use of enforceable undertakings where ASIC's evidence is not tested and the accountant may not admit or may disagree with the concerns.[52]

Summary

6.47 This chapter has canvassed various criticisms of the role of ASIC and the CALDB in their oversight of insolvency practitioners. It is concerned that ASIC's mindset is insufficiently proactive and that it is slow and unresponsive in handling complaints. It is not clear what has contributed to this situation. However, one can reasonably speculate that the causes lie in a mix of outdated regulatory structures, the regulatory culture within ASIC and the various competing priorities for ASIC's time and resources.

6.48 The committee is also concerned that the CALDB is not strictly independent from ASIC and that it takes too long to adjudicate on matters. Chapters 10 and 11 discuss these issues further.

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52 Institute of Chartered Accountants of Australia, *Submission 66*, p. 5.

Chapter 7

The system for registering insolvency practitioners

7.1 This chapter examines the adequacy of procedures for registering and deregistering a liquidator. The key concern is whether the registration process is sufficiently rigorous to test for the probity and capacity of applicants and whether registered practitioners have adequate checks on their conduct and performance.

7.2 In this broad context, the chapter raises several issues and options, including:

- broadening the recruiting base of insolvency practitioners (paragraph 7.8–7.14);
- implementing an interview process (paragraph 7.15–7.20);
- a written examination (paragraphs 7.21–7.23);
- monitoring and checking practitioners' professional indemnity insurance (paragraph 7.24–7.37);
- implementing a licensing regime with a requirement for regular renewal; (paragraphs 7.38–7.48)
- stratifying registration to match practitioners' skills and experience with the appropriate jobs (paragraphs 7.49–7.51);
- a single registration body for personal and corporate insolvency practitioners (paragraphs 7.52–7.53); and
- promoting ongoing professional education (paragraphs 7.54–7.57).

The registration process

7.3 Recall from chapter 3 that the Australian Securities and Investments Commission (ASIC) determines an applicant to be 'a fit and proper person' if it is satisfied as to their honesty, integrity, good reputation and personal solvency. ASIC's submission noted that in making this assessment, it relies on:

- a letter of membership from a professional accounting body;
- the applicant's experience with corporate insolvency, focusing on length of experience and seniority;
- two referees attesting to currency and depth of liquidation experience, competency, integrity and reputation (whether applicant is 'fit and proper');
- proof of relevant qualifications;
- historical searches on the status of the applicant (i.e. whether subject of any previous adverse decisions);
- a statement by the applicant, declaring that they are not:

- an insolvent under administration;
- convicted of a criminal offence;
- subject of disciplinary action by their professional body or the Australian Taxation Office (ATO); and
- disqualified from managing corporations under Part 2D.6.[1]

7.4 Mr Stefan Dopking of ASIC told the committee that in terms of this checklist:

> the team which undertakes this work does it quite thoroughly, not only by looking at the paper but by making inquiries of our own of people who know the industry quite well in each state and talking to those referees.[2]

7.5 However, ASIC has noted that one of its current projects is to review the registration process (Regulatory Guide 186) to see if it can strengthen the 'fit and proper' test. The Chairman of ASIC, Mr Tony D'Aloisio, told the committee that once a liquidator is registered 'it is not that easy for ASIC to deregister'. Further, he observed that in contrast to licensing, the requirements of registration 'are not a high hurdle'.[3]

7.6 The Insolvency Practitioners Association of Australia (IPAA) observed in its submission that to be registered as a liquidator in Australia:

> A person requires tertiary qualifications and significant experience…Apart from a degree which includes three years of accounting and two years of legal study, persons applying to be registered must have worked under the supervision of a registered liquidator for a period of 5 years out of the preceding 10. Many of the profession's current senior practitioners have over 30 years' experience, and have been successfully involved in the restructure and orderly administration of many insolvent companies, always acting in the interests of creditors and employees.[4]

7.7 The IPAA also told the committee that it has specific training in its Code of Professional Practice. Further, the new accounting standard, APS 330, adopts a great majority of what is in the code.[5]

Broadening the practitioner base

7.8 The committee has received evidence that current entry requirements for registering as an insolvency practitioner are too narrow, and should be broadened. Mr Geoffrey Slater, a barrister who has represented liquidators, described the

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1 ASIC, *Submission 69*, p. 130.

2 Mr Stefan Dopking, *Committee Hansard*, 12 March 2010, p. 11.

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

4 IPAA, *Submission 36*, p. 22.

5 Mr Mark Robinson, *Committee Hansard*, 12 March 2010, p. 53.

insolvency profession as a 'little club' of accountants with a vested interest in keeping this arrangement. He told the committee:

> Section 1282 of the Corporations Act sets out all the qualifications that people must have…It says that you have to be an accountant and ASIC decides whether that qualification is adequate or not according to their opinion. On what basis do they decide that? If you turn to regulation 9.2.02, it sets out a series of universities and so on. What it essentially does, however, is create a monopoly for accountants. Australia is the only country that does this. In the United Kingdom anybody can sit an exam, including solicitors, and become a liquidator. The same thing applies in the United States. In Europe, you must be a solicitor before you can act as a liquidator. Why is this so? The answer is because…what liquidators are really doing is not accounting and not looking at ledger. Their real skills are commercial.[6]

7.9 Mr Slater told the committee that the type of skills required to be an insolvency practitioner are quasi-judicial skills, which accountants do not have. In this context, he added:

> The first recommendation I would make to this committee is that the door should be thrown open, to open the field to anybody who wants to sit the exam. This should be removed from ASIC and Australia should be brought into harmony with the United States and England so that anybody who is qualified or who has a law degree or an accounting degree with sufficient law should be able to sit the exam.[7]

7.10 Mr Slater identified the significant consequence of this exclusive arrangement as the charging of 'monopoly rents'. He contrasted the salaries of partners at private law firms with the earning capacity of partners at insolvency firms. The latter, he claimed, are earning well over $4 million a year.[8]

7.11 Other submitters to this inquiry have claimed that the insolvency profession operates as a self-interested clique. Mr Ian Fong of Carlovers Carwash, for example, told the committee:

> I think the industry is quite small and it is dominated by a small number of practitioners, accountants and lawyers who all help each other make money. For example, when we took legal action to complain about Mr Ariff's conduct his lawyers somehow managed to convince the court that this matter was just a commercial dispute rather than one that involved fraud and criminality. The lawyers put up all sorts of hurdles to stymie a bit. They managed to convince the court to appoint a mediator. The mediator is someone that works within the insolvency industry. They rely on the insolvency industry for work. They then go and get an independent expert

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6 Mr Geoff Slater, *Committee Hansard*, 13 April 2010, pp. 47–48.

7 Mr Geoff Slater, *Committee Hansard*, 13 April 2010, pp. 47–48.

8 Mr Geoff Slater, *Committee Hansard*, 13 April 2010, p. 49.

> report from another insolvency practitioner. Again, all of them rely on work from each other. How can you have independence?[9]

ASIC's view

7.12 ASIC noted in its supplementary submission that it is open to the concept of broadening the base for insolvency professionals provided that strong standards of conduct, experience and continuing professional development are maintained.[10] It noted that the eligibility criteria was broadened in the 2007 Amendments with the repeal of section 1282(a)(1) relating to membership of an accounting body.

7.13 Mr Slater claimed that this reform was designed to prevent solicitors from becoming liquidators. He noted that the Institute of Chartered Accountants Australia (ICAA) allowed solicitors to join, and the ICAA was listed in the Corporations regulations as being one of the qualifications for becoming a liquidator. Mr Slater thereby reasoned that the repeal of section 1282(1)(a) prevented solicitors from entering the insolvency profession.[11]

Tightening requirements

7.14 The committee notes that there is, perhaps, some tension between demands to increase competition in the market for insolvency professionals by broadening eligibility criteria and improving standards. Some witnesses argued that rather than broadening the qualifications criteria, it should be tightened. One option in this regard would be to require all practitioners to hold a Masters of Business Administration (MBA). As Mr Bill Doherty told the committee:

> These people are basically accountants with no specialist skills. I suppose that they have worked for another group of insolvency practitioners for a while and I suppose they have done a couple of corporate law units in their degree, but how can somebody qualified to that degree then take total control of such a variety of enterprises, in Ariff's case nightclubs, earthmoving companies, metal finishing companies. They simply do not have the expertise. But, yes, certainly tighten up the entry. They should at least have an MBA. I would think it would probably be more appropriate if they were legally qualified.[12]

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9 Mr Ian Fong, *Committee Hansard*, 14 April 2010, p. 44.

10 ASIC, *Supplementary submission*, p. 13.

11 Mr Geoff Slater, *Committee Hansard*, 13 April 2010, p. 48.

12 Mr Bill Doherty, *Committee Hansard*, 14 April 2010, p. 13.

An interview process

7.15 ASIC identified an interview process as one of the issues it is currently considering as part of its planned re-write of Regulatory Guide 186. Mr D'Aloisio explained that an interview process would be supplementary to the existing background checks:

> An interview may assist. We will have a look at it, but really at the end of the day it is the substantive qualifications that underpin it. So an interview may give you a feeling as to whether a person is being straight with you, but the checks you do in the background with the accounting bodies—the experience, the referees and the declarations that are made to you—are the substance of any application and we do look at that very thoroughly.[13]

7.16 ASIC's supplementary submission noted that the Commission will consult on how an interview process could be implemented. It considered the key questions to be whether the interview is conducted by a panel of interviewers and if so, who should be represented on the panel and how would the panel be constituted.[14]

7.17 The IPAA supports an interview process for prospective practitioners. It argued in its submission that an interview process may be important to identifying those 'with an appropriate and informed approach to the practice of insolvency'.[15]

7.18 The IPAA highlighted the Insolvency and Trustee Service Australia's (ITSA) requirement for applicant Bankruptcy Trustee practitioners to attend an interview conducted by a three person panel. The interview panel comprises a delegate of the Inspector-General in Bankruptcy, an APS employee (usually from Attorney-General's Department) and an experienced registered trustee nominated by the IPA.[16] Mr Jeff Hanley of ITSA told the committee that the interview consists of 20 questions which are asked to each applicant.[17]

7.19 The ICAA also supported an interview process to register insolvency practitioners. As it observed in its submission:

> We consider that including an interview as part of the registration process for liquidators would strengthen it. An interview would require the applicant to respond to a range of practical questions, so that they can demonstrate they have the necessary understanding of the legislation deal with the varying issues that may arise.[18]

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13 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, p. 11.

14 ASIC, *Supplementary submission*, p. 12.

15 IPAA, *Submission 36*, p. 21.

16 IPAA, *Submission 36*, p. v–vi.

17 Mr Jeff Hanley, *Committee Hansard*, 13 April 2010, p. 58.

18 Institute of Chartered Accountants, *Submission 66*, p. 3.

7.20 Dr Vivienne Brand of the University of Adelaide expressed some doubt about the initial interview process but supported ITSA's model of frequent face to face interviews of registered practitioners. As she explained to the committee:

> I do not know that I am convinced by the initial interview idea. I think that people who do not have the level of competence they need would probably be picked up by checking the paperwork. The people who had genuinely fraudulent intentions would probably be quite impressive at interview, so I am not sure that that is where you would pick it up. I like that ITSA has a look at people every year, face-to-face. I think that they would then have ongoing exposure to the person and that would probably be helpful. I think there needs to be ongoing checking.[19]

A written examination

7.21 This inquiry has received some evidence suggesting that, either in place of or as a complement to an interview, there should be a written examination to screen applicants.

7.22 Associate Professor David Brown told the committee that ITSA currently conducts both an interview and a written examination to screen applicants. He explained that if applicants do not come up to scratch in the interview, they have to sit an exam.[20] Mr Mark Robinson of the IPAA flagged the possibility of an exam as a secondary screening process to register corporate insolvency practitioners:

> Looking to improve the review of whether somebody is a fit and proper person would also be by way of interview and, if somebody does not present well at an interview, it might go further, even to a written exam, which is the process through which ITSA considers the fitness of a person to be a registered trustee in bankruptcy.[21]

7.23 Mr Geoffrey Slater is a strong proponent of a written examination as part of the insolvency registration process. Specifically, he argued that the exam must be:

> …a closed-book exam as distinct to an open-book exam, so that people can prove that they have a fundamental grasp of equitable principles and company law—not just parroting neat little answers that they have cribbed from one of those nutshell books but actually demonstrating to an examiner that they truly understand the underlying concepts.[22]

19 Dr Vivienne Brand, *Committee Hansard*, 9 April 2010, p. 10.

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

21 Mr Mark Robinson, *Committee Hansard*, 12 March 2010, p. 39. See also IPAA, *Submission 36*, p. 21.

22 Mr Geoffrey Slater, *Committee Hansard*, 12 April 2010, pp. 51–52.

Professional Indemnity Insurance

7.24 Since July 2008, a registered liquidator is required to maintain adequate and appropriate professional indemnity (PI) insurance and fidelity insurance to cover for claims that may be made against him or her. This requirement was introduced under new section 1284 of the *Corporations Act*.[23]

7.25 The policy purpose of the insurance requirements is to ensure that funds are available to compensate creditors and other claimants for loss suffered as a result of the inadequate or improper performance of duties by a registered liquidator or their staff in connection with externally administered companies.[24] If a practitioner has not paid the insurance premium or the cover has lapsed or been cancelled, creditors will not have recourse to that PI cover. This was the case with Mr Ariff, whose policy lapsed prior to various insurance claims from creditors.[25]

7.26 ASIC has identified its administration of section 1284 of the *Corporations Act 2001* as one of its key responsibilities in the insolvency area. It has published a *Regulatory Guide* for stakeholders to explain how it will administer the insurance requirements for registered liquidators under section 1284. The Guide states:

> We may undertake targeted or random surveillance to ensure that registered liquidators or their firms comply with the insurance requirements. Registered liquidators will also have to confirm each year on Form 908 Annual statement by a liquidator that their insurance cover meets the insurance requirements.[26]

7.27 ASIC's Chairman, Mr Tony D'Aloisio, also told the committee that it is conducting ongoing work to assess how the regime is operating and how to improve lapses of PI insurance.[27] In its submission, ASIC noted that by December 2010, it will have:

> …requested practitioners to provide confirmation of relevant insurance policies to test compliance by practitioners with the new provisions and ASIC's regulatory guide. In instances of non-compliance ASIC will proceed to cancel registration under s1290A.[28]

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23 Anthony Housego and Bernard Poole, Bills Digest No. 180, 2006–07, Parliamentary Library, 14 June 2007, http://www.aph.gov.au/library/pubs/bd/2006-07/07bd180.htm (accessed 24 June 2010).

24 Australian Securities and Investments Commission, 'Insurance requirements for registered liquidators', *Regulatory Guide 194*, June 2008, p. 6.

25 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, p. 8.

26 Australian Securities and Investments Commission, 'Insurance requirements for registered liquidators', *Regulatory Guide 194*, June 2008, p. 9.

27 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, p. 4.

28 ASIC, *Submission 69*, p. 11.

Criticism of ASIC's monitoring of professional indemnity insurance

7.28 The committee has received strong views that the current system for monitoring practitioners' PI insurance cover is inadequate and must be strengthened. Mr Geoff Slater, a barrister, gave the following critique:

> There is a section that says that they have to have insurance. But guess what the problem is: nobody actually checks to see whether they have insurance. And if they do not have insurance, guess what—the section does not lay down a penalty. If I drive a car, and I do not have a green slip, I get fined and I get into big trouble—but, more to the point, under the RTA in New South Wales my registration and my insurance march in lock step. We have a situation with ASIC where there is this enormous risk transfer. They can take on big cases with no insurance and nobody is looking at it. If I wanted to say to a liquidator, 'Have you got current insurance? Provide proof to me', and they are an official liquidator appointed by the court, they do not have to do that. There is no official public register to make sure they are currently registered, in the same way that I can check whether a car is currently registered. Why is that the case? It is the case because ASIC does not actually interview any of these people when they get in; it is a registration process—they stamp bits of paper.[29]

7.29 Mr Bill Doherty inferred that ASIC needs to verify that insolvency practitioners actually make insurance payments. He explained that in the past, the practitioner has gone:

> …to an insurance broker and they say, 'I want to renew my insurance.' The insurance broker gives them a certificate of compliance and a deal where they pay their insurance monthly. Having got their certificate of compliance, then they simply do not pay the payments and the insurance is void. That is how it happened.[30]

7.30 Mr Jeff Hanley of ITSA told the committee that ITSA checks that trustees have PI insurance at the point of registration, three years later at the point of license renewal and through its annual checks.[31]

7.31 Professor Scott Holmes of the University of Newcastle argued that the obvious solution to the regulatory gap with PI insurance is to require the insurer to notify ASIC when a practitioner's policy lapses or is not renewed. ASIC should be required to ensure they have current insurances through appropriate inquiry.[32]

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29 Mr Geoff Slater, *Committee Hansard*, 13 April 2010, p. 50.

30 Mr Bill Doherty, *Committee Hansard*, 14 April 2010, p. 13.

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

32 Professor Scott Holmes, *Submission 21*, p. 25.

7.32 Another submitter argued that there should be criminal sanctions if registered practitioners do not hold a valid PI insurance policy.[33]

Run-off cover

7.33 Professional Indemnity insurance has a 'Claims Made Basis' policy: the practitioner must have a policy in place at the time a claim is made against them, rather than at the time the alleged act is committed. The PI policy that covers a practitioner is the policy he or she has at the time the claim is made, not the policy held at the time of the alleged act. Accordingly, insurance companies may offer 'run off cover' on a policy where the practitioner will continue to be covered by a policy despite it having lapsed.

7.34 The committee asked Mr D'Aloisio to comment on a proposal whereby insurance companies would be required to notify ASIC if an insolvency practitioner's PI insurance lapsed. Mr D'Aloisio replied that this system would entail monitoring costs for both the insurance industry and ASIC. He added:

> …it does not help either, because how do you reinstate it? If the claims occur after, you may not have dealt with the issue that you are concerned with. The issue you are concerned with I think might be better dealt with if you have run-off cover for a period of time: after the policy is cancelled there is cover for claims that occur within a certain period of time.[34]

7.35 The committee understands that ASIC currently requires insolvency practitioners to have 'run-off' cover as part of their PI insurance. ASIC's *Regulatory Guide* states that registered liquidators should:

> …use their best endeavours to obtain automatic run-off cover for as long as reasonably practicable. In any event, their insurance policy should contain run-off cover for at least one year after the expiry of the policy period in the event of insolvency or external administration of the registered liquidator or firm.[35]

7.36 However, the committee received evidence from the IPAA that to their understanding, the insurance industry have advised that they will not offer run-off cover for insolvency practitioners.[36]

7.37 The committee is also concerned that PI insurance does not cover fraud and deliberate wrongdoing. In other words, creditors in the Ariff matters would not have been covered. One submitter has suggested that all insolvency practitioners should be

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33 Name withheld, *Submission 93*, p. 1.

34 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, p. 8.

35 Australian Securities and Investments Commission, 'Insurance requirements for registered liquidators', *Regulatory Guide 194*, June 2008, p. 33.

36 Ms Denise North, *Committee Hansard*, 12 March 2010, p. 51.

members of the ICAA, the CPA or the National Institute of Accountants. Each professional organisation should have a fidelity fund which would cover fraud.[37]

A licensing regime

7.38 The committee notes that the possibility of a licensing system for insolvency practitioners was considered as part of the 2007 Amendments (see chapter 1). This proposal included a requirement for regular renewal of licenses to monitor compliance with practice capabilities and professional education standards, the provision for the cancellation and conditional issuing of licenses and more active monitoring of practitioners by ASIC. The government rejected this proposal, preferring instead to target reform of the existing registration process. This was seen as the more appropriate response as it avoided the transitional costs and new compliance obligations of a licensing regime.[38]

7.39 Despite the 2007 reforms, the committee has concerns that the current registration regime lacks the flexibility to enable the regulator to suspend a practitioner's activities while an investigation takes place. As past experience has shown, considerable damage can be done to creditors while a practitioner is under investigation.

7.40 As detailed earlier (paragraph 7.5), ASIC's Chairman has himself recognised that it is not easy to deregister a liquidator. In addition to the often protracted processes of natural justice, the law requires ASIC to prove the case against the practitioner before he or she is deregistered. Mr D'Aloisio contrasted this approach with a police power to stop a motorist at the traffic lights and issue an infringement notice.[39]

7.41 Mr D'Aloisio was asked whether a licensing regime would give ASIC the power to suspend immediately the practitioner's activities. He acknowledged that a licensing system, such as the AFS (Australian Financial Services licence) regime, is not without its problems. However, he noted that while a licensing system for insolvency practitioners is ultimately a policy matter for government, 'I think the current policy framework is in that direction'.[40]

7.42 In its supplementary submission, ASIC compared insolvency practitioners' registration obligations under section 1288 of the *Corporations Act 2001* with the AFS licence obligations under section 912A. It noted that:

> The general obligations of AFS licensees under s912A provide a basis to address concerns about variable levels of experience of insolvency

37 Name withheld, *Submission 93*, p. 1.

38 ASIC, *Supplementary submission 69a*, pp. 9–10.

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

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

> practitioners through the ongoing requirement to ensure that the licensee and their representatives are competent. These requirements also provide a mechanism through which to address practitioner misconduct by allowing the suspension or cancellation of a licence.
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> …
>
> …the requirements of s912A and 912B for AFS licensees ensure that the licensee not only has appropriate IDR [internal dispute resolution] processes in place, but that they are also a member of an EDR [external dispute resolution] scheme.[41]

7.43 ASIC emphasised that under the AFS licence regime, where it seeks to cancel, suspend or vary a licence, it does need to afford the licensee the right to appear before a hearing on the proposed action and the right to appeal any decision.[42] Mr Donald Magarey, the Chairman of the Companies Auditors and Liquidators Disciplinary Board (CALDB), also raised this concern. He recognised that a proposal to withdraw a practitioner's registration in lieu of a disciplinary process is a policy matter for government. However, he urged caution:

> …I have always taken the view that in this area the existing system has been based on the proposition that, until people have an adequate hearing and an opportunity to present their case and they have natural justice and the rights to see the decision and all the reasons for the decision, taking away their registration would somehow be in breach of the golden rule of innocent until proven guilty. That is my own view; that is the way I have always looked at it. I have never seen that written down but that is the way I have always looked at it.[43]

License renewal

7.44 In addition to quickly stopping wrongdoing, a licensing system would also have the advantage of improved monitoring of insolvency practitioners. Unlike the current registration process, a licensing system would have a requirement for regular renewal. This would involve the practitioner lodging information every three years (for example) and an assessment by the regulator of the practitioner's conduct and need for professional development. Pending this assessment, the regulator has the options of renewing the license, imposing conditions on it, suspending the license or revoking it.

7.45 The committee notes that regular, systematic surveillance of insolvency practitioners is not a feature of the current system. ASIC only reviews individual practitioner conduct if a complaint is made.[44] The contrast is with ITSA, which

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41 ASIC, *Supplementary submission*, p. 8.

42 ASIC, *Supplementary submission*, p. 8.

43 Mr Donald Magarey, *Committee Hansard*, 13 April 2010, p. 8.

44 IPAA, *Submission 36*, p. 17.

conducts annual reviews of their practitioners and requires them to register every three years (see chapter 10).

7.46 ASIC does require insolvency practitioners to lodge an annual statement concerning personal and practice details and the liquidations that they have conducted (Form 908).[45] Mr Jeffrey Fitzpatrick, Dr Vivienne Brand and Associate Professor Christopher Symes describe this requirement as a 'de facto process of indirect periodic renewal of registration'. They note that the annual statements are not open to public inspection and copying due to the confidential nature of their content.[46]

7.47 One submitter suggested that an avenue to improve the monitoring of the profession is to put in place quarterly reporting requirements. He suggested that this could be paid for through a registration fee payable to ASIC.[47]

7.48 ASIC estimated in its supplementary submission that the cost of implementing a license regime with a renewal process would be two start-up full time equivalent (FTE) staff and seven ongoing FTE staff.[48] This costing assumed the current 662 insolvency practitioners would undergo renewal of their license every three years.

Stratifying registration

7.49 Some submitters favoured a stratified system of registration (or licensing) where practitioners are deemed qualified for particular types of insolvency work. This idea was raised in a submission by Mr Fitzpatrick, Dr Brand and Associate Professor Symes. They noted that currently, a registered practitioner has the ability to accept an appointment of any company despite its size, complexity or industry. It is left to the professionalism of the individual liquidator to 'self-govern' whether he or she is 'fit and proper'.[49]

7.50 The academics suggested that despite the higher costs involved, stratifying registration could overcome this 'one size fits all' dilemma. Associate Professor Symes told the committee:

> …we were thinking something along the lines of restricted and unrestricted registration, that we might need to review the idea of category A and category B type registered liquidators…There is a distinct possibility of a person having an unrestricted licence—registration as it is now—and that they can embark upon any size liquidation, any size administration or any size receivership. It is possible, I suppose, to look at a stratification where

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45 See 'Annual statement by a liquidator', http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/908.pdf/$file/908.pdf (accessed 3 July 2010).

46 Mr Fitzpatrick, Dr Brand and Associate Professor Symes, *Submission 6*, p. 11.

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

48 ASIC, *Supplementary submission*, p. 4.

49 Mr Fitzpatrick, Dr Brand and Associate Professor Symes, *Submission 6*, p. 19.

> you would have specialist insolvency practitioners looking at only operating in the small and medium enterprise area. It is possible to restrict on the basis of the size of the company which is going to be wound up or administered or the size of the turnover. If we were to introduce categories, I think we would have to look at differences between education, perhaps putting in hurdles for both education and supervision.[50]

7.51 The IPAA also supports the idea of stratifying registration, albeit through a licensing regime. Mr Mark Robinson, President of the IPAA, told the committee:

> …what attracts the IPA to the concept of a licensing regime is two things. On the initial licensing of a person who is reputedly of good standing but whom we have not seen actually operate in the market let us put some terms and conditions to see how they run for a period of time. Maybe we could put some speeding restrictions, if you like, in terms of the number of matters they take on. What also attracts our organisation to a licensing regime [is]…that, if it is on a three-year to a five-year basis, you virtually have to go through a re-application cycle, so your history and past conduct can be taken into account in terms of whether the licence will be renewed.[51]

A single registration body

7.52 Some submitters to this inquiry argued that there is no need for two separate registration processes for personal bankruptcies and corporate insolvencies. Associate Professor David Brown from the University of Adelaide queried whether Australia needs two separate registration systems when both are essentially the same people wearing different hats.[52] He suggested that in pursuing a single registration model, ITSA's approach should be preferred to that of ASIC:

> ITSA is now regulating debt agreement administrators on an ongoing basis and requiring them to be interviewed and have an exam. If they do not come up to scratch in the interview, they have to sit an exam. So it seems that ITSA is pursuing that sort of ongoing monitoring and initial entry into the door to a greater standard than ASIC is doing, at least on an ongoing basis.[53]

7.53 Dr Colin Anderson from the Queensland University of Technology and Dr David Morrison from the University of Queensland have also argued in their submission that given that most registered trustees are also registered as liquidators, there should be one registration authority for insolvency practitioners. They observed that the eligibility requirements for bankruptcy and corporate insolvencies are essentially the same. Further, the merging of personal and corporate insolvency

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

51 Mr Mark Robinson, *Committee Hansard*, 12 March 2010, p. 43.

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

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

regimes should be easier now than it has been in the past given that all corporate law is regulated at Commonwealth level. The academics suggested that:

> …even if it is not feasible to integrate all of insolvency regimes under the one supervisory authority, it is possible to place the registration and supervision of the profession under one body.[54]

Professional education

7.54 Another issue raised during this inquiry concerned the educational requirements for insolvency practitioners to become registered and to remain registered. Several submitters noted that standard could be improved. Professor Scott Holmes, for example, told the committee that current regulation of ongoing continuing education is 'pretty slack'.[55] Mr Bill Doherty identified the need for an MBA and legal qualifications (see paragraph 7.14).[56]

7.55 Mr Geoffrey McDonald, on the other hand, argued that determining what type of education is necessary to be registered and remain registered as an insolvency practitioner is not easy. In his view:

> The disciplines that you need for insolvency are very widespread. In many respects, the accounting discipline is probably one of the least disciplines you need. The ability to understand tax law is not necessary. These companies do not pay tax; they do not make profits. Regarding the ability to deal with consolidated accounts and the like, I just do not see that the accounting skills are really the trick; it is commercial skills and probably the law. Defining the skills and qualifications that are needed for a liquidator to become registered is a challenge in its own right. The legal profession, obviously, is very disciplined and has its statutory backing. You cannot act as a legal practitioner without being qualified. That is a breach of the legislation. You can be an insolvency practitioner—not to take on the appointments, but be an insolvency practitioner without necessarily having these qualifications.[57]

7.56 To be a full member of the IPAA, practitioners must have successfully completed the Association's Insolvency Education Program (IEP). The IEP provides a professional qualification for insolvency specialists and is a prerequisite for full membership of the IPA. It is a combination of two units of post-graduate university level study, attendance and performance at workshops conducted by senior practitioners, and written assessment on an ethics topic. The IEP takes a minimum of one year to complete and covers each of the different types of insolvency administration, in both personal and corporate, and includes topics of establishing insolvency, workouts, and ethics.

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54 Dr Colin Anderson and Dr David Brown, *Submission 79*, p. 6.

55 Professor Scott Holmes, *Committee Hansard*, 14 April 2010, p. 60.

56 Mr Bill Doherty, *Committee Hansard*, 14 April 2010, p. 13.

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

7.57 The IPAA also requires their members to undertake 40 hours of professional development per year. It conducts audits of their members to ensure they have satisfied this requirement. Professional development activities may be offered by the practitioner's firm, through educational institutions or through industry associations. The IPAA, for example, offers the Introduction to Insolvency Program (IIP), which is a two day face-to-face interactive course providing new entrants to the profession with knowledge of insolvency and restructuring. It also runs a 439A Report Training course. This course assists practitioners with the theory of section 439A reports as well as the legal and professional standards, tools for gathering information and presenting information to creditors.

Summary

7.58 This chapter has considered various options to improve the registration process to become an insolvency practitioner. The committee recognises a continuing need to make improvements to this process to ensure that the regulators can have confidence that new practitioners are of high capability and integrity. A more rigorous registration system also serves to bolster public confidence in the profession.

7.59 Chapter 11 of this report provides the committee's view on the key options of a licensing system, an interview process, a written examination, a stratified registration system and a single registration body for practitioners. The merit of each option should be considered in the context of the committee's views on the need for broader reform of the regulatory framework.

Chapter 8

The remuneration of liquidators and administrators

> *It is in the area of remuneration that the most obvious conflict between the commercial interests of the practitioner and his or her firm, and the interests of the creditors and the wider public interest is manifest.*[1]

Background

8.1 The level at which liquidators and administrators have been remunerated in Australia has been a source of complaint from creditors. From 2006–2010, eight per cent of insolvency related complaints to the Australian Securities and Investments Commission (ASIC) concerned remuneration issues, including excessive fees and poor disclosure of remuneration. A further 12 per cent of complaints were critical of insolvency practitioners failing to act in a timely manner.[2] This inquiry has also received complaints of overcharging and over servicing by insolvency practitioners.

8.2 Previous inquiries have recommended reforming the remuneration framework for insolvency practitioners in Australia. In 1988, notably, the Australian Law Reform Commission (ALRC) recommended that a statutory board should have exclusive power to determine and set remuneration scales for insolvency practitioners. The ALRC preferred maximum amounts to fixed remuneration scales, but emphasised that fees must be subject to approval by creditors.[3]

8.3 Another inquiry explicitly avoided proposing this type of regulation. In 2004, as part of a review of Australia's insolvency laws, the Parliamentary Joint Committee (PJC) on Corporations and Financial Services argued that in light of concerns about the impact on competition, a scale of maximum fees for insolvency practitioners is 'inappropriate'. The committee insisted that the market must determine the most efficient and cost-effective fee setting mechanism.

8.4 However, the PJC did recognise that enhanced disclosure of the basis of fee setting 'can address some of the concerns expressed by creditors'.[4] Specifically, if creditors can understand and negotiate meaningfully with practitioners about fees, they are better able to protect their interests. Accordingly, the committee recommended that ASIC:

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1 Professor David Brown and Associate Professor Christopher Symes, *Submission 40*, p. 6.

2 ASIC, *Submission 69*, p. 58.

3 General Insolvency Inquiry, Australian Law Reform Commission, 1988, pp. 379–380. This inquiry was known as the Harmer Report.

4 Parliamentary Joint Committee on Corporations and Financial Services, 'Corporate Insolvency Laws: A stocktake', June 2004, p. 122.

> …work with the professional bodies to encourage the promotion of best practice standards in remuneration charging and in particular the provision of adequate disclosure of the basis of fees charged by insolvency practitioners and on a more timely basis.[5]

8.5 Both ASIC and the Insolvency Practitioners Association of Australia (IPAA) have since sought to clarify 'best practice standards' in remuneration. In 2008, the IPAA introduced a section in its Code of Professional Practice dealing with remuneration. The Code established three remuneration principles: that the work is 'necessary and proper'; that a claim for a fee is accompanied by 'sufficient, meaningful, open and clear disclosure'; and that approval is gained and recorded before remuneration is drawn. The same year, ASIC released an information sheet giving general information for creditors on the approval of liquidators' and administrators' fees. The sheet included a section indicating to creditors how they might decide if the amount of fees charged by the liquidator or administrator is reasonable.[6]

8.6 There has also been statutory reform of the requirements for insolvency practitioners in setting and receiving their fees. The Corporations Amendment (Insolvency) Bill 2007 amended the *Corporations Act 2001* to require liquidators and external administrators to prepare a report on their fees for creditors. The report must contain information that will enable the committee of creditors to make an informed assessment of whether the proposed fees are reasonable (see paragraphs 8.54–8.56).

Chapter outline

8.7 Despite these clarifications and reforms, there clearly remains disquiet about the fees charged by insolvency practitioners and concern at the lack of effective regulatory oversight. This chapter discusses the issues relating to insolvency practitioners' fees in closer detail. It is divided into the following parts:

- the calculation of, and methods of charging for, insolvency services (paragraphs 8.8–8.15);
- the level at which fees are charged, including the committee's evidence of overcharging and over servicing (paragraphs 8.16–8.27);
- disbursement payments (paragraphs 8.31–8.38);
- the priority given to the payment of insolvency practitioners (paragraphs 8.39–8.52);
- the current regulatory framework including (paragraphs 8.53–8.64):
    - the practitioner's report on proposed fees;

5 Parliamentary Joint Committee on Corporations and Financial Services, 'Corporate Insolvency Laws: A stocktake', June 2004, p. xxii.

6 ASIC, 'Approving fees: A guide for creditors', *Information sheet 85*, 2008, p. 4.

- the remuneration principles and guidelines of the IPAA Code of Professional Practice;
- ASIC's information sheets for creditors on approving fees, liquidation and voluntary administration; and

- the need for better data on fees in the insolvency industry (paragraphs 8.65–8.76).

Methods of charging

8.8 There is no statutory direction or formula to provide a basis for calculating the remuneration of insolvency practitioners in Australia. The statutory and judicial expectation is that remuneration is 'reasonable'.[7]

8.9 The IPAA's Code of Professional Practice notes that the fees of an administrator may be calculated using one of four methods:

- time spent by the administrator and their staff according to hourly rates;
- a quoted fixed fee based on an estimate of the costs; or
- a percentage, usually of the realised assets; and
- a success or contingency fee.[8]

8.10 The IPAA has no preference for the method of calculating fees, although fees are most commonly charged on hourly rates.[9] The IPAA does require full disclosure of the basis for calculation to be provided to the parties that approve the external administrators' fees.[10] This requires a practitioner to maintain a system that requires staff to record:

- the period of time spent;
- the categories of work performed; and
- details of the work being performed.

8.11 For time based charging, the practitioner must ensure that the number and qualifications of staff allocated to an administration is appropriate for the nature of work being performed. The IPAA Code notes that a balance needs to be found between having sufficient staff to undertake the required tasks and over servicing the administration.[11]

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7 See section 473(1) of the *Corporations Act 2001*; *Korda; Stockford Ltd* (2004) 52 ACSR 279. Associate Professor David Brown, *Supplementary submission*, p.2.

8 IPAA Code of Professional Practice, p. 99.

9 IPAA Code of Professional Practice, p. 67.

10 ASIC, *Submission 69*, p. 5.

11 IPAA Code of Professional Practice, p. 99.

Criticism of the hourly rate of payment

8.12 Some witnesses argued that the hourly rate of payment encouraged overcharging. Professor Scott Holmes of the University of Newcastle argued in his submission that:

> Charging for services by the hour does not encourage an efficient allocation of time and time allocated can prove difficult to dispute. Often the fees accrued are substantial and there is no formal mechanism for review, other than creditors calling a meeting and requesting a report. There is no real control over outgoings, as the VA can basically operate at their discretion in administering their duties. All of this has proven attractive to some individuals, rorting the latent opportunities this provides.[12]

8.13 Associate Professor David Brown of the University of Adelaide argued that 'no amount of information or guidelines in a Code about method and basis of calculation can prevent allegations that actual rates applied to time are excessive'.[13] He also claimed that in the absence of caps on remuneration, it is very difficult for a court as the final arbiter to assess or fix 'reasonable' remuneration.[14]

8.14 Mr Ian Fong of Carlovers Carwash Limited and Berjaya Corporation Berhad told the committee of his preference for a fixed price regime because it will 'incentivise the practitioner to do the work as quickly as possible…and allows the creditors and the owners of the business to assess the cost benefit of choosing administration or liquidation upfront'.[15]

8.15 Similarly, Mr Pierre Della-Putta argued that many of the standard services that liquidators undertake should be at a fixed scale of charges set by an independent ombudsman. He argued that hourly rates should be used only where no other system is possible.[16]

The level of fees charged by liquidators and administrators

8.16 Most of the committee's evidence on the issue of liquidators' and administrators' remuneration was concerned not with how fees are set per se, but the level at which they are charged. This section looks at some of the factors that may—reasonably or otherwise—contribute to the high cost of a liquidator or administrator's appointment. These include:

- the complexity of the work and the difficult task of disseminating company accounts;

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

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

14 Associate Professor David Brown, *Submission 40*, p. 6.

15 Mr Ian Fong, *Committee Hansard*, 14 April 2010, p. 43.

16 Mr Pierre Della-Putta, *Submission 10, Supplementary*, p. 3.

- the insolvency practitioner's high level of exposure to risk;
- where a practitioner performs fee generating tasks that are extraneous to the liquidation, thereby extending the time charged;
- the need to employ third parties to assist with the liquidation; and
- a practitioner overcharging to compensate for lack of fee generating opportunities on small insolvency jobs.

Support for the current fee-setting system

8.17 Some witnesses to (and commentary during) this inquiry expressed support for the current system of remunerating insolvency practitioners. They noted that while there might be cases of overcharging, insolvency practitioners by and large earn their rewards within a system of remuneration that is fair and appropriate.

8.18 In May 2010, former High Court Judge Michael Kirby argued that the 'pernickety' work of administering an insolvency is inherently expensive because of the 'intensive nature of the investigation of accounts that insolvency practitioners must analyse and understand'. He added that unless the public is willing to absorb all such costs, a significant burden on creditors is virtually inescapable'.[17]

8.19 Mr Geoffrey McDonald, a former insolvency practitioner (see chapter 5), told the committee that as a liquidator:

> …you may or may not recover your fees. For a number of years the fact that fees have not been recovered on insolvency appointment has been the justification for having a relatively high base rate of fees. I do not see that as necessarily the problem that needs to be addressed.[18]

8.20 Mr Mark Korda, partner at the large liquidation firm KordaMentha, wrote in a submission to this inquiry that the focus on liquidation costs is understandable given that stakeholders are losing money. However, Mr Korda defended the current system of insolvency practitioners being paid predominantly on hourly rates in preference to a system where liquidators receive a percentage of proceeds. He noted:

> We have considered fees being paid as a percentage of realisations. The problem then will be insolvency practitioners will be accused of a quick sale of the assets so as to get paid. We also note that investment banks in the restructuring areas charge significantly more than the hourly rate based insolvency professionals. The hourly rates of the insolvency professionals administering the larger companies are at the lower end of the standard rates of accounting and legal professions.[19]

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17 Mr Michael Kirby, 'Bankruptcy and Insolvency: Change, Policy and the vital role of integrity and probity', Address to the IPAA National Conference, 19 May 2010, pp. 25–26.

18 Mr Geoffrey McDonald, *Committee Hansard*, 13 April 2010, p. 35.

19 KordaMentha, *Submission 32*, p. 2.

8.21 Another large insolvency firm, McGrathNicol recognised that liquidators' fees can often be a vexed issue, particularly with small and medium sized businesses where the costs of insolvency relative to available assets is high. However, the firm argued that the current provisions on creditor approval of fees, rights of oversight by ASIC and appeal to the courts 'adequately provides for the protection of creditors interests'.[20] McGrathNicol argued that in cases where the fee framework may have failed creditors, it is important to address the source of the problem rather than pursue wholesale reform of the system. It noted that these problems could include poor understanding by complainants and the community generally as to the real costs of insolvency.[21]

Criticism of liquidators' excessive fees

8.22 Several submitters and witnesses to this inquiry were critical of the largesse of insolvency practitioners' fees. Most notably, Mr Geoffrey Slater, a barrister, told the committee that the insolvency industry is:

> …an industry of 663 people where people are making millions of dollars a year…For some of the larger firms in Australia we are talking well over $4 million, or $5 million or $6 billion per year for the partners of the insolvency. That is more than any of the partners make at the big firms such as Allens Arthur Robinson or Clayton Utz or anywhere like that. I think even the Prime Minister only earns about $300,000 or $400,000 a year. So the lowest paid liquidator earns three times more than the Prime Minister—something that the committee might want to consider.[22]

8.23 In his evidence to the committee, Mr Slater recited excerpts of court judgments critical of liquidators and their fees. He noted the comments of Justice Palmer in *Hall v Poolman* 2009 [NSWCA]:

> A liquidator is appointed to salvage as much as possible for the benefit of creditors. If a proposed course of action—whether it be a legal proceeding or a commercial transaction—is not likely to produce a worthwhile benefit for creditors, the liquidator should not undertake it simply because it will generate enough to pay the liquidator's fees in undertaking that very transaction or litigation—a practice which is familiarly known in the market place as 'churning and burning'.[23]

8.24 As chapter 5 discussed, the Ariff case highlights the worst excesses of liquidators' fee practices. Mr Fong told the committee that:

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20 McGrathNicol, *Submission 30*, p. 1.

21 McGrathNicol, *Submission 30*, p. 1.

22 Mr Geoffrey Slater, *Committee Hansard*, 13 April 2010, pp. 48–49.

23 Mr Geoffrey Slater, *Committee Hansard*, 13 April 2010, p. 50. For a legal perspective of this case, see: http://www.aar.com.au/pubs/insol/foinsolapr09.htm (accessed 22 May 2010).

> …one of his staff charged $60 for reading an article in the newspaper about him. When we first broke this story to the media *The Australian* published an article. His staff charged $60 just to read an article about his boss doing something wrong.[24]

8.25 Professor Holmes wrote in his submission that once a liquidator is appointed and a fee schedule approved, creditors have little control over the hours worked and the fees accrued. He added:

> This is compounded by the fact that there are no controls over the associated value of outgoings incurred by the VA. There is also no need to keep returning to the creditors, or creditors' panel, to seek approvals for drawing down fees and outgoings. As a result, Ariff went off to luxury resorts, hired limousines and paid his father (who had no role in the actual administration of Carlovers) a retainer of $10,000 a month in undertaking the Carlovers administration.[25]

Cross subsidising

8.26 The committee heard evidence that some liquidators deliberately inflate their costs on the larger, long-running insolvencies to make up for the lack of work (and opportunities to fee gouge) in smaller jobs. This observation was made by Mr Slater:

> A lot of the jobs that official liquidators take on they lose money on. If we are really being honest about this, what we have is a system whereby we let people make up for the loss jobs by absolutely ripping off people on the good, fat and juicy jobs. So it is a cross-subsidy, and that is a nasty little fact that nobody really wants to talk about because to really solve that we have to talk about government funding of loss jobs. The government probably just does not want to fund that. That is how we would solve the problem.[26]

8.27 Associate Professor David Brown noted that under the 'cab rank' principle, official liquidators receive small liquidations and 'do not necessarily get paid for those'. However, he noted that liquidators 'do okay on the bigger jobs'.[27] Associate Professor Christopher Symes suggested that ASIC could be made responsible for undertaking no-asset liquidations.[28]

8.28 Ms Kate Spargo, Chairperson of the Accounting Professional and Ethical Standards Board, commented on the potential for cross-subsidisation in terms of the responses of different-sized firms. She told the committee that:

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

25 Professor Scott Holmes, *Submission 21*, p. 6.

26 Mr Geoffrey Slater, *Committee Hansard*, 13 April 2010, p. 52.

27 Associate Professor David Brown, *Committee Hansard*, 9 April 2010, p. 23.

28 Associate Professor Christopher Symes, *Committee Hansard*, 9 April 2010, p. 25.

> …If there is a lot of that work available to a good firm then they have a greater capacity to also take some other work that may not be at that sort of rate. Some firms will not do that. Some firms will entirely look for the stuff at the other end that I mentioned and will not do any. A lot of good firms who want a good corporate reputation might temper what they do a bit in terms of who the client is and so on. As soon as I say that it sounds wrong, but there are ways to do it that are not wrong.[29]

8.29 Ms Spargo was asked her view of a model whereby the government agency performed the 'low end' jobs to free up the other work. She responded:

> I think the dilemma is that the smaller entity…is often less well resourced, has less sophisticated advisers et cetera and has a board that is less sophisticated…So it is often the entity that really needs the help the most. It often needs it at quite a sophisticated level. If you go up to the other end of the spectrum with big entities, often they are extremely well resourced, they have plenty of advisers and they have plenty of people hanging off them.[30]

Criticism of the court appointed liquidation process

8.30 The committee heard some criticism that the court appointed liquidation process is inefficient and contributes to high fees. In his submission, Mr Della–Putta identified a number of structural problems in the court appointed process which enables liquidators to maximise their profits. These include:

- where solicitors actively encourage a court appointed liquidation process as a means to resolve a dispute even if the company is not in financial difficulty without any obligation to advise clients as to the accurate cost and length of time of the process and with the knowledge that solicitor fees will be paid during the liquidation process;
- liquidators engaged on a non-competitive basis with no obligation to define a scope of work and time line, or competitive fee proposal and under no obligation to proceed only with work which is only required to maximise return to shareholders or statutory obligations; and
- where the Court is in no position to make a detailed assessment of whether the liquidator's claim for fees is reasonable without detailed information from the shareholders which the liquidator is in a position to actively discourage.[31]

Disbursements

8.31 Insolvency practitioners must account to creditors for disbursements or third party costs. These expenses must be 'reasonable and necessary' although they are not

29 Ms Kate Spargo, *Committee Hansard*, 9 April 2010, p. 33.

30 Ms Kate Spargo, *Committee Hansard*, 9 April 2010, p. 33.

31 Mr Pierre Della-Putta, *Submission 10*, p. 3.

part of a practitioner's remuneration. ASIC's submission to this inquiry noted that disbursement expenses might include:

(a) retrieval costs for recovering the company's computer records;

(b) storage costs for the company's books and records;

(c) legal fees;

(d) real estate agent's and auctioneer's fees; and

(e) stationery, photocopying, telephone and postage costs.[32]

8.32 Insolvency practitioners are not required to seek creditor approval for disbursements, but creditors do have the right to question these costs and can challenge disbursements in court.[33]

Criticism of excessive disbursement payments

8.33 The committee also received comment that liquidators have been able to circumvent the provisions of 449E of the *Corporations Act* and inflate their remuneration through disbursement payments. Mr Stephen Epstein SC gave the following example:

> The liquidator will employ a third party to, say, send out notices to creditors. The provision of that service, the posting out of circulars to creditors, can have within it a profit element for whoever gets paid for it. So if the liquidator does it himself, his profit in undertaking the task of posting the circulars is part of his remuneration. If he engages an outside party to post out the circulars to creditors and pays that outside party and treats it as a disbursement then that charge is not the subject of regulation in the same way that remuneration is. Where it is part of the insolvency administrator's function, it ought to be remuneration and not disbursements.[34]

8.34 Mr Epstein suggested to the committee that a solution might be to have regard to the decided case law on the meaning of remuneration and codify the judicial definition of remuneration 'in some more complete fashion than simply using the word without any explanation to it'.[35] He added:

> What I am saying is that what is in truth remuneration and not disbursements should be the subject of the regime which section 449E prescribes…the insolvency administrator ought not to be allowed to outflank the regime for remuneration, which section 449E prescribes, by

32 ASIC, *Submission 69*, p. 42.

33 IPAA Code of Professional Practice, p. 95.

34 Mr Stephen Epstein, *Committee Hansard*, 13 April 2010, p. 31.

35 Mr Stephen Epstein, *Committee Hansard*, 13 April 2010, p. 31.

> characterising payments which in substance are remuneration as activities which are merely disbursements.[36]

8.35 Mr Bill Doherty argued in his submission to this inquiry that disbursement payments are an unusual feature of the insolvency industry. He noted that 'one could reasonably expect' that the hefty hourly fees that insolvency practitioners charge for both themselves and their 'managers' would reflect an overhead component. Instead, photocopying, printing and internal meeting room hire is all charged additionally.[37]

8.36 Mr Slater also identified disbursement payments as a potentially expensive and hidden area of liquidators' fee structure. He likened the liquidation process to appointing a shark and the third party payments as 'a whole lot of fish feeding behind'. Mr Slater elaborated:

> You hear the headline figure the administrator, the liquidator or the insolvency practitioner—or whatever description you want to give them—is going to charge you $400, $600 or whatever per hour. What they do not mention is that there are clerical staff at $300 an hour, the girl who serves up the tea and coffee at the creditors' meeting is being billed out at $300 an hour and the photocopies are being charged out at $2 page and so are the emails. Very quickly you get a cascade effect where you are not supporting the liquidator; you are supporting an entire colony of people who are sucking off the corpse of these companies. Suddenly, then comes a creditors' meeting and they go to approve the remuneration—which is another problem. They say my remuneration is X but, 'We forgot to mention all these disbursements'.[38]

8.37 Various submitters gave their own personal experiences of where third parties were engaged on an anti-competitive or unnecessary basis at substantially above market value. Mr Della-Putta, for example, noted that in his experience a sales agent was employed, a contractor to clear the site and legal advisers 'to dissuade us from objecting to the liquidator's claim for remuneration'.[39]

8.38 Mr Della-Putta recommended that liquidators should only engage third parties on a competitive basis if it is required to facilitate the liquidation or is likely to increase the return to shareholders. Third parties nominated by shareholders to perform work should be selected by liquidators on the basis of at least two fee proposals for any services. Further, he recommended that copies of all invoices from third parties should be provided as part of the report to creditors.[40]

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36 Mr Stephen Epstein, *Committee Hansard*, 13 April 2010, p. 32. *Submission 28*, p. 3.

37 Mr Bill Doherty, *Submission 9*, p. 3.

38 Mr Geoffrey Slater, *Committee Hansard*, 13 April 2010, p. 54.

39 Mr Pierre Della–Putta, *Submission 10, Supplementary*, p. 3.

40 Mr Pierre Della-Putta, *Submission 10, Supplementary*, p. 3.

Priority payment for liquidators

8.39 Insolvency practitioners' remuneration is paid in priority to payments to various other groups, including unsecured creditors. Subsection 556(1)(a) of the *Corporations Act* provides that all proper costs, charges and expenses of and incidental to the winding up (including the remuneration of the liquidator) are payable out of the property of the company in priority to all other claims.

8.40 ASIC notes that generally, the order in which funds are distributed is:

(a) costs and expenses of the liquidation, including liquidators' fees;

(b) outstanding employee wages and superannuation;

(c) outstanding employee leave of absence;

(d) employee retrenchment pay; and

(e) unsecured creditors.

8.41 Each one of these categories must be paid in full before the next category is paid. If there are insufficient funds to pay a category in full, the available funds are paid on a pro rata basis and the next category will be paid nothing.[41]

8.42 The Law Council of Australia argued in its submission that the insolvency practitioner may take on personal liability and their personal expenditure and remuneration is often uncertain. A practitioner may take on litigation with a view to recovering assets or returning transactions, in which case they face personal liability for all costs and expenses in the litigation.[42] The Council thereby argued that in the absence of statutory or standard remuneration for activity in winding up assetless companies, the priority of payment for insolvency practitioners should be maintained.[43]

8.43 The Law Council did recognise the 'understandable dissatisfaction' arising from individuals who have already suffered from a corporate failure, are unfamiliar with the system 'and see practitioners charge large sums of money, which are paid out in priority to their own claims'. Nonetheless, it argued that:

> …given the personal exposure of practitioners, there is no other readily apparent system, which would operate fairly or mitigate the risk in fair manner for practitioners or the public.[44]

8.44 The IPAA defended the priority payment system on the following basis:

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41 ASIC, 'Liquidation: A guide for creditors', *Information Sheet 45*, p. 7.

42 Law Council of Australia, *Submission 68*, p. 4.

43 Law Council of Australia, *Submission 68*, p. 5.

44 Law Council of Australia, *Submission 68*, p. 4.

> Without such a priority, it is unlikely that an insolvency practitioner would be prepared to undertake the work. An insolvent company necessarily has a deficiency of assets over liabilities, and without a priority, the insolvency practitioner would have no expectations of being paid, except in relatively few instances. In this scenario, there would be no reason for a practitioner to accept the appointment and its associated risks. In no other profession is a highly qualified professional expected to work for free on a regular basis.[45]

8.45 Mr Bill Doherty, a victim of Mr Ariff (see chapter 5), took issue with this argument. He told the committee that:

> …the Insolvency Practitioners Association said in…[its] submission that the IPs take on considerable risks which help to justify their extraordinary fees—firstly, the risk of litigation. Actually they do not take a risk there, because what they do is use the company they have seized control of as a litigant. Also, that in taking on assetless administrations they have the financial risk. They do not, because they simply do not do anything when they have them.[46]

8.46 Other witnesses offered broader criticism of the priority payment system, arguing that liquidators' fees effectively accounted for all costs recovered. This point was made by Mr Fong of Carlovers Carwash Limited:

> …the current system is very costly and inefficient. The fact that fees to liquidators and lawyers usually equal what is recovered with no return to creditors, again, says it all. You need to introduce a fixed price regime or introduce more competition to reduce costs.[47]

8.47 Mr Andrew Garrett, a winemaker, wrote in his submission that the priority payment works against the public interest by encouraging insolvency practitioners to make a claim over 'as many assets as possible to ensure the payment (and overpayment) of fees'. He added:

> Often the claims of insolvency practitioners over assets can include unrelated assets that they know cannot be related to their appointment but by making those claims the goal of the practitioners is not to act in the public interest or properly exercise quasi judicial power but rather to act solely in a personal interest resulting in the binding of all classes of assets in claims that will require resolution by a court. As a result of binding all classes of assets (related and unrelated) in such a way; an aggrieved person is rendered impecunious. This has the unenviable consequence of resulting in an aggrieved party often being unable to fund the acquisition of legal advice and effectively contest the actions of insolvency practitioners.[48]

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45 IPAA, *Submission 36*, p. 22.

46 Mr Bill Doherty, *Committee Hansard*, 14 April 2010, p. 9.

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

48 Mr Andrew Garrett, *Submission 13*, p. 2.

Alternatives to the priority system

8.48 The remuneration of insolvency practitioners in the United Kingdom may be set based on assets handled, time spent or a fixed fee. At the first creditors' meeting, the practitioner may propose that fees be paid either:

- as a specified percentage of the value of either the property the IP has to deal with (administration) or the assets which are realised or distributed or both (insolvent liquidation);
- by reference to the time properly given by the administrator and his staff in attending to matters arising in the administration/liquidation; or
- on a fixed basis, as of April 2010.[49]

8.49 The practitioner is able to use any of the three bases, or a combination of these methods, to set his or her remuneration. Different bases may be applied to different functions performed by the practitioner (Amendment to Insolvency Rules 2010).[50]

8.50 In the United States, remuneration is determined by a court. The United States Trustee is responsible for reviewing claims under section 330 and filing objections with the Court, where appropriate.[51]

8.51 In New Zealand, a liquidator is entitled to charge reasonable remuneration for carrying out their duties. An Official Assignee who is appointed as a liquidator must charge remuneration in accordance with rates prescribed by the Governor General under section 277 of the Companies Act.[52]

8.52 Canada's system of paying insolvency practitioners is somewhat similar to Australia's. Section 39 of Canada's Bankruptcy and Insolvency Act establishes that the remuneration of the trustee is voted on by a meeting of creditors. However, where the remuneration of the trustee has not been fixed by creditors, the trustee may receive remuneration in a sum not exceeding 7.5 per cent of the amount remaining out of the realisation of the debtor after the claims of the secured creditors have been paid or satisfied.[53]

The regulation of liquidators' and administrators' fees

8.53 This inquiry has raised questions about the adequacy of current arrangements to monitor both an individual practitioner's fees and the fee structure of the insolvency

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49 Office of Fair Trading, 'The market for corporate insolvency practitioners: A market study', June 2010, pp. 21–22.

50 Office of Fair Trading, 'The market for corporate insolvency practitioners: A market study', June 2010, pp. 21–22.

51 ASIC, *Submission 69*, pp. 112–113.

52 ASIC, *Submission 69*, pp. 112–113.

53 ASIC, *Submission 69*, p. 113.

industry at large. This section considers the committee's evidence and consideration of these issues.

What is 'reasonable'?

8.54 A key issue in the regulation of liquidators' fees is how to indicate to creditors that the fees are 'reasonable'. In December 2008, ASIC published Information Sheet 85 titled *Approving fees: A Guide for creditors*. It details the requirement that the external administrator must send creditors a report when seeking approval of fees. It advises that if work is yet to be carried out, a dollar cap should be set and if the work exceeds this figure, a further creditors' meeting should assess whether to approve a further amount of fees.

8.55 The Information Sheet also notes a range of factors to guide creditors in deciding whether the administrator's fees are reasonable and the options for creditors if they believe the fees are not reasonable.[54] These factors are:

- the method used to calculate fees;
- the major tasks that have been performed;
- the fees for each of the major tasks;
- the size and complexity of the external administration;
- the amount of fees previously approved;
- where the fees are calculated on a time basis:
    - the period over which the work was performed;
    - the time spent by each level of staff on each task; and
    - if there are fees for future work, whether they are capped.[55]

8.56 Most of these factors should be apparent from the remuneration report.

Disclosure and the practitioner's remuneration report

8.57 As mentioned earlier, the *Corporations Amendment (Insolvency) Act 2007* introduced a requirement that insolvency practitioners must prepare a report setting out such matters as will enable the approving body to make an informed assessment as to whether the proposed remuneration is reasonable. The report must include a summary description of the major tasks performed and planned and the costs associated with those tasks.[56] This requirement is established in subsections 449E(5), 449E(6), 449E(7), 473(11), 473(12), 499(6) and 499(7) of the Corporations Act.

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54 ASIC, 'Approving fees: A guide for creditors', *Information Sheet No. 85*, p. 4.

55 ASIC, 'Approving fees: A guide for creditors', *Information Sheet No. 85*, p. 4.

56 ASIC, *Submission 69*, p. 40.

8.58 Insolvency practitioners must also lodge an account detailing their receipts and payments at the end of the six month period beginning on the date of their appointment. They must then lodge an account for every six month period thereafter during which they are the administrator of the company, detailing the aggregate amounts of receipts and payments since their appointment (Corporations Act, subsection 438E(1)). ASIC may cause the accounts of any administrator to be audited by a registered company auditor (subsection 438E(3)). The cost of this audit is fixed by ASIC, and forms part of the expenses of administration (subsection 438E(7)).

A liquidator's view

8.59 Mr Bryan Hughes, Managing Director of Pitcher Partners, urged in his submission to this inquiry that the existing 'extensive remuneration requirements' are not added to. He noted that in accordance with the IPAA Code, practitioners must prepare remuneration reports each time that approval for remuneration is sought. These reports are on average 20 pages in length and address both retrospective and prospective remuneration. Mr Hughes argued that, if anything, the committee's inquiry into the matter of remuneration might consider:

> Whether current Administrator's Reports contain too much information for the average stakeholder to comprehend? Whether the information is meaningful and able to be understood? Whether all stakeholders read such a lengthy report? As always, there should be a cost/benefit analysis of the Remuneration Report, especially when you consider the costs incurred to provide this information, including staff hours required in reviewing timesheets, preparing the report, additional photocopying and postage requirements, which can be significant if you have 200 creditors or more.[57]

8.60 In its submission, Pitcher Partners provided an example of an Administrator's Report to Creditors (pursuant to section 439A of the Corporations Act), which includes a remuneration report.[58] The remuneration report follows the template set out in the IPAA's Code of Professional Practice.

8.61 The first section of the report lists expenses incurred to date, along with a table showing the standard scale of fees for various staff classifications within the firm. There is also a section on disbursements divided into externally provided professional services (legal fees), externally provided non-professional costs (taxis, parking, postage and advertising), and internally provided non-professional costs (photocopying, telephone, fax and mobile use).

8.62 A separate section of the remuneration report sought approval for prospective expenses. It gave two options:

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

58 Monarch Gold Mining Company Limited

- if a deed of company arrangement is approved, the firm 'will seek remuneration for the administration and deed administration not to exceed $606,993, plus GST and disbursements'; or
- if creditors resolve to wind up the company, the firm 'will seek remuneration for the administration and *liquidation,* not to exceed $1,043,256'.[59]

8.63 For both options, the report gave an anticipated time period, a general description of the likely tasks and a list of the specific actions the firm would undertake to deliver these tasks.

Criticism of the fee vetting process

8.64 Some witnesses expressed concern that insolvency practitioners are not subject to the same rigour in scrutinising their accounts as are other professions. Mr Greg Nash told the committee that:

> As a lawyer, my accounts are subject to strict scrutiny—absolutely strict scrutiny. I have to have cost agreement. I have to advise people on how they can challenge my account. I have to have my account submitted for assessment. If I miss some technical detail, I run the risk of not being paid at all for any of my work. Liquidators do not do that. They just give you a list of their charge-out rates. They are supposed to be approved by the court and really that is just a rubber stamp. The court approves whatever is put in front of them. I have never seen a court not approve a liquidator's set of fees.[60]

The need for better data on fees in the insolvency industry

8.65 For the committee, one of the most striking deficiencies in the insolvency regulation framework is the lack of public detail on the fees of the insolvency industry. ASIC's Annual Reports contain no detail on liquidators' and administrators' remuneration.

ASIC's plans

8.66 Encouragingly, ASIC's submission noted that it intends to:

- obtain statistical data from practitioners to allow an assessment of the relationship between asset recoveries, remuneration charged and returns to creditors. Results will be made available to creditors and the market; and
- capture detailed information of insolvency remuneration and other key financial data following a redesign of Form 524 (Statement of Receipts and Payments) and implementation of improved electronic data capture systems.[61]

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59 Pitcher Partners, *Submission 47*, p. 48 of Administrator's report.

60 Mr Greg Nash, *Committee Hansard*, 14 April 2010, p. 7.

61 ASIC, *Submission 69*, p. 79.

8.67 In its supplementary submission, ASIC noted that its forward program includes a project titled *Remuneration: Approval compliance and surveillance project*. The project includes consultation on what further information and disclosures should be made to relevant stakeholders to increase the level of informed approval decisions. ASIC adds that it may also consult and obtain industry feedback on the appropriateness of using 'cost assessors' as an alternative for stakeholders to assess the 'reasonableness' of remuneration.[62]

8.68 The Chairman of ASIC, Mr Tony D'Aloisio, gave the committee an overview of the rationale and focus of its future work on liquidators' fees:

> [W]e want to delve much more deeply into the level of fees to see whether we can come up with guides about relating them to the value of assets recovered, for example. If you recover 50c in the dollar but it costs you 10c to get that 50c, if you have that sort of information as a creditor, you might regard that as good value. If you have recovered 20c in the dollar but in actual fact it then costs you 18c or 20c for that, as a creditor you are going to be pretty annoyed...[N]ow that the framework has the disclosure, the returns and the forms which give you this information, our challenge is going to be, through surveillance and through specific cases, to delve into the quality of the remuneration, the return and the advice that was given. We think that is really to work with the professional because at the end of the day that is a reputation issue for the profession and for the practitioners.
>
> …
>
> They have to demonstrate to their clients, ultimately to the market, that the fees being charged in the context of what work was needed to recover assets in that particular insolvency are reasonable. I see our role in our forward program on the fees is to move from disclosure to testing the quality of the disclosure and to assist creditors to then make judgments about whether they have been treated fairly.[63]

8.69 Several submitters to this inquiry have argued the need for insolvency practitioners' fees to be collated, published and independently analysed on an industry-wide basis. They claim that a central and publicly accessible database of insolvency practitioners' fees would:

- enable a comparison of the level of liquidators' and administrators' fees in Australia relative to other nations;
- allow ASIC to monitor a given practitioner's fees relative to an industry average to indicate possible overcharging; and
- educate the public about what costs are reasonable in a typical insolvency.

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62 ASIC, *Supplementary submission*, pp. 16–17.

63 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, pp. 17–18.

A basis for comparison

8.70 Dr Colin Anderson from the Queensland University of Technology argued in his submission the need for a better system of data collection on insolvency practitioners' fees (among other matters) to allow an international comparison of fee levels. He observed:

> Currently there are academics such as ourselves and other colleagues at various institutions around Australia who are willing to engage in research in areas relevant to the enquiry but it is almost impossible to obtain the appropriate data because it is simply too expensive to purchase it from ASIC and possibly for financial reasons ASIC is unable to provide it without payment. Whilst research funding is available to a certain extent it will not cover the purchase of data. If we take one area relevant to this enquiry – the professional remuneration and fees charged by insolvency practitioners. We have no comprehensive data upon that. There is no comprehensive data enabling any meaningful comparisons or conclusions to be drawn. We would contrast this with the position in the United States where funding by the profession itself has enabled comprehensive data to be collected in this area. If such data were able to be collected in Australia some international comparisons might be possible to see if charges here are higher than in comparable countries. Because of our system it is not possible to obtain this data outside of the government agencies of ASIC and ITSA.[64]

8.71 Mr Jeffrey Fitzpatrick from Flinders University argued that the collation of statistics on insolvency matters could be done by an independent agency. The agency could be the Productivity Commission, the National Institute of Labour Studies at Flinders University, the Australian Institute of Criminology, or a new insolvency unit designated to look specifically at insolvency statistics.[65]

Monitoring an insolvency practitioner's fees

8.72 Better data on insolvency practitioners' fees would also serve as a regulatory tool for ASIC to monitor overcharging and complaints against individual practitioners. As Mr Slater told the committee:

> Every time a liquidator does a job they have to put in a detailed report as to how much money they make from the job and so on. Does anybody actually collect all of this data and put it into a central database? No. Should they? Yes. What would it tell us? It would tell us how much they are charging. More to the point, it would operate as what we call a mineshaft canary with respect to whether the fees are getting too big or there are too many complaints. You could simply look at a histogram of complaints per practitioner, in the same way that Medicare looks at doctor fraud—they say, 'You've got a few too many pathology reports here' or 'Look at this guy:

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64 Professor Colin Anderson, *Submission 79*, p. 3.

65 Mr Jeffrey Fitzpatrick, *Committee Hansard*, 9 April 2010, p. 14.

> there is this huge spike.' That is how they home in on people and use their resources more efficiently. These are the basic sorts of things that should be done at ASIC, which are not done.[66]

8.73 Associate Professor David Brown from Flinders University also acknowledged that one of the problems in the insolvency area is the lack of statistics. He argued that, notwithstanding the existing fee disclosure requirements, this is a legitimate role for a body like an ombudsman to independently assess the reasonableness of liquidators' fees. Associate Professor Brown told the committee:

> I think the IPA code of professional practice devotes quite a lot of its pages to remuneration and to disclosure of the basis of remuneration of insolvency practitioners. This information is put before creditors who, after all, are the ones who normally have the decision as to whether the remuneration could be approved. However, as I have just said, creditors might not always have sufficient skills to access that information. Notwithstanding that there is nowadays more detailed disclosure both through the IPA code and through various court decisions, I think, as Dr Brand identified, a lot of creditors are not repeat victims and therefore are not able to assess the information that comes to them, so some other channel for assessing whether the remuneration rates are value for money is certainly to be welcomed. Whether that is through the ombudsman using some sort of independent assessor or whether the courts need an independent assessor when cases come to court on remuneration is something else that could be developed.[67]

Educating the public as to what is 'reasonable'

8.74 Dr Vivienne Brand from Flinders University acknowledged the need for greater education of creditors to understand the work of liquidators and what a reasonable fee structure might look like. She told the committee that creditors:

> …might well live and work in an economy where to charge $850 an hour is just unbelievable. They do not know what the normal run of a liquidation would look like, so they cannot really tell if they are being ripped off. They do not have the information that the liquidator has. They do not have access to the full understanding of the company's operations. It is very hard for them to make an informed decision about whether or not the liquidator is doing the right thing. I think the liquidator is, most of the time…That is perhaps where an ombudsman has a particular role, because they might be able to help those people understand: this is how it is and, in this particular case, perhaps what happened had to happen.[68]

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66 Mr Geoffrey Slater, *Committee Hansard*, 13 April 2010, pp. 50–51.

67 Associate Professor David Brown, *Committee Hansard*, 9 April 2010, p. 18. *Submission 40*, p. 4.

68 Dr Vivienne Brand, *Committee Hansard*, 9 April 2010, pp. 14–15.

8.75 In his evidence to the committee, Mr Fitzpatrick argued that an industry ombudsman would assist to 'throw some sunlight onto the issue of fees'. He envisaged that an ombudsman would also:

> …probably be able to have an educative role as well so that the creditors would have access to information about what is involved, what the fees are or what the fees should be so they have got some idea of what is going on.[69]

8.76 The issue of educating the public on a reasonable fee structure, and various other matters relating to the insolvency profession, is discussed in more detail in chapters 10 and 11.

Summary

8.77 This chapter has considered the often vexed issue of insolvency practitioners' fees. It has identified specific areas of tension including overcharging through excessive disbursement payments, unnecessarily prolonging an appointment and 'cross-subsiding' jobs. The chapter also observed the fairly weak current incentives for practitioners to become more price-competitive, particularly given the security of the priority payment system and in the absence of a competitive tendering process.

8.78 Nonetheless, as chapters 10 and 11 discuss in more detail, there are currently in place important fee disclosure requirements for insolvency practitioners. This is an important basis for better data on practitioners' fees and better regulation of overcharging and over servicing.

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

PART III

Reforming Australia's corporate insolvency system

This part of the report examines the options for reform of Australia's corporate insolvency system. Part II established that even if the highly publicised cases of insolvency practitioner misconduct are unrepresentative of the performance of the industry at large, there are sufficient concerns with the regulatory framework as to warrant significant recommendations for reform.

Chapter 9 deals with the **lack of adequate data** on corporate insolvency in Australia. It acknowledges that this has been a problem for a considerable time, and emphasises that better data collation and analysis will assist all stakeholders to understand better the nature and scale of misconduct and poor performance in the insolvency profession.

Chapter 10 revisits the problem areas identified in Part 2 and suggests **options to sharpen the incentives for the insolvency profession to improve its standards**, and for ASIC to become more responsive to complaints and more proactive in monitoring practitioners and communicating with stakeholders. Some of these options seek to develop existing practices through better disclosure, complaints handling and outreach programmes. Other options propose significant structural reform: adopting the 'chapter 11' bankruptcy process, creating a single insolvency regulator; establishing a 'flying squad' to monitor practitioners; and setting up an insolvency ombudsman to respond to complaints.

Chapter 11 concludes the report with the **committee's views** on these issues and makes several recommendations.

Chapter 9

The need for better data

I suspect there is gold in the statistics.[1]

9.1 One of the frustrations of this inquiry, and several others into Australia's insolvency industry, is the lack of adequate data to identify precisely the dimensions of the policy problem. Chapter 2 presented some basic data on the industry. Much of this information comes from the Australian Securities and Investments Commission's (ASIC) submission to this inquiry. There is also ASIC's June 2008 report *External administrators: Schedule B statistics 1 July 2004–30 June 2007*.[2] This aside, the committee is not aware of publicly available, properly collated insolvency industry data.

9.2 This lacuna of corporate insolvency industry data is a problem. Effective regulation, policy-making and public debate relies crucially on the collation and analysis of detailed and accurate statistics. This chapter canvasses the committee's evidence on the lack of data, ASIC's plans to improve the situation and some of the broader options for reform.

A familiar theme

9.3 The lack of adequate, publicly available data on the state of the corporate insolvency industry in Australia has been a recurring theme in several past inquiries. In 1988, for example, the Harmer Report commented that statistics on corporate insolvency in Australia are not readily available in any 'comprehensive, identifiable or intelligent form'.[3] The Australian Law Reform Commission (ALRC) described the lack of relevant statistical information as 'one of the major handicaps' impeding its inquiry. Interestingly, the Commission contrasted the lacuna of corporate insolvency statistics with the collection and publication of detailed and relevant information on personal bankruptcies.

9.4 The Harmer Report recommended that statistical information on corporate insolvency should be published by the National Companies and Securities Commission on a quarterly basis with a yearly summary. Specifically, it proposed publishing data on:

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1 Dr Vivienne Brand, *Committee Hansard*, 9 April 2010, p. 14.

2 ASIC, *External administrators: Schedule B statistics 1 July 2004–30 June 2007*, June 2008 http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_132.pdf/$file/REP_132.pdf (accessed 20 June 2010).

3 Law Reform Commission, *General Insolvency Inquiry*, Report No. 45, 1988, p. 27.

- the number of companies subject to a formal insolvency administration;
- a breakdown of those numbers by category (compulsory, voluntary, etc.);
- a breakdown by these categories of the dates of incorporation, the reasons for failure and the principal business activity;
- estimates of the assets and liabilities of the companies; and
- a breakdown of payments made by the practitioner into remuneration, legal costs and dividend to unsecured creditors.[4]

9.5 The Commission envisaged that this information would be gathered from practitioners, who 'should be required to complete a form setting out details of each corporate insolvency administration'.[5] It noted strong stakeholder support for these proposals.[6]

9.6 The 2004 Parliamentary Joint Committee (PJC) on Corporations and Financial Services noted the lack of basic data on the operation of corporate insolvency laws. It quoted a submission from Dr Colin Anderson of the Queensland University of Technology which observed that there is virtually no data on the operation of the voluntary administration procedure beyond the number of commencements. The PJC recommended that ASIC:

> …consider enhancing its capacity to provide more comprehensive, comparable analyses of statutory reports of liquidators for the assistance of journalists, academic researchers, the public and the Government and its own management requirements. Such information should be assessed in terms of maintaining public confidence in the administration and enforcement of corporate laws.[7]

9.7 The Insolvency Practitioners Association of Australia (IPAA) noted the PJC's recommendation in its submission to this inquiry. It also commented that, whether in response to this recommendation or not, in June 2008 ASIC issued a statistical report titled *External administrators: Schedule B statistics 1 July 2004–30 June 2007*.[8] The report was compiled from the estimates and opinions contained in statutory reports lodged with ASIC by practitioners.

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4 Law Reform Commission, *General Insolvency Inquiry*, Report No. 45, 1988, p. 21.

5 Law Reform Commission, *General Insolvency Inquiry*, Report No. 45, 1988, p. 3.

6 Law Reform Commission, *General Insolvency Inquiry*, Report No. 45, 1988, p. 21.

7 'Corporate Insolvency Laws: A stocktake', *Parliamentary Joint Committee on Corporations and Financial Services*, June 2004, p. 5.

8 ASIC, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_132.pdf/$file/REP_132.pdf (accessed 20 June 2010).

The need for better data on insolvencies

9.8 Several groups have commented to the committee on the need to improve the collection and analysis of statistics on the insolvency industry. These comments underline the potential benefit for the regulator, industry associations, practitioners, creditors, academic researchers, the parliament and the public from a thorough and independent system of data collection on insolvency in Australia.

ASIC's forward program

9.9 ASIC Commissioner Mr Michael Dwyer explained to the committee that the data that ASIC has relates to:

- information from liquidators' lodged section 533 reports, which is collated and made publicly available (see ASIC's June 2008 statistical report); and
- information from liquidators' ongoing receipts, payments and statements of position (Form 524), which is publicly available and open for academics to analyse but cannot currently be collated using ASIC's technology.[9]

9.10 Mr Stefan Dopking of ASIC told the committee that ASIC's ability to gather information through section 533 reports has improved in recent times. He noted the PJC report's recommendation that the data from these reports be published triennially and told the committee that the:

> …first batch of triennial data has been published. The next batch of data is due to be published at the end of this financial year. Some have commented that it would be better to have that annually. That is something we are looking at.[10]

9.11 In addition ASIC has advised that as part of its forward program it will obtain 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. ASIC will also improve data collection by redesigning Form 524 relating to receipts and payments.[11]

Technology

9.12 The Chairman of ASIC, Mr Tony D'Aloisio, was asked his view of the IPAA's comment that the Commission must gather and publish more detailed information on insolvencies. He responded that while this task is on ASIC's agenda, it is contingent on an update of their technology:

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9 Mr Michael Dwyer, *Committee Hansard*, 23 June 2010, p. 33.

10 Mr Stefan Dopking, *Committee Hansard*, 23 June 2010, p. 37.

11 ASIC, *Submission 69*, pgs. 9 and 80. Mr Stefan Dopking, *Committee Hansard*, 23 June 2010, p. 37.

> There is a lot of information which comes in through the various forms which are lodged. There are two parts to this. The first is: is all the information being collected what the industry would like? We think it probably is. The second is: how are all the reports prepared and disseminated? We would like to work further to improve those…
>
> Our limitation in relation to the production of those reports at the moment is connected with our star program. ASIC is in the process of a complete rejig of its technology so that it is clearly more up to date. It is quite old, so our systems and our technology do not have the ready ability to convert data, aggregate, produce reports and publish electronically. A lot of our processes are still manual, including the lodgement of these forms. With our new technology platform, which will come in progressively over the next two or three years, we expect we will be in a much better position to provide aggregated reports and data on the information we collect, better than we are doing at the moment.[12]

9.13 The Chairman restated the point in his evidence at a subsequent public hearing. He told the committee:

> At the moment part of where we are with ASIC is that we are upgrading our systems. We will have tremendously more flexibility with the new systems in place to be able to release data and statistics.[13]

Criticism of ASIC's approach

9.14 Mr Geoffrey Slater, a barrister, criticised the lack of system in the way ASIC identifies potential misconduct. As chapter 8 noted, he is particularly critical of the lack of systematic data collection on insolvency practitioners' fees and complaints on the level of charging. Mr Slater argued that the collection of basic statistics is elementary to monitoring and regulating the profession.[14]

The IPAA's view

9.15 The committee acknowledges that the IPAA is a strong supporter of improved insolvency statistics. In evidence to the committee, the IPAA's President, Mr Mark Robinson, commented on the high quality of ASIC's June 2008 statistical report:

> This excellent report gave information such as the average dividend per matter, the industries the liquidations were in, whether they were SMEs or big companies involved, the average time taken to conduct the administration and the number of offences recorded against directors in terms of 533 reports. All of that sort of information is pretty key to understanding where the industry is currently at and where it is trending.[15]

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12 Mr Tony D'Aloisio, *Committee Hansard*, 12 March 2010, pp. 22–23.

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

14 Mr Geoffrey Slater, *Committee Hansard*, 13 April 2010, p. 50.

15 Mr Mark Robinson, *Committee Hansard*, 12 March 2010, p. 45.

9.16 The IPAA stated in its submission that while it welcomed ASIC's 2008 report:

> …we consider it is essential that more detailed and current information on insolvencies should be gathered by ASIC and published. For the purpose of this submission, the IPA conducted its own limited member surveys but we were constrained by the fact that much basic and current information about corporate insolvencies is not readily available.[16]

Academics' perspectives

9.17 The committee received evidence from several legal academics based in Brisbane and Adelaide who were critical of the lack of public data on insolvency.

9.18 Dr Anderson and Dr David Morrison from the Queensland of University have argued for some time about the need for better insolvency statistics. As noted earlier, Dr Anderson put this case in a submission to the 2004 PJC inquiry. In his submission to this inquiry, he cited the PJC's recommendation on better insolvency data (see paragraph 9.6) and urged the committee to take action.[17]

9.19 Indeed, Dr Anderson and Dr Morrison identified the independent collection of data associated with business failure and the operation of the insolvency regime as the one positive outcome—above all others—that this inquiry could achieve. They reasoned that in the absence of this data, it is very hard to tell how many 'Ariff type' problems exist.[18] They argued that:

> It is possible to argue that the level of wrongdoing by insolvency practitioners is small relative to the matters that they deal with. This is no doubt the basis of some submissions to the enquiry. On the other hand it could be widespread, necessitating changes to the law and practice. The bottom line is that we simply do not know.[19]

9.20 The same argument was made by Associate Professor David Brown from the University of Adelaide Law School. He argued that without better data on the industry, it is difficult to know the size of the misconduct problem:

> We see a few cases coming to court, we see a few enforceable undertakings being accepted by ASIC and we think that that must be, if not the tip of the iceberg, surely not the extent of the problem. Therefore, it would be good if the statistics reflected that.[20]

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16 IPAA, *Submission 36*, p. v. See also Mark Robinson, *Committee Hansard*, 12 March 2010, p. 45.

17 Dr Colin Anderson, *Committee Hansard*, 23 June 2010, p. 17.

18 Dr Colin Anderson, *Committee Hansard*, 23 June 2010, p. 16

19 Dr Colin Anderson, *Submission 79*, p. 2.

20 Associate Professor David Brown, *Committee Hansard*, 9 April 2010, p. 22.

Comparisons

9.21 Associate Professor Brown also commented that the UK and New Zealand governments have far more developed data gathering mechanisms than Australia. He explained to the committee that:

> The way the World Bank, the IMF and others conduct these types of inquiries is that they normally send a questionnaire to the government and get someone to provide information. But it is fair to say that in the UK there are a panoply of regulators and self regulators in the insolvency industry and there is no shortage of statistics kept by the government insolvency service and by the separate regulatory professional bodies. So I would not think that it is a problem in the UK. In New Zealand there is not any regulation, really. Again, it would be the government supplying the statistics.[21]

9.22 In the context of international comparisons, Dr Anderson told the committee that one of the important matters in all jurisdictions is the issue of how much liquidators are being paid as opposed to how much they are returning to creditors. On this score:

> …we have no information in Australia about how we rate…[T]here has been a large study in the US so we have started there about how much the costs are. You could make those sorts of international comparisons if you had that data here. As I understand it, liquidators have to put in an account or report at the end of each administration and within that is included things like fees and costs. It would appear to us that at least a start could be made on collating some of that information if it were used.[22]

Academic research

9.23 From a professional viewpoint, Associate Professor Brown expressed his frustration at the lack of adequate insolvency statistics. He told the committee that it is difficult to inform students of even basic data, such as the number of administrations in 2009. Further, the data that is available is not presented in a user-friendly manner.[23]

9.24 Dr Morrison noted that the purpose for which ASIC wants insolvency data and the academic community's interest in this data often does not intersect. He told the committee that:

> …if you want data from ASIC, if you are an academic and you would like to look at something independently, unless it is a priority area that is presumably flagged between the government and ASIC, ASIC cannot provide it to you. If you want to pay to get data at ASIC, even if you can afford to pay for it—and most of us cannot, of course, because we are

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21 Associate Professor David Brown, *Committee Hansard*, 9 April 2010, p. 22.

22 Dr Anderson, *Committee Hansard*, 23 June 2010, p. 19.

23 Associate Professor David Brown, *Committee Hansard*, 9 April 2010, p. 22.

> employees of the government and therefore paid small amounts of money—the records they have are based on paper and microfiche, so you have to pay a search fee every time you want something and you have to go into quite an archaic set of files. So, even if ASIC wanted to help people with independent information, they actually do not have the technology to do it, and that is a very stark contrast to ITSA, the bankruptcy regulator.[24]

9.25 In response to this comment, Mr Warren Day of ASIC told the committee that historical data on insolvencies predating the creation of ASIC is available on microfiche. He noted that ASIC is in the middle of a project to scan the microfiche information 'so that it is all more accessible by academics and other parties'. Mr Day acknowledged Dr Anderson and Dr Morrison's concerns about the cost of accessing this data, but explained that the payments are required by law.[25]

Options for reform

9.26 Dr Anderson and Dr Morrison proposed that an information gathering agency should be established that is independent from the regulator and focussed in its task of researching and analysing the data. They suggested that this agency could be structured 'along the lines of the Australian Institute of Criminology'.[26]

9.27 The academics emphasised the importance of the new agency's independence from the regulator. Their argument was based on probity and resource considerations. On ensuring probity, Dr Anderson told the committee:

> Our point of view is that if you rely upon data which is coming from the regulator then it always raises the question of whether you are being told only what you want to hear. I am not saying that either ASIC or ITSA are doing that, but it raises that potential problem. It seems to us that in an important area like the regulation of the economy through corporations and through insolvency there is room for some way of funding information in an independent way.[27]

9.28 On the issue of adequate resources, Dr Anderson and Dr Morrison explained that ASIC currently uses the data it gathers only in a supervisory sense. They saw this as 'not surprising' given the competing demands upon ASIC's resources and the lack of any incentive to provide researchers with the access they require to undertake meaningful independent research.[28]

9.29 Dr Morrison contrasted ASIC's publication of data with that of the Insolvency and Trustee Service Australia (ITSA). He told the committee that the contrast between

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24 Dr David Morrison, *Committee Hansard*, 23 June 2010, p. 17.

25 Mr Warren Day, *Committee Hansard*, 23 June 2010, p. 33.

26 Dr Anderson, *Submission 79*, p. 3.

27 Dr Colin Anderson, *Committee Hansard*, 23 June 2010, p. 16.

28 Dr Colin Anderson, *Submission 79*, p. 3.

the paucity of insolvency data on ASIC's website and the detailed data on ITSA's website is 'quite remarkable'. The Australian Taxation Office also has 'quite a remarkably well set up and resourced website' which shows that it is possible for a large government agency to provide 'relevant, accurate and timely information'.[29]

9.30 Mr Jeffrey Fitzpatrick from Flinders University also argued that ASIC is not well placed to gather the requisite statistics on insolvency matters. He was asked whether the Productivity Commission might be the appropriate body for this task and responded:

> It could be the Productivity Commission but if you think of other examples, there is the National Institute of Labour Studies at Flinders which looks at labour statistics, there is the Australian Institute of Criminology that looks at criminology statistics, there might be the need for an insolvency unit that looks at insolvency statistics so that they can be processed in a meaningful way. ASIC is stretched to the limit and to expect them to do everything for everybody is an impossible task.[30]

Committee view

9.31 The committee strongly agrees with the view that there needs to be a better system for collating and analysing corporate insolvency data in Australia. It agrees with Dr Anderson and Dr Morrison that the lack of data is an issue that needs to be addressed in a comprehensive way to ensure confidence in information about the perceived problems and the policy that results. Chapter 11 makes a recommendation to this end.

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29 Dr David Morrison, *Committee Hansard*, 23 June 2010, p. 17.

30 Mr Jeffrey Fitzpatrick, *Committee Hansard*, 9 April 2010, p. 15.

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]

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

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.

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.

Chapter 11

The committee's views and recommendations

11.1 The final chapter of this report makes important recommendations on each of the report's three key themes—the regulation, registration and remuneration of the insolvency profession in Australia. The committee considers that there is clearly a strong case for a new framework to enhance oversight of the insolvency profession.

11.2 In making these recommendations, the committee is mindful of how its proposals are likely to interact with each other. As far as possible, the intent is to make these measures complementary and to ensure they build on existing structures and systems. There are useful systems and processes currently in place in the oversight of the insolvency industry in Australia. Notwithstanding the need for structural reform, the committee's intent is to preserve and enhance these elements.

Regulating the profession

11.3 As chapters 4 and 6 discuss in detail, the committee heard a range of evidence concerning the role and competence of the Australian Securities and Investments Commission (ASIC), the Companies and Liquidators Disciplinary Board (CALDB) and the Insolvency Practitioners Association of Australia (IPAA). The criticism of ASIC's approach to monitoring the insolvency industry as outlined in chapter 6 of this report is of particular concern for the committee.

11.4 ASIC has consistently claimed that it has the resources to fulfil its current responsibilities in insolvency matters.[1] It has also admitted that there are areas in which it could improve.[2] Taken together, these comments suggest that ASIC believes it can address these areas without more funding, provided its responsibilities in insolvency are not increased.

11.5 However, the committee believes that regardless of funding, ASIC is overburdened. The oversight of insolvency practitioners is just one of 13 'stakeholder teams' within ASIC's organisational structure.[3] Its 2008–09 Annual Report lists six strategic priorities, none of which relate directly to corporate insolvency matters.[4] Understandably, the strategic priority of managing the domestic and international implications of the Global Financial Crisis has consumed much of ASIC's time and resources.

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1 Senate Economics Committee, *Senate Estimates*, 11 February 2010, p. 183.

2 Mr Tony D'Aloisio, *Committee Hansard*, 23 June 2010, p. 22.

3 ASIC, *Annual Report 2008–09*, p. 57.

4 ASIC, *Annual Report 2008–09*, pp. 04–05. One of the priorities related to improving responsiveness to complaints.

11.6 The committee believes that corporate insolvency in Australia needs more priority and prominence in the regulatory framework. This will not be achieved through more funding and responsibilities for the same overburdened agency. Rather, as chapter 10 flagged, the committee argues that there is a need to combine the regulation of personal bankruptcy and corporate insolvency under the one body. This would be best achieved by transferring ASIC's corporate insolvency responsibilities to within the Insolvency and Trustee Service Australia (ITSA). The new agency would therefore be under the Attorney-General's portfolio.

11.7 The committee foresees several benefits in this reorganisation. These include:

- giving more prominence to corporate insolvency matters through enabling the Chief Executive of the new structure greater control and focus over day-to-day functions and more strategic oversight;
- promoting a more proactive mindset in the regulation of corporate insolvency, conducive to establishing a flying squad and a system of licensing (see recommendations 3 and 5);
- the opportunity to feed off ITSA's current processes to devise a panel interview and written exam to screen corporate insolvency practitioner applicants;
- greater coordination of the registration process and hence a lower compliance burden given that many practitioners are registered as both personal and corporate insolvency practitioners;
- improving corporate insolvency data gathering and dissemination through building on ITSA's systems;[5] and
- providing an opportunity to treat insolvency matters more holistically.

11.8 The committee recognises that the creation of a single insolvency regulator built on ITSA's framework would require a transfer of ASIC's skills and expertise on corporate insolvency matters. Both ITSA and the IPAA commented that ITSA does not currently have that knowledge.[6] The committee believes it should be possible to transfer resources, however.

Recommendation 1

11.9 The committee recommends that the corporate insolvency arm of ASIC be transferred to ITSA to form the Australian Insolvency Practitioners Authority (AIPA). The agency should be governed by the *Financial Management and Accountability Act* under the Attorney General's portfolio.

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5 See David Morrison, *Committee Hansard*, 23 June 2010, p. 18.

6 See Mr Mark Robinson, *Committee Hansard*, 23 June 2010, p. 7; Ms Veronique Ingram, *Committee Hansard*, 13 April 2010, p. 60.

11.10 The Memorandum of Understanding between ASIC and ITSA should be updated to ensure that ASIC provides to the new agency adequate resources and the expertise needed to support the oversight of corporate insolvency sector.

11.11 The committee believes that as part of this restructure, the government should also review the *Bankruptcy Act 1966* and the *Corporations Act 2001* to examine opportunities to harmonise personal and corporate insolvency legislation (see chapter 10).

Recommendation 2

11.12 The committee recommends that the government commission the Australian Law Reform Commission to inquire into the opportunities to harmonise Australia's personal insolvency and corporate insolvency legislation. The Commission must report to the government within 12 months of the tabling of this report.

Proactive surveillance

11.13 Chapter 10 noted two options to improve the monitoring of corporate insolvency practitioners: an annual (or biennial) review of all practitioners and a random audit through a 'flying squad'.

11.14 Firstly, the committee believes that the current approach to monitoring the practices of insolvency practitioners is inadequate (see chapters 5 and 6). The complaints system alone, however responsive and attuned, will not deter all misconduct. A proactive approach is needed to deter misconduct and place practitioners on notice that, either on a random or systemic basis, they will be monitored.

11.15 The question then becomes, which of these two proactive options is preferable. The annual inspection program that ITSA employs has the advantage of being relatively thorough in the detection, and therefore the deterrence of misconduct.[7] A flying squad might use the regulator's market intelligence, but the surveillance of particular practitioners would be done randomly. One would therefore expect a flying squad to have lesser impact in terms of both detection and deterrence of misconduct.

11.16 The flying squad has the advantage of being less costly than the ITSA model. Chapter 10 noted ASIC's estimate that an additional 65 full time employees would be needed for it to conduct an annual inspection of all 662 insolvency practitioners. If correct, this constitutes a tripling of ASIC's current staffing load in the corporate insolvency area.

7 While ITSA inspects every practitioner, the selection of files is done randomly.

11.17 The committee's view is that as a first step towards a more proactive approach, the new regulatory agency should have a flying squad that conducts spot checks of insolvency practitioners. It believes that this initiative would have a considerably greater effect on both the detection and deterrence of practitioner misconduct than the current complaints system. The work of the flying squad must be based on detailed and accurate market intelligence and data analysis.

Recommendation 3

11.18 The committee recommends that a 'flying squad' be established within the new insolvency regulator. The unit should be responsible for conducting investigations of a sample of insolvency practitioners, some selected at random, others with the aid of a risk profiling system and market intelligence.

An Insolvency Ombudsman

11.19 Chapter 10 noted the support of several submitters to this inquiry for an Insolvency Ombudsman. In large measure, this support reflected complainants' frustration with ASIC's current complaints handling process and the widespread perception that the CALDB is inefficient in its role and subject to ASIC's direction.

11.20 The committee notes that the Office of Fair Trading in the UK has recently recommended the creation of an independent complaint handling body with the ability to review complaints and assess fees. It proposed that the body should be funded by the IP profession and should be able to sanction insolvency practitioners in a way that deters future transgressions. If the body finds that a practitioner has overcharged, it should have the power to order that any overcharge be returned to creditors.[8]

11.21 The committee can see several potential advantages to establishing an Insolvency Ombudsman. These include:

- a designated body to review promptly smaller financial matters;
- providing a voice for complainants;
- performing an educative role on what is acceptable conduct and reasonable fees;
- maintaining community confidence in the insolvency regime;
- a body that is independent from the regulator and is not subject to directions from the regulator;
- an Ombudsman appointed for a fixed term and must not be—or be able to be perceived as—an advocate for the insolvency industry;
- a body with statutory power to dismiss a liquidator from an appointment; and

8 Office of Fair Trading, 'The market for corporate insolvency practitioners', June 2010, p. 7.

- a body that is able to enquire into systemic issues as well as individual complaints.

11.22 However, the committee believes the priority must be to establish the structure and role of the new insolvency regulator. It is hoped that the new Authority's complaints system will be responsive to the concerns of small creditors and businesses. If a new regulatory insolvency agency is established and the government considers that it is *not* handling complaints promptly and effectively, then the committee believes that an Insolvency Ombudsman should be seriously considered.

11.23 If an Insolvency Ombudsman is created, it is important to establish a clear delineation between its powers and responsibilities and those of the regulator and the disciplinary board. While an Ombudsman must not be subject to direction from either the regulator or the disciplinary board, there would need to be some level of coordination between these bodies.

11.24 An Ombudsman should have the power to obtain information from the regulator and must be able to refer a matter it has investigated to the CALDB for disciplinary proceedings. The regulator should be able to refer a matter to the Ombudsman, where it is deemed appropriate. Both the regulator and the Ombudsman should be able to obtain information on matters that the other has investigated. The Ombudsman should have an unconditional right to make public reports and statements on the findings of investigations and on issues giving rise to complaints.[9]

The CALDB

11.25 The committee believes that the CALDB should be retained in its current form. The Board's focus will continue to be on determining the disciplinary action to take against practitioners.

11.26 The committee is concerned, however, that the CALDB's investigative and adjudicative processes lack transparency. It believes that the Board's deliberations and findings should be given in open unless there is a ruling otherwise. Past hearings and evidence of the CALDB should also be open to inspection by any person.

Recommendation 4

11.27 The committee recommends that section 213 of the *Australian Securities and Investment Commission Act 2001* be replaced with the following:

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9 This is consistent with the criteria for an Ombudsman as endorsed by the Executive Committee of the Australian and New Zealand Ombudsman Association (ANZOA). See 'Essential criteria for describing a body as an Ombudsman', *ANZOA Policy Statement*, February 2010, http://www.anzoa.com.au/ANZOA%20Policy%20Statement_Ombudsman_Essential%20Criteria.pdf (accessed 9 July 2010).

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

Registration

11.28 Chapter 7 of this report referred to the idea of a licensing system to replace the current registration system for insolvency practitioners. The committee strongly supports this idea for the flexibility that a licensing system gives the regulator to review, suspend and cancel a practitioner's appointment.

Recommendation 5

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

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

11.31 The committee also supports the idea of a licensing fee to be levied prior to licensing new practitioners and upon renewing licenses. It should be clearly stated on forms requiring this payment that purpose of the fee is to cover the insurance industry for its new responsibilities.

Recommendation 6

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

11.33 As discussed in Chapter 7, the committee believes that insolvency practitioners, like other professionals, should undertake continuing professional development and education.

Recommendation 7

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

A written exam and / or an interview

11.35 The committee supports the introduction of a written examination, the passing of which should be a pre-requisite for gaining a license as an insolvency practitioner. The examination should be 'closed book' and must test candidates' knowledge of their fiduciary duties as a practitioner. It should cover issues including the conduct of meetings, the use of casting votes, different types of resolutions, basic equitable legal concepts, as well as recent legislative changes to consumer protection and corporations law.

Recommendation 8

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

11.37 The committee recommends that the new regulator convene an eight person advisory panel to discuss and devise the format and content of the examination. The panel should include a senior official from the new Insolvency Authority, a representative from the Institute of Chartered Accountants of Australia, a representative from the Insolvency Practitioners Association (IPAA), an insolvency practitioner nominated by the IPAA, two academic experts on insolvency law, a person nominated by the Australian Bankers' Association and a person nominated by the Council of Small Business Organisations of Australia. The committee suggests that this panel reconvene annually to discuss any changes that should be made to the content and format of the examination.

Recommendation 9

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

- **a representative from the Institute of Chartered Accountants of Australia;**
- **a representative from the Insolvency Practitioners Association (IPAA);**
- **an insolvency practitioner nominated by the IPAA;**
- **two academic experts on insolvency law chosen by the Authority;**
- **a person nominated by the Australian Bankers' Association;**

- **a person nominated by the Council of Small Business Organisations of Australia; and**
- **a person nominated by a consumer advocacy group.**

Professional indemnity insurance

11.39 The committee believes it is very important that the administration of section 1284 of the *Corporations Act* relating to professional indemnity (PI) insurance is tightened. Currently, ASIC's approach is to wait for confirmation in annual statements by liquidators that practitioners have adequate PI insurance. It is also of concern that insurance companies have advised the IPAA that they do not offer run-off cover. This is despite ASIC's *Regulatory Guide* stating that practitioners should obtain run-off cover for as long as reasonably practicable (see chapter 7).

11.40 Other requirements should be put in place to provide the regulator and the public greater assurance that registered practitioners have not let their PI insurance lapse. In the committee's opinion, the regulator must work with insurance companies to devise a system whereby the company advises the regulator when a registered liquidator is operating without PI insurance. If the insurance company advises that a practitioner's PI insurance has lapsed or expired, the regulator should contact the practitioner and give 14 days to update their insurance. If it is not updated in this time, the regulator should suspend the practitioner's license.

11.41 The regulator should, as part of its random and routine checks of practitioners (see recommendations 3 and 5), sight the PI insurance documents of the practitioner. The licensing fee (see recommendation 6) should be hypothecated to assist the insurance industry to cover the monitoring costs of this system.

Recommendation 10

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

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

Recommendation 11

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

11.45 As chapter 10 discussed, a typical PI insurance policy will cover practitioners for negligence but not fraud. Premia are considerably higher for policies that cover fraud and wrongdoing. The Law Society operates a fidelity fund to cover its members for fraud and wrongdoing. The committee believes a similar arrangement would be appropriate for the insolvency profession.

Recommendation 12

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

Remuneration

11.47 The committee notes the concerns of many contributors to this inquiry about the high level of fees being charged by liquidators. It recognises that in some cases, these charges may well be justified given the complexity of the task and the practitioner's exposure to risk. In other cases, there is clearly overcharging and over servicing.

11.48 Chapter 10 noted various proposals for reforming the remuneration system. These included:

- a committee-set schedule of fees;
- reintroducing scale rates for each staff member, depending on education and experience;
- establishing a fixed price government tendering process for appointments;
- limiting appointments to a timeframe that is pre-set with company directors;
- requiring the administrator to set a baseline value for assets and fixing remuneration according to the realisation of this value;
- a competitive tendering process for each appointment;
- broadening the educational statutory requirement for registration; and
- improved disclosure and itemising of fees.

11.49 In this context, the committee makes two points. The first is that the market must set prices to remunerate practitioners. It is important that complex work done to a high standard attracts commensurate financial reward. The committee believes that any attempt to control practitioners' fees will create distortions and disincentives. The first four of the options listed above fall into that category.

11.50 The suggestions of a competitive tendering process and a set timeframe (items 3 and 6, above) are appealing in principle. However, they would force insolvency practitioners to meet pre-agreed estimates on cost and time. The committee feels that this is unreasonable given that the complexity of an insolvency job is often not apparent prior to an appointment.

11.51 The second point, however, is that the market for insolvency practitioners is distorted as it is. Practitioners lack adequate incentives to offer fees that are genuinely commensurate with the efficient and effective performance of their duties. The market lacks the competitive tension that would put downward pressure on practitioners' fees, and return more to creditors' pockets.

11.52 In this context, mention should also be made of the priority payment system for liquidators and administrators. The committee is aware of the arguments for keeping and for changing this system. On the one hand, there needs to be a guarantee that a practitioner will be remunerated for his or her work. The priority payment system provides that assurance. On the other hand, a system whereby the liquidator receives full payment before a secured or unsecured creditor receives any return seems to lack incentives for the practitioner to maximise returns to creditors.

11.53 In the absence of data on the proportion of funds taken by the liquidator as fees and by secured and unsecured creditors, it is difficult to recommend any change to the priority payment system. The committee suggests that once this data is collected and properly analysed (see recommendation 17), consideration should be given to various options for reform. One option is to set a pre-agreed baseline fee for the liquidator, beyond which secured and unsecured creditors would be paid. If there are funds remaining after these payments, the liquidator would receive a further payment.

Introducing competition

11.54 The committee believes the best way to resolve the problem of overcharging and over servicing is to open the profession to more entrants. Presently, the requirements for registration as a liquidator are for 'a course of study in accountancy of not less than three years' and 'a course of study in commercial law of not less than two years'.[10] The committee believes the profession should also attract applicants with suitable experience from the legal profession as well as applicants with a Masters in Business Administration and relevant commercial experience. The committee emphasises, however, the importance of a written examination to screen the wider range of applicants (see recommendations 8 and 9).

Recommendation 13

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

> **…is an Australian Legal Practitioner holding a current practising certificate with at least five years' post admission experience as a practising commercial lawyer;**
>
> **and / or**
>
> **…holds a Masters of Business Administration with at least five years' commercial experience.**

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10 Section 1282(2)(a)(ii), *Corporations Act 2001*

Dismissing a liquidator

11.56 The committee is concerned that there are no checks against a dishonest liquidator from charging more than the costs cited in the remuneration report. As in the Ariff case, there is nothing that creditors can do to stop a liquidator in the middle of the process to check the veracity of the remuneration report.[11]

Recommendation 14

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

11.58 The committee believes that in addition to the proposed insolvency regulator having the power to dismiss a liquidator, the courts should be able to remove a liquidator. Currently, section 503 of the *Corporations Act* states that '[T]he Court may, on cause shown, remove a liquidator and appoint another liquidator'. This section should be amended to state that:

> For purposes of this section, cause shown includes:
>
> (a) A vote of no confidence by a majority of creditors;
>
> (b) Where it appears time based charging of the incumbent liquidator has not or will not result in a reasonable cost-benefit analysis for the company.

Recommendation 15

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

> **For purposes of this section, cause shown includes:**
>
> **(a) A vote of no confidence by a majority of creditors;**
>
> **(b) Where it appears time based charging of the incumbent liquidator has not or will not result in a reasonable cost-benefit analysis for the company.**

Disclosure

11.60 The committee believes that the remuneration report template established by the IPAA's Code of Professional Practice is a sound and clear basis upon which to inform creditors of past and future expenses. The committee views the remuneration report as a key measure to hold liquidators to account and guard against overcharging and over servicing. It is crucial that company directors and creditors can readily access an itemised list of past and proposed expenses.

11.61 The committee believes that while disbursement payments are an inevitable part of the insolvency process, they need to be clearly and accurately listed in the

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11 See *Committee Hansard*, 14 April 2010, pp. 43–44.

remuneration report. It is also important that the new regulator alerts creditors to their right to query disbursement payments. The regulator must also be alert to and dissuade attempts to blur the distinction between disbursement payments and the section 449E understanding of 'remuneration'.

Recommendation 16

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

Better data

11.63 The committee considers that there is a strong need for industry-wide data on the fees charged by insolvency practitioners. Properly gathered, published and analysed, this data will be a useful source for the regulator to identify potential cases of over charging and for creditors and the public at large to make an assessment of what is a reasonable fee for a practitioner's services. For each appointment, data must be gathered on:

- the type of insolvency (VA, court appointed etc);
- the proportion of total assets recovered;
- the return to creditors;
- the method of calculating fees;
- the hours spent and staff rates paid;
- the cost of disbursements; and
- the size of the liquidator or administrator (employees and capital).

Recommendation 17

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

A final comment

11.65 The committee recognises that the role of the insolvency practitioner is important to the proper functioning of a market economy. Practitioners require a range of financial, investigative, written and interpersonal skills to perform their role well. Their proficiency allows troubled businesses to stay afloat and, where this is not possible, enables vulnerable creditors to maximise their returns. The committee also acknowledges that the process of corporate insolvency is often turbulent and distressing for company directors and employees. Insolvency practitioners deserve to be properly remunerated.

11.66 By the same token, the insolvency profession must also be properly regulated. There are significant responsibilities vested in the insolvency practitioner to act in the interests of creditors and employees and in the public interest. Accordingly, there must be an effective framework to promote high performance and deter misconduct.

11.67 This inquiry has found several regulatory gaps in the framework for regulating insolvency practitioners in Australia. Of greatest concern is that ASIC lacks a proactive approach and its response to complaints is often slow and unsatisfactory.

11.68 The recommendations made in this chapter are bold and substantive. The committee believes they are necessary and, in many cases, long overdue. It foresees several advantages from transferring ASIC's insolvency functions to within ITSA, all of which will improve the monitoring of the corporate insolvency profession.

11.69 In the committee's opinion, the financial costs associated with implementing the recommendations are far outweighed by the deterrent effect they will have on misconduct. Moreover, if properly implemented and enforced, the recommendations will restore stakeholders' and the public's confidence in the performance and reputation of corporate insolvency industry.

11.70 To this end, the committee believes it is important that there is a review of the effectiveness of the recommendations that are implemented from this inquiry. In particular, it is necessary to evaluate the effect of the proposal to widen eligibility to become an insolvency practitioner (recommendation 13). If this recommendation is implemented, the Senate Economics References Committee should, after five years, revisit the matter in light of the trends in fee growth. If fees have increased substantially over this period, there may be a strong case to consider more prescriptive measures to ensure the clients of insolvency practitioners receive value for money.

Senator Alan Eggleston
Chair

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Maicon Engineering
2	Confidential
3	Mr Steven Kugel
4	Confidential
5	Mr Vanda Gould
6	Dr Vivienne Brand
7	BizExchange Pty Ltd
8	Mr Michael Mumford
9	Mr Bill Doherty
10	Mr Pierre Della-Putta • Supplementary Submission
11	Mr Antal Bittmann • Supplementary Submission
12	Mr Grant Gittus
13	Mr Andrew Garrett
14	Ms Patricia Norden
15	Mr Richard Wright
16	Confidential
17	Confidential
18	Treasury • Supplementary Submission
19	Co-operative Federation of Victoria
20	Confidential
21	Professor Scott Holmes
22	Confidential
23	Confidential
24	Paul Gleeson
25	Adamstown Rosebud Sport & Recreation Club Co-op Ltd
26	Carlovers Carwash Limited & Berjaya Corporation Berhad
27	Confidential
28	Mr Stephen Epstein
29	Confidential
30	McGrathNicol
31	Australian Credit Forum
32	KordaMentha
33	Mr Geoffrey McDonald
34	Confidential
35	Confidential
36	Insolvency Practitioners Association of Australia • Supplementary Submission
37	Confidential
38	Confidential

39 Mr Martin Vink
40 Associate Professor David Brown
- Supplementary Submission 1
- Supplementary Submission 2

41 Mr Duncan Ross
42 Kaizen Enterprises Pty Ltd
43 Confidential
44 Confidential
45 Confidential
46 Boundary Bend Ltd
47 Pitcher Partners
48 Insolvency and Trustee Service Australia
49 Accounting Professional & Ethical Standards Board Ltd
50 Mr Bevan Crowley
- Supplementary Submission

51 Confidential
52 Mr Ron Coomer
- Supplementary Submission

53 Confidential
54 Mr Brian Powell
55 Confidential
56 Confidential
57 Confidential
58 Confidential
59 Confidential
60 Confidential
61 Armidale Dumaresq Council
62 Confidential
63 Confidential
64 Confidential
65 Confidential
66 The Institute of Chartered Accountants in Australia
67 Confidential
68 Law Council of Australia
69 Australian Securities and Investments Commission
- Supplementary Submission

70 Mr Bernard Wood
71 Confidential
72 Confidential
73 Confidential
74 Mr Nicholas Bishop
75 Confidential
76 Confidential
77 Crouch Amirbeaggi Insolvency Accountants
78 Mr Jeffrey Bradford
79 Dr Colin Anderson
80 Name Withheld
81 Confidential
82 Mr Claude Cassegrain
83 Confidential
84 Confidential

85 Mr Stephen Koci
86 Mr Jeffrey Knapp
87 Victorian Independent Education Union
88 Confidential
89 Confidential
90 Confidential
91 Confidential
92 Mr Bevan Crowley
93 Name Withheld
94 Confidential
95 Confidential

Additional Information Received

- Received from Treasury: answers to Questions on Notice taken at a public hearing in Canberra on 12 March 2010
- Received from Vivienne Brand, Jeffrey Fitzpatrick and Christoper Symes on 17 May 2010: answers to Questions on Notice taken at a public hearing in Adelaide on 9 April 2010

TABLED DOCUMENTS

SYDNEY, 13 April 2010

- Tabled by Vanda Gould: opening statement
- Tabled by Vanda Gould: correspondence between Gould and ASIC exchanged between 24/12/09 and 06/04/10, including agreement to resolve proceedings between Gould and CALDB & ASIC
- Tabled by Geoff Slater: submission

NEWCASTLE, 14 April 2010

- Tabled by Bill Doherty: newspaper article *'One man's trash is another man's pressure'*
- Tabled by Ian Fong: correspondence between Fong, ASIC and Fong's lawyer
- Tabled by Edward Maher: report to creditors from Ariff regarding Armidale YCW Rugby League Football Club
- Tabled by Edward Maher: Armidale YWC Rugby League Football Club financial report for year ending 2006
- Tabled by Richard Wright: ANZ 1999 Annual Report
- Tabled by Richard Wright: BA & RB Wright & Partners brochure
- Tabled by Richard Wright: correspondence from Wright to Board Director of ANZ
- Tabled by Richard Wright: Jeogla v ANZ (1999) NSW Supreme Court
- Tabled by Richard Wright: folder entitled 'Liquidators' containing correspondence

- Tabled by Richard Wright: folder entitled 'ASIC' containing correspondence between Wright and ASIC
- Tabled by Richard Wright: folder entitled 'Receivers' containing correspondence between Wright and receiver
- Tabled by Richard Wright: folder entitled 'ANZ' containing bank statements showing deducted legal fees and correspondence between Wright and ANZ
- Tabled by Richard Wright: folder entitled 'Contract of sale of Jeogla Station Bald Hills' containing contract for sale of land, plant & equipment AND copy of the receivers court appeal from 1999
- Tabled by Richard Wright: Deed to Settle prepared by the receiver and ANZ solicitors

CANBERRA, 23 June 2010

- Tabled by Senator Xenophon: letter from ASIC dated 3 June 2010 and written response by the Clerk of the Senate of 7 June 2010
- Tabled by Insolvency Practitioners Association of Australia: opening statement

APPENDIX 2

Public Hearing and Witnesses

CANBERRA, 12 MARCH 2010

D'ALOISIO, Mr Tony, Chairman,
Australian Securities and Investments Commission

DAY, Mr Warren, Senior Executive Leader, Stakeholder Services,
Australian Securities and Investments Commission

DOPKING, Mr Stefan, Senior Executive Leader, Insolvency Practitioners and Liquidators, Australian Securities and Investments Commission

DWYER, Mr Michael, Commissioner,
Australian Securities and Investments Commission

GLEESON, Mr Bruce, New South Wales Regional Chairman,
Institute of Chartered Accountants in Australia

McAULIFFE, Mr Daniel, Analyst, Governance and Insolvency Unit, Corporations and Financial Services Division, Treasury

NORTH, Ms Denise, Chief Executive Officer,
Insolvency Practitioners Association of Australia

PRESTON, Ms Kate, Manager, Governance and Insolvency Unit, Corporations and Financial Services Division, Treasury

ROBINSON, Mr Mark, President,
Insolvency Practitioners Association of Australia

WHITE, Mr Lee, General Manager, Leadership and Quality,
Institute of Chartered Accountants in Australia

WILKINSON, Ms Vicki, Principal Adviser, Corporations and Financial Services Division, Treasury

ADELAIDE, 9 APRIL 2010

BRAND, Dr Vivienne, Senior Lecturer in Law, Flinders Law School,
Flinders University

BROWN, Associate Professor David,
Private capacity

FITZPATRICK, Mr Jeffrey, Lecturer in Law, Flinders Law School,
Flinders University

McNAMARA, Mr Stephen Patrick,
Private capacity

SPARGO, Ms Kate, Chairperson,
Accounting Professional and Ethical Standards Board

SYMES, Associate Professor Christopher Francis,
Private capacity

VISCARIELLO, Mr John,
Private capacity

WIJESINGHE, Mr Channa, Technical Director,
Accounting Professional and Ethical Standards Board

SYDNEY, 13 APRIL 2010

EPSTEIN, Mr Stephen,
Private capacity

GOULD, Mr Vanda Russell,
Private capacity

HANLEY, Mr Jeff, Acting National Manager, Regulation and Enforcement,
Insolvency and Trustee Service Australia

INGRAM, Ms Veronique, Chief Executive and Inspector-General in Bankruptcy,
Insolvency and Trustee Service Australia

MAGAREY, Mr Donald Rees, Chairman,
Companies Auditors and Liquidators Disciplinary Board

McDONALD, Mr Geoffrey David,
Private capacity

OSBORNE, Mr Matthew, Principal Legal Officer, Corporate Strategy and Support,
Insolvency and Trustee Service Australia

SLATER, Mr Geoff,
Private capacity

NEWCASTLE, 14 APRIL 2010

DOHERTY, Mr Bill,
Private capacity

FONG, Mr Ian Kim Seng, Authorised Representative,
Carlovers Carwash Limited and Berjaya Corporation Berhad

GLEESON, Mr Paul, Director,
Singleton Earthmoving

HOLMES, Professor Scott,
Private capacity

MAHER, Councillor Edward James, Deputy Mayor,
Armidale Dumaresq Council

NASH, Mr Gregory,
Private capacity

WILLIAMS, Mr Ronald Frederick, President,
Adamstown Rosebud Sport and Recreation Club Co-op Ltd

WOOD, Mr Bernard Nicholas, Director,
Singleton Earthmoving

WRIGHT, Mr Richard Bruce, Director,
Jeogla Pty Ltd

CANBERRA, 23 JUNE 2010

ANDERSON, Associate Professor Colin,
Private capacity

D'ALOISIO, Mr Tony, Chairman,
Australian Securities and Investments Commission

DAY, Mr Warren, Regional Commissioner—Victoria,
Australian Securities and Investments Commission

DOPKING, Mr Stefan, Senior Executive Leader, Insolvency Practitioners and Liquidators, Australian Securities and Investments Commission

DWYER, Mr Michael, Commissioner,
Australian Securities and Investments Commission

MORRISON, Associate Professor David,
Private capacity

NORTH, Ms Denise, Chief Executive Officer,
Insolvency Practitioners Association of Australia

ROBINSON, Mr Mark, President,
Insolvency Practitioners Association of Australia