ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

8 December 2015

Ms Toni Matulick
Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Parliament House
CANBERRA ACT 2600

By email: corporations.joint@aph.gov.au.

Dear Ms Matulick

Inquiry into impairment of customer loans – questions on notice

We thank the Committee for the opportunity to provide further information on the three matters you raised. We offer our advice below:

1. **Please provide comment on the concerns that have been raised regarding the independence of valuations, for example see submissions 101, 103, 124, 12 and 21.**

We have reviewed the above submissions. The primary theme in these submissions appears more to be around what value was realised on the sale of assets, rather than the independence of valuations *per se*.

We would point out that ARITA cannot comment on valuations that were undertaken prior to the appointment of receivers as that is a matter that rests solely with the lender and is prior to any engagement our members would have (other than investigative accounting work).

Directly in respect of the independence of valuations that may be used by receivers, valuations are a guide for a receiver but they do not form a central part of the receiver's work. A receiver may use a valuation as a guide for how they may approach the sale of an asset, but s 420A of the *Corporations Act 2001* places obligations on receivers to maximise the realised value and that would be regardless of any prior valuations received.

It is critical to once again highlight that what value can be realised in the sale of any asset is determined by how attractive that asset is to the market and how many buyers there are for that asset at that point of time. What was paid for the asset and subsequently invested in it is not relevant in determining market value. There are many examples of businesses that have failed because they invested far too much in an asset. Consider the famous Kerry Packer line "you only get one Alan Bond in your lifetime"

ARITA
ACN 002 472 362 Level 5, 33 Erskine Street, Sydney NSW 2000 Australia | GPO Box 4340, Sydney NSW 2001
t +61 2 8004 4344 | f +61 2 8006 5540 | e admin@arita.com.au | arita.com.au

regarding the 1987 sale price of Channel 9 to Bond of a reported $1.05 billion which Packer subsequently bought back for $250 million only three years later.

We reiterate that there have been very few court actions around s 420A where receivers have been found wanting in their actions and despite the emotive cases found in many submissions to the Inquiry, we find little unbiased evidence to contradict that.

A recurring theme in these submissions appears to be a frustration that assets were sold for value lower than those that may have been achievable prior to the Global Financial Crisis (GFC). Far from being unexpected, this was exactly a circumstance of the GFC. Asset prices, across most asset classes, were significantly reduced during the GFC and buyers were hard to find.

The example of the hotel in Submission 12 is instructive. Sale prices for hotels collapsed in the GFC. There were a number of highly geared “pub trusts” – portfolios of hotels – that either collapsed or were in significant financial distress during the GFC. There were few available buyers, little was available in the way of finance to purchase these types of assets and many were trying to sell (often as a distressed sale). On simple supply and demand, prices plummeted and in many cases by very significant amounts. There was also substantial uncertainty as to when or if prices would rebound, making a forced sale at that time all the more likely.

Similar circumstances appear in the other submissions related to property investments. Again, property developments, especially those that were part completed in the GFC, saw dramatic falls in values as there were few buyers in the market (again, the lack of available funding for potential buyers was critical in driving this). Accordingly, what an asset was valued at prior to the GFC had little bearing on what a receiver could, with any and all endeavours, achieve for sale of the same asset during that downturn. Also, once more, there was very little certainty as to when or if prices would return at that point of time.

2. What arrangements does ARITA have for implementing and monitoring the professional standards of receivers?

ARITA sets the highest standards for all insolvency practitioners. Voluntarily some 76% of registered liquidators (and 85% of registered bankruptcy trustees) have chosen to become ARITA professional members and thereby subject themselves to the ARITA Code of Professional Practice (the Code) and to ARITA’s conduct processes.

The Code is now often referred to by Courts as the default for best practice and sets the benchmark for the profession.

The Code, now in its 3rd version, stretches to some 130 pages and covers all aspects of formal appointments. The Code is publicly available from our website at http://www.arita.com.au/about-us/arita-publications/code-of-professional-practice

ARITA's conduct processes allow for the handling of complaints against member practitioners and also for ARITA to unilaterally investigate a "concern" over a member's conduct without a complaint needing to be lodged. We publish our statistics for the number of complaints and concerns each year in our Annual Report (publicly available from our website) and also publish the outcome of ARITA actions against members on our website (http://www.arita.com.au/insolvency-you/complaints-and-member-discipline/arita-action).

We concede that we do not have the investigative authority and powers of discovery of a regulator and we do not have any authority at all over the 24% of registered liquidators who are not our members. However, as a professional body we are unstinting in pursuing conduct that we see as inappropriate and we dedicate significant resources to lifting professional standards. The vast majority of our members choose to be part of ARITA for this very reason. We contend that it is our leadership in this area, and the support of our members in doing this, that has had the most positive influence in ensuring high standards.

3. Recommendation 36 of the Financial System Inquiry addressed amendments to the external administration regime to provide additional flexibility for businesses in financial difficulty. Could you update the committee with any actions that ARITA has taken since the Financial System Inquiry concluded.

Recommendation 36 stated that the Government should "consult on possible amendments to the external administration regime to provide additional flexibility for businesses in financial difficulty." As the only professional body for restructuring, insolvency and turnaround professionals, it is regrettable to report that there has been little proactive consultation with ARITA as a result of this recommendation. We would also note that we were disappointed that the Financial System Inquiry (FSI) paid so little attention to the critical area of insolvency in its report despite the extensive information we provided to them.

We furnish a copy of our submissions and responses to the FSI.

We also provide you a copy of our thought leadership document, A Platform for Recovery, published in November 2014 and the policies for reform that we arrived at in February 2015 as a result. Those policies have formed the basis of the recommendations made by the Productivity Commission (PC) in its Inquiry into Business Set-up, Transfer and Closure. We worked closely with the PC on their Inquiry and we note that they reference ARITA some 70 times in their final report and endorse our thought leadership work.

ARITA has been the most proactive agitant for positive change in the area of insolvency law reform. Indeed, until the PC's report, we had been calling for a focussed inquiry into insolvency law reform and had made representation to Government on this. We now

believe that the independent and comprehensive work done by the PC in their Inquiry provides the necessary template.

We are heartened that our recommendations for Safe Harbour and Ipso Facto reform have been taken up in the recent Innovation Statement and are hopeful that the Government will also endorse all of the other recommendations of the PC and work with us on building workable legislation to achieve those outcomes.

Yours sincerely

John Winter
Chief Executive Officer

ARITA CODE OF PROFESSIONAL PRACTICE 3RD EDITION

AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

Code of Professional Practice

for Insolvency Practitioners

Third Edition – 1 January 2014

ARITA
ACN 002 472 362
Level 5, 33 Erskine Street, Sydney NSW 2000 Australia | GPO Box 9985, Sydney NSW 2001
t +61 2 9290 5700 | f +61 2 9290 2820 | e admin@arita.com.au | arita.com.au

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Foreword

As part of its commitment to building professional excellence, the Australian Restructuring Insolvency and Turnaround Association (ARITA) is proud to release the Third Edition of its Code of Professional Practice. The Code is the fundamental building block upon which the insolvency profession sets and manages standards of professional conduct.

We were gratified to see the continuing acceptance of the Code by the profession, Regulators and the Courts following the release of the second edition.

This third edition seeks to take into account the feedback that we continue to receive on the Code's operation and to include other issues that have been identified.

The Code is a living document. It will continue to be amended from time to time to reflect changes and developments in insolvency law and practice and this release of the third edition demonstrates ARITA's continued commitment to maintaining the highest of professional standards.

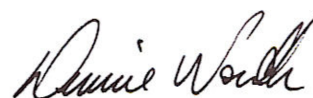
Effective Dates

The first edition of the Code was effective in two stages. The sections of the Code dealing with Independence and Remuneration were effective from 31 December 2007, with a transition period which expired on 1 April 2008. The balance of the first edition was effective from 21 May 2008. The first edition of the Code was withdrawn on 31 December 2010.

The second edition of the Code was effective from 1 January 2011 to 31 December 2013.

The third edition of the Code is effective from 1 January 2014.

The update to the Code would not have been possible without the extensive input from members, Regulators and the dedicated staff of ARITA.



David Lombe
President
ARITA

Denise North
Chief Executive
ARITA

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Part A: Introduction

1 Introduction and Purpose of the Code

The primary purposes of the Code are to:

- set standards of conduct for insolvency professionals;
- inform and educate ARITA Members as to the standards of conduct required of them in the discharge of their professional responsibilities; and
- provide a reference for stakeholders and disciplinary bodies against which they can gauge the conduct of ARITA Members.

Members should be guided not only by the specific terms of the Code but also by the spirit of the Code.

The Code is in four parts:

Part A introduces the Code
Part B sets out the overarching principles.
Part C contains detailed guidance and examples to assist in applying the principles
Part D contains templates and practice notes that should be adopted for use in practice.
Under the Constitution, Members are required to comply with the Code. Failure to do so may result in disciplinary proceedings in accordance with the Constitution.

1.1 Interaction with Legislation and Regulation

The Code is not a simple restatement of Legislation, regulations and judicial pronouncements, rather it is a set of principles and guidance based on standards of conduct that are founded in established precedent. Some standards imposed on Members are higher than those existing legal requirements. Where the law is silent, or ambiguous, the Code introduces principles to clarify understanding of the desired behaviour.

The goal is the creation of a system of professional standards, which protects the integrity of the insolvency system, and is:

- fair;
- effective;
- practical; and
- readily understood.

1.2 Principles based

The practice of insolvency is often complex and varied. It is impossible to conceptualise and codify every possible situation or scenario. Accordingly, the Code establishes broad principles that can be applied to every situation. The use of principles avoids the prospect of loopholes being used to justify conduct by distinguishing the particular situation from restrictions set down in a prescriptive list. As statements of principle are necessarily general, explanatory guidance is provided.

The guidance will also assist stakeholders in understanding the limits of the principles so that they do not have unreasonable expectations of what Practitioners are required to do.

Practitioners are expected to use their professional and commercial judgment and when they have doubt should seek legal or other advice, or the assistance of the Court, before proceeding.

1.3 Must, should and may

The Code uses a three level hierarchy of wording to describe and explain its requirements:

- mandatory requirements (must / must not);
- recommended behaviours (should / should not); and
- permissive statements (may).

Where a Practitioner decides not to follow a recommendation (should / should not), then the practitioner will need to be able to justify why the recommended course of action was not taken and why the course taken was within the spirit and intent of the relevant principle. In these situations, the Member should:

- record the reasoning used for diverging from the Code;
- state the rationale used to determine that the action followed is not proscribed by the Code; and
- be able to explain that the path taken results in an equal or better outcome for stakeholders.

1.4 Regulators and courts

The insolvency profession is regulated by the Australian Securities and Investments Commission (ASIC) and the Australian Financial Security Authority (AFSA). The conduct of Practitioners may be the subject of review by the relevant disciplinary tribunals and by the courts.

It is anticipated that the Code will be used by Regulators, the tribunals and courts to assist them in enforcing acceptable insolvency practice and proper professional standards.

At the same time, the Code remains subject to the views of the courts, which may decide not to accept or follow particular requirements or guidance in the Code. In such cases, the Code will be amended to properly reflect the law. Also, a Member may obtain court directions or orders that differ from requirement or guidance in the Code, for example in relation to independence. The Code always remains subject to the law and the courts.

1.5 Other professional standards

Most Members are also members of other professional associations. The requirements of other professional associations will, in many areas, be similar to those in the Code, for example APES 330 Insolvency Services.

The Regulators also release regulatory guidance that applies to registered liquidators and registered trustees. Practitioners must have regard to such guidance.

To the extent that the Code imposes a higher standard on Practitioners than requirements from other associations or the Regulators, the Code will prevail.

1.6 Application of the Code

The Code applies to all Members of ARITA insofar as they conduct or are involved in the administration of insolvencies, formal and informal. The Code therefore applies not only to liquidators and trustees, but also to lawyers, accountants, financiers and others who are Members of ARITA. These obligations are stated in the Code when it refers to '*Members*'. The Code applies to insolvency practitioners in so far as they are appointed to, or contemplating appointment to, any Appointment under the Corporations Act or the Bankruptcy Act. These obligations are addressed in the Code to '*Practitioners*'. Members that are practising in the field of insolvency outside of Australia are bound by any requirements in the Code relating to '*Members*', unless in direct conflict with the laws of the jurisdiction in which they operate.

Within the definition of Practitioners, the Code refers to, and treats, liquidators, administrators, and controlling/Part X/trustees as broadly within the one category, primarily as fiduciaries responsible to creditors.

Controllers, although Practitioners, do not have the same fiduciary responsibilities to all creditors. Where appropriate, the Code makes separate mention of Controllers and excludes them from certain requirements of the Code.

Members Voluntary Liquidations are also treated differently as they involve the liquidation of a solvent entity, where the interests of shareholders are of primary importance to the winding up process. The Corporations Act treats the independence of liquidators in Members' Voluntary Liquidations differently and so does the Code by excluding them from Principles 2 and 3.

Examples provided within the Code are for illustrative purposes only and Members must consider the particular facts of each case when determining how the Code applies to them. The fact that a situation or relationship encountered by a Member is not specifically covered in an example given in the Code does not mean that the situation or relationship would be acceptable under the Code. Members must always have regard to spirit and intent of the Code.

Table 1: Application of Principles

No.	Principle	Controllers / MVL	Practitioners	Members
1	In addition to the obligation to comply with the law, Members must exhibit the highest levels of integrity, objectivity and impartiality in all aspects of administrations and practice management.	x	x	x
2	When accepting or retaining an appointment the Practitioner must at all times during the administration be, and be seen to be, independent.		x	
3	Disclosure and acceptance of a lack of independence is not necessarily a cure.		x	
4	Members must communicate with affected parties in a manner that is accurate, honest, open, clear, succinct and timely to ensure effective understanding of the processes, and their rights and obligations.	x	x	x
5	Members must attend to their duties in a timely way.	x	x	x
6	A Practitioner must not acquire directly or indirectly any assets under the administration of the Practitioner.	x	x	
7	When promoting themselves, or their Firm, or when competing for work, Members must act with integrity and must not bring the profession into disrepute.	x	x	x
8	When dealing with other Members in transitioning or parallel appointments, Practitioners must be professional and co-operative, without compromising the obligations of the Practitioner in their own particular appointment.	x	x	
9	Members must maintain professional competency in the practice of insolvency.	x	x	
10	A Practitioner is entitled to claim Remuneration, and disbursements, in respect of necessary work, properly performed in an Administration.	x	x	

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No.	Principle	Controllers / MVL	Practitioners	Members
11	A claim by a Practitioner for Remuneration must provide sufficient, meaningful, open and clear disclosure to the approving body so as to allow that body to make an informed decision as to whether the proposed Remuneration is reasonable.	x	x	
12	A Practitioner is only entitled to draw Remuneration once it is approved and according to the terms of the approval.	x	x	
13	When accepting an appointment the Practitioner must ensure that their Firm has adequate expertise and resources for the type and size of the administration, or the capacity to call in that expertise and those resources as needed.	x	x	
14	Members must implement policies, procedures and systems to ensure effective quality assurance.	x	x	X
15	Members must implement policies, procedures and systems to ensure effective compliance management.	x	x	X
16	Members must implement policies, procedures and systems to ensure effective risk management.	x	x	X
17	Members must implement policies, procedures and systems to ensure effective complaints management.	x	x	X

2 The Insolvency Profession

2.1 Introduction

Registered insolvency practitioners in Australia are usually qualified accountants with experience in the administration of insolvencies. Entry criteria are established by Legislation. Registration as a liquidator or trustee is managed by ASIC and AFSA respectively.

Insolvency is a difficult situation for those involved. Every insolvency involves financial loss for creditors, in particular employees who may also lose their source of employment. An individual and their family may lose their home and other assets. The consequent emotional stress often creates a difficult environment.

Insolvency can result in financial and social disorder. The regime of insolvency law seeks to control this disorder while a process of balancing the respective rights and entitlements of those parties is pursued.

2.2 Insolvency practitioners

Insolvency Practitioners:

- are fiduciaries. They are entrusted with property of the Insolvent and required to deal with it in accordance with the law and consistently with the obligations and duties of fiduciaries;
- are appointed to implement the insolvency regime and to deal with and determine the rights and entitlements of all the parties involved;
- owe responsibilities to the creditors as a whole, not just to one creditor (except where appointed as a Controller, where the principal responsibility is to their appointor) and other parties;
- are experienced and qualified professionals who are expected to display high degrees of application and professional competence;
- are subject to court and regulatory supervision;
- have specific legal obligations under the Legislation;
- are required to report offences identified during the conduct of Administrations to the Regulators;
- are required to exercise a high level of commercial and professional judgment;
- operate in difficult circumstances, often involving distressed parties, competing demands, strict deadlines, and complex legal, financial and factual issues;
- can be personally liable for debts incurred during an administration;
- are legally entitled to be remunerated for the work they do as a priority payment in the administration; and
- from time to time will accept and complete Administrations even though there are insufficient funds to pay their Remuneration and disbursements.

2.3 Powers

Practitioners are given extensive powers, including to:

- secure and realise the assets of the Insolvent for the benefit of creditors (or Secured creditor in the case of a Controller);

- compel individuals involved to answer and explain the circumstances of the insolvency;
- investigate and refer breaches of the Legislation to appropriate authorities; and
- decide the claims of the various parties.

2.4 Control of Assets and Activities

The appointment of a Practitioner to the affairs of a person or a company is legally and practically significant.

- On being appointed as a trustee in bankruptcy, all divisible property of the Insolvent vests in the trustee, who immediately assumes power over and responsibility for that property.
- Similarly, a liquidator or administrator immediately takes control of the company, including responsibility for its assets, employees and other aspects of its business.
- Those creditors who had previously dealt with the individual or the company are required to deal with the Practitioner.

Once that initial appointment occurs, the Practitioner (except where appointed as a Controller) has the authority and responsibility to deal with the competing interests of the various parties.

- The creditors, who are likely to have suffered from the financial demise of the Insolvent, have interests to be protected; principally that realisation of assets of the Insolvent are made available from which any dividend might be paid.
- At the same time, the Practitioner has to ensure that creditors are treated fairly in accordance with their legal rights, including to ensure that those assets are not seized by one particular creditor to the disadvantage of others.
- Complexities of creditors' interests are compounded further by issues of secured and priority claims.
- In adjudicating on interests, and payment of dividends, the Practitioner will follow the priorities set out in the Legislation.
- Creditors are entitled to expect that a Practitioner will apply expertise, experience and professional judgment when making decisions about the conduct of the administration. The Practitioner can and may seek the views or approval of creditors, and often has to make commercial and professional decisions in situations of creditor conflict or stalemate.

2.5 Duties and Obligations

The standards of conduct expected of Practitioners have their origin in the special position Practitioners occupy.

They have:

- extensive power and autonomy;
- control of assets; and
- power to adjudicate on competing, conflicting and often hostile interests.

In corporate appointments Practitioners become '*officers*' of the company and are required to adhere to the obligations and duties of company officers.

These combine to create a complex web of fiduciary responsibilities.

Practitioners:

- owe a fiduciary responsibility to the parties involved;
- have a duty to be fair and act without bias in assessing the competing interests of stakeholders;
- have an important role in protecting the public interest, by identifying and reporting to creditors and the Regulators on a range of issues; and
- have important statutory investigatory and reporting obligations they are required to pursue even though the costs of investigation and reporting will reduce the funds available to creditors.

This distinguishes a Practitioner's position from that of other professionals. Normal professional relationships have:

- an identifiable client who has willingly selected the professional;
- a contract for professional services which can be terminated at any time in accordance with the contract;
- contracted arrangements for Remuneration; and
- may or may not have a fiduciary component.

With the exception of appointments as a Controller, in insolvency there is no single client. In an appointment as a Controller the Practitioner's primary, but not sole, responsibility is to maximise the return to the Secured creditor who appointed them.

2.6 Supervision and Scrutiny

Practitioners are subject to scrutiny by:

- creditors, (particularly through creditors' meetings and committees of inspection);
- directors, debtors and others associated with the Insolvent;
- Regulators;
- government agencies;
- the courts; and
- ARITA and other professional bodies.

The range and extent of the scrutiny that applies is beyond that of most other professionals.

2.7 Skill and Judgment

Insolvency involves the difficult intersection of accounting, business and law. Skills are needed to handle complex situations which invariably happen quickly, with immediate impact on a range of parties beyond the Insolvent.

There is great divergence in the types of commercial activities. The business of the insolvent company may range from that of a builder with two employees to an airline with several thousand, and the affairs of the insolvent individual may involve contentious family law disputes, or complex personal tax issues. Assets may be at risk of being disposed of, or serious business decisions may need to be made. Quick commercial judgment and business acumen are required, in particular in view of the fact that a positive commercial outcome – by way of a return to creditors – is all the more difficult in circumstances of limited funds.

3 Stakeholders

Part of the complexity of insolvency is the broad range of stakeholders. Each stakeholder group has a unique perspective, expectations, and obligations. Often they have competing, mutually exclusive interests. The Practitioner also has his or her own legitimate interests which were dealt with in the preceding section. The nature of the interests of the various stakeholders are summarised below.

3.1 Creditors

Creditors:

- are parties to whom a debt is owed by the Insolvent and will have a right to prove for that debt in the Administration.
- will normally have traded with the Insolvent with an expectation of being paid for services provided, goods sold, or moneys loaned;
- are parties whose rights of payment by the Insolvent are replaced by a right to a dividend;
- are usually disadvantaged financially;
- are reliant on the Practitioner's experience and skill in having their losses recouped;
- rely on the Practitioner to be informed about the administration;
- have some obligation and interest in informing and otherwise assisting the Practitioner in making decisions where creditor approval is required;
- are parties whose dividend payments are the outcome of work done by the Practitioner in realising or recovering funds;
- have power to approve Remuneration; and
- may, if they have received a preference payment, be required to repay the preference, notwithstanding that they may have additional monies owed.

3.2 Employees

Employees:

- can be more immediately affected by the insolvency of their employer, in terms of immediate loss of wages, and accrued entitlements;
- can rely on statutory priorities over other creditors and may have an right to claim all or part of their entitlements under the government safety net schemes; and
- can require particular attention and consideration by a Practitioner above and beyond other creditors.

3.3 Suppliers

Suppliers:

- are usually creditors of the Insolvent with claims in the insolvency and may be subject to claims by the Practitioner, for recovery of preferences or for disputed retention of title claims;
- are persons whose support (for ongoing supplies or services to the Insolvent) is often needed for a trade-on of an Insolvent in Administration; and
- can require particular attention by a Practitioner if such on-going support is required.

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3.4 Regulators

Regulators:

- have a statutory interest in the proper administration of the legislation;
- release regulatory guidance to assist Practitioners to comply with their obligations;
- have statutory powers to review the conduct of Practitioners, including powers to initiate a review by the courts of the Remuneration claimed;
- are available to assist creditors with complaints and concerns;
- have an obligation to government and the courts;
- have a role in the registering and regulation of Practitioners; and
- in the case of personal insolvency, the power to review or approve Remuneration.

3.5 The courts

The courts:

- may assist the Practitioner in determining complex issues by giving directions, determining and enforcing rights of recovery, and protecting Practitioners as required;
- may determine the rights and responsibilities of all parties, including to review the decisions of Practitioners;
- may review the performance and Remuneration of a Practitioner;
- rely upon the honest and competent representation of parties to assist the courts in making decisions in accordance with the law and to advance the interests of justice;
- expect and enforce high standards of conduct; and
- can make orders which override any of the requirements of this Code (for example, to allow an appointment which the Code may otherwise prevent).

3.6 Statutory agencies

Statutory agencies, such as the Australian Taxation Office and Department of Employment:

- may be creditors in the Administration;
- may have a statutory interest in the conduct of the Administration; and
- have statutory powers in respect of specific aspects of the Administration.

Practitioners may have obligations to notify statutory agencies of their Appointment and comply with ongoing reporting obligations.

3.7 The public

The public:

- has an interest in ensuring that the law is clear and understood, that it is upheld and also that commercial morality is maintained;
- has an expectation that improper conduct will be investigated and reported to the relevant authorities; and
- has an expectation that the insolvency profession is staffed by persons of high competence and integrity.

3.8 In corporate insolvency only

3.8.1 Shareholders

Shareholders:

- have an interest in the Insolvent's affairs being properly administered including so as to ensure that surplus funds, if any, are paid to them;
- may also be creditors and have separate claims in that capacity; and
- may be liable to the Insolvent for unpaid share capital.

3.8.2 Directors

Directors:

- have obligations under the law with a view to assisting in the proper administration of the Insolvent including in any recoveries for the benefit of creditors;
- can be personally liable for losses to the administration at the suit of the Practitioner, or in some cases the Regulator, or the Australian Taxation Office; and
- may also be creditors or shareholders and have separate claims in those capacities.

3.9 In personal insolvency only

3.9.1 The Insolvent

The Insolvent:

- has obligations under the law to assist and co-operate with the trustee; and
- has duties owed to them by the trustee, including to protect them from creditor claims.

3.9.2 The spouse of the Insolvent

The spouse of the Insolvent:

- is often the joint owner of the matrimonial home with the Insolvent or has an interest in that and other joint assets, in equity or under family law, which the trustee needs to assess.

3.9.3 Official Trustee and the Official Receiver

The Official Trustee:

- undertakes the administration of the majority in number of bankruptcy estates with the remainder handled by Practitioners; and
- may transfer the administration of estates to Practitioners.

The Official Receiver:

- provides services to registered trustees in relation to the filing of documents, issue of statutory notices, maintenance of the National Personal Insolvency Index and the conduct of examinations.

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4 Definitions and Interpretation

4.1 Construction

The meanings of the words must/must not, should/should not and may are explained at 1.3. These words are used throughout the Code and indicate the standard of conduct required of the Practitioner. The Code is meant to complement and be additional to any statutory obligations and regulatory requirements that Practitioners have in carrying out their responsibilities.

The application of the Code to ARITA Members is detailed at 1.6.

4.2 Defined Terms

The following defined terms are used throughout the Code, shown commencing in capitals. Unless otherwise indicated, the terms have the meanings below.

Administration	Refers to an Appointment under either the Bankruptcy Act or the Corporations Act. In some cases, there may be corporate insolvency appointments under other legislation such as co-operatives and Aboriginal corporations legislation. Where appropriate, the term applies to a solvent administration under Chapter 5 of the Corporations Act.
Alternate	The Practitioner nominated to replace the Incumbent.
Appointment	The formal legal appointment of a Practitioner as a trustee in bankruptcy, a trustee appointed under s 50 of the Bankruptcy Act, a debt agreement administrator under Part IX, or a trustee under Part X; or as a liquidator or provisional liquidator, a voluntary administrator or a deed administrator under Part 5.3A of the Corporations Act, or as a controller; or as a scheme manager under Part 5.1. The word "Appointee" has a parallel meaning.
Approving body	The body with authority to approve Remuneration or a course of conduct; usually the creditors, the committee of creditors or the court.
ARITA	Australian Restructuring Insolvency and Turnaround Association.
Associate	For Administrations under the Corporations Act, Associate has the meaning according to that Act. For personal insolvency administrations, Associate is a spouse, dependent or direct relative of the Insolvent, or the spouse or dependant of a direct relative, and any entity with which the Insolvent or any of the persons previously mentioned are associated with (refer 6.10 for further information).
Bankruptcy Act	Bankruptcy Act 1966
Cap	An upper limit for the amount of Remuneration approved for prospective fee approval. It is not a fixed fee. May be used in the context of a capped amount.
Co-appointments	Where more than one Practitioner is appointed to an Administration, either jointly or jointly and severally.

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Code	The Code of Professional Practice issued by ARITA for Insolvency Professionals as amended from time to time.
Controller	A person appointed as either a controller or managing controller under Part 5.2 of the Corporations Act; or a receiver appointed to property of an individual. Does not include a receiver appointed by the court.
Corporations Act	Corporations Act 2001
DIRRI	The Declaration of Independence, Relevant Relationships and Indemnities.
Disbursements	Refers to necessary financial outlays incurred or paid by the Practitioner in the administration. The term includes expenses, costs and disbursements.
Entity	A body corporate, a partnership, an unincorporated body, an individual or a trust, including in relation to a trust, the trustee.
Fiduciary duty	The duty owed by a liquidator or trustee to exercise rights and powers in good faith for the benefit of relevant stakeholders in an insolvency.
Firm	(a) A sole practitioner, partnership, corporation or other entity of professionals; (b) An entity that controls such parties through ownership, management or other means; (c) An entity controlled or influenced by such parties through ownership, management or other means; or in which they share in the profits; or (d) Practices operating under the same or substantially the same business name, whatever the financial arrangement (refer 6.4 for further information).
Incumbent	The Practitioner acting as the Appointee.
Indemnity	Any arrangement, either directly or indirectly, to make a payment to the Practitioner for the purposes of meeting Remuneration or Disbursements of the Practitioner.
Insolvent	The entity, either an individual or corporation, who is insolvent, whether they are yet subject to an Administration or not.
Legislation	The Bankruptcy Act and the Bankruptcy Regulations and the Corporations Act and Corporations Regulations. The term also refers to other legislation under which Appointments can be made.
Material interest	Ownership, which is material to either the owned Entity, or material to the Practitioner, his or her partners, Firm, staff, or their respective Relatives; or in which the Practitioner, his or her partners, Firm, staff or their respective Relatives has any management involvement whatsoever.
Member	Members in any capacity of ARITA, and, unless otherwise indicated, includes the Member's Firm, partners and staff.

Practitioner	A Member of ARITA who acts under an Appointment, or is considering accepting an Appointment as an Appointee, and, unless otherwise indicated, includes the Practitioner's Firm, partners and managerial employees.
Pre-appointment advice	Any professional advice, whether providing an opinion or not, provided prior to the Appointment.
Professional relationship	Any Professional Service under which the Appointee or a partner in his or her Firm, has given professional advice in accounting, insolvency, financial advice, tax or other such areas for the Insolvent and includes an Appointment.
Professional services	All work undertaken by a Member or a Member's firm.
Referring Entity	An Entity that has provided a Practitioner's contact details to a director(s), debtor or creditor for the purposes of the director(s), debtor or creditor seeking specialist insolvency advice that may result in an Appointment.
Regulators	Australian Securities and Investments Commission (ASIC) and the Australian Financial Security Authority (AFSA) or the Inspector-General in Bankruptcy.
Relative	The spouse, parent or remoter lineal ancestor, child or remoter issue, or brother or sister of the person.
Remuneration	The monies claimed by a Practitioner on account of work performed or to be performed by the Practitioner in the Administration. Also referred to as '*fees*'.
Secured creditor	Includes any creditor whose debt is secured by a security interest under the Personal Property Securities Act, a mortgage over real property or other charge which entitles the creditor to realise the security for the purpose of repaying their debt.
Specific referral	Arises where an Appointment is made following the director(s), debtor or creditor being referred to a Practitioner by the Referring Entity. If the Referring Entity provided details of several Practitioners to the director(s), debtor or creditors at the same time, it is still a Specific referral once an Appointment is made.
Upfront payment	Any payment to a Practitioner prior to the Appointment for the purposes of meeting Remuneration or Disbursements of the Practitioner.

ARITA

Part B: The Principles

Conduct

Principle 1	In addition to the obligation to comply with the law, Members must exhibit the highest levels of integrity, objectivity and impartiality in all aspects of Administrations and practice management.
Principle 2	When accepting or retaining an Appointment the Practitioner must at all times during the Administration be, and be seen to be, independent.
Principle 3	Disclosure and acceptance of a lack of independence is not a cure.
Principle 4	Members must communicate with affected parties in a manner that is accurate, honest, open, clear, succinct and timely to ensure effective understanding of the processes, and their rights and obligations.
Principle 5	Members must attend to their duties in a timely way.
Principle 6	A Practitioner must not acquire directly or indirectly any assets under the administration of the Practitioner.
Principle 7	When promoting themselves, or their firm, or when competing for work, Members must act with integrity and must not bring the profession into disrepute.
Principle 8	When dealing with other Members in transitioning or parallel appointments, Practitioners must be professional and co-operative, without compromising the obligations of the Practitioner in their own particular appointment.
Principle 9	Practitioners must maintain professional competency in the practice of insolvency.

Remuneration

Principle 10	A Practitioner is entitled to claim Remuneration, and disbursements, in respect of necessary work, properly performed in an Administration.
Principle 11	A claim by a Practitioner for Remuneration must provide sufficient, meaningful, open and clear disclosure to the Approving Body so as to allow that body to make an informed decision as to whether the proposed Remuneration is reasonable.
Principle 12	A Practitioner is only entitled to draw Remuneration once it is approved and according to the terms of the approval.

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Practice Management

Principle 13	When accepting an Appointment the Practitioner must ensure that their Firm has adequate expertise and resources for the type and size of the Administration, or the capacity to call in that expertise and those resources as needed.
Principle 14	Members must implement policies, procedures and systems to ensure effective Quality Assurance.
Principle 15	Members must implement policies, procedures and systems to ensure effective Compliance Management.
Principle 16	Members must implement policies, procedures and systems to ensure effective Risk Management.
Principle 17	Members must implement policies, procedures and systems to ensure effective Complaints Management.

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Part C: Guidance

5 Integrity, Objectivity & Impartiality

Principle 1: In addition to the obligation to comply with the law, Members must exhibit the highest levels of integrity, objectivity and impartiality in all aspects of administrations and practice management.

5.1 Integrity

Members are required to show high levels of integrity by:

- being straightforward;
- being honest;
- being truthful; and
- adhering to high moral and ethical principles in the conduct of their practices and appointments.

5.2 Objectivity

Members must be objective. This requires Members to exercise their judgment free from:

- bias;
- conflict of interest; and
- undue influence of others.

5.3 Impartiality

When exercising their judgment, Members must be impartial by taking care to ensure that they:

- are not influenced by personal feelings, prejudice or difficult relationships with individual stakeholders;
- are making decisions based on the known facts;
- have no direct personal interest; and
- are not favouring one person or side more than another when applying the law.

Before exercising their judgment, Members should take reasonable steps to ascertain the necessary facts to ensure that a sound judgment can be made.

5.4 Structuring of assets

A Member must not advise an Insolvent (nor, if the Insolvent is a company, its directors) on how to structure its financial affairs to defeat creditors.

A Member is not prevented from providing advice to a solvent Entity on the structuring of its financial affairs.

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5.5 Confidential information

A Member who acquires confidential or personal information in the course of an Appointment must not use that information for any purpose other than the proper performance of the Administration.

ARITA

6 Independence

Principle 2: When accepting or retaining an appointment the Practitioner must at all times during the Administration be, and be seen to be, independent.

6.1 The Test of Independence

Independence has two parts. A Practitioner must:

- be independent in fact; and
- be seen or perceived to be independent.

A Practitioner must be independent in fact, that is, they should act and conduct the Administration in an independent manner.

A Practitioner must be seen to be independent, that is, they must not accept an appointment, or continue to act under an existing appointment, if:

- a reasonable and informed third party;
- on the information available (or which should have been available) at the time;
- might reasonably form the opinion that the Practitioner might not bring an independent mind to the administration and thus may not be impartial or may in fact act with bias;
- because of a lack of independence, or a perception of a lack of independence.

The requirement for independence as described in the Code does not apply to Controllers who are appointed by the Secured creditor and have a contractual relationship with the appointor. Nor does it apply to liquidators appointed to a Members' Voluntary Liquidation. There may nevertheless be independence issues that arise for Controllers and liquidators appointed to Members' Voluntary Liquidations under the Legislation.

6.1.1 Not a State of Mind

While Practitioners may consider that their personal integrity and skill makes them immune to the influences of conflicts, this is not the test. This is not a reflection on the integrity of the Practitioner; it is a consequence of the need to preserve the perception of independence.

It is important to recognise that there is likely to be contact between the Practitioner and the Insolvent, directors, creditors or advisors to them before the acceptance of the Appointment. Mere contact does not create a threat to independence. What is important is the nature of the relationship between the Practitioner and the various stakeholders. This is discussed at length in the following sections.

6.1.2 Possible Conflicts - How Real or Perceived?

The mere possibility of a conflict is not a bar to accepting or continuing an appointment. The test is whether a reasonable and informed third party on the information reasonably available at the time, could have formed the view that a conflict was *likely* to arise.

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The Practitioner must be proactive in anticipating, identifying and uncovering the circumstances that may give rise to a conflict of interest, and not to simply address the issue when the conflict arises.

6.1.3 Timing

The independence test is to be applied:

- on the facts reasonably available at the time the decision to accept the Appointment;
- when circumstances change or become known to the Practitioner, and a decision is made on whether to continue the Appointment; and
- not retrospectively with the benefit of hindsight in relation to facts and circumstances that could not reasonably be expected to have been known or discoverable.

6.1.4 Allegations of lack of independence

Allegations of a lack of independence may be made by self-interested parties wishing to improve their position. For example claims may be made:

- that directors, or a debtor, chose a Practitioner because of some perceived reputation for being lenient on Insolvents, or less diligent in pursuing matters;
- by Insolvents and their Associates who are being investigated or sued by the Practitioner; or
- by a creditor being pursued for a preference.

The mere existence of an allegation is not evidence of a conflict. When an allegation of lack of independence is made a Practitioner should:

- objectively assess any such claim;
- decide accordingly; and
- advise the claimant of the outcome.

The Practitioner may seek directions from the court.

6.1.5 The Declaration of Independence, Relevant Relationships and Indemnities

Completion of the Declaration of Independence, Relevant Relationships and Indemnities (DIRRI) required under the Legislation and the Code is a step that is taken once the Practitioner has determined that he or she is independent and takes the Appointment.

Disclosure of interests or relationships that create a lack of independence, or a perception of a lack of independence, in the DIRRI does not remedy or cure the situation.

The provision of a DIRRI is a process for identifying relationships that are *not* threats to independence, but need to be disclosed to creditors to ensure transparency.

This chapter of the Code provides guidance to Practitioners on relationships, when a lack of independence may arise and disclosure requirements in situations where there is a relationship that does not result in a lack of independence.

When considering the nature of any relationship, whether set out in this Code or not, Practitioners must always bear in mind the ultimate test – both being, and being seen to be, independent.

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6.2 Rationale for the Independence Principle

Independence is critical because of the nature of the role of the Practitioner. Tasks such as adjudicating on complex and competing interests, preserving and selling assets and investigating and pursuing claims all require a high degree of independence.

Stakeholders need to have confidence in the Practitioner's conduct and decision making. They need to be able to regard the Practitioner as fair, unbiased and not acting from self interest when exercising his or her professional and commercial judgment.

The Practitioner must act independently of all stakeholders. The appointment of a Practitioner by a director or creditor does not in itself result in a lack of independence (refer 6.1.1, 6.1.2 and 6.8.1B).

> *Example*
>
> The Practitioner must be independent of and be seen to be independent of each of the creditors, including the creditor who initiated the appointment and in respect of which appointment a perception of bias can often be an issue. A Practitioner may be required to pursue a claim against that creditor for recovery of a preference. Other creditors expect that such a claim will be brought, irrespective of the fact of the initial appointment.
>
> The Practitioner must also be independent of and be seen to be independent of each of the directors, who may have initiated the appointment. All creditors should be able to expect that the Practitioner will properly investigate and report on the causes of the company's failure and inquire into the conduct of the directors notwithstanding that the directors or their advisors initiated the appointment. In particular, the Practitioner must secure compliance by the directors with their responsibilities; pursue investigations which may result in civil claims against those directors, their family or associates, or result in criminal prosecution. Parallel responsibilities apply in bankruptcy.

6.3 Threats to Independence

A threat to independence can most easily be seen as a hierarchy of thresholds. At each threshold there will be limited circumstances (exceptions) which permit the acceptance or continuation of the appointment. These are set out in the following sections.

The hierarchy is illustrated in the diagram below.

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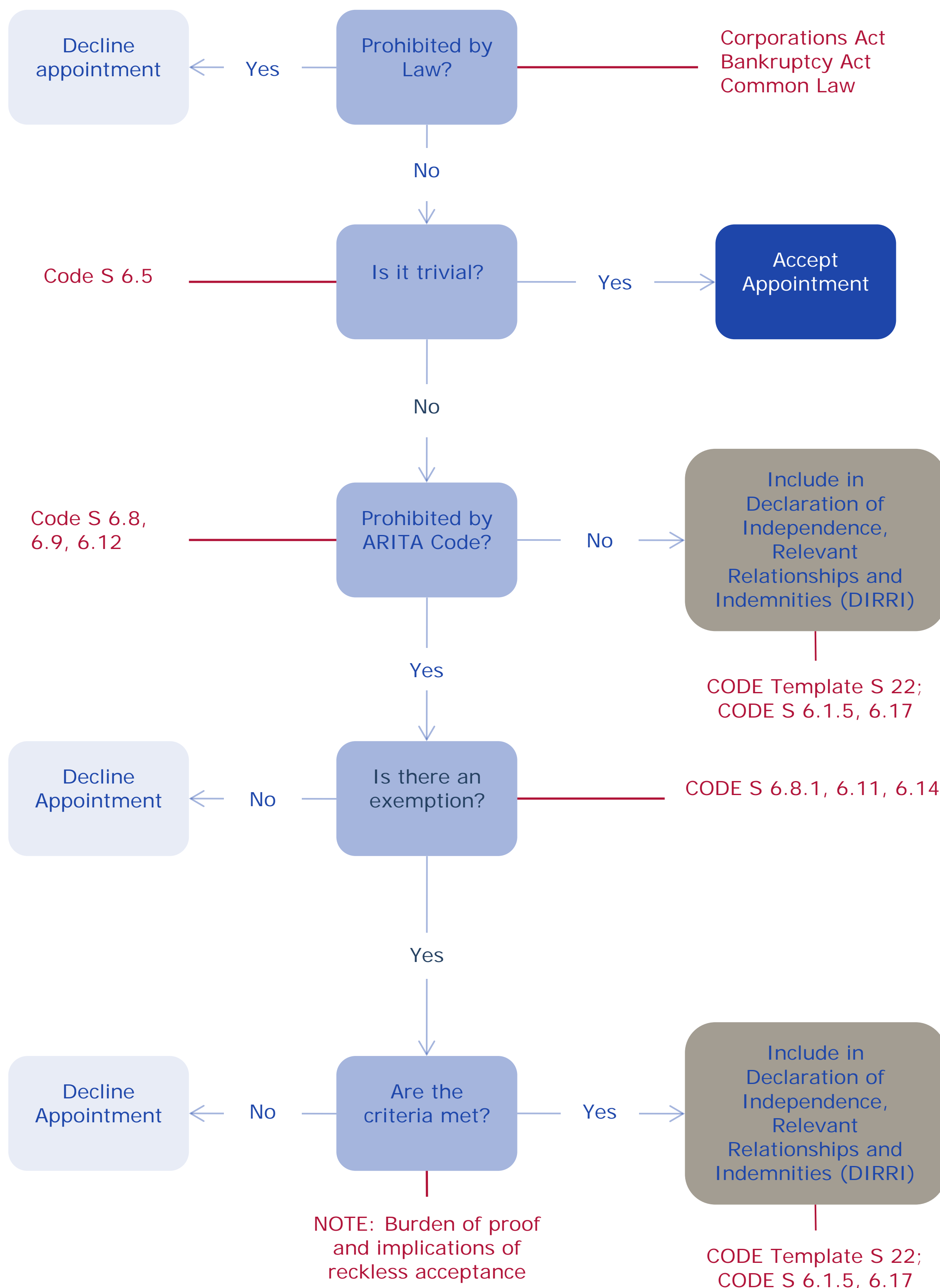
Diagram 1: Independence Hierarchy



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6.4 Independence of the Firm

When considering the issue of independence, it is not just a matter of whether the individual Practitioner is independent. The Practitioner must also consider the relationships held by his or her partners and Firm.

The definition of Firm in the Code includes:

- A sole practitioner, partnership, corporation or other entity of professionals;
- An entity that controls such parties through ownership, management or other means;
- An entity controlled or influenced by such parties through ownership, management or other means or in which they share in the profits; or
- Practices operating under the same or substantially the same business name, whatever the financial arrangement.
- Therefore, when completing the DIRRI, the declaration of relevant relationships must include relationships of the Practitioner and their Firm, as defined.
- In relation to the definition of Firm, a relevant test is what a reasonable and informed third party would reasonably perceive to be the Practitioner's Firm.

Example

If a practice enters into a network relationship with a group of other insolvency practices and each of the practices includes on its firm documentation a claim that they are part of the "X network of firms", then the public perception is that they are one Firm, and should be treated as such for the purposes of completing the DIRRI and considering the Practitioner's independence to accept the appointment.

If a practice enters into an arrangement to pay a fee for access to training materials and standard documentation, but there is no public statement of cooperation/federation/association, then the practice would not be considered part of the same Firm as the practice providing access to the materials.

If a practice establishes a company that provides turnaround services to distressed businesses and the partners in the practice own the shares in the company, they are one Firm. Any relationships of the turnaround company to the Insolvent would also have to be considered when reviewing independence and disclosed if the Appointment was accepted.

6.4.1 Previous firms

- If a Practitioner has moved Firms or two or more Firms have merged or a Firm has dissolved in the preceding two years, the Practitioner should be cognisant of any relationships that the Insolvent may have had with the previous Firm(s) during the time that the Practitioner was a partner.
- Where a Practitioner moves Firms, or a Firm has dissolved a Practitioner is not required to request searches of previous Firms. However, if the Practitioner is aware of a relationship or a relationship comes to the Practitioner's attention during the course of the Administration, this relationship may need to be disclosed to creditors.
- Where two or move Firms merge, the Practitioner must undertake conflict searches of client records of the merged Firm and the previous Firms as part of their conflict checking protocols.

- The risk is that during the conduct of the Administration, the Practitioner may need to take action against their previous Firm in relation to services provided to the Insolvent at a time when the Practitioner was a partner. As a result, the Practitioner may also have a liability should such an action be successful. In such a circumstance, the Practitioner cannot be independent.

6.5 Trivial relationships

Trivial relationships are not a bar to acceptance or retention of an appointment. A Practitioner is not required to list trivial relationships in the DIRRI.

However, there is no simple definition of what is trivial. Useful indicators would be that the relationships may be considered inconsequential, remote, or coincidental.

Example

Examples of Trivial Relationships:

- A chance meeting at a social event through a mutual acquaintance.
- Members of the same club (e.g. Lions, Rotary) or school committee.
- Having personal banking relationships with a financial institution that is a creditor.

The boundaries of what is trivial would be reached once there has been a pattern of interaction that was more personal or continual.

6.6 Referrals from other Professionals and Creditors

Practitioners may accept a series of appointments from individual creditors, lawyers, accountants or from another Practitioner. However, Practitioners must always have regard to how an ongoing relationship may affect their independence or the perception of independence.

Networks of referrals between professionals are normal and are acceptable provided the referral and relationship are based on the quality of professional service and expertise. This would invariably have been identified through prior experience.

A Practitioner must not accept an appointment if the Practitioner would not be independent in fact, or would not be perceived to be independent. Regard must be had to this when considering whether to accept the referral of an appointment.

If a Practitioner accepts an appointment following a Specific referral, the Referring Entity (name and firm/organisation) must be disclosed in the DIRRI. If the Referring Entity has a connection with the Insolvent (ie accountant for the Insolvent), the Practitioner should also disclose in the DIRRI how the Referring Entity is connected to the Insolvent.

A Practitioner must not accept any referral that contains, or is conditional upon:

- the giving or receiving of referral commissions, inducements or benefits;
- the giving or receiving of spotter's fees;
- the giving or receiving of recurring commissions;
- understandings or requirements that work in the Administration will be given to the referrer; or

- any other such arrangements that restrict the proper exercise of the Practitioner's judgment and duties.

Panel arrangements, ie where a Practitioner is on a panel of practitioners maintained by a creditor for selection for appointment, will not in itself result in a lack of independence, but must be included in the DIRRI as a Specific referral.

Example

- A Practitioner may undertake work from time to time on behalf of a major bank.
- A Practitioner may be on a panel of practitioners for a major creditor such as the Australian Taxation Office.

- The larger the number, size or significance of Appointments referred from a Referring Entity, the greater the likelihood that the Appointment will result in a perceived lack of independence of the Practitioner.

Example

- Regular referrals from a director in relation to a number of her companies may be more likely to result in a perceived lack of independence than regular referrals from a law firm.
- A larger number of referrals from one source could result in a perception that the Practitioner has become dependent on the workflow and thus is no longer independent.

6.7 Ongoing relationships with creditors

The fact that a Practitioner or the Practitioner's Firm has had an ongoing relationship with a creditor, whether Secured or unsecured, of the Insolvent will not in itself result in a lack of independence. However, a Practitioner must always be aware of the overriding obligation to be both independent and seen to be independent.

A Practitioner must not accept an appointment if the Practitioner would not be independent in fact, or would not be perceived to be independent. Regard must be had to this when considering whether to accept or continue an appointment considering the relationship with a creditor of the Insolvent.

Where a Practitioner has a relationship in the prior two years with a Secured creditor who has a security over the whole or substantially the whole of the Insolvent's property, that relationship must be disclosed in the DIRRI. The following information must be included:

- the name of the Secured creditor;
- type of work that is generally performed for the Secured creditor;
- details of any specific dealings with the Secured creditor regarding the Insolvent;
- fees received for any work done for the Secured creditor in respect of the Insolvent; and
- the Appointee's reasons for believing that the relationship does not result in a conflict of interest or duty.

Example		
Name	Nature of relationship	Reasons
ABC Bank – Secured Creditor	XYZ Insolvency Firm undertakes receivership and	I believe that this relationship does not result in a conflict of interest or duty

of the company	investigatory accountant roles for ABC Bank.	because: • XYZ Insolvency Firm has never undertaken any work for ABC Bank in respect of the company. • The work that XYZ Insolvency Firm undertakes for ABC Bank will not influence my ability to be able to fully comply with the statutory and fiduciary obligations associated with the Voluntary Administration of the company in an objective and impartial manner.

While relationships with unsecured creditors are not defined as a "relevant relationship" (refer to the Corporations Act), it would be possible in some circumstances for a relationship with an unsecured creditor to create an independence issue and Practitioners should be aware of this when considering whether to accept the Appointment.

6.8 Professional Relationships within two years

Subject to the exceptions identified below, Practitioners must not take an appointment if they have had a Professional Relationship with the Insolvent during the previous two years. The purpose of this restriction is to avoid any perception of a lack of independence of the Practitioner. This is referred to as the 'two year rule'.

6.8.1 Exceptions to the two year rule

A number of narrow exceptions to the two year rule have been created because the exceptions may, in the specific circumstances, be in the interests of creditors, or the professional relationship was of such a nature as to have no material bearing on the independence of the Practitioner.

The Practitioner must examine the particular circumstances carefully and document clearly the reasons why and how the decision to accept the appointment was reached.

The onus of justifying how independence is preserved when relying on any of these exceptions is on the Practitioner. It is not sufficient for a Practitioner to simply include the relationship in a DIRRI. Such a declaration will not cure a real or perceived lack of independence.

Practitioners must be able to explain the circumstances that give rise to the potential conflict and the reasons for believing the exception can be applied in the circumstances. This must be recorded in writing on the relevant file.

If a Practitioner is relying on an exception to the two year rule to be able to accept the Appointment, the details of the exception must still be disclosed in the DIRRI.

At a minimum the creditors must be fully informed so that they understand the situation. The Practitioner should also consider seeking legal advice to determine whether court approval of such appointments should be sought.

A. Immaterial Professional Relationship

Where the Practitioner has had a prior professional relationship with the Insolvent within a period of two years before the proposed appointment, the Practitioner may accept the appointment if the prior professional relationship was an immaterial professional relationship'.

An immaterial professional relationship is an assignment that:

- was of limited scope; and limited time and/or fees; and
- would not normally be subject to review by the Practitioner during the course of the Administration.

When determining whether the prior professional relationship was an immaterial professional relationship, the Practitioner must consider whether a fully informed reasonable person would be of the same view.

A Practitioner must disclose to creditors in the DIRRI:

- the nature of the services provided in the prior professional relationship;
- the period or periods over which the services were provided;
- the fees received for those services, the unbilled time costs and outlays, and any amounts written off; and
- the Appointee's reasons for believing that the services provided do not result in a conflict of interest or duty

Example	
Nature of professional service	Reasons
The tax division of XYZ Firm prepared and lodged a BAS for the company 18 months ago. After the lodgement of that BAS, the company did not continue to use XYZ Firm. A fee of $2,500 was paid for these services.	I believe that this relationship does not result in a conflict of interest or duty because: • XYZ Firm did not provide ongoing services to the company. Other than preparing and lodging one BAS, XYZ Firm had no other professional relationship with the company and no other professional services were provided to the company. • The preparation and lodgement of one BAS by XYZ Firm for the company is not a matter that would be subject to review during the liquidation and will not influence my ability to be able to fully comply with the statutory and fiduciary obligations associated with the liquidation of the company in an objective and impartial manner.

B. Pre-appointment communications and meetings

The need for Insolvents (individuals or companies) to seek prompt and appropriate advice about their financial position is emphasised by the law and by the Regulators. It is common for Practitioners to give such advice or other information to the Insolvent about the insolvency process and options available to the Insolvent prior to taking an Appointment. Most insolvencies are initiated by the Insolvent - for example, the company, through its directors, appoints a voluntary

administrator, or the individual debtor appoints a controlling trustee – and in such cases, it is necessary for the Insolvent and their advisor(s) to meet with the Practitioner in order to obtain the Practitioner's agreement to be appointed, and for a consent to act to be obtained.

Example

- A company will generally need to approach a Practitioner for advice on the insolvency or likely insolvency of their company before the board resolves to appoint a Practitioner as administrator under s 436A of the Corporations Act;
- An individual will need to approach a Practitioner for advice on options in personal insolvency, for example between a personal insolvency agreement or bankruptcy.

Notwithstanding that the Practitioner may meet with the Insolvent and give advice, he or she is a professional with obligations to all stakeholders, and the mere fact of this initial contact having occurred should not be taken to constitute a bias or lack of independence if the Practitioner is appointed. This is the case provided that any advice or information given by the Practitioner is restricted to:

- the financial situation of the Insolvent;
- the solvency of the Insolvent;
- consequences of insolvency; and
- alternative courses of action available to the Insolvent in the case of insolvency.

If the Insolvent is a company, a Practitioner must exercise care when meeting with directors to determine whether he or she is being asked to advise (a) one of more of its directors in relation to the Insolvent company itself, (b) one or more of its directors in respect of their obligations/ liabilities as directors of the Insolvent company or (c) one or more of the directors of the Insolvent company in relation to their personal financial affairs.

The provision of advice to the directors in either capacity (b) or (c) creates a risk to independence that will prevent the Practitioner being appointed to the Insolvent company unless information provided is of a general nature about the insolvency process and the consequences of insolvency.

Any advice which involves the Practitioner obtaining a detailed understanding of the director's financial position or access to their personal documents with a view to addressing the director's own personal solvency, will create a risk to independence in connection with any appointment to the Insolvent company.

In any such meetings, the Practitioner should be mindful of these issues:

- The Practitioner must not give any assurance to the Insolvent, or other parties, about the outcome of the insolvency;
- The Practitioner must explain to the Insolvent that information provided by them to the Practitioner at the meeting may be used by the Practitioner for the purpose of the Administration, unless otherwise stated; and
- The Practitioner should explain to the Insolvent that the Insolvent itself will have obligations to, or become subject to claims of the, or any, Practitioner in any Appointment.

If it becomes apparent that the director is seeking anything other than general information in either their capacity as a director or their own personal capacity, then if the Practitioner wishes to leave open the prospect of an appointment to the company, the Practitioner should recommend that the director obtain that advice from another Practitioner.

While pre-appointment communications and meetings generally raise no question of independence, a Member must disclose the circumstances whereby they had contact with the

Insolvent prior to the appointment. The DIRRI has provisions for those circumstances to be disclosed.

The DIRRI does recognise that there can be instances where there is no contact at all with the Insolvent; for example in court appointments, or bankrupt estates transferred by the Official Receiver.

A Practitioner must disclose to creditors in the DIRRI:

- the number of meetings and time period over which advice was provided to the Insolvent, officers of the Insolvent (if the Insolvent was a company) and/or their advisors prior to the Appointment;
- a summary of the general nature of the issues discussed;
- the amount of any Remuneration received for this advice; and
- the Appointee's reasons for believing that the relationship does not result in a conflict of interest or duty.

If the Appointment is to a company, the Practitioner must disclose to creditors in the DIRRI:

- the names of the directors attending the meetings.

A Practitioner must also make a declaration that no information or advice, beyond that outlined in the DIRRI, was provided to the Insolvent, officers of the Insolvent (if the Insolvent was a company) or their advisors.

Example

Circumstances of appointment

This appointment was referred to me by John Smith of XYZ Law Firm, the legal advisor to the company.

I had two meetings with the company, its directors (Mr A and Mr B) and legal advisor during the month prior to my appointment for the purposes of:

- obtaining sufficient information about the company to advise the company, its directors and legal advisors on the solvency of the company,
- to clarify and explain for the company and its directors the various options available to the company and the nature and consequences of an insolvency appointment, and
- for me to provide a consent to act.

I received no remuneration for this advice.

I believe that these meetings do not result in a conflict of interest or duty because:

- the Courts and ARITA's Code of Professional Practice specifically recognise the need for practitioners to provide advice on the insolvency process and the options available and do not consider that such advice results in a conflict or is an impediment to accepting the appointment;
- the nature of the advice provided to the company is such that it would not be subject to review and challenge during the course of the voluntary administration; and
- the pre-appointment advice will not influence my ability to be able to fully comply with the statutory and fiduciary obligations associated with the voluntary administration of the company in an objective and impartial manner.

I have provided no other information or advice to the company, its directors or advisors prior to my appointment beyond that which I have outlined in this DIRRI.

ARITA

C. Investigating Accountant leading to Appointment

A Practitioner may, in some circumstances, accept an Appointment after acting as an Investigating Accountant (IA), whether the IA role was for a creditor of the Insolvent or the Insolvent itself. However, Practitioners must always have regard to how a prior Investigating Accountant's appointment may affect their independence or the perception of independence. A Practitioner must not accept an appointment if the work undertaken in connection with the IA appointment would compromise their independence or be subject to review or challenge. Particular regard must be had to whether any remuneration received by the Practitioner for undertaking the IA may be a preference in a subsequent Appointment.

Where the IA role was for the Insolvent, the restrictions regarding pre-appointment advice apply (refer B above).

The following details about the IA appointment must be included in the DIRRI:

- who appointed the Practitioner;
- scope of the engagement;
- to whom the Practitioner reported;
- the period of the engagement;
- the fee paid;
- who paid the fee; and
- the Appointee's reasons for believing that the relationship does not result in a conflict of interest or duty.

Example – IA - appointment by the company	
Nature of professional service	Reasons
Prior to my appointment as Voluntary Administrator, I was engaged by the company to provide the company with a report on: • the financial situation of the company; • the solvency of the company; • consequences of insolvency; and • alternative courses of action available to the company. • The engagement occurred over a period of 2 months and I was appointed voluntary administrator one week after the report was provided to the company. I was paid a fee of $15,000 for the service provided.	I believe that this relationship does not result in a conflict of interest or duty because: • The work undertaken during the Investigating Accountant engagement has assisted me in developing an understanding of the company and its activities. • Much of the investigatory work done during the Investigating Accountant engagement is work that would have been done by myself in order to be able to report to creditors under s439A of the Corporations Act. As such, this information will be made available to creditors when I report to them in due course. • The nature of the report provided to the company is such that it would not be subject to review and challenge during the course of the voluntary administration. The Investigating Accountant engagement will not influence my ability to be able to fully comply with the statutory and fiduciary obligations associated with the voluntary administration of the company in an objective and impartial manner.

Example – IA – appointment for the Secured creditor		
Name	Nature of relationship	Reasons
ABC Bank – Secured Creditor of the company	XYZ Insolvency Firm undertook an Investigating Accountants engagement for ABC Bank prior to my appointment as Voluntary Administrator. The purpose of the engagement was to consider the company's financial position and the security position of the Bank. I reported to the Bank on the outcome of my investigations. The Investigating Accountants engagement continued for a period of two months and was completed one month prior to my appointment as voluntary administrator. I was paid $20,000 by ABC Bank for this engagement. XYZ Insolvency Firm also undertakes receivership and investigatory accountant roles for ABC Bank.	I believe that this relationship does not result in a conflict of interest or duty because: • The work undertaken during the Investigating Accountants engagement has assisted me in developing an understanding of the company and its activities. The investigation did not reveal any issues with the validity of ABC Bank's security in respect of the company. • The report that XYZ Insolvency Firm provided to ABC Bank is not of the nature that it would be subject to review during the voluntary administration. The work undertaken by my firm for ABC Bank will not influence my ability to be able to fully comply with the statutory and fiduciary obligations associated with the voluntary administration of the company in an objective and impartial manner.
Note: If you are disclosing an IA appointment for a Secured creditor, you will also have a relationship with that creditor to disclose.		

D. Transitioning appointments

A Practitioner may accept an Appointment which arises as a result of a transition from one type of Administration to another under the relevant legislation, subject to the terms of that legislation. For example, from an Appointment as a voluntary administrator to a creditors' voluntary liquidator; or a trustee of a personal insolvency agreement to a trustee of the bankruptcy.

A transitioning Appointment that occurs in accordance with the relevant legislation does not need to be disclosed in the DIRRI.

This exemption does not apply to a situation where a Practitioner is replacing an Incumbent during the transition from one type of Administration to another.

ARITA

6.9 Professional relationships beyond two years

A Practitioner may take an appointment if the professional relationship with the Insolvent occurred more than two years prior to the date of the Appointment.

Nevertheless, the Practitioner must not take the Appointment if the prior relationship:

- is material to the insolvency;
- has real potential for a litigation claim against the Practitioner by a stakeholder; or
- is related to structuring of financial affairs of the entity in order to avoid the consequences of insolvency ie. the distancing of the assets from creditors in the event of insolvency, even if this advice was provided at a time when the entity was solvent.

Example

- A Practitioner's Firm was the auditor of ABC Limited, a large public company, 4 years ago. This professional relationship may be material to the insolvency and/or have real potential for a litigation claim against the Practitioner's Firm. If so, the Practitioner must not take the appointment.
- A Practitioner previously advised John Brown 3 years ago, at a time when he was entering into a new partnership arrangement and he was solvent, on structuring of his financial affairs. Such advice would be material to the bankruptcy and as such, the Practitioner must not take the appointment.
- A Practitioner's Firm provided due diligence services to XZY Limited in its acquisition of a major manufacturing business 4 years ago. After the acquisition, XZY's performance declined and now the company is seeking the services of an insolvency practitioner. This professional relationship may be material to the insolvency and/or have real potential for a litigation claim against the Practitioner's Firm. If so, the Practitioner must not take the appointment.
- A Practitioner's Firm provided a valuation service on assets prior to its sale to a third party 3 years ago. It is unlikely that this would be material to the insolvency or have a real potential for a litigation claim against the Practitioner by a stakeholder. If so, the Practitioner may take the appointment.

6.10 Relationships with Associates

The Corporations Act and the Code require disclosure of relationships within two years of the Appointment with Associates of the Insolvent. As a result of the requirements of the Code, this disclosure is required on all corporate and personal insolvency appointments, excluding appointments as a Controller and as a liquidator in a Members' Voluntary Liquidation.

Although neither the Corporations Act or the Code mandate the disclosure of relationships with Associates more than two years prior to the Appointment, a Practitioner must always be aware of the overriding obligation to be both independent and seen to be independent. As such, where a Practitioner has a relationship with an Associate that extends for, or occurred, more than two years prior to the Appointment, consideration should be given to disclosing that relationship to creditors in the DIRRI.

Whilst a relationship with an Associate of an Insolvent will not necessarily prevent a Practitioner from accepting an Appointment, Practitioners must always have regard to how the relationship may affect their independence or the perception of their independence.

ARITA

A Practitioner must not accept an Appointment if the Practitioner would not be independent in fact, or would not be perceived to be independent. Regard must be had to this when considering whether to accept or continue an Appointment in considering the relationship with an Associate of the Insolvent.

6.10.1 Associate defined

An Associate is a wide concept and is defined in the Code at 4.2.

Under the Corporations Act, an Associate is defined as (principally in section 11):

- A director or secretary of the body;
- A related body corporate; and
- A director or secretary of a related body corporate.

A director is defined in section 9 of the Corporations Act to include a person that acts in the position of a director or whom the directors of the company are accustomed to act in accordance with their instructions or wishes.

A related body corporate is defined as (section 50 of the Corporations Act):

- A holding company of another body corporate;
- A subsidiary of another body corporate; and
- A subsidiary of a holding company of another body corporate.

For Administrations under the Bankruptcy Act, Associate is a spouse, dependent or direct relative of the Insolvent, or the spouse or dependent of a direct relative, and any Entity with which the Insolvent or any of the persons previously mentioned are associated with.

6.10.2 Examples of Associates

Examples of Associates per the definition are:

- In corporate insolvency administrations where you accept an Appointment to ABC:
    - Entities that are part of the same corporate group;

      Example: ABC and DEF are both subsidiaries of XYZ Pty Ltd. ABC is an Associate of DEF. You would have to disclose relationships with DEF.

    - Director of a company;

      Example: Mr Brown is a director of ABC Pty Ltd. Mr Brown is an Associate of ABC. You would have to disclose all relationships with Mr Brown (ie. previously acted as liquidator in the winding up of another company that Mr Brown was a director of; or your firm provides taxation services to a company that Mr Brown is a director of).

    - Subsidiary and holding company;

      Example: ABC Pty Ltd is a wholly owned subsidiary of DEF. ABC is an associate of DEF. You would have to disclose relationships with DEF.

- In personal insolvency administrations where you accept an Appointment to Mr Brown:

- Director of a company;

  Example: Mr Brown is a director of ABC Pty Ltd. ABC is an Associate of Mr Brown. You would have to disclose relationships with ABC.

- Trustee of a trust.

  Example: Mr Brown is a director of the trustee of ABC Trust, ABC Pty Ltd. ABC Trust and ABC Pty Ltd are associates of Mr Brown. You would have to disclose relationships with ABC Trust and ABC Pty Ltd.

6.10.3 Information to be provided

Where the Practitioner has a relationship with an Associate of the Insolvent in the two year period prior to the Appointment, the following details about the relationship with the Associate must be included in the DIRRI:

- the name of the Associate;
- the relationship of the Associate to the Insolvent;
- nature of the Practitioner's relationship with the Associate;
- if the relationship between the Practitioner and Associate is professional:
  - the type of work performed;
  - the scope of the engagement;
  - frequency of contact;
  - period over which the work was performed; and
  - if the engagement has been completed, when it was completed;
- if the relationship is not a professional relationship:
  - the nature and period of the relationship (Noting the strict prohibitions on non-professional relationships set down in the Code – refer 6.12); and
- the Appointee's reasons for believing that the relationship does not result in a conflict of interest or duty.

Example		
Name	Nature of relationship	Reasons
Associate Pty Ltd – a subsidiary of the holding company of Insolvent Pty Ltd.	I have previously acted as voluntary administrator and subsequently liquidator of Associate Pty Ltd. This appointment continued for a period of 3 years and concluded 18 months prior to my appointment to Insolvent Pty Ltd.	I believe that this relationship does not result in a conflict of interest or duty because: • The voluntary administration of Insolvent Pty Ltd is completely unrelated to the prior insolvency of Associate Pty Ltd. Insolvent Pty Ltd does not operate the same or similar business to that operated by Associate Pty Ltd. The appointment to Associate Pty Ltd occurred 4.5 years ago, and except for the conduct of the insolvency administrations of Associate Pty Ltd, I have had no

		contact with the holding company, officers or any other entities associated with the corporate group. • The role undertaken by me as voluntary administrator and liquidator of Associate Pty Ltd will not influence my ability to be able to fully comply with the statutory and fiduciary obligations associated with the voluntary administration of Insolvent Pty Ltd in an objective and impartial manner.

6.11 Concurrent Appointments to related parties

6.11.1 Group Company Appointments

There are sound commercial and practical reasons to appoint a Practitioner to a group of related companies. For example, a group appointment can result in cost savings, data sharing, and a more complete and accurate picture of the group activities and its financial position.

Practitioners need to be aware of possible conflicts that could arise as a result of group appointments. These include circumstances where there are:

- preference payments between the group or other voidable or contestable transactions;
- insolvent trading liabilities of the parent company; and
- contentious proofs of debt.

There may be no lack of independence where there is no real dispute as to the facts, or as to the validity of transactions between companies in the group.

Notwithstanding the requirement to make suitable enquiries before accepting an appointment, threats to independence stemming from group appointments may often only be identified after acceptance of the appointment. If, after accepting the group appointment, a conflict arises, such as disputed inter-company loans or transactions that may result in dispute or litigation putting the Practitioner in effect on both sides of the dispute, then, in order to preserve independence, the Practitioner must:

- advise creditors on how the issue will be managed; or
- seek directions from the court; or
- seek approval for the appointment by the court of a special purpose administrator or liquidator.

It is not a breach of the Code to have accepted the appointment provided suitable enquiries were made prior to the appointment and no conflicts were identified, if the Practitioner takes appropriate action once any threat is identified.

The DIRRI completed for each company in the group must disclose the Practitioners' appointment to the other companies in the group, state that the Practitioner is not aware of any conflicts at the time of their appointment and advise creditors how any conflicts that arise during the course of the Administration will be dealt with.

Example		
Name	Nature of relationship	Reasons
456 Pty Ltd – subsidiary of 123 Pty Ltd	I was appointed voluntary administrator of 456 Pty Ltd on the same day as my appointment as voluntary administrator to 123 Pty Ltd.	I believe that this relationship does not result in a conflict of interest or duty because: • 123 Pty Ltd and 456 Pty Ltd operate the manufacturing business together. The nature of the business operations mean that the administrations can be conducted more efficiently by one practitioner. • At the time of my appointment, I was not aware of any conflicts of interest between the two companies. Should such a conflict arise, I will keep creditors informed and take appropriate action to resolve the conflict.

6.11.2 Individual/Company Appointments

There can be circumstances where similar commercial and practical reasons allow a practitioner to be both the liquidator of a director's company and the trustee of that director's bankruptcy. However, care is required in taking either appointment after the other because there is a high risk of both actual and perceived lack of independence in these types of Appointments. A director will often be either a debtor or a creditor of the company, and may have liabilities for insolvent trading or breach of duties. In those cases it would be difficult to avoid a lack of independence or the perception of it.

Each case must be assessed on its merits and the following factors, among others, may be relevant:

- the timing of the second appointment – for example the personal insolvency may arise, unconnected to the company, at the end of the Administration of the company;
- whether there are any real benefits in having concurrent administrations; and
- if there are or there is a likelihood of recoverable transactions or contestable claims between the two administrations.

Threats to independence stemming from such appointments may arise later in which case, in order to preserve independence, the Practitioner must:

- advise creditors on how the issue will be managed; or
- seek directions from the court; or
- seek approval for the continuation of the appointment by the court, or the appointment of another trustee or liquidator.

Each case must be assessed on its merits and suitable enquiries must be made to identify any threats to independence prior to accepting such an Appointment. Legal advice or court approval may need to be obtained.

If the subsequent appointment is made by the court, the consent to act must contain full details of the prior appointment.

When the DIRRI is completed, it must include details of the appointment to the other associated Insolvent to which the practitioner has been appointed, state that the Practitioner is not aware of any conflicts at the time of their appointment and advise creditors how any conflicts that arise during the course of the Administration will be dealt with.

6.11.3 Joint personal insolvency appointments

The Bankruptcy Act contemplates concurrent Appointments in the case of joint Insolvents, often spouses or business partners, and prescribes how such joint estates are to be administered.

A practitioner can accept such concurrent Appointments. However, this is always subject to the need to be independent and be seen to be independent.

Practitioners need to be aware of possible conflicts that could arise as a result of concurrent Appointments. These include circumstances where there are:

- preference payments between the parties or other voidable or contestable transactions;
- there is a claim by the estate of a wife on the estate of her husband, at family law or as a commercial claim; or
- contentious proofs of debt.

There may be no lack of independence where there is no real dispute as to the facts, or as to the validity of transactions between the parties.

Notwithstanding the requirement to make suitable enquiries before accepting an Appointment, threats to independence stemming from concurrent Appointments usually are only identified after acceptance of the Appointment. If, after accepting the Appointment, a conflict arises that may result in dispute or litigation putting the Practitioner in effect on both sides of the dispute, then, in order to preserve independence, the Practitioner must:

- advise creditors on how the issue will be managed; or
- seek directions from the court; or
- resign the appointment; or
- seek approval for the appointment by the court of a special purpose trustee.

It is not a breach of the Code to have accepted the Appointment provided suitable enquiries were made prior to the Appointment and the Practitioner takes appropriate action once the threat is identified.

The DIRRI completed for each of the Insolvents must disclose the Practitioners' Appointment to the other Insolvent, state that the Practitioner is not aware of any conflicts at the time of their appointment and advise creditors how any conflicts that arise during the course of the Administration will be dealt with.

6.12 Other Relationships

Other non-trivial relationships include personal or business relationships or interests with the Insolvent that are not professional relationships. A Practitioner must not take an Appointment if

there are or have been any such relationships with the Insolvent at any time. Unlike professional relationships, the two year time limit does not apply.

Examples of other relationships are set out below.

6.12.1 Family

In family (or close personal) relationships, the potential for conflict is so great that the Practitioner must not consent to act. These relationships include close or immediate family relationships with:

- the Insolvent;
- An Associate of the Insolvent (if the Insolvent is a company); or
- an employee or advisor of the Insolvent who is in a position to exert direct and significant influence.

6.12.2 Business

Where the Practitioner has had business dealings with the Insolvent or an Associate of the Insolvent, outside what would be termed a professional relationship, the Practitioner must not consent to act unless:

- the business dealing was immaterial; or
- the business dealing occurred more than two years ago

Whether business dealings are immaterial is dependent on the size of the Firm, the size of the Insolvent and the nature and quantum of the business dealings.

Where the Practitioner, in a capacity other than as an Appointee, has a controlling interest in, or the ability to influence a business operating in the same, or principally the same market as the Insolvent, the Practitioner should consider whether this would lead to a perception of a lack of independence.

Example

Examples of business dealings include, but are not limited to, where a Practitioner (personally, or through related entities):

- has a financial interest in the Insolvent or an Associate, solely or jointly;
- is involved in partnerships, joint ventures, co-investments;
- received a loan from or made a loan to an Insolvent or related entity or any of its Directors, officers or senior employees;
- partners or senior employees of his or her firm, are, or have been, a director, officer or substantial shareholder or employed by the Insolvent or related entity in a position to exert direct and significant influence; or
- provision of goods or services by the Insolvent to the Practitioner or Firm.

6.12.3 Friendship

Where the Practitioner has a friendship with the Insolvent or an Associate of the Insolvent, the Practitioner must not consent to act.

There is necessarily no test for friendship and regard should be had as to how a reasonable and informed third party would view the friendship. A trivial friendship creates no lack of independence, for example a casual acquaintance, but longer term relationships and friendships will.

6.12.4 Animosity

Animosity is a threat to Independence as it may bias the behaviour of the Practitioner against the Insolvent, or be perceived to do so. If there is a history of animosity with the Insolvent or an Associate of the Insolvent, then the Practitioner should carefully consider whether to take the Appointment.

It is not unusual for the Insolvent, an Associate of the Insolvent, or some creditors to dislike or disagree with the Practitioner, particularly if there has been vigorous prosecution for recovery of funds or tracing of assets. This is not a ground for a claim of breach of independence based on animosity.

6.13 Pre-appointment disclosure of proposed basis of Remuneration

Where the Practitioner is considering accepting an appointment to the Insolvent, the Practitioner must provide the directors/individual Insolvent with a disclosure of the basis of Remuneration prior to their Appointment. This is not an approval process, but is to ensure that the directors/individual Insolvent are fully informed, in writing, of the Practitioner's proposed basis of Remuneration, prior to making the appointment.

This requirement does not apply to Controllers, Voluntary Administration appointments made by a Secured creditor or any Appointments made by the court.

Where the Practitioner proposes that they will use hourly rates as the basis of their Remuneration, the scale of hourly rates must be provided in the pre-appointment disclosure.

Practitioners should also include an explanation that:

- the actual Remuneration drawn in the Administration will be that approved by the Approving body after the Approving body is provided with a Remuneration report in accordance with the applicable Legislation and Code;
- creditors will be advised of the basis proposed to directors/individual Insolvent,; and
- if the directors/individual Insolvent or other Entity has paid, or will be paying, money up-front for the purposes of the Practitioner's Remuneration, approved Remuneration over and above this amount can be paid from the assets of the Administration.

There is no mandatory requirement to provide an estimate of cost of the Administration to the directors/Insolvent, but where an estimate of the cost of the Administration is provided, it must be:

- in writing to the directors/individual Insolvent as part of the pre-appointment disclosure, clearly detailing any variables which may affect the estimate;
- in the pre-appointment disclosure, the director/Individual insolvent must be advised that:
    - creditors will be advised of the estimate provided to the directors/individual Insolvent; and

- the actual Remuneration drawn in the Administration may exceed that estimate and this higher amount can be approved by the Approving body;

- disclosed to creditors in the Initial Advice to Creditors (refer section 15.3.2 and 23.2.1); and
- if the estimate to the directors/individual Insolvent differs to any subsequent estimate to creditors or actual Remuneration amount claimed, an explanation must be provided for any variance.

Practitioners must exercise care in providing an unconditional quote or fixed fee to directors/individual Insolvent prior to accepting an appointment, as this may be perceived to restrict the proper conduct of the Administration. If a fixed fee or unconditional quote is provided, the Practitioner must not ask for a fee approval greater than this amount from the Approving Body.

To reduce disputes regarding what information was provided to the directors/individual Insolvent, Practitioners should obtain the directors'/individual Insolvent's acknowledgement of receipt of the information regarding the proposed basis of Remuneration and any estimate, quote or fixed fee.

The suggested format for providing pre-appointment disclosure of basis of Remuneration to the directors/individual Insolvent is at 23.2.3.

6.14 Up-front payment for Remuneration

6.14.1 Companies

Practitioners may accept monies to meet the costs of the Administration, prior to the acceptance of the Appointment, provided that:

- the monies are held on trust;
- there are no conditions on the conduct or outcome of the Administration attached to the monies (i.e. achieving a certain outcome); and
- full disclosure is made to the creditors in the Indemnities and Upfront payments section of the DIRRI.

Monies held on trust must only be drawn as Remuneration in the same manner as normal Remuneration claims and accounted for as funds of the administration. Monies should be paid from the Trust account into the Administration bank account prior to being drawn for Remuneration.

Example		
Name	Relationship with the company	Nature of indemnity or payment
Mr A	Director of the company	Mr A provided an upfront payment of $10,000 to cover my initial remuneration and expenses associated with the creditors' voluntary liquidation of the company. The money is currently held in my firm's trust account and will not be drawn to meet my remuneration until such time that it is approved by creditors. There are no conditions on the

		conduct or outcome of the liquidation attached to the provision of these funds.

6.14.2 Personal Insolvencies

Practitioners must refer to guidance issued by AFSA in respect of up-front payments for Remuneration and indemnities in personal insolvency Administrations.

6.15 Court appointment disclosure requirements

6.15.1 Consent to Act – Court Liquidation

Liquidators are required to provide a consent to the Court when consenting to act as liquidator in a Court Liquidation. As part of that consent, the liquidator is required to make a declaration that either:

- he or she is not aware of any relevant relationships mentioned in section 60(2) of the Corporations Act (which are essentially the relationships required to be disclosed by a CVL liquidator in their DIRRI), or
- he or she has had within the preceding 24 months, the relevant relationships mentioned in subsection 60(2) of the Corporations Act (and disclose details of any such relevant relationships).

Although a DIRRI itself is not required to be lodged with the court, a full conflict check will need to be performed prior to completing the consent to act and documented in accordance with 6.16. Subsequent to their appointment, Practitioners must then complete and provide a DIRRI to creditors (refer 6.17).

6.15.2 Currency of Consents in Court Appointments

In court Appointments, there will be a period of time between the signing of the consent and the making of the Appointment. During this time, the Practitioner's consent will remain pending. Practitioners must ensure that their consent is correct when signed, and then remains accurate until the time of their Appointment; that is, that the circumstances of their independence and their relationships do not change during this period.

Practitioners must consider pending consents when determining whether a subsequent Appointment should be accepted or consented to.

Practitioners must ensure that they withdraw any pending consents where a subsequent Appointment or consent to act results in a conflict of interest in respect of the pending consent.

6.15.3 DIRRI after a Court Appointment

A DIRRI is required to be provided by a Practitioner after their appointment by the court (court liquidation, provisional liquidation, court appointed receiver or trustee in bankruptcy) in their first communication with creditors pursuant to 6.17 of the Code.

The DIRRI requires disclosure of the circumstances of the appointment. The Code focuses on appointments by directors and does not provide any guidance on situations where a Practitioner is appointed by the Court.

In the "circumstances of appointment" section of the DIRRI the following points should be addressed for Court appointments:

- The name of the petitioning creditor/applicant;
- When you consented to act; and
- the Appointee's reasons for believing that the consent does not result in a conflict of interest or duty.

> *Example*
>
> I was appointed Liquidator of ABC Pty Ltd (in Liquidation) by the Court on the application of Creditor Pty Ltd. I consented to act as liquidator on the request of Creditor Pty Ltd's solicitor, 123 Solicitors, on 1 January 2014. This consent does not affect my independence for the reason that the giving of a consent to act does not result in any duty owed to that creditor that would conflict with my interests or duties under the Act.
>
> OR
>
> I am on the ATO panel to act as liquidator where the ATO is a creditor. On 2 January I received the form of consent from the ATO which I signed and returned to the ATO. This does not affect my independence for the reason that being on a panel and giving a consent to act to a creditor does not result in any duty owed to that creditor that would conflict with my interests or duties under the Act.

6.16 Independence processes and documentation

Practitioners must actively seek to identify any risks to independence before accepting an Appointment.

As a minimum, every Firm must document and implement policies and processes that:

- recognise the importance of independence;
- establish clear criteria to identify and categorise threats;
- standardise the steps of investigation, enquiry, reporting and resolution;
- require education of principals and staff on the process;
- include a process of consultation with senior staff for difficult cases;
- provide guidance as to courses of action to be taken if a threat to independence is identified after an Appointment is accepted; and
- monitor adherence to the process.

Practitioners must ensure that for every Appointment, a written record is maintained which demonstrates compliance with the Firm's independence processes and provides a working paper to support the completed DIRRI.

An effective process will help to embed in the Firm culture an understanding that independence issues are significant and important. It will also provide a consistency in approach and a commitment to reducing risk.

The Practitioner:

- may delegate to staff the task of gathering information on which the decision is based; but
- is responsible for ensuring adherence to the process; and
- cannot delegate the decision on independence.

6.17 Format of the DIRRI

Disclosure of interests or relationships that create a lack of independence, or a perception of a lack of independence, does not remedy or cure the situation. The provision of a DIRRI is a process for identifying relationships that are *not* threats to independence, but need to be disclosed to creditors to ensure transparency. Declarations of relevant relationships and declarations of indemnities are required under the Corporations Act in certain instances. It is intended that the provision of a DIRRI in the template prepared by ARITA meets, and goes beyond, those statutory requirements.

In the case of personal insolvency, the DIRRI template will need to be amended to address the nomenclature and relationships of bankruptcy. For Part X agreements, Practitioners must also complete the particular statutory requirements under the Bankruptcy Act.

For all corporate and personal insolvency appointments, excluding appointments as a Controller and liquidator in a members' voluntary liquidation, at the earliest practical opportunity, the Practitioner must provide a DIRRI to creditors.

The DIRRI comprises three components:

A. Declaration of Independence;
B. Declaration of Relationships, which includes:
    i. Circumstances of appointment;
    ii. Relevant relationships with the Insolvent and others in the previous 24 months;
    iii. Prior professional services with the Insolvent in the previous 24 months;
    iv. A declaration that there are no other relationships to declare; and
C. Declaration of Indemnities and up-front payments.

A suggested template for a DIRRI is at section 22.1.

Any relationships, indemnities or up-front payments disclosed in the DIRRI must not be such that the Practitioner is no longer independent. The purpose of components B and C of the DIRRI is to disclose relationships that, while they do not result in the Practitioner having a conflict of interest or duty, ensure that creditors are aware of those relationships and understand why the Practitioner nevertheless remains independent.

A Practitioner only needs to declare a relationship once in the DIRRI. The Practitioner should select the most appropriate section of the DIRRI for the declaration to appear.

6.17.1 Content of the DIRRI

The Practitioner must include in the DIRRI a statement as to who the declarations in the DIRRI relate to. The Practitioner should include a brief explanation of the purpose of the DIRRI

A. Declaration of Independence

A declaration that the Practitioner

- has undertaken a proper assessment of risks to independence in accordance with the law, Code and applicable professional standards;
- has determined that the assessment identified no real or potential risks to independence; and
- is not otherwise aware of any impediments to taking the Appointment.

B. Declaration of Relationships

i. Circumstances of Appointment

A declaration setting out the circumstances of the Appointment by way of explaining:

- the number of meetings and time period over which advice was provided to the Insolvent, officers of the Insolvent (if the Insolvent is a company) and/or their advisors prior to the Appointment;
- a summary of the general nature of the issues discussed;
- the amount of any Remuneration received for this advice;
- the Appointee's reasons for believing that such meetings do not result in a conflict of interest or duty;
- the Referring Entity (name, firm/organisation and, if applicable, connection to the Insolvent), if applicable; and
- that no other information or advice, beyond that outlined in the DIRRI, was provided to the Insolvent, officers of the Insolvent (if the Insolvent was a company) or their advisors.

If the Appointment is to a company, the Practitioner must also disclose the names of the directors attending the meeting(s).

ii. Relevant Relationships (excluding professional services to the Insolvent)

A Declaration setting out prior relationships the Practitioner, or Firm has had in the preceding 24 months with:

- the Insolvent;
- an Associate of the Insolvent;
- a former Practitioner of the Insolvent;
- a person who has a charge on the whole of or substantially the whole of, the Insolvent's property.

As a minimum, the Practitioner must state:

- who the relationship is with;
- the nature of each relationship; and
- the Appointee's reasons for believing that the relationship does not result in a conflict of interest or duty.

The Code provides specific guidance on the information to be disclosed in respect of relationships with:

- Secured creditors (section 6.7);
- Associates of the Insolvent (section 6.10); and

- appointments to related parties (corporate groups, corporate/personal and multiple personal insolvency appointments to related parties) (section 6.11).

iii. Prior Professional Services to the Insolvent

A declaration setting out any professional services (if any) provided to the insolvent by the Practitioner or Firm, in the preceding 24 months, including:

- the nature of the professional service;
- when the professional service was provided;
- what period the professional service was provided over;
- the fees paid for the professional service; and
- the Appointee's reasons for believing that the professional services disclosed do not result in a conflict of interest or duty.

The Code provides specific guidance on the information to be disclosed in respect of:

- immaterial professional services (6.8.1A);
- pre-appointment advice (6.8.1B); and
- investigating accountant engagements for the Insolvent (6.8.1C);

iv. No other relevant relationships to disclose

A declaration that there are no other relevant relationships, including personal, business and professional relationships, from the previous 24 months with the Insolvent, an Associate of the Insolvent, a former insolvency practitioner appointed to the Insolvent or any person or entity that has a charge over the whole or substantially whole of the Insolvent's property that should be disclosed.

C. Indemnities and Up-Front Payments

A Declaration of Indemnities and up-front payments disclosing:

- the identity (name and relationship with the Insolvent) of each indemnifier or provider of an upfront payment;
- the extent (dollar caps and/or other limitations or conditions) and nature of each indemnity or upfront payment, including what the indemnity or upfront payment may be used for (other than statutory indemnities); and
- a statement about where the funds are being held (if applicable);
- a statement about when and how the funds will be applied (if applicable); and
- a statement that there are no other indemnities or upfront payments to be disclosed.

Because disclosure of indemnities is only required in order to identify relationships that do not in fact create a lack of independence and to ensure transparency, and because disclosure of these confidential arrangements may be contrary to the interests of creditors, Practitioners are not required to disclose indemnities provided in connection with the funding of litigation or investigations, unless in the case of voluntary administration, disclosure is required by s 436DA.

6.17.2 Additional requirements for appointments under Part X of the Bankruptcy Act

Appointees under Part X must comply with the particular disclosure requirements of the Bankruptcy Act.

6.17.3 The nature of explanations / disclosures in the DIRRI

Disclosures in the DIRRI are aimed at providing an explanation to creditors of relationships with the Insolvent and other relevant party and the reasons why these relationships do not result in a lack of independence on the part of the Practitioner. Therefore, the disclosures should focus on providing this information.

All declarations and explanations must be clear, concise, meaningful and in terms that the creditors can understand.

Statements such as:

- I do not have a conflict,
- This relationship is allowed under ARITA's Code; or
- My firm has a contractual relationship with the secured creditor

do not provide a meaningful explanation of the relationship or the administrator's reasons for believing why it does not result in a conflict of interest or duty.

Matters that Practitioners may consider when drafting the explanation to creditors may include, but are not limited to:

- whether the relationship is one specifically allowed under professional standards established for the insolvency industry;
- whether the Practitioner has considered and applied applicable professional standards when determining whether they were independent;
- what was the scope / purpose of the engagement / advice – ensure that the scope purpose is outlined in the explanation, was it limited?;
- whether the engagement would not normally be subject to review by the Practitioner during the course of the Administration;
- whether advice was provided to the directors and the directors were advised to obtain their own professional advice;
- whether the engagement / relationship / advice provided will influence the ability of the Practitioner to fully comply with the statutory and fiduciary obligations associated with the appointment;
- whether the engagement / relationship / advice provided will influence the objectivity, impartiality or judgment of the Practitioner in performing their duties;
- in respect of relationships with Secured creditors, whether there is any evidence of issues with the validity of charges held in respect of the Insolvent;
- whether any work has ever been conducted in respect of the Insolvent on behalf of the entity with which the relationship is held;
- what type of advice was provided and how that may be used or relate to the subsequent administration; and
- whether a group appointment is beneficial and whether any potential intercompany conflicts have been identified.

The explanation must be provided in conjunction with a meaningful explanation of the relationship.

6.17.4 Signing of the DIRRI

In circumstances where two or more Practitioners have been appointed to an Insolvent, each Practitioner must sign the DIRRI as it is a declaration made by the Practitioner in their own individual capacity.

In exceptional circumstances, a DIRRI may need to be issued where all of the Appointees have not been able to sign it. It is considered that this may only occur in exceptional circumstances which must be clearly documented on the file. A record of the co-appointee's consent to the issuance of the DIRRI without his or her signature must also be included on the file.

The DIRRI must also include an explanation to creditors as to why all Appointees were not able to sign the DIRRI.

In a situation where one Appointee signs the DIRRI on behalf of another Appointee, each Appointee is equally responsible for the content of the DIRRI. Due enquiry must be made by both Appointees as to the accuracy of the DIRRI and the completeness of the declarations made.

The co-appointee who has not signed the DIRRI must do so as soon as possible and the Practitioners must ensure that the updated DIRRI is provided to creditors.

6.17.5 Timing

The DIRRI must:

- be provided with the first communication to creditors;
- be provided no later than with the notice of the first meeting of creditors; and
- be tabled at the first meeting of creditors.

The tabling of the DIRRI must be included as an agenda item and in the minutes.

6.17.6 Replacement Appointees

The requirements in relation to a DIRRI also apply to any Practitioner accepting a replacement appointment.

All replacement Practitioners must:

- table a copy of the DIRRI at the meeting prior to the casting of the vote regarding their appointment; and
- if they are appointed, provide a copy of their DIRRI to all creditors with their next communication to creditors.

For additional requirements of replacement administrators, refer to 11.7.

6.17.7 New Information

If a Practitioner becomes aware that the DIRRI has become out of date or there is an error, then a Practitioner must update the DIRRI and provide it to creditors with the next communication with them and also table the DIRRI at the next meeting of creditors.

This would include situations where a Practitioner accepts a subsequent appointment to a company with a common director. Not only must the DIRRI for the new appointment disclose the prior appointment, but if the prior appointment is still ongoing, the DIRRI for that administration must also be updated to reflect the new appointment.

6.18 Post Appointment Actions – threat to Independence Identified

If information comes to light about relationships and threats to independence that were not known at the time of the acceptance of the Appointment, or the circumstances materialised after the Appointment commenced, then the following applies.

6.18.1 Non-precluded Relationships

Where the relationship or threat to independence is identified and it was one that would not have precluded the acceptance of the appointment, then, if the Practitioner:

- followed the requirements of the Code;
- has adequate policies, systems and processes;
- the situation was a result of inadvertence; and
- it was not reasonable to know or anticipate the situation at the time of accepting the appointment;

then the omission is not a breach of this Code and the Practitioner may continue with the Administration subject to amending the DIRRI and sending the amended DIRRI to creditors.

6.18.2 Precluded Relationships

Where a relationship, or conflict of interest is identified and the relationship or conflict was one where the Appointment should not have been accepted if the circumstances had been known at the time, then the following applies.

A. Immediate Actions

As soon as practicable after the circumstances or facts are identified the Practitioner must prepare and deliver a report for creditors, and as appropriate, ASIC, AFSA, the court, and/or ARITA setting out:

- the nature of the relationship and conflict;
- the key facts and origin;
- reasons why the issue was not detected prior to acceptance of the Appointment;
- the potential impact on perceived independence;
- the status of the Administration – work done, work in progress and work to complete the Administration;
- the costs of stepping down and transferring the Appointment; and
- fees taken and outstanding.

B. Innocent or Inadvertent Behaviour with Mitigating Factors

If the Practitioner:

- followed the requirements of the Code;
- has adequate policies, systems and processes;
- the situation was a result of inadvertence; and
- it was not reasonable to know or anticipate the situation at the time of accepting the appointment;

then this will not be a breach of the Code.

Notwithstanding the innocent behaviour with all the mitigating factors in place the Practitioner should:

- where the Administration is substantially complete;
    - apply to the Court for leave to continue and complete the Administration;
- where the Administration is not substantially complete:
    - expeditiously resign from the Appointment;
    - hold a creditors' meeting or apply to the Court to transfer the Administration; and
    - bear his/her costs of the transfer of the Administration.

The Practitioner may, unless ordered by the Court, retain fees that have been approved for work necessarily and properly done until the identification of the threat to independence. The Practitioner may not charge for transferring the Appointment and must ensure that the new Appointee is provided with all materials as expeditiously as possible.

The Court may determine that it is acceptable in the circumstances for a Practitioner to continue, notwithstanding the breach of the Code.

C. Reckless, Negligent or Intentional Behaviour or Behaviour without Mitigating Factors

Where the Practitioner:

- has wilfully or negligently taken the Appointment; or
- has not followed the requirements of the Code; or
- does not have adequate systems and processes to assure independence,

then this will be a serious breach of this Code.

The Practitioner should call a creditors' meeting or apply to the Court for a replacement Practitioner to be appointed, and should only continue as the Appointee if the Court so determines.

ARITA

7 Limited Value of Disclosure

Principle 3: Disclosure and acceptance of a lack of independence is not a cure.

In many financial relationships, disclosure and consent, often involving partitioning of information such as '*Chinese Wall*' arrangements, is accepted as a cure for many types of conflicts of interest.

The independence obligations of Practitioners are greater. Where there is a threat to independence as identified in the previous section, then disclosure, even with consent will not cure the problem and the appointment must not be taken.

While a court may permit the acceptance or continuation of the Administration, the defence of full disclosure to creditors who gave their approval will not be accepted as a defence for breach of the Independence provisions of the Code.

ARITA

8 Communication

Principle 4: Members must take care to communicate with affected parties in a manner that is accurate, honest, open, clear, succinct and timely in order to ensure their effective understanding of the processes, and their rights and obligations.

8.1 Need for Effective Communications

Effective communication in insolvency is essential because of the:

- legal and commercial complexity of the insolvency processes;
- legal and commercial implications of letters and reports;
- high emotions surrounding financial loss and loss of livelihood; and
- lack of knowledge and expertise in the insolvency process, and its language and terminology, of most stakeholders.

Accordingly, communications from Members should be:

- clear and concise and written where possible in lay terms (except when communicating with sophisticated creditors and advisors);
- objective;
- responsive;
- timely; and
- expressed in a professionally courteous tone and manner.

Members should take care to ensure that all communications, including reports, whether issued personally, or by delegation are accurate and free from false or misleading statements; do not omit, or obscure information required to be included or relevant to users of the communication; and preserve confidential or private information where necessary, unless such disclosure is required by legislation.

Practitioners should carefully exercise their professional judgment when balancing the needs of individuals for information or responses to inquiries with the overall efficiency and costs of the administration. Furthermore, Practitioners must have regard to any legislative requirements to respond to creditor requests for information.

Practitioners should display sensitivity in dealing with individual creditors who will have suffered a financial loss that may be small in the broader context, but may be significant to them. Clarity in explaining the various rights, obligations, processes and timeframes can diffuse feelings of animosity wrongly directed to the Practitioner.

The timely reply by the Practitioner to inquiries from creditors will assist in diffusing animosity and concern that they are not being heard.

Communicating with the Insolvent, directors and others involved in the insolvency may require firm and forthright communication, particularly in situations where there is a refusal to co-operate, and belligerence, or where examinations or litigation are involved.

8.2 Plain English

The use of jargon should be avoided. Simple language should be used wherever possible. Members should be aware that terms with which they are familiar on a daily basis may mean little to a creditor with no experience in insolvency.

8.3 Use of Templates

Document templates provide a cost effective way to prepare standard letters and reports. Properly constructed they:

- reduce costs;
- reduce drafting risk;
- reduce legal risk;
- prompt for inclusion of material; and
- prompt for the exercise of professional judgment.

However, care should be taken to use templates appropriately. Templates must be tailored for the specifics of each Administration. Use of a template without customisation may result in a Member failing to meet their duties.

> *Example*
>
> Use of the example list of tasks in the remuneration report template may result in tasks that have not been completed for a particular Administration being inappropriately included in that Administration's remuneration report, which would mislead creditors as to the work performed in the Administration.

There is a real risk that slavish or unthinking adherence to templates may result in:

- overly long documents;
- incorrect or irrelevant statements;
- inappropriate application;
- obscurity of the real purpose of the document;
- failure to make conscious decisions about what should be included; and
- lack of attention to detail.

The objective is to ensure that all communication is relevant, clear and concise.

8.4 Tailoring reports

Reports should be tailored to the particular circumstances of each administration.

In providing information in a report, the Practitioner should as a matter of good practice:

- provide information that is specific to the administration, rather than generic;
- ensure, where possible, that the level of information is proportionate to the size and complexity of the administration;
- try to assist creditors by highlighting the key components of the report and any areas that creditors are likely to view as contentious;
- provide a summary of high-level information;
- explain that further levels of detail are available at the meeting or on request;

- make explanations concise and clear; and
- provide disclosure that is meaningful, clear, succinct and appropriate overall.

8.5 Document Construction

Given the diverse nature of stakeholders, particular care should be taken in the structure and layout of documents.

It should never be assumed that creditors and other stakeholders understand:

- the process;
- the impact of the document;
- the steps they need to take; and
- references to prior events or issues.

Documents should:

- clearly state the purpose and import of the document – i.e. why is this document being sent;
- have a summary which clearly sets out what the recipient of the document should/may do next;
- use headings, bullet lists, short sentences to improve readability; and
- include the use of tables where appropriate e.g. the comparison of scenarios in a section 439A report, declarations of relevant relationships, assessment of creditor claims.

8.6 Modes of Communication

Subject to the specific legal requirements, Practitioners should use the most appropriate means of communication including by:

- website;
- email;
- teleconference;
- as well as the more traditional communications of telephone, mail and facsimile.

8.7 Use of Websites

Practitioners should take care when placing information on the website to:

- ensure the minimum paper based communication requirements are met;
- comply with the privacy laws; and
- restrict access to those entitled to view it (for example, by the use of passwords).

8.8 Use of Electronic Communications

Electronic communications, such as email and SMS, have the same force and effect as other forms of written communication and their preparation should be treated with the same care and attention. Certain notices are required to be sent by post.

Electronic communications, while efficient and cost effective, have the potential to be undertaken without full regard to the content and may be hastily prepared and dispatched.

Electronic communications have the potential to be easily sent to the wrong recipient. This has the potential to waive privilege and breach confidentiality, among other consequences.

Disclaimers on the footer of emails are wise, but may not offer the protection needed.

8.9 Communications Training and Skill Development

Communication skills are critical and Members should ensure that they and their staff are properly trained both in formal and informal communications.

8.10 Information Sheets for stakeholders

ARITA, AFSA and ASIC produce information sheets which contain useful information for stakeholders.

For corporate Administrations, a list of the information sheets available has been prepared and Practitioners should provide this summary sheet to stakeholders with their first communication. For personal insolvency Administrations, the Practitioner should direct creditors to relevant information sheets on the AFSA website.

In corporate Administrations, the summary of the information sheets available must be provided to creditors before the holding of a creditors meeting or the payment of a dividend. It need only be provided once.

8.11 Use of specialists

Where a Practitioner engages an industry or other specialist and relies on the advice of that specialist (for example, valuation services) in an Administration, the Practitioner should disclose in relevant reports or other relevant communications the name, whether the specialist is part of the Firm, qualifications of the specialist and the areas in which specialist advice has been obtained. This obligation does not extend to legal advice in situations where the provision of this information would result in a waiver of legal professional privilege.

8.12 Specific forms of communication

For detailed guidance on communicating via creditors' meetings and s 439A Reports in Voluntary Administrations, refer to Part C of the Code.

9 Timeliness

Principle 5: Members must attend to their duties in a timely way.

The insolvency of a company or individual has an immediate effect on the rights of the Insolvent, the creditors and other stakeholders. There is an inherent need to have those rights resolved as quickly as possible. It is therefore important that the insolvency process is managed as quickly as is commercially and reasonably possible.

Timeliness is necessary at many levels, in relation to:

- statutory based time limits;
- reduction of risk;
- minimisation of cost; and
- minimising negative emotion.

9.1 Statutory Time Limits

To ensure that statutory requirements are met, Practitioners must use a checklist or other systems which alert the Practitioner to critical dates such as:

- statutory obligations and notifications;
- meetings; and
- reporting.

9.2 Reduction of Risk

The timely attention to tasks on an Administration will reduce the risk to the Practitioner.

Examples

- One of the primary duties of Practitioners is to promptly secure the assets and funds of the Insolvent. A failure to act promptly could see the dissipation of assets.
- When appointed to an administration the Practitioner may not know what assets are owned by the Insolvent, however, it is important to promptly arrange appropriate insurance cover so that all risks are insured. A failure to arrange such insurance could expose the Practitioner in the event of an uninsured incident.

9.3 Minimisation of Cost

Administrations which are conducted in a timely manner will generally be more efficient and effective. In the interests of minimising costs, administrations should be conducted in a timely manner.

9.4 Minimising Negative Emotion

Insolvency is stressful and traumatic for those involved. Prompt, clear and courteous communications and replies to queries all reduce angst and improve trust in the Practitioner.

ARITA

Many complaints have their origin in the sense of the complainant being ignored rather than in technical or substantive acts or omissions of the Practitioner.

9.5 Failure to meet Deadlines

The failure to meet time limits has a number of consequences including:

- the cost of seeking extensions of time;
- rights of the Practitioner are lost which can involve a financial loss to the Administration;
- personal liability for the Practitioner; and
- creating an issue of the fitness of the Practitioner to practise.

9.6 Duty to Advise

Practitioners must ensure that stakeholders are clearly advised of time limits that impact on them and the consequences of not meeting those time limits.

9.7 Policies, Processes and Education

Practitioners must implement policies and processes, and educate staff, to minimise the risk of failing to meet deadlines. The processes should include:

- checklists or other systems;
- training; and
- auto-reminder schedules (software).

These policies and processes must be maintained in a timely manner for every Administration.

9.8 Extensions of Time

If an extension of time is required, the Practitioner will need to:

- apply to the applicable body to approve such an extension; and
- give reasons for the need for additional time e.g. if the issue being addressed is complex.

A Practitioner may claim Remuneration and costs of applying for an extension of time from the Administration, subject to any order from the court.

A Practitioner must not claim Remuneration and costs for applying for an extension of time if the reason for the failure to meet the deadline was attributable to the poor conduct of the Practitioner such as:

- inattention to the passage of time;
- lack of knowledge of the time limits;
- poor processes; or
- inadequately trained or supervised staff.

10 Dealing with Property

Principle 6: A Practitioner must not acquire directly or indirectly any assets under the administration of the Practitioner.

A Practitioner, his or her partners, Firm, staff, their respective Relatives and Entities that any of those parties have Material interest in, must not acquire directly or indirectly in any manner whatsoever any assets under the Administration of the Practitioner, subject to the following exemptions:

- from a retail operation under administration of the Practitioner where those assets are available to the general public for sale and where no special treatment or preference over and above that granted to the public is offered to or accepted by the Practitioner, his or her partners, Firm, staff, and respective Relatives and any Entities that any of those parties have an ownership interest in; or
- with the approval of the court to which full facts must be disclosed.

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11 Competition and Promotion

Principle 7: When promoting themselves, or their Firm, or when competing for work, Members must act with integrity and must not bring the profession into disrepute.

11.1 Introduction

Insolvency is a competitive profession. The flow of work to Members is dependent on referrals from creditors such as financial institutions and from advisors to companies and individuals such as accountants and lawyers. Work is also referred directly in response to Member marketing and advertisements.

The standards of competition and promotion that apply in the wider community may not be acceptable in a profession that must be seen to have high levels of integrity and independence.

Members will be held responsible for the form and content of any advertisement, publicity or solicitation:

- where expressly or impliedly authorised by the Member; or
- which is placed or undertaken personally, or by another person on behalf of a Member or their Firm.

11.2 Advertising, publicity and solicitation

Members may promote their business through general and targeted advertising using the full range of media and marketing techniques including through web sites, print, direct mail and brochures. Any advertising, publicity and solicitation is subject to the operation of any relevant privacy legislation.

11.2.1 Call Centres

Members must ensure that follow up communications, including calls by third parties and call centres under the direction of the Member, are terminated when the recipient has so requested either directly to the Member, a third party working on behalf of the Member, or through ARITA, other professional body or Regulator. Any continued contact is a breach of this Code.

Advice on insolvency matters must not be given by inappropriately experienced staff.

11.2.2 Internet

This Code applies equally to advertising on the internet; and includes websites operated by or on behalf of the Member or the Member's Firm.

11.2.3 Statutory Advertisements

Advertisements required to be placed by Legislation which are paid for from funds in the Administration are not an appropriate place to promote the Practitioner or the Practitioner's Firm.

Statutory advertisements:

- may contain contact details such as Firm name, telephone number, physical address, postal address, email and website.
- may not contain:
    - slogans;
    - claims about the Firm;
    - logos; or
    - other promotional materials.

11.2.4 Other Administration Advertisements

Advertisements for the Administration, other than statutory advertisements (ie. to sell the Insolvent's assets or business) must comply with the same restrictions as statutory advertisements; however, they may include the Firm's logo.

11.3 Misleading and Deceptive Conduct

The provisions of the Consumer and Competition Act 2010 or Fair Trading legislation may apply to statements by Members regarding their service offering, competence and any comparative claims.

In addition to the general legal prohibitions, Members must not:

- make claims in marketing material and then substantially change the arrangement unless there is fully informed consent;
- make negative remarks about another Member or their Firm as to their competence, professional practices or fees charged;
- claim endorsement of ARITA except as may be permitted from time to time under the Constitution and Rules;
- create false or unjustified expectations of favourable results in an Administration;
- imply the ability to influence any court, tribunal, Regulator or similar body or official; or
- make self-laudatory statements that are not based on verifiable facts or which contain unidentified testimonials or endorsements or contain representations that would be likely to cause a reasonable person to misunderstand or be deceived.

11.4 Charge-out Rate and Value Comparison

When comparing charge-out rates, Practitioners must provide adequate disclosure of the:

- qualifications; and
- experience of staff levels,

and not simply compare rates by title.

> *Example*
>
> The experience and competence of a 'manager' can vary from firm to firm. In relevant cases, creditors should be advised, for example, that 'the majority of staff by grade have the skills and experience as described. However, there are staff employed at particular grades who have alternative skills and experience that warrant their title and charge out rate.

ARITA

11.5 Relationship Marketing - Inducements

Members must not provide any inducements to any person or entity:

- with a view to securing the person's own appointment or nomination; or
- to securing or preventing the appointment or nomination of some other person.

This prohibition extends to all forms of formal insolvency appointment, both corporate and personal.

In this context, an inducement is any benefit, whether monetary or not, given by a Member, or an employee, agent, consultant or contractor of the Member, to a third party which may, in the view of a reasonable person, influence that person's decision to refer, make, or prevent a formal insolvency appointment.

Care should be taken, when marketing services to potential referral sources, to ensure that the Independence provisions are adhered to. Particular care should be taken to limit relationship development activity to prevent the impression of a conflict of interest.

An inducement does not include:

- bonus payments to employees structured as part of their salary package or adjustments to an employee's salary where obtaining referrals of administrations is one of the performance indicators considered;
- benefits of an insignificant value (when considering the significance of the benefit, regard is to be had to the total benefits provided to the third party);
- sponsorship of events or publications open to the public, or members of a professional association; or
- retainer or other payments to marketing consultants engaged by the Firm.

11.6 Sponsorship

Sponsorship of an event, venue, industry body or interest group as a means of a Member promoting their business is acceptable on the proviso that that sponsorship does not create any obligations to or by those who are responsible for making appointments or referring Appointments.

Example

- Sponsorship of an industry body's event for a determined dollar value amount is acceptable.
- Sponsorship of an event based on a percentage of fees obtained as a result of referrals from members of that industry body would not be acceptable.

11.7 Replacing an Incumbent

A Practitioner may be requested by creditors to consent to act as an Alternate to the Incumbent. There may be other practitioners also put forward as the Alternate.

Practitioners must not make negative statements about other Practitioners, make false comments, nor directly or indirectly request solicitors, creditors or their own staff to make such statements, or laudatory comments in support of a Practitioner's election as the Alternate.

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Any claims made on a Practitioner's behalf by others which are contrary to the Code or to guidance issued by the accounting bodies or Regulators and which are known to the Practitioner at or before the meeting of creditors, must be corrected by the Practitioner at the meeting of creditors or in writing to creditors before the meeting. The fact that such claims may be made not by the Practitioner but by others on the Practitioner's behalf is no excuse. A Practitioner is responsible for the professional behaviour and statements of their staff, consultants or contractors.

There will be instances where other stakeholders for their own reasons may wish to replace an appointed Practitioner. Creditors who may be asked to vote on the issue of replacing the Appointee should examine the motives of and ask for reasons from, those proposing the change.

11.7.1 Notice

The Alternate must provide the Incumbent with not less than one business day's notice in writing of the Alternate's consent to act, except where the request to consent occurs within one business day before the meeting. In this circumstance, notice to the Incumbent must be given immediately the request is received.

11.7.2 No Solicitation

Practitioners must not, directly or indirectly, solicit nominations from creditors in order to replace an Incumbent.

Practitioners must not, directly or indirectly, solicit proxies from creditors for the purposes of replacing an Incumbent or retaining an existing Appointment.

11.7.3 Conduct at the Meeting

The Incumbent must allow any Alternate(s) the right to address the meeting.

The Alternate must provide the meeting with:

- a DIRRI;
- the Remuneration basis as set out in the Code eg. a schedule of the hourly rates or details of an alternative method of charging fees; and
- full details of their relationship with the creditor, if any, nominating them as an Alternate.

The Alternate, or those speaking on the Alternate's behalf, when addressing the meeting of creditors, must remain factual and avoid making any statements that cannot be fully substantiated, or may be considered false, misleading or deceptive.

ARITA

12 Transitioning or parallel appointments

Principle 8: When dealing with other insolvency practitioners in transitioning or parallel appointments, Practitioners must be professional and co-operative, without compromising the obligations of the Practitioner in their own particular appointment.

An Insolvent may be subject to two or more types of insolvency, either in parallel – for example a voluntary administration and a receivership – or in sequence – for example a voluntary administrator replaced with a different liquidator at the second meeting or a bankruptcy trustee being replaced by creditors at a meeting.

In the situation of two parallel appointments, there will be two insolvency practitioners who will be dealing with each other in relation to their respective Administrations of the affairs of the Insolvent.

In the situation of transitioning Appointments, the first insolvency practitioner will be dealing with the second insolvency practitioner in relation to the on-going Administration of the Insolvent.

In both situations, an Administration or Administrations will benefit from the experience and knowledge in insolvency law and practice being professionally applied by each insolvency practitioner.

In these situations, one or both of these insolvency practitioners may be Members. This principle applies to Members.

Example

- A trustee of the bankruptcy of a director will need to deal with the liquidator of the director's company in relation to the lodgement of a proof of debt in the liquidation. Issues of contest about the proof may usefully be the subject of informed discussion between the two insolvency practitioners.
- A liquidator of a company may attend a meeting of creditors of another administration, where the company is a creditor. The conduct of the meeting will be assisted by mutual respect and sharing of knowledge between the two insolvency practitioners.
- A liquidator may wish to publicly examine a receiver about issues that arose in the receivership. The conduct of the examination will be assisted by mutual respect between the insolvency practitioners as to dates for the examination, and service of documents.
- A Practitioner who is requested by a creditor to attend a meeting as their representative or advisor should notify the Appointee that they are going to attend.
- An Incumbent who is replaced by a new Appointee should assist with the transfer of records and information, without compromising their own legal position.

ARITA

13 Competence

Principle 9: Members must maintain professional competence in the practice of insolvency.

A Practitioner's competence is an essential cornerstone to the proper conduct of insolvency Administrations. It is important that not only are Practitioners competent in insolvency at the time of achieving their registration, but that they maintain their knowledge and skills throughout their professional career.

This obligation extends beyond that of Practitioners to all Members to the extent that they are providing supporting services in insolvency Administrations.

A Member should take steps to ensure that those working under the Member's authority in a professional capacity have appropriate training and supervision.

13.1 Continuing professional development

The maintenance of professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments. Continuing professional development develops and maintains the capabilities that enable a Member to perform competently within the professional insolvency environment.

A Member must ensure that they fulfil their relevant professional bodies' obligations, including ARITA, for continuing professional education.

Members are encouraged to take every opportunity to improve and extend their knowledge on insolvency issues, including attending relevant training and conferences offered by ARITA.

Members should also provide opportunities and encouragement to their staff to attend appropriate insolvency training and training on other skills complementary to the practice of insolvency.

13.2 Specialisation

A Practitioner may specialise in a particular aspect of insolvency, for example receiverships. If a Practitioner chooses to specialise in a particular type of Appointment, then the Practitioner should not seek to be appointed to Administrations outside of this specialisation without taking steps to ensure that he or she is still technically competent in the area outside of their specialisation.

This may involve undergoing training to regain competency.

13.3 Use of specialist services

A Practitioner may seek the assistance of experts in situations where the Appointment relates to a business with particular industry issues and the Administration would benefit from the involvement of an expert in that area.

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14 Necessary and Proper Remuneration

Principle 10: A Practitioner is entitled to claim Remuneration and Disbursements, in respect of necessary work, properly performed in an Administration.

A Practitioner's right to be paid is recognised under the legislation and at general law and is given a high priority of payment from the Insolvent's funds.

The entitlement to Remuneration exists only in respect of work done that was necessary and was properly performed.

14.1 Necessary Work

A Practitioner is entitled to Remuneration only in respect of work done that was necessary for the Administration. The term '*necessary*' means work that was:

- connected with the Administration; and
- done in furtherance of the exercise of the powers and performance of the duties of a Practitioner as required by the Legislation, Code and applicable professional standards.

Example

- report to creditors;
- investigations of conduct of directors;
- protection and recovery of assets;
- preparing and filing a S533 report to ASIC;
- if the company has trading operations throughout Australia, it will generally be necessary for the Practitioner to make relevant searches of property titles in all States and Territories;
- if the company is a small local operation only, it would not be necessary to make international enquiries; and
- reconstruction of financial statements.

The examination of claims for Remuneration will necessarily be made with the benefit of hindsight. However a Practitioner may claim for work that may not have produced a positive outcome provided there was a proper exercise of professional judgment in the Practitioner deciding to do the work at the time the work was undertaken. Refer to section 18.2 for guidance on work papers and maintenance of Administration files.

Once that is established, the work will remain '*necessary*' for the purposes of a Remuneration claim, even if subsequent events show that the work was not necessary.

Example

- searches revealing no assets;
- examination of directors resulting in no new information; or
- unsuccessful claims for preference recovery or insolvent trading.

Before a decision is made to claim for Remuneration, the Practitioner must ensure that work that was done, by him or herself, or by staff members, was necessary.

> *Example*
>
> In a provisional liquidation, there are limits on the work required to be done. If work is done beyond those limits it may not be regarded as necessary.

14.2 Properly performed

In order to claim Remuneration for necessary work, the Practitioner will need to establish that the work was properly performed.

Work done poorly, or, at worst, improperly and needing to be reworked should not be charged.

> *Example*
>
> - It may have been necessary to inquire of all property titles countrywide, but if the staff member doing that work pursued inquiries through the wrong agency because of ignorance or inattention, then that work was not done properly.
> - It may have been necessary for the Practitioner to have convened a meeting of creditors, but if work done in convening that meeting took an inordinate amount of time, through the inexperience of the staff member, it was not done properly. While an allowance is made for junior staff through the lower hourly rate, where activity is redone, care should be taken to ensure that the amount charged reflects the true value of the work.
> - Work performed to convene an invalid meeting would not be properly performed.

Creditors are entitled to expect that Administration funds are not expended on work that was not properly performed.

All time spent for necessary work properly performed should be recorded against the Appointment using an appropriate system.

Before claiming Remuneration, the Practitioner must identify any work and time that should not be claimed.

The Remuneration requirements of the Code for work that is necessary and properly performed are consistent with, or impose a higher standard than, the Legislation.

Prior approval of fees does not remove the obligation to establish that the work was necessary and properly performed. The mere approval does not give the right to draw Remuneration if the work was not necessary or was not properly done.

14.3 Deciding what work to undertake

The Practitioner should exercise professional and commercial judgment in considering whether work is to be performed. Clearly, work that improves the return for creditors should be undertaken.

> *Example*
>
> A judgment will need to be made in relation to the pursuit of unfair preference claims or other voidable transactions in terms of the likely cost and likely return. This may involve consultation with creditors, and, if appropriate, legal advice, or reference to the court.

Not all work is associated with directly seeking a return for creditors. Many of the general statutory tasks of a Practitioner – for example in reporting to creditors, lodging documents with ASIC, and maintaining accounts – are properly performed and charged even though the Remuneration charged will not produce a financial return and will reduce the funds available for distribution.

In a liquidation, a Practitioner is not obliged to do work unless there are funds available for their Remuneration, except for certain statutory tasks that must be undertaken regardless of available funds. Practitioners should have regard to any assistance that may be available from the Regulators.

14.4 Outsourcing

A Practitioner may outsource work subject to the restrictions on delegation (e.g. decision making and exercise of judgment remain the Practitioner's responsibility and cannot be delegated or outsourced).

The decision to outsource is a matter of commercial judgment for the Practitioner, based on such considerations as:

- geography and location (the business may have its operations spread throughout the country and it may be commercially necessary to appoint local agents to deal with particular tasks);
- time constraints; or
- costs considerations (the external source may be able to attend to an urgent task quickly, or more cheaply).

If work is outsourced, the Practitioner's obligations under this Code remain the same as if the Practitioner or members of staff had performed the work.

For guidance on whether outsourced work is Remuneration or a Disbursement refer to 14.10.2.

Practitioners should have regard to APES GN 30 – Outsourced Services. A copy of GN 30 can be accessed from the Accounting and Ethical Standards Board website (www.apesb.org.au).

14.5 Work that cannot be remunerated

If a Practitioner, other than a bankruptcy trustee, seeks to be remunerated for work that is outside the scope of the powers of the Practitioner or undertaken prior to the Appointment, approval can only be sought from the court.

> *Example*
>
> A Practitioner may claim that pre-appointment work was necessary for the Administration and would have had to be undertaken, but it is undertaken prior to the Appointment and thus the Practitioner must seek court approval if remuneration is to be claimed. However, case law indicates such approval is unlikely to be obtained.

An exception is if it relates to a transitioning Appointment and the Legislation allows Remuneration relating to the prior Administration.

It is not sufficient in itself to obtain approval from a committee or from the creditors. These restrictions are a threshold test before applying the '*necessary and properly performed*' test.

A Practitioner appointed as a bankruptcy trustee may draw Remuneration for pre-appointment work where that work is approved in accordance with the Bankruptcy Act.

Remuneration must not be claimed for work that results in, or is the result of, a breach of the Practitioner's duties.

14.6 Staff levels and numbers

In time-based charging, the Practitioner must ensure that the number and qualifications of staff allocated to an Administration is appropriate for the nature of the work being performed so that the Administration is completed in the most efficient and effective manner.

> *Example*
>
> An experienced liquidator generally would not attend to more routine tasks – such as preparing notices for a meeting – given that such tasks could be done as well and at a lower charge-out rate by a more junior member of staff.

This will require commercial and professional judgment. While a particular task may be appropriate to a particular level of employee, the Practitioner may consider that, even though charging at a higher hourly rate than the employee, he or she may be able to do the work in one quarter of the time.

> *Example*
>
> It may be more cost effective for the Practitioner to prepare and finalise a report for creditors, if the report is required urgently and requires the Practitioner's input.

Care should be taken in allocating the appropriate number and level of staff to an Administration or task, particularly when travel is required. This is a balance between having sufficient staff available to undertake the required tasks and over servicing the Administration.

14.7 Setting hourly rates

In time based charging, the Practitioner should ensure that appropriate hourly rates are set for the Administration.

Generally, market forces will ensure that a Practitioner sets appropriate standard hourly rates which are generally applied to Administrations. However, a Practitioner should ensure the appropriateness of these standard hourly rates is specifically considered for each Administration. Factors that may result in a variation of the standard hourly rates include:

- complexity of the Administration;
- location of the business operations of the Insolvent and the scale of the rates that would normally be applied in that location;
- risk associated with the Administration; and/or
- the specialised nature of the Administration (if any).

14.8 Costs of claiming Remuneration

Practitioners may claim the necessary and proper costs of record keeping and seeking approval or determination of their claim for Remuneration.

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If additional costs are incurred because of inadequacies of the Practitioner or Firm's time recording systems, or due to staff not properly recording their time, these costs would not be necessary and proper. It is not appropriate to charge this additional cost to the Administration and it should not form part of the claim for Remuneration.

> *Example*
>
> - Necessary and proper remuneration costs may include the cost of producing a report for creditors to allow creditors to make an informed decision whether to approve the remuneration or the costs of applying to the court (subject to any order of the court).
> - Reworking information produced from an inadequate time recording system in order to prepare a remuneration report for creditors is not necessary and proper.

14.9 Costs of communicating with Regulators or professional bodies

A Practitioner must not claim Remuneration for time spent:

- communicating with Regulators or professional bodies regarding complaints about the Practitioner or the conduct of a particular Administration;
- on Regulator surveillance, professional audits or inspection of files, or on peer reviews; or
- unsuccessfully defending a breach of the law or this Code, subject to any order of the court.

14.10 Disbursements

Disbursements may only be claimed if they were necessary and properly incurred.

In incurring Disbursements, a Practitioner must use their commercial judgment, adopting the perspective of, and acting with the same care as, a reasonable person exercising care and skill would act in incurring expenses on their own behalf.

While Practitioners must account to creditors for Disbursements, the reimbursement for the payment of Disbursements does not require creditor approval before being drawn. Thus, the categorisation of activity as Remuneration or Disbursement is significant.

14.10.1 What is a Disbursement?

The Practitioner needs to determine whether the claim for payment is in the nature of a Disbursement, or whether it represents Remuneration. Disbursements are:

- costs paid from the Administration's bank account directly to third parties; or
- costs paid to third parties by the Practitioner and later claimed back from the Administration; or
- costs claimed by the Practitioner for non-professional services provided by the Firm and/or outlays incurred by their staff in the proper conduct of the Administration.

A Practitioner should separate Disbursements from the expenses of running their practice which may only be recovered through Remuneration (for example, in the case of time based remuneration by factoring overheads into the hourly charge-out rate and in fixed fees, by factoring overheads into the fixed fee calculation).

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Table 2: Disbursement types

Disbursement type	Criteria	Examples	Rationale
Professional			
External advice, non-insolvency	These are fees that satisfy both the following criteria. They are: (a) for professional services (non-insolvency services) relating to specific tasks required to be done during the Administration; and (b) are properly incurred by independent outside consultants engaged by, and not associated with, the Practitioner and their Firm.	• independent lawyers, • auctioneers, valuers, real estate agents, • independent tax advisors or accountants.	This is a Disbursement because it involves the Practitioner retaining an external advisor for work to be done in the Administration, at an agreed fee or rate. These expenses are claimed from the Administration at cost.
Non-professional			
External	These are costs that satisfy all the following criteria. They are: (a) not for professional services; and (b) incurred with a third party in relation to work required to be done during the Administration.	• administration advertising, • travel and accommodation for staff, • room hire, • document storage, • photocopying and printing, • external word processing and secretarial services.	These are typical Disbursements because they involve an outlay in relation to the Administration. These expenses are claimed from the Administration at cost.
Internal	These are costs that satisfy all the following criteria: (a) they are not for professional services; (b) they are for goods or services properly provided by the Practitioner or their staff in the Administration; and (c) they are not overheads covered in the Remuneration claim.	Reasonable costs of: • telephone calls, • postage, • stationery, • photocopying and printing, • data room hosting.	These are also typical Disbursements, except they are incurred internally by the Firm. These expenses, if charged to the Administration, would generally be charged at cost; though some expenses such as telephone calls, photocopying and printing may be charged at a rate which recoups both variable and fixed costs.

ARITA

14.10.2 What are not Disbursements?

Given the significance of a claim for payment by a Practitioner being classified as a Disbursement, it is useful to list what are not Disbursements:

A. Overheads

An overhead is not a Disbursement. It is a cost that can only be charged for and recovered across all the administrations handled by the Practitioner's Firm.

In contrast, an out of pocket expense is an expense actually incurred in respect of that Administration. It can be claimed as a Disbursement. The Practitioner must be able to show how the expense:

- is uniquely and directly attributable to the Administration; and
- was calculated and allocated to the Administration.

> *Example*
>
> Rent, insurance, professional indemnity insurance, professional memberships, staff costs, training, depreciation are examples of overheads.

B. Internal non-insolvency professional costs

A Practitioner may engage internal non-insolvency related professional services only after proper commercial consideration to that decision has been given that such an engagement is in the interests of creditors and the efficient conduct of the Administration. This includes non-insolvency professional services provided by another practice within a federated practice structure or associated practice.

The point to consider is whether the benefit of the engagement fee will be received by the Practitioner, the Practitioner's Firm or an entity related to the Practitioner or perceived to be related to the Practitioner.

These items are Remuneration and must be disclosed and approved in the same manner as insolvency services (refer to Remuneration Report template for further guidance).

> *Example*
>
> Legal advice, tax advice, real estate valuations, auctioneering provided by a Practitioner's Firm are examples of internal professional costs.

C. External insolvency professional costs

If a Practitioner outsources insolvency tasks, the fees charged to the Practitioner may only be claimed as Remuneration, notwithstanding that the fees may be payable before the claim for Remuneration can be made. The necessary and properly performed test applies.

It is not always clear whether the out-sourced work is better categorised as insolvency work (which is claimed as Remuneration), or general non-insolvency work (which is classified as a Disbursement).

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Factors to be taken into account when making this assessment include:

- was the contractor an insolvency firm?
- was there a regular resource sharing/provision arrangement?
- would the Practitioner have done the work if there had been sufficient resources?

Where the task involves standard expertise and skills of an insolvency practitioner, the outsourced costs will be a Remuneration claim of the Practitioner. Where the task involves more general or particular skills that are not insolvency specific, then the outsourcing costs will be a Disbursement.

Example

- A stocktake is required in an Administration. It is a matter for the Practitioner's judgment either to use his or her own Firm's staff, or contract out the work to a suitably qualified specialist; or
- There is a branch of the company's business that is in an outlying country area. The Practitioner may choose to have the stocktake done by a local firm because it would be cheaper than sending the Practitioner's staff to do the stocktake;
- In that country area, the Practitioner considered using a professional stocktaking firm to undertake the stocktake, but selected a local accounting firm. In this instance there are arguments both ways for the costs of the local accountant to be remuneration or a disbursement.
- Similarly, the Practitioner's Firm may have valuation expertise (chargeable as remuneration) but the Practitioner may choose to engage an external valuer (disbursement). This will be a matter for the practitioner's professional judgment having regard to the interests of creditors.

When a Practitioner makes a decision that an expense of this nature is a Disbursement rather than Remuneration, the invoices received for the services should detail the work performed and it should be clear from the description that the services were not insolvency services.

D. Late lodgement fees

Any late fee or penalty imposed by a court, Regulator or agency for late lodgement or other default should be borne by the Practitioner.

Late lodgement fees imposed by ASIC or AFSA must not be charged to the Administration.

E. Unreasonable Travel Costs

Travel should be bought on the best commercial terms and the style of travel and accommodation should be appropriate for the trip being undertaken.

Care should be taken in claiming the costs of travel by the Practitioner between offices of his or her firm for the purposes of a particular Administration.

Where there are geographically spread locations for a particular Administration, consideration should be given to the retention of local staff or agents to carry out tasks which are appropriate and capable of delegation, in order to minimise the costs to the Administration. However, it may well be appropriate for the Practitioner and/or his or her staff to attend at these locations and incur the relevant travel costs.

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Every Firm should have a policy on travel (including time charged and Disbursements), which should be made available to creditors on request. This policy can be Administration specific or a general policy.

> *Example*
>
> - Travel costs to and from an Administration's place of business is normal and chargeable;
> - If the Administration's business is conducted around Australia, or internationally, it may be appropriate for the Practitioner to personally attend at each location, depending on the size and nature of the business, even if the practitioner has offices around Australia or internationally.

F. Pre-appointment expenses

Any expenses incurred prior to the Appointment must not be claimed from the Administration as a Disbursement. Practitioners are only entitled to claim Disbursements incurred after their Appointment.

14.10.3 Necessarily and properly incurred

A. Professional Disbursements

A Practitioner may engage external professional services (refer to the table at section 14.10.1) as Disbursements without creditor approval, but only after exercising proper commercial consideration.

The Practitioner should consider issues of:

- expertise;
- quality;
- timeliness; and
- reasonable and appropriate cost.

Practitioners must assess each engagement of a professional service provider in terms of the interests of creditors and their fiduciary responsibilities.

Unless the Disbursement is insignificant, the Practitioner should document the decision making process identifying why the work was necessary and why the particular firm or professional was engaged. While the approval of creditors is not required, creditors are entitled to be informed of and to understand the decision process if the issue is raised.

Before authorising payment of Disbursements, the Practitioner must ensure that:

- the task has been properly performed; and
- the quantum of the professional service fee is as agreed or is reasonable.

> *Example*
>
> - Legal advice, the service provided being assessed on quoted price or time charges, quality and focus of advice, and timeliness of delivery; and
> - Agent's sale of property, the service provided being assessed on commission rate, sale price and any quoted expenses.

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B. Non-professional Disbursements

A Practitioner may incur non-professional Disbursements, both internal and external, (refer to the table at section 14.10.1) without creditor approval, but only after exercising proper commercial consideration. While the approval of creditors is not required, creditors are entitled to be informed of and to understand the decision process if the issue is raised.

For internal Disbursements:

- the recovery basis must be set on commercial terms;
- creditors must be advised as part of the initial advice to creditors on Remuneration (refer 15.3.2 and 23.2.1), details of the basis of charging for these types of Disbursements; and
- details of actual internal Disbursements paid (eg. quantity and total cost) must be reported to creditors in each Remuneration report (refer 15.3.2 and 23.2.2).

The Practitioner should consider the reasonableness and appropriateness of the cost of the non-professional Disbursement before authorising the Disbursement. This is equally applicable to internally provided and externally provided non-professional Disbursements.

Practitioners must assess each Disbursement for an Administration in terms of the interests of creditors and their fiduciary responsibilities.

Before authorising payment of Disbursements, the Practitioner must ensure that:

- the benefit has been provided to the Administration; and
- the quantum of the fee is as agreed or is reasonable.

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15 Meaningful disclosure in Remuneration claims

Principle 11: A claim by a Practitioner for Remuneration must provide sufficient, meaningful, open and clear disclosure to the Approving body so as to allow that body to make an informed decision as to whether the proposed Remuneration is reasonable.

A Remuneration claim requires information to be conveyed to the Approving body (creditors, committee of creditors, committee of inspection, or the court). That information encompasses a number of elements:

- a system of recording that information (refer section 15.1);
- a basis for calculating Remuneration (refer section 15.2);
- sufficient detail to justify the amount of Remuneration (refer section 15.3); and
- relevant timing of the information being provided (refer section 15.3).

15.1 Recording of Work Done

Regardless of the Remuneration method to be applied, the Practitioner must maintain a proper record of work that was done on an Administration in order to:

- claim Remuneration; and
- report to creditors on the progress of the Administration.

The Practitioner should maintain a system that requires staff to record:

- the period of time spent;
- the categories of the work performed (see Remuneration Report Template);
- details of the work being performed; and
- contemporaneously at the time the work is done in order to maximise accuracy.

Time recording provides good practice management information, even though time data will not be required for reporting to creditors in claims for fixed fee or percentage based Remuneration.

ARITA's Remuneration Report Template provides a description of some common work categories that should be used (refer section 23.2.2).

15.2 Bases of calculation

There are several bases by which Remuneration can be calculated (refer sections 15.2.1, 15.2.2, 15.2.3, 15.2.4 and 15.2.5). ARITA has no preference as to the method of calculating fees. Practitioners must be transparent and fully explain to creditors the main bases by which Remuneration can be calculated, the method proposed to be used in the Administration and the reasons for selecting that particular basis (refer to section 15.3.2).

The terms of that Remuneration are a matter for the Approving Body, upon full disclosure of the arrangement being explained to them by the Practitioner.

15.2.1 Time based charging

Time based is a common form of charging. Practitioners calculate Remuneration by reference to the hourly or time unit rate which is applied to the time spent on necessary work properly performed.

A Practitioner should ensure that regular reviews of the WIP on an Administration are performed to ensure that only time spent on necessary work, properly performed is retained on the WIP. Such a review must be performed prior to issuing any Remuneration requests for approval.

15.2.2 Prospective Fee Approval

A Practitioner may seek approval from creditors for time based Remuneration to be determined in advance of the work to be performed. The approved amount must have a Cap to a nominated limit.

The claim for Remuneration will subsequently be calculated on a time basis for necessary work properly performed and can be drawn without further approval of creditors up to the Cap.

The hourly rates to be applied may be increased by an agreed formula where the escalation factors are objectively and independently determinable. If a Practitioner wants to be able to increase hourly rates that are charged on an Administration in the future without having to obtain creditor approval, a specific formula must be included in the resolution for the approval of the prospective Remuneration (for example, rates are increased annually by the CPI amount). A reference to changes in rates from time to time (or similar) must not be included in resolutions to approve prospective fees.

Any increase approved does not apply to the capped total, only to the hourly charge rate.

If a Practitioner wishes to change the capped amount, or the hourly rate scale other than as agreed, a Practitioner will need to seek Approving body approval (refer section 15.3.2 for reporting obligations).

15.2.3 Fixed fee

A Practitioner may claim Remuneration based on a quoted fixed amount with creditor approval. A fixed fee arrangement provides certainty to creditors about how much the Remuneration claim will be. The risk of excessive time spent is transferred to the Practitioner.

Once a fee is fixed for an agreed task, set of tasks or the conduct of the Administration, it remains fixed and a Practitioner must not seek further approval if the original estimate is wrong.

Examples

- In a small Administration, where the issues can reasonably be anticipated, the Practitioner may wish to have remuneration approved for a fixed amount.
- Towards the end of an Administration where remuneration has been based on a time basis, a Practitioner may choose to charge a fixed fee for work to be done in finalising the Administration, rather than obtaining prospective approval on an hourly basis to a capped amount.

15.2.4 Percentage

A Practitioner may claim Remuneration based on a percentage of a particular factor, usually assets disclosed, or assets realised.

15.2.5 Success or Contingency Fees

A Practitioner must not seek Remuneration on the basis that they will receive a specified bonus, success fee, super-profit or additional percentage as Remuneration, in the event that a specified contingent future event occurs or particular circumstances arise, if that arrangement would place the Practitioner in a position of conflict, or generate a perception of a lack of independence.

This is based on the principles that:

- no additional incentive should be required or offered in order to have the Practitioner perform duties that are required;
- the independence and objectivity of the Practitioner, even if only as perceived, may be compromised by such an arrangement; and
- the arrangement must not be inconsistent with the fiduciary obligations of a Practitioner.

Example

An example of a duty that may not be a required duty is the pursuit of litigation. The decision to pursue litigation is a matter of professional judgment for the Practitioner, particularly in instances where there are no funds on hand in the Administration and no ready source of funding.

When considering whether a proposed fee arrangement is acceptable, the Practitioner must consider whether the arrangement could be perceived as the Practitioner acting in his or her own interests rather than the interests of the creditors.

If a Practitioner is intending to use this type of fee arrangement, full disclosure of the terms of the proposed arrangement must be made to creditors and the consent of the creditors obtained prior to work commencing under a proposed contingent fee arrangement.

If an arrangement is in breach of this Code, the arrangement will still constitute a breach even if creditors have approved the arrangement.

When considering whether a contingent fee arrangement might be a suitable fee arrangement in a particular Administration, the Practitioner should consider:

- any restrictions that may apply under the relevant legislation;
- funds available in the Administration;
- funding from alternate sources such as creditors or a litigation funder;
- costs of the alternate source of funds compared to a contingent fee arrangement;
- risk associated with the tasks to be undertaken for the contingent fee; and
- the appropriateness of the possible contingent fee amount considering the nature of the Administration and the risk associated with the task to be undertaken.

Example

An example of an acceptable contingent fee arrangement is discounting standard hourly rates until a certain objective is achieved. If that objective is achieved, standard hourly rates will then be charged.

15.3 Information to be disclosed and when

Information on the particular basis of Remuneration claimed should be provided to creditors at two main points of time in an Administration.

- First, soon after the appointment, in order to advise creditors of the available bases by which Remuneration can be calculated and the proposed basis upon which Remuneration will be claimed for the Administration. This will generally be with the notice of first meeting of creditors in a voluntary administration or a creditors' voluntary liquidation, or a Part X agreement; or by including it in the first circular sent to creditors in other Administrations.

  This is the equivalent of an Initial Remuneration Notice (IRN) in relation to a personal Administration.

- Second, before any meeting is held at which approval for the Remuneration is to be sought. The information should be sent to creditors in the normal course with any reports and other documents required for the conduct of that meeting in the time frames required by the legislation.

  This is the equivalent of an Remuneration Approval Notice (RAN) in relation to a personal Administration.

The table below summarises the timing of the provision of information for each Remuneration basis.

Basis	First communication after appointment	During the Administration
Time based	Advice on the basis chosen. Estimate of fees and comparison to pre-appointment estimate, if one provided.	Report on work undertaken and request approval of quantum. Comparison to initial estimate of fees provided to creditors.
Prospective Fee (time based)	Advice on the basis chosen. Request for approval for time based charging to a capped amount.	Report on work undertaken and request further approvals.
Fixed fee	Advice on the basis chosen. Request for approval of the quantum.	Report on achievement of milestones for the drawing of Remuneration.
Percentage	Advice on the basis chosen Request for approval of the percentage	Report on the factors underlying the entitlement to claim the Remuneration.
Contingency	Advice on the basis chosen Request for approval of the arrangement.	Report on the achievement of the contingency event or otherwise.
Note: Mixed Fee Arrangements: There will be circumstances where a Practitioner will seek approval for a different basis of Remuneration for a particular aspect of an appointment or finalisation of the appointment; the appropriate information (refer section 15.3.2) will need to be provided at the time of seeking the creditors' approval of that arrangement.		

The Remuneration reporting requirements do not apply to Controllers. A Controller should report to their appointor in the manner requested by their appointor. The guidance in this section of the Code may still be of assistance to Controllers when preparing their Remuneration reports.

15.3.1 Court requirements

In addition, where an application is made to a court for an order that a company be wound up or for an official liquidator to be appointed as a provisional liquidator of a company, regard must be had to any additional requirements of the courts. For example, with the Consent to Act, Practitioners may be required to disclose their hourly rates. The same applies in relation to Part X agreements under the Bankruptcy Act.

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15.3.2 Information to be provided for all Remuneration bases

	Basis of Fee Approval				
	Time – Retrospective	Time – Prospective	Fixed	Percentage	Contingent
Initial Notification to creditors	A Practitioner must provide the following information to creditors regarding Remuneration in their first communication with creditors (refer section 23.2.1): • a brief explanation of the types of methods that can be used to calculate Remuneration; • the particular method or methods that the Practitioner intends to use to calculate Remuneration in the Administration; • why the Practitioner considers this method to be suitable for the Administration; • details of the basis of any internally generated Disbursements that will be charged to the Administration (e.g. Page rate for photocopying done internally); • details of any estimate or fee provided to directors/Insolvent prior to the appointment (refer 6.13); and • if the estimate or fee provided to the directors/Insolvent is no longer appropriate, an explanation of the change from the pre-appointment information provided. Examples of reasoning for choosing time based Remuneration: • It ensures that creditors are only charged for work that is performed. • The Practitioner is required to perform a number of tasks which do not relate to the realisation of assets, for example responding to creditor enquiries, reporting to ASIC, distributing funds in accordance with the provisions of the Corporations Act or the Bankruptcy Act. • The practitioner is unable to estimate with certainty the total amount of fees necessary to complete all tasks required in the Administration. In respect of Disbursements, a Practitioner must provide general information on the classes of Disbursements and information on the				

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	Basis of Fee Approval				
	Time – Retrospective	Time – Prospective	Fixed	Percentage	Contingent
	basis of recovering internal Disbursements.				
	If a Practitioner is intending to use time based Remuneration (either retrospectively or prospectively), they must also provide: the scale of rates that will be used, including qualifications and experience generally of staff at each level; and a best estimate of the costs of the Administration to completion, or to a specific milestone. If rates change or the estimate is no longer reliable, the Practitioner must notify creditors and advise new rates or a new estimate and provide an explanation to creditors as to why previous estimates have changed.				
Remuneration Approval Request	Details of the Remuneration claimed ARITA's Recommended Remuneration Report template (refer section 23.2.2) , as adapted for the facts and circumstances of the particular Administration, should be used as the means of giving creditors the information they need to make an informed decision at the meeting as to the reasonableness of the Remuneration. It is a guide for time based Remuneration claims and may assist with other bases of Remuneration claims. If broadly followed, the proposed format constitutes good practice.				
	Where a time based Remuneration claim for retrospective fees is being made, the Practitioner will	Where a time based Remuneration claim for prospective fees is being made, the	Where a fixed fee is claimed, the Practitioner will need to report to the relevant	Where a percentage based claim is made, information must be provided to the relevant	If a contingency arrangement within the scope of this Code is proposed, there must

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	Basis of Fee Approval				
	Time – Retrospective	Time – Prospective	Fixed	Percentage	Contingent
	need to report to the relevant Approving body on: • the amount of time spent; • a description of work performed on an Administration, broken down into the broad categories of work performed; • the classification of staff engaged on the Administration for each broad category of work; and • the Remuneration incurred for each broad category of work. The Practitioner will also need to compare the estimated Remuneration provided in the initial advice with the actual Remuneration approval sought and provide an	Practitioner will need to report to the relevant Approving body on: • a summary description of the major tasks still remaining to be done on the Administration for the period that the Remuneration is sought (e.g. to completion or other relevant milestone); • an explanation of the estimated fees remaining to complete the Administration (or to the next major milestone) including the estimated fees for each major task; • a monetary 'cap' on the Remuneration; • an explanation as to what the monetary	Approving body on: • the amount of the fixed fee proposed; • the basis upon which the fee has been calculated (work to be undertaken and the costs for each category of work and scope of work) in the same manner as for prospective fees; • the services to be provided for the fixed fee amount in sufficient detail for the Approving body to make an informed decision about why the fee is reasonable; • what services will not be included in the fixed fee and the basis of	Approving body to enable it to make an informed assessment of whether the percentage is reasonable. The following information must be provided: • the percentage proposed; • the nature and estimated value of the individual assets realised or to be realised (or if the percentage is to be applied to another factor, the value of that factor); • the formula to be applied for calculation of the Remuneration; • what services are to be provided for this percentage amount and the tasks that will comprise this work;	be full disclosure of the proposed arrangement to the relevant Approving body, including: • exactly what the arrangement is contingent upon; • how achievement of the contingency will be assessed; • what the Practitioner's Remuneration will be in the event that the contingency is or is not achieved; • why a contingency arrangement is in the best interests of creditors; and • when the Remuneration will be drawn.

	Basis of Fee Approval				
	Time – Retrospective	Time – Prospective	Fixed	Percentage	Contingent
	explanation for any variance.	capped amount represents; and • when it is proposed that the fees be drawn (for example, monthly).	charging for these excluded services; and • the milestones as to when Remuneration will be drawn from the Administration. Note: a Practitioner must not draw fixed fee Remuneration up-front. A Practitioner seeking a fixed fee basis for Remuneration must include in the quote for the fixed fee the: • costs of all statutory investigations; • costs of reporting to the creditors and Regulators; • cost of issuing letters of demand for preferences; and	• what work has been, or is intended to be outsourced that would normally be carried out by the Practitioner or their staff and whether this outsourced work will be billed separately or included in the percentage based Remuneration claim; • the milestones for when the Remuneration will be drawn from the Administration; and • the expected range of possible Remuneration outcomes. Full disclosure of the terms of the arrangement, and the expected Remuneration	

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	Basis of Fee Approval				
	Time – Retrospective	Time – Prospective	Fixed	Percentage	Contingent
			• costs of meeting all statutory obligations. Example Acceptable exclusions • litigation for recovery of preference payments. • litigation for insolvent trading. If a Practitioner is intending to make a claim for Remuneration on a fixed fee basis, this must be done at the first opportunity after the Practitioner is appointed. The only exceptions to this are where a Practitioner chooses to make a claim for a fixed fee to enable finalisation of the Administration, or	outcome, or range of possible outcomes must be made clear to creditors to minimise any perception of conflict of interest.	

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<table>
<tr><td rowspan="2"></td><td colspan="5">Basis of Fee Approval</td></tr>
<tr><td>Time – Retrospective</td><td>Time – Prospective</td><td>Fixed</td><td>Percentage</td><td>Contingent</td></tr>
<tr><td></td><td></td><td></td><td>for a specific aspect of the Administration.</td><td></td><td></td></tr>
<tr><td></td><td colspan="5">Statement of Remuneration claim – The practitioner should clearly:

• state the precise terms of the agreement(s) sought from the committee or the resolution(s) sought from creditors including the amount to be approved and when the Remuneration will be drawn. Separate statements of Remuneration claim are required for each distinct remuneration period (e.g. retrospective and prospective);
• set out the total Remuneration previously determined; and
• indicate whether they will be seeking the determination of further Remuneration at some time in the future.

A summary of receipts and payments to and from the Administration bank account must be provided. The receipts and payments summary should be prepared up to a date that is as close as possible to the date on which the notice and report is given to creditors. The summary should be clearly labelled as being prepared 'as at' a particular date or for a specified period. If large or exceptional receipts and payments are received or made after the report is prepared but before the meeting at which the Remuneration claim is to be considered, the Practitioner should provide additional information to committee members or creditors at the meeting.

Details of Disbursements paid from the Administration, including:

• general information on the different classes of Disbursements;
• a declaration that the Disbursements were necessary and proper;
• in relation to Disbursements paid to the Firm, whether directly or in reimbursement of a payment to a third party:

- who the Disbursement was paid to (only for externally provided professional services);
- what the Disbursement was for;
- the quantity and rate (only for internal Disbursements); and
- the amount paid; and

• details of the basis of any internal Disbursements that will be charged to the Administration in the future (eg. Page rate for</td></tr>
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	Basis of Fee Approval				
	Time – Retrospective	Time – Prospective	Fixed	Percentage	Contingent
	photocopying done internally). Note that payments direct to third parties from the Administration bank account only need to be clearly included in the receipts and payments. Practitioners should always support their Remuneration report with a general report providing the creditors with information about the progress of the Administration, detailing matters resolved and those matters still outstanding. The general report should assist creditors with understanding: • matters that may have contributed to the Remuneration claim; • complexities or difficulties that have been faced by the Practitioner; • goals that have been achieved since the last report; • outcomes including explanations as to why that outcome was better or worse than originally predicted; and • future tasks to be undertaken and why they need to be done. • for corporate Administrations, information on how to access the Creditor Information Sheet on approving Remuneration in external administrations (if not previously provided). The Creditor Information Sheet is designed to fully inform creditors about: • the process of determining Remuneration; and • the rights and responsibilities of Practitioners, committee members and creditors. The Information Sheet (or advice as to how creditors can access this information sheet online) must be provided to creditors before approval of Remuneration is sought. It may be provided to creditors at the time of advising them of the basis on which Remuneration will be charged.				

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	Basis of Fee Approval				
	Time – Retrospective	Time – Prospective	Fixed	Percentage	Contingent
Future reporting and/or further Remuneration approval requests	Any further Remuneration approval requests for retrospective fees on time basis have the same reporting requirements as the first Remuneration approval request.	Any further fee approval requests for prospective fees on a time basis have the same reporting requirements as the first Remuneration approval. In addition, the Approving body must be advised on: • Remuneration already drawn under the prospective approval; • comparison of actual fees to the estimated fees provided in the original Remuneration approval report; • tasks undertaken; and • tasks remaining to be completed. The above applies even	Once a fee is fixed for an agreed task, set of tasks or the conduct of the Administration, it remains fixed and a Practitioner must not seek further approval if the original estimate is wrong. After approval of a fixed fee, Remuneration reporting will focus on the progress of the work in the Administration, for example by way of explaining milestone achievements, and the work still to be done.	Future reporting to creditors will need to focus on the factors underlying the entitlement to claim the Remuneration, for example by way of reporting on asset realisations and the percentage taken from those realisations to pay Remuneration.	Future reporting to creditors will need to include information on whether the Practitioner has achieved the contingency and the effect on the calculation of the Practitioner's Remuneration.

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	Basis of Fee Approval				
	Time – Retrospective	Time – Prospective	Fixed	Percentage	Contingent
		if the Practitioner is only seeking an increase in the previously set capped amount. If the Practitioner is seeking an increase in the capped amount, they will need to provide the Approving body with an explanation as to the reason for the change in the capped amount. If a Practitioner wishes to change the rate scale other than as agreed, the Practitioner will need to seek Approving body approval and provide the Approving body with an explanation as to the reason for the change in the rate scale.			

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15.4 Sources of Funding

15.4.1 Department of Employment payments

A. Corporate Administrations

Funding received from the Department of Employment (DE) to facilitate a FEG or GEERS distribution by Appointees may be a limited or partial funding agreement. As such, where higher fees are incurred than the amount agreed with DE there is no restriction in the administration being charged for the shortfall on the basis that all Remuneration claimed is necessary and properly incurred in accordance with ARITA's Code.

While the money received from DE is not subject to creditor approval and can be paid directly to the practitioner, any shortfall must be appropriately approved in accordance with the relevant legislation prior to drawing. In seeking creditor approval for any shortfall, Practitioners must provide separate disclosure of the total time charged, DE receipt(s) and any shortfall amount in the Remuneration report.

Practitioners must ensure that they do not "double dip" in relation to FEG or GEERS Remuneration and that the amount received from DE is allocated to the Administration. To facilitate this, Practitioners must ensure that any work undertaken in relation FEG or GEERS distributions is appropriately identified in their time recording system, including an adjustment for any direct payments from DE.

B. Personal insolvency Administrations

Practitioners must have regard to guidance issued by AFSA in respect of the requirements for approval of funding received from DE or any shortfall.

15.4.2 Assetless Administration funding

Funding received from ASIC under the Assetless Administration Fund may be a limited or partial funding agreement. As such, if higher fees are incurred than the amount agreed with ASIC there is no restriction in the administration being charged for the shortfall on the basis that all Remuneration claimed is necessary and properly incurred in accordance with ARITA's Code.

Some funding received from ASIC from the assetless administration fund requires creditor approval prior to drawing and some types of funding can be paid directly to the practitioner without creditor approval. Practitioners should refer to RG 109 for ASIC guidance on when approval is required for assetless administration funding.

If approval is not required, any shortfall must be appropriately approved in accordance with the Corporations Act prior to drawing. In seeking creditor approval for any shortfall, Practitioners must provide separate disclosure of the total time charged, ASIC receipt(s) and any shortfall amount in the Remuneration report.

Practitioners must ensure that they do not "double dip" in relation to this Remuneration and that the amount received from ASIC is allocated to the Administration. To facilitate this Practitioners must ensure that any work undertaken for ASIC in relation the Assetless Administration Fund is appropriately identified in their time recording system, including an adjustment for any direct payments from ASIC.

15.4.3 Litigation funding

Remuneration from litigation funding from any source, must be:

- paid into and drawn from the Administration bank account; and
- disclosed and approved in accordance with the requirements detailed at chapters 14 and 15.

15.4.4 Creditor funding

Remuneration from funding by creditors provided for any purpose, must be:

- paid into and drawn from the Administration bank account; and
- disclosed and approved in accordance with the requirements detailed at chapters 14 and 15.

15.4.5 Secured creditor funding

Where secured assets are realised in the course of an Administration, except for Appointments as a Controller, any Remuneration in relation to the realisations, including funds withheld from realisations or payments made directly by the Secured creditor, must be:

- paid into and drawn from the Administration bank account; and
- disclosed and approved in accordance with the requirements detailed at chapters 14 and 15.

15.4.6 Indemnities and up-front payments

Remuneration drawn from an indemnity or an up-front payment provided for any purpose, must be disclosed and approved in accordance with the requirements detailed at chapters 14 and 15.

15.5 General guidance on reporting

The provision to creditors of voluminous detailed information is not a substitute for a clear and concise report. It is the *relevance, quality* and *focus* of the information rather than the quantity and detail that is important. Creditors and even committees are not necessarily conversant with insolvency issues and processes, nor do they have the capacity or time to understand WIP records. Creditors have the right to ask questions and have them answered and to inspect supporting documentation if requested.

The information provided to creditors must be:

- Sufficient – be in enough detail for the purposes for which it is prepared and in the context of the work done in the Administration;
- Meaningful - be presented in a way that allows creditors to understand what was done and why it was done;
- Clear - use non-technical terms so that what is being claimed is readily understandable;
- Relevant - limited to what is needed; and
- Concise.

A Practitioner should:

- provide information that is specific to the Administration, rather than generic;

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- try and ensure that the level of information is proportionate to the size and complexity of the Administration;
- try to assist committee members or creditors by highlighting the key components of the Remuneration claim and any areas that committee members or creditors are likely to view as contentious; and
- provide a summary of relevant information.

Questions from creditors should be anticipated and not discouraged.

Additional information should be provided if requested.

15.6 At the meeting

At a meeting at which a request for approval of Remuneration is being considered, a Practitioner must:

- table the information provided to creditors/the committee in support of the Remuneration request; and
- ask creditors whether there are any questions before putting the resolutions for approval of Remuneration to the meeting.

It is not acceptable to wait until the meeting to provide the required information to creditors. Additional information provided at the meeting should be limited to:

- responding to creditors' questions; or
- clarifying information that has already been provided.

Introducing new information at the meeting disadvantages creditors who did not attend the meeting, or who provided proxies for the meeting based on the information provided prior to the meeting.

Refer to Chapter 24 for further information about meeting requirements.

15.7 Changing basis of Remuneration

The basis for claiming Remuneration may be changed with creditor consent, however changing the basis to time based is only possible if proper records have been kept of time and activity. Note the restriction on fixed fees in section 15.2.3.

> *Example*
>
> A percentage of realisations basis does not require recording of time spent. To change to a time basis would only be possible if proper records of time spent had been kept.

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16 Approval before drawing Remuneration

Principle 12: A Practitioner is only entitled to draw Remuneration once it is approved and according to the terms of the approval.

16.1 Drawing of Remuneration

A Practitioner is only entitled to draw Remuneration once it is approved, subject to the terms of the approval.

Evidence of the approval must be recorded and maintained on the file. In the case of a resolution of a meeting of creditors, or of the committee, the minutes must be prepared and lodged where required (for example, with ASIC for corporate Administrations). In the case of court-approved Remuneration, the court order must be obtained.

If a Practitioner draws Remuneration in accordance with the default provisions under the Corporations Act or Bankruptcy Act, this must be clearly documented on the Administration file.

If fees have been approved prospectively, in terms that allow them to be drawn at nominated hourly rates, the Practitioner must only draw the Remuneration progressively, on completion of the work, unless it is the final Remuneration account for the finalisation of the Administration.

In respect of percentage-based Remuneration, it is acceptable for the Practitioner to draw his or her Remuneration from each nominated realisation, provided that there are sufficient funds available to meet higher-ranking priority debts.

In respect of a contingency arrangement, fees may be drawn on the basis approved by creditors. Any conditions imposed by creditors when approving a contingency arrangement, (for example, independent assessment of the achievement of a result) must be satisfied before Remuneration is drawn.

In respect of fixed fees, the terms approved by creditors should be that the fixed amount may be drawn only at the conclusion of the Administration; or in specified amounts at nominated milestones in the Administration. Practitioners must not draw fixed fee Remuneration 'up-front'.

16.2 Monies received in advance

If a Practitioner is provided with money in advance for the costs of conducting a formal insolvency Administration, the Practitioner is not entitled to apply those monies against their Remuneration until their Remuneration is approved by the Approving body. For details of when it is acceptable to receive monies in advance refer to section 6.14.

16.3 Remuneration drawn inappropriately

If a Practitioner becomes aware that fees have been improperly taken, because, for example, the correct process has not been followed, the Practitioner must immediately repay the amount in question into the Administration account.

Remuneration may then only be redrawn on approval being obtained and an explanation as to why the fees were improperly taken must be provided to creditors at that time.

Fees and expenses incurred in rectifying inappropriately drawn fees must be borne by the Practitioner.

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17 Resources, expertise and capacity

Principle 13: When accepting an appointment the Practitioner must ensure that their firm has adequate expertise and resources for the type and size of the Administration, or the capacity to call in that expertise and those resources as needed.

Insolvency administrations can range from a straightforward bankruptcy with a residential property as the only asset, and consumer creditors, or a single director trading company that has ceased trading to complex and difficult corporate failures, or personal bankruptcies, involving a wide geographic spread of assets and creditors, including overseas, and involving complex structures and transactions.

In agreeing to accept an appointment, a Practitioner must have regard to whether their Firm has the resources and expertise to properly conduct the Administration and where those resources are located in relation to the Insolvent. This has to be assessed on information reasonably known at the time of consenting to act. The Practitioner must try to obtain enough information about the Insolvent before consenting to enable this assessment to be made. When making this assessment, a Practitioner should have regard to whether the Firm has adequate human and technology resources, systems and processes to effectively:

- monitor work performed on the Administration,
- manage risks;
- monitor potential conflicts; and
- deal with complaints.

Practitioners should always have regard to their professional indemnity insurance (limits and any exclusions) when deciding whether to accept an Appointment.

Many Practitioners' Firms have networks or alliances that allow the firm to call upon extra resources should the need arise. Such arrangements can be taken into account by the Practitioner in deciding whether to consent.

However a Practitioner must not consent to be appointed to an Administration that the Practitioner knows to be beyond their capacity, based on an expectation that the Practitioner should be able to seek other assistance on an informal basis.

A Practitioner takes a personal appointment as an Appointee. The Practitioner must not take on an Appointment if they do not themselves have adequate capacity to properly oversee the Administration, and to supervise staff assisting them.

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18 Practice Quality Assurance

Principle 14: Members must implement policies, procedures and systems to ensure effective quality assurance.

18.1 Policies

Members must implement policies, procedures and systems within their Firm to ensure effective quality assurance. More specifically, Practitioners should apply APES320. A copy of APES320 can be accessed from the Accounting Professional and Ethical Standards Board website (www.apesb.org.au).

In addition to the requirements of APES 320, Practitioners must develop and implement policies, systems and processes that enable adherence to this Code and in particular the provisions relating to:

- Independence;
- Remuneration; and
- Competition and Promotion.

18.2 Maintenance of Administration files

A Practitioner must prepare and maintain working papers that appropriately document the work performed on the Administration. The documentation prepared by the Practitioner must:

- provide a sufficient and appropriate record of the procedures performed for the Administration, in particular how key issues were dealt with and significant decisions that were made;
- demonstrate that the Administration was conducted in accordance with the Legislation, this Code and regulatory requirements.

Files may be maintained either in paper or electronically. Notwithstanding how files are maintained, Practitioners should have in place controls to ensure that files satisfy the requirements of the Code.

A Practitioner may destroy these working papers in accordance with the requirements of the Legislation as applicable.

18.3 Checklists

A Practitioner must maintain current checklists for all types of administrations undertaken by the Practitioner. This includes for pre-appointment independence requirements referred to at section 6.16.

A Practitioner must use an appropriate checklist for every Administration to which the Practitioner is appointed.

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19 Compliance Management

Principle 15: Members must implement policies, procedures and systems to ensure effective compliance management.

Insolvency is a highly regulated profession and compliance with the Legislation, fiduciary obligations and the requirements of this Code is essential.

Practitioners have extensive powers and privileges and have commensurate duties and obligations. The cost of compliance is real, but the potential impact of non-compliance on public confidence is unacceptable for the profession and the insolvency regime.

The Australian Standard for Compliance AS 3806 (available at www.saiglobal.com) provides a useful template for Members when establishing or reviewing their compliance framework. AS 3806 defines compliance as adhering to the requirements of laws, industry and organisational standards and codes, principles of good governance and accepted community and ethical standards.

AS 3806 sets the following principles for supporting compliance management:

Commitment

The principles supporting compliance programs that relate to commitment are:

- Principle 1: Commitment by the governing body and top management to effective compliance that permeates the whole organisation.
- Principle 2: The compliance policy is aligned to the organisation's strategy and business objectives, and is endorsed by the governing body.
- Principle 3: Appropriate resources are allocated to develop, implement, maintain and improve the compliance program.
- Principle 4: The objectives and strategy of the compliance program are endorsed by the governing body and top management.
- Principle 5: Compliance obligations are identified and assessed.

Implementation

The principles supporting compliance programs that relate to implementation are:

- Principle 6: Responsibility for compliant outcomes is clearly articulated and assigned.
- Principle 7: Competence and training needs are identified and addressed to enable employees to fulfil their compliance obligations.
- Principle 8: Behaviours that create and support compliance are encouraged and behaviours that compromise compliance are not tolerated.
- Principle 9: Controls are in place to manage the identified compliance obligations and achieve desired behaviours.

Monitoring and Measuring

The principles supporting compliance programs that relate to monitoring and measuring are:

- Principle 10: Performance of the compliance program is monitored, measured and reported.
- Principle 11: The organisation is able to demonstrate its compliance program through both documentation and practice.

Continual Improvement

The principle supporting compliance programs that relates to continual improvement is:

- Principle 12: The compliance program is regularly reviewed and continually improved.

20 Risk Management

Principle 16: Members must implement policies, procedures and systems to ensure effective risk management.

20.1 Policies

Every appointment contains a range of risks to be managed. While liability insurance provides a degree of protection, it cannot be relied upon as the sole risk management strategy. Insurance cannot protect against risks associated with breaches of independence or failure to lodge documents, or take action on time.

The Australian Professional and Ethical Standards Board maintains APES 325 which may be of some assistance to Members.

The AS/NZS ISO 31000:2009 (available at www.saiglobal.com) provides a useful template for Members when establishing an appropriate risk management program.

20.2 Identity of Director(s)/individual Insolvent(s)

A Practitioner must make reasonable enquiries to satisfy themselves of the identity of the director(s)/individual Insolvent(s) prior to accepting an Appointment, where the Appointment is being made by the director(s)/individual Insolvent.

20.3 Joint and Several Appointments

Where a Practitioner accepts Co-appointments with another insolvency practitioner, they:

- make this decision with the knowledge that all Appointees are equally responsible for all decisions made on Co-appointments; and
- should ensure that their Firm has in place policies and procedures to ensure that all Appointees are knowledgeable about the conduct of the Administration, even if one Appointee is leading the conduct of the Administration.

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21 Complaints Management

Principle 17: Members must implement policies, procedures and systems to ensure effective complaints management.

The nature of insolvency work means that Members and their Firms are likely to receive complaints from stakeholders in Insolvency Administrations during the course of their career. All complaints must be taken seriously and handled effectively.

An effective complaints management system will ensure that all complaints are properly handled and provides an opportunity to obtain feedback on the quality of work done and if used effectively it is a useful diagnostic for quality assurance.

The failure to effectively manage complaints may result in their escalation to Regulators and professional bodies which can be costly and time consuming to manage and may damage reputation unnecessarily.

The Australian Standard for Complaints Management AS-ISO-10002-2006 (available at www.saiglobal.com) provides a useful reference for Members when establishing an appropriate complaints management system.

Key points for an effective complaints management system should include:

- a statement about how stakeholders in an Administration can contact the Firm with queries;
- a clear process for staff to follow when a complaint is received;
- a process to deal with minor complaints by Appointee or Administration staff (providing guidance on what would be a minor complaint);
- a process for escalating complaints or dealing with complaints that are not of a minor nature;
- delegation of an appropriate person ("complaints manager") not involved in the conduct of the Administration to be responsible for handling the complaint. This may be one person in a large firm who is no longer practising in insolvency (ie Chief Operating Officer) or may rotate to a partner not appointed to the Administration in a small firm;
- establishment and maintenance of a complaints register;
- a process to be followed by the complaints manager in respect of all complaints referred to him or her;
- a process for ensuring that the outcome of complaints are used to improve the Firm policies, procedures and systems; and
- a set of Firm principles relating to complaints handling.

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Part D: Practice Notes and Templates

22 Declaration of Independence, Relevant Relationships and Indemnities

A DIRRI must be provided to creditors by Practitioners for all corporate and personal insolvency appointments, excluding appointments as a Controller and liquidator in a members' voluntary liquidation. This obligation extends to Practitioners who have been invited to replace the Incumbent.

The template provided here is a guide to assist Practitioners with meeting their disclosure requirements.

Full guidance on the DIRRI can be found in Section 6.17 of the Code.

22.1 DIRRI Template

[Insolvent name]
[ACN / Estate number]

This document requires the Practitioner/s appointed to an insolvent entity to make declarations as to:

A. their independence generally;

B. relationships, including

- i the circumstances of the appointment;
- ii any relationships with the [*company/debtor*] and others within the previous 24 months;
- iii any prior professional services for the [*company/debtor*] within the previous 24 months;
- iv. that there are no other relationships to declare; and

C. any indemnities given, or up-front payments made, to the Practitioner.

This declaration is made in respect of myself, my partners, [*firm name*] and [*list any entities covered by the extended definition of firm*].

A. Independence

I/We, *[name, firm]* have undertaken a proper assessment of the risks to my/our independence prior to accepting the appointment as *[liquidator/administrator/trustee]* of *[Insolvent name]* in accordance with the law and applicable professional standards. This assessment identified no real or potential risks to my/our independence. I am/We are not aware of any reasons that would prevent me/us from accepting this appointment.

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B. Declaration of Relationships

i. Circumstances of appointment

This appointment was referred to me/us by [*name and firm/organisation of referrer, and connection to Insolvent*].

I/We had [*number*] meetings with the [Insolvent name, directors (*if applicable) and its advisors*] during [*time period*] for the purposes of:

- [*Explain relevant issues discussed having regards to the limitations imposed under Principle 2 in respect of pre-appointment advice*].

I/We received *[remuneration amount]* for this advice.

In my opinion, this/these meeting(s) does/do not affect my/our independence for the following reasons:

- [*provide here the Appointee's reasons for believing that the relationship does not result in a conflict of interest or duty*].

I have provided no other information or advice to the [*Insolvent name, directors (if applicable) and its advisors]* prior to my appointment beyond that outlined in this DIRRI.

ii. Relevant Relationships (excluding Professional Services to the Insolvent)

Neither I/of us, nor my/our firm, have, or have had within the preceding 24 months, any relationships with *[Insolvent name]*, an associate of *[Insolvent]*, a former insolvency practitioner appointed to *[Insolvent]* or any person or entity that has security over the whole or substantially whole of *[Insolvent name's]* property.

or

I/We, or a member of my/our firm, have, or have had within the preceding 24 months, a relationship with:

Name	Nature of relationship	Reasons
		I believe that this relationship does not result in a conflict of interest or duty because: •

iii. Prior Professional services to the Insolvent

Neither I/we, nor my/our firm, have provided any professional services to *[Insolvent name]* in the previous 24 months.

or

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I/We, or a member of my/our Firm, have provided the following professional services to *[Insolvent name]* in the 24 months prior to the acceptance of this appointment:

Nature of Professional Service	Reasons
	I believe that this relationship does not result in a conflict of interest or duty because: •

iv. No other relevant relationships to disclose

There are no other known relevant relationships, including personal, business and professional relationships, from the previous 24 months with [*Insolvent name*], an associate of [*Insolvent name*], a former insolvency practitioner appointed to [*Insolvent name*] or any person or entity that has security over the whole or substantially whole of [*Insolvent name's*] property that should be disclosed.

C. Indemnities and up-front payments

I/We have been provided with the following indemnities [*and/or upfront payments for remuneration*] for the conduct of this *[Administration type]*:

Name	Relationship with [Insolvent name]	Nature of indemnity or payment

This does not include statutory indemnities. I/We have not received any other indemnities or upfront payments that should be disclosed.

or

I/We have not been indemnified in relation to this administration, other than any indemnities that I/we may be entitled to under statute and I/we have not received any up-front payments in respect of my/our remuneration or disbursements.

Dated:

....

[signed, Practitioner name] *[signed, Practitioner name]*

Note:

1. If circumstances change, or new information is identified, I am/we are required under the Corporations Act 2001 and ARITA's Code of Professional Practice to update this Declaration and provide a copy to creditors with

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my/our next communication as well as table a copy of any replacement declaration at the next meeting of the insolvent's creditors.

2. Any relationships, indemnities or up-front payments disclosed in the DIRRI must not be such that the Practitioner is no longer independent. The purpose of components B and C of the DIRRI is to disclose relationships that, while they do not result in the Practitioner having a conflict of interest or duty, ensure that creditors are aware of those relationships and understand why the Practitioner nevertheless remains independent.

*[*** DOES NOT FORM PART OF DIRRI****

Important points for Practitioners to note when preparing a DIRRI:

- *ARITA's Code of Professional Practice provides guidance on the completion of the DIRRI and should be referred to when completing this template.*
- *a Practitioner's firm is defined to include:*

  (a) A sole practitioner, partnership, corporation or other entity of professionals;

  (b) An entity that controls such parties through ownership, management or other means;

  (c) An entity controlled by such parties through ownership, management or other means; or in which they share in the profits; or

  (d) Practices operating under the same, or substantially the same, business name, whatever the financial arrangement.

- *an Associate is defined in ARITA's Code of Professional Practice - For Administrations under the Corporations Act, Associate has the meaning according to that Act. For personal insolvency administrations, Associate is a spouse, dependent or direct relative of the Insolvent, or the spouse or dependant of a direct relative, and any entity with which the Insolvent or any of the persons previously mentioned are associated with (refer 6.10 for further information). Therefore, the term Associate includes directors and associated entities of an insolvent corporation.*
- *in co-appointments, each Practitioner must sign the DIRRI. A DIRRI can only be issued without all signatures in exceptional circumstances, which must be documented on the file and a fully signed DIRRI must be provided to creditors as soon as possible.*
- *if the Appointment is under Part X of the Bankruptcy Act, Practitioners must comply with the particular requirements of the Bankruptcy Act.*
- *Although the use of a DIRRI may not be required under law in certain Administrations, the Code requires a DIRRI to be issued on all Administrations except Appointments as Controller.]*

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23 Remuneration Report

23.1 Overview and Explanation of the Recommended Report

The recommended format for a report to creditors should be used by Practitioners seeking retrospective and/or prospective determination of Remuneration on a time basis, although aspects of the report may be useful for other remuneration bases.

This report may not be suitable for reporting on Remuneration for an appointment as a Controller, and Practitioners in those appointments should seek guidance from their appointor as to the required format of their Remuneration reporting.

Reports should be tailored to the particular circumstances of each Administration.

In providing information in a report, the external Practitioner should as a matter of good practice:

- provide information that is specific to the Administration, rather than generic;
- ensure, where possible, that the level of information is proportionate to the size and complexity of the Administration;
- try to assist committee members or creditors by highlighting the key components of the Remuneration claim and any areas that committee members or creditors are likely to view as contentious;
- provide a summary of high-level information;
- explain that further levels of detail are available at the meeting or on request;
- make explanations concise and clear; and
- provide disclosure that is meaningful, clear, succinct and appropriate overall.

The courts expect a Practitioner to exercise their professional judgment when putting together a report to committee members or creditors.

It is recommended that the Remuneration report accompany or be combined with a general report that the Practitioner is preparing for committee members or creditors. For example, where a voluntary administrator is seeking the determination of Remuneration at the meeting to consider the company's future and the Practitioner is already under an obligation to prepare a section 439A report.

Committee members or creditors may or may not be familiar with insolvency procedures and are not being remunerated for their time. Therefore, providing more information does not necessarily inform creditors in a more effective manner than providing less: it is the relevance and quality of the information, rather than the quantity, that is the key.

At the meeting, it is good practice for committee members or creditors to be made aware that all supporting documentation may be viewed if requested, provided sufficient notice is given to the Practitioner.

23.2 Structure of the Recommended Reports

23.2.1 Initial advice to creditors

This is the suggested format for the initial advice to creditors on Remuneration:

Remuneration Methods

There are four basic methods that can be used to calculate the remuneration charged by an insolvency practitioner. They are:

Time based / hourly rates

This is the most common method. The total fee charged is based on the hourly rate charged for each person who carried out the work multiplied by the number of hours spent by each person on each of the tasks performed.

Fixed Fee

The total fee charged is normally quoted at the commencement of the administration and is the total cost for the administration. Sometimes a practitioner will finalise an administration for a fixed fee.

Percentage

The total fee charged is based on a percentage of a particular variable, such as the gross proceeds of assets realisations.

Contingency

The practitioner's fee is structured to be contingent on a particular outcome being achieved.

Method chosen

Given the nature of this administration we propose that our remuneration be calculated on [*insert basis*]. This is because:

[*Provide reasoning for the fee calculation method chosen.]*

Explanation of [Hourly Rates/Fixed fee/Percentage/Contingency]

Use the following guidance for time based remuneration:

The rates for our remuneration calculation are set out in the following table together with a general guide showing the qualifications and experience of staff engaged in the administration and the role they take in the administration. The hourly rates charged encompass the total cost of providing professional services and should not be compared to an hourly wage.

Title [2]	Description [3]	Hourly Rate (excl GST)
Appointee		$
Director/		$
Senior Manager		$
Manager		$
Supervisor		$
Senior		$
Intermediate		$
Secretary		$
Clerk		$
Junior		$

[Notes:

1. *Each firm should develop a table which is appropriate for their firm using the columns set down in the above table.*
2. *These are example titles only. Each firm should use the titles appropriate to their firm.*
3. *Information that should be incorporated in the description column includes years of experience, qualifications, education, staff supervised etc.]*

For time based remuneration claims, the Practitioner must also include his or her best estimate of the costs of the administration to completion or to a specified milestone.

Where the Practitioner is appointed to the Insolvent, in the case of a company by the directors, or the case of an individual by the Insolvent, any estimate provided to the directors/individual Insolvent must be disclosed. Note the requirements to ensure consistency of the estimates provided to directors/individual Insolvent and the creditors, or an explanation for any variance (6.13).

If fixed fee, percentage of realisations or contingency arrangements are proposed, use the following guidance for this section of the initial advice to creditors:

If charging on a fixed fee basis, a fixed amount quote for the cost of the administration, details of what services are included as part of the fixed fee and the basis upon which the balance of services will be charged.

If using a percentage of realisations method, the percentage to be applied, clearly documenting what the percentage is to be applied to, when the remuneration will be paid and the expected range of possible remuneration outcomes.

If a contingency arrangement within the scope of this Code is proposed, there must be full disclosure of the proposed arrangement and the range of possible remuneration outcomes.

If it is intended that some services will be provided on a different basis, the reporting obligations for each different basis must be complied with.

Disbursements

Disbursements are divided into three types:

- Externally provided professional services - these are recovered at cost. An example of an externally provided professional service disbursement is legal fees.
- Externally provided non-professional costs such as travel, accommodation and search fees - these are recovered at cost.
- Internal disbursements such as photocopying, printing and postage. These disbursements, if charged to the Administration, would generally be charged at cost; though some expenses such as telephone calls, photocopying and printing may be charged at a rate which recoups both variable and fixed costs. The recovery of these costs must be on a reasonable commercial basis.

I am/We are not required to seek creditor approval for disbursements, but must account to creditors. Details of the basis of recovering internal disbursements in this administration are provided below . Full details of any actual costs incurred will be provided with future reporting.

Basis of disbursement claim

Internal Disbursements [Suggestion Only - delete or add details as appropriate to the disbursements claimed]	Rate (Excl GST)
Advertising	[At Cost or X]
Binding	$[X.XX] per bind
Courier	[At Cost or X]
Faxes & Photocopies	$[X.XX] per page
Postage	[At Cost or X]
Stationery	
- Folders	$[X.XX] per folder
- Filing Index	$[X.XX per set of X]
Staff per diem travel allowance	$[X.XX per day]
Staff vehicle use	$[X.XX per km]

Scale applicable for financial year ending XX XXXX XXXX

23.2.2 Approval requests

A. Structure of the Remuneration approval request report

The recommended report is divided into eleven parts with the first seven being Remuneration specific.

Part 1: Declaration

Part 2: Executive summary

Part 3: Description of Work

Part 4: Calculation of Remuneration

Part 5: Statement of Remuneration claim

Part 6: Remuneration recoverable from external sources

Part 7: Disbursements

Part 8: Report on Progress of the Administration

Part 9: Summary of Receipts and Payments

Part 10: Queries

Part 11: Information sheet

In practice, the report should form a coherent narrative where an overview and status report is followed by the substantive claims and then general explanatory information.

Part 1: Declaration

This is a declaration by the Practitioner that he or she has reviewed the Remuneration claim and it is necessary and proper for the conduct of the Administration.[1]

Part 2: Executive Summary

The executive summary provides readers with a summary of Remuneration approved to date and the Remuneration for which the Practitioner is currently seeking approval.

Part 3: Description of Work

The tasks which Practitioners undertake can be broadly divided into seven categories. These are:

a. Assets
b. Creditors
c. Employees
d. Trade On
e. Investigation
f. Dividend
g. Administration

Information on the seven categories is to be set out in table form making it easy for creditors to understand the type and purpose of work being undertaken. A typical list of tasks is included as guidance. The narrative provided must be sufficient, meaningful, open and clear and provide specifics of the work done for this particular appointment.

The table format should be used for both retrospective and prospective fee approval requests (a separate table for each fee request/resolution).

The table included in the report for the particular Administration should properly reflect the work done / to be done on that appointment. Inclusion of the full typical list of tasks from the General Description column for all appointments is not appropriate and is not a proper reflection of the work undertaken / to be undertaken on the appointment. That column is indicative only and should be amended to suit the particular appointment. Use specific details (i.e., detailing specific asset or class of asset realisations). Proper time recording systems should be able to readily generate reports thus reducing the time taken to prepare this information.

[1] Note that IG Practice Direction 18 specifically requires a statement that the costs are “necessary and reasonable”.

Where the method of Remuneration is time based, dollar value of Remuneration attributed to that category of work and hours taken should be included under the task heading for each task category.

Further details and particulars may be required for large Administrations (i.e more or different sub-categories) or where the Remuneration claimed relates to a lengthy period of time (i.e. may need to be divided into time periods).

If non-insolvency services are provided by the Firm in the Administration, an additional category and adequate description of tasks undertaken, for any services provided must be added to the table. For example, if the Firm's tax division provided services to the Administration, a description of tasks undertaken by the tax division would need to be added to the end of the table.

Part 4: Calculation of Remuneration (Time Basis)

The suggested format provides all the information necessary to allow a creditor to understand the calculations for the claim for Remuneration. Who did what for how long and at what rate?

If non-insolvency services are provided by the Firm in the Administration, an additional Calculation of Remuneration table must be included for those non-insolvency services.

Part 5: Statement of Remuneration claim

Full and exact statements, including precise dollar amounts, of all Remuneration resolutions for which approval is being sought must be included here.

The Remuneration approval sought at the meeting must be in accordance with the statements provided in the Remuneration report.

Part 6: Remuneration recoverable from external sources

Where payments are received from external sources such as DE, ASIC, litigation funding, creditor funding, up-front payments, indemnities etc, details of that funding should be provided in this section of the report.

Part 7: Disbursements

The suggested format provides for general information on Disbursements, a declaration by the Practitioner as to the necessary and proper status of the Disbursements paid, details of Disbursements claimed from the administration by the Practitioner and their Firm, and the basis of Disbursement claims.

Part 8: Report on Progress of the Administration

It is common practice to include a progress report with the Remuneration report. While not forming part of the Remuneration claim, it provides context for creditors to understand the stage of the Administration – work completed, work under way, work still to be undertaken. The progress report may be incorporated as part of a more general report to creditors rather than as part of the Remuneration report.

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Part 9: Summary of Receipts and Payments

The report must include a summary of receipts and payments for the Administration prepared up to a date as close as possible to the date on which the report is given to creditors.

Part 10: Queries

Information must be provided to creditors on their right to obtain further information. How this information can be obtained should be detailed here.

Part 11: Information Sheet

Creditors must be provided with either the actual information sheet or instructions on how to access it prior to them being requested to approve a Remuneration claim. This information should be included in this section of the report.

B. Approval Request report pro-forma

Part 1: Declaration

I, *[name, firm]* have undertaken a proper assessment of this remuneration claim for my appointment as *[Appointment type]* of *[Insolvent]* in accordance with the law and applicable professional standards. I am satisfied that the remuneration claimed is in respect of necessary work, properly performed, or to be properly performed, in the conduct of the Administration.

Part 2: Executive Summary

To date, *[no remuneration/remuneration totalling $[amount]]* has been approved and paid in this administration. This remuneration report details approval sought for the following fees:

Period *[Suggestion only – delete or add details as appropriate]*	Report Reference	Amount (ex GST)
Past remuneration approved: [period] [period] *Total past remuneration approved*		 $*[amount]* $*[amount]* *$[TOTAL]*
Current remuneration approval sought:		
Voluntary Administration		
Resolution *[#]*: *[date from]* – *[date to]*	*[X]*	$*[amount]*
Resolution *[#]*: *[date from]* – *[date to]**	*[X]*	$*[amount]*
Resolution *[#]*: *[date from]* – signing of the Deed of Company Arrangement (if applicable)*	*[X]*	$*[amount]*
*Total – Voluntary Administration**		*$[amount]*
Deed of Company Arrangement (if applicable)		
Resolution *[#]*: Commencement of Deed of Company Arrangement to *[completion/milestone/date]**	*[X]*	$*[amount]*

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Period *[Suggestion only – delete or add details as appropriate]*	Report Reference	Amount (ex GST)
Liquidation (if applicable)		
Resolution *[#]*: Commencement of liquidation to *[completion/milestone/date]**	*[X]*	$*[amount]*
* Approval for the future remuneration sought is based on an estimate of the work necessary to the completion of the administration. Should additional work be necessary beyond what is contemplated, further approval may be sought from creditors.		

Remuneration sought in relation to groups should be separately identified in summary table, in a format similar to the below.

Period	Report Reference	Group Entity 1 Amount (ex GST)	Group Entity 2 Amount (ex GST)	Group Total Amount (ex GST)

Please refer to report section references detailed in the above table for full details of the calculation and composition of the remuneration approval sought.

This is consistent with the estimate of costs provided in the Initial Advice to Creditors dated [*date*], which estimated a cost to *[completion/milestone]* of the administration of $*[amount]* (excluding GST). OR This differs to the estimate of costs provided in the Initial Advice to Creditors dated [*date*], which estimated a cost to *[completion/milestone]* of the administration of $*[amount]* (excluding GST), for the following reasons:

- [*detail reasons*]

Part 3: Description of work completed / to be completed

Resolution [#] from [date] to [date][Note: A separate description of work completed / to be completed (ie. table below) must be provided for each resolution sought and this should be consistent with the executive summary. A separate remuneration report is NOT required for each resolution sought.]

Task Area	General Description	Includes [Suggestion Only - delete or add details as appropriate to the work done]
Assets [hours] [$ x]	Sale of Business as a Going Concern	Preparing an information memorandum Liaising with purchasers Internal meetings to discuss/review offers received
	Plant and Equipment	Liaising with valuers, auctioneers and interested parties Reviewing asset listings

Task Area	General Description	Includes [Suggestion Only - delete or add details as appropriate to the work done]
	Sale of Real Property	Liaising with valuers, agents, and strata agent Attendance at auction
	Assets subject to specific charges	All tasks associated with realising a charged asset
	Debtors	Correspondence with debtors Reviewing and assessing debtors ledgers Liaising with debt collectors and solicitors
	Stock	Conducting stock takes Reviewing stock values Liaising with purchasers
	Other Assets	Tasks associated with realising other assets
	Leasing	Reviewing leasing documents Liaising with owners/lessors Tasks associated with disclaiming leases
Creditors [hours] [$x]	Creditor Enquiries	Receive and follow up creditor enquiries via telephone Maintaining creditor enquiry register Review and prepare correspondence to creditors and their representatives via facsimile, email and post Correspondence with committee of creditors members
	Retention of Title Claims	Search to the PPSR register Notify PMSI creditors indentified from PPSR register Receive initial notification of creditor's intention to claim Provision of retention of title claim form to creditor Receive completed retention of title claim form Maintain retention of title file Meeting claimant on site to identify goods Adjudicate retention of title claim Forward correspondence to claimant notifying outcome of adjudication Preparation of payment vouchers to satisfy valid claim Preparation of correspondence to claimant to accompany payment of claim (if valid)
	Secured creditor reporting	Notifying PPSR registered creditors of appointment Preparing reports to secured creditor Responding to secured creditor's queries
	Creditor reports	Preparing section 439A report, investigation, meeting and general reports to creditors
	Dealing with proofs of debt	Receipting and filing POD when not related to a dividend Corresponding with OSR and ATO regarding POD when not related to a dividend
	Meeting of Creditors	Preparation of meeting notices, proxies and advertisements

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Task Area	General Description	Includes [Suggestion Only - delete or add details as appropriate to the work done]
		Forward notice of meeting to all known creditors Preparation of meeting file, including agenda, certificate of postage, attendance register, list of creditors, reports to creditors, advertisement of meeting and draft minutes of meeting. Preparation and lodgement of minutes of meetings with ASIC Responding to stakeholder queries and questions immediately following meeting
	Shareholder enquiries	Initial day one letters ITAA Section 104-145(1) declarations Responding to any shareholder legal action
Employees [hours] [$x]	Employees enquiries	Receive and follow up employee enquiries via telephone Maintain employee enquiry register Review and prepare correspondence to creditors and their representatives via facsimile, email and post Preparation of letters to employees advising of their entitlements and options available Receive and prepare correspondence in response to employees objections to leave entitlements
	FEG/GEERS	Correspondence with FEG/GEERS Preparing notification spreadsheet Preparing FEG/GEERS quotations Preparing FEG/GEERS distributions
	Calculation of entitlements	Calculating employee entitlements Reviewing employee files and company's books and records Reconciling superannuation accounts Reviewing awards Liaising with solicitors regarding entitlements
	Employee dividend	Correspondence with employees regarding dividend Correspondence with ATO regarding SGC proof of debt Calculating dividend rate Preparing dividend file Advertising dividend notice Preparing distribution Receipting POD Adjudicating POD Ensuring PAYG is remitted to ATO
	Workers compensation claims	Review insurance policies Receipt of claim Liaising with claimant Liaising with insurers and solicitors regarding claims Identification of potential issues requiring attention

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Task Area	General Description	Includes [Suggestion Only - delete or add details as appropriate to the work done]
		of insurance specialists Correspondence with insurer regarding initial and ongoing workers compensation insurance requirements Correspondence with previous brokers
	Other employee issues	Correspondence with Child Support Correspondence with Centrelink
Trade On [hours] [$x]	Trade On Management	Liaising with suppliers Liaising with management and staff Attendance on site Authorising purchase orders Maintaining purchase order registry Preparing and authorising receipt vouchers Preparing and authorising payment vouchers Liaising with superannuation funds regarding contributions, termination of employees employment Liaising with OSR regarding payroll tax issues
	Processing receipts and payments	Entering receipts and payments into accounting system
	Budgeting and financial reporting	Reviewing company's budgets and financial statements Preparing budgets Preparing weekly financial reports Finalising trading profit or loss Meetings to discuss trading position
Investigation [hours] [$x]	Conducting investigation	Collection of company books and records Correspondence with ASIC to receive assistance in obtaining reconstruction of financial statements, company's books and records and Report as to Affairs Reviewing company's books and records Review and preparation of company nature and history Conducting and summarising statutory searches Preparation of comparative financial statements Preparation of deficiency statement Review of specific transactions and liaising with directors regarding certain transactions Liaising with directors regarding certain transactions Preparation of investigation file Lodgement of investigation with the ASIC Preparation and lodgement of supplementary report if required
	Examinations	Preparing brief to solicitor Liaising with solicitor(s) regarding examinations Attendance at examination

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Task Area	General Description	Includes [Suggestion Only - delete or add details as appropriate to the work done]
		Reviewing examination transcripts Liaising with solicitor(s) regarding outcome of examinations and further actions available
	Litigation / Recoveries	Internal meetings to discuss status of litigation Preparing brief to solicitors Liaising with solicitors regarding recovery actions Attending to negotiations Attending to settlement matters
	ASIC reporting	Preparing statutory investigation reports Preparing affidavits seeking non lodgements assistance Liaising with ASIC
Dividend [hours] [$x]	Processing proofs of debt	Preparation of correspondence to potential creditors inviting lodgement of POD Receipt of POD Maintain POD register Adjudicating POD Request further information from claimants regarding POD Preparation of correspondence to claimant advising outcome of adjudication
	Dividend procedures	Preparation of correspondence to creditors advising of intention to declare dividend Advertisement of intention to declare dividend Obtain clearance from ATO to allow distribution of company's assets Preparation of dividend calculation Preparation of correspondence to creditors announcing declaration of dividend Advertise announcement of dividend Preparation of distribution Preparation of dividend file Preparation of payment vouchers to pay dividend Preparation of correspondence to creditors enclosing payment of dividend
Administration [hours] [$x]	Correspondence	
	Document maintenance/file review/checklist	First month, then six monthly administration review Filing of documents File reviews Updating checklists
	Insurance	Identification of potential issues requiring attention of insurance specialists Correspondence with insurer regarding initial and ongoing insurance requirements Reviewing insurance policies Correspondence with previous brokers

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Task Area	General Description	Includes [Suggestion Only - delete or add details as appropriate to the work done]
	Bank account administration	Preparing correspondence opening and closing accounts Requesting bank statements Bank account reconciliations Correspondence with bank regarding specific transfers
	ASIC Form 524 and other forms	Preparing and lodging ASIC forms including 505, 524, 911 etc Correspondence with ASIC regarding statutory forms
	ATO and other statutory reporting	Notification of appointment Preparing BAS Completing group certificates
	Finalisation	Notifying ATO of finalisation Cancelling ABN / GST / PAYG registration Completing checklists Finalising WIP
	Planning / Review	Discussions regarding status of administration
	Books and records / storage	Dealing with records in storage Sending job files to storage
Other professional services provided by the Firm	[Insert description of services undertaken]	[insert details of included tasks eg tax, general accounting etc]

Additional matters particular to Personal Insolvency Administrations may include:

Task Area	General Description	Includes [Suggestion Only - delete or add details as appropriate to the work done]
Assets [hours] [$ x]	Income assessments	Liaising with the Bankrupt during each contribution assessment period in relation to particulars of income derived during the period, including as to number of dependants and circumstances etc Assessing the Bankrupt in accordance with the Bankruptcy Act and serving assessment Monitoring the income of the Bankrupt during the course of the bankruptcy, including as to any change in circumstances Receipting income contributions.
	Non-divisible property	Assessing personal property of the Bankrupt Assessing value of car, tools of trade and realising excess
	Family issues	Assessing value of family home and contributions to its purchase etc. Determine security over home and current equity,

Task Area	General Description	Includes [Suggestion Only - delete or add details as appropriate to the work done]
		including current payments under mortgage. Arrange for sale of home including discussions with non-bankrupt spouse as to their equity Arrange for vacant possession and sale Assess possible family law or other claims by spouse.
Investigation [hours] [$x]	Collection of books and records, statement of affairs etc of Bankrupt	Reviewing books & records Obtain Statement of Affairs from Bankrupt(s) and review and pursue further inquiries, searches Preparation of and issuing of demand notices under the Act to various entities – business partners, family members etc associated with the Bankrupt(s). Liaising with Official Receiver as to issue of notices. Analysing books and documents received.
	Searches	Carrying out searches of Land Titles Office, ASIC, etc. Assess bank accounts and notify banks etc, including as to payment of Bankrupt's salary and access to funds for living expenses etc
	Transactions	Review of transactions which may be voidable under the Act, in particular in relation to transfer to family members, or trusts. Assess superannuation of the Bankrupt and circumstances of prior and current payments into fund.
	Conduct issues	Assess conduct of Bankrupt as to extension of bankruptcy. Lodge Objection to Discharge including preparation of relevant reasons and grounds. Assessing and reporting possible offences to AFSA.
Administration [hours] [$x]	AFSA reporting	Preparing of and lodgement of Annual Estate Returns with AFSA Reconciliation and calculation of Realisations and Interest Charge Lodgement of Realisation and Interest Charge Return

Part 4: *[Resolution X]* - Calculation of Remuneration

Employee [1]	Position	$/hour (ex GST)	Total actual hours	Total ($)	Task Area						
					Assets hrs $	Creditors hrs $	Employees hrs $	Trade on hrs $	Investigation hrs $	Dividend hrs $	Administration hrs $
	Appointee										
	Appointee										

Total				$	x	x	x	x	x	x	x
GST				$							
Total (Incl GST)				$							
Average hourly rate				$	x	x	x	x	x	x	x

Other professional services provided by the firm

Employee [1]	Position	$/hour (ex GST)	Total actual hours	Total ($)	Non-insolvency Service		
					Service 1 $	Service 2 $	Service 3 $
Total				$	x	x	x
GST				$			
Total (Incl GST)				$			
Average hourly rate				$	x	x	x

[Note 1: The inclusion of Employee names is not mandatory, but some form of coding should be used e.g. Employee A. The name of the Appointee and Co-appointees must be identified.]

[Note Regarding claims for Future fees

If the Practitioner is intending to request approval of prospective remuneration, the Practitioner must provide the following information to the approving body:

- a summary description of the major tasks still remaining to be done on the Administration;
- an explanation of the estimated fees remaining to complete the Administration (or to the next major milestone), including the estimated fees for each major task.

The Practitioner may also choose to estimate the time to be spent by the staff at different levels.

The format in which this information is provided should be consistent with that provided for retrospective remuneration approvals in Part 3. The Practitioner may also choose to include the table in Part 4 for future fees, but this is not mandatory. It is recommended that each agreement or resolution sought be clearly labelled to enable easy reference to the executive summary (e.g. Resolution 1, Resolution 2 ...).]

Part 5: Statement of remuneration claim

The Practitioner must clearly:

- state the precise terms of the agreement sought from the committee or the resolution(s) sought from creditors;
- set out the total remuneration previously determined; and

- indicate whether they will be seeking the determination of further remuneration at some time in the future.

For any future fee requests:

- the monetary cap on the remuneration;
- an explanation as to what the cap represents; and
- when it is proposed that the fees be drawn.

It is recommended that each agreement or resolution sought be clearly labelled to enable easy reference to the executive summary (e.g. Resolution 1, Resolution 2 ...).

Part 6: Remuneration recoverable from external sources

In respect of corporate Administrations, Remuneration payments received in relation to the Fair Entitlements Guarantee Act 2012 or predecessor schemes, or from the Assetless Administration Fund operated by ASIC are considered separate arrangements involving a limited or partial funding agreement. Where higher fees are incurred than the amount covered by the funding agreement there is no restriction in the Administration being charged for the shortfall on the basis that all remuneration claimed is necessary and properly incurred in accordance with ARITA's Code.

While the money received under the funding arrangement is not subject to creditor approval and can be paid directly to the practitioner, any shortfall must be appropriately approved in accordance with the appropriate legislation prior to drawing. In seeking creditor approval for any shortfall, ARITA recommends that specific disclosure of the total time charged, funding receipt(s) and shortfall amount be made in the remuneration report. Particular care must be taken to ensure that the Administration is not charged for amounts recovered from under the funding.

In respect of personal insolvency Administrations, Practitioners should refer to guidance issued by AFSA in respect of approval of payments from DE and claiming any shortfall.

Any funding obtained from other external sources, such as litigation funding, creditor funding, up-front payments, indemnities etc, details of that funding should also be provided in this section of the report.

Part 7: Disbursements

Disbursements are divided into three types:

- Externally provided professional services - these are recovered at cost. An example of an externally provided professional service disbursement is legal fees.
- Externally provided non-professional costs such as travel, accommodation and search fees - these are recovered at cost.
- Internal disbursements such as photocopying, printing and postage. These disbursements, if charged to the Administration, would generally be charged at cost; though some expenses such as telephone calls, photocopying and printing may be charged at a rate which recoups both variable and fixed costs. The recovery of these costs must be on a reasonable commercial basis.

A declaration must be made that the disbursements were necessary and proper. An example declaration is provided below.

I have undertaken a proper assessment of disbursements claimed for *[Insolvent]*, in accordance with the law and applicable professional standards. I am satisfied that the disbursements claimed are necessary and proper.

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You must provide details of disbursements paid from the Administration to your Firm, including:

- who the disbursement was paid to (only for external provided professional services);
- what the disbursement was for;
- the quantity and rate (if applicable – internal disbursements only);
- the amount paid; and
- details of the ongoing basis of any internal disbursements that will be charged to the Administration (eg. Page rate for photocopying done internally).

An example disclosure is provided below.

The following disbursements have been paid by the Administration to my firm for the period from *[date]* to *[date]*. Where amounts have been paid to my firm for externally provided services and costs, those payments are in reimbursement of costs previously paid by my firm, either due to a lack of funds in the Administration at the time the payment was due, or the direct invoicing of my firm by the supplier. All of the below transactions appear in the receipts and payments listing attached to this report as Appointee disbursements. Where payments to third parties are paid directly from the Administration bank account, they are only included in the attached listing of receipts and payments.

Disbursements paid *[Date]* to *[Date]* [Suggestion Only - delete or add details as appropriate]	Basis	Total (Excl GST)
Externally provided professional services		
Legal costs (firm name)		$Amount
Legal costs (firm name)		$Amount
Externally provided non-professional services		
Advertising		$Amount
Printing		$Amount
Travel		$Amount
Internal disbursements		
Photocopies	XX pages @ $X.XX/page	$Amount
Postage	XX letters @ $X.XX per letter	$Amount
Staff vehicle use	XX kms @ $X.XX per km	$Amount
Staff per diem travel allowance	XX days @ $X.XX per day	$Amount
Total		$Amount

You are not required to seek creditor approval for disbursements, but must account to creditors, this includes providing details of the basis of charging for these types of disbursements to creditors as part of the remuneration report. An example table detailing the basis for charging internal assistance disbursements is provided below.

Future disbursements provided by my firm will be charged to the administration on the following basis:

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Internal disbursements [Suggestion Only - delete or add details as appropriate to the disbursements claimed]	Rate (Excl GST)
Advertising	[At Cost or X]
Binding	$[X.XX] per bind
Courier	[At Cost or X]
Faxes & Photocopies	$[X.XX] per page
Postage	[At Cost or X]
Stationery	
- Folders	$[X.XX] per folder
- Filing Index	$[X.XX per set of X]
Staff vehicle use	$X.XX per km

Rates applicable for financial year ending XX XXXX XXXX

Part 8: Report on Progress of the Administration

While not strictly part of the remuneration request, it is important that Practitioners provide progress reports to place the claim in context. This narrative should normally preface the remuneration claim.

It may well be that this information has already been incorporated into a general report to creditors. If so, it is not necessary to repeat this information as part of the remuneration request. Rather the remuneration report will be supplemental to the main report.

Part 9: Summary of Receipts and Payments

A summary of receipts and payments to and from the Administration bank account must be provided.

The receipts and payments summary should be prepared up to a date that is as close as possible to the date on which the notice and report is given to creditors. The summary should be clearly labelled as being prepared 'as at' a particular date or for a specific period.

If large or exceptional receipts and payments are received or made after the report is prepared but before the meeting at which the remuneration claim is to be considered, the Practitioner should provide additional information to committee members or creditors at the meeting.

Part 10: Queries

Creditors need to be informed of their right to obtain further information and that they can request that information.

Part 11: Information Sheet

Creditors must be provided with the remuneration information sheet (or instructions on how to access it) before creditors are requested to approve a remuneration claim.

23.2.3 Pre-appointment proposed basis of Remuneration disclosure

This is the suggested format for the pre-appointment advice to directors/individual Insolvents regarding the proposed basis of Remuneration. This advice is to be used for all Appointments made by directors/individual Insolvents, this specifically excludes Controllers or any Appointment made by the court (refer section 6.13).

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This template has been prepared on the basis that no fixed fee or quote has been provided by the Practitioner – only an estimate. If a fixed fee or quote has been provided, you will need to customise this template accordingly.

Introduction

This information is to assist you with understanding how remuneration is calculated and paid in an insolvency administration.

Whilst I/we may provide you with an estimate of the cost of the administration in this document, I/we advise that the actual remuneration drawn in this administration will be subject to the approval of the creditors, committee of creditors or court, after I/we have provided a remuneration report in accordance with the requirements set down in the legislation and ARITA's Code of Professional Practice.

If I/we have provided you with an estimate of the cost of the administration, this information will be provided to creditors in my/our initial remuneration advice that I am/we are required to provide to creditors. However, the actual remuneration that is approved by creditors may exceed this estimate and this higher amount can be approved by the creditors, committee of creditors or court.

If you have paid or are paying money up front, or are providing me with an indemnity, for the purposes of my remuneration, you should be aware that approved remuneration may exceed this amount and can be paid from the assets of the administration.

Remuneration Methods

There are four basic methods that can be used to calculate the remuneration charged by an insolvency practitioner. They are:

Time based / hourly rates

This is the most common method. The total fee charged is based on the hourly rate charged for each person who carried out the work multiplied by the number of hours spent by each person on each of the tasks performed.

Fixed Fee

The total fee charged is normally quoted at the commencement of the administration and is the total cost for the administration. Sometimes a practitioner will finalise an administration for a fixed fee.

Percentage

The total fee charged is based on a percentage of a particular variable, such as the gross proceeds of assets realisations.

Contingency

The practitioner's fee is structured to be contingent on a particular outcome being achieved.

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Method proposed

Given the nature of this administration I/we propose that my/our remuneration will be calculated on [*insert basis*]. This is because:

[*Provide reasoning for the fee calculation method chosen.]*

Details of the hourly rates are included below *[delete if hourly rates are not being used]*.

Creditors will be advised of the proposed basis of remuneration in my/our initial remuneration advice to them.

Estimate of the cost of the administration

[*If you are providing the directors/individual Insolvent with an estimate of the cost of the administration that information should be provided here. If an estimate is not being provided, this section can be deleted.]*

I/We estimate that this administration will cost approximately $XXX to complete, subject to the following variables which may have a significant effect on this estimate and that I am unable to determine until I have commenced the administration:

- *[list variables here]*

Explanation of Hourly Rates

Use the following guidance for time based remuneration:

The rates for my/our remuneration calculation are set out in the following table together with a general guide showing the qualifications and experience of staff that will be engaged in the administration and the role they take in the administration. The hourly rates charged encompass the total cost of providing professional services and should not be compared to an hourly wage.

Title [2]	Description [3]	Hourly Rate (excl GST)
Appointee		$
Director/		$
Senior Manager		$
Manager		$
Supervisor		$
Senior		$
Intermediate		$
Secretary		$
Clerk		$
Junior		$

[Notes:

1. *Each firm should develop a table which is appropriate for their firm using the columns set down in the above table.*
2. *These are example titles only. Each firm should use the titles appropriate to their firm.*
3. *Information that should be incorporated in the description column includes years of experience, qualifications, education, staff supervised etc.]*

Acknowledgement

To acknowledge that you have received and understood the information that I have provided to you regarding the basis of remuneration, please sign and date this document and return it to me/us on or before making the appointment.

Sign: ____________________

Name: ____________________

Date: ____________________

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24 Creditors' Meetings

Practitioners must call, conduct and report on creditors' meetings in a professional manner.

24.1 Introduction

Creditors' meetings (meetings) are an essential part of the communication and decision process of Administrations. Meetings:

- enhance accountability and transparency;
- provide an opportunity for the Practitioner to explain:
    - the Practitioner's role;
    - the insolvency process;
    - the general rights and obligations of creditors;
    - Administration reports;
    - the progress, status and future of the Administration;
- provide a forum for creditors to ask questions and for answers to be provided;
- have statutory support giving creditors the power to:
    - approve the compromise of a debt;
    - approve the entry into an agreement extending beyond three months;
    - approve Remuneration claims;
    - replace an appointed Practitioner; and
    - make a decision about a company's future under Part 5.3A.

The informed co-operation and assistance of creditors will assist the Practitioner in the proper conduct of the Administration. A Practitioner should have regard to the views of creditors and must act on directions given by creditors if legally required to do so.

A major factor in the conduct of meetings, and in insolvency communications generally, is the varying levels of sophistication of creditors. Many will have little or no understanding of the insolvency processes and in particular the role of meetings. Practitioners should take particular care to ensure that the communications in relation to meetings are clear and concise, that the role of the parties at the meeting and the impact of the meeting are easily understood.

There are five guidance areas for Practitioners in respect of meetings:

- The decision to call a meeting;
- Calling the meeting;
- Conducting the meeting;
- Reporting on the meeting; and
- The conduct of Practitioners that are not the Appointee.

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24.2 The decision to call a meeting

Meetings are convened by the Practitioner for a number of reasons. Meetings can:

- be required by statute, for example in voluntary administrations, or Part X agreements; or can be held at the request of a required percentage of creditors;
- allow the Practitioner to explain progress in the Administration and to seek the views of creditors on the further conduct of the Administration;
- give authority to adopt a particular course of action, such as to approve a settlement of a claim by the company; or
- approve the Practitioner's Remuneration.

The cost of convening a meeting is an important consideration as the costs are charged to the Administration. The major costs are:

- professional time;
- advertising;
- communications (including postage of notice of meeting); and
- venue hire.

Where the Practitioner has discretion to hold a meeting, an assessment should be made of the costs and benefits of holding the meeting. Where appropriate, the Practitioner should use the cost reduction processes, where permissible under the legislation, to reduce costs and improve efficiency:

- the use of proxies;
- '*mail-out*' facilities;
- telephone attendance; or
- putting a resolution to creditors without a meeting.

Convening a meeting to discuss a number of on-going issues and resolve them promptly at the meeting may be a cost saving measure.

In addition, the Practitioner should be aware of provisions in the legislation whereby creditors may request a meeting be called and where an indemnity can be sought from a particular party for the cost of calling a meeting in certain instances.

In some cases, it may be appropriate to obtain court dispensation of some requirements of the meeting process, for example by way of an order under s 447A of the Corporations Act in a Voluntary Administration as to how creditors may be notified, or how the meeting is to be held.

24.3 Calling the meeting

24.3.1 Venue and time of meeting

In addition to the legal requirements, when selecting a venue, the Practitioner should consider:

- the convenience to the majority of persons entitled to receive notice of the meeting:
  - date;
  - time;

- geographic location; and
- the capacity to accommodate those likely to attend.

24.3.2 Notice of the meeting

Apart from the need for Practitioners to comply with the various statutory notice requirements, practitioners should despatch notices of meeting as early as possible having regard to the circumstances of the particular Administration.

It is recognised that in Voluntary Administrations, and Part X agreements, extra notice is unlikely to be possible due to tight timeframes imposed by the legislation.

24.4 Provision of information prior to creditors' meeting

Unless previously provided, in addition to statutory notices required to be sent to creditors when convening a first meeting, Practitioners must provide to creditors and other eligible recipients:

- A Declaration of Independence, Relevant Relationships and Indemnities (DIRRI);
- For corporate Administrations, a copy of the ASIC list of insolvency information sheets or similar document subsequently issued by ASIC and/or ARITA;
- Information prescribed under the Code Chapter 15 to be sent to creditors in the Administrator's first communication with creditors; and
- If approval of Remuneration is being sought, information in accordance with the Code Chapter 15 for Remuneration approval requests.

24.4.1 List of Creditors

Apart from the statutory requirements to provide a list of creditors, a schedule of creditors (name and amount) should also be made available on the request of any creditor. The information is publicly available from the Report as to Affairs lodged with ASIC or Statement of Affairs filed with AFSA. Any request to provide a list of creditors should always be considered in the context of any relevant privacy laws.

To minimise costs, where possible the schedule should be provided electronically (PDF recommended).

24.5 Proxies

24.5.1 Form of Proxy

Proxy forms accompanying the notice must conform strictly to the Legislation containing:

- the name of the Insolvent;
- the address, date and time of the meeting;
- space for:
    - the identity of the creditor;
    - the identity of the proxy holder;
    - signature and dating by the creditor;

- space for the creditor to set out the proxy instructions:
  - the voting instruction on each item; or
  - delegation e.g. name proxy holder or chairman.

Proxy forms must not be pre-completed. They must not contain:

- the name of the creditor;
- the instructions on how the vote is to be cast; or
- the name of the proxy holder.

If resolutions for Remuneration are intended to be put to the meeting, the exact wording of the resolutions, including amounts, must be included on the proxy form. It is not acceptable to direct creditors to vote for, against or abstain on a resolution to regarding Remuneration without specifying the exact amounts to be voted on. A proxy that does not contain this information cannot be used by the Practitioner as a special proxy to vote on Remuneration. Notwithstanding these requirements, a Practitioner can only use a special proxy in circumstances allowed under the relevant legislation.

Information accompanying the proxy form should specify:

- the date by which the completed proxy must be returned; and
- the address for return of proxy (post, fax, email).

Given the convenience for many creditors in voting by proxy, and the significance of the power given to a Practitioner under a proxy, Practitioners must ensure that all legal requirements as to the form of the proxy and instructions as to its completion are complied with.

Returned proxies should be carefully checked to ensure that they are valid.

24.5.2 Validity of Proxies

A Practitioner must not accept a form of proxy that is incorrectly completed in a way that the Practitioner considers renders it invalid or of doubtful validity. If time permits, the creditor should be asked to rectify any deficiencies in the proxy.

However, a Practitioner should not reject a proxy simply because of a minor error in its completion provided that:

- the form of proxy sent with the notice of the meeting (or a substantially similar form) has been used;
- the identity of the creditor and the proxy holder are clear; and
- the nature of the proxy holder's authority and any instructions given to the proxy holder are also clear.

24.6 Proof of debt / Statement of claim

Practitioners may accept a creditor's proof of debt/statement of claim at any time before voting, even during the course of the meeting itself.

Due to the effect that votes by Associates of the Insolvent can have on the outcome of voting, Practitioners must carefully review any proofs of debt or statements of claim received from

Associates of the Insolvent to verify the validity of the amount claimed. The minutes of the meeting should document how claims of Associates were adjudicated.

The admission or rejection of proofs/claims for voting purposes is the responsibility of the chairperson of the meeting, other than meetings held pursuant to the Bankruptcy Act, where the Trustee has this responsibility.

24.7 Conduct of the meeting

24.7.1 Attendance at the meeting

The Practitioner as the Appointee should be physically present at all meetings of creditors.

Practitioners should request at least one director or the bankrupt/debtor be present at the first meeting of creditors in order to have them answer any questions that creditors may have in relation to the affairs of the Insolvent. There may be instances where it is not appropriate to have them attend. For example, where there is concern for their safety.

In respect of a voluntary administration, Practitioners should request at least one director to be present at the second meeting of creditors.

Creditors and their authorised representatives are entitled to attend any meeting. In addition, a person who holds themselves out as representing a creditor should, in the absence of evidence to the contrary, be allowed to attend the meeting and to ask questions, but he or she is unable to vote unless a valid proxy is provided.

The chairperson of the meeting must decide whether to allow any third parties, such as shareholders, the press or the police, to attend, after taking into account the views of the creditors present. In some cases, a representative from ARITA may ask permission to attend.

Regulators must be allowed to attend meetings. Their presence at a meeting must be announced at the meeting.

24.7.2 Use of technology

Practitioners should consider the use of technology to assist in the conduct of creditors' meetings, subject to any limitations imposed under statute, to improve the quality of the communication and explanation for creditors. Useful technology includes tele- and video-conferencing and digital projection.

24.7.3 Information to be provided to the meeting

Information to be tabled at the meeting must include:

- a copy of the Declaration of Independence, Relevant Relationships and Indemnities (DIRRI);
- if approval of Remuneration is being sought, information in accordance with Chapter 15 of the Code; and
- any other documents as are required by the statutory provisions applicable to the relevant insolvency procedure.

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If it is a first meeting of creditors, a brief history of the Insolvent and its current financial position should be provided to the meeting. If it is a second or subsequent meeting, any significant changes circumstances or the financial position must be explained.

All decisions required of creditors at the meetings should be based on information provided prior to the meeting, unless that information is immaterial. Decisions based on information not previously provided may disadvantage creditors. Creditors would have made their decision to not attend, or in how they allocated their proxy based on only part of the information. It is recognised that there will be occasions where this is not possible as developments may have occurred in the time between issue of the notice of meeting and the holding of the meeting.

24.7.4 Use of the casting vote

Applicable to Voluntary Administrators, Deed Administrators and Liquidators only

The casting vote provides to the Appointee a very powerful tool. Practitioners must exercise the casting vote according to law using their professional judgment in the circumstances of the particular Administration.

The legal principles that govern the exercise of the casting vote are explained in the case law and texts and are summarised below:

- the Chairperson has discretion whether to exercise the casting vote. The chair 'should proceed to exercise the casting vote and resolve the deadlock (thereby resorting to the power for the purpose for which it exists) unless there is some good reason to refrain from doing so'. Failure to exercise the casting vote for some irrational or irrelevant reason is inconsistent with the person's duty;
- the Chairperson must weigh up all relevant factors and act honestly and according to what they believe to be in the best interests of those affected by the vote; and for a proper purpose;
- the exercise of the casting vote is most appropriate in circumstances where either creditors with a majority in value have such an overwhelming interest that it is inappropriate to allow a majority in number, who do not have the same monetary interest to carry the day, or vice versa. However, there is no presumption in favour of the majority in value, although any large disproportion between the values of the debts of the numerical minority and the numerical majority will be a factor to be taken into account; nor is there any presumption in favour of maintaining the status quo;
- The Practitioner is entitled to, and should, bring his or her experience and practical considerations to bear in deciding how to exercise the vote;
- In a Voluntary Administration, the objectives of Part 5.3A must be considered in making the decision.

Some matters for consideration when exercising a casting vote are, but not limited to:

- Do creditors with a majority in value however not in number have an overwhelming interest over those in number?
- What opinion, if any, was proffered by the Practitioner in support or opposition of the resolution in any report to creditors or otherwise?
- Has any information come to the Practitioner's attention since the Practitioner formed his or her opinion that might require a change in support of that opinion?

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- Do any of those creditor(s) voting have a motive that serves their own interests, which may not be in the best interests of all creditors and/or contrary to the purpose and objectives of the appointment?
- Are those creditors opposing the Practitioner's opinion making an informed and unbiased decision?
- Can the purpose for exercising the casting vote be substantiated by independent, objective and impartial reasoning?
- Will any unfair advantages accrue to the directors by exercising a casting vote in a particular way?
- Should the Practitioner seek to adjourn the meeting for the purpose of further consideration or taking advice?
- What proxies have been given on the basis that the Practitioner would vote in accordance with his or her recommendation?

A Practitioner must not be influenced by any direct or indirect opportunity of financial benefit that he or she may receive in deciding how to exercise the casting vote; for example, the fact that Remuneration will be higher if a deed is entered into. Practitioners should also be aware of the need to avoid any negative perception of self interest swaying the decision.

Except in very limited circumstances, a Practitioner should not use the casting vote in relation to any resolution determining or fixing the Practitioner's Remuneration[2].

A Practitioner must declare the rationale for:

- exercising his or her casting vote (whether for or against a particular resolution), or
- choosing not to exercise, his or her casting vote.

The reasons must be minuted.

24.7.5 Attendance records

Creditors and their representatives attending the meeting are required to sign an attendance list. This list should be made available for inspection to anyone attending the meeting and form part of the minutes (refer section 24.9). This list must be retained as part of the records of the Administration.

24.7.6 Questions at the meeting

The Practitioner should, at the beginning of the meeting, or at an early stage, invite creditors and their representatives to make statements or to ask questions.

Any creditor or creditor's representative wishing to speak, ask questions, or make a nomination, should be asked to identify themselves and the creditor they represent.

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[2] Refer to the decision in *Krejci as liquidator of Eaton Electrical Services* (2006) 58 ACSR 403 against the use of the casting vote stating it was in breach of the liquidator's fiduciary duties. Contrast with the decision in *Williams as liquidator of C & D Global Protection Pty Ltd (in liquidation) v CD Protective Services Pty Ltd & Ors (No 3)* [2010] QSC 224 which allowed, in very particular circumstances (99.9% of creditors voting voted in favour of remuneration), the use of the casting vote to approve remuneration.

Practitioners should assess the range of types of creditors who are attending the meeting, and ensure they understand the issues being discussed and that they are able to ask questions and seek clarification as necessary. Practitioners should not be dismissive or curt with what may be basic or uninformed questions. There is usually a need for sensitivity in any explanations or discussions or answers given at a meeting.

A Practitioner should appreciate that many creditors wish to have the issues resolved promptly and that extensive debate may not be productive. Where there is apparent understanding by most of the attendees at the meeting, but where a small number may not fully appreciate all the detail, the Practitioner may suggest to the individual(s) that explanation of the matter be deferred until immediately after the formal meeting in order to avoid unnecessary delay or diversion of the meeting.

24.7.7 Chairperson and control

The Practitioner who chairs the meeting is in control, subject to any Legislation which may provide for a person other than the Practitioner to chair the meeting. The Practitioner should be prepared to make rulings on issues in order to ensure a productive and properly conducted meeting. For example, the Practitioner may decline to allow a question to be put if, for example:

- the questioner refuses to give the name of the creditor they represent and their own name or that of their firm;
- the questioner does not claim to be or to represent a creditor;

or may decline to answer it if, for example:

- the answer may prejudice the successful outcome of the Administration or the creditors' interests;
- the answer may be construed as slanderous if subsequently proved incorrect.

The Practitioner should state the grounds for his or her decision.

Creditors are entitled to information on the causes of the Insolvent's failure or bankruptcy. The level of detail provided should be commensurate with the circumstances of the Administration.

24.8 Committee of Inspection / Creditors

Where creditors/members are entitled to appoint a Committee of Inspection/Creditors, they should be told of the right to appoint a committee and of the nature of the committee's functions.

If the Practitioner is of the opinion that a committee is not required for the Administration, the Practitioner should explain their reasoning to the meeting.

A Practitioner should ensure that a committee is properly convened under the legal requirements, is representative of the body of creditors/members, is aware of its rights and responsibilities and that it acts within its authority.

24.9 Reporting on the meeting

Minutes must be kept of all meetings of creditors, committees of creditors/inspection, or members, even where a meeting lapses due to no quorum being present.

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The minutes should include the following information:

- the title of the proceedings;
- the date, time and venue of the meeting;
- the name and description of the chairperson and any other person involved in the conduct of the meeting;
- a list, in the format prescribed under law, of the creditors, members or contributories attending or represented at the meeting;
- the name of any officer or former officer of the company attending the meeting if not attending in one of the above capacities;
- the exercise of any discretion by the chairperson in relation to the admissibility or value of any claim for voting purposes, particularly how related party claims were adjudicated;
- the resolutions taken and the decision on each one and, in the event of a poll being taken, the value or number (as appropriate) of votes for and against each resolution;
- if the casting vote is exercised, details and the reasons for how it was cast;
- where a committee is established, the names and contact details of the members; and
- such other matters as are required by the statutory provisions applicable to the relevant insolvency procedure.

The minutes should record sufficient detail about matters discussed at the meeting to enable an understanding of the business conducted. This does not require recording of the meeting word for word, unless the Practitioner considers this to be necessary.

Any documents tabled at the meeting must be noted as being tabled in the minutes and should, be retained with the minutes of the proceedings on the Administration file. The Practitioner should use their professional judgement when determining whether any of the tabled documents should be lodged with the minutes where lodgement of minutes is required under the relevant legislation.

The Practitioner must ensure that the minutes record the tabling of the DIRRI at the meeting.

If confidential matters are discussed at the meeting, the Practitioner should exercise their discretion when deciding what level of detail is to be recorded in the public record.

Where a meeting has been asked to approve a Practitioner's Remuneration, the information provided to the meeting in support of that request should form part of, or be retained with, the minutes of the proceedings.

The minutes should be signed by the chairperson, retained on the Administration files and, where applicable, lodged with either ASIC or AFSA (if required under the relevant legislation).

Where a Practitioner is the Appointee, but has not acted as chairperson of the meeting, they should endeavour to ensure that the record is signed by the chairperson and complies with the above principles.

If the Practitioner is not satisfied that the record signed by the chairperson is an accurate record of the proceedings, they should either prepare their own record for the files or prepare a note for the files explaining in what respects they disagree with the chairperson's record.

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24.10 Recording the meeting

If the Practitioner wishes to make an audio recording of the conduct of the meeting, the meeting must be advised beforehand and creditors' permission obtained.

24.11 Conduct of practitioners that are not the appointee

Where a Practitioner is asked to act as an Alternate Appointee in an Administration and attends a meeting of creditors in that capacity, regard must be had to the requirements of the Code of Professional Practice, specifically section 11.7, at all times.

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25 Reports under s 439A of the Corporations Act

25.1 Introduction

The purpose of this chapter of the Code is to:

- provide guidance to an Administrator of a company in fulfilling their statutory responsibilities in preparing the Section 439A report on the company's business, property, affairs, financial circumstances and any proposal for a deed of company arrangement;
- provide guidance on reporting to eligible employee creditors where a Deed of Company Arrangement proposes to alter the statutory priorities under sections 556, 560 and 561;
- promote transparency in respect of the company's affairs, the relationship between the Administrator and creditors and the relationship between the company and the Administrator.

25.2 Definitions

For the purpose of this part of the Code,

Administrator means a voluntary administrator of a company appointed under Part 5.3A of the Corporations Act.

Section 439A report means:

- a report on the company's business, property, affairs and financial circumstances required to be given to creditors pursuant to subsection 439A(4) of the Corporations Act; and
- a statement pursuant to paragraph 439A(4)(b) of the Corporations Act, setting out the Administrator's opinion and reasons as to each of the options available under section 439C in respect of the company's future.

Deed means a Deed of Company Arrangement under Part 5.3A of the Corporations Act.

Eligible employee creditor has the meaning given by s 9 of the Corporations Act.

Prospective financial information means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It is highly subjective in nature and its preparation requires the exercise of considerable judgment. Prospective financial information can be in the form of:

- a forecast, that is, prospective financial information prepared on the basis of reasonable assumptions as to future events expected to take place or outcomes to occur as at the date the information is prepared; or
- a projection. A projection is prospective financial information based on hypothetical assumptions about future events and management actions which are not necessarily expected to take place – for example, when an entity is in a start-up phase or is considering a major change in the nature of its operations. A projection can also be a mixture of best estimate and hypothetical assumptions, which illustrates the possible consequences, as at the date the information is prepared, if the events and actions were to occur (a '*what-if*' scenario); or
- or a combination of both, for example a one year forecast plus a five year projection;

Statutory priorities means the priority for the payment of unsecured creditor claims set down in ss 553, 560 and 561 of the Corporations Act.

25.3 Professional Judgment

Companies to which Administrators are appointed vary in size, type of business, structure and type of creditors. The extent of investigations performed by an Administrator is dependent on many factors. These factors include the limited and strict timeframes prescribed by Part 5.3A of the Corporations Act; the nature of the proposal, if any, for the future of the company; as well as the size, business conducted and structure of the company. Accordingly, the Administrator must exercise professional judgment in the preparation of the reports required by ss 439A(4) of the Corporations Act taking into account all factors.

The Administrator of a company in Voluntary Administration has a statutory duty to investigate the company's business, property and affairs. Section 545 of the Corporations Act does not apply to Part 5.3A. The statutory duty to investigate the company's business, property and affairs cannot be contractually restricted or limited by the Administrator.

However, the law does recognise the Administrator must maintain a balance between speed and accuracy in attending to the duties expected under Part 5.3A and the obligation to provide a report to creditors.

The Administrator should exercise judgment to decide if additional time is needed. In these circumstances the Administrator should:

- seek an extension of the convening period; or
- the creditors should be asked if the meeting may be adjourned.

25.4 Court involvement

An Administrator should keep in mind that circumstances may arise where an application to the court is required during the course of a Part 5.3A Administration. For example, there may be difficulties in obtaining information or books and records from directors, or the information provided may be known to be false; there may be related parties claiming to act as creditors. In such cases, legal advice may need to be obtained to assess whether directions from the court should be sought.

25.5 Legislative requirement

Subsection 438A requires the Administrator to investigate the company's business, property affairs and circumstances and form an opinion on the three options available to creditors.

Subsection 439A(4) of the Corporations Act requires the Administrator to include with the notice convening the second meeting of creditors in a Voluntary Administration a copy of:

- a report by the Administrator about the company's business, property, affairs and financial circumstances;
- a statement setting out the Administrator's opinion about each of the following matters:
    - whether it would be in the creditors' interests for the company to execute a Deed;

- whether it would be in the creditors' interests for the administration to end;
- whether it would be in the creditors' interests for the company to be wound up;
- his or her reasons for those opinions; and
- such other information known to the Administrator as will enable the creditors to make an informed decision about each matter covered by subparagraph (i), (ii) or (iii); and
- if a Deed is proposed, a statement setting out details of the proposed Deed.

Regulation 5.3A.02 also requires the Administrator to specify in the report whether there are any transactions that appear to the Administrator to be voidable transactions.

The Administrator's role in a Part 5.3A administration is best described as that of an impartial expert. The Administrator's primary duty is owed to the company's creditors who are entitled to rely upon the expert opinion of the Administrator. In reporting, the Administrator must investigate the company's business, property and affairs. The Administrator must also form an opinion as to whether it would be in the creditors' interest, about each of the three alternative outcomes to the administration.

25.6 Content of the 439A report

25.6.1 Purpose of the report and Summary

The first section of the report should:

- clearly inform creditors as to the report's purpose;
- provide creditors with a summary of the investigation's undertaken;
- provide creditors with a summary of the main issues dealt with in the report; and
- include the Administrator's recommendation.

This section of the report is essentially an executive summary and should provide creditors with an easy to understand overview of the entire report and the Administrator's recommendation.

25.6.2 Background Information

The section 439A report must contain sufficient information to provide creditors with an understanding of the history of the company and the circumstances leading up to and the need for the appointment of a Voluntary Administrator.

Shareholders, Officers and Charges

The section 439A report should incorporate details of the company's existing shareholders and officers and details of registered charges. Relevant changes in these details that have occurred within twelve months before the Administrator's appointment should also be disclosed.

Books and records

The section 439A report must incorporate an opinion as to whether the company's books and records are maintained in accordance with s 286 of the Corporations Act.

Failure by the company to maintain books and records in accordance with s 286 provides a rebuttable presumption of insolvency of the company. This presumption can be relied upon by a

liquidator in an application for compensation for insolvent trading and other actions for recoveries pursuant to Division 2 of Part 5.7B of the Corporations Act from related entities. Accordingly, the state of the company's books and records is considered material to a creditor's decision concerning the company's future.

Financial statements

A company's financial statements are an essential tool in the management of the business conducted by the company. The presence, or absence, of timely financial reporting in a company may provide an indication of the management capabilities of the company officers. Accordingly, financial statements are considered material to a creditor's decision concerning the company's future.

The section 439A report should disclose the date to which the company's financial statements were prepared prior to the Administrator's appointment.

Historical financial performance

The section 439A report must incorporate a summary of the company's historical financial results and a preliminary analysis and commentary from the Administrator.

Administrator's prior involvement

Whilst it is acknowledged that the Administrator must detail his or her prior involvement with the company at the first meeting of creditors, the section 439A report must reiterate any relationships that were disclosed in the DIRRI provided with the notice of first meeting. For further information about disclosure of relevant relationships, refer to Chapter 6 of the Code.

Directors' report as to affairs

The section 439A report should outline the content of the directors' report as to affairs and include the Administrator's comments as to the Administrator's estimate of realisable value of assets and liabilities. If directors have failed to provide a report as to affairs, this must be disclosed.

Explanations for difficulties

The section 439A report should include the directors' explanation for the company's difficulties and the Administrator's opinion of the reasons for the company's difficulties.

Outstanding winding up applications

A creditor incurs substantial costs in making an application to have a company wound up. The timing of a company's decision to appoint an Administrator, relative to the date on which the application was to be heard, may be a material factor to creditors in deciding the company's future.

The section 439A report should disclose any winding up applications filed against the company prior to the appointment of the Administrator and the petitioning creditor in such applications.

Related entities

A creditor of the company may apply to the court to set aside or modify a resolution authorising the execution of a Deed if the resolution was carried as a consequence of a related entity casting a vote. Similarly, a defeated resolution for the company to be wound up may be declared to have been carried, if it was defeated because of the vote cast by a related entity.

The section 439A report must disclose to the best of the Administrator's knowledge:

- those creditors of the company who are related entities;
- the quantum of their claims; and
- the process taken by the Administrator to verify the claims made by related entities.

The report should also disclose:

- when the debt was incurred; and
- how the debt was incurred.

25.6.3 Offences, voidable transactions and insolvent trading

Offences

An Administrator is required to complete and lodge a report pursuant to section 438D of the Corporations Act with ASIC where it appears to the Administrator that a past or present officer of the company may have been guilty of an offence in relation to the company; and in other limited circumstances.

Where any such identified offences appear materially relevant to the creditors' decision on the company's future, these alleged offences should be disclosed.

Voidable transactions

The section 439A report must disclose whether there appears to the Administrator to have been any voidable transactions in respect of which money, property or other benefits may be recoverable by a liquidator. If able to be ascertained, the section 439A report should disclose the quantum of any voidable transactions identified, the beneficiaries of those transactions and the likelihood and estimated cost of recovery.

Voidable transactions include unfair preferences (s 588FA), uncommercial transactions (s 588FB), insolvent transactions (s 588FC) and unfair loans (s 588FD).

To reduce the amount of generic information included as part of the section 439A report, an information sheet with explanations about offences, voidable transactions and insolvent trading has been prepared and should be provided to creditors as an attachment to the section 439A report.

Insolvent trading

The section 439A report must include comment regarding whether the company engaged in insolvent trading and should, if possible, provide an estimate of the loss incurred by the company as a result.

Director's personal financial position

Where voidable transactions against a company director or a potential insolvent trading claim are identified, the Administrator should comment on the likelihood of recovering monies from the directors in the event that the company were to proceed into liquidation. In forming an opinion, the Administrator should make reasonable enquiries to establish the directors' capacity to pay any judgment obtained.

The Administrator, due to time constraints, is unlikely to conduct a public examination of the company's directors. Therefore the Administrator will be limited to public information and information provided by the director, or authorised by the director to be disclosed by third parties.

In the section 439A Report, the Administrator should:

- detail the enquiries undertaken; and
- include, as appropriate, the results of these enquiries.

When a director does not provide this information, or authorise its disclosure by third parties, this must be disclosed in the report.

25.6.4 Estimated return from a winding up

All section 439A reports, including those for a company where a Deed is being proposed, must disclose:

- the estimated return to creditors from a winding up of the company;
- the effect of related party creditor claims on the estimated return;
- likely timing of the return to creditors from a winding up of the company;
- the basis on which Remuneration will be sought by the liquidator if the company is placed into liquidation and the Administrator is appointed liquidator; and
- an estimate of the likely costs of administering the winding up of the company.

It may not be possible to quantify the estimated return from a winding up of the company. In such circumstances, the Administrator should provide a range of possible outcomes and the factors that influence each outcome.

If approval of Remuneration for administering the liquidation is sought prospectively, details of the Remuneration claim must be provided in accordance with the Code.

Where a Deed is proposed, the section 439A report should include a table providing creditors with a direct comparison of the estimated returns and costs in a liquidation and under the Deed.

25.6.5 Effect on employees

The position of employees in a Voluntary Administration differs to that of other unsecured creditors. It is important that specific information targeted at the employees' situation is provided so that they can make a fully informed decision.

In situations where a Deed proposes to alter the statutory priorities, refer to section 25.7 of the Code.

In all other situations, the Administrator must include the following information in the section 439A Report in order to properly inform employees:

- The position of employees as a priority creditor in a liquidation
- The estimated return to employees in a winding up of the company
- The availability of any government safety net scheme for their entitlements and a basic outline of that scheme; and
- if a Deed is proposed:
    - The position of employees as priority creditors in the Deed;
    - The estimated return to employees under the Deed;
    - The estimated timing of payment(s) under the Deed; and
    - The effect of the Deed on the employees' ability to access any government safety net scheme for their entitlements.

25.6.6 Proposal for a deed of company arrangement

Reporting for all proposed Deeds

If a Deed is being proposed, the section 439A report must disclose:

- the key features of the proposed Deed;
- the monitoring and reporting arrangements that are to be put in place to ensure that the terms of the Deed are met and that creditors are fully informed of the progress of the Administration;
- the estimated return to creditors and likely timing of the return to creditors from the proposed Deed;
- how related party creditor claims are being dealt with under the Deed and the effect of related party creditors' claims on the estimated return;
- a comparison of the estimated return to creditors from the proposed Deed to the estimated return to creditors from a winding up of the company and for ease of understanding this information should be provided in a table providing creditors with a direct comparison of the estimated returns and costs in a liquidation and under the Deed;
- a summary of the Administrator's reasoning as to why the Deed will provide creditors with a greater return than in a liquidation;
- in circumstances where a guarantor proposes to retain control of the business pursuant to the proposed Deed, details of the creditors holding the guarantees and the quantum of the debt secured by the guarantees. The report should request that any creditor holding a guarantee which is not disclosed in the report provide details to the Administrator as soon as possible;
- where approval of Remuneration for the Voluntary Administration is sought, details of the Remuneration claim in accordance with the Code; and
- the basis on which Remuneration will be sought by the Administrator of the proposed Deed and an estimate of the total Remuneration payable for administering the proposed Deed. If approval of Remuneration for administering the Deed is sought prospectively, details of the Remuneration claim in accordance with the Code.

Reporting for proposed Deeds with contributions by the company from on-going trading

In addition to the general reporting requirements, if the Deed is proposing that the company make contributions to the Deed fund from trading, the section 439A report must also include the following information:

- how the intended trading will enhance the return to creditors given the trading position of the Company prior to the Administrator's involvement;
- subject to commercial confidentiality, a summary of the prospective financial information relied upon for the proposed Deed and the assumptions relied upon in the preparation of the prospective financial information. Commercial confidentiality must not be used as a reason to not provide any information about the prospective information relied upon;
- if the prospective financial information was prepared by a third party, a comment on the validity of the assumptions relied upon in the preparation of the prospective financial information;
- if the prospective financial information was prepared by the Administrator, the Administrator should summarise the key assumptions relied upon in the preparation of the prospective financial information; and
- a comment by the Administrator as to the likelihood of the company being able to achieve the proposed contributions.

Reporting for proposed Deeds including a Creditors' Trust arrangement

In addition to the general reporting requirements, if the Deed is proposing the establishment of a Creditors' Trust, the Administrator should be aware of the guidance provided in ASIC's Regulatory Guide 82 *'External administration: Deeds of company arrangement involving a creditors' trust'*.

Reporting for proposed Deeds including a payment by a party other than the company

In addition to the general reporting requirements, if the Deed is proposing payment into the Deed fund from a party other than the company, the section 439A report must also include the following information:

- the arrangements that are to be put in place to ensure that the third party is bound by the Deed; and
- the steps to be taken should the third party fail to make the proposed payments.

The Administrator must also consider and comment upon the capacity of the third party to make the proposed payments.

25.6.7 Administrator's Opinion

The Administrator must express:

- an opinion as to whether the option is in the creditors' interests; and
- reasons for the opinion;

for each of the options available to the creditors to decide pursuant to section 439C of the Corporations Act, being that:

- the company execute the proposed Deed;
- the administration end; and
- the company be wound up.

25.6.8 Other Material Information

The section 439A report must include any other information that is materially relevant to creditors being able to make an informed decision on the company's future.

25.6.9 Incomplete or additional information

Where the Administrator needs more time in which to obtain information and complete investigations in order to give the opinion required under s 439A, the Administrator should, where appropriate, apply to court for an extension of time within which to hold the second meeting.

> *Example*
>
> An administrator is appointed to a large administration with complex and numerous assets and liabilities. The administrator may apply to the court for an extension of the convening period in order to gain more time to complete investigations and give an opinion.

Where a report containing an opinion is given to creditors within time and the Administrator receives further information about the company, then the Administrator should advise creditors before, or at the second meeting, that, in light of this further information, the creditors may decide to adjourn the meeting in order to allow the further information to be investigated or considered.

> *Example*
>
> An Administrator sends a report to creditors with an opinion that the company enter into a Deed. Immediately after the report is sent, a creditor provides the Administrator information about non-disclosed assets of the company. If time permits, the Administrator should send a supplementary report to creditors as to the new information. At the meeting the Administrator will explain the new information and may suggest to creditors that the meeting be adjourned for up to 45 business days in order to allow further investigations to be made. Ultimately it is a matter for the creditors whether to adjourn the meeting or vote on the three options available.

25.7 Report where Deed alters Statutory Priorities

25.7.1 Legislative requirement

Where it is proposed that the Deed alter the statutory priorities, eligible employee creditors must pass a resolution agreeing to this alteration at a meeting of eligible employee creditors convened for this purpose under s 444DA of the Corporations Act. This meeting must be held prior to the meeting of creditors under s 439A.

Written notice must be provided to eligible employee creditors at least five business days before the meeting and the notice of meeting must be accompanied by a statement setting out:

- the Administrator's opinion whether the alteration of the statutory priorities would be likely to result in the same or a better outcome for eligible employee creditors as a whole than would result from an immediate winding up of the company;
- his or her reasons for that opinion; and
- such other information known to the Administrator as will enable the eligible employee creditors to make an informed decision.

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25.7.2 Content of statement

Where it is proposed that a Deed will alter the statutory priorities, the Administrator must provide to eligible employee creditors the following:

- information required to be provided under the Code for the section 439A report:
  - Background Information;
  - Offences, Voidable Transactions and Insolvent Trading;
  - Estimated return to employees from the company's monies in a liquidation (excluding payments that employees may be eligible to receive under the any government safety net scheme for their entitlements) and the timing of that return;
- a comprehensive and clear explanation of the proposed alteration. If different groups of eligible employee creditors are affected in different ways, the explanation should provide details for each group of eligible employee creditors;
- estimated return to eligible employee creditors (or each different group of eligible employee creditors) under the proposed Deed and the timing of that return;
- an explanation as to how related party creditor claims are being dealt with under the Deed and the effect of related party creditors' claims on the estimated return;
- details of the government safety net scheme or any replacement scheme, including what entitlements the employees may be entitled to claim under the scheme should the company go into liquidation, and the effect that the alteration of the statutory entitlements will have on the employees' rights under that scheme in the event that the Deed fails and the company proceeds into liquidation.

25.7.3 Administrator's Opinion on altering Statutory Priorities

The Administrator must express:

- whether the alteration of the statutory priorities would be likely to result in the same or a better outcome for eligible employee creditors as a whole than would result from an immediate winding up of the company; and
- reasons for that opinion.

Where there are groups of eligible employee creditors that will be affected by the alteration in different ways, when making his or her recommendation, the Administrator must consider the position of the eligible employee creditors as a whole.

This recommendation should be accompanied by a comparison of the estimated return in a liquidation and the estimated return under the proposed Deed in a table format. The possible entitlements that employees may be able to claim under any government safety net scheme in a liquidation should also be included.

25.7.4 Other Material Information

The statement must include any other information that is materially relevant to the eligible employee creditors' decision on the company's future.

25.7.5 Additional information

The Administrator should advise eligible employee creditors in writing, if practicable, of any additional matter that comes to the Administrator's attention after the dispatch of the statement that a reasonable person would consider to be material to the eligible employee creditors' decision.

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26 Expert opinions

A Member who gives expert evidence for the purposes of court proceedings must be aware of the obligations imposed by the law and by courts in relation to the giving of evidence and in particular the giving of expert evidence.

Those obligations include owing a paramount duty to the court, and to assist the court on matters relevant to the Member's area of expertise in an objective and unbiased manner.

A Member may give evidence in two separate capacities:

- As an expert witness retained on behalf of a party to litigation to give that evidence.
- As an Appointee who gives evidence about the Insolvent for the purposes of court proceedings.

In the first case, the Member is an expert witness retained on behalf of, and paid by, a party to litigation. The Member is not an Appointee. Court guidelines apply and must be observed by Members giving such evidence.

In the second case, a Member who is also an Appointee will often need to form an opinion about the solvency of the Insolvent, and its timing, for example for the purposes of pursuing a preference. If litigation is commenced, the Appointee may need to prepare and give evidence in court about that insolvency and related issues. This evidence will be based on the Appointee's expertise as an insolvency practitioner and on their knowledge of the Insolvent. Court guidelines apply, to the extent relevant, and must be observed by Members giving such evidence.

In that second situation, the Appointee is giving expert evidence in relation to the Insolvent to which they are appointed, and in relation to which the Appointee may have an interest. For example, successful recovery of a preference claim, based on the Appointee's expert opinion as to the insolvency of the company, may result in the Appointee securing monies from which Remuneration can be drawn.

The fact that the Appointee is related to the Insolvent and may have an interest in the outcome of the evidence given, does not necessarily affect the admissibility of the expert evidence given, although the court will assess the weight that it will give to such evidence in the context of the role of the Appointee. Nor does this alter the duties and obligations of an insolvency Appointee in giving objective evidence and providing full disclosure to the court about the extent to which the Appointee may obtain a financial benefit from the outcome of the case by way of payment of Remuneration.

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AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

A Platform for Recovery 2014

Dealing with Corporate Financial Distress in Australia: A Discussion Paper

Policy Development and Thought Leadership by the

Australian Restructuring Insolvency and Turnaround Association

October 2014

ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

Executive Summary

ARITA believes that the existing Australian insolvency and restructuring framework not only serves the Australian financial system and economy well, but that it also stands up strongly in comparison to other regimes across comparable global markets. Nonetheless, there are several key areas for improvement and these are identified as the following:

Issue:	Lack of a restructuring culture in Australia
Solution:	Safe Harbour
Issue:	Value destruction as a result of entering external administration
Solution:	Informal Restructuring
Issue:	No 'Chapter 11' style regime to aid in the rehabilitation of large enterprises in financial distress
Solution:	Reworked Schemes/Voluntary Administration
Issue:	Critical supplier contracts automatically terminated on appointment of an external administrator, inhibiting formal restructuring
Solution:	Extension of moratorium to ipso facto clauses
Issue:	Maximising the chance of continuing the operations of financially distressed but viable small companies
Solution:	Micro Restructuring
Issue:	Maximising the return to creditors where companies with minimal liabilities fail
Solution:	Streamlined Liquidation
Issue:	Enabling viable businesses to continue, and maximise return for creditors, via a sale of business negotiated prior to the appointment
Solution:	Pre-positioning

Please note that Annexure A provides for a comparison table of major comparable markets' formal restructuring mechanisms and ARITA's position on these mechanisms.

We Value Your Input

The goal of this discussion paper is to create informed debate, which will inform our final policy paper.

To that end we'd like to hear your thoughts, comments and feedback on the issues raised.

Please contribute to the debate on ARITA's online discussion forums at www.arita-forums.com.au.

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1 Introduction

It is part of the good operation of market economics that some businesses and individuals will enter into financial distress. Indeed, this process is vital in ensuring the efficient allocation of capital. However, there are also significant human and social elements to financial distress of which a responsible society takes ownership.

The Australian regime for dealing with corporate and personal insolvency seeks to find a balance between these elements and to cover for various market failures that are naturally found in a market economy. We, as a society, make decisions about the framework that best suits our view of the balance we seek. That view changes over time and as a result of the economic cycle itself.

Australia's corporate insolvency regime has evolved to have a bias towards protecting the rights, and capital, of creditors i.e. those who provide the funding to allow businesses to undertake their activities with some level of financial gearing. In other markets, the bias may be viewed as being more towards the sustaining of the corporate entity itself, at the cost of the creditors' interests.

Australia's last major review of our corporate insolvency regime came in 1993 following the highly respected Harmer Report[1]. Its recommendations continue to underpin our current regime, including the voluntary administration framework. As with any regime, it is important that it evolves and is improved over time, especially as markets themselves change and evolve. Indeed, it's important to note that the economy itself has evolved substantially since that time.

2 About *A Platform for Recovery*

A Platform for Recovery is a discussion paper. It isn't a final policy document, though that is its ultimate evolution. The goal of this document is to create active and informed discussion of the issues and concepts that are raised. This will inform ARITA's final policy position.

We invite you to contribute to the debate on ARITA's discussion forums or add your comments on our website.

Importantly, this paper does not go to the detail of specific legislative change. Rather, it identifies current issues or deficiencies in the current insolvency regime and proposes concepts, by way of law reform or best practice, to remedy these issues.

[1] Australian Law Reform Commission Report No 45: General Insolvency Inquiry 1988

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3 ARITA's past policy and thought leadership work

Over the last several years ARITA has actively and thoroughly responded to many of the government inquiries into different aspects of insolvency law and practice. Outcomes from these by way of actual legislative reform have been limited.

The most significant of these have been in relation to our:

2007 insolvent trading submission where ARITA [then IPA] recommended a financial judgment rule – a safe harbour – in order to ameliorate the potential liability of directors for insolvent trading

2010 joint submission with Turnaround Management Association (TMA) and Law Council to Treasury, again on the safe harbour proposals

2010 response to the Australian Securities and Investments Commission's (ASIC) insolvent trading guide

2010 recommendation to the Productivity Commission on insolvency alignment reform

2011 response to the government's options paper on insolvency reform

2012 our further response to the government proposals paper on insolvency reform

2013 submissions to the Senate inquiry into ASIC

2013 our responses to the Insolvency Law Reform Bill 2013, and our continued input into 2014

2014 our submissions to the Financial Systems Inquiry.

In deference to these government inquiries, ARITA has variously organised discussion groups, conference topics and ARITA journal articles to promote an informed debate. In addition, in that period, in our journal, forums and our local and international conferences we have raised and debated other issues including directors' liabilities, tax penalties on directors, creditors' rights and engagement, reform proposals for receiverships, and the need for a government role in liquidations.

In particular, ARITA has funded significant empirical research studies, under its Terry Taylor Scholarship, one into the personal costs to liquidators of administering nil return administrations ordered by the court; the other into the dividend returns from DOCAs. Also, more statistics are now available from ASIC, and the Australian Financial Security Authority (AFSA), which confirm the generally poor outcomes of insolvency administrations.

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4 Context

It is ARITA's view that the current regime has served Australia well. In particular, it has sustained economic value through a number of downturns and market shocks and major corporate failures. Importantly, during the GFC it should be noted that the Australian economy fared better than its competitors and that is reasonable to claim that our insolvency regime played a part in that – especially from credit provision and market confidence perspectives.

It's also notable that at times Australians tend to hold an idealised view of how other markets operate. We see the success but gloss over some of the failings. ARITA believes that we should carefully and scientifically analyse recovery and insolvency regimes elsewhere to see what may operate better than we have and learn from those approaches, however, a notion that we can simply transplant other systems here fails to acknowledge our own unique circumstances and ethos.

Informed by our past consideration of a wide spectrum of insolvency law reform issues, and by the experience and knowledge of ARITA and its members, we are now offering our view on reform of the Australian restructuring and insolvency regime.

ARITA's view is not whether change is needed, but that change and reform is needed, for the regime to improve its social and economic outcomes. We necessarily accept some of the current legal and practice structures in place in Australia and do not wish to suggest the impossible or impractical; for example, we are content to maintain the separate laws for personal and corporate insolvency.

At the same time, we do say that fundamental changes are needed, in particular in the need for greater emphasis on restructuring outcomes.

It has been put to ARITA in the past that 'evidence' is needed in order to consider reform of aspects of our insolvency laws. While we have gathered some evidence, it is also the case that much is not available, nor readily extracted, given the low levels of information about our insolvency regime. That the Financial Service Inquiry Interim Report had to rely on a 2000 Productivity Commission report on insolvency statistics is indicative of that. However, we ourselves are informed by the considerable experience and views of our members. Law reform can proceed on such an intuitive basis, backed by experience and informed input.

The Australian regime could currently be described as one with a strong bias towards preserving creditors' rights. Some other jurisdictions have more of a bias towards the preservation of the ongoing nature of organisations in financial distress. There are significant arguments around where the balance is appropriately set between these two approaches, and that that balance may alter dependent on where an economy's performance may be trending.

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5 Aims of insolvency law

We accept the fundamental principles of and aims of insolvency law are to[2]:

- provide an equal, fair and orderly procedure in handling the affairs of insolvent debtors to ensure that creditors receive an equal and equitable distribution of the debtor's assets - the pari passu (equal sharing) principle
- provide procedures and processes for dealing with an insolvency with as little delay and expense as possible
- ensure that administrations are conducted in an independent, competent and efficient manner
- provide mechanisms which allow for treatment of the affairs of insolvents before their position becomes hopeless
- provide procedures which enable both debtors and creditors to be involved in the resolution of the reality of insolvency
- ascertain the reasons for the insolvency and to provide mechanisms which allow for the examination of the conduct of insolvents, their associates and the officers of corporate insolvents, and
- ascertain whether any offences have been committed by insolvents or their associates with a view to those offences being prosecuted.

These last two go to support the maintenance of the integrity of the insolvency process and of 'commercial morality'.

The reality is however that many of those aims are not being met. We measure our own proposals by those principles and aims, and suggest that they are better met by our new structure, or at least, that our proposals are more worthy of consideration than any acceptance of the status quo.

We therefore positively encourage and invite responses not only from our members, but also accountants, lawyers and financiers, the regulators and from government.

6 ARITA's policy aims

ARITA proposes an alternative regime to address the financial decline and potential termination of businesses.

We have a number of purposes in mind in proposing this, guided by our series of principles as to how the regime should operate. The principles are based on the accepted aims of insolvency law as discussed above. The regime should:

[2] The list is adapted from the Harmer Report ([33]) and the Cork Report ([198]).

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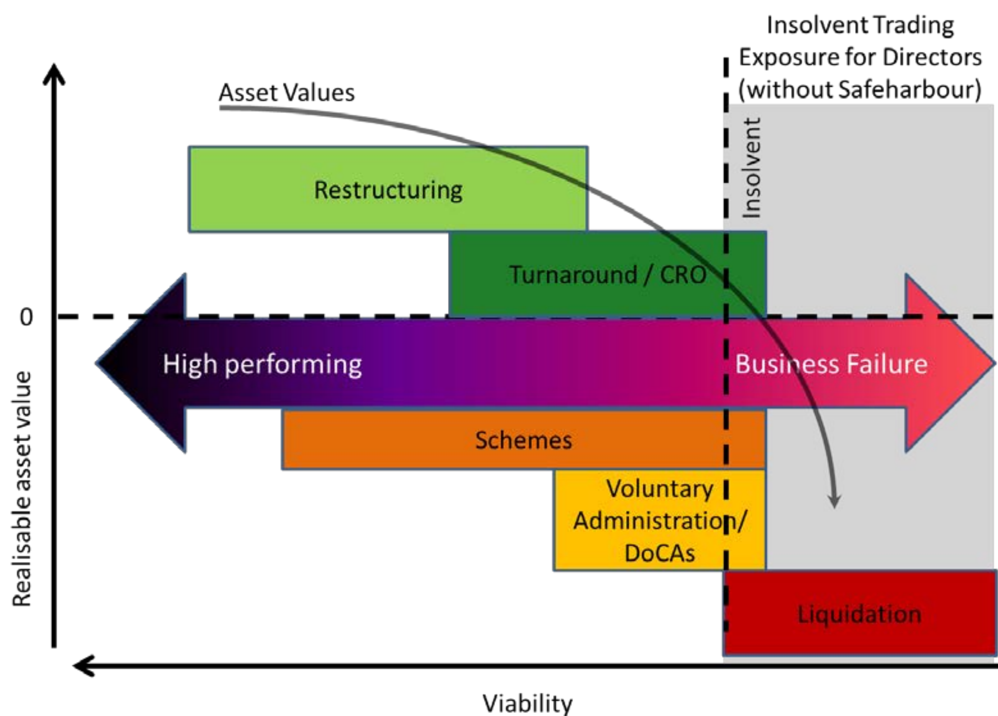
- support the maintenance of the viability of good businesses that have otherwise found themselves in or are heading towards financial distress, with the minimum requirements of these businesses being that they have good financial systems and controls, are tax compliant, are compliant with other regulatory obligations – corporate, WHS, environmental, product safety etc - and demonstrate good corporate governance
- recognise the value to the economy of sustaining continuous employment for employees involved in viable organisations facing financial distress
- recognise that, as a micro-economic principle, capital should be recycled from non-performing businesses to performing businesses and that some element of business failure is a necessary and appropriate mechanism in ensuring an efficient and productive economy
- encourage or allow the prevention of the terminal insolvency of a failing but potentially viable business
- encourage and allow directors and management and independent, qualified and experienced financial and insolvency advisers, to assist in the recovery a viable company from financial distress
- to that end, provide a safe harbour from potential later claims, subject to certain requirements
- otherwise support the preservation of a viable business as a going-concern, including to allow the business to continue to have the benefit of existing contracts and leases
- require the interests of existing and new creditors to be taken into account, but at the same time recognise their responsibilities to attend to their own interests
- do so at a cost in proportion to the value and potential of the business
- require and allow any resolution of the company's financial distress to be dealt with as quickly as possible, consistently with the interests of creditors and of the company
- provide for the prompt assessment and orderly disposal of a failed business recognising that there is a cost to delivering this service
- accept that the nature and size of company businesses is extremely variable – from one director micro businesses, through SME businesses, to large enterprises, with a management structure and a board of several independent directors
- have regard to international precedents in the UK, US, New Zealand, Canada and elsewhere, and our on-going assessment of them, and
- provide proper remuneration for its practitioners, and not require its practitioners to do work or incur expenses without recompense.

The distinction between high performing and distressed companies and the impact on asset values over the viability spectrum is depicted below.



Value v Viability Diagram

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7 The structure of 'a platform for recovery'

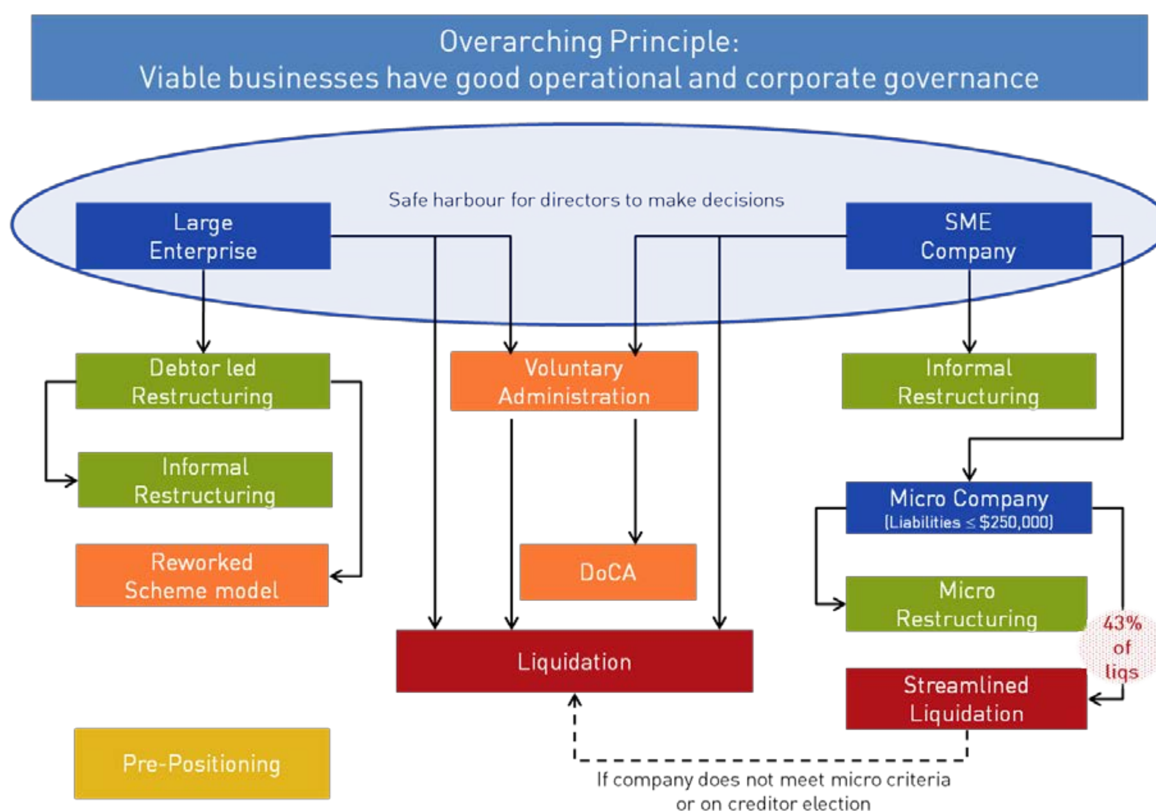
In preparing this paper we identified current issues, or deficiencies, in the current insolvency regime and proposed solutions to those issues. A foundation of our thinking is that the current 'one size fits all' approach to dealing with companies in financial distress is flawed. For example, such an approach does not take into account the scale of societal impacts of insolvencies in large enterprise collapses compared to small and nor does it take into account the differences in governance between large and small entities.

To that end, we conceive that there are three framework approaches required:

- Large Enterprises
- Small/Medium Enterprises (SMEs)
- Micro Companies (Liabilities less than $250,000).

Partnered by Chartered Accountants Australia and New Zealand and CPA Australia, ARITA is currently co-sponsoring empirical research being conducted by leading academics Jason Harris from UTS and Trish Keeper from Victoria University (NZ) on SME insolvency. This work is running concurrently with the consultation on this discussion paper and will be used to hone policy in this space at its completion.

The below overview provides a summary of the proposed reform concepts developed by ARITA based on the detailed three approaches above and the belief that size distinctions are required to better achieve the aims of Australian insolvency law.



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8 Restructuring and a safe harbour

Issue	• Lack of a restructuring culture in Australia
Solution	• Safe Harbour

Much of what we propose requires there to be some deregulation of any laws that may impede restructuring, in particular the laws that impose on directors, and potentially their advisers, liability for insolvent trading.

There has been significant debate about this in recent years, to which ARITA has contributed, by way of submissions and through encouraging member and community debate. We are keenly aware of the issues and the arguments on both sides. In particular we are aware of the need to balance the rights of existing and on-going creditors of the company, who may suffer through insolvent trading, against the opportunities for the business to be restructured and the consequential benefits that may bring, including to those creditors.

It is said, and it has been raised as recently at the Financial System Inquiry Interim Report[3], that the threat of liability for insolvent trading serves to cause some directors to seek the protection of the voluntary administration regime too readily, rather than allowing those directors to continue to make genuine efforts to reverse and resolve the company's distress. Whether there is 'evidence' of that is problematic, from our members' perspective. But we do nevertheless consider that the liability for insolvent trading does exist in the minds of many directors and their advisers, but this does depend on the size of the company and the nature of its directors.

In that respect, we are also aware of the fact that our insolvency regime pays little regard to the obvious differences between large and small enterprises, and their respective directors and the directors' motivations. That difference is particularly relevant when considering the duties of directors.

Large companies most often have professional directors with little personal involvement in the fate of the company, beyond their duties to it as directors. They may tend to be risk averse in what is often referred to as the insolvency twilight zone in order to preserve their professional reputation and minimise their personal liability. They may be more readily prompted to invoke a formal insolvency appointment in order to avoid any risk of liability for insolvent trading.

[3] The Financial System Inquiry 2014 (Murray) Interim Report, released 15 July 2014

In contrast, small companies most often have directors who are also owners and guarantors of the company's liabilities, and they do not necessarily have the same 'professional' reputation to preserve. Theirs is more a business and commercial focus. Accordingly, in the insolvency twilight zone, they have everything on the line and tend to be comparably large risk takers. The threat of insolvent trading and of breach of directors' duties is far less.

We have addressed this difference in what is a large and threshold issue in this debate. We do not suggest separate insolvent trading regimes. Rather we offer an amelioration of that regime, but only to those directors who can show a satisfactory level of good corporate and financial judgment in the conduct of the company's operations generally and in the lead up to its financial distress.

In the current debates, this is typically expressed in terms of the need for a business judgment rule.

Insolvent trading laws[4] are intended to make directors act to prevent a company from incurring a debt if the company is insolvent at the time the debt is incurred, or becomes insolvent as a result of incurring the debt. Directors who trade whilst the company is insolvent face civil liability for debts incurred, which can be substantial and criminal prosecution, which can result in imprisonment.

It is our view that these laws do not work as intended for the following reasons:

1. In the case of larger companies with directors that are independent of the owners of the company (or listed companies), directors are generally educated and informed of their obligations, duties and risk of personal liabilities. They are also concerned about their reputation of being associated with a 'failed' company. As such, when a company is in financial distress, they are more likely to want to take steps to appoint an administrator to end the potential of insolvent trading liability, rather than 'risk' an informal restructure even if the company could potentially be turned around. Thus the insolvent trading laws act as a deterrent to restructuring attempts, even when a restructuring may be in the best interests of the creditors and the company. In this situation, there is an inherent conflict for directors between protecting themselves from personal liability and acting in a way which is in the best interests of the company and creditors.

2. In the case of SMEs where the directors are also generally the owners of the company, the directors' personal financial affairs are usually inexorably related to the financial affairs of the company and once the company is in a state of financial distress, the directors may well be too. With nothing left to lose, but a lot to gain if the business is able to continue, the distant threat of liability for insolvent trading is not enough to prevent the directors from continuing the business until there is nothing left to continue with[5]. Thus arguably, the insolvent trading laws do not act as an effective deterrent to reckless trading, particularly in the SME sector.

[4] Primarily s 588G of the *Corporations Act 2001*

[5] ASIC statistics support this with 61.1% of companies in external administration having less than $10,000 in assets and 40.1% having less that $1 (Report 371 Insolvency Statistics: External Administrators' Reports for the period July 2012 to June 2013).

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3. It is inherently difficult for directors to assess the insolvency of their company in real time. Whilst under law a company is either solvent or insolvent, in reality a company can teeter on the edge of insolvency for some time and determining whether any business of even moderate size is insolvent is difficult unless it is clearly insolvent – even by an experienced insolvency practitioner.

4. Historically insolvent trading actions are difficult to prove and expensive to pursue. The reality that there are limited or no assets in a large number of administrations means that insolvent trading claims are unlikely to eventuate, particularly in SMEs where the claims are likely to be at the smaller end. Furthermore, asset protection strategies employed by directors and the fact that secured creditors and a number of trade creditors will hold personal guarantees from directors, means that often directors are unable to meet any compensation orders if an insolvent trading action is proved against them. We do recognise however that the threat of an insolvent trading action can result in out of court settlements in liquidations and payments under deeds of company arrangement to prevent further action being taken, resulting in benefits for the creditors.

It is clear that there is significant doubt as to whether the insolvent trading laws are achieving any of their objectives, but may instead be preventing directors from undertaking restructuring efforts in situations where that may be in the best interests of the company and creditors. It is ARITA's view a business judgement rule for insolvent trading (commonly referred to as a 'safe harbour) needs to be provided to facilitate directors being able to undertake restructuring efforts in appropriate circumstances.

The US regime does not include a concept of insolvent trading, while the concept above is an element of UK equivalent.

Much work has already been done on what the terms of such a safe harbour should be[6]. ARITA's views have not largely changed since our 2010 Joint Submission with the Law Council of Australia and the Turnaround Management Association. In summary, we support a business judgement rule with the following elements, that the directors7:

- make a business judgement in good faith for proper purpose
- after informing themselves about the subject matter of the judgement to the extent they reasonably believe to be appropriate
- rationally believe that the judgement was in the best interests of the corporation
- the director has taken all proper steps to ensure that the financial information of the company necessary for the provision of restructuring advice is accurate, or is ensuring that

[6] The Minister for Financial Services, Superannuation and Corporate Law released a discussion paper on 19 January 2010 titled *Insolvent Trading: A Safe Harbour for Reorganisation Attempts outside of External Administration*. ARITA (then the IPA) made a submission jointly with the Law Council of Australia and the Turnaround Management Association Australia dated 2 March 2010 and we also made a supplementary submission of our own dated 18 March 2010. Copies of our submissions are available from the ARITA website.

[7] Taken directly from the ARITA (then IPA), Law Council of Australia and the Turnaround Management Association Australia joint submission dated 2 March 2010 in response to the discussion paper *Insolvent Trading: A Safe Harbour for Reorganisation Attempts outside of External Administration*

all resources necessary in the circumstances to remedy any material deficiencies in that information are being diligently deployed

- the director was informed with restructuring advice from an appropriately experienced and qualified professional engaged or employed by the company, with access to all pertinent financial information, as to the feasibility of and means for ensuring that the company remains solvent, or that it is returned to a state of solvency within a reasonable period of time
- it was the director's business judgement that the interests of the company's body of creditors as a whole, as well as members, were best served by pursuing restructuring, and
- the director took all reasonable steps to ensure that the company diligently pursued the restructuring.

Our joint submission put forward five principal reasons why there should be a safe harbour defence to insolvent trading liability:

1. the existing law, without any safe harbour, can impede or prevent proper attempts at informal workouts
2. the adverse effect of the existing laws on honest, capable directors, particularly non-executive directors
3. the focus of directors of a financially troubled company should primarily be (as it is everywhere else in many other comparable jurisdictions) on the interests of creditors
4. the existing insolvent trading law limits the options available to deal with financial distress, and
5. a safe harbour defence would promote the critically important policy objective of obliging directors to obtain early restructuring advice.

We see these principal reasons as continuing to apply.

We note that directors should not be permitted to see the safe harbour provisions as a relaxation of their responsibilities. If anything, their responsibilities should be seen as being heightened during this period by the business judgement rule requiring positive and beneficial governance thresholds to be met before the rule can be used.

Consideration should also be given as to whether, in situations where the safe harbour protections are not met, the insolvent trading rules should actually be easier for a liquidator to prove in order to be able to obtain compensation for the affected creditors.

We are also strongly of the opinion that any strengthening of insolvency trading rules should also be supported by better regulation of directors. Consideration should be given to the implementation of a unique 'director identity number' (DIN) in order to more readily identify and monitor a director's involvement in companies. Presently there is no requirement to provide proof of identity when updating the corporate register maintained by ASIC of a director appointment. Safeguards, such as proof of identity requirements, could be put in place at the time of obtaining a DIN to mitigate the chance of inconsistent, misleading or false information being included on the corporate register.

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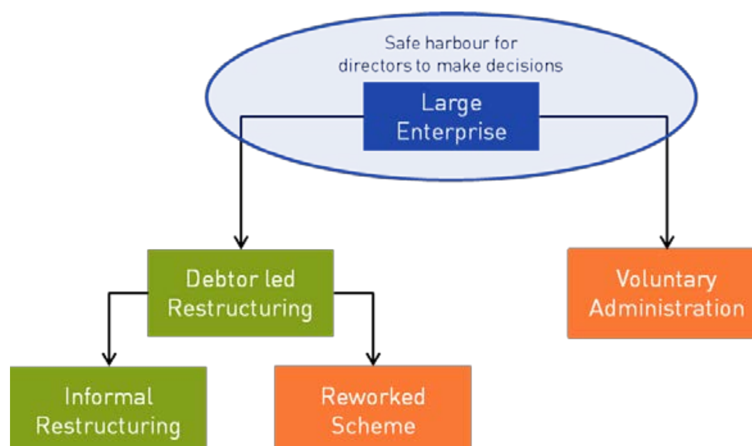
As we have noted above, there is a spectrum of skills of directors and there is a need to ensure that *all* directors adequately understand the duties and responsibilities of their position, and the good corporate and financial judgment requirements that underpin our safe harbour proposal. We recommend that the successful completion of a suitably structured 'new director' course be required as a pre-requisite to the issuing of a DIN. This could be offered by ASIC as an online course.

9 Large enterprise framework



9.1

Issue	• Value destruction as a result of entering external administration
Solution	• Informal Restructuring

As previously discussed in Section 8, the safe harbour proposals are intended to provide an environment whereby, in appropriate circumstances, companies and their directors can undertake informal restructuring initiatives without the threat of insolvent trading liabilities. It is reiterated that eligibility for safe harbour protection is dependent on meeting specific criteria.

Furthermore, the safe harbour protections will mean that appropriately qualified and experienced professionals can be engaged in roles such as a Chief Restructuring Officer (CRO) without the potential for insolvent trading liability as a shadow director. This would allow greater scope in a CRO role than is currently possible due to the risks imposed under current legislation.

The protection provided by safe harbour would also provide more time to explore informal restructuring options where the solvency of a company may be in doubt.

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9.2

Issue	• No "Chapter 11" style regime to aid in the rehabilitation of large enterprises in financial distress
Solution	• Reworked Schemes/Voluntary Administration

ARITA recommends that the following enhancements be made to the current Scheme of Arrangement provisions (and in some instances, to the Voluntary Administration/Deed of Company Arrangement provisions in Part 5.3A) to better foster restructuring in Australia via statutory insolvency administration:

- implementation of ARITA's safe harbour proposal to remove the current necessity for a precursor administration in Schemes of Arrangements
- specific provision for application to the court for a scheme to have a standalone moratorium, including a restriction on the exercising of ipso facto clauses
- extension of the voluntary administration moratorium to ipso facto clauses (refer section 9.3 below)
- ability to recover director related antecedent transactions in Schemes of Arrangement (and Deeds of Company Arrangement) to reduce their misuse by directors to protect their own interests.
  - Directors to have the ability to contract out of this liability with the Administrator in both Schemes and Deeds
- statutory provision for the obtaining of financing via a Scheme of Arrangement (or Voluntary Administration/Deed of Company Arrangement)
- removal of related party voting in a Scheme of Arrangement (and Voluntary Administration/Deed of Company Arrangement) and reduction of voting requirements to majority threshold in line with those in a Voluntary Administration/Deed of Company Arrangement, and
- voting using purchased debts to be limited to the value of consideration paid, consistent with the current requirements in the *Bankruptcy Act 1966*.

In addition to the above, ARITA believes that consideration should be given to the implementation of a 'Schemes Panel' to replace the Court's oversight of Schemes of Arrangement. It is envisaged that this panel would operate in a similar manner to the Takeovers Panel and be a government regulated peer review panel.

ARITA recommends that further work be done to recognise and promote Schemes of Arrangement as a viable and functional reorganisation mechanism for large enterprises in the

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Australian market. To achieve this, a general shift in the Australian environment from a focus on the return to creditors to the rehabilitation of businesses is required.

In considering the above concepts, ARITA reviewed and considered the following aspects of similar restructuring mechanisms in like economic markets (USA, UK and Canada):

- Main objectives
- Director liability
- Who is appointed/oversees the process
- Stay of proceedings, and
- Voidable transactions.

A detailed analysis of these considerations is provided in Annexure A.

In addition to the above, it is noted that consideration of the adoption of aspects of a US style 'Chapter 11' regime in Australia has been discussed in various forums over a number of years, including

- Senate Economics References Committee 'Inquiry into the Performance of the Australian Securities and Investments Commission' July 2014.
- Parliamentary Joint Committee on Corporations and Financial Services Corporate Insolvency Laws: a Stocktake August 2004.
- Corporations and Markets Advisory Committee 'Rehabilitating large and complex enterprises in financial difficulties Report' October 2004.

None of these reviews has recommended the implementation of a 'carbon copy' Chapter 11 regime in Australia. In 2004, the CAMAC Report into large enterprises found 'no compelling need, or intrinsic shortcoming in the VA procedure, which requires or justifies adopting Chapter 11 as an additional or substitute corporate recovery procedure for large and complex, or other, enterprises'[8]

Most recently the ASIC inquiry made this recommendation:

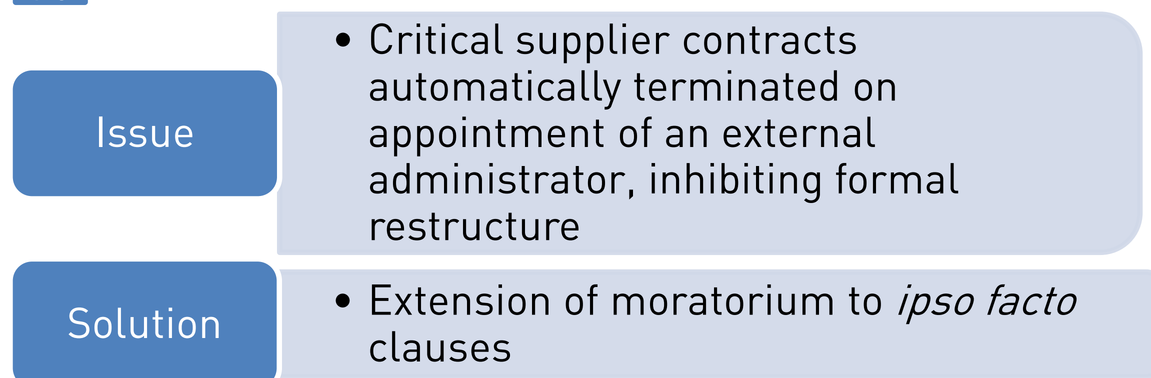
> Recommendation 61
>
> 27.52 The committee recommends that the government commission a review of Australia's corporate insolvency laws to consider amendments intended to encourage and facilitate corporate turnarounds. The review should consider features of the chapter 11 regime in place in the United States of America that could be adopted in Australia.

Given the extensive historical consideration of this matter, ARITA does not propose to revisit the question of the fulsome adoption of a Chapter 11 style regime. ARITA has given specific consideration of the current Australian Schemes of Arrangement process detailed in Part 5.1 of

[8] Corporations and Markets Advisory Committee *Rehabilitating large and complex enterprises in financial difficulties* October 2004

the *Corporations Act 2001* and aspects of Chapter 11, and other foreign restructuring mechanisms in developing our proposals.

9.3



An ipso facto contractual clause allows one party to terminate a contract by reason only of the fact (ipso facto) of the insolvency of the other party. These clauses are found in the majority critical supplier contracts, franchise and license agreements as well as leases for land and equipment. Ipso facto clauses have played a pivotal role in the shutdown of major organisations that were in financial distress (examples such as the carrier contracts of One.Tel being terminated soon after the company entered voluntary administration resulting in One.Tel being unable to provide services to its customers, are obvious). It is ARITA's view that voluntary administrations are not as successful in restructuring businesses as they could be due to the fact that the moratorium in a voluntary administration does not extend to ipso facto clauses.

Under s 301 of the *Bankruptcy Act 1966*, ipso facto clauses are rendered void if the relevant obligor becomes bankrupt. However, there is no such prohibition in relation to corporate insolvency, and more particularly voluntary administration, under the *Corporations Act 2001*.

As a result, if a financially distressed but viable business that is reliant on essential contracts continuing enters into voluntary administration, it is likely that:

- contracts will immediately be terminated
- there will no longer be any business to restructure, and
- there will no longer be any value for creditors.

In some cases, directors may in fact be reluctant to place their companies into voluntary administration because of concern that this may result in creditors exercising their right to terminate under an ipso facto clause and in effect terminate the company's business. This delay may weaken the company's chance of financial recovery.

The justification for such a moratorium being extended to cover ipso facto clauses is to ensure that important contracts of the business are maintained such that goodwill is preserved while the company is under administration. This serves to maximise the chances of the company and its business continuing as a going concern or otherwise maintaining its value to third parties. This is currently not the case in Australia and the experience of our members is that where the

business is reliant on maintenance of contracts, voluntary administration sees the swift demise of the business due to termination of these contracts.

The Harmer Report recommended that any contractual provision such as those discussed above be void against a liquidator or administrator[9]. The reasoning for the Report's recommendation was that there has been a similar provision in the *Bankruptcy Act 1966* (s 301) since 1968. The bankruptcy provision was recommended by the 1965 Clyne Committee on the basis that to permit such an agreement to be terminated merely because of insolvency may sometimes have the effect of depriving the trustee of a bankrupt person of an opportunity to deal with the property comprised in such an agreement to the advantage of the creditors[10]. The ALRC adopted that reasoning and considered that it should apply with equal force to a company and recommended legislation to bring this into effect[11]. It is ARITA's opinion that this position is still correct, including in the corporate insolvency context.

Voluntary administration provides a limited and temporary moratorium against ipso facto clauses in some types of contracts once a company enters voluntary administration. Section 440B restricts the rights of landlords, secured creditors, and others during the voluntary administration process, but not contracts generally. We see the need for a restriction on the right to exercise rights under all ipso facto clauses at least for the period of the administration, which is generally some few weeks, with court approval for any extension of that period generally required.

The law in favour of the validity of ipso facto clauses is inherently counterproductive and contrary to the spirit of the Part 5.3A regime. We consider that the law should apply in the same way to contracting parties, subject to court leave, and subject to distinctions as may be necessary between different types of contracts. In our view, in cases where such contracts are in issue, that would be a very significant improvement in the effectiveness of Part 5.3A.

The US has a prohibition against contractors terminating a supply contract when a company enters Chapter 11. This is one element of Chapter 11 that ARITA has consistently supported[12]. ARITA has long recommended the law in Australia adopt this US approach as one way of countering the reduction in value of a business on its entering insolvency.

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[9] ALRC 45, vol 2, s AT10. See also vol 1, paras 703 – 705.
[10] Clyne Committee Report, para 383.
[11] The recommended legislation was: Certain provisions in agreements to be void
AT10.
(1) Where a company is a party to an agreement (other than a charge) that contains a provision to the effect that, if the company commences to be wound up in insolvency or becomes a company under administration, then
  (a) the agreement is to terminate or may be terminated
  (b) the operation of the agreement is to be modified, or
  (c) property to which the agreement relates may be repossessed by a person other than the company,
the provision is void, unless the Court otherwise orders, as against the liquidator or administrator.
(2) This section extends to agreements made before the commencement of this section.
[12] ARITA's first submission regarding the need for a moratorium on ipso facto clauses was it submission (then as the IPAA) in April 2003 to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Australia's Insolvency Laws.

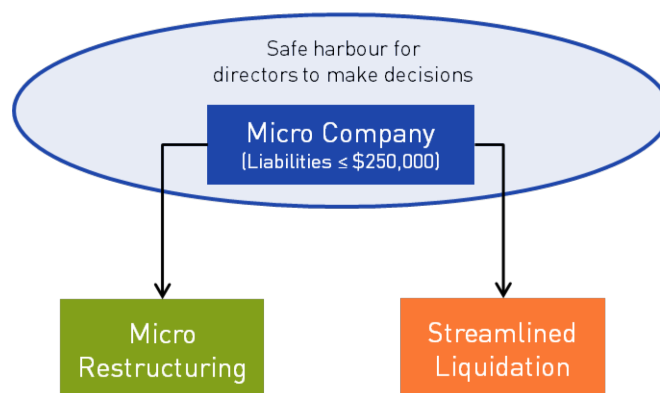
The UK is presently considering extending the avoidance of such clauses in telecommunications collapses[13], an area where our experience in Australia shows such a law is particularly needed.[14]

10 Small/medium enterprises, including micro companies

As mentioned earlier, ARITA has partnered with Chartered Accountants Australia and New Zealand and CPA Australia to co-sponsor empirical research on SME insolvency. This work is running concurrently with the consultation on this discussion paper and will be used to hone policy in this area at its completion.

Notwithstanding the specific SME considerations from the joint initiative, the ipso facto concepts detailed at section 9.3 above would equally apply to the SME market, although it is envisaged that this would more commonly be via a voluntary administration than a scheme of company arrangement due to the size of the enterprises.

The safe harbour concepts outlined in section 8 of this Discussion paper do not differentiate based on the size of an organisation and would also equally apply to SMEs and its subset of micro companies. We envisage that companies would engage advisers appropriate to their business size but we do not see this as a limiting factor for eligibility for the safe harbour protection.



Micro companies, as we have chosen to define them[15], form the vast majority of insolvencies in Australia. ASIC's statistics report that 43% of insolvencies have liabilities of less than $250,000 while some 40% of insolvencies are assetless[16] at the time of insolvency. In the case of assetless insolvencies, there are, by definition, no available funds to support the work of a liquidator and, in particular, to fund the investigations work of liquidators. The latter is of particular concern, with much anecdotal evidence that companies are often wound down to this point specifically to avoid investigations work. It is noted that ASIC operates an Assetless Administration Fund. However, practitioners are placed in the invidious position of needing to undertake unfunded work in order to access this, with little certainty of it being made available at the end of that work

[13] Continuity of supply of essential services to insolvent businesses, UK Government, Open Consultation, 8 July 2014, closing 8 October 2014.
[14] ARITA is working with the Communications Alliance in Australia to address this issue in the telecommunications sector.
[15] Less than $250,000 in liabilities to unrelated entities
[16] ASIC Report 371 *Insolvency Statistics: External Administrators' Reports* for the period July 2012 to June 2013

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ARITA has previously supported research that reported on the extent of unfunded work undertaken by insolvency practitioners and valued it at $48 million per annum[17]. This is obviously unsustainable for the profession.

In recent times, there has been significant political discourse around the need to provide a 'streamlined' process for SME insolvencies. Given the lack of funding available for SME insolvencies, ARITA concurs that a reduced process option should be made available in certain circumstances.

For companies where the micro criteria is not meet or creditors elect for a creditors voluntary liquidation with the current investigation requirements, there should be more ready access for practitioners to an enhanced Assetless Administration Fund-style arrangement.

This is driven home by recent ASIC statistics that show that of the 10,073 reports submitted by practitioners in the last year, 7,218 identified misconduct by directors alongside 43% of all insolvencies having estimated liabilities of $250,000 or less.[18]

10.1

Issue	• Maximising the chance of continuing the operations of fincially distressed but viable small companies
Solution	• Micro Restructuring

Section 185C of the *Bankruptcy Act 1966* provides a mechanism for individual debtors who meet specific eligibility criteria to enter a binding agreement with their creditors to accept a sum of money that the debtor can afford, more commonly referred to as a Part IX Debt Agreement.

We propose that a similar mechanism be implemented to deal with micro companies. It is envisaged that this process would be more streamlined and cost effective than the compromise alternatives that are available under the existing Voluntary Administration/Deed of Company Arrangement provisions of the *Corporations Act 2001*.

Eligibility criteria to undertake a micro restructuring agreement would include:

- must meet the definition requirements for a micro company
- company must be insolvent, and

[17] *An analysis of official liquidations in Australia*, Amanda Phillips (ARITA Terry Taylor Scholarship Recipient), February 2013

[18] ASIC Report 412 Insolvency Statistics: external administrators' reports (July 2013 to June 2014) September 2014

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- not available to companies who, or companies whose directors, have previously done a micro restructuring agreement. Such protection would be available under our Safe Harbour proposal detailed at section 8.

Although we do not propose to go into operational detail in this paper, we would recommend that any micro restructuring mechanism would require:

- The company to prepare a Report as to Affairs (RATA) to be provided with the proposal[19].A Registered Liquidator to oversee the development and implementation of the proposal, possibly referred to as a Restructuring Monitor:
  - who examines and approves the proposal[20]
  - issues the proposal to creditors, and
  - may set fixed or other fee basis for creditor consideration and approval at same time as proposal.
- Creditors vote to accept or to put the company into liquidation:
  - no need for physical meeting, with resolution able to be considered by circulation
  - if they vote for liquidation then the company proceeds to liquidation immediately
  - related parties cannot vote, and
  - if debt is purchased then purchase only entitled to vote for amount for which debt purchased.
- An accepted proposal would be put into effect by the Liquidator/Restructuring Monitor and would be subject to the following provisions:
  - no requirement to call or hold further meetings
  - if debts to unrelated entities exceed $250,000 then appointment would automatically convert to a Voluntary Administration with full investigation and reporting requirements (if directors wish to continue to put a Deed of Company Arrangement proposal to creditors), or creditors voluntary liquidation (if there is no Deed of Company Arrangement proposal)
  - streamlined proofs of debt process for debts under $10,000
  - no tax clearance from Australian Taxation Office required where dividend is less than $25,000 (10% of maximum liability amount) or 10 cents in the dollar, and
  - a default longer than 6 months automatically results in the company being placed into liquidation.
- Creditors may apply set aside the proposal if there is a lack of full disclosure in the proposal or injustice provisions, similar to the current requirements in a Part IX Debt Agreement.

[19] S185D of the *Bankruptcy Act 1966* requires that a Statement of Affairs (the personal insolvency equivalent of a RATA)be given with a debt agreement proposal
[20] For Part IX Debt Agreements this is currently done by debt agreement administrators are not registered trustees. We propose that debt agreements for companies be undertaken by registered liquidators.

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10.2

Issue	• Maximising the return to creditors where companies with minimal liabilties fail
Solution	• Streamlined Liquidation

The current requirements of Australia's liquidation processes impose a number of statutory reporting and process obligations on liquidators, which have the effect of increasing the costs of the liquidation and reducing, or eliminating, the return to creditors

We propose that, where a company meets the micro company criteria (i.e. liabilities to unrelated entities less than $250,000) the new streamlined liquidation process automatically apply.

A new streamlined liquidation process would differ from the current liquidation requirement as follows:

- removal of requirement to call meetings, report to creditors, undertake investigations into the company and officers' conduct and complete statutory reporting (e.g. s 533 report)
- expedited dividend process[21]:
  - Streamlined proofs of debt dealing process for debts under $10,000
  - No tax clearance required from the Australian Taxation Office where the dividend is less than $25,000 (10% of maximum liability amount) or 10 cents in the dollar, and
  - Streamlined advertising and notice requirements for dividends less than $25,000 (10% of maximum liability amount) or 10 cents in the dollar, and
- fixed fee set by government for this type of liquidation, no remuneration accounting or approval.

In order to protect the rights of creditors and the integrity of the regime, the streamlined liquidation process would incorporate provisions whereby:

- the liquidator would report to creditors on appointment and gives them the option of converting the streamlined liquidation into a full creditors' voluntary liquidation (i.e. where normal investigating and reporting obligations apply and remuneration of liquidator is given priority in the normal way)[22]

[21] Note that ASIC statistics show that of the 43% of liquidations with less than $250,000 of debt, 97% receive 0-11 cents in the $ dividend which should mean that the majority of these liquidations will fit within the streamlined process

[22] Section 545 of the *Corporation Act 2001* which provides that a liquidator does not have to undertake work if there is insufficient funds, would also apply

- if a majority of creditors (excluding related party creditors) vote for this to occur then it converts and the Liquidator does not have the power to convert to a full liquidation without this consent
- if the liquidator subsequently becomes aware of a matter which may warrant investigation, they can again seek creditor directions (including resolution by circulation, if appropriate) as to whether the liquidation should convert to a full liquidation, and
- if liabilities at any time in the process exceed $250,000 to unrelated entities the streamlined liquidation process would no longer be available and the existing creditors' voluntary liquidation requirements would apply.

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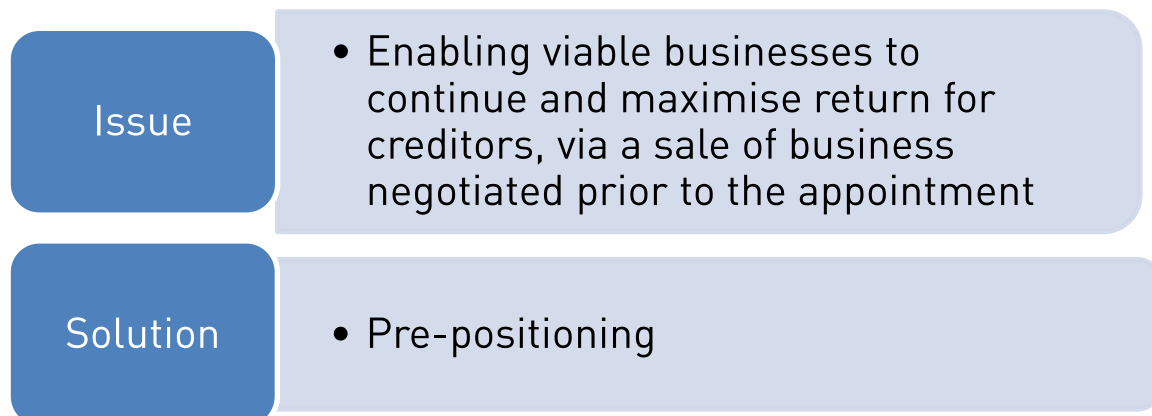
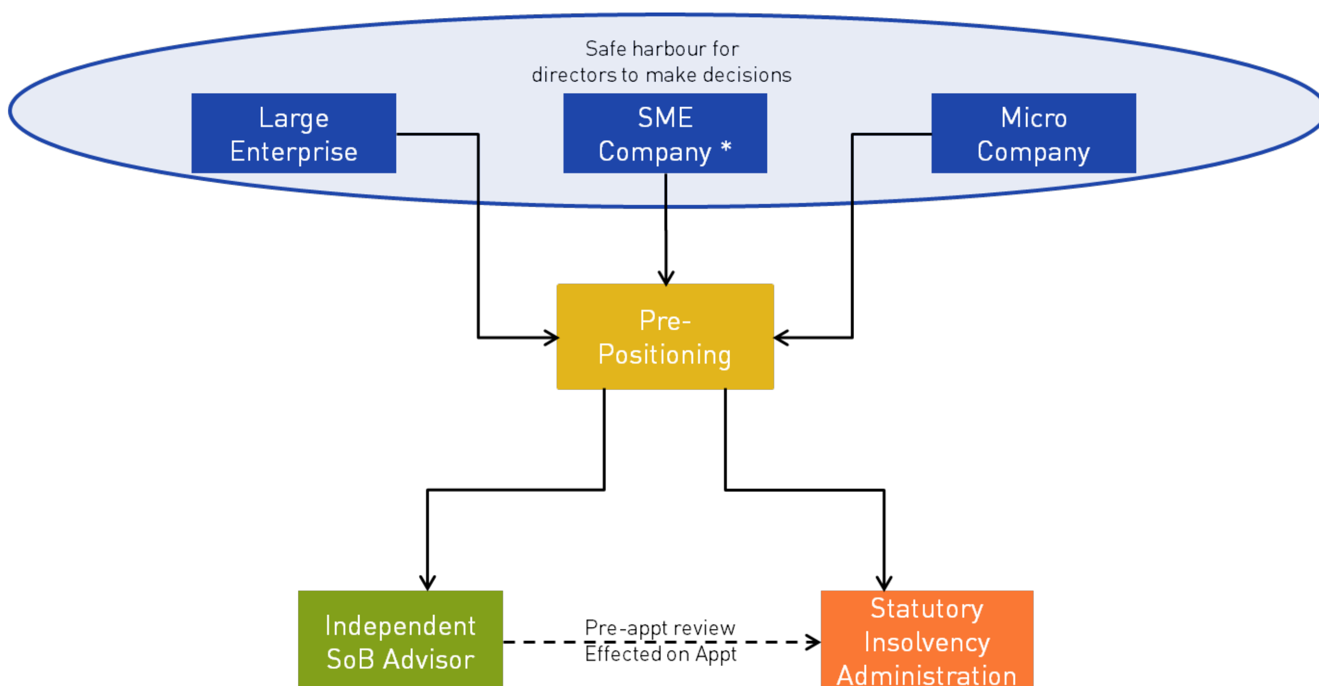
11 Pre-positioned sales





As a general position, ARITA supports the restructuring and turnaround of viable businesses suffering financial distress. A key aspect of this is an economic and legal environment that supports business restructuring and turnaround. ARITA's safe harbour proposals are a fundamental part of developing that environment.

There has been some call to 'legalise' or promote UK style pre-packs within Australia as another restructuring / turnaround tool in the toolkit of the restructuring specialist.

As part of our consideration of what should be done to promote restructuring and turnaround in Australia, ARITA has given detailed consideration to whether a pre-pack style arrangement should be introduced into Australia.

For a number of reasons, including independence, whether the sale is for value and the lack of creditor involvement, which are discussed in more detail at Appendix B, we do not consider that a UK pre-pack process would be suitable for Australia. However, we see that there is a role for 'pre-positioning' in the Australian insolvency context. What do we mean by pre-positioning? Pre-positioning is work done prior to a statutory insolvency appointment, with directors taking advantage of the safe harbour protections, subject to meeting the criteria for eligibility, to undertake an orderly wind down of the company's operations – that is a well-managed process where assets may be realised for market value in a non-distressed sale – prior to making a formal insolvency appointment. Directors may obtain the assistance of advisors, including insolvency practitioners, during this process.

The main differences between the UK's pre-packs and ARITA's proposed pre-positioning are:

- Any advisor retained by the directors in the pre-positioning phase cannot subsequently be appointed in any formal insolvency administration. This is consistent with the current and appropriate, independence requirements for insolvency practitioners in Australia.
- Any sales that occur in the pre-positioning phase must be for value and would be subject to review in any subsequent statutory insolvency administration.
- Any sale of assets undertaken during the statutory insolvency administration, where the terms of sale were negotiated in the pre-positioning phase, would be subject to review by the external administrator prior to being effectuated and the external administrator would be subject to the currently existing statutory and professional requirements regarding the sale of assets.

It is ARITA's view that consideration should be given to restricting the sale of company assets/business to related entities during this pre-positioning phase. Rather where the sale of a business or the assets to a related entity is contemplated, and the company is insolvent, that sale must be undertaken under the control of an independent insolvency practitioner through a statutory insolvency regime – either a VA (subject to ARITA's recommendations for improvements), a Micro restructuring (refer to section 10.1 above) or liquidation.

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Annexure A - Restructuring Mechanisms – Overview

	Chapter 11 (USA)	CCAA (Canada)	CVA (UK)	Scheme of Arrangement (UK)	Scheme of Arrangement (Aus)	Voluntary Administration/ Deed of Company Arrangement (Aus)	ARITA Position/ Recommendation
Main objectives	A reorganization plan proposed by a debtor to keep its business alive and pay creditors over time	A regime whereby the principals of a company (owing its creditors in excess of $5 million) and its creditors are brought together under the supervision of the court to attempt a reorganization or compromise or arrangement under which the company could continue in business	A procedure that allows a company: • To settle debts by paying only a proportion of the amount that it owes to creditors. • To come to an arrangement with its creditors over the payment of its debts.	Binding, court-approved agreements that allow the reorganisation of the rights and liabilities of members and creditors of a company	Binding, court-approved agreements that allow the reorganisation of the rights and liabilities of members and creditors of a company	Provide a mechanism to maximise the chances of a business continuing in existence or at the very least, provide a better return to creditors	Generally the main objectives of the different mechanisms are substantially similar. However it should be noted the USA and Canadian models reflect the prioritisation business rehabilitation over the ultimate return to creditors, which remains a key focus in Australia. Promotion of Schemes as a viable and functional reorganisation tool, requiring a shift in the current focus.

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	Chapter 11 (USA)	CCAA (Canada)	CVA (UK)	Scheme of Arrangement (UK)	Scheme of Arrangement (Aus)	Voluntary Administration/ Deed of Company Arrangement (Aus)	ARITA Position/ Recommendation
Director liability	No exposure to insolvent trading offences	Initial stay orders can be sought indemnifying directors so that those who are important to the restructuring will stay during the restructuring period	Offences for trading while insolvent – duty/responsibility to prioritise the interests of creditors		Offences for trading while insolvent	Offences for trading while insolvent	Early intervention would increase the likelihood of return to creditors – safe harbour provisions required where company acts in good faith to reorganise and meets criteria. Current necessity for precursor administration. Safe harbour provisions necessary to make Schemes a more useful restructuring tool for large enterprise

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	Chapter 11 (USA)	CCAA (Canada)	CVA (UK)	Scheme of Arrangement (UK)	Scheme of Arrangement (Aus)	Voluntary Administration/ Deed of Company Arrangement (Aus)	ARITA Position/ Recommendation
Who is appointed/ oversees the process	Debtor in possession appointment - overseen by Bankruptcy Court Lawyers & other professionals (Insolvency Professionals) engaged, usually separate set of lawyers/IPs per stakeholder group: • Debtor company • Secured creditor(s) • Creditor committee • Employees	Debtor in possession appointment - overseen by monitor	Directors remain in control but supervised by nominee (IP)		Optional to appoint a Scheme Administrator, but if one is appointed they must be a Registered Liquidator or a person approved by the Court, i.e. CRO, (cannot be a director/manager/s nr manager/employee) Debtor led administration - Scheme Administrator oversees scheme and does not run the business	Registered Liquidator – known as Voluntary Administrator /Deed Administrator	

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	Chapter 11 (USA)	CCAA (Canada)	CVA (UK)	Scheme of Arrangement (UK)	Scheme of Arrangement (Aus)	Voluntary Administration/ Deed of Company Arrangement (Aus)	ARITA Position/ Recommendation
Stay of proceedings	As prescribed by law	Within the court's discretion Expressly prohibits enforcement of ipso facto clauses	If requested by the directors to the court	No moratorium but Scheme doesn't commence until approved by the Court after the meeting of creditors. This means that the Scheme needs to operate within the protection of another insolvency process to be used to restructure an insolvent company (due to insolvent trading laws).	Currently no moratorium but Scheme doesn't commence until approved by the Court after the meeting of creditors. This means that the Scheme needs to operate within the protection of another insolvency process to be used to restructure an insolvent company (due to insolvent trading laws).	As prescribed by law but does not extend to ipso facto clauses	Ipso facto clauses can have a detrimental impact on the ability of a business to continue (e.g. telecommunication businesses). The extension of the VA moratorium to ipso facto clauses would help preserve business viability. Application to the Court for Scheme to have standalone moratorium (incl. restriction on termination of contracts) so that undertaken outside of a VA/Liq process, but still have protection from creditor recovery action and preserve value

	Chapter 11 (USA)	CCAA (Canada)	CVA (UK)	Scheme of Arrangement (UK)	Scheme of Arrangement (Aus)	Voluntary Administration/ Deed of Company Arrangement (Aus)	ARITA Position/ Recommendation
Voidable Transactions	Unfair preferences: • Undo a transfer of money or property within 90 days before filing petition (subject to defences) • Transfers to relatives, general partners, directors/officers within 1 year before filing	Preferential transactions and transactions at undervalue recoverable	Not available	Not available	Not available	Not available	Extend director related payment recoveries to Schemes and VA/DOCAs– reduces misuse by directors to protect their own interests, but can be contracted out of
Financing	Debtor-in-possession allowed	Debtor-in-possession allowed	Not available		Subject to approval of the Court	Has been considered and approved by the Courts but no specific statutory provisions	We accept that cases have allowed third party financing in a VA/DOCA, but we believe there should be a recognised process for prioritising funding to enable a restructure via a Scheme or VA/DOCA.

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Annexure B

What are 'pre-packs'?

A pre-pack administration occurs when an administrator sells the business at or soon after his or her appointment, often to the existing owners/directors. All the preparatory work for the sale is carried out in advance of formal administration and before the creditors have been told about the failure of the business.

UK Experience

The Graham Report into pre-packs has recently been released in the UK. This is timely to our consideration of pre-packs for Australia. The information in the Graham Report has been utilised when developing this paper.

In the UK pre-packs are undertaken through the Administration process, whereby an administrator can be appointed by the company, the directors or by the holder of a qualifying floating charge out of court. Immediately after appointment, the administrator transfers the business for a pre-agreed price without the need for a creditors' meeting to be called to consider the terms of the deal. The administrator then distributes the proceeds of sale. If there is no money for unsecured creditors, the administrator can immediately file for the dissolution of the company. If there are funds for the unsecured creditors, the administrator will usually be appointed as liquidator to make the distribution to unsecured creditors and then dissolve the company. In either situation, there is no independent insolvency practitioner undertaking a review of the steps taken.

Differences between the Australian and UK markets

A very different insolvency approach exists in the UK and Australia, where in the UK, in an Administration, if a creditor is 'out of the money[23]' they are essentially precluded from any decision making about the assets. In Australia, under current government policy, creditors (even those unlikely to receive any dividend) are entitled to be involved in the insolvency process and have a voice. Certainly the proposed Insolvency Law Reform Bill from 2013 proposes to further increase the role and powers of unsecured creditors in insolvency processes. ARITA has questioned whether this is a position that we should seek to lobby to change to align Australia with the approach taken in the UK. However, the view that we have taken is that it is appropriate for creditors to have a role in insolvencies as it is their money that has been lost and effectively the assets of the company are held for their benefit once the company is insolvent. Whether creditors wish to exercise that right and participate in the process is up to them; however it is important that they have that right.

Unlike Australia, the UK no longer has a receivership mechanism. Often pre-packs undertaken through an Administration are effectively quasi receiverships in that the only creditors receiving a payment are secured creditors as the remaining creditors are out of the money. Therefore it is largely the secured creditors driving the decision making during the pre-

[23] The creditor is not going to receive a dividend – the debt is worthless. Where the administrator believes that no payment will be made to the unsecured creditors, there is no requirement for a meeting of creditors to be held at all in the administration.

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pack. ARITA does not propose the abolition of receiverships in Australia at this time, therefore Receiverships work as a viable formal insolvency appointment for secured creditors. Alternatively, in the proposed safe harbour environment[24], secured creditors would be able to work with their clients to restructure or turnaround the business (which may involve a sale of the business for value) in a safe environment.

Independence of insolvency practitioners appointed in a formal insolvency in Australia has a test of real and reasonably perceived independence which is incompatible with the UK system of practitioner involvement in the sale process prior to appointment. Whilst the UK also has independence requirements, it is a system of threat identification and management which allows for practitioner pre-appointment involvement in the pre-pack process.

Key risks with UK pre-packs

- Lack of independence of the practitioner involved – usually it is the same practitioner advising pre-appointment and appointed in the subsequent formal insolvency.
- Lack of transparency in the pre-pack process and guidance such as SIP16 does not seem to resolve creditor concerns in respect of this issue.
- Valuations are of dubious value to the process with sales made at the same $ as valuation particularly when sales are to related parties, and valuations often being only of real assets and not taking into account intangibles such as value of the business name, goodwill, intellectual property.
- Sale for undervalue as the business may not be appropriately marketed.
- Sale to a related party, often with deferred consideration – resulting in relatively high failure rate of the 'newco' (92 out of 310 connected sales in the UK study had failed within 36 months – 30%; increasing the 37% failure rate if there was also deferred consideration).
- The UK experience indicates that in 60% of pre-packs there was no distribution to unsecured creditors, so therefore in the majority of pre-packs there is no benefit of the process to unsecured creditors.
- Potential insolvent trading while the 'pre-pack' is being put together, though this is not as great a risk as if it were under the current Australian insolvent trading regime.

Key reported benefits

- Protects value of the business.
- Saves jobs.
- Pre-packs are cheaper than a formal insolvency process where the sale is undertaken.

Some comments on the UK Pre-packs report

- Pre-packs represent only 3.5% of insolvencies in the UK.
- Approximately 65% of all pre-packs resulted in sales to related parties.

[24] Subject to the company meeting the criteria to take advantage of the safe harbour protections.

- 60% of all pre-packs result in no dividend to unsecured creditors (though there may have been a payment to secured creditors).
- 86% of pre-packs with a sale to related parties result in no dividend to unsecured creditors (though there may have been a payment to secured creditors) – so essentially pre-pack sales to related parties return no value to unsecured creditors.
- 25.5% of all pre-pack sold businesses fail within 36 months of the purchase.
- Where it is a related party sale, this increases to 30% failure with 36 months (17.5% of business pre-pack sold to unrelated parties fail).
- Where there is a related party sale and deferred consideration the failure rate within 36 months increases to 37%.
- Deferred consideration generally results in higher failure rate with 36 months (nearly 39% failure).
- Of the 121 purchasers that failed within 36 months, 1/3 entered into a rescue procedure.

Alternatives in the Australian environment

1. Sale before formal insolvency – if the sale is 'for value' to a related party or via an arms-length sale during the pre-positioning phase, it will not result in the sale being challenged or recovery action by a subsequently appointed insolvency practitioner. It will however, provide opportunity for an independent review of the transaction with the benefit of creditors in mind. Practitioner appointed must be different to any practitioner advising the directors/company regarding the pre-appointment transaction to ensure independence in the review of the transaction.

   An issue with this approach is potential director liability for insolvent trading during the period of marketing and attempting to sell the business. ARITA's safe harbour proposal will resolve this issue for directors that meet the criteria to take advantage of the safe harbour protections. If the safe harbour proposals are introduced, it is difficult to argue that this will not provide sufficient protection for directors to allow them to achieve a sale. The safe harbour proposals provide protection for directors that are able to make informed decisions based on proper financial records and are getting appropriate professional advice. Should a business that cannot meet the basic requirements of proper financial records be able to be moved into another corporate entity, particularly where it is being controlled by the same parties?

   There may be an argument to say that related party sale (or restructure) should have to be undertaken through an appropriate formal insolvency process – see 2 below. Note that the UK has proposed legislation to ban related party pre-packs if the Graham report recommendation of the creation of a pre-pack pool to review related party sales is not implemented.

2. Formal insolvency administration – either VA (subject to ARITA's recommendations for improvements) or a Micro debt agreement (refer ARITA's SME thought leadership paper). If a sale to an entity controlled by the same parties is contemplated, then this can be achieved via the current VA regime or via the proposed new micro enterprise debt agreement regime. One argument is that where it is intended that related parties/the

company wants an opportunity for an insolvent business 'to have another go' it is appropriate that it is the creditors who should make the decision as to whether this is acceptable. When a company is insolvent, it is, in reality, the creditors' assets that are being dealt with and it should be their decision as to what happens with them.

Can the Australian options have the same benefits without the risks of the UK pre-pack system?

Benefit	Does the Australian pre-positioning alternative have the same benefits?
• Protects value of the business	Yes • Sale can occur pre-appointment as long as it is for value. • Safe harbour protections for informal restructuring/sale of business. • Improved VA process and new Micro Debt Agreement proposal.
• Saves jobs	• Business sales or restructures are able to be achieved with outside or within formal insolvency regime – saving jobs wherever there is a viable business to be saved.
• Pre-packs are cheaper than a formal insolvency process where the sale is undertaken	• Sale of business not limited to being undertaken via a formal insolvency. Where for value not subject to challenge. • Safe harbour proposals support directors where criteria met to support informal restricting/sale of viable businesses.

Risk	Does the Australian pre-positioning alternative address the risk?
• Lack of independence of the practitioner involved – usually it is the same practitioner advising pre-appointment and appointed in the subsequent formal insolvency.	• Independence of practitioner maintained as not involved in any pre-appointment sale or negotiation.
• Lack of transparency in the pre-pack process and guidance such as SIP16 does not seem to resolve creditor concerns in respect of this issue	• Independent practitioner will be reviewing any pre-appointment sales, or • creditors will have a right to have a say in any sales/restructuring occurring through a formal insolvency process.

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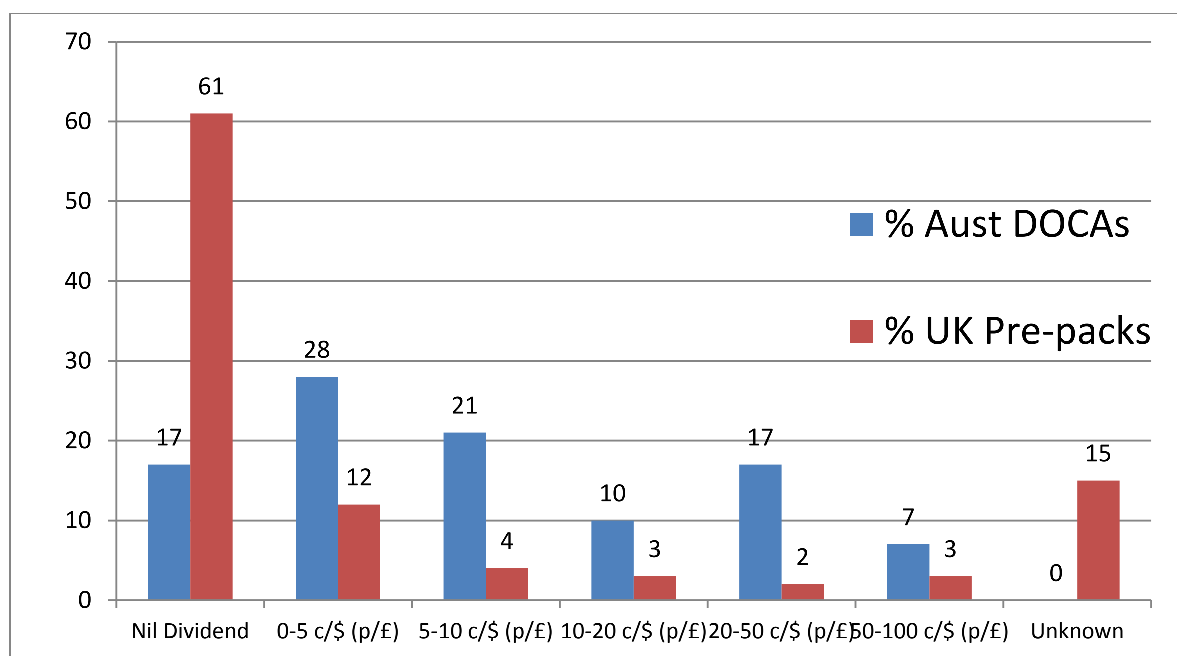
Risk	Does the Australian pre-positioning alternative address the risk?
• Valuations are of dubious value to the process with sales made at the same $ as valuation particularly when sales are to related parties, and valuations often being only of real assets and not taking into account intangibles such as value of the business name, goodwill, intellectual property	• Independence of the insolvency practitioner undertaking the sale process (must comply with common law obligations), or • independent practitioner reviewing the sale that was undertaken prior to appointment – will have power to overturn sale if not for value.
• Sale for undervalue as the business may not be appropriately marketed	• Independence of the insolvency practitioner undertaking the sale process (must comply with common law obligations), or • independent practitioner reviewing the sale that was undertaken prior to appointment – will have power to overturn sale if not for value.
• Sale to a related party, often with deferred consideration – resulting in relatively high failure rate of the 'newco' (92 out of 310 connected sales in the UK study had failed within 36 months – 30%; increasing the 37% failure rate if there was also deferred consideration)	• Independence of the insolvency practitioner undertaking the sale process (must comply with common law obligations) and will assess the virtue of the offer. Creditors will also have a chance to be involved in the process, or • independent practitioner reviewing the sale that was undertaken prior to appointment.
• The UK experience indicates that in 60% of pre-packs there was no distribution to unsecured creditors, so therefore in the majority of pre-packs there is no benefit of the process to unsecured creditors	• The role of creditors in Australia means that a DOCA proposal is unlikely to be accepted if creditors don't get offered some type of return (refer to comparison table below). • Independent practitioner reviewing the sale that was undertaken prior to appointment – will have power to overturn sale if not for value.
• Potential insolvent trading while the 'pre-pack' is being put together, though this is not as great a risk as if it were under the current Australian insolvent trading regime	• Safe harbour proposals will resolve this issue for directors that can meet the criteria.

Compare returns in Australian DOCAs vs. UK Pre-packs

The Australian voluntary administration/deed regime is criticised for providing low returns to creditors. Mark Wellard has recently undertaken research for ARITA under the Terry Taylor Scholarship on returns from DOCAs in Australia. The results of this research were released around the same time as the Graham Report into Pre-packs. Subsequent to the release of his

findings, Mr Wellard has prepared an addendum which compares the returns in pre-packs with the returns in DOCAs. The findings are as follows:



It should be noted that the returns in Administrations in the UK not involving a pre-pack sale are similar to that for pre-packs[25].

Mr Wellard made the following observations in his addendum:

Australian DOCAs and UK pre-packs cannot purely be compared on a 'like-with-like' basis due to inevitable differences in the features and nuances of the respective regimes and legal frameworks operating in each jurisdiction. For example, I understand that significant or 'substantial' secured creditors (charge holders) are more prevalent stakeholders in UK pre-packaged administrations due to the inability of a UK secured creditor to appoint an 'administrative receiver' (the UK equivalent to Australia's 'receiver and manager'). In Australia, secured creditors invariably 'stand outside' a DOCA (indeed, in the cases of Australian SME companies it appears that often there is no substantial charge holder involved at all).

Notwithstanding the imperfections of jurisdictional comparisons, it does appear that Australian DOCAs perform relatively well for unsecured creditors in comparison with the UK 'pre-pack' procedure.

This demonstrates that although the regime in Australia could be improved to better facilitate the restructuring and turnaround of viable businesses, it may not be as unsuccessful as first thought.

[25] The Wolverhampton report concludes section B2.5 by stating that '[t]he data available does not show a substantial difference between the levels of distributions to unsecured creditors, as a proportion of overall debts, made in either pre-pack or trading administrations.'

Policy Positions

of the

Australian Restructuring Insolvency and Turnaround Association

as at February 2015

ARITA

Policy 15-01: ARITA law reform objectives (corporate)

We believe that the Australian corporate restructuring, insolvency and turnaround regime should:

- support the preservation of viable organisations that have otherwise found themselves in, or heading towards, financial distress, provided they:
  - have good financial systems and controls
  - are tax compliant
  - are compliant with other regulatory obligations (e.g. corporate, WHS, environmental, product safety, etc.), and
  - demonstrate good corporate governance
- recognise the value to the economy of sustaining continuous employment for employees involved in viable organisations facing financial distress
- recognise as a micro-economic principle that capital should be recycled from non-performing businesses to performing businesses and that some element of business failure is a necessary and appropriate mechanism in ensuring an efficient and productive economy
- encourage directors, management, and independent and qualified financial and insolvency advisers to assist organisations operating viable businesses to recover from financial distress and provide a restructuring moratorium (safe harbour) from potential later claims, subject to certain requirements
- otherwise support the preservation of a viable business as a going-concern, including to allow the business to continue to have the benefit of existing contracts and leases
- require the interests of existing and new creditors to be taken into account, but at the same time recognise their responsibilities to attend to their own interests and to do so at a cost in proportion to the value and potential of the business
- allow the resolution of a company's financial distress to be dealt with as quickly as possible, consistently with the interests of creditors and of the company
- provide for the prompt assessment and orderly disposal of a failed business, recognising that there is a cost to delivering this service

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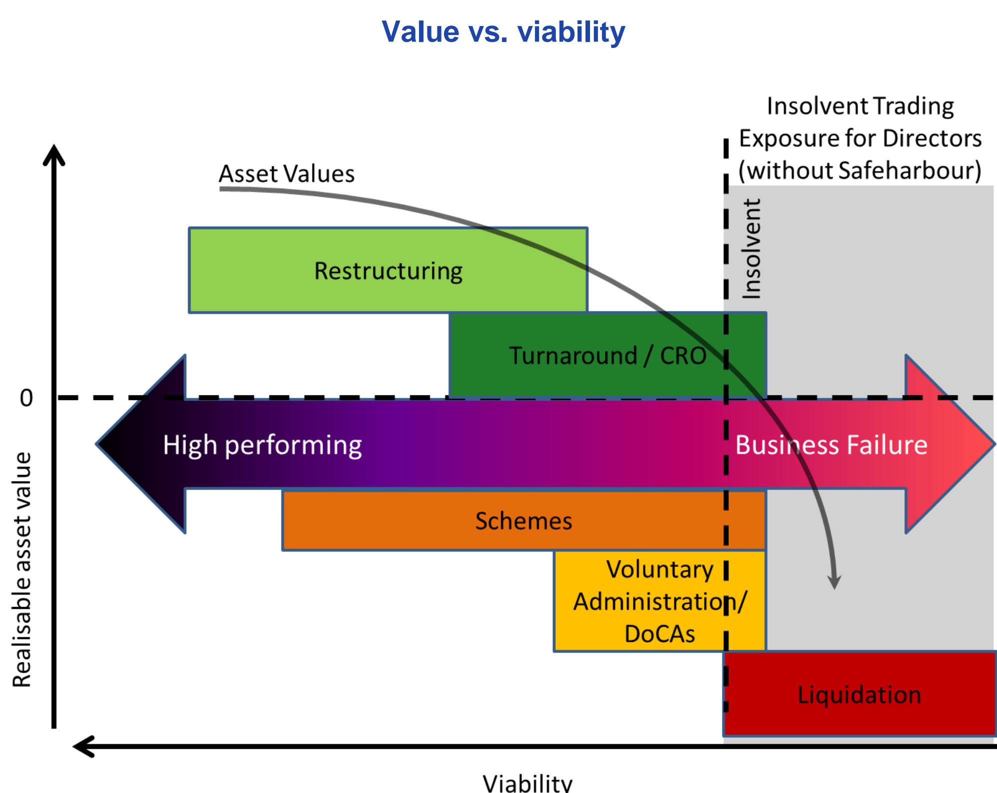
- acknowledge that different sized companies may require different approaches to dealing with financial distress
- have regard to international precedents and best practice in the UK, US, New Zealand, Canada and elsewhere, and
- provide proper remuneration for its practitioners, and not require them to do work or incur expenses in assetless administrations without recompense.

Explanatory notes:

The distinction between high performing and distressed companies and the impact on asset values over the viability spectrum is depicted below.

Value vs. viability



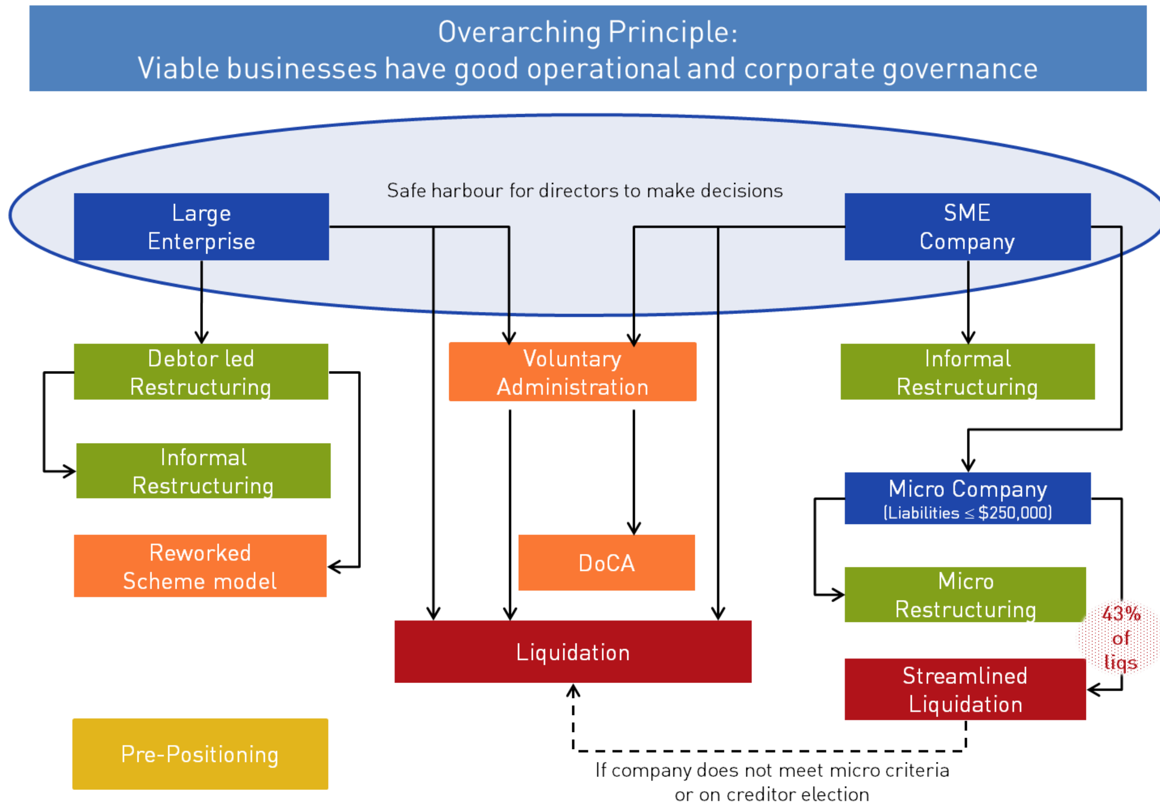
A foundation of our thinking is that a "one size fits all" approach to dealing with companies in financial distress is flawed. For example, such an approach does not take into account the scale of societal impacts of insolvencies in large enterprise collapses compared to small. Nor does it take into account the differences in governance between large and small entities.

To that end, we conceive that there are three framework approaches required:

- large enterprises
- small-to-medium enterprises (SMEs)
- micro companies (provable liabilities less than $250,000).

The following flowchart provides a summary of the proposed reform concepts developed by ARITA based on the three approaches detailed above and the belief that size distinctions are required to better achieve the aims of Australian insolvency law.

Reformed insolvency regime



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Policy 15-02: Aims of insolvency law

We believe that the fundamental principles of and aims of insolvency law are to:[1]

- provide an equitable, fair and orderly procedure for handling the affairs of insolvent debtors to ensure that claims of priority creditors are appropriately recognised and other creditors receive an equitable distribution of the debtor's remaining assets: the pari passu (equal sharing) principle
- provide procedures and processes for dealing with an insolvency with the greatest efficiency and as little expense as possible
- ensure that administrations are conducted in an independent, competent and efficient manner
- provide mechanisms that allow for rehabilitation of the affairs of insolvents before their position becomes hopeless
- provide procedures which enable both debtors and creditors to have a voice in the resolution of the reality of the insolvency
- ascertain the reasons for the insolvency and to provide powers and mechanisms which allow for the examination of the conduct of insolvents, their associates and the officers of corporate insolvents, and
- enable identification of any offences have been committed by insolvents or their associates with a view to those offences being prosecuted.

[1] The list is adapted from the Harmer Report ([33]) and the Cork Report ([198]). See also the 2004 Parliamentary Joint Committee Report, Appendix 4.

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Policy 15-03: Current Australian corporate restructuring, insolvency and turnaround regime and the need for change

It is ARITA's position that our current corporate insolvency regime has served, and continues to serve, Australia well. In particular, it has sustained economic value through a number of downturns and market shocks and major corporate failures.

Importantly, during the 2008 global financial crisis the Australian economy fared better than other comparable economies. It is reasonable to claim that our robust insolvency regime played a part in that – especially from credit provision and market confidence perspectives.

At the same time, we do believe that fundamental changes are needed, in particular in relation to government involvement in the regime, and the need for greater emphasis on enabling restructuring outcomes.

Explanatory notes:

Australians tend to hold an idealised view of how other markets operate: we see the successes but gloss over some of the failings.

ARITA believes we should carefully and systematically analyse recovery and insolvency regimes elsewhere to see what approaches we may employ here to improve our regime. However, the notion that we can simply transplant other systems here fails to acknowledge our own unique circumstances and ethos.

ARITA's view is that change and reform is needed for the regime to improve its social and economic outcomes. We necessarily accept some of the current legal and practice structures in place in Australia and do not wish to suggest the impossible or impractical; for example, we are content to maintain the separate laws for personal and corporate insolvency.

The current Australian regime could be described as having a strong bias towards preserving creditors' rights. Other jurisdictions are more biased towards preserving the troubled company as a going concern. There are significant arguments around where the balance is appropriately set between these two approaches, and the balance point advocated may alter depending on where an economy's performance is trending.

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Policy 15-04: Creation of a restructuring moratorium

ARITA supports a business judgement rule with the following elements, that directors[2]:

- make a business judgement in good faith for proper purpose
- after informing themselves about the subject matter of the judgement to the extent they reasonably believe to be appropriate
- rationally believe that the judgement was in the best interests of the company (and its shareholders)
- the director has taken all proper steps to ensure that the financial information of the company necessary for the provision of restructuring advice is accurate, or is ensuring that all resources necessary in the circumstances to remedy any material deficiencies in that information are being diligently deployed
- the director was informed with restructuring advice from an appropriately experienced and qualified professional engaged or employed by the company, with access to all pertinent financial information, as to the feasibility of and means for ensuring that the company remains solvent, or that it is returned to a state of solvency within a reasonable period of time
- it was the director's business judgement that the interests of the company's body of creditors as a whole, as well as members, were best served by pursuing restructuring, and
- the director took all reasonable steps to ensure that the company diligently pursued the restructuring.

A restructuring moratorium (safe harbour) that provides a defence to insolvent trading liability is required as:

1. the existing law, without any restructuring moratorium, can impede or prevent proper attempts at informal workouts
2. the adverse effect of the existing laws on honest, capable directors, particularly non-executive directors
3. the focus of directors of a financially troubled company should primarily be (as it is in many other comparable jurisdictions) on the interests of creditors
4. the existing insolvent trading laws limit the options available to deal with financial distress, and

[2] Taken directly from the ARITA (then IPA), Law Council of Australia and the Turnaround Management Association Australia joint submission dated 2 March 2010 in response to the discussion paper *Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration*

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5. a restructuring moratorium would promote the critically important policy objective of obliging directors to obtain early restructuring advice.

We note that directors should not be permitted to view the restructuring moratorium provisions as a relaxation of their responsibilities. If anything, their responsibilities should be seen as being heightened during this period by the business judgement rule requiring positive and beneficial governance thresholds to be met before the rule can be used.

In situations where the obligations for the protections are not met, the insolvent trading rules should actually be easier for a liquidator to prove in order to be able to obtain compensation for the affected creditors.

ARITA

Policy 15-05: Stronger regulation of directors and creation of a director identification number

The strengthening of insolvent trading rules should be supported by stronger regulation of directors. Consideration should be given to the implementation of a unique "director identity number" (DIN) in order to more readily identify and monitor a director's involvement in companies.

Explanatory notes:

Presently there is no requirement to provide proof of identity when updating the corporate register maintained by the Australian Securities & Investments Commission (ASIC) of a director appointment. Safeguards, such as proof of identity requirements, could be put in place at the time of obtaining a DIN to mitigate the chance of inconsistent, misleading or false information being included on the corporate register.

The skills and abilities of directors cover a wide spectrum. There is a need to ensure that all directors adequately understand the duties and responsibilities of their position, and the good corporate and financial judgment requirements that underpin our proposal for the creation of a restructuring moratorium. We recommend that the successful completion of a suitably structured "new director" course be required as a pre-requisite to the issuing of a DIN. This could be endorsed by ASIC and offered as an online course.

ARITA

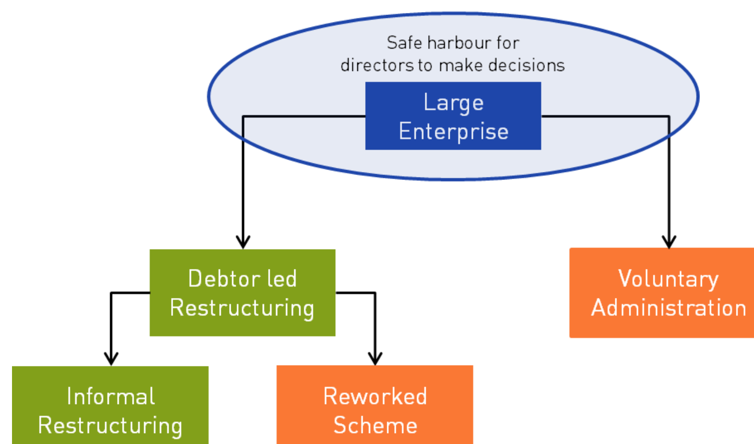
Policy 15-06: Advocate for informal restructuring

Restructuring moratorium proposals are intended to provide an environment whereby, in appropriate circumstances, companies and their directors can undertake informal restructuring initiatives without the threat of incurring liability from insolvent trading. It is reiterated that eligibility for this protection is dependent on meeting specific criteria.

Furthermore, the protections will mean that appropriately qualified and experienced professionals can be engaged in roles such as a chief restructuring officer (CRO) without facing the potential risk of incurring an insolvent trading liability as a shadow director[3]. This would allow greater scope in a CRO role than is currently possible due to the risks imposed under current legislation.

To The protection provided by the safe harbour of a restructuring moratorium would also deliver time to explore informal restructuring options where the solvency of a company may be in doubt.

Explanatory notes:



[3] Noting that other statutory duties may still apply to these types of roles

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Policy 15-07: Reworked Schemes/Voluntary Administration to aid in the rehabilitation of large enterprises in financial distress

ARITA recommends that the following enhancements be made to the current Scheme of Arrangement provisions (and in some instances, to the Voluntary Administration/Deed of Company Arrangement provisions in Part 5.3A of the *Corporations Act 2001*) to further foster restructuring in Australia via statutory insolvency administration:

- implement ARITA's restructuring moratorium (safe harbour) proposal to remove the current necessity for a precursor administration in Schemes of Arrangements
- enact a specific provision enabling a Scheme of Arrangement, subject to court approval, to have a standalone moratorium, including a restriction on the exercising of ipso facto clauses
- extend the voluntary administration moratorium to ipso facto clauses (refer policy 15-08 below)
- legislate to enable recovery of director related antecedent transactions in Schemes of Arrangement and Deeds of Company Arrangement to reduce their misuse by directors to protect their own interests
    - directors to have the ability to contract out of this liability with the Administrator in both Schemes and Deeds
- implement statutory provision for the obtaining of financing via a Scheme of Arrangement (or Voluntary Administration/Deed of Company Arrangement)
- remove related party voting in a Scheme of Arrangement and Voluntary Administration/Deed of Company Arrangement and reduction of voting requirements to a majority threshold in line with those in a Voluntary Administration/Deed of Company Arrangement, and
- limit voting using purchased debts to the value of consideration paid, consistent with the current requirements in the *Bankruptcy Act 1966*.

In addition to the above, ARITA believes that consideration should be given to the implementation of a "Schemes Panel" to replace the Court's oversight of Schemes of Arrangement. It is envisaged that this panel would operate in a similar manner to the Takeovers Panel and be a government regulated peer review panel.

ARITA

Policy 15-08: Extension of moratorium to ipso facto clauses

It is ARITA's view that successful restructuring through voluntary administrations is hampered because the moratorium in a voluntary administration does not extend to clauses that allow the termination of contracts simply because of the insolvency event (ipso facto clauses).

Extending the moratorium to cover such clauses will ensure that important contracts of the business are maintained so that goodwill is preserved while the company is under administration. This serves to maximise the potential of the company and its business continuing as a going concern or otherwise maintaining its value to third parties. Currently the experience of our members is that where the business is reliant on maintenance of contracts, voluntary administration sees the swift demise of the business due to automatic termination of these contracts – the rights of contractual counterparties are escalated above the rights and interests of creditors as a whole.

Voluntary administration already provides a limited and temporary moratorium against ipso facto clauses in some types of contracts. The law restricts the rights of landlords, secured creditors, and others during the voluntary administration process, but not contracts generally. We see the need for a restriction on the right to enforce all ipso facto clauses at least for the period of the administration, which is generally some few weeks. Leave of the court could be available to challenge the moratorium.

Explanatory notes:

An ipso facto contractual clause allows one party to terminate a contract by reason only of the fact (ipso facto) of the insolvency of the other party. These clauses are found in the majority of critical supplier contracts, franchise and license agreements as well as leases for land and equipment.

Under s 301 of the *Bankruptcy Act 1966*, ipso facto clauses are rendered void if the relevant obligor becomes bankrupt. However, there is no such prohibition in relation to corporate insolvency, and more particularly voluntary administration, under the *Corporations Act 2001*.

As a result, if a financially distressed but viable business that is reliant on essential contracts continuing enters into voluntary administration, it is likely that:

- contracts will immediately be terminated
- there will no longer be any business to restructure, and
- there will no longer be any going concern value for creditors.

In some cases, directors may in fact be reluctant to place their companies into voluntary administration because of concern that this may result in creditors exercising their right to terminate under an ipso facto clause and in effect terminate the company's business. This delay may weaken the company's chance of financial recovery.

ARITA

Policy 15-09: Streamlined liquidation for micro companies

Given the inherent lack of funding available for a formal insolvency process in financially distressed SMEs. ARITA believes that a reduced process liquidation option should be made available in certain circumstances for those companies at the small end of the SME spectrum, "the "micro companies".

For companies where the micro criteria is not met, or creditors elect for a creditors voluntary liquidation in order to ensure investigation processes are undertaken, ready access for practitioners to an enhanced Assetless Administration Fund-style arrangement is necessary.

The current requirements of Australia's liquidation processes impose a number of statutory reporting and process obligations on liquidators, which have the effect of increasing the costs of the liquidation and reducing, or eliminating, the return to creditors

We propose that to maximise the return to creditors, where companies with minimal liabilities fail, and they meet the micro company criteria (i.e. liabilities to unrelated entities less than $250,000), a new streamlined liquidation process automatically apply.

A new streamlined liquidation process would differ from the current liquidation requirement as follows:

- no requirement to call meetings, report to creditors, undertake investigations into the company and officers' conduct and complete statutory reporting (e.g. s 533 report)
- expedited dividend process:
  - streamlined proofs of debt dealing process for debts under $10,000
  - no tax clearance required from the Australian Taxation Office where the dividend is less than $25,000 (10% of maximum liability amount) or 10 cents in the dollar, and
  - streamlined advertising and notice requirements for dividends less than $25,000 (10% of maximum liability amount) or 10 cents in the dollar, and
- fixed fee set by government for this type of liquidation, no remuneration accounting or approval.

In order to protect the rights of creditors and the integrity of the regime, the streamlined liquidation process would incorporate provisions whereby:

- the liquidator would report to creditors on appointment and gives them the option of converting the streamlined liquidation into a full creditors' voluntary liquidation (i.e. where normal investigating and reporting obligations apply and remuneration of liquidator is given priority in the normal way)
- if a majority of creditors (excluding related party creditors) vote for this to occur then it converts and the liquidator does not have the power to convert to a full liquidation without this consent
- if the liquidator subsequently becomes aware of a matter which may warrant investigation, they can again seek creditor directions (including resolution by circulation, if appropriate) as to whether the liquidation should convert to a full liquidation, and
- if provable liabilities at any time in the process exceed $250,000 to unrelated entities the streamlined liquidation process would no longer be available and the existing creditors' voluntary liquidation requirements would apply.

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Policy 15-10: Micro Restructuring

Section 185C of the *Bankruptcy Act 1966* provides a mechanism for individual debtors who meet specific eligibility criteria to enter a binding agreement with their creditors to accept a sum of money that the debtor can afford, more commonly referred to as a Part IX Debt Agreement.

Maximising the prospects of continuing the operations of financially distressed but viable small companies, we propose that a similar mechanism be implemented to deal with micro companies. It is envisaged that this process would be more streamlined and cost effective to implement than the compromise alternatives that are available under the existing Voluntary Administration/Deed of Company Arrangement provisions of the *Corporations Act 2001*.

To be eligible to undertake a micro restructuring agreement the company must:

- meet the definition requirements of a micro company
- be insolvent, and
- not have, or have directors who have, previously done a micro restructuring agreement. Such protection would be available under our restructuring moratorium proposals in Policy 15-04.

We would recommend that any micro restructuring mechanism would require:

- The company to prepare a Report as to Affairs (RATA) to be provided with the proposal.
- A Registered Liquidator to oversee the development and implementation of the proposal, possibly referred to as a Restructuring Monitor:
  - who examines and approves the proposal
  - issues the proposal to creditors, and
  - may set fixed or other fee basis for creditor consideration and approval at same time as proposal.
- Creditors vote to accept or to put the company into liquidation:
  - no need for physical meeting, with the resolution able to be considered by circulation
  - if creditors vote for liquidation then the company proceeds to liquidation immediately
  - related parties cannot vote, and

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- – if debt is purchased then purchaser only entitled to vote for amount for which debt purchased.

- An accepted proposal would be put into effect by the Liquidator/Restructuring Monitor and would be subject to the following provisions:
  - – no requirement to call or hold further meetings
  - – if provable debts to unrelated entities exceed $250,000 then appointment would automatically convert to a Voluntary Administration with full investigation and reporting requirements (if directors wish to continue to put a Deed of Company Arrangement proposal to creditors), or creditors voluntary liquidation (if there is no Deed of Company Arrangement proposal)
  - – streamlined proofs of debt process for debts under $10,000
  - – no tax clearance from Australian Taxation Office required where dividend is less than $25,000 (10% of maximum liability amount) or 10 cents in the dollar, and
  - – a default longer than six months automatically results in the company being placed into liquidation.
- Creditors may apply set aside the proposal if there is a lack of full disclosure in the proposal or injustice provisions, similar to the current requirements in a Part IX Debt Agreement.

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Policy 15-11: Pre-positioned sales

ARITA supports a "pre-positioning" arrangement in situations of corporate financial distress, to enable viable businesses to continue and maximise return for creditors via a sale of business negotiated prior to an insolvency appointment.

Pre-positioning is work done prior to a statutory insolvency appointment. Directors take advantage of the proposed restructuring moratorium protections, subject to meeting the criteria for eligibility, to undertake an orderly wind down of the company's operations – that is a well-managed process where assets may be realised for market value in a non-distressed sale – prior to making a formal insolvency appointment. Directors may obtain the assistance of advisors, including insolvency practitioners, during this process.

ARITA's proposed pre-positioning framework would require that:

- Any advisor retained by the directors in the pre-positioning phase could not subsequently be appointed in any formal insolvency administration. This is consistent with the current and appropriate independence requirements for insolvency practitioners in Australia.
- Any sales that occur in the pre-positioning phase must be for value and would be subject to review in any subsequent statutory insolvency administration.
- Any sale of assets undertaken during the statutory insolvency administration, where the terms of sale were negotiated in the pre-positioning phase, would be subject to review by the external administrator prior to being effectuated and the external administrator would be subject to the currently existing statutory and professional requirements regarding the sale of assets.

It is ARITA's view that consideration should be given to restricting the sale of company assets/business to related entities during this pre-positioning phase. Rather, where the sale of a business or the assets to a related entity is contemplated, and the company is insolvent, that sale must be undertaken under the control of an independent insolvency practitioner through a statutory insolvency regime; either a Voluntary Administration (subject to ARITA's recommendations for improvements), a micro restructuring (refer Policy 15-10) or liquidation.

For a number of reasons (including independence, whether the sale is for value and the lack of creditor involvement) we do not consider that a UK-style pre-pack process would be suitable for Australia.

26 August 2014

Mr David Murray AO
Chair
Financial System Inquiry
GPO Box 89
SYDNEY NSW 2001

By email: fsi@fsi.gov.au

Dear Mr Murray

Financial System Inquiry Interim Report

The Australian Restructuring Insolvency and Turnaround Association ("ARITA") represents insolvency practitioners and other professionals who specialise in the field of insolvency, restructuring and turnaround. We cover more than 2,200 members including accountants, lawyers, bankers, credit managers, academics and other professionals with an interest in insolvency and restructuring. ARITA's mission is to support insolvency and recovery professionals in their quest to restore the economic value of underperforming businesses and to assist financially challenged individuals. We deliver this through the provision of innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large. 76% of all registered liquidators and 86% of all registered trustees in bankruptcy are members of ARITA.

Our members have dealt with many of the significant external administration issues raised in the Inquiry's Interim Report ("the Interim Report"), including the winding up of managed investments schemes, insurers, and financiers, and small to medium enterprise ("SME") businesses. ARITA itself has made many submissions to government on issues raised in the Interim Report (refer Annexure A for a list of relevant submissions). We are also pursuing our own thought leadership in this area by way of proposing an insolvency framework with recommendations to improve the overall operation of the corporate insolvency regime in Australia.

Our submission largely focuses on responding to Chapter 3 of the Interim Report - *Funding – External Administration* - with some commentary on other areas of the Report that touch upon the insolvency and reconstruction of entities in financial distress. These issues include banks (ADIs), the use of technology, managed investment schemes, and the need for general reform of insolvency legislation.

ARITA

1 Executive Summary

ARITA will, in the coming weeks, deliver a comprehensive thought leadership project which will recommend improvements to the operation of Australia's corporate insolvency regime including the need for earlier intervention in distressed businesses. We believe this will be instructive to the Inquiry and we will make it available shortly.

Key elements of that work draw on established thinking in ARITA, and include:

- *Safe harbour* – It is ARITA's view that consideration needs to be given to providing a business judgement rule for insolvent trading, commonly referred to as a "safe harbour", to facilitate directors being able to undertake restructuring efforts in appropriate circumstances that may be in the best interests of the company and creditors. We note that directors should not be permitted to see the safe harbour provisions as a relaxation of their responsibilities and, rather, these should be seen as being heightened during this period by requiring positive and beneficial governance thresholds to be met before the rule can be used. Consideration should also be given as to whether, in situations where the safe harbour protections are not met, the insolvent trading rules should actually be easier for a liquidator to prove in order to be able to obtain compensation for the affected creditors. This protected environment is an element of the US "Chapter 11" and the UK has an equivalent.

- *Ipso facto* – An ipso facto contractual clause allows one party to terminate a contract by reason only of the fact (ipso facto) of the insolvency of the other party. The Australian Law Reform Commission recommended that ipso facto clauses be void against a liquidator or administrator and this is also an element of the US "Chapter 11" (and also the UK model) that ARITA has consistently supported. It is ARITA's view that voluntary administrations are not as successful in restructuring businesses as they could be due to this. Ipso facto clauses have played a pivotal role in shutdowns such as One.Tel.

- *Chapter 11* – ARITA concurs with the Interim Report in its observation that Chapter 11 is a costly regime that "could leave control in the hands of those who are often the cause of a company's financial distress". However Chapter 11 is undergoing a major review in the United States in recognition that it may require significant reform and improvement. ARITA is monitoring the progress of that review.

  ARITA has not previously supported the adoption in Australia of other elements of Chapter 11 such as their fully court-supervised model where stakeholders are generally individually legally represented and, in turn, have their own accountants and advisers through the process. This aspect adds a multiplier cost and complexity to Chapter 11 turnarounds. We consider this would have a deleterious effect of further eroding remaining creditor assets.

Other key points:

- The insolvency regime currently applies a "one size fits all" approach. ARITA is considering the benefits of streamlined liquidation and restructuring processes for micro businesses which account for approximate 60% of all external administrations. Furthermore ARITA is working with Chartered Accountants ANZ and CPA Australia to

assess best practice in comparable international insolvency regimes and consider the options for SMEs in Australia. There are risks and benefits associated with any decision to streamline the insolvency process. Whilst the process may become quicker and cheaper, the savings must necessarily arise as a result of removing something from the process that is currently undertaken by insolvency practitioners - such as their independent investigations, reporting to creditors and ASIC, and recovery actions that are a fundamental cornerstone of the current liquidation process.

- In relation to the regulation of the insolvency profession, ARITA supports a single regulator for both personal and corporate insolvency practitioners, as recommended by the 2010 Senate Inquiry Report. If that is not to be implemented, we nevertheless support the proposed reforms in the Insolvency Law Reform Bill 2013, in particular in relation to the alignment of the processes of regulation of the profession by ASIC and AFSA and the potential involvement of ARITA in a co-regulation process. We commend the Inquiry to the draft Bill.

- There is a cost to restructuring, whether that is undertaken informally, by way of consultants and advisors; or formally via a voluntary administration or scheme of arrangement. If a business is to be viable into the future, it must be able to bear the cost of the restructuring process. Those costs should be considered an investment in the future of the business. It should be noted that in many, or even most, SME liquidations, the company has little or no assets remaining, such that while the liquidator may well have time-based fee entitlements, the entitlements are not realised by way of payment for the work done. The insolvency profession, in effect, contributes significantly to the operation of the insolvency regime.

- The public interest responsibilities of liquidators are not well understood by creditors and the community. In addition to a primary duty to recover assets and pay dividends to creditors, liquidators are required to investigate the conduct of parties leading up to the liquidation, report offences and other misconduct to ASIC, and assist in the pursuit of such misconduct. That is why ASIC itself refers to liquidators as the "front line investigators of insolvent corporations".

- The insolvency laws should be modernised to allow for the speed and cost advantages of email and internet and other technology based processes.

The ARITA Code, the improved regulatory processes under the ILRB, and the oversight of the courts, all provide an effective basis for the maintenance of high standards of liquidator conduct. ARITA itself has effective complaints-handling and disciplinary processes and is working to further improve them.

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2 ARITA thought leadership

ARITA has commenced a thought leadership initiative with the objective of reviewing the operation of Australia's corporate insolvency regime as a whole, and make recommendations on how the regime should be structured to optimise the restructuring of viable businesses and ensure the efficient reallocation of the capital of those businesses which are no longer viable.

While the framework is formative and open to an extensive consultation and redrafting process, some of the key issues that will be ventured include:

- the need for earlier intervention in distressed businesses and the promotion of reform that encourages that;
- the consequent limiting of potential liabilities for those working in that earlier stage by way of a "safe harbour" protection from liability for insolvent trading for directors; but only for those who meet certain strict criteria around obtaining advice and maintaining good financial management;
- the adoption of aspects of relevant international arrangements suitable in the Australian environment, such as the prohibition of "ipso facto clauses", based on US and UK law; the streamlining of Chapter 5 of the Corporations Act; and the alignment of personal and corporate insolvency law.
- consideration of distinct approaches to the restructuring and insolvency needs of each of large, SME and micro businesses; and
- greater opportunity for the restructuring of businesses outside of the formal insolvency regime; this is linked to the safe harbour protection above.

Consultation on ARITA's thought leadership will be being undertaken with our members and others with an interest in the improvement of Australia's corporate insolvency regime over the coming months. ARITA will keep the FSI informed as to the framework that is developed as it may be of relevance to the FSI's recommendations concerning external administration.

3 Chapter 3 Funding - External Administration

3.1 Policy options for consultation - Questions

3.1.1 Is there evidence that Australia's external administration regime causes otherwise viable businesses to fail and, if so, what could be done to address this?

In the experience of our members, a company is almost always insolvent prior to entering into voluntary administration. This is supported by the fact that the law requires director/s to formally resolve that the company is insolvent or likely to become insolvent prior to appointing a voluntary administrator.

As such, it is not the appointment that results in the failure of the business, but rather the failure of the business that results in the appointment. Once the appointment occurs, there are consequences outside of the control of the external

administrators which can limit their ability to maintain the business and preserve value as a going concern, other than that inherent in tangible assets.

3.1.1.1 Stigma of formal insolvency

Despite the critical role the insolvency regime plays in the efficient allocation of capital, there is a widely held stigma associated with insolvency in Australia. Whether it is bankruptcy for an individual[1] or voluntary administration/liquidation for a company[2], calling in an insolvency practitioner is not well regarded by the Australian community. As a result, this impacts on the ability of a company to be able to use formal restructuring and insolvency mechanisms such as voluntary administration (under Part 5.3A of the *Corporations Act*) to facilitate the turnaround of the business.

This can be contrasted with the US, where there is a different emphasis on how to react to insolvency[3]. ARITA research in Australia shows that currently it may well be correct that voluntary administrations are not resulting in the turnaround of the business for a large proportion of companies using them[4].

We see this arising from a combination of factors including:

- the stigma of insolvency resulting in directors responding to underperformance of their business by delaying in seeking expert advice;
- a lack of a "turnaround culture" in Australia, which may largely be driven out of a fear of liability for insolvent trading so that directors are not prepared to seek alternatives to formal insolvency once there is financial distress. We address this issue at 3.1.1.2 below;
- the value destruction of a business caused by customers' and suppliers' exercise of ipso facto clauses which we address at 3.1.1.3 below;
- possible concerns around the potential for a 'run' on any business where it becomes public knowledge that there are concerns around its solvency or a need for restructuring; and
- directors of companies not being aware of the options available in addressing "endemic" and "temporary" distressed situations.

By undertaking reforms that:

- improve the effectiveness of voluntary administrations as a formal restructuring tool;
- create an environment where directors are able to undertake restructuring of a business outside of formal insolvency without the risk of incurring personal

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[1] Sylvia Pennington, 19 June 2013, Go for broke – insolvency can be the best solution, The Sydney Morning Herald

[2] Clive Lee, 12 December 2008, Australia: A second chance through voluntary administration?, Mondaq

[3] Cameron Cheetham, 2 February 2012, Ipso Facto clauses and insolvency, Clayton Utz Insights.

[4] Mark Wellard, Terry Taylor Scholarship 2013, *A review of deeds of company arrangement,* which found that in 72% of cases a deed of company arrangement delivers a quasi-liquidation outcome. However, for 28% of deeds a successful restructuring appeared to be the outcome.

liability for insolvent trading if certain strict criteria around obtaining advice and financial management are met;
- result in quality directors being able to be attracted and retained by businesses in times of financial stress; and
- foster a culture whereby all stakeholders in the process work together to achieve an outcome,

ARITA considers that Australia will develop a restructuring environment which will enhance the operation of an already world class insolvency regime. However, for this to be accepted and successful, all stakeholders will need to make a conscious effort to change current public perceptions of mistrust and punishment and encourage the support for a business to be given a second chance where appropriate.

3.1.1.2 Influence of insolvent trading laws on the decisions of directors

Insolvent trading laws[5] are intended to make directors act to prevent a company from incurring a debt if the company is insolvent at the time the debt is incurred, or becomes insolvent as a result of incurring the debt. Directors who trade whilst the company is insolvent face civil liability for debts incurred, which can be substantial; and criminal prosecution, which can result in imprisonment.

It is our view that these laws do not work as intended for the following reasons:

1. In the case of larger companies with directors that are independent of the owners of the company (or listed companies), directors are generally educated and informed of their obligations, duties and risk of personal liabilities. They are also concerned about their reputation of being associated with a "failed" company. As such, when a company is in financial distress, they are more likely to want to take steps to appoint an administrator to end the potential of insolvent trading liability, rather than "risk" an informal restructure even if the company could potentially be turned around. Thus the insolvent trading laws act as a deterrent to restructuring attempts, even when a restructuring may be in the best interests of the creditors and the company. In this situation, there is an inherent conflict for directors between protecting themselves from personal liability and acting in a way which is in the best interests of the company and creditors.

2. In the case of SMEs where the directors are also generally the owners of the company, the directors' personal financial affairs are usually inexorably related to the financial affairs of the company and once the company is in a state of financial distress, the directors may well be too. With nothing left to lose, but a lot to gain if the business is able to continue, the distant threat of liability for insolvent trading is not enough to prevent the directors from continuing the business until there is nothing left to continue with[6]. Thus arguably, the insolvent trading laws do not act as an effective deterrent to reckless trading, particularly in the SME sector.

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[5] Primarily s 588G of the *Corporations Act*

[6] ASIC statistics support this with 61.1% of companies in external administration having less than $10,000 in assets and 40.1% having less that $1 (Report 371 Insolvency Statistics: External Administrators' Reports for the period July 2012 to June 2013).

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3. It is inherently difficult for directors to assess the insolvency of their company in real time. Whilst under law a company is either solvent or insolvent, in reality a company can teeter on the edge of insolvency for some time and determining whether any business of even moderate size is insolvent is difficult unless it is clearly insolvent – even by an experienced insolvency practitioner.

4. Historically insolvent trading actions are difficult to prove and expensive to pursue. The reality that there are limited or no assets in a large number of administrations means that insolvent trading claims are unlikely to eventuate, particularly in SMEs where the claims are likely to be at the smaller end. Furthermore, asset protection strategies employed by directors and the fact that secured creditors and a number of trade creditors will hold personal guarantees from directors, means that often directors are unable to meet any compensation orders if an insolvent trading action is proved against them. We do recognise however that the threat of an insolvent trading action can result in out of court settlements in liquidations and payments under deeds of company arrangement to prevent further action being taken, resulting in benefits for the creditors.

It is clear that there is significant doubt as to whether the insolvent trading laws are achieving any of their objectives, but may instead be preventing directors from undertaking restructuring efforts in situations where that may be in the best interests of the company and creditors. It is ARITA's view that consideration needs to be given to providing a business judgement rule for insolvent trading, commonly referred to as a "safe harbour", to facilitate directors being able to undertake restructuring efforts in appropriate circumstances.

This protected environment is an element of the US Chapter 11 and the UK has an equivalent.

Much work has already been done on what the terms of such a safe harbour should be[7]. ARITA's views have not largely changed since our 2010 Joint Submission with the Law Council of Australia and the Turnaround Management Association. In summary, we support a business judgement rule with the following elements, that the directors[8]

- make a business judgement in good faith for proper purpose;
- after informing themselves about the subject matter of the judgement to the extent they reasonably believe to be appropriate;

[7] The Minister for Financial Services, Superannuation and Corporate Law released a discussion paper on 19 January 2010 titled "Insolvent Trading: A Safe Harbour for Reorganisation Attempts outside of External Administration". ARITA (then the IPA) made a submission jointly with the Law Council of Australia and the Turnaround Management Association Australia dated 2 March 2010 and we also made a supplementary submission of our own dated 18 March 2010. Copies of our submissions are available from the ARITA website.

[8] Taken directly from the ARITA (then IPA), Law Council of Australia and the Turnaround Management Association Australia joint submission dated 2 March 2010 in response to the discussion paper "Insolvent Trading: A Safe Harbour for Reorganisation Attempts outside of External Administration"

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- rationally believe that the judgement was in the best interests of the corporation;
- the director has taken all proper steps to ensure that the financial information of the company necessary for the provision of restructuring advice is accurate, or is ensuring that all resources necessary in the circumstances to remedy any material deficiencies in that information are being diligently deployed;
- the director was informed with restructuring advice from an appropriately experienced and qualified professional engaged or employed by the company, with access to all pertinent financial information, as to the feasibility of and means for ensuring that the company remains solvent, or that it is returned to a state of solvency within a reasonable period of time;
- it was the director's business judgement that the interests of the company's body of creditors as a whole, as well as members, were best served by pursuing restructuring; and
- the director took all reasonable steps to ensure that the company diligently pursued the restructuring.

Our joint submission put forward 5 principal reasons for why there should be a safe harbour defence to insolvent trading liability:

1. the existing law, without any safe harbour, can impede or prevent proper attempts at informal workouts;
2. the adverse effect of the existing laws on honest, capable directors, particularly non-executive directors;
3. the focus of directors of a financially troubled company should primarily be (as it is everywhere else in many other comparable jurisdictions) on the interests of creditors;
4. the existing insolvent trading law limits the options available to deal with financial distress; and
5. a safe harbour defence would promote the critically important policy objective of obliging directors to obtain early restructuring advice.

We see these principal reasons as continuing to apply.

We note that directors should not be permitted to see the safe harbour provisions as a relaxation of their responsibilities. If anything, their responsibilities should be seen as being heightened during this period by the business judgement rule requiring positive and beneficial governance thresholds to be met before the rule can be used.

Consideration should also be given as to whether, in situations where the safe harbour protections are not met, the insolvent trading rules should actually be easier for a liquidator to prove in order to be able to obtain compensation for the affected creditors.

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3.1.1.3 Effect of ipso facto

An ipso facto contractual clause allows one party to terminate a contract by reason only of the fact (ipso facto) of the insolvency of the other party. These clauses are found in all critical supplier contracts, franchise and license agreements as well as leases for land and equipment. Ipso facto clauses have played a pivotal role in the shutdown of major organisations that were in financial distress (examples such as the carrier contracts of One.Tel being terminated soon after the company entered voluntary administration resulting in One.Tel being unable to provide services to its customers, are obvious). It is ARITA's view that voluntary administrations are not as successful in restructuring businesses as they could be due to the fact that the moratorium in a voluntary administration does not extend to ipso facto clauses.

Under s 301 of the Bankruptcy Act 1966, ipso facto clauses are rendered void if the relevant obligor becomes bankrupt. However, there is no such prohibition in relation to corporation insolvency, and more particularly voluntary administration, under the Corporations Act.

As a result, if a financially distressed but viable business that is reliant on essential contracts continuing enters into voluntary administration, it is likely that:

- contracts will immediately be terminated;
- there will no longer be any business to restructure; and
- there will no longer be any value for creditors.

In some cases, directors may in fact be reluctant to place their companies into voluntary administration because of concern that this may result in creditors exercising their right to terminate under an ipso facto clause, and in effect terminating the company's business. This delay may weaken the company's chance of financial recovery.

The justification for such a moratorium being extended to cover ipso facto clauses is to ensure that important contracts of the business are maintained such that goodwill is preserved while the company is under administration. This serves to maximise the chances of the company and its business continuing as a going concern or otherwise maintaining its value to third parties. This is currently not the case in Australia and the experience of our members is that where the business is reliant on maintenance of contracts, voluntary administration sees the swift demise of the business due to termination of these contracts.

The Australian Law Reform Commission ("ALRC") in its General Insolvency Inquiry Report recommended that any contractual provision such as those discussed above be void against a liquidator or administrator[9]. The reasoning for the ALRC's recommendation was that there has been a similar provision in the Bankruptcy Act (s 301) since 1968. The bankruptcy provision was recommended by the 1965 Clyne Committee on the basis that to permit such an agreement to be terminated merely because of insolvency may sometimes have the effect of depriving the trustee of a

[9] ALRC 45, vol 2, s AT10. See also vol 1, paras 703 – 705.

bankrupt person of an opportunity to deal with the property comprised in such an agreement to the advantage of the creditors[10]. The ALRC adopted that reasoning and considered that it should apply with equal force to a company and recommended legislation to bring this into effect[11]. It is ARITA's opinion that this position is still correct, including in the corporate insolvency context.

Voluntary administration provides a limited and temporary moratorium against ipso facto clauses in some types of contracts once a company enters voluntary administration. Section 440B restricts the rights of landlords, secured creditors, and others during the voluntary administration process, but not contracts generally. We see the need for a restriction on the right to exercise rights under all ipso facto clauses at least for the period of the administration, which is generally some few weeks, with court approval for any extension of that period generally required.

The law in favour of the validity of ipso facto clauses is inherently counterproductive and contrary to the spirit of the Part 5.3A regime. We consider that the law should apply in the same way to contracting parties, subject to court leave, and subject to distinctions as may be necessary between different types of contracts. In our view, in cases where such contracts are in issue, that would be a very significant improvement in the effectiveness of Part 5.3A.

The US has a prohibition against contractors terminating a supply contract when a company enters Chapter 11. This is one element of Chapter 11 that ARITA has consistently supported[12]. ARITA has long recommended the law in Australia adopt this US approach as one way of countering the reduction in value of a business on its entering insolvency.

The UK is presently considering extending the avoidance of such clauses in telecommunications collapses[13], an area where our experience in Australia shows such a law is particularly needed.[14]

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[10] Clyne Committee Report, para 383.

[11] The recommended legislation was:

Certain provisions in agreements to be void

AT10. (1) Where a company is a party to an agreement (other than a charge) that contains a provision to the effect that, if the company commences to be wound up in insolvency or becomes a company under administration, then –

(a) the agreement is to terminate or may be terminated;
(b) the operation of the agreement is to be modified; or
(c) property to which the agreement relates may be repossessed by a person other than the company,

the provision is void, unless the Court otherwise orders, as against the liquidator or administrator.

(2) This section extends to agreements made before the commencement of this section.

[12] ARITA's first submission regarding the need for a moratorium on ipso facto clauses was it submission (then as the IPAA) in April 2003 to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into Australia's Insolvency Laws.

[13] Continuity of supply of essential services to insolvent businesses, UK Government, Open Consultation, 8 July 2014, closing 8 October 2014.

[14] ARITA is working with the Communications Alliance in Australia to address this issue in the telecommunications sector.

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3.1.2 The Inquiry would value views on the costs benefits and trade-offs of the following policy options or other alternatives: no change to current arrangements; implement the 2012 proposals to reduce the complexity and cost of external administration for SMEs.

ARITA made numerous submissions, participated in round table discussions, separately consulted with Treasury and provide detailed input into the government's costings of the impact of the 2012 proposals, which now are pending legislation in the form of the Insolvency Law Reform Bill 2013 ("ILRB").

Whilst not in complete agreement, ARITA is largely supportive of the reforms proposed by the ILRB. We note however, that we are yet to see the consequential amendments to the Corporations Act or the Bankruptcy Act, or the regulations. The regulations in particular will hold significant details which will determine the practical operation of the ILRB.

In particular, the ILRB seeks to align the processes by which members of the profession are regulated by the two regulators – ASIC and AFSA, an alignment much supported by ARITA.

The ILRB also seeks to align other procedures under the Bankruptcy Act and Corporations Act, in relation to the conduct of meetings, and creditor engagement, though the full extent of the alignment will not be apparent until the regulations and consequential legislative amendments are available.

As such, although ARITA supports the ILRB and has dedicated substantial resources to its development, we are unsure at this time as to how much reduction in complexity and cost of external administration will result for SMEs.

As part of its thought leadership project, ARITA is considering the benefits of streamlined liquidation and restructuring processes for micro businesses[15]. Furthermore ARITA is working with Chartered Accountants Australia and New Zealand and CPA Australia to assess international insolvency regimes and consider the options for SME reforms in Australia. The results of this assessment will also be used in ARITA's thought leadership project.

[15] ARITA defines a micro business as one with unsecured creditors of less than $250,000. According to ASIC's Report 371 Insolvency Statistics: External Administrators' Reports for the period July 2012 to June 2013 external administrations of companies with less than $250,000 in liabilities comprise 61.7% of external administrations.

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3.2 Interim Report comments

We now provide our views on specific comments made in the Interim Report.

3.2.1 Some submissions argue that the current regime is biased towards liquidation. They claim the prohibition on trading while insolvent, and its associated penalties, make directors more cautious in attempting to reorganise a business that could continue to be viable.

We refer you to our discussions at 3.1.1.1 above.

3.2.2 Stakeholders suggest that placing a company into voluntary administration can lead to the failure of a business that could survive with some restructuring, because voluntary administration processes can significantly devalue a company and involve significant cost.

There are two issues to be considered in respect of that statement – the effect of voluntary administration on the value of the company; and secondly the cost of the process itself.

3.2.2.1 Devaluation of the business

As to the devaluation of a business upon an insolvency appointment, this may well be correct given the nature of a formal insolvency administration and the customer and community perception of the vulnerability of its position. There is also the stigma associated with insolvency which impacts upon the value of a business that enters into a formal insolvency administration; we discuss that at 3.1.1.1 above. Herein lies some of the benefit of a "safe harbour" protection – whereby orderly wind down (either full or complete) may be undertaken in a more protected environment in which the assets of the business do not, themselves, become distressed due to the need for a pressured realisation.

As we discussed at 3.1.1.3, we consider that ipso facto clauses have a significant impact on the value of a business subsequent to an insolvency appointment and this is an issue that needs to be addressed.

3.2.2.2 Cost of external administration

There is a cost to restructuring, whether that is undertaken informally, by way of consultants and advisors; or formally via a voluntary administration or scheme of arrangement. If a business is to be viable into the future, it must be able to bear the cost of the restructuring process. Those costs should be considered an investment in the future of the business. It is also worth recognising that it is a long-standing and fully accepted practice for successful businesses to undertake reviews and engage expert advisers (management consultants, accountants, etc) to enhance their business performance – we suggest that the engagement of restructuring, insolvency and turnaround professionals is an analogous arrangement.

When considering the cost of a formal insolvency administration, it must be noted that the nature of insolvency is such that it can be an expensive exercise for a number of reasons – an experienced and qualified insolvency practitioner is required, who, most significantly, bears personal liability for the period of the appointment; their tasks are extensive in investigating and trying to find a solution; they have statutory reporting obligations to the creditors and ASIC; court assistance can be required; the affairs of the company are invariably in some disarray and its structure and business operations can be complex; the directors may or may not be co-operative; and the creditors' claims can be numerous and in dispute.

In addition to a primary duty to recover assets and pay dividends to creditors, liquidators are required to investigate the conduct of parties leading up to the liquidation, and report offences and other misconduct to ASIC, and assist in the pursuit of such misconduct. That is why ASIC itself refers to liquidators as the "front line investigators of insolvent corporations".[16] Payment of the liquidator for that work in itself consumes funds in the administration, often thereby reducing funds, if there are any, available to pay a dividend. These public interest and fiduciary responsibilities of liquidators are significant.

It should be noted that in many, or even most, SME liquidations, the company has little or no assets remaining[17], and those assets often prove to be insufficient to meet the liquidator's costs in full.

A study of court ordered liquidations under the 2012 Terry Taylor Scholarship[18] showed that, in the conduct of official liquidations, official liquidators annually:

- incur $1.9 million in disbursements;
- recover $0.5 million of disbursements from asset realisations;
- fund $1.4 million of disbursements from their own resources;
- incur $55.6 million in remuneration; and
- recover $8.3 million in remuneration from asset realisations.

The study concluded that official liquidators, on average, annually fund $47.3 million in unpaid remuneration from their own resources.

Under current ASIC requirements, an official liquidator is obliged to conduct a liquidation to which they are appointed by the court even though no funds are available for their remuneration. This is largely a product of Australia having no government liquidator. We do note that ASIC operates an Assetless Administration Fund from which practitioners may apply to obtain funding to prepare investigative reports to assist ASIC prosecutions, though our members report that funding may be difficult to obtain and doesn't fully remunerate for the work involved.

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[16] ASIC's Regulatory Guide 16

[17] According to ASIC's Report 371 Insolvency Statistics: External Administrators' Reports for the period July 2012 to June 2013, 61.1% of external administrations have $10,000 or less in assets, with 40.1% having less than $1.

[18] The Terry Taylor Scholarship is a research project funded annually by ARITA

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3.2.3 Other submissions suggest that the current arrangements are too complex and costly for SMEs.

3.2.3.1 Streamlined processes

A fundamental point we make is that the insolvency regime currently applies a "one size fits all" approach, such that Part 5.3A applies as much to a SME as to a large enterprise. To a large extent this is the case because, in general, corporate law itself makes no relevant distinction between large and small companies.

As mentioned at 3.1.2 above, ARITA is considering the benefits of streamlined liquidation and restructuring processes for micro businesses which account for approximate 60% of all external administrations[19]. Furthermore ARITA is working with Chartered Accountants Australia and New Zealand and CPA Australia to analyse international insolvency regimes and consider the options for SMEs in Australia.

There are risks and benefits associated with any decision to streamline the insolvency process. Whilst the process may become quicker and cheaper, the savings must necessarily arise as a result of removing something from the process that is currently undertaken by insolvency practitioners. That "something" is likely to be the independent investigations, reporting to creditors and ASIC, and recovery actions that are a fundamental cornerstone of the current liquidation process. The process will be more of a "cookie-cutter" approach, arguably no longer requiring the professional expertise of a registered liquidator. The risk of course, is without the pragmatic, independent insolvency expert overseeing the end of the company, there is a substantial risk that inappropriate conduct will not be detected, reported and prosecuted.

Careful consideration needs to be given to this issue due to the large number of SME businesses in our economy and the effect on the economy if poor business practices were to become the norm due to no or limited consequences for breaching the law. According to the Commissioner of Taxation's Annual Report 2012- 2013, small business accounts for 60% of the ATO collectable debt. The report further notes that taxpayers who do not comply with their obligations have an unfair advantage over their competitors and the same would be said of companies who breach other laws without fear of detection.

The cost benefit analysis has obviously been undertaken in respect of personal insolvency, as around 85% of bankruptcies are consumer bankrupts with little to no assets. These bankruptcies are dealt with in a largely procedural manner by the Official Trustee. Furthermore, Part IX Debt Agreements were introduced in 1996 to allow for the low cost restructuring of low income, low debt and low asset individual debtors and they now account for over a third of personal insolvencies and pay more in dividends to creditors than bankruptcies.

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[19] According to ASIC's Report 371 Insolvency Statistics: External Administrators' Reports for the period July 2012 to June 2013 61.7% of companies had less than $250,000 in liabilities.

The need for corporate insolvency to adopt the more expeditious measures taken in personal insolvency was the subject of a suggestion by the Hon Michael Kirby AC, CMG, at our national conference in 2010.[20]

Costs of insolvencies are in focus internationally. ARITA made a submission to a current UK consultation on remuneration; the report from which commented favourably on the Australian guidance and approach taken by the ARITA Code of Professional Practice on practitioners' remuneration.[21]

A useful comment made in that context, with which we in principle agree, was that the proposed UK reform focusing on remuneration was

> "trying to tackle the wrong problem. There seems to be an over-riding presumption, for example, that costs are too high but around 90 percent of these costs are made up by compliance with law. ... an ill thought through focus on cost reduction could risk innovation. Since the collapse of Lehman in 2008, we have seen the insolvency profession develop new and interesting ways of rescuing business, which have protected jobs and protected more of the value of the business. We must be careful that any changes do not change this culture of innovation and business rescue".[22]

3.2.3.2 Personal liability of business owners

The personal liability of business owners as directors will often exist irrespective of the insolvency of their company. The Interim Report refers to personal guarantees from directors required by lenders to businesses. The directors may themselves fund the business through personal borrowings. The tax regime imposes personal liability on directors in some cases, as a deliberate policy approach following the removal of the ATO's priority in insolvency in 1993, and the potential for this liability being imposed is increasing.

There are additional potential liabilities in insolvency, which are not limited to SMEs. There may also be breaches of general corporate law duties. Chapter 5 of the Corporations Act itself allows actions in relation to uncommercial transactions, director focused transactions and breaches of employee obligations, along with insolvent trading.[23] These allow liquidators to make financial recoveries, for the benefit of creditors, from those who may have been involved in absconding with company assets, including directors.

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[20] *Bankruptcy and Insolvency, Change, policy and the vital role of integrity and probity,* (2010) 22(2) A Insol J 4, Michael Kirby.

[21] ARITA submission to UK consultation paper - *Strengthening the regulatory regime and fee structure for insolvency practitioners*, 28 March 2014

[22] Insolvency regime reform is an opportunity for the UK to improve on its world class position, according to KPMG, KPMG UK press release 27 March 2014.

[23] See generally, *Keay's Insolvency*, Murray & Harris, 8th ed.

Whether these various personal liabilities should exist is a policy decision for the government. As mentioned above, ARITA is considering the benefits of streamlined liquidation and restructuring processes for micro business which may result in a lessening of some of the potential exposures in insolvencies.

3.2.4 In some cases, liquidator misconduct in areas of improper gain, including excessive remuneration, and liquidator independence and competence affect the cost of effectiveness of liquidation for SMEs.

3.2.4.1 Misconduct

We recognise that there have been isolated, but highly visible, examples of liquidator misconduct. However, we unequivocally reject the wording of this part of the FSI Interim Report as there is simply no evidence to support this claim. Further, we believe that pejorative and unsubstantiated stereotypes like this unnecessarily damage confidence in our financial system as a whole and undermine the effectiveness of insolvency practitioners whose role it is to shepherd businesses through an already traumatic and fraught process.

It is our view that only a small number of registered liquidators do not fulfil their duties and this is not representative of the industry as a whole. Indeed, the rigorous enforcement of ARITA's Code of Professional Practice yields few substantiated complaints of this type considering the inherently controversial role that is necessarily played by practitioners.

The most recent ASIC report on liquidator conduct[24] indicates good standards of liquidator conduct and a reduction in the number of complaints received by ASIC in relation to liquidators. Comparable reports by AFSA, often in relation to the same persons,[25] support this.

Liquidators are highly qualified and experienced professionals who are required to have certain tertiary and further professional qualifications in accounting and law, and extensive experience before they are able to be registered by ASIC.

3.2.4.2 Professional standards

In 2008 ARITA issued a Code of Professional Practice ("Code").[26] The Code sets a high professional standard of behaviour for the profession, with seventeen principles and associated guidance on a range of conduct, remuneration and practice management issues. The Code must be complied with by members of ARITA. The

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[24] Report 389 ASIC regulation of registered liquidators: January to December 2013

[25] Most trustees are also liquidators. See www.afsa.gov.au

[26] The Code is available from the ARITA website at www.arita.com.au/about-us/arita-publications/code-of-professional-practice

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courts have referred to codes of conduct as relevant to the assessment of a liquidator's performance of his or her duties.[27]

The Code is responsive to changes and developments in insolvency law and practice, with the third edition of the Code effective from 1 January 2014. ARITA supports the Code with targeted training courses on issues such as independence and remuneration and regularly presents on professional standards at ARITA conferences and forums.

3.2.4.3 ARITA's professional standards processes

It is important that the FSI is aware that ARITA is in the process of further developing its already robust and highly regarded member conduct regime. ARITA's member conduct regime is detailed on our website[28] and in our Constitution and Regulations,[29] and the outcomes of our disciplinary process are also published on our website.

At this time we are considering the creation of an independent tribunal to determine complaints and concerns about insolvency practitioners that arise largely under the current framework of the Code.

That Tribunal would also offer educative advice to the community about both personal and corporate insolvency and an ADR process to manage issues that do not require a formal disciplinary process. We believe that this approach would help close financial literacy gap issues that often drive complaints and, where an action against a practitioner is warranted, will display the appropriate lack of bias that all participants expect. In short, ARITA wishes to take a stronger self-regulatory role.

Further, at our most recent National Conference, ARITA welcomed Dr Robert Austin[30] to talk on extending our Code to new areas of focus in the restructuring and turnaround space. We believe that this is a critical element to ensuring higher levels of ethical practice in the pre-insolvency arena that is currently largely unregulated.

It is a fundamental focus of our thought leadership framework that early intervention in circumstances of financial distress is required. That earlier phase is at present under-regulated, including in personal insolvency; and raises potential for abuse of the commercial processes. Hence ARITA seeks to provide some of its own regulation, and the experience and knowledge of its members, for the better enhancement of the Australian economy. It is envisaged that the review of the Code for this purpose will occur during 2015.

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[27] *Dean-Willcocks v Companies Auditors and Liquidators Disciplinary Board* [2006] FCA 1438.

[28] www.arita.com.au/insolvency-you/complaints-and-member-discipline

[29] www.arita.com.au/about-us

[30] Dr Robert Austin 2014, Keynote presentation at ARITA National Conference Melbourne on the future of professional standards. Dr Austin is a former Judge of the Supreme Court of New South Wales, and an honorary member of ARITA. His details are at www.minterellison.com

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3.2.4.4 Moving insolvency regulatory functions from ASIC to AFSA

On page 3-127 of the Interim report, the FSI raises the option of moving insolvency functions from ASIC to AFSA.

We see that there are benefits with having one regulator that is focused on the regulation of insolvency and attuned to the particular legal, fiduciary and public interest aspects of the role of liquidators and trustees. We note that this was recommended by the 2010 Senate report on liquidators and their regulation by ASIC. The government has not accepted that recommendation.

Single regulation and alignment of processes would, in our view, lead to cost efficiencies, for both government, practitioners and creditors. Our reference of the issue to the Productivity Commission in 2010 resulted in a report recommending greater alignment.[31]

ARITA itself regards its membership as a whole, in that we do not differentiate between our members that are trustees or liquidators. This is evident in the Code and in our Constitution. We consider it beneficial to see the regulation of the profession in the same way. Registered Trustees are invariably Registered Liquidators and the different regulatory approach taken to each is not beneficial to the profession.

However, an important issue is that whoever is responsible for the regulation of the industry, appropriate funding is provided to enable effective regulation to occur.

3.2.4.5 Cost of regulation

On page 3-111 of the Interim Report, there is discussion about the funding of ASIC's regulatory functions. ASIC also discusses this issue in detail in its April 2014 submission in paragraphs 188 to 212, where it promotes a user pays based cost recovery model.

In its submission, ASIC states that the regulation of insolvency practitioners costs $11 million per year. Firstly, we query this amount and readings of ASIC's own reports suggest that this is not correct, with the costs most likely cover the regulation of all ASIC's engagement with insolvency matters rather than merely the regulation of insolvency practitioners. A critical distinction. A spend of $11 million to regulate approximately 689[32] liquidators, implies an average cost of nearly $16,000 per liquidator per year which seems extraordinary. Looked at through a different lens, the $11 million spend resulted in ASIC taking4 civil actions and achieving 7 administrative remedies against liquidators in 2013/14[33] –a cost of $1 million per action.

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[31] Productivity Commission Research Report, August 2010, at 4.5

[32] Report 389 *ASIC regulation of registered liquidators: January to December 2013*

[33] Report 383: ASIC enforcement outcomes: July to December 2013 and Report 402: ASIC enforcement outcomes: January to June 2014

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Given that ARITA already brings a well-respected oversight function to around 90% of the profession, we would suggest that further government support for ARITA's self-regulatory function is preferable, and warranted.

Secondly we would stress that the benefits of a well regulated insolvency regime extends to all companies, not just those that are currently in some form of external administration. If registered liquidators are required to meet the total cost of ASIC's regulation of insolvency, this cost would necessarily be passed on to the various insolvency administrations via increased fees hence the cost would be borne not by the perpetrators of corporate failure or the beneficiaries of corporate limited liability but by the "victims" of corporate failure– the unpaid creditors.

As such, if a cost recovery model is proceeded with, costs need to be borne by all who benefit.

We do note that AFSA operates on a costs recovery model, and absent a mechanism parallel to the registration of companies where a levy may be imposed, imposes a realisations charge, and other fees, to fund its operations.[34]

3.2.5 To prevent viable businesses from entering voluntary administration, some submissions suggest that Australia adopt the US Chapter 11 regime, or certain aspects of it.

We are not aware of which submissions the Interim Report refers to in this recommendation or the context of their claims. In the absence of those, we generally do not agree that Australia should adopt the US Chapter 11 regime per se, or indeed adopt any insolvency regime directly from another jurisdiction. There are dangers for any country in doing so. This is the subject of comment in the interim PPS report[35].

ARITA believes that it is important to understand what is meant by "Chapter 11" in the minds of most commentators. To many, Chapter 11 is simply a system that provides for a "safe harbour" and protected (ipso facto preservations) environment for restructuring, which we have already commented positively on in this submission. However, it is often not understood that the US system of Chapter 11 also includes a full court-supervised model where stakeholders are generally individually legally represented and, in turn, have their own accountants and advisers through the process. This aspect adds a multiplier cost and complexity to Chapter 11 turnarounds and is not widely understood by many proponents in the Australian context (the recent American Airlines Chapter 11 was reported as incurring some $375 million in consultant fees[36]). This is not an aspect of Chapter 11 that ARITA is supportive of for the delays that it can place into the process, the need

[34] See www.afsa.gov.au

[35] Interim report on the statutory review of the *Personal Property Securities Act* 2009, Bruce Whittaker, 15 August 2014.

[36] http://www.nytimes.com/2014/06/27/business/hundreds-of-millions-are-sought-for-firms-in-airlines-bankruptcy.html?partner=rssnyt&emc=rss&_r=1

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for the development of a commercial court system in Australia and for the deleterious effect it would have on further eroding remaining creditor assets. Further, ARITA is not convinced that the Australia community would be accepting of another key aspect of Chapter 11 – that in which existing management who led the organisation into distress, would be allowed to largely remain in influential roles within the entity during a formal restructuring process.

However, as part of our thought leadership framework discussed at Part 2 of our submission above, we are considering the various and different insolvency processes in the UK, US and Canada. Furthermore, ARITA is working on a joint project with Chartered Accountants Australian and New Zealand and CPA Australia to assess international insolvency regimes and their approaches to the insolvency of SMEs.

Consideration of the adoption of aspects of a US style Chapter 11 regime in Australia has been the subject of various reports over a number of years, including:

- Senate Economics References Committee Report - "Inquiry into the Performance of the Australian Securities and Investments Commission" July 2014;
- Parliamentary Joint Committee on Corporations and Financial Services "Corporate Insolvency Laws: a Stocktake" August 2004; and
- Corporations and Markets Advisory Committee (CAMAC) "Rehabilitating large and complex enterprises in financial difficulties Report" October 2004.

There is also a range of academic literature on the topic.

None of these reports have recommended the implementation of a "carbon copy" Chapter 11 regime in Australia. The CAMAC Report found "no compelling need, or intrinsic shortcoming in the VA procedure, which requires or justifies adopting Chapter 11 as an additional or substitute corporate recovery procedure for large and complex, or other, enterprises". ARITA has generally agreed with this view and has done so since our submission to the Parliamentary Joint Committee on Corporations and Financial Services in April 2003.

However, we are aware that Ch 11 is widely and harshly criticised in its home jurisdiction and under review by the American Bankruptcy Institute in the United States and a report is expected by the end of 2014. ARITA will consider that report and reassess any relevant issues that arise from it. We note that a report on this review is being presented at the International Association of Insolvency Regulators' conference in Washington, USA, in September, which both ASIC and AFSA are attending.

We also note that while the US system has historically put more emphasis on a debtor in-possession framework with the goal to rescue and rehabilitate the distressed company, the European systems have a legacy of creditor-in-possession frameworks, like that of Australia. In recent years, and since 2008, European corporate finance has emphasised more diffused US-style capital market products and practices. As a consequence, European insolvency laws are changing to include Chapter 11 type approaches. A recent European Commission recommendation on its

proposed “new approach to business failure and insolvency” has emphasised the need for laws to accept business failure and encourage entrepreneurs.[37] We understand that while there is a general trend towards more rehabilitative processes in Europe, substantial differences between countries remain, so that forum shopping occurs. It is said that the UK Scheme of Arrangement process is the established pre-insolvency forum of choice.[38]

In other words, the quality of a country’s insolvency regime, and its international standing on current insolvency principles, can be a factor in whether international capital is attracted to that country.

3.2.6 Adopting such a regime would create more uncertainty for creditors by limiting their rights.

Creditors’ “rights” are significantly affected by any insolvency, although the rights of secured creditors, such as banks and those creditors with security interests registered on the Personal Property Securities Register, are generally currently protected in Australia. Ultimately it is a policy decision as to whether Australia’s current creditor focused insolvency regime remains.

It may also need to be considered whether the focus on creditors’ rights creates an unhealthy moral hazard in the operation of businesses, such that creditors have an unjustified expectation of their protection in the face of a trading party’s insolvency. The PPS regime offers suppliers and others a strong and effective process to reduce the risk of counterparty insolvency. However, it appears that Australian SME businesses do not yet avail themselves of the PPS protections and consequent good financial protection and risk assessment.[39]

The policy decision is largely between whether our creditor focused insolvency regime remains or whether there is recognition of the wider role that the debtor itself and its advisors can play in the restructuring of a business in appropriate circumstances.

In any event, ARITA is itself encouraging its members to try to engage earlier with distressed businesses, before they become insolvent, when greater opportunities for turnaround and reconstruction exist. Necessary guidance and ARITA Code obligations are being formulated.

It is however, essential to have a clear framework so that all parties to an insolvency or formal restructuring process understand where they stand in the process.

[37] Brussels, 12.3.2014, C(2014) 1500.

[38] Fitch: Insolvency Regimes in Spotlight as Investors Look to Next Default Cycle, 13 February 2014

[39] Interim report on the statutory review of the *Personal Property Securities Act* 2009, Bruce Whittaker, 15 August 2014.

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3.3 Other issues

3.3.1 Director knowledge and identity

ARITA, and others, have consistently said that the right to operate a limited liability company is a legal privilege. This view has been substantially reinforced by the experience of our practitioners in dealing with the directors of failed entities. This is so particularly in the insolvency context where the directors are generally not liable for the company's debts. In this regard, we consider that directors of all companies should be required to have basic knowledge of their obligations as directors. ARITA members appointed to insolvent companies consistently encounter directors, and sometimes their advisers, who have little or no understanding of their duties, obligations and potential liabilities as directors, particularly in the SME sector. Further, these directors often have inadequate financial competency.

There is also a need for directors to properly identify themselves when they set up a company. ARITA members have encountered fictitious non-existent directors of insolvent companies, or directors with aliases or with variations on earlier names used. Despite ASIC's business registry role, there is no current requirement to provide identity checks as part of the registration of a company or when reporting a change in directorships. We see the need for such identity checks as a means of countering unlawful phoenix activity.

An academic member of ARITA recently said that, in relation to the privilege of incorporation,

> "the government, as the grantor of this privilege, is entitled to demand certain standards be met, and has the right to withhold this privilege otherwise. This is not unreasonable or even uncommon. The privilege of being allowed to hold a driver's licence is dependent upon satisfying certain standards of ability, as well as the requirement to prove identity and pay a fee". [40]

The simple proposal that has been recommended is that each director be allocated a director identity number – a DIN – which would be recorded in relation to each company of which they were a director. The DIN would also serve to facilitate the process of directors establishing new companies. ARITA supports this proposal.

3.3.2 Crisis management of ADIs, insurers and superannuation funds

ARITA liquidator members have acted as insolvency administrators of major insurers, banks (ADIs) and other prudentially regulated entities; one prominent example was the failure of HIH Insurance.

We are aware that there is limited literature in Australia on the insolvency issues in relation to prudentially regulate entities, in particular, in the context of the FSI, in relation to ADIs.

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[40] '*An Ounce of Prevention – Practical Ways to Hinder Phoenix Activity*', (2013) 25(3) A Insol J 16, Helen Anderson.

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A detailed analysis of the Australian regime for the crisis management of banks, in comparison with international regimes, is soon to be published.[41] We can advise the FSI further on this if required. To assist the FSI's considerations in this regard please find attached an overview of the insolvency issues in relation to ADIs at Annexure B.

One other current issue is the impact of personal insolvency on self managed superannuation funds, and the use of such funds to protect assets from creditors. We can elaborate further on this if required.

3.3.3 Managed Investment Schemes

Our members have had significant involvement in administering the collapse of managed investment schemes (MIS) which have raised difficult and complex legal and factual issues. These have included Timbercorp, Willmot Forests and Great Southern, and their administrations are, in many cases, on-going.

We note that we made a submission to CAMAC in its major inquiry into MIS, which led to CAMAC's Report of July 2012 titled *Managed Investment Schemes*. It appears that the government was awaiting the outcome of a further aspect of CAMAC's inquiry, in relation to further issues raised in CAMAC's 2014 Discussion Paper. ARITA also made a submission to the issues raised in that paper. We note that CAMAC has since been disbanded and the responsibility for the CAMAC recommendations and its further discussion paper issues now lies with Treasury and government.

We also note there is a current inquiry into the structure and development of forestry MIS by the Senate Economics References Committee, for it to inquire and report by 27 October 2014. ARITA will be making a submission by the due date of 4 September 2014.

We can elaborate further on these issues if needed.

3.3.4 Legislation

The laws of insolvency are mostly contained in Chapter 5 of the *Corporations Act* 2001 and in the *Bankruptcy Act* 1966. Both are largely 'old laws', in their drafting, and are based on even older 19th century, and earlier, concepts. They are largely based on old English law, even though in many areas UK law has advanced to modernity.

One UK paper notes that its own insolvency law framework was established in the second half of the 19th century and that despite major revisions in recent times some of the processes in insolvency procedures are

[41] *Crisis Management in the Banking Sector,* Haentjens and Wessells, editors, is soon to be published by Edward Elgar Publishing. The Australian chapter is written jointly by Professor Ros of QUT, an academic member of ARITA, and chair of INSOL International Academics, and Michael Murray, Legal Director of ARITA, and visiting fellow at QUT.

> "essentially unchanged from these Victorian beginnings. Commerce, communications and credit have all changed greatly over this period - some parts of this insolvency framework, while important and relevant when first formulated, may no longer be relevant for today's insolvency market".[42]

As examples, corporate law processes are based on old concepts of close court involvement in insolvencies, leading to separate regimes within Chapter 5 of the Corporations Act for court and voluntary liquidations. Timing and stay arrangements are different for each type of administration. The priority of employee claims is difficult.

Even modern laws impacting upon insolvency have often added to the complexity; a recent example being the *Personal Property Securities Act* 2009[43] and certain tax law changes.

Tax laws are in fact a significant example as they are not necessarily developed with insolvency considerations in mind. As a result have unintended consequences when inconsistencies arise. Insolvency provisions in relation to tax are to be found, with difficulty, throughout the *Income Tax Assessment Act* 1936, the *Taxation Administration Act* 1953, the *Income Tax Assessment Act* 1997, the GST laws (where insolvent companies and bankrupts are termed "incapacitated entities"), and others.

Insolvency is necessarily cost sensitive and the costs of administering the insolvency are added to by undue legal complexity.

We do not consider it necessary to have only one piece of legislation, however, we do consider that the insolvency laws need a complete review and modernisation.

3.3.5 Technology

There is only limited use of technology permitted by insolvency law, for example by way of service of documents by email. Website notification is not permitted, although courts will make such orders under their general powers where appropriate. For example, in *RiverCity Motorway*,[44] the Court directed that the administrators inform creditors and others by means of post, facsimile or email, but that in respect of creditors for whom the administrators did not have such contacts, the administrators were to give notice on the 'Creditor Information' section of the website of their firm, PPB Advisory. The only section allowing the court to make such orders is the general remedial section in Part 5.3A of the *Corporations Act*, s 447A, which only applies to voluntary administrations.

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[42] *Red Tape Challenge - changes to insolvency law to reduce unnecessary regulation and simplify procedures* Consultation Paper, The Insolvency Service, UK, 2014.

[43] On 31 July 2014 Mr Bruce Whittaker delivered his interim report on the statutory review of the PPS Act to the Attorney-General and Parliamentary Secretary to the Prime Minister. It comments on the undue complexity of this new law.

[44] *Owen, in the matter of RiverCity Motorway Pty Limited (Administrators Appointed) (Receivers and Managers Appointed) v Madden (No 5)* [2013] FCA 1443

Most insolvency firms have website information for the access of creditors. These can be used for general communications with creditors, without court order. An example, that of Ferrier Hodgson, is referred to in *Sherwin Iron Limited*.[45]

But we also point out that the Australian Law Reform Commission's inquiry into privacy gave a response to ARITA's submission that favoured a bias towards protection of insolvency information rather than its publication.[46] Our submission in fact referred to the case of a bankruptcy trustee found to have breached privacy laws because of his firm's website notice about the bankrupt and the bankruptcy. The government has yet to decide on that recommendation of the ALRC.

We have said that insolvency is necessarily cost sensitive and the costs of the administration are a first priority before creditors are paid. It is also a process necessitating continuing communication with often a large number of creditors, including by way of meetings.

It is necessary to contain those communication costs as much as possible whilst remaining aware of the need for quality communication with the various stakeholders.

ARITA recommends that more legislative attention and permission be given to the use of technology. Indeed, we believe that this would be to the clear benefit of almost all stakeholders in an insolvency process, given that the default for contemporary business communications is, indeed, an online method. The UK is itself examining this issue; we can explain this further if required.[47]

In the area of personal insolvency, we consider that AFSA is making significant progress in the adoption of new technology in the administration of the personal insolvency regime,[48] for example in its online services and "desktop" audits of trustees. Again, this emphasises the difficulty of having separate insolvency regulators, and the potential for cost effective and uniform approaches to insolvency generally.

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[45] *Gothard, in the matter of Sherwin Iron Limited (Administrators Appointed) (Receivers and Managers Appointed)* [2014] FCA 826, at [16]

[46] ALRC 108, Chapter 44.

[47] Red tape Challenge – changes to insolvency law to reduce unnecessary regulation and simplify, The Insolvency Service, UK, 2014.

[48] See www.afsa.gov.au – Future online services

4 International comparisons

ARITA is aware of the need to monitor international developments in insolvency and it does so through a range of means and contacts. ARITA members are members of INSOL International, some are members of the INSOL Academics Group and of INSOL Europe. Many of our members have practised in relevant jurisdictions, including the UK, the US, Asia and Europe. Their knowledge and experience feeds into this submission. Should the Inquiry need further details on international insolvency regimes, we can readily access that information.

5 Conclusion

ARITA hopes that our comments are of assistance to the Inquiry. We are ready to assist with any direct contact as may be required.

We will keep the Inquiry informed as the progress of our thought leadership project.

Should you wish to discuss any aspect of our submission, please contact either:

- John Winter, CEO at jwinter@arita.com.au or 02 9290 5741
- Michael Murray, Legal Director mmurray@arita.com.au or 02 9080 5826; or
- Kim Arnold, Technical Director karnold@arita.com.au or 02 4283 2402.

Yours sincerely

John Winter
Chief Executive Officer

ARITA

Annexure A

Relevant ARITA/IPA submissions

- 'Safe harbour' submission - ARITA (then the IPA)'s submission to Treasury jointly with the Law Council of Australia and the Turnaround Management Association Australia dated 2 March 2010; supplementary submission of ARITA dated 18 March 2010.

- Strengthening APRA's Crisis Management Powers – Consultation Paper – September 2012, ARITA (IPA) submission December 2012

- ARITA submission to UK consultation paper - Strengthening the regulatory regime and fee structure for insolvency practitioners, 28 March 2014.

Relevant government reports

- Productivity Commission Research Report August 2010, *4.5 Insolvency practitioners*
- Senate Economic References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, September 2010 report
- Senate Economics References Committee Report - "Inquiry into the Performance of the Australian Securities and Investments Commission" July 2014.
- CAMAC Report - Managed Investment Schemes, July 2012.
- *Red Tape Challenge - changes to insolvency law to reduce unnecessary regulation and simplify procedures* Consultation Paper, The Insolvency Service, UK, 2014.

Relevant ARITA journal and academic articles

- Mark Wellard, Terry Taylor Scholarship Report 2013, *A review of deeds of company arrangement.*
- *Bankruptcy and Insolvency, Change, policy and the vital role of integrity and probity,* (2010) 22(2) A Insol J 4, Michael Kirby.
- *An Ounce of Prevention – Practical Ways to Hinder Phoenix Activity*, (2013) 25(3) A Insol J 16, Helen Anderson.

Relevant other publications

- Keay's Insolvency: Personal and Corporate Law and Practice, Michael Murray and Jason Harris, 8th edn, Thomson Reuters, 2014.
- Orderly and Effective Insolvency Procedures, International Monetary Fund, 2 Aug 1999, Chapter 2.
- Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions (2011)
- International Monetary Fund, Australia: Financial Safety Net and Crisis Management Framework, (Financial Sector Assessment Program Update, Technical Note, 2012)
- International Monetary Fund, Australia: Financial System Stability Assessment, (IMF Country Report No 12/308, 2012)
- 'Insolvencies, bailouts and resolutions: Dealing with banks when the music stops' (2014) 25 JBFLP 71, Ayowande A McCunn.
- Alan Tyree, Banking Law in Australia (7th edn, LexisNexis 2011)

- The Economic and Strategic Structure of Insolvent Trading, Michael J Whincop, 2000;
- Andrew Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66 Modern Law Review 665.

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Annexure B

Discussion of crisis management of ADIs, insurers and superannuation funds

It may assist if we offered a brief explanation of the insolvency issues in relation to ADIs on which the literature in Australia at least, is limited. The Banking Act 1959 contains a range of legal measures allowing APRA to maintain and regulate financial stability in the banking sector, and measures to allow a crisis management response by APRA in the event that it is required. The Act also allows the formal insolvent winding up of the ADI. These provisions are largely contained in Part II of the Act.[49]

If an ADI's financial position is in decline, APRA may decide to appoint an 'ADI statutory manager'. Typically that person would be a registered company liquidator, mostly likely an ARITA professional member. That manager takes immediate control of the ADI's business and has a range of powers and duties in effect to resolve the ADI's financial distress. The directors are removed and their authority is displaced. The ADI statutory manager must report to APRA as required. The manager can recommend action by APRA, including that APRA apply to wind up the ADI.

APRA may then apply under the *Banking Act* to the court for an order that the ADI be wound up and that an official liquidator be appointed to the ADI.[50] Separately, APRA also has authority under the *Corporations Act* to apply to wind up an ADI and have an official liquidator appointed. On the appointment of a liquidator, who would also most likely be an ARITA professional member, APRA may terminate the position of the ADI statutory manager.[51]

The winding up of the ADI would then largely proceed under the *Corporations Act* regime. Significantly, the court order for winding up allows the government to immediately implement the Financial Claims Scheme (FCS) by which depositors of the failed bank would be paid to a certain level. The liquidator has a significant role under the FCS in assessing depositors' claims and facilitating payment.

The 2012 IMF's Financial Sector Assessment Program broadly explains and assesses the Australian regime as follows:

"Powers for early intervention in problem banks (including to provide liquidity assistance) and to resolve non-systemic banks appear robust. Liquidity assistance in the first instance would be accomplished via the RBA's daily repo auction process; in the second instance, assistance would be negotiated on an individual institution basis, in consultation with APRA vis-à-vis supervisory and solvency concerns. The scope of eligible collateral that the RBA accepts through its normal market operations makes it extremely unlikely that an ADI would be unable to obtain adequate liquidity under most circumstances. Legislation grants APRA strong powers to direct ADIs to take corrective actions. Such powers (eg, the power to order a recapitalisation or to remove or replace directors and officers) could be used to facilitate the resolution of an ADI while it is under

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[49] Banking Act, ss 7-36.

[50] Banking Act, s 14F.

[51] Termed an 'ultimate termination of control': Banking Act, s 13C.

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private control. APRA also has appropriate grounds to appoint a statutory manager to resolve an ADI before it becomes insolvent. Powers to compel a purchase and assumption transaction are robust. APRA could issue a determination that an ADI should transfer assets and /or liabilities to a willing, healthy ADI, a bridge bank, or asset management company while the failing bank is under private control or under statutory management (including immediately before a winding-up). Winding up occurs through a court-based procedure with APRA involvement".[52]

The IMF did suggest further steps were necessary in relation to the preparation of recovery, resolution and contingency plans for systemic and other ADIs.[53]

The *Corporations Act* gives the liquidator extensive powers and discretions, including to sell the business of the company or any part of it. The *Banking Act* imposes some overlays by way of limiting and oversighting the role of the liquidator. For example, section 62C provides that before making any application to a court in relation to a matter arising under the winding-up of an ADI – for example to bring voidable transaction proceedings - a liquidator must advise APRA which is then entitled to be heard before the court. Also, section 63 requires the Treasurer to consent to any reconstruction of the affairs of an ADI that may be proposed by a liquidator. The *Banking Act* also imposes responsibilities on the liquidator to manage the FCS.

Beyond that, the *Corporations Act* is the sole source of how the winding up is to be conducted.[54] It requires the liquidator to gather in and realise assets, ascertain the creditors, take proceedings for recovery as may be possible, and pay dividends to creditors. Creditors' claims against the ADI are stayed, save for secured creditors. A liquidator may trade on the insolvent company's business only to the extent necessary to facilitate its winding up.

It is apparent that the ADI would have been "pre-positioned" for its winding up through the exercise by APRA of its statutory management and other powers. The funds of depositors would necessarily be assets of the ADI over which the liquidator retains control; a freeze on depositors' funds would apply but at the same time the FCS would immediately apply to allow payments to depositors to be made. A major task of the liquidator would be to assess and facilitate those payments. No other banking business could be conducted. Loan books of the ADI would continue to be managed and may be sold. These issues would be common in any comparable insolvency regime.

The winding up of an ADI would be potentially complex. However the *Corporations Act* is suited to dealing with the administration of large and complex insolvencies, a significant example being

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[52] IMF, *Australia: Financial System Stability Assessment*, (IMF Country Report No 12/308, 2012) [5].

[53] IMF, *Australia: Financial System Stability Assessment*, (IMF Country Report No 12/308, 2012) [Table 1]. The nature of such plans – lately termed 'living wills' - is explained by the Chair of APRA: Dr John Laker, 'APRA's Regulatory Priorities – An Update', FINSIA Financial Services Conference, 25 October 2011.

[54] See generally Michael Murray and Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice* (8th edn, Thomson Reuters (Professional) Australia Limited 2014).

that of HIH Insurance.[55] Australia also obviously has a well developed and experienced insolvency profession by international standards.[56]

Creditors of a bank are ranked and paid in the ordinary course according to the provisions of the *Corporations Act*. Depositors are creditors of the bank and as such they must prove for the amount of the debt and, subject to specific provisions mentioned below, would rank behind secured creditors and any preferential creditors such as employees. Also, APRA's costs of having an ADI statutory manager in control of an ADI's business are payable from the ADI's funds and are a debt due to APRA.[57]

A significant feature of the *Banking Act* is that it provides, in relation to both insolvent Australian banks and the Australian branches of insolvent foreign banks, that deposit liabilities in Australia receive a priority out of Australian assets. That is, the assets of the bank in Australia are to be available to meet the bank's liabilities in Australia in priority to other liabilities of the bank.[58] In support of these priorities, ADIs that take retail deposits in Australia are required to hold assets in Australia at least equal to their deposit liabilities in Australia.[59]

The Financial Claims Scheme

The FCS is only activated when APRA applies to have an ADI wound up and the Minister has declared that the FCS will be applied to that ADI. The Treasurer may seek advice from APRA, ASIC or the Reserve Bank. APRA may require the liquidator to assist APRA in paying account holders their entitlements, to which the liquidator must give precedence over any other aspects of winding up the ADI, including any requirements under the *Corporations Act*.[60] Priority is given to prompt payment to depositors; for example, the liquidator may admit a depositor's claim even if it has not been proved according to the requirements of the *Corporations Ac*t.[61] When depositors are paid, APRA then takes the place of each of the depositors as a creditor in the winding up of the ADI, and is entitled to receive a dividend in respect of those payments in the final winding up of the ADI.[62] Costs incurred by APRA in administering the FCS are admissible as a debt due to APRA.[63] The liquidator's remuneration and expenses are given priority.

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[55] See also Corporations and Markets Advisory Committee, *Rehabilitating Large and Complex Enterprises in Financial Difficulties Report* (2004).

[56] See www.arita.com.au

[57] Banking Act, s 16. These priorities apply over all other unsecured debts but subject to the statutory priorities for the application of assets of an ADI in Australia, under s 13A(3) Banking Act.

[58] Banking Act, s 11F in relation to a foreign bank and, s 13A(iii) in relation to an Australian bank. There is a similar priority to that found in the Insurance Act 1973, s 116.

[59] Banking Act, s 13A(4).

[60] Banking Act, s 16AJ.

[61] Banking Act, s 16AQ.

[62] Banking Act, s 16AI.

[63] Banking Act, s 16AO.

More information

As we have said, we have access to further information on this area, on which there is little academic or other comment in Australia, if required.

31 March 2015

Senior Adviser
Financial System and Services Division
Treasury
Langton Crescent
Parkes ACT 2600

Email: fsi@treasury.gov.au

Dear Sir/Madam

Financial System Inquiry Final Report

We thank you for the opportunity to provide further comments in relation to the Financial System Inquiry Report (FSIR).

Other than our short comments to follow, the Australian Restructuring Insolvency and Turnaround Association (ARITA) would commend to you our two detailed Financial System Inquiry (FSI) submissions, on which the FSI did not substantially report. In addition, we have subsequently completed further policy work which we provide for your information.

Time for review

Even though it is one of the cornerstones of an effective market, restructuring, insolvency and turnaround has received only tangential legislative attention in the last two decades. We believe the time is right for a focussed inquiry into this critical function.

The existing Australian insolvency and restructuring framework not only serves the Australian financial system and economy well, but also stands up strongly in comparison to other regimes across comparable global markets.

Nonetheless, we believe there is room for improvement, particularly in the area of encouraging the recovery of viable businesses in financial distress. To that end ARITA, has developed a list of policies which address the need for a fundamental review of Australia's insolvency and restructuring framework. Our Policy Positions Paper is attached at Appendix A.

Law reforms

In addition to our Policy Positions Paper, ARITA has identified other needed law reforms for personal and corporate insolvency. These have been the subject of submissions to government over several years. However, many of these reviews and inquiries were limited in scope or had insolvency issues only as a by-product of a larger review.

Appendix B provides a listing of ARITA's prior submissions, Appendix C provides details of law reform matters previously raised with Treasury and Appendix D provides a listing of other matters that require reform to ensure the ongoing smooth operation of the insolvency regime.

In many cases, our submissions and recommendations (and those of other highly qualified experts in the field) have not been embraced or resulted in the reforms we were seeking. Disappointingly, many inquiries ended with no action being taken at all. We had anticipated that the FSIR would provide some high level structure and guidance on how our insolvency laws are operating and how they need to change. The Report instead made limited comment.

It is apparent from this that the attention given to review and reform of the insolvency regime is of low priority. This is in the context of significant ideas and developments being pursued in the UK, Europe and the US.

Australia cannot afford to be left behind if our regime is to retain or improve its standing in the global economy. By contrast, Singapore is currently pushing to become a regional centre for insolvency and restructuring, as the UK has already become in Europe. With our stable political regime, transparent and robust legal system and a global reputation for low levels of corruption, Australia is otherwise very well positioned to become a profitable hub for these services.

Golden opportunity

As we are presently experiencing very low levels of corporate insolvency, the government should grasp the opportunity of a quieter period to undertake a wide reaching, focused review of Australia's insolvency and restructuring regime, beyond that suggested by the FSIR.

Australia has not had a comprehensive review of its insolvency laws since the referral to the Australian Law Reform Commission in 1983. This resulted in the 1988 Harmer Report and the introduction of the revolutionary voluntary administration regime in 1993.

But times have changed, and the way of doing business has changed. For example, businesses are now much less 'bricks and mortar' and far more service- and virtual-based than in 1988.

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As such, it is time for Australia to reassess its insolvency regime and make the changes required to ensure the regime's ability to save viable distressed businesses and to efficiently and effectively redistribute the capital of those businesses that cannot be saved.

Any reform of corporate insolvency should include personal bankruptcy. The process of alignment of bankruptcy and corporate insolvency commenced under the Insolvency Law Reform Bill 2014 should be continued.

We have taken the liberty of suggesting some terms of reference for this review of our restructuring, insolvency and turnaround laws which we have attached at Appendix E.

Should you wish to discuss any aspect of this letter, its attachments, or our submissions to the FSI, please do not hesitate to contact me or Ms Kim Arnold, ARITA Technical Director, on 02 8004 4344.

Yours sincerely

John Winter
Chief Executive Officer

About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents practitioners and other associated professionals who specialise in the fields of insolvency, restructuring and turnaround.

We have more than 2,000 members including accountants, lawyers, bankers, credit managers, academics and other professionals with an interest in insolvency and restructuring.

Some 76 percent of registered liquidators and 86 percent of registered trustees are ARITA members.

ARITA's mission is to support insolvency and recovery professionals in their quest to restore the economic value of underperforming businesses and to assist financially challenged individuals.

We deliver this through the provision of innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large.

The Association promotes best practice and provides a forum for debate on key issues facing the profession. We also engage in though leadership and advocacy underpinned by our members' knowledge and experience.

ARITA

Appendix A – ARITA's Policy Positions Paper: February 2015

ARITA has previously provided you with a copy of its discussion paper, *A Platform for Recovery 2014*. This discussion paper has recently been finalised into a Policy Positions paper and a copy is attached for your reference.

The policies in the Policy Positions paper form the key basis of ARITA's position on needed reform to Australia's insolvency framework:

- Policy 15-01: ARITA Law Reform Objectives (Corporate)
- Policy 15-02: Aims of insolvency law
- Policy 15-03: Current Australian corporate restructuring, insolvency and turnaround regime and the need for change
- Policy 15-04: Creation of a Restructuring Moratorium (Safe Harbour)
- Policy 15-05: Stronger regulation of directors and creation of a director identification number
- Policy 15-06: Advocate for Informal Restructuring
- Policy 15-07: Reworked Schemes/Voluntary Administration regimes to aid in the rehabilitation of large enterprises in financial distress
- Policy 15-08: Extension of moratorium to ipso facto clauses
- Policy 15-09: Streamlined Liquidation for Micro Companies
- Policy 15-10: Micro Restructuring
- Policy 15-11: Pre-positioned sales

Fundamentally, ARITA believes that the existing Australian insolvency and restructuring framework not only serves the Australian financial system and economy well, but that it also stands up strongly in comparison to other regimes across comparable global markets. Nonetheless, we believe that the policies identified above are key areas for improvement of the existing framework to provide the best outcomes for the wider community.

Policy Positions

of the

Australian Restructuring Insolvency and Turnaround Association

as at February 2015

ARITA

Policy 15-01: ARITA law reform objectives (corporate)

We believe that the Australian corporate restructuring, insolvency and turnaround regime should:

- support the preservation of viable organisations that have otherwise found themselves in, or heading towards, financial distress, provided they:
  - have good financial systems and controls
  - are tax compliant
  - are compliant with other regulatory obligations (e.g. corporate, WHS, environmental, product safety, etc.), and
  - demonstrate good corporate governance
- recognise the value to the economy of sustaining continuous employment for employees involved in viable organisations facing financial distress
- recognise as a micro-economic principle that capital should be recycled from non-performing businesses to performing businesses and that some element of business failure is a necessary and appropriate mechanism in ensuring an efficient and productive economy
- encourage directors, management, and independent and qualified financial and insolvency advisers to assist organisations operating viable businesses to recover from financial distress and provide a restructuring moratorium (safe harbour) from potential later claims, subject to certain requirements
- otherwise support the preservation of a viable business as a going-concern, including to allow the business to continue to have the benefit of existing contracts and leases
- require the interests of existing and new creditors to be taken into account, but at the same time recognise their responsibilities to attend to their own interests and to do so at a cost in proportion to the value and potential of the business
- allow the resolution of a company's financial distress to be dealt with as quickly as possible, consistently with the interests of creditors and of the company
- provide for the prompt assessment and orderly disposal of a failed business, recognising that there is a cost to delivering this service

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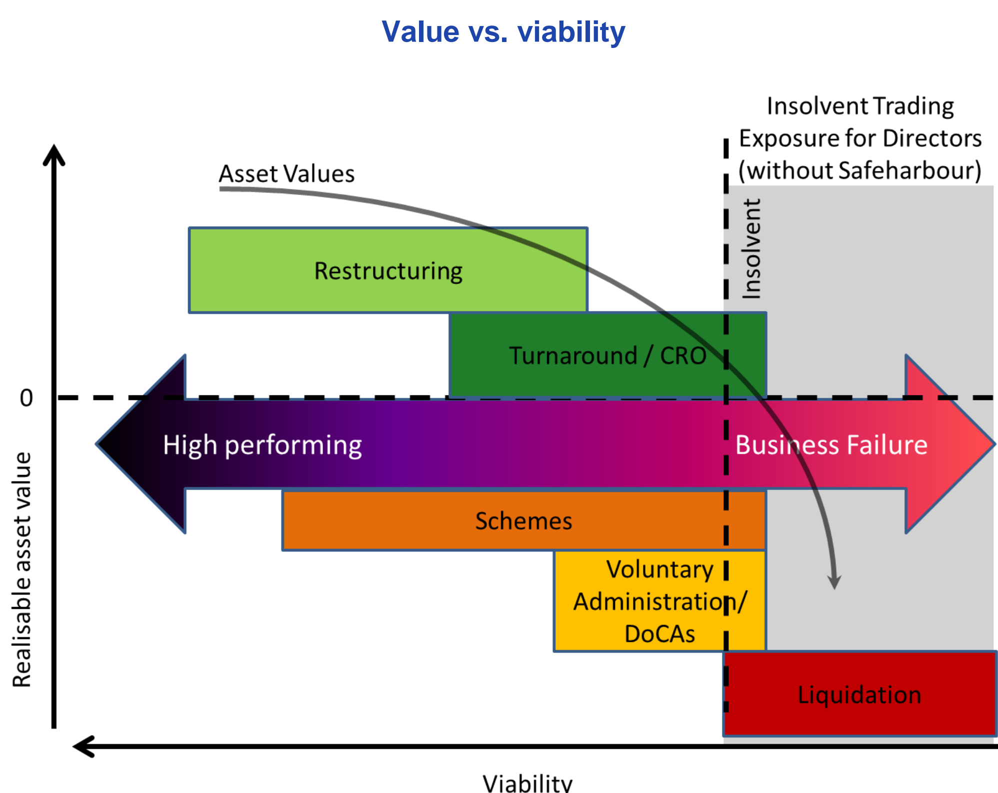
- acknowledge that different sized companies may require different approaches to dealing with financial distress
- have regard to international precedents and best practice in the UK, US, New Zealand, Canada and elsewhere, and
- provide proper remuneration for its practitioners, and not require them to do work or incur expenses in assetless administrations without recompense.

Explanatory notes:

The distinction between high performing and distressed companies and the impact on asset values over the viability spectrum is depicted below.

Value vs. viability



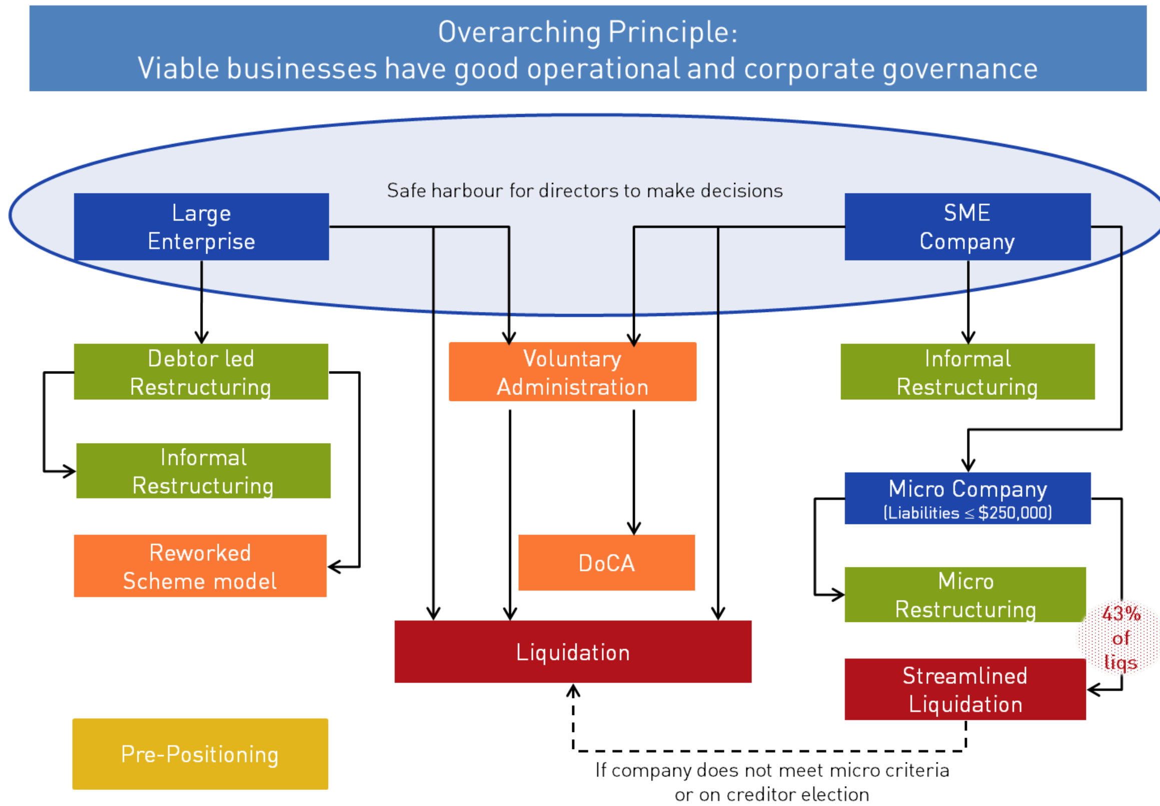
A foundation of our thinking is that a "one size fits all" approach to dealing with companies in financial distress is flawed. For example, such an approach does not take into account the scale of societal impacts of insolvencies in large enterprise collapses compared to small. Nor does it take into account the differences in governance between large and small entities.

To that end, we conceive that there are three framework approaches required:

- large enterprises
- small-to-medium enterprises (SMEs)
- micro companies (provable liabilities less than $250,000).

The following flowchart provides a summary of the proposed reform concepts developed by ARITA based on the three approaches detailed above and the belief that size distinctions are required to better achieve the aims of Australian insolvency law.

Reformed insolvency regime



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Policy 15-02: Aims of insolvency law

We believe that the fundamental principles of and aims of insolvency law are to:[1]

- provide an equitable, fair and orderly procedure for handling the affairs of insolvent debtors to ensure that claims of priority creditors are appropriately recognised and other creditors receive an equitable distribution of the debtor's remaining assets: the pari passu (equal sharing) principle
- provide procedures and processes for dealing with an insolvency with the greatest efficiency and as little expense as possible
- ensure that administrations are conducted in an independent, competent and efficient manner
- provide mechanisms that allow for rehabilitation of the affairs of insolvents before their position becomes hopeless
- provide procedures which enable both debtors and creditors to have a voice in the resolution of the reality of the insolvency
- ascertain the reasons for the insolvency and to provide powers and mechanisms which allow for the examination of the conduct of insolvents, their associates and the officers of corporate insolvents, and
- enable identification of any offences have been committed by insolvents or their associates with a view to those offences being prosecuted.

[1] The list is adapted from the Harmer Report ([33]) and the Cork Report ([198]). See also the 2004 Parliamentary Joint Committee Report, Appendix 4.

ARITA

Policy 15-03: Current Australian corporate restructuring, insolvency and turnaround regime and the need for change

It is ARITA's position that our current corporate insolvency regime has served, and continues to serve, Australia well. In particular, it has sustained economic value through a number of downturns and market shocks and major corporate failures.

Importantly, during the 2008 global financial crisis the Australian economy fared better than other comparable economies. It is reasonable to claim that our robust insolvency regime played a part in that – especially from credit provision and market confidence perspectives.

At the same time, we do believe that fundamental changes are needed, in particular in relation to government involvement in the regime, and the need for greater emphasis on enabling restructuring outcomes.

Explanatory notes:

Australians tend to hold an idealised view of how other markets operate: we see the successes but gloss over some of the failings.

ARITA believes we should carefully and systematically analyse recovery and insolvency regimes elsewhere to see what approaches we may employ here to improve our regime. However, the notion that we can simply transplant other systems here fails to acknowledge our own unique circumstances and ethos.

ARITA's view is that change and reform is needed for the regime to improve its social and economic outcomes. We necessarily accept some of the current legal and practice structures in place in Australia and do not wish to suggest the impossible or impractical; for example, we are content to maintain the separate laws for personal and corporate insolvency.

The current Australian regime could be described as having a strong bias towards preserving creditors' rights. Other jurisdictions are more biased towards preserving the troubled company as a going concern. There are significant arguments around where the balance is appropriately set between these two approaches, and the balance point advocated may alter depending on where an economy's performance is trending.

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Policy 15-04: Creation of a restructuring moratorium

ARITA supports a business judgement rule with the following elements, that directors[2]:

- make a business judgement in good faith for proper purpose
- after informing themselves about the subject matter of the judgement to the extent they reasonably believe to be appropriate
- rationally believe that the judgement was in the best interests of the company (and its shareholders)
- the director has taken all proper steps to ensure that the financial information of the company necessary for the provision of restructuring advice is accurate, or is ensuring that all resources necessary in the circumstances to remedy any material deficiencies in that information are being diligently deployed
- the director was informed with restructuring advice from an appropriately experienced and qualified professional engaged or employed by the company, with access to all pertinent financial information, as to the feasibility of and means for ensuring that the company remains solvent, or that it is returned to a state of solvency within a reasonable period of time
- it was the director's business judgement that the interests of the company's body of creditors as a whole, as well as members, were best served by pursuing restructuring, and
- the director took all reasonable steps to ensure that the company diligently pursued the restructuring.

A restructuring moratorium (safe harbour) that provides a defence to insolvent trading liability is required as:

1. the existing law, without any restructuring moratorium, can impede or prevent proper attempts at informal workouts
2. the adverse effect of the existing laws on honest, capable directors, particularly non-executive directors
3. the focus of directors of a financially troubled company should primarily be (as it is in many other comparable jurisdictions) on the interests of creditors
4. the existing insolvent trading laws limit the options available to deal with financial distress, and

[2] Taken directly from the ARITA (then IPA), Law Council of Australia and the Turnaround Management Association Australia joint submission dated 2 March 2010 in response to the discussion paper *Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration*

5. a restructuring moratorium would promote the critically important policy objective of obliging directors to obtain early restructuring advice.

We note that directors should not be permitted to view the restructuring moratorium provisions as a relaxation of their responsibilities. If anything, their responsibilities should be seen as being heightened during this period by the business judgement rule requiring positive and beneficial governance thresholds to be met before the rule can be used.

In situations where the obligations for the protections are not met, the insolvent trading rules should actually be easier for a liquidator to prove in order to be able to obtain compensation for the affected creditors.

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Policy 15-05: Stronger regulation of directors and creation of a director identification number

The strengthening of insolvent trading rules should be supported by stronger regulation of directors. Consideration should be given to the implementation of a unique “director identity number” (DIN) in order to more readily identify and monitor a director’s involvement in companies.

Explanatory notes:

Presently there is no requirement to provide proof of identity when updating the corporate register maintained by the Australian Securities & Investments Commission (ASIC) of a director appointment. Safeguards, such as proof of identity requirements, could be put in place at the time of obtaining a DIN to mitigate the chance of inconsistent, misleading or false information being included on the corporate register.

The skills and abilities of directors cover a wide spectrum. There is a need to ensure that all directors adequately understand the duties and responsibilities of their position, and the good corporate and financial judgment requirements that underpin our proposal for the creation of a restructuring moratorium. We recommend that the successful completion of a suitably structured “new director” course be required as a pre-requisite to the issuing of a DIN. This could be endorsed by ASIC and offered as an online course.

ARITA

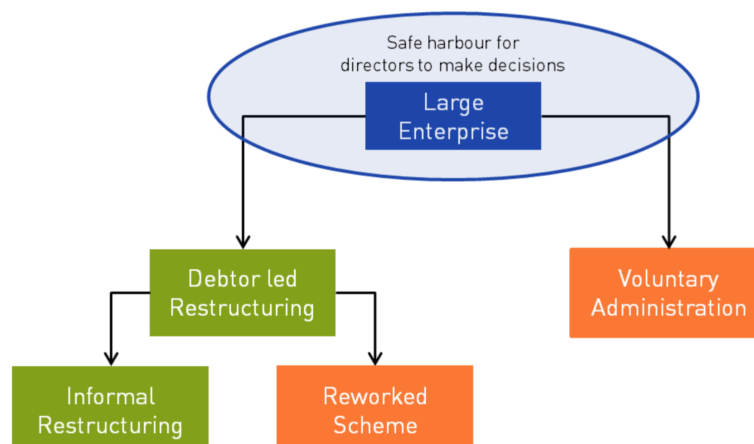
Policy 15-06: Advocate for informal restructuring

Restructuring moratorium proposals are intended to provide an environment whereby, in appropriate circumstances, companies and their directors can undertake informal restructuring initiatives without the threat of incurring liability from insolvent trading. It is reiterated that eligibility for this protection is dependent on meeting specific criteria.

Furthermore, the protections will mean that appropriately qualified and experienced professionals can be engaged in roles such as a chief restructuring officer (CRO) without facing the potential risk of incurring an insolvent trading liability as a shadow director[3]. This would allow greater scope in a CRO role than is currently possible due to the risks imposed under current legislation.

To The protection provided by the safe harbour of a restructuring moratorium would also deliver time to explore informal restructuring options where the solvency of a company may be in doubt.

Explanatory notes:



[3] Noting that other statutory duties may still apply to these types of roles

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Policy 15-07: Reworked Schemes/Voluntary Administration to aid in the rehabilitation of large enterprises in financial distress

ARITA recommends that the following enhancements be made to the current Scheme of Arrangement provisions (and in some instances, to the Voluntary Administration/Deed of Company Arrangement provisions in Part 5.3A of the *Corporations Act 2001*) to further foster restructuring in Australia via statutory insolvency administration:

- implement ARITA's restructuring moratorium (safe harbour) proposal to remove the current necessity for a precursor administration in Schemes of Arrangements
- enact a specific provision enabling a Scheme of Arrangement, subject to court approval, to have a standalone moratorium, including a restriction on the exercising of ipso facto clauses
- extend the voluntary administration moratorium to ipso facto clauses (refer policy 15-08 below)
- legislate to enable recovery of director related antecedent transactions in Schemes of Arrangement and Deeds of Company Arrangement to reduce their misuse by directors to protect their own interests
  - directors to have the ability to contract out of this liability with the Administrator in both Schemes and Deeds
- implement statutory provision for the obtaining of financing via a Scheme of Arrangement (or Voluntary Administration/Deed of Company Arrangement)
- remove related party voting in a Scheme of Arrangement and Voluntary Administration/Deed of Company Arrangement and reduction of voting requirements to a majority threshold in line with those in a Voluntary Administration/Deed of Company Arrangement, and
- limit voting using purchased debts to the value of consideration paid, consistent with the current requirements in the *Bankruptcy Act 1966*.

In addition to the above, ARITA believes that consideration should be given to the implementation of a "Schemes Panel" to replace the Court's oversight of Schemes of Arrangement. It is envisaged that this panel would operate in a similar manner to the Takeovers Panel and be a government regulated peer review panel.

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Policy 15-08: Extension of moratorium to ipso facto clauses

It is ARITA's view that successful restructuring through voluntary administrations is hampered because the moratorium in a voluntary administration does not extend to clauses that allow the termination of contracts simply because of the insolvency event (ipso facto clauses).

Extending the moratorium to cover such clauses will ensure that important contracts of the business are maintained so that goodwill is preserved while the company is under administration. This serves to maximise the potential of the company and its business continuing as a going concern or otherwise maintaining its value to third parties. Currently the experience of our members is that where the business is reliant on maintenance of contracts, voluntary administration sees the swift demise of the business due to automatic termination of these contracts – the rights of contractual counterparties are escalated above the rights and interests of creditors as a whole.

Voluntary administration already provides a limited and temporary moratorium against ipso facto clauses in some types of contracts. The law restricts the rights of landlords, secured creditors, and others during the voluntary administration process, but not contracts generally. We see the need for a restriction on the right to enforce all ipso facto clauses at least for the period of the administration, which is generally some few weeks. Leave of the court could be available to challenge the moratorium.

Explanatory notes:

An ipso facto contractual clause allows one party to terminate a contract by reason only of the fact (ipso facto) of the insolvency of the other party. These clauses are found in the majority of critical supplier contracts, franchise and license agreements as well as leases for land and equipment.

Under s 301 of the *Bankruptcy Act 1966*, ipso facto clauses are rendered void if the relevant obligor becomes bankrupt. However, there is no such prohibition in relation to corporate insolvency, and more particularly voluntary administration, under the *Corporations Act 2001*.

As a result, if a financially distressed but viable business that is reliant on essential contracts continuing enters into voluntary administration, it is likely that:

- contracts will immediately be terminated
- there will no longer be any business to restructure, and
- there will no longer be any going concern value for creditors.

In some cases, directors may in fact be reluctant to place their companies into voluntary administration because of concern that this may result in creditors exercising their right to terminate under an ipso facto clause and in effect terminate the company's business. This delay may weaken the company's chance of financial recovery.

ARITA

Policy 15-09: Streamlined liquidation for micro companies

Given the inherent lack of funding available for a formal insolvency process in financially distressed SMEs. ARITA believes that a reduced process liquidation option should be made available in certain circumstances for those companies at the small end of the SME spectrum, "the "micro companies".

For companies where the micro criteria is not met, or creditors elect for a creditors voluntary liquidation in order to ensure investigation processes are undertaken, ready access for practitioners to an enhanced Assetless Administration Fund-style arrangement is necessary.

The current requirements of Australia's liquidation processes impose a number of statutory reporting and process obligations on liquidators, which have the effect of increasing the costs of the liquidation and reducing, or eliminating, the return to creditors

We propose that to maximise the return to creditors, where companies with minimal liabilities fail, and they meet the micro company criteria (i.e. liabilities to unrelated entities less than $250,000), a new streamlined liquidation process automatically apply.

A new streamlined liquidation process would differ from the current liquidation requirement as follows:

- no requirement to call meetings, report to creditors, undertake investigations into the company and officers' conduct and complete statutory reporting (e.g. s 533 report)
- expedited dividend process:
  - streamlined proofs of debt dealing process for debts under $10,000
  - no tax clearance required from the Australian Taxation Office where the dividend is less than $25,000 (10% of maximum liability amount) or 10 cents in the dollar, and
  - streamlined advertising and notice requirements for dividends less than $25,000 (10% of maximum liability amount) or 10 cents in the dollar, and
- fixed fee set by government for this type of liquidation, no remuneration accounting or approval.

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In order to protect the rights of creditors and the integrity of the regime, the streamlined liquidation process would incorporate provisions whereby:

- the liquidator would report to creditors on appointment and gives them the option of converting the streamlined liquidation into a full creditors' voluntary liquidation (i.e. where normal investigating and reporting obligations apply and remuneration of liquidator is given priority in the normal way)
- if a majority of creditors (excluding related party creditors) vote for this to occur then it converts and the liquidator does not have the power to convert to a full liquidation without this consent
- if the liquidator subsequently becomes aware of a matter which may warrant investigation, they can again seek creditor directions (including resolution by circulation, if appropriate) as to whether the liquidation should convert to a full liquidation, and
- if provable liabilities at any time in the process exceed $250,000 to unrelated entities the streamlined liquidation process would no longer be available and the existing creditors' voluntary liquidation requirements would apply.

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Policy 15-10: Micro Restructuring

Section 185C of the *Bankruptcy Act 1966* provides a mechanism for individual debtors who meet specific eligibility criteria to enter a binding agreement with their creditors to accept a sum of money that the debtor can afford, more commonly referred to as a Part IX Debt Agreement.

Maximising the prospects of continuing the operations of financially distressed but viable small companies, we propose that a similar mechanism be implemented to deal with micro companies. It is envisaged that this process would be more streamlined and cost effective to implement than the compromise alternatives that are available under the existing Voluntary Administration/Deed of Company Arrangement provisions of the *Corporations Act 2001*.

To be eligible to undertake a micro restructuring agreement the company must:

- meet the definition requirements of a micro company
- be insolvent, and
- not have, or have directors who have, previously done a micro restructuring agreement. Such protection would be available under our restructuring moratorium proposals in Policy 15-04.

We would recommend that any micro restructuring mechanism would require:

- The company to prepare a Report as to Affairs (RATA) to be provided with the proposal.
- A Registered Liquidator to oversee the development and implementation of the proposal, possibly referred to as a Restructuring Monitor:
    - who examines and approves the proposal
    - issues the proposal to creditors, and
    - may set fixed or other fee basis for creditor consideration and approval at same time as proposal.
- Creditors vote to accept or to put the company into liquidation:
    - no need for physical meeting, with the resolution able to be considered by circulation
    - if creditors vote for liquidation then the company proceeds to liquidation immediately
    - related parties cannot vote, and

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- if debt is purchased then purchaser only entitled to vote for amount for which debt purchased.

- An accepted proposal would be put into effect by the Liquidator/Restructuring Monitor and would be subject to the following provisions:
    - no requirement to call or hold further meetings
    - if provable debts to unrelated entities exceed $250,000 then appointment would automatically convert to a Voluntary Administration with full investigation and reporting requirements (if directors wish to continue to put a Deed of Company Arrangement proposal to creditors), or creditors voluntary liquidation (if there is no Deed of Company Arrangement proposal)
    - streamlined proofs of debt process for debts under $10,000
    - no tax clearance from Australian Taxation Office required where dividend is less than $25,000 (10% of maximum liability amount) or 10 cents in the dollar, and
    - a default longer than six months automatically results in the company being placed into liquidation.
- Creditors may apply set aside the proposal if there is a lack of full disclosure in the proposal or injustice provisions, similar to the current requirements in a Part IX Debt Agreement.

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Policy 15-11: Pre-positioned sales

ARITA supports a “pre-positioning” arrangement in situations of corporate financial distress, to enable viable businesses to continue and maximise return for creditors via a sale of business negotiated prior to an insolvency appointment.

Pre-positioning is work done prior to a statutory insolvency appointment. Directors take advantage of the proposed restructuring moratorium protections, subject to meeting the criteria for eligibility, to undertake an orderly wind down of the company’s operations – that is a well-managed process where assets may be realised for market value in a non-distressed sale – prior to making a formal insolvency appointment. Directors may obtain the assistance of advisors, including insolvency practitioners, during this process.

ARITA’s proposed pre-positioning framework would require that:

- Any advisor retained by the directors in the pre-positioning phase could not subsequently be appointed in any formal insolvency administration. This is consistent with the current and appropriate independence requirements for insolvency practitioners in Australia.
- Any sales that occur in the pre-positioning phase must be for value and would be subject to review in any subsequent statutory insolvency administration.
- Any sale of assets undertaken during the statutory insolvency administration, where the terms of sale were negotiated in the pre-positioning phase, would be subject to review by the external administrator prior to being effectuated and the external administrator would be subject to the currently existing statutory and professional requirements regarding the sale of assets.

It is ARITA’s view that consideration should be given to restricting the sale of company assets/business to related entities during this pre-positioning phase. Rather, where the sale of a business or the assets to a related entity is contemplated, and the company is insolvent, that sale must be undertaken under the control of an independent insolvency practitioner through a statutory insolvency regime; either a Voluntary Administration (subject to ARITA’s recommendations for improvements), a micro restructuring (refer Policy 15-10) or liquidation.

For a number of reasons (including independence, whether the sale is for value and the lack of creditor involvement) we do not consider that a UK-style pre-pack process would be suitable for Australia.

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Appendix B – Previous ARITA submissions

- ARITA (then the IPA) submission and letters of 26 November 2003, 8 March 2004 and 30 August 2005 to CAMAC in relation to its discussion paper on Rehabilitating large and complex enterprises in financial difficulty
- ARITA (IPA) submission of 15 June 2007 to Treasury in relation to the Review of Sanctions in Corporate Law
- ARITA (IPA) submission of 16 May 2008 to CAMAC in relation to its discussion paper on Issues in external administration
- ARITA (IPA) submission to Treasury jointly with the Law Council of Australia and the Turnaround Management Association Australia dated 2 March 2010 in relation to its discussion paper on Insolvent trading: A safe harbour for reorganisation attempts outside of external administration; supplementary submission of ARITA dated 18 March 2010.
- ARITA (IPA) submission to CAMAC of 7 October 2011 in respect of its June 2011 Managed Investment Scheme discussion paper
- Strengthening APRA's Crisis Management Powers – Consultation Paper – September 2012, ARITA (IPA) submission December 2012
- ARITA submission to CAMAC of 10 June 2014 in respect of its March 2014 discussion paper on the Establishment and operation of Managed Investment Schemes
- ARITA submission to UK consultation paper – Strengthening the regulatory regime and fee structure for insolvency practitioners, 28 March 2014
- ARITA submission of 26 August 2014 in response to the Financial Systems Inquiry Interim Report
- ARITA submission of 4 September 2014 to the Senate Standing Committees on Economics inquiry into Forestry Managed Investment Schemes
- ARITA supplementary submission to the Financial Systems Inquiry of 13 October 2014 regarding the use of technology
- ARITA submission of 2 March 2015 to the Productivity Commission in response to their inquiry into Business Set-up, Transfer and Closure
- ARITA's numerous submissions to the Personal Property Securities Act Review
- Numerous consultations and submissions to Treasury in relation to the Insolvency Law Reform Bills 2013 and 2014

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Appendix C – Specific areas for amendment

These suggestions for amendment are in the nature of minor or technical amendments and are in two groups, by reference to particular sections and by reference to terminology across sections. They were initially provided to Treasury in 2009. This list only contains outstanding matters.

Comments on particular sections of Chapter 5	
Section of *Corporations Act*	**ARITA Comment**
421A	The requirement to prepare a report in this section is described as being 'to a day not later than 30 days before the day when it is prepared'. We think this is very unclear wording, in fact have difficulty in clearly understanding it, and suggest that it be changed.
435C	Section 435C(3)(h) provides that an administration ends when 'management of the general insurer vests in a judicial manager of the company appointed by the Federal Court under Part VB of the Insurance Act 1973 or Part 8 of the Life Insurance Act 1995'. Part 8 of the *Life Insurance Act* deals with judicial management of life companies, as that term is defined. It seems that section 435C(3)(h) should say '...management of the general insurer vests in a judicial manager of the company appointed by the Federal Court under Part VB of the Insurance Act 1973 or management of the life company vests in a judicial manager of the company appointed by the Federal Court under Part 8 of the Life Insurance Act 1995'.
440D and 440F	Section 440D provides that during the administration of a company, 'a proceeding in a court against the company or in relation to any of its property' cannot be begun or proceeded with, except with the administrator's written consent or with court leave. Section 440F provides that during the administration of a company, 'no enforcement process in relation to property of the company can be begun or proceeded with' except with court leave. There is a difference in grammar and voice between these two sections, the reason for which is not apparent.
442C	Section 442C(4) refers to a situation where the administrator proposes to dispose of property *of the company* under paragraph 442C(2)(a) and provides that the Court may by order direct the administrator not to carry out that proposal. However, section 442C(5) refers to orders being made on the application of persons affected by either paragraph 442C(1)(a) or (b) and paragraph 442C(1)(b) of course refers to property that does not belong to the company.

	In the context of what is anticipated by section 442C(5) i.e. that an order may be made referable to disposals of property referred to under either paragraphs 442C(1)(a) or (b), then section 442C(4) needs to be amended to accommodate this. It should state either: *(4) 'If the administrator proposes to dispose of property under paragraph (2)(a), the Court may, by order, direct the administrator not to carry out that proposal'.* In other words, delete '…of the company.' or: *(4) 'If the administrator proposes under paragraph (2)(a)to dispose of property of the company or property of which someone else is the owner or lessor, the court may, by order, direct the administrator not to carry out that proposal'.*
466/556	In s 466, there is a reference to 'taxed costs' and these are accorded a priority under s 556(1)(b). However there is no longer concept of costs being 'taxed' in some jurisdictions where costs are assessed – see *Morepine v Crush Pacific Industries* (1996) 14 ACLC 898. As well, the amount involved is such that any formal process of determining the costs should not be required – we suggest that the phrase 'as taxed, assessed or agreed'.
477	Section 477(1) refers to the fact that the liquidator may carry on the business of the company 'so far as is necessary for the beneficial disposal or winding up of that business'. Is there any logical reason for the different wording in s 493 which provides that the company must 'cease to carry on its business except so far as is in the opinion of the liquidator required for the beneficial disposal or winding up of that business'?
491	Section 491 refers to a 'printed copy of the resolution' – we think that what is meant is a copy of a written record of the resolution. In any event, it is clear enough to say 'a copy of the resolution' – see s 507(11) as an example.
497	Section 497(1) requires the liquidator to 'cause' a meeting of the creditors to be 'convened' within 11 days. The word 'convene' means to arrange the holding of a meeting; this is the way the term is used elsewhere in the *Corporations Act* and in the equivalent provisions in the *Bankruptcy Act*. We do not think this is what was intended – the Explanatory Memorandum [4.196] says that 'the required timing for the creditors meeting will be extended to 11 days after the day of the members' meeting'; if that was so, the section would say the liquidator should cause the meeting to be 'held' within 11 days. As it is, ARITA is generally content with the present wording and timing, that is, to require the convening of the meeting within 11 days and then the holding of it

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	7 days thereafter. This is so particularly in light of the fact that directors have 7 days to provide a RATA (s 497(5)). However, we think that a time limit should be set on the maximum period of notice that can be given for the meeting. At the moment, there is a minimum notice requirement of 7 days (s 497(2)) but no maximum, so theoretically a liquidator could give a lengthy notice period for a meeting. We suggest that the words 'must cause a meeting of the company's creditors to be convened' might more simply be expressed as 'must convene a meeting of the company's creditors …' and s 497(2)(a) should read 'give to the creditors at least 7 days but no more than 14 days notice of the meeting'. ***We note that if the ILRB 2014 proceeds, the section is subject to significant amendment ***
497(8)	Section 497(1) requires the liquidator to convene the meeting of creditors. Section 497(8) states that 'the creditors may appoint one of their number or the liquidator to preside at the meeting', but regulation 5.6.17 states that if a meeting is convened by 'a liquidator [etc] …that person, or a person nominated by that person, must chair the meeting'. An issue of inconsistency was discussed in *Re Henry Walker Eltin Group Limited (Administrators Appointed)* ACN 007 710 483 [2006] FCA 353. ARITA suggests that an inconsistency arises here because originally (pre 2007) the CVL meetings were convened by the company, not the liquidator. That is why creditors had a choice in appointing a chair for the meeting. However, now that it is the liquidator convening the meeting, CVLs should be made consistent with other meetings held by liquidators and it should be the liquidator, or his or her nominated alternate, that chairs the meeting. The difference, if any, between 'presiding (over)' and 'chairing' a meeting is raised at the end of this schedule.
536/423	You are referred to the decision of the Victorian Supreme Court in *Vink v Tuckwell* [2008] VSC 100 which was critical of the drafting of this section. The Court said that [185] '... the legislature should consider amending s 536 of the Act to limit the persons who may complain to the court to those who have an interest in the liquidation'. The *Bankruptcy Act* equivalent is s 179. There is no similar issue involved – s 179 limits the applicants to the Inspector-General, a creditor or the bankrupt. It may be that you should consider something similar to s 179. The same issue affects s 423.

548	Section 548 provides that the liquidator must, if so requested by a creditor or contributory, convene separate meetings of the creditors and contributories for the purpose of determining whether a committee of inspection should be appointed etc. This appears to be the only power whereby a committee can be appointed and it strictly means a committee can only be initiated by a creditor or contributory. This compares for example with the simplicity of s 436E(1)(a). ***We note that if the ILRB 2014 proceeds, this provision is subject to significant amendment ***
565-567	Will these pre-1993 sections be repealed?
588FE(4)	Section 588FE(4) is as follows: The transaction is voidable if: (a) it is an insolvent transaction of the company; and (b) a related entity of the company is a party to it; and (c) it was entered into, or an act was done for the purpose of giving effect to it, during the 4 years ending on the relation-back day. We consider that the term a 'related entity of the company is a party' is broader than intended and that it was properly meant to say 'the transaction is in favour of a related entity of the company' or some such words. To illustrate the issue, if X1 grants a charge to its (unrelated) bank for a previously unsecured debt, the bank would expect only to have to wait for 6 months for the security to 'harden'. However, if, as part of the price for the bank agreeing not to press for repayment of its debt, it not only requires X1 to give security but also that X2, a related entity of X1's, to give a guarantee (and maybe security), it is at least arguable (and may be more or less arguable depending on exactly how the deal is documented) that there is a single 'transaction' (being the whole deal) to which not only X1 but also a related entity of X1 is a party. In that instance, the bank would have to wait 4 years for its security to harden. We do not consider this is contemplated by the provision. This issue may bear further consideration.
601AH	In *Foxman v Credex* [2007] NSWSC 1422, Justice Richard White of the NSW Supreme Court was critical of the drafting of s 601AH, saying that the section 'is a law reform measure itself in need of reform'. We refer you to that judgment for your assessment of the legal and drafting issues raised. As you have said, this issue may bear further consideration.

<table>
<tr><th colspan="2">Comments on general issues of terminology across a number of sections</th></tr>
<tr><th>Issue</th><th>ARITA Comment</th></tr>
<tr><td>Fixing and determining remuneration</td><td>Section 425 refers to the Court’s power to ‘fix’ remuneration; as do sections 495, 499, 473 and 484. Section 449E refers to remuneration being ‘determined’, as does section 473(3).

There appears to be no reason for the difference in wording; the word ‘fix’ is used in the Bankruptcy Act and is preferred as the historically based and well known term used. The word ‘determine’ is used in other senses in the Corporations Act.</td></tr>
<tr><td>Timing and service</td><td>As a general comment, we suggest there be a review of how time limits are expressed in Chapter 5, with a view to simplicity and consistency; and of document service requirements. Time limits are important in insolvency and often strictly applied. Practitioners should be able to readily calculate the time within which an action should be taken, by them or by creditors or others. Likewise, means of service and at what time a document is served should be clear.

We have not done a detailed review but suggest that Chapter 5, and the Act itself, is not simple or consistent. Examples are:

• Under s 439A(3)(a), written notice of a meeting is given at the time it is put in the post for the purpose of sending it to the person by prepaid post as required by Regulation 5.6.12(2)(b) – Re Vouris; Epromotions Australia Pty Limited v Relectronic-Remech Pty Limited (in liq) [2003] NSWSC 702; 47 ACSR 155; Yates, in the matter of G Retail Ltd (Adm’r App’d) [2006] FCA 370. That approach has the benefit of certainty but it relies upon judicial interpretation;

• A similar but more significant issue (as to the date of service of a tax penalty notice) arose in Deputy Commissioner of Taxation v Meredith [2007] NSWCA 354, which again relies upon judicial interpretation.

• General issues of complexity as to timing and service are raised in Scope Data Systems Pty Ltd v David Goman as Representative of the Partnership BDO Nelson Parkhill [2007] NSWSC 278; (2007) 210 FLR 161, which we consider a simpler regime would avoid. Even in relation to relatively straightforward timing calculations under what appear to be clear provisions, judicial assistance can be required – see Weston Application; Employers Mutual Indemnity (Workers Compensation) Ltd v Omni Corporation Pty Ltd [2009] NSWSC 264 (s 588FF(3)); and Amorin Constructions Pty Ltd v Kamtech Electrical Services Pty Ltd [2008] NSWSC 267 (s 459R).</td></tr>
</table>

ARITA

Appendix D – Other matters for reform

There are other matters for reform that should also be examined, as these issues can directly affect the effectiveness of Australia's insolvency regime. We bring the following matters to your attention, although we note that this list is not exhaustive:

The insolvency of trading trusts – The nature of trusts results in many problems when they become insolvent. This is clearly demonstrated in the recent failures of managed investment schemes and the large number of complex court actions required to progress them. We refer you to our many submissions on this issue listed at Appendix B.

Tax – Many problems and inconsistencies arise due to the fact that tax legislation is written from the perspective of an ongoing business that will continue to trade and pay its tax debts in due course. The financial failure and wind down of a business, with a change of control to an external administrator, terminates this process and tax legislation largely does not cope well with this occurrence. Two examples of this are:

> **Capital gains tax** – There is much uncertainty around the liability for, and priority of, capital gains tax in insolvency. We refer you to the recent decisions in *Australian Building Systems Pty Ltd v Commissioner of Taxation* [2014] FCA 116 and its appeal in *Deputy Commissioner of Taxation v Australian Building Services Pty Ltd (In liquidation)* [2014] FCAFC 133. We note that the Deputy Commissioner of Taxation has also lodged a High Court special leave application which is being heard on 17 April 2015.
>
> The position put forward by the ATO suggests that the following inconsistency can occur: If an asset is sold for a profit one day prior to the appointment of a liquidator, the capital gain would fall as pre-appointment income and would be a provable debt. However, if the same asset were sold one day after appointment, the whole amount of the capital gain would be income of the liquidation, with the resulting tax payable an expense of the liquidation which has a high priority under s 556, and possibly a personal liability of the liquidator.
>
> **Superannuation Guarantee Charge** – Misalignment of obligations to pay interest under the Superannuation Guarantee Act and how interest is treated under the Corporations Act when proving a debt.

Personal Properties Securities Act – We draw your attention to recommendations 365 and 366 from the report on the Personal Property Securities Act 2009. These reform issues referred to Treasury relate to the treatment of securities in insolvency. ARITA made numerous submissions to this review and they are available on the Attorney-General's website for the Review.

Lack of clarity in the priority of employee entitlements – The problem of employee priorities has been mentioned in several court decisions, particularly where there are multiple appointments (for example a receiver and a liquidator), and we refer you to a submission by the Law Council to Treasury, which was supported by ARITA, and the following recent articles in The Australian Insolvency Journal (attached for your reference).

- ‘Employee entitlements in corporate insolvency: some unresolved issues’, Dr Garry Hamilton, Minter Ellison lawyers
- ‘Employee priority, subrogation and breach of trust developments’, Michael O’Donnell and Sam Carragher, Thomson Geer Lawyers

07

DR GARRY J HAMILTON
Partner,
Minter Ellison Lawyers

comment and opinion

EMPLOYEE ENTITLEMENTS IN CORPORATE INSOLVENCY: SOME UNRESOLVED ISSUES

Dr Garry Hamilton puts the spotlight on six employee entitlements issues that insolvency practitioners should be aware of.

Since at least as early as 1969, with the decision of the High Court in *Stein v Saywell* (1969) 121 CLR 529, Australian courts have grappled with both the proper construction of ss 433 and 561 of the *Corporations Act 2001* (Cth) (Act) (and their predecessor sections in the *Companies Codes*) and the question of how the sections interact. During the course of this journey, the courts have resolved some of the issues.

I have written this article to highlight six issues that are important, either because the decided cases are in conflict or the issue simply has never been addressed. I don't provide any suggested resolution of the issues, but rather simply bring them to your attention so that should they arise in your work, you don't proceed on any false assumptions.

RELEVANT STATUTORY PROVISIONS

Before proceeding to the examples, it is instructive to refer to the relevant sections of the Act. The provisions, highlighted for emphasis, are set out below.

First, s 433 provides relevantly as follows:

Section 433: Property Subject To Circulating Security Interest – Payment of Certain Debts to Have Priority
[There is no subsection 1.]

433(2) **This section applies where**:
(a) **a receiver is appointed** on behalf of the holders of any debentures of a company or registered body that are secured by a circulating security interest, or possession is taken or control is assumed, by or on behalf of the holders of any debentures of a company or registered body, of **any property comprised in or subject to a circulating security interest; and**
(b) **at the date of the appointment** or of the taking of possession or assumption of control ...
(i) **the company or registered body has not commenced to be wound up voluntarily; and**
(ii) **the company or registered body has not been ordered to be wound up by the Court.**

433(3) In the case of a company, **the receiver** or other person taking possession or assuming control of property of the company **must pay, out of the property coming into his, her or its hands, the following debts or amounts in priority to any claim for principal or interest in respect of the debentures**:
(a) [not relevant];
(b) [not relevant];
(c) ... next, **any debt or amount that in a winding up is payable in priority to other unsecured debts pursuant to paragraph 556(1)(e), (g) or (h)** ...

Secondly, s 556 provides relevantly as follows:

Section 556: Priority Payments

556(1) Subject to this Division, in the winding up of a company the following debts and claims must be paid in priority to all other unsecured debts and claims:
...

(e) ...

(i) wages, superannuation contributions and superannuation guarantee charge payable by the company in respect of services rendered to the company by employees before the relevant date; or

...

(g) ... all amounts due:

(i) on or before the relevant date; and

(ii) because of an industrial instrument; and

(iii) to, or in respect of, employees of the company; and

(iv) in respect of leave of absence;

(h) ... next, retrenchment payments payable to employees of the company.

Thirdly, s 558 provides relevantly as follows:

Section 558: Debts Due To Employees

558(1) [Date of termination of employment] **Where a contract of employment with a company being wound up was subsisting immediately before the relevant date, the employee under the contract is, whether or not he or she is a person referred to in subsection (2), entitled to payment under s 556 as if his or her services with the company had been terminated by the company on the relevant date**.

Fourthly, s 561 provides relevantly as follows:

Section 561: Priority of Employees' Claims Over Circulating Security Interests

561 **So far as the property of a company available for payment of creditors other than secured creditors is insufficient to meet payment of**:

(a) **any debt referred to in paragraph 556(1)(e), (g) or (h); and**

(b) any amount that pursuant to subsection 558(3) or (4) is a cost of the winding up, being an amount that, if it had been payable on or before the relevant date, would have been a debt referred to in paragraph 556(1)(e), (g) or (h); and

(c) any amount in respect of which a right of priority is given by s 560; **payment of that debt or amount must be made in priority over the claims of a secured party in relation to a circulating security interest created by the company and may be made accordingly out of any property comprised in or subject to the circulating security interest**.

THE SIX EMPLOYEE ENTITLEMENTS ISSUES

1. For the purposes of s 433 do a receiver's costs, charges and expenses (including the receiver's remuneration) have priority over the employee entitlements which are the subject of that section?

The answer to this question would appear to be a tentative 'yes'.

A case, often quoted with approval, is the decision of *Bryson J in Whitton v ACN 003 266 886 Pty Ltd (Controller Appointed) (in liquidation)* (1996) 42 NSWLR 123 (*Whitton*).

In *Whitton*, Bryson J held that a receiver's liability under that section equates to the value of the assets the subject of a floating charge (or circulating security interest) at the date of the appointment of the receiver. His Honour stated (at p 146):

> *Any rights to preference under s 433 could extend only to property which was subject to a floating charge before crystallisation on [the date the receiver was appointed]. Cash, money at bank and stock in trade then would be; it is out of these assets that the controller is obliged by s 433 to pay the preferential debts, and if he does not do so and uses them, even in an economically rational way, to bring some other assets into existence such as book debts for completed work, his liability for damages for breach of his statutory duty is measured by reference to the value of the assets subject to the floating charge on [the date of his appointment], and not by reference to the value of anything towards the later creation of which they contributed.*

His Honour made no reference to the question of whether a receiver's costs, charges and expenses (including the receiver's remuneration) could be deducted, to the extent which may be necessary, from the value of the assets subject to the floating charge, without the receiver becoming liable for any 'shortfall'. The question of whether such costs, charges and expenses have priority over employee entitlements was not considered by his Honour.

That issue was however addressed specifically in the earlier decision of *Waters v Widdows* [1984] VR 503. In that case, Nicholson J undertook a detailed and historical review of whether the costs, charges and expenses of a receiver had priority over the payment of the employee entitlements payable under s 331 of the *Companies (Victoria) Code* (now s 433 of the Act).

As Nicholson J noted, the section gives priority to claims of employees over any claim for 'principal and interest in respect of the debentures' and accordingly it was his Honour's view that it would be necessary to categorise the receiver's costs, charges and expenses as falling within the expression 'principal and interest' before one could conclude that any employee entitlements were to be paid in priority to the receiver's costs, charges and expenses.

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It is unrealistic, in my opinion, to suggest that work in progress is not an asset and its characterisation as a 'potential asset' is unhelpful.

As his Honour noted in *Widdows*, the authorities examined by him went back at least 75 years in respect of similarly worded sections of legislation governing employee entitlements in both Australia and England. Those authorities support his Honour's finding in *Widdows*.

Bryson J did not consider the position of the extent of employee entitlements under s 561 of the Act i.e. where liquidation precedes receivership. That issue was however addressed directly by Nicholson J in *Waters v Widdows* where his Honour concluded that, as was his Honour's view of s 433, the cost charges and expenses (including the receiver's remuneration) would have priority over the employee entitlements payable by reason of s 561.

It would seem therefore that despite the mandatory language of ss 433 and 561, these provisions need to be qualified by the fact that a receiver's costs, charges and expenses (including his or her remuneration) take priority over the employee entitlements.

2. How does one value the assets subject to the circulating security interest/floating charge for the purpose of s 433?

This answer to this question is unknown.

The question is relevant particularly where the receiver decides to 'trade on' and does in fact do so with a view to selling the business as a 'going concern'.

In those circumstances it seems logical to assume that the assets the subject of the floating charge at the date of the appointment of the receiver should be valued on a 'going concern' basis rather than by 'auction' or upon a 'forced sale' basis.

One 'asset' that appears to make a significant difference to the quantum of the employee entitlements where a trade-on of a manufacturing enterprise is involved is work in progress. Work in progress is arguably an asset subject to the ambit of a circulating security interest.

However, in *Whitton*, Bryson J thought it difficult to conceive of work in progress as an asset. His Honour thought that it may be a 'potential asset' or 'an opportunity' but such that the opportunity must be availed of and the work carried out to the point where some money is contractually payable before work in progress matures into a book debt (at p 137). With respect, work in progress must fall within one or other of the categories of fixed or floating security interests.

It is unrealistic, in my respectful opinion, to suggest that work in progress is not an asset and its characterisation as a 'potential asset' is unhelpful.

Certainly, in a trade-on situation or alternatively where the receiver keeps the business alive and later sells it as a 'going concern', which often is the case with manufacturing businesses, it does not seem realistic or appropriate to ascribe no value at all to work in progress.

Work in progress aside, the broader issue however remains; and that is whether the circulating assets should be valued on a going concern basis or an auction basis when the receiver trades the business. Surprisingly, there appears to be no legal precedent which addresses this issue.

3. Do retrenchment payments have priority under s 433 whenever they arise or only where the company is in liquidation?

The answer to this question depends on the particular decision that one follows.

There appear to be only two reported decisions which directly address the priority of retrenchment payments under s 433.

In *Whitton*, the company was in receivership but not in liquidation, yet Bryson J held that redundancy amounts arising subsequent to the appointment of the receivers in fact had priority under s 433(3)(c). His Honour reached that conclusion by reliance upon the definition of 'retrenchment payments' in s 556(2), meaning any retrenchment payments whenever they become payable, 'even if after the controllers assuming control' (at p 148).

The opposite conclusion was reached by Finkelstein J in *McEvoy v Incat Tasmania Pty Ltd & Ors* [2003] FCA 810

(*Incat*) where again the company was in receivership but not in liquidation and his Honour held that unless the employees had actually been retrenched at the date of the appointment of the receivers, then the receivers had no liability under s 433 (or otherwise) to pay any retrenchment payments which later arose in the receivership.

There does not appear to be any other reported decision which addresses this particular issue, such that the correct answer to the question remains unresolved.

4. Do ss 433 and 561 cover assets subject to a crystallised floating charge in circumstances where the receiver continues to trade and generates finished goods, book debts and cash at bank?

The answer to this question is unknown.

In *Whitton*, Bryson J held that only the assets subject to a floating charge were those in existence at the date of the appointment of the receivers and were available to meet the employee entitlements.

In his Honour's view, a controller's liability 'neither increases with success nor diminishes with failure of any venture in which he utilises assets which have been subject to a floating charge' (at p 146). This view results from his Honour's opinion that any asset of whatever nature brought into existence after crystallisation of a floating charge will not be the subject of s 433 (at p 146). As his Honour stated (at p 146):

> ***Any rights to preference under s 433 could extend only to property which was subject to a floating charge before crystallisation on [the date the receiver was appointed]****.* *Cash, money at bank and stock in trade then would be; it is out of these assets that the controller is obliged by s 433 to pay the preferential debts, and if he does not do so and uses them, even in an economically rational way, to bring some other assets into existence such as book debts for completed work,* ***his liability for damages for breach of his statutory duty is measured by reference to the value of the assets subject to the floating charge on [the date of his appointment], and not by reference to the value of anything towards the later creation of which they contributed*** *[emphasis added].*

Four comments can be made in response to that proposition.

First, s 9 of the Act defines a 'circulating security interest' which is the expression used in ss 433 and 561. Section 9 defines the expression by reference to s 51C that refers back to the definition of a 'floating charge' in s 9. The expression 'floating charge' is defined to include a charge that conferred a floating charge at the time of its creation but which later becomes a fixed or specific charge. That definition was inserted into the legislation to overcome the loophole in the predecessor to s 433, as identified by the High Court in *Stein v Saywell* (1969) 121 CLR 529.

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Secondly, it is well established that a floating charge continues to attach to assets acquired after crystallisation In WJ Gough, *Company Charges* (2nd ed), Butterworths, the learned author says (at p 123) that:

> *[t]he crystallised charge continues to cover present and future assets held or acquired by the chargor during the course of the receivership. Even in the case of winding up, the crystallised charge should in principle also extend to assets acquired during the course of the winding up through the exercise of the limited trading powers of the liquidator or otherwise.*

Thirdly, as noted above, his Honour's view is that assets which come into existence after the crystallisation of a floating charge are not the subject of s 433. This means that in most cases where the receiver carries on the business, collecting book debts, using the cash so obtained to trade and turning stock into finished goods which are then sold to produce new book debts, the assets which were the subject of a floating charge at the date of the receiver's appointment will have ceased to exist.

Fourthly, his Honour's view that the liability under s 433 is to be measured by reference to the value of the floating charge assets at the date of the receiver's appointment (and does not increase or decrease because of what trading activities the receiver may subsequently undertake), is difficult to reconcile with the comments under point one above. That is, assuming that the view of Nicholson J in *Widdows* is correct (and it would seem to be, based on many years of precedent), then the receiver's liability under s 433 may reduce by the the receiver's costs, charges and expenses (including remuneration) should the receiver decide to trade the business.

5. What is the position where s 558 is engaged following receivership and the receiver continues trading, employing the company's employees?

The answer to this question is unknown.

The cases consistently hold that once a company goes into liquidation, s 558 operates to effect a termination of employment contracts at the 'relevant date' and entitle the employees to the priorities under s 556, one such priority being redundancy payments under s 556(1)(h).

In general, the 'relevant date' (in cases not involving a winding up under s 439C being one which follows a voluntary administration), is, in the case of a court-ordered winding up, the date of the winding up order, and in the case of a voluntary winding up, the date of the passing of the resolution (see the definition of 'relevant date' in s 9 and Division 1A of Part 5.6 of the Act).

Is the liquidator or the receiver obliged by s 561 to use assets subject to a circulating security interest to pay redundancy payments even where the receiver is still in control and still trading the company?

No decision appears to have ever considered this point.

On one view, it seems illogical to suggest that a person who is not in fact retrenched is entitled to a retrenchment payment because of the deeming provision in s 558.

6. How do s 433 and s 561 interact where a receiver is appointed to a company that later goes into liquidation?

The answer to this question is unclear.

This was one of the questions before Master Sanderson in *Re Great Southern Ltd (in liquidation); Ex parte Thackray* (2012) 260 FLR 362 (*Great Southern*).

The Master considered whether both sections operated in a 'complementary' manner. The Master referred to the decision of Finkelstein J in *Cook v Italiano Family Fruit Co Pty Ltd (in liquidation)* (2010) 190 FCR 474 (*Cook v Italiano*), and said that the possibility that both sections apply relies heavily upon the decision in *Cook v Italiano*. The Master said (at p 369):

> *[Finkelstein J] concluded that the two provisions were intended to be 'complementary'. But as a discussion of the provisions above has indicated, they are not really complementary at all, at least so far as employee entitlements are concerned.*

However, a few paragraphs later, the Master concluded that: 'The proper course is … that [the two sections] be treated as complementary.'

With respect, the logic from getting from the second last mentioned quote to the last mentioned quote is somewhat difficult to follow. The quotes appear directly contradictory.

Nevertheless, the Master states that, in his view, s 433 operates as at the date of the appointment of the receiver and there is no warrant for any suggestion that it ceases

to operate upon the liquidation of the company. The Master also says that the terms of s 561 are clear in that once a resolution is taken by the creditors to wind up the company, then s 561 applies (at p 370).

There of course then arises the question of whether the circulating assets to which s 561 apply are the same as the circulating assets in existence when s 433 previously applied. In practical terms, they would rarely be the same and then one reverts to the considerations under issue 4 above.

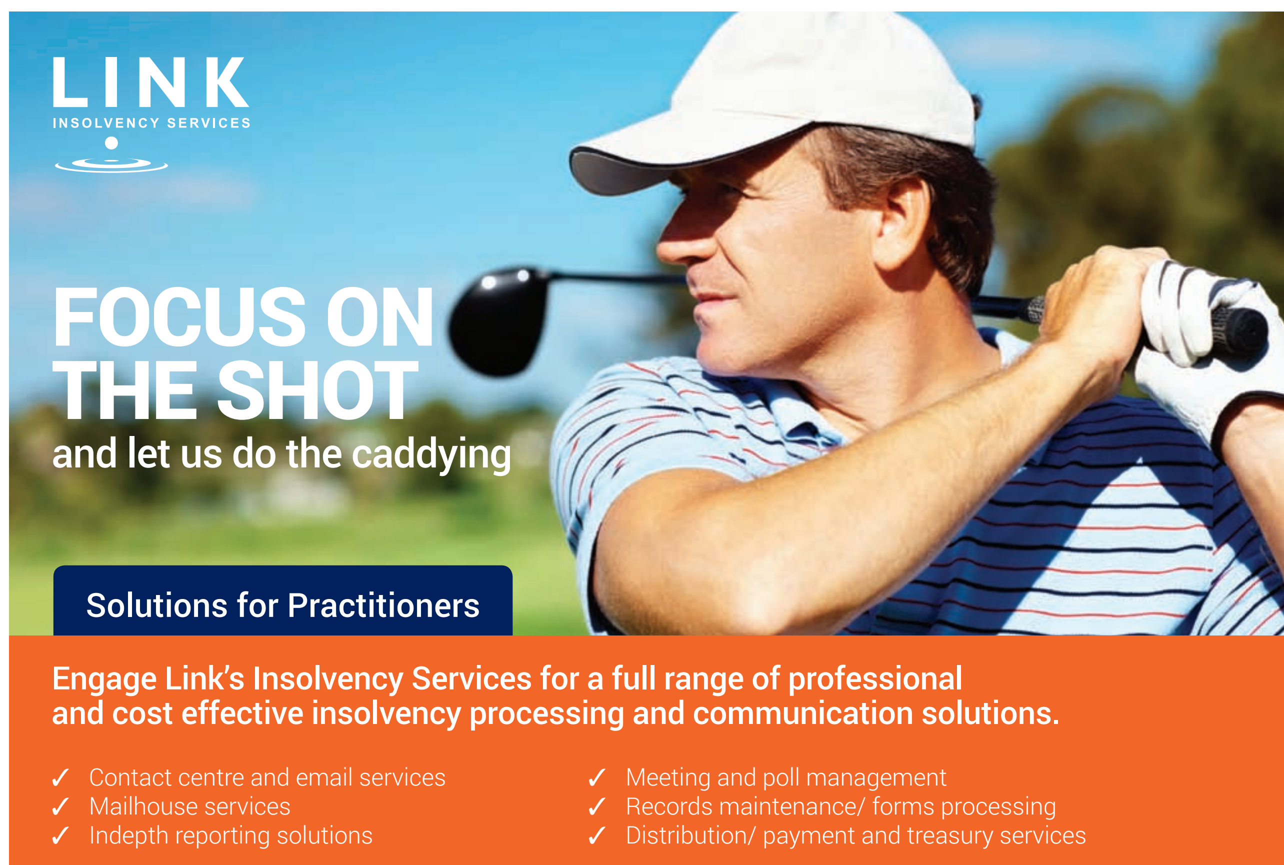
In other words, it may be the case that by the time the company goes into liquidation following receivership, none of the assets subject to the circulating security interest, which were in existence when the receivers were appointed, are still in existence and available to pay employee entitlements.

CONCLUDING THOUGHTS

As the examples above illustrate, the law regarding employee entitlements in corporate insolvency is far from being finally settled. In fact, there are some basic aspects of this area of law that remain unresolved.

In many cases where the judicial interpretation of legislation has resulted in either practically inconvenient or absurd results, there is often a cry for legislative reform. That approach is probably not warranted here.

Over time, the courts have found sensible and practical solutions to this small area of corporate insolvency law and for those cases in apparent conflict, the appellate courts will no doubt, over time, rectify those inconsistencies. In addition, in respect of those areas not yet subject to judicial scrutiny, they will no doubt eventually be considered by the courts and clarified.



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MICHAEL O'DONNELL
*Partner,
Thomson Geer
Lawyers*

SAM CARRAGHER
*Senior Associate,
Thomson Geer
Lawyers*

EMPLOYEE PRIORITY, SUBROGATION AND BREACH OF TRUST DEVELOPMENTS

A review of the current state of the authorities on these complex issues and some possible future developments.

When a secured creditor appoints a receiver under a general security agreement (Charge), s 433 of the *Corporations Act 2001* (Cth) (Act) requires the proceeds from the sale of circulating assets to be applied to certain employee entitlements in priority to the secured creditor (Bank). Section 561 of the Act has a similar effect where a company is in liquidation, but only if there are insufficient uncharged assets otherwise available to pay the employee entitlements.

Recent cases have addressed whether a Bank can subrogate to the employees' priority rights and enjoy a priority dividend out of preference recoveries, despite its charge not capturing these recoveries.[1]

The courts have also considered allegations of breach of trust by insolvency practitioners flowing from legal uncertainty about whether payment of certain employee entitlements is required of receivers unconditionally under s 433, or whether it is a deferred obligation that is conditional on there being insufficient uncharged assets under s 561 of the Act.

This article reviews the current state of the authorities and discusses future development of these issues.

BACKGROUND: ITALIANO AND DAMILOCK

In *Italiano* [2] Finkelstein J held that s 561 requires a liquidator to assess whether there is insufficient property of the company available to meet priority employee entitlements before the proceeds of certain charged assets may be used to discharge them. The Court held that the assessment must only be made once enough is known about the company's affairs and cannot be made on an interim basis. Until that assessment can be made, a liquidator must hold the proceeds on trust.

This means employees may be left unpaid for a long time due to uncertainty about whether the payment should come from charged assets or liquidators' recoveries. Receivers and Banks may face unnecessary ongoing administration costs. Liquidators or receivers may feel pressure to take a commercial approach of 'paying early', leaving accounts to be adjusted later when the liquidators' recoveries are finalised. However that approach risks a court finding a breach of trust. That was the outcome in *Italiano*.

Justice Finkelstein offered a solution. If the Bank provides fully informed consent, the receiver or liquidator may make early payment of funds to priority employee entitlements without risk of a finding of breach of trust. The Court found that the Bank will then have the right to subrogate into the employees' priority in respect of the company's free assets.

That approach appears to have been followed by the liquidators in *Re Carter; Damilock Pty Ltd (in liquidation)* [2012] FCA 1445 (*Damilock*) who, with the approval of the Bank, paid employee entitlements. The Court in that case directed that the available funds held

1 See *NA Kratzmann Pty Ltd (in liq) v Tucker (No 2)* (1968) 123 CLR 295. **2** *Cook v Italiano Family Fruit Co Pty Ltd (in liq)* (2010) 190 FCR 474.

by the liquidators be paid to the Bank accordingly.

While helpful, these decisions turned on their facts and did not establish a generally available right of a Bank to subrogate into the position of employees who have had their priority entitlements paid out by receivers under s 433 of the Act. The Court in *Italiano* also toyed with a question as to whether there remained a 'right of recoupment'. That right previously existed under long since repealed predecessors of s 433 of the Act.

RE EXDVD DECISION

The issues were recently revisited in a case in which the authors assisted Adelaide liquidator George Divitkos. On 30 June 2014 Justice White of the Federal Court handed down a decision in *Re Divitkos; ExDVD Pty Ltd (in liquidation)* [2014] FCA 696 (ExDVD). The decision usefully clarifies a number of uncertainties as follows.

Section 433 does not require payment of employee termination entitlements in the case of receivership alone, where the termination entitlements are not crystallised by termination in fact or because of any winding up.

However, if the company subsequently goes into liquidation, s 558(1) of the Act has the effect of deeming the termination entitlements to be due. This will, in turn, give rise to an obligation under s 433(3)(c) for the receiver to pay the termination amounts. Alternatively it will justify their past payment, if the receiver has already paid out the amounts in anticipation of liquidation.

As to recovery by the Bank of money paid to employees under these provisions, the 'right of recoupment' that was found to exist in *Italiano* was considered by Justice White, who cautiously observed that the recognition of a right of recoupment would not, by itself, provide priority over unsecured creditors.

> Whether there is any commercial advantage of a formal appointment over a managed workout is something that must be closely considered on a case by case basis.

However his Honour found a right of subrogation exists:

> *The present case does not fall into any of the established categories in which rights of subrogation are recognised. But those categories should not be regarded as closed ... In my opinion, the situation of a secured creditor or of a receiver appointed to a company by a secured creditor who, in accordance with s 433 of the Corporations Act, makes payments to priority creditors, is analogous to that of a person who, other than voluntarily, discharges the security of another. That is a well recognised circumstance in which rights of subrogation arise ... Accordingly, although the present may be a new class of case, I consider that an equitable right of subrogation should be recognised.*[3]

MIGHT *EXDVD* PROVIDE A REASON FOR BANKS TO APPOINT RECEIVERS?

Consider the position of a Bank that has a charge over a viable operating business worth $5 million, that has unpaid employee entitlements of $1 million. Faced with financial stress the company may sell its business.

Assume the employee entitlements are taken over by the purchaser who pays a net $4 million for the business, which the Bank accepts as its return on charged assets. If a liquidator is subsequently appointed and recovers $1 million in preferences from third parties, the recoveries are not available to the Bank under its charge.

As there was no formal appointment at the time of the sale, ss 433 and 561 have no application. This leaves the Bank unable to maintain that the employee entitlements were paid involuntarily under statutory compulsion. On the law as it stands following *ExDVD*, subrogation would *prima facie* not be available, meaning the Bank would not enjoy any part of the $1 million preference recovery.

In contrast, if a receiver had been appointed to effectuate the sale, the employee entitlements could have been paid 'involuntarily' under s 433. In that event the sale might have realised $5 million with the receiver using $1 million to pay employees before any distribution to the Bank. While the Bank would still net $4 million initially, it would enjoy a right to subrogate into the employee priorities and recover the $1 million in preference recoveries: *ExDVD*. The final result for the Bank would be $5 million-$1 million better than if it had it made no appointment.

Obviously the example discussed above is an over simplification. Whether there is any commercial advantage of a formal appointment over a managed workout is something that must be closely considered on a case by case basis. However, care is needed on the part of Banks and their advisers. An informal lower cost approach could prove to be false economy, if it results in a material reduction in the amount recovered under the security.

3 *Re Divitkos; ExDVD Pty Ltd (in liq)* [2014] FCA 696 at [75]-[79].

FURTHER DEVELOPMENT OF SUBROGATION?

The *ExDVD* decision was based on equitable rights of subrogation. Generally speaking, equity proceeds on broad principles of fairness and puts substance over form. That being so, one might expect equitable subrogation to be available wherever a Bank pays employee entitlements out of its charged assets.

That is not the position on current law. The payment must have the requisite degree of 'involuntariness', as it does where there is statutory compulsion under ss 433 and/or 561. However it may be arguable that lesser forms of compulsion should be sufficient for equitable subrogation.

Consider a non-appointment sale of assets, where the terms negotiated apply the sale proceeds toward satisfying employee entitlements. By releasing the assets from its charge to allow completion, it is arguable that the Bank is still, in substance, paying the employee entitlements out of charged assets. It would seem fair that the Bank should be in no worse position for having achieved that outcome directly and in a manner designed to minimise costs, than the position it would enjoy had a receiver or liquidator been appointed.

It might be argued that the payment is sufficiently involuntary, for example because of workplace laws relating to devolution of entitlements and the costs otherwise faced. Depending on the circumstances, a Bank might be able to show that it had no commercial choice but to pay. In those circumstances the court might be urged to view a mere commercial or contractual compulsion to be sufficient for rights of subrogation to arise.

It seems unlikely that the courts will readily extend rights of subrogation to a Bank in such circumstances. It is more likely that the employee entitlements will be simply viewed to have been extinguished, so that as at the date of a subsequent appointment, there is no employee entitlement that has crystallised into a provable debt. In that case questions of subrogation do not arise at all.

Nonetheless, there are commercial approaches available that may potentially avoid the cost of receivership, yet still preserve the ability to subrogate into employee claims. There appears no logical reason why the law, or at least insolvency practice, might not develop in this area. Banks and potential appointees should take advice as to maximising the opportunities in the circumstances discussed.

ONGOING RISKS OF BREACH OF TRUST

It is not satisfactory that uncertainty in the law continues to leave insolvency practitioners at risk of court findings of breach trust.

The difficulty stems from ss 433 and 561 leading to different results in respect of certain employee entitlements. Where a contract of employment is brought to an end after the appointment of receivers, certain accrued entitlements will not be afforded priority under s 433 because they do not crystallise until after the 'relevant date' under s 556(1)(g), which is the date of appointment of the receiver: s 433(9).

However if a liquidator is appointed, s 558 deems the contract of employment to have been terminated at the commencement of a winding up so that all of the entitlements crystallise and gain s 561 priority.

Hence some employee entitlements do not have priority and should not be paid where there is only a receiver, but that will change if a liquidator is appointed. This raises questions as to whether the receiver should pay and whether receivers who wish to retire before any liquidation has formally commenced are at risk if they do not first pay or provide for entitlements that will crystallise in the event of a subsequent liquidation.

Compounding this uncertainty is the fact that s 433 obliges the receiver to make immediate payment of priority employee entitlements, whereas s 561 obliges the person holding the proceeds of the circulating assets to make payment only if there are no free assets otherwise available to satisfy those entitlements.

On one view of the provisions, where there is a receivership followed by a liquidation, the receiver must pay some employee entitlements under s 433 from the circulating assets and then simply wait, as long as it takes, until a proper determination can be made as to whether there will be sufficient free assets available to pay the remaining leave and retrenchment entitlements under s 561. This appears to the approach favoured by the Court in *Italiano*.

However the same issue was considered by Master Sanderson in *Re Great Southern Ltd (Receivers and Managers Appointed)(in liquidation); Ex Parte Thackray* (2012) 260 FLR 362 (*Great Southern*).

Master Sanderson held that where administrators had already

been appointed, receivers should (in anticipation of the company then being wound up) hold sufficient proceeds to meet payment of the accrued entitlements 'on trust', pending determination of whether the company's free assets will be sufficient or insufficient to meet the remaining claims. Should the receivers wish to retire, they should arrange for the liquidators to become substitute trustees of the remaining charge proceeds.

In *ExDVD*, White J took a different approach. His Honour held that if a company in receivership later commences to be wound up, then the deeming provision in s 558(1) applies in respect of s 433. Hence accrued leave and retrenchment entitlements, which would not obtain priority under s 433 in a receivership only scenario, will enjoy priority under s 433 where there is also a concurrent winding up.

This approach avoids the complication acknowledged by Master Sanderson of the receiver having to hold the proceeds on trust pending a final determination of whether the company's free assets will be sufficient to make payment of the remaining accrued leave and retrenchment entitlements.

While White J did not refer to the decision of Master Sanderson in *Great Southern*, he was presented with that authority during submissions and can be assumed to have simply preferred the approach evident from the *ExDVD* judgment.

A practical difficulty of the *Great Southern* approach was illustrated by a subsequent decision in connection with the same company: *Saker, in the matter of Great Southern Limited* [2014] FCA 771. In accordance with the order of Master Sanderson, the receivers held charge proceeds in trust to pay the remaining priority employee entitlements if it was later found that the company's free assets were insufficient. When the receivers retired they paid the proceeds to the liquidators to be held in trust by them under the same arrangement.

However, the liquidators sought to apply the funds to cover remuneration and expenses under s 556(1). McKerracher J held that neither the receiver nor subsequently the liquidators were 'trustees' of those funds. Rather, each of the receivers and liquidators were bound by ss 556 and 561 to apply the funds for the benefit of particular persons. The result was that the liquidators were able to apply the funds to the liquidators' entitlements in priority to the remaining employee entitlements.

This raises a question (which was alluded to by the Judge) of whether the receivers, in complying with the order of Master Sanderson, might not have complied with the requirements of s 561 in that they should have postponed payment to the Bank until it was determined that there were sufficient free assets of the company to pay the remaining priority employee entitlements.

The difficulty illustrated above would arguably not have occurred had the approach set out in *ExDVD* been followed because the receivers would have been obligated to pay all the employee entitlements under s 433, or could have proceeded with the fully informed consent of the Bank. No issue of having to hold moneys on trust would have arisen.

At the present time the issues remain very complex and the law is not settled. Banks and insolvency practitioners should seek specific advice to minimise the risk of adverse findings.

FUTURE DIRECTIONS

In two law reform submissions that the Law Council of Australia made to the Assistant Treasurer in March 2014, it was well reasoned that:

- all employee entitlements should crystallise and be paid upon the appointment of receivers
- there should be greater freedom to pay employee entitlements early, without risk of findings of breach of trust
- re-introduction of a right of recoupment in s 561 should be considered.

While the ExDVD decision is largely consistent with the Law Council submissions, in light of the remaining issues discussed in this article, it seems likely there will be further developments to report on in the future.

At the present time the issues remain very complex and the law is not settled. Banks and insolvency practitioners should seek specific advice to minimise the risk of adverse findings.

ARITA

Appendix E – Suggested terms of reference for a restructuring, insolvency and turnaround inquiry

The 1983 terms of reference for the Australian Law Reform Commission's General Insolvency Inquiry form an excellent starting point for the terms of reference that we suggest for Australia's next restructuring, insolvency and turnaround inquiry. However, we believe that the terms of reference should place an emphasis on the recovery of viable businesses that are in financial distress.

ARITA suggests that the federal Attorney-General and the Treasurer ask the Australian Law Reform Commission or other suitable body to inquire into the law and practice relating to the insolvency of both individuals and bodies corporate, in particular:

(a) the provisions of the *Bankruptcy Act 1966*, in their application to both business and non-business debtors
(b) Chapter 5 of the *Corporations Act 2001* so far as it relates to the restructuring, insolvency and turnaround of companies, and
(c) any related matter

with a view to:

(a) alignment of the personal and corporate insolvency laws
(b) encouraging the restructuring and turnaround of viable businesses in financial distress, and
(c) ensuring the efficient and effective redistribution of capital of those businesses that cannot be saved.